

*This is a joint report by China Matters and PwC Australia. PwC Australia has supported China Matters since its inception in 2015. The report aims to stimulate discussion of this issue and provides policy recommendations.*

## PRC Investment in Critical Infrastructure

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### Key Points

Infrastructure is an attractive asset class for investors worldwide, and investors from the People's Republic of China (PRC) are no exception. With an estimated A\$1 trillion of investment needed over the next twenty years, Australia is likely to see more PRC investor interest in our critical infrastructure. PRC investment is challenging Australia in new ways, but our business and security communities continue to talk past each other on these complex and rapidly evolving issues.

Our foreign investment regime aims to facilitate investment in all assets except those of the most extreme sensitivity. And for the most part, this principles-based and flexible approach to foreign investment has served Australia, and foreign investors, well.

Investors seek clarity, consistency and certainty about bids. The security establishment voices concerns about the potential risks of foreign ownership of critical infrastructure assets. Meanwhile, the government faces the challenge of managing the often negative public perceptions of investment from the PRC.

Australia needs a realist approach that balances the legitimate concerns of its security establishment and the Australian public on the one hand, and PRC investors on the other. The government must assure PRC investors that their money is welcome while assuring Australian security experts and the public at large that our critical infrastructure is safe. Achieving this will require a deeper partnership between our national security and business communities as well as clarity and a more nuanced understanding of the PRC.

### Introduction

Federal Treasurer Scott Morrison says that foreign investment rules need to be strong, effective and enforceable. Business leaders say foreign investors need rules that are clear, consistent and certain. Both sides say Australia needs foreign investment, including in critical infrastructure. A meeting of minds in every case is unachievable. There will always be foreign investors who are unhappy with the approval process – but we can, and must, do better than we have done.

The 2013 decision by the then Treasurer to reject an American company's purchase of Grain-Corp was an apt reminder of the sensitivities

around foreign investment. The then chairman of the Foreign Investment Review Board (FIRB) publicly admitted the decision was political. Australia's largest agribusiness was not to be owned by Americans. The fact that Australia and the United States have a military alliance did not matter. Add to the equation investors from an authoritarian state governed by the Communist Party of China (CPC) vying for criti-

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cal infrastructure and the challenge for the Australian government becomes manifold. Australians are familiar with the United States; our understanding of the People's Republic of China (PRC) is limited and often based on overly black-and-white presumptions. We need to understand how decisions are made in the PRC and what rationale the CEO of a PRC company has to wish to invest in an Australian infrastructure asset.

This report explores the challenge of how best to protect the security of vital assets linked to national security while still facilitating foreign investment in critical infrastructure, particularly investment from a country with an opaque decision-making political system such as the PRC. Critical infrastructure is defined to include ports, electricity, water and telecommunications. The government is considering whether gas assets should also be added to the definition. Based on interviews for this project, it is apparent that in today's world certain types of data should also be defined as critical to national interests and therefore should also be protected from risks associated with espionage, sabotage and criminal exploitation. Safeguarding critical infrastructure also entails ensuring that ownership of an asset may not be used to coerce the management of an Australian company or the Australian government.

The government estimates that Australia requires A\$1 trillion in critical infrastructure investment over the next twenty years. Much of this money may come from foreign sources. The PRC is now the fifth-largest source of FDI in Australia (behind the US, Japan, UK and the Netherlands) with a stock of A\$42 billion, or 5.3 per cent of our total stock at the end of 2016. The PRC stock is still less than half that held by Japan (A\$91 billion) and is dwarfed by the US stock (A\$195 billion). Over the period between 2008 and 2016, the PRC accounted for A\$38 billion, or 10.8 per cent of the total increase in our FDI stock. Only the US and Japan increased their total stock by more adding A\$95 billion and A\$54 billion respectively.

Outbound investment from the PRC has shifted from its early energy and mining focus towards a more balanced portfolio of interests. Infrastructure is an attractive asset class for investors worldwide. PRC investors are no exception.

Those with a favourable view of PRC investment in Australia remind us of the "skin in the game" factor, in other words commercial interests provide ballast when tensions arise in the bilateral relationship, as they inevitably do. Commercial factors serve as an incentive to keep the relationship on an even keel. Robust commercial ties with the PRC are very much in Australia's national interest. So of course is maintaining our national security as well as responding to public perceptions. Here lies arguably the greatest challenge: investment from the PRC is high-profile and often unpopular in Australia. Worries, particularly in the national security community, about PRC strategic intentions raise further challenges.

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A set of rules and a review process which provides investors with the "three Cs" – clarity of rules, consistency of application and certainty of outcomes – should be a guiding principle of our foreign investment regime. While it may not be realistic to expect that we will be able to provide the "three Cs" on every occasion, our business leaders, public servants and politicians have a collective responsibility to explain to the public why PRC investment is both needed and welcome. At the same time politicians and regulators need to be able to assure voters that appropriate safeguards are in place to protect national security.

Research conducted for this project probed two questions: Can the twin needs of a stronger investment relationship with the PRC and a secure Australia be fulfilled? How will this affect critical infrastructure, the most likely flashpoint in the next few years?

### **Oversight by the federal government**

The leasing of the Port of Darwin to Landbridge Group (Landbridge) in October 2015 was a wake-up call. Former Northern Territory Chief Minister Adam Giles tried fourteen times to convince Canberra to fund development of the Darwin port. On the fifteenth attempt he gave up, and he and his government went to market.

Eventually they chose Landbridge, a private PRC company. The Northern Territory government received A\$506 million for the 99-year lease. Landbridge also committed to spend a further A\$35 million on the port within five years and to invest A\$200 million over a 25-year period. “This is about getting off the teat of Canberra, becoming less and less reliant on money from Canberra”, an unnamed senior government official told a local newspaper.

Landbridge was a known entity in Australia. When Landbridge signed a deal in 2014 to buy Brisbane-based coal seam gas producer WestSide Corporation, Prime Minister Tony Abbott and President Xi Jinping witnessed the signing. This fact received little attention when alarms were raised in the Australian media about Landbridge’s supposed connections to the PRC government after the Darwin port lease was signed. US President Barack Obama is reported to have asked Prime Minister Malcolm Turnbull to “let us know next time”.

Australia’s security agencies and the Australian Department of Defence had all carefully examined the Landbridge investment and judged that it did not pose any security threat. Dennis Richardson, Secretary of Defence at the time, said “We and ASIO have looked very carefully at it from the point of view of espionage and issues of a security nature. We are at one in agreeing that this was not an investment that should be opposed on defence or security grounds”. Mr Richardson also warned that some critics of PRC investment were hiding behind the cover of defence and security.

The furore around Landbridge’s lease of the Port of Darwin was followed by the Treasurer’s August 2016 rejection of a reported A\$13 billion bid by State Grid Corporation (State Grid), a PRC state-owned enterprise (SOE), to buy a 50.4 per cent interest in the NSW electricity distributor, Ausgrid. The Treasurer also ruled out a competing bid by Hong Kong listed Cheung Kong Infrastructure (CKI). Both bids were, in the Treasurer’s opinion, “contrary to the national interest, in accordance with the required provision on the grounds of national security”.

Both State Grid and CKI already owned significant energy infrastructure in Australia. Adding further confusion, less than a year earlier, State Grid had partnered with Macquarie Infrastruc-

ture and Real Assets (MIRA) to bid for the NSW electricity transmission network operator, TransGrid. It is understood that bidders for TransGrid were informed by FIRB of certain “Treasurer’s preferences” in relation to the proposed sale which included, inter alia, a number of governance measures and a ceiling on the ownership level that a foreign SOE may have at 50 per cent.

TransGrid was ultimately sold to a 65 per cent internationally owned consortium led by ASX-listed Spark Infrastructure and Hastings Funds Management. In the circumstances it seems highly improbable that the NSW government, or the Ausgrid bidders for that matter, would not have considered the proposed ownership structure and “Treasurer’s preferences” as expressed during the TransGrid process. The Ausgrid rejection would have been even more embarrassing if State Grid/MIRA had been successful in their bid for TransGrid.

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Not only was foreign investor confidence undermined because the potential buyers of Ausgrid had been led to believe that the bid would be accepted until the very last minute; the fact that “national security concerns” were identified at such a late juncture also undermined public confidence in the government’s capabilities. A senior public servant privately describes the manner in which Ausgrid was handled by the government as a “monumental stuff-up”.

The 50.4 per cent interest in Ausgrid was subsequently sold in October 2016 to AustralianSuper and IFM for A\$10.4 billion, upwards of A\$2 billion less than the reported State Grid bid. The headline price difference does not take into account any additional remediation or security costs that may have been incurred had the higher alternate bid been accepted. In that sense, the net difference may not actually be as large as initially reported. Nevertheless, that is money that could have been earmarked for other infrastructure investment in NSW. There is nothing wrong with a line being drawn where our national security is concerned, but we

should explain to the public clearly just what the economic cost is.

In the aftermath of the Port of Darwin sale, and with the November 2015 rejection on national security grounds of Shanghai Pengxin Group's bid for S. Kidman and Co fresh in the Treasurer's mind, former Australian Ambassador to China and Director-General of both ASIS and ASIO, David Irvine, was appointed to the FIRB in December 2015. The Treasurer said at the time that "it will be increasingly important for FIRB to not only have the commercial expertise and background to deal with complex commercial transactions, but to also have an even greater understanding of the broader strategic issues ... that are essential to protect our national interest".

Shortly afterwards in April 2016, the Treasurer rejected a revised bid from Shanghai Pengxin Group for S. Kidman and Co, this time citing the "size and significance of the Kidman portfolio" as a concern in making the investment "not in the national interest". The business community were again left wondering whether there was a common understanding of what exactly the "national interest" was.

After the series of controversies surrounding decisions involving PRC investors, Mr Irvine was appointed as Chairman of the FIRB in April 2017. Mr Irvine's appointment was widely seen as a response by the government to public criticism of a series of foreign investment decisions involving national security considerations and proposed PRC investment.

That same month, the FIRB cleared CKI's A\$7.5 billion acquisition of ASX listed Duet Group, the owner of power lines, gas pipelines and power plants. The FIRB also cleared a reported A\$4 billion acquisition of electricity and gas retailer, Alinta Energy Limited, by Hong Kong private company Chow Tai Fook Enterprises Limited (CTFE). In May 2017, a consortium led by MIRA and AMP Capital, that also included two foreign funds with a combined interest of 42.8 per cent in the consortium, acquired a 50.4 per cent interest in power distributor, Endeavour Energy for a reported A\$7.6 billion. Finally, in November 2017, CTFE obtained the FIRB's approval for its acquisition of the Loy Yang B coal fired power station that produces 17 per cent of Victoria's energy needs. These transactions provide am-

ple evidence that foreign investment in our critical infrastructure is both possible and welcome.

Whatever the rights and wrongs of the investment proposals discussed above, the confidence of both the public and business community in our foreign investment review process has been adversely affected. PRC investment will continue to present increasingly complex questions for policy makers and regulators. It is, therefore, essential that the business community, national security community and government work closely together in developing our understanding of PRC investment and to restore the community's confidence in the processes.

### The challenges of critical infrastructure

Critical infrastructure poses a new set of issues with regards to PRC threats to our national security.

Investment in critical infrastructure is likely to trigger security concerns because of rapidly changing technology. Software, rather than hard infrastructure, is often a risk now and it is very difficult to predict where that will be in a year, let alone over a longer investment horizon typical in infrastructure projects. The "internet of things", where everything is connected, will make the challenge of defining and importantly maintaining any view of critical infrastructure extremely difficult. Assets will be highly interconnected and therefore activities are likely to occur offshore as much as onshore, using software and equipment from around the world, and making location less relevant.

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While significant PRC investment in critical infrastructure has not always raised national interest or resulted in community concern, one can identify many critical infrastructure projects which have led to a public reaction due to proposed PRC involvement. In telecommunications, a private company Huawei Technologies Co. Ltd was banned from providing infrastructure to the National Broadband Network (NBN)

following a rigorous and lengthy security assessment. In energy provision, there was the rejection, on national security grounds, of proposed investments in Ausgrid as described above. In ports, there was the Landbridge investment discussed above. Finally, although the concerns were related to agriculture rather than critical infrastructure in particular, water was a subject of public interest during the mooted PRC purchase of the Cubby Station agricultural property due to its significant water allocation rights under the Murray Darling Basin Plan.

Not all critical infrastructure is equally worrisome. It is easier to regulate and segregate ports and water infrastructure for example, but more difficult to mitigate risks when it comes to telecommunications and energy assets. Access to data is a concern that unites all areas of critical infrastructure, and one that is difficult to assess. It is very difficult, for example, to calculate the potential future consequences of ceding control over, or access to, data to PRC investors. And the environment is changing rapidly as more and more connected devices create far larger datasets. Access to this data may prove an unforeseen future security risk.

Vulnerabilities are not so much in the physical infrastructure as the software and intelligent systems that power them. The rapid pace of technological change is challenging traditional ways of thinking about assessing foreign investment and national security threats.

### Does ownership matter?

There are legitimate concerns about PRC ownership of critical infrastructure assets, especially given the possibility that the PRC could use economic levers to coerce the Australian government, asset owners or managers. Ownership may also increase the risk of deliberate disruption of services that jeopardise security. Traditionally, Foreign Direct Investment (FDI) from the PRC into Australia has been dominated, at least in dollar terms, by SOEs. SOEs are encouraged by the central government in Beijing to invest abroad.

SOEs attract considerable attention in debates about investment. An enterprise can be classified as a state-owned enterprise if any member of the foreign government's body politic "holds

a substantial interest of at least 20 per cent" in the enterprise. Australia has historically been less comfortable with SOE investment as opposed to private investment. The status of SOEs are understood to have been a sticking point in the China-Australia Free Trade Agreement (ChAFTA) negotiations. In contrast to many other countries, PRC private enterprises were granted a higher threshold above which FIRB approval is generally required. The rules related to SOEs remain unchanged and apply to enterprises of all nationalities.

In off-the-record discussions, government officials say that in the case of PRC investment, private and SOE-investors are assessed through a similar lens reflecting a view that the PRC government has a number of means at its disposal to exert influence over a private enterprise regardless of the legal ownership of the enterprise.

Critical infrastructure in some cases obviates this debate. The nationality or ownership category of an investor is inconsequential if the critical infrastructure asset is one that cannot be sold. Some assets, such as Ausgrid, may not be sold to foreigners, regardless of which country the investment may come from.

The assets that cannot be sold should be clarified. Parts of this process are already in motion. Former FIRB chairman, Brian Wilson, has publicly advised that there are certain firms that Chinese investors should probably "steer clear of". Moreover, the government is developing a critical asset register. Although the register is not intended for public viewing, assets that cannot be sold should be clearly identified for government reference. Care needs to be taken to ensure that assets appearing on the register are truly "critical infrastructure" – otherwise the register risks becoming a negative investment list that is used to serve the popular politics of the day, rather than being there to better safeguard our national security.

Another way to look at the question is to separate active and passive investors. PRC investors have so far tended to focus more on active investment where control is obtained, raising both the national security risk and political risks for governments.

While the PRC has a number of sovereign

wealth funds, they tend to act more as policy banks than simple passive investors and in that sense might be regarded as sitting somewhere between an active SOE investor and a passive SOE investor.

Encouraging more passive investment or participation in consortiums may reduce national security risks as well as political tensions. Scant public attention was paid to the A\$9.7 billion sale of the Port of Melbourne in September 2016. The investor was a consortium in which the China Investment Corporation, one of the PRC's sovereign wealth funds, had an effective 20 per cent stake, alongside the Future Fund and the Queensland Investment Corporation. This was despite the transaction taking place in the middle of the controversy surrounding the Ausgrid sale in NSW.

While passive investment, or participation in a consortium, may still expose the investee firm to some of the risks of coercion, and it could provide access to more information for anyone who wished to do harm, it may also provide a more suitable structure for critical infrastructure investments. Each situation needs to be assessed on a case-by-case basis, but some form of graded risk scale could be considered to provide investment proponents with guidelines about what might be acceptable in relation to particular assets on the register.

When David Irvine was head of ASIO he said publicly that the PRC can do Australia harm without owning an electricity grid. In today's world of cyber-attacks it is legitimate to ask why ownership of an asset increases the security risk. Cyber experts say that ownership reduces the time needed to plot an attack and become acquainted with the asset's vulnerabilities, i.e. ownership can (but not always) reduce the time needed to do harm.

Business leaders interviewed for this report were divided on the question of whether physical ownership matters. They state that companies spend considerable time and money assessing and mitigating security risks. These risks, they say, generally do not exist in the boardroom but are in the control rooms and other operational centres in the organisation where employees with detailed knowledge of the systems work. Why, they argue, would a

PRC company pay billions of dollars to own an asset only to sabotage that asset when they could achieve the same outcome by exploiting existing employees or vulnerabilities in cyber defences?

Other business leaders were more concerned with the potential for sensitive information to be obtained through coercion by a PRC shareholder. This might occur for example through the shareholder's ability to gradually influence the appointment of senior executives and/or the setting of remuneration and incentive awards. Concerns were also raised in relation to the ability of a shareholder to either directly or indirectly influence the choice of service providers or the suppliers of equipment and software that may expose critical infrastructure to risks.

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There are questions about whether the risk is higher when a foreign investor owns more of the company. More ownership may be allowed when the potential investor does not demand control in the governance of the asset through seats on the board, for example. There is a trade-off here: active FDI is generally thought to be better for economic productivity as it gives Australia access to foreign management, technology and networks – and the PRC is the world leader in mobile payment technologies and amongst the leaders in emerging technologies including robotics, artificial intelligence and green-tech.

In many cases though, the management of the asset may be more important than the direction of the board. Other than access to capital, the benefits that Australia expects to receive from a proposed investment – such as access to technology, know-how or new markets – are important considerations for the FIRB.

Equally, the actual ability and track record that a PRC investor has in managing a critical infrastructure asset efficiently and effectively are relevant considerations that warrant more attention in the approval process. There is also a

reasonable case to be made that a demonstrable track record of, and capacity for, delivering on promised development should form a more prominent part of our FIRB considerations.

Just how much ownership really matters if there is intent to do harm remains a vexed question. What is clear though is that our business and national security communities continue to talk past each other on this vital issue. That is not a sustainable state of affairs and requires the urgent attention of both communities.

## **Critical Infrastructure Centre**

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The Port of Darwin and Ausgrid cases contributed to the government's decision to create a new, more rigorous regime to deal with foreign investment in critical infrastructure. The government decided to both regulate decisions taken independently by state governments on Australia's critical infrastructure and identify critical infrastructure that needs to be kept in Australian hands regardless of the price offered or nationality of the potential buyer.

A new regulatory body, the Critical Infrastructure Centre (CIC), started work within the Attorney-General's Department in early 2017. The CIC's role is to "increase the resilience of Australia's critical infrastructure to threats of coercion, control or sabotage", as well as to provide "more comprehensive, coordinated and timely advice on national security considerations for any prospective investment". Specifically, the centre focuses on the potential for a malicious foreign actor to gain access and control of Australia's critical infrastructure, via ownership, offshoring, outsourcing and supply chain arrangements.

The CIC's role goes beyond just investment. The CIC sees its primary role as being to work with business to make Australia's critical infrastructure more resilient regardless of its current ownership. The CIC also seeks to act before any new investment proposal is made or changes to existing arrangements are contemplated.

Early interaction between business, state governments, and the federal government using the CIC has a number of advantages. The CIC's broader role beyond mere investment review provides a mechanism for business and government to work together to mitigate some of the

concerns associated with PRC ownership or where no suitable mitigation is possible, to address this at the outset so that public confidence is maintained and vendors and potential investors are not embarrassed by an unnecessary process. Regular dialogue between business and government is essential to minimise the risk that a potential bid, which receives initial indications of government support, in the end is not allowed to proceed.

Unlike investment regulation, critical infrastructure regulation focuses on the ability of outsiders to access and control critical infrastructure.

FIRB's role is to facilitate, not stop foreign investment. The CIC can play a positive role in helping to allow investments that might otherwise not be allowed by proposing conditions that need to be met before FIRB approval. The CIC and FIRB are encouraging early consultation with buyers and sellers on specific risk mitigation strategies.

Critical infrastructure regulators can provide information to make assets more resilient prior to any sale. This information should improve the prospects of foreign investors, as it can provide greater certainty for investors and better mitigation strategies for regulators. The key to this success will be in business and government working together to ensure early warning for both sides.

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The CIC has two mechanisms available to improve regulation, public confidence and interaction between business and government. Firstly, it can further develop the way the CIC interacts with business, introducing more effective consultative mechanisms.

Secondly, the CIC and/or FIRB can communicate and share measured intelligence judgments and case studies including foreign examples. The Report to Congress by the US-China Economic and Security Review Commission provides this type of material, for example. Where sensitivities do not allow a public disclosure, consideration could be given to providing infor-

mation behind closed doors to select entities and through trusted industry networks. Critics argue that information sharing must be reconciled with the need to keep security information private. But surely, information can be carefully formulated — and there would be considerable gains in releasing the information.

Both of these measures would help inform public opinion; and also lead to better information being provided to the Treasurer, the ultimate decision-maker.

## **Australian public opinion**

When it comes to PRC investment in critical infrastructure, ultimately the “elephant” in the room is the PRC’s political system and strategic intent. Australia has always relied on foreign capital to fund the domestic investment required to maintain economic growth. The money for this investment has in the past come from countries that by and large adhere to similar principles of representative government and civil liberties, such as the US, the UK and Japan.

The real challenge is to convince Australian politicians that they need to be forthright with Australian voters: foreign investment is needed and as the pools of surplus savings in the world are increasingly in Asia, particularly in the PRC, it is likely that investors from the PRC will be ever more present in our future. At the same time, the government needs to convey that it is absolutely committed to safeguarding our critical infrastructure assets.

Politicians should not be shy in talking about the importance of the “three Cs”: clarity, consistency and certainty. If we wish for PRC investors to remain interested in Australia, we need to acknowledge the importance of investor confidence. In the case of a government asset sale, the extra monies that PRC investors are often willing to pay help fund essential public services. This greater value is rarely recognised, nor publicly expressed.

Much of the media reporting about “problems” with PRC investment and its regulation are related to perceptions – and often outright misinformation. In the current atmosphere anything related to the PRC evokes attention. Historically, the rise of a new power causes jitters. The PRC is no exception. The uncertainty of how the PRC

will use its power is a source of anxiety among Australians generally, and in particular when, for example, PRC investors wish to invest in critical infrastructure. Regulators face a difficult task in predicting how a rising PRC will act in many years’ time when its relative power has grown further, or indeed during periods of diplomatic tension.

Our poor understanding of how the PRC political system works is in part due to the opaque nature of decision-making in the PRC. But, in part, it is also due to general ignorance about the PRC. During the media storm around the Port of Darwin lease, Australian media cited statements by Australian “experts” that the existence of a people’s militia in an enterprise was proof of the enterprise’s close ties to the People’s Liberation Army, all part and parcel of an article claiming that Australia’s smallest port was part of a strategic plan by the PRC to dominate our region. If the existence of an armed militia within an enterprise and/or ownership by a person with connections to the Communist Party are criteria for not allowing PRC investment, Australia cannot allow any investment from the PRC. The existence of armed militias and connections to the CPC are integral to the way society functions in the PRC.

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Under the relevant legal definitions governing Australian foreign investment, Landbridge is a private company. But it has a CPC Party Committee, and its chairman is presumably a CPC member. Some 1.63 million private companies in the PRC have Communist Party committees – more than half of all private businesses in the PRC. And millions of Party members work in the private sector. Companies such as Landbridge will wish to invest more and more in Australia. We need to be clear what assets we do not wish for a PRC entity to invest in, but we need to be wary of security commentators winding up public opinion about every bid by a PRC-based company.

Since 2005, the Treasurer, acting upon the advice of FIRB, has blocked only five projects, and



interposed in only nine per cent of PRC resource projects. Despite that, polls consistently show that 50-57 per cent of Australians believe their government is “allowing too much investment from China”. Moreover, studies show that newcomer PRC investors still perceive the Australian FDI process as cumbersome, confusing and targeted at the PRC. PRC media reports regularly blame Australian media and popular opinion for bias against PRC investors. But it is also true that the PRC government and potential investors could do more to address community concerns through better communication, understanding of public sensitivities and sophistication in managing the investment process.

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*This public dialogue has the potential to sway the mind of the politician – the decision-maker – but is unlikely to provide nuance and clarity.*

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Admittedly, it is easy to call for a new approach by government ministers and public servants to manage public perceptions of PRC investment, especially in critical infrastructure. It is more difficult to define in detail a realistic, candid and proactive approach that explains both the benefits of accepting PRC investment and the complexities and risks associated with safeguarding critical infrastructure.

For the elected official, the key test of an investment is whether it is in the interests of the Australian people. This test will always be subject to public opinion, and the desire of the elected official to remain in office. Tests based on popularity run the risk of appearing to react to popular events. As such, they will always strain relations with investors, who seek guarantees and the “three Cs” rather than popular will. Investment approvals are made behind closed doors by politicians, while the investments are debated and discussed publicly. This public dialogue has the potential to sway the mind of the politician – the decision-maker – but is unlikely to provide nuance and clarity. Online media and local newspapers both influence politicians’ thinking far more than is commonly appreciated.

## A call for realism

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The FIRB process is not simply an instrument for economic regulation. It is also an instrument of Australia’s foreign and trade policy, which, like other such instruments, is designed both to promote and to protect the national interest. It seeks to facilitate foreign investment in accordance with both of these objectives. In this sense it operates within the parameters and according to the norms of foreign, trade and national security policy. These elements will, for example, significantly influence the precise terms in which the government can explain publicly the intelligence assessments or security vulnerabilities informing decisions on some elements of critical infrastructure.

The recent push to proactively regulate foreign investment in Australia’s critical infrastructure is a positive step toward providing clarity. The biggest advantage of this new approach is that government advice can be proactive and occur before any investment decisions are made.

Prospective investors want clear, consistently applied rules leading to relatively certain outcomes. They want this information before a deal is made. Bids are expensive, consortium forming is delicate, and deal rejections damaging. Uncertainty is the biggest problem for any investor, and investment from the PRC is no different. In this sense, it doesn’t matter so much what the rules are but we must have a regime that delivers investors their “three Cs”.

The choice is between the negative list approach, which gives the clarity and certainty investors seek, and the more open case-by-case approach, which aims to facilitate foreign investment in assets of all but the most extreme sensitivity.

Australian investment policy does not apply blanket foreign investment bans to whole sectors of the economy or critical infrastructure (as, for example, a “negative list” would). Rather, Australia has been prepared to consider FDI in all sectors, and examines proposals on a case-by-case basis.

The government’s dilemma then is that it cannot give complete certainty to investors, lest it appear not to be critically evaluating a prospective deal.

The Treasurer may reject any investment that is not in the national interest. Under Australia's current foreign investment screening regime, both the "national interest" test and the "character of the investor" test lack specific criteria. The Treasurer is under a public expectation that he is critically assessing investment proposals rather than simply promoting investment.

Though many reports argue that the Australian investment system needs more transparency, the investment regime is unlikely to change. Policymakers prefer discretion. And for the most part, this principles-based and flexible approach has served Australia, and foreign investors, well. The majority of investment proposals in critical infrastructure have been approved.

Business needs to do more to work together with government to explain the benefits of foreign investment in public. While the Treasurer as the ultimate decision-maker must be circumspect in commenting publicly upon specific investment proposals that are likely to come before him for decision, the Treasurer has a duty to explain the role, importance and contribution of foreign direct investment in Australian enterprises. That duty of leadership should be shared with other members of the government, for example, the Minister for Trade and Investment. Ministers should be supported in their public advocacy of the value of foreign investment by the bureaucracy, including Austrade and DFAT – and the FIRB itself.

The defence and security community currently speaks in a much louder voice on the security risks linked to foreign investment. To resolve this, either a minister, who cannot be the Treasurer, or the public service (through the Department of the Prime Minister and Cabinet) should speak regularly and publicly on the benefits of foreign investment, mindful that they do not have to make any decisions on investment reg-

ulation. The costs of any national security decision should be made clear. And the business community should support the government of the day in that endeavour.

Businesses bear most of the cost of risk mitigation. But critical infrastructure risk mitigation is more costly: shifts in technology occur rapidly, and it is likely that Australia's critical infrastructure will need significant investment in order to be sufficiently resilient to such a level that risk-based methodologies will allow foreign investment to occur. There will be greater demands on government monitoring and assessment, and more government resources will be imperative.

## Conclusion

Australia needs foreign investment. PRC money will be insistent and relentless. We need to deal with the PRC, the comfortable and uncomfortable alike, as it will be a major influence for many years to come.

Critical infrastructure is an area we can look to as a means of building trust. Significant capital is required for critical infrastructure in Australia and it is likely that increasing amounts will come from overseas, including from the PRC. Getting our policy and processes right for critical infrastructure investments is important if we want to encourage PRC investment in a wider range of areas in our economy.

Perceptions are crucial to investment, and PRC investment is the most pained of these perceptions. Both government and business need to reassure investors that their money is welcome, and the public that their infrastructure is safe. The PRC is on the front line of this battle of reassurance. PRC investors are highly visible, yet the Chinese political and economic system opaque. Building trust will be difficult. The public narrative on the People's Republic of China needs clarity as well as greater, and nuanced, understanding.

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## Policy recommendations for the federal government

1. Articulate a clear vision of what Australia wants from its economic relationship with the PRC, including a narrative on the balance of our national interests and economic interests.
2. Support initiatives that bring business and national security communities together regularly to develop a common understanding of each other's concerns.
3. Release measured intelligence judgments and case studies behind closed doors to select audiences via trusted industry networks, outlining the evidence base for critical infrastructure decisions.
4. Designate either a minister, who cannot be the Treasurer, or a senior public service official (for example in the Department of the Prime Minister and Cabinet) to speak publicly on the benefits of foreign investment, and also to explain the cost of any national security decision. Engage the business community in this conversation.
5. Support, for government use, the continued development of a critical asset register, with a risk-based grading of the registered assets that are available for foreign investment as long as certain conditions are met (include assets that will not be available for foreign investment).
6. Place greater emphasis in the FIRB review process on the track record of an investor candidate to competently manage the assets as well as the candidate's ability and history of making good on promises to invest more in the future.
7. Revise the definition of "critical infrastructure" to include specified types of sensitive data.

**China Matters welcomes your ideas and involvement.**

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