Foreign Investment

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Definition

- Foreign debt refers to funds that are owed to an overseas investor
- Foreign equity refers to a foreign investors claimed on profits as a result of purchasing part of a company
- Foreign Liabilities are outflows to foreign investors
- Foreign Assets are inflows from foreign investors

Why does Australia need Foreign Investment?

- As a result of the existence of a savings investment gap Australian firms need to access overseas funds in order to meet investment demands
- To acquire foreign funds Australia firms can either borrow overseas (Foreign Debt) or sell equity in their firm (Foreign Equity)
- Australia has been historically opposed to selling its national assets and as a result the majority of Australia's foreign liabilities are in foreign debt
- Since 2013 Australia has held a net equity asset position i.e. Australia holds more equity overseas than foreign investors hold in Australia

Foreign Debt

- Foreign debt refers to the borrowing of funds from overseas investors that are then payed back with interest
- Australia's high levels of foreign debt are the reason for the existence of the structural income deficit in the current account
- Foreign debt must be serviced i.e. payed back
- An example of foreign debt would be Rio Tinto borrowing funds from a bank in London

Foreign Equity

- Foreign equity refers to overseas investors purchasing part of a company and thus having a claim on company profits
- This is achieved through direct investment (10%+)
- Australia holds a net equity asset position
- Foreign equity will result in profits flowing offshore
- An example of foreign equity is a Chinese investor buying part ownership in an Australian mine

The Twin Evils of Foreign Investment

- This refers to the fact that there is a trade-off between foreign debt and foreign equity
- However Australia <u>must</u> attract one or the other due to the existence of the savings investment gap
- Foreign debt does not allow company profits to be siphoned offshore but must be serviced i.e. payed back
- Foreign assets do not have to be serviced but will result in profits being siphoned offshore

Risks of Foreign Debt

- Australia could lose its AAA credit rating as the State of Western Australia did in 2013
    - However the large majority of Australian foreign debt is private sector debt and the Australian government public debt is much lower than many other OECD nations
- Australia will not be able to pay back its foreign debt
    - The majority of foreign debt is private sector debt by firms who are motivated by profitability
    - We can thus be confident that the large majority of private sector debt will be repayed

Recent Foreign Investment

- Foreign investment has fallen in the post mining boom era due to investment demand falling
- Since 2013 Australia has held a net equity asset position
- Currently Australia holds $1 trillion in gross foreign debt