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A STRATEGIC ANALYSIS OF THE AUSTRALIAN FOREIGN INVESTMENT REGIME AND THE PROSPECT OF REFORM

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Abstract:

Australia’s foreign investment regime arguably has four primary objectives: to facilitate the flow of inbound foreign investment; to screen that investment for the potential to damage the Australian national interest; to reassure the Australian people that foreign investment is consistent with the national interest; and to educate foreign investors about Australian laws, regulations, and community standards. This paper uses a strategic framework developed by Harvard’s Kennedy School of Government to assess whether Australia’s foreign investment regime is sufficiently delivering on its four main objectives. We ask if the regime could offer even greater public value to the Australian people were changes to be made to its structure and operation. We conclude that the foreign investment regime is very far from dysfunctional. Indeed, economic indicators suggest that it is doing a reasonably good job of fulfilling its objectives. We argue, however, that more public value may accrue from bringing the regime into line with accepted principles of good governance. We also propose that additional value may be generated by creating a specialist body to educate foreign investors and provide them with ongoing assistance in adjusting to the Australian environment. As an alternative, we suggest that these latter responsibilities could readily be assigned to the Department of Foreign Affairs and Trade consistent with its existing mandate.

Key words: foreign investment; FIRB; law; regulation; good governance; public value.

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1 INTRODUCTION

Chinese companies have had highly variable experiences of investing in the Australian market. A senior executive of Chinese manufacturer Bright Food Group, which plans to make major inroads into the Australian wine and dairy industries, has described Australia as 'quite friendly and open' and has reported that local partners are 'quite pleasant to work with' (Kitney, 2014). Chinese investors have not always spoken so favourably of investing in Australia. In 2009, for example, executives of Chinese state owned enterprise (**SOE**), Chinalco, were reportedly deeply disappointed at the collapse of their proposed investment in Rio Tinto after a prolonged foreign investment review process. The Australian government insisted that commercial reasons were responsible for the collapse, but Chinese state media blamed it on an administration that they saw as prejudiced against Chinese investors (Uren, 2012).

Chinalco's proposed acquisition in Rio came at a time of heightened sensitivity in Australia over Chinese investment in resources and agriculture. As the mining boom has gradually wound down, the focus has shifted away from the resources sector – it is now the Australian property market that has emerged as a primary source of sensitivity. Australia's residential real estate market, especially in big cities like Sydney and Melbourne, is widely thought to be overheated and this has made it challenging for many first home buyers to enter the market despite unusually low interest rates. There has been some community concern – generally downplayed by those with knowledge of, and expertise in, the real estate market – that foreign investment is contributing to Australia's housing bubble. These concerns were arguably a motivating factor behind the House of Representatives' 2014 inquiry into foreign investment in residential real estate,[1] and the Abbott Government's subsequent regulatory changes that seek to better detect and penalise infractions of the rules regarding foreign investment in real estate.

Although Australia has relied heavily on foreign investment ever since colonisation, it is also a matter that has long been a periodic source of tension.[2] Anxiety over Chinese investment in resources and agricultural land, and more recently, residential real estate, is the latest manifestation of a pattern that seems likely to resurface in an ostensibly 'novel' form at some time in the future.

In this paper, we seek to make a strategic assessment of how well Australia's foreign investment regime is performing in an effort to move beyond the cyclical and emotive debates that tend to emerge around the issue of foreign investment. In making our assessment we utilise Moore's strategic framework for the public sector, which he adapts from corporate management theory (Moore 1995). The framework encourages government organisations to deliver the maximum

[1] House of Representatives' Standing Committee on Economics, 2014. 'Inquiry into Foreign Investment in Residential Real Estate'. http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Foreign_investment_in_real_estate

[2] Drysdale observes that earlier waves of American and Japanese investment in Australia generated similar spikes in economic nationalism to the most recent rise in investment from China. See Drysdale 2011, 56.

‘public value’ in the same way that private executives should optimise profits. By discussing the foreign investment regime in terms of the public value that it generates, we aim to assess the regime against a set of criteria that helps introduce added rigour into the Australian debate on foreign investment. It seems timely to conduct a strategic assessment of Australia’s foreign investment regime given that the Federal Government has itself launched a wide ranging consultation process on potential reforms to the regime that will presumably conclude in the latter half of 2015. Although none of the reforms being contemplated are as ‘radical’ as some of the suggestions made here, we hope that our proposals might be closer to the mainstream in the not-too-distant future.

Part 2 of this paper outlines the salient features of Australia’s approach to regulating overseas capital and the tension at the core of the foreign investment regime. Part 3 details Moore’s strategic framework and assesses its implications for the structure and operation of Australia’s foreign investment regime. Part 4 offers some concluding remarks.

2 AUSTRALIA’S FOREIGN INVESTMENT REGIME AND THE TENSION AT ITS CORE

Australia’s foreign investment regime is a political compromise with a consequent tension at its core. One the one hand, the basic structure of the regime reflects the view that foreign investment tends to be in Australia’s national interest. The regime is designed in such a way that intervention by the Treasurer to block foreign investment is the exception rather than the rule. There is effectively a legislative presumption in favour of foreign investment: the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**) does not require foreign investors to affirmatively demonstrate that their proposal is in the national interest in order for it to proceed. Instead, the ‘national interest’ test is a negative one – foreign investment is to go ahead without government intervention unless the Treasurer takes the adverse view that it is ‘contrary’ to the Australian national interest. The test was clearly framed in this way so that foreigners wanting to invest in Australia are not subject to undue burden. The adoption of this legislative form is a concession to the view – shared by both major Australian political parties – that foreign investment is generally in the national interest as it drives economic growth, job creation, investment in infrastructure, the development of advanced technology, access to overseas markets, and so on.

On the other hand, there is an intrinsic cautiousness about the way in which Australia’s foreign investment regime deals with overseas capital. The existence of the FATA suggests that Australia believes foreign investment may have a different character to domestic investment. The Act singles out foreign investors for special treatment – they may be subject to ‘at the border’ in addition to ‘behind the border’ regulation. This means that foreign investors are not just subject to the ordinary laws and regulations that apply to all legal persons within Australia’s territorial jurisdiction. Where a proposed foreign investment triggers the government’s review

process,[3] the Treasurer must decide *ex ante* (at the Australian border, as it were) whether the investment should be blocked or subject to conditions designed to safeguard the Australian national interest. There is thus a process for vetting foreign investment for which there is no domestic equivalent. Ultimately, then, there is a tension at the core of Australia's foreign investment regime. The regime is designed to facilitate the flow of overseas capital into Australia through a legislative presumption that foreign investment is in the national interest. But there is also an institutional wariness that suggests there might be something different about foreign investment such that *ex ante* scrutiny is warranted.

The tension in Australia's foreign investment regime, and the ambiguity it creates as to Australia's position on overseas capital, is arguably magnified by the amorphous nature of the national interest 'test'. The FATA establishes the 'national interest' as the standard to be used by the Australian Treasurer or a delegate when considering whether to block a foreign investment proposal or subject it to conditions. The legislation does not, however, go on to define the term. Our primary understanding of the national interest therefore comes from the government's Foreign Investment Policy, which 'sets out a matrix of factors, including economic and security considerations…[that] are relevant to determining whether a proposal is in the national interest' (Mendelsohn and Fels 2014, 63). While the policy provides a loose guide to the national interest, it is clear from the document itself that it is not intended as an exhaustive and legally binding statement of the term.[4]

The absence of a legislative definition and a policy that is a mere guide gives the Treasurer a broad political discretion to determine the national interest in the context of particular foreign investment applications. That discretion is particularly large as the Treasurer is not legally bound to provide reasons for foreign investment decisions, and those decisions are not subject to direct parliamentary oversight and have little chance of coming before a court or tribunal for administrative review. The nature of this arrangement creates some uncertainty as to whether particular foreign investment proposals will be judged to be in the national interest, compounding an institutional design that already adopts a somewhat ambiguous position on foreign investment.

Building a certain institutional wariness of foreign investment into the regulatory regime was presumably about having a mechanism for managing objections from the Australian polity. Australians have sometimes been less than supportive of what they see as overseas investors 'buying up' Australian assets. The institutional ambiguity of the foreign investment regime allows the government flexibility in dealing with foreign investment applications: where a

[3] Not all proposed foreign investment must be notified for review by the Australian Treasurer. A foreign investment proposal is reviewable by the Treasurer depending on whether it meets various monetary and other thresholds set out in the *Foreign Acquisitions and Takeovers Act 1975* (Cth) and the Government's Foreign Investment Policy (Treasurer of Australia 2015).

[4] The policy, for example, states that the 'Government reviews foreign investment proposals against the national interest case-by-case' and that it prefers 'this flexible approach to hard and fast rules' (Treasurer of Australia 2015, 1).

proposal is highly unpopular, the government can accede to public pressure by declaring it to be contrary to the national interest.[5]

The foreign investment regime arguably has four primary objectives that reflect the view at the heart of the regime that foreign investment is at once welcome but also needs to be treated with caution. The regime seeks to:

(1) Optimise the levels of foreign investment that Australia receives. It therefore aims to provide prospective investors with confidence about the review process, including its consistency and fairness.
(2) Screen inbound foreign investment to guard against potentially deleterious effects.
(3) Play a symbolic role by reassuring the Australian public that foreign investment is being adequately scrutinised. This ability to reassure helps the Australian government manage political pressures around foreign investment: it reduces the prospect that foreign investment proposals will need to be rejected on the grounds of public unpopularity.
(4) Educate foreign investors about Australian standards and expectations.

Our strategic assessment below evaluates the foreign investment regime in the light of these objectives and the notion of public value.

3 A STRATEGIC ASSESSMENT OF AUSTRALIA'S FOREIGN INVESTMENT REGIME

This section uses a framework proposed by Moore (1995) of Harvard's Kennedy School of Government to pose a series of questions about the purpose, political parameters, and performance of Australia's foreign investment regime. Rather than providing definitive answers to the questions raised, it aims to highlight areas where more policy attention might be desirable.

Given present elevated levels of discussion around foreign investment, and particularly Asian investment in Australian agriculture and the residential property market, it seems timely to strategically evaluate the foreign investment regime and consider afresh how well it is serving the interests of Australia and inbound investors.

3.1 Conducting an Assessment Using the 'Strategic Triangle'

Moore's central premise is that government departments and agencies (henceforth collectively referred to as 'organisations') should deliver value to the public. He argues that leaders of these organisations should ask themselves three main questions that form a 'strategic triangle'.

[5] This was implicitly acknowledged by the Chairman of the FIRB, Brian Wilson, in his comments on the Abbott Government's rejection of Archer Daniels Midland's proposed acquisition of GrainCorp. See Wilson quoted in Hyland (2014).

Question 1: the Notion of Public Value

The first set of questions centre on the public value the organisation delivers:

- What public value should the organisation serve?
- Is it delivering its promised value?
- Could it deliver greater value? For example, by changing its product or garnering more resources.

Identifying value is relatively straightforward in the private sector. Profit is usually the best indicator of value – a firm's product is demonstrably valuable where consumers are willing to pay for it at a price that generates profit for the firm (Moore 1995, 30). Value is harder to judge in the public sector, since the link between what the government produces and people's willingness to pay for that product is less apparent than in the private sector. Government products and services are delivered largely on the basis of compulsory taxation, but there is usually no direct mechanism through which citizens can indicate their preference for certain products over others (Moore 1995, 30). The closest approximation of people's preferences is elections for representative government, where citizens endorse government policies over those of the opposition giving the government a mandate for action (Moore 1995, 30-31). But this process is an imperfect expression of preferences (Moore 1995, 52), since not all prospective government action is the subject of an election policy. Ascertaining public, as opposed to private, value is therefore inescapably contestable.

Moore argues that the creation of public value has two facets (1995, 53). One indicia of public value is actually providing a desired public good or service – in other words, the delivery of results. Another is the process through which that good or service is delivered. Moore suggests that people are inclined to view fair, efficient, and accountable public enterprises as intrinsically valuable (53). As a consequence, proper processes are said to help enhance the legitimacy of government decision-making (126). In some cases, an organisation's willingness to embrace openness and accountability may also help generate support for the organisation, including from its political patrons (273; 281).

Moore reminds us that the ends do not necessarily justify the means. The question is not just whether the government is producing something ostensibly worthwhile. The final product must also be worth the costs entailed in the exercise of government power (Moore 1995, 29). One cost is levying compulsory taxation from citizens to finance government activities, which arguably detracts from personal freedom and reduces the funds available to be spent in the private market (Moore 1995, 29). Another is the effect of a coercive exercise of government power,[6] which may have domestic and international financial implications and an impact on the perceptions, relationships, and liberties of Australians and foreigners. Where the exercise of

[6] Where the government compels or prohibits certain behaviour.

government power may have a significant adverse effect on those subject to the power, it is appropriate to inquire into the process and propriety of government intervention.

A public organisation's value can be increased through:

- Delivering more products and services.
- Producing something of better quality.
- Improving the processes that surround the delivery of products and services.
- Measuring the preferences of citizens more accurately and better responding to them (Moore 1995, 211).

In the end, while judging public value may pose difficulties at a theoretical level, public servants find themselves having to resolve the matter on a daily basis in order to keep government running (Moore 1995, 39).

Question 2: the Authorising Environment

The second question that leaders should ask themselves relates to the 'authorising environment' of the government organisation. Analysing the authorising environment involves looking closely at the sources from which the organisation derives authority and legitimacy. Public organisations in Australia ultimately derive their legitimacy from the implied consent of the Australian people, who delegate their authority to elected officials through the process of representative government. The politics surrounding an organisation is a critical part of the authorising environment, since it may affect the support (both financial and political) that an organisation receives and thus its capacity to achieve its objectives. Laws and regulations are a product of the authorising environment, and may confer or constrain the powers of a public organisation. Skilled leaders recognise that an organisation's authorising environment is dynamic – a prevailing favourable environment should not be taken for granted, as the situation can change in response to real-world events. Conversely, it may be possible to shift the authorising environment in ways that help an organisation expand or better achieve its objectives.

Question 3: Operational Capacity

The third question looks at an organisation's operational capacity, and asks what can feasibly be delivered given existing financial resources, human capital, administrative structures, legal powers, and so on. The goal is to assess whether the operational capacity is optimal in the light of the organisation's objectives and authority. Operational capacity, too, is changeable and subject to negotiation. Moore encourages leaders of government organisations to seek to alter the operational capacity if doing so will improve the product being delivered or enhance the organisation's authority and legitimacy.

A Fourth Question: the Issue of Co-producers

Moore urges leaders of government organisations to think about a fourth ancillary question, *viz.* whose support, outside the organisation's political masters and its own employees, is needed for the organisation to fulfil its mandate (1995, 210). The task is to identify 'co-producers' who have an interest in the area handled by the government organisation. Co-producers may include individual citizens, interest groups, business leaders, professionals and professional associations, lobbyists, the media, legislative committees, other government agencies or departments, and the courts (Moore 1995, 119-125).

The endorsement of co-producers can be of profound benefit to an organisation, since their efforts may boost the organisation's efficacy without an additional injection of resources on its part. Co-producers can effectively supplement an organisation's operating capabilities (Fels 2010, 516-517), enabling it to provide more while using the same or fewer resources. Australian citizens are co-producers in the law enforcement context – they assist police in preventing and solving crimes by providing information to the 'Crime Stoppers' hotline. This relationship arguably assists the police in keeping Australians safe notwithstanding stretched resources.

After the initial identification of co-producers, an organisation then needs to consider how they can be mobilised. Engaging with the media can be an effective way to communicate the mission of an organisation and attract co-producers (Moore 1995, 120-121). In the 1990s and early 2000s, the Trade Practices Commission – the forerunner of the Australian Competition and Consumer Commission (**ACCC**) – began to use media coverage to encourage ordinary Australians to engage with the regulator's goals. Senior leadership within the regulator at the time felt that it could deliver far greater public value to the Australian people (Fels 2010, 508-509). In particular, there was a sense that more could be done to rein in anti-competitive behaviour by big business and to strengthen consumer rights. There was, however, little political support for a more active regulator as the then Labor Government did not wish to antagonise business interests (Fels 2010, 509).

The ACCC embarked on a program designed to give effect to its expanded view of the public value that it could deliver. This included prosecuting a number of high profile anti-cartel cases (Fels 2010, 509). At the same time, it began a media campaign that sought to raise public awareness of the regulator's renewed agenda (510-511). Fels, who was Chairman of the ACCC at the time and is one of the authors of this paper, argues that this campaign made co-producers of the Australian people. As the community came to appreciate the regulator's strengthened mission, the political authorising environment was made to shift (Fels 2010, 511-512). Increasing public opinion in favour of action by the ACCC meant that the Labor Government had to concede to a more activist competition regulator despite its initial reservations.

Why Invoke the Strategic Triangle?

This section has outlined three main questions that a leader of a public organisation might find it useful to ask. They can be summarised in shorthand by asking:

> (1) [W]hat *should* be done (i.e., what would be of value to the public?); (2) what *may* be done (i.e., what does the legislation permit or require to be done?); and (3) what *can* be done (i.e., what is operationally possible, given the resources and powers available…) (Fels 2010, 492).

There are two reasons for a leader to ask these questions. First, they help the leader test the 'adequacy' of her or his strategic vision for the organisation (Moore 1995, 22). They remind the leader to think about whether her or his vision is of public value, will be endorsed in law and politics, and is achievable in practice (Moore 1995, 22). Secondly, the questions encourage thinking around the practical steps needed in order for the vision to be realised. They encourage this kind of thinking by highlighting:

> [T]hree different aspects of…[the leader's] job: (1) judging the value of their imagined purpose; (2) managing upwards, towards politics, to invest their purpose with legitimacy and support; and (3) managing downward, toward improving the organisation's capabilities for achieving the desired purposes (Moore 1995, 23).

There is, of course, a dynamic relationship between the three questions or elements that leaders should consider. What is valuable is partly determined by what is legally and politically supportable and operationally achievable. A vision that commands little support and is unattainable in real terms may be of questionable value (Moore 1995, 71-72). The authorising environment may also be more or less supportive and susceptible to change depending on how the public value is articulated and the prospects of the value actually being fulfilled. Finally, what is operationally achievable may be affected by how the public value is expressed and the political support that the expression commands – both these factors can affect available resources and the willingness of co-producers to help implement a particular vision. A successful strategy for a public organisation is one that recognises this inherent dynamism and brings the three questions or elements into 'coherent alignment' (Moore 1995, 71). In other words, a good strategy conceives of public value in a way that commands the necessary support and is likely to be achievable.

In the following discussion, we use Moore's strategic triangle to assess the structure and operation of the Foreign Investment Review Board (**FIRB**) and the foreign investment regime more generally with a view to considering what changes, if any, might be desirable.

Question 1: What Public Value Does the Foreign Investment Regime Serve and How Can it be Maximised?

The first question to ask is what public value is generated by the foreign investment regime generally, and by review by the FIRB in particular.

<u>Objective 1: Facilitating Foreign Investment</u>

The current regime generates public value by delivering tangible results – *viz.* through facilitating the flow of foreign investment into Australia. Because of the capital intensive nature of the Australian economy and an historical shortage of domestic savings, the country has long relied on foreign investment to develop areas like resources and agriculture. Prime Minister Tony Abbott acknowledged this reality during a visit to Australia by Japanese Prime Minister, Shinzo Abe, in 2014. When the pair toured the Pilbara mining region in Western Australia, the Australian PM reportedly observed that the extensive development of WA's mining sector would have been impossible without the past high levels of Japanese investment (Garvey 2014, 5).

Foreign investment is widely seen as contributing to Australian economic growth through the expansion of productive capacities, stimulation of competition, development of cutting edge technology, generation of jobs, improvement of infrastructure, and the creation of new overseas markets for Australian goods and services. As we have already suggested, the institutional design of the foreign investment regime is in considerable measure geared towards encouraging the investment of overseas capital in Australia. Drysdale – who was involved in the policy discussions around establishing a foreign investment review process – argues that while the regime may ostensibly appear restrictive in relation to overseas capital, in actual fact the primary goal has always been to promote its flow into Australia. He recalls that the government created the foreign investment regime in the 1970s as a policy tool to manage the rising economic nationalism in Australia in response to high levels of foreign direct investment in the resources sector mostly by US firms (Drysdale 2011, 56).

If we see facilitating foreign investment as being of public value, it can be argued that the present regime is doing reasonably well. This can be concluded from the large number and value of reviewable foreign investment applications relative to the modest budget allocated to the review process. Let us briefly consider the bodies involved in the review process, some pertinent statistics, and the cost of running the foreign investment regime.

The foreign investment review process is administered by the FIRB and Treasury's Foreign Investment and Trade Policy Division (**FITPD**). The FIRB is the pinnacle advisory body that currently comprises five members. Four members are part-time and are mostly senior executives drawn from the business community (FIRB 2015a). One member of the FIRB – the 'Executive Member' – is full-time and also serves as the General Manager of the FITPD. The FIRB advises the Treasurer on the law and policy surrounding foreign investment, and on individual high profile foreign investment applications. It also performs an oversight role in relation to the

handling of foreign investment applications (FIRB 2015b, 5). The FIRB functions as a steering committee: it meets on a monthly basis, and in the intervening period communicates through telephone conversations between the full-time Executive Member and individual board members (FIRB 2015b, 5).

The FIRB is not involved in the day-to-day administration of the foreign investment review process, and instead relies heavily on the secretariat services provided to it by the FITPD in order to fulfil its role. The FITPD carries out an initial review of all foreign investment applications that it receives, and then advises the FIRB of applications that have been assessed as potentially significant (FIRB 2015b, 7). It also generates a weekly report to the FIRB on all applications received in that time (FIRB 2015b, 5). The FITPD consults with state and territory governments and other government agencies about the potential impact of proposed foreign investment where proposals are deemed sufficiently significant (FIRB 2015b, 7). FITPD officials also make the vast majority of foreign investment decisions pursuant to a delegated authority from the Treasurer (FIRB 2015b, 6).[7] The seniority of the FITPD decision maker depends on the value of the proposed foreign investment and its sensitivity.[8]

In 2013-2014, the expenses of the FIRB amounted to AUD$328,048 – a majority of this went towards remunerating Board members (FIRB 2015b, 9). The cost of running the FITPD for the same period was AUD$3.9 million, most of which paid for staff salaries and administration (FIRB 2015b, 9). During that time, 25,005 foreign investment applications were considered (mostly by the FITPD). 24,102 of those applications were approved (FIRB 2015b, 9), with a combined worth of AUD$167.4 billion (FIRB 2015b, 20).[9] Three foreign investment applications were rejected in 2013-2014 (FIRB 2015b, xi),[10] continuing a trend in which only a small number of applications are prevented from proceeding (FIRB 2015b, Table 2.1, 20).[11] Two of those rejections were in the residential real estate sector, although the third was of the far more significant bid by US firm Archer Daniels Midland to acquire the Australian grain storage and distribution company, GrainCorp (FIRB 2015b, xi).

[7] In 2013-2014, of the 24,105 foreign investment applications decided, 23,205 (just over 96 per cent) were decided by an FITPD official with the remaining 900 decided by a Treasury minister (FIRB 2015b, 9).
[8] Whether a foreign investment decision is made by a Treasury minister or an FITPD official depends on the sensitivity of the application, with more sensitive applications decided by a minister. The sensitivity of an application may be indicated by the FIRB, the Executive Member of the FIRB, or a government agency involved in assessing the application. Where an application is to be decided by the FITPD, it is the amount of money involved that determines how senior an official is needed to decide the application. An internal Minute by the Treasurer stipulates various monetary thresholds and the associated level of seniority needed to sign off on a foreign investment proposal of any given magnitude.
[9] Figures reflect levels of foreign investment approved rather than actually received.
[10] The difference between the number of applications considered and the number approved is attributable to the withdrawal of 719 applications and the finding that 181 applications were not reviewable under the FATA or the government's Foreign Investment Policy (FIRB 2015b, 9).
[11] Only three significant FDI proposals have ever been rejected by Australian governments: Royal Dutch Shell's planned takeover of Woodside Petroleum in 2001, the Singapore Stock Exchange's proposed acquisition of the ASX in 2011, and ADM's bid for GrainCorp in 2013.

To sum up the figures simply, a modest outlay of AUD$4.2 million on the administration of Australia's foreign investment regime resulted in the approval of more than AUD$167 billion in foreign investment. Armstrong's econometric analysis estimates that Australia tends to receives close to the maximum level of foreign investment that it could potentially expect (2011, 31). On the face of it, then, the government's expenditure is a highly cost effective way of generating good economic results for Australia. An important question, however, is whether there is a need for pre-screening of foreign investment at all and whether the national interest review process is the most effective way to achieve the collective objectives of the foreign investment regime. These questions are explored further below.

Objective 2: Screening Foreign Investment for Potential Harm to Australian Interests

Another way in which the foreign investment regime arguably creates public value is through screening investment proposals for potentially deleterious effects on Australian interests. If we are to see the regime as valuable in this sense, we need to accept the propositions that:

(1) Foreign investment may have special characteristics that render it more problematical than domestic investment.

(2) A dedicated 'at the border' review process is the most appropriate way to deal with the potentially harmful consequences of proposed foreign investment.

Chinese investment in Australia has been controversial in recent years, and presents a useful case study through which to briefly interrogate these two propositions. First, is there something different about Chinese investment that warrants special *ex ante* scrutiny? The majority of Chinese investment in Australia has been by SOEs – although there are indications this trend may be starting to change – in the mining sector (KPMG and University of Sydney China Studies Centre 2013, 1, 6-7).[12] Concerns about investment by Chinese SOEs tend to focus on the relationship with their major shareholder, the Chinese government. It is sometimes suggested that Chinese SOEs are likely to be guided by political or strategic motives rather than pure commerciality, and that there is ample scope for the Chinese government (whether at the central, provincial, or local level) to exercise control over company decision making.[13] There is also the argument that SOEs enjoy an unfair advantage over other prospective investors as they can access finance at unusually low interest rates through the Chinese government.

It is beyond the scope of this paper to assess these concerns in detail, although other papers parallel to this one do attempt such an assessment. Importantly, however, it cannot be unequivocally said that Chinese SOEs are motivated by non-commercial imperatives, are subject

[12] Importantly, these trends are changing. FDI from private Chinese companies is on the rise, and there appears to be a shift away from FDI in resources towards the energy (especially LNG) sector (KPMG and University of Sydney China Studies Centre 2013, 1, 15, 6).

[13] See extensive commentary by Barnaby Joyce MP in five separate hearings of the Senate Economics References Committee into foreign investment by SOEs (Senate Economics References Committee 2009).

to the direct control of the Chinese government, and universally enjoy preferential finance. Since the late 1970s the Chinese Communist Party (**CCP**) has enacted a series of reforms, many of which affect SOEs, in an attempt to transition from a centrally planned economy to market-based socialism. Earnest efforts to reform SOEs began in the 1990s, and have included:

- Early (pre-1990s) initiatives to increase the autonomy of SOEs over daily managerial decisions and to allow them to keep a portion of firm profits.
- Limited privatisation of unprofitable SOEs.
- Efforts to subject SOEs to greater competition by leveling the business and regulatory playing field so that it is easier for private firms to emerge and flourish.
- Changes in ownership structure, with the public listing of some SOEs and the creation of opportunities for non-government investors to participate as minority shareholders.
- An increasing emphasis by the central government on modernising the administration of SOEs, including through the creation of formally accountable boards of directors answerable to shareholders.
- Efforts to ensure that new loans to SOEs by government banks are not 'soft loans', but are instead primarily extended based on a firm's financial performance and capacity to make repayments (Zhang and Freestone 2013).

These reform efforts have nudged Chinese SOEs[14] closer towards the position of private firms. There is a far greater need and incentive for SOEs to behave commercially than ever before, including when it comes to accessing finance. The role of the Chinese government in the daily operations of SOEs has also reduced. Public listing of some SOEs and changes in the corporate governance of many firms mean that these companies are no longer 'direct affiliates to the central planning system' – the CCP has ceased to be 'involved in…[the] day-to-day operations' of most SOEs (Dong and Freestone 2013). Despite the considerable accomplishments to date, there is a long way to go before Chinese SOEs and private firms stand on an equal footing. Some Chinese SOEs do still enjoy special privileges, including government protection of monopolies, state subsidisation, and easy access to finance as a consequence of the government's willingness to guarantee their corporate debt (Dong and Freestone 2013). In most cases, the government is also able to exert high level control over SOEs by appointing or demoting senior company management (Dong and Freestone 2013).

Deeper reform of SOEs is likely to be relatively slow to transpire: even 'after twenty years, SOE reform is still one of the most difficult tasks facing the Chinese government' (Huang

[14] While 'Chinese SOEs' are referred to here as if they constitute a homogenous group, in actual fact SOEs differ widely in various respects, including their:

- Ownership and management structures (for example, they may be owned by the local/provincial/central government; they may or may not be wholly government owned; they may be publicly listed; they may or may not have a board of directors).
- Strategic importance and consequent leverage over the Chinese government.
- Competitiveness and profitability.

2012, 95). This brief discussion of Chinese SOEs reveals that foreign investment has the potential to present challenges not typical of domestic Australian investment. There are ostensible differences between state-backed foreign investment and Australian private, or indeed government, investment. In the latter cases, there certainly seems to be a perception among some in Australia that the interests of the investor are much more likely to align with those of the Australian people as a whole. But while SOEs continue in many respects to be creatures of the Chinese state, this does not necessarily mean that their actions will be markedly different to those of private commercial entities. There is still more work to be done in analysing the impact of ownership structure on corporate behaviour.

Since there are some different and potentially problematical features of investment by Chinese SOEs, the next question is whether a pre-screening process is the most effective way of dealing with the possible adverse consequences of prospective investment. An empirical study of this question does not seem to have been carried out in Australia, presumably because of the complexities that would be involved in any such study, including the need to assess almost unanswerable counterfactuals. It is worth briefly exploring these counterfactuals to demonstrate their inherent complexity.

The comments immediately below pertain to a regime like Australia, which effectively pre-screens certain categories of foreign investment. Let us take the case of an investment that passes the pre-screening process and is therefore allowed to proceed, and that later fails to produce any consequences that are perceived to be adverse from a national interest perspective (this will be referred to as 'scenario A'). In scenario A, it will be difficult to attribute the absence of adverse consequences to pre-screening as opposed to some other factor (for example, the foreign investor's experience of Australia's regulatory and cultural environments) or combination of factors. Scenario B is a situation where adverse consequences are proactively prevented by blocking a particular foreign investment proposal at the pre-screening stage. While the decision to block an investment eliminates the potential for negative effects, it too comes at a cost as Australia misses out on the injection of foreign capital and its associated opportunities. In scenario B, it may be difficult to unequivocally assert that blocking the investment was unavoidable – Australia's domestic regulations and corporate culture may in themselves have been sufficient to avert any negative effects of the proposed investment. Of course there is also a third scenario, in which adverse consequences eventuate despite the presence of a pre-screening process. These various scenarios are challenging to investigate empirically because of the difficulty in locating sufficiently like cases to use as comparators. In the case of scenario A, for example, showing that pre-screening is effective in preventing adverse consequences would require us to find a near identical investment that was not subject to pre-screening and where adverse consequences did in fact come about.[15] Given the obstacles to researching this area, arguments for and

[15] This would involve pairing investments where all important variables were matched, including: investment size and industry; a similar 'behind the border' legal/regulatory environment; company profile and experience.

against pre-screening tend to be based on ideological positions rather than robust empirical investigation.

There is a need for greater analysis of whether benefits derived from pre-screening foreign investment are worth the cost, which presumably includes some (perhaps small) deterrent effect on foreign investment. We know that Chinese foreign direct investment (**FDI**) in Australia has decreased since its historic and politically controversial peak in 2008 (KPMG and University of Sydney China Studies Centre 2012, 1). A recent explanation for this lies in the winding down of Australia's mining boom. But quite independent of, and preceding, this phenomenon, there were suggestions that some Chinese investors were making smaller investments so as to avoid triggering review by the Australian government. Still others may be opting to invest elsewhere – there are indications that while Australia remains a favoured destination for Chinese FDI, other countries are increasingly attractive to Chinese investors (KPMG and University of Sydney China Studies Centre 2013, 1-2). There are presumably hopes within the Australian Government that the recent signing of the China-Australia Free Trade Agreement (**ChAFTA**) will counteract these trends by sending a powerful message that Australia welcomes Chinese investment. The investment chapter of the ChAFTA raises the threshold that triggers review by the FIRB from AUD$252 million to more than AUD$1 billion (DFAT 2015). It remains to be seen whether that article will in fact encourage more Chinese investment in Australia, since it will only apply to private investors in so-called 'non-sensitive' sectors (DFAT 2015). The article does not liberalise existing screening arrangements for Chinese investment in agricultural land, agribusiness, or other sensitive sectors, and it will remain the case that investment by SOEs and other entities affiliated with the Chinese government is universally scrutinised regardless of its value (DFAT 2015).

While pre-screening may have historically deterred some foreign investment – and may continue to do so, especially in the case of countries not party to a bilateral Free Trade Agreement with Australia – it may also be insufficient to genuinely protect the national interest. The decision by Australia and the US to preclude Chinese firm, Huawei, from participating in the provision of telecommunications infrastructure on national security grounds exemplifies this insufficiency. Moran (2014) argues that such decisions may do little to safeguard the security of those countries given the globalised nature of IT supply chains (48). He observes that almost all international IT companies presently manufacture some of their equipment in China (48). Thus regardless of whether companies like Huawei are permitted to participate in Western markets directly, there is ample opportunity for them to behave malevolently – for example, by inserting 'trapdoors', 'backdoors', and surveillance systems into technology for overseas export (48). Moran proposes several ways of effectively safeguarding national security that are more imaginative than simple pre-screening, including comprehensive vetting processes where hardware and software are independently audited by trusted third parties (48-49).

A strong empirical basis for the view that pre-screening effectively safeguards the Australian national interest has yet to be developed. Perhaps more importantly, a simple process of pre-screening may be under-delivering to the Australian people on the promise of public value in the foreign investment space. Now might be the time to think more creatively about how to secure the Australian national interest.

Objective 3: Reassuring the Australian Public on Foreign Investment

The symbolic role played by Australia's foreign investment review process is of public value because it supports another objective of the regime, *viz.* to facilitate overseas investment. The review process seeks to reassure Australians that foreign investment is scrutinised to ensure consistency with the national interest. This reassurance has helped to maintain public support for foreign investment, which in turn has assisted in counteracting political pressure to deal with foreign investment less liberally (Drysdale 2011, 56). The review process has therefore allowed Australia to remain relatively open to foreign investment (Drysdale 2011, 56).

Despite this general trend, cyclical sensitivity in parts of the Australian community to foreign investment does tend to suggest that a good many people are unpersuaded of the benefit delivered by that investment. This sensitivity is sometimes reflected in periodic spikes in attention by the Australian legislature (and the executive) to the issue of foreign investment. In 2009, for example, there were five separate hearings of the Senate Economics References Committee into foreign investment by SOEs. Between November 2011 and May 2013, the Senate Standing Committees on Rural and Regional Affairs and Transport held a total of 12 hearings in Canberra, New South Wales, and Western Australia to examine the national interest test (Senate Standing Committees on Rural and Regional Affairs and Transport 2012-2013). These community concerns were also apparent in the mandate that the House of Representatives' Standing Committee on Economics had to investigate the adequacy of the approach to regulating foreign investment in residential real estate. The Committee was charged with its investigative role amid rising community concerns that overseas (and especially Chinese) property investment is contributing to the affordable housing crisis in Australia (House of Representatives' Standing Committee on Economics 2014; Anderson 2014). Since early 2015 the Abbott Government has itself been conducting a far more expansive consultation process on a raft of possible reforms to the foreign investment regime, some of which are in the process of being implemented without the need for antecedent legislative change (see Australian Government 2015; Treasury 2015).

The attention that the parliament devotes to the issue of foreign investment would seem to indicate that notwithstanding the reassurance offered by the review process, it continues to be a matter of contention and one that some within the community are troubled by. A survey of more than 1000 Australian adults by the Lowy Institute provides some support for this conclusion (Hanson 2012). Eighty one per cent of respondents were against 'allowing

foreign companies to buy Australian farmland to grow crops or farm livestock', with 63 per cent strongly against the idea (Hanson 2012, 4). Chinese investment was identified as particularly problematic, with 56 per cent of respondents (532 people) agreeing that 'the Australian government is allowing too much investment from China' (Hanson 2012, 12). Forty six per cent of those who agreed that there is too much investment from China also agreed that 'the Australian government is allowing too much foreign investment from all countries, not just China' (Hanson 2012, 12).

The mutual position of Australia's two major political parties seems to be that there is great public value in facilitating foreign investment. The question is therefore how to more effectively convince the Australian people of this view and better reassure them that their interests are being adequately protected by the regime. Building a popular consensus around foreign investment is important not least because it reduces the pressure politicians feel to reject overseas investment proposals because of public unpopularity. The issue of consensus building as a precursor to delivering on the promise of public value is explored further below.

Objective 4: Educating Foreign Investors on Australian Standards and Expectations

An explicit goal of the foreign investment regime is to educate foreign investors about Australian laws and regulations so that they are clear on the standards expected of them after they invest and appreciate how to comply with those standards. This educational objective is of public value to the Australian people because it aims to support the goal to minimise the adverse effects of foreign investment on the national interest. It also potentially supports the objective of facilitating foreign investment. Investors who have a keen understanding of the Australian operating environment are more likely to see their investment succeed than those who do not, and those with positive experiences of investing may be more inclined to expand their Australian operations or make fresh investments.

The FIRB and the FITPD already work to educate foreign investors by:

- Publishing fact sheets on Australia's laws, regulations, and policy (FIRB 2014, iv).
- Sending delegations of government officials to foreign countries in an effort to provide prospective investors with context on the Australian environment and community expectations.[16]
- Communicating with foreign consular officials and the lawyers and business advisors of foreign investors about matters of compliance (FIRB 2014, iv).

[16] In May 2014, for example, Brian Wilson travelled to China for the third time in his capacity as Chairman of the FIRB to help explain Australia's approach to foreign investment (FIRB 2015b, iii).

Despite these efforts, there is anecdotal evidence that some foreigners still find it difficult to navigate the Australian system after making their investment. Where this is the case, Australia may not be deriving the full benefit of the investment. In some instances, the net effect of an investment may even be negative. The foreign investment regime implicitly recognises that those new to the Australian environment may have trouble adjusting and conforming to its expectations and legal requirements. The regime attempts to deal with this issue primarily through the mechanism of conditional approvals. The FATA allows the Treasurer to approve proposals subject to conditions designed to protect the national interest. Foreign investors run the risk of divesture if they ultimately fail to observe any conditions that were attached to their proposal. Many conditions simply re-state existing Australian laws. Conditions that fall into that category are largely a reminder to foreign investors about Australian expectations, as well as a symbolic indicator to the Australian people that the government carefully regulates inbound investment.

While imposing conditions on foreign investment may have some symbolic value, it is an imperfect mechanism for ensuring the long-term consistency of investments with the Australian national interest. The FIRB and the FITPD purport to be serious about ensuring compliance with conditional approvals.[17] Historically, however, they have had to rely heavily on other government agencies to engage in enforcement activities because of limited resources of their own to devote to the task. This position was implicitly acknowledged in the recent decision of the Abbott Government to temporarily charge the Australian Taxation Office with the task of enforcing the rules relating to foreign investment in residential real estate given that it already has the necessary financial and human resources (Hockey 2015). The historical lack of enforcement capacity by the FIRB and the FITPD is, however, soon likely to be a thing of the past. The Government has signalled plans to enact legislation that would require foreign investors to pay a fee for the review of their proposals (Hockey 2015). There have been indications that some of the money collected is likely to be earmarked for enforcement activities by the FITPD and the FIRB (House of Representatives Standing Committee on Economics 2014, vi).

While it looks as though the enforcement activities of the foreign investment regime will be better resourced in the future, encouraging compliance at the outset will always be preferable to having to deploy the coercive powers of the state in order to penalise *ex post* infractions of the rules relating to foreign investment. It is therefore still relevant to ask how we might

[17] The following statement appears in the FIRB's annual report for 2012-13:

> The Board has introduced new initiatives to strengthen compliance with Australia's foreign investment arrangements. This involves a range of activities to better educate and inform investors about their compliance responsibilities. It also involves monitoring and investigatory action by the Secretariat and efforts to engage the business community, legal professionals and foreign government representatives in Australia about foreign investment compliance requirements. The Secretariat has worked closely in these activities with other Australian Government agencies, including by assisting in specific compliance investigations (FIRB 2014, iv).

better encourage foreign investors to educate themselves about the Australian environment and actively abide by local laws and other applicable standards after their initial investment.

How can the Foreign Investment Regime Deliver Greater Public Value?

We have so far identified some areas in which the foreign investment regime may be under-delivering on its potential public value. It has been suggested that:

(1) The regime may be deterring some foreign investment.

(2) Pre-screening alone may not be an effective guarantor of Australia's long-term interests.

(3) Parts of the Australian community are not entirely convinced that the foreign investment regime works to their advantage.

(4) Some foreign investors find it difficult to adjust to the Australian environment notwithstanding the efforts at education by the FIRB and the FITPD.

There is a common thread to the last three of these shortcomings – *viz.* that pre-screening alone may be insufficient to ensure that foreign investment serves the long-term Australian national interest. If the current institutional structure of the foreign investment regime is falling short of the regime's own objectives, the question is what structural changes might help to better fulfil those objectives.

3.2 Reforming the Foreign Investment Regime to Accord with Principles of Good Governance

When considering whether institutional changes could help better fulfil the objectives of the foreign investment regime, it is useful to return to the question of co-producers. Who are the co-producers of value who help deliver on the aspirations of the foreign investment regime? There are two obvious candidates: foreign investors themselves, and the Australian public, whose continued support is needed for the very maintenance of the foreign investment regime.

The project of attracting foreign investment while protecting from its potentially adverse effects requires a positive and robust partnership with foreign investors themselves. It is important that foreign investors are not only willing to contribute their capital, but are also keen to educate themselves about the Australian environment and are willing to abide by local laws, regulations, and community expectations. Australia needs to devote more attention to cultivating a partnership where foreign investors are enthusiastic about the country as a destination for their capital, and are also favourably disposed to 'doing the right thing' once they have invested. Building the goodwill of foreign investors is critical to this exercise. Australia needs to distance itself from historical perceptions of its foreign investment regime as biased and discriminatory (Larum 2011). The focus should be on

striving to create a regime under which foreign investors feel fairly treated – those who are dealt with openly and even-handedly are more likely to be pre-disposed to entering a productive partnership with the government and the Australian people after their investment.

The Australian people are also indispensable co-producers of value – their continued support of the foreign investment regime is needed for it to fulfil its facilitative goal. And yet there is not always unambiguous public support for foreign investment in Australia: some clearly remain to be convinced of its benefits. The question is what the regime can do in order to encourage greater public support for foreign investment.

In a previous paper, we argued for the reform of the foreign investment regime in line with principles of good governance. These include greater transparency about the review and decision making process, enhanced independence from government, and the routine availability of parliamentary oversight and administrative review (Mendelsohn and Fels 2014, 73-78). We recommended that:

- The FIRB should be granted the status of an independent agency sitting outside Treasury, with clear procedures governing the limits of interaction between the Board, the Treasurer, and the FITPD.[18]

- Foreign investment decisions ought to be subject to a statutory right to administrative review. This would require reasons to be provided for decisions, and would minimise the risk that irrelevant considerations determine decisions or that decisions become politicised.

- Parliament should be given a regular mechanism for overseeing the administration of the foreign investment regime.

There are two main ways that the FIRB could be made more independent of government. The first is to create a fully independent statutory authority with the power to review foreign investment proposals and make binding determinations on them. If this model were adopted, the FIRB would assume the totality of the foreign investment functions currently performed by the FITPD and the Treasurer – for example, reviewing all foreign investment proposals, liaising with other government departments on applications, and (most importantly) making foreign investment decisions. The Treasurer would lose the ability to make or directly influence foreign investment decisions.

[18] There is currently considerable overlap between the FIRB and the government, since the FIRB is a non-statutory authority established pursuant to the government's executive power and relies heavily on personnel from Treasury's FITPD to discharge its functions. The FIRB's only full-time member is also the General Manager of the FITPD, and the FITPD provides secretariat services to the FIRB.

The creation of an independent statutory authority exercising extensive government powers is not without precedent. Both the ACCC and the Reserve Bank of Australia, for example, today exercise formidable powers in regulating competition and consumer law and setting interest rates respectively. Although the exercise of these powers could have a significant impact on a government, both bodies are able to perform their duties free of undue influence by the executive.[19]

There are a number of arguments in favour of establishing a fully independent statutory authority. Constituting an independent body would help de-politicise the foreign investment review process, as it would remove the power to make foreign investment decisions from a politician (the Treasurer). The presence of an independent statutory authority would assist in increasing the objectivity of the foreign investment regime, since such a body would be unlikely to take party political matters into account in making their decisions.

The presence of a full-time, well resourced, fully independent expert statutory authority would also signify to the Australian public and foreign investors the great importance the major political parties attach to overseas capital and its fair and thorough review. It would enhance the credibility of the claim that Australia welcomes foreign investment provided that it is in the national interest, and would thus be consistent with the objectives of facilitating foreign investment and reassuring the Australian people.

Establishing a full-time regulator that is exclusively dedicated to foreign investment would also help develop greater specialisation in the area. An even more knowledgeable and well-resourced regulator with permanent staff and a deep insight into the issues around foreign investment is presumably good for both foreign investors and the Australian public. An independent statutory authority would also be well placed to refine the processes that apply to foreign investment proposals to ensure they are coherent, predictable, and maximally transparent.

There are, however, plausible objections to establishing the FIRB as an independent statutory authority. Some may oppose a more independent, transparent regulator on the basis that foreign investment matters are best dealt with by the executive. There is an argument, albeit a weak one, that dealing with foreign investment proposals more openly and transparently should be avoided since they often contain information that is commercial in confidence. This objection is unconvincing: regulators like the ACCC and the Australian Securities and Investment Commission routinely handle sensitive information and procedures could be implemented that balance the interests of openness and confidentiality. A second objection suggests that foreign investment ought to remain within the purview of the executive since it

[19] In the case of the ACCC, the government can direct that the body consider a particular matter in their decision making but cannot require that a certain decision be reached. Similarly, the government routinely sets inflation targets for the RBA, but is not entitled to direct the body as to the interest rate that should be implemented in order to achieve that target. Historically, of course, it was the Australian government that set interest rates.

may involve matters of diplomacy where the interests of foreign governments are at stake. A further possible objection is that having an independent regulator might compromise the efficiency of the review process, since the regulator may lack the FITPD's close working relationship with other government departments and agencies.

A less radical departure from the present regime would be to endow the FIRB with some of the features of an independent statutory authority, like a measure of autonomy from government and the ability to speak publicly on foreign investment matters, while stopping short of granting it full independence and final decision-making power. The FIRB could review, decide, and publicly report on significant foreign investment applications with the Treasurer retaining a final right of veto. A less confrontational model might replicate the position with respect to the Productivity Commission: the FIRB could make public recommendations on significant foreign investment applications, which could then be adopted or set aside by the Treasurer.

These two options reserve for the executive the final say on foreign investment matters, but would nonetheless create some fresh limits on the exercise of government authority. While they might be a step in the right direction, they also pose a number of political challenges. In both scenarios, the government may find itself in the difficult situation of vetoing or refusing to implement a decision or recommendation of the FIRB. Another challenge is that without greater resourcing, the FIRB would have to confine itself to reviewing 'significant' foreign investment applications. Ambiguity could, however, arise in the course of daily attempts to delineate the proposals that are sufficiently significant as to warrant decision by the FIRB. Indeed, one can imagine that political pressure might be applied to underestimate the significance of applications so that they are decided within Treasury rather than by an independent FIRB. Without deeper pockets, the FIRB would also still have to rely on the FITPD for secretariat support. But the efficacy of the relationship between the FIRB and the Treasury Division could conceivably be compromised in a situation where a more autonomous regulator might arrive at a position contrary to that of the government. While a fully independent FIRB might be aspirational in the present political environment, the less radical reform options canvassed here also have their own, not insubstantial, challenges.

Apart from the question of whether the FIRB should be made more independent of government, there is also the matter of whether there ought to be a regular mechanism for parliamentary oversight of the foreign investment review process and a statutory right to administrative review of foreign investment decisions. In private roundtable discussions on an earlier paper of ours, several academics and policy analysts expressed doubts as to the desirability of such changes. It was argued that introducing routine parliamentary oversight of the area – for example, through a dedicated parliamentary committee – might have the perverse consequence of further politicising the issue of foreign investment. It was even suggested that greater openness in the foreign investment review process could lead to public

calls for tighter regulation, which (if implemented) would be to the detriment of the Australian economy.

In those same discussions, we ourselves acknowledged the possibility that creating an easy avenue for a party adversely affected by a foreign investment decision to seek administrative review could create prolonged uncertainty and unacceptable indeterminacy. We observed that business decisions, including whether to proceed with a foreign investment proposal, might have to be put on hold indefinitely at substantial cost while a court or tribunal determines whether to uphold a foreign investment decision. Of course, the worst possible scenario is one in which a business decision that has already been taken has to be reversed because of the findings of a court or tribunal. These objections are legitimate, but not insurmountable: almost all of the foreshadowed negative consequences could be ameliorated through careful legislative and policy design. Our guiding question should therefore be one of principle – do we think that reforming the foreign investment regime in line with the principles of good governance to create a more open, transparent, and independent review process is of public value?

The reforms we have proposed are motivated by a concern to deal with foreign investors fairly and openly. They aim to foster the goodwill of overseas investors through transparent and consistent treatment at the Australian border. Treating foreign investors in this manner may encourage them in their role as co-producers who drive investment flows and help uphold Australian laws, regulations, and community expectations.

The proposed reforms are also concerned to encourage greater trust in the Australian community around the issue of foreign investment. We have identified a need to bridge the gap between the two major Australian political parties and parts of the community on foreign investment. The reform options we have raised may help address this gap by enabling the government and the FIRB to talk more openly about foreign investment within the parameters of what is acceptable commercially and from a security perspective. The potential reforms we have canvassed would bring the foreign investment regime out of the shadows and effectively require the government of the day to put its conception of the national interest to the Australian people. Even if (as seems likely) the Treasurer were to retain the final power to make foreign investment decisions, the government would nonetheless find itself having to routinely and publicly account for a decision not to intervene in, or to block, an investment. A more independent FIRB would also probably find itself freer to communicate with the Australian people about foreign investment generally, its methods of review, and the daily issues it encounters.

A critical part of building a considered and constructive dialogue on foreign investment in Australia is to have the government and the FIRB talk about the issue in a way that is more frank and comprehensive and less reactive. A dialogue of this kind would be a positive

development for an advanced liberal democracy like Australia, and could ultimately lead to greater public conviction that foreign investment is serving the national interest.

3.3 Creating a Facilitative/Educational Body to Sit in Parallel to the FIRB

If we are concerned to facilitate foreign investment while also averting the potential for detriment it may we worth considering 'behind the border' measures that could help secure the continued observance of Australian laws, regulations, and community expectations after investments are made.

One option is to provide greater advice and support to foreign investors once their investment has been allowed to proceed. The mandate of the FIRB and the FITPD could be expanded so that they function as a kind of 'one stop shop' that is responsible not only for vetting prospective foreign investment but also facilitating its mutually beneficial progress once approved by providing overseas investors with information and other assistance.[20] A conflict of interest could, however, arise in seeking to combine the functions of a regulator and facilitator in the same two bodies. It would therefore be preferable to create a body that sits in parallel to the FIRB and the FITPD that acts as a facilitator of foreign investment and as an educator of the investors themselves. This would require an increase in the funds allocated to the foreign investment regime. Increased expenditure is potentially justifiable as it could help the foreign investment regime deliver greater public value by boosting its capacity to: engage with foreign investors; promote the national interest over the long-term; and reassure the Australian public. Rather than creating a new body to perform the role we have described, it is also theoretically possible for the Department of Foreign Affairs and Trade (**DFAT**) to take it on as part of its existing mandate. The benefit of this latter option is that there may be fewer political and financial obstacles to its implementation, and it would avoid creating unnecessary duplication in the government bureaucracy.

An objection to assisting foreign investors in the way we have proposed is that it would provide them with preferential treatment by offering a service paid for by the Australian taxpayer that is not available to local firms. On closer inspection this seems like a weak argument. If we accept the important role that foreign investment plays in the Australian economy, extending limited assistance to overseas investors to foster better compliance with the Australian environment seems like a good idea and one that is in the national interest. The Australian people may also feel more comfortable knowing that there is a government body responsible for providing guidance to foreign investors on how to be good corporate citizens in Australia over the long-term. Moreover, DFAT already performs many of the functions we have proposed in relation to overseas trade and there is no clear rationale for why foreign investment ought to be treated differently.

[20] For example, by assisting with obtaining relevant permits and licences, by advising more intensively on labour and environmental laws, by advising on how to create modern corporate governance arrangements etcetera.

Question 2: Does the Authorising Environment of the Foreign Investment Regime Support an Expanded Conception of Public Value?

The next step is to look at the authorising environment of Australia's foreign investment regime and ask whether there is likely to be the political and legal support needed for the expanded conception of public value we have outlined. That is, does the existing environment support good governance reforms to the foreign investment regime as well as the creation of a facilitative and educational body to sit alongside the FIRB?

There is no doubt that there would need to be a shift in the present authorising environment before the changes proposed in this paper could garner support. The Australian people are the ultimate authorisers of government activity through the process of representative government. It is unclear, however, that a majority of Australians would favour the kinds of reforms we have suggested. Indeed, tougher regulation of foreign investment often seems to be more popular than the soft power approach advocated for here. Thus there is probably a gulf between what the public wants and the 'public value' we have theorised here. Movement in the authorising environment is therefore needed for fundamental reform to become a realistic prospect. Most importantly, the Australian public will need to be convinced of the desirability of reform for there to be a political mandate for change. It will be critical to frame the case for reform in terms that are meaningful to a domestic audience so as to avoid creating an impression that the proposed changes are primarily for the benefit of foreigners. We discuss this further below.

For the public to be persuaded, the reform agenda will first need to attract the support of influential Australian politicians. A difficulty in this regard is that the present structure of the foreign investment regime favours the exercise of executive power, and thus tends to serve the interests of the two major Australian political parties that have historically formed governments. The structure of the foreign investment regime gives Australian governments of various political persuasions enormous flexibility in dealing with foreign investment. The good governance reforms we have proposed here would detract from this flexibility by taking away the Treasurer's monopoly on foreign investment decisions and subjecting those decisions to improved public scrutiny. At first blush, this course of action is unlikely to be enthusiastically adopted by the current Government or the ALP.

Attracting political support for reform is also challenging in a difficult economic climate because it calls for an increase in the financial and human resources allocated to the foreign investment regime. The reforms we have proposed would also impose fresh operational burdens on existing bodies. The introduction of parliamentary oversight, for example, would require government committees to devote time and energy to that role with possible consequences for the performance of other functions. Another hurdle to garnering political support is that it is hard to establish that the foreign investment regime is sufficiently 'broken' to warrant systemic reform. It must also be conceded that it cannot be proven in

advance that the reforms we have suggested will generate greater public value – much has to rest on the persuasiveness of the analytic case. Moore (1995) himself argues that certainty 'new ideas are valuable' is not always needed to justify changes in public policy: it is 'often enough that the ideas seem plausible and worth experimentation' (95). Changes to the foreign investment regime do, of course, need to be carefully devised to avoid sovereign risk and the perversity of good intentions creating poor outcomes.[21]

The obstacles discussed do not make the authorising environment immutable. The question is therefore how to shift it in a direction that would support the sort of changes we have advocated. Academics can play an important role in reform movements by making a strong analytic case for change (Patashnik 2008, 112). This paper, together with its precursor published in January 2014, seeks to contribute to that case.

So-called 'policy entrepreneurs' can also be indispensable to the successful enactment of reforms (Patashnik 2008). Policy entrepreneurs are politicians who take up the case for reform and promote it in the public domain (Patashnik 2008, 112). In doing so, they translate academic arguments into terms that are relevant to the everyday issues experienced by the population at large.

The role of policy entrepreneur in the foreign investment debate is up for the taking. The politicians who are willing to campaign for reform will need to reframe the debate so that changes are not seen as being about foreigners, or even fairness and good governance in an abstract sense. Reform should be explained as being of worth to Australians because of its potential to facilitate the inflow of much needed foreign capital, while also introducing better mechanisms to help secure the country's national interest in the long-term.

The case for facilitating foreign investment will need to be communicated in terms that resonate with the Australian people and their everyday experiences. The present economic environment may, somewhat counterintuitively, actually be a good time to start building such a case. People are becoming increasingly cognisant of what Garnaut (2013) has termed the post-mining boom 'dog days', in which living standards are expected to drop unless Australia sees major productivity gains. Foreign investment in areas like infrastructure and agriculture has the potential to offset some of the blowback from the end of the resources boom. This more bearish economic context arguably provides an impetus to think about foreign investment afresh and to seek to translate the argument for reform into terms that align with the lived experience of Australians, including cost of living pressures and the potential for rising unemployment and falling wages.

[21] Some government officials and policy analysts have, for example, expressed concern that greater transparency in the foreign investment regime may result in public demands for more rigorous scrutiny of overseas investment to the ultimate detriment of the Australian economy.

Agitating for an inquiry by the Productivity Commission might be another way of promoting the case for reform. The Productivity Commission could conceivably look into the loss to the Australian economy from teething problems experienced by foreign investors. The argument in favour of change would be bolstered if there was ultimately a finding that the estimated loss exceeded the anticipated cost of reform.

In the final analysis, the success of a reformist agenda will in large measure turn on how effectively academic arguments for change are translated into terms that are meaningful to the Australian people.

Question 3: How Operationally Feasible Are the Proposed Reforms?

A two part reform project has been proposed in this paper. We have argued that the foreign investment regime ought to be brought into line with the principles of good governance. We have also suggested that it might be desirable to establish a body that sits in parallel to the FIRB, and is tasked with facilitating the smooth progress of foreign investment and educating investors about the Australian environment. Another option we raised was to have the latter responsibilities assigned to DFAT as part of its existing mandate. These changes would all entail costs well beyond those associated with the present foreign investment regime. For such substantial reforms to be enacted and then implemented there would first need to be a shift in the existing operating capacity of the foreign investment regime. Let us briefly consider in general terms some of the anticipated costs of reform.

The initial establishment of the FIRB as an independent statutory authority would be a fairly expensive exercise. It would require the careful drafting of laws and regulations by the Attorney-General's department in consultation with other areas of government. It would also involve redeploying staff from the FITPD, or engaging new full-time employees who would have to be appropriately trained at some cost. New premises would need to be secured and fitted out. Suitable administrative systems would have to be developed and software purchased.

The option of creating a semi-autonomous FIRB with the power to make foreign investment decisions or recommendations that could be vetoed or set aside by the Treasurer ostensibly involves fewer financial costs, as much of the current structure of the regime could remain unchanged. This option is not, however, entirely without costs. The Treasurer would have to spend time justifying a decision to veto or set aside a FIRB decision or recommendation. In our view this would be a positive development. Publicly ignoring the FIRB's position might also come at a political cost to the government, although it is not clear that this would be bad either.

Introducing a regular mechanism for parliamentary oversight of the foreign investment regime and providing a statutory right to review of foreign investment decisions would create new obligations for existing government service providers. These innovations would require

legislative change. The ready availability of administrative review would likely create a culture of spending more time documenting the review of foreign investment proposals in anticipation of possibly having to publicly justify decisions in a court or tribunal. Again, this might be all to the good. The courts and tribunals tasked with hearing foreign investment matters would probably need to create new dedicated lists. Judges and tribunal members with specialist expertise pertaining to foreign investment might need to be appointed, and additional support staff and expanded premises may also be required. Parliament would also need to spend time on its oversight role. For reasons similar to those already recounted, setting up a facilitative/educational body in parallel to the FIRB would also require a new injection of funds in excess of the AUD$4.2 million currently allocated to the foreign investment review process. Admittedly, however, the exercise might be considerably cheaper were DFAT to take on these responsibilities.

In sum, the reforms we have proposed involve the creation of new roles or the revision of existing ones and would therefore require additional financial resources to cover a range of expenses including employee salaries and office space and equipment. The ability to access additional funds will largely depend on how persuaded the government is that reforms will deliver public value that is worth the cost of the necessary financial outlay and expenditure of political capital.

This paper has sought to lay an analytical foundation for reform. A next step is to conduct economic modelling that prices the cost of the suggested reforms. It would also be useful to quantify the hidden cost to the Australian economy of post-investment teething problems, and to estimate the potential gains of having investors who are pre-disposed from the outset to observe Australian laws, regulations, and community expectations. Empirical work of this kind would allow for an evidence based assessment of whether the reforms we have proposed are indeed of public value and are likely to generate the necessary political and financial support.

4 CONCLUSION

Reform is a ‘formidable political task’ because ‘it requires current officeholders to acknowledge that the current direction of policymaking is dysfunctional and to alter governing arrangements on which social actors have come to rely’ (Patashnik 2008, 16). To describe the structure and operation of the foreign investment regime as dysfunctional would be a gross exaggeration. The regime seems to be doing a reasonably good job of delivering public value, in that it facilitates a large volume of foreign investment for a modest expenditure. Armstrong’s work (2011) also suggests that the regime has at most a small deterrent effect on foreign investment. Our strategic assessment nonetheless implies that particular innovations could increase the public value being delivered to the Australian people by helping to better fulfil some of the explicit objectives of the regime.

Our assessment has pointed to shortcomings in the process for reviewing foreign investment. We have argued that changes to align the foreign investment regime with core principles of good governance like transparency and autonomy from government may help enlist the support of foreign investors, who are likely to be encouraged by a sense of fair and open treatment. Securing their goodwill and cooperation is indispensable to the regime being able to fulfil its own objectives, which include educating foreign investors, protecting Australian interests over the long-term, and persuading the public that they are doing a good job of safeguarding the national interest. In opening up the regime to greater scrutiny, good governance reforms may also be a catalyst for a more open dialogue on foreign investment that eventually helps build increased confidence in the ability of the system to safeguard Australian interests.

We have also raised the possibility of creating a body to sit alongside the FIRB with the primary goal of helping foreign investors navigate the Australian environment after making an investment. We have suggested that DFAT could perform these responsibilities equally well at potentially less cost. Either of these options may help deliver on the same objectives as good governance reforms.

For our reform suggestions to gain momentum they will need to attract political and financial support. Whether this happens in large part depends on how persuaded the right people are of the case that they will deliver greater public value at an acceptable cost. This paper is an early part of our effort to make that case.

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