

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 multi-faceted 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 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 administration and promotion 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.

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.

Over the past 15 years Australian outward FDI stocks have grown more strongly than inward FDI stocks. This trend of Australian firms increasingly investing abroad has added another dimension to the contribution that FDI makes to Australia's economic growth. 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.

The strong growth in global cross-border FDI activity is also linked to the recent increase in government-to-government investment-related negotiations in multilateral, regional and bilateral forums. Given the importance of FDI flows to Australia and the positive role that investment-related agreements can play in enhancing international investment flows, Australia pursues a broad agenda on investment in international forums.

Multilateral investment issues

While at the multilateral level there is not a 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 and APEC. 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 countries which are the source of more than 80 per cent of global investment flows. It is responsible for the OECD Codes of Liberalisation of Capital Movements and 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 inter-governmental cooperation on developing best policy practices and peer review-based approaches to outreach activities. The text of the Declaration is at Appendix F.

The Committee's work programme 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.

The Committee concluded two major projects in 2006:

- The *Policy Framework for Investment* (the PFI) was adopted by the OECD Ministerial Council on 24 May 2006. The PFI provides a checklist of policy issues for consideration by governments interested in creating an attractive investment environment. The checklist encourages policy makers to focus on ten policy areas in reaching judgments about the appropriateness of their policy settings. These are: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance; responsible business conduct; human resource development; infrastructure and financial sector development; and public governance.
- The OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones (WGZs) was adopted by the OECD Executive Council on 8 June 2006. The Risk Awareness Tool aims to assist investing companies from developed countries to better assess the risks they face when investing in WGZs. It provides a checklist of questions that companies may use to self-assess their procedures and practices.

OECD Guidelines for Multinational Enterprises

The *OECD Guidelines* provide voluntary principles and standards for responsible business conduct consistent with applicable domestic laws.

The *OECD Guidelines* are recommendations by governments to MNEs operating in or from the 30 OECD Member countries and nine non-Member adhering countries (Argentina, Brazil, Chile, Estonia, Israel, Lithuania, Slovenia, Latvia and Romania). 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 NCP 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 a 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.

During 2005-06 the ANCP conducted a review of a specific instance lodged in June 2005 by a consortium of five Australian and overseas non-government organisations (NGOs). The specific instance alleged that, through its provision of immigration detention services to the Australian Government, GSL (Australia) Pty Ltd (a UK-controlled MNE) had breached the human rights and consumer interest provisions of the *OECD Guidelines*. The review process culminated in a mediation session through which the ANCP was able to facilitate conciliation on many of the issues raised in the submission. The ANCP successfully concluded the proceedings and released a public final statement on 6 April 2006. This statement is available on the ANCP website at www.ausncp.gov.au.

The promotional activities of the ANCP during the period have included:

- Conducting a combined business and community consultation in May 2006. The consultation focused on the Australian textiles, clothing and footwear (TCF) industry, but was attended by participants from a diverse range of organisations including representatives from business, industry groups, trade unions, NGOs and other interested parties. This was the first ANCP consultation to target a specific industry sector. Consultations provide a forum for the ANCP to promote the *OECD Guidelines*, and for interested parties to provide ideas and assistance with their promotion and raise issues relevant to the Guidelines with the ANCP. Consultations are also used to facilitate discussion on OECD working papers.

- 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.
- Attending corporate social responsibility conferences hosted by other organisations (for example, the bi-annual DFAT and NGO Human Rights Consultations).

More information on the *OECD Guidelines* and the activities of the ANCP can be found at www.ausncp.gov.au.

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, 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.

In the lead-up to Australia hosting APEC in 2007, the division has taken on a more active role in APEC's work by accepting the convenorship of the Investment Experts Group (IEG). Under Australia's convenorship, the IEG has developed a range of work programmes focused on promoting investment liberalisation and improving the transparency of investment regimes in the APEC region. Work projects undertaken by IEG in the last year have included:

- promoting increased coherence and convergence in the FTA investment chapters of APEC Members;
- introducing the OECD's PFI to APEC Members;
- cooperating with the United Nations Conference on Trade and Development (UNCTAD) in the area of investor-state dispute settlement; and
- commencing work on the updating and publication of the sixth APEC Investment Guidebook.

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.

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 play an important role in improving investment climates, reducing regulatory barriers to international trade and investment and enhancing the benefits that can be derived from FDI. Evidence indicates a link between the quality of the overall investment climate and the quality of productive investment that is ultimately attracted. Bilateral agreements can provide greater security, certainty and opportunities for outward FDI from Australia, and at the same time, ensure that Australia is a desirable destination for overseas investors. This includes 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 and provide momentum to our wider multilateral trade objectives. 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, with non-trade provisions such as investment, services, government procurement and competition policy playing important roles. In fact, research has suggested that the effects of these non-trade provisions in FTAs are 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 and the United States (US).

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

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.fta.gov.au.

Current negotiations

Investment is a significant component of Australia's current FTA negotiations with China, Malaysia and (with New Zealand) the Association of South-East Asian Nations (ASEAN).

Australia-China Free Trade Agreement negotiations

Australia and China announced their intention to commence FTA negotiations on 18 April 2005. Five negotiating rounds had taken place by June 2006.

Australia-Malaysia Free Trade Agreement negotiations

The commencement of FTA negotiations was announced on 7 April 2005. Three FTA negotiating rounds had taken place by June 2006.

Australia-New Zealand-ASEAN Free Trade Agreement negotiations

Australian, New Zealand and ASEAN leaders announced the commencement of FTA negotiations on 30 November 2004. Six rounds of negotiations had taken place by June 2006.

Australia-New Zealand Closer Economic Relations

In February 2006, Australia's Treasurer and New Zealand's Finance Minister agreed to commence negotiations on an Investment Protocol to form part of the ANZCERTA. Two rounds of negotiations had taken place by June 2006, with initial discussions focusing on technical issues relating to the structure of the proposed Protocol.

FTA feasibility studies

During 2005-06 the division participated in the ongoing feasibility study into a possible FTA between Australia and Japan. The feasibility study is expected to be completed by the end of 2006.

On 21 June 2006, Australia announced that it would consider negotiating a FTA with the six members of the Gulf Cooperation Council (GCC). This followed a decision by the United Arab Emirates (UAE) that Australia's existing bilateral FTA negotiations with them should be incorporated into broader GCC negotiations. The GCC consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE.

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, Pakistan, Papua New Guinea, China, Peru, the Philippines, Poland, Romania, Uruguay and Vietnam. Agreements with Sri Lanka, Mexico and Turkey have also been signed, but are 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 2006 was \$1,305.8 billion. This represents an increase of \$197.4 billion (17.8 per cent) over the level at 30 June 2005. FDI accounted for \$287.8 billion of total investment, a \$19.7 billion (7.3 per cent) increase over the level at 30 June 2005.

At the same time the stock of Australian investment abroad was \$764.9 billion. This represents an increase of \$160.2 billion (26.5 per cent) over the stock at 30 June 2005.

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 Foreign investment levels were previously reported on a non-financial year basis.

4 Source: ABS Catalogue No. 5302.0 Balance of Payments and International Investment Position, Australia, June Qtr 2006.

FDI accounted for \$274.9 billion of the total stock of investment abroad, an increase of \$73.7 billion (36.6 per cent) from 30 June 2005.

Foreign direct investment levels by country

Chart 4.1 depicts recent trends in FDI flows 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 45 per cent of all Australian direct investment abroad flows to the US. At 31 December 2005, Australia had \$41.5 billion more direct investment in the US than the US had in Australia.

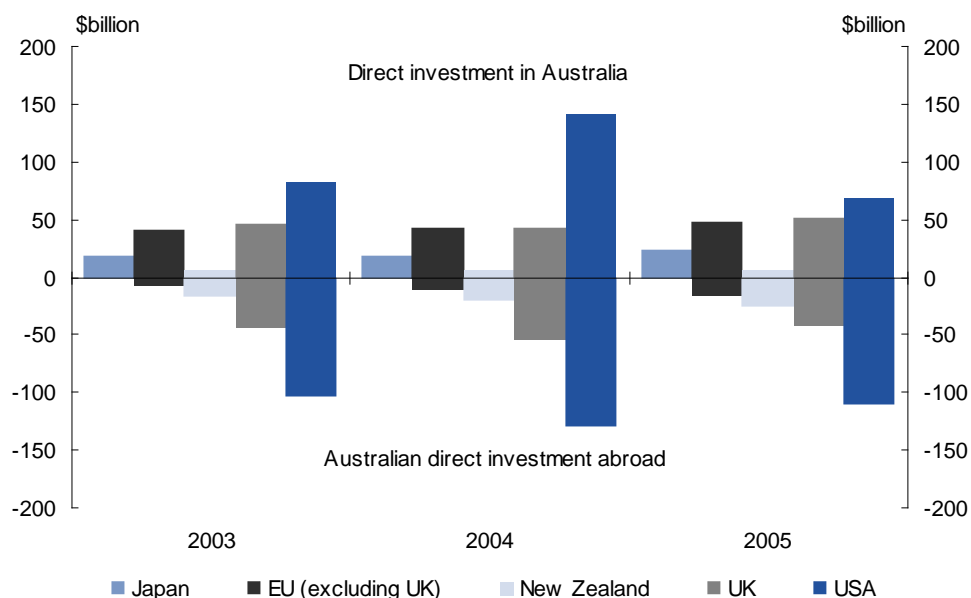
The UK has traditionally been Australia's other major source of FDI. At the end of 2005, \$51.3 billion, or approximately 18 per cent, of the level of FDI in Australia originated from the UK. The level of Australian direct investment in the UK fell slightly in 2005 to \$42.4 billion.

The level of Japanese FDI in Australia grew strongly in 2005 to \$23.8 billion. However, Australian FDI in Japan remains at a very low level.

The level of Australian direct investment in New Zealand grew significantly in 2005 to \$38.3 billion. New Zealand direct investment in Australia remained relatively steady at \$5.9 billion in 2005.

The level of EU (excluding the UK) direct investment in the Australian economy grew slightly in 2005 to \$47 billion. Australian direct investment in the EU has more than doubled over the past two years to \$16.1 billion as at the end of 2005.

Chart 4.1: Level of foreign direct investment by country at 31 December 2005



Source: ABS Catalogue No. 5352.0 International Investment Position, Australia: Supplementary Country Statistics 2005.

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

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. The inflow of \$136.5 billion in 2005-06 is the largest ever annual inflow of foreign investment into Australia. The outflow of \$83.1 billion in 2005-06 is the largest ever annual outflow of Australian investment abroad.

Table 4.1: Foreign investment flows 2001-02 to 2005-06

	2001-02	2002-03	2003-04	2004-05(a)	2005-06
	\$b	\$b	\$b	\$b	\$b
Australian investment abroad(b)					
Direct investment					
Equity and reinvested earnings	-26.0	-12.1	-24.5	55.6	-25.6
Other capital	4.8	4.3	-1.3	-1.4	-0.7
Portfolio investment					
Equity	-17.9	-12.4	-7.4	-11.4	-20.7
Debt	-10.1	-5.0	-15.5	-14.1	-25.9
Derivatives	-0.7	3.3	24.4	23.1	12.0
Other investment(c)	-6.2	-0.1	-14.7	-3.5	-16.6
Reserve assets	0.8	-5.6	-5.1	-8.1	-5.6
<i>Total Australian investment abroad</i>	<i>-55.3</i>	<i>-27.6</i>	<i>-44.2</i>	<i>40.1</i>	<i>-83.1</i>
Foreign investment in Australia(b)					
Direct investment					
Equity and reinvested earnings	16.3	15.6	11.6	-13.6	17.1
Other capital	5.0	5.8	-1.7	4.1	1.5
Portfolio investment					
Equity	10.7	3.3	17.5	-38.3	14.4
Debt	28.6	31.5	86.5	68.2	97.2
Derivatives	1.5	-4.3	-25.5	-20.8	-13.1
Other investment(c)	14.1	16.0	0.7	13.7	19.3
<i>Total foreign investment in Australia</i>	<i>76.2</i>	<i>67.9</i>	<i>89.0</i>	<i>13.4</i>	<i>136.5</i>
Net foreign investment	20.9	40.3	44.8	53.5	53.4

(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.

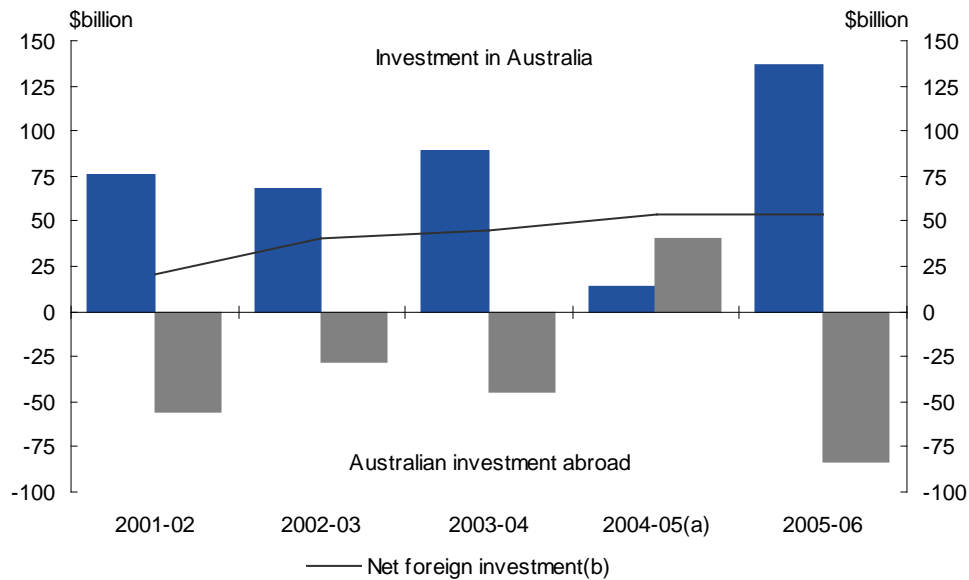
(c) Other investment includes all other investment.

Note: Figures may not add due to rounding.

Source: ABS 5302.0 Balance of Payments and International Investment Position, Australia, June Qtr 2006, Table 25 — Financial Account (a)(b).

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 2001-02 to 2005-06



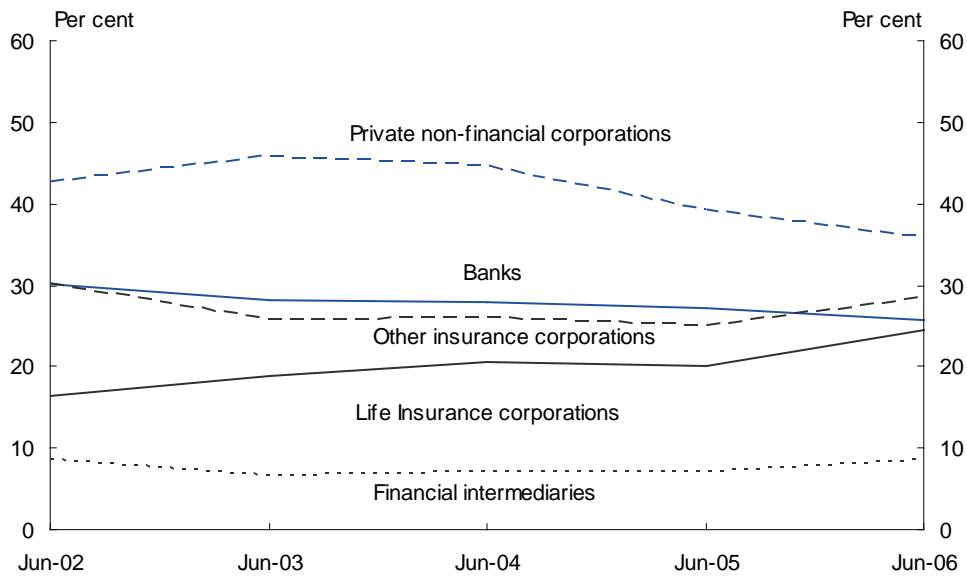
- (a) The figures for 2004-05 were significantly affected by one particular transaction whereby a major corporate reorganisation was recorded both as a transaction reducing Australian Investment Abroad and also reducing Direct Investment in Australia. The net effect of this transaction was zero.
- (b) The net foreign investment figure has been derived from determining the difference between foreign investment in Australia and Australian investment abroad.

Source: ABS 5302.0 Balance of Payments and International Investment Position, Australia, June Qtr 2006, Table 25 — Financial Account (a)(b).

Foreign investment by sector

Over the period 1 July 2005 to 30 June 2006, the percentage of foreign ownership of Australian equity declined for private non-financial corporations and banks and increased for financial intermediaries and life and other insurance corporations (see Chart 4.3).

**Chart 4.3: Foreign ownership of Australian equity by sector
2002-03 to 2005-06**



Source: ABS 5232.0 Financial Accounts, Australia, June quarter 2006, Tables 40 and 41 — Listed and Unlisted Shares and Other Equity Market (a).

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 Investment 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
Invest Australia	www.investaustralia.gov.au
The <i>OECD Guidelines for Multinational Enterprises</i>	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>The 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 2005-06</i>	www.treasury.gov.au
UNCTAD Series on Issues in International Investment Agreements	www.unctad.org
UNCTAD World Investment Directory	www.unctad.org
UNCTAD World Investment Report	www.unctad.org

