While Australia has an official position of welcoming foreign direct investment (FDI), the existing policy framework creates uncertainty both for foreign investors and vendors of Australian assets.

Restrictions on FDI in Australia have been substantially liberalised since 1986, however, inward FDI has become more contentious in recent years. A number of high-profile cross-border acquisitions, particularly by foreign state-owned enterprises (SOEs), has raised new issues about the role and regulation of FDI in the Australian economy. Debate has often focused on the commercial and other merits of individual transactions at the expense of the bigger picture of the overall regulatory framework for FDI and whether it best serves Australia’s interest in maximising FDI inflows.

The existing framework provides the Treasurer with broad discretion to reject transactions deemed to be ‘contrary to the national interest’. This discretion can allow politicians to choose the politically optimal course of action at any given time in relation to potentially contentious cross-border direct investment transactions subject to approval under Australian law. Unfortunately, this is not necessarily optimal for other decision makers. The existing framework creates uncertainty for both foreign investors and vendors of Australian assets.

Although Australia is officially open to foreign investment, more cross-border mergers and acquisitions (by value and by number) were withdrawn for regulatory reasons or political opposition in Australia between 2008 and 2012 than in any other country. The value of these deals was $87.8 billion, according to the United Nations Conference on Trade and Development’s (UNCTAD) latest World Investment Report. While this figure represents only eight out of the thousands of cross-border investment proposals reviewed by the Australian Government, this low explicit rejection rate in itself implies that many transactions are receiving unnecessary and costly scrutiny.

The current regulatory framework may deter FDI before reaching the approval stage. The implicit rejection rate may be significantly higher than the explicit rejection rate reported by the Foreign Investment Review Board (FIRB). The current framework devalues the stock of domestic equity and other capital by introducing sovereign risk into the calculations of foreign investors and reducing the number of potential bidders. Lost FDI can deny Australia access to much needed capital, employment opportunities, new technologies, international managerial networks and global supply chains.

Regulatory barriers to FDI also encourage other countries to maintain their barriers. Australian outward mergers and acquisitions worth $112.9 billion were withdrawn for regulatory reasons or due to political opposition in other countries between 2008 and 2012, more than any source.
country based on UNCTAD data. The continued globalisation of Australian business is put at risk by restrictions on cross-border investment both at home and abroad.

Australian treasurers have often stretched the concept of the ‘national interest’ into a laundry list of unlegislated policy considerations that are poorly defined or far removed from genuinely vital national interests. Even those foreign investment proposals that meet with approval sometimes have conditions imposed so that the regulation of FDI becomes an arm of domestic industry and employment policy.

The rise of foreign state-owned enterprises and sovereign wealth funds as sources of FDI raises new policy issues. In responding to the growth in FDI from non-traditional sources, it is vital for Australia to maintain its adherence to principles such as open markets, transparency and the rule of law, and not sacrifice these principles when faced with investment from countries that do not fully share them. The OECD has formulated general principles for FDI regulation to which Australia has agreed, but along with other countries, often fails to follow in practice.

It is not the government’s role to prevent foreign or domestic firms from making bad business decisions or second-guess the commercial strategies underlying foreign acquisitions. Instead, the focus should be on creating a non-discriminatory regulatory framework that provides predictability and certainty for both foreign investors and vendors of Australian assets, enhances Australia’s reputation as an investment destination, and maximises FDI inflows while securing Australia’s vital interests.

The concept of ‘the national interest’ should not be undermined by associating it with issues that are not genuinely national in scope or of vital concern. Nor should the national interest be seen as a thinly disguised proxy for domestic political concerns. Similarly, the regulation of FDI should not be used as a second-best approach to filling gaps or fixing problems created by regulatory failure in other areas of public policy such as housing or taxation.

**REFORM OPTIONS**

Options for reforming Australia’s regulatory framework include an open-door policy with some regulation ‘at the border’ to address national security concerns, similar to the regulatory regime in the United States. Under this regime, all regulatory issues apart from national security would be addressed ‘behind the border’ on a non-discriminatory national treatment basis.

Another reform option is a full delegation of the Treasurer’s powers over FDI under the *Foreign Acquisitions and Takeovers Act* to an independent statutory authority that would perform similar functions to the FIRB. This would reduce the scope for political interference in cross-border investment transactions, increasing certainty for foreign investors and vendors of Australian assets.

Australia could also consider raising the threshold for scrutiny of foreign acquisitions of Australian businesses to $1.078 billion — the threshold that currently applies to investment from the US and New Zealand under free trade agreements. Extending this threshold across the board to foreign investors from other jurisdictions, particularly China, would increase inward FDI and reduce the costs associated with scrutinising relatively small acquisitions that are unlikely to raise genuine ‘national interest’ concerns. This could also facilitate the successful negotiation of a broader free trade agreement with China.

Given the importance of FDI to the Australian economy, reforming its regulation should be addressed as part of a broad financial system inquiry, similar to the 1997 Wallis Inquiry, to harmonise FDI regulation with other aspects of regulating the financial system and business investment.

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After winning the recent federal election, Prime Minister Tony Abbott proclaimed Australia is “under new management and open for business”, and renewed interest in Australia’s agriculture, mining and infrastructure assets appears to be emerging. The proposed GrainCorp takeover by Archer Daniels Midland and the Indonesian company Santori purchasing 5500 square kilometres of pastoral land in the Northern Territory are just two transactions that will be further scrutinised by the Foreign Investment Review Board over the next couple of months.

Should nationally significant businesses, infrastructure and land be owned by foreign entities?

Finsia’s campaign on foreign direct investment tackles these issues. Finsia’s latest discussion paper, *Regulating Foreign Direct Investment in Australia*, is a useful resource for examining the current foreign investment review process and how it can be improved. Developed by Finsia’s Corporate Finance Advisory Group through a Finsia industry roundtable, this discussion paper will be launched in Sydney in February 2014. If you would like to be involved in the campaign or require additional information please contact Sam Bell (s.bell@finsia.com).