The Senate

Economics
References Committee

Foreign investment by state-owned entities

September 2009

© Commonwealth of Australia 2009

ISBN 978-1-74229-149-9

Printed by the Senate Printing Unit, Parliament House, Canberra.

Senate Economics References Committee

Members

Senator Alan Eggleston, Chair	Western Australia, LP
Senator Annette Hurley, Deputy Chair	South Australia, ALP
Senator David Bushby	Tasmania, LP
Senator Barnaby Joyce	Queensland, NATS
Senator Louise Pratt	Western Australia, ALP
Senator Nick Xenophon	South Australia, IND

Participating Members participating in this inquiry

Senator Mark Bishop	Western Australia, ALP
Senator the Hon Bill Heffernan	New South Wales, LP
Senator Scott Ludlam	Western Australia, AG
Senator John Williams	New South Wales, NATS

Former members

Senator Doug Cameron	New South Wales, ALP
Senator Mark Furner	Queensland, ALP

Secretariat

Mr John Hawkins, Secretary
Dr Timothy Kendall, Principal Research Officer
Mr Glenn Ryall, Senior Research Officer
Ms Hanako Jones, Executive Assistant
Ms Lauren McDougall, Executive Assistant
Ms Meredith Bond, Executive Assistant

PO Box 6100
Parliament House
Canberra ACT 2600
Ph: 02 6277 3540
Fax: 02 6277 5719
E-mail: economics.sen@aph.gov.au
Internet: http://www.aph.gov.au/senate_economics/

TABLE OF CONTENTS

Membership of Committee iii

Executive Summary ix

Chapter 1 1

Introduction and conduct of inquiry 1

Referral of inquiry 1

Terms of reference 1

Conduct of inquiry 1

Terminology 2

Previous inquiry related to this reference 2

Current inquiry 3

Structure of report 4

Chapter 2 5

Foreign investment in Australia 5

Current levels of foreign investment in Australia 5

Foreign investment in Australia's resource sector 7

Foreign investment and sovereignty over natural resources 10

Public attitudes towards foreign investment 10

Adjusting to new global capital flows 17

Chapter 3 19

Administration of foreign investment in Australia 19

History of foreign investment regulation in Australia 20

Foreign Investment Review Board 21

Timeframes for review 30

Applying conditions to approvals 31

Other frameworks for regulating foreign investment 33

Restrictiveness of Australia's foreign investment regime 35

Recommendations from the *Percentage Players* report 37

Chapter 4 39

Sovereign wealth funds and state-owned entities 39

Characteristics of SWFs 41

Examples of Sovereign Wealth Funds 41

International Working Group of Sovereign Wealth Funds and the Santiago Principles 45

State-owned entities 47

Chinese capital and China's outbound investment 54

China's 'going out' strategy 55

Commercial imperatives of Chinese SOEs 55

Regulation of SOEs 57

Dissenting Report by Senators Joyce, Ludlam and Xenophon 63

Introduction 63

Foreign investment trends 63

China's rise 66

Potential political consequences of foreign investment – 'The elephant in the room!' 68

National Interest Test 69

Human Rights 70

Corporate governance dangers 73

Risks to Competition 73

A case of reciprocity 75

Conclusion 76

APPENDIX 1 .... **79**

Submissions Received **79**

Additional Information Received **81**

APPENDIX 2 .... **83**

Public Hearings and Witnesses **83**

APPENDIX 3 .... **85**

Treasurer's 2008 guidelines for assessing proposals by SOEs **85**

APPENDIX 4 .... **87**

Major Chinese government-related investments in Australia **87**

Executive Summary

At a time of heightened public interest in foreign investment, it is critical that the Australian regulatory system provides certainty, predictability, transparency and confidence. It is important that the Australian public, and potential foreign investors, have confidence in Australia's system for administering foreign investment applications.

The committee notes that one of the specified roles of the Foreign Investment Review Board (FIRB) is to 'foster an awareness and understanding, both in Australia and abroad, of the policy and the FATA' (*Foreign Acquisitions and Takeovers Act 1975*). The committee believes that public debate about foreign investment should be facilitated by the availability of information and therefore in Chapter 2 recommends that FIRB do more to inform the community of how Australia's foreign investment regime operates and how Australia benefits from foreign investment.

Recommendation 1

The committee recommends that FIRB develop a more effective communication strategy to improve public understanding of the risks and benefits of foreign investment to Australia. This strategy should also provide additional information about how foreign investment decisions are made and provide information about the emergence of sovereign wealth funds and state-owned entities internationally.

Confidence in the foreign investment review process could also be strengthened through a higher degree of parliamentary scrutiny. The committee acknowledges that FIRB publishes an annual report for tabling in Parliament, which provides information on the administration of foreign investment policy, the approval process, and statistics for applications and decisions for the period. The committee notes that the last FIRB report was tabled in parliament 14 months after the years to which it refers.

Recommendation 2

The committee recommends that the Minister require FIRB to be more assiduous in producing a timely annual report.

Historically, one of the reasons Australia has relied upon foreign investment is because it has had shallow domestic capital markets, relative to the large size of its natural resources. This continues to be the case particularly when it comes to capital intensive sectors such as the mining industry. The committee considers that it is critical that Australia continue to be seen as a country that welcomes foreign investment and that it remains an attractive and competitive place to invest. The committee believes that foreign investment is critical to the development of Australia's industries and infrastructure and has significant benefits for the Australian community at large.

The committee also believes that the best way for Australia to manage the new capital flows that have stemmed from the emergence of sovereign wealth funds and state-owned entities is through developing robust domestic legislation. In Chapter 3 of the report the committee recommends that the government look at tightening *Foreign*

Acquisitions and Takeovers Act 1975 (FATA) legislation to deal with complex acquisitions where takeovers of smaller strategic assets may be masked by an application which, in total, does not represent more than 15 per cent, and therefore does not trigger review.

Recommendation 3

The committee recommends that the government tighten the FATA legislation to deal with complex acquisitions where takeovers of smaller strategic assets may be masked by an application which, in total, does not represent more than 15 per cent, and therefore does not trigger review. The committee would like FIRB to give adequate consideration to the interaction between the various components of an acquisition.

The committee believes that the current regulatory framework for assessing foreign investment proposals, whether they are made by private commercial interests, sovereign wealth funds or state-owned entities, is sufficient. The committee considers that the combined powers of the *Foreign Acquisitions and Takeovers Act 1975*, *Foreign Acquisitions and Takeovers Regulations 1989, Trade Practices Act 1974* and laws related to transfer pricing and environmental and worker protection, are sufficient to provide for the robust assessment of foreign investment applications and satisfactory regulation of the conduct of foreign investors. The committee is also of the belief that, having considered all the evidence, the system of case-by-case assessment, based on the national interest, has also served Australia well.

The committee considers that the chief virtue of the national interest test is its flexibility. Its unwritten or undefined character—the fact that it is a negative test—enables it to adapt more easily to changing circumstance. A prescriptive test with specific criteria would not allow this degree of flexibility. The committee also believes that the national interest test should continue to focus on the commercial use of an asset and not upon its ownership.

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:

---

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 Chinaclo 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.

Chapter 2

Foreign investment in Australia

2.1 Australia has always relied on foreign investment to enhance trade relationships, grow industries and develop jobs and infrastructure. For over 200 years, Australia has welcomed investment—initially from Britain, later from the United States and more recently from Japan. This investment has been critical to the development of Australia's industries and infrastructure.

2.2 It is in Australia's interests to welcome foreign investment. Foreign investment generates a range of potential benefits including: productivity and competitiveness through the provision of new technology; specialist knowledge; marketing expertise in specific markets; access to global supply chains; access to capital; and the opportunity for shifting risks. Domestically, foreign investment can also increase tax receipts and result in higher incomes.[1]

Current levels of foreign investment in Australia

2.3 The level of foreign investment in Australia reached $1,724 billion as at 31 December 2008. Portfolio investment accounted for $921 billion (53 per cent), direct investment for $393 billion (23 per cent), other investment liabilities for $303 billion (18 per cent), and financial derivatives for $108 billion (6 per cent).[2]

2.4 The leading investor economies in Australia, as at 31 December 2008, were the United Kingdom (24.8 per cent), the United States (24.3 per cent), Japan (5.2 per cent), Hong Kong SAR (3.3 per cent) and Singapore (2.5 per cent). The People's Republic of China (hereafter China) was ranked 15th at 0.5 per cent. Investment by China was lower than, for example, Belgium or the British Virgin Islands.

2.5 Foreign direct investment in Australia is also dominated by the United States (24.3 per cent) and the United Kingdom (15.4 per cent). Foreign direct investment is a subcategory of foreign investment and refers to a company from one country making a direct investment into another country, or the establishment of an enterprise by a foreigner. It does not include portfolio investment.

---

1 A recent report from the Committee for the Economic Development of Australia (CEDA) identifies many other advantages attached to foreign investment. These include: increasing the 'pool' of savings; facilitating portfolio management; encouraging specialisation; creating 'spillovers'; increasing taxation revenue; increasing global integration; and increasing global standards of living, 'The contribution of foreign direct investment and the mining industry to the welfare of Australians', Information Paper Number 92, November 2008, Appendix to *Submission 6*, pp. 9–11.

2 Australian Bureau of Statistics, 'International Investment Position, Australia: Supplementary Statistics, 2008', Cat Number 5352.0, (accessed 11 August 2009).

Foreign investment in Australia as at end 2008[3]

Country/Region	$ billions	% of total
China	7.9	0.5
Malaysia	10.1	0.6
Belgium	11.8	0.7
Canada	18.2	1.1
British Virgin Islands	19.2	1.1
New Zealand	27.1	1.6
France	28.9	1.7
Netherlands	32.9	1.9
Germany	36.3	2.1
Switzerland	38.1	2.2
Singapore	43.1	2.5
Hong Kong	56.3	3.3
Japan	89.5	5.2
United States of America	418.4	24.3
United Kingdom	427.1	24.8
ASEAN	58.3	3.4
EU	567.5	32.9
APEC	685.6	39.8
OECD	1161.2	67.3
Total all countries	1724.4	100

Foreign direct investment in Australia as at end 2008

Country/Region	$ billions	% of total
China	3.0	0.8
Luxembourg	3.3	0.8
Malaysia	5.1	1.3
Belgium	5.2	1.3
New Zealand	5.4	1.4
Hong Kong	9.5	2.4
Singapore	10.1	2.6
Canada	10.2	2.6
France	13.4	3.4
Germany	13.7	3.5
Switzerland	19.5	5.0
Netherlands	25.1	6.4
Japan	36.0	9.2
United Kingdom	60.4	15.4
United States of America	95.4	24.3
ASEAN	15.4	3.9
EU	133.2	33.9
APEC	176.3	44.9
OECD	302.2	76.9
Total all countries	392.9	100

2.6 It should be noted that there have been strong increases in the levels of Chinese investment in the period after these figures were produced. There have been a series of substantial applications approved by the Treasurer. These include: the Hunan

---

3 These tables are based on data included in 'International Investment Position, Australia: Supplementary Statistics, 2008', Australian Bureau of Statistics, Catalogue Number 5352.0, (accessed 11 August 2009).

Valin Iron and Steel Group's application for a 17.55 per cent holding in the Fortescue Metals Group; the China Minmetals Non-ferrous Metals Company's application for certain mining assets of OZ Minerals; and the Anshan Iron and Steel Group Corporation's application to acquire additional shareholdings in Gindalbie Metals, up to a maximum of 36.28 per cent. While the 2008 figures suggest that investment from China may be increasing from a very low base, had the proposed Chinalco acquisition of a 19 per cent stake in Rio Tinto taken place, this deal alone would have seen China assume a very different place within this table—probably near the middle of the table, around Switzerland and Germany.

2.7 The increased Chinese interest in Australia as an investment destination was made clear in a comment by the Treasurer Wayne Swan in a speech to the China–Australia Chamber of Commerce in June 2008:

> China has until recently been a relatively small source of foreign investment. At the end of 2006, the stock of Chinese investment in Australia was only $3.4 billion, and accounted for just 0.2 per cent of foreign investment in Australia.
>
> But I'm glad to say this seems to be changing. In the fiscal years 2005–06 and 2006–07, Australia approved around $10 billion in proposed investment from mainland China. In 2007–08, the value of proposed investment from mainland China could rise to more than $30 billion. Since we came to office, Chinese investment proposals have been approved at the rate of around one per fortnight.[4]

2.8 Even with the approvals of foreign investment applications from China during 2009, China remains, at least in the short term, a much less significant investor than either the United Kingdom or the United States. (A list of major Chinese government-related investment in Australia is found at Appendix 4.)

Foreign investment in Australia's resource sector

2.9 At a recent national infrastructure conference, Rio Tinto's CEO Mr Sam Walsh, explained how Japanese capital underwrote the expansion of Australia's mining industry in the 1980s, drawing particular attention to the establishment of rail networks out of the Pilbara:

> Our rail system was established over four decades, and I would like to remind all here how that was done: very much in partnership with the Japanese steel industry, which underwrote the massive up-front costs on what was an extraordinary vision to open up the Pilbara. Without that support, without that underwriting, it is impossible to imagine that Australia

4 The Hon Wayne Swan MP, 'A remarkable place at a remarkable time', China–Australia Chamber of Commerce, 10 June 2008, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2008/018.htm&pageID=005&min=wms&Year=&DocType=1 (accessed 20 April 2009). In the following month the Treasurer claimed: 'I have approved a Chinese investment proposal on average once every nine days since coming into office'. Treasurer Wayne Swan, 'Australia, China and this Asian Century', Speech to the Australia China Business Council, Melbourne 4 July 2008.

> would have an iron ore industry, and our greatest export business would simply not have occurred.
>
> And at various steps along the way, whether through the Robe River JV with the Japanese companies Mitsui, Nippon and Sumitomo or the more recent partnerships with Sinosteel at our Channar mine or Baosteel at Eastern Ranges, we have sought and relied on customers to help underwrite our infrastructure investment.[5]

2.10 In the above statement Mr Walsh refers to the establishment of the Channar iron ore mine in the Pilbara in 1986. This was a result of a joint venture between Sinosteel (40 per cent) and Hamersley Iron, now Rio Tinto (60 per cent). The Channar mine was China's first large-scale investment into Australia. The Australia China Business Council added:

> This was the largest overseas investment by China at the time and, indeed, remained China's single most significant investment in Australia for many years.[6]

2.11 The development that took place was a result of a joint venture between Hammersley/ Rio Tinto and a Chinese state-owned entity.

2.12 As this background suggests, Australia's geographically remote and capital intensive mining industry is particularly reliant upon access to international capital. Foreign investment has enabled Australia to access the global capital it needs to develop its natural resources. The committee received evidence that suggested that Australia must accept foreign capital if it is to develop its resource sector adequately. Mr David Murray AO, Chairman of the Board of Guardians, Future Fund, expressed this argument in the following terms:

> In Australia's case, we have a very small population and working population relative to our resource base and hence we have been capital dependent on the rest of the world for a long time…[7]

2.13 In their submission to the inquiry, Professor Peter Drysdale (the Australian National University) and Professor Christopher Findlay (University of Adelaide) reinforced how Australia's mining industry has benefited from foreign investment:

> Australia has perhaps the most efficient mining sector in the world. This is importantly due to its openness to foreign investor competition and participation, because that brings with it, and fosters, the technology, management know-how and market links that are essential ingredients in the development of a world class, internationally competitive industry. Australia, therefore, has a long record, and a strong policy regime,

---

5 Sam Walsh, Australian Financial Review National Infrastructure Conference, Sydney 2 April 2009, 'Infrastructure—securing Australia's iron ore exports', http://www.riotintoironore.com/documents/Sam_Walsh_AFR_Infrastructure.pdf (accessed 28 April 2009).

6 *Committee Hansard*, 2 July 2009, p. 2.

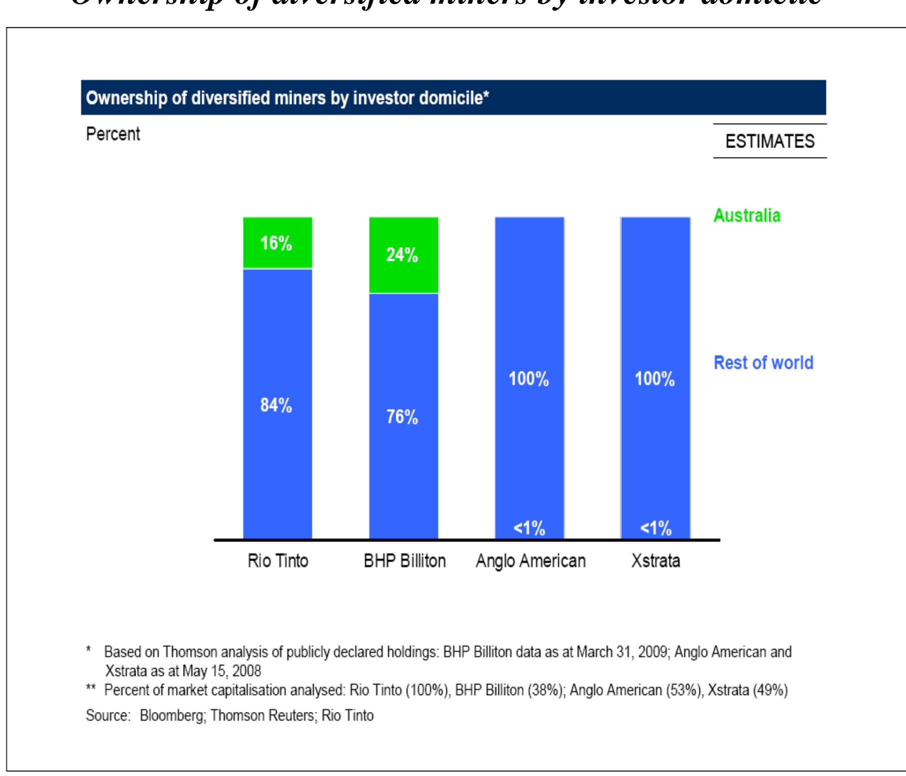
7 *Proof Committee Hansard*, 10 August 2009, p. 20.

characterised by openness towards foreign investment in its resource industries…

Foreign direct investment has accounted for more than one third of capital formation in all Australian industry since the turn of the century; in mining and resources it has accounted for almost half, and in some years a much higher proportion, of total capital formation in the sector. Importantly, foreign investors have played a similarly prominent role in capturing export markets, and account for a growing share of minerals exports (ABS, 2007).[8]

2.14 In making an observation about the high levels of foreign ownership in the international resource sector, Rio Tinto explained that among the major mining companies operating in Australia, BHP-Billiton, Anglo American, Xstrata and Rio Tinto itself, are all majority foreign owned.[9] This perspective was reinforced by Mr Patrick Colmer, FIRB, who suggested that '…BHP under our laws is a foreign corporation—as is Rio Tinto'.[10]

Ownership of diversified miners by investor domicile[11]



8 *Submission 40*, pp. 2–3.

9 A list of Australian resource projects that are controlled by foreign investors is maintained by the Mayne Report see: http://www.maynereport.com/articles/2007/07/17-2040-8377.html (accessed 29 April 2009).

10 *Committee Hansard*, 22 June 2009, p. 4.

11 *Submission 47*, 'Exhibit 3', p. 17.

Foreign investment and sovereignty over natural resources

2.15 Many concerns were expressed to the committee over foreign investors gaining control over Australia's natural resources. This was a common theme throughout both the submissions and in the evidence taken at public hearings.

2.16 It is worth noting that foreign investment does not diminish Australia's sovereign ownership of its natural resources. Mining companies in Australia do not own the land from which natural resources are extracted. Federal and state government grant these companies licences and leases which allow them to operate. Australia also retains control over all business activities taking place within its borders. Professor Peter Drysdale reiterated this message:

> There is no question of Chinese investors, Japanese investors or American investors ultimately having control of these resources. We have control of these resources. They are our resources; they are our sovereign resources. The policy regime that you and your colleagues put in place is what governs the use of these resources within a market. If there are problems in the market, if there are monopolies and distortions in the market, then the policymakers need to deal with those. We have the power to deal with them, including the power to deal with markets in which foreign investors are heavily involved and regulate them in respect of a whole range of things, including the way in which they develop the resources sensitive to the environment, Indigenous people and all the considerations that you and we as interested citizens would want to have sensitivities to.
>
> Control over these resources is within our province. It is not the province of the investor that has delivered to it the right to undertake it, whether it be a foreign investor or a domestic investor. Again it might seem like a moot point but actually it is a fundamental point in the understanding of how we have to manage these market activities, whether they be market activities that foreigners take part in or domestic businesses take part in.[12]

2.17 Long term, foreign investment in the capital intensive resource industry has the potential to increase income flows for individuals, companies and host governments through mineral royalties and licence fees, income tax and indirect taxes (payroll, fringe benefits, fuel excise, land and other taxes).

Public attitudes towards foreign investment

2.18 The Treasury's policy document on Australia's Foreign Investment Policy acknowledges that, despite the fact that foreign investment has played a critical role in the development of a modern Australian economy, Australians typically remain concerned about foreign investment:

> The Government recognises community concerns about foreign ownership of Australian assets. One of the objectives of the Government's foreign

12 *Committee Hansard*, 1 July 2009, p. 35.

investment policy is to balance these concerns against the strong economic benefits to Australia that arise from foreign investment.[13]

2.19 An information paper titled, 'The contribution of foreign direct investment and the mining industry to the welfare of Australians', published by the Committee for Economic Development of Australia (CEDA), outlines six concerns that are commonly articulated about foreign investment:

- *Concern 1*: Foreign firms may flout local rules;
- *Concern 2*: Foreign investment is shifting domestic production towards low-value activities;
- *Concern 3*: Unlike foreign investment in physical capital, nothing useful happens when an Australian firm is purchased by a large multinational firm;
- *Concern 4*: Australians would be better off if transactions took place only among Australians;
- *Concern 5*: Foreign labour will displace Australian jobs;
- *Concern 6*: Foreign investment causes profits to leave the country.[14]

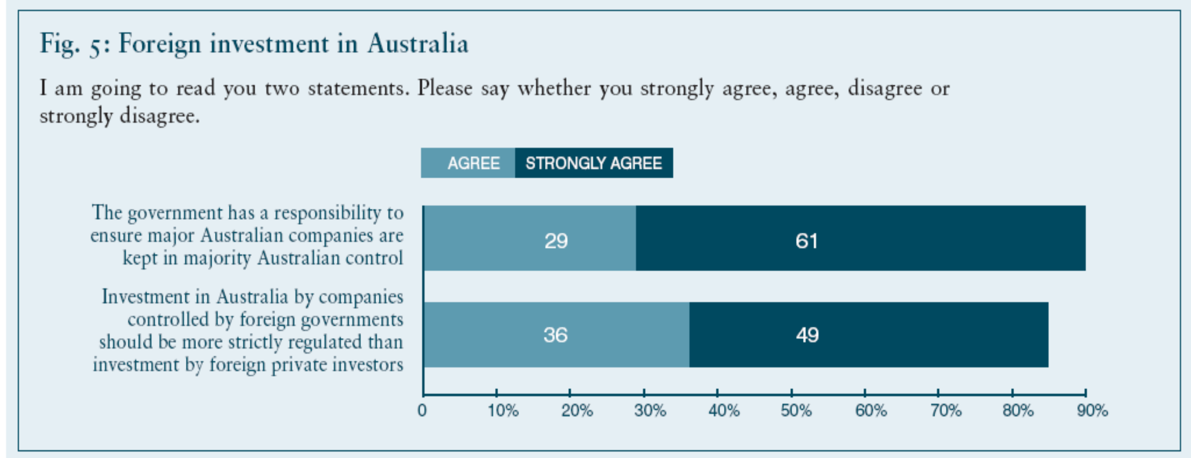
2.20 In addressing the matter of public perceptions of foreign investment in Australia numerous submitters made reference to the *2008 Lowy Institute Poll: Australia and the world*. Conducted in July 2008, the poll found that 90 per cent of Australians either 'strongly agree' or 'agree' that the Australian government has a responsibility to ensure major Australian companies are kept in majority Australian control. The poll also demonstrates that there was also overwhelming agreement (85 per cent) that investment by companies controlled by foreign governments should be more strictly regulated than investment by foreign private investors.[15]

---

13 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).

14 Committee for the Economic Development of Australia (CEDA), 'The contribution of foreign direct investment and the mining industry to the welfare of Australians', Information Paper Number 92, November 2008, Appendix to *Submission 6*, pp. 23–25.

15 Fergus Hanson, The Lowy Institute Poll 2008, *Australia and the world: Public opinion and foreign policy*, Lowy Institute for International Policy, p. 6.



2.21 Numerous witnesses agreed that there was some 'ingrained animosity' towards foreign investment in Australia. Ms Julie Novak, Institute of Public Affairs, suggested:

> Certainly there are ingrained animosities held by certain sections of the community against foreign investment—basically an essential distrust of the foreigner, a lack of understanding of how foreign trade works to ensure the comparative advantages of countries are reconciled. The same concept does actually occur in terms of investment but there are, as we suggest in the submission, ingrained biases, ingrained sentiments and beliefs that, for example, selling off the mine or selling off the farm is damaging to Australia’s interests. We would certainly argue to the contrary, but the increasing interest with respect to foreign investment in recent years is a product in part of that ingrained aversion to and distrust of foreign investment.[16]

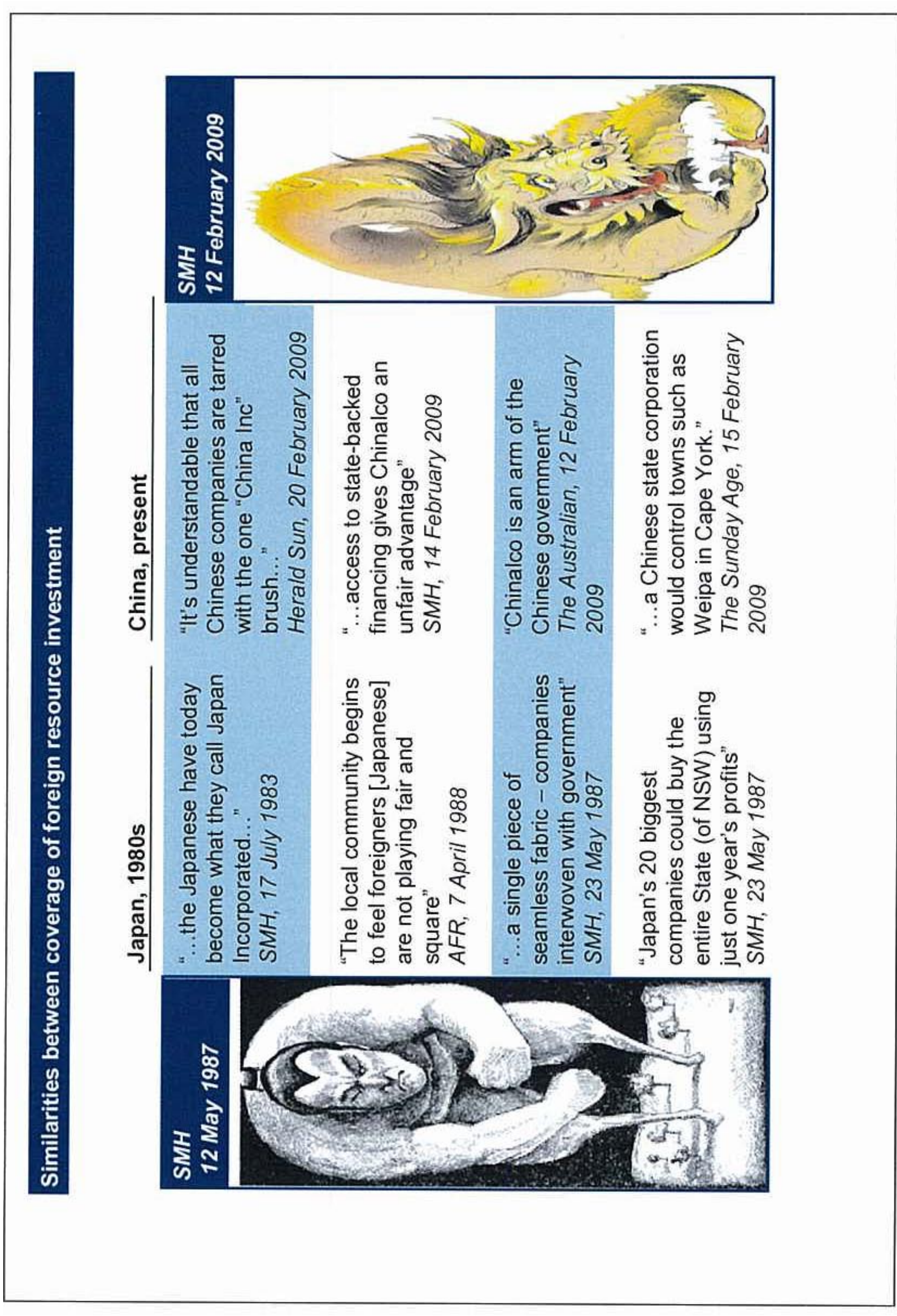
2.22 Rio Tinto's submission placed recent public reaction to Chinese investment in Australia within an historical continuum, making direct comparisons with public reaction to the increase in Japanese investment in Australia during the 1980s:

> Each new wave of foreign investment has brought new challenges. Investment by western countries such as the United Kingdom and the United States raised concerns as to whether Australia was losing control of its destiny to companies based overseas, and as to whether Australia's national culture and identity would be challenged. In the 1980s, investment by Japanese companies in mining, manufacturing, tourism and other ventures received close scrutiny and considerable public opposition. While the next wave of foreign investment is expected to come from China, it should be noted that until now, China's investments in Australia have been small and well below what we might expect given the extent of Australia's trading relationship.[17]

16 *Committee Hansard*, 23 June 2009, p. 3.

17 *Submission 47*, p. 6.

2.23 The graphic contained in Rio Tinto's submission (below) seeks to reinforce this, arguing that recent reaction to increased Chinese investment in Australia echoes the earlier reaction against Japanese investment.



Rio Tinto, Submission 47, p. 41

2.24 However, there are some key differences between Japanese foreign investment and Chinese foreign investment. The Australia China Business Council distinguished between the two eras of investment in the following way:

> Obviously, the investments have taken place at different times and at different states of development of the Western Australian economy. In many ways, the Japanese investment created the iron ore industry, whereas now there is an existing iron ore industry. The current Chinese investment is looking not at creating new industry but at boosting and increasing existing industry. I think, with hindsight, Japanese investment has served Australia well and also Western Australia well. The joint venture model preferred by the Japanese appears to have served Western Australia well by helping us to develop many new industries and many new projects, which have grown the state, created revenue for the state and created many jobs for Western Australians.[18]

2.25 To this we can add another critical distinction. Prior to 1993, applications from foreign investors could only be approved if there was no other source of local capital, and even then, an investor was required to form a strategic partnership with an Australian firm who was required to maintain 51 per cent ownership. The changes that have taken place in Australia's regulatory system will be examined in more detail in the following chapter.

Committee view

2.26 At a time when there has been heightened public interest in foreign investment, it is critical that the Australian system provides certainty, predictability, transparency and confidence. It is important that the Australian public, and potential investors, have confidence in Australia's system for administering foreign investment applications. The committee also believes that it is important that there is a balanced debate over Chinese investment in Australia. Public debates about foreign investment should be facilitated by readily available information and more could be done to inform the community why Australia needs foreign investment. Equally, more could be done to manage the perception that there is a problem with Australia's foreign investment policy.

2.27 It is of concern to the committee that over the course of the inquiry the Foreign Investment Review Board was frequently described, both in the media and in public hearings, as operating under the cloak of secrecy. The committee is of the opinion that more could be done to demystify this perception. The committee believes that a higher degree of public education would arrest some community anxiety about foreign investment.

The committee acknowledges that the Treasurer has been responsive in clarifying Australia's foreign investment position, particularly for potential Chinese investment.[19] However, from the evidence given by some witnesses to this inquiry it is

---

18 *Committee Hansard*, 2 July 2009, p. 8.

19 See for example, The Hon Wayne Swan MP, 'A remarkable place at a remarkable time', China–Australia Chamber of Commerce, 10 June 2008; Wayne Swan: 'Australia, China and this Asian Century' Speech to the Australia China Business Council 4 July 2008; Wayne Swan 'Australia, China and the Global Recession', Address to the ANU China Update Conference 14 July 2009;Wayne Sawn: 'Foreign investment and the long road to recovery' Address to the Thomson Reuters Newsmakers Series, 4 August 2009.

evident that there remains in some sectors a level of concern about foreign investment in Australia.

2.28 The committee feels that the FIRB website, which is largely used as a vehicle to provide technical or procedural advice to applicants, could do more to inform the public about the foreign investment application and review process. This would be of benefit to potential foreign investors and the Australian public more generally.

2.29 Given that one of the specified roles of the Board is to 'foster an awareness and understanding, both in Australia and abroad, of the policy and the FATA' (*Foreign Acquisitions and Takeovers Act 1975*) this lack of publicly available material is surprising.[20] The committee also notes that there is scant information on the website about SWFs or SOEs. The only material on the website that relates to investments by foreign governments is as follows:

> All direct investments by foreign governments or their agencies irrespective of size are required to be notified for prior approval under the Government's foreign investment policy. This applies whether the investment is made directly or through a company that is owned 15 per cent or more by a foreign Government. Applications must be submitted for:
>
> - the establishment of any new business activity, regardless of value of investment;
> - acquisitions of real estate of any value;
> - acquisitions of interests in companies or business assets of any amount or value.
>
> Decisions are subject to the national interest test and the general requirements of policy.
>
> The only exception is acquisitions of developed residential real estate acquisitions where the land is to be used exclusively for the purposes of the diplomatic mission of that country or as a diplomatic residence.[21]

2.30 While the committee understands that many of the applications that FIRB accesses contain material that is commercial in confidence it believes that the FIRB website could be more effective in providing public information. The committee notes for example, that the website does not include a register of substantial commercial matters under consideration.

---

20 As articulated at: http://www.treasury.gov.au/documents/178/HTML/docshell.asp?URL=ch3.asp (accessed 12 August 2009).

21 FIRB website: http://www.firb.gov.au/content/direct.asp?NavID=36 (accessed 12 August 2009). The committee acknowledges that there is more information on the Treasury website, for example: http://www.treasury.gov.au/documents/178/HTML/docshell.asp?URL=ch3.asp (accessed 12 August 2009).

Recommendation 1

2.31 The committee recommends that FIRB develop a more effective communication strategy to improve public understandings of the benefits of foreign investment to Australia. This strategy should also provide additional information about how foreign investment decisions are made and provide information about the emergence of sovereign wealth funds and state-owned entities internationally.

Reporting requirements and announcement of foreign investment decisions

2.32 Confidence in the review process could also be strengthened through public disclosures, or through providing a higher degree of parliamentary scrutiny. The committee acknowledges that FIRB publishes an annual report for tabling in the Parliament, which provides information on the administration of foreign investment policy, the approval process, and statistics for applications and decisions for the period. With regard to FIRB's reporting responsibilities the committee notes that the Foreign Investment Review Board's *Annual Report 2007–8* was sent to the Minster on 20 July 2009. It was received by the Senate on 30 July 2009 and was tabled on 11 August 2009, 14 months after the years to which it refers. Given that the annual report is one of the primary reporting and accountability documents for FIRB, the committee is concerned about the time it is taking to report to the parliament. FIRB's capacity to act as a conduit for public information about foreign investment is limited by the deficiencies in its website and by the timeliness of its annual report.

2.33 In a time of heightened interest in the activities of the Board it would be useful if the annual reports were made available earlier. The committee also notes that the recently tabled report provides data which is largely out of date and does not contain, for example, up to date figures on sectorial approvals and up to date data on approvals by country, and so on.

2.34 With regard to reporting on decisions of substantial commercial cases, the committee notes that the Treasurer makes public the reasons for approving or rejecting an application. These decisions are made public through both FIRB and the Treasurer's website. The committee notes for example that in March 2007, Treasurer Wayne Swan advised, in a media release, that the government had determined that the Minmetals proposal for OZ Minerals could not be approved if it included the Prominent Hill site because this mine was situated near the Woomera Prohibited Area weapons testing range.[22]

Recommendation 2

2.35 The committee recommends that the Minister require FIRB to be more assiduous in producing a timely annual report.

---

22 Treasurer Wayne Swan, 'Foreign Investment', Media Release, 27 March 2009, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/029.htm&pageID=003&min=wms&Year=&DocType=0 (accessed 12 August 2009).

Adjusting to new global capital flows

2.36 Numerous submitters to the inquiry identified the shift that has taken place in foreign investment flows as investment from Europe and the United States has been gradually replaced by foreign investment from China, India and Russia. Those traditional investor-nations that have played an important role in Australia's development, such as the United Kingdom and the United States, are no longer the growth economies for foreign investment.[23] Dr Brain Fisher, Concept Economics explained:

> …historically Australia has depended heavily on countries such as the United States and the United Kingdom for its net foreign investment inflows. However, that appears set to change in the future. Most of that change, of course, is a consequence of the changing world economic order. Basically gross savings in emerging developing countries such as China are growing rapidly. The output share of those countries is growing rapidly relative to our traditional development country sources of capital, and those changes are set to continue.[24]

2.37 Submitters drew different conclusions as to whether this shift in foreign investment flow was to be feared or favoured. Some believed that this represented an opportunity for stable, investor friendly nations like Australia to attract foreign investment; others argued that these new global capital flows will result in a new form of strategic dominance. Citing a comment from the United States investor and commentator, Warren Buffett, the National Civic Council claimed:

> The world is witnessing a new form of strategic dominance. Countries that excessively depend on foreign borrowing risk losing their sovereignty, being 'colonised by purchase rather than conquest'.[25]

2.38 Submitters were in agreement that Australia needed to develop a regulatory system that responded effectively to these new global capital flows. However, the committee received widely divergent views on what type of regulatory framework was most appropriate.

---

23 See, for example, National Civic Council, *Submission 31*, p. 3 or Concept Economics, *Submission 6*, p. 2.

24 *Proof Committee Hansard*, 10 August 2009, p. 31.

25 *Submission 31*, p. 3.

Chapter 3

Administration of foreign investment in Australia

3.1 As suggested in the introduction to this report, 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 U.S. investors. The FATA also provides a legislative mechanism for ensuring compliance with the policy.[1] The FATA is administered by the Foreign Investment Review Board (FIRB)—a non-statutory review body which was established in 1976.

3.2 Australia's foreign investment policy as articulated in Treasury's policy documents states:

> The Government's approach to foreign investment policy is to encourage foreign investment consistent with community interests. In recognition of the contribution that foreign investment has made and continues to make to the development of Australia, the general stance of policy is to welcome foreign investment. Foreign investment provides scope for higher rates of economic activity and employment than could be achieved from domestic levels of savings. Foreign direct investment also provides access to new technology, management skills and overseas markets.[2]

3.3 In giving evidence to the committee, Mr Patrick Colmer, FIRB/ Department of the Treasury, referred to the 'default position' contained within the legislation:

> The way that the legislation is set up is that the default position is that the investment is allowed to proceed. The legislation is set up so that it is clearly the exception rather than the rule to intervene in an investment case. What the legislation does is provide an opportunity for the Treasurer, as the responsible minister, to raise objections if a proposal is considered to be against the national interest.[3]

---

1 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).

2 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).

3 *Committee Hansard*, 22 June 2009, p. 5.

3.4 All applications before the FIRB are examined on a case-by-case basis and as this comment suggests, the Treasurer can make determinations based on the national interest.[4]

History of foreign investment regulation in Australia

3.5 Listed below are some of the major landmarks in the development of Australia's foreign investment policy. Since the introduction of the *Foreign Acquisitions and Takeovers Act* in 1975, there has been an increasing liberalisation of Australia's foreign investment policy through:

- the introduction of higher thresholds, below which proposals do not require approval; and
- the progressive abolition of Australian equity and control requirements.

3.6 The *Foreign Acquisitions and Takeovers Act 1975* established a regime for screening takeovers and authorising proposals to establish new businesses, investments by foreign governments and real estate purchases. It was established to provide clarity on Australia's foreign investment policy and, at least in part, address fears about Japanese investment in Australia.[5]

3.7 In 1976 a further package of reforms was announced which included the establishment of FIRB to replace the existing committee of public servants with a three member panel, comprising two members with business sector experience and a senior Treasury official. The explanation for the change focused on the government's perceived need to obtain independent expert advice from persons who reflected community and business sector interests.[6]

3.8 In 1986 the test requiring applicants to demonstrate net economic benefits, and that Australians had had the opportunity to purchase the target business, was dropped. A new test was introduced which assessed whether a proposal for foreign investment was in the 'national interest'.[7] The national interest test is examined later in this chapter from paragraph 3.33.

3.9 From 1987, new monetary thresholds, below which the relevant FATA provisions do not apply, were introduced for foreign takeovers of less

---

4 See The Treasury, 'Australia's Foreign Investment Policy' available at: http://www.firb.gov.au/content/_downloads/Australia's%20Foreign%20Investment%20Policy.pdf (accessed 21 May 2009), p. 2.

5 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, p. 179.

6 *Percentage Players*, June 1994, p. 179.

7 *Percentage Players*, June 1994, p. 179.

than $5 million.[8] (1987 was also significant as Hamersley Iron, now Rio Tinto, established a joint venture with China's Sinosteel (60/40) to develop the Channar iron ore deposit. This was China's first large-scale investment in Australia and remained China's most significant investment in Australia for many years.[9])

3.10 In 1993 the rule that 50 per cent Australian equity was required in a resource project—unless it could be demonstrated that that equity was not available—was abolished.[10]

3.11 In 1999 the threshold for which applications are registered but are generally not fully examined is raised from $50 million to $100 million.[11]

3.12 In 2008 Treasurer Wayne Swan announced new guidelines for assessing foreign investment by sovereign wealth funds and state-owned entities. These sought to clarify the government's position on foreign investment from state-owned entities. That guideline which relates most specifically to investment by SOEs states: 'In considering issues relating to independence, the Government will focus on the extent to which the prospective foreign investor operates at arm's length from the relevant government'.[12] These guidelines are available at Appendix 3.

Foreign Investment Review Board

Administrative structure

3.13 The FIRB is a non-statutory body, with a board of directors, who advise the Treasurer on the government's foreign investment policy and its administration. Current board members of the FIRB are: Mr John Phillips AO, Ms Lynn Wood, The Hon Chris Miles and Mr Patrick Colmer.[13] Mr Patrick Colmer, as the Executive Member of the Board and as the General Manager of the Foreign Investment and Trade Policy Division of the Department of the Treasury, provides the link between the Board and the Treasury. While the Board provides advice on the application of the

---

8 CEDA, 'The contribution of foreign direct investment and the mining industry to the welfare of Australians', Information Paper No 92, November 2008, p. 15.

9 Australia China Business Council, *Committee Hansard*, 2 July 2009, p. 2.

10 Hence, most of the Japanese investments during the 1970s and 80s were less than 50 per cent holdings. Numerous witnesses spoke to the committee about this paradigm shift in foreign investment policy, see Mr Patrick Colmer, FIRB/ Treasury, *Committee Hansard*, 22 June 2009, p. 3 and Professor Peter Drysdale, *Committee Hansard*, 1 July 2009, p. 40.

11 Treasurer Peter Costello, 'Foreign Investment Policy Changes', 2 September 1999, http://www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/1999/055.htm&min=phc (accessed 30 July 2009).

12 A submission from the Minerals Council of Australia suggests, these new guidelines 'represented an elaboration, rather than any significant amendment to the existing rules which are set out in the *Foreign Acquisitions and Takeovers Act 1975*', *Submission 57*, p. 4.

13 Biographical data on board members can be found in the *Annual Report 2007–08*, p. 4 or the FIRB website: http://www.firb.gov.au/content/who.asp?NavID=48 (accessed 29 April 2009).

policy across the range of proposals, much of the day to day administration associated with foreign investment applications is undertaken by Treasury staff within the Division. The Division also provides guidance to foreign investors, and where necessary, assists shape proposals to conform to the policy.[14]

FIRB's jurisdiction

3.14 As suggested above, the Foreign Investment Review Board is responsible for administering the *Foreign Acquisitions and Takeovers Act 1975*. The Board's functions are strictly advisory and it has no authority to approve or reject foreign investment applications. Responsibility for the policy, and for making decisions on foreign investment proposals, rests with the Treasurer.[15] The Treasurer does not have to accept the advice of FIRB, and makes determinations on a case-by-case basis according to an assessment of the national interest.[16]

3.15 The role of the Board, as outlined in its annual report, is to:

- Examine proposed investments in Australia that are subject to the policy and supporting legislation, and to make recommendations to the Treasurer on these proposals;
- Advise the Treasurer and other Treasury portfolio ministers on the operation of the policy and the *Foreign Acquisitions and Takeovers Act 1975* (the FATA), and on proposed investments that are subject to each;
- Foster an awareness and understanding, both in Australia and abroad, of the policy and the FATA;
- Provide guidance to foreign persons and their representatives/agents on the policy and the FATA; and
- Monitor and ensure compliance with the policy and the FATA.[17]

Administration of applications to the FIRB

3.16 At the Budget Estimates hearing of June 2009, Mr Patrick Colmer offered the following description of the way the review process works:

> The way that the system works is that applications for foreign investment approval are, in the first instance, assessed by Treasury in my division. My division provides secretariat services to the board as well as advice to the minister. Under the legislation, the Foreign Acquisitions and Takeovers

---

14 FIRB, *Annual Report 2007–08*, pp. 4–5.

15 FIRB, *Annual Report 2007–08*, pp. 3–4.

16 This was the case in 2001 when Treasurer Peter Costello rejected Shell Australia's proposed acquisition of Woodside Petroleum, Treasury website, http://www.treasury.gov.au/documents/178/HTML/docshell.asp?URL=ch3.asp (accessed 12 August 2009).

17 FIRB, *Annual Report 2007–08*, p. 3.

> Act, the Treasurer is the minister who is required to make a decision on each case. The Treasurer does that with a combination of advice from the Foreign Investment Review Board and the Treasury as his department. It varies depending on the nature of the case and the size and similar sorts of things, but typically we consult confidentially with other relevant government departments, we do our own analysis of the particular issues that might arise in a particular case, and then depending on the significance of the case and what sort of issues might appear, the Foreign Investment Review Board will have a varying degree of involvement. The Foreign Investment Review Board itself does not look at the routine cases; it only looks at the more significant cases and that provides [confidential] advice to the minister via the department.[18]

3.17 Mr Colmer also made it clear that the Treasurer does not approve each 'significant case' but rather he has the opportunity to raise objections about an application within the statutory period:

> The way the legislation is set up all that it requires at its simplest level is for people who are proposing an investment to make a notification. Under the legislation there is then a statutory period, which is usually 30 days but can be extended, during which the Treasurer may raise objections. If the Treasurer does not raise objections, at the conclusion of that statutory period there is no further capacity for the government to intervene. It is an important distinction…but the government does not approve foreign investment proposals. If they are concerned about a foreign investment proposal the minister needs to take a positive step to raise an objection. That is what the legislation does. The minister can object outright or apply conditions to mitigate the national interest in each case.[19]

3.18 In 2007–08, 7,841 proposals received foreign investment approval under Australia's foreign investment policy and the *Foreign Acquisitions and Takeovers Act 1975*. This compares with 6,157 the previous year, representing an increase of 27 per cent. The real estate sector recorded 7,357 approvals (31 per cent higher than the 5,614 approvals in 2006–07). There were 484 proposals approved in other sectors in 2007–08 compared with 543 in 2006–07, a decrease of 11 per cent.[20]

3.19 In 2007–08, one proposal was rejected by the way of a Final Order, compared with 27 in 2006–07. There were no Divestiture Orders made in 2007–08, (compared with none in 2006–07 and five in 2005–06). There were 13 Interim Orders (90 in 2006–07), extending the 30-day statutory decision making period by up to 90 days.[21]

---

18 *Committee Hansard*, Senate Economics Legislation Committee, *Budget Estimates*, 4 June 2009, p. 13.

19 *Committee Hansard*, Senate Economics Legislation Committee, *Budget Estimates*, 4 June 2009, p. 57.

20 FIRB, *Annual Report 2007–08*, p. xv.

21 FIRB, *Annual Report 2007–08,* p. xv; FIRB, *Annual Report 2006–07*, p. xv.

3.20 Approvals in 2007–08 involved proposed investment of $191.9 billion. This represented a 22 per cent increase on the previous year's approvals of $156.4 billion (while, for the previous reporting period, the figure was $87 billion).[22]

Applications considered 2002–03 to 2007–08—number of proposals[23]

Outcome	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
Approved unconditionally	1,105	995	1,127	1,386	1,520	1,656
Approved with conditions	3,562	3,452	3,233	3,800	4,637	6,185
Total approved	4,667	4,447	4,360	5,186	6,157	7,841
Rejected	80	64	55	37	39	14

3.21 As noted in the previous chapter, while these figures are indicative of broader trends, they do not incorporate applications made after 1 July 2008. It should also be noted that the majority of foreign investment proposals involve the purchase of real estate. Of the 7,841 applications which were considered during 2007–08, more than 7,000 were real estate applications. However, despite the differences in numbers of applications, non-real estate applications were worth considerably more than those for real estate.[24]

Total approvals by industry sector in 2007–2008—proposed investment value[25]

Sector	Share
Mineral exploration and development	33%
Real estate	24%
Services	19 %
Manufacturing	16%
Finance and insurance	5%
Tourism	2%
Agriculture, forestry and fishing	1%
Resource processing	Less than 0.5%

22 FIRB, *Annual Report 2007–08,* p. xv; FIRB, *Annual Report 2006–07*, p. xv.

23 Adapted from, FIRB, *Annual Report 2007–08*, p. 20.

24 For a more complete breakdown in figures see FIRB, *Annual Report 2007–08*, p. 22.

25 Adapted from FIRB, *Annual Report 2007–08*, p. 27.

Rejected applications

3.22 At Budget Estimates, June 2009, Treasury officials were asked the number of business case deals (rather than real estate applications) that have been recently rejected by the Treasurer. Mr Colmer responded that none had been rejected by the current Treasurer and that one—Shell Australia's proposed acquisition of Woodside Petroleum in 2001—was rejected by the previous Treasurer.[26] In total, 16 had been rejected since 1990.[27] In appearing before the committee for the purposes of this inquiry, Mr Colmer went further explaining:

> If you look back at the cases that we have rejected, you can see that we have not rejected outright very many at all. In fact our best information is that 16 cases have been rejected since 1990. That is out of something in the order of, on average, about 500 business cases a year. We have had a different pattern in real estate but I have not actually been talking about that. The predominant reason for rejecting those cases has been to do with various forms of criminality on the part of the proposer. There is also the Shell-Woodside case where the decision was taken back in 2001 that Shell was not going to develop that resource; and the decision was taken at the time that the national interest was best served by developing that resource much more quickly than Shell was expected to do it.[28]

Monetary thresholds and determining substantial interest

3.23 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 U.S. investors.[29]

3.24 The FATA empowers the Treasurer to examine proposals by foreign persons who seek to:

- acquire, or to increase, a substantial shareholding in, or acquire a controlling interest in the assets of, a prescribed Australian corporation valued above the relevant thresholds; or
- acquire an interest in Australian urban land.[30]

---

26 This proposal was rejected on national interest grounds. The then treasurer, Peter Costello, was of the view that if approved Shell may not give preference to developing the North West Shelf project to its maximum potential, see http://www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/2001/025.htm&min=phc (accessed 31 July 2009).

27 *Committee Hansard*, Senate Economics Legislation Committee, Budget Estimates, 4 June 2009, p. 55.

28 *Committee Hansard*, 22 June 2009, p. 6.

29 Australia's Foreign Investment Policy, http://www.firb.gov.au/content/_downloads/Australia's%20Foreign%20Investment%20Policy.pdf (accessed August 12 2009).

30 FIRB, *Annual Report 2007–08*, p. 45.

3.25 A substantial interest therefore is where a person, alone or together with any associate(s), is in a position to control not less than 15 per cent of the voting power or holds interests in not less than 15 per cent of the issued shares of a corporation.[31]

3.26 Currently, under the FATA, the threshold is total assets which amount to $100 million or more.

3.27 In August 2009 the Treasurer announced additional reforms to Australia's foreign investment policy (with the amended regulations to be introduced in September 2009). These reforms, which represent a significant liberalisation of foreign investment policy, would see the threshold for reviewable applications adjusted from $100 million to $219 million. Accordingly, individual investments above 15 percent of a target company that are worth less than $219 million will no longer require FIRB examination. The effect of the changes is that approximately 20 per cent of all business applications will no longer be screened by FIRB.[32] It is also proposed that the some of the thresholds will be indexed annually against the GDP deflator. The summary of measures announced is included in the following table.[33]

<table>
<tr><th>Current Thresholds</th><th>Proposed Thresholds</th></tr>
<tr><td>Foreign Investor—Interest in an Australian business
$100 million (not indexed)</td><td rowspan="4">$219 million (ALL indexed on 1 January each year to the GDP price deflator in the Australian National Accounts for the previous year)</td></tr>
<tr><td>Foreign Investor—Offshore Takeover
$200 million (not indexed)</td></tr>
<tr><td>US investors only—Sensitive sector acquisition
$110 million (indexed)</td></tr>
<tr><td>US Investors only—Offshore Takeover
$219 million (indexed)</td></tr>
<tr><td>US Investors only—Interest in an Australian business
$953 million (indexed).</td><td>$953 million (indexed on 1 January each year to the GDP price deflator in the Australian National Accounts for the previous year)</td></tr>
<tr><td>Foreign Investor—establishing a new business
$10 million (not indexed)</td><td>Abolished</td></tr>
</table>

31 An aggregate substantial interest is where two or more persons together with any associate(s), are in a position to control not less than 40 per cent of the voting power or hold interests in not less than 40 per cent of the issued shares, of a corporation. FIRB, *Annual Report 2007–08*, p. 45.

32 Treasurer Wayne Swan, 'Reforming Australia's foreign investment framework', http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/088.htm&pageID=003&min=wms&Year=&DocType= (accessed 12 August 2009).

33 Treasurer Wayne Swan, 'Reforming Australia's foreign investment framework', http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/088.htm&pageID=003&min=wms&Year=&DocType= (accessed 12 August 2009).

3.28 As this table indicates, the thresholds of investments from the United States are higher than they are for citizens/ corporations investing from other nations.

Structuring applications to avoid review

3.29 During public hearings Senator Barnaby Joyce frequently identified concerns he had with companies structuring multiple bids in a way that avoids meeting the threshold that triggers government review. When the committee was in Brisbane Sentor Joyce stated:

> You go piece by piece by piece so that you never trigger the guidelines. Also they could separate it into different companies—Chinalco buys that and Shenhua buys that and—surprise, surprise—none of them is over $100 million.

3.30 Senator Joyce went on to question whether there should be a related entity test in the Foreign Investment Review Board guidelines that says:

> You're all part of the government of the People's Republic of China so, if you are buying land in Australia, we are going to add it all up into a bundle. That can be a trigger. If it adds up to more than $100 million we will look at it en globo?[34]

3.31 When asked about whether parties may manipulate the process through reducing their total ownership to below 15 per cent while still assuming more than 50 per cent of a strategic asset, Mr Patrick Colmer, suggested that the legislation still required tightening:

> The way that the legislation is written says that a 15 per cent interest in either the issued shares or the voting power of the company is the trigger. That is the way that the law is written. That is the way it has been since 1975. Yes, it is possible to construct a proposal that may not trigger that. It is one of the reasons why the government announced that we would be looking at a legislative fix on that.[35]

Committee view

3.32 The committee notes that the legislation identifies that a substantial interest refers to an instance where a person, alone or together with any associate(s), is in a position to control not less than 15 per cent of the voting power or holds interests in not less than 15 per cent of the issued shares of a corporation.[36] The committee also notes Mr Colmer's comment that it is possible to structure a proposal so that total

---

34 *Committee Hansard*, 1 July 2009, pp. 8–9.

35 *Committee Hansard*, 22 June 2009, pp. 11–12.

36 An aggregate substantial interest is where two or more persons together with any associate(s), are in a position to control not less than 40 per cent of the voting power or hold interests in not less than 40 per cent of the issued shares, of a corporation. FIRB, *Annual Report 2007–08*, p. 45.

ownership is below 15 per cent while component parts of the application may be for more than 15 per cent of a strategic asset—something which Mr Colmer explains that the government is reviewing.

Recommendation 3

3.33 The committee recommends that the government tighten the FATA legislation to deal with complex acquisitions where takeovers of smaller strategic assets may be masked by an application which, in total, does not represent more than 15 per cent, and therefore does not trigger review. The committee would like FIRB to give adequate consideration to the interaction between the various components of an acquisition.

National interest test and case-by-case assessment

3.34 The FATA empowers the Treasurer to prohibit an acquisition if he/she is satisfied that the acquisition would be 'contrary to the national interest'. However, the national interest, and hence what would be contrary to it, is not defined in the FATA. Given the important role foreign investment has played in Australia's national development—and the default position of FIRB—it would appear that there is a general presumption that foreign investment proposals will generally serve the national interest.[37]

3.35 Additional guidance on aspects of the national interest include, for example:

- Existing whole-of-government policy and law—reflecting the view that existing policy and law define important aspects of the national interest (for example, telecommunications, media, aviation, environmental regulation and competition policy);
- National security interests; and
- Economic development.[38]

A proposal that does not meet the requirements set out in the policy would be regarded as being contrary to the national interest.

---

37 For a full description of the 'national interest' criteria see the *FIRB Annual Report 2006–07*, pp 7–8, http://www.firb.gov.au/content/Publications/AnnualReports/2006-2007/_downloads/2006-07_FIRB_AR.pdf (accessed 15 May). In evidence provided to the committee at Senate Estimates, Treasury official Mr Jim Murphy suggested: 'The "national interest" prior to this government has been a term which, to some extent, has been criticised because it was not clear what a government would take into account in terms of the national interest. This government put forward those principles or guidelines to give some guidance to people who are making foreign investment proposals as to the types of things the government would take account of. They do not limit the government in terms of what it can take account of as to what is in the national interest. *Committee Hansard*, Senate Economics Legislation Committee, Budget Estimates, 4 June 2009, p. 56.

38 FIRB, *Annual Report 2006–07*, p. 8.

3.36 In responding to questions about the how the national interest is defined, Mr Colmer suggested:

> But if you look at what elements might make up a national interest concern, then I think you cannot do better than to go back to the Treasurer's statement of February last year where he announced the principles for foreign government investments. As I am sure you are aware, there were six principles that were laid out there—only one of which is specifically relevant to state owned enterprises. The other five are considerations that we take into account on any proposal. They are things like competition impacts, the taxation implications, national security considerations, the impact on other Australian businesses and how well a company can be expected to operate within the Australian system.[39]

3.37 Treasury documents also identify the way that the test operates as a 'negative' rather than a 'positive' test:

> Although the existence of a national interest test may appear to be non-transparent, it is a negative test rather than a prescriptive test to a list of criteria. The onus is on the Australian authorities to have reason to reject a proposal, rather than on the investor to show benefits to Australia, and the reasons for rejection are always made known to the investor.[40]

3.38 Many submitters to the inquiry agreed that defence and security industries (and/or sites) should be quarantined from foreign ownership or control. Further that, in such instances, the national interest test had clear application. However, others argued that beyond the security sphere the notion of the national interest is vague and insufficiently defined. The IPA argued that the national interest test is 'opaque' and 'nebulous' and that the Treasurer can deny entry to any significant foreign investor 'in the national interest' without legal constraints or transparent explanation.[41] Professor Tony Makin claims that the national interest has not been adequately defined and that it is 'devoid of any economic meaning'.[42]

3.39 Others saw benefits in the national interest test. Professor Peter Drysdale claimed, '…the national interest test encompasses all the relevant factors that you need to apply in the consideration of foreign investment proposals in Australia'.[43] While Mr

---

39 *Committee Hansard*, 22 June 2009, p. 6.

40 Department of the Treasury, 'Foreign Direct Investment Policy', http://www.treasury.gov.au/documents/178/HTML/docshell.asp?URL=ch3.asp (accessed 14 August 2009).

41 *Submission 32*, pages 4, 11, 14.

42 Professor Tony Makin, 'Capital xenophobia and the national interest', Australia's Open Investment Future, Institute of Public Affairs, Melbourne, 4 December 2008, p. 1.

43 *Committee Hansard*, 1 July 2009 p. 32. In relation to Chinese investment in the minerals sector, Professor Drysdale and Professor Findlay claimed 'there are no issues that cannot be dealt with under the umbrella test of national interest in managing the growth in Chinese FDI into the Australian minerals sector', *Submission 40*, p. 1.

Julian Tapp, Fortescue Metals Group, suggested 'In our view it (the national interest test) worked very well…We looked at it and we thought it was an eminently sensible test'.[44]

3.40 Rio Tinto identified the importance of a having a flexible system through which applications would be assessed on a case-by-case basis:

> The flexibility of the structure that we have in Australia to be able to look at it on a case-by-case basis does allow for appropriate consideration to be given to factors in the particular circumstances of that particular case. A hard and fast application of a rules based process would risk coming up with the wrong policy results.[45]

3.41 This approach was also supported by the Australia China Business Council who argued: 'The fact that the current FIRB rules are structured to address individual applications on a case-by-case basis is the correct approach, and it has served Australia well'.[46]

Committee view

3.42 The committee considers that the chief virtue of the national interest test is its flexibility. Its unwritten or undefined character—the fact that it is a negative test—enables it to adapt more easily to changing circumstance. A prescriptive test with specific criteria would not allow this degree of flexibility. The committee also believes that the national interest test should continue to focus on the commercial use of an asset and not upon its ownership.

Timeframes for review

3.43 Under the FATA, the Treasurer has 30 days to review investments, a 10-day notice period and a mechanism for a 90-day interim order extension (that is made public) if considered necessary.

3.44 Some concerns were expressed to the committee about the length of time it can take FIRB to review applications. In identifying concerns related to timeframes for review the Australian China Business Council (ACBC) identified the application made by Chinese steel producer Angang Steel for a minority shareholding in Gindalbie:

> …there has been a lot of concern about the time frame taken over decision making and delays. For example, one of the more vanilla investments into Australia was Angang's minority shareholding into Gindalbie, which took six months to get approval and which seems very difficult to understand. By contrast, the time taken by the government to consider the Chinalco bid

44 *Committee Hansard*, 2 July 2009, p. 29.

45 *Committee Hansard*, 1 July 2009, pp. 46–47.

46 *Committee Hansard*, 2 July 2009, p. 4.

> for Rio does not appear to be unreasonable because that is a very major and significant transaction for Australia involving existing mature assets, not just greenfield developing projects. But I think that issue of delay and the lack of accountability does create concerns overseas that different countries get treated differently.[47]

3.45 The ACBC recommended reviewing the time taken to make decisions under the FATA.[48] Rio Tinto reinforced that timely responses were imperative, particularly when large capital transactions were involved:

> Clear and prompt decision making by government is critical in demonstrating that Australia is welcoming of foreign investment. In undertaking major capital transactions, time is of the essence.[49]

3.46 In their evidence to the committee, Fortescue Metals explained with reference to Hunan Valin's $650 million application for a 17.55 per cent share of Fortescue, that they would 'have liked the approval in a faster time frame' but felt that FIRB 'acted quickly in terms of their frame of reference'. Mr Tapp went on to explain, 'It took longer than 30 days to get the approval through. I think it would have been around 40 to 45 days'.[50]

Applying conditions to approvals

3.47 As noted above, conditions can be applied to foreign investment applications. At the time of writing, there have been three statements by the Treasurer during 2009 on substantial commercial cases where he has announced his approval with conditions attached. Each related to an application from a Chinese SOE.[51]

3.48 These relate to the following approvals:

- The Ashan Iron and Steel Group's application to acquire an additional shareholding in Gindalbie Metals up to a maximum of 36.28 percent.[52]
- Minmetals Non-ferrous Metals Company application to acquire certain mining assets of OZ Minerals.[53]
- Hunan Valin Iron and Steel Group for up to a 17.55 per cent shareholding in the Fortescue Metals Group (as outlined below).[54]

---

47 *Committee Hansard*, 2 July 2009, pp. 6–7.

48 *Committee Hansard*, 2 July 2009, p. 3.

49 *Committee Hansard*, 1 July 2009, p. 44.

50 *Committee Hansard*, 2 July 2009, p. 30.

51 See FIRB website, 'Publications', http://www.firb.gov.au/content/publications.asp?NavID=5 (accessed 14 August 2009).

52 FIRB website, 'Foreign Investment Decision', 8 May 2009, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/045.htm&pageID=003&min=wms&Year=&DocType=0 (accessed 14 August 2009).

53 FIRB website, 'Foreign Investment Decision', 23 April 2009, (accessed 14 August 2009).

Fortescue Metals Group and Hunan Valin

3.49 On 31 March 2009, the Treasurer approved the application of the Hunan Valin Iron and Steel Group for up to a 17.55 per cent shareholding in the Fortescue Metals Group. Under the proposal, Fortescue agreed to issue new shares to Hunan Valin to raise $650 million in funds for the next phase of its iron ore mining operations in the Pilbara.

3.50 The approval was subject to formal undertakings from both Hunan Valin and Fortescue. Those undertakings are as follows:

- Any person nominated by Hunan Valin to Fortescue's board will comply with the Directors' Code of Conduct maintained by Fortescue;
- Any person nominated by Hunan Valin to Fortescue's board will submit a standing notice under the *Corporations Act 2001* of their potential conflict of interest relating to Fortescue's marketing, sales, customer profiles, price setting and cost structures for pricing and shipping; and
- Hunan Valin and any person nominated by it to Fortescue's board will comply with the information segregation arrangements agreed between Fortescue and Hunan Valin.

Hunan Valin has also been asked to report to the FIRB on its compliance with these undertakings.[55] The Treasurer's announcement approving the deal states:

> Penalties for non-compliance with these undertakings are contained in the *Corporations Act 2001* and breaches of the Code of Conduct can lead to the director's removal from the company board.[56]

3.51 There are further enforcement provisions in the FATA. According to the act, if the Treasurer raises no objections to a proposal, subject to conditions, and the parties do not comply with the conditions, they may commit an offence under subsection 25(1C) of the FATA. Failure to comply with an order made by the Treasurer constitutes an offence under Section 30. The FATA empowers the Treasurer to make orders to prohibit schemes entered into for the purpose of avoiding its provisions (Section 38A). In addition, the provision of false or misleading information can constitute an offence under the Crimes Act 1914 and Chapter 7 of the Criminal Code Act 1995.[57]

---

54 FIRB website, 'Foreign Investment Decision', 31 March 2009, (accessed 14 August 2009).

55 Treasurer Wayne Swan, Press Release, 'Foreign Investment Decision', 31 March 2009, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/032.htm&pageID=003&min=wms&Year=&DocType=0 (accessed 24 June 2009).

56 Treasurer Wayne Swan, Press Release, 'Foreign Investment Decision', 31 March 2009, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/032.htm&pageID=003&min=wms&Year=&DocType=0 (accessed 24 June 2009).

57 FIRB, *Annual Report 2007–08*, p. 49.

Other frameworks for regulating foreign investment

3.52 Beyond the *Foreign Acquisitions and Takeovers Act 1975*, Australia has a series of other regulatory frameworks to ensure that foreign investment in Australia operates lawfully and in the national interest. This is maintained through administrative bodies like the ACCC, and through legislation like the *Trade Practices Ac*t. In addition, work place and environmental standards are maintained through a range of separate regulatory entities.

Trade Practices Act

3.53 The purpose of the *Trade Practices Act 1974* is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. The Act deals with almost all aspects of the marketplace: the relationships between suppliers, wholesalers, retailers, competitors and customers. In broad terms, the Act covers unfair market practices, industry codes, mergers and acquisitions of companies, product safety, product labelling, price monitoring, and the regulation of industries such as telecommunications, gas, electricity and airports.[58]

ACCC

3.54 The Australian Competition and Consumer Commission (ACCC) is an independent statutory authority that deals with competition law and anticompetitive practices. Formed in 1995 to administer the *Trade Practices Act 1974* and other relevant acts, the ACCC differs from that of the FIRB in so far as it does not have any role in relation to the *Foreign Acquisitions and Takeovers Act 1975*. Rather, they are the body responsible for evaluating the effect of foreign investment on competition. In evidence provided to the committee the ACCC explained:

> Our role in relation to acquisitions is restricted to purely competition assessment under section 50 of the Trade Practices Act, which prohibits, in effect, anticompetitive mergers…Of the, say, 400 mergers that we review each year, a fair number are actually referred to us by the Foreign Investment Review Board, and we will often conduct assessments in relation to those.
>
> Under section 50(3) the commission must have regard to a number of factors in assessing whether or not there is a breach of section 50. In that subsection the commission must have regard to things like input competition, concentration, barriers to entry, the likelihood of the removal of a vigorous and effective competitor, degree of substitutability and a few others.[59]

---

58 ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/54137 (accessed 28 April 2009).

59 *Committee Hansard*, 22 June 2009, pages 14, 18.

3.55 Section 50 prohibits mergers and acquisitions that would be likely to have the effect of substantially lessening competition in a market in Australia. In assessing whether a merger or acquisition will contravene Section 50, the ACCC may only have regard to matters that have an effect on competition. Section 50(3) of the act sets out the factors that the ACCC must take into account in assessing the competition effects of a proposed acquisition. As suggested in the above evidence, no other factor other than those that relate to competition may be considered.[60] The ACCC also provided explanation on how they access proposed acquisitions in the mining sector:

> For acquisitions in the mining sector, there are two particular theories of competitive harm that we will examine when we are looking at a merger in terms of our assessment of whether or not there is a breach of section 50 of the Trade Practices Act. We are looking at the likely effect on competition, and there are several different types of theory of competitive harm that we will explore to see whether there is an anticompetitive effect. On the one hand, we will look at any horizontal aggregation of interests that the acquirer might already hold in addition to its acquisitions. For instance, if an acquirer already has some interests in Australia that compete with the target that it is intending to acquire, then we will look at the extent to which there might be some chilling or a diminution of competition in the market as a result of that acquisition. Separately—and this was an issue we explored particularly in the mooted Chinalco acquisition of Rio Tinto—we look at the vertical relationship as well, where you have an acquirer who does not necessarily have an interest that competes with its target head-to-head but it is a purchaser or has a related entity that is a purchaser of the product—the ore, for example—that is being produced by the target it is acquiring. The theory of harm we will examine there is the extent to which there can be any foreclosure of competitors through the vertical integration that might result or ensue from that acquisition. So they are two different anticompetitive effects that we will examine when we are looking at mergers generally and some of the acquisitions of mining interests in particular.[61]

3.56 In March 2009, the ACCC concluded, that on the basis of information provided to it during its review of the proposed Chinalco acquisition of a part of Rio Tinto, the acquisition was unlikely to substantially lessen competition under section

---

60 ACCC, Public Competition Assessment, Chinalco (Aluminium Corporation of China)–proposed acquisition of interests in Rio Tinto plc and Rio Tinto Ltd, 25 March 2009, http://www.accc.gov.au/content/item.phtml?itemId=866062&nodeId=682aa011d83ba73fa9794e6cd75a75e3&fn=Chinalco%20(Aluminium%20Corporation%20of%20China)%20-%20proposed%20acquisition%20of%20interests%20in%20Rio%20Tinto%20and%20Rio%20Tinto%20Ltd%20-%2025%20March%202009%20-%20Mining%20.pdf (accessed 15 June 2009).

61 *Committee Hansard*, 22 June 2009, pp. 14-15.

50 of the Trade Practices Act and was unlikely to have the ability to unilaterally decrease global iron ore prices below competitive levels.[62]

Taxation

3.57 Concerns have been raised that companies who are partly foreign owned may become involved in transfer pricing arrangements—the pricing of assets, services and funds transferred within an organisation.[63] The transfer price will affect the allocation of the total profit among the parts of the company and may also be used to reduce taxable profits. The ATO examines transfer pricing arrangements for all companies operating in Australia.

Australian Stock Exchange

3.58 The Australian Stock Exchange can also provide a mechanism to protect against undue influence of foreign investors, including disclosure and corporate governance measures which ensure transparency and accountability. In its submission the Institute of Public Affairs argued:

> …the Australian government maintains the right to appropriately regulate where there may be a perceived risk from an external…investor. For example, the government can do so by ensuring that the standards of corporate governance for firms listed on the Australian Stock Exchange are rigorous and prevent large controlling shareholders from looting the firm's assets or expropriating firm value from minority shareholders. Given appropriate corporate governance standards, large controlling shareholders need not pose any investment threat or any other type of threat to Australia. With appropriate shareholder protection all investment would be in the national interest.[64]

Restrictiveness of Australia's foreign investment regime

3.59 Some submitters to the inquiry suggested that Australia needs to provide a regulatory environment that encourages foreign investment and that this could be achieved through easing its regulatory restrictions. Julie Novak, Institute of Public Affairs, argued Australia's foreign investment regulations were too restrictive and that if Australia is to attract more foreign capital it needs to relax its regulatory frameworks.[65] Dr Brian Fisher, Concept Economics, suggested that there are 'potential

---

62 ACCC, Public Competition Assessment, Chinalco (Aluminium Corporation of China)–proposed acquisition of interests in Rio Tinto plc and Rio Tinto Ltd, 25 March 2009, (accessed 15 June 2009).

63 For example, *Submission 47*, p. 42.

64 *Submission 32*, p. 2.

65 *Committee Hansard*, 23 June 2009, p. 4. In relation to Chinese investment, Professor Peter Drysdale also cautioned '…if we deny ourselves the opportunity of hosting Chinese investment here, it will go elsewhere', *Committee Hansard*, 1 July 2009, p. 34.

deterrents in the current regime', while Rio Tinto also cautioned about having too much regulatory 'red tape', particularly for government-owned investors:

> …it is crucial that these principles (for assessing foreign investment proposals) be applied in a way that creates a foreign investment regime that will be sustainable in a period where more capital flows are likely to come from government owned investors. The fact is that investment capital will go elsewhere, particularly in the resources sector, if it is too difficult to do so in Australia. This means that the Australian economy will miss out on growth opportunities and that Australian businesses will lose market share to global competitors. This has occurred in the past, resulting in the creation of substantial competitors to Australian iron ore, in the case of Brazil, and coking coal, in the case of Canada, and at great cost to Australia.[66]

3.60 It would appear that, to some extent, this is a view shared by the Australian government. The Treasurer's statement on 4 August 2009, announcing reforms to Australia's foreign investment framework, made it clear that the government wanted to reduce disincentives to foreign investment:

> These reforms will help boost Australia's growth as the global economy recovers—streamlining Australia's foreign investment regime, cutting red tape and compliance costs, and improving Australia's competitiveness as a place to invest.[67]

3.61 This announcement clearly seeks to position Australia, during a time of capital scarcity, as an attractive and competitive destination for foreign investment.

3.62 Numerous submitters to the inquiry cited studies undertaken by the OECD, which suggest that Australia rates high in the OECD's 'regulatory restrictiveness index'. Julie Novak argued:

> I do not think there is too much doubt that Australia's regulatory regime is more restrictive than those of other countries, particularly those of continental Europe. One has to recognise that, for example, in continental Europe they have a free trade and investment zone, so, yes, that is a caveat. I think that the OECD investment restrictiveness index is reasonably credible. They have developed this index for a period of 10 years. Interestingly enough, it happens to be a by-product of Australian work in the late 1990s on investment in the services industry.[68]

---

66 *Proof Committee Hansard*, 10 August 2009, p. 32; *Committee Hansard*, 1 July 2009, pp. 44–45.

67 Treasurer Wayne Swan, 'Reforming Australia's Foreign Investment Framework', 4 August 2009, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/089.htm&pageID=003&min=wms&Year=&DocType= (accessed 17 August 2009).

68 *Committee Hansard*, 23 June 2009, p. 3.

3.63 It is most likely that the recent decision to raise reviewable thresholds to $219 million will reduce Australia's high-end score on the OECD index.[69]

3.64 Others suggested that Australia's foreign investment framework was not sufficiently restrictive. Mr Ian Melrose argued that it is rare for FIRB to 'knock anything back' and there needs to be review of the board's 'parameters, direction and its ability to act in Australia's long-term interests'.[70] By comparison, the Farmers from the Liverpool Plans suggested lowering thresholds for mandatory FIRB assessment below $100 million.[71]

Recommendations from the *Percentage Players* report

3.65 The 1994 report by the Senate Select Committee on Certain Aspects of Foreign Ownership Decisions in Relations to the Print Media, recommends that the FIRB be replaced by an independent statutory authority to be known as the Foreign Investment Commission (FIC). The report also claims, citing a statement made by Treasurer the Hon Phillip Lynch in 1976, that it was originally envisaged that FIRB would eventually become a statutory body.[72] Making FIRB a statutory body would increase its decision making power and give it a higher degree of independence in foreign investment decisions.

3.66 Under the model proposed in the *Percentage Players* report the Treasurer would still make decisions on difficult or sensitive applications:

> (The) FIC would assume responsibility for administering foreign investment policies; making decisions on applications in non-key sectors; and referring proposals involving key sectors to the Treasurer accompanied by recommendations which would be made public.[73]

3.67 This recommendation was made because under the majority of foreign investment applications do not have national interest implications and could therefore

---

69 The committee took limited evidence on the way Australia's foreign investment regulations compare with those of other nations. Mr Colmer suggested that, in a very general sense, Australia has a similar system to Canada, New Zealand and the United States. He suggested, 'There are quite different arrangements at the detailed level, but they are generally similar types of systems': The United States has a system called the Committee on Foreign Investment in the United States, generally referred to as CFIUS, and that is similar to the foreign investment process that we run. I would say, though, that our system is much more interventionist than the United States system…' *Committee Hansard*, 22 June 2009, p. 10.

70 *Proof Committee Hansard*, 10 August 2009, p. 25.

71 *Committee Hansard*, 1 July 2009, p. 8.

72 Statement to House of Representative 1 April 1976, 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, Recommendation 10.8, p. 232.

73 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, Recommendation 10.8, p. 232.

be handled by an independent statutory body. The report adds that there would 'need to be a clear delineation between the powers of decision-making vested in FIC and those which would remain with the Treasurer' and that the new legislation would need to identify those classes of decisions to be made by the FIC.[74]

Committee view

3.68 As a non-statutory body FIRB's powers are formed under the government's common law or prerogative powers. However, because it is an advisory body, FIRB does not have effective or determinative power.

3.69 The committee can see possible advantages in FIRB being made a statutory body. This higher level of independence would allow decisions on foreign investment to operate at arm's length from government and this may assist depoliticise decision making on foreign investment. However, the committee is concerned about the implications this would have for the national interest test.

3.70 Under Australia's current system the power to decide upon the national interest is entrusted to an elected representative, in this case, the Treasurer. The committee believe that, in keeping with systems of delegated power in a Westminster system, an elected representative should continue to be ultimately responsible for determining the national interest.

3.71 The committee agrees with the proposal in the *Percentage Players* report, which suggest that it may be possible to establish a system whereby the new statutory authority makes the majority of decisions and sensitive 'national interest' cases continue to be referred to the Treasurer. However, the committee feels that such a system would not deliver outcomes much different to what we have under the current system and establishing a new system would only result in administrative duplication.

---

74 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, Recommendation 10.8, p. 234.

Chapter 4

Sovereign wealth funds and state-owned entities

4.1 The terms of reference for the inquiry directed the committee to examine both the international and Australian experience of sovereign wealth funds (SWFs) and state-owned entities (SOEs). In this chapter the committee turns to outline the recent emergence of SWFs and SOEs before then examining the effectiveness of Australia's regulatory system for managing foreign investment applications by sovereign wealth funds and state-owned entities.

4.2 In recent years the rapid accumulation of assets in various countries has resulted in the growing number of SWFs. SWFs have emerged as a key player in the international capital markets and SWFs are currently estimated to hold close to $US3 trillion in assets.[1] Evidence received by the committee suggested that their presence is set to grow with the IMF estimating that SWFs could grow to about US$12 trillion by 2012.[2] In their submission, Dr Malcolm Cook and Mr Mark Thirlwell, Lowy Institute for International Policy, referred to SWFs as a 'move towards state capitalism'.[3]

4.3 The Future Fund's Chairman Mr David Murray AO, explained from where the money contained in SWFs has been sourced:

> …75 per cent of the money in sovereign wealth funds, as far as I can assess it, is oil sourced, about 20 per cent export surplus sourced and about five per cent budget surplus sourced. Australia would be in that last category.[4]

4.4 Mr Murray also explained that some nations establish SWFs because they are resources dependant while others establish SWFs because they are export surplus countries. Resource dependent countries like the United Arab Emirates, Kuwait, Saudi Arabia, Norway and Brunei look to protect themselves from resource depletion by setting up significant SWFs for the long term.

4.5 Dr Brian Fisher, Concept Economics, referred to this as 'rents from exhaustible resources'. He suggested that these 'rents' could be used productively to

---

1 As a consequence of the global financial crisis there has been growth in the number and size of SWFs. Rio Tinto's submission suggests that, since September 2008, at least 14 financial institutions have become either wholly or partly owned by SWFs, *Submission 47*, p. 34.

2 *Submission 56*, Appendix 2, Malcolm Cook and Mark Thirlwell, 'The Changing Global Financial Environment: Implications for Foreign Investment in Australia and China', Lowy Institute for International Policy, July 2008, p. 4.

3 *Submission 56*, Appendix 2, Malcolm Cook and Mark Thirlwell, 'The Changing Global Financial Environment: Implications for Foreign Investment in Australia and China', Lowy Institute for International Policy, July 2008, p. 4.

4 *Proof Committee Hansard*, 10 August 2009, p. 20.

ensure intergenerational equity through drawing on the annual output from the capital stock:

> There is a vast amount of economic literature on this very interesting subject that goes back a long time and, in fact, led the Norwegians to establish their oil investment fund. Basically, their view was that you can either have the oil in the ground and save it up until some point in the future or you can exploit it and put a proportion of the rent into some fund, invest the money and earn interest on the money. Under reasonable conditions those two things are potentially equivalent. Much of the economic literature talks about what is the optimal trajectory for the exploitation of a non-renewable resource such as oil.
>
> The theory is relatively straightforward, but in the practical world where we have uncertainty about what future demand is for a particular commodity the practice is a little bit more difficult. In the case of iron ore, for example, it is unlikely that there is going to be, in the near term, lots of substitutes for steel, so we are going to end up using lots of iron ore into the future, and it just so happens, luckily, that there is lots of iron ore on the planet as well, so we are unlikely to run out of the stuff in the short term or even the very long term…
>
> If, for example, you decide to store a product in the ground like oil and somebody turns up with a nice substitute, all of a sudden you are sitting on some black stuff that five years ago was very valuable and now all of a sudden is not very valuable at all…It is much more difficult to think about intergenerational equity than just saying that we will save the iron ore for future generations. It might actually be much more efficient to sell to the Chinese, Japanese and the Koreans iron ore today and put the rent in the bank or in your super fund, save it that way and then pass it on to future generations.[5]

4.6 The other category of SWF referred to by Mr Murray is that established by export surplus countries:

> In the case of export surplus countries, they simply arrive at a situation, for various reasons, where their foreign reserves are much larger than could normally be expected to be needed in their central bank for the normal reserve purposes…They often split their funds into either wealth funds or budget stabilisation funds, in addition to what is held for international purposes in the central bank…In Australia's case, we are working off favourable terms of trade over a considerable period in which we had budget surpluses and we have chosen to set those aside in the interests of better public sector savings specifically to deal with the likely budget situation from 2020 and beyond with ageing of the population.[6]

---

5 *Proof Committee Hansard*, 10 August 2009, pp. 35–36.

6 *Proof Committee Hansard*, 10 August 2009, pp. 23–24.

4.7 At the Budget Estimates hearing of June 2009, Mr Patrick Colmer explained that FIRB had not identified any significant problems with SWFs in Australia:

> The experience that we have had with sovereign wealth funds goes back many years. There has been some very recent attention on sovereign wealth funds. Our experience over quite a few years has been that, generally speaking, we have not identified any problems with sovereign wealth funds in the way that they operate in Australia.[7]

Characteristics of SWFs

4.8 Mr David Murray—who along with being the Future Fund's Chairman of Board of Guardians is also Chairman of the newly formed International Forum of Sovereign Wealth Funds—suggested that their were three distinguishing features of a SWF:

- It has a defined special purpose;
- Its assets are held for the community and not individual interest; and
- It invests in financial assets.[8]

4.9 The International Working Group on Sovereign Wealth Funds draws attention to the status and behaviour of SWFs:

- In their home countries, SWFs are institutions of central importance in helping to improve the management of public finances and achieve macroeconomic stability, and in supporting high-quality growth;
- In many instances they take a long term view of investment and 'ride out' business cycles, bringing important diversity to global financial markets.[9]

Examples of Sovereign Wealth Funds

Abu Dhabi Investment Authority

4.10 Established in 1976, the Abu Dhabi Investment Authority's (ADIA) principal funding source is from a financial surplus from oil exports. The ADIA replaced the Financial Investments Board which was created in 1967 as part of the then Abu Dhabi Ministry of Finance. It is the largest SWF; it is wholly owned and subject to supervision by the government of Abu Dhabi. The fund is an independent legal identity with full capacity to act in fulfilling its statutory mandate and objectives. As much as 75 per cent of its assets are administered by external managers.

---

7 *Economics Legislation Committee Estimates Hansard,* 4 June 2009, p. 10.

8 *Proof Committee Hansard*, 10 August 2009, p. 24.

9 International Working Group on Sovereign Wealth Funds: 'Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles"', October 2008, p. 3.

4.11 ADIA's funding sources derive from oil, specifically from the Abu Dhabi National Oil Company (ADNOC) and its subsidiaries which pay a dividend to help fund the ADIA and its sister fund Abu Dhabi Investment Council (ADIC). Established in 2006, the Abu Dhabi Investment Council has a local and regional focus and holds stakes in two large state owned banks, Abu Dhabi Commercial Bank and the National Bank of Abu Dhabi.[10]

Singapore's Temasek Holdings

4.12 Created in 1974, Singapore's Temasek Holdings is a SWF which primarily focuses on Asia and Singapore. Temasek holds significant stakes in the major corporations: Merrill Lynch, Barclays Bank and SingTel. (SingTel, who owns Optus is majority owned by Temasek Holdings, which holds 54 per cent of SingTel's issued share capital.) The Lowy Institute for International Policy suggests that Singapore has been the regional leader in 'creating new investment vehicles to manage the accumulation of a diversified portfolio of foreign assets'.[11]

China Investment Corporation (CIC)

4.13 The China Investment Corporation (CIC) was established in September 2007. Modelled on Singapore's Temasek Holdings, the CIC is responsible for managing part of China's foreign exchange reserves. It is responsible for managing China's $200 billion sovereign wealth fund. To date it has made substantial investments in financial firms. The previous vehicle, state-owned Central Huijin Investment Limited, was merged into the new company as a wholly-owned subsidiary company. Typically there is a separate entity that is interposed to manage investments on behalf of the CIC. The Lowy Institute for International Policy explains that two-thirds of the CIC's investment portfolio is expected to be targeted at recapitalising the domestic financial sector with only one-third for investment overseas, mostly through fund managers.[12]

Australian Government Future Fund

4.14 Established in 2006, the Australian Government Future Fund, or pension fund, is an independently managed investment fund into which the Australian government has deposited fiscal surpluses. The purpose of the fund is to meet the

---

10 Sovereign Wealth Fund Institute, http://www.swfinstitute.org/fund/adia.php (accessed 23 April 2009).

11 *Submission 56*, Appendix 2, Malcolm Cook and Mark Thirlwell, 'The Changing Global Financial Environment: Implications for Foreign Investment in Australia and China', Lowy Institute for International Policy, July 2008, p. 4.

12 *Submission 56*, Appendix 2, p. 6. CIC deputy general manager, Wang Jianxi, (who is also a member of the National Committee of the Chinese People's Political Consultative Conference, the top political advisory body), recently stated that it was now a 'good opportunity' for the CIC to make international investments. 'China's sovereign wealth fund sees "good opportunity" for int'l investment', *Xinhua*, 11 March 2009: http://news.xinhuanet.com/english/2009-03/11/content_10992451.htm (accessed 23 April 2009).

government's future liabilities for the payment of superannuation to retired public employees. The stated aim of the fund is to hold $140 billion by 2020; this figure would free up $7 billion in superannuation payments each year from the federal budget.

4.15 The Future Fund was established by the *Future Fund Act 2006* to assist future Australian governments meet the cost of public sector superannuation liabilities by delivering investment returns on contributions to the Fund. Investment of the Future Fund is the responsibility of the Future Fund Board of Guardians with the support of the Future Fund Management Agency. From 1 January 2009, the Board of Guardians gained responsibility for the investment of the assets of the Education Investment Fund (EIF), the Building Australia Fund (BAF) and the Health and Hospitals Fund (HHF).

4.16 The Board is collectively responsible for the investment decisions relating to the special purpose public funds and is accountable to the government for the safekeeping and performance of those assets. As such, the Board's primary role is to set the strategic direction of the investment activities of the funds consistent with the Investment Mandate for each fund. The Board is supported in its functions by the Future Fund Management Agency. The Agency is responsible for the development of recommendations to the Board on the most appropriate investment strategy for each fund and for the implementation of these strategies. All administrative and operational functions associated with the management of the funds are undertaken by the Agency.[13] The Future Fund invests in an array of assets and as at 31 March 2009 the Future Fund assets (including Telstra shares valued at $6.8 billion) are $58.1 billion.[14]

4.17 Mr Murray was question by the committee as to whether the Future Fund may look to invest in resource and infrastructure projects within Australia into the future, to which he responded:

> To achieve our objective we need to invest in an array of assets. We do that by building a strategic asset allocation that, in our opinion, is likely to meet the return objective we have been given in our mandate from the government. We, therefore, need to have some diversity of assets but, given the type of return target we have, infrastructure investments will be an important component and Australian equities will be an important component. By investing in Australian equities we would be an important investor in Australian mining companies.[15]

4.18 The committee also notes that numerous submitters to the inquiry recommended that Australian entities, in particular the Future Fund and

---

13 Future Fund website: http://www.futurefund.gov.au/ (accessed 3 August 2009).

14 Future Fund, 'Portfolio update at 31 March 2009', http://www.futurefund.gov.au/__data/assets/pdf_file/0016/3175/Final_Portfolio_update_31_March_09.pdf, 4 May 2009 (accessed 3 August 2009).

15 *Proof Committee Hansard*, 10 August 2009, p. 21.

superannuation funds, look to invest more in Australia's resource sector, arguing that this would reduce the sector's reliance on foreign capital.[16]

Largest Sovereign Wealth Funds (in US$ Billions)[17]

Country	*Fund(s)*	*Size*
UAE	Abu Dhabi Investment Authority	704
Norway	Government Pension Fund	379
Singapore	Government Investment Corporation/ Temasek Holdings	378
Saudi Arabia	No designated name	287
Kuwait	Revenue Fund for Future Generations/ Government Reserve Fund	222
China	China Investment Corporation	218
Russia	Reserve Fund/ National Welfare Fund	158
Australia	Australian Future Fund	101
Libya	Libya Investment Corporation	86
Algeria	Reserve Fund/ Revenue Regulation Fund	56
USA	Alaska Permanent Reserve Fund	50
Qatar	State Reserve Fund/ Stabilisation Fund	44
Brunei	Brunei Investment Authority	43
Korea	Korea Investment Corporation	31
Kazakhstan	National Fund	30

16 See, for example, Mr and Mrs I Voesenek, *Submission 18*; Mr Len Johnson, *Submission 43*, p. 1; Mr Arthur Johnson, *Submission 44*.

17 Adapted from 'Exhibit 19', Rio Tinto, *Submission 47*, p. 36.

International Working Group of Sovereign Wealth Funds and the Santiago Principles

4.19 The International Working Group (IWG) comprises 26 IMF member countries with SWFs.[18] They were formed to identify and draft a set of generally accepted principles and practices (GAPP) that properly reflect their investment practices and objectives. These investment practices and objectives have come to be embodied in the Santiago Principles. Mr David Murray informed the committee about the development of the Group:

> I would like to point to the history of development of that group. When there was first fairly serious concern in the US and Europe about investments from sovereign wealth funds into predominantly western countries the IMF, through its representative ministers, formed an international working group of sovereign wealth funds and set out to form an agreed standard of practices dealing with sovereign wealth funds, which eventually became the Santiago principles. Australia was a supporter of that process through its IMF representative minister, the Treasurer, and the guiding objectives for those principles were to help maintain a stable global financial system and free flow of capital investment to comply with all applicable regulatory and disclosure requirements in the countries in which sovereign wealth funds invest, to invest on the basis of economic and financial risk and return-related considerations, and to have in place transparent and sound governance structures.[19]

4.20 The Santiago Principles are the generally accepted principles and practices of the International Working Group of Sovereign Wealth Funds. As suggested above, the Santiago Principles were a response to pressure, particularly from the U.S. Congress, through the IMF, to create a set of principles which, if adhered to would give recipient countries of foreign investment comfort that those sovereign wealth funds acted more from commercial principles than any other principles. They also sought to provide a framework that reflects appropriate governance, accountability and transparency arrangements. Mr Murray added: 'The publication of those principles has gone a long way to placate some of the critics of sovereign wealth funds'.[20] There are 24 generally accepted principles and practices. These were established on 11 October 2008 and can be found at: http://www.iwg-swf.org/pubs/gapplist.htm.

---

18 IWG member countries are Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Islamic Republic of Iran, Ireland, Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad and Tobago, the United Arab Emirates, and the United States. Permanent observers of the IWG are Oman, Saudi Arabia, Vietnam, the OECD, and the World Bank. International Working Group on Sovereign Wealth Funds: 'Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles"', October 2008, p. 1.

19 *Proof Committee Hansard*, 10 August 2009, p. 20.

20 *Proof Committee Hansard*, 10 August 2009, pp. 21–22.

International Forum of Sovereign Wealth Funds

4.21 In April 2009 the International Working Group of Sovereign Wealth Funds established the International Forum of Sovereign Wealth Funds through the 'Kuwait Declaration'. The Forum is a voluntary group of SWFs that seeks to provide the opportunity for SWFs to meet, exchange views on issues of common interest, and facilitate an understanding of the Santiago Principles and SWF activities. The Forum does not seek to be a formal supranational authority and its work does not carry any legal force.[21]

4.22 The purpose of the Forum is to act as a platform for:

- Exchanging ideas and views among SWFs and with other relevant parties. These will cover, inter alia, issues such as trends and developments pertaining to SWF activities, risk management, investment regimes, market and institutional conditions affecting investment operations, and interactions with the economic and financial stability framework;
- Sharing views on the application of the Santiago Principles including operational and technical matters; and
- Encouraging cooperation with investment recipient countries, relevant international organisations, and capital market functionaries to identify potential risks that may affect cross-border investments, and to foster a non-discriminatory, constructive and mutually beneficial investment environment.[22]

4.23 This has proved another endeavour to establish international frameworks for SWFs to help develop confidence across the international community.

Committee view

4.24 The committee notes that while concern has been expressed about the size and power of SWFs the evidence obtained by the committee does not point to any significant concern about the investments or behaviour of SWFs. By contrast, the majority of the concerns that were raised over the course of the inquiry related to the investment activities of state-owned entities. Some submitters classified SWFs and SOEs in the same terms. The committee saw this as problematic and recognised that, by and large, they represent two distinct types of investment activity.

4.25 While the committee welcomes the fact that organisations like the International Working Group of Sovereign Wealth Funds have sought to codify the behaviours of SWFs, through establishing a set of core principles related to

---

21 International Working Group of Sovereign Wealth Funds, http://www.iwg-swf.org/mis/kuwaitdec.htm (accessed 18 August 2009).

22 International Working Group of Sovereign Wealth Funds, http://www.iwg-swf.org/mis/kuwaitdec.htm (accessed 18 August 2009).

governance, accountability and transparency, the committee believes that the best way for Australia to regulate the conduct of foreign investors (be they SWF, SOE or private commercial operator), is through developing robust domestic legislation.

State-owned entities

4.26 SOEs are distinguished from SWF by their institutional closeness to the state. SOEs are a legal entity created by a government to undertake commercial or business activities on behalf of the owner government. Like SWFs, SOEs may have access to funds that often exceed that available to private commercial interests and they may have levels of influence and power that extends beyond many large multinational companies. What distinguishes SOEs from SWFs are some of the features of SWFs outlined above. Moreover, the International Working Group of Sovereign Wealth Funds has also sought to distinguish SWFs from SOEs through the Santiago Principles in terms of their standards of public disclosure, governance frameworks and reporting requirements.[23]

4.27 Professor Peter Drysdale and Professor Christopher Findlay point out that there may be substantial variation in the character and operations of SOEs and that SOEs operate under a range of policy regimes:

> State-owned enterprises operate under different policy regimes in different countries. The regime under which Swedish state-owned enterprise operates may be different from that under which Chinese or Indian state-owned enterprise operates. Do these differences affect the impact of investment from these different sources? And the regime under which state-owned enterprise operates changes over time, as it clearly has changed and is changing in China. Do these changes need to inform the strategy that host countries might adopt towards FDI from this source?[24]

4.28 There is concern the foreign governments might not act in the same way as private investors—they may be more explicitly political in their behaviour and may seek to exert influence in ways that extend beyond seeking to protect their investment. Beyond concerns about the power, size and scope of SOEs, various submitters to the inquiry expressed concerns about the effect investment by SOEs may have on: corporate governance, competition and national security. These arguments are outlined below.

Corporate governance

4.29 There have been criticisms that operators of SOEs lack transparency and accountability. Board members may find themselves representing two sets of interests—those of the SWF/ SOE and those of the company on whose board they sit:

---

23 International Working Group on Sovereign Wealth Funds: 'Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles"', October 2008.

24 *Submission 40*, p. 4.

> …if you have board members appointed by the foreign owned enterprise … (t)hat person may have divided loyalties towards the target company or the Australian company and the foreign country that appoints them. This notion of a separate legal entity is well established in our corporate law system, but it may not be so well established in other legal systems where if you sit as a board member you have a duty to that company solely. This issue of divided loyalties is being dealt with under corporate law in Australia, whereas the person may have those divided loyalties and it may be hard to pin those down.[25]

4.30 However, Fortescue Metals Group, who as outlined above, recently accepted a deal worth $650 million which saw Hunan Valin assume a 17.55 per cent stake in the company, informed the committee of steps they had taken to reduce or eliminate the prospect of any such conflict:

> …when Fortescue sought investment and got investment from Hunan Valin, we were quite clear to restrict their shareholding, their board positions and their ability to look through to our costs…So we were quite clear: yes, they could be on the board; yes, they could be part of discussions, but if it involved anything to do with our cost or pricing structure they would have to excuse themselves from the discussion and not be circulated with any of the relevant information…
>
> The other thing that we did was ensure that the representative on our board was a specified person. The reason for that was some concern on our part that the Chinese can at times send a subordinate to fulfil the role, he can be difficult and then, when you have argued with them and argued with them, ultimately they say, 'Sorry, he wasn't really authorised to do that', and they pull him out and put somebody else in. Our view was that the way to control that was to make sure that it is actually the chairman of Hunan Valin who is on our board and that he is not allowed to send an alternate. That means that whatever he says he has to stand by.

4.31 Mr Tapp further explained that as a result of their investment they obtained the right to have one board member but were not allowed a representative on any of the subcommittees. Moreover, that as a condition of FIRB approval, Valin was required to sign up to Fortescue's code of conduct. While this would have been required under the Companies Act, because it was attached to the FIRB approval, it was given additional weight.[26]

4.32 Writing about Chinese SOEs, Dr Ann Kent has also raised concerns about both the differences in corporate culture and the enforcement of insider trading laws. In the first instance she explains: it is not simply that businessmen can become politicians without election but that the relationship between commerce and officialdom in China is much more complex and fluid than Australia. In the second, when referring to the proposed Chinalco acquisition of an interest in Rio Tinto, she

---

25 Associate Professor Zumbo, *Committee Hansard*, 10 August 2009, p. 2.

26 *Committee Hansard*, 2 July 2009, p. 27.

suggests that while board members 'would be subject to our laws by virtue of their board positions and under Australian insider trading laws, the enforcement of such obligations is poor in both Australia and China'.[27]

4.33 By contrast, IPA suggests that while there has been a 'perception of risk' associated with SOEs, appropriate regulation would see that Australian interests are protected:

> In Australia an SOE only enjoys the same commercial environment as any other investor. And the Australian government maintains the right to appropriately regulate where there may be a perceived risk from an external SOE investor. For example, the government can do so by ensuring that the standards of corporate governance for firms listed on the Australian Stock Exchange are rigorous and prevent large controlling shareholders from looting the firm's assets or expropriating firm value from minority shareholders. Given appropriate corporate governance standards, large controlling shareholders need not pose any investment threat or any other type of threat to Australia. With appropriate shareholder protection all investment would be in the national interest.[28]

4.34 This position was reinforced by evidence provided by Mr Patrick Colmer who reiterated that all Australian law applies to equally to all investors:

> It is important to recognise that an investor in this country will be subject to the industrial law, to the environmental law, to the health and safety law. All the Australian laws apply equally to a foreign investor once they are established in the country as they do to any other company operating in this country.[29]

4.35 Dr Brian Fisher, Concept Economics, suggested therefore that it was up to Australia to develop adequate regulatory frameworks for foreign investors:

> What this really comes back to is ensuring that our domestic legislation holds everyone to the same playing field. It does not matter who owns the company just as long as the OH&S rules, environment rules and the competition rules—all of those things—apply to those entities equally and we make sure that there is no improper transfer pricing and so on. That really comes down to our domestic arrangements. In my view, this is more about domestic settings than it is about attempted control of the initial investment.[30]

---

27 Ann Kent, 'No need to rush Rio Tinto deal', *Canberra Times*, 17 April, 2009, p. 13.

28 *Submission 32*, p. 2.

29 *Committee Hansard*, 22 June 2009, pp. 8–9.

30 *Proof Committee Hansard*, 10 August 2009, p. 33.

Competition

4.36 The committee also heard concerns about competition and market manipulation in instances where buyers gain control over the supply chain. In relation to Chinese investment in the Australian resource sector, there is criticism that the Chinese government will use pricing information obtained through their association with the target company in their future contract negotiations. Associate Professor Zumbo suggested that this could result in manipulation or discriminatory pricing, that:

> (i) benefit state-owned companies that are customers of the Australian target company, or (ii) benefit customers from the country sponsoring the sovereign wealth fund or which controls the state-owned companies. Such discriminatory practices would be detrimental to other customers of the Australian target company competing with those favoured customers from the country sponsoring the sovereign wealth fund or which controls the state-owned companies.[31]

4.37 Associate Professor Zumbo also raised concerns about patterned strategic acquisitions—whereby a SWF or SOE seeks to acquire a series of companies within the same sector in order to gain a controlling stake in certain sectors of the economy. This, he suggests, would limit or remove the freedom of action of those target companies to negotiate with competitors and may ultimately result in forcing up prices for domestic consumers. Beyond the domestic market, Associate Professor Zumbo suggests that 'the process of creeping acquisitions in the same sector on a global scale would pose a very real and considerable danger to competition and consumers around the world'.[32] Concern over patterned or creeping acquisitions in the resources sector was also raised by Mr William Edwards:

> The areas where they are showing most interest in buying our assets are those that involve inputs into their own economy, so that they are able to exercise a stranglehold. There is a consistency to the pattern of their investment elsewhere in the world, and that is to get a stranglehold on things, particularly natural resources.[33]

Committee view

4.38 The committee acknowledges that the legislation identifies a substantial interest is where a person, alone or together with any associate(s), is in a position to control not less than 15 per cent of the voting power or holds interests in not less than 15 per cent of the issued shares of a corporation. It also notes that the legislation identifies an aggregate substantial interest as an instance where one or more persons together with any associate(s), are in a position to control not less than 40 per cent of

31 *Submission 38*, p. 3.

32 *Submission 38*, p. 5.

33 *Committee Hansard*, 1 July 2009, p. 24.

the voting power or hold interests in not less than 40 per cent of the issued shares, of a corporation.[34].

4.39 The committee also notes that if a SOE sought to acquire a series of companies within the same sector, in order to gain a controlling stake in certain sectors of the economy, then the ACCC could rule against successive acquisitions on the basis that they were anticompetitive. Section 50 of the Trades Practices Act prohibits mergers and acquisitions that would be likely to have the effect of substantially lessening competition in a market in Australia. The committee also believes that the Treasurer would also have the power to prevent such acquisitions if he believed they were against the national interest.

Benchmark pricing regime for iron ore

4.40 Prices for iron ore are largely determined by the benchmark pricing system, whereby producers negotiate with consumers and agree on a price that will prevail for the following year. Price is affected as much by supply and demand as it is determined by the effectiveness of the two parties' negotiating position. While participants often regard this system as flawed, and companies like BHP-Billiton have withdrawn from annual benchmark pricing negotiations, progress towards a more transparent market pricing system has been limited. Fortescue identified the repercussions this might have for partner/ buyers.

> The point I want to make about this is that having information about the cost structure of Australian entities could potentially be damaging to those undertaking benchmark negotiations. It is not clear how long the benchmark system will continue to run. But certainly our view is that for the Japanese joint ventures, to the extent that they have had a look through to mining costs, that has favoured them when it comes to the annual benchmark negotiations because they have an understanding of what the cost position of the person they are negotiating with is.
>
> The issue at stake here is that, ultimately if uncommercial expansion takes place for the purpose of driving down the price, that will be damaging to Australia's national interest.[35]

4.41 In order to protect their interests, Mr Tapp explained that Fortescue were quite clear to restrict Hunan Valin's 'shareholding, their board positions and their ability to look through to our costs' and they (given the way the investment has been structured) 'see no threat'.[36] Therefore, to protect Fortescue's bargaining position in price negotiations, they limited Chinese access to price sensitive materials that may be used in benchmark pricing negotiations. Mr Tapp went further in identifying the way in which Fortescue have eliminated the capacity of the owner/ buyer to drive the price down:

---

34 FIRB, *Annual Report 2007–08*, p. 45.

35 *Committee Hansard*, 2 July 2009, p. 28.

36 *Committee Hansard*, 2 July 2009, p. 28.

> As far as we are concerned, what was imposed on Hunan Valin was entirely consistent with our own corporate code of conduct and entirely consistent with the Corporations Act. If you are a director of a company, you have a duty to declare when you have a conflict of interest. If you are on that board representing the Chinese government or, indeed, a steel mill, you have a conflict of interest when it comes to negotiating the price. So we were quite clear: yes, they could be on the board; yes, they could be part of discussions, but if it involved anything to do with our cost or pricing structure they would have to excuse themselves from the discussion and not be circulated with any of the relevant information…
>
> I will be quite clear about what our fear is: investment in expanding production for the sole purpose of increasing supply to drive the price down. That is not something you can do unless you control the entity. It is not something you can do if you only control a very small entity.
>
> Clearly, when large companies like Fortescue, Rio or BHP are involved, they are able to increase their production to the point where they can have a material impact on the overall supply situation. I would not want to see a situation where somebody else controlled them to the extent that they had the ability to demand that they expand production. Even though that would be bad for the company, it would ultimately be good for the customer. If you are the Chinese government and you own both the company and most of the steel mills, it can be in your interest to engage in such commercial activity.[37]

Committee view

4.42 The committee notes with interest the evidence offered by the Fortescue Metals Group and considers it a useful example of where conditions may be placed on SOEs where it is believed there is potential for some type of commercial conflict.

National security and geo-strategic concerns

4.43 The fifth principle contained in the Treasurer's Guidelines for Foreign Investment Proposals focuses on national security:

> An investment may impact on Australia's national security.
>
> The Government would consider the extent to which investments might affect Australia's ability to protect its strategic and security interests.

4.44 Recently the Treasurer ruled against the Minmetals $2.6 billion bid for OZ Minerals in March 2009 on national security grounds as the Prominent Hill copper/gold mine was deemed to be within the Woomera Prohibited Area of South Australia, a weapons testing range. Subsequently the terms of the deal were revised, omitting the Prominent Hill mine and the Treasurer approved the application.

---

37 *Committee Hansard*, 2 July 2009, pp. 28–29.

4.45 With respect to Chinese investment in Australia, it is worth noting that traditionally Australia's most important trading partners have also been its security partners. They have also been democracies. Mark Thirlwell, Lowy Institute for International Policy, notes:

> A further important complication is (geo-) political. Traditionally Australia's most important trading partners have also been our key security partner (the UK and then the US)—or at least an ally of our key security partner (Japan), all of them democracies. Now for the first time our largest trading partner is authoritarian, a quasi-mercantilist, and a strategic competitor of our major ally.[38]

4. 46 Others submitters did not see the national security concerns explicitly linked to security. Rather they referred to the way in which Chinese acquisitions would result in a gradual erosion of Australian sovereignty. This concern has been outlined above.[39]

Additional concerns about Chinese SOEs

4.47 Many of the concerns related to Chinese foreign investment were similar to those related to foreign investment generally. These typically relate to issues of transparency; conflict of interest (wherein the seller becomes a buyer); loss of control over natural resources in a time of global resource scarcity; and concern over whether the Chinese government might not act in the same way as a private investor. China-specific concerns related to: the fact that Chinese SOEs are considered to be government controlled; the ceding of sensitive technologies to a potential military competitor; and the human rights record of the Chinese government and by extension its state-owned entities. The Leader of the Opposition, Malcolm Turnbull, has raised two further concerns: one related to the transfers of assets, the other related to matters of mutuality.[40]

4.48 Others have a more extreme position arguing that the operations of Chinese SOEs are part of a strategic campaign by a non-democratic nation to undermine the Australian economy and threaten Australian sovereignty. A number of submitters to

---

38 Mark Thirlwell, 'Is the Foreign Investment Review Board acting fairly?', Institute of Public Affairs, AOIF Paper 4, p. 15, Lowy Institute for International Policy, *Submission 56*, Appendix 1.

39 For example, *Submission 38* (Associate Professor Frank Zumbo), p. 5.

40 '…it is worth noting that the transaction documents would allow Chinalco to transfer its interests in the operating joint ventures including the Hamersley iron ore mines to another Chinese Government state-owned enterprise' and 'There is no prospect that an Australian or any foreign company would be able to acquire a stake of this kind in a major Chinese resource company – not least because they are all state owned'. Malcolm Turnbull, 'Power Balance in Asia: The Coalition perspective', Address to the Lowy Institute, Sydney, 1 May 2009, p. 9. http://malcolmturnbull.com.au/Media/LatestNews/tabid/110/articleType/ArticleView/articleId/454/Power-Balance-in-Asia-The-Coalition-perspective-Address-to-the-Lowy-Institute.aspx (accessed 5 May 2009).

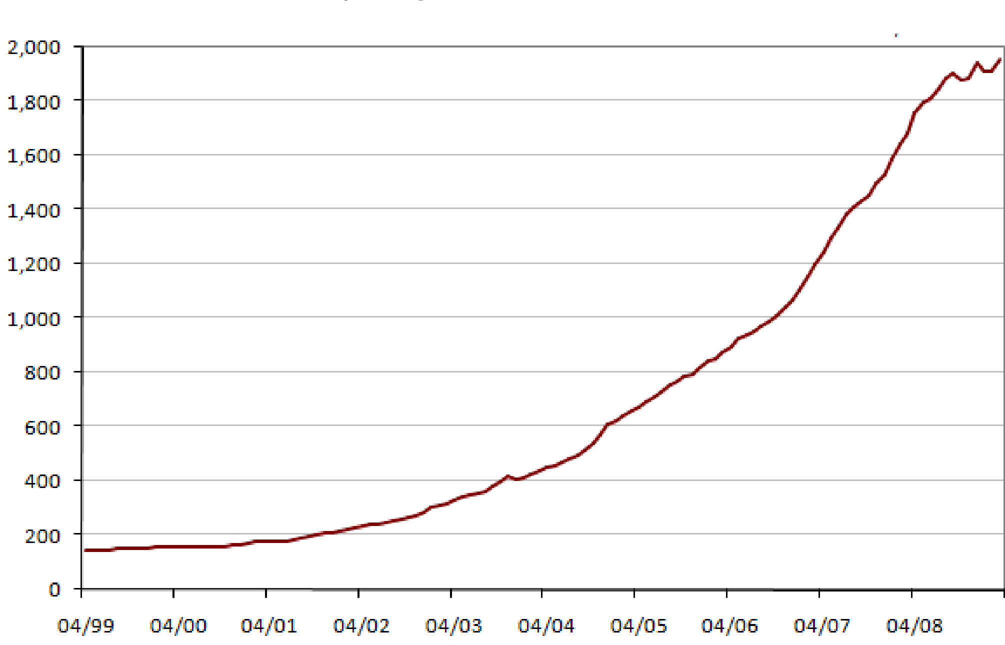
the inquiry articulated this strategic dominance/ Trojan horse thesis. The National Civic Council warned that China's emergence as a hegemonic economic power presents an acute challenge to Australia's national security and that Australia risks falling victim to China's strategic dominance through its foreign investment.[41]

Chinese capital and China's outbound investment

4.49 For some years the People's Republic of China (PRC) has been acquiring very significant foreign reserves. The PRC currently has around US$2 trillion in foreign exchange reserves in US currency or US Treasury bonds. In addition to the US$200 billion sovereign wealth fund, which is managed by the China Investment Corporation (CIC), China also has the National Social Security Fund (NSSF, $U.S. 80 billion). The NSSF collects pension contributions and the proceeds of state assets and has signalled that it would explore further investments offshore.

4.50 The Chinese market accounts for one third of global demand and two thirds of global demand growth in industrial metals. China consumes over a third of the world's aluminium, over a quarter of the world's copper and over half of the world's seaborne iron ore.[42] China's domestic iron ore resources cover less than 50 per cent of demand.

Chinese foreign reserves (US billions)[43]



4.51 Therefore, it is not surprising that China is considering ways of diversifying its investments through securing investment in the international resource sector. With so much money, at a time of scare global liquidity, the Chinese government is actively

41 *Submission 31*, p. 3.

42 Rio Tinto, *Submission 47*, p. 58.

43 People's Bank of China, as cited by the Sovereign Wealth Fund Institute, http://www.swfinstitute.org/ (accessed: 23 April 2009).

encouraging its domestic entities to diversify and explore overseas opportunities—particularly in the energy and resource sector. Resource-rich nations like Australia and Canada have become the focus of China's strategic efforts.

China's 'going out' strategy

4.52 China's recent foreign investment activity has been prompted by the announcement, at the Chinese Communist Party's Sixteenth Congress in 2002, that the Chinese leadership was encouraging Chinese companies to 'zou chuqu'—step out into the global economy, not only through exports, but also by investing overseas. Professor Peter Drysdale offered the following context for this strategy:

> They are undertaking this investment in the context of what is called in China a 'going out' strategy, which is a policy that released the controls on foreign investment abroad and encouraged Chinese enterprise to take up stakes in foreign companies and undertake foreign investment, and foreign investment has grown rapidly under that policy.[44]

4.53 Professor Drysdale went on to explain how China's State-owned Assets Supervision and Administration Commission of the State Council has been charged, since 2003, with devolving responsibility of SOEs; making SOEs implement corporate governance reforms and having SOEs conform to commercial market disciplines:

> Since 2003 the State-owned Assets Supervision and Administration Commission of the State Council, SASAC, in China has assumed the responsibility for exercising ownership of state owned enterprises on behalf of the Chinese government. SASAC has two important roles. It supervises the key state enterprises and their management; it exercises a monetary role in their profit and management performance. Its second important role is that it carries forward the reform of state owned enterprises. It has the responsibility for reforming state owned enterprises, the privatisation of state owned enterprises, their governance and their consolidation. All of these things are also a main responsibility for SASAC.[45]

4.54 Professor Drysdale's argument extended further suggesting that it was important for Australia to engage these enterprises because it offers an opportunity to influence them and introduce them to the Australian system.[46]

Commercial imperatives of Chinese SOEs

4.55 The committee received evidence that those Chinese companies seeking to invest in Australia display highly commercial orientations. The Australia China Business Council suggested that there is 'growing evidence that corporate China is

---

44 *Committee Hansard*, 1 July 2009, p. 29 and *Submission 52* and *52a*.

45 *Committee Hansard*, 1 July 2009, p. 30.

46 *Committee Hansard*, 1 July 2009, p. 38.

behaving commercially, or, as the Chinese would say, they are following a policy of "*zhengqi fenkai*"—proper separation of government functions from business operations'.[47] In speaking of his personal experience dealing with Chinese SOEs Mr Douglas Ritchie, Rio Tinto, explained:

> I have to say that not only do I find them commercial in their approach but I find that their standards, in terms of employment, occupational health and safety and attitudes to environment, are every bit as good as those of equivalent corporations elsewhere. I would also say that I have found that the people who manage these corporations manage them in exactly the same way as people like me manage our own corporations and they are judged in exactly the same way. That has to do with return on investment and the standards that one maintains that relate to the standards that the corporation itself sets. So I think that a lot of these fears that you express, Chair, as being around the place come from primarily, and unfortunately, a lack of familiarity with these state owned enterprises by the people who are making these comments.[48]

Chinese investment in Australia by industry, as approved by the Foreign Investment Review Board (FIRB) 1992–2007[49]

Year	Number	Agriculture, forestry and fisheries ($A million)	Manufacturing	Mineral exploration and resource processing	Real estate	Services and tourism	Total
1993–94	0	0	0	0	0	0	0
1994–95	927	0	1	42	426	52	522
1995–96	267	0	6	52	137	31	225
1996–97	102	10	3	5	176	17	210
1997–98	0	0	0	0	0	0	0
1998–99	0	0	0	0	0	0	0
1999–00	259	35	5	450	212	10	720
2000–01	0	0	0	0	0	0	0
2001–02	237	0	47	20	234	10	311
2002–03	0	0	0	0	0	0	0
2003–04	170	0	2	971	121	5	1,100
2004–05	206	2	0	39	181	42	264
2005–06	437	0	223	6,758	279	0	7,259
2006–07	874	15	700	1,203	712	11	2,640

47 *Committee Hansard*, 2 July 2009, p. 3.

48 *Committee Hansard*, 1 July 2009, p. 45.

49 Adapted from Professor Peter Drysdale and Professor Christopher Findlay, 'Chinese Foreign Direct Investment in Australia: Policy Issues for the Resource Sector', *Submission 40*, p. 10.

4.56 The committee also received evidence that characterised Chinese companies very differently. The National Civic Council suggested:

> …Chinese corporations—at least government-owned corporations—are not only government owned but these corporations are overwhelmingly state-run monopolies in which the key positions are appointed not just by the government but by a sole party which runs the government, which is the Chinese Communist Party.[50]

4.57 Referring to the size of China's SWF, the Farmers from the Liverpool Plains suggested that the Chinese government were 'wandering around the world…picking the eyes out of pretty well anything they can find and having a go at purchasing it'.[51]

Regulation of SOEs

4.58 Australia's guidelines for assessing foreign investment applications by foreign governments are similar to those for private sector proposals; however, they do identify some differences. In a February 2008 statement titled, 'Government improves transparency of foreign investment screening process' Treasurer Swan stated:

> Proposed investments by foreign governments and their agencies (for example, state-owned enterprises and sovereign wealth funds (SWF)) 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.
>
> This reflects the fact that investors with links to foreign governments may not operate solely in accordance with normal commercial considerations and may instead pursue broader political or strategic objectives that could be contrary to Australia’s national interest.
>
> The Government is obliged under the *Foreign Acquisitions and Takeovers Act 1975* to determine whether proposed foreign acquisitions are consistent with Australia’s national interest.[52]

4.59 The committee received varying evidence related to the government's guidelines for assessing investment by sovereign wealth funds and state-owned entities. Professors Drysdale and Findlay raised concern about the government's new guidelines arguing that 'the elaboration of these principles was somewhat damaging to

---

50 *Committee Hansard*, 23 June 2009, p. 8.

51 *Committee Hansard*, 1 July 2009, p. 3.

52 Treasurer Wayne Swan , 'Government improves transparency of foreign investment screening process', http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/009.htm&pageID=003&min=wms&Year=2008&DocType=0 (accessed 18 August 2009).

Australia's foreign investment climate'. They suggest that the government's statement that 'investors owned or controlled by a foreign government raise additional factors that must also be examined', has the effect of discriminating specifically against Chinese investment proposals and creates uncertainty about Australia's foreign investment policy. Moreover, that through creating a class of investments which require special scrutiny Australia has departed from a 'well-established and respected case-by-case approach'.[53] Rio Tinto had a different view explaining it 'supports the six principles set out by the Treasurer in February 2008 for screening investments linked to foreign governments'.[54]

4.60 The committee received strong evidence suggesting that the government must act to ensure the appropriate legislative and regulatory frameworks are in place for assessing applications from SOEs. The IPA suggested:

> Rather than fearing investment from SOEs, the Australian government should be: ensuring the appropriate legislative and regulatory frameworks are in place to ensure investors act appropriately; and liberalising the Australian investment regulatory regime to ensure Australia is an attractive destination for investment capital.[55]

4.61 In its submission, the Lowy Institute for International Policy explained that while they view the emergence of new sources of foreign capital as positive for Australia they believe that a greater degree of regulatory oversight is required in the case of foreign investment by government-controlled entities:

> In our judgment, the present regulatory and policy framework for foreign investment applications is robust enough to manage this growing trend and provides a reasonable balance between Australia's openness to foreign investment and the responsibility of the government to ensure that economic and commercial change in Australia is in line with community interests and concerns. This framework's long-standing distinction between private sector foreign investment and investment originating from state-owned entities is both justifiable…[56]
>
> We also believe, however, that a greater degree of regulatory oversight in the case of foreign investment by government-controlled entities compared to that applied to private foreign investment is warranted.[57]

4.62 Arguing that as Australia seeks new forms of capital investment from overseas it needs to come to terms with applications from state-owned entities, Professors Drysdale and Findlay suggested:

---

53 *Submission 40*, pages 33, 25, 27.

54 *Committee Hansard*, 1 July 2009, p. 44.

55 *Submission 32*, p. 2.

56 *Submission 56*, p. 2.

57 *Submission 56*, p. 2.

> There is no reason in principle why state-owned foreign firms will not deliver benefits to Australia or other host countries to foreign investment of a kind that is similar to those delivered by private owned foreign corporations. Technological advantages, management know-how, market ties, capital costs or other advantages that come with FDI can be associated with state-owned firms and support their competitiveness and viability in the same way as they do with private multinational corporations. It would therefore be unusual if the ownership of foreign investors was germane to approval of their investment. In seeking to secure supplies and establish relationships that are important to integrated operations across a resource supply chain or to exploit marketing advantages, an investment involving state ownership would be behaving no differently than many privately owned investments.[58]

4.63 By extension, they posit that 'there are no issues that cannot be dealt with under the umbrella test of national interest in managing the growth in Chinese FDI into the Australian minerals sector'.[59] Professors Drysdale and Findlay identify three main 'additional factors' that could demand a test of suitability beyond the 'national interest':

- FDI investments involving state ownership and dominant shareholding and control might be used to serve as a vehicle for shifting profits back to the home country through underpricing exports.
- FDI investments involving state ownership and dominant shareholding and control might be used to serve as an instrument for subsidising the development of 'excess capacity' or 'extra-marginal' projects and ratchetting resource prices down.
- FDI investments involving state ownership and dominant shareholding and control might be used to pursue political or strategic goals inconsistent with the efficient development and marketing of national resources.

4.64 However, they conclude that in each case a 'national interest' test provides adequate protection.[60] Dr Malcolm Cook, Lowy Institute for International Policy, similarly stated:

> …we think the existing regulatory framework before an investment review board and within that the differentiation made between private sector for an investment into Australia above 15 per cent and foreign investment by state owned entities is justified. Our basic view is that it is not broken so there is no real need to fix it.[61]

---

58 *Submission 40*, p. 11.

59 *Submission 40*, p. 1.

60 *Submission 40*, pp. 25–26.

61 *Proof Committee Hansard*, 10 August 2009, p. 13.

4.65 This perspective was reiterated by Mr Mark Thirlwell, Lowy Institute for International Policy:

> It is not clear to me what falls through the gaps of the existing system, what additional tool we would need or what additional review processes we would need that is not already provided for in the existing framework.[62]

4.66 Mr Stephen Creese, Rio Tinto, also offered the following advice for determining the independence of SOEs

> We think there is a subset of questions that really need to be asked about independence from the government from which the state owned enterprise springs. We say you have to go down to the real nitty-gritty questions of control. Can the state owned enterprise actually control operating assets through its investment? Can it actually influence and control key business decisions about such things as capital investments, product mix, production levels, pricing, contracting strategies, marketing and those things? You need to go down to that level of detail. If you answer, 'Yes, they can', then you have got to say, 'Now we understand the detail of how that might work in the context of that particular transaction, is this contrary to the national interest in terms of the way that would operate?' So we think there is a more detailed level of inquiry than simply looking at: is it 'independent'?[63]

4.67 While suggesting that there was no need for wholesale conceptual reform, the Australia China Business Council suggested that the Foreign Acquisitions and Takeovers Act should be tightened so that:

> …the policy requirements in relation to investments by SWFs and SOEs (are incorporated) into the body of the Foreign Acquisitions and Takeovers Act to avoid arguments that the policy requirements may be beyond the ambit of the FATA…[64]

4.68 By contrast, the committee also heard several calls for the reform of FIRB and for increasing the regulation of foreign investment by SOEs. These included:

- Establishing an authority that is separate from the FIRB to control and administer the investment of sovereign funds into Australia, especially into the mining and resource sector.[65]
- Abolishing the case-by-case approach to better manage creeping acquisitions by SOEs.[66]

---

62 *Proof Committee Hansard*, 10 August 2009, p. 15.

63 *Committee Hansard*, 1 July 2009, p. 47.

64 *Committee Hansard*, 2 July 2009, p. 3.

65 Mr Norman McNally, *Committee Hansard*, 2 July 2009, p. 20.

66 Mr William Edwards stated: 'would, I think, abolish the case-by-case approach to the review of foreign investments, because I think that all that leads to, ultimately, is creeping takeover of our assets', *Committee Hansard*, 1 July 2009, p. 23.

- Establishing more restrictive caps on foreign acquisitions/ ownership within specific strategic sectors (the mining industry, prime agricultural land) where a certain percentage of capitalisation should not exceed a certain level.[67]
- Giving FIRB to power to examine licenses issued by state governments.[68]

Committee view

4.69 Historically, one of the reasons Australia has relied upon foreign investment is because it has had shallow domestic capital markets. This continues to be the case particularly when it comes to capital intensive sectors such as the mining industry. The committee considers that it is critical that Australia continue to be seen as a country that welcomes foreign investment and remains an attractive and competitive place to invest. The committee believes that foreign investment is critical to the development of Australia's industries and infrastructure and has significant benefits for the Australian community at large.

4.70 The committee also believes that the best way for Australia to manage the new capital flows that have stemmed from the emergence of SWFs and SOEs is through developing robust domestic legislation. The committee has acknowledged that the FATA legislation could be tightened to deal with complex acquisitions where takeovers of smaller strategic assets may be masked by an application which, in total, does not represent more than 15 per cent, and therefore does not trigger review. As suggested above, the committee would like FIRB to give adequate consideration to the interaction between the various components of a total acquisition.

4.71 As has been suggested throughout this chapter, much of the evidence received by the committee argued that the current system for assessing foreign investment applications is adequate. Nevertheless, the committee also heard a range of other opinions which suggested that the current system was either too restrictive or not restrictive enough. The committee notes that while the Treasurer's recent announcement to increase the thresholds for reviewing applications from $100 million to $219 million may be welcomed by those seeking a more liberal foreign investment regime; it will be of serious concern to others. The committee notes that those who are critical of the current system, and who would like the thresholds for reviewing foreign investment applications lowered, have particular concern over how these higher thresholds may be used to assist companies or state-owned entities acquire assets in a patterned or strategic manner which may give them an opportunity to engage in the manipulation of pricing, particularly in the resource sector.

4.72 The committee believes that the current regulatory framework for assessing foreign investment proposals, whether they are made by private commercial interests,

---

67 For example, Mr William Edwards, *Committee Hansard*, 1 July 2009, p. 23; Mr Ian Melrose, *Committee Hansard*, 10 August 2009, p. 25; Farmers from the Liverpool Plains, *Committee Hansard*, 1 July 2009, p. 14.

68 Farmers from the Liverpool Plains, *Committee Hansard*, 1 July 2009, p. 8.

sovereign wealth funds or state-owned entities, is sufficient. The committee considers that the combined powers of the *Foreign Acquisitions and Takeovers Act 1975*, *Foreign Acquisitions and Takeovers Regulations 1989, Trade Practices Act 1974* and laws related to transfer pricing and environmental and worker protection, are sufficient to provide for the robust assessment of foreign investment applications and satisfactory regulation of the conduct of foreign investors. The committee is also of the belief that, having considered all the evidence, the system of case-by-case assessment, based on the national interest, has also served Australia well.

Senator Alan Eggleston
Chair

Dissenting Report by Senators Joyce, Ludlam and Xenophon

Introduction

1.1 We acknowledge the comments of our Coalition colleagues; however, both the Chair and Coalition Senators Reports do not seem to fully recognise the challenges currently facing Australia with regards to investment by foreign entities, and the long term issues that this Parliament could face, long after we have vacated our seats.

1.2 Australia is not alone in its review of foreign investments by state-owned entities (SOEs) and sovereign wealth funds (SWFs).

According to a report by Will Devlin and Bill Brummitt, referred to in a report completed by Mr Mark Thirlwell from the Lowy Institute for International Policy:

> "… the German government is reportedly considering legislating to block state-controlled foreign investments; the European Commission is inquiring into whether state-controlled investment funds from Russia, China and the Middle East threaten Europe's single market; and the United States has revised legislation governing its Committee on Foreign Investment in the United States."[1]

1.3 Certainly while generally foreign investment can have positive economic effects, with it can come political consequences, impacts on corporate governance and risks to competition, and each of these factors need to be strictly considered by the Foreign Investment Review Board before approval for investment is granted. This Dissenting Report will seek to explain our concerns on each of these matters.

Foreign investment trends

1.4 Globalisation and the opening of trade doors by nations previously removed from international commerce has seen a significant increase in investment by foreign entities through sovereign funds and also through acquisition of majority shares in Australian companies.

---

[1] Mr Mark Thirlwell, *Australia's Open Investment Future*, December 2008, pg 9

> "Australia has managed to attract extra foreign capital stock over the past 25 years – increasing from about $25 billion in 1980-81 to $347 billion in 2006-07 (or from about 18 percent of GDP to about 33 percent)."[2]

In a December 2008 report titled *Is the Foreign Investment Review Board acting fairly?,* Mr Mark Thirlwell, Program Director, International Economy, Lowy Institute for International Policy, stated:

> "Over the past two financial years, Australia has approved some A$10 billion in proposed Chinese investment, and earlier this year forecasts for 2007-08 suggested a figure for proposed investment in excess of A$30 billion. In this sense the China relationship is following the pattern of Australia's highly successful economic relationship with Japan, dating back to the 1970's, which saw major Japanese investment follow trade in the resources sector."[3]

1.5 The comparison between China's and Japan's investments in Australia was discussed at length during the Senate Committee hearings, however it must be noted that at the commencement of Japanese investment, they were under joint venture agreements; investment was completed by corporate interest, not government interest; and, Japan is a democracy, with an open and transparent court system.

Indeed, as Mr Mark Thirwell stated:

> "Traditionally Australia's most important trading partners have also been our key security partner (the UK and then the US) – or at least an ally of our key security partner (Japan), all of them democracies. Now for the first time our largest trading partner is authoritarian, a quasi-mercantilist, and a strategic competitor of our major ally."[4]

1.6 However, the dynamics of the global environment have changed.

> "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."
>
> "Complementing these espoused principles is the notion that Australian foreign direct investment policy does not discriminate between investors. Recently, the Prime Minister, Kevin Rudd, said Australian foreign investment regulation is non-discriminatory'. We have had a foreign investment from Japan and Korea and the US and Great Britain for decades on a large scale."[5]

---

[2] Institute of Public Affairs, *Submission 32,* pg 7
[3] Mr Mark Thirlwell, *Australia's Open Investment Future*, December 2008, pg 15
[4] Mr Mark Thirlwell, *Australia's Open Investment Future*, December 2008, pg 9
[5] Institute of Public Affairs, *Submission 32,* pg 9

As at 31 December 2008, the United States and the United Kingdom were the largest foreign investors in Australia, 24.8 percent and 24.3 percent respectively. Japan, Hong Kong and Singapore were ranked 3rd, 4th and 5th, and China was ranked 15th, with just 0.5 percent, lower than, for example, Belgium or the British Virgin Islands.

In its submission to the Committee, the Lowy Institute for International Policy wrote:

> "The twenty largest SWFs are all based either in major resource-exporting countries (including Australia and its growing Future Fund) or in East Asian economies with large stocks of foreign exchange reserves. The IMG estimates that SWFs could grow to control about US $12 trillion by 2012, four times as much (nominally) as they control now."[6]

1.7 Under the *Foreign Acquisitions and Takeovers Act 1975*, a pre-screening process exists for major investment applications, "defined as any purchase by a foreign entity, and any associates, of more than 15 percent of an Australian company, or by several foreign entities of more than 40 percent in aggregate"[7].

> "Investors are obligated to notify government of their proposal, prior to commencement, if it exceeds a set of monetary thresholds, and there are additional restrictions on sensitive industries such as airports, banking, media, residential real estate, telecommunications and transport (civil aviation and shipping)."[8]

Foreign investment proposals are assessed in accordance with a 'national interest test', having regard to the "widely held community concerns of Australians,"[9] and "the Treasurer can reserve the right to impose conditions on a major foreign investment proposal in order for it to be approved"[10].

1.8 During the Senate Committee hearings, Mr Patrick Colmer, General Manager, Foreign Investment and Trade Policy Division, Treasury, was asked when a foreign investment could be considered "bad" for Australia.

> Mr Colmer — That is a question which I think varies over time. If you look back at the cases that we have rejected, you can see that we have not rejected outright very many at all. In fact our best information is that 16 cases have been rejected since 1990. That is out of something in the order of, on average, about 500 business cases a year. We have had a different pattern in real estate but I have not actually been talking about that. The predominant reason for rejecting those cases has been to do with various forms of criminality on the part of the proposer. There is also the Shell-Woodside case where the decision was taken back in 2001 that Shell was

---

[6] Lowy Institute for International Policy, *Submission 56*, pg 4
[7] Institute of Public Affairs, *Submission 32,* pg 11
[8] Institute of Public Affairs, *Submission 32,* pg 11
[9] Institute of Public Affairs, *Submission 32,* pg 11
[10] Institute of Public Affairs, *Submission 32,* pg 11

> not going to develop that resource; and the decision was taken at the time that the national interest was best served by developing that resource much more quickly than Shell was expected to do it.[11]

China's rise

1.9 Since the 1980s, when the People's Republic of China opened its economy to the rest of the world, it has grown to become an economic super power.

> "China is not only, by far, the largest emerging market, it has also been the fastest growing major economy for the last three decades with many, including Treasurer Swan, believing that this growth will continue. Last year, China accounted for a larger share of total world growth than the United States."[12]

> "Prior to 1991, Chinese foreign investment was negligible. Since 2000 though and the launch of the 'Going Out' foreign investment strategy, the Chinese state has provided significant support for Chinese firms to invest overseas to gain access to sources of supply, new markets and greater organisational capabilities. China's 150 state-owned 'central enterprises', that together control three-quarters of the listed companies in China, have been at the forefront of this strategy."[13]

1.10 For example, in its submission to the inquiry, Chinalco, the Aluminium Corporation of China, detailed its current and future foreign ventures in Australia and around the world:

> "Chinalco has 34 directly owned or controlled subsidiaries ... Chinalco is also exploring business opportunities in various countries including Russia, Vietnam, Mongolia, Guinea, Indonesia and India."[14]

1.11 China's investment in Australia in particular is growing rapidly.

> "In 2006, the stock of Chinese investment in Australia was about $3.5 billion, while last financial year investment applications rose to $10 billion and this year may hit $30 billion. The Treasurer noted that since coming to power in late November 2007, he had approved a Chinese investment application on average once every nine days."[15]

1.12 Given China's position of strength as an emerging economic super power, and the vulnerability that Australia could one day find itself in at the bargaining table, it must be acknowledged that the safest and most prudent position to take is one where that position of strength cannot be exerted on Australia in years to come.

---

[11] Mr Patrick Colmer, *Proof Committee Hansard*, pg 6
[12] Lowy Institute for International Policy, *Submission 56*, pg 5
[13] Lowy Institute for International Policy, *Submission 56*, pg 5
[14] Chinalco, *Submission 23,* pg 3 and 4
[15] Lowy Institute for International Policy, *Submission 56*, pg 7

This would mean precluding state-owned enterprises from the capacity to invest, in a substantial form, in the assets in Australia, especially in our long-term key strategic assets such as mineral deposits.

1.13 Indeed, foreign direct investment in the mining sector in particular has rising strongly since 2001.[16] According to Concept Economics,

> "… the mining sector is the industry with the greatest amount of investment by foreigners. The ABS estimated that the level of direct foreign investment in mining was $77 billion in 2006. The manufacturing sector has the next highest level of foreign investment with $59 billion followed by the wholesale/retail trade and finance and insurance industries which have about $50 billion each."[17]

Concept Economics goes on to state in its submission that foreign investment in Australia's mining sector is crucial.

> "The ability of Australia to attract foreign investment to its mining sector has positioned Australia to take advantage of current world prices for minerals commodities. Foreign investment was, and remains, crucial to discovering and assessing Australia's mineral reserves."[18]

1.14 Indeed, a number of submissions argued that foreign investment by state-owned enterprises is just another form of foreign investment and therefore should not be limited.

The Institute of Public Affairs wrote in its submission to the Committee:

> "In Australia an SOE only enjoys the same commercial environment as any other investor. And the Australian government maintains the right to appropriately regulate where they may be a perceived risk from an external SOE investor … Given appropriate corporate governance standards, large controlling shareholders need not pose any investment threat or any other type of threat to Australia."[19]

1.15 However, the Institute of Public Affairs also quoted Western Australian Premier, Colin Barnett, who stated in late September 2008, 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."[20]

---

[16] Concept Economics, *Submission 6*, pg 16
[17] Concept Economics, *Submission 6*, pg 16
[18] Concept Economics, *Submission 6*, pg 19
[19] Institute of Public Affairs, *Submission 32*, pg 2
[20] Institute of Public Affairs, *Submission 32,* pg 13

1.16 Furthermore, it can be argued that the potential consequences of a dispute involving a foreign investment by a state-owned enterprise can have far reaching effects, as can be seen by the current case involving Rio Tinto executive, Stern Hu.

Potential political consequences of foreign investment – 'The elephant in the room!'

1.17 Government involvement in commercial agreements creates an entirely different proposition to corporate ownership. Ultimately, the 'elephant in a room' which must be acknowledged is: 'Do we know the outcome when a dispute arises with an entity that is majority-owned by another nation?'

For example, when there is a dispute between two corporate entities, the matter is taken to court which makes a ruling that is abided by by both parties. However, when a dispute about a corporate matter involves another nations' government, matters such as bilateral trade agreements, seats at the United Nations and diplomatic relations come into play.

1.18 Australia's current Foreign Investment Review Board guidelines do not take into account these complexities and are ineffectual against the new possible maladies that are brought about by a foreign government's sovereign ownership within Australia.

Indeed, although one of the principles the Foreign Investment Review Board considers in its assessment of investment proposals is whether operations are independent from the relevant foreign government, this has clearly not been invoked in practice.

In fact, during the Senate Estimates hearings on 04 June 2009, it was admitted by Treasury's Mr Patrick Colmer, that it is virtually impossible for a state-owned entity to be completely independent from its government owners.

> Mr Colmer—The reality is that any government-owned entity will not be totally independent from the government. The questions that we look at are: what is the governance of the entity, how does it operate, and can we see that it is operating independently and without direct and continuing government control, because any government entity will have a relationship with its government.
>
> ...
>
> I guess the easiest way to answer your question is that bearing in mind that government entities are related to governments, we have not to date taken the view that any particular company has such overriding government control that it has been a problem.[21]

[21] Mr Patrick Colmer, *Proof Committee Hansard (04 June 2009)*, pg 12

1.19 Journalist, Greg Sheridan, gave an example in *The Australian* newspaper on 26 February 2009 of how foreign investment can impact political relationships.

> "The Chinese run a very sophisticated and integrated government. As with any huge system, not everything runs like clockwork, but it is nonsense to think the different arms of policy are not ruled by the central government. In one famous example, China's State Administration of Foreign Exchange bought Costa Rican government bonds in exchange for Costa Rica cutting diplomatic ties with Taiwan and establishing them with Beijing."[22]

1.20 Currently, there is no recognised or formal process to compel or require a state-owned entity to modify their operations to comply with Australia's standards; and there is a real risk that any request for operational modifications will refused.

Furthermore, if Australia is, as some submissions have claimed, so reliant on foreign investment for our own economic growth, will this result in the Foreign Investment Review Board caving in to demands, at the expense of Australia's national interest, for the sake of a contract?

National Interest Test

1.21 According to Treasury, Australia's Foreign Investment Policy states:

> "The Government's approach to foreign investment policy is to encourage foreign investment consistent with community interests."[23]

It goes on to state that:

> "The Government determines what is 'contrary to the national interest' by having regard to the widely held community concerns of Australians."[24]

1.22 However a 2008 poll conducted by the Lowy Institute found that while "62 percent of Australians agree that China's growth has been good for Australia … [there was] growing unease about the strategic consequences of China's rise. 60 percent agreed that China's aim is to dominate Asia and 52 percent agreed that Australia should join with other countries to limit China's influence."[25]

1.23 In February 2008, the Treasurer released a set of six principles that are considered by the Foreign Investment Review Board in determining, on a case by case basis, whether particular investments by foreign governments and their agencies are consistent with Australia's 'national interest'.

---

[22] Greg Sheridan, *The Australian, 26 February 2009*
[23] Treasury, *Australia's Foreign Investment Policy*, March 2009
[24] Treasury, *Australia's Foreign Investment Policy*, March 2009
[25] Mr Mark Thirlwell, *Australia's Open Investment Future*, December 2008, pg 15

- 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; and,
- 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.[26]

However, these guidelines leave a lot to be desired and need to be stricter and more explanation given to each criterion to ensure that the correct assessment is made in Australia's national interest.

1.24 Further, it should be a matter of consideration that the decision by the Foreign Investment Review Board to allow investment by a foreign state-owned entity is not at the expense of Australia's position on human rights and our call for human rights laws to be abided internationally.

1.25 In a similar way, private entities from foreign nations who participate in or support activities that go against broadly held Australian values should be barred from investing in Australian assets.

For example, if a foreign company that, as part of its other investments, supports the development of land mines, and seeks to invest in major supermarket chains, Coles or Woolworths, surely the Foreign Investment Review Board should decide that it is in not in Australia's interests to approve their investment proposal.

Human Rights

1.26 Treasury's policy documents states:

> "The Government's approach to foreign investment policy is to encourage foreign investment consistent with community interests."[27]

However, there is currently no consideration given by the Foreign Investment Review Board to the human rights record of the nation which is seeking to invest.

[26] Treasury, *Australia's Foreign Investment Policy*, March 2009
[27] Treasury, *Australia's Foreign Investment Policy*, March 2009

1.27 For the purposes of assessing adherence to human rights standards, Principle 2 of the Foreign Investment Review Board's guidelines ("that the investor is subject to and adheres to the law and observes common standards of business behaviour") would seem the obvious benchmark.

However, it became evident during the Senate Committee hearings that the checks and balances implied in this principle is insufficient to block investments by institutions operating in partnership with some of the world's worst human rights abusers.

For example, the Foreign Investment Review Board is currently considering a $505 million deal that will deliver the state-owned 'China Non Ferrous Mining Metal Group Co. Ltd' (CNMMC) a 51.6 percent stake in Australian company, Lynas Corporation, which owns the Mt Weld Rare Earths mine near Laverton in Western Australia, thought to contain one of the worlds’ largest supplies of high-grade rare earths.

However, CNMMC operates the largest nickel mine in Burma in active partnership with the Burmese military regime and is seeking further acquisitions in Burma.

CNMMC also has extensive mining operations in countries including North Korea, Iran, Zambia, Mongolia and Thailand. Many of these projects are carried out in joint partnership with the authorities of these nations.

A question on this issue was put to General Manager, Foreign Investment and Trade Policy Division, Treasury, Mr Patrick Colmer, during a Senate Committee hearing:

> Mr Colmer—The position, as I understand it from the basis of the information that we have, is that the Chinese company is operating in Burma. That in itself does not tell us anything except that it is operating in Burma. The fact that a company may be operating in Burma-I believe we have an embassy in Burma.
>
> Senator LUDLAM—Yes we do.
>
> Mr Colmer— It does not seem, of itself, to be a relevant consideration. If there is information about its operations in Burma or anywhere else that are relevant to the way that it operates in Australia, then that would be something that we may be interested in.

If by 'common standards of business behaviour', the Foreign Investment Review Board is willing to approve investment by a company which collaborates with a ruthless and corrupt dictatorship, it is fair to argue that the guidelines are due for an overhaul.

1.28 China’s approach to human rights is a stark contradiction to Australia’s stance and as such should be a factor of consideration when assessing whether to

allow the government of China, through its state-owned entities and sovereign wealth funds to benefit from Australia's successful industries and economy.

1.29 In his submission to the Committee, businessman and human rights activist, Ian Melrose, refers to China's Human Rights record. He says:

> "This is not a Government we should allow to own Australian strategic mining resources which will be for their benefit, not ours."[28]

Further, he argues that "politicians and businessmen who say you should not mix human rights with trade are cowards and opportunists."[29]

1.30 According to Amnesty International –

- China executes more people each year than the rest of the world put together;
- Internet censorship remains pervasive in China with few signs that the authorities are prepared to relax policies of surveillance and control;
- Critics of the government and members of banned religions can be sent to a labour camp for up to 4 years, without charge or trial;
- Torture is widespread in the criminal justice system - common methods include electric shocks, beating and sleep deprivation;
- Nearly 20 years after the military crackdown on demonstrators in Tiananmen Square, dozens of people arrested then still remain in prison;
- People who make a stand on human rights are harassed and arrested, often relating to vague charges like 'state secrets'. They include lawyers, journalists, HIV activists and trade unionists;
- Trade unions are illegal; and,
- Unofficial religious groups - such as the Falun Gong spiritual movement - are banned as 'subversive' and individual practitioners detained.[30]

1.31 Despite this, Prime Minister, Kevin Rudd, and Treasurer, Wayne Swan, and have openly stated they welcome investment from Chinese SOEs and SWFs.

> "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."
>
> "Complementing these espoused principles is the notion that Australian foreign direct investment policy does not discriminate between investors. Recently, the Prime Minister, Kevin Rudd, said Australian foreign investment regulation is non-discriminatory'. We have had a foreign

[28] Mr Ian Melrose, *Submission 8*, pg 3
[29] Michelle Grattan, The Age, *TV ads oppose Chines firm's bid for Rio Tinto*, 1 June 2009
[30] Amnesty International, *China's human rights record* http://www.amnesty.org.uk/content.asp?CategoryID=11204

investment from Japan and Korea and the US and Great Britain for decades on a large scale."[31]

1.32 Further to the Foreign Investment Review Board's guidelines, investment by a state-owned enterprise from a country with a poor human rights record should be specifically restricted, and the Foreign Investment Review Board's guidelines for investment should be amended accordingly.

Corporate governance dangers

1.33 Another issue of concern with regard to foreign investment by state-owned entities and sovereign wealth funds is the threat it poses to corporate governance. According to Associate Professor Frank Zumbo from the University of New South Wales:

> "Sovereign wealth funds and state-owned companies are generally operated by their respective Governments in a secretive manner that prevents scrutiny of their size, source and management of funds and state-owned companies. Secrecy also generally surrounds the investment and other objectives of the funds or the state-owned companies."[32]

> "Indeed, allowing sovereign wealth funds and state-owned companies to take controlling or influential positions in Australian target companies means that the future direction of the Australian target companies in those strategic industries will be determined by persons or entities whose agendas and objectives are not publicly known and whose agendas and objectives may be inconsistent or even detrimental to the other shareholders, as well as to suppliers and customers of the Australian target company."[33]

1.34 This possibility must be a factor during consideration by the Foreign Investment Review Board, to ensure that a majority of a sector or industry is particularly targeted, and some form of monitoring must be in place to ensure that creeping acquisitions are not taking place.

Risks to Competition

1.35 Increases in foreign investment also place pressure on Australia's ability to compete internationally.

1.36 Associate Professor Frank Zumbo says that to allow SWFs and SOEs to take controlling positions in Australian companies enables them to set market prices which may subsequently price Australian products/services out of the international market.

> "Dangerously for competition this influence could lead to the Australian target company implementing discriminatory pricing practices that (i) benefit state-owned companies that are customers of the Australian target

[31] Institute of Public Affairs, *Submission 32,* pg 9
[32] Associate Professor Frank Zumbo, *Submission 38*, pg 2
[33] Associate Professor Frank Zumbo, *Submission 38*, pg 2

> company, or (ii) benefit customers from the country sponsoring the sovereign wealth fund or which controls the state-owned companies."[34]

1.37 Associate Professor Frank Zumbo also argues that competition can be "dampened" should a state owned company acquire a controlling or influential position in an Australian target company as part of a strategy to vertically integrate.

> "If a state-owned company is a steel producer the state-owned company may take a controlling or influential position in Australian target companies that mine the raw materials needed for steel production. In doing so, the state-owned company would considerably strengthen its position to raise steel prices as it has locked up Australian suppliers of the raw materials to the detriment of other competing steel producers who may no longer be able to obtain competitively priced raw material supplies from the Australian target company."[35]

1.38 The Foreign Investment Review Board, through its six core principles, looks at whether 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.

Further to the current CNMMC investment proposal being considered, the Vice Chairman of the Autonomous region of Inner Mongolia, Zhao Shuanglian, told a media conference on Wednesday 2nd September that local rare earths production at high quality ore mines would be recommended to limit exports to prop up prices.[36]

Anti-competitive price fixing obviously does not adhere to Australia's common standards of business behaviour and handing a Chinese state-owned enterprise one of the worlds' largest supplies of high-grade rare earths mines shores up its potential to successfully set prices in the future whether it chooses to advertise the fact or not.

And, as a state-owned enterprise, it is almost a given that CNMMC will be influenced by the behaviour of China's wider mining and pricing strategies which will seriously impact Australia's competitive advantage.

1.39 Furthermore, arbitrary lines in the sand on shared ownership for state owned enterprises ignore the influence that a large shareholder can have without having a majority share.

---

[34] Associate Professor Frank Zumbo, *Submission 38*, pg 3
[35] Associate Professor Frank Zumbo, *Submission 38*, pg 3
[36] Australian Associated Press Financial Newswire, *Lynas under pressure after Chinese Comments*, 3 September 2009

If Chinalco, for example, had been successful in its bid to own 18 percent of Rio Tinto's shares in February 2009, while it may not have been the majority shareholder, it would have been the biggest shareholder by significant margin.

Such shareholding would have a huge influence on the final spectrum of appointed directors, as the controller of the largest block of shares would have the largest say of all shareholders as to who was ultimately elected to the board.

1.40 Again, this reiterates that the Foreign Investment Review Board must have in place measures to ensure that one particular nation is not able to buy into Australia's strategic assets, and certainly not to gain majority control of a sector, to ensure that the market remains in Australia's best interests.

A case of reciprocity

1.41 One of the best ways to put perspective on the issue of investment by state-owned enterprises is to look at it through the eyes of reciprocity;

For example, would the Chinese government allow an Australian government-owned entity to hold more than a 50 percent share in its coal mines?

If the answer is 'No', then surely one must ask why Australia should open its doors to foreign investment by a country who would deny it entry.

1.42 Evidence from Mr Patrick Colmer, Executive Member of the Foreign Investment Review Board, during the Senate Committee hearings included that two of the most restrictive countries with Foreign Investment policy, that being India and China, are the fastest growing economies in the world.

Conversely, the most open economies were Iceland and Ireland, both economies having now collapsed.

> Senator JOYCE—Are there boards equivalent to the Foreign Investment Review Board in other countries, such as India, China or the United States?
>
> Mr Colmer—Yes and no. The United States has a system called the Committee on Foreign Investment in the United States, generally referred to as CFIUS, and that is similar to the foreign investment process that we run. I would say, though, that our system is much more interventionist than the United States system, and in the OECD in this area we are ranked 35 out of 41, as being the 35th least restrictive—get your head around that! It is difficult; I don't know which way to count on that—
>
> Senator JOYCE—Who is the most restrictive?
>
> Mr Colmer—The most restrictive is either China, India or Russia, but I am not sure which one.
>
> Senator JOYCE—China, India or Russia—they are all up the top there somewhere?

> Mr Colmer—They are down at 41. We are at the bottom.
>
> Senator JOYCE—I know, but the most restrictive on investment are China, India and Russia?
>
> Mr Colmer—Yes, I think that is right, from memory. And the least restrictive are typically the European countries. I think maybe Iceland might be No. 1, but I have not looked at the ranking for a while. The UK is up in the top five.
>
> Senator JOYCE—The problem at the moment, of course, is that Iceland is broke, Ireland is broke and Britain is making its very best attempt at going broke. Would these be good indicators of how you should operate?
>
> Mr Colmer—I am not sure whether or not you can relate their economic situation totally to their investment regime. I think there are probably a wide range of other factors that are in play.
>
> Senator HURLEY—You are just relying on the last 18 months out of many decades of prosperity.
>
> Senator JOYCE—What are the great sensitivities of Russia? In what section of its economy has it got immense sensitivity about where people invest?
>
> Mr Colmer—I am not terribly familiar with the Russian investment system, except that I do know that it is one of the more restrictive ones. We are probably better compared to places like Canada, New Zealand and the US, who all have—in a very general sense—a similar system to ours. There are quite different arrangements at the detailed level, but they are generally similar types of systems.[37]

1.43 Given that, for example, China may restrict Australian funds or entities from investing within its borders, it is fair to argue that Australia should not be so open to allowing China's government to invest in our assets and should place restrictions on China until it reciprocates the investment opportunities.

Conclusion

1.44 While Australia's economy certainly benefits from foreign investment, it is crucial that it is not at the expense of our ability to be competitive in the international marketplace and that it doesn't enable another nation to have indirect control over Australia's independence, governance, ethics and values.

Australia's integrity must never be compromised by a commercial imperative.

1.45 The Foreign Investment Review Board must, as part of its considerations for any investment proposal by a foreign entitiy, particularly a sovereign wealth fund or state-owned entity, acknowledge the possible consequences that go far beyond a simple monetary investment.

[37] Mr Patrick Colmer, *Proof Committee Hansard*, pg 10

1.46 Similarly, the Foreign Investment Review Board must monitor in particular a countries interest in specific sectors, to ensure creeping acquisitions are not taking place which would negatively impact on Australia's economy and Australian companies and jobs.

Recommendation 1

A foreign government shall not use any corporate vehicle which they control to be allowed to purchase any strategic assets within Australia.

Further, for a non-state-owned entity, a related entity test will be applied so that different corporate entities with the same ultimate majority controlling influence represented by equity, debt or other mechanisms will be deemed as the one entity for assessment as to whether it will result in more than 10 percent of control of any strategic asset market in Australia.

Recommendation 2

The Foreign Investment Board will be required to, as a point of consideration in its decision, assess whether Australia has reciprocal rights of investment in the proposer's country.

Recommendation 3

The Government must look to enact effective laws to prevent creeping acquisitions of Australian businesses and assets owned by state-owned entities.

Recommendation 4

The Foreign Investment Review Board needs to provide clear criteria of what the 'national interest' test is and that abbreviated versions of FIRB advice to the Minister be tabled in both houses of Parliament.

Further, that the Government defines what it means by 'community interest' and 'common standards of business behaviour' and subject major investment proposals to rigorous public scrutiny to ensure that they meet genuine common standards of business behaviour.

Recommendation 5

That the human rights records of the country of state-owned entity seeking to invest in Australia be a key factor during consideration by the Foreign Investment Review Board. Similarly, that all foreign non-state-owned entities be subject to consideration of their other investment activities and whether these conflict with Australia's ethical positions.

SENATOR BARNABY JOYCE

SENATOR SCOTT LUDLAM

SENATOR NICK XENOPHON

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Mr Frank Owen
2	Mr George Chmelik
3	Brian & Linda Hall
4	Mr John Campbell
5	Charter Pacific Securities
6	Concept Economics
7	Confidential
8	Mr Ian Melrose
9	Mr John Butler
10	Mr Mark Bourne
11	Mr Stewart Mulligan
12	Confidential
13	The Hazledine Family
14	Mr John Morrissey
15	Mr John Morgans
16	Mr Bob Vinnicombe
17	Mr Rod Charlton
18	Mr & Mrs Voesenek
19	Ms Susan Butler
20	Mr Alan Starkey
21	Tony and Susie Young
22	Mr Peter Matters
22a	Mr Peter Matters supplementary submission
23	Chinalco
24	Mr Brian Cotgrove
25	FP and A Bullen
26	Mr Craig Symons
27	Dr Clinton Fernandes
28	Mr Bill Edwards

28a	Mr Bill Edwards supplementary submission
29	Mr Kim Smith
30	Mineral Council of Australia
31	National Civic Council
32	Institute of Public Affairs
33	Ms Mary Jenkins
34	Mr Anthony Grizaard
35	John & Judith Dingle
36	Ms Joy Slade
37	Ms Marie Burton
38	Associate Professor Frank Zumbo
39	Mr Ivan Rowe
40	Peter Drysdale (ANU) and Christopher Findlay (University of Adelaide)
41	Ms Janette Hartley
42	Mr Robert Pincevic
43	Mr Len Johnson
44	Mr Arthur Johnson
45	Ms Vivienne Johnson
46	Dr Peter Freckleton
47	Rio Tinto
48	The Australian Workers' Union
49	AV Engineering
50	Keith J. Graham
51	Ms Maree Watson
52	NS McNally
52a	NS McNally supplementary submission
53	Mr John E. Gott
54	Mr John W. Ferguson
55	Mr Cedric Clarke
56	Lowy Institute for International Policy
57	Movement for Sustained Economic Development

Additional Information Received

TABLED DOCUMENTS

Brisbane, Wednesday 1 July 2009

- Tabled documents received from Mr William Edwards: presentation notes
- Tabled documents received from Professor Peter Drysdale: *'China as a new foreign investor'*

Canberra, Monday 10 August 2009

- Tabled document received from Dr Brian Fisher, Concept Economics: *'Inquiry into Foreign Investment by State-Owned Entities – Global Sources of Savings and Investment'*

APPENDIX 2

Public Hearings and Witnesses

Canberra, Monday 22 June 2009

BORDIGNON, Mr Stephen, Assistant Director, Transport and General Price Oversight, Australian Competition and Consumer Commission

COLMER, Mr Patrick, General Manager, Foreign Investment and Trade Policy Division, Treasury

GRIMWADE, Mr Tim, Executive General Manager, Mergers and Acquisitions Group, Australian Competition and Consumer Commission

ROSSER, Mr Michael John, Manager, Investment Review Unit, Foreign Investment and Trade Policy Division, Treasury

Canberra, Tuesday 23 June 2009

BYRNE, Mr Patrick, National Vice President,
National Civic Council

NOVAK, Ms Julie, Research Fellow,
Institute of Public Affairs

WESTMORE, Mr Peter, National President,
National Civic Council

Brisbane, Wednesday 1 July 2009

BUTLER, Mr John Leslie Thomas,
Private capacity

CLIFT, Mr Michael,
Private capacity

CREESE, Mr Stephen Ernest Nigel, Managing Director,
Rio Tinto Australia

DRYSDALE, Professor Peter David,
Private capacity

EDWARDS, Mr William Alexander,
Private capacity

HIGGINS, Mr John Andrew,
Private capacity

LYLE, Mr John Ranken,
Private capacity

RITCHIE, Mr Douglas Campbell Walter, Managing Director, Strategy,
Rio Tinto Ltd

Perth, Thursday 2 July 2009

CALDER, Mr Duncan Harvey, Western Australia President,
Australia China Business Council

McNALLY, Mr Norman Stephen,
Private Capacity

McROBERT, Mr Shaun Barry, Committee Member,
Australia China Business Council

PHILLIPS, Mr Wayne Frederick Laurence, Director,
AV Engineering

TAPP, Mr Julian Robin Paul, Head of Government Relations,
Fortescue Metals Group

Canberra, Monday 10 August 2009

COOK, Dr Malcolm, Program Director, East Asia,
Lowy Institute for International Policy

FISHER, Dr Brian,
Concept Economics

MELROSE, Mr Ian, Clerk,
Optical Superstore

MURRAY, Mr David, AO, Chair,
Future Fund Board of Guardians

THIRLWELL, Mr Mark, Director, International Economy Program,
Lowy Institute for International Policy

ZUMBO, Associate Professor Frank,
Private capacity

APPENDIX 3

Treasurer's 2008 guidelines for assessing proposals by SOEs

On 17 February 2008, the Treasurer released new (or additional) guidelines for investment proposals by foreign governments or state-owned entities. The guidelines require state-owned entities (including government agencies and sovereign wealth funds) to address six criteria. Of the six criteria 5 out of the 6 would appear to apply to all foreign investment proposals—guideline one deals with the relationship between the SOE and the foreign government.

1) **An investor's operations are independent from the relevant foreign government.**

   In considering issues relating to independence, the Government will focus on the extent to which the prospective foreign investor operates at arm's length from the relevant government.

   It also considers whether the prospective investor's governance arrangements could facilitate actual or potential control by a foreign government (including through the investor's funding arrangements).

   Where the investor has been partly privatised, the Government would consider the size and composition of any non government interests, including any restrictions on governance rights.

2) **An investor is subject to and adheres to the law and observes common standards of business behaviour.**

   To this end, the Government considers the extent to which the investor has clear commercial objectives and has been subject to adequate and transparent regulation and supervision in other jurisdictions.

   Proposals by foreign government owned or controlled investors that operate on a transparent and commercial basis are less likely to raise additional national interest concerns than proposals from those that do not.

3) **An investment may hinder competition or lead to undue concentration or control in the industry or sectors concerned.**

   These issues are also examined by the Australian Competition and Consumer Commission in accordance with Australia's competition policy regime.

4) **An investment may impact on Australian government revenue or other policies.**

   For example, investments by foreign government entities must be taxed on the same basis as operations by other commercial entities. They must also be consistent with the Government's objectives in relation to matters such as the environment.

5) An investment may impact on Australia's national security.

The Government would consider the extent to which investments might affect Australia's ability to protect its strategic and security interests.

6) 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.

The Government would consider any plans by an acquiring entity to restructure an Australian business following its acquisition. Key interests would include impacts on imports, exports, local processing of materials, research and development and industrial relations.

The Government would also consider the extent of Australian participation in ownership, control and management of an enterprise that would remain after a foreign investment, including the interests of employees, creditors and other stakeholders.[1]

[1] Principles Guiding Consideration of Foreign Government Related Investment in Australia, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/009.htm&pageID=&min=wms&Year=&DocType=0 (accessed 28 April 2009).

APPENDIX 4

Major Chinese government-related investments in Australia[1]

May 2009

China Nonferrous Metal Mining Group: agreed to take a majority stake in Australian rare earths miner, Lynas Corp Ltd, for A$252 million (US$185.7 million). CNMC will buy 700 million new Lynas shares at 36 Australian cents each to gain a 51.7 per cent stake.

February 2009

Hunan Valin Iron and Steel Group: will pay A$1.2 billion for a 16.5 per cent stake in Fortescue Metals Group, Australia's third-largest iron ore miner.

MinMetals: has offered $US1.206 billion to buy the majority of OZ Minerals' operations including Sepon, Avebury, Rosebury, Golden Grove, Century and Dugald River.

December 2008

Centrex: Wuhan Iron and Steel would invest A$180 million for 50 per cent share in five of its iron ore tenements on the Eyre Penisula. WISCO will also take a 15 per cent stake in the company for A$9.7 million. It is Centrex's second major Chinese partner – the company is 10.1 per cent owned by Chinese state-owned steel maker, Baotou Iron & Steel Group.

October 2008

Shenhua Energy Co: paid for a licence to explore coal deposits at the Watermark allotment, Liverpool Plains, NSW (initial licence fee A$300m, initial investment, A$175m).

September 2008

Xinwen Mining: agreed to pay A$1.5 billion for Linc Energy's Bowen Basin coal tenements in Queensland

August 2008

Jilin Tonghua Iron & Steel: bought 10 per cent of IMX Resources which is attempting to develop the Cairn Hill copper-gold project near Cooper Pedy in South Australia, along with other Australian and African projects.

May 2008

China West Mining: bought 10 per cent (~ 15 million shares) in FerrAus, an iron ore exploration company in the Eastern Pilbara

March 2008

China Petrochemical Corporation: China's biggest energy distributor bought 60 per cent and control of the Puffin oil field in the Timor Sea from AED Oil for $600 million.

---

1 Material form Professors Drysdale and Findlay's updated submission, p. 13. They note that this data was amended from Stephen Mayne's Mayne Report, Chinese investments in Australian resources, May 9, 2009; Track list of Chinese Government investments in Australian resource projects, available from http://www.maynereport.com/articles/2008/05/19-2213-8127.html. Mayne also provides a list of foreign owned resource projects at http://www.maynereport.com/articles/2007/07/17-2040-8377.html. Note: The firms listed here may be listed both in China and abroad and are not necessarily dominantly government-owned.

Jinchuan Group Ltd: has secured government approval for its 11 per cent stake in Australian nickel producer Fox Resources Ltd, Fox says. By agreeing to buy 18.8 million shares at a premium issue price of A$0.95, Jinchuan becomes Fox's largest shareholder.

February 2008

Chinalco : acquired 9 per cent of Rio Tinto shares in London on February 3, 2008 worth $15.5 billion, announced it would seek the Treasurer's approval and the agreement of Rio Tinto shareholders for another $US19.5 billion investment into the company.

China Metallurgical Group: has committed to pay A$400 million for the Cape Lambert Iron ore project in WA.

Shougang Corp: spent $400 million buying 20 per cent of WA iron ore company Mt Gibson Iron in early 2008.

Sinosteel: spent A$100 million for Midwest Corp in early 2008 and completed a A$1.37 billion agreed takeover at $6.37-a-share in 2008.

January 2008

Consortium: five Chinese companies were given FIRB approval in January 2008 to fund A$3 billion Oakajee port and rail project in WA.

December 2007

Jiangsu Shagang: Maanshan Iron & Steel: Tangshan Iron & Steel: Wuhan Iron & Steel: have a total stake of 15 per cent in BHP's Wheelarra iron ore mine near Newman in the Pilbara which produces 12 million tonne per annum.

September 2007

Anshan Iron & Steel: paid A$39 million in September 2007 for 13 per cent of iron ore miner Gindalbie and signed A$1.8 billion joint venture deal.

Baotou Iron & Steel: agreed to invest up to A$40 million for 10 per cent equity stake in Centrec Metals and 50 per cent of its prospective Bungalow iron ore project in South Australia.

Chalco: in September 2007 Queensland government awards rights to develop A$3 billion bauxite project near Aurukun.

July 2007

CITIC: spent $113m lifting stake in Macarthur Coal stake from 11.6 to 19.9 per cent.

March 2007

Shougang Corp: steel group spent A$56 million in March 2007 buying 13 per cent or iron ore developer Australian Resources and agreed to fund $US2.1 billion development of the Balmoral South project and associated port project in WA.

September 2006/April 2008

Shanghai Baosteel Group: owns 46 per cent of the Rio Tinto-operated Eastern Range iron ore mine in Pilbara which produces 6.5 million tonnes a year worth more than A$500 million a year. The Chinese investment is now worth more than $1 billion.

June 2006

CNOOC: holds a 25 per cent share in China LNG, a new joint venture within the existing US$19 billion North West Shelf structure that diluted the other six joint venture parties down to 12.5 per cent each.

Earlier projects

China Iron & Steel: The Rio Tinto-operated Channar iron-ore mine in the Pilbara has a capacity of 10mtpa and is 40 per cent owned by China Iron and Steel (1987)

CITIC: paid more than A$400 for a 22.5 per cent stake in the Portland Aluminium Smelter (1998).