CHAPTER 9

THE COSTS AND BENEFITS OF FOREIGN INVESTMENT

Introduction

9.1 Although data is not standardised, and differences of opinion remain concerning the methodology for determining the net benefit of tourism to the economy, there appears to be consensus that benefits do accrue from tourism, particularly inbound tourism. Nevertheless, a question remains about the actual effects of foreign investment on the level of benefits which tourism provides to Australia.

Treasury's Approach to Determining Costs and Benefits

9.2 It has been argued that foreign ownership of tourism projects reduces the benefit for Australia because Australians do not fully share in the wealth generated by foreign-owned enterprises. The Treasury, however, has argued against such a suggestion in its submission by pointing out that:

- foreign-owned enterprises often have synergies to exploit (e.g. overseas links to international hotel groups and travel agencies promoting company products) which may generate higher tourism growth rates with 'spin-off' benefits to the Australian community;

- investment in many new tourism businesses may not otherwise have taken place, with consequential losses in tax earnings, employment generation and infrastructure development;

- the level of economic benefits generated by tourism is correlated strongly to its sourcing of inputs which are generally Australian;

- foreign investment often provides access to new technology and standards of service otherwise not available; and

- foreign acquisitions of Australian-owned tourist-related business assets release domestic capital funds for potentially higher earning alternative investment opportunities and for other alternatives.[1]

Treasury clearly believes that effects of direct economic benefit to Australia flow from foreign investment in tourism.

9.3 Turning to the question of overall net benefit, the issue is whether foreign investment in tourism has an adverse effect that reduces benefits. On this matter Treasury has suggested that if, as a result of foreign investment, the number of tourists visiting Australia and/or the length of stay increases as a consequence of better quality and more appealing facilities being available, foreign investment produces net benefits to Australia overall.[2]

9.4 Of the foreign investment proposals for tourism projects, a small number of high value proposals account for most of the total amount to be invested. In 1990/91, 11 of the 50 tourism proposals accounted for 66 per cent of the total expected value of foreign investment in the tourism sector and, of those, 4 proposals accounted for 38 per cent of the expected value in the tourism sector. In direct contrast with BTR's suggestion[3] that foreign investment has not significantly changed the nature or quality of tourism services, Treasury has suggested that the tourist developments undertaken in Australia in recent years have resulted typically

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1 *Evidence*, p. 1411-2

2 *Evidence*, p. 1412

3 Bureau of Tourism Research *Occasional Paper No 10*, 1991, p. 58

in the establishment of high quality facilities. This has been of benefit to both the industry's international reputation and its growth prospects. It is most unlikely that these developments would have proceeded without foreign capital.[4] On this basis, Treasury would conclude that foreign investment in tourism contributes to the generation of net benefits for Australia.

The BTR Approach to Determining Costs and Benefits

9.5 In recent years the Bureau of Tourism Research has sponsored research on the question of the costs and benefits of foreign investment in Australian tourism. This resulted in the March 1990 BTR *Occasional Paper No. 6 Foreign Investment in Australian Tourism* and the July 1991 BTR *Occasional Paper No. 10 Impacts of Foreign Investment in Australian Tourism.*

9.6 The BTR has summarised the arguments often put against foreign investment.[5] They are, first, that foreign investment increases employment of foreign nationals and the import of materials, resulting in fewer opportunities for Australians. Second, it is sometimes argued that foreign ownership of facilities, particularly where only acquisition of existing facilities occurs, will direct profits out of the country, lessening benefits to Australia while Australia bears the cost of catering for tourism. Outflow is often believed to be exacerbated by high levels of vertical integration. (The BTR[6] considers that 'Vertical integration occurs where one seller of a final product gains control over the production of the various inputs that go towards making up the product'.)

9.7 Third, BTR has noted the suggestion that foreign ownership may lead to facilities catering exclusively for certain foreign nationals, thereby denying Australians the opportunity to experience aspects of their own country (either

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4 *Evidence*, p. 1412

5 Bureau of Tourism Research *Occasional Paper No.6*, pp.17-8

6 Bureau of Tourism Research *Occasional Paper No. 6*, p. 43

through price or capacity constraint). This is mainly a problem where alternative opportunities do not exist. Fourth, BTR also notes the argument that rapid development of the industry can overheat the economy and enhance adverse social and environmental effects; in some cases foreign tourists may introduce new imports. Fifth, it has been suggested that foreign interests have advantageous access to cheaper finance that enables them to bid out Australian interests. Finally, one argument put against foreign investment in tourism is that foreign capital tends to alter the nature of the Australian tourism product, thereby reducing this country's unique appeal and attractiveness to local populations.

9.8 The BTR has sought to test these arguments and suggestions about the costs of foreign investment in tourism. To more fully assess the costs and benefits of foreign investment, the BTR grouped the economic considerations under five headings:

- employment and resource allocation effects;
- balance of payments effects;
- effects on government revenue;
- effects on competition; and
- environmental and social effects.

Employment and Resource Allocation Effects

9.9 There are estimates of employment attributable to tourism; BTR puts the figure at 441,000 in 1989/90. And various attempts have been made to estimate the employment effects of foreign investment in tourism. It has been estimated, for example, that each 10 per cent real increase in earnings from international tourism leads to a $180 million increase in GDP and an extra 8,700 jobs.[7] However, in 1990 the BTR advised that with respect to foreign investment in the Australian tourist

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7 Centre for International Economics, *Economic Effects of International Tourism*, 1988

industry, no reliable data existed regarding the net amount of employment generated.[8]

9.10 In a 1991 report the BTR was similarly cautious in its claims about the effects of foreign investment in tourism on employment. Nevertheless, it drew attention to the fact that benefits were more likely to be present during periods of economic recession, since additional tourism demand leads to increased output and employment in the economy.[9]

Balance of Payments Effects

9.11 The BTR has noted that the balance of payments will be favourably affected by foreign investment where it is export creating.[10] Where foreign investment leads to an increase in tourism, there will be increased foreign exchange earnings and the exchange rate will rise. This results in higher prices for Australian exports. Further, where foreign investment results in an increase in inbound tourists, the price of resources rises (including land for resorts). The BTR has argued that the net benefit from this effect is almost certainly positive.[11]

9.12 With regard to the current account, the BTR considers that:

> It is often believed that the impacts of tourism and foreign investment are positive and desirable so far as the current account balance is concerned. These views come from taking an incomplete look at the effects. It is likely that both tourism and foreign investment increase the deficit in the short term, but if investment is well judged, there is no problem. Thus there is neither a

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8 *Occasional Paper No. 6*, p. 18

9 Bureau of Tourism Research, *Occasional Paper No. 10*, 1991, p. 68

10 *Occasional Paper No.6*, p. 20

11 *Occasional Paper No. 10*, pp. 67-8

benefit nor a cost from the impact of foreign investment on the current account balance.[12]

Effects on Government Revenue

9.13 The BTR has pointed out that foreign investment in the Australian tourist industry can increase government receipts through:

- company taxes on profits;
- income tax paid by employees;
- indirect taxes;
- excise taxes;
- import taxes;
- sales taxes;
- state and local taxes (property taxes, stamp duties, vehicle registration fees etc.);
- airport landing fees;
- departure taxes etc.[13]

However, the BTR has cautioned that there need not be a net increase in tax revenue resulting from foreign investment especially where the investment would have taken place in any case by Australian investors. Only if it can be shown that the investment would not have occurred without the foreign capital can the additional tax receipts be attributed to foreign investment.[14]

9.14 Further, foreign investment in tourism (as in other sectors) can have an adverse effect on exports where transfer pricing occurs; transfer pricing is the transferring of goods and services across international boundaries at prices that do

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12 *Occasional Paper No. 10*, p. 69

13 *Occasional Paper No. 6*, p. 22

14 *Ibid.*

not reflect their true value. The BTR suggests this is done to minimise aggregate tax liability, and can work either to the advantage or disadvantage of the host country depending on the tax rates. The Australian Taxation Office attempts to police the practice, and recent changes to the way tax systems interact between countries has lessened the potential for transfer pricing. It remains a possibility, however, and it could lead to losses for Australia.[15] The BTR has confirmed that no information is available on the extent to which such tax losses occur in the tourist industry. It considers that the potential for such tax losses, however, would be enhanced by any tendency towards vertically integrated ownership of tourist facilities.[16]

Effects on Competition

9.15 BTR has suggested that the entry of foreign interests can tend to provide benefits such as eroding monopoly positions and practices when foreign firms introduce superior new management, production and marketing practices, particularly when these are adopted by local companies resulting in increased industry efficiency.[17]

9.16 However, it has also advised that the entry of foreign firms into an industry may be accompanied by a reduction in competition in those cases where economic power concentrates in the hands of foreign interests through acquisition and control of new or established businesses.[18] While this is a useful caution, it is important to note that the BTR *Occasional Paper* provided no empirical grounds to support any contention that this situation actually prevails.

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15 *Occasional Paper No. 10*, p. 70

16 *Occasional Paper No. 6*, p.22

17 *Occasional Paper No. 6*, p. 23

18 *Ibid.*

Environmental and Social Effects

9.17 In considering environmental and social effects on foreign investment in tourism, BTR has pointed out that:

- foreign tourist facility owners have strong incentives to maintain the environment (and so reap the rewards of investment): the incentives of foreign and domestic interests are equivalent;
- both foreign and domestic interests are subject to the same environmental laws;
- when considering the local effects of land sales to foreign interests, it must be remembered that high selling costs benefit the seller: nevertheless, property values are only fully realised upon sale of the property and local people can suffer in the short term; and
- losses resulting from expenses entailed by ownership of high value land can be offset for residents adjacent to tourism developments through capital gains, increased employment opportunities, improved infrastructure and better recreational facilities.

9.18 The BTR has noted, however, that often local residents believe the increased cost of services outweigh any benefits of tourism infrastructure. They can regard themselves as subsidising unwelcome development. The BTR has pointed out that public financed infrastructure is generally provided on a 'capacity to pay' rather than a 'user pays' basis with heavy subsidisations from owners of high value properties to help finance new infrastructure in developing areas. The current trend is to charge developers or to insist on extra work (e.g on access road improvement) at their direct cost. The BTR has suggested that Governments may need to carefully review present rating structures and revenue raising instruments so as to require costs to be met by those who benefit the most from the improvements in infrastructure.[19]

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19 *Occasional Paper No. 6*, p. 25

BTR Conclusions

9.19 In its *Occasional Paper No. 6*, BTR proposed the resolution of net benefit questions about tourism in Australia by employing Benefit Cost Analysis in three contexts:

- Simple Ownership;
- Vertically Integrated Package; and
- Vertically Integrated Package with Additional Tourism.

It concluded that the main differences created by a vertically integrated, foreign owned tourism industry and a domestically owned one were:

- a possible greater reliance on imports by the former; and
- a possible increase in demand for tourism created by it.[20]

Whether the country gains depends on:

- what benefits there are from tourism;
- how imported and domestic inputs are taxed;
- the effects on factor markets; and
- the extent to which a foreign owned industry sources its inputs elsewhere.[21]

9.20 This BTR study subsequently concluded that many of the views expressed in popular discussions have a superficial plausibility, but are based on simplistic understandings of the way the economy works, or sometimes, on straight misconceptions.[22] The BTR noted that this is true both of arguments for and against foreign investment.

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20 *Occasional Paper No. 6*, p. 34

21 *Ibid.*

22 *Occasional Paper No.6*, p 49

9.21 One such argument is that foreign investors have an advantage over domestic investors in that they have ample supplies of cheap finance - in general they do not, though their finance may *appear* to be cheaper. Another argument is that foreign investment is necessary because of the balance of payments deficit; this is matched by the contrary claim that it is undesirable because it adds to overseas debt. According to the BTR, some claim that employment effects are enormous, while others claim that they are nil. (In fact, it is very difficult to determine the employment effects.) Others are worried about environmental effects and impacts on local communities - in fact foreign investment will have effects, but they will be much the same as those of domestic investment.

9.22 The BTR has noted that at a more sophisticated level of discussion, there is widespread concern that foreign ownership and increased vertical integration will mean a leakage of benefits from Australia. The BTR argues that the reverse could be the case. It is misleading to claim that profits from foreign-owned facilities are lost to Australia, since the foreign owners would have had to pay Australians for the right to earn those profits. Some make a stronger claim that Australia does not gain *at all* when tourists buy goods and services from a foreign-owned firm. This is simply incorrect, since the sources of the inputs into the goods and services can be, and often are, quite independent of who owns the company selling them. (This emphasis on inputs with regard to foreign ownership was shared with the BTR by Ms Farmer of the tourism company, ID Tours South Pacific Pty Ltd - see next section of this Chapter.)

9.23 In conclusion, the BTR has suggested that if foreign investment replaces domestic investment, and does little else, there is likely to be little in the way of net gain or loss to Australia. If foreign investment results in increased investment and increased tourism, then to the extent that tourism involves net benefits, foreign investment results in greater benefits. The BTR argues that, if anything, a vertically integrated group may have a larger positive effect on tourism, and on net benefits to Australia than unrelated investments. Because of the capitalisation of profits from foreign-owned facilities, and the likelihood that the source of inputs into tourism will change rather little, the benefits of tourism to Australia depend very little upon who *owns* the facilities.[23]

9.24 The BTR's most recent publication on this matter, *Impacts of Foreign Investment in Australian Tourism*, continued and emphasised this view. There it advised that taking into account all these effects, it can be concluded that foreign investment leads to net economic gains for Australia. To the extent that there are adverse effects, they are likely to be small and capable of being controlled. Thus, for example, if it were thought that transfer pricing problems are present, these could be eliminated by appropriate taxation measures. The contribution of foreign investment results in a greater supply of facilities, a more competitive product and, thereby, an increased flow of tourists with corresponding benefits. The BTR advised that it is difficult to estimate the size of this impact or of the impacts that individual investments might make, though the positive direction of this impact is clear.[24]

9.25 In press releases commenting on *Occasional Paper No. 10*, the Minister for the Arts, Tourism and Territories (Hon. David Simmons) stated that positive impacts of foreign investment included the purchase of assets, which he believed represented an up-front payment to the Australian economy that is offset over a number of years against a foreign interests' ability to make profits.[25] In referring to the BTR study the Minister stated:

> A report released today confirms that the Australian economy overall benefits from foreign investment in tourism...[26]

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23 *Occasional Paper No. 6*, p. 49

24 *Occasional Paper No. 10*, p. 71

25 The Hon. David Simmons, *Press Statement*, 22 July 1991

26 *Ibid.*

9.26 Another concern about the costs of foreign investment in tourism is the potential for the repatriation on profits. Considerable debate has surrounded the question of repatriation of profits by foreign tourism interests operating in Australia. Ms Farmer (General Manager, ID Tours South Pacific) provided the Committee with a working paper on a study to track the Japanese tourist dollar. The objective of the study was to make preliminary observations regarding the disbursement of both prepaid and optional expenditure on a typical Japanese tour, including disbursement to Australian, Japanese and other foreign interests. It represents a first stage attempt at tracing the tourist dollar and was meant to identify areas for further, more in-depth analysis by professional research bodies.[27]

9.27 According to Ms Farmer the study chose a typical Japanese package tour, and examined where the dollars were actually going on the basis of stated ownership of various supplier component services in that tour. A summary of the findings illustrated that 64 per cent of the disbursement of total tourist expenditure went to Australian interests, 27 per cent to Japanese interests and 9 per cent to other foreign interests.[28]

9.28 Ms Farmer emphasised that the study was a preliminary exercise with two limitations:

- the disbursement of funds was determined initially on the basis of stated ownership of the various supplier services; and
- the study stops short of following through to track the tourist expenditure beyond the direct supplier, without attempting to estimate the domestic

27 *Evidence*, p. 588

28 *Evidence*, p. 588

versus the import content of goods and services offered by both foreign and domestically owned tourism suppliers.[29]

However, Ms Farmer highlighted that the key issue for determining the net benefit to Australia was not foreign ownership, but rather where the inputs to a service are sourced. Like the BTR, Ms Farmer suggested that greater vertical integration by a foreign firm can lead to less benefits; she advised that this could be the case through less domestic purchases of inputs. She cautioned however, that at the time she gave evidence (March 1991) there was no definitive research examining that issue. Further, she also noted the potential positive effect from greater commitment by tourist firms to increasing tourism flows to Australia that result from foreign ownership and vertical integration.[30]

9.29 Finally, Ms Farmer put forward a recommendation to the Committee that a small working party be formed comprising members of government organisations, including the Bureau of Tourism Research, the Australian Tourism Industry Association, DASETT and members of private industry, ID Tours, and herself. This group would:

- canvass the research that has been done and is either currently under way or planned in the area of impact of foreign investment on the tourism industry, and the net benefits to the economy; and

- consider how such research can be directed and co-ordinated now and in the future, until such time as a permanent steering committee can be formed with a view for ongoing monitoring of such research.[31]

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29 *Evidence*, pp. 588-9

30 *Evidence*, p. 589

31 *Evidence*, p. 590

Ms Farmer indicated she had consulted with the Bureau of Tourism Research and DASETT as well as ATIA along these lines. The Bureau of Tourism Research believed that it was well within its charter to co-ordinate and take a leading role in co-ordinating such a group. It would also be willing to provide funding by way of the secretariat support in such a group being formed and developed.[32]

9.30 Since Ms Farmer gave this evidence the BTR has published *Occasional Paper No 10* (July 1991) which concluded that foreign investment does not lead to a massive repatriation, or leakage, of profits to overseas investors.[33] Further, the BTR study shows that the main reason for the large retention of economic gains is the fact that most inputs used in foreign-owned facilities are sourced in Australia. That is, there is predominantly local employment and purchase of goods and services.[34]

State Views

Victoria

9.31 Submissions provided to the Committee by State Governments referred favourably to foreign investment in tourism. Victoria's submission, however, emphasised the inadequacy of information concerning the extent of foreign investment in tourism facilities in Australia. It concluded that improved information systems should be established to monitor investment patterns in the industry at a national level. The Victorian submission suggested this would put both Federal and State Governments in a position where trends could be identified and via a process of Federal/State consultation, decisions could then be made on the need to adjust foreign investment policy and guidelines to protect the interest of Australians.[35]

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32 *Ibid.*

33 The Hon. David Simmons, *Press Release*, 22 July 1991

34 The Hon. David Simmons, *Press Statement*, 22 July 1991

35 *Submission No. 60*, pp. 5-6

Queensland

9.32 The other States have clearly endorsed the provision of foreign capital investment in Australian tourism. In June 1991, the Queensland Government advised that because tourism was a major growth sector for the Queensland economy, there was a continuing need for capital investment. Accordingly, the Queensland Government encourages foreign investment in the tourism industry, preferably joint venture projects between Australian and foreign companies.[36]

Tasmania

9.33 The Tasmanian Government stated in its submission that foreign investment has a role to play in tourist and other developments in Australia, and suggested that it may be preferable to off-shore borrowings as a means of financing tourism development. The Tasmanian Government noted that both benefits and costs were associated with foreign investment. Benefits may include:

- the injection of management capability and specialist knowledge required to successfully cater for the needs of international visitors; and

- international distribution and marketing links which directly benefit such developments.

The Tasmanian submission, however, warned that the potential costs of foreign investment could include adverse impacts on the lifestyle of residents, and the viability of local operators. For the Tasmanian Government, foreign investment needs to be managed so as to protect the social, cultural and physical environment in which it is located.[37]

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36 *Submission No. 100*, pp. 6-7

37 *Submission No. 101*, p. 8

Northern Territory

9.34 Foreign investment was also supported by the Northern Territory Government; it argued in its submission that tourism constitutes a larger share of gross regional product in the Northern Territory than in other States. The Government believes that due to its small population base, the Northern Territory is dependent on external sources of finance. It confirmed that strong linkages exist between foreign investment and the ability of the region to attract foreign tourists. The Northern Territory Government noted that there is already significant foreign investment in the Territory's tourist development.[38]

New South Wales

9.35 The NSW Tourist Commission commented in its submission on the role of foreign investment in supplementing Australia's national savings, thereby enabling a higher level of national investment and greater economic development to occur. The New South Wales Government supports use of overseas capital sources to enable a higher level of economic activity to occur than would otherwise prevail. Benefits of foreign investment cited by the submission include:

- improvements to the Capital Account in the Balance of Payments (useful when in Terms of Trade Deficit);

- management expertise which tends to accompany direct investment funds and is beneficial to emerging industries or large scale projects new to Australia; and

- wide ranging economic spin-offs both during the construction and operating phases.[39]

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[38] *Evidence*, p. 1175

[39] *Submission No. 58*, p. 14

South Australia

9.36 While the South Australian Government did not comment on the foreign investment issue in its submission proper, in a paper from the Department of State Development and Technology it advised that economic growth resulting from a tourist industry is maximised when it is based on spending and investment capital attracted from outside the region. In Australia this effect is evident where overseas visitors take vacations within Australia and, where foreign investors establish tourist infrastructure in Australia. (The submission noted that to date this has been concentrated, to a large extent, in the coastal areas of Eastern Australia.) Benefits of foreign investment, according to the paper, may include:

- greater numbers of overseas visitors than the same development would have attracted if undertaken by domestic investors; and

- projects being undertaken which may be beyond or outside the scope of local industry developers.[40]

9.37 In another paper provided to the Committee from Tourism South Australia, it was pointed out that the distinction should be drawn between investment in new development which creates new tourism assets, and property acquisition by foreign interests, with a lower level of national benefit. Tourism South Australia commented that there are few tourism industry arguments to support mere property acquisition, unless such is accompanied by change in management and subsequent change in quality of service provided.[41]

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40 *Submission No.41*

41 *Submission No. 41*

Conclusions

9.38 There is broad agreement across the States that foreign investment has an important role to play in the development of tourism in Australia. While some caution has emerged about the nature of some foreign investment and the extent to which it should be encouraged, its role and benefits are clearly acknowledged.

9.39 The Committee heard evidence that foreign investment is necessary if the Australian tourism industry is to meet demand. The available data suggests that foreign investment is supplementing Australian investment by filling a gap in the Australian tourism market that would not be filled by Australian investors. This is contributing to national economic growth.

9.40 The issue of determining more precisely the costs and benefits of foreign investment would be facilitated by a more comprehensive set of data, and agreement about the methodologies which might be employed to analyse this data. Although BTR recommends a cautious approach to foreign investment, it supports the view put forward by Treasury that overall, foreign investment in Australian tourist facilities has a net economic gain for the Australian economy. The Committee notes, however, that this assertion is tempered by questionable empirical data concerning at least two key factors:

- information about the net employment generated by foreign investment in tourism; and
- information about the extent to which tax losses occur because of transfer pricing activity.

9.41 It is also important that the costs and benefits of foreign investment are measured with reference to the possible levels of investment in tourism by Australians. As the BTR has noted, the real benefit to the Australian Balance of Payments and government revenue generation can only be determined if the effects of Australian investment are taken into account.

9.42 Misconceptions about foreign investment effects on the economy, the environment and the community have coloured Australian reactions to this issue. BTR has suggested that without further data, the economic outcomes of foreign investment cannot be determined with certainty. However, the environmental implications of foreign investment are likely to be similar to that of local investment since all forms of tourist developments are covered by the relevant legislation and regulations in Australia.

9.43 Information supplied by various State governments shows strong support for continued foreign investment providing the social and physical costs are monitored and taken into account.

9.44 The Committee concurs with the support for foreign investment in tourism that has been forthcoming from the Commonwealth Government, the States, the Commonwealth Department of the Treasury, the Bureau of Tourism Research, and the tourism industry.