

Chinese Investment in Australia

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Abstract

Chinese investment in Australia is emerging as an important part of the Australia-China economic relationship. This paper overviews the major characteristics of Chinese investment in Australia up to the present - its volume, form, sectoral distribution and the major players. It then discusses the policies that have been driving recent increases and those that are likely to have a more profound impact over the longer term.

JEL classifications – F14, F21

Keywords: Australia, China, investment

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1. Introduction

The backbone of the Australia-China economic relationship has long been the trade of goods and services and this continues to flourish. China has now overtaken the U.S. and Japan to become Australia's number one trading partner with bilateral merchandise and services trade set to exceed \$A60 billion in 2007. Australian Bureau of Statistics (ABS) data show that in the 12 months from July 2006 to June 2007, Australia's merchandise exports to China amounted to \$A24.8 billion (up from \$6 billion in 2000) while merchandise imports from China reached \$A29.2 billion (up from \$A9 billion in 2000). Thus, not only have trade ties between Australia and China grown rapidly, they have remained roughly in balance. During this same period, Australia's trade deficit vis-à-vis the U.S. and trade surplus vis-à-vis Japan stood at around \$A16 billion in both cases. Australia's merchandise exports to China are dominated by raw materials from the mining and energy sector, reflecting the huge increase in demand for these fundamental production inputs as economic output in China has surged, as well as an increased reliance by China on imports to fill the domestic demand-supply gap. China has not been alone in seeking to secure access to Australia's natural resources and has faced stiff regional competition from the likes of Japan, Korea and India. It is this competition that has begun to usher in a new phase of the Australia-China economic relationship - one where Chinese investment in Australia features prominently. It has been reported that in early 2007 Chinese companies were studying more than 15 minerals and energy projects in Australia worth around \$US10 billion (IHT, 13/02/02007).

Given the preponderance of trade flows in the past, the subject of investment flows between Australia and China has received little attention to date. This paper

seeks to contribute to filling this gap. It begins by providing an overview of the major characteristics of Chinese investment in Australia up to the present - its volume, form, sectoral distribution and the major players. It then discusses the policies that have been driving recent increases and those that are likely to have a more profound impact over the longer term.

2. An Overview of Chinese Investment in Australia

Table 1 presents ABS data over the period 1991-2006 to illustrate some of the salient features of Chinese investment in Australia to date.

Firstly, when viewed alongside trade flows, the value of investment flows has been modest. Over the entire period, inflows of Chinese investment averaged just \$A180 million annually. By 2006, the accumulated stock of Chinese investment in Australia stood at \$A3.5 billion, on par with that of Taiwan, which is listed as a separate investor country in ABS statistics. The stock of the number one investor country in Australia, the U.S., was \$A362.8 billion, and the combined stock of all countries was A\$1.4 trillion. China's 0.25 per cent share of this total stock made it only Australia's 17th most important foreign investor. Hong Kong (SAR of China) held a more substantial investment stock of \$A38.5 billion. Given the porous border between Hong Kong and the mainland, some proportion of Hong Kong's stock might include capital of mainland origin.

Secondly, in stark contrast to trade flows, investment flows have not trended upwards. After averaging \$A279 million annually during the 1990s, Chinese investment in Australia actually turned to dis-investment over the period 2000-2005

before recovering in 2006. In 1991, China's stock of foreign investment stood at \$A1.4 billion, which made it the 14th largest investor country in Australia at the time.

Thirdly, while recent years have brought several high profile instances of Chinese direct investment in Australia, prior to this most Chinese capital entered in forms other than direct investment. The bulk has come under the category of "Other Investment", which includes trade credits, loans, and currency and bank deposit holdings by Chinese entities in Australia.

Table 1 here

ABS data do not disaggregate Chinese investment in Australia according to economic sector. Foreign Investment Review Board (FIRB) data regarding investment proposals provide some indication, although mainly only with respect to larger, direct investments. Not all foreign investments require FIRB approval and not all approved foreign investment proposals need necessarily reach full fruition. Table 2 shows FIRB approved investment proposals from China by sector since the early 1990s. It indicates that Chinese direct investment has been heavily concentrated in just two sectors – real estate; and mineral exploration and development and resources processing. With respect to the latter sector, a recent spike in investment is evident in the \$A6.8 billion of approved investment in the latest year, which far surpassed approved investment in any other year or sector in the data set.

Table 2 here.

According to the Australian Government's Department of Foreign Affairs and Trade (DFAT), which ranks direct investors according to annual revenues, the three

largest Chinese direct investors in Australia are China Trust and Investment Company (CITIC) Australia, CITIC Australia Trading and Sinosteel Australia. CITIC Australia has annual revenues of \$A677 million and is a wholly owned subsidiary of the CITIC Group, one of China's largest state-owned companies. CITIC Australia was originally formed in 1986 to hold a 10 per cent stake in the Portland aluminium smelter in Victoria that at the time was worth \$A140 million and was China's largest single overseas investment. Aluminium and traditional raw material interests such as coal continue to weigh heavily in CITIC Australia's investment portfolio. However, in light of China's growing energy demands and the recent nuclear pacts signed between the two countries, CITIC Australia also recently took a 7.5 per cent stake in Southern Gold, an Adelaide-based gold and uranium explorer. CITIC Australia Trading has annual revenues of \$A613 million. Aside from being directly involved in the export and import business where it focuses on the export of base metals and minerals from Australia to China, it is also involved in providing trade finance to support the burgeoning flow of goods and services between the two countries. Sinosteel Australia has annual revenues of A\$135 million and is a 100 per cent owned subsidiary of Sinosteel Corporation, one of China's largest steel traders. Sinosteel Australia was formed in 1987 and its centrepiece investment is a 40 per cent interest in the Channar iron ore joint venture with the Australian resource company, Hamersley Australia. Earlier this year Sinosteel Australia also began investing in the uranium industry in a joint venture with PepinNini Minerals of Australia.

3. Drivers of Chinese Investment Abroad

It is well known that since the Open Door Policy was initiated in 1979, China has become one of world's leading host countries of foreign investment, particularly

foreign direct investment (FDI). According to the United Nations Conference on Trade and Development (UNCTAD) data, in 2005 alone it attracted \$US72 billion in FDI, second only to the U.S., which attracted \$US99 billion. However, while the Open Door Policy led to the barriers restricting inward FDI being reduced, controls over most other types of capital flows remained largely in place. The impact of these controls can be seen in the official Balance of Payments data presented in Figure 1. Until 1995, Chinese investment abroad remained low and stable. Official data do not tell the full story as some Chinese capital was able to move abroad through unofficial channels such as trade mis-invoicing. For example, Gunter (2004) estimated that capital flight from China might have reached as high as \$US148 billion in 1998. Nonetheless, the evidence suggests that capital controls continue to bite in terms of restricting capital flows. Modelling by Laurenceson and Tang (2007) estimated that in the early 2000s the volume of non-FDI capital crossing China's borders was only 55 per cent of that which would be expected if its capital account were fully open. Capital account liberalization has picked up pace on a number of fronts in more recent years and this sets the stage for greater flows of Chinese capital abroad in the future.

Figure 1 here

3.1. The Go Abroad Policy

In the late 1990s, the Chinese government embarked upon a Go Abroad policy that encouraged Chinese companies, particularly large ones, to look beyond the domestic market and engage in direct investment abroad. As China's raw materials shortage has worsened and pressure on the exchange rate has intensified, the Go Abroad policy has become increasingly prominent in policy speeches. The objectives of the Go Abroad policy are chiefly to secure access to important raw materials, which is the manifestation of the policy most commonly seen in Australia, and the

acquisition of advanced technology and brand names such as when the Chinese computer manufacturer Lenovo acquired IBM's PC division in 2004. The government also sometimes provides the financial wherewithal for companies to expand overseas, albeit most of the companies investing abroad are usually at least partly government-owned themselves. For example, when Shanghai Auto acquired a stake in the Korean manufacturer Ssangyong Motors, 66 per cent of the acquisition was financed through preferential loans from three state-owned banks (Lunding, 2006). The impact of the Go Abroad policy can be seen in Figure 1. China's FDI abroad jumped from \$US1.8 billion in 2004 to \$US17.8 billion in 2006. By the end of the third quarter 2006, China's overseas FDI stock exceeded \$US70 billion (People's Daily, 19/12/2006). The potential for China's FDI abroad to expand further is indicated by UNCTAD's outward FDI performance index. This index ranks countries by dividing their share in global FDI outflows by their share in global GDP. In 2005, China ranked a modest 71st out of 141 countries.

3.2 Growth and Diversification of Reserve Assets

Against the backdrop of a heavily managed exchange rate, a large trade surplus (equal to 8 per cent of GDP at the end of June 2007) and speculative capital inflows, China now holds the world's largest stock of foreign exchange reserves (equal to \$US1.33 trillion at the end of June 2007). To maintain the value of the RMB to the \$US, China's state bank dominated financial system has invested heavily in \$U.S. assets, in particular, U.S. Treasury bonds. The spike in investment of this type since 2004 is clearly seen in Figure 1. Australia has not been directly affected by this outflow of capital although China's willingness to buy these assets has contributed to the low interest rate environment in the U.S. Holding reserves predominantly in \$US

has exposed China to a growing foreign exchange risk and when combined with the fact that these assets are low-yielding has prompted the authorities to begin taking steps to diversify the form in which reserves are held (Frankel and Wei, 2007). One institutional development that reflects this intention was announced in early 2007 by China's Finance Minister who outlined plans to establish a State Investment Company modelled along the lines of the Singaporean government's Temasek Holdings (IHT, 09/03/2007). While still a work in progress, the new company has the potential to emerge as a major overseas investor, including in Australian assets. The Chinese official media has reported that \$US200 billion in Chinese government treasury bonds will be issued to kick start its operations (People's Daily, 16/03/2007). Some foreign commentators have speculated that these bonds might be sold to the People's Bank of China (PBC), the country's central bank, in exchange for a portion of the foreign exchange reserves now held on its balance sheet (Financial Times, 27/06/2007). An existing Chinese government agency recently purchased a \$US3 billion stake minority stake in Blackstone, a U.S private equity group, on behalf of the State Investment Company that is still being set up. In discussing the deal the Chinese buyer stated that they expected the State Investment Company would engage predominantly in portfolio investment such as in funds that track broad stock indices or purchase minority stakes in foreign companies rather than direct investment and takeovers (New York Times, 21/05/2007). This sits at odds with certain alarmist reports appearing in the local press that the new company might seek to buy marquee Australian companies such as BHP (e.g., Herald Sun, 07/06/2007). It also reflects an acceptance by the Chinese government side that any attempt by a Chinese government agency to buy a controlling stake in a foreign company is likely to be met with stiff regulatory opposition abroad. There are several precedents for this contention such as

in 2004 when a bid by CNOOC, a Chinese state-owned oil company, for Unocoal, a U.S oil company, was blocked by Congressional opposition.

3.3. The Qualified Domestic Institutional Investor (QDII) scheme

The Chinese government has also begun loosening controls over Chinese individuals investing abroad. In 2005, the Qualified Domestic Institutional Investor (QDII) scheme was launched. This is the counterpart program to the Qualified Foreign Institutional Investor (QFII) scheme launched in 2003 that gave foreigners limited access to China's capital markets. QDII allows Chinese individuals to invest in overseas securities through licensed institutions, each of which is issued with an allowable quota for making such investments. Initially, the scheme was limited to domestic banks investing in overseas fixed income products. More recently, it has been expanded to include securities companies and fund managers and the menu of allowable investment products to include overseas equities. The aggregate QDII quota now stands at around \$US19 billion, although only a fraction of this has been utilised in view of booming domestic equity markets and the gradually appreciating RMB (China Daily, 24/05/2007). Current rules only permit investment in equities and equity funds authorized by a supervisory authority with which the China Banking Regulatory Commission (CBRC) has signed a Memorandum of Understanding. The Hong Kong authorities are the only ones to have done so to date. Nonetheless, over time some QDII money might begin flowing into the likes of the Australian Stock Exchange.

4. Conclusion

The Australia-China economic relationship is set to be further bolstered by greater flows of Chinese investment to Australia. In the short term, these flows will likely be an escalation of the type recently seen in the natural resources sector that have been prompted by the Chinese government's Go Abroad policy. Such investment would receive a further boost if a Free Trade Agreement (FTA) was signed between the two countries given that some Australian raw material exports still face tariff barriers, albeit their level has declined since China joined the WTO in 2001. In the longer term, more flows can be expected in the form of portfolio investment as developments such as the State Investment Company and QDII make their mark. The potential for future growth is vast. Direct capital markets in China remain under-developed and Chinese individuals currently have in excess of \$US2 trillion sitting in bank account savings deposits earning negative real rates of interest (Wall Street Journal, 27/06/2007). As China's capital account continues to open, it can be expected that some of these savers will seek out higher returns abroad. The strong trade ties and stable political relationship between Australia and China positions Australia well to become a significant beneficiary of this liberalization process.

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Table 1. Chinese investment in Australia, 1991-2006 (\$A millions)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total	585	482	831	359	-907	-1058	1148	277	795	-58	-126	-370	218	-601	28	1280
FDI	11	29	-28	84	-33	-196	44	31	-21	6	-21	12	n.p	-80	-58	306
Portfolio investment	574	453	859	275	-875	n.p	1	1	1	2	-2	n.p	n.p	n.p	n.p	n.p
Other investment	n.a	n.a	n.a	n.a	n.a	n.p	1103	245	813	n.p	-112	-433	174	-693	-280	666

Notes –

1. n.a – not available; n.p – not published. In some cases n.p data can be inferred as it should be able to be calculated as a residual.

2. There is a sharp decline in reported portfolio investment after 1995. This appears to be a data reporting artefact whereby the ABS began reclassifying “Portfolio investment – debt securities” as “Other investment”.

Source – ABS Cat 5352.0

Table 2. FIRB Approved Chinese Investment in Australia (\$A millions)

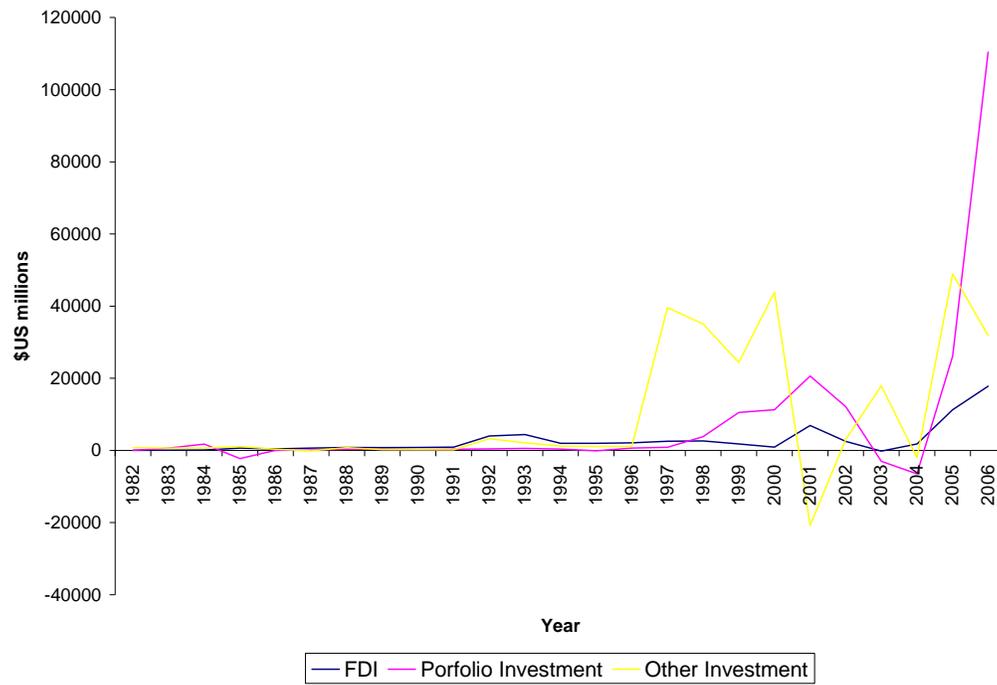
	Number of approvals	Agriculture, forestry and fishing	Finance and insurance	Manufacturing	Mineral exploration and development and resource processing	Real estate	Services excluding tourism	Tourism	Total
1992-93	-	-	-	-	-	-	-	-	-
1993-94	927	-	-	1	42	426	16	36	522
1994-95	267	-	-	6	52	137	31	-	225
1995-96	102	10	-	3	5	176	5	12	210
1996-97	-	-	-	-	-	-	-	-	-
1997-98	-	-	-	-	-	-	-	-	-
1998-99	259	35	-	5	450	212	10	-	720
2000-01	-	-	-	-	-	-	-	-	-
2001-02	237	-	-	47	20	234	-	10	311
2002-03	-	-	-	-	-	-	-	-	-
2003-04	170	-	-	2	971	121	-	5	1100
2004-05	206	2	-	-	39	181	36	6	264
2005-06	437	-	-	223	6758	279	-	-	7259

Notes –

1. With respect to the number of approvals, – indicates that in that particular year the number of Chinese proposals was not sufficiently large to warrant listing as a separate country in the FIRB's reporting tables. With respect to economic sectors, - indicates that the volume of investment was either zero or sufficiently close to zero for reporting purposes.

Source – FIRB Annual Reports.

Figure 1 – Chinese investment abroad, by type



Source – International Monetary Fund, International Financial Statistics.