Foreign Investment: What is it?

David Marcus and Clive Hamilton

The aim of this paper is to make two points about foreign investment in Australia. In the first section we make the point that a remarkably small proportion of the activities of Transnational Corporations (TNCs) in Australia is funded by money brought in from overseas. Funds are mostly generated in Australia by means of retained earnings and within local capital markets. The second section makes the point that a comparison of visible flows of funds into and out of Australia through TNCs indicates a massive net outflow over recent years (since 1972/73). The third section deals briefly with the relation between the two points.

I

The most powerful argument in favour of foreign investment in Australia is summarised in the following statement by John Stone, conservative economist and Treasury Secretary.

> Let me begin by stating one belief which I think may find fairly general support among you. Looking to the 1980s, I think that there would be a very widespread agreement in this country - and perhaps almost unanimous agreement within this room - that the development task before us is going to be greater than Australians will be capable of undertaking from their own savings alone. In terms of real resources, the capital investments that we shall seek to undertake will outrun the extent to which, as a nation, we shall be prepared to abstain from currently consuming our real national product.
>
> (Speech to the Australian Institute of Management 19.11.79)

But is it really true that the growth of the Australian economy is as dependent on overseas funds as Stone suggests? After all, foreign investment in the recent past has not been all that foreign.

(a) Undistributed Income

An increasing proportion of foreign investment in Australia is financed by the "undistributed income" of foreign companies operating in Australia. In fact, undistributed income of foreign companies is counted as "direct foreign investment" in the first instance by the Bureau of Statistics on the assumption that it will be re-invested in Australia. Table 1 shows that undistributed income as a proportion of total foreign investment has risen steadily in recent years. On average, it comprised 27.8 per cent between 1968-69 and 1972-73 but had climbed to 51.8 per cent on average between 1973-74 and 1977-78.

Table 1: Undistributed Income as a Proportion of Total Foreign Investment in Enterprises in Australia, 1947-48 to 1977-78

	$m	% of total
1948-49 to 1952-53	188	30
1953-54 to 1957-58	385	39
1958-59 to 1962-63	549	31
1963-64 to 1967-68	730	23
1968-69 to 1972-73	1,218	27.8
1973-74 to 1977-78	2,675	51.8

Source: Foreign Investment Review Board, 1978 Report.

But the story does not end there. Table 2 gives a further breakdown of the sources of foreign investment in foreign enterprises in the period 1973-74 to 1977-78. In this table - also from the 1978 report of the Foreign Investment Review Board - note that "undistributed income" is called "retained earnings", and is calculated slightly differently.

Table 2: Direct Foreign Investment in Foreign Owned or Controlled Enterprises in Australia, 1973-74 to 1977-78

	$m	per cent
Retained earnings of foreign controlled companies	2675	65
Inter-company indebtedness (trade and related credits) of foreign controlled companies	807	20
Loans raised overseas by foreign controlled companies	420	10
Equity: - direct $449 m - portfolio -$217 m	232	5
	4134	100

Source: Foreign Investment Review Board, 1978 Report.

It is clear from the table that only 35 per cent of foreign investment in foreign enterprises actually came from overseas. The other 65% was generated inside Australia in the form of retained earnings. Loans raised on Australian capital markets by TNCs are not classified as "foreign investment". However, funds so raised must be included in examining the importance of local funding in general.

(b) Use of Local Capital Markets

A large part of the finance used by TNCs in Australia is raised locally, and this trend is strengthening.

In the words of the FIRB (1978 Report);

> Inflows of foreign capital do not, however, wholly reflect the level of investment activity by foreign investors in Australia: investment by foreign interests is undertaken with funds owned or

obtained from both overseas sources and the Australian domestic capital market. Funds raised from the Australian capital market and from internal reserves of foreign-controlled companies operating in Australia have become a particularly significant part of total investment by foreign interests in Australia in the 1970s.

The statistics are not very good but they do give a fair idea of the importance of that portion of total domestic funding which is provided by the local capital market.

Table 3 shows the amount of investment in foreign-owned or controlled companies by Australian investors and can be compared with total investments in foreign companies. The table gives cumulative totals (i.e. sums of each type of investment over the years).

Table 3: Investment in Foreign Controlled Enterprises[a] in Australia, 1973 to 1978. Cumulative Level of Investment[b] as at 30 June.

Date	Amount - $m			Proportion - %		
	Raised in Australia	Raised Overseas	Total	Raised in Australia	Raised Overseas	Total
30 June 1969	1,977	5,761	7,738	25.5	74.5	100
30 June 1970	2,274	5,896	8,170	27.8	72.2	100
30 June 1971	2,728	6,948	9,676	28.2	71.2	100
30 June 1972	3,004	8,723	11,727	25.6	74.4	100
30 June 1973	3,220	9,586	12,806	25.1	74.9	100
30 June 1974	4,003	10,072	14,075	28.4	71.6	100
30 June 1975	4,121	11,481	15,602	26.4	73.6	100
30 June 1976	5,277	13,029	18,306	28.8	71.2	100
30 June 1977	7,225	17,338	24,563	29.4	70.6	100
30 June 1978	7,605	19,514	27,119	29.0	71.0	100

a Foreign controlled enterprises are defined as enterprises where 25% or more of the ordinary capital is held by foreign investors.

b Statistics on the Level of Investment are based on Bureau of Statistics figures on corporate equity adjusted according to Australian Treasury practices to give a more accurate measure of equity.

Compiled from issues of Foreign Investment, published by the Australian Bureau of Statistics and Reserve Bank Statistical Bulletin: Company Supplement.

Clearly, the proportion of capital raised by foreign companies which is supplied by Australian investors is rising.

The FIRB, using more complete data, made the following points in its 1979 Report:

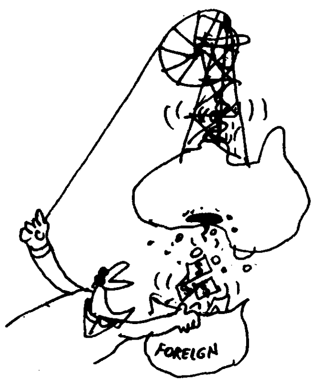
> In addition to bringing funds from overseas, foreign investors also raised funds from the Australian capital market to finance their Australian operations. The available information on the extent of recourse by foreign-controlled enterprises to the Australian capital market, including that provided to the Board by foreign investors when submitting their proposals, suggests that the amount of funds provided by Australian investors to these enterprises is significant and has been steadily increasing throughout the 1970s. Using data provided by the Australian Bureau of Statistics, it is estimated that in 1976-77 funds provided by Australian investors, mostly in the form of loans, amounted to about one-third of total funds employed in foreign-controlled enterprises. Of the net increase in funds employed in that year by these enterprises, more than half were derived from Australian sources. It is estimated that in the eight years between 1969 and 1977, total Australian loans to these enterprises increased five fold. (emphasis added).

As an example of what this means in practice, the following is an extract from the 1978 Annual Report of BP (Australia):

> The Group is in a sound financial position. Locally generated funds have been used during the year to provide for capital investment expenditure, exploration activities, the payment early in 1979 of the third instalment on the purchase of the first fifty percent of Clutha issued share capital and a substantial increase in working capital needs arising from the prise rise in indigenous crude oil in August 1978.

In March 1980, BP borrowed $60 million mostly from Australian banks.

> The medium-term borrowing package has been by a group lead managed by the National Bank of Australasia Ltd., with the Bank of N.S.W., the A.N.Z. Banking Group, Chase-N.B.A. and Barclays, participating.
> BP says the borrowings and initial drawdowns will take place in the next couple of weeks.
>
> (Australian Financial Review, 17.3.80)



It is clear that with undistributed income and local capital raisings providing such a high proportion of the funds employed by transnational corporations in Australia, the common argument that Australia "needs" foreign investment because it cannot provide the capital itself starts to look very thin. What the figures given in this article show is that remarkably little "foreign-investment" actually flows in from overseas. To a large and increasing extent, "foreign capital" in Australia is generated from the bank accounts of Australian investors and by the sweat of Australian workers. It remains true, however, that the lion's share of the profit on this "foreign capital" accrues to the transnational corporations which organise the productive capital and labour.

II

With the release of the January 1980 foreign investment figures by the Australian Bureau of Statistics, the pattern of foreign economic domination of Australia has become clearer. Table 4 shows various series of inflows and outflows of funds. The final inflow series (A) is obtained after deducting "undistributed income" from the total foreign investment in enterprises and after deducting "portfolio investment and institutional loans". Note that "undistributed income" is also deducted from income payable abroad, on the assumption that it is re-invested in Australia. Income payable on portfolio investment and institutional loans is also deducted from the "gross outflow", as is interest payable on foreign holdings of Australian public authority securities. This last deduction isolates payments by the private sector. The reason for deducting portfolio investment and institutional loans in obtaining inflow (A) and income payable on portfolio investment and institutional loans in obtaining outflow (B) is to isolate the flows associated with investment directly undertaken by TNCs.

It is clear from Table 4 that, since 1972-73, the outflow of funds associated with direct foreign investment by overseas firms in Australia has exceeded the actual annual inflow of funds from abroad. In fact, over the period 1972-73 to 1978-79, the excess (or net outflow) amounted to $1,933 million.

III

Table 5 indicates generally the point that while the percentage of company income generated in Australia that is payable to overseas residents is tending to increase, the proportionate contribution of new funds by overseas residents has been tending to fall. It should be noted that the investment figures overstate the proportionate contribution of funds from abroad since they include undistributed income generated in Australia.

CONCLUSION

Clearly Australians already contribute the greatest part of the finance for investment directly undertaken by foreign companies in Australia. The finance becomes available to the foreign companies either through their retention of earnings or through their issues of financial securities in Australian capital markets. The possibility exists that the share of finance which the companies have actually transferred from abroad could have been raised by more purposeful overseas borrowing by Australian financial institutions. As things have developed, however, the foreign companies have become the beneficiaries of a share of total company income after tax that is something in the order of two to three times the share of new finance which they bring to Australia.

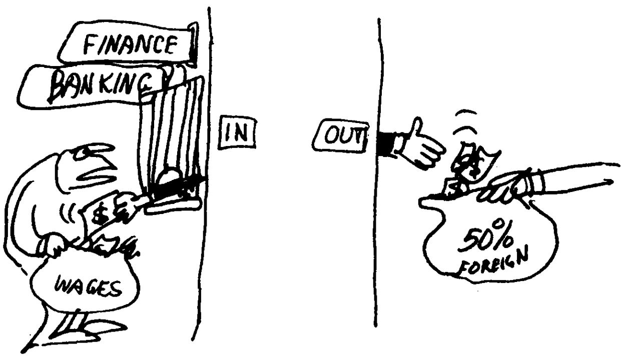


Table 4: Flows of Foreign Investment in Enterprises in Australia, 1970-71 to 1978-79, $m

	70-71	71-72	72-73	73-74	74-75	75-76	76-77*	77-78*	78-79*
IN									
Foreign investment in enterprises	1,549	1,446	484	471	881	762	1,544	1,316	1,964
- Undistributed income	239	217	297	420	241	605	672	650	791
	1,310	1,229	187	51	640	157	872	666	1,173
- Portfolio Investment & Institutional Loans	652	577	94	-134	237	198	452	285	600
Inflow (A)	658	652	93	185	403	-41	420	381	573
OUT									
Income payable abroad	708	747	935	1,082	1,015	1,469	1,705	1,833	2,156
- Undistributed income	239	217	297	420	241	605	672	650	791
- Interest payable on foreign holdings of Australian public authority securities	89	89	82	76	76	86	114	162	307
	380	441	556	586	698	778	919	1,021	1,058
- Income payable on Portfolio Investment + Institutional Loans	105	134	150	163	208	242	256	297	353
Outflow (B)	275	307	406	423	490	536	663	724	705

Source: ABS, Foreign Investment (1977-78 Annual Bulletin) and (1978-79 Preliminary)

* These figures differ from those in Table 2 as they represent later, revised figures.

Table 5: Foreign Investment in Australia

	Income payable abroad as % of total company income after tax[1]	Foreign investment of % of total investment expenditure by enterprises[2]
1960-61	31.3	26.1
61-62	27.4	26.0
62-63	29.2	28.5
63-64	27.9	25.0
64-65	25.1	23.3
65-66	27.7	29.3
66-67	26.5	21.7
67-68	31.7	35.3
68-69	30.7	31.9
69-70	29.2	27.7
70-71	28.8	36.8
71-72	26.2	34.0
72-73	30.2	11.3
73-74	30.5	7.0
74-75	25.8	11.8
75-76	31.3	9.2
76-77	33.4	15.4[3]
77-78	35.6	14.0[3]
78-79		17.6[3]

Source:
1. Treasurer's Statement, 31.3.80, "Foreign Investment in Australia". These figures can be taken to be the most conservative estimates of the proportion of income payable abroad.
2. Foreign Investment Review Board, Report, 1978.
3. Calculations derived from ABS preliminary estimates in the same manner as FIRB figures were derived for the period to 1975-76.