MINERALS COUNCIL OF AUSTRALIA

SUBMISSION TO THE JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE INQUIRY INTO THE IMPLICATIONS OF THE COVID-19 PANDEMIC FOR AUSTRALIA'S FOREIGN AFFAIRS, DEFENCE AND TRADE

17 JULY 2020

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EXECUTIVE SUMMARY

The COVID-19 pandemic has challenged national governments and political systems around the world, with varying levels of success in balancing the need to protect the community while keeping people employed and economies afloat.

The Australian mining, minerals and energy sector, with the support of national resources ministers, acted rapidly at the onset of the pandemic to develop industry protocols based on official advice that enabled the industry to continue to operate safely and responsibly.

The combination of a responsive and responsible resources sector working together with Australian governments and partners meant that – in contrast to nations where mining operations have shut down – Australian mining has continued to support the national economy and regional jobs by keeping its workforce, families and communities safe from COVID-19.

As a consequence, Australian mining will emerge into the post-COVID world in a position of relative strength. With further pragmatic and targeted reforms, the government has a unique opportunity to reinforce this position so the minerals industry can continue to underpin a sustainable community and economic recovery within Australia and across the region.

Prior to COVID-19, trade accounted for 42 per cent of economic output and one in every five jobs in Australia relied on trade.[1] Trade liberalisation over the past 35 years has increased the income of the average Australian family household by an estimated $8,448 per year.[2]

This increased income is a result of lower tariffs on imported goods and services and the contribution of trade liberalisation to economic growth. Lower tariffs give greater purchasing power and therefore support higher living standards in lower income households.[3]

Open markets and reduced barriers to trade have been especially important to Australia’s minerals and Mining Equipment and Technology Services (METS) sectors. Mining is by far Australia’s largest export industry, and the resources sector continues to generate more export revenue for Australia than all other sectors put together.

In the 2019 calendar year resources accounted for 58 per cent of Australia’s total export revenue, a record high of $289 billion generated by the 1.1 million employees working in the mining and METS sectors and mostly located in regional Australia.

These remarkable figures could not have been achieved without competitive policy settings which attracted foreign investment in the infrastructure, productive capacity, skilled workforce and technical expertise required to support Australia’s export industries.

Investment created the opportunity and the infrastructure to efficiently produce the materials required by the growing economies in our region.

The capacity to efficiently produce commodities for export was supported by ongoing investment in jobs and technology together with investment by successive governments in a rules-based multilateral trading framework and a globally competitive investment regime. In turn, this helped the Australian minerals and energy sector become a global leader with a reputation as an efficient, reliable and secure supplier.

Despite Australia’s success in controlling infection levels, the pandemic has led to significant strategic risks and an acceleration of pre-existing trends towards nationalism, protectionism and an unwinding of the multilateral trade rules at a regional and global level.

[1] Department of Foreign Affairs and Trade, *Composition of Trade 2016-17*, January 2018; Australian National Accounts: National Income, Expenditure and Product, December 2017, Cat No 5206.0; and Centre for International Economics, *Australian trade liberalisation* October 2017, p. 8.

[2] Centre for International Economics, *Australian trade liberalisation* October 2017, p. 8.

[3] ibid., p. 2.

Governments and policymakers must carefully manage these issues so that the substantial social, economic and security benefits gained by Australia through trade and investment over past decades continue.

As Australia begins to recover economically and socially from the COVID-19 pandemic, securing future foreign investment to the Australian economy has never been more important.

Foreign investment provides critical funding to mining and resources projects and supports job creation through more the provision of infrastructure and scaled-up industries across the economy. Australia's share of world foreign direct investment (FDI) inflow fell from 4.8 per cent in the 1970s to 2.5 per cent in the post-GFC period, raising concerns that domestic and foreign investment policy settings are eroding Australia's broader business investment attractiveness.

Severe restrictions on investment into Australia at a time when the economy has experienced a major shock can negatively impact equity and debt markets, undermine job creation and cripple economic recovery.

While it may be tempting to respond to protectionist sentiments through more stringent foreign investment screening, trade barriers or weakening efforts to negotiate international agreements, it is essential to Australia's strategic interests that government continues to support and promote strong investment, open markets and free trade while building enduring relationships with all nations.

The minerals industry has consistently advocated for trade diversification and domestic policy settings that deliver an efficient and globally competitive pro-investment regime. Diversification is best achieved by adding markets, growing the number of customers as well as the sources of investment rather than reducing the size of any one.

Calls to find alternative markets as a response to disputes or differences of opinion fail to recognise the benefits associated with depth of understanding, cooperation and social connections that grow from trading relationships. This value is much deeper than the commercial benefits, often resulting in longstanding cooperation on shared challenges, trust and resilience to conflict in other areas of the relationship.

Australia supplies the raw materials that underpin the technologies of the modern age to countries all over the world, making the economy dependent on demand-side risks as much as supply-side risks. The best strategy to mitigate risks associated with demand is for governments and industry to approach diversification with a view to growing overall demand – increasing the customer base – by building on existing relationships rather than seek to replace them.

Australia's national interest will be best served if it continues to be seen as an open trading nation supporting multilateral trade, cooperation and an open, transparent and non-discriminatory investment framework which recognises the contributions of trade and foreign investment to national security, quality jobs, stronger communities and economic growth.

Summary of recommendations

With the rise of nationalism and protectionism and the tendency of large economies to drive political deals on trade, it has become more important for trading economies to work together in support of free and fair trade underpinned by a rules-based order. Trade negotiations should aim to:

- Deepen economic and geopolitical partnerships with other trading nations and collaborate to support multilateral trade and investment agreements and a rules-based order
- Actively build a coalition of nations to support multilateral trade networks supported by stronger rules-based dispute resolution mechanisms
- Promote the economic, security and technological benefits of trade, investment and cooperation.

Any reform that constrains foreign investment on national security grounds should be balanced with a simplified, transparent, streamlined foreign investment approvals process which excludes non-sensitive sectors and minimises sovereign risk.

Australia's national interest lies in developing its resources quickly enough to supply changing and growing global demand before other potential suppliers. It has no monopoly on the supply of resources. Australia's interests are not served by limiting their development to protect the interests of other countries.

Australia relies on open and transparent markets for trade and capital. Any constraint on the timing, size or use of capital will have an impact on its availability and the capacity to develop Australia's resources.

A national interest framework should continue to be part of a proactive approach to attracting investment. In this context, the current reform of foreign investment arrangements should be supported by other measures so the reforms increase Australia's attractiveness as a destination for foreign investment. These include:

- Measures to inform the Australian community on the importance of international investment to jobs and economic prosperity
- Continue domestic reforms, including reducing the corporate tax rate, streamlining approvals, reducing energy costs and progressing industrial relations reforms to support downstream processing and manufacturing, and balance the impact of other factors on investment decisions
- Ensure the new foreign investment framework offers investors in sectors with lower national security sensitivity and with a national interest benefit clear streamlining and process certainty, given that reducing sovereign risk, uncertainty and complexity are central to successfully competing for global capital.

1. AUSTRALIA HAS BENEFITED FROM TRADE LIBERALISATION

- Australia has built its wealth and economic security through trade and investment
- The Australian mining industry's capabilities are world-class and one of the nation's major competitive advantages
- Trade and investment drives ongoing technology development, new approaches and significant national and regional social and economic benefits
- In the 2019 calendar year resources exports were at a record high of $289 billion, or 58 per cent of Australia's total export revenue
- With the right policy settings in place, mining will continue delivering on opportunities for regional development, jobs growth and national economic security well beyond COVID-19
- The need to maintain open markets and enhance trade has become more important as world economies integrate. Over time, businesses have developed increasingly sophisticated value chains, developing strong relationships across borders
- Trade has also proved to be vitally important to the Australian labour market, accounting for 42 per cent of economic output. One in every five jobs in Australia relies on trade. Over the past 35 years, trade liberalisation has increased the income of the average Australian family household by an estimated $8,448 per year
- This includes workers in heavily export-focused industries like agriculture, minerals and energy, as well as tens of thousands of employees who work to bring imported goods into Australia and distribute them to consumers and businesses who need them
- With the right domestic, trade and investment policy settings, these opportunities can also increase in other parts of the Australian economy.

Australia has long been a trading nation. It has built its wealth and economic security through attracting investment in the development of its natural resources, services and technology expertise and exporting to regional and global customers on terms underpinned by open and competitive markets and free trade.

Australia's success as a trading nation is also founded on the sustained liberalisation of trade barriers and reduced industry protection. Since the 1980s Australia has embarked upon unilateral, bilateral and multilateral trade liberalisation, which has led to a more flexible and resilient economy better placed to take advantage of emerging opportunities and better prepared for global economic uncertainty.

The growth of Australian mining as a global powerhouse and the nation's largest export industry has been central to this success.

The resources sector generates more export revenue for Australia than all other sectors put together: In the 2019 calendar year resources exports were at a record high of $289 billion, or 58 per cent of Australia's total export revenue.

The Australian mining industry's capabilities are world-class and one of the nation's major competitive advantages. With the right policy settings in place, mining will be well placed to continue delivering on opportunities for regional development, jobs growth and national economic security well beyond COVID-19.

The need to maintain open markets and enhance trade has become even more important as world economies have become more integrated. Over time, businesses have responded to trade liberalisation by developing increasingly sophisticated regional and global value chains, developing strong and valuable relationships across borders.

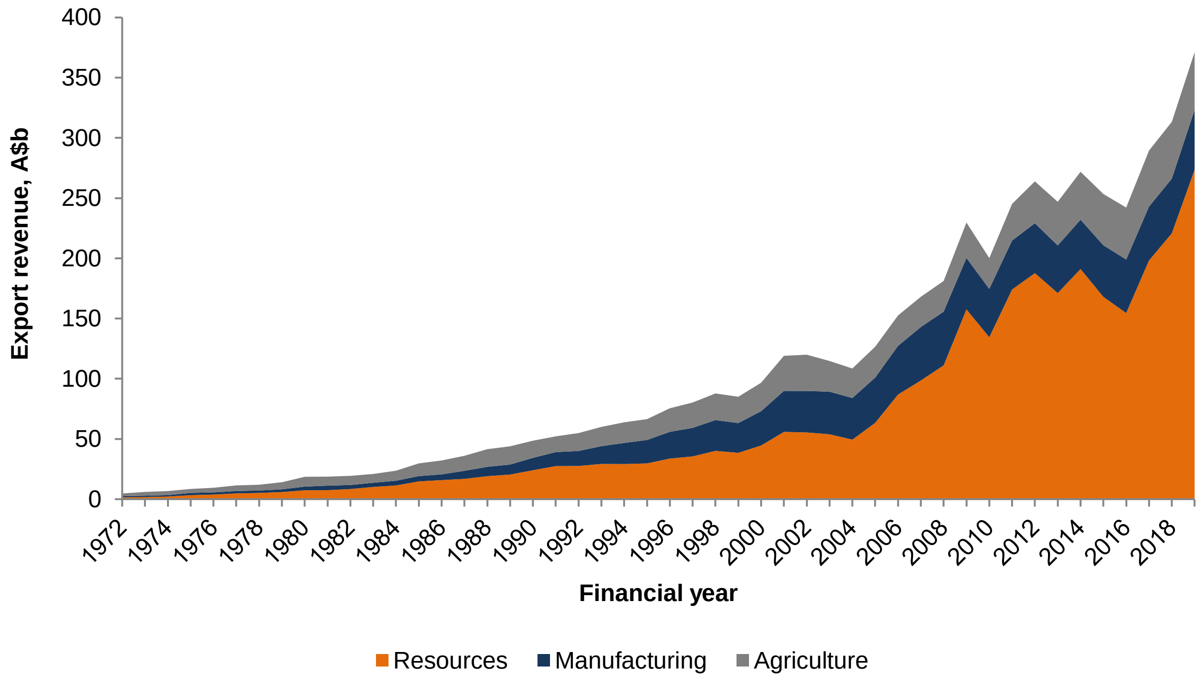
Trade has many other benefits for Australia and the world. The multilateral and bilateral trade architecture that underpins strong trade and economic relationships has led to greater prosperity, lifting millions out of poverty globally.

In the last decade world gross domestic product (GDP) has increased substantially, underpinned primarily by growth in non-Organisation for Economic Co-operation and Development (OECD) nations such as China, India and Indonesia.

Urbanisation, industrial expansion and rising middle class incomes have led to rapid increases in the demand for a range of commodities, including mineral and energy commodities, food, education and other services.

This has allowed Australia to build a reputation as a responsible, sustainable and reliable trading and investment partner and to forge strong trade relations with its regional partners while integrating into global supply chains.

Chart 1: Change in Australia's goods exports



Source: Australian Bureau of Statistics, cat no. 5368 *International Trade in Goods and Services, Australia, April 2020*.

Trade has also proved to be vitally important to the Australian labour market, accounting for 42 per cent of economic output. One in every five jobs in Australia relies on trade. Over the past 35 years, trade liberalisation has increased the income of the average Australian family household by an estimated $8,448 per year.[4] This includes workers in heavily export-focused industries like agriculture, minerals and energy, as well as tens of thousands of employees who work to bring imported goods into Australia and to distribute them to consumers and businesses who need them.[5]

The increased income is a consequence of reduced tariffs on imported goods and services and the contribution of trade liberalisation to economic growth. Lower tariffs give greater purchasing power and therefore increase the living standards of all households. When the gains from trade liberalisation

[4] Centre for International Economics, *Australian trade liberalisation*, October 2017, pp.13-14.
[5] ibid., pp.14-16.

are expressed as a share of household income, those households on a lower income have gained more from trade and investment liberalisation than higher income households.[6]

Open markets and reduced barriers to trade are especially important to Australia's minerals and METS sectors. Deloitte Access Economics estimates that in 2015-16 the mining and METS sector supported 1.1 million jobs across Australia or one in every 10 Australian jobs.

[6] Centre for International Economics, *Australian trade and investment liberalisation,* January 2018, p.3.

2. THE IMPORTANCE OF FOREIGN INVESTMENT TO THE AUSTRALIAN ECONOMY AND THE MINING SECTOR

- Without international investment, Australia would need to take on additional debt or forgo the revenue inflows and jobs generated by investment in productive capacity
- Australia's share of world foreign investment has been trending downwards since the 1980s, particularly in non-mining sectors. While Australia is still an attractive place to do business, competition for investment has grown
- This has manifested as a slowing in the growth rate of our capital stock (or capital deepening), which is flowing through to lower labour productivity growth and low wage growth over the past decade
- Central to Australia's continued economic prosperity is the ability to effectively compete for its share of global savings as capital inflows
- Reforms supporting foreign investment should include a simplified, transparent, streamlined approvals process which minimises barriers for non-sensitive sectors or parts thereof, and minimises sovereign risk
- A national interest framework should be part of a proactive approach to attract investment. New foreign investment arrangements should be supported by other measures to ensure the reforms increase Australia's attractiveness as a destination for foreign investment.

The ability to attract foreign investment to develop resources has been vital to the success of the Australian minerals industry.

Australia is usually a net importer of capital, requiring international investment to fill the gap between domestic saving and investment. This capital shortfall has been on average about 4 per cent of GDP over the last decade. Without international investment, Australia would need to take on additional debt or forgo the revenue inflows and jobs generated by investment in productive capacity.

Australia has relatively high barriers to foreign direct investment (FDI) compared to other OECD countries. The OECD's FDI Regulatory Restrictiveness Index indicates that in 2018 Australia was significantly more restrictive than the OECD average.[7]

While it is critical that there is public confidence in the foreign investment regime and that the national interest is protected, it is important for Australia's long-term economic success, stability and prosperity that any change provides investor certainty and minimises the regulatory burden.

Restrictions are mostly in the form of screening and approval mechanisms that are placed on foreign investment, but also include equity restrictions in a number of Australian industries.

Placing restrictions on (FDI) limits the level of foreign investment available to Australian businesses in Australia and around the world, reducing the productivity of Australian workers, returns to shareholders, revenue to government and economic growth.

While national security risks must be managed, the national interest also relies on access to the capital needed in Australia to develop productive capacity and by Australian companies to develop projects in Australia and overseas.

Reducing barriers to FDI should be a priority for Australian governments.

[7] OECD FDI restrictiveness index, 2020.

Capital investment is an important part of economy growth and prosperity. Investment has a direct effect on GDP. Gross Fixed Capital Formation contributes to GDP (expenditure approach to measuring GDP), and accounts for almost one-quarter of Australia's GDP.

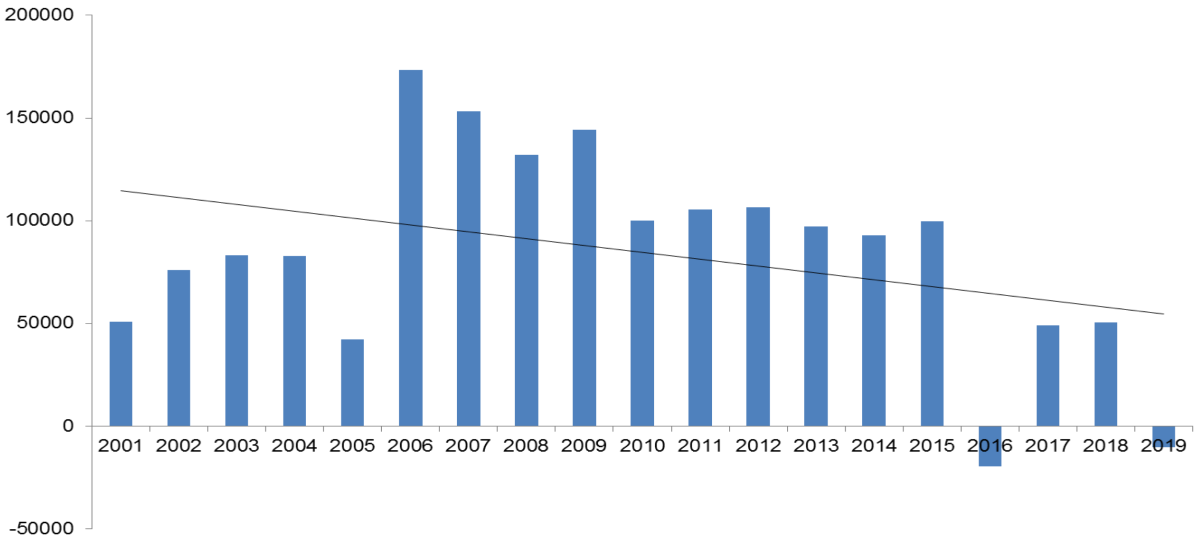
It also plays an important role in increasing productivity. When the capital to labour ratio increases, labour productivity rises and wages increase.

The Australian economy has a large capital requirement for business and infrastructure investment, but a small domestic savings pool. It draws on international investment to fund much of the capital stock that is growing our economy.

This capital stock not only creates jobs in construction, but also other new jobs that use the larger capital stock to increase production. When this additional production is traded, it produces export revenue for the economy.

Australia currently has an investment problem. Business investment has been declining for some time (particularly non-mining business investment). This has manifested as a slowing in the growth rate of our capital stock (or capital deepening), which is flowing through to lower labour productivity growth and the low wage growth Australia has experienced over the past decade.

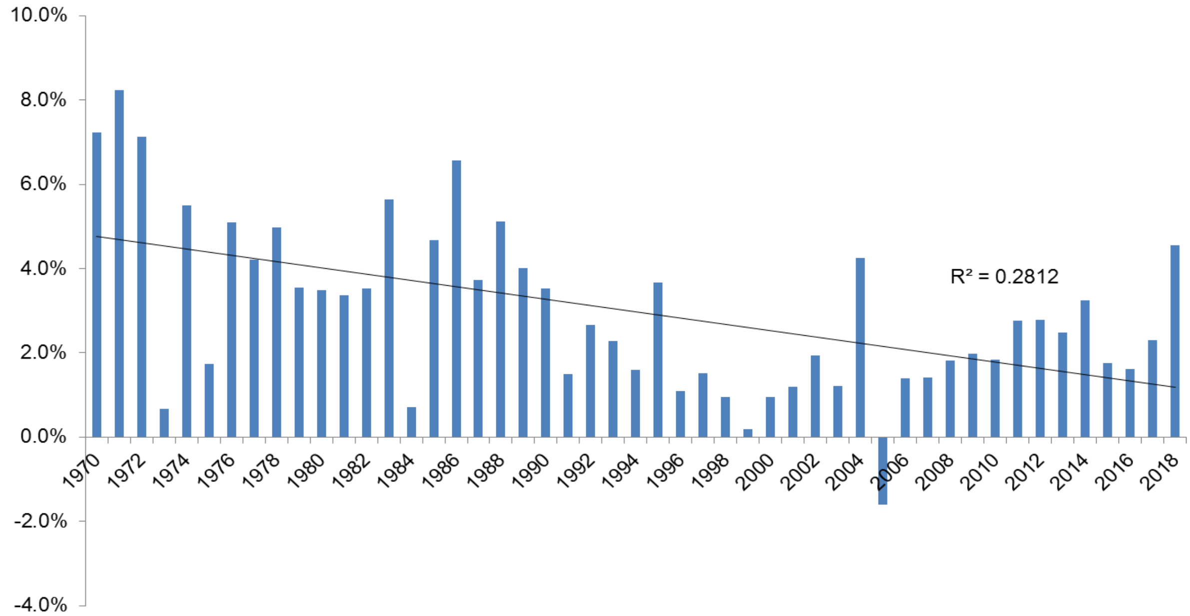
Chart 2: Annual foreign investment into Australia



Source: ABS cat no. 5352.0 - International Investment Position, Australia: Supplementary Statistics, 2019; table 1

Australia's share of world foreign investment has been trending downwards since the 1980s. While Australia is still an attractive place to do business, competition for investment has grown. This is reflected in the Fraser Institute's *Annual Survey of Mining Companies*, which shows the investment attractiveness of emerging mining regions in South America and Africa has been rising relative to Australia.

Chart 3: Australia's share of world FDI inflow (BoP basis, current USD)



Source: World Bank, World Development Indicators.

Australia needs to attract more international investment to stimulate its economy, create new high paying jobs, import and develop new technology and knowhow, expand its exports and operate in offshore jurisdictions.

Factors affecting Australia's attractiveness as a destination for foreign investment in the mining sector

Foreign investors consider a range of factors when assessing and ranking the range of potential investment destinations and projects around the world.

Investors rank projects based on the risk adjusted rate of return that an investment may deliver based on the following factors:

- The rule of law and transparent, timely and stable arrangements for resolving disputes
- The level of sovereign risk associated with domestic policy settings, including regulatory frameworks for approvals and appeals as well as the potential for delay and arbitrary changes that may increase or decrease the risk
- Access to high-quality resource deposits and the cost of infrastructure and energy required to mine, process and transport product
- Access to geological data and its ability to reduce the risk of exploration and development activities
- Alignment between the project and the investor's broader business objectives
- Access to a skilled and educated workforce, and the cost of workforce attraction, retention and development
- The corporate tax and royalty rate and other costs imposed at a local, state/territory and national level
- The FDI restrictiveness imposed by national governments to manage national security, competition and national interest
- Environmental, social and governance aspects.

Delays and uncertainty on regulatory decision-making both in terms of inwardly-focused regulatory processes and outwardly-focused assessment and approvals processes – including those associated with foreign investment approvals – play a significant role in determining the ranking of investment projects and their host countries. Box 1 sets out some of these considerations and their impact.

Box 1: Alto Metals – delays and uncertainty undermine investment and opportunity

On 29 March 2020 the Australian Government announced that to ensure appropriate oversight during the COVID-19 crisis it would temporarily reduce monetary screening thresholds to $0 for all foreign investments subject to the *Foreign Acquisitions and Takeovers Act 1975*. It went on to note that the Foreign Investment Review Board (FIRB) would work with applicants to extend the timeframes for decision making to up to six months.[8]

Alto Metals Ltd is a Western Australian based company and is focused on gold exploration in Australia. Alto's focus is on 800sq.km of the Sandstone belt in Western Australia where it has resources of 331,000 ounces. Alto was seeking to raise immediate capital in the near-term to fund exploration and working capital to realise value from the sandstone project for shareholders and in light of the uncertainty seen in current global equity markets.[9]

On 1 May 2020 Alto Metals Ltd directors unanimously recommended that shareholders accept the off-market bid by a Chinese company. That company lodged its formal offer for Alto on March 24, and increased its bid from 6.5c to 7.5c in late May due to a competing 6.6c bid. It was also offering $1.4 million for all Alto's options. It had secured 14.62 per cent in Alto and wanted 50.1 per cent.

The offers remained conditional on the Chinese company receiving FIRB approval. In March the company agreed with FIRB to a voluntary one-month extension until 27 May 2020, to enable FIRB to continue its assessment process given the increased workload associated with FIRB's reduced thresholds during the COVID-19 period.

On 24 June 2020 the Chinese company issued a statement disclosing its intention to let its takeover offers for the shares and options in Alto lapse on 8 July 2020. In the statement the company noted that in light of FIRB advice that it would require a further six months to complete the review (ten months from the initial application), and as FIRB would not clarify why the extension was needed the company would withdraw its application.[10]

Impact of delays and uncertainty

While the Alto case relates to a small gold investment under the temporary foreign investment screening protocols related to COVID-19, it and other similar constraints demonstrate how procedural delays and unclear approval processes can lead directly to a lack of clarity on government process and national security concerns, and the potential for this to result in lost capital inflows needed to support the development of productive capacity and jobs in Australia. In many instances the lost investment is also at the cost of technology transfer into Australia.

The fact that an investment in a gold resource not located near a sensitive defence area raised flags with FIRB sufficient to require an extension of six months would also cause concern among investors looking to place capital in the Australian resource sector. Further, a FIRB process taking ten months may not have made a bid viable for Alto Metals in any climate.

The calculation of a risk-adjusted rate of return enables an investor to balance the impact of these factors and assess investment projects on a risk-adjusted basis. The balance between risk and

[8] M. Brennan, Intan Eow andPaul Schroder, FIRB – protection or extinction for critical mineral miners?, *Australian Financial Review*, 28 April 2020.
[9] Alto Metals Ltd, ASX announcement update on takeover offers, 25 June 2020.
[10] Gilbert and Tobin, ASX announcement, 24 June 2020.

opportunity determines whether a country can compete successfully for a share of available global capital.

In addition, Australia's ability to effectively compete for its share of global savings as capital inflows also drives access to new technologies and new ways of doing things. This benefits the Australian economy by maintaining technological currency and the associated efficiency, safety, sustainability and competitiveness of advanced processes. This is increasingly important in sectors and technology applications where Australia may not yet be a global leader, including some minerals processing and mining activities.

But there are several other factors also limiting the investment into downstream processing, and the significant value added benefits of these activities.

Box 2: Altech Chemicals – Australia, Malaysia and Germany as investment destinations

Altech Chemicals Limited (Altech) is one of a small number of ASX-listed companies with plans to mine, process and supply high purity alumina (HPA). HPA is a high-value refined product with a range of technology applications, including in the production of LEDs, sapphire glass, high-performing batteries and semiconductors.

Demand for HPA is forecast to grow significantly over the next five to ten years, driven by continuing growth in the LED lighting market and, increasingly, growing demand for HPA-coated separators for the lithium-ion battery markets. The growth is centred in the Asia Pacific region, with APEC accounting for approximately 70 per cent of global demand for the product.[11]

The company was granted a mining lease on 19 May 2016 near the Western Australian town of Meckering, approximately 140km east of Perth. The Meckering kaolin deposit will provide the feedstock for processing using the company's patented acid leach process.

The company considered a range of locations for its processing plant, including Australia, but has opted to set up the plant within the Tanjung Langsat Industrial Complex, near Johor Bahru in southern Malaysia. Construction on the plant commenced in August 2018. Clay will be mined from the company's Meckering deposit and then shipped to Malaysia for processing.

Production is planned to ramp up over the next three years to reach 4,500 tonnes of HPA per annum at full scale production and an offtake agreement is in place with Mitsubishi Corporation for 100 per cent of the first ten years production.

An investment research report prepared for the company in May 2019 outlines some of the factors impacting on the company's decision to build its processing plant in Malaysia.[12] The report compared Australia and Malaysia as investment destinations, noting that 'Malaysia as an operational jurisdiction include low operating costs when compared to Australia – for the HPA plant these are expected to be 60 per cent lower than those for an equivalent plant in Australia, with key contributors being power and acid'. The report also noted Malaysia's favourable corporate tax regime, with Malaysia's corporate tax rate of 24 per cent and the potential for a 5 to 10 year tax holiday, weighing in its favour.

On 14 July 2020, Altech announced it had executed an option to purchase agreement for a ~10 hectare industrial site in the Schwarze Pumpe Industrial Park in Saxony, Germany, for the construction of a second HPA plant.[13] While Altech has invested in Australia for resource extraction, this investment was made as part of a business plan in which the downstream processing that adds the most value to the final product – generating tax revenues and creating high skilled jobs in the process – will occur outside Australia.

[11] Altech Chemicals Limited, Presentation to 5th Asian Bauxite & Alumina Conference, October 2015.
[12] Independent Investment Research, Altech Chemicals Limited (ASX: ATC, FRA: A3Y, May 2019.
[13] ASX Announcement and Media Release, 14 July 2020.

The case study in Box 2 demonstrates how the high costs of doing business in Australia are considered by investors who view a range of considerations when evaluating on of where to allocate capital.

International capital markets have many alternative options for investing funds. Mining is just one asset class that can attract investment, and within this pool of funds Australia is competing with many other resource-rich regions. In the Altech example it was clear that Australia was not viewed as competitive as a destination for a processing facility, notwithstanding the natural advantages inherent in locating processing facilities near the place of primary resource extraction.

Despite its substantial mineral endowment, Australia does not have a monopoly on the supply of any commodity and cannot control or influence world commodity markets in the long run. Attempts to do so will eventually be responded to by investment flowing to alternative sources of supply in other regions or developing new technologies that are less reliant on a particular commodity.

Investment tends to flow to asset classes and places that provide the best risk-adjusted returns. In the long term, the risk-adjusted rate of return for Australian mining projects will be affected by diminishing returns. Resources in Australia will inevitably become more difficult to extract and require more capital investment with higher risks for lower return.

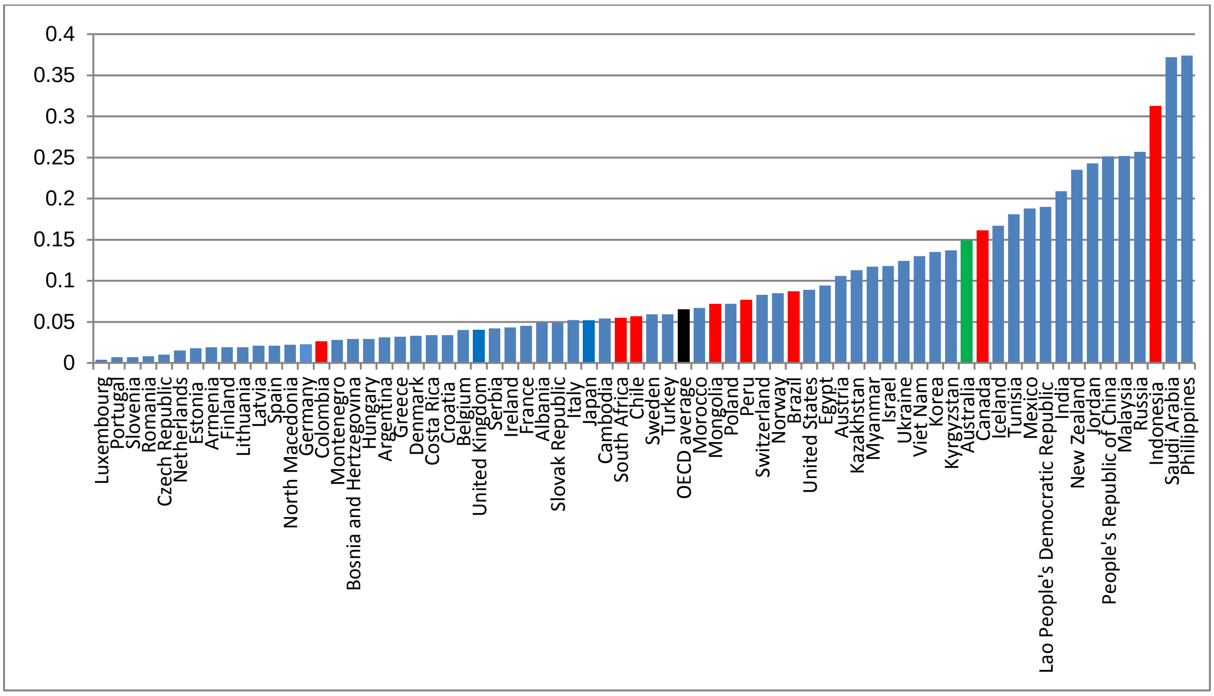
For these reasons, it is imperative that governments do not increase investors' perceptions of risk, through regulations, raising taxes and imposing conditions on developing new mines that limit their ability to respond to market changes. Without a commensurate increase in financial returns, investment will flow to competitor regions with better risk-adjusted returns.

The downward trend in Australia's share of world foreign investment suggests that on balance, Australia's position as an attractive destination for foreign direct investment relative to other countries has been slipping.

One of the more significant levers available to shift overall investment attractiveness is the restrictiveness and clarity of the foreign investment regime.

FDI restrictiveness is an OECD index gauging the restrictiveness of a country's FDI rules by looking at four main types of restrictions: foreign equity restrictions; discriminatory screening or approval mechanisms; restrictions on key foreign personnel and operational restrictions. Implementation issues are not addressed and factors such as the degree of transparency or discretion in granting approvals are not taken into account. The index compares the FDI regime restrictiveness of countries with a major resources sector between 1997 and 2018.

Chart 4: OECD FDI restrictiveness 2018



Source: OECD FDI restrictiveness index https://data.oecd.org/fdi/fdi-restrictiveness

While Australia will continue to compete with Canada, Canada is not the only destination seeking to maximise its competitive advantage as a destination for foreign investment. Mining jurisdictions (identified by the red bars in the chart above), such as South Africa, Colombia, Chile, Peru and Brazil continue to adjust factors affecting investment attractiveness to position themselves as a competitive destination for investment.

Box 3: Case study - Canada's scrutiny of foreign investment

Canada and Australia share some striking similarities: both are developed nations with comparable resource based economies; both rely on foreign investment to raise capital for major projects and adopt a similar regulatory approach to FDI requiring approval of transactions above certain monetary thresholds.

Since 1985 foreign investment in Canada has been regulated by the *Investment Canada Act*, which regulates investments by non-Canadians that exceed monetary thresholds. The FDI review threshold under the ICA differs between private investors and state-owned enterprises (SOEs). Private investors from a World Trade Organization member country can invest up to C$1.045 billion before triggering the review, while an FDI from an SOE will be screened if it is above C$416 million.

When a monetary review threshold is triggered, policy makers perform a 'net benefit test' which evaluates 'the nature of the asset or business activities' of a company that is being acquired by a foreigner. As part of the net benefit test, the government examines the social and economic benefits of the investment and its compatibility with national policies.

In June 2008 the Canadian government embarked on a reform agenda to liberalise and improve its competitiveness as a destination for foreign investment. This included raising minimum review thresholds for the 'net benefit' assessment more than threefold.

In 2009, Canada introduced a separate national security test, which applies independently of investment thresholds. Ministerial guidelines on the National Security Review of Investments identify factors for consideration such as the potential for the proposed investment to undermine Canada's security and defence capacities including through technology transfer and the acquisition of critical infrastructure, and the potential impact of the investment on the supply of critical goods and services.

In 2012, CNOOC, one of the three largest Chinese SOEs operating in the oil and gas industry, announced its plan to acquire Nexen, a Canadian oil and gas company for C$15.1 billion. After a prolonged deliberation amid protectionist reactions to the deal, the Canadian government approved the transaction. One of the key reasons for concern in Canada was the fact that oil sands are a strategic resource that is viewed as critical to Canada's economic prosperity.

The acquisition triggered a tightening of foreign investment regulation to restrict state-owned enterprises from gaining control of oil sands assets in the future, with then Canadian Prime Minister Stephen Harper stating that the acquisition of control of a Canadian oil-sands business by a state-owned enterprise would be assessed to be of net benefit 'only in an exceptional circumstance'. The increase in restrictiveness can be seen as taking effect in the chart below with a corresponding decrease in investment flows.

In June 2017, screening thresholds for the 'net benefit test' were relaxed, increasing from $800 million to $1 billion. This reflected a more welcoming approach to foreign investment. Canada also actively pursued foreign direct investment in March 2018 when the Canadian government launched 'Invest in Canada', a program promoting Canada to global investors and entrepreneurs and providing a single-window service to those interested in accessing opportunities in Canada.

On 18 April 2020, the Canadian government followed Australia and other developed nations in announcing enhanced scrutiny of foreign investments in Canadian businesses related to public health or the supply of critical goods and services, as well as all foreign investments by state-owned investors as a result of COVID-19. These changes were introduced to stop investments by actors that may be 'motivated by non-commercial imperatives that could harm Canada's economic or national security interests'.

Looking at the comparative restrictiveness of resource-based economies it is clear that Australia and Canada have much more restrictive regimes than their competitors. The question remains whether higher risks in Latin America, South Africa, Mongolia and elsewhere can offset the higher hurdles set in Australia and Canada when considered in the context of a risk-adjusted rate of return.

National interest test

Australia needs to ensure its competitiveness as a destination for foreign investment if it is to continue to capitalise on the competitive and comparative advantages it has developed through economic reforms over the last 50 years.

Resources sector investment of US$5 billion per year is required to maintain current production levels, and further investment is required to ensure the resources sector maintains its share of growing global demand for minerals and energy.

Ensuring Australia is able to access the capital needed to build the infrastructure and develop the productive capacity of its industries is clearly in the national interest and a national security consideration.

It is then a question of whether the capital is more efficiently drawn from domestic savings, debt or foreign savings. Australia has historically attracted foreign savings and direct investment to develop its export industries, enabling Australia and Australians to benefit from the trade-related growth in jobs, wages and economic development nationally and in the economies with which Australia trades.

Reforms rebalancing foreign investment on national interest grounds should include a simplified, transparent, streamlined foreign investment approvals process which excludes non-sensitive sectors or parts thereof and minimises sovereign risk.

A national interest framework should be part of a proactive approach to attract investment. New foreign investment arrangements should be supported by other measures to ensure the reforms increase Australia's attractiveness as a destination for foreign investment. These include:

- Continuing domestic reforms including reducing red tape and taxes to soften the impact of other factors on investment decisions
- Recognise the national security and national interest benefits of maximising the potential of minerals and energy exploration, development and trade
- Ensure the new foreign investment framework offers investors in sectors with lower national security sensitivity and a national interest benefit clear streamlining and process certainty, given that reducing sovereign risk, uncertainty and complexity are central to successfully competing for global capital.

3. CHALLENGES TO TRADE AND THE GLOBAL RULES BASED ORDER FOLLOWING COVID-19

- There have been increasing calls to roll back decades of trade liberalisation and renegotiate or even remove current trade and common market agreements, global rules and multilateral trade arrangements
- Returning to a protectionist trading regime and by association restricting imports should not be seen as a necessary precursor to the return of manufacturing
- The rise of nationalism and protectionism has highlighted the importance for trading economies to work together to establish effective multilateral trade networks underpinned by a shared commitment to a rules-based order and an effective dispute resolution process
- Trading nations should work to normalise economies, champion cooperation between private sectors and promote investment in common areas of national interest which are identified as non-sensitive from a national security perspective.

One impact of COVID-19 has been to accelerate protectionist sentiment in key economies, heightening the risk to sustaining higher rates of global economic growth.

Recent policy shifts in several countries that aim to limit free trade are now likely to reduce world economic growth rates in the short to medium term. This has been highlighted in recent downwards revisions to economic outlooks by many of the world's leading economic institutions including the International Monetary Fund, World Bank and OECD.

There have been increasing calls to roll back decades of trade liberalisation and renegotiate or even remove current trade and common market agreements, global rules and multilateral trade arrangements. Proponents of this roll back claim that trade liberalisation has come at the expense of local jobs and a loss of sovereignty.

An oft-cited concern is the loss of local manufacturing jobs and capability, which is attributed to trade liberalisation and increasing imports. Returning to a protectionist trading regime and by association restricting imports is seen as a necessary precursor to the return of manufacturing.

Australia's success as a trading nation has contributed to and is a consequence of developing our comparative strengths through an economic reform program since the 1970s aimed at realising a more flexible and resilient economy, primarily through the liberalisation of trade and investment.

These reforms have seen Australia become integrated into the global economy with trade growing faster than GDP. The Australian labour market also benefited, with 2.2 million people or one in five workers employed in a trade related activity in 2017.

Trade liberalisation has also increased overall GDP and average Australian household incomes. For the average Australian family, trade liberalisation between 1986 and 2016 is estimated to have increased real income by A$8448 in 2016 than would have been the case otherwise.[14]

The anti-multilateral trade agenda and anti-global rules based order has in some instances also been motivated by a view that more powerful economies can gain a stronger trade advantage where they are able to harness a geopolitical agenda to secure favourable bilaterally negotiated trade outcomes.

Given the rise of nationalism and protectionism and the tendency of large economies to drive political deals on trade, it has become more important for trading economies to work together to establish effective multilateral trade networks underpinned by a shared commitment to a rules-based order and an effective dispute resolution process.

[14] Centre for International Economics, *Australian trade liberalisation*, October 2017 pp.1-2

Trade negotiations should identify and work to normalise economies, champion cooperation between private sectors and promote investment in areas of common national interest which are identified as non-sensitive from a national security perspective.

4. SUPPLY CHAIN RISKS: GETTING THE BALANCE RIGHT

- COVID-19 has provided a better understanding of the kinds of services and systems that are critical during times of constraint, and highlighted the risk associated with long and integrated supply chains during a global shock to supply and demand
- Resilience can be built into supply chains by ensuring existing manufacturing capacity can pivot to new uses where needed, particularly where automation and pre-approved products and product design speed up timelines
- There will be an ongoing cost and risk trade-off between integrated global supply lines, domestic manufacturing capacity and domestic stockpiles.

Trade is more than finding customers. It is about developing markets and building relationships.

In the post-pandemic environment and amid heightened protectionist sentiment, the trust built on decades of cooperation and strong relationships with our largest trading and investment partners is under pressure.

COVID-19 has also provided a better understanding of the kinds of services and systems that are critical during times of constraint while highlighting the risk associated with long and integrated supply chains during a global shock to supply and demand.

The contention that governments are better placed to prepare for future crises (e.g. by securing stockpiles) may only hold if stockpiles are actively managed and secured without a significant cost premium during or just before a crisis and without pursuing policies that scale back trade and investment while reducing Australia’s competitiveness.

For example, many global governments responded to the 2005 avian influenza pandemic by stockpiling face masks and Tamiflu medications. Large quantities of both masks and medication were discarded as they were out of date and no longer useable several years later. The cost and value of various strategies need to be carefully considered and integrated into a broader emergency response protocol at a national level.

The preferred approach may be to ensure manufacturing capability and capacity is available and ready to pivot if needed. Essential inputs to the supply chains of key products must also be secured to avoid a situation where manufacturing capacity is halted by a shortage of essential inputs.

One option may be to contract domestic manufacturers to maintain the capacity to source inputs and produce essential products into the future.

The risks of different supply chain value propositions

The COVID-19 pandemic has further highlighted some of the inherent risks associated with long integrated supply chains and lean inventories.

For example, the spike in demand for face masks drove a global shortage of respirator masks suitable for worker health and safety in mining and related heavy industries. This caused a rapid increase in the price of suitable respirator masks and an increased risk that some operations would have to close due to a shortage of required masks.

Domestic manufacturing did increase in response to the global shortage. However, the delay in Therapeutic Goods Administration approvals and the work required to ensure product design met the specific needs of the mining sector saw the cost and risk impact of the shortage continue for several months, before domestic manufacturing became available to help meet significant specialist mining mask supply shortfalls.

The response of firms to future supply chain risks is dependent on a wide set of variables and potential outcomes, each of which will be assessed differently in relation to likelihood and consequence.

However, it is reasonable to assume that the lower the cost difference between a product sourced through an integrated supply chain and a local manufacturer using local inputs, the more likely it is that the local supplier will deliver long-term value to the end user.

The ability to use existing manufacturing capacity, particularly where automation and pre-approved products and product design speed up production timelines, reduces overall risks associated with vulnerable supply chains and reduces the need to maintain orders to retain manufacturing capacity.