



17 July 2015

Manager
International Investment & Trade Unit
Foreign Investment & Trade Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ForeignInvestmentConsultation@treasury.gov.au

Dear Sir/Madam

Implementing Foreign Investment Reforms

The Australian Financial Markets Association welcomes the opportunity to comment on the exposure drafts for implementing the government's foreign investment reforms.

AFMA welcomes the proposed modernisation of Australia's foreign investment framework, particularly insofar as the proposed legislative amendments improve the transparency of the existing framework and better align the framework with other regulatory regimes, most notably, the takeover provisions of the Corporations Act.

The proposed amendments potentially alleviate administrative and compliance burdens in relation to some categories of foreign investment, as noted in our previous submission to the Options Paper.¹

Screening Thresholds

The proposed legislative changes also give effect to the government's tightening of scrutiny over foreign acquisitions in relation to residential real estate, agricultural land and agribusiness through a lowering of screening thresholds that will impose an additional compliance burden and potential deterrent effect on foreign acquisitions valued between the new and existing thresholds. This is at odds with the government's stated intention to promote foreign investment and Australia's participation in global

¹ Australian Financial Markets Association, Australia's Foreign Investment Framework: Modernisation Options, submission dated 29 May 2015.

supply chains, particularly in the agricultural sector, where the government has identified significant export growth potential requiring foreign investment.

The lowering of screening thresholds raises the question as to whether the government is imposing unnecessary and costly scrutiny on investments in areas that are unlikely to raise 'national interest' or other policy concerns, especially given the low explicit rejection rates for foreign investment applications in these areas. Apart from the application of screening thresholds, the government does not otherwise propose to change the criteria by which foreign investment applications are evaluated. This suggests that lower screening thresholds will not result in a change in foreign investment approval rates for a given volume of investment, but will increase compliance burdens and potential deterrent effects on foreign investment. However, given that these thresholds have been incorporated into recent Free Trade Agreements, it is appropriate to align the foreign investment framework with these commitments.

Application Fees

The legislation introduces a range of application fees for foreign investment applications. Currently, no fees apply.

The proposed fees will act as a tax on foreign investment, albeit a small one. It should be noted that the effective incidence of the proposed fees will fall on both foreign investors and the resident vendors of domestic assets.² As the Henry review observed, foreign direct investment has a particularly high elasticity with respect to tax rates given the international mobility of foreign capital and the discretionary nature of foreign investors' exposure to Australian regulation. The application fees would also amplify the deterrent effect arising from uncertainty in relation to the Treasurer's discretion to reject applications or impose conditions on approvals on effectively open-ended 'national interest' grounds. Australia recently ranked relatively poorly in an international comparison of foreign investor perceptions of the rule of law.³

Australia's regulation of foreign investment in residential real estate and agricultural land is internationally anomalous when compared to our developed country peers, such as the United States and the UK, which do not regulate such investment, although the US maintains a federal foreign land ownership register. This internationally anomalous treatment, which was recognised by the House of Representatives Standing Committee on Economics' *Report on Foreign Investment in Residential Real Estate*, could be expected to increase the sensitivity of foreign direct investment in these sectors to the introduction of application fees given that other jurisdictions provide competing investment opportunities without the same compliance burden and policy uncertainty

² The price elasticity of demand for housing, in particular, is thought to be around 1%, suggesting a change in quantity demanded proportional to any increase in price. Foreign purchasers could be expected to have a higher price elasticity of demand for the reasons given above, so foreign investment demand could be price elastic. The price elasticity supply for housing is generally thought to be inelastic (<1%), and close to zero in the short-run. See Peter Abelson and Roselyn Joyeux, 'Price and Efficiency Effects of Taxes and Subsidies for Australian Housing,' *Economic Papers* 26:2 (June 2007).

³ Hogan Lovells, Bingham Centre for the Rule of Law, British Institute of International Comparative Law, *Risk and Return: Foreign Direct Investment and the Rule of Law*, 3 June 2015.

flowing from the Treasurer's discretionary powers. Any reduction in foreign investment would come at the expense of domestic capital formation and other benefits associated with foreign investment.

The increased sensitivity of foreign direct investment may be exacerbated by other measures currently being pursued by the Government, including the imposition of a 10% non-final withholding tax for disposals of taxable Australian real property by non-residents.

Parliamentary Budget Office analysis of the implications of foreign investment application fees for residential real estate for the fiscal balance show a positive impact, but under the assumption of no behavioural change on the part of foreign investors.⁴ Allowing for potential behavioural responses could see less revenue collected than anticipated. In modelling the impact of proposals to impose additional stamp duty on foreign purchases of residential real estate, the PBO notes that:

Foreign investors, particularly those who invest purely for financial returns, would be expected to be highly sensitive to the introduction of a Commonwealth Government stamp duty as the stamp duty would reduce the potential financial return from investing in Australian residential property relative to alternative investment opportunities. Foreign investors would be expected to respond by switching some part of their investments to other lower cost jurisdictions or to other Australian assets. This means that the introduction of the foreign investor stamp duty would be expected to reduce the number of residences purchased by foreign investors.⁵

While the proposed application fees in the exposure draft are small relative to proposals for the imposition of additional stamp duty of up to 20%, the effect of these fees on foreign investor demand could be expected to differ only in the magnitude rather than in the direction of the effect. The PBO analysis was not referenced in the Regulation Impact Statement.

Application of Cost Recovery Guidelines

AFMA notes that the proposed fees are part of a trend to shifting the administrative cost burden of regulation from the taxpayer to the private sector. Where the government provides a service of direct benefit to foreign investors, it is appropriate for government to impose cost recovery arrangements, although as noted above, this may come at the expense of foreign investment, which has a discretionary exposure to domestic regulation. AFMA submits that the proposed fees for foreign investors should be made subject to the government's Cost Recovery Guidelines.

⁴ House of Representatives Standing Committee on Economics, *Report on Foreign Investment in Residential Real Estate*, Appendix C, Parliamentary Budget Office Costings for a Proposed FIRB Application Fee.

⁵ House of Representatives Standing Committee on Economics, *Report on Foreign Investment in Residential Real Estate*, Appendix C, Parliamentary Budget Office Costings for a Proposed FIRB Application Fee. p. 121.

The government has noted that the proposed fees are also intended to cover the cost of broader regulatory functions, including data collection, compliance and enforcement activities, in addition to the application and approval process. Given that these activities are undertaken for the public benefit and not the direct benefit of foreign investors or resident vendors, it is more appropriate that these activities are funded through general tax revenue.

The fungibility of revenue accruing to government makes any hypothecation of foreign investor application fees to these regulatory activities indistinguishable from an increase in the general tax burden, but with the incidence of that burden falling directly on domestic capital formation. The proposed fee schedule should not be calibrated to cover general regulatory functions or activities that are more appropriately taxpayer-funded.

Recent public concerns about foreign investment in residential real estate are in part a reflection on successive governments' under-resourcing of compliance and enforcement activities relative to the tasks Australia's foreign investment framework was expected to perform. As the government notes, perceptions of a lack of compliance and enforcement have undermined public confidence in the framework.

Shifting the cost of increased compliance and enforcement activities on to the private sector eases the government's budget constraint and is likely to lead to an over-supply of regulation, which is under-priced from the government's perspective. If the additional compliance and enforcement costs associated with the government's proposed changes to the foreign investment framework were to remain on-budget, the government might be more reluctant to devote additional resources to this area at the expense of other policy priorities or consider alternative policy approaches.

Implications for Housing Supply and Housing Affordability

The foreign investment policy with respect to residential real estate aims to increase Australia's housing stock. However, the proscription of established dwellings being acquired by foreign persons may not effectively serve this objective. Limiting foreign investment to newly-built dwellings still creates indirect foreign competition for the established housing stock.

Foreign acquisitions of residential real estate are a transfer of foreign wealth to Australian residents, either in the form of additions to the domestic housing stock or higher valuations for that stock. The split between new supply and higher prices due to changes in foreign demand is largely a function of domestic regulation of the supply-side of the housing market and not the attributes of Australia's foreign investment regime. Increased resources devoted to compliance and enforcement are not likely to improve housing (including rental) affordability given that it is determined by domestic regulation and could undermine affordability to the extent that foreign investment in new dwelling stock and non-resident holdings of the total stock are reduced. This outcome would be at odds with the stated intention of the foreign investment framework.

Controls on the acquisition and disposal of residential real estate by temporary residents are at odds with government policies that seek to promote temporary migration for the purposes of remediating labour market imbalances and exporting higher education and other services. To the extent that temporary residents are discouraged from the owner-occupied housing market they will migrate to the rental market and reduce affordability in that market.

A greater public policy focus on increasing the flexibility of the supply-side of the housing market would enable the market to accommodate increased domestic and foreign demand without upward pressure on prices. This would in turn would obviate the need for Australia's internationally anomalous proscription of foreign investment in established residential real estate and the associated compliance and enforcement burden borne by government and now proposed to be shifted on to the private sector to the detriment of domestic capital formation.

Register of Foreign Ownership of Land

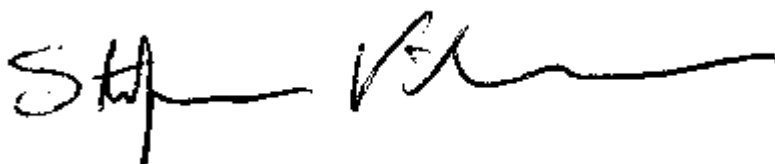
AFMA supports the establishment of a register of foreign ownership of agricultural land. This measure can be expected to lead to better community understanding of the nature of foreign investment in Australia.

In addition to making these statistics available on a web site, the government should ensure that the data are supplied in a machine-readable format and that a consistent methodology is applied in compiling the data to ensure the comparability of the data over time. This will facilitate empirical examination of the effects of foreign investment policy changes on the future stock of foreign investment.

Concluding Remarks

Australia's foreign investment framework should remain focussed on promoting domestic capital formation and other benefits of foreign investment, while ensuring Australia's 'national interest' is appropriately safe-guarded. These outcomes can be achieved without imposing an excessive regulatory and compliance burden on foreign investors and domestic residents which, when combined with the Treasurer's discretion over foreign acquisitions, may have a deterrent effect on foreign investment that is contrary to the government's stated policy intention to promote foreign investment. The modernisation of Australia's foreign investment framework should reflect these considerations.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Stephen Kirchner', with a long horizontal flourish extending to the right.

Stephen Kirchner
Economist