

Inquiry into Foreign Investment Proposals

Submission to Senate Economics Committee

Submission

David Richardson

March 2020

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ISSN: 1836-9014

Summary

This submission begins with some general thoughts based on earlier work at The Australia Institute. We note that Australia's history has included rigorous debates about foreign ownership of the Australian economy. Sometimes that debate has taken twists and turns from Australian control of uranium mining to the question of Chinese influence. However it must be said that at the official level there has been an increasing tendency to 'leave it to the market' which essentially means much of what the players want they get. We make the point that the presumption that Australian interests are advanced by foreign investment is often wrong. Australia's economy is increasingly dominated by big business and most markets are increasingly subject to monopoly, duopoly, or oligopoly; often foreign owned. One consequence has been the increasing share of profits at the expense of labour's share of national income with foreign corporations bound up in that development.

Foreign takeovers should be examined very critically, especially when they buy up Australian companies. If a foreign investor wishes to set up in Australia they can do so and attempt to compete against incumbents from a greenfield operation. If they compete and succeed then they add to competition and choice in Australia. However, in general Australia is a very uncompetitive environment and so a takeover necessarily involves replacing domestic owners in an industry that lacks innovation and dynamism.

We also discuss the conditions often placed on foreign investors. The record of the Foreign Investment Review Board (FIRB) and especially on monitoring compliance is poor and a strong monitoring and compliance role for the FIRB is something that was never seriously pursued. We know of no example where a decision has been revoked because conditions were violated. Companies were able to flout any agreements they made with the government in order to gain foreign investment approval. One of Costello's decisions effectively conceded Don Chipp's accusations decades earlier; no-one is in a position to follow up delinquent foreign investors after the approval process.

The role of the Foreign Investment Review Board is unlikely to change in the near future. What little nationalism there was in the early Boards seems to have gone and the Board seems to be stacked with businesspeople and former coalition politicians.

We make a number of recommendations that should improve the operation of the foreign investment policy.

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Introduction

The Australia institute is pleased to make the present submission to the Senate Economics Committee Inquiry into foreign investment proposals.

In this submission we propose to answer each of the terms of reference in turn. However, we might begin with a few general thoughts. Foreign investment has had a mixed reception in Australia. Prime Ministers Chifley and Morrison have both expressed concern about General Motors ripping off Australians. Chifley was concerned that General Motors contributed none of its own capital but repatriated a fortune in profits (See Richardson 2018). Morrison was concerned that GM accepted billions in subsidies before letting the Holden brand 'wither away' (McGowan 2020).

Huawei's attempt to break into the domestic market for 5G has raised questions about Australia's approach to foreign investment. Foreign investment is a topic newly considered in *Wrong Way*, a new book that questions the direction government policy has taken in a number of areas but in the general direction of neoliberalism (Richardson 2018).

Despite public attitudes to globalisation and issues like privatisation official attitudes to foreign investment have changed dramatically over the years. In 1972 Treasury outlined the problems with foreign investment when it asked:

Are the economic benefits of foreign capital sufficient to outweigh the gains it reaps from Australia? Will the growth of these gains impose, over time, a long-run burden on the balance of payments? Should we be content to have our natural resources developed by foreign companies? Are Australian exports being hindered by the policies of international corporations with affiliates in Australia? Do foreign-controlled enterprises in Australia behave in other ways contrary to our national interests? Do foreign takeovers of Australian enterprises raise special problems? Is there a general need for majority Australian ownership of investment projects? Could we finance more of our own development from local savings?

These were questions that were worth asking in 1972 and remain relevant now. But when Tony Abbott won the 2013 election his government declared Australia is open for business by which they meant there was to be an open door for foreign investment. Treasury's earlier questions were ignored. This view reflects the neoliberal resurgence which has a takeaway message: "Leave it to the market". Moreover there is now a view that foreign investors should be given anything they want because we want to be seen as a desirable place to invest. In fact when the then Treasurer, Scott Morrison, went so far as to suggest Australia should not do anything that might scare off foreign investment—something now called 'sovereign risk'

(Morrison 2017). Some people in 1972 took a similar view that we should be careful not to scare off foreign investment. Treasury then described this derisively as the 'startled fawn' approach to foreign investment.

In other areas there is some sort of intellectual backing for leaving it to the markets. As producers fight to survive they are supposed to do so in ways that benefit the consumer who ultimately controls what is produced, how it is produced and when it is produced. All of that is a far cry from the situation in Australia where megacorporations control the Australian economy in banking, retail, resources, and elsewhere. In areas such as cafes competition may well mean it is the consumer that benefits. The interests of the consumer and the producer are aligned. But when a multinational with a significant world share in a particular commodity takes over an Australian miner the benefits are indeed uncertain. Sometimes the conflict of interest is blatantly obvious and governments are forced to act. Shell's attempted takeover of Woodside was rejected on the grounds that Shell's and Australia's interests were not congruent as we explain below.

The magnitudes are enormous. The stock of foreign investment in Australia is \$3.2 trillion, or 184 per cent of GDP. Nobody invests that amount without expecting a commensurately huge return on their investment. Income paid abroad on that investment is likewise enormous which is why the 1965 Vernon Report warned about reliance on foreign investment when it said:

Once an economy has a substantial body of overseas investment, it is in a sense 'on the tiger's back' ... The continuation of capital inflow becomes seemingly more and more desirable as a means of offsetting the increasing [income payable overseas]. As the annual amounts become larger, the immediate consequences for the economy of an interruption of the capital inflow, either contrived or occurring by reason of external circumstances, become more and more serious.

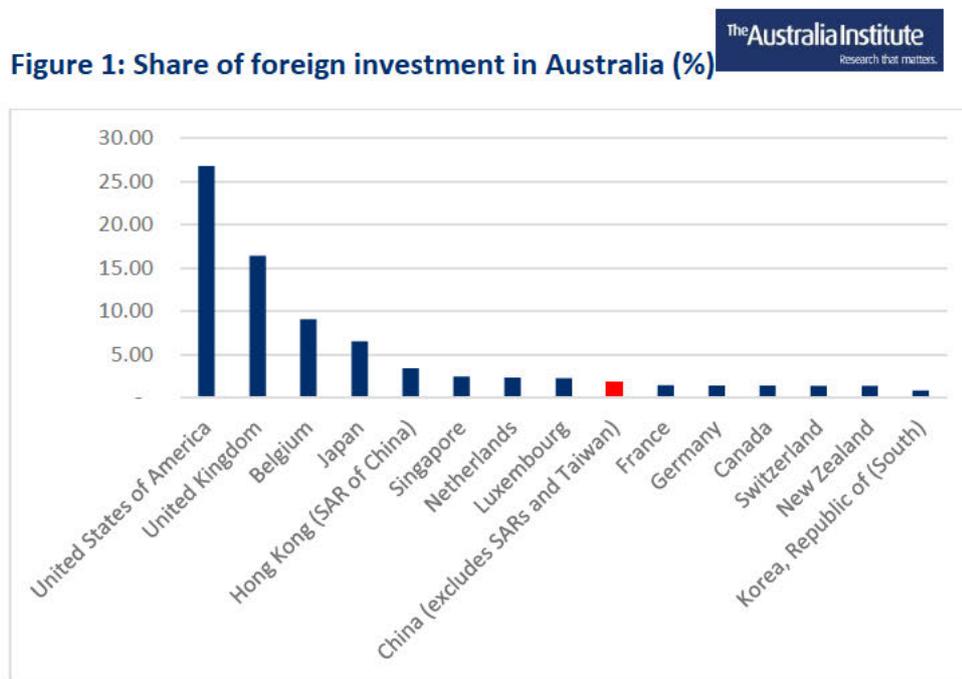
Following the Vernon Report there were a number of initiatives under the Gorton Government and subsequently. The 1972 election contest included concerns about buying back the farm before it was too late (Richardson 2018). We have forgotten this lesson but we should be aware that it was in the context of the drying up of the resources boom that Morrison referred to 'the fight to attract the investment capital' (Morrison 2016) and as a result used that as an excuse for lower company tax cuts.

One of the arguments is that there is inadequate savings in Australia. But as the resources boom showed, it was the Australian people and machinery that dug the mines, dredged the harbours, built the railways and transported the ores. Foreign companies did finance much of this but you simply do not need foreign capital inflows to pay Australian workers and suppliers in Australian dollars.

Australian contractors have been calling on governments to require local companies be involved in big infrastructure projects and to be more "tactical" in how they award contracts, to avoid the nation's roads and railways all being built by foreign-owned firms (Wiggins 2019). This would apparently go against market forces.

Increasingly over the past decade or so Australia has absorbed American fears of a resurgent China. Treasurer Swan introduced stricter guidelines for approving foreign investment proposals from state-owned enterprises (Swan 2008). Whilst that potentially applies to a multitude of companies from Saudi oil interests to Singapore infrastructure and transport companies it was introduced to counter Chinese interests. We only need mention Huawei. As another example the FIRB rejected Chinese takeover of Lynas Corporation which mines rare earths etc on national security grounds. The FIRB said the \$252 million bid for a 51 per cent stake could threaten supply to non-Chinese buyers of what have emerged as key ingredients in permanent magnets used in electric vehicles and the aerospace and defence industries (Thompson 2019).

Despite the interest surrounding Chinese matters it is worth reminding ourselves of the main source countries for the present level of foreign investment in Australia. The graph in Figure 1 shows the shares of foreign investment by the main source countries for foreign investment in Australia.



Source: ABS (2019) *International Investment Position, Australia: Supplementary Statistics, 2018*, Cat no 5352.0, 8 May.

The graph in Figure 1 clearly shows that foreign investment is dominated by the US, UK, Belgium and a group of Asian countries with China itself at ninth position with just 1.81 per cent of total foreign investment.

It is also important here to remind ourselves that Australia's economy is increasingly dominated by big business and most markets are increasingly subject to monopoly, duopoly, or oligopoly. One consequence has been the increasing share of profits at the expense of labour's share of national income. Not only that but the distribution of income has worsened; first as a result of the increasing profit share but also because of the impact of high profit margins on the price of life's essentials; from power to supermarket items. Foreign investment cannot be thought of as separate from those concerns because so many of Australian businesses are foreign owned or controlled.

We might wind up these preliminary comments by noting that the presumption that Australian interests are advanced by foreign investment is often wrong. Take the example of foreign interests taking over a profitable company in Australia without changing its business model and content to sit on the profits formerly enjoyed by the previous owners. Nothing changes with respect to its output, employment and so on and so GDP is exactly what it would have otherwise been in the absence of the foreign investment. However, Australia's net national income has fallen because the profits generated no longer accrue to Australian owners but to foreign investors. There will also be an outflow of income over the balance of payments. However, there is a good chance that there may be other adverse impacts as the Australian operation becomes victim to the multinational's global strategy.

The protection of Australia's market-based system from manipulation that would benefit proposed foreign investment

We are not clear what this clause is getting at. However, if we read it as '... would benefit the proposed foreign investor' it may be clearer. We can see that in the case of the old proposal for Shell to takeover Woodside Petroleum. Shell as a global oligopolist could have used production controls over Woodside in its global gas strategy as discussed below. There have also been massive interventions in the market on the part of governments trying to maximise the revenue they receive on selling state-owned businesses. For example the Port of Newcastle was sold subject to a recently exposed condition that NSW would impose a levy on the Port for any significant container ship activity so it would not compete with Botany Bay terminal (Green 2020).

In other parts of this submission we raise issues to do with concentration and competition. A concentrated and uncompetitive industry is precisely the environment in which big business can manipulate the market. Some of our recommendations below address the relevant issues.

The assessment of the impact of proposed foreign investment on market concentration and competition

Many of the approvals granted by the Treasurer amount to foreign takeovers of Australian companies while some other proposals have been rejected, such as the case of GrainCorp which was subject to a takeover bid by Archer Daniels Midland (ADM), an American company which threatened a foreign monopoly over wheat handling and marketing.

As a general principle we might suggest that foreign takeovers be examined very critically. If a foreign investor wishes to set up in Australia they can do so and attempt to compete against incumbents. If they are up to scratch they will succeed. However, in general Australia is a very uncompetitive environment and so a takeover necessarily involves replacing domestic owners in an industry that lacks innovation and dynamism. Foreign takeovers in beverages, milk processing, utilities and other areas have not changed those industries as much as sharing in lazy uncompetitive markets. Moreover, there are cases where foreign owners have prohibited their Australian subsidiary from using Australia as an exporter to markets in third countries (that is neither Australia nor the domicile of the parent company).

Another good example which violates other conditions was AXA SA, a French insurance company that wanted to take over National Mutual. A condition was that AXA would generate its Asian business through National Mutual as the vehicle. National Mutual had been making inroads into the Asian markets. Very soon new moves into Asia were undertaken instead by the parent AXA SA and that remains the case. Axa Australia's operations are largely confined to Australia.

We recommend that competition and concentration issues be taken on board in assessing foreign investment proposals.

The imposition of conditions on foreign investors

From the outside we cannot know all of the conditions foreign investors have had to agree with. However, we do know that many high profile takeovers have had conditions imposed but the foreign companies ignored them. This makes it a good time to examine the record of the FIRB and especially the FIRB's record on monitoring the compliance with conditional foreign investment approvals and what happens when conditions are not met. In 1976 the FIRB was established in part 'to keep in touch with their [foreign-controlled companies] activities' according to the then Treasurer, Phil Lynch. However, the suggestion of a strong monitoring and compliance role for the FIRB is something that was never seriously pursued.

Senator Don Chipp, the first Leader of the Democrats, never stopped complaining about the lack of a capacity to follow up FIRB decisions in the 1970s and 1980s. There was simply no provision for any sanctions for non-compliance by foreign companies. For example, early on Australian foreign investment policy included guidelines for the appropriate level of foreign equity for different industries. The FIRB was understandably willing to recommend proposals which did not meet the guidelines provided that the foreign investor agreed to allow additional Australian participation in the future. Often the foreign investor was asked to commit itself to a certain timetable for achieving agreed levels of Australian equity. However, once the commitment was obtained and approval given there was no mechanism for ensuring compliance with the commitment and withdrawing approval—it would normally be too late to do anything. Nor is there any evidence that the FIRB seriously monitored its decisions. Most of the decisions were secret but some of the major decisions have been released over the years.

We know of no example where a decision has been revoked because conditions were violated. Nor are there any cases where other sanctions were imposed for non-compliance. Arguably the government simply does not have the appropriate sanctions at its disposal. Even so, the corporate advisors who specialise in foreign investment would know that the history shows many conditional approvals and the absence of any sanctions in the event of violations. We mentioned the example of Axa which got away without sanctions despite violating the conditions associated with approval.

The only hope of ensuring compliance seemed to be the threat of not allowing future investments which require approval. An example was foreign-owned broking firm Wigham Poland Australia Pty Limited (WPA) which had agreed to increase its Australian shareholding from 15 to 50 per cent within two years but did nothing and the government took no action. However, in 1982 the Government prevented it acquiring H.S. Harvey Pty Limited and gave

WPA a further 90 days to 'provide WPA with the opportunity to re-assess the introduction of Australian equity'. It seems that there was very little else that the Government could do to enforce its guidelines apart from waiting for a new application by the same company, if it ever came. But the failure to enforce conditions did not stop the Government approving takeovers subject to various conditions.

CRA, now Rio Tinto Australia, is another good case study. CRA, whose initials had stood for ConZinc Riotinto of Australia, had been concerned to 'Australianise' or reach 50 per cent Australian ownership under the then policy in order to make investments that complied with the FIRB guidelines. The then chair and managing director, Sir Roderick Carnegie, promised CRA would reach 50 per cent 'as fast as we can' and in 1979 CRA announced that the Government was granting it 'naturalising' status. Of course CRA took advantage of its 'naturalising' status with investments in the Ashton diamond joint venture agreement, and the takeovers of Australian Biotechnological Holdings Pty Ltd and Techno-Proteins Pty Ltd. The actual agreement and the timetable for 50 per cent Australian ownership was not made public but today Rio Tinto, the successor company, remains more foreign-owned than it was in the 1970s and has well and truly outlasted the 'naturalising' policy. As far as we can tell it never abided by any conditions and got what it wanted anyway.

Various contrivances were used to get around the formal FIRB Australian ownership guidelines and often the companies involved successfully stared down the Treasurer of the day. An example was provided by the Yeelirrie uranium arrangement which provided for 75 per cent ownership by Western Mining Corporation (WMC). However, 35 per cent of the capital costs for which WMC was responsible was to be provided by Esso which, in return was to receive an additional 35 per cent of the output. This arrangement with Esso effectively circumvented the then 75 per cent Australian equity guidelines for uranium projects as Esso was to control 50 per cent of the project and market 50 per cent of the output. The then Treasurer, John Howard, effectively turned a blind eye and admitted the project 'would not fully meet the requirements for 75 per cent Australian equity and Australian control,' but nevertheless granted approval.

These examples show how companies were able to flout any agreements they made with the government in order to gain foreign investment approval. Arguably governments eventually understood this. In 2001 Shell was involved in a landmark decision by Peter Costello the Treasurer under the Howard Government. Shell attempted a hostile takeover bid against Woodside Petroleum Ltd that raised a good deal of debate in Australia. Shell was and still is a major gas producer with projects all over the world. That was an issue since the commercial imperative for Shell did not necessarily coincide with Australia's interests. Press reports at the time suggested the Government was considering conditional approval subject to fairly strict conditions including reducing Shell's eventual holdings to 56 per cent and establishing a new company to undertake the marketing of North West Shelf gas reserves.

Ultimately the Treasurer rejected the Shell bid on national interest grounds and said it was not possible to put 'enduring conditions' in place that would be enforceable. This was historic being the first recorded instance of a Treasurer admitting to the problems of imposing conditions on an approval and the inability to monitor and enforce any such conditions. Peter Costello effectively conceded Don Chipp's accusations decades earlier.

We recommend the Committee note the lack of any monitoring of, or sanctions for, violating the conditions imposed on foreign investors. That lack of sanctions needs to be remedied.

We further recommend the government develop a set of sanctions in varying degrees of severity and that they be applied in proportion to the severity of any actual breaches that take place.

The extent to which the risk that foreign investment proposals are being used for money laundering is examined

We have nothing to say under this heading. However, money laundering operations are unlikely to be substantial and so would come in under the present thresholds for examining proposed investments. If this is an issue there may be a case for police checks on proponents of foreign investments.

The role of the Foreign Investment Review Board

We have noticed the role of the FIRB has shrunken over the years. For example, in the earlier years the Annual Reports used to contain extensive discussions of the extent of foreign investment, its sectoral composition, its role in the economy and recent developments. The extent of foreign ownership and the like were also discussed. However, when we fast forward to the present the FIRB annual reports deal only with some of the administrative data generated by reportable applications and the decisions made. However, one matter remains unchanged; there is still no discussion of any compliance activity and we can only assume there is not any taking place.

We are also concerned that the bias of the FIRB (who are not alone) is that anything that business says is good. To some extent that is inevitable given the membership of the board. The board is composed of the following people:

David Irvine (Chair) who has an intelligence background as head of both ASIO and ASIS,

Teresa Dyson former partner at Ashurst and Deloitte advising on corporate matters,

Alice Williams senior management and board level experience in the corporate and government sectors,

Mr David Peever former Managing Director of Rio Tinto Australia, former Vice Chairman of the Minerals Council of Australia and former Director of the Business Council of Australia and currently Chairman of the Brisbane Airport Group of Companies,

Hon. Cheryl Edwardes, a solicitor by profession, former Minister in the Court Government has executive roles with business,

Nick Minchin former Coalition Leader of the Government in the Senate,

Margaret (Meg) McDonald experience in senior public and private sector roles Chief Operating Officer of the Clean Energy Finance Corporation; CEO of Low Carbon Australia Limited (LCAL),

Mr Roger Brake, Executive Member as the Division Head of Treasury's Foreign Investment Division.

So apart from the ex officio member, Roger Brake, the board is basically homogeneous with a business background or conservative political background. The exception is the former head

of both ASIO and ASIS. Paul Keating made the comment that Australia's spy bosses are 'nutters' running foreign policy (Greene 2019). At the very least we note that funding for the intelligence community is likely to reflect concerns about foreign influences in Australia as described by the intelligence community. The exercise of soft power on the part of the US goes unnoticed and unremarked while the same on the part of China...

The business background of the majority of the board is also a concern. Big business leaders are unlikely to have the same feel for the 'national interest' as community leaders in other pursuits. Policy positions by the Business Council of Australia (BCA) favour foreign investment and something like half the BCA membership are foreign-owned businesses.

We might that the political members hardly represent a bipartisan or independent perspective. Instead those members point to the nature of the government that appointed them and hardly engender community trust in the decisions of the board.

We recommend the structure of the board be reconsidered to better reflect the wider community. In particular there should be strong representatives from people from other backgrounds who also have legitimate perspectives on Australia's national interest.

Conclusions

Foreign investment raises a number of issues that need to be rethought in Australia. Some decades ago, we seemed to have a better appreciation of the prospects and pitfalls associated with foreign investment. By contrast the pendulum has swung fully in the opposite direction and we seem to have adopted a fairly uncritical approach to foreign investment which is unlikely to reflect Australia's national interest. We have made several recommendations in this submission designed to improve the foreign investment approval process to better reflect the national interest.

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