1 May 2009.

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir

Re: Inquiry into Foreign Investment by State-Owned Entities

This submission is made by the Minerals Council of Australia (MCA) in response to the Senate Standing Committee on Economics *Inquiry into Foreign Investment by State Owned-Enterprises.*

The MCA is the peak industry organisation representing Australia's exploration, mining and minerals processing industry nationally and internationally in its contribution to sustainable development. The MCA's strategic objective is to advocate public policy and operational practice for a world-class industry that is safe, profitable, innovative, environmentally and socially responsible and attuned to its communities' needs and expectations. MCA member companies produce more than 85 per cent of Australia's annual minerals output, and will account for about 60 per cent of Australia's merchandise exports in the year to June 2009.

The critical importance of foreign investment to Australia

The MCA is strongly committed to preserving and expanding an open and transparent international trade and investment environment. The progressive liberalisation of trade and global investment regimes has been a significant contributor to economic growth and development. Freer trade in goods and services and higher levels of foreign investment encourage innovation, the spread of new technologies and lead to higher productivity and increased living standards. The greater predictability and transparency of countries' investment regimes associated with investment liberalisation has played a key role in the expansion and consolidation of the global mining sector.

Inwards investment

The MCA considers that Australia's current policy settings and procedures for reviewing foreign investment proposals are appropriate. Australia's foreign investment regime as set out in the *Foreign Acquisitions and Takeovers Act* 1975 and government policy guidelines, and administered by the Foreign Investment Review Board (FIRB, has served Australia well. Australia has pursued an open, non-discriminatory, liberal approach to foreign investment as evidenced by the levels of foreign ownership, including in the minerals sector, in Australia. This foreign capital has played a key role in Australia's economic development.

Australia, however, cannot afford to be complacent. It is vital that we remain open to foreign investment The current tight international credit environment highlights this imperative but even in more normal financial times there is no guarantee of continued investment in the development and exploitation of Australia's minerals wealth. While Australia has a natural comparative advantage in the supply of minerals products, that does not necessarily equate to competitive strength in a highly globally integrated industry.

The Australian minerals industry has lost global market share in many key commodities and billions in revenue and profits over the five years to 2007. Moreover, the global resource base remains strong and Australia faces ongoing competition as a destination for foreign capital. Sovereign risk is a key determinant in foreign capital holders' strategic decision making in

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regard to maintaining and expanding investment in mining projects in competing overseas markets. Foreign investment policy is a key factor influencing decisions on where to locate resource developments.

The latest economic survey by the International Monetary Fund (IMF) commented that one of the significant downside risks to the Australian economy moving out of recession quickly is our relatively high level of external debt and hence our continued dependence on foreign capital raisings. The IMF estimated that at the end of 2008, net foreign liabilities for Australia were over 60 per cent of national income. The concern is that continuing weak world demand and a slower than expected recovery in world commodity prices, together with continued elevated spreads on external finance owing to increased risk aversion by foreign lenders, could make external financing for Australia more difficult.

This concern by the IMF mirrors points the MCA raised in our 2009-10 Pre-Budget submission to the Federal Government:

> *"While a recession will reduce demand for imports into Australia, there is a chance that export revenues may fall even further as a result of a continued weakness in commodity export prices. Access Economics warns that the current account deficit may almost double from $55 billion in 2008 to close to $100 billion in 2009. Markets have not yet factored in the risk of a current account deficit of this level in Australia.*
>
> *If markets start to think that the recent fall in commodity prices may be an extended one, they may become concerned by the current account deficits in prospect for Australia just at the time when the budget has also moved into deficit. If such an adverse sentiment over "twin deficits" in Australia took hold in financial markets the $A could come under considerable pressure, the costs of borrowing from world financial markets could increase substantially and the downturn in the economy could be much more severe."*

The MCA recognises that the factors that impact on the decisions of overseas capital holders in relation to Australia's shorter term financing needs are somewhat different to the considerations involved in making longer term foreign investment decisions. Nonetheless in all of these assessments, judgements over the level of risk and confidence in Australia are vital. In particular, they reinforce the imperative for Government policy settings to ensure a stable and predictable economic environment which encourages private investment, including increased foreign direct investment.

Australian investment abroad

Australia also has vital interests in maintaining open investment regimes internationally.

Despite a turnaround in the second half of 2008 as the financial crisis took effect, one of the significant structural shifts in Australia over recent years has been the strong growth in the level of Australian foreign direct investment (FDI) abroad. The gap between Australian FDI abroad and the level of FDI in Australia has narrowed significantly. In the December quarter 2008 the level of Australian FDI abroad was $285 billion. At the same time FDI in Australia was $387 billion.

Despite the more recent easing in FDI abroad, it is expected that this longer term trend of increasing outwards investment from Australia will continue. A survey recently released by the Export Finance Insurance Corporation (EFIC), the *2009 Global Readiness Index*, found that 84 per cent of companies with offshore operations planned to expand these activities. Of survey respondents without offshore operations, 44 per cent were planning to establish a presence offshore. It is also noteworthy that the overwhelming reason respondents gave for investing overseas was to "increase revenue and/or market share". Seventy one per cent of respondents gave this as the primary driver for establishing overseas operations. Only 3 per cent of respondents cited the "pursuit of economies of scale and/or decreasing costs" as the primary reason for overseas investment.

The importance of outwards investment for the mining industry is also under appreciated in Australia. The level of foreign assets held by Australian mining companies rose by about 30 per cent during 2008 to reach $46 billion. Over the same year the level of foreign investment in mining in Australia (as measured by the level of financial liabilities in the mining sector in Australia) rose by about 9 per cent to $137 billion. Overall in the four years from 2004 to 2008 the level of outwards investment by mining rose more than four times, while foreign investment in mining in Australia almost doubled.

The increased activity of Australian mining companies investing in overseas projects is also demonstrated in the recent *Mining Deals 2008* review prepared by PricewaterhouseCoopers (PwC). The review found that there was an easing in the level of merger and acquisition deals from overseas companies seeking to invest in Australian resources in 2008 (down from $US 19.2 billion in 2007 to $US 17.1 billion in 2008). At the same time however, PwC found that Australian companies have continued to step up their quest for mining assets worldwide. In 2008 the "total deal value" where Australasian entities were buying overseas mining assets rose 12 per cent, from $US 9.1 billion to $US 10.2 billion.

Sovereign wealth funds and state owned enterprises

The impetus that emerged globally in 2007 and 2008 for the development and elaboration of foreign investment guidelines in relation to so-called Sovereign Wealth Funds (SWF) was driven by the rapid growth and increasing prominence of these funds. According to various estimates the number of these state-owned funds doubled from about 20 in 2000 to 40 in 2008. The value of funds under management in 2008 was estimated at around $US3 trillion, a figure expected to grow to reach $13 trillion within a decade, and $28 trillion by 2022. These funds varied substantially in mode of operation, with some run at arms-length from government control, others had a more direct reporting structure to government. Overall however, it is accepted that the transparency of these funds and the details of their investment management strategies are limited.

There is little doubt that the global financial crisis has impacted negatively on the value of the funds. Lower oil prices have clearly affected the Middle East and other oil dependent funds, while falling global equities would have taken a toll across all funds to a greater or lesser extent. Nonetheless they remain a most important source of funds especially in tight credit markets.

State-owned enterprises (SOEs) represent another means by which sovereign wealth is built and expended. SOEs are typically companies which are fully or partially owned by governments. The concerns expressed over SOEs are very similar to those voiced about SWFs. The principal concerns are that such government owned investments cannot be assumed to act always in ways that are consistent with the host country's national interests. Moreover, the investment may not be driven from a purely commercial standpoint but may have broader political or strategic objectives or be seeking commercial advantage or knowledge to assist other state-run enterprises.

Policy responses

- *Globally*

In 2008 the OECD adopted a Declaration of its Members to "preserve and expand an open international environment for SWFs." The OECD member countries developed guidelines towards SWFs and reaffirmed their commitment to avoid erecting protectionist or discriminatory barriers to foreign investment. Where national security concerns arose the OECD members accepted that any investment safeguards should be transparent, predictable, proportional and accountable. At the same time, the OECD encouraged the IMF to complete its work on best practice guidelines for SWFs and in the interim called on those governments with SWFs to enhance confidence by taking steps to strengthen transparency and governance in their SWFs.

Against this background a number of governments took action to strengthen their evaluation of foreign government investment.

- **USA** - In July 2007, the US Congress strengthened its foreign investment regime when it passed the Foreign Investment Security Act 2007, which, among other things, enhanced the review process for non-US acquisitions and added critical infrastructure and foreign government-controlled transactions to the factors for review.

- **Canada** - In December 2007, the Canadian Government issued new Guidelines clarifying the application of the *Investment Canada Act* as it relates to foreign state-owned enterprises (SOEs) investing in Canada. The Guidelines spell out what the government expects from foreign SOEs wishing to invest in Canada. The *Investment Canada Act* calls for major foreign investments that meet the threshold for review to be assessed by the Minister of Industry to ensure they provide a 'net benefit' to Canada.

The MCA considers that the development internationally of a set of best practices for sovereign wealth funds, offers a way to increase the accountability of SWFs. The International Monetary Fund (IMF) has been identified as a logical international vehicle for the development of best practices approaches/codes for SWFs, building on the existing Guidelines for Foreign Exchange Reserve Management. The MCA encourages the Australian Government to engage actively in this work.

- *In Australia*

The Australian Government also acted, with the Treasurer Wayne Swan announcing in February 2008 new principles setting out the "main factors that are considered in determining, on a case-by-case basis, whether particular investments by foreign governments and their agencies are consistent with Australia's national interest".

The new principles represented an elaboration, rather than any significant amendment to the existing rules which are set out in the *Foreign Acquisitions and Takeovers Act* 1975. The key provisions of existing legislation related to investments by foreign government controlled entities are that:

> ***"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."*

The MCA supports the thrust of the transparency principles. The elaboration of criteria should enhance the transparency of Australia's approach to foreign investment. They will provide intending investors with more clarity and certainty on the issues that will influence the consideration of foreign investment proposals without compromising the inherent flexibility provided by the FIRB and needed for the case-by-case appraisal of the national interest. They will provide greater accountability by engendering confidence that in Australia it is market forces that are the primary determinants of resource allocation and not decisions by foreign governments for their own strategic, political or other reasons.

Under the FIRB an appropriate balance in Australia's approach to foreign investment has been largely achieved. The "national interest test" of the FIRB has served Australia well. The MCA considers that legitimate concerns over SWFs and SOEs can be addressed within the context of the current policy settings and procedures, without surrendering to protectionist pressures. FIRB screening and the case-by-case approach allows appropriate conditions to be attached to specific investment proposals. It is important that these performance requirements do not represent disguised protectionism and are not so intrusive as to restrict legitimate investment.

It was important that the changes announced by the Government in February 2008 did not represent a reversal of Australia's approach to foreign investment. Australia has long operated an open, liberal investment regime, which has served Australia's national interest well. The regime must remain open and pressure to adopt more protectionist investment policies must be resisted. This is vital, not just because of Australia's ongoing requirements to access foreign capital, but also because we have key interests in open, transparent, non-discriminatory and complementary investment regimes internationally.

Yours sincerely

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