**Foreign investment notes.**

**7.1**

**Introduction**

Foreign investment is made up by the flows into the country. At any point, we can calculate the stock of foreign liabilities into the country. The liabilities are made up of foreign debt and foreign equity.

Historically in Australia, both foreign debt and foreign equity have been liabilities. However in recent times, foreign equity has turned into an asset position, but foreign debt has remained as a liability. Overall, we have a foreign liability position.

**Definition**

The term ‘foreign investment’ can be applied to all financial flows recorded in the financial account of the balance of payments.

In the balance of payments accounts the **FLOW** of foreign investment is recorded as:

* Direct (more than 10% ownership)
	+ Foreign equity (that is more than 10% ownership)
* Portfolio (less than 10% ownership)
	+ This is made up of foreign debt and equity (that is less than 10% ownership)
* Other
* Reserve Bank

The FLOW of finance comprises

* Borrowing
* Sale and purchase of assets

Gross Foreign Investment
The total amount of foreign investment inflows that come into the country.

Net Foreign Investment
Gross foreign investment less foreign investment outflows is net foreign investment. Outflows of foreign investment represent Australian investment into other countries.

Foreign Liabilities

The term ‘foreign liabilities’ refers to Australia's foreign obligations to the rest of the world. These obligations are in the form of foreign debt and foreign equity.

The STOCK of foreign liabilities comprises

* Debt (from accumulated borrowing)
* Foreign equity (from the balance of sale and purchase of assets)

Foreign Assets

The term 'foreign assets' refers to rest of the world's financial obligations to Australia. These obligations take the same form as foreign liabilities (debt and foreign equity)

7.2

**Introduction**

The term ‘foreign liabilities’ refers to Australia's foreign obligations to the rest of the world. These obligations are in the form of foreign debt and foreign equity.

**Foreign Liabilities**

Foreign assets and foreign liabilities are known as referred to as **stock**, because we refer to these figures at a point in time, as opposed to flows which happen for a period of time (e.g. Balance of Payments).

Foreign Liabilities

The term ‘foreign liabilities’ refers to Australia's foreign obligations to the rest of the world. These obligations are in the form of foreign debt and foreign equity.

The STOCK of foreign liabilities comprises

* Debt (from accumulated borrowing)
* Foreign equity (from the balance of sale and purchase of assets)

Foreign Assets

The term 'foreign assets' refers to rest of the world's financial obligations to Australia. These obligations take the same form as foreign liabilities (debt and foreign equity)

**Types of Foreign Liabilities (Stock)**

The stock of foreign liabilities and assets is made up of debt and equity.

Foreign Equity

Foreign equity is the extent to which foreign residents own Australian assets. Gross foreign equity – the total ownership of Australian assets by non-residents

* Portfolio investment
	+ Foreign equity investments that lead to a less than 10% stake in the company is known as portfolio investment. The purpose of portfolio investment is usually to gain income or make a capital gain. It is usually done for speculation purposes.
* Direct investment
	+ A foreign equity investment that is greater than a 10% stake in the company is known as direct investment. The purpose of direct investment is to have part ownership of a company to exert control and influence over its operations.
	+ Usually undertaken by private equity firms, sovereign wealth funds and multi-national corporations.

Foreign debt

Foreign debt is the amount of money that Australian residents (both private and public) owe to the rest of the world. There are two types of foreign debt:

* Official
	+ This type of debt is issued by the government (state or federal) so that money can be raised to fund fiscal policy measures
* Non-official
	+ This type of debt is undertaken by firms, mostly by large corporations to fund capital expenditure or undertaken by the financial sector to provide funding to their customers.

**7.3**

**Relationship**

* Financial account records the flow of foreign investment into and out of Australia
* There are more foreign investment flows into Australia than outflows and most of this capital inflow is in the form of borrowing.
* The income flows associated with foreign liabilities are recorded in the current account. The servicing costs associated with foreign liabilities result in a large primary income deficit In Australia’s current account.
* Negative / Inverse relationship, this is as an increase in foreign liabilities increases the capital and financial account and hence decrease the current account, in addition to increased income outflows.

**Foreign Investment into Australia**

* Increases Australia’s foreign liabilities, foreign debt and foreign equity.
* Inflow into the financial account
* Outflow in the current account due to net primary income outflows such as interest, dividends and profit.

**Foreign Investment Abroad**

* Increases Australia’s foreign assets, Australia’s lending and Australia’s equity.
* Outflow in the financial account
* Inflow in the current account due to net primary income inflows such as interest, dividends and profit.

**What's happening currently?**

1. Foreign investment stocks in the form of debt, lead to an increase in portfolio investment inflows through the financial account. From there, the repayment of interest happens through the current account in outflows through the income balance. Australia is in a net liability position in the holding of foreign debt, mostly owed by governments.
2. Foreign investment stocks in the form of equity is currently in an asset position (as opposed to a liability position as it previously been). This means that there is an outflow from the financial account as superannuation funds are used to invest for greater returns overseas, whilst there is an increase in inflows into the current account through the return of profits and dividends from superannuation fund investments.
3. Overall, we have seen a capital and financial account deficiti and a current account surplus. Whilst this has been mainly driven by an overwhelmingly favourable terms of trade, there has to be a recognition that Australia's foreign investment inflows have shifted from equity to long-term debt and that our foreign investment outflows continue to increase through the growth in superannuation funds.

**Introduction**

Prior to the 1980s, foreign investment in Australia generally took the form of foreign direct investment. In the early 1980s, Australia's financial sector underwent a period of deregulation, which included the removal of capital controls and the floating of the Australian dollar in 1983.

As a result of these reforms, Australian residents could use their savings to invest overseas more freely than before and overseas investors were able to invest in a broader range of Australian assets. Reflecting this, capital flows to and from Australia increased substantially and became more varied in their type. In particular, investment in portfolio assets (e.g. equities, bonds and cash) increased dramatically. During the 2010s, however, foreign direct investment again represented a large share of net capital inflows.

Since 2019, Australia has experienced a net outflow of capital. This reflects a reduction in inflows of foreign direct investment and an increase in portfolio outflows, such as purchases of foreign equities by Australian investment funds (e.g. superannuation funds).

During the 2010s, net capital flows to the Australian banking sector declined to around zero as banks funded more of their operations using domestic deposits. Meanwhile, there were large public sector capital inflows related to purchases of Australian government debt.

Foreign investment also played an important role in expanding the capacity of Australia's resources sector in order to meet growing global demand for Australian commodities. These capital inflows to the private sector have been partially offset by outflows from Australian superannuation funds, which have accumulated a large stock of foreign assets, particularly foreign equities.

Since 2020, there have been net capital outflows from the financial sector, including banks. This is mainly because banks reduced their stock of overseas debt, partly reflecting access to low cost domestic funding, including through the RBA's Term Funding Facility.

As a result of net capital inflows from abroad, Australia has accumulated a net liability (borrowing) position with the rest of the world. However, the composition of these net foreign liabilities can shift over time. In recent years, net long-term debt liabilities have risen as foreign investors have increased their holdings of Australian government debt.

Meanwhile, net short-term debt liabilities have fallen. Australia's net foreign equity liabilities have also declined markedly in recent years. Since 2013, Australia has had a net foreign equity asset position – Australian residents own more equity in foreign companies than non-residents own in Australian companies.

Most of Australia's liabilities with the rest of the world are denominated in Australian dollars, rather than foreign currencies. This includes foreign investment in the equity of Australian companies and in Australian government debt. In addition, many Australian firms that borrow funds in international markets convert their foreign currency borrowings into Australian dollars using financial instruments known as derivatives. This practice is known as ‘hedging’ and ensures that a depreciation in the Australian dollar does not make it more expensive for firms to repay their foreign debts. In contrast, over half of Australia's foreign assets are denominated in foreign currencies.

This results in Australia having a net foreign currency asset position: Australian residents own more assets denominated in foreign currencies than we owe liabilities denominated in foreign currencies to non-residents. The currency composition of Australia's foreign assets and liabilities determines how the external position is affected by movements in the exchange rate. Because Australia has a net foreign currency asset position, when the Australian dollar depreciates, the value of foreign currency denominated assets increases in Australian dollar terms, and so our gross foreign assets increase relative to our gross foreign liabilities. In addition, the income received on our foreign assets increases relative to the income paid on our foreign liabilities. This means that, overall, a depreciation of the currency would tend to strengthen Australia's external position and result in a narrowing of the net income deficit.

**7.5**

**Why do overseas corporations undertake foreign direct investment in Australia?**

* Opportunities for profit
	+ Our natural resources (e.g. Chinese interest in FMG and Rio Tinto)
	+ Solid growth performance
* Skilled, flexible labour
* Infrastructure
* Political stability – low ‘sovereign risk’
* Economic stability
* Government incentives such as:
* tax concessions (e.g. keeping company tax rates at competitive levels)
* direct subsidies
* indirect subsidies (e.g. in the form of subsidised services such as electricity)
* tariff protection (e.g. in car industry)
* promises on wage constraints

**What might put firms off coming to Australia?**

* Red, green and black tape
* Sovereign risk – new taxes imposed during projects
* High wage costs

**Advantages of foreign direct investment (FDI)**

* Closes investment – savings gap
* Investment allows for the development of industries in which we have a comparative advantage (e.g. mining)
* Investment sets off multiplier processes (local industries supply inputs)
* Promotes exports (easier market access to country of origin of FDI, more competitive markets and products, moves us up ‘value-added chain’)
* Inward transfer of knowledge and technology, and more rapid uptake of these
* Adoption of new management and work practices

**Disadvantages of foreign direct investment (FDI)**

* Loss of ownership
* Loss of economic sovereignty
* Outflow of dividends and profits
* Susceptible to bad behaviour by multinational corporations
	+ Transfer pricing (selling to themselves at prices that distort tax and trade payments – intra-company trade accounts for about one third of all trade)
	+ Countries become ‘branch office’ economies (MNC’s bring in outsiders to do the top jobs)
	+ Limited value-adding here – making the multiplier effect quite small
	+ Increase concentration, may gain monopoly power
	+ Over-ride local environmental controls (?) – race to the bottom syndrome
	+ Cause ‘loss of national economic sovereignty’ - may operate against national interest (e.g. Chinalco)
	+ They are undemocratic and not accountable
	+ They add to structural change