

Chapter 4

International investment issues and Australia's international investment position

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Introduction

One of the Government's principal policy objectives is to generate and capture benefits for the Australian community through international trade and investment liberalisation. This is pursued through a multifaceted policy involving complementary multilateral, regional and bilateral engagement.

The Treasury's Foreign Investment and Trade Policy Division (the Division) is responsible for ensuring effective representation of Australia's foreign investment policy (the policy) and negotiating position on international investment issues. This includes: multilateral forums, such as the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO); regional forums, such as Asia-Pacific Economic Cooperation (APEC); and bilateral mechanisms, such as free trade agreements (FTAs) and investment protection and promotion agreements (IPPAs).

The Division also supports the Executive Member of the Board in his role as the Australian National Contact Point (the ANCP) for the *OECD Guidelines for Multinational Enterprises* (the OECD Guidelines) and related corporate social responsibility issues. The role of the ANCP is to ensure the effective promotion and implementation of the OECD Guidelines in Australia.

Over the past two decades, growth in worldwide flows of foreign direct investment (FDI) has been particularly strong. This growth in FDI largely reflects the worldwide relaxation of trade and investment controls, together with advancements in information technologies, communications and transport, and the emergence of global production chains. The current global financial crisis is likely to impact on global capital flows. The OECD estimates that member country outflows of FDI fell 6 per cent while inflows dropped 13 per cent in 2008.

Australia has traditionally relied on inward FDI to meet the shortfall between domestic saving and the level of domestic investment. Foreign investment supplements local savings, thereby supporting higher rates of economic growth and employment levels which in turn improves the wellbeing of the Australian people. Inward FDI also continues to play a significant role in making Australian industry internationally competitive, and thereby contributing to export growth, facilitating access to new technologies, financing new and often risky innovations, and providing opportunities for global integration and networking.

Outward FDI enables Australian firms to expand their business beyond the potential constraints imposed by the limited size of the domestic market. By extending their market presence and access to resources, expertise and technology in other markets, Australian firms are able to become more efficient and competitive in global markets. Outward FDI also has a multiplier effect through stimulating the demand for goods and services provided by component and other input suppliers.

Multilateral investment issues

While at the multilateral level there is no comprehensive instrument covering foreign investment, an international legal framework for foreign investment has begun to emerge. The Division's role in negotiating international investment agreements and the investment chapters in Australia's FTAs allows it to contribute to the further development of an international rules-based system that takes appropriate account of both the interests of foreign investors and the wellbeing of Australians. The Division's involvement in the OECD Investment Committee (the Committee) and promotional work on the OECD Guidelines domestically supports Australia's other contributions to the international policy framework for investment. By promoting the OECD Guidelines, the Division seeks to encourage good corporate behaviour and the positive contribution of multinational enterprises (MNEs) to sustainable development.

While the Division has primary responsibility for the OECD Guidelines and the Government's engagement on international investment issues in the OECD, the Department of Foreign Affairs and Trade (DFAT) has direct responsibility for Australia's involvement in trade-related forums such as the WTO. The Division provides advice and briefings on foreign investment issues to the Treasurer and DFAT.

OECD Investment Committee

The Division represents Australia on international investment issues in the Committee. The Committee's mission is to provide a forum for international cooperation, policy analysis and advice to governments on how best to enhance the positive contribution of investment worldwide.

The Committee facilitates discussion on the policy challenges facing OECD and non-OECD countries as they seek to attract investment and maximise its benefits to host societies. It represents the community of policy makers, including treaty negotiators and National Contact Point (NCP) representatives for the OECD Guidelines, from OECD and other participant countries. It is responsible for the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations.

The Committee also has primary responsibility for the *OECD Declaration on International Investment and Multinational Enterprises* (the Declaration). The Declaration was adopted by OECD Governments in 1976 to facilitate direct investment among OECD members. It represents a broad political commitment to open and transparent investment policies and encourages the positive contribution of MNEs. Since adoption,

the Declaration has been the basis for extensive intergovernmental cooperation on developing best policy practices and peer review-based approaches to outreach activities. The text of the Declaration is included in the OECD Guidelines provided at Appendix F.

The Committee's work program falls into five main categories: promoting transparent and non-discriminatory investment policies; encouraging the positive contribution of MNEs to sustainable development; cooperating with non-Members to mobilise investment for development; monitoring developments in international investment agreements; and monitoring FDI trends.

During 2007-08, the Committee continued its work on Freedom of Investment, National Security and 'Strategic' Industries. The aim of the project is to help policy makers to find ways to safeguard legitimate national security and essential public interests while at the same time keeping their investment regimes transparent and non-discriminatory and thus continuing to reap the demonstrated benefits of free international investment flows. Ten roundtables have now been held to solicit input from relevant stakeholders including policy makers and business representatives.

As an integral part of the Freedom of Investment Project, the Investment Committee considered the issue of recipient country policies toward Sovereign Wealth Funds (SWFs) and other government-controlled investment entities. The *OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies* was made by Finance Ministers meeting at the OECD in June 2008. This was followed by the release of *OECD Guidelines for Recipient Country Investment Policies Relating to National Security* in 2008.

The OECD's Policy Framework for Investment (PFI), which was developed in 2006, was used in a preliminary evaluation of policy priorities for investment climate reform in Vietnam. Australia jointly funded this OECD project with Japan and is involved in an investment climate reform assessment of Vietnam's investment policy, competition policy, tax policy, investment promotion and facilitation, financial sector development and trade policy.

OECD Guidelines for Multinational Enterprises

The OECD Guidelines provide voluntary principles and standards for responsible business conduct consistent with applicable domestic laws (see Appendix F).

The OECD Guidelines are recommendations by governments to MNEs operating in or from the 30 OECD member countries and 11 non-member adhering countries (Argentina, Brazil, Chile, Egypt, Estonia, Israel, Latvia, Lithuania, Peru, Romania and Slovenia). They are the only comprehensive and multilaterally endorsed code of conduct for MNEs that governments are committed to promoting.

The OECD Guidelines apply to the activities of MNEs in OECD and non-OECD countries alike. They establish principles covering a broad range of issues

including information disclosure, employment and industrial relations, environment, combating bribery, consumer interests, science and technology, competition, human rights and taxation.

The Australian Government has established a National Contact Point (known as the ANCP) to implement and promote the OECD Guidelines to Australian businesses and other interested parties. The ANCP is the Executive Member of the Foreign Investment Review Board.

An important aspect of the OECD Guidelines is its formal review mechanism, which provides for an examination of an MNE's conduct where that conduct is claimed to be contrary to the OECD Guidelines. Such an examination is termed a specific instance and it is conducted by the relevant NCP. In accordance with the OECD's *Procedural Guidance* for NCPs, the ANCP has committed to contribute to the resolution of issues relating to the implementation of the OECD Guidelines in any such specific instances.

In 2007-08, the ANCP reviewed a submission regarding an Australian company's involvement in a mining operation in South America. The ANCP commenced an initial assessment as to whether the issues raised warranted further consideration as a specific instance. The matter is ongoing.

The ANCP's main method of informing the public about the Guidelines and other OECD Investment Committee work is through the ANCP's website at www.ausncp.gov.au. This website provides a range of information including: core documents such as the text of the Guidelines and the Risk Awareness Tool; basic procedural information such as the NCP's service charter, procedures for lodging specific instances and the NCP's procedures for handling them; and official OECD Investment Committee and Guidelines-related documents (in a secure section for registered social partners). It also hosts other useful documents including conference papers and submissions by NGOs.

The promotional activities of the ANCP during 2007-08 have included:

- attending regular interdepartmental committee meetings chaired by the Attorney-General's Department on the *OECD Convention against Bribery of Foreign Public Officials in International Business Transactions*;
- continuing efforts to promote the OECD Guidelines through embassy and consular networks. This has included the ANCP personally briefing senior DFAT officials prior to them taking up postings; and
- attending corporate social responsibility conferences hosted by other organisations (for example, the Australian Centre for Corporate Social Responsibility and the United Nations Environment Programme).

World Trade Organization

In July 2004, negotiations on multilateral rules on investment were discontinued as part of the current Doha Round of WTO trade negotiations. As a consequence, the WTO-related work of the Division was largely confined to advising DFAT on investment issues relating to negotiations covering trade in services.

Asia-Pacific Economic Cooperation

Australia continues to participate actively in the work of APEC (2007 was Australia's host year), including in relation to foreign investment. Australia's main investment interest in APEC is to encourage APEC Members to enhance the environment for investment in their economies and to improve transparency.

The Division, which holds the chair of the Investment Experts Group (IEG), has developed a range of work programs focused on investment liberalisation and improving the transparency of investment regimes in the APEC region. The IEG work program in the last year included:

- continuing analysis of behind-the-border barriers to investment climate reform;
- exploring the usefulness of the PFI for investment climate reform by APEC's developing member economies including a pilot project involving an Ausaid-funded PFI assessment of Vietnam;
- a joint APEC-United Nations Conference on Trade and Development (UNCTAD) project examining the best practices in the use of foreign direct investment in the provision of electricity and roads infrastructure; and
- the development and endorsement by APEC Ministers and Leaders of a three-year *APEC Investment Facilitation Action Plan*.

Business is an active contributor to IEG in sharing its ideas on how to improve the regional investment environment, with particular focus on behind-the-border impediments to investment and the need for improved investment policy coherence.

Officials from the Division also participated actively in two investment climate reform capacity building projects targeting APEC economies undertaken by the Australian APEC Study Centre and Melbourne APEC Finance Centre.

Bilateral investment negotiations

With the slow rate of progress in multilateral trade negotiations and the decision not to negotiate multilateral rules on investment in the current Doha Round, Australia has significantly increased its participation in bilateral trade and investment agreements.

Bilateral agreements can provide greater security, certainty and opportunities for outward FDI from Australia. At the same time, they can ensure that Australia is a desirable destination for overseas investors, by reducing existing compliance costs faced by investors and the cost of capital for Australian businesses.

In contrast to multilateral forums, bilateral agreements are less cumbersome to initiate and maintain, and they may be tailored to meet the needs of unique relationships between nations. They can secure practical results for Australian businesses. However, they can also introduce complexity and hence new compliance costs where each agreement contains slightly different provisions and thresholds or triggers.

Free trade agreements

The coverage of modern FTAs has extended beyond trade in goods to include non-trade provisions such as investment, services, government procurement and competition policy. Research has suggested that the effects of these non-trade provisions in FTAs can be more positive than the trade provisions.¹ The Division, through its policy responsibility for foreign investment, is involved in the negotiation of the investment and services chapters of Australia's FTAs.

Existing agreements

Australia concluded its first FTA with New Zealand in 1983 (the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA)). Since 2003, it has concluded FTAs with Singapore, Thailand, the United States (US), Chile and (together with New Zealand) the Association of South-East Asian Nations (ASEAN). The Australia-United States Free Trade Agreement (AUSFTA) involved significant liberalisation of Australia's foreign investment framework. Further information on the rules that now apply to US investors is at Appendix A. Detailed information on Australia's existing bilateral FTAs is available at www.dfat.gov.au/trade/ftas.html.

Current negotiations

Investment is a component of Australia's current FTA negotiations with the Gulf Cooperation Council (GCC), Japan, China, the Republic of Korea and Malaysia. Australia has also resumed negotiations for an Investment Protocol to the CER Agreement with New Zealand and announced that it will participate in the Trans-Pacific Partnership.

Australia-Chile Free Trade Agreement

On 27 May 2008, Australia concluded FTA negotiations with Chile. The agreement entered into force on 6 March 2009.

1 Adams, R, Dee, P, Gali, J and McGuire G, (2003), 'The Trade and Investment Effects of Preferential Trading Arrangements – Old and New Evidence', *Productivity Commission Staff Working Paper*, Canberra, May 2003.

Australia-Gulf Cooperation Council (GCC) Free Trade Agreement negotiations

On 13 December 2006, Australia announced it would be seeking FTA negotiations with the GCC. The third round of negotiations was held in February 2009. The GCC consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

Australia-Japan Free Trade Agreement negotiations

Australia and Japan agreed to commence negotiations on an FTA on 12 December 2006. The eighth round of negotiations was held in March 2009.

Australia-China Free Trade Agreement negotiations

Australia and China announced their intention to commence FTA negotiations on 18 April 2005. The thirteenth round of negotiations was held in December 2008.

Australia-Malaysia Free Trade Agreement negotiations

The commencement of FTA negotiations was announced on 7 April 2005. The agreement was signed on 27 February 2009.

Australia-New Zealand-ASEAN Free Trade Agreement negotiations

Australian, New Zealand and ASEAN leaders announced the commencement of FTA negotiations on 30 November 2004. Negotiations concluded on 28 August 2008.

Australia-New Zealand Closer Economic Relations

In February 2006, Australia and New Zealand agreed to commence negotiations on an Investment Protocol to form part of the ANZCERTA. In March 2009, the Australian and New Zealand Prime Ministers agreed to finalise an investment protocol in 2009.

The Trans-Pacific Partnership Agreement

On 20 November 2008 at the APEC Ministerial Meeting in Lima, Peru, the Minister for Trade announced that Australia would participate in negotiations on a comprehensive Trans-Pacific Partnership Agreement alongside the United States, Brunei Darussalam, Chile, New Zealand, Singapore and Peru. Vietnam is also considering possible participation.

Australia-Republic of Korea Free Trade Agreement negotiations

Australia and the Republic of Korea agreed to enter into FTA negotiations in March 2009. The first round of negotiations was held in May 2009.

FTA feasibility studies

Australia is currently undertaking a joint FTA feasibility study with India. In addition, the Australian and Indonesian governments are considering the findings of the completed joint feasibility study, with a view to possible commencement of negotiations towards an FTA.

Investment protection and promotion agreements

IPPAs are bilateral investment agreements between governments, which aim to stimulate the flow of investment by providing investors with guarantees relating to non-commercial risk.

To date, Australia has IPPAs in force with Argentina, Chile, the Czech Republic, Egypt, Hong Kong, Hungary, India, Indonesia, Laos, Lithuania, Mexico, Pakistan, Papua New Guinea, China, Peru, the Philippines, Poland, Romania, Sri Lanka, Uruguay and Vietnam. An agreement with Turkey has also been signed, but is not yet in force.

Australia's international investment position

This section summarises trends in foreign investment in Australia and Australian investment abroad using Australian Bureau of Statistics (ABS) data.² Foreign investment in Australia refers to the stock of financial assets in Australia owned by non-residents and financial transactions that increase or decrease this stock. Conversely, Australian investment abroad refers to the stock of foreign financial assets owned by Australian residents and financial transactions that increase or decrease that stock.

ABS data on Australia's international investment position is compiled in accordance with the relevant international statistical standards promulgated by the OECD and the International Monetary Fund. This data is a measure of the actual cross-border transactions that have occurred and the level of foreign investment held at a particular time. By contrast, FIRB statistics relate to proposals submitted for approval, regardless of the source of finance or whether proposals were actually implemented. These differences are explained in Chapter 2.

Foreign investment levels³

According to ABS statistics,⁴ the stock of foreign investment in Australia at the end of June 2008 was \$1,682.1 billion. This represents an increase of \$85.3 billion over the level at 30 June 2007. FDI accounted for \$391.6 billion of total investment, a \$40.4 billion (11 per cent) increase over the level at 30 June 2007.

At the same time, the stock of Australian investment abroad was \$1,002.7 billion. This represents an increase of \$34.1 billion over the stock at 30 June 2007. FDI accounted for \$318.2 billion of the total stock of investment abroad.

2 As ABS data is subject to periodic revision, data included in the current report may differ from that published for the same period in previous reports.

3 Prior to 2005-06, foreign investment levels were reported on a non-financial year basis.

4 Source: ABS cat. no. 5302.0 Balance of Payments and International Investment Position, Australia, March Quarter 2009.

Foreign direct investment levels by country

Chart 4.1 depicts recent trends in FDI levels between Australia and its five most important FDI partners: the US, the United Kingdom (UK), Japan, New Zealand and the European Union (EU) (other than the UK).

The US is Australia's single largest source of inward FDI and the most important destination for Australian FDI abroad. Almost a quarter of all FDI in Australia comes from the US and approximately 43 per cent of all Australian direct investment abroad flows to the US.

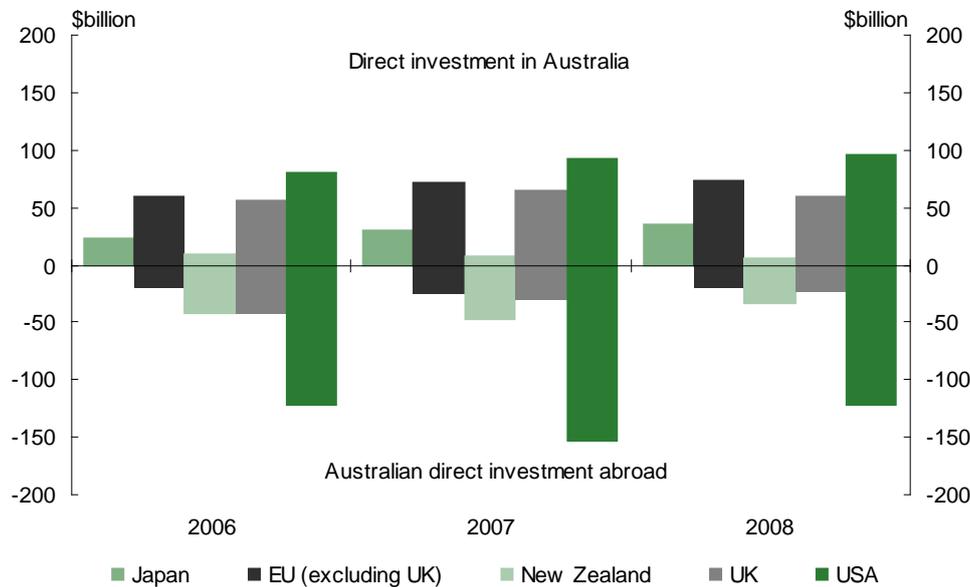
The UK has traditionally been Australia's other major source of FDI. At the end of 2008, \$60 billion, or approximately 15 per cent, of the level of FDI in Australia originated from the UK. The level of Australian direct investment in the UK was \$23 billion at the end of 2008.

The level of Japanese FDI in Australia at the end of 2008 was \$36 billion. However, Australian FDI in Japan remains at a very low level.

The level of Australian direct investment in New Zealand at the end of 2008 was \$34 billion. New Zealand direct investment in Australia was \$5 billion at the end of 2008.

The level of EU (excluding the UK) direct investment in the Australian economy grew to \$73 billion by the end of 2008. Australian direct investment in the EU (excluding the UK) was \$20 billion at the end of 2008.

Chart 4.1: Level of foreign direct investment by country at 31 December 2008



Source: ABS cat. no. 5352.0 International Investment Position, Australia: Supplementary Country Statistics 2008.

Foreign investment flows

Foreign investment transactions involve changes in the levels of Australian foreign assets and liabilities (including the creation or extinction of foreign assets and liabilities). A current account deficit is balanced by a surplus on the capital and financial account, after allowing for errors and omissions. The balance on the financial account represents net financial transactions with the rest of the world, that is, the inflow of foreign investment into Australia, minus the outflow of Australian investment abroad.

International investment flows and stocks are divided into direct, portfolio, financial derivatives, other investment, and reserve assets. Under the international standards used to compile ABS foreign investment statistics, direct investment represents capital invested in an enterprise by an investor in another country which gives the investor a 'significant influence' (either potentially or actually exercised) over the key policies of the enterprise. Ownership of 10 per cent or more of the ordinary shares or voting stock of an enterprise is considered, under the ABS framework, to indicate significant influence by an investor. Portfolio investment is cross-border investment in equity and debt securities other than direct investment. Financial derivatives are linked to a specific financial instrument or indicator, or to a particular commodity. Other investment is a residual group that comprises many different kinds of investment. Reserve assets are those external financial assets available to and controlled by the

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Reserve Bank of Australia or the Australian Treasury for use in financing payment imbalances or intervention in foreign exchange markets.

Table 4.1 provides a breakdown of the flow of foreign investment over the past five years measured by ABS statistics. In 2007-08, the inflow of foreign investment into Australia was \$159.2 billion. The outflow of Australian investment abroad was \$91.9 billion.

Table 4.1: Foreign investment flows 2003-04 to 2007-08

	2003-04	2004-05(a)	2005-06	2006-07	2007-08
	\$b	\$b	\$b	\$b	\$b
Australian investment abroad(b)					
Direct investment					
Equity and reinvested earnings	-24.8	55.6	-30.9	-23.9	-25.5
Other capital	-1.4	3.7	1.2	-6.7	-7.9
Portfolio investment					
Equity	-7.7	-15.2	-27.7	-39.7	-42.1
Debt	-14.9	-16.4	-33.3	-38.9	-24.4
Derivatives	24.7	23.2	13.0	14.4	-4.1
Other investment(c)	-14.8	-3.1	-17.3	-21.5	-32.1
Reserve assets	-5.1	-8.1	-5.6	-20.1	44.3
<i>Total Australian investment abroad</i>	<i>-43.9</i>	<i>39.7</i>	<i>-100.6</i>	<i>-136.4</i>	<i>-91.9</i>
Foreign investment in Australia(b)					
Direct investment					
Equity and reinvested earnings	12.0	-13.7	17.7	25.4	36.2
Other capital	-1.7	5.9	5.5	15.3	23.6
Portfolio investment					
Equity	18.3	-37.8	18.0	31.9	2.9
Debt	86.7	70.0	105.6	110.0	58.4
Derivatives	-27.5	-22.2	-16.7	-10.9	-5.0
Other investment(c)	0.8	14.0	22.5	21.8	43.0
<i>Total foreign investment in Australia</i>	<i>88.6</i>	<i>16.1</i>	<i>152.6</i>	<i>193.5</i>	<i>159.2</i>
Net foreign investment	44.7	55.8	52.0	57.1	67.2

(a) The figures for 2004-05 were significantly affected by one particular transaction whereby a major corporate reorganisation was recorded both as a transaction reducing Australian investment abroad and also reducing direct investment in Australia. The net effect of this transaction was zero.

(b) In keeping with balance of payment conventions, credit entries are shown without sign and debit items are shown as negative entries. Thus, investment flows going from Australia to offshore destinations are shown as a negative.

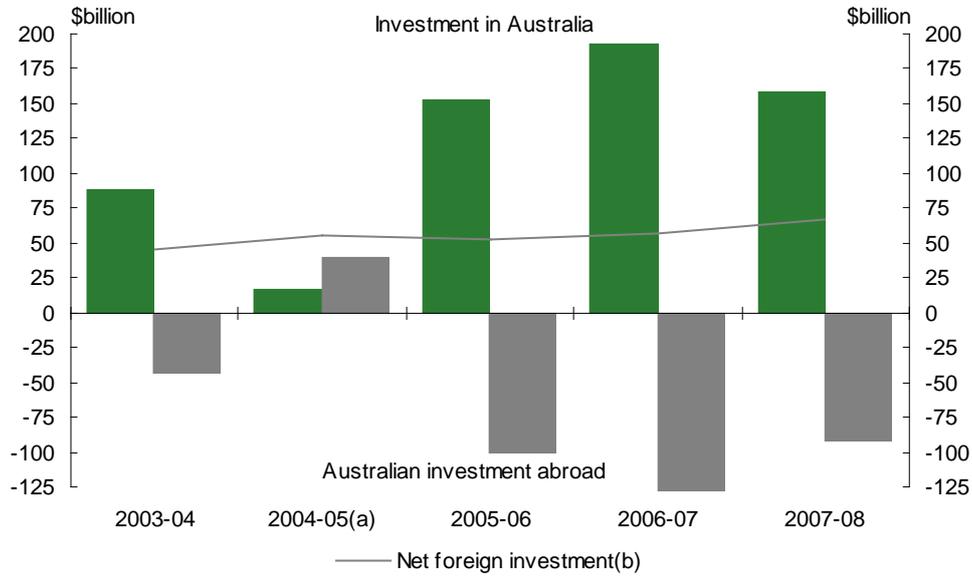
(c) Other investment includes all other investment.

Note: Figures may not add due to rounding.

Source: ABS cat. no. 5302.0 Balance of Payments and International Investment Position, Australia, March Quarter 2009, Table 75. Financial Account — Financial Year.

Chart 4.2 summarises major trends in foreign investment flows using the data in Table 4.1. It indicates that Australia remains a net importer of capital.

Chart 4.2: Foreign investment flows 2003-04 to 2007-08



(a) The figures for 2004-05 were significantly affected by one particular transaction whereby a major corporate reorganisation was recorded both as a transaction reducing Australian investment abroad and also reducing direct investment in Australia. The net effect of this transaction was zero.

(b) The net foreign investment figure has been derived from determining the difference between foreign investment in Australia and Australian investment abroad.

Source: ABS cat. no. 5302.0 Balance of Payments and International Investment Position, Australia, March Quarter 2009, Table 75. Financial Account — Financial Year.

Useful references on international investment issues

Websites

Organisation	Address
APEC: Investment Experts Group (IEG)	www.apecsec.org.sg
Attorney-General's Department	www.ag.gov.au
Australian Bureau of Statistics (ABS)	www.abs.gov.au
Australian Competition and Consumer Commission	www.accc.gov.au
ANCP for the <i>OECD Guidelines for Multinational Enterprises</i>	www.ausncp.gov.au
Australian Prudential Regulatory Authority	www.apra.gov.au
Australian Securities and Investments Commission	www.asic.gov.au
Australian Treasurer	www.treasurer.gov.au
Business and Industry Advisory Committee to the OECD	www.biac.org
ComLaw (Commonwealth Law)	www.comlaw.gov.au
Department of Foreign Affairs and Trade	www.dfat.gov.au
Foreign Investment Review Board	www.firb.gov.au
International Monetary Fund	www.imf.org
OECD Guidelines for Multinational Enterprises	www.oecd.org
Online guide to Australia's Free Trade Agreements	www.fta.gov.au
Organisation for Economic Co-operation and Development (OECD)	www.oecd.org
The Treasury	www.treasury.gov.au
United Nations Conference on Trade and Development (UNCTAD)	www.unctad.org
World Trade Organization (WTO)	www.wto.org

Documents

Document title	Available at:
<i>Code of Liberalisation of Capital Movements</i>	www.oecd.org
<i>Economic Roundup</i> (Treasury series)	www.treasury.gov.au
General Agreement on Tariffs in Trade (GATT)	www.wto.org
General Agreement on Trade in Services (GATS)	www.wto.org
<i>Guide to the Investment Regimes of the APEC Member Economies</i> (5th Edition)	www.apecsec.org.sg
<i>International Direct Investment Statistics Yearbook</i>	www.oecd.org
<i>OECD Code of Liberalisation of Current Invisible Operations</i>	www.oecd.org
<i>OECD Declaration on International Investment and Multinational Enterprises</i>	www.ausncp.gov.au
<i>OECD Guidelines for Multinational Enterprises</i>	www.ausncp.gov.au
<i>Policies and International Integration: Influences on Trade and Foreign Direct Investment</i> (OECD Study)	www.oecd.org
The Trade and Investment Effects of Preferential Trading Arrangements – Old and New Evidence (Australian Productivity Commission Staff Working Paper)	www.pc.gov.au
<i>The Treasury Annual Report 2007-08</i>	www.treasury.gov.au
UNCTAD Series on Issues in International Investment Agreements	www.unctad.org
UNCTAD World Investment Directory	www.unctad.org
<i>UNCTAD World Investment Report</i>	www.unctad.org