

Business
Council of
Australia



Discussion Paper on
Foreign Investment and
State-owned Enterprises:
Managing the Risks to
Maximise the Benefits

AUGUST 2014

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The Business Council of Australia (BCA) is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this discussion paper

This paper discusses Australia's foreign investment environment and policy settings in relation to foreign and state-owned enterprises (SOEs).

The paper is designed to inform the Forum on Chinese State-owned Enterprises and Global Investment, jointly held by the BCA and the Australian National University (ANU) on 29 August 2014. The forum will explore what needs to be done to maintain Australia's competitiveness as an investment destination, recognising the changing global landscape and the rise of SOEs as an important source of capital.

It also recognises the need for an investment regime that can build community confidence in foreign direct investment (FDI) and the many benefits it brings to Australia.

The paper draws on the findings of a report commissioned by the BCA and undertaken by KPMG and the University of Sydney, titled *Demystifying SOE Investment in Australia*. The report assesses the role played by SOEs in global direct investment, including the motivations and behaviour of Chinese SOEs investing in Australia.

This discussion paper sets out an analysis of contemporary issues and the range of policy options – including potential changes to Australia's foreign investment policy settings – that may be available to address them.

What is a state-owned enterprise?

While there is no consensus on the definition of an SOE, they are often defined as enterprises comprising parent enterprises and their foreign affiliates in which the government has a controlling interest (full, majority, or significant minority).

The United Nations Conference on Trade and Development (UNCTAD) 2013 World Investment Report defines government control as a stake of 10 per cent or more of the voting power, or where the government is the largest single shareholder.

The Foreign Investment Review Board (FIRB) uses a 15 per cent benchmark for aggregate government interest from a single foreign country to define an SOE, or 40 per cent for aggregate interest from governments from more than one foreign country.

Key points

The importance of foreign investment

- ▶ Australia has always relied on foreign investment to build our economy. Attracting foreign investment will continue to be essential to underpin our lifestyles into the future. Since 2001, foreign investment as a share of new investment has increased markedly, averaging about 40 per cent and in some years has reached 60 per cent. As of 30 June 2013, the stock of foreign investment in Australia at \$AUD2.46 trillion accounted for just over 50 per cent of Australia's total capital stock of \$AUD4.82 trillion.

SOE investment is increasing

- ▶ The global sources of foreign direct investment is changing, and state-owned enterprises are an increasingly large proportion of the pool of available global capital. In 2013, SOEs invested \$US160 billion internationally, representing 11 per cent of global foreign direct investment flows, despite making up 1 per cent of total transnational corporations.

SOE behaviour: Is it changing?

- ▶ In the past, concerns have been raised over the potential for an SOE's home government to direct the SOE to undertake non-commercial activity in the countries they invest in. Things have changed, although to varying degrees.
- ▶ The report commissioned by the BCA and prepared by KPMG and University of Sydney found that in the view of some SOEs, current FIRB investment screening rules for SOEs are overly restrictive compared to investors from other countries and investment approvals should be decided on commercial merits, not on ownership.
- ▶ The report also found that major Chinese SOEs active in Australia are increasingly commercially motivated and behave like other private sector companies. Chinese SOEs are learning from past experience and adapting their approach to suit Australian market conditions. The report found that they are increasingly displaying:
 - compliance with the same domestic laws and regulations that apply to all companies in Australia
 - employment of Australian executives and appointing Australian board members
 - using professional services companies, including Big Four auditors, to improve their operations in Australia
 - working to integrate themselves with local communities.
- ▶ Maintaining the status quo on SOE investment policy risks Australia missing out to competitor countries who are increasingly more adept at attracting these new sources of capital.

Challenges of reforming the investment regime

- ▶ There are three overarching challenges for Australia in reviewing its investment policy:
 - The need to ensure that we are a world-leading destination for foreign capital and that we do not have a gap with competitor countries when it comes to attracting SOE investment.
 - The desire for Australian companies to engage and compete against foreign companies and SOEs on similar commercial terms.
 - Managing the perceived and real risks associated with SOE investment.

Options for reform

- ▶ This paper identifies a range of options reflecting trade-offs between encouraging foreign investors on the one hand and satisfying concerns within the community on the other hand – while at all time sending out a signal that Australia is open for business.
- ▶ Failure to manage these three overarching challenges appropriately could be detrimental to Australia as a nation, and could affect our level of infrastructure, jobs and future prosperity.

The options

There are a range of sensitivities and complexities associated with foreign investment by SOEs in Australia. A discussion of relevant issues and the trade-offs involved would benefit policy deliberations. To assist with this, the BCA has prepared this discussion paper, which outlines a range of options. These options provide for varying degrees of liberalisation; however, they should not necessarily be viewed as mutually exclusive. Some of the options could be packaged together and used to raise community confidence.

Domestic Regulation Model: Remove the FIRB screening regime and strengthen domestic laws to ensure SOEs operating in Australia behave like private enterprises.

FTA Model: Provide SOE investors the same treatment as foreign private investors under a free trade agreement (FTA). The FIRB screening threshold would be raised to \$1.078 billion.

Private Enterprise Model: Provide SOE investors with the same treatment as foreign private investors and raise the threshold for SOEs to the existing general threshold for private enterprise (\$248 million).

Historical Accreditation Model: Establish an accreditation scheme that operates in parallel with current FIRB processes, and provide SOEs who have a proven track record of investing in Australia with the same investment thresholds afforded to foreign private enterprises (\$248 million).

Operational Accreditation Model: Establish an accreditation scheme that operates in parallel with current FIRB processes, and assess SOEs against operational criteria guided by standards expected of private enterprises operating in Australia. Once awarded accreditation, the SOE would be afforded the same threshold as a foreign private enterprise (\$248 million).

Minimalist Model: Raise FIRB's screening threshold for SOEs by a small amount (\$54 million). The amount reflects the same screening investor threshold for foreign commercial real estate by a foreign private individual investor.

Existing Model: Maintain the status quo. Screen all SOE investments.

Introduction

Australia is falling behind in the race for capital

Australia's investment regime is one that welcomes foreign investment as being overwhelmingly in the national interest.

Like many other countries, we maintain a screening process to ensure our national interests are protected. Screening is an important factor in maintaining community support for foreign investment.

Australia, as other countries are doing, needs to respond to the rise of state-owned enterprises as sources of foreign direct investment while recognising opportunities this development offers us. We need to respond in a way that ensures our foreign investment regulatory regime and broader business environment continue to make us an attractive investment destination.

The BCA identified foreign capital as a one of the keys to improving its international comparative advantage. Significant capital would be required to improve our productivity and efficiency in sectors such as mining, agriculture, education and tourism. Foreign capital is necessary to be global leaders.

Australia is losing ground to others in the global race for capital. In 2013, the United States replaced Australia as Chinese investors' most preferred destination of investment by flow. In 2013, the US attracted 17 per cent of Chinese investment while Australia attracted 8 per cent. Australia now ranks behind the US but ahead of Canada, Brazil and Britain. Our competitors already recognise that foreign capital flows are changing, and increasingly the sources are coming from SOEs.

SOEs by their design are different to private enterprise and Australia has more stringent screening in place for SOEs. Our existing SOE investment policy was designed in part to address the commercial sector's preference to deal with companies they know are comparable, and operate under the same predictable behaviour.

SOEs are becoming more commercial

This screening does need to recognise that many SOEs have become more commercially focused and have demonstrated investment behaviour similar to other foreign investors. However, this view is not universally supported.

Recognising these developments, and that uncertainty remains, it is appropriate to consider how and whether adjustment to Australia's foreign investment policy is warranted.

We also need to continue to recognise and manage any ongoing risks associated with the operation and governance of SOEs investing in Australia. If we do not adopt a risk management mindset with SOEs, and continue to rely on the existing FIRB screening regime to satisfy community concerns, we run the risk of losing out on the opportunities these new sources of capital provide.

A risk management approach is key

Australia can adjust its investment settings to maintain its attractiveness as an investment destination in a way that recognises the changing behaviour of some SOEs and provides the community with confidence that risks are managed.

This paper examines these challenges and proposes a range of options for updating Australia's foreign investment policies in relation to SOEs. Whatever path we choose, it must be carefully designed to serve Australia's long-term interest and manage both the risks and benefits of SOE investment.

The importance of foreign investment

Australia was built with foreign investment.

Throughout Australia's history we have relied on foreign investment to expand our economy to develop our key economic sectors, particularly where domestic capital markets have been unable to fund good investment opportunities. In the second half of the 1800s, around 35 per cent of Australian new capital investment was financed from abroad, and in the 1880s this share reached as high as 50 per cent. Since 2001, foreign investment as a share of new investment has increased markedly, averaging about 40 per cent and in some years has reached 60 per cent.

Australia's iron ore industry, our largest export commodity worth \$69 billion in 2013 and producing one in five of our export dollars, would not have been developed without investment from US and Japanese capital, including from companies like Mitsui and Marubeni, underwriting the massive up-front development costs of the industry in the mid-1960s.

Australia continues to have considerable need for investment in infrastructure and in our export sectors that cannot be met from domestic savings alone. Significant amounts of capital will be required in sectors where Australia enjoys a comparative advantage in order to improve our productivity and efficiency and enable us to succeed in global markets – for example, in mining, agriculture, education and tourism.

Some \$760 billion in physical infrastructure investment will be needed in the next decade alone for roads, railways, ports, airports, water, communications and energy services. And \$600 billion in capital investment in Australian agriculture will be required through to 2050 to facilitate a step-up in production growth in the agriculture sector.

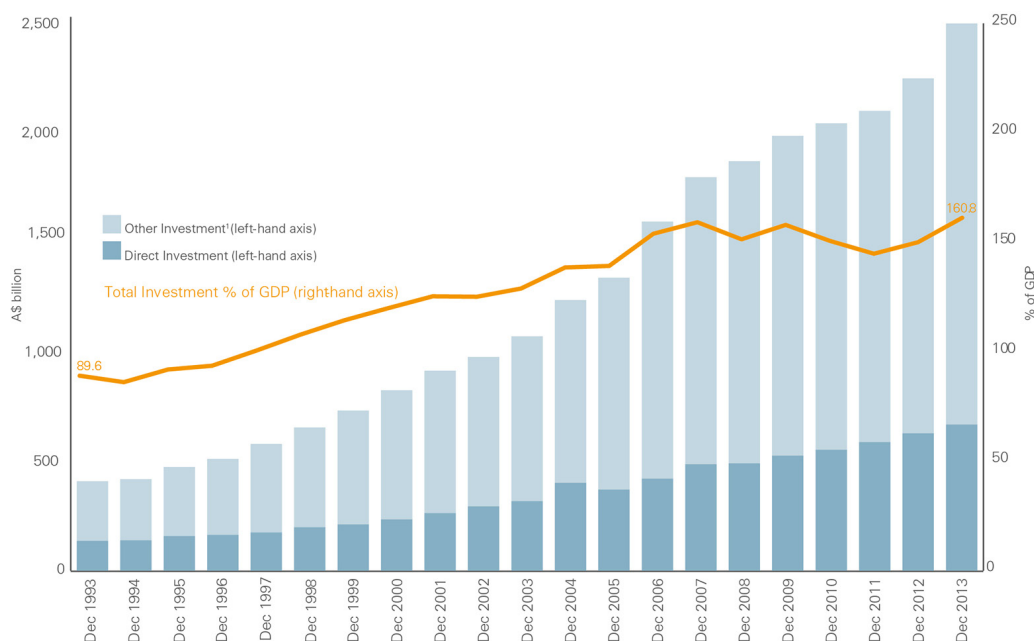
Large amounts of capital will also be needed in sectors where Australia has latent potential, where on the basis of our endowments we are a contender but are not yet a globally competitive, for example, in food manufacturing and selected specialised value chains.

Foreign investment is essential to this development and to enhancing our comparative advantage internationally.

Australia's domestic capital markets alone are unlikely to be able to fund these requirements. As we have done in the past, we will need access to foreign capital.

In a global economy where more countries are competing for investment, Australia must ensure it does what it can to remain at the front of the pack as an attractive destination for capital that is increasingly mobile and looking for the best risk-weighted returns.

Figure 1: Foreign investment stock in Australia



Source: Austrade, *Why Australia* Benchmark Report, June 2014 Update

Figure 2: Stock of foreign direct investment in Australia by economy

	2007	2008	2009	2010	2011	2012	Share %	CAGR % 2007-12	Change % 2011-12
USA	100.9	99.9	98.2	112.1	117.8	131.3	23.9	5.4	11.4
UK	62.4	59.6	61.5	54.9	70.2	79.4	14.4	4.9	13.1
Japan	31.1	36.7	45.6	51.1	54.1	61.2	11.1	14.5	13.1
Netherlands	24.8	19.2	32.4	30.1	32.9	32.3	5.9	5.4	-1.8
Singapore	14.2	10.4	16.7	18.8	20.0	23.8	4.3	10.9	19.2
Switzerland	16.4	19.5	17.8	20.9	22.9	22.5	4.1	6.6	-1.6
Canada	7.2	7.3	12.2	14.9	19.0	21.2	3.9	24.0	11.8
Virgin Islands, British	np	np	np	np	np	19.2	3.5	na	na
China	np	3.6	9.1	12.9	14.4	16.7	3.0	46.4	16.2
Germany	19.8	15.5	18.1	16.8	14.1	13.6	2.5	-7.2	-3.4
France	12.6	12.9	13.0	13.0	7.2	7.6	1.4	-9.7	5.4
Hong Kong	7.2	9.1	5.4	6.6	7.6	7.3	1.3	0.2	-3.9
Bermuda	5.6	5.8	9.7	7.9	6.3	6.4	1.2	3.0	1.5
Belgium	2.9	5.2	5.6	6.2	6.2	6.1	1.1	16.0	-2.6
Malaysia	np	np	4.5	3.7	np	5.7	1.0	na	na
New Zealand	7.8	5.6	6.2	6.4	5.3	4.3	0.8	-11.3	-19.3
Luxembourg	np	np	3.2	1.5	3.4	4.3	0.8	na	24.5
South Korea	np	1.0	1.3	2.1	np	2.1	0.4	na	na
Sweden	1.7	1.7	1.3	1.7	1.5	1.6	0.3	-0.9	4.1
India	np	0.1	np	np	np	1.3	0.2	na	na
Total all countries	396.9	396.0	441.2	472.6	506.1	549.6	100.0	6.7	8.6

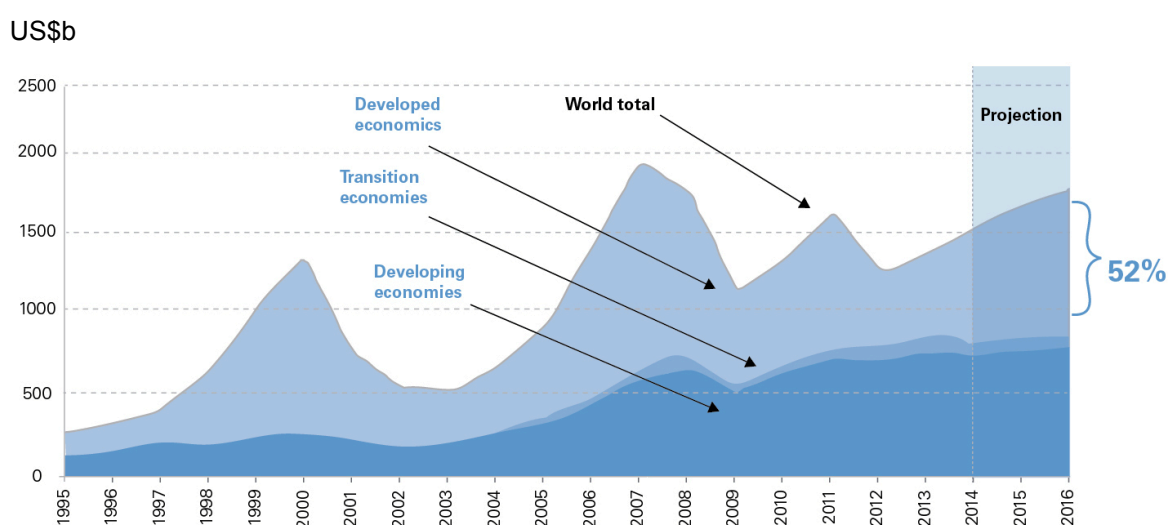
Source: Austrade, Data Alert, 22 May 2013

SOE investment is increasing

As the world's economic centre of gravity shifts from the United States and Europe towards Asia, global capital markets are also going through a major transformation, with SOEs becoming increasingly important sources of funds.

For the first time in modern history, developing countries now absorb more foreign direct investment than developed countries¹ and there is a growing trend that will make them the larger source of outbound foreign direct investment than developed countries.

Figure 3: FDI inflows, global and by group of companies, 1995–2013 and projections, 2014–16



Source: *UNCTAD World Investment Report 2014*

With Asia's combined economy forecast to surpass that of the US and Europe combined in less than two decades,² this trend in global capital markets is likely to be maintained.

SOEs are making up an increasingly significant proportion of the global capital pool. Together they have over \$2 trillion worth of assets invested globally, and in 2013, it was estimated that they invested a total of \$US160 billion. Despite representing 1 per cent of all transnational corporations in 2013, SOEs represent over 11 per cent of global FDI flows.

Foreign SOEs – including from Japan, South Korea, Singapore, Malaysia and Qatar – have a history of investing in Australia. Over the last decade, there has been a significant increase in Chinese SOE investment in Australia, with SOEs accounting for nearly 90 per cent of \$20.8 billion of total Chinese investment in Australia.

1. UNCTAD World Investment Report 2013.

2. IMF Survey Magazine, 29 May 2014.

While China is Australia's largest trading partner, Chinese investment stock in Australia is still relatively small, accounting for only 3.3 per cent of the total stock of FDI in Australia (compared with the United States at 24 per cent and the United Kingdom at 14 per cent). The Chinese Government has committed publicly to increase its overseas investment, and is expected to transfer between \$500 billion and \$750 billion abroad over the next five years.

Top five destinations for accumulated Chinese investment 2005–2013 (US\$ million)

Country	Total value 2005–2013	Global share (%)
USA	59,900	13%
Australia	57,250	12%
Canada	37,650	8%
Brazil	29,180	6%
Britain	18,530	4%

Source: The Heritage Foundation China Global Investment Tracker Dataset 1

In 2013, the United States attracted 17 per cent while Australia attracted 8 per cent. Australia now ranks behind the United States but ahead of Canada, Brazil and Britain.

Top five destinations for Chinese investment 2013 (US\$ million)

Country	Total Value	Global share (%)
USA	14,550	17%
Australia	7,130	8%
Guinea	5,950	7%
Kazakhstan	5,300	6%
Russia	5,170	6%
Global total	84,450	

Source: The Heritage Foundation China Global Investment Tracker Dataset 1

Australia's foreign investment policy

All foreign investors, regardless of origin, must abide by Australia's laws and regulations and pay appropriate amounts of tax in accordance with our system of taxation. Most foreign investors want to be seen as good corporate citizens and most operate in accordance with our laws.

Like many other countries, Australia reviews foreign investment proposals. Investment screening by the FIRB helps give confidence to the community that foreign investment is in the national interest.

For non-sensitive areas, a privately owned foreign investor needs to notify the FIRB and obtain prior approval before acquiring a substantial interest (i.e. where the interest exceeds 15 per cent) in a corporation or control of an Australian business that is valued above \$248 million. For the United States and New Zealand companies (and soon Japan and Korea) the general threshold for their investment is \$1.078 billion.

For the so-called ‘prescribed sensitive sectors’, which include, among others, media, telecoms, airports, ports, the manufacture of military equipment and encryption and security technologies, either different thresholds or specific legislation applies in respect to the foreign investment.

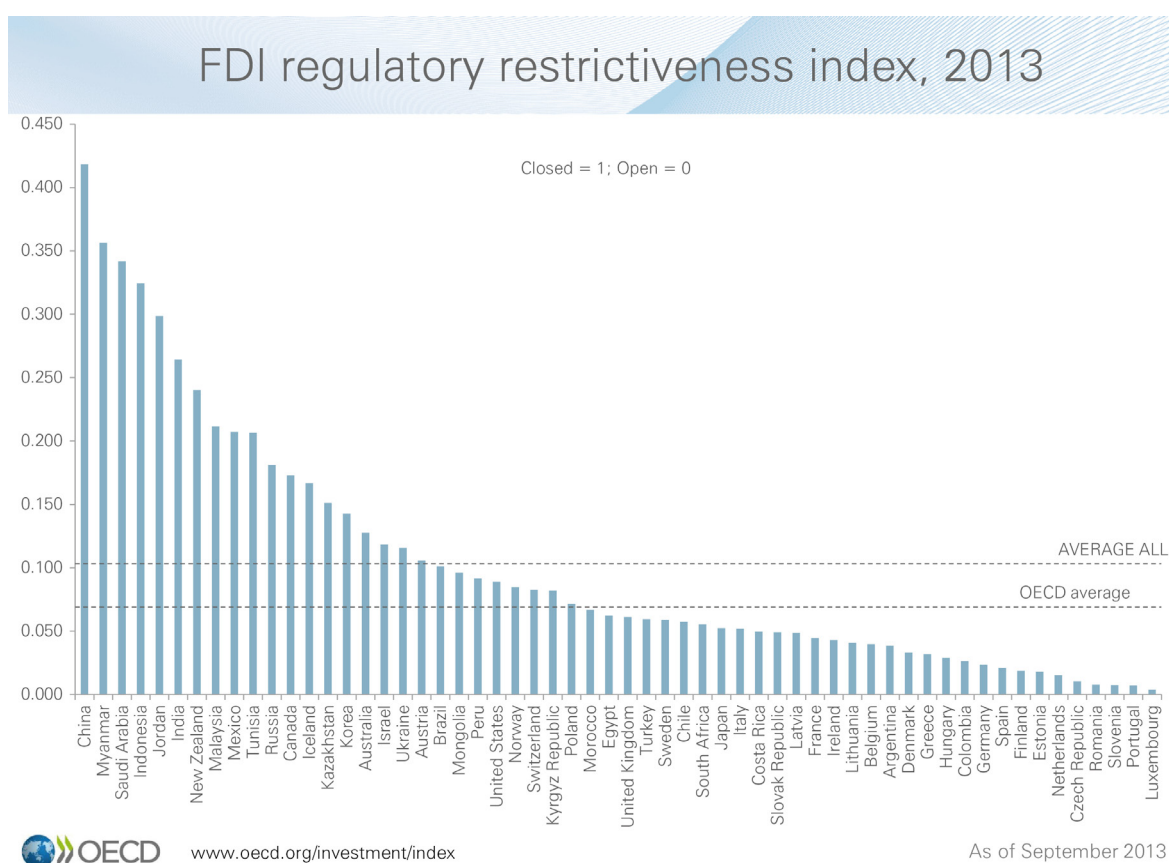
Under current policy arrangements, all foreign government investors – which includes sovereign wealth funds and SOEs – must obtain approval regardless of the value of the investment. In considering these proposals the government considers factors such as whether investors operate fully at arm’s length and on a commercial basis when it applies the national interest test.

International competition for foreign investment is rising

Australia is not the only country seeking foreign capital.

The B20 reported that at least \$US57 trillion is needed globally by 2030 to fund physical infrastructure investments alone, but on current trends approximately \$US20 trillion will remain unfunded.

Figure 4: FDI Regulatory restrictiveness index, 2013



Source: OECD Investment Index

Competitors have adopted different settings to attract international investment. The US in 2013, replaced Australia as the preferred destination of Chinese investment. Canada decided to raise unilaterally its screening threshold for private investment from C\$354 million to C\$1 billion over the next four years, and set their SOE screening threshold at \$330 million.

Failure to respond to the moves our international competitors are making to position themselves to take advantage of the rising pool of SOE foreign investment capital will simply result in the capital flowing to other countries at the expense of our economy.

The United Kingdom has also shown a recent willingness to embrace SOEs and sovereign wealth funds, including in several areas of critical infrastructure. In late 2011 and early 2012, Chinese and Abu Dhabi sovereign wealth funds separately acquired a combined 18.6 per cent stake in the parent company of the United Kingdom's largest water and sewage company, Thames Water, which services 14 million people.

In 2012, the same Chinese sovereign wealth fund took a 10 per cent stake in the parent company of Heathrow Airport, joining a Singaporean sovereign wealth fund on the list of owners. And in 2013, the UK approved two Chinese SOEs to take stakes in a nuclear power station project in western England, which is expected to supply seven per cent of the United Kingdom's electricity needs by completion in 2023. And the UK has recently welcomed Chinese SOE investment in a high-speed rail project.

The UK's experience demonstrates possible pathways for public acceptance of foreign government investment in key parts of a host country's economy.

SOE behaviour: Is it changing?

The BCA commissioned a study by KPMG and University of Sydney on SOE investment in Australia. This study drew on a sample of 58 Chinese SOEs who combined have invested \$52.26 billion across 122 deals in Australia, and of this group it collected information from various sources including surveys on 23 of these SOEs. The report found that in the view of some SOEs, current FIRB investment screening rules for SOEs are overly restrictive compared with other countries, and this is threatening Australia's attractiveness as a destination for investment. It also found that the majority of Chinese SOE executives feel welcome to invest in Australia; however, they feel Australia is more welcoming to investors from other countries than to Chinese investors.

The KPMG report found that major Chinese SOEs active in Australia were commercially focused and having similar investment motivations to other foreign investors. The companies looked for profitable growth, access to new customers, growth beyond their home markets, and securing reliable, high-quality natural resources for their own economic development objectives.

Indicators for comparison: Foreign investment screening thresholds

Countries	SOE screening threshold	General threshold for private companies	Other relevant requirements
Australia	From \$0	From \$248 million	Proscribed sensitive sectors
United Kingdom	No screening	No screening	Resident UK director requirement
Singapore	No screening	No screening	Ownership limits on sensitive sectors
United States	No threshold	No threshold	National security and anti-trust review
Canada	From \$C330 million	From \$C354 million rising to \$1 billion over 4 years	Excluded sectors – tar sands industry
New Zealand	From \$NZ100 million	From \$NZ100 million	Publishes data regularly

Chinese SOEs are learning from past experience and adapting their approach to suit Australian market conditions. They were increasingly displaying:

- compliance with the same domestic laws and regulations that apply to all companies in Australia
- employment of Australian executives and appointing Australian board members
- using professional services companies, including Big Four auditors, to improve their operations in Australia
- working to integrate themselves with local communities.

While there is some public record of a small number of high-profile legal disputes between shareholders and there may be isolated examples of orderly negotiations with Treasury/FIRB, ASIC, ASX, APRA, ATO, EPA, industrial relations and various authorities, the report found that to date there is no record of major public scandals involving illegal activities including fraud, tax evasion, environmental pollution or work safety breaches that have involved Chinese SOEs in Australia.

Do Chinese SOEs comply with domestic laws?

To keep pace with our international competition, and continue to attract foreign investment to Australia, potential exists to make greater use of existing 'behind-the-border' measures to shape behaviour of SOEs to be more commercially focused. Domestic laws and regulations that apply to all companies operating in Australia generally operate well and are robust in regulating behaviour domestically. These will certainly build confidence in the community.

Issues relating to competition and fair trading by all businesses in Australia are managed by the Australian Competition and Consumer Commission (ACCC), which is responsible for enforcing the Competition and Consumer Act 2010 (formerly the Trade Practices Act 1974).

The study by KPMG and the University of Sydney found that while Chinese SOEs do tend to access loans from China's policy banks, SOEs are increasingly using overseas financing for their foreign investment activities as these are more competitive than accessing domestic funding. The study noted CNOOC relied on a consortium of foreign and Chinese bank funding on commercial terms to purchase Canadian company Nexen in 2013, and Chinese SOE Bright Food Group had used overseas borrowing and overseas syndicated loans and bonds to take advantage of cheaper funding in international capital markets.

The Australian Taxation Office has responsibility for managing issues relating to transfer pricing, to ensure that goods are sold offshore at market prices. This prevents companies underpaying Australian tax by requiring companies to price related party international dealings according to what truly independent parties acting independently would reasonably be expected to have done in the same situation.³

Australia has a robust anti-dumping regime, administered by the Anti-Dumping Commission, to prevent international companies undercutting domestic business through selling at lower-than-cost prices.

SOEs listed on the ASX have to abide by Australian listing requirements, and SOEs in certain industries – in the financial services sector, for example – are regulated by specific regulators, such as APRA.

Similarly, SOEs must comply with Australia's domestic requirements on environmental approvals, migration and industrial relations.

As the study by KPMG and the University of Sydney highlights, provided a willing vendor is prepared to sell a controlling share in the investment and the SOE investment is approved by shareholders and regulators and subject to ongoing compliance with laws and regulations, including ASX minority shareholder protections, then SOEs controlling Australian companies and projects should not create concerns.

We need to recognise the importance of all companies operating in Australia playing by the same rules domestically. This ultimately means ensuring that SOEs investing in Australia operate in a commercial fashion.

Changes to foreign investment rules must be proportionate to the risks present and not compromise Australia's competition law and policy regulations.

We need to accept there may be some risks associated with the operation and governance of SOE investors in Australia, and acknowledge these risks are manageable. If we do not adopt a risk management mindset with SOEs, and continue to rely on the existing FIRB screening regime to satisfy community concerns, we run the risk of losing out on the opportunities these new sources of capital provide.

3. Australian Taxation Office, 'International Transfer Pricing: Introduction to Concepts and Risk Assessment', viewed 9 July 2014, <<https://www.ato.gov.au/Business/International-tax-for-businesses/In-detail/Transfer-pricing/International-transfer-pricing---introduction-to-concepts-and-risk-assessment/>>.

Options for adjusting Australia's investment policy settings that apply to SOEs

A range of options exist across the spectrum when it comes to considering foreign investment proposals from SOEs.

At one end of the spectrum is the option to substantially liberalise investment approval requirements either by removing the requirement for FIRB screening altogether or requiring FIRB notification and Treasurer approval on only the largest proposals, for example those above a \$1.078 billion threshold.

At the other end, an option exists to retain more restrictive policy settings with all investment from SOE's required to be notified to FIRB regardless of value and approval sought from the Treasurer.

Between these two extremes, options exist to set different investment value thresholds or pursue other approaches that reward or incentivise good commercial and corporate governance behaviour. These latter options could involve various screening dispensations to SOEs with a proven track record. Options also exist to introduce an accreditation process.

As with most policy decisions, these options reflect trade-offs between encouraging the interests of foreign investors on the one hand and satisfying legitimate concerns within the community on the other hand – while at all times sending out a signal that Australia is open for business.

There are a range of sensitivities and complexities associated with foreign investment by SOEs in Australia. A discussion of relevant issues and the trade-offs involved would benefit policy deliberations. To assist with this, the BCA has prepared this discussion paper outlining the following range of options. These options provide for varying degrees of liberalisation; however, they should not necessarily be viewed as mutually exclusive. Some of the options could be packaged together and be used to raise community confidence.

The options

1. **Domestic Regulation Model:** Remove the FIRB screening regime and strengthen domestic laws to ensure SOEs operating in Australia behave like private enterprises.

Purpose: To use domestic laws to regulate SOE behaviour and build confidence that SOEs are operating like commercial enterprises.

This option would require abolishing all FIRB screening thresholds and rely on domestic laws as the primary tool to regulate SOE behaviour. It would require a review of existing laws to ensure domestic provisions were sufficiently robust to mitigate any potential risks raised by foreign investment from SOEs and private investors. This option potentially would require new anti-trust and transfer pricing laws to provide the level of confidence to the community. It would represent a very significant liberalisation of existing foreign investment policy.

2. **FTA Model:** Provide SOE investors with the same treatment as foreign private investors under an FTA. FIRB screening threshold would be raised to \$1.078 billion.

Purpose: To increase foreign investment from SOEs to the same level afforded to the United States and New Zealand SOEs. The maximum level accepted by the community.

This seeks to raise the SOE FIRB screening threshold to the highest level to encourage the maximum level of investment the community is willing to accept in Australia. This would also represent a very significant liberalisation of Australia's existing foreign investment policy. The FTA negotiated SOE threshold agreed between Australia and the United States and New Zealand (and soon Japan and Korea) are a guide on the level of risk a community is willing to accept with respect to foreign SOE investment. Raising the SOE threshold to this amount would reduce the proportion of the economy subject to foreign investment screening. If this solution is adopted, however, it will impact on arrangements with bilateral FTA partners.

3. **Private Enterprise Model:** Provide SOE investors with the same treatment as foreign private investors and raise the threshold for SOEs to the existing threshold for foreign private enterprises (\$248 million).

Purpose: To increase foreign investment from SOEs to the same level afforded to SOEs in general. This threshold represents the maximum level the community is willing to accept from non-FTA partners.

This proposal raises the FIRB screening threshold for SOEs from zero to the general screening threshold for foreign private investors. It presumes that SOEs are already operating like private enterprises, and does not distinguish between foreign investment on the basis of ownership. This would represent a material liberalisation of foreign investment policy settings.

4. **Historical Accreditation Model:** Establish an accreditation scheme that operates in parallel with current FIRB processes, and provide SOEs who have a proven track record of investing in Australia with the same investment thresholds afforded to foreign private enterprises (\$248 million).

Purpose: To provide SOEs who have operated in Australia over a period of time with the same level of treatment as private enterprises.

This option proposes to differentiate SOEs on the basis of their track record of investment domestically. SOEs which demonstrate a proven track record of investment in Australia, would be afforded the same FIRB screening threshold as other private enterprises.

It presumes that if an SOE has acted consistently with its commercial interests in the past, it will continue to act in a similar way in the future.

Under this proposal, SOEs that demonstrate a proven track record (which may be defined by a range of criteria including the amount of investment made in Australia over a designated period of time) would be treated like foreign private enterprise in Australia.

Defining the criteria of a proven track record would need to be debated. But once the criteria was fulfilled, an SOE would automatically receive accreditation. Accreditation would provide SOEs with the same FIRB screening investment thresholds as private enterprises.

5. **Operational Accreditation Model:** Establish an accreditation scheme that operates in parallel with current FIRB processes, and assess SOEs against operational criteria guided by standards expected of private enterprises operating in Australia. Once awarded accreditation, the SOE would be afforded the same threshold as a foreign private enterprise (\$248 million).

Purpose: To provide SOEs who meet a defined standard of behaviour with the same level of treatment as private enterprise.

Similar to Option 4, it proposes to differentiate SOEs on the basis of behaviour. However, instead of granting accreditation based on a proven track record, it seeks to test SOEs against a range of behavioural indicators.

Like a license system, if an SOE meets a range of indicators, it would be granted accreditation.

This could potentially allow new SOE investors to be treated on the same footing as past SOE investors, if they met predefined criteria.

The granting of accreditation would need to be managed by an independent arbiter, and potentially a government agency like the FIRB. It would require a level of judgement on whether an SOE's transparency, commercial objective or corporate governance resembled that of a private enterprise.

6. **Minimalist Model:** Raise FIRB's screening threshold for SOEs by a small amount (\$54 million). The amount reflects the same screening investor threshold for foreign commercial real estate by a foreign private individual investor.

Purpose: To increase foreign investment from SOEs to the same level afforded to SOEs in general. This threshold represents the maximum level the community is willing to accept from non-FTA partners.

This proposes to raise the threshold by the minimum amount. It uses the investment threshold for commercial real estate as guidance on the amount of risk the community was willing to bear with respect to SOE investment. The low investment threshold would be expected to only partially address Australia's need for foreign capital investment.

7. **Existing Model:** Maintain the status quo. Screen all SOE investments.

Purpose: Recognises the community is not ready to accept reform of Australia's investment policy to accept more foreign investment from SOEs.

Under this option there would be no change in the existing FIRB threshold for SOEs. All proposed SOE investment would require screening by the FIRB.

An indicative list of strengths and weaknesses for each proposal is presented in the table below.

Options	Strengths	Weaknesses
<p>Domestic Regulation Model</p> <p>Remove the FIRB screening regime and strengthen domestic laws to ensure SOEs operating in Australia behave like private enterprises.</p> <p>Purpose: To use domestic laws to regulate SOE behaviour and build confidence that SOEs are operating like commercial enterprises.</p>	<p>Stimulates foreign investment in Australia</p> <p>Does not discriminate between SOEs or private enterprise</p>	<p>Possibly expose Australia to investment contrary to our national interest</p> <p>Domestic laws might not be adequate to regulate SOE behaviour</p> <p>Requires extensive review of domestic laws to regulate SOE investment to behave like private enterprise</p>
<p>FTA Model</p> <p>Provide SOE investors the same treatment as foreign private investors under an FTA. FIRB screening threshold would be raised to \$1.078 billion.</p> <p>Purpose: To increase foreign investment from SOEs to the same level afforded to the United States and New Zealand SOEs. The maximum level accepted by the community.</p>	<p>Stimulates SOE investment in small, medium and large companies</p>	<p>Undermines concessions made to FTA partners</p> <p>Does not distinguish between community's concern of SOEs and private investors</p> <p>Does not encourage SOE behaviour to be more like private enterprise</p>

<p>Private Enterprise Model</p> <p>Provide SOE investors with the same treatment as foreign private investors and raise the threshold for SOEs to the existing threshold for foreign private enterprises (\$248 million).</p> <p>Purpose: To increase foreign investment from SOEs to the same level afforded to SOEs in general. This threshold represents the maximum level the community is willing to accept from non-FTA partners.</p>	<p>Stimulates SOE investment in small and medium enterprises</p>	<p>Does not attract investment to large companies</p> <p>Does not distinguish between the community's concerns about SOEs and private enterprise investors</p> <p>Does not encourage SOE behaviour to be more like private enterprise</p>
<p>Historical Accreditation Model</p> <p>Establish an accreditation scheme that operates in parallel with current FIRB processes, and provide SOEs who have a proven track record investing in Australia with the same investment thresholds afforded to foreign private enterprises (\$248 million).</p> <p>Purpose: To provide SOEs who have operated in Australia over a period of time with the same level of treatment as private enterprises.</p>	<p>Stimulates SOE investment in small and medium enterprise</p> <p>Minimal additional reporting for existing SOEs</p> <p>Encourages SOEs to behave in accordance with domestic laws to maintain accreditation</p> <p>Might encourage SOEs to invest further to establish proven track record</p> <p>Allows government to operate at-arms-length</p>	<p>Does not attract investment in large companies</p> <p>Indicates a preference of past SOE investors over new SOE investment</p>

<p>Operational Accreditation Model</p> <p>Establish an accreditation scheme that operates in parallel with current FIRB processes, and assess SOEs against operational criteria guided by standards expected of private enterprises operating in Australia. Once awarded accreditation, the SOE would be afforded the same threshold as a foreign private enterprise (\$248 million).</p> <p>Purpose: To provide SOEs who meet a defined standard of behaviour with the same level of treatment as private enterprise.</p>	<p>Stimulates SOE investment in small and medium enterprise</p> <p>Does not discriminate between existing investment and future foreign investment from SOEs</p> <p>Ensures accredited SOEs are operating like private enterprises</p>	<p>Does not attract investment in large companies</p> <p>Potentially creates the perception there are two investment screening regimes</p> <p>Requires government to assess whether an SOE operates like a private enterprise</p>
<p>Minimalist Model</p> <p>Raise FIRB's screening threshold for SOEs by a small amount (\$54 million). The amount reflects the same screening investor threshold for foreign commercial real estate by a foreign private individual investor.</p> <p>Purpose: To increase foreign investment from SOEs to the same level afforded to SOEs in general. This threshold represents the maximum level the community is willing to accept from non-FTA partners.</p>	<p>Stimulates SOE investment in small enterprises</p>	<p>Does not stimulate sufficient investment to meet domestic capital shortfalls</p>

<p>Existing Model</p> <p>Maintain the status quo. Screen all SOE investments</p> <p>Purpose: Recognises the community is not ready to accept reform of Australia's investment policy to accept more foreign investment from SOEs.</p>	<p>Maintains strong control over SOE investment in Australia</p>	<p>Erodes our international competitiveness as a destination for foreign capital</p> <p>Fails to attract required investment</p>
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Discussion questions

1. Are the three challenges outlined in the discussion paper the major considerations facing reform of investment policy ?
– Are there other challenges?
2. How do we encourage SOE investment in Australia while ensuring it is in the national interest?
3. How do we encourage SOEs to operate like commercial enterprises in Australia and are there ways to encourage better transparency?
4. How do we build the community's confidence that SOE investment is in the national interest?
5. How do we manage the risks?
6. Is there agreement that SOEs are becoming more commercial?
7. Are there alternatives to the options proposed?
8. How could these options be packaged?

Conclusion

This discussion paper presents a range of options to stimulate public debate.

SOE investment in Australia is an important policy issue worthy of discussion. Current policy settings have not kept with changes internationally, and are out of step with contemporary approaches in other countries. Our investment policy needs to manage the risk associated with SOE investment, while addressing community attitudes.

The options outlined provide the government a range of ways to manage the risks posed by SOE investment, and recognises the community must bear some level of risk if Australia is to continue to attract needed foreign capital from SOEs.

Failure to manage these risks appropriately will be detrimental to Australia's as a nation, and will affect our level of infrastructure, jobs and future prosperity.

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