

## Gaining from Investment

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### Synopsis

*The Intergenerational Report has laid down a challenge for all Australians, we must strive for higher levels of productivity if we are to prosper in the latter part of the 21<sup>st</sup> century. The free-trade agreement with the US is an important element of the endeavour to improve our productivity and probably in no area more than investment. Foreign direct investment is as important to Australia as when Governor Phillip ruled the colony, however now investment is a two way flow further liberated by the FTA.*

### Introduction

In the last week we have seen the Government take the first tentative steps to prepare for Australia's changing demographics. The Government has identified some of the challenges which demographic change will bring to our society. In 2042 almost one in every four Australians will be aged 65 or over with the largest increase being in the number of Australians aged 85 and over. At the same time, growth in the people of workforce age is expected to fall from around 1.2% per annum over the last decade to zero in forty years' time.

Much of the focus on the debate has been around changing work and superannuation patterns but for some time the Government has recognised that we are living in a "Red Queen race" because, like the Red Queen in *Through the Looking-Glass*, we must race furiously simply to stay still.<sup>1</sup> If Australian's are to prosper in the years to come above all else we must enhance our national productivity; this is an important element of the preventing Australia from becoming a victim of our demography. In this context the Australia-United States Free Trade Agreement (FTA) builds on other work that has been done to improve our future economic prosperity.

In order maintain Australia's competitiveness in the global economy the removal of barriers to investment is likely to produce great benefits for our nation. Like the free flow of goods and services, free international capital flow promotes economic welfare. This is explicitly recognised by Australia's foreign investment policy:

*The Government's approach to foreign investment policy is to encourage foreign investment consistent with community interests. In recognition of the contribution that foreign investment has made and continues to*

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<sup>1</sup> Accordingly, the metaphor *Red Queen* represents the situation in nature where creatures must adapt quickly to changing environmental threats just to survive from generation to generation. In *Through the Looking Glass* (Lewis Carroll *Through the Looking-Glass and What Alice Found There*), Alice complains that she has to run just to stay in the same place.

*Well, in our country," said Alice, still panting a little, "you'd generally get to somewhere else -- if you ran very fast for a long time, as we've been doing.*

*A slow sort of country!" said the Queen. "Now, here, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!*

*make to the development of Australia, the general stance of policy is to welcome foreign investment. Foreign investment provides scope for higher rates of economic activity and employment than could be achieved from domestic levels of savings. Foreign direct investment also provides access to new technology, management skills and overseas markets.<sup>2</sup>*

Even before the FTA Australia and the US were already among the most open economies in the world with few practical restrictions on investment. In this sense the FTA's gains will be less important as a fact than they will be as a reflection of sentiment.

### **New investment rules for Australian investors**

While the US market is relatively open, the US has a large number of county administrations and State Governments. Under the FTA, Australian investors in the US market will secure the same rights of protection as US investors.<sup>3</sup>

It has long been recognised that expanding offshore allows Australian companies to access bigger markets, as well as diversifying risk across markets and currencies. Offshore investment facilitates exports by building networks in overseas markets. In the 12 months to 30 June 2001, Australian companies invested \$417 billion more than 42% of this was direct investment.<sup>4</sup>

A recent survey of large enterprises by the Productivity Commission found that 50% of firms reported that offshore investment had increased their overall profitability and 35% reported higher exports as a result of foreign direct investments.<sup>5</sup>

### **New investment rules for US investors**

The Government has the power under the *Foreign Acquisitions and Takeovers Act (Cth) 1975* to block foreign investment proposals to acquire businesses worth over \$50 million on the basis that Treasurer believes the acquisition would be contrary to the national interest. Under the FTA investments by US investors will no longer be subject to these restrictions.

US investors seeking to acquire Australian businesses under \$800 million will no longer need the approval of Australia's Foreign Investment Review Board. The FIRB will continue to examine acquisitions in the telecommunication, transport and defence industries over \$50 million. No change is proposed to the restrictions on ownership of real property, Telstra, Qantas and CSL. Similarly, US investment in the Australian media will also require approval regardless of value.

### *Impact on other trade commitments*

It has been suggested that Australia's existing trade commitments to Japan and New Zealand mean these investment concessions will also need to be extended to them. Under the FTA, foreign investors in each of the three countries are accorded a legal right to national treatment.

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<sup>2</sup> *Summary Of Australia's Foreign Investment Policy*, The Treasury, Canberra, May 2000, pg 1.

<sup>3</sup> Alan Oxley, Free Trade Agreements in the era of globalization - new instruments to advance new interests - the case of Australia. (Australian APEC Centre, Monash University, July 2002) <http://www.austa.net/publicForum/publicForum37.htm>

<sup>4</sup> Investing in Australia at [http://www.dfat.gov.au/geo/australia/tradingnation/investing\\_in\\_australia.html](http://www.dfat.gov.au/geo/australia/tradingnation/investing_in_australia.html)

<sup>5</sup> *Offshore Investment by Australian Firms: Survey Evidence*, Productivity Commission, Commission Research Paper, <http://www.pc.gov.au/research/commres/offshinvest/index.html>, Feb-02

### *Application of dispute procedures*

It remains unclear whether the Free-Trade Agreement dispute panel procedures will would apply to the power of the Treasurer under the Foreign Acquisitions and Takeovers Act to reject foreign investment proposals on the basis the acquisition is not in the national interest a decision that is not usually able to be reviewed.

### **Foreign direct investment and improved productivity**

Foreign direct investment is one means by which non-marketable goods and services can be exchanged.<sup>6</sup> In a world driven by better ideas, improving technical competencies, better managerial styles and other “knowledge intensive” foreign direct investment provides a powerful tool for Australian to access goods and services that are not easily commoditised and traded on markets.

For both Australia and the US the value of outward foreign investment and sales by foreign-based subsidiaries is greater than exports from home based companies. Recently there have been two major studies of foreign investment abroad by Australian companies: one by the Productivity Commission and one by the Department of Foreign Affairs and Trade.<sup>7</sup> Both found a very high level of foreign participation by Australian firms. Both also concluded that, on balance, foreign investment by Australian companies was a good thing for the economy. As well as the profits that flow from such operations, the studies found that there could also be positive spin-offs for firms' domestic operations.

In most cases, companies undertook offshore investment because they had developed strong skills and expertise within their particular fields, which they could profitably take overseas. Negative reasons for moving operations overseas – eg because there was something wrong with the Australian business environment – seemed to be in a minority.

Investment is the vehicle that delivers new technology. Each year our State premiers compete to attract US investment in new technology industries.<sup>8</sup> There can be little doubt that the US is at the forefront of technology, adaptation and innovation in industries that are likely to dominate the 21<sup>st</sup> century like, telecommunications, finance, transport, retailing and distribution.

As Alen Oxley has said:

*When it comes to business and technology, Australia cannot afford to be anywhere except cheek by jowl with the US. If Australian business sets its reference points to US standards, it will continue to create jobs and prosperity for Australians and be able to succeed in any market in the world. If it lags behind, it will not succeed.*<sup>9</sup>

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<sup>6</sup> Ian Harper *Is the Proposed Merger of Shell and Woodside Contrary to Australia's National Interest?* February 2001 [http://www.mbs.edu/home/harper/HTMLpages/Articles/ianharper\\_fullreport.pdf](http://www.mbs.edu/home/harper/HTMLpages/Articles/ianharper_fullreport.pdf)

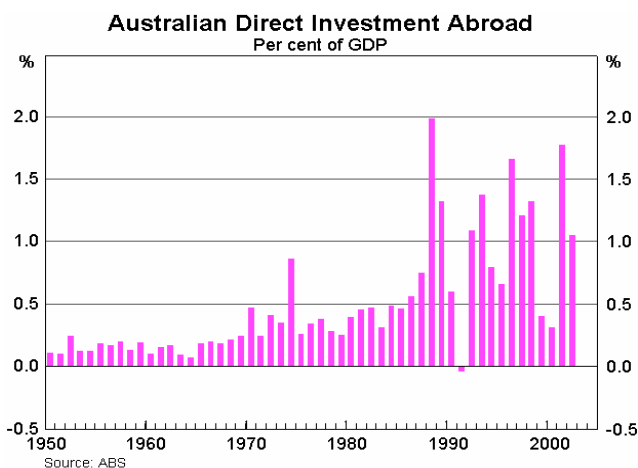
<sup>7</sup> Productivity Commission, *Offshore Investment by Australian Firms: Survey Evidence*, Commission Research Paper, February 2002 <<http://www.pc.gov.au/research/commres/offshinvest/index.html>>, Feb-02 Department of Foreign Affairs and Trade, *The Big End of Town and Australia's Trading Interests*, March 2002

<sup>8</sup> Alan Oxley, The Free Trade Agreement is about securing our trading future. By <http://www.onlineopinion.com.au/view.asp?article=1887#Author's%20bio>

<sup>9</sup> Alan Oxley, The Free Trade Agreement is about securing our trading future. By <http://www.onlineopinion.com.au/view.asp?article=1887#Author's%20bio>

The value of Australia's outward foreign investment to the US was about equal to the annual level of exports over that period.<sup>10</sup> In 2000 Australia was the eight largest owner of US assets. Australian investment was greater than that from France or Japan. In 2001, the stock of Australian direct investment in the US was \$98 billion.<sup>11</sup> The increase in investment marks an important change in the character of Australia's economic relationship with the US.

None the less Australia is an overall capital importer – ie. in net terms each year, capital flows into the country. The graph below shows the annual flows of direct foreign investment by Australians, and into Australia measured as a per cent of GDP. The sharp increase over the past decade or two is clear.<sup>12</sup> These flows are, on average, about the same size as the portfolio outflows by funds managers.



The bulk of foreign direct investment by Australian firms is in the United States. Investment by Australian companies in the US at June 2001 was \$95 billion or 55% of total foreign direct investment see below. The second most important destination was the UK at 17%, with Continental Europe, Asia and New Zealand all roughly similar at \$13 billion or 8% of the total.<sup>13</sup>

<sup>10</sup> Alan Oxley, Free Trade Agreements in the era of globalization - new instruments to advance new interests - the case of Australia. ( Australian APEC Centre, Monash University, July 2002) <http://www.austa.net/publicForum/publicForum37.htm>.

<sup>11</sup> ABS (2001) Australian Bureau of Statistics Balance of Payments and International Investment, Cat. 5363.0, Canberra: Australian Bureau of Statistics from Alan Oxley, Free Trade Agreements in the era of globalization - new instruments to advance new interests - the case of Australia. ( Australian APEC Centre, Monash University, July 2002) <http://www.austa.net/publicForum/publicForum37.htm>.

<sup>12</sup> The source of these graphs is Ric Battellino Assistant Governor (Financial Markets) "Australia as a Capital Exporter" Address to Conference on 'The Impact of An Australia–US Free Trade Agreement :Foreign Policy Challenges and Economic Opportunities' Canberra - 29 August 2002 [http://www.rba.gov.au/Speeches/2002/sp\\_ag\\_290802.html#t1](http://www.rba.gov.au/Speeches/2002/sp_ag_290802.html#t1)

<sup>13</sup> Ric Battellino Assistant Governor (Financial Markets) "Australia as a Capital Exporter" Address to Conference on 'The Impact of An Australia–US Free Trade Agreement :Foreign Policy Challenges and Economic Opportunities' Canberra - 29 August 2002 [http://www.rba.gov.au/Speeches/2002/sp\\_ag\\_290802.html#t1](http://www.rba.gov.au/Speeches/2002/sp_ag_290802.html#t1).

**Foreign direct investment by large Australian firms**

Company	Per cent of total assets	
	1994/95	1999/00
News Corp	81	89
QBE	51	76
Brambles	60	69
Pioneer	40	62
AMP	44	61
Rio Tinto	61	60
Coca Cola	48	59
Lend Lease	11	57
Pac Dunlop	39	53
NAB	42	46
Amcor	33	46
MIM	28	44
BHP	36	41
CSR (now CSR/Rinkler)	34	41
ANZ	40	26
Boral	23	24
Fosters	55	21
Westpac	27	20
CBA	15	14
Telstra	0	8
Coles Myer	0	0
Woolworths	0	0
Qantas	0	0
C&W Optus	0	0
St George	0	0
PBL	0	0

Source: DFAT

These patterns are apparent in virtually all industrial countries. The widespread trend towards increased offshore investment seems to reflect the globalisation of economies and capital markets, rather than developments specific to any particular country.<sup>14</sup>

### FTA and tax

The importance of the free flow of investment between Australia and the US has been relatively free for some time and in this sense the FAT is more evolutionary than revolutionary but it needs to be viewed along a continuum of which the recent revisions to US/Australia Double Tax Agreement at the urging of a number of groups including the Business Council of Australia form an important part.<sup>15</sup>

Under the protocol to the US double tax agreement, which came into effect on 1 July 2003, firms with at least 80% ownership of the operation in the other country will be exempt from withholding tax. For other firms, with at least 10% ownership in the other country, the rate will reduce to 5%. This has increased the incentive for US firms to locate and/or expand their operations in Australia and for Australian public companies to bring profits made by their US subsidiaries back to Australia without any further tax being payable.

<sup>14</sup> Ric Battellino Assistant Governor (Financial Markets) "Australia as a Capital Exporter" Address to Conference on 'The Impact of An Australia-US Free Trade Agreement :Foreign Policy Challenges and Economic Opportunities' Canberra - 29 August 2002 [http://www.rba.gov.au/Speeches/2002/sp\\_ag\\_290802.html#t1](http://www.rba.gov.au/Speeches/2002/sp_ag_290802.html#t1)

<sup>15</sup> Business Council of Australia, White Paper Removing Tax Barriers to International Growth December 17, 2001 <http://www.bca.com.au/content.asp?newsID=87634>.

## Conclusion

The FTA preserves Australia's foreign investment policy, but with a range of changes that maintain Australia's ability to screen all investment of major significance. As Robert Zelic the US trade representative wrote recently:

*No trade agreement is ever a cookie-cutter precedent for the future, because each negotiation presents unique economic and political circumstances. But the important common thread is that each of these past trade agreements -- like the recent Australia agreement -- struck careful balances that could win broad political support, thereby opening the door to new economic opportunities and vastly expanded trade and incomes.<sup>16</sup>*

The FTA involves a significant and welcome liberalisation of Australia's foreign investment regime. The implementation of the policy generally indicates that the Government appears to be ready to implement this liberalisation in a non-discriminatory manner - for all investors, not only those from America. This will undoubtedly boost productivity in this country.<sup>17</sup>

Australia's future lies in the global growth sectors - manufacturing and services in particular. In today's world, investment is as important for growth as trade. It will be more important in the future.

Stories of the Australian companies that have been successful have some common threads a sound overseas strategy that leverages off domestic experience and the persistence to learn from the inevitable errors<sup>18</sup> that follow any overseas adventure but traditionally it has not been restricted by investment restrictions.

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<sup>16</sup> Robert . Zoellick "Don't Get Bitter About Sugar" in *The Wall Street Journal*, Updated February 25, 2004.

<sup>17</sup> Jane Drake-Bockman, So, what difference will the Free Trade Agreement actually make to our lives? By <http://www.onlineopinion.com.au/view.asp?article=1889>

<sup>18</sup> Adele Ferguson and David James "Secrets and traps" *Business Review Weekly* 06/05/2003 pg 40 The authors survey a number of companies and conclude that the reasons include: failure to stick closely to core areas of expertise; failure to take a long-term strategic view; flooding the foreign acquisition with second-rate expatriates who do not understand the culture, market or legal system; paying too much for the business; failure to manage synergies; and an inability to buy the number-one or number-two business. In addition, Australian companies' lack of size makes it difficult to use acquisitions to create cross-border advantages between different consumer and financial.