Victorian Government Submission on Foreign Investment Reform (protecting Australia's National Security) Bill 2020

Victoria supports the intent to streamline and improve the screening and approvals process for foreign investment and recognises that national security is a critical role of the Commonwealth Government. As highlighted in the Explanatory Memorandum, foreign investment plays a critical role in the Australian economy, and likewise is of critical importance to the Victorian economy.

Foreign companies investing into Victoria create jobs, drive enhancements in productivity and boost exports. Foreign investment leads to increased competition and exposure to international standards and best practices, technology and innovation transfers, leading to higher productivity and higher paid jobs. Furthermore, and critically in the current economic crisis due to COVID-19, foreign investment accelerates domestic firms' integration into global value chains and increases trade opportunities. The proposed legislation in its current form has the potential to disadvantage Australia's ability to secure international investment and consequently risks economic growth and recovery, development of human capital, knowledge transfer and innovation for the nation. The research and university sector already heavily impacted by COVID-19 is likely to be significantly negatively impacted by the proposed changes, as it relies heavily on investment from foreign owned companies.

Over five years, from 2015-2019, it's estimated that foreign companies invested over $27 billion in capital expenditure in Victoria across 449 projects, supporting the creation of almost 50,000 jobs.[1] Thirty percent of these investments were in the Software and IT sectors, areas which will likely be disproportionately impacted by the proposed changes.

While the Commonwealth and State governments, and the Australian public are generally welcoming of foreign investment, it should be recognised that Australia is not as open nor as proactive in securing investment as many of our developed country peers.

Australia ranked 9th highest in the OECD's 2019 FDI Regulatory Restrictiveness Index, and tellingly ranked 2nd highest (only behind New Zealand) in terms of screening and approvals. The likely impact of these changes would see Australia rise in the rankings as one of the most restrictive OECD members with regards to foreign investment regulations. This could not occur at a worse time for the nation's economic prosperity, when foreign investment is more critical than ever in supporting the nation's economic recovery.

Foreign investment can play an important role in economic growth recovery and significantly lead to enhanced competition and productivity gains, placing the economy on a better foothold to face future crises. Therefore, we have highlighted areas of concern with regards to the proposed reforms, that we understand will negatively impact on Australia's economic competitiveness and ability to secure foreign investment. Victoria seeks the Commonwealth's consideration of these issues in balancing its national security obligations with the need to provide an attractive environment for the attraction of international investment. Our concerns cover the following areas:

[1] Financial Times fDi Markets Database

1) National Security
    a. Notifiable national security actions
    b. Non-commercial consideration timeframes
    c. Call-in power
    d. Last resort powers
    e. Regulatory burden on the capacity of FIRB
2) Improving the integrity of the framework
3) A fairer and simpler framework for foreign investment fees
4) Register of Foreign Owned Australian Assets
5) Proposed changes potential impact on water

1) National Security

The proposed reforms are broad and may have unforeseen impacts. The nature of the changes will likely lead to a significant number of investments *being* subject to FIRB review that would not have been reviewed in the past. The broad reaching and retrospective nature of the powers risk creating a perception of increased sovereign risk for foreign investors that could result in Australia being considered a less attractive investment destination.

The rationale for the significant reforms with regard to National Security, as outlined in the Explanatory Memorandum, is limited. For these reforms to be welcomed by stakeholders and foreign investors we would suggest the Commonwealth reasonably articulate why these changes are needed and why they should be coming into effect at this point in time. It would be beneficial if the Commonwealth elaborated on how the current national interest test is not sufficient to deal with the "rising national security concerns" that are the stated impetus for undertaking these changes.

The guidance in the Explanatory Memorandum on the overall sectors and investment characteristics that will require FIRB approval is helpful, however there is a lack of clarity with some of the definitions regarding national security that could allow a large amount of subjective interpretation from the Commonwealth Treasurer and FIRB when determining the investments that will be deemed a 'national security business'.

Notifiable national security actions

Victoria is home to Australia's highest concentration of defence companies with more than 400 businesses and which make equipment and provide services for defence activities. This sector contributes up to $8 billion to the state's economy annually and directly employs 7,000 people with thousands more employed in the broader supply chain. The proposed notifiable national security actions will have a disproportionate impact compared to other states and territories on Victorian businesses, the sector and associated supply chains given the lack of clarity outlined below.

The added 'national security' notifiable action raises concern due to the lack of clarity around determining what would classify as a national security business based on the definitions provided and on current public information. Within the Explanatory Memorandum (para 1.40 to para 1.61), a wide-reaching list including critical infrastructure, telecommunications, defence and data and personal information related to defence are considered national security businesses.

However, there is no clear definition of what a 'critical' good, technology or service is (paras 1.47, 1.50, 1.51). The Explanatory Memorandum points to 'publicly available defence documents' that

may include these identified assets (para 1.51). This appears to be ambiguous by design, as it relies on non-exhaustive lists and will likely result in a large influx of pre-approval requests in cases where it is not needed. This will delay the process of investing into Australia, increase regulatory and reporting burden, and ultimately disincentivise investment. Multiple sectors will be affected by this measure, specifically where provision of services and goods intended for commercial use can be classified as *'intended for defence*'.

Businesses that may not consider themselves a National Security Business (e.g. businesses outside traditional national security sectors such as defence and supply chain businesses that may not have full visibility of the end uses of their goods, such as componentry) may trigger notification and compliance obligations without being aware of the requirements of the Bill to their investment activities.

Another potential concern is where a company currently supplying to foreign governments or agencies, regardless of whether they will be conducting business with the defence and intelligence community in Australia, will be subject to FIRB review if considering an investment in Australia to service commercial clients (para 1.56 of the Explanatory Memorandum). This broad definition could impose a regulatory burden (and disincentivise investment) on a very large cohort of businesses that provide technology or services to defence companies in their home markets or indeed in any of the countries that they operate. Many of the businesses that seek to invest in Victoria in non-defence sectors will face increased cost, delay and regulatory uncertainly due to this broad definition.

In particular, the potential impact on healthcare and health technology is also significant due to the critical service and data collection descriptions for determining a national security business (paras 1.60, 1.61 of the Explanatory Memorandum). Hospitals and healthcare providers that cater to the Australian Defence Force and intelligence communities, as well as their IT, medical device and pharmaceutical supply chain partners could fall under this definition.

Furthermore, the term 'critical' goods, technology and services would benefit from greater explanation. There doesn't appear to be a generally accepted definition of what constitutes 'critical' goods, technology or services, nor does it nominate the entity that will confirm categorisation. It should be clear whether this will be confirmed by the Defence Export Controls office, as well as describing the type of information considered in confirming criticality. Similarly, as far as data and personal information is concerned, a business' level of access to classified information is very unlikely to be public domain information. Therefore, it may prove to be quite difficult to identify some of these companies, particularly those involved in data storage.

These issues create uncertainty and have the ability to greatly impact on a company's decision to invest into Australia and therefore negatively impacts the attraction of new and innovative technologies, reducing our economic competitiveness during a significant economic downturn.

Foreign investment may also be deterred by the lack of clarity around whether a proposed purchase of agricultural land requires mandatory notification and approval. Mandatory notification of proposed investment in Australian land is required where the location or use of the land could prejudice Australia's national security. Mandatory notification also applies to land in which the national intelligence community has an interest, where the foreign person acquiring the interest could reasonably be expected to be aware of the agency's interest in the land. Both requirements create possible uncertainty and difficulty for investors in determining if an acquisition of land should be notified.

Non-commercial consideration timeframes

The proposed extension of the timeframe for FIRB consideration from 30 days to 90 days (at the request of either the applicant or the Treasurer) (p.23) should only be applied in exceptional cases. Delays securing land or a business acquisition will likely cause commercial issues for projects that are time critical and risks losing these opportunities to other jurisdictions with faster and/or less onerous review processes. Furthermore 90 days in order to provide investment certainty for international investors would not be regarded as in keeping with general commercial timelines. It is foreseeable that businesses that are seeking to invest in Australia and are required to make commercial offers that are subject to FIRB approval which may take 90 days would be at a competitive disadvantage compared to local firms that do not have the same encumbrances.

Call-in power

The introduction of this power will increase investor uncertainty, as it widens the scope of reviewable investments that will be subject to FIRB and, additionally, does not provide clear guidance on when or how it will be used.

The Explanatory Memorandum states (para 1.23) that "*A person can extinguish the Treasurer's ability to use the call-in power by voluntarily notifying of an action*". The widened scope of reviewable investments and desire for certainty will likely cause a large influx of voluntary notifications for actions, further increasing the volume burden on the approval process, delays and costs associated with investing in Australia.

We encourage the Commonwealth to provide additional information and guidance on how it will deliver process transparency and improvement (particularly around voluntary notification) and rapid responses to maximise investor understanding and confidence.

Last resort powers

These measures have the potential to diminish Australia's ability to attract innovation, research and development, and novel technologies across a wide variety of sectors, particularly in the life sciences, technology and energy sectors. International investors in these sectors over the past five years have created over 6,000 jobs and $8 billion in capital investment. The criteria (para 1.91) that would constitute a change in the national security considerations of an action, specifically material changes in activity or market circumstances, could mean hypothetically that a company operating in Australia that develops game changing renewable energy technology, lifesaving vaccines, or numerous other market shifting technologies, may be at risk of unexpected imposition of conditions or even forced divestment.

Risks, perceived or otherwise, from these changes may have significant flow on impacts to venture capital, private equity and sovereign wealth fund inflows into Australia. This will in turn reduce the attractiveness of conducting research and development in Australia and therefore reduce the nation's competitiveness in key sectors of the future. Over the past 5 years international investment in research and development has created over 1,800 jobs and over $500 million in capital investment in Victoria.

Regulatory burden on the capacity of FIRB

Victoria has concerns around the prioritisation of applications with the expected increase in applications and submissions. The commercial reality is that speed is key to international investors. On top of the reporting requirements and due diligence required to ascertain 'nation security' status as accurately as possible, it is unclear how workload and timelines will be managed, given there are already reports of significant delays in unlocking offshore capital.

Victoria would seek assurance that modelling has been done on the expected increase of FIRB's workload as a result of the changes, what impact this will have on average timelines for processing and whether the Commonwealth plans to increase its workforce to deal with increased demand and not impose uncommercial delays on international investors.

2) Improving the integrity of the framework

The Commonwealth is currently reviewing protected interest provisions relating to sharing of information. Consideration should be given to increasing the capacity for information sharing between the Commonwealth and states. Details regarding the location of foreign owned land and businesses (such as geospatial mapping) may assist states with their planning and land use processes, including Crown land.

It is possible that State Government agencies may be in discussions with foreign entities without knowledge of live national security matters and foreign interests in National Security Land. This engagement may even progress to financial and non-financial assistance, which may implicate state agencies in the event of non-compliance. Some state agencies also offer site selection services to prospective investors; these services may not be aware of issues regarding National Security Land. A clear mechanism should be in place for states and other consulting partners to enquire about possible national securities issues as part of their due diligence processes for potential investments. This function will also need to be considered in resourcing requirements for timely processing of requests.

Additionally, we have strong concerns that there is a significant change to the existing law around information sharing with foreign governments that could bring to bear uncertainty and concern for foreign investors.

In section 2.54 of the Explanatory Memorandum, it is not that clear what is defined as 'a person' in reference to who can share protected information with foreign governments. It does not appear to be defined in the current section of FATA (Section 7 Division 3), and the new power to share with foreign governments does not provide clarity. Furthermore, this power appears to be subject to agreements in place between the Commonwealth and the foreign counterpart (para 2.53) with no specific guidance on the agreements that will be permissible under this Bill. This also infers (para 2.55) that information sharing can occur to assist the foreign government regardless of FATA implications. There is no clarity on the disclosing party and the satisfied party (para 2.57) and whether this is a unilateral process or if multiple persons are involved.

Another concern that has elements of sovereign risk is outlined at section 2.17 and states the Commonwealth Treasurer shall have the ability to make a new order even if a court has found that an order or decision made by the Commonwealth Treasurer is invalid. This amendment in isolation is very concerning and would benefit from further explanation by FIRB on its practical implications.

3) A fairer and simpler framework for foreign investment fees

The proposed Bill and changes explained in the Explanatory Memorandum only provide that changes will occur. Victoria considers that any changes to the investment fee structure should be for increased fairness or simplicity. Based on the information provided the proposal appears to create new fee criteria and adds complexity rather than simplicity. There is also no detail on the level of fees that will be imposed either in the Explanatory Memorandum or the draft Bill. Victoria seeks notification of the fee structure as early as practicable and an assurance that it will be set with a view to minimising costs to avoid disincentivising potential investors. The principle that international investors should bear the cost of regulations imposed by the Commonwealth ignores the contestable nature of these investments and the benefits that they bring to the Australian economy.

For Victoria, which attracts a large number of smaller investments (many of which have large growth potential), the increased uncertainty, incentive to voluntarily notify the Commonwealth and associated costs, may deter smaller investors to whom these costs represent a larger proportion of total market entry costs.

4) Register of Foreign Owned Australian Assets

There does not appear to be a threshold for 'interests' that need to be recorded in the Register of Foreign Owned Australian Assets. Without a reasonable threshold an investor with a 1 per cent interest in land, for example, would be subject to significant reporting requirements. If this is the case, there would be an unnecessary increase of government and private sector administrative burden.

The use of information on the agricultural land and water register is currently governed by the *Taxation Administration Act 1953*. Further clarity on how information on agriculture land included on the Register of Foreign Owned Australian Assets will be governed and maintained would be helpful.

The addition of assets to a register not already currently maintained by the Australian Tax Office (ATO) and the Australian Communications and Media Authority (ACMA) increases the reporting burden and complexity for all foreign investors regardless of FIRB applicability under the current wording (4.11 dot points 3 & 4 of the Explanatory Memorandum). Under this description it seems that all investors in an Australian entity must register with the Treasury and/or ATO or risk a civil fine.

5) Proposed changes potential impact on water

Victoria generally does not support imposing additional regulation or regulatory oversight on foreign investment except when the proposed reform addresses critical policy gaps and can be done in a way that delivers net benefits to our community.

Victoria believes there is a strong policy rationale for FIRB oversight of water entitlements acquired separately to land purchases by foreign investors.

Under the existing framework, the acquisition of water entitlements is treated as the acquisition of a business asset and does not fall within any of the categories that require compulsory FIRB approval.

It is only if the water entitlement is being acquired as part of a purchase including land or a company, or if the purchaser is a foreign government that the acquisition is reviewed by FIRB. This is a policy gap that should be addressed.

Water is a high value and scarce commodity, and one that has no substitute. Water is vital to our environment and regional communities who use it to grow food and fibre for the nation. The approximate value of water trading across the Murray Darling Basin annually is $2 billion.

Historically, water entitlements were tied to land, and therefore would have been captured under FIRB criteria. Over the past two decades, significant volumes of water entitlements have been separated from land across the entire Murray-Darling basin through unbundling of water from land and development of water markets, consistent with the vision of the National Water Initiative and Murray-Darling Basin Plan trading rules.

In Victoria, these water entitlements largely used for agricultural purposes and unbundled from land are called 'water shares'. Large volumes of water shares are now held, and sold, without an attachment to land. This is the case in others states and territories. It is now important that the criteria for referral to FIRB is updated to reflect the Murray-Darling Basin Plan and State entitlement frameworks.

Victoria requests that foreign purchases of water entitlements ('water shares' in Victoria), become subject to a similar level of scrutiny as agricultural land by FIRB. For foreign acquisition of water entitlements, Victoria considers that FIRB is well placed to balance Australia's attractiveness as a foreign investment destination with national interests. FIRB will need to consider the impact of this reform, including if it is appropriate to set a threshold or limit on the volume of water entitlement that would trigger FIRB consideration.

Conclusion

Australia needs to ensure that it maintains its national security interests and its attractiveness as an investment destination in the current global economic climate. In its current form, the proposed reforms have the potential to jeopardise the ability to attract foreign investment in a highly competitive global environment.

The Victorian Government understands and generally supports principles behind this legislation. However, the potential for increased complexity and delay of investment projects and the dis-incentivisation of innovation, research and development stemming from the proposed measures will have a significant impact on the future of key sectors in Australia such as pharmaceuticals, medical technologies, artificial-intelligence and other high-tech industry sectors.

Victoria requests that FIRB and the Treasurer comprehensively consider the issues raised in this submission and work towards achieving a better balance in the proposed legislation between regulatory oversight and commercial practicalities.