FDI: How to improve the investment environment

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1. OVERVIEW

- In order to improve Australia’s investment environment, Australia needs to improve its competitiveness in terms of attracting foreign direct investment (FDI) (including from Japan). Most commentators focus on reducing restrictions on FDI, and particularly on the role of the Foreign Investment Review Board (FIRB). Although reforming FIRB’s processes and remit is important, Australia already has a substantially liberalised FDI framework. The focus therefore should instead be on attracting FDI to Australia rather than reforming the foreign investment screening and approval regime.

- International measures find that Australia is already fairly competitive in terms of attracting FDI, including due to its political and regulatory stability, economic resilience and potential, and wealthy, educated and multicultural population (this is "the pitch" made to investors). Given these factors and its natural resources endowment, Australia has historically been successful in attracting Japanese FDI. However, it is unclear whether Australia is living up to its FDI potential. Australia’s share of global FDI flows has been in relative decline for some time and inward FDI does not appear to be making as large a contribution to Australia’s gross domestic product (GDP) as it could and should. It is further unclear whether the factors underpinning Australia’s FDI "pitch" still hold true to the same degree.

- In recent times Australia’s political and regulatory stability may have been diminished in the view of foreign investors due to:
  - a lack of bipartisan approach to significant legislative reforms;
  - investor uncertainty regarding the current Commonwealth Government’s ability to implement its legislative agenda in the Senate;
  - increasingly lengthy and complex project approval processes; and
  - corruption scandals in New South Wales.

  Australia’s economic attractiveness may also be an issue given its high labour cost, labour market inflexibility and overvalued currency. International benchmarks indicate that Australia’s international economic competitiveness has declined across a range of measures over the last decade.

- Long-term trends indicate that Australia will have increasing needs for FDI in the future, so these disincentives and deterrents to FDI should be remedied. The

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current Commonwealth Government is aware of this need and has taken a number of actions to attempt to improve the investment environment.

- In addition to these initiatives, Australia needs to re-establish investor confidence in the factors that have long made it an attractive destination for direct investment, namely political and regulatory stability. Australia’s FDI environment may also be improved by minimising the regulatory overlap and duplication that exists under its federal system of government.

2. BACKGROUND

2.1 Why is FDI important?

- As a large, resource-rich country with high demand for capital and an insufficient pool of domestic savings, Australia relies on foreign investment, including FDI, to support the development of its economy.¹

- For 2012-13, total investment in Australia stood at A$372.6 billion, including A$317 billion in domestic savings and A$55.6 billion in FDI.²

- Foreign investment helps Australia reach its economic potential by providing capital to finance new industries and enhance existing industries. This boosts infrastructure, productivity, and employment opportunities in the process. The higher growth supported by foreign investment also increases tax revenues to the Commonwealth and State governments.³

- Other than injecting new capital (and in distinction to portfolio investment), FDI also opens up additional export opportunities and encourages competition and increased innovation by bringing new technologies and services to the Australian market.⁴ Compared to portfolio investment, FDI is more stable. Whereas portfolio investment in equity and debt securities can be reversed very quickly, FDI gives foreign investors a more substantial, long-term stake in the economy, making the stock of FDI in Australia less vulnerable to capital flight. FDI is usually associated with a high level of reinvestment of income by the foreign owners in local assets in the Australian economy. Since the late 1980s, around 46% of FDI in Australia has been sourced from retained earnings.⁵

2.2 Japanese FDI in Australia

- Japan and Australia have had a continuous bilateral trade and investment relationship since the 1950s. This has been influenced by the complementarity of both economies, whereby resource exports from Australia are exchanged for industrial exports from Japan.⁶

The historical cornerstone of the Japan-Australia economic partnership is the Agreement on Commerce, signed on 6 July 1957. This agreement defined the future direction for Japan's almost six decade long expansion of bilateral trade and investment with Australia.

The Basic Treaty of Friendship and Cooperation of 1976 (commonly known as the Nara Treaty) provided the foundations for a broader relationship and people-to-people exchange, which prompted further investment.

The recently signed Japan-Australia Economic Partnership Agreement (JAEPAP) has reinvigorated the relationship. JAEPAP raises the screening threshold at which private Japanese investment in non-sensitive sectors is considered by FIRB from A$248 million to A$1.078 billion, which may contribute to increased Japanese FDI inflows.7

In terms of the numbers, in 1965, Japan’s FDI to Australia was less than US$1 million. It amounted to US$156 million in 1975 and US$468 million in 1985. It exceeded the $1 billion level first in 1987 (US$1.222 billion) and then peaked at US$4.256 billion in 1989. Following the burst of Japan's asset price bubble, FDI declined to a low of US$756 million in 1996 before starting to increase again from 2004 (reaching US$1.854 billion in that year).8 Recent years have seen FDI from Japan reach new highs, as set out in the below table.9

**Japanese FDI in Australia**

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (A$ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>7.3</td>
</tr>
<tr>
<td>2008</td>
<td>5.6</td>
</tr>
<tr>
<td>2009</td>
<td>9.0</td>
</tr>
<tr>
<td>2010</td>
<td>5.4</td>
</tr>
<tr>
<td>2011</td>
<td>3.0</td>
</tr>
<tr>
<td>2012</td>
<td>7.9</td>
</tr>
<tr>
<td>2013</td>
<td>1.2</td>
</tr>
</tbody>
</table>

As at 31 December 2013, Japan had a total of A$63.26 billion worth of FDI in Australia.10 Japan now represents more than 10% of the total amount of FDI in Australia and this share is rising. By way of comparison, Australia’s total

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investment stock (ie portfolio and FDI) in Japan was only A$50.23 billion as at 31 December 2013, with just A$480 million of this amount being FDI.\textsuperscript{11}

- Currently, Japan is the third-largest overall investor in Australia, with total investment stocks worth over A$130 billion. The following table sets out the total investment stocks, including the FDI component, for other major investors in Australia (as at 31 December 2013).\textsuperscript{12}

<table>
<thead>
<tr>
<th>Country</th>
<th>Total investments</th>
<th>FDI component</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount (A$ billion)</td>
<td>Percentage</td>
</tr>
<tr>
<td>United States</td>
<td>657.9</td>
<td>27</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>562.9</td>
<td>23</td>
</tr>
<tr>
<td>Japan</td>
<td>131</td>
<td>5</td>
</tr>
<tr>
<td>Singapore</td>
<td>60.5</td>
<td>2</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>51.3</td>
<td>2</td>
</tr>
<tr>
<td>Switzerland</td>
<td>47.1</td>
<td>2</td>
</tr>
<tr>
<td>China (excluding special administrative regions and Taiwan)</td>
<td>31.9</td>
<td>1.2</td>
</tr>
<tr>
<td>South Korea</td>
<td>15.1</td>
<td>0.6</td>
</tr>
</tbody>
</table>

- It is interesting to note that significant FDI from China into Australia is a relatively recent phenomenon and cumulative investment is outstripped by FDI from a number of other countries, including the USA, UK and Japan. The amount of media attention and community debate regarding Chinese FDI appears to be out of proportion to its relative share of total FDI in Australia.

- Japanese investment in Australia has traditionally been in minerals, energy and food. Major iron ore and coal mines operated by BHP Billiton, Rio Tinto, Anglo and Glencore often have Japanese equity participation, as do the LNG and oil & gas projects operated by Woodside and indeed almost all major LNG projects under development in Australia. These projects are also underpinned by Japanese power and gas utilities as foundation customers.\textsuperscript{13} Japanese investment into these sectors has often been undertaken in order to secure offtake or supply.


\textsuperscript{13} Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, Australia’s trade and investment relationship with Japan and the Republic of Korea, May 2013, p 38.
• Up to 50% of global profit of the major Japanese trading houses over recent years have been generated in Australia.\textsuperscript{14} This illustrates the importance of Australian investments for a number of Japanese businesses.

2.3 A new paradigm for Japanese FDI in Australia?

• Although not as well known, Japan also has a number of diversified investments in Australia’s manufacturing, agriculture and tourism sectors. Japanese investors have been recognised for the significant contributions they have made to the development of those sectors.\textsuperscript{15} Recent trends tend to indicate a new paradigm for Japanese FDI in Australia, where investments are made not to source minerals, energy or food, but to achieve a return by competing locally. In other words, they are driven by the idea that Australia can be a profitable market in its own right. This includes forays by Japanese investors into infrastructure, power and water utilities, rolling stock and asset management. Some recent notable investments include:

Consumer services / retail

• **Fuji Xerox** - $375 million acquisition of the business process outsourcing business from Salmat.

• **Muji** - the retailer opened its first Australian store in Melbourne in November 2013 and plans to open a Sydney store and an online store in late 2014.\textsuperscript{16}

• **Nippon Paper Group** - A$600 million acquisition of Paper Australia in 2009.\textsuperscript{17}

• **Pola Orbis** - A$300 million acquisition of cosmetics provider Jurlique International in December 2011.\textsuperscript{18}

• **Uniqlo** - the retail group opened its first Australian store in Melbourne in April 2014 and plans to open a Sydney store in late 2014, with further plans to open another 50 stores nationwide over the next three years.\textsuperscript{19}

• **Sekisui House** - A$190 million joint venture with Payce Consolidated to construct 4,500 sustainable homes in Homebush Bay, NSW and Ripley.

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\textsuperscript{15} Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, *Australia’s trade and investment relationship with Japan and the Republic of Korea*, May 2013, p 38.


\textsuperscript{17} Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, *Australia’s trade and investment relationship with Japan and the Republic of Korea*, May 2013, p 38.

\textsuperscript{18} Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, *Australia’s trade and investment relationship with Japan and the Republic of Korea*, May 2013, p 38.

Valley, Queensland and an A$18.5 million acquisition of the contract building division of AV Jennings in 2010.20

- **Toyota Motors** - A$800 million invested in manufacturing facilities since 2004.21

**Financial services**

- **Dai Ichi Life** - A$1.2 billion acquisition of Tower Insurance in 2011.22
- **Mitsubishi UFJ Financial Group** - A$425 million acquisition of 15% of AMP Capital in December 2011.23

**Food and Beverages**

- **Kirin** - A$2.9 billion acquisition of National Foods in November 2007, A$910 million acquisition of Dairy Farmers in December 2008, and A$3.5 billion acquisition of Lion Nathan in June 2009.25
- **Suntory** – Acquisition of Frucor (a NZ company) in 2009, owner of popular drink brands Evian, V and Mizone.

**Infrastructure**

- **Consortium of Mitsubishi, JGC Corp and INCJ** – A$225 million acquisition of water business of United Utilities Australia (now known as TRILITY) in 2010.
- **Itochu** - participation in Victorian desalination plant from 2009.
- **MIRAIT** – acquisition of minority interest in telecommunications construction company Relative Services in May 2011 (with a view to the NBN opportunity).26

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21 Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, *Australia’s trade and investment relationship with Japan and the Republic of Korea*, May 2013, p 38.
• **Marubeni** – participation in **Gold Coast Light Rail Project** from 2010 and **North West Rail Link Project** from 2014.

• **Mitsui** – acquisition of a 28% interest in five assets owned by **GDF SUEZ Australian Energy**, including a 46 MW wind farm in South Australia, a 1,542 MW coal-fired power station in Victoria, a 479 MW gas-fired power station in South Australia, 396 MW gas-fired peaking plants in South Australia, and retail energy business in Victoria/South Australia with some 350,000 electricity and gas accounts.27

3. **AUSTRALIA’S FOREIGN INVESTMENT ENVIRONMENT**

3.1 **Restrictions on FDI**

- Restrictions on FDI are often categorised as follows:
  - formal restrictions on FDI, including limits on foreign ownership;
  - screening and approval procedures;
  - constraints on foreign personnel and operational freedom; and
  - informal barriers, eg opaque informal public or private measures.28

Few of these restraints apply in Australia.

3.2 **FIRB screening and approval processes**

- One high profile FDI restraint that does apply in Australia is the screening and approval of investment proposals by **FIRB**.

- **FIRB** is a non-statutory body that advises the Government on foreign investment policy and its administration. The Board examines proposals by foreign investors to undertake direct investment in Australia and makes recommendations to the Government on whether those proposals are suitable for approval under the Government's policy and the **Foreign Acquisitions and Takeovers Act 1975** (Cth). Broadly speaking, acquisitions by foreigners above a monetary threshold of A$248 million (indexed annually to inflation) of an interest in agricultural land or agribusiness or in 15% or more in an Australian business or corporation are subject to government approval. Higher monetary thresholds currently apply to investments from New Zealand and the USA under free trade agreements and will also apply to Japan and South Korea when bilateral agreements with those countries have been implemented. Approvals, including approvals issued with conditions, are typically valid for a period of 12 months.

- In 2012-13, a total of 13,322 applications for foreign investment approval were considered by **FIRB**. Of the 12,731 applications decided (ie those approved or rejected but not those withdrawn or exempt), over 99% of proposals were decided within 30 days. In 2012-13, **FIRB** did not reject any applications.

- The role of **FIRB** in screening investment proposals is often contested, yet the number of applications that are explicitly rejected are few. They include, for example:

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- **Royal Dutch Shell’s** proposed acquisition of **Woodside Petroleum** (2001) - Woodside is the operator of the North West Shelf project, Australia’s largest developed energy resource. FIRB considered it to be in the national interest for the operator of this project to develop the resource to its maximum potential and for sales from the project to be promoted in preference to competing sales from projects in other parts of the world. FIRB considered that Royal Dutch Shell might promote other projects not in Australia over the development of the North West Shelf project, and so found the proposed acquisition not in the national interest.

- **China Minmetals’** original bid for 100% of **OZ Minerals** (2009) - OZ Minerals operates the Prominent Hill mine situated in the Woomera Prohibited Area in South Australia. This site is a weapon testing range that makes a unique and sensitive contribution to Australia's national defence. FIRB considered the proposed 100% foreign acquisition of OZ Minerals that would include this site not to be in the national interest. (A deal not including the Prominent Hill mine was later approved.)

- **China Nonferrous Metal Mining’s** bid for ‘rare earths’ producer **Lynas Corp** (2009) - FIRB considered that if China Nonferrous Metal Mining’s offer for a 51.6% stake in Lynas was successful, production of rare earths could be controlled to the detriment of non-Chinese end users. This would be inconsistent with the government's policy of maintaining Australia’s position as a reliable supplier to all of its trading partners, and FIRB considered that China Nonferrous Metal Mining’s holding should be limited to a stake of less than 50%.

- **Singapore Exchange’s** (SGX) bid for the **Australian Securities Exchange** (ASX) (2011) - FIRB considered that the acquisition of the ASX by SGX would be contrary to Australia's interest in maintaining a stable and strong financial system. The acquisition would likely diminish Australia's economic and regulatory sovereignty and would not enhance Australian business and investor access to capital markets.

- **Archer Daniels Midland’s** proposed acquisition of **GrainCorp** (2013) – GrainCorp accounts for 85% of eastern Australia's bulk grain exports, grain storage, distribution and marketing. In circumstances where members of FIRB could not provide a unanimous recommendation, the Treasurer found that at a period in time where the Government’s focus is on increasing competition in the market, the proposed acquisition would reduce competition and impede growers' ability to access the grain storage, logistics and distribution network, and therefore be contrary to the national interest.

- While only a few of the thousands of cross-border investment proposals reviewed by FIRB are explicitly rejected, FIRB’s screening and approval function arguably entails a wider deterrent effect on FDI before it reaches the approval stage. The implicit rejection rate (where foreign investors withdraw their application after receiving an indication, rather than an official government decision, that they will not receive approval) is also suspected to be significantly higher than the explicit rejection rate reported by the FIRB. Other transactions have been approved subject to highly prescriptive conditions, including conditions regarding industry and employment policy.

- FIRB conditions are not immutable. Following significant adverse changes in the coal sector, conditions imposed on Chinese state-owned enterprise Yanzhou Coal Mining Company when it received approval to acquire 100% of Yancoal Australia Limited in 2009 were removed by the Treasurer in 2013.
Notwithstanding the above criticisms, the fact is that the overwhelming majority of applications made to FIRB are approved, including applications made by Japanese investors. Accordingly, in terms of improving Australia’s investment environment, focus should not be unduly placed on FIRB. Australia’s challenge is not primarily to reduce (legal) barriers to FDI or restrictions on investment (although this should also be pursued), but rather to increase its competitiveness in attracting FDI.

3.3 Australia’s FDI "pitch"

- Australia enjoys an abundant natural resources endowment (coal, iron ore, gold, copper, LNG, crude petroleum, zinc, tin ores, nickel, aluminium, wheat, barley, raw sugar, wool, mutton, beef and other rural farm products, etc). These are natural "pull" factors for Japanese FDI. However, such FDI requires an enabling environment.

- Australia’s traditional FDI “pitch” as to why it is an attractive destination for FDI includes the following factors:
  - Stable political environment – Australia has low levels of inequality, a strong state and strong governance norms, relatively high levels of social provision, public trust in political institutions and a limited history of political unrest.
  - Stable regulatory environment - Australia has a transparent and well-regulated business environment. It has long had an official position of welcoming FDI. Restrictions on FDI have been substantially liberalised since the 1980s.
  - Stable tax, royalties and stamp duty.
  - Commitment to the rule of law.
  - Stable economic environment - Australia is well into its 23rd consecutive year of annual economic growth and its average real GDP growth from 2013 to 2019 is expected to exceed all other major advanced economies. Australia is rated triple ‘A’ by all three global rating agencies and enjoys levels of net public debt that are among the lowest in the OECD.
  - Population growth through natural increases and immigration.
  - Wealthy, educated and multicultural population – Australia has one of the highest levels of GDP per capita, the world’s highest secondary education enrolment rate, and is ranked second in the United Nations Development


Programme’s Human Development Index. More than a quarter of Australian's labour force of 12.3 million people was born overseas.

- Broad community acceptance of foreign investment.
- Sophisticated financial and capital markets.
- Japan's long history of direct investment in Australia has been made on the basis of these factors.

3.4 **Is Australia achieving its FDI potential?**

- Despite Australia's historical success at attracting Japanese FDI, it is unclear whether Australia has performed as well as it could.
- Inward FDI transactions from all countries have risen in absolute terms since the late 1980s, but as a share of GDP, FDI has shown only a modest upward trend.
- Since the late 1980s, FDI has steadily declined as a share of total foreign investment in Australia, falling from more than 35% to just over 25%.
- Australia's share of global FDI inflows has also steadily declined since the 1970s, as well as its share of global FDI relative to its share of global GDP. The ratio of Australia’s percentage share of global inward FDI compared to its percentage share of global GDP has slid from an average of 2 in 1970 to 1.3 since 2003. Comparable developed economies such as New Zealand and Canada have experienced similar trends. Among other things, the downward trend in relative FDI performance reflects the increasing competition to attract global FDI flows from emerging market economies such as China and India.
- The United Nations Commission on Trade and Development (UNCTAD) ranks Australia in the first quartile of the countries making up its FDI potential and attraction indices. Similarly, over the past three years Australia has consistently ranked as the sixth or seventh most attractive destination for FDI in the A.T. Kearney FDI Confidence Index, a measure of senior executive sentiment of the world’s largest companies. However, when it comes to the contribution FDI makes to the economy and the amount of inward FDI as a share of GDP, Australia

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only registers in the third quartile.\textsuperscript{40} This discrepancy tends to indicate that Australia is not translating all potential FDI into actual FDI. Furthermore, much recent FDI has been resources and energy related. It is worth querying whether Australia is failing to attract adequate FDI in other sectors.

- The OECD’s FDI Regulatory Restrictiveness Index ranks Australia as having the seventh most restrictive FDI regime in the OECD (although this is largely due to restrictions in a small number of sensitive sectors, such media and airlines).\textsuperscript{41}

- This issue is arguably not part of the mainstream discourse regarding FDI. Popular debate and media attention typically focuses on the commercial and other merits of individual proposed investments. Rarely is there public discussion on Australia’s overall FDI regulatory framework and its performance in terms of maximising FDI inflows.

- Australia’s declining FDI performance has occurred alongside declining international competitiveness across a range of measures over the last decade. A recent Business Council of Australia discussion paper reports that:

  - “The World Economic Forum placed Australia 21st out of 148 countries on its Global Competitiveness Index, down from 15th place a few years ago.
  - The World Economic Forum identified labour regulation, government bureaucracy and tax rates as the most problematic factors for doing business in Australia.
  - The World Economic Forum placed Australia 23rd out of 138 countries on its Enabling Trade Index 2014, down from 15th place in 2010.
  - A study of manufacturing cost competitiveness across 25 countries by the Boston Consulting Group found that Australia had the highest absolute costs and the largest decline in competitiveness (equal to Brazil) over the last decade.
  - Australia’s retail and wholesale sectors are 20\% less productive than the average productivity of their global competitors, according to a study by Deloitte.
  - The Productivity Commission found that Australia’s productivity growth between 2007 and 2010 was lower than eight peers, France, Germany, Sweden, Ireland, the UK, the US, Singapore and South Korea.”\textsuperscript{42}

  - The re-emergence of union power during the Rudd and Gillard Governments (2007-2013), increases in labour disputes, and ongoing inflexible work practices have contributed to the decline in Australia’s international competitiveness and Australia’s lack of productivity growth.


3.5 Does the traditional "pitch" for FDI in Australia still apply? Current disincentives for investing in Australia.

- Historically, Australia's political and regulatory stability and its economic resilience and potential have been perceived to provide a safe, low-risk environment in which to do business. This proposition should be tested, particularly in circumstances where it appears that Australia is not meeting its FDI potential.

- Consider Australia's political and regulatory stability. In a recent Parliamentary Committee Inquiry, Japanese businesspeople described this factor as "extremely important" and "a key benefit" in relation to investing in Australia.

- According to UNCTAD, by value and by number, for cross-border mergers and acquisitions by foreign investors that had already been announced, more were withdrawn for regulatory reasons or political opposition in Australia between 2008 and 2012 than in any other country (a possible cause of withdrawal of some of those investments may have been the investor receiving an unofficial indication that they would not receive approval). The UNCTAD reports that the value of these withdrawn deals was US$87.8 billion. The accuracy of this surprisingly high figure, which is based on Thomson Reuters's database on mergers and acquisitions, is difficult to scrutinise.

- Projects have faced opposition from community groups that have been very vocal, as illustrated by the effect of the "shut the gate" movement on the development of Whitehaven's Maules Creek mine.

- While there is no doubt that Australia's liberal democratic political regime is firmly entrenched, it has experienced leadership instability in recent years (for example, in 2013 there were three different prime ministers in 12 months).

- The ability of the current Government to implement its legislative agenda in view of the current Senate composition (with micro-parties holding the balance of power) may contribute to investor uncertainty. The proposed repeal of the Renewable Energy Target scheme is illustrative. Although the Government may foreshadow change and allow time for businesses to adjust their approach, where the Government does not have the ability to pass the amending law, this leads to an even longer period of uncertainty, causing investors to disengage from the opportunity altogether. Notwithstanding the merits or otherwise of the renewables industry, this approach sends an unfortunate message about the general investment environment which is difficult to explain and overcome.

- The lack of a bipartisan approach to key legislative reforms in recent years has contributed to investor uncertainty, key examples of which are the carbon tax and the Minerals Resources Rent Tax (MRRT). Japanese investors have identified these issues as "challenges" to investing in Australia.

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44 Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, Australia’s trade and investment relationship with Japan and the Republic of Korea, May 2013, p 38.


47 Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, Australia’s trade and investment relationship with Japan and the Republic of Korea, May 2013, p 38.
Perceptions of political corruption in Australia have increased, particularly in New South Wales (NSW). Proceedings of the Independent Commission Against Corruption (ICAC) in NSW have led to the resignation or standing aside of ten members of the NSW Parliament, including the NSW Premier, Barry O'Farrell (although some of these changes were for political and other reasons rather than due to findings of corruption). The NSW Parliament also introduced legislation pursuant to ICAC recommendations to cancel exploration licences that were considered to have been granted by processes tainted by serious corruption. Some Japanese investors held interests in the companies that owned these licences. While concerns were raised about the impact this would have on NSW's sovereign risk profile, the NSW Government's view was that "the greatest form of sovereign risk, the greatest threat to the stability and certainty needed by business in dealing with governments, is the risk of corruption." Events such as these tarnish Australia's reputation of having transparent and effective public governance institutions.

Obtaining approvals for major projects (in which Japanese investors are often equity participants) has become an increasingly complex and lengthy process. Not knowing how long the approval process will take and uncertainty as to its outcome, as well as the often complex conditions that are attached, is a deterrent to foreign investment. The experience of a company seeking approval for a major resources project set out in a recent Business Council of Australia report is illustrative of these issues:

"The environmental assessment for the project was done under Australian Government and State legislation. The assessment took more than two years, involved more than 4,000 meetings, briefings and presentations across interest groups, and resulted in a 12,000-page report. The assessment was advertised widely across Australia for comment and resulted in about 40 submissions. When approved, more than 1,500 conditions – 1,200 from the State and 300 from the Commonwealth – were imposed. These conditions have a further 8,000 sub-conditions attached to them. In total, the company invested more than A$25 million in the environmental impact assessment."

Consider also Australia's economic attractiveness. While long-term growth prospects for the Australian economy remain fairly robust, certain structural issues have deterred FDI in recent years. In particular, Australia's high labour costs have been identified as an issue by Japanese investors. This was one of the key reasons cited by the Browse joint venture for foregoing an onshore proposal for Browse LNG at James Price Point in favour of floating LNG technology. A Business Council of Australia report found that project costs in Australia were 40% higher than in the US Gulf Coast and that labour productivity was at least one-third lower.

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48 New South Wales, Parliamentary Debates, Legislative Assembly, 30 January 2014 (Barry O'Farrell).
51 Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, Australia’s trade and investment relationship with Japan and the Republic of Korea, May 2013, p 38.
lower. Japanese investors have also identified Australia’s high transport and infrastructure costs as economic impediments.

- Australia’s economy is highly regulated and the complexity of the laws applying to proposed investments (particularly for major projects) may act as a deterrent to investors. In particular, the interaction between Commonwealth and State arrangements is liable to confuse, especially where there is overlap in responsibilities for environmental approvals.

4. IMPROVING THE INVESTMENT ENVIRONMENT

4.1 Why this is an issue

- As described above, there are many reasons why FDI is important. However, Australia should be particularly concerned to improve its ability to attract FDI (and remove existing impediments and deterrents) in view of the long-term economic and structural factors that indicate that Australia will be increasingly reliant on FDI moving forwards.

- Australia’s population growth will increase the need for foreign capital if spending continues to exceed savings on a per capita basis.

- Similarly, the ageing of the population (and associated reduction in proportion of working age Australians) increases the need for labour productivity improvements in order to sustain or improve living standards. This will add to Australia’s capital requirements, principally through the process of capital deepening which effectively gives workers more equipment and machinery to operate (i.e. an increase in the capital-to-labour ratio).

- Australia typically runs a current account deficit on its balance of payments with the rest of the world, which is ‘balanced’ by a capital account surplus. Accordingly, reliable foreign equity capital flows are also needed for the ongoing finance of Australia’s current account deficit.

- A recent Business Council of Australia report found that “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 A$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 A$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.”

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54 Inquiry of the Trade Sub-Committee Inquiry of the Joint Standing Committee on Foreign Affairs, Defence and Trade, *Australia’s trade and investment relationship with Japan and the Republic of Korea*, May 2013, p 41.

55 Access Economics, *Foreign Investment in Australia* (February 2010) p 44.

56 Access Economics, *Foreign Investment in Australia* (February 2010) p 44.

57 Access Economics, *Foreign Investment in Australia* (February 2010) p 44.

4.2 **Action being taken to improve the investment environment**

- The current Commonwealth Government realises that the global market for FDI is very competitive and that Australia's regulatory settings need to be adjusted in order to attract FDI. The Government has taken a number of measures in an attempt to increase Australia's attractiveness, including:
  - repealing the carbon tax;
  - repealing the MRRT;
  - implementing a "one stop shop" for environmental approvals and reducing Commonwealth and State duplication in this area (i.e., reducing green tape);
  - instituting an annual "Repeal Day" to simplify regulation and reduce red tape;
  - streamlining approval processes for major projects;
  - establishing an industry-based Trade & Investment Policy Advisory Council to advise the Minister for Trade and Investment; and
  - introducing a three-year multiple entry visa for Chinese business people to improve labour mobility.

- The Government has signed JAEPA that, as noted above, raises the screening threshold for private Japanese investment in non-sensitive sectors. JAEPA also reduces restrictions on the access of Australian legal services and other advisory firms entering the Japanese market, which should increase the availability of legal, accounting and other professional and technical advisors to assist Japanese businesses to invest in Australia.

- The Government has similarly entered into a free trade agreement (FTA) with South Korea and is progressing FTA negotiations with China.

- The ruling political parties in Japan and Australia each have an "open for business" mantra. The broader Australia-Japan relationship is quite strong. Prime Minister Abe and Prime Minister Abbott are developing a close personal relationship. Taken together with the signing of JAEPA, there is a sense of optimism or momentum towards increasing economic integration between Australia and Japan. This confidence may become a self-fulfilling prophecy.

5. **HOW TO IMPROVE THE INVESTMENT ENVIRONMENT**

5.1 **Purpose of Australia's foreign investment policy**

- The purpose of Australia's foreign investment laws should be to promote policies that:
  - signal an openness to investment;
  - are neutral with respect to the sources of investment;
  - are clear and predictable in their application;
  - promote consistent treatment of investment proposals through consistency in decision making; and
restrict investment only when there is a clear national interest justification for doing so.\textsuperscript{59}

Arguably Australia’s foreign investment laws already adequately promote these policies. Attention should not therefore be solely directed towards reforming Australia’s foreign investment regulatory framework, but rather towards addressing the underlying commercial and other factors which disincentivise investment in Australia.

5.2 **Australia needs to understand its place in the global strategies of Japanese investors**

As discussed above, Australia is competing with the rest of the world in capturing Japanese investment and the competition is becoming increasingly intense. Australia’s long-standing Japanese business partners are already global and heavily invested in Australia relative to the rest of the world. Many are now seeking to diversify across industry sectors and geographies. The challenge for Australia is to maintain those relationships but also attract investment from new investors, many of which are not yet global. Australia may be the first overseas investment in a strategy to establish in developed markets first and then in the developing markets in Asia. In this way, Australia may be competing against the US and Europe as the first place for overseas investment. Australia needs to understand this competitive dynamic and ensure that its regulatory and policy settings are geared towards making it the preeminent investment destination vis-à-vis its competitors.

5.3 **Increase the transparency, certainty and security associated with investing in Australia**

- Political and policy uncertainty is one of the key factors inhibiting FDI inflows into Australia that should be addressed.\textsuperscript{60}

- The screening of FDI can be improved by reducing the politicisation of FIRB’s approval processes. Although most FIRB approvals are made under a delegation of authority from the Treasurer, larger and more politically contentious transactions are often considered at the ministerial level. FIRB’s advice on these transactions is not legally binding on the Treasurer and has at times been ignored. In circumstances such as this, foreign investors may suspect that the “national interest” test is sometimes used to cover domestic political considerations.\textsuperscript{61}

- The Government should ensure that key reforms are not suddenly announced, are undertaken in an orderly manner, are subject to consultation, and are subject to bipartisan approval. Sudden introductions and reversals of policy, of which the carbon tax and MRRT are the key examples in recent years, should be avoided. It should be noted that the current Government has responded to the business sector’s concerns in this regard and stated its intention to be a “no surprises Government”.\textsuperscript{62}


5.4 **Reduce Commonwealth/State overlap and confusion**

- The Government should aim to minimise the regulatory overlap and duplication that exists under Australia’s federal system of government. Where an area of regulation is a shared responsibility between jurisdictions, there should be a move towards a single consistent and national regime. The "one stop shop" for environmental approvals is a positive example of this.

- The impetus to reconcile and harmonise differences between the Commonwealth and the States as well as between the States may run counter to the "competitive federalism" approach of some current State and Territory Premiers and Chief Ministers. Proponents of this approach laud differences between the different regulatory and policy settings of the States and Territories as an asset that allow the States and Territories to conduct policy experiments and compete with each other for, among other things, foreign investment.

- Australia’s federal system can be very confusing for foreign investors. It can be difficult to discern the law applicable to their investment. Activities at the Commonwealth and State and Territory levels can also exacerbate misunderstandings. Consider the following sample of business missions from the four largest States to some of Australia’s overseas trade and investment partners over the past three years.

<table>
<thead>
<tr>
<th>Date</th>
<th>State</th>
<th>Coordinated by</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 February 2013</td>
<td>Queensland</td>
<td>Premier’s office</td>
</tr>
<tr>
<td>3 March 2013</td>
<td>Victoria</td>
<td>Victorian Government (food and beverage)</td>
</tr>
<tr>
<td>19 October 2013</td>
<td>New South Wales</td>
<td>Deputy Premier’s office</td>
</tr>
<tr>
<td>18 February 2014</td>
<td>Queensland</td>
<td>City of the Gold Coast</td>
</tr>
<tr>
<td>6 June 2014</td>
<td>Victoria</td>
<td>Victorian Government (education)</td>
</tr>
<tr>
<td>8 June 2014</td>
<td>Queensland</td>
<td>Queensland Japan Chamber of Commerce and Industry</td>
</tr>
<tr>
<td>27 August 2014</td>
<td>New South Wales</td>
<td>Tourism NSW</td>
</tr>
<tr>
<td>2 October 2014</td>
<td>Victoria</td>
<td>Victorian Government (IT)</td>
</tr>
<tr>
<td>13 October 2014</td>
<td>New South Wales</td>
<td>NSW Business Chamber</td>
</tr>
<tr>
<td>22 February 2012</td>
<td>Victoria</td>
<td>Premier’s office</td>
</tr>
<tr>
<td>29 October 2012</td>
<td>New South Wales</td>
<td>Premier’s office</td>
</tr>
<tr>
<td>30 November 2012</td>
<td>Queensland</td>
<td>Premier’s office</td>
</tr>
<tr>
<td>20 September 2013</td>
<td>Victoria</td>
<td>Victorian Government</td>
</tr>
<tr>
<td>1 December 2013</td>
<td>New South Wales</td>
<td>Premier’s office</td>
</tr>
<tr>
<td>17 February 2014</td>
<td>Queensland</td>
<td>City of the Gold Coast</td>
</tr>
</tbody>
</table>
The wide variety of offices and organisations that have coordinated these business missions may make it difficult for foreign investors to identify the appropriate decision maker. It also highlights the overlap between investment promotion activities undertaken by Austrade (the Commonwealth Government’s trade commission) and by the States, business chambers, local councils and cities. It is worth querying whether such business missions serve their intended purpose of increasing trade and investment or amount to little more than an entertaining trip for principals of small and medium sized enterprises. A recent University of British Columbia study found that they have negligible impacts.63

Thought should be given to the best way to educate foreign investors about Australia’s complicated regulatory environment, including by reducing the overlap and duplication in investment promotion activities undertaken by federal, state and local governments.

5.5 Reduction of trade and investment barriers

In order to promote greater FDI inflows, Australia should continue to reduce trade and investment barriers through pursuing bilateral and multilateral agreements. Such agreements have been proven to expand both trade and investment flows.64

As noted above, Australia is currently progressing bilateral FTA talks with China. It is also a party to negotiations on the proposed Trans Pacific Partnership Agreement and the ASEAN led Regional Comprehensive Economic Partnership. One of the reasons for Australia’s historical success in attracting investment from Japan and other countries in the region is its existing trade links. Strengthening these links by securing FTAs will increase Australia’s ability to capture regional FDI flows.

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5.6 **Australian FDI into Japan needs to be encouraged**

- Although Japan is Australia’s sixth-largest destination for foreign investment, a mere 1% of this investment is FDI. The failure of Australian businesses to establish operations in Japan means that Australia is severely under-represented as a business community in the Japanese market. If this were not the case, awareness of Australia as an investment destination and understanding of Australian ways of doing business would undoubtedly be greater. Australian FDI into Japan therefore needs to be encouraged.

- It takes time to establish new relationships with potential Japanese business counterparts and it is highly challenging to do this on a fly in fly out basis. If Australian businesses do not have the capital to execute this strategy then thought needs to be given to other ways in which companies can maintain representatives on the ground in Japan. Austrade performs its role admirably but is not resourced to represent every Australian company that has, or should have, an interest in Japan.

5.7 **Australia needs to capitalise more on its people and their culture**

- As a multicultural society with strong educational institutions, Australia’s human resources should have significant competitive advantages over other countries in the Asia Pacific region in terms of cultural skills and language skills. Also, Australia ranks very highly internationally in terms of the number of people who are studying Japanese (being fourth with 296,672 language learners as at 2012, behind China (1,046,490), Indonesia (872,411) and South Korea (840,187)). This should make Australia particularly attractive not only as a first place to invest (due to access to workforces which are open to investment by Japanese and have the language and cultural skills to work productively with Japanese colleagues) but as part of a strategy to build international capabilities. For example, in acquiring Australian cosmetics provider Jurlique International, Pola Orbis cited the importance of Jurlique’s international network, which was more developed than its own.

- Unfortunately, Australian businesses have not capitalised on this skill base as much as they could have, including promoting people with these skills to leadership. Australia can do more to improve the development and promotion of people with these skills to attract greater Japanese investment. There has been public discussion on this topic in recent time. While the recommendation by the previous Government’s Australia in the Asian Century White Paper that a third of all board members at top Australian companies should have deep Asian experience received a fairly mixed reception, organisations such as AsiaLink have developed thoughtful strategies on how to develop an Asia capable workforce in Australia.

5.8 **Australia needs to work with Japanese investors to ensure local communities welcome Japanese investment**

- Although the Australian population generally welcomes foreign investment, there are some economic sectors in which the active support of affected rural communities is required for the broader community to embrace foreign investment, particularly where that investment is likely to result in change. Australian governments and businesses wishing to work with Japanese investors need to

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facilitate the development of closer relationships between those communities and foreign investors through stakeholder engagement and corporate social responsibility efforts. Doing so will ensure that projects proceed without opposition from communities.

- Senior Japanese business people are, relative to their counterparts from other countries, often reluctant to engage with the Australian media. This should not be the case. The reality is that Japan has a fantastic story to tell of its emergence from its period of stagnation. Due to the complementary nature of the trade and investment relationship, Japan can rightly be proud of the significant and unique contribution that it has made to Australia's development in many areas over the past half century, particularly in the resources and energy sector. Yet public awareness of Japan's important role in Australia's economic history is low, and is often overshadowed by the public's concerns regarding contemporary Chinese investment. In order to improve public acceptance of foreign investment, Japanese business people should not hesitate to promote their accomplishments.

- It is important that these actions be taken together with the ongoing efforts to reduce red tape and green tape, otherwise those efforts will not necessarily produce the desired outcomes. Community acceptance that foreign investment is in Australia's national interest is a critical element of the Government being able to further liberalise regulation.

5.9 **Create a conversation about margins, not costs**

- While there is no doubt that labour costs and the cost of living in Australia are relatively high, the positive aspect of this is that Australians are wealthy, have relatively higher disposable incomes and have the capacity to spend it. This is in contrast to other economies in the Asia Pacific region that have far larger populations and are growing faster, but the populations are still relatively poor and it is hard to make satisfactory margins. Fast fashion brands demonstrate that excellent cost performance (ie relatively cheaper for excellent quality) performs well in Australia. For example, sales at Uniqlo's first Melbourne store have exceeded initial targets. Similarly, retailer Daiso is also doing well, where each product costs A$2.80 in Australia but only JPY100 in Japan.

- The even greater opportunity for Japanese investors may be in the services sector. This sector is the largest part of the Australian economy, accounting for around three quarters of GDP and four out of five jobs. Australians expect to pay for good service. Like fast fashion, there is probably a niche for high quality and reasonably priced services that would generate high levels of demand.

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