



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

ECONOMICS REFERENCES COMMITTEE

**Reference: Foreign investment by state owned entities**

TUESDAY, 23 JUNE 2009

CANBERRA

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**SENATE ECONOMICS  
REFERENCES COMMITTEE**

**Tuesday, 23 June 2009**

**Members:** Senator Eggleston (*Chair*), Senator Hurley (*Deputy Chair*), Senators Bushby, Joyce, Pratt and Xenophon.

**Participating members:** Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Sterle, Troeth, Trood, Williams and Wortley.

**Senators in attendance:** Senators Bushby, Eggleston, Hurley, Pratt and Xenophon

**Terms of reference for the inquiry:**

To inquire into and report on:

- a. the international experience of sovereign wealth funds and state-owned companies, their role in acquisitions of significant shareholdings of corporations, and the impact and outcomes of such acquisitions on business growth and competition; and
- b. the Australian experience of foreign investment by sovereign wealth funds and state-owned companies in the context of Australia's foreign investment arrangements.

**WITNESSES**

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**Committee met at 7.30 pm****NOVAK, Ms Julie, Research Fellow, Institute of Public Affairs**

**CHAIR (Senator Eggleston)**—I declare open this hearing of the Senate Economics References Committee inquiry into foreign investment by state owned entities.

On 18 March 2009, the Senate referred the following matters to the Standing Committee on Economics for inquiry and report by 17 September 2009:

- a) the international experience of sovereign wealth funds and state-owned companies, their role in acquisitions of significant shareholdings of corporations, and the impact and outcomes of such acquisitions on business growth and competition; and
- b) the Australian experience of foreign investment by sovereign wealth funds and state-owned companies in the context of Australia's foreign investment arrangements.

These are public hearings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

I welcome to these proceedings Ms Julie Novak from the Institute of Public Affairs. Would you like to make an opening statement?

**Ms Novak**—Certainly. Thank you very much for the opportunity to attend this evening. The central tenet of the IPA's submission is that Australia stands to attract additional foreign investment if it eases its regulatory restrictions on such activity. This is a central policy issue, because the continuing economic uncertainties afflicting the world present challenges and opportunities for Australia as an investment destination going forward. Surveys by the United Nations suggest that global investors are becoming more cautious about their medium-term investment plans. Worryingly, Australia has lost some ground as an attractive FDI destination as perceived by major investors. How Australia reacts to these trends will be critical to attracting more capital onto our shores.

Despite the current challenges, we can position ourselves as a global safe haven for investment in troubled times if we understand that FDI is something to be welcomed, not repelled. In saying that, one should recognise that the global composition of FDI is changing, with managers of state owned enterprises and sovereign wealth fund vehicles looking to acquire assets overseas. As the committee well appreciates, there have been a number of high-profile investments—for example, in the Australian mining sector by Chinese state owned enterprises.

The IPA submits that these developments are, on balance, (a) economically useful and (b) politically benign. In relation to point (a), one cannot discount that SOE and SWF managers might pursue a non-commercial investment agenda. However, this is unlikely to be a regular occurrence, given that investments are subject to continuous market testing. If a non-commercial agenda affects the investment value, domestic project proponents may be less likely to entertain such FDI proposals from these investor classes in the future. So it provides really a check and balance.

Concerning point (b), the fact is that foreign governments have no additional economic power in a domestic economy does any other foreign investor does. Foreign investments are circumscribed by the laws of the host country. SOE and SWF investors must ascribe to our federal, state and local laws with respect to competition, labour and tax, among other things. If one accepts the case that most FDI projects by SOEs and SWFs are commercially motivated, there seems to be little point in blocking any proposed investment by these entities, subject to the observance of domestic laws and corporate governance standards. Yet Australia has been independently assessed by the OECD as having a relatively restrictive FDI policy regime, grounded on a concept of the national interest that is left undefined in the relevant legislation.

The screening procedures applying to major foreign investments by the Foreign Investment Review Board, the FIRB, are pivotal to Australia's unenvied position on the FDI policy scale. In early 2008, the Commonwealth Treasurer added to the regulations by introducing six policy principles on investments by SOEs or SWFs, relating to operator independence, business standards, competition, revenue, security and economic impacts. The view expressed in the IPA submission is that this extra regulation contradicts assertions that our foreign investment regime is non-discriminatory towards all comers. The six criteria introduce an element of prejudgment into the FDI review process and may duplicate other policies that already exist, for

example in the areas of competition policy and tax. Instead of being unafraid of SOEs and SWFs, Australia should continue to liberalise its foreign investment policies in order to attract new capital, which could be achieved even during these difficult economic times. I am pleased to take your questions.

**CHAIR**—Thank you. I might just ask you a few questions, and I am sure Senator Hurley will ask you some. Is there a difference between state owned enterprises and sovereign wealth funds and their behaviour as investment vehicles?

**Ms Novak**—The international literature, for example by the Peterson institute in the United States, does suggest that sovereign wealth funds—and I might say as an aside that Australia has its own effective sovereign wealth funds in terms of the Future Fund—tend to have a long-term investment horizon in terms of their behaviour. In terms of SOEs, it is quite clear that, due to their proximity to the state institutionally, they might be tempted to pursue a non-commercial agenda, but, as I alluded to in my opening remarks, there is continuous market testing in a globalised capital market. And, quite frankly, if you read some of the media reports—for example from some of the state owned enterprises which have expressed an interest to acquire assets in Australia—you will find that they are actually very keen to understand Western practices in terms of corporate governance standards. They are very keen to publicly express a long-term approach to investment. So there are some differences in terms of the institutional structure, and possibly behaviour, of these two separate vehicles. But, in terms of a long-term policy implication, I do not think there is much of a problem here.

**CHAIR**—You say in your submission that SOEs represent a reversal of privatisation. Do you want to comment on that, for the purposes of the record?

**Ms Novak**—Think about state owned enterprises in a potential investor country for Australia—for example, China. We have found that over the past 20 years the number of state owned enterprises that have been privatised in China has been quite substantial. Certainly China has pursued a deregulatory agenda going down that path. Obviously, in some of the key sectors of the Chinese economy there still remain state owned enterprises that are intimately linked to the government. From a broader perspective, SOEs and SWFs represent a new player in the international scene. We might suggest that it represents a reversal of privatisation. In terms of the inflow of investment into Australia by these vehicles, from an economic perspective they are pretty much synonymous with any private investor. No government entity in an overseas country has extraterritorial powers in Australia.

**CHAIR**—That is an important point, isn't it? The vehicle is an investment vehicle; the foreign government really cannot control the laws or affect the outcomes.

**Ms Novak**—That is right. As Australia is a sovereign entity, it has its own priorities and policies for labour market standards, competition policy, taxation and the like. Any investor from overseas wishing to acquire Australian assets or a shareholding in a major Australian company has to adhere to Australian laws. There is no evidence that they are not.

**CHAIR**—You also say in section 4 of your submission:

Australian FDI policy has also come under greater scrutiny because of adverse political and community reactions to a growing number of investment applications from China. Concerns have been raised by the political elite and general community alike regarding the rising Chinese FDI in Australian mining.

But in a way we have been through all this before in the sixties, seventies and eighties with the Japanese. Would you like to make any comparisons between the Japanese and Chinese investment activities in Australia?

**Ms Novak**—Going back to the 1960s, perhaps in Japan there was a greater extent of government involvement in investment activities. For example, you had the Ministry of International Trade and Industry, MITI, which certainly had a key influence in Japanese industry and economic policy at the time. I think Japanese investment, on balance, has proven to be very favourable, for example, for Western Australian investment in the mining sector; there is no question about that. In the Japanese case there has been no doubt in my mind that there have been shared objectives between the foreign and the host interests in terms of maximising production for the net benefit of Australia. Obviously, as Australians we get a transfer of revenue through state tax royalties and the like. I think that the evidence we see so far with a number of Chinese entities acquiring mines in Western Australia is a continuation of an age-old trend that has occurred in Australia—that is, the fact that we have a deficiency of savings, we rely on global capital in order to develop our economic base and it is in everyone's mutual interest to do so.

**CHAIR**—The absence of sufficient Australian investment capital is an important point, too.

**Ms Novak**—Exactly. One of the telling stories of Australia's economic development for over 200 years has been the very fact that there have been insufficient levels of savings, at least as a proportion of GDP. That has basically required us to run up a capital account surplus, which is the flipside of a current account deficit. In Australia's early days we had investment in London, and now we are probably seeing some more investment from China but we still have to recognise that the US and UK still represent the main sources of foreign investment in Australia.

**CHAIR**—You mentioned MITI, which was the Japanese government agency that was involved with Japanese foreign investment in the sixties and seventies. I do not know whether MITI still exists. Could you tell us, if you can, about the relationship between MITI, the Japanese government and private investment houses?

**Ms Novak**—Certainly a lot of countries in the Western world and also in East Asia had, after the Second World War, broad policies of indicative planning of the overall economy where government investment agencies tried to steer the overall direction of economic development. I am not exactly sure to what extent there was a close, intimate, controlling relationship between MITI and investors into Australia, but I dare say it was a non-trivial relationship. I think MITI still does exist, albeit in a different form. Obviously there have been trends throughout the Western world and in East Asia over the past 20 years in favour of more light-handed regulation of industries on the basic acknowledgement that governments tend to be quite poor and ineffective in picking investment and economic development winners.

**CHAIR**—Could people have said, in the sixties, seventies and eighties, that MITI represented the heavy hand of the Japanese government in terms of, say, the Pilbara in Western Australia, the Australian iron ore industry? Would that kind of criticism have existed at that time?

**Ms Novak**—Certainly there are ingrained animosities held by certain sections of the community against foreign investment—basically an essential distrust of the foreigner, a lack of understanding of how foreign trade works to ensure the comparative advantages of countries are reconciled. The same concept does actually occur in terms of investment but there are, as we suggest in the submission, ingrained biases, ingrained sentiments and beliefs that, for example, selling off the mine or selling off the farm is damaging to Australia's interests. We would certainly argue to the contrary, but the increasing interest with respect to foreign investment in recent years is a product in part of that ingrained aversion to and distrust of foreign investment.

**Senator HURLEY**—In your submission you say that Australia has an already restrictive regime and you quote the OECD index scores, which I think we also heard from Treasury last night. The potential restrictions you list, which the indicators take into account, are equity restrictions, screening restrictions and operational restrictions. I am interested in whether you think Australia is any more restrictive in any of those particular areas and in whether you think any one of those areas in particular could be handled more lightly.

**Ms Novak**—Could you clarify, Senator. You mean more restrictive in recent times?

**Senator HURLEY**—No, more restrictive than the other countries that finish up ahead of us in that index.

**Ms Novak**—I do not think there is too much doubt that Australia's regulatory regime is more restrictive than those of other countries, particularly those of continental Europe. One has to recognise that, for example, in continental Europe they have a free trade and investment zone, so, yes, that is a caveat. I think that the OECD investment restrictiveness index is reasonably credible. They have developed this index for a period of 10 years. Interestingly enough, it happens to be a by-product of Australian work in the late 1990s on investment in the services industry.

Regarding whether a reduction in investment regulatory restrictions will lead to a reduction in Australia's high-end index score, I would answer in the affirmative, as we suggest in the submission. For example, if Australia relaxed some of its regulatory restrictions—and I am happy to talk about that further if you wish—particularly with respect to the screening regulations that we have, then it should be able to scale itself back towards the middle of the pack in terms of its position among OECD scores. I draw your attention to figure 2 in the submission. I think this is the chief contributor to Australia's high-end score against the OECD index.

**Senator HURLEY**—The screening is interesting. Do you think that is a result of policy requirements, or do you think it is due to the ACCC who, I think, do that kind of screening job? Are they perhaps a bit too rigorous in their application of it?

**Ms Novak**—In terms of this index, it does not take into account actual enforcement. Basically, this is a statutory restrictiveness index. The Commonwealth Treasurer, I understand, has basically said that these index scores should be caveated in the sense that our enforcement is quite generous. We allow a lot of major foreign

investments, including by Chinese SOEs, to come in, but the fact remains that Australia's foreign investment policy regime is in place. It is obviously circumscribed by the Foreign Acquisitions and Takeovers Act 1975. Any future or current government can use those regulations to the full extent if they wish. So therein lies, I think, the sovereign risk and the regulatory risk that is posed by Australia's foreign investment regime. There have been some cases where, for example, Chinese SOEs have expressed concerns about what they see as quite uncertain and confusing FDI regulations. There has been some anecdotal evidence of some withdrawals of investments as well. So certainly, from the IPA's perspective, we would argue for a relaxation of those regulatory restrictions if Australia is to attract more capital in the long run.

**Senator HURLEY**—Then let us go to those guidelines that were, in fact, introduced in response to a number of concerns early last year. You said, I think, that those policy-guiding principles were not necessary. Were some of them implicit in the law and guidelines previously anyway?

**Ms Novak**—It is very hard to say. The Commonwealth Treasurer probably insists that it is so, but the fact of the matter is that they were not codified in the past and they are codified now. So, effectively, it does represent new regulation.

**Senator HURLEY**—I wonder if some of these give comfort to people that SOEs or similar entities are not a threat and give form to the existing policies—things like ‘an investment that may impact on Australia's national security’ or ‘an investment that may impact on Australian government revenue or other policies.’ In some senses, they are fairly practical and commonsense applications.

**Ms Novak**—What this basically implies is that much of the guidelines are in fact duplicative, because we happen to have already in effect laws with respect to competition, laws with respect to tax and so on. Even if it does give comfort or discomfort to prospective investors, the fact is that we have these things sorted out already.

**Senator HURLEY**—To move to sovereign wealth funds and SOEs, I think we clearly need more FDI in Australia to advance our industry, but have you seen a pattern in investments by SWFs or SOEs in which they tend to go to safer types of investments? Is there any other pattern in the kinds of investments recently?

**Ms Novak**—No, I have not really detected any such pattern that you might ascribe—really the investment decisions of investors tend to be quite heterogeneous. For example, there have been some much-cited cases in the US where some sovereign wealth funds invested in US banks last year. We have had cases in Australia where these sorts of entities have expressed an interest to invest in the mining sector. There is really a rich diversity of investment destinations where funding could effectively be parked. At the end of the day, that is a decision for the individual SOE, SWF and of course the affected firm involved—whether it might accept acquisition of its assets.

**Senator HURLEY**—Where I am going with this is that you tend to need funding particularly in those areas for which it is a bit harder to attract funds and which tend to be more venture capital related. They are things where you might need a bit of extra capital to grow something that might be seen as a little bit risky or as something new. It is in those areas that we particularly want to see FDI come in and bolster. It might be a small or medium business that has a good idea.

**Ms Novak**—That might be so from the position of an external observer, but we would not really want to see governments try to pick investment winners on the basis that the investment funds might flow to sectors that might be seen as desirable from the perspective of the external observer or the policymaker. At the end of the day, it is really an individual's decision. Investment funds flow through a whole variety of complex and less complex activities. It is a heterogeneous, globalised world out there and it is very hard to prejudge where the most desirable destinations are.

**Senator HURLEY**—I am not suggesting that government should direct funds; I am wondering if there is evidence that funds flow across a number of areas, including into those newly developing areas.

**Ms Novak**—As I mentioned a couple of moments ago, I think there is at least anecdotal evidence that the intentions of these bodies tend to be quite diverse and quite flexible in terms of the objectives that they are trying to bring to bear.

**Senator HURLEY**—A final topic: until fairly recently, the star in the FDI firmament was Ireland, which grew rapidly on the back of FDI. I think it was Senator Joyce who commented last night that a lot of those OECD countries that were above us are now in financial strife. Do you see any relationship to that? How do you see that playing out now?

**Ms Novak**—The case of Ireland is actually very interesting. In a previous life, I worked in the federal department of industry and I tendered a submission to a House of Representatives inquiry about investment attraction. What I found in this submission was that the sources of growth for Ireland were not so much the high-profile FDI which, as it so happened, tended to flow out of the Irish economy about three or four years after it was attracted by government funds. It was really due to major endemic catch-up type sources of growth such as increasing labour market participation, especially by women, and higher birth rate—basically, the so-called ‘three Ps’ that the Treasury often talk about in terms of long-term sources of growth. In the Irish case those seemed to be the more direct and influential drivers of growth rather than basically frittering money away to high-profile firms who just relocated out again when convenient to them.

**Senator Hurley**—The last part of that question was if you see any connection between the difficulties those economies are in now and the fact that they have a regulatory regime. Do you see any connection at all?

**Ms Novak**—Certainly, when I look at the OECD index I do not see Ireland in the top 5 or exceeding Australia at all, so I do not really see that as a major connection. Apart from FDI, there are other forces at work that determine the growth prospects of economies.

**Senator HURLEY**—To go a bit further on that, we are talking mostly about major industrial economies. Would any of those economies that have advanced without a significant amount of foreign investment?

**Ms Novak**—China is a great example of a catch-up economy where, for example, they have net savings in their economy—so much so, in fact, that they are effectively lending money out to net borrowing countries like Australia. Foreign investment, as important as it is in key sectors of the economy and, arguably, as important as it is for small, open economies like Australia, is not necessarily a story that is repeated for each and every economy across the world.

**Senator PRATT**—Rarely does the human rights record of a state owned entity or sovereign wealth fund come into play when considering approval for investment—notwithstanding that numerous activist groups and community groups often raise these kinds of issues. I wonder whether you have looked at these issues in your consideration.

**Ms Novak**—No, not at those broader issues that you allude to. This submission essentially focuses on the economic aspects of foreign investment. To make a general point, freer economies tend to respect human civil rights anyhow. I think one of the long-term benefits for those countries that have SOEs that tend to invest abroad is that they learn about, for example, Western standards of corporate governance, business standards and so on and so forth. So it is a long-run, evolutionary learning exercise for them. I think, on balance, it is certainly very beneficial to have open capital markets, not only for economic reasons but for extra-economic reasons as well.

**CHAIR**—We have had quite a lot of Chinese investment in Australia for quite a long time. It is interesting that there was so much controversy about the Chinalco proposal when in fact, if you go back to 1987, there was a joint venture in the Channar mine between Rio Tinto and Sinosteel. Has that mine come to the end of its life?

**Ms Novak**—I am not sure actually. If you wish, I am happy to find out for you. But you are quite right; Australia has had a long-run relationship with China, from an investment perspective, starting in the late eighties. There is some Chinese investment—for example, in Victoria in the aluminium sector. So it is broad and it is quite pervasive. It is interesting that, if you look at some of the investment statistics from the Foreign Investment Review Board, you will find that obviously there had been some net inflow of foreign capital from China, but certainly, over the past couple of years, there has been an increase in interest. This comes with the ebbs and flows, I think, of the global economies. Certainly China’s economic prospects have improved in trend terms over the past 20 years. They do need resources, so I think here is an opportunity for mutual advantage between the two countries.

**CHAIR**—Yes. That is true. I do recall, however, when Channar was set up, it was done with great flamboyance and I think the Chinese Vice Premier came to Western Australia, the investment was very much welcomed and, I presume, Sinosteel was a state owned enterprise.

**Ms Novak**—Yes. That is right. That is my understanding.

**CHAIR**—The other question I would like to ask you about state owned enterprises is with regard to the Browse Basin gas fields off the Kimberley coast and Imprex. I have been told that that may be in some way a state owned enterprise of the Japanese government. Is that the case or not?

**Ms Novak**—I am not aware of that case. No.

**CHAIR**—Thank you very much appearing, Ms Novak.

**Ms Novak**—Thank you very much for the opportunity.

[8.08 pm]

**BYRNE, Mr Patrick, National Vice President, National Civic Council**

**WESTMORE, Mr Peter, National President, National Civic Council**

*Evidence was taken via teleconference—*

**CHAIR**—I now welcome witnesses from the National Civic Council. Mr Westmore and Mr Byrne, do you wish to make any opening statements?

**Mr Westmore**—Yes, thank you. Our concern is with the state owned enterprises investing or buying corporations in Australia. We believe that there should be strategic industries, including oil and gas, iron ore, uranium, coal, banking and media where acquisition—that is the purchase of Australian companies—should be prohibited. We believe that foreign state owned enterprises should be able to take a shareholding in those strategic industries up to 14 per cent. In other industries—other important industries—we believe that foreign ownership should be restricted to 49 per cent, except where it could be shown to be in Australia's national interest to permit a higher concentration.

**Mr Byrne**—Part of our submission has dealt with the issue of Australia's own economic vulnerability, particularly in the time of a crisis like we are facing at the moment world wide. I would like to refer to the committee—just for their interest—to the UK *Financial Times* of 16 June, and an article by Martin Wolf, the editor. It very significantly tracked the stages of this current worldwide recession and compared it to 1929. Mr Wolf said there were certain frightening similarities. I would be happy to provide that to the committee.

**CHAIR**—If you would that would be appreciated.

**Mr Byrne**—It is based on research by several researchers looking at tracking industrial output, trade volume, fiscal balances and money supply since the onset of this worldwide recession and compares it to the similar time around 1929. He used the words 'rather frightening similarities', although there is a different array of policies being put in place now compared to that time. Secondly, I would like to draw the committee's attention to the *Financial Review*, front page of 18 June, where our Australian banks' chiefs have warned on the funding gap in Australia. For example, in this article the Australia and New Zealand Banking Group chief Mike Smith says the credit crunch has highlighted the limits of the funding model that has caused the Australian banks to be over lent, particularly through borrowing from offshore. The article also refers to Ashok Jacob, chief executive of Consolidated Press Holdings and a key adviser to James Packer, who said at a Macquarie Group conference just recently that Australia had the most leveraged banking system in the world: \$900 billion deposits and \$1.5 trillion in loans—a \$600 billion shortfall. He said that Australian banks' loan – to-deposit-ratio was 153 per cent, well ahead of the UK at 144 per cent and the US 110 per cent. Historically the figure for Australia was around 100 per cent.

I simply draw the committee's attention to this because Jacob goes on to say that we are going to face a potential \$200 billion in loans to be rolled over by our banks in the next few years. If we are going to have a shortfall we are going to have to borrow from somewhere. And if we have to borrow—I fear it will be from countries that are the major savings countries, like China, the oil producing countries or even Russia—you will be a combination of results. Perhaps they will lend to us but it may be on the condition that we make our various industries that Peter Westmore just referred to, such as our mining industry and so on, available for takeover by their sovereign wealth funds or their government controlled or government run industries. So I think I am trying to put this in the context that it is not simply the interest of some other countries and their sovereign wealth funds and our industries; it is a vulnerability that Australia may well be facing in the near future, and which the *Financial Review* put on its front page on 18 June. That is the conclusion of my opening statement.

**CHAIR**—Thank you very much. One of the arguments that have been put in favour of direct foreign investment is the limitation on Australian financial resources to developing minerals projects and other big projects. With your proposed percentage limits on investment how do you think we might be able to proceed to some of these multi-billion dollar investments if foreign investment is restricted?

**Mr Byrne**—Could I suggest about this article in the *Financial Review*: the banks go on to make suggestions as to changes that they think may be needed; for example, that tax concessions for savings in banks should be brought into line with the various concessions that super funds have, in order to attract a certain amount of funds in that area. They go on to several other suggestions. I would like to add to that that

Australia has a rather peculiar savings and investment imbalance. We actually have, as it says here, a \$600 billion shortfall in domestic funds being available for various industries. I do point out, however, that while the mining industry is part of it, a lot of that borrowing offshore has actually gone into the housing market. On the other hand, we have about \$1.1 trillion in superannuation funds and around 30 per cent of that is invested offshore.

We believe that there should be some balance brought in between savings and investment in Australia, in part through greater encouragement of domestic savings through the banking system but also through putting mechanisms in place that allow the investment of some of those funds out of super funds into other areas of investment in Australia. We used to have in Australia—and other countries do have—instruments to handle that sort of thing. One of them is a government-backed development bank. We believe that those sorts of instruments will be needed. We are not saying that we should not have any borrowing offshore. We are overborrowed offshore. The banks themselves are saying that, and we are going to have to confront the problem if we cannot roll over these funds—and we are talking about \$600 billion.

**CHAIR**—That is a huge amount of money, I agree, and that is a very interesting concept. That was the *Financial Review* of 18 June—

**Mr Byrne**—It was 18 June, on front page: ‘Bank chiefs warn on funding gap’.

**CHAIR**—Thank you. I will ask you one other question. I notice that on page 12 of your submission you say:

Investment from China comes with far more political strings than came with Japanese investment in Australian energy and minerals industries in the 1970s and '80s.

One of the things we heard last night and tonight is that there was a Japanese organisation called MITI, which was in effect an arm of the Japanese government, which did play a role Japanese investment in Australian resource projects. I wondered if you would like to flesh out the comment you make that there were far more political strings coming with Chinese as against Japanese investment.

**Mr Westmore**—Firstly, I think there are two fundamental differences between Japan then and China today. The first is that Japan is a democracy; China is a totalitarian regime. I want to develop that point a little further, because there is a belief around that Chinese corporations are just like corporations from the United States or Japan or wherever. I would contest that view, because the Chinese corporations—at least government-owned corporations—are not only government owned but these corporations are overwhelmingly state-run monopolies in which the key positions are appointed not just by the government but by a sole party which runs the government, which is the Chinese Communist Party. I think it is a point which people are generally unwilling to mention. I want to quote from a paper on foreign policy of March-April 2006 by Minxin Pei. This from a paper given to the Carnegie Endowment for International Peace. The article is called ‘The dark side of China’s rise’, and it says:

As China continues to open itself, [observers] predict, state control will ease and market forces will clear away inefficient industries and clean up state institutions. The strong belief in gradual but inexorable economic liberalization often has a political corollary: that market forces will eventually produce civil liberties and political pluralism.

Then he says:

It is a comforting thought. Yet these optimistic visions tend to ignore the neo-Leninist regime’s desperate need for unfettered access to economic spoils. Few authoritarian regimes can maintain power through coercion alone. Most mix coercion with patronage to secure support from key constituencies, such as the bureaucracy, the military, and business interests ... Most authoritarian regimes know that much, and none better than Beijing.

He goes on to say:

Today, Beijing oversees a vast patronage system that secures the loyalty of supporters and allocates privileges to favored groups.

Here is the key quote:

The party appoints 81 percent of the chief executives of state-owned enterprises and 56 percent of all senior corporate executives. The corporate reforms implemented since the late 1990s designed to turn wholly state-owned firms into shareholding companies haven’t made a dent in patronage.

So we are not just talking about corporations operating in China similar to, say, BHP or Rio Tinto or Qantas or others. We are talking about corporations which are really controlled by the ruling party. It is also important to me to keep in mind that, in the past, the Chinese government has been accused of attempting to buy influence, including in the United States in the 1990s, simply by effectively influencing the major political parties. It

seems to me as though that is a concern which would be exacerbated in the case where Chinese corporations owned a major stake in strategic Australian industries.

**Senator HURLEY**—Thank you. I am just wondering what your background is in terms of an understanding of banking investment or foreign affairs.

**Mr Westmore**—I have been involved with the National Civic Council for very many years. If you want my academic qualifications, I hold a Master of Engineering Science from Sydney University. I can only say that I am a person who has had an interest in these fields over a very long period of time. My colleague, Pat Byrne, has an economics degree from the University of Queensland and has been an observer and commentator on economic policy issues in Australia for many years.

**Senator HURLEY**—Thank you. Your submission talks mostly about the Chinese influence. Do you have enough corporate history to tell us about the NCC's attitude to Japanese investment or other major economies' investment in Australia?

**Mr Byrne**—We all know that the Japanese have a long history of involvement in investment in Australia. But, as Peter Westmore has pointed out, we draw a distinction in investment that has come in from countries that have been democracies, that are part of the western alliance, that respect universal human rights, that respect free market principles and ownership of private property. We are not trying to treat China as an enemy; we stated that in the submission. We believe that China is now and will be an increasingly major player in world affairs and that we have a responsibility to help bring China towards those principles I have just described—principles that Japan has had and that we have had here. China is still a long way from it. To do that, our argument is that Australia needs to maintain as independent a position as it can in terms of both economics and foreign policy, in order to play a role in bringing China in that direction. China has not changed since Tiananmen Square.

**Senator HURLEY**—When you were talking about foreign investment in strategic industries, and restrictions, were you talking just about China or were you talking about other countries as well, including democratic countries?

**Mr Byrne**—A point to make about sovereign wealth funds is that sovereign wealth funds to a certain extent have come from some democracies, but they are small places like Singapore. By and large—with a couple of notable exceptions, like Norway—sovereign wealth funds are from countries that are yet to discover the western concept of democracy. Therefore, while it is a little general in the way it is described here, our particular concern is the fact that the major sovereign wealth funds are places like China and a lot of the countries in the Middle East.

**Senator HURLEY**—Can you tell me then what proportion of the sovereign wealth funds are from countries you regard as not—

**Mr Byrne**—That is a good question. I have not got the figures in front of me, but I know that one of the academics at Melbourne University has done some figures on this and I could probably dig them out and supply them to the committee.

**Senator HURLEY**—Is it divided up into democratic and non-democratic countries?

**Mr Byrne**—I have got it on my computer but not in front of me at the moment. I can try to find those figures and supply them to the committee. But if you look at China, for example, by the end of this year China's sovereign wealth funds will be in the vicinity of about \$3 trillion. I saw in the *Financial Times* the other day, again it was an article by Martin Wolf, that China's trade surplus is going to be about \$440 billion this year—one of the largest trade surpluses in the world.

I should add one other thing, and that is: China has achieved its huge trade surpluses through manipulation of exchange rates. When I say China does not apply by market principles, I mean Australians are floating the exchange rate, the United States has a floating exchange rate, I think Europe operates on a floating exchange rate, but China does not. It has given China a huge trade advantage—in fact, the greatest form of protectionism you can have is to manipulate your exchange rate—and has allowed it to amass these sovereign wealth funds. Trade is virtually a zero sum game, and if they are running such huge surpluses it is at the cost of deficits largely in the western democracies.

Also in our paper, the concern that we have had with Chinese investment, and this has come out of recent hearings—similar to what you are having here—in the United States. The US hearings are on the issue of Chinese investment worldwide and the mercantilist nature of its investment. It is not just on the same sort of

commercial basis as we have accepted investments from, say, Britain, the United States or elsewhere. It has tended towards, in a number of countries, ownership, control, setting of price, et cetera.

**Senator HURLEY**—Setting of price? Where does that occur?

**Mr Byrne**—If you have got ownership and control, you are in a position where you can influence price as well.

**Senator HURLEY**—Where has that happened?

**Mr Byrne**—As I mentioned, Gabon is one place where they have moved for a major investment in a huge untapped iron ore deposit in Africa. If you read what Robert Gottliebsen had to say about where China could take Rio Tinto had it got the stake in it that it was after—with a 600-page agreement—and how that would affect even BHP Billiton, you would find that he says it will influence price. This is not abiding by the same market principles as we abide by and generally accept. Are we going to have a level playing field or not?

**Senator HURLEY**—You do not accept the argument that has been put here that once a company invests in Australia then it is subject to Australian laws, including the market related laws?

**Mr Byrne**—I am talking about ending up in a position where you can influence the world price. I refer you to Gottliebsen's article; I have put part of it at the back of my submission. If the committee would like the three-part series that I think is the best analysis done of the deal that was drawn up by Chinalco to go with Rio, I think it explains very well how it would ultimately influence price. And I think that is extremely important for Australia; we are such a huge resource country, and we are close to China compared to other countries.

**Senator HURLEY**—So you think that if China restricted its foreign investments to the level that you are suggesting that we would not be influenced by Chinese growth and market setting power?

**Mr Byrne**—I do not think any one investment by China in Australia threatens Australia's sovereignty or the direction of its foreign policy. I think, cumulatively, over time—

**Senator HURLEY**—No, I did not ask about that. I asked: if Australia cut itself off in the fashion that you are suggesting, would it be influenced by China's growth and market setting and price setting powers?

**Mr Byrne**—We are not saying we should cut ourselves off. We are saying that there are appropriate restrictions to put on. I have referred to other countries looking at restrictions—for example, Germany which has faced a similar problem with Russian investment coming in. It is not a cutting of ourselves off; it is a protection of our sovereignty. I do add that, as I said earlier, Australia has an enormous amount of domestic savings but there is a huge imbalance between our savings and investment. I think we have to look at tapping our own domestic savings a lot more—

**Senator HURLEY**—I accept that you are saying there should not be a cutting off but that there should be a restriction of foreign investment. Do you think that would save us from influence by China's ability, because it is growing strongly, to influence the market?

**Mr Westmore**—I also do not believe that we want to cut China off. Our approach is similar to that which was announced by the federal Treasurer early last year, when he recommended that there should be guiding principles on investment by state owned enterprises, which effectively meant that they would be subject to far closer supervision. Then the question is, as far as we are concerned: just where do you draw the line? Our view is that there should be an attempt to say which industries we regard as being strategic industries which we should ensure have Australian ownership. That, by the way, does not stop those corporations from borrowing overseas. All major corporations are also borrowing. They not only have shareholdings but also borrow. So we are not proposing restrictions on Australian corporations, or corporations in these areas, from borrowing overseas. We are proposing that there should be restrictions on ownership in certain select industries. I hope that makes the position a little bit clearer, Senator.

**CHAIR**—There being no further questions we thank you, gentlemen, for appearing tonight and conclude this hearing.

**Mr Byrne**—We will forward that relevant documentation to you tomorrow.

**CHAIR**—We would be very pleased if you could forward that to the secretary of the Senate Economics Committee at Parliament House.

**Committee adjourned at 8.35 pm**