Capital Xenophobia
Australia's Controls of Foreign Investment

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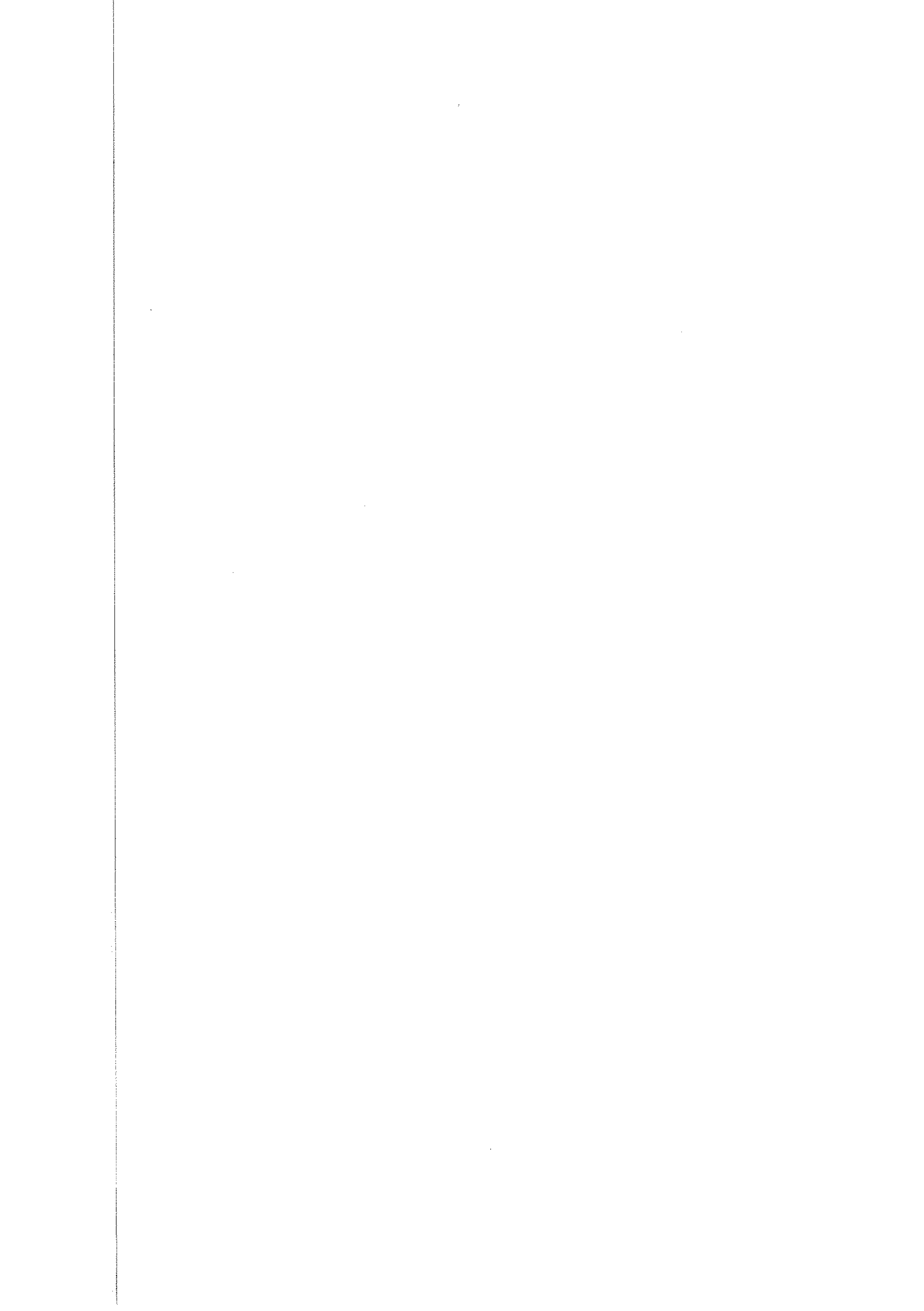

Capital Xenophobia
Australia's Controls of Foreign Investment

Wolfgang Kasper

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Foreword

Ross Parish

As Professor Kasper points out, the familiar arguments for free trade apply to the international movements of capital as well as trade in commodities. Yet the case against import barriers appears to be better and more widely understood than the case against barriers to foreign investment. In this monograph he seeks to redress this imbalance by providing a non-technical account of the arguments, economic and non-economic, for and against foreign investment in Australia. He also gives a brief history and description of Australian investment controls and reports the results of a survey of businessmen's experiences with and attitudes toward the controls and their administration.

The official policy of discrimination against foreign investors induces private discrimination. In recent months, several leading Australian companies have amended their Articles of Association to give their directors power to limit foreign shareholdings by refusing to register share purchases by foreigners or by selling shares owned by persons 'deemed to be foreign'. These changes are designed to ensure that the companies remain Australian within the meaning of the Foreign Takeovers Act, which defines as 'foreign' any company 40 per cent owned by foreigners or 15 per cent owned by a foreign individual. Foreign companies are subject to various constraints, including the need to have the prior approval of the Foreign Investment Review Board to make takeovers.

This internationalisation within the firm of discrimination against foreign investment is a natural, though probably unintended, consequence of the Government's controls. Presumably the directors consider the benefit of these moves exceeds the cost in terms of reduced demand for the companies' shares. However, the changes may result in a more effective and extended application of the existing controls on foreign investment, and on that account be economically disadvantageous. For example, it has been pointed out that one of the contingencies against which directors are insuring themselves — becoming foreign by foreign portfolio investment exceeding the 40 per cent ownership level — is something at which Governments have habitually turned 'Nelsonian blind eyes', whereas 'making an issue out of it, and virtually assuming an obligation to unmask foreign portfolio investment . . . could force the regulatory hand' (Terry McCrann, *The Age*, 14 October 1984).

Extending or tightening foreign investment controls would appear to be singularly inappropriate in the present climate of opinion in which a good deal of deregulation of the finance industry has taken place. It is to be hoped, instead, that the impetus of financial deregulation will be maintained, and the admission of foreign banks will be followed by the removal or substantial relaxation of controls on foreign investment generally.

Introduction

In the late 1960s Australia abandoned its traditional 'open door policy' towards foreign capital. Since then there have been repeated changes in the policy to control capital inflows. There has also been an ongoing public debate about various specific aspects of that policy. Despite this, Australian foreign investment controls, like trade controls such as tariffs, have been tolerated by all major parties and large sections of the Australian community.

However, basic economic theory teaches that controls over international trade and capital movements interfere with free market competition and resource allocation and hence create economic costs. In recent years, this has been widely accepted in the Australian economic debate with regard to the tariff. Even politicians and bureaucrats have begun to accept publicly that the real costs of the tariff are misallocation of resources and long-term loss of competitive dynamism. It is increasingly acknowledged that the result of tariff protection has been slow economic growth in Australia, as well as in New Zealand, Argentina, and other heavily protected countries.

By contrast, the basic economic argument in favour of opening national capital markets to free international competition is rarely heard in this country. This may be because Australia does not have a long tradition of foreign investment controls and has enjoyed bountiful capital inflows despite the controls. It is also possible that the long-term effects of the tariff are easier for the public to understand than the effects of controls on the structure and level of capital formation.

This study is mainly concerned with existing controls over direct foreign investment in Australia. It covers both the basic arguments for and against controls over foreign capital and the practical administrative problems of policy implementation that have arisen in the last few years.

Chapters 1 and 2 provide a summary of the basic theory of capital mobility and a history of the ideas surrounding it. In Chapter 3 the merits of purely economic arguments for and against controls of direct capital inflows are examined. Chapter 4 looks into the pros and cons of efforts to secure economic advantages (rents) for nationals by capital controls, which is a half-economic, half-political issue. Chapter 5 deals with the nationalist-Mercantilist and the anti-capitalist arguments for controls, which have little to do with economics.

The later Chapters examine the administrative problems with the present controls of foreign ownership and foreign businesses in Australia and describe how these controls work in practice. The

study concludes by recommending the abolition, or at least a basic re-evaluation, of Australian investment policy.

* * *

This research was hampered by a lack of reliable, independent statistics and by the fact that foreign investment appears to elicit emotional responses rather than rational analysis from the Australian public. Moreover, there is no formal statute setting out the policy other than the Foreign Takeovers Act, which covers only a part of foreign investment controls. The scope for bureaucratic interpretation and reinterpretation of the Act and the policy is very wide. Implementation by negotiation and administrative or political decree has resulted in an unpredictable, obscure policy — in other words, a policy that lacks transparency. And transparency is essential for any good regulatory policy.

To overcome these obstacles I conducted numerous interviews with businessmen and other knowledgeable people. Although there is no shortage of interesting case studies that could be written up, it is difficult to document the experiences individual firms have had with capital controls. Because most firms will have to deal again with Treasury, which administers the controls, they are reluctant to be publicly quoted. It is an indictment of Australia's policy on foreign investment that informed people are so fearful of being drawn into a public controversy.

For this reason, I relied on a questionnaire to document some of the practical problems that have arisen. This questionnaire was devised after interviews with about 30 businessmen and officials with a wide range of insights and opinions. My research assistant, Mrs Sharon Jackson, helped me with the compiling of the answers to the questionnaire.

I thank the many persons who helped me in my research and who found the time to respond to the questionnaire. I also thank the anonymous referees of an earlier draft, and Ms Rose McGee, the Executive Editor of the CIS, for her friendly and perceptive help in converting the draft into readable English. For the reason mentioned above, I decided — with regrets — not to thank anyone in business or government by name. All remaining shortcomings and errors of fact and interpretation are of course my own responsibility.

Chapter 1

Capital Mobility and Social Welfare

It is one of the basic, time-tested precepts of economics that the wealth of nations increases if capital is freely mobile. New savings (and old capital accumulated in earlier periods) benefit society most when employed in uses for which investors — after taking the unavoidable risks of economic life into account — bid the highest rate of return. This contention is based on two presumptions: that investors, who risk their own assets, tend to be best informed about the prospective returns of an investment project; and that high private yields from capital investment in a competitive economy contribute to social welfare. Since old capital has already been cast in the form of fixed capital goods and therefore has only limited mobility, it is even more important that new savings, which are still 'malleable', be kept as mobile as possible between competing uses.

International Capital Mobility

This basic and overriding principle applies not only within national economies but also worldwide. Savers may want to reduce the risks in their portfolios by investing part of their assets abroad; and borrowers are likely to be able to lower the cost of their capital requirements if they can borrow from the cheapest sources worldwide. International capital mobility therefore benefits savers and investors, and hence global welfare. Its benefit will be greatest when capital can move freely between all competing uses, including real assets that confer control over management (direct investment). A xenophobic reaction against direct foreign investment thus in all likelihood creates economic costs to society.

This is particularly true of a country like Australia.

- Australia has bountiful untapped natural resources that could be developed if capital were more abundant and cheaper.
- A country that has an immigration of labour should consider matching it by an 'immigration of capital', because domestic saving is likely not to be high enough to maintain a sufficiently high capital endowment per job to allow Australians to exploit the most productive production technology.
- Australia's population is relatively young compared to other OECD countries. Relatively young people will work longer with new capital equipment than old people and are likely to adjust better to new capital. Moreover, the old industrial societies in the Northern hemisphere prefer to put part of their savings into foreign investments so that they can draw on them when large parts of their population reach pension age. The next generation of Australians could therefore obtain relatively cheap capital by allowing the pension burden of Europe or Japan to be defrayed out of the productive gains of foreign investment in Australia.
- Compared to most young societies, especially in the developing countries, Australia offers comparatively low political risks and can therefore borrow relatively cheaply.

Given this favourable constellation, Australia should attract savings from overseas that would enable its economy to grow at its full development potential. Indeed, it is hard to imagine Australia's economic and social development over the past 200 years without the massive amounts of capital that — up to the late 1960s — came in from overseas virtually unimpeded. And it is still true that, by inhibiting free capital inflows, we forgo economic growth and job creation and our investors are forced to borrow capital at a higher cost than necessary.

Flexibility of Capital Structures

International capital movements help to develop more flexible capital structures. This is particularly critical in Australia for long-term economic growth, innovation, and structural adjustment at a time of rapid technical and social change. Here, many markets for manufactured products and services are of limited size and are protected against the challenges of international and sometimes even interstate competition. Hence they are able to rely heavily on self-finance for investment. This means that much saving is done

within established firms under established management. New production ventures and pioneering innovations, which are so essential to economic development (Schumpeter, 1961), job creation and growth, tend to be under-capitalised. The economy tends merely to reproduce its old capital structure, and potential pioneers find it harder to obtain venture capital. Sometimes they even emigrate to countries with more openly competitive capital markets. In such an economy, foreign capital adds not only flexibility but also competitive impulses from outside — and outside competition is what matters most in creating an economy that produces socially desirable results.

Capital Outflows

At present Australia has no significant restrictions on capital outflow, or on the repatriation of capital, interest, profits and dividends. There are important economic reasons for maintaining this freedom to move capital out of the country. First, savers do not like to see capital they own locked in. A wide open door for capital to leave the country is the best attraction for it to come in. We can therefore attract internationally mobile capital at the lowest possible cost only if we also allow free capital outflows and repatriation of capital, interest, profits and dividends.

Second, we live and work in a risky world where savers and investors have different perceptions of the future, different tastes for risk and different opportunities for diversification. It is therefore essential for the well-being of savers that they be able to channel their savings to those investment opportunities that offer the highest return at their desired distribution of risk. To some this may mean placing their 'savings eggs' in more than one national basket in order to minimise the personal risk of exposure to the policy blunders of one government.

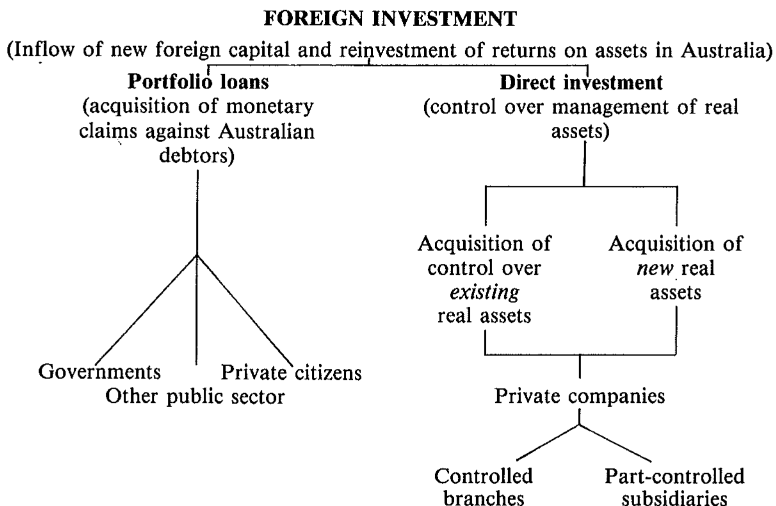
A third reason for permitting the free outward mobility of capital is more political: if Australians have misgivings about the excessive profitability of overseas firms that operate branches in Australia, then the best counter-argument is to allow Australian citizens to buy a part of those multinational companies by investing in overseas share markets.

Types of Capital Inflow

Although capital outflows from Australia were subject to controls for a long time, these have been eased over the last decade and seem to pose no problems at present. For that reason, we shall concern ourselves only with controls over capital inflows. Indeed,

the main focus of this study is on foreign **direct** investment, namely, establishment of new business ventures, takeovers of existing Australian-owned firms, and reinvestment of profits made in Australia. Foreign direct investment differs from international loans and foreign portfolio investments (which are made solely to earn income) in that it gives the foreign investor some degree of control over the Australian-based firm. Figure 1 shows how the most frequently used concepts and terms in the area of foreign investment relate to each other.

Figure 1



Despite the fact that the basic economic principles concerning the free mobility of foreign capital are simple and straightforward, capital controls have attracted relatively little public discussion or criticism during the past two decades (a few noted exception are McDougall, 1960; Brash, 1966; Johns, 1967; Swan, 1972; Arndt, 1977; Russell, 1978; Parry, 1983). Until recently, proponents of intervention in capital markets showed little sign of being aware at all of the costs that capital controls impose on Australian society.

Chapter 2

A Brief History of Ideas About Foreign Investment

Another Economic Consequence of Mr Keynes

The notion that capital controls harm economic and social welfare would have been accepted by and large by public opinion in the 19th and early 20th centuries. But in the 1930s ideas about the desirability of free capital movements between nations changed. New, more nationalistic views favouring government intervention gained wide currency and time-tested economic principles were brushed aside.

Free international capital mobility came to be seen as something potentially harmful, or at least irrelevant to the welfare of society, during the neo-Mercantilist period of the Great Depression. In the unusual circumstances of that period, politicians and bureaucrats of many countries tried to impose much tighter state controls over national and international economic affairs. To the neo-Mercantilist controllers, internationally mobile capital was an irritant because it often caused other controls to fail and showed up the limits of power of the nation state. This was the case, for example, when capital outflows highlighted the economic costs of monetary and fiscal expansionism and limited the effectiveness of the expansionary policies.

International capital was therefore viewed with suspicion, and not only in Moscow, Berlin and Rome. 'The decadent international but individualistic capitalism . . . is not a success . . . we dislike it, and we are beginning to despise it . . .' wrote Keynes in 1933 (1933:36-37).

These new attitudes helped form the social atmosphere in which

the foundations of the post-war international economic system were laid. Because of the glaring costs of trade controls, free international trade was seen as essential to prosperity when post-war reforms to the international system were discussed in the 1940s. But free international capital movements continued to be perceived as irrelevant to prosperity and a threat to sovereign national economic management.

This surprising dichotomy was clearly reflected in the Bretton Woods Agreement, which was signed in July 1944 and laid the basis for the International Monetary Fund. In the discussions of the post-war currency system, John Maynard Keynes prepared a plan for a Clearing Union ('The Keynes Plan') that still reflected his 1933 views and stated explicitly:

> It is widely held that control of capital movements both inward and outward should be a permanent feature of the post-war system — at least so far as we are concerned. If control is to be effective it probably involves the machinery of exchange control over all transactions, even though a general licence is often given to all remittances in respect of current trade. (Horsefield, 1969:13)

Keynes' *dirigiste* attitude towards international capital movements prevailed in the negotiations. The resulting Bretton Woods Agreement stated that one of its primary objectives was to 'facilitate the expansion of and balanced growth of international trade' (Article 1). But at the same time, the Agreement stipulated that the new International Monetary Fund 'may request a member to exercise controls against capital outflows' (Article 7), and explicitly permitted member countries 'to exercise such controls as are necessary to regulate international capital movements' (Article 6; Horsefield, 1969:193-194).

One of the main reasons for the different treatment of international trade flows and capital flows was that the fathers of the IMF Agreement wanted to ensure fixed exchange parities and feared that free capital flows would make that goal unsustainable. Another reason was that the costs of capital controls to welfare and economic growth were not clearly seen in the historic setting of the early 1940s, when virtually all international transactions were subject to severe regulations and economic life was subject to many war-time controls.

Free Trade and Capital Controls

In the 1940s, the view was widely held among economic theorists that free movements of production factors, including capital, were not needed to raise the community's living standard to its full

potential as long as international trade was free of regulation (Stolper and Samuelson, 1941; Samuelson, 1948). The rationale behind this school of thought is impeccable: consider, for example, a country with capital shortages that are aggravated by controls against capital inflows. If such a country engages in free international trade, entrepreneurs will respond to the high domestic interest rates by making and exporting capital-extensive products and by importing scarce capital embodied in capital-intensive products. International trade and domestic industrial structures thus adjust to compensate for the capital shortage.

In the 1950s, this idea may have helped to dampen nagging doubts of policy makers about interfering with capital flows. The view that international capital flows could be restricted without cost to living standards gained popularity when wartime controls over international trade were being dismantled under GATT and Organisation for European Economic Cooperation (OEEC) auspices.

However, the theoretical preconditions of this line of thinking do not fully apply in the industrial countries and certainly not in Australia:

— International trade itself is not free from government inverventions; therefore it cannot fully and promptly compensate for different factor endowments. Transport costs pose additional barriers to trade.

— The adjustment of the economy to high interest rates and capital shortages is costly in the short run and leads to loss of capital-based growth in the long run. Domestic industrial and employment structures are not as flexible as was popularly assumed in the 1940s and 1950s. The world is continually changing and the production apparatus can only adjust with a time lag and at some cost to society. Controlling the flow of capital places greater burdens on adjustment of industrial and employment structures and thus often makes structural change more costly than is necessary.

— Capital inflow is frequently coupled with the inflow of other scarce production factors, such as management skills or entrepreneurship. Inhibiting the foreign supply of these components in the 'foreign investment package' tends to slow down structural adjustment even further.

— When capital flows in, it often brings with it new ideas that stimulate market competition. These are essential in maintaining a dynamic market economy that can produce

socially desirable results. Restrictions on capital flows keep productive ideas and creative impulses away.

— In Australia, controls over capital inflows, latent capital shortages in industrial investment, and tariffs on the import of consumer goods have combined to twist industrial production towards consumer goods industries with low growth potential. This is against Australia's long-term comparative advantage in metal industries and has eroded the growth potential from new technologies in capital goods industries. Discrimination against capital goods production will restrict economic growth even more seriously in the future (Kasper et al., 1980:27).

The OECD and Capital Liberalisation

In today's world it is widely recognised that there are constant and unavoidable changes in technology, social conditions and markets. This means that economies must have as many adjustment mechanisms and equalising devices as possible, so that adjustment burdens are distributed widely and economies can cope faster with new dynamic situations. Capital mobility is crucial in managing economic change for the benefit of society.

Most member countries of the Organisation for Economic Cooperation and Development (OECD) have recognised what a crucial role international capital movements have played in the outstanding economic growth over the last generation. In the late 1950s, the high costs of continued capital controls became apparent. Most OECD countries therefore liberalised capital flows as well as trade flows. In 1961, the OECD adopted a 'Code of Liberalisation of Capital Movements', which commits all member countries — including Australia — to 'progressively abolish between one another ... restrictions of capital' (OECD, 1961). Twenty years later, the OECD concluded in an official report that

> liberalised capital flows ... offer benefits to the world economy and to individual countries similar to those derived from more developed capital markets within their countries. This provision of financial resources and real capital on the most efficient basis is an important element in fostering the achievement of the economic policy goals of Member countries. (OECD, 1982a)

One of the most dramatic steps in the direction of decontrolling capital flows in recent years was the decision by the UK Government to do away totally with all such controls, after behaving for years as 'the odd man out' among developed countries. Between April and October 1979, the Thatcher

Government completely removed all controls over international capital flows, partly because it saw the demonstrated benefits of free capital movements in countries like the United States, Switzerland and Germany (see Chapter 10). Britain joined key OECD countries in accepting that 'it has become increasingly difficult to isolate domestic capital markets... The supposed benefits of controls... [are] shortened ... while the costs involved in stemming given portfolio flows ... rise' (OECD, 1980). Although some observers predicted dire consequences, such as a speculative run from Sterling (*International Currency Review*, 1979), the transition to free capital flows in the UK went smoothly.

As we shall see, Australia went against the international trend in the 1960s and closed its traditionally open door to foreign capital (see Chapter 6).

Chapter 3

The Economic Pros and Cons

Because direct investment gives foreigners some degree of control over business management, Australian concerns with long-term capital flows focus on direct foreign investments and not on mere portfolio investment. For example, the 1982 Platform of the Labor Party urged policy makers to increase 'the portion of capital inflow on the basis of loan capital rather than equity capital' (Australian Labor Party, 1982:45). These concerns seem to be accentuated when foreign investment is concentrated in certain industries — e.g., the media or financial institutions — or when it involves substantial land ownership.

A rational discussion of these concerns should be based on the major national economic objectives. We should ask how far foreign investment promotes or inhibits (1) external equilibrium, (2) stability of the economy, and (3) economic growth of the productive potential and job creation. In this Chapter, we discuss the effects of investment controls on these fundamental economic objectives one by one.

I. CAPITAL FLOWS AND EXTERNAL BALANCE

Australian economic instincts have traditionally been shaped by persistent concern with a weak balance of payments. Although the mining boom of the late 1960s and early 1970s and strong capital inflows in recent years have made this concern less acute, the balance of payments still attracts attention. Recently this preoccupation has been transformed into concern with the weakness of the floating exchange rate. Economic theory suggests that the primary effect of capital controls is on relative prices and

microeconomic allocation, and that any effects on aggregate monetary phenomena like the exchange rate or the balance of payments are only secondary. However, one cannot dismiss out of hand arguments that relate investment controls to external equilibrium. These arguments take several forms: fear that foreign-controlled firms import more and export less than domestic firms; concern about the repayment burden of the capital we now import on our children's generation; the relative merits of foreign loans versus equity capital; and the structural adjustment that capital influx necessitates. We shall discuss these concerns one by one.

Import Propensity and Export Franchises

It has been frequently argued that foreign direct investment has an immediate impact on the current account of the balance of payments because multinational companies import more than they allow their Australian branches to export (Department of the Treasury, 1972). It is true that foreign investors may have better knowledge of world markets and therefore will buy capital goods and production materials from the cheapest source, irrespective of whether this is in Australia. But this is in the economic interest of Australia. Economic growth and job security are enhanced by supply from the cheapest source, even if this should lead to a higher import propensity.

Of course, multinational corporations may have motives other than price for importing, e.g. transferring profits to locations with lower taxes or building up capacities in other countries. If such practices are based on monopoly powers, they should be controlled by a policy that encourages competition. The wholesale control of foreign capital is not an appropriate way of coming to grips with competition-limiting practices of dominant firms. On the whole, however, there is no evidence that foreign direct investment has a bias towards more imports, and this has not caused problems for Australia's external balance in the recent past.

Restrictions on export franchises of Australian branches of multinational firms should be treated as restrictive trade practices. It seems appropriate that the revision of the 1984 *Guidelines* for foreign investment include an explicit reference to 'export limitation agreements as a criterion of whether an investment is of benefit to Australia or not' (Department of the Treasury, 1983).

Export limitations that inhibit the growth of Australian branches of foreign firms limit overall economic growth and national economic welfare. They may also limit the profitability of foreign-controlled plants, constrain the career opportunities of Australian workers and managers, and limit competitiveness and structural flexibility.

In 1975, the Jackson Committee — composed of R.J.L. Hawke, E.L. Wheelwright, R.G. Jackson of CSR Limited, and others — examined Australian industry policies for the Whitlam Government and also investigated the issue of export limitations. The Committee argued that 'access [to technology] is sometimes conditional upon the acceptance of restrictions on its use, especially in competition with the parent or other subsidiary', but finally concluded that 'most firms, both foreign and Australian, said that this was not the case' (Committee to Advise on Policies, 1975:98-99).

It is not surprising that the Jackson Committee found little hard evidence of export franchises, since these would normally not be in the economic interest of the overseas parent company or the managers of the Australian operation. Where there are tendencies to impose export franchises, it is the responsibility of the managers of the Australian ventures to reject them. If they see such franchises as an obstacle to future expansion, they should be able to negotiate their removal and should be given the protection of the law to do so. Where this is not feasible, there may be a case for intervention by the Trade Practices Commission. Although the problem of limited export franchise is frequently mentioned in the literature with regard to branches of multinationals in developing countries, there is little evidence that the problem is very relevant in Australia (Parry, 1983:15-20) or that Australian managers of overseas-owned firms consider such limitations as binding.

The 'Repayment Problem'

It has been argued that massive capital inflows create a 'repayment problem'. Today's capital inflows and the interest will have to be repaid eventually and this may weaken the external balance in the future.

In the first place, this argument implies that foreign capital adds less to the Australian productive potential than the cost of borrowing such capital. And this in turn implies a lack of sufficiently productive investment opportunities in Australia and a systematic overestimation of profit opportunities by foreign investors before they bring their capital in.

In principle, arguments surrounding the 'repayment problem' are different for fixed-interest borrowing than they are for direct investment, where the income to foreigners varies with profitability and hence the efficiency of the use to which foreign capital is put. Indeed, directly invested foreign capital may never return to its country of origin and a debt problem may never arise. We shall take these two categories of overseas investment in turn.

In the case of **fixed-interest borrowing**, loans must be scrutinised by the borrowers to make sure that the productive gains from employing additional capital exceed or at least match the costs of borrowing. This is true of domestic as well as foreign borrowing. Such calculations about the profitability of additional investments are an essential part of the capitalist process and profit maximisation.

No rational firm will willingly borrow at costs that exceed expected long-term returns. This would amount to a conscious decision to make a loss. However, businesses may be mistaken in their profit expectations; almost inevitably they incur losses from time to time. This is the very essence of life in the competitive marketplace. And losses in ventures that use foreign capital are 'burdens' to the balance of payments. But one cannot go on from the recognition of such occasional losses to the general assumption that **all** businesses that borrow overseas regularly overrate profit expectations and incur losses, resulting in a burden on the future balance of payments. Basic logic and experience indicate that — on average and over the long run — private fixed borrowing abroad will occur only if it is profitable and therefore will not burden the balance of payments with a 'repayment problem'.

Some argue that governments should institute a licensing system for foreign borrowing because of the dangers that excessive private profit expectations create for the balance of payments. But this argument rests on weak foundations. How can governments acquire superior information that private borrowers, who are directly involved and bear the risks of their projects, cannot obtain? How can government authorities ensure that foreign private borrowings lead to profitable investment? In the final analysis, government agencies could acquire most of their information from the borrowers themselves. If they were to set certain guidelines for licences to borrow overseas, they would probably be told only what they want to hear and not necessarily the true information on prospective investment projects. When government agencies intervene by licensing private loans, they create an impression of false security for businesses. If such projects later fail to pay off, government participation can easily be construed as having established a tacit co-responsibility of government. In interventionist economies, licencees then tend to seek a socialisation of their losses.

We can conclude that the profit motive is sufficient protection against the danger that private fixed-interest borrowings lead to long-term balance of payment burdens. But such 'natural' protection against excessive borrowing does not exist where governments or government-related bodies borrow overseas. They

are not bound by the need to earn a profit, but can rely on taxes for repayment. If borrowers are not controlled by the need to make a profit from their investment, there can be a 'repayment problem'. Indeed, virtually all the debt crises of the late 1970s and 1980s have been the consequence of large borrowings by governments or under government guarantees. These borrowers have failed to scrutinise the productive gain from investments or to ensure that foreign capital was productively used. Loans to East European, African or Latin American governments were often used for prestige projects with insufficient productivity gain. By contrast, the East Asian new industrial countries were careful to use overseas loans for productive industrial investment and, despite heavy borrowing, they face no debt crises.

The governments in Eastern Europe, Africa and Latin America that incurred major official debts are now discovering that foreign loans have a further disadvantage: namely, that loans can be withdrawn more easily than equity capital if political, social or economic conditions change. This has become a major issue in many countries that neglected or discouraged equity capital and sought loans instead (*The Economist*, 1984). They are now often losing more old loan capital than they can borrow anew.

In Australia, concerns with public borrowing overseas have been sharpened by the 'new federalism policy'. States and state public authorities have now been given much greater access to overseas capital markets, but they do not share overall policy objectives such as external balance. What ultimately controls state borrowing overseas is the need to service debts out of limited state tax resources. To ensure that state borrowing does not create a national 'repayment problem' in the future and is in line with general economic policies, strict Federal supervision of public borrowing seems desirable and justified.

In the case of foreign **direct investment**, such concerns about the balance of payments are not normally valid because foreign investors do not aim to engage in unprofitable production in Australia. As long as foreign investors aim to earn profits and produce new wealth, foreign capital should strengthen the long-term external balance. Generally, foreigners will invest here only if their capital adds enough to production or cuts costs enough to ensure that they make a profit. Some special cases, such as asset stripping in which no additional production is created, might impose a burden on the balance of payments. Yet this, on its own, hardly justifies the cost of a government screening process for all foreign investment. After all, it is virtually impossible for a government investigator to identify intended asset stripping before the event. Moreover, even when foreigners buy out an Australian

company for that purpose, they may 'unlock' Australian capital that can then generate new growth elsewhere in the economy.

The growth generated by foreign direct investment helps to ease the 'repayment problem' and creates a permanent attraction to international investors: as long as growth opportunities exist, direct investments remain in the country, perhaps permanently. In 1820 when the Americans celebrated the bicentennial of white settlement by the Pilgrim Fathers of the Mayflower, they might have panicked about excessive foreign investment in the United States if they had known their balance of payments statistics. They might have wondered how they would ever repay all that capital! Instead they went on borrowing overseas and developed their country. Gradually, much of the foreign-owned wealth became their own. Likewise, Australians have a chance to attract ample foreign capital and to convert much of that capital into genuinely and permanently Australian wealth. Many overseas-owned companies will never leave. They become permanent citizens whose shares we may acquire as we become more affluent ourselves. For this reason alone, a 'repayment problem' will frequently not arise at all.

We must also be aware that much foreign direct investment in Australia consists of profits made in Australia by foreign companies, which are reinvested. It is foolhardy to use controls to discourage the investment of incomes made here. We should instead ensure that as much re-created capital as possible remains on a permanent basis.

To sum up, we have to conclude that the time-tested contention stands: overseas investment will benefit the external balance if it makes a positive contribution to production. Fears of a long-term weakness in the external balance due to foreign investment are not justified as long as foreign investment and borrowing from overseas add at least as much to national output as the income accruing to foreigners. While doubts about this seem appropriate in the case of copious public borrowing, a future 'repayment problem' due to private overseas investment is highly implausible.

Structural Adjustment

It has been argued that foreign capital may finance additions to the national supply potential that do not add to future exports or replace imports, thus creating a future balance of payments problem. What happens, for example, if a foreign investment raises the supply of non-tradeables such as water supply? As Eric Russell (1978) pointed out, economists tacitly assume that economies always adjust in the long term to foreign investment through price and other changes, but this assumption may not always be justified.

It is well known that changes in the external balance — from whatever cause, be it capital inflows, a mining boom or some change in the terms of trade — require corresponding adjustments in the internal structure of the economy. In a well-functioning market system, exchange-rate and other price changes and factor mobility will eventually ensure that added output, wherever it occurs, is translated into incomes that are transferable overseas. But moderate price changes will bring about the necessary market adjustment of excess demands and supplies only in a well-functioning, malleable and responsive economy. In many respects, the relatively regulated Australian economy does not conform with the ideal of a responsive market system. This is reflected in a long-running Australian tradition of 'adjustment pessimism', which pervaded the Vernon and Crawford reports and is an essential ingredient in the 'Gregory thesis'. This pessimism is based on a distrust of the creative responsiveness of the market system, and has often led to a vicious circle that begins with well-meaning interventions and ends by destroying the very adjustment capability of the unregulated market.

Because the ability of markets to respond to change is so essential to overall economic performance, it is important for policy to promote price flexibility and factor mobility (OECD, 1983a). Experience shows that all societies, especially young ones like Australia, benefit from adjusting to change. Rejecting and resisting any such adjustment may be the way to create a stagnant society like that of traditional Tibet.

Under flexible exchange rates, capital inflows on their own create a tendency towards currency appreciation. This in turn sets in motion that 'most efficient and rapid calculating machine' (Meade), the market. Even marginal currency appreciation will make some previous exports unprofitable and promote marginal import competition. If this occurs in a climate of economic growth, the necessary adjustments are normally easily coped with. But even during times of underemployment and slow growth, adjusting to capital inflows is the price we must pay to regain growth and high employment. Nothing could be more counterproductive in such a situation than the stance taken by the Crawford Committee regarding adjustments to the tariff cuts — that we should adjust only when we have regained high employment (Study Group on Structural Adjustment, 1970:10.35). Adjustments to more productive activities and to more capital are the very means to promote employment and growth. It is not logical to argue that the patient should only take the medicine when he is well again.

II. STABILITY AND INTERNATIONAL CAPITAL MOVEMENTS

One of the traditional arguments against the free international mobility of capital is that foreign investors are footloose and may therefore pull out their capital quickly. In certain situations this could trigger a depreciation-inflation spiral that causes further capital flight. Likewise, sudden capital inflows may lead to currency appreciations that impose undesirable adjustment burdens on the economy. Such capital movements may create great instability in a national economy. Recent debt crises around the world have added renewed substance to these long-standing concerns with internationally mobile capital.

The stability argument applies most directly to short-term loans and portfolio investments, but it also arises in discussions of foreign direct investment. Fears occasionally surface in Australia that multinationals might pull out quickly to use the cheaper labour in Asia. Since many observers who comment on long-term direct investment are preoccupied with stability, it seems appropriate to discuss it here.

Stability Begins at Home

The fear of destabilising international speculation, which dominated the thinking of economists in the 1930s (see Chapter 2 above), has played a big role in maintaining the very detailed and cumbersome exchange controls in Australia from the end of the second world war to late 1983.

The first point to make against the still widespread notion that international capital is volatile is that capital flows themselves are not the cause of instability. International capital movements are but a visible symptom of an underlying disequilibrium. Controlling capital movements in such a situation suppresses the symptoms, but it does nothing to remove the cause of instability. Indeed, suppressing the vexing symptoms may allow policy makers to avoid addressing the difficult underlying causes of disequilibrium, thereby worsening the imbalance.

Where domestic policies are stable and where free capital mobility and reasonably flexible exchange rates offer a degree of elasticity, it is virtually impossible to imagine a case of sustained destabilising capital flight. We would have to assume that speculators are persistently out to make losses. After all, speculators make a profit only if they buy a certain currency when it is relatively cheap (capital inflow) and sell it when it is expensive (capital outflow), correctly anticipating long-term price trends. This type of capital movement

stabilises the currency, pushing its price up when it is relatively cheap and down when it is relatively expensive.

We thus conclude that speculative international capital flows are destabilising in the long run only if speculators continually buy when the currency is relatively expensive and sell when it is relatively cheap — in other words, if they persistently make losses.

The Historic Roots of the Instability Argument

Concerns about capital flight derived largely from rather superficial analyses of cases like the German spiral of devaluation, inflation and capital flight in 1922 and 1923, after Germany had lost the war and was faced with a massive reparations bill. Yet, the real cause of capital flight has always been diagnosed by knowledgeable German economists as inflationary domestic monetary and fiscal policy. Capital flight and depreciation of the currency were but the visible consequences of these inflationary policies. The prominent liberal German economist Walter Eucken wrote at the time: 'The reduction, even elimination of public and private inflation ought to be the primary aim of our monetary policy . . . It is . . . extremely pernicious to let each depreciation of the exchange rate be followed by a prompt increase in the money volume' (1923:70-71; my translation). In other words, the root cause was destabilising, irresponsible management of domestic money supply — not capital movements.

Such analyses were brushed aside in later summary studies that became internationally known — especially Ragnar Nurkse's work (Nurkse, 1944). Nurkse concluded that 'hot money' was the cause of the instabilities of the interwar period. This conclusion was not widely challenged and became conventional wisdom, possibly because it fitted with the evolving prejudices of the time. It was not until the early 1950s that Nurkse's conclusions were questioned. Milton Friedman then wrote that Nurkse's influential study 'rests . . . primarily on an oversimplified interpretation of the movements of so-called "hot" money during the 1930s. At the time, any speculative movements which threatened a depreciation of the currency . . . were regarded as destabilising . . . the evidence he (Nurkse) cites is by itself inadequate to justify any conclusion' (Friedman, 1953:176). It is amazing, though by no means unique in the social sciences, when slipshod empirical analysis leads to long-standing beliefs that shape policies for a generation or more afterwards.[1]

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1. An interesting case is the incredibly durable influence of Margaret Mead on anthropology and sociology, based on a singular and probably faulty observation in the early 1920s. Her conclusions were refuted in detail only in the early 1980s by Freeman (1983), whose book is a most illuminating

How Markets Stabilise Themselves

In a severe political crisis, international capital markets could stabilise themselves in the following ways. If capital could leave the country without controls, it is likely that, initially, politically sensitive and internationally mobile capital would begin to leave. This would exert a downward pressure on the spot and forward rates of the Australian dollar and trigger three immediately stabilising reactions:

(a) The depreciation of the dollar would make it more expensive to disinvest because the price of non-Australian assets would rise and the price of Australian assets would fall, raising the return on them. Capital flight would stop sooner or later.
(b) The depreciation would enhance the short-term profitability of domestic producers (exporters and import competitors), creating an immediate market incentive for capital to stay in Australia. Also, domestic demand would switch from foreign to domestically-produced goods, helping further to move the trade balance into surplus.
(c) Most importantly, currency depreciation and capital outflows would give a clearly visible and immediate signal to policy makers by highlighting the economic consequences of the political crisis. This could create a stabilising feedback into policy making. For example, capital outflows after the Mitterand election seem to have had such an effect on policy making in France in 1980-83.

Of course, such adjustments are not painless and take time. But unchecked disequilibria are eventually more painful and costly.

If governments try by direct intervention to maintain disequilibrium exchange rates and delay adjustments to the new political risks — as was the case in the 1930s — then capital flows will be perceived as destabilising.

When theoretical economists try to find out whether capital flight is destabilising, they frequently postulate fixed elasticities and assume away complex and changeable circumstances under the *ceteris paribus* assumption. In reality, elasticities can of course be influenced by policy. After all, it is the art of responsible economic policy-making to influence elasticities in the market, often by

case study of how influential myths in the social sciences are generated and perpetuated.

creating a degree of certainty about basic variables like the price level.

Politicians and bureaucrats may find free international capital flows undesirable because capital movement responds very visibly to changes in policy. Politicians and bureaucrats of a Machiavellian bent, who believe that they know best what is good for the wealth of their nation, dislike this conspicuous assessment of the future consequences of their actions. They resent the public censure by capital flight and depreciation when their budgetary and monetary policies are inflationary. The temptation is then great to shift the blame for inflationary policies to exchange markets, capitalists or foreign speculators. The temptation is often even greater to suppress the irritating evidence by reintroducing exchange controls. The Australian dollar float has not yet come to that test of tolerance.

This discussion should make it clear that capital controls should not be used to defend fixed exchange rates. Under flexible exchange rates, treasuries need not retain monopoly powers over domestic money markets. Instead, they can use the effective mechanism of flexible interest and exchange rates to achieve stabilisation.

A flexible response system will ultimately create greater confidence in stability, just like an auto-pilot in a boat makes small and frequent adjustments but avoids the danger of a capsize in the longer term. The flexibility of free markets ultimately enhances stability.

III. FOREIGN INVESTMENT, ECONOMIC GROWTH AND JOB CREATION

Traditionally the growth of incomes and employment in Australia has relied to a considerable extent on capital infusions from overseas and particularly on direct foreign investment. This country would not have developed an advanced economy in less than 200 years without many of those 'foreign investment packages' consisting of capital, management and marketing skills, technology and design, and market access. As in other industrial countries, many new ideas and solutions have been transferred to Australia through direct foreign investment. And many more development opportunities exist in the 'lucky country'.

Australia's Growth Potential

Australia is favoured by a number of circumstances that provide considerable potential for profitable investment and hence economic growth, a potential that exceeds the capacity of our own

resources to develop (for a detailed discussion, see Kasper et al., 1980:95-169, 215-240):

- — an extraordinarily rich and varied endowment of natural resources, including energy resources;
- — a relatively young and mobile population compared to most other OECD countries, which are increasingly facing a pension burden;
- — a reasonably diversified structure of industries and skills that can benefit from new technological developments;
- — a location near the dynamic East Asian fringe where many new industries and markets develop;
- — a tradition of relative political and social stability and a Western democratic society, which make Australia more attractive to international investors than many developing countries; and
- — living conditions that most owners and managers of internationally mobile firms find attractive.

The existence of this potential does not mean that economic growth will automatically happen. To make it happen, Australia must attract more capital and technology. We can do so at comparatively low cost because of our stability and growth potential. Although Australia has reasonably high savings rates, we could still profitably absorb a considerable amount of foreign capital.

Foreign Capital Adds to Our Resources

In a country with such considerable potential for economic growth, foreign capital adds to the resources for growth and job creation. Not only can we benefit as a nation from additional capital to upgrade and expand our capital stock, but we can also widen our resources by utilising the other components in the foreign direct investment package: management skills, new technologies and designs, and the potential for developing Australian skills. If we widened the supply of these factors by removing all controls over foreign investment, our rate of economic growth would begin to rise and match Australia's considerable and widely recognised growth potential.

If the above assumptions were wrong and if opportunities for foreign investment were insufficient, then the play of supply and demand in capital markets would ensure that we did not get excessive and unprofitable investment. Foreign investors would discover from persistently low returns on their Australian

investments that more capital has been invested here than Australia can beneficially absorb, and they would automatically invest less. It is not the concern of governments to protect capitalists from the losses of excessive investment.

The Process of Capitalist Growth and Innovation

To understand the costs and benefits of borrowing overseas, we must focus on the essential role of capital in the process of economic growth. Modern economic growth since the Industrial Revolution has required increasing amounts of savings to be turned into new capital goods. This raises labour productivity and leads to a growth of incomes and demand. Higher incomes and demand ensure that the greater production capacity created by capital investment is utilised, and that more and better-paid jobs are generated. This process of capitalist growth has always been coupled with continuing technical innovation, growing demand for higher skills, and often creative destruction of old capital (Schumpeter, 1939, 1961). Innovation and skill creation have kept the process of capitalist growth alive and vigorous, and have prevented Marx's prediction of a collapse of the capitalist system from coming true. Instead of an impoverished proletariat, modern capitalist societies are made up of a majority of skilled workers enjoying high living standards and working conditions that no one in the 19th century would have imagined.

New products and more efficient production processes are essential to the vigour of the capitalist system, but they can happen only under continued effective competition (Clark, 1961).[2] What matters in this context is not the 'perfect' atomistic competition of the standard economic textbooks, but the openness of the system to new challenges and ideas. Oligopolistic markets frequently are more competitive and generate more innovation and growth than atomistic markets — but only if oligopolist competitors are confronted with potential challenges and innovations from outsiders or from the other oligopolists. If oligopolies are shielded from such challenges, by either cartel or government protection, market performance deteriorates. The result is slow growth, high rents to suppliers, poor product quality and eventually a host of social problems.

What also matters in the capitalist growth process is how flexible and responsive to new challenges the capital market is. In this

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2. A relevant and constructive interpretation of competition cannot be found in the static Marshallian textbook tradition but in the dynamics of the Austrian School. See, for example, Dolan (1976) and Klein (1977).

respect, Australian capital markets have been deficient in two respects:

(a) Past regulations have side-tracked savings from industrial job creation into housing and the finance of government deficits. Many of these regulations have now been removed.

(b) Many manufacturers and services have enjoyed and still enjoy high tariff protection for their products. This allows a high proportion of their business investments to be self-financed. But self-finance limits the mobility of capital to new uses. Established firms under established managements tend to reinvest profits in the same structures as before, and new ventures and small firms are under-capitalised. With greater product market competition, Australians would have the opportunity to reinvest a greater share of the nation's savings elsewhere.

At times of rapid economic and technical change and in the still highly regulated Australian setting, the flexibility offered by foreign investors is doubly important. Investors who open new markets of course often reap pioneer profits and earn high returns on the venture capital they put up. When such pioneer profits show up in the balance sheets of foreign investors, they are often eyed with envy by the less enterprising part of the Australian community that does not understand the essential social function of profits in economic growth and job creation.

Innovation, Competition and Foreign Enterprise

An understanding of this process of growth, innovation and effective competition is essential in the discussion of foreign investment in Australia. In a small economy like Australia's (15 million consumers), effective competition cannot be sustained in many industrial markets if they are closed to new challenges from overseas, to import competition in product markets and to foreign investment. Only the potential rivalry of foreign producers and investors can effectively stir up the quasi-cartels that tend to develop in Australia's small protected markets. This view is not popular with established Australian capital owners and workers, who have developed cosy 'market niches' that permit them to draw adequate incomes without incurring the risk of launching new processes or new products. Protection makes life more comfortable for producers, but it is bad for the wealth of nations.

The Tariff and Foreign-owned Tariff Factories

If one looks at past performance, it can be argued that foreign investors sometimes have not filled the role of stimulating outside competition but rather have joined the rent-seeking game in Australia's protected markets. Many British and American firms came to Australia in the post-war era of import controls simply to defend their Australian markets. Once admitted to protected markets, they did not behave like Schumpeterian entrepreneurs but often acted as if they administered government-granted markets. Some foreign-controlled firms have become the most outspoken proponents of protectionism and the greatest beneficiaries of administrative featherbedding. Economic theory shows that foreign investment can be 'immiserising' in certain extreme conditions if markets do not perform properly and are distorted by government intervention (Brecher and Diaz Alejandro, 1977). If foreign capital is invested in industries that make artificially high profits due to tariff protection, and if such profits are repatriated, foreign direct investment may indeed reduce economic growth.

This is a problem in some less developed countries, and to a limited extent it is also evident in Australia. The post-war strategy here and elsewhere of developing a broad, diversified industrial base behind a tariff wall (import substitution) has attracted overseas investors to establish 'tariff factories' with dubious long-term growth potential. Many overseas-owned firms, once they had saturated the limited Australian market and found themselves faced with diseconomies of small scale, have abandoned effective competition in favour of 'oligopolistic peace', price leadership, cost-plus pricing and lobbying. This type of commercial behaviour does not benefit the common interest, and partially explains why multinationals have a poor reputation in Australia and other countries with high tariff protection. Firms produce socially desirable results only if their market power is controlled by effective competition.

To illustrate this hypothesis, we need only compare the public image of multinationals in openly competitive economies like Holland, the US, Germany or Switzerland, where they are seen just as any other corporate citizen, with the public image of such firms in protected economies like Australia or Argentina, where their presence has generated emotion and agitation. Public opinion correctly perceives the differences in competitive behaviour and understands the long-run effects of import substitution on living standards. The fault lies not with the existence of foreign investment, but in the protectionist policies of governments. If we do not want foreign capitalists to inhibit our growth, we must

expose them to the continuous stimulation of world-market competition by abolishing the tariff and other import controls.

Technological Dependence

Technological innovation, which plays a big role in the process of growth, is also important in the discussion of whether we want foreign investment. Some observers maintain that multinational companies concentrate their research and development (R&D) in their headquarters, so that countries like Australia become technologically dependent.

All Australian industry — whether foreign controlled or not — has a low commitment to R&D. This is typical of protected, cartelised industries. However, the Jackson Committee found in 1975 that 'foreign firms are at least as active as Australian firms in terms of local research and development expenditure' (Committee to Advise on Policies, 1975:98-99). And subsequent research has shown that foreign-owned subsidiaries tend to spend more on R&D in Australia than Australian-owned companies (Parry, 1978).

Multinational companies are one of the most important conduits for the transfer of new process and product technology, not only because they apply new solutions in their own susidiaries, but also because they cross-fertilise other firms and have demonstration effects on local businesses (Parry, 1983:16-19; Behrman and Wallender, 1976). The role foreign capital has played in countries like Singapore demonstrates that there is nothing inherent in foreign investment that retards the spread of new technology.

Does Foreign Investment Cost Jobs?

Unions opposing foreign investment sometimes allege that foreign capital destroys jobs, even if it lifts the growth rate. It is true that more production and more employment are not synonymous, and that output growth has always been faster than employment growth in the long run. A rise in labour productivity is the only solid guarantee of higher incomes for workers and sustained rises in living standards.

The fact that some investment is carried out by foreign firms does not, by itself, affect the gradual process of output and productivity growth. If foreign firms lean towards more capital-intensive and labour-saving production techniques than comparable domestic firms, they are quite likely to contribute to innovation and the creation of secure high-income jobs. Australia is not an underdeveloped country where multinationals from

advanced economies import totally inappropriate technologies. Our factor endowment and wage costs are reasonably comparable with the US, Europe and Japan, so that there is much less need to adjust imported technologies. Hence, there is little basis for the general contention that foreign investment is inappropriate to assist us in lowering unemployment. Indeed, in a continually changing world, multinational companies frequently identify new opportunities for profit and job creation because of their richer information base about different market conditions. A recent OECD study concluded that multinationals are better placed than purely domestic firms to exploit the opportunities offered by shifts in the comparative advantages of different countries (OECD, 1981:17).

The argument that foreign capitalists somehow do less for Australian employment than Australian capitalists often comes from the observation that foreign firms tend to concentrate in capital-intensive industries, e.g. mining. If multinational companies find the biggest productive advantage in capital-intensive operations, then they serve the overall economic interest of the nation best by concentrating on those pursuits. Also, highly productive, capital-intensive jobs create other less capital-intensive jobs: miners require schools, banks and other services, and their expenditures are other peoples' incomes. Developments driven by foreign investment have considerable job-creation multipliers throughout the economy.

Another argument about foreign capital and employment is that capital inflows trigger adjustments in employment structures. Structural adjustment entails a loss of some jobs somewhere in the economy and a gain of jobs elsewhere, but on balance it promotes overall economic growth and high levels of employment. Australian society has to acknowledge that attaining high employment levels requires the 'creative destruction' of some jobs and changes in the structure of employment. Particular supplier interests — unstable alliances of unions, capital owners and managers in certain industries — angle for public support by confusing the preservation of a given **structure** of employment with the national objective of a high overall **level** of employment. But we cannot raise the employment level if we insist on preserving old employment structures.

There is also a fear in Australia that overseas companies will import sharper labour-management practices than prevail in the sheltered Australian market. But if a foreign takeover injects new, more efficient work practices, then job security and the potential for income growth are enhanced.

IV. CONCLUSION

No plausible economic case can be made for restricting a free inflow of foreign capital. This is especially so since policy has given up on fixed exchange rates as an intermediate objective to economic stabilisation. Conditions have changed considerably since the late 1960s when the open door was closed.

Chapter 4

Rent Seeking and Income Distribution

Rent Distribution and Foreign Capital Controls

Mercantilist states have always seen one of their major roles as creating and distributing rents to a selected few among their subjects, ever since Elizabeth I of England and other absolutist rulers of the 16th and 17th centuries licensed merchant monopolies. The state — i.e. the ruler, the politicians or the bureaucracy — imposes a general prohibition on certain economic activities and then 'grants' licences to a limited number of merchants to engage in those activities. This has always had great advantages for the rulers, who gained prestige, power and income from licensing, and for those among the ruled who had access to the limited number of available licences, which granted them profitable quasi-monopolies. The big loser in this kind of state favouritism has always been the average citizen, who has to pay higher prices for the licensed products, live with the economic and political power of the licensees and the rulers, and suffer the consequences of slower economic growth and less job creation.

All this has been known since Adam Smith, but that has not stopped modern states from adhering to the Mercantilist tradition. In Australia everyone gets a 'fair go' — including those who underperform in the market. Regulations and interventions on behalf of supplier groups at the expense of the consumer and the general economic interest have been more widespread here than in America or post-war Europe. The result has cost the nation economic growth, effective competition, and ultimately economic welfare.

All forms of protection from international competition create rents. These rents consist of incomes shifted away from consumers and the general public toward relatively scarce production factors. The scarce production factors that benefit most from such controls tend to be Australian workers, the managers and owners of Australian firms, and the owners of Australian land. However, artificial redistribution favours their real incomes for only a limited time after controls have been imposed. In the longer term, the loss of economic growth exceeds the distributional gain for everyone, including the beneficiaries of controls (Kasper, 1983).

The 'distribution game' therefore reflects a short-term time horizon and a lack of long-term vision in policy making. In the long run, it makes us all poorer and less productively employed than we would otherwise have been.

Do Controls Secure High Returns on Savings?

Opponents of the free inflow of foreign capital often argue that increasing the supply of capital in Australia will reduce returns to Australian savers. In a strictly static sense and on the assumption that nothing else will change, this argument is true: a greater supply of savings lowers the price for saving. But, like most *ceteris paribus* arguments, it is misleading: in reality, we live in a dynamic world where more and cheaper capital creates its own new markets and growth opportunities. The marginal efficiency of capital is not static for long. Competitive, innovative entrepreneurs push it up and foreign investment directly adds to that competition. Higher capital efficiency raises the income of Australian savers.

While this argument is immediately obvious to an economist steeped in Austrian economics and capital theory, it is much less obvious to an Australian economist brought up in the tradition of short-term, *ceteris paribus* analyses à la Marshall and the Keynesian model, where the marginal efficiency of capital and productivity are assumed to be given. In reality, the efficiency of capital is determined by how competitively and cost-consciously businesses produce and invest. It is always a variable and should never be seen as a constant unaffected by economic policy.

The available evidence does not support the conclusion that foreign control of companies makes it less attractive for Australian savers to invest in them. Between 1971 and 1980, Australian investment in all foreign-controlled companies in Australia rose from 24 per cent to 34 per cent (Foreign Investment Review Board, 1982:33-34). Such an increase would not have been possible without the solid profitability of foreign-controlled companies, which have clearly offered Australian savers a welcome avenue for investment.

Do We Sell Out Too Cheaply?

Another distributional argument against the unrestricted inflow of long-term capital is that Australians might undervalue their assets when overseas buyers are offering high prices to gain control (Russell, 1978:202). It would be a sign of a bad post-colonial inferiority complex if Australians assumed that they were automatically less shrewd as investors in their own country than foreigners. In reality, there is no factual basis for the contention that Australians part with assets below the long-term earnings potential (for a few 'glass beads' offered by foreigners), making it necessary for the Government to monitor and control foreign investment. And even if Australians did systematically underestimate the earnings potential of Australian assets: Can one presume that bureaucrats can make a better informed valuation of assets than the market?

We must also remember that the voluntary transfer of assets from Australians to foreigners enhances the mobility of Australian-owned capital. It is very important that foreign takeovers enable Australians to invest in other ventures where they expect higher returns. Otherwise they would not sell their assets in the first place. If the market for assets is widened to include overseas demand, this benefits Australian capital owners. Controls that exclude foreign buyers often only prevent Australians from realising the full value of their assets and thus directly infringe on their property rights.

It is true that certain industrial assets in Australia may have relatively low market values and are therefore easy prey to foreign takeovers. This is because traditional Australian management has adopted practices that create high labour costs. Such practices are widespread in industries sheltered from international competition by high transport cost and government protection. However, high labour costs are not in Australia's national interest because they undermine our competitiveness and our economic growth potential. Nor are they in the long-term interest of individual workers, whose job security they erode. If foreign takeovers eliminate these practices, they benefit our economic interest.

Another reason for concern with foreign takeovers might be that foreigners buy up bundles of Australian assets and then 'pick out' the most profitable parts. However, there is no difference between takeovers by foreigners and by Australians in this respect, so that this constitutes no reason to control foreign investment.

In some cases it is argued that Australian businesses must use their profits from one branch to subsidise less profitable lines of business for the overall welfare of the country. This argument for cross-subsidation has been made in relation to Australian ownership of banking: it was said that only the highly profitable

'Martin Place business' enables banks to maintain adequate banking services in far-flung rural communities. Protection from foreign competition in banking thus grants a hidden subsidy to remote areas, whose continued economic use is held to be somehow meritorious. But it is doubtful whether the underlying assumptions of this argument are true. Genuine international competition in banking would probably lead to some streamlining of bank services. Unnecessary staff and subsidiaries would be eliminated, and this would contribute to overall productivity growth. But wider competition in the financial system is also likely to lead to improved technology, such as automatic tellers or telephone banking for remote communities.

From a national standpoint, there is no justification for underrating the value of the nation's productive capital by keeping foreign demand at bay. Realising the full value of our saved capital by exposing ourselves to world demand amounts to no more and no less than reaping the full material benefits of our resource endowments, our skills and our social stability. Controls that prevent a full valuation of Australian assets benefit only Australian bidders for assets, who might avoid paying the full world-parity price. This may explain why some big and expanding Australian companies favour controls against foreign investors. But the benefit is at best temporary: once these Australian bidders have acquired the assets in question, their interest will also be to value them at world-parity prices.

Governments Are Not Responsible for Private Profits

A tacit assumption often underlies the public discussion of foreign investment controls: that the government is somehow responsible for ensuring the profitability of private investments. This view may be based on the Australian notion that society owes everyone a 'fair go', even the capitalist who has made a poor investment decision. This social attitude probably has its socio-psychological roots in the very severe losses that nature and inexperience inflicted on many early pioneers in Australian history. But such social attitudes are not appropriate in a mature, developed economy like Australia's. The risks of losses and bankruptcy are part and parcel of the incentive structure of the market system. We have only to compare overall performance in countries where business failure is accepted, such as the United States or Hong Kong, and countries where some of these risks have been socialised, such as Australia and New Zealand.

Trying to contain individual business losses by some sort of social 'insurance' limits the efficiency of the market as a signalling

system. One of the great advantages of the market system over all other alternatives is the very powerful signal of red ink that shows that society does not want a certain product. Protecting investors against losses on the basis of vague notions of equity or social justice is like killing the nerves because we object to occasional pain.

In any event it is doubtful whether the government is able to ensure private profitability by intervention and, in particular, by intervention in international capital flows. The only way it could do so successfully is if it had superior foresight about developments in specific markets. Of course it does not. We therefore must conclude that open competition, new skills, know-how and technology, and a wider capital base — all brought about by foreign investor participation — enhance the potential for profit growth in the Australian economy. Forgoing this general benefit because the state wants to protect the profitability of individual firms only erodes overall national efficiency.

Is Mining a Special Case?

Observers who favour free capital mobility may still be inclined to accept the merits of controlling foreign investment in land and mining. They argue that mining draws on exhaustible resources, which are ultimately the property of the nation, and that exploitation of limited resources bestows rents that ought to be shared by the entire nation. Another side of this argument is that profit-maximising mining enterprises over-exploit the resources for short-term profit at the expense of the social welfare of future generations, making government controls the only way to overcome market failure.

But is mining really different from other wealth-creating activities? And if so, is foreign investment control a good and efficient way of capturing rents?

In a well-functioning, dynamic market system, 'rents' arise where there are shortages and bottlenecks. They are the market signal to pioneering entrepreneurs that an innovative, creative effort is desired by society to overcome the shortage. Joseph Schumpeter (1961) labelled these rents 'pioneer profits' and showed that they fulfil an essential role in society. In a well-functioning market system, in which government regulations do not artificially prolong shortages and thus ensure durable rents, new competitors will be attracted into a highly profitable activity. The initial pioneer profit will be whittled away by effective competition. In this way, innovative methods and products are introduced and their social desirability is tested. In short, wealth is created.

Such pioneer profits cannot fulfil their social role where it is impossible for entrepreneurs to widen the bottleneck. Even if extremely high demand pushes the market reward for producing another Leonardo da Vinci original higher and higher, there can be no constructive market response, for the supply of da Vinci originals is totally inelastic. Owners of da Vincis enjoy rising and durable rents. There is a tradition in economics, going back to the Physiocrats of the 18th century, that sees an analogy between the Leonardo da Vinci case and the limited stock of land and minerals. In recent years, 'Neo-Physiocrats' have provided the justification for special taxation and control of land ownership and mining.

But the analogy between da Vincis and minerals is not appropriate. It is true that in the short term shortages or bottlenecks can drive up the price of some mineral supplies and lead to very high profits for mining companies. An example was the post-1973 oil market. As in other fields of mining, the constructive response of the market — to **remove** the bottleneck by new supply or new substitutes — took considerable time, and pioneer profits for oil companies were fairly durable. But we now observe the pioneer profits fulfilling their expected social role: high oil prices led to expanded exploration efforts, some of which were successful. Old oil wells were tapped again and more costly extraction methods were used to obtain additional supplies. New oil extraction technologies were tried and further increased oil supplies. At the same time, high oil prices induced consumers to save scarce and costly energy and to search for substitutes. Over a wide spectrum of human effort, creative energies were mobilised to overcome the temporary oil botttlenecks by new technologies. Pioneer profits in the oil industry have begun to be eliminated in the normal competitive process of innovation. And we now discover that the world's supply of energy is not a fixed stock but rather is expandable by human intelligence and effort.

It is therefore an empirical question whether mining is a special case or whether we should treat it as just another industry in which pioneer profits occasionally occur and fulfil a valuable social function. Long experience has shown that the Malthusian notion of a fixed stock of minerals is inappropriate and that temporarily high mining profits have been whittled away by competition, just as pioneer profits elsewhere have been.[3]

If this is so, controlling mining entrepreneurs who might respond to high profits by engaging in more intensive searches for minerals

3. Indeed, the break in the underlying growth trend of the world economy has led to mining profits that have recently been below profits in other sectors. For the Australian evidence see Reserve Bank of Australia (1983).

and new exploration technology is counterproductive: instead of solving the problem of mineral shortages, it makes the problem more durable. Such interventions only convert socially constructive pioneer profits into long-term rents for those who happen to be established in existing mining ventures. Whether intended or not, the effect of controlling access by foreign capital to Australian mineral exploitation is to create and distribute rents, no different from similar interventions in other industries, which inhibit economic growth.

If the government decides that pioneer profits in the mining industry are too high for too long and that the response of new technology and exploration comes too slowly, it may decide to appropriate some of the benefits of mining through special taxes. That will slow down the constructive responses of the market further, but at least such special taxes on the results of mining do not hinder the expansion of mineral supply as clumsily as quantitative controls.

The issue of whether a profit-driven system leads to excessive mineral exploitation today at the expense of the opportunities of future generations has generated a long and detailed discussion ever since Hotelling (1931) showed in the 1930s that genuinely limited, known stocks of resources should increase in price over time at the rate of interest, just like any other useful asset. This price adjustment will be carried out by the market mechanism. Sometimes price rises according to the 'Hotelling pricing rule' turn out to be inappropriate because new stocks of resources are found or because new technology allows substitution away from a particular mineral, but market price adjustments can take account of the new information as it emerges. On no account do we have to rely on a process of investor control to ensure that our children will not 'run out of everything'.

Controls over foreign investment in mining are inappropriate and counterproductive as a means to capture rents. They only create and extend such rents and limit efforts to narrow gaps between mineral supply and demand.

Chapter 5

Nationalism, Socialism and Controls of Foreign Investment

Economic Welfare and Other Social Objectives

The analysis in the preceeding chapters has shown the economic costs of capital controls: lost growth and lost jobs, and rents distributed to the privileged and powerful rather than to those who perform well in the market place. But economic arguments alone cannot explain why governments control foreign investors. The nation may decide to bear the economic costs because of non-economic objectives that deserve higher priority. Yet rational policy making requires that the economic costs and the non-economic gains at least be spelled out clearly, so that conscious choices can be made.

Several non-economic objectives might be pursued, including national independence and security, and preserving a liveable environment — especially in the case of mining. In addition, there is the para-economic objective of promoting an equitable distribution of income, wealth and economic power — not according to performance in the market, but instead according to some desired equality of outcomes. Such socialist objectives often motivate campaigns against capitalists, including foreign investors.

What Is Australian?

The objective of national independence, including economic independence, is related partly to freedom and partly to security, which covers the intertemporal aspect of freedom of choice. It also pertains to a feeling of identity, of belonging to a select group set

apart from the rest of the world — similar to the feelings that were inculcated in us when we grew up as part of a family.

Understandably, new, exposed nations feel an urge to create their own identity by erecting fences around their domain. They may feel insecure and hence pursue inward-looking policies. We see such reactions in many newly independent developing countries or in nations that strive against the odds for a national identity, like Canada. To some extent, this trait is also present in Australia.

This is not surprising because there is no clear answer to the question: What is an Australian? Is a British-born resident who has lived 30 years in Australia but not taken Australian citizenship less Australian than a new immigrant who becomes a citizen after three years? What is an Australian company? A company that has operated in Australia for over 50 years — even though some of its major shareholders happen to be registered overseas? Is it more or less an Australian company if some of its directors are long-time residents but not Australian passport holders? Should company ownership be denied to an Australian citizen who resides overseas (as is media ownership)? Such questions highlight the dubious definitional basis for controls over foreign capital in an immigrant society like Australia. They also point to delicate issues that make some of the Australian foreign investment controls a bit farcical — especially when they are administered by recent immigrants or even non-Australians who hold public service jobs on the basis of their British citizenship.

The licensing of foreign investments is even less soundly based when we accept that what really matters is not ownership of voting stock but effective control. Effective control is often hard to discern for an administrator of regulations. Should a firm, 40 per cent of whose voting stock is owned by an overseas portfolio investor and whose affairs are directed by Australians, be treated as foreign and made subject to controls? Or should firms managed by Australian citizens but in fact controlled by a 10 per cent overseas minority stockholder be regulated?

Despite doubts about a precise definition of 'Australianness', Australia does not suffer from a national identity crisis. We are sufficiently set apart by distance, we are secure, and we should be mature enough after 200 years of existence on the Australian continent not to need artificial props like investment controls to assert our independence. The period of neo-Mercantilist nationalism has long passed among the industrial countries in the Northern hemisphere. They successfully overcame the nationalism of the 1930s by opening their doors in the 1950s and 1960s. These countries have subsequently benefitted handsomely from the internationalisation of their economies. The Australian economy is

now mature and strong enough to catch up and do without artificial economic barriers at the border. It is not appropriate for Australians to put themselves in a position of inferiority, to acknowledge a 'prevailing colonial mentality' or a 'fundamental diffidence in the Australian character' (Jones, 1982:222-223), or to seek security behind artificial barriers and controls like an immature, underdeveloped country.

National Independence Requires Wealth

Even if Australians were to value national independence and freedom enough to sacrifice some economic growth for it, we must keep in mind that no single social objective — freedom and independence included — can be achieved in the absolute. If it were, all other social objectives would be absolutely neglected.

We must also be aware that independence and national security depend in the long run on economic welfare. To illustrate the importance of economic growth to national security and independence, we can go through a simple back-of-the-envelope calculation: suppose that capital and trade controls, which economic nationalists promote, were to cost Australia only 0.5 per cent of economic growth annually. After a person's working life of 45 years, the difference in the national product would amount to nearly as much as the present national product.[4] Such a vast difference may at first seem exaggerated but economic history proves that it is not: differences in economic growth rates between Australia and the more open industrial economies or the new industrial countries of East Asia have widened. As a consequence, Australia has slipped from being one of the most affluent countries on earth to a fairly moderate ranking within the group of developed nations.

Poor economic growth undermines not only the national defence potential but many other important aspects of national security and independence as well (Kasper et al., 1980:206-207, 241-242). If Australia maintains xenophobic economic policies that cost economic growth, it will ultimately not be able to afford the resources to safeguard national security and independence. In addition, only openness to new ideas and international competition can ensure the continued creativity and vigour of our society. Economic openness is essential in this. Economically stagnant

4. Based on a current national product of about $160,000 million and a long-term growth rate of 2.5 per cent per annum instead of 3.0 per cent, which would be possible if there were no controls.

societies have always been confronted eventually by outside threats to their independence and have not had the material resources to ensure their long-run security. This is a lesson of history that short-sighted economic nationalists tend to overlook.

Technological Independence

The same lesson is overlooked by people mesmerised by the notion of 'technological independence': the idea that a country like Australia should be or could be independent of overseas technology. Wheelwright and Crough appealed to narrow nationalistic sentiments when they pointed out that 93 per cent of all patents lodged in Australia were foreign (Crough and Wheelwright, 1982:15; Wheelwright, 1984). However, technology today is international. Australians make up only 1.9 per cent of the OECD population, but contribute 7 per cent of the technically useful, patented knowledge that is used in this country. To shun technical knowledge simply because it is foreign or has been brought here by a foreign-controlled enterprise is economic masochism that retards growth and job creation even further.

Anti-Capitalism and Controls

There remains, finally, the argument that foreign investment promotes capitalism and a type of distributional justice that socialists find abhorrent. This is not the place to discuss the merits of distributing economic rewards irrespective of economic performance versus according to economic performance. But that choice strongly influences attitudes of people toward foreign investment. Many arguments against foreign investment — especially foreign **direct** investment — are dressed up in economic clothes but spring in reality from anti-capitalist motivations and the desire to transfer the idyllic and attractive solidarity of the family, where we all learnt to share, to a large, modern industrial society. Those who seriously study Soviet or Chinese efforts to implement socialism in a large society must conclude that the lack of information and solidarity in a society as large as a nation makes the competitive market system a much more efficient system of allocation if not the only feasible one (Hayek, 1978a,b, 1979). As we now know, even the most strictly controlled centrally planned economies have to rely on illegal or black markets for many allocational decisions.

Socialists who campaign against international capital mobility and for controls over foreign investment may succeed in annoying foreign investors, but this is only a side effect. The main casualty

is economic growth and competition. But genuine market competition is the only effective way to control capitalists and to ensure that their profit-motivated, self-interested efforts produce socially desirable outcomes. Controlling foreign enterprise merely strengthens the position of capitalists already inside the Australian market and allots rents to them.

Regulators, politicians, lobbyists, and the people who educate them often advocate capital controls and give the Mercantilist reason that the state loses power over business if capital is mobile (Crough and Wheelwright, 1982:29-30; Australian Labor Party, 1982:44-45). But these groups are the clearest net beneficiaries of such controls. After all, there is considerable prestige and gain in controlling and exempting from controls. Such power of the state makes for a totalitarian society and exposes us totally to the blunders of politicians and planners.

Growth or Ownership?

It is easy to gain influence and public consensus by controlling identifiable and unpopular groups, like 'the capitalists' and 'the foreigners'. But the ultimate question about direct government controls over foreign economic activity in Australia is this: What economic and social costs are we as a nation prepared to bear for the benefit of nationalistic or anti-capitalist gratification? What really matters is the long-term economic cost that becomes apparent only over a generation span and that we impose on our children. The real issue is not foreign ownership of equity, much of which will never leave Australia in any event. It is whether we will use all available resources — including foreign capital, know-how and management — to develop the growth potential of Australia, and whether we will manage to create sufficient productive jobs for our children.

Chapter 6

Australian Investment Controls

I. AUSTRALIA'S POLICY TOWARD FOREIGN OWNERSHIP

In the post-war period, Australian economic policy did not follow the general trend toward liberalisation that was so successful in the other OECD countries (Chapter 2). Australians tended to place less trust in market forces, including international competition. Despite the protection of product markets, Australia kept the door wide open for foreign entry into the factor markets for labour and capital. During the post-war period, Australia maintained a policy that welcomed and even actively sought foreign investment, except in some areas such as banking and civil aviation, which were reserved for national ownership. The open door policy for overseas investment was based on a long tradition and went largely unchallenged, although there had been concerns in the 1920s about the extent of fixed-interest borrowing abroad and the burden debt servicing might place on future balances of payments.

Closing the Open Door

The general and fairly unqualified welcome to foreign investment changed in the 1960s when Australian public opinion and policy became concerned with the extent and the consequences of foreign ownership and control. A new nationalism developed, as it did in Canada or Argentina. Australians also seem less sure of themselves in a competitive market place, and therefore rate the benefits of interventionism more highly than Americans or many Europeans.

Although this is not the place for a detailed description of the history of Australian foreign investment policy and present controls, a thumbnail sketch of both is needed to understand the problems that have arisen with Australia's foreign investment controls (for a very readable coverage of the history of foreign investment policy, see Arndt, 1977; also see Anderson, 1983:ch.4; Sexton and Adamovich, 1981).

Up to the mid-1960s, foreign investment was not a political issue. The inflow of long-term investment funds was subject only to general foreign exchange control by the Reserve Bank of Australia. It was widely acknowledged that foreign capital and enterprise were crucial to Australia's development into a modern industrial nation within a comparatively short time span. Indeed, governments actively encouraged foreign direct investment, often by providing tariff protection that ensured artificially high profits (and wages) in the protected industries.

In the 1950s and 1960s, it became apparent that the small, protected Australian markets were saturated and that the opportunities for industry-driven growth, as well as for foreign investment, were becoming limited (Kasper et al., 1980:185-193). But at this time new opportunities arose to develop mineral resources; and the basis was laid for a new wave of foreign investment in natural resource projects. Foreign ownership in the mining industry increased from 27 per cent in 1963 to over 50 per cent by the mid-1970s (Anderson, 1983:76).

In the early 1960s, doubts arose in public discussion about the level of foreign ownership of Australian industry and about the national benefit of foreign-owned 'tariff factories'. Arthur Calwell, leader of the Australian Labor Party, called for a Committee of Inquiry into foreign investment. The Vernon Committee was set up to look into long-term economic growth in Australia and, among other things, it was given a reference to investigate the role of foreign investment. The Committee was chaired by the then head of CSR. In 1965 it presented its report that generally favoured tariff protection and, following this rationale, recommended controls on foreign investment: '... an increase above the recent level of "new" overseas investment is to be avoided if possible,' because the Committee noted nationalist feelings which 'cannot be ignored' (Committee of Economic Enquiry, 1965:285,288).

The Vernon Committee focused on short-term distribution effects of interventions in international trade and investment and underrated the long-term effects on economic dynamism and growth. The Committee — like much Australian public discussion since — believed that a 'scientific tariff' and selective controls over

capital inflows are appropriate instruments for redistributing rents from foreigners to Australians, so that Australia can gain 'net economic benefits'. This Mercantilist stance overlooked the overwhelming experience of the OECD countries in the Northern hemisphere during the 1950s and 1960s, namely, that the removal of interventions in trade and capital flows stimulates spontaneous growth in the market so that everyone — nationals and foreigners alike — is better off. The nationalistic-Mercantilist flavour of the Vernon Report (and the subsequent Jackson and Crawford Reports) was picked up by a few Australian academics but not by the general public — possibly because the average Australian was so remote from the experience of post-war liberalisation under OEEC/OECD auspices. In any event, the Vernon Report stands as the visible mark at the beginning of change in Australian policy towards foreign investment.

The international atmosphere during the Vietnam war and the renewed massive influx of foreign capital in the first Australian minerals boom created the conditions for an end to Australia's traditional 'open door' policy to foreign investment. Since then, there has been steady pressure for controls. Despite changes in the rhetoric, these controls have always had broad bipartisan support. Deputy Prime Minister McEwan (Country Party), who had promoted tariffs that gave foreign investors protected rents, warned in the late 1960s against free capital inflows, saying that 'we are selling off the farm to pay for the mortgage' (Crough and Wheelwright, 1982:3). The phrase was later echoed by ALP Minister Connor, who called for the Australian Government to borrow to 'buy back the farm' (buy out foreign capitalists). The ACTU argued for controls of capital inflows and outflows, and the Liberal/Country Party Governments of the late 1960s and early 1970s began to intervene openly in foreign investments (Arndt, 1977:136-138). In September 1969, Prime Minister Gorton stated that 'the Government expressly reserves the right to prevent foreign takeovers considered to be contrary to the national interest' (*The Age*, 1969).

Unease about ad hoc interventions and the new official view that not all foreign investment was beneficial led to a request to Treasury to explore the foreign investment issue. The Senate Select Committee on Foreign Ownership and Control was established, and it concluded that 'key strategic or sensitive areas (should be identified) where ... foreign investment should be limited or excluded' (Senate Select Committee on Foreign Ownership, 1973:5; Department of the Treasury, 1972; Russell, 1978; Swan, 1972).

During the 1972 election campaign the ALP appealed to nationalist sentiment. In this atmosphere the McMahon

Government introduced the Companies (Foreign Takeovers) Bill 1972, which was adopted by Parliament. The Act introduced a screening mechanism for foreign direct investment. Although subsequent administrative unease with this mechanism is reflected in numerous changes to the Act and the bureaucratic-advisory set-up to implement it, all Governments since have maintained the essential features of the intervention mechanism set up in 1972.

The Whitlam and the Fraser Years

During the Whitlam years industrial policy was in disarray and business/government relations reached a low point. This was particularly true with regard to the nationalistic and socialist stance of the Labor Government toward foreign investment. Anti-foreign and anti-capitalist sentiments became particularly apparent in mining policy. Mining Minister Connor advocated policies that would ensure maximum Australian ownership, in particular ownership by big public enterprises. For example, he proposed a Petroleum and Minerals Authority to own a 12,000 km national pipeline network to replace coal in the industrial southeast of Australia by gas from the Northwest Shelf. As a result of such attitudes, 'direct investment from overseas in foreign companies based in Australia fell by more than 50 per cent between 1971-72 and 1972-73; inflow into mining declined much more' (Kasper et al., 1980:59). Most exploration came to a standstill, which affected the sluggish post-1975 recovery and the sudden rush into minerals in the early 1980s. The 'Whitlam effect' was also reflected in a dramatic shrinkage of Australia's share in the total foreign direct investments in OECD countries. While Australia had attracted 14.4 per cent of all these capital transfers between 1961 and 1973, that share dropped to 9.5 per cent betwen 1974 and 1978, the Whitlam and immediately post-Whitlam years (OECD, 1981:41).

The Fraser Government (1975-83) eased the rhetoric and changed policy implementation, but adhered to the new *Foreign Takeovers Act* 1975. Like its predecessor, it saw controlling foreign ownership of capital as a way to secure economic rents for Australian citizens. In 1976 the new Government replaced the cumbersome inter-Departmental Committees to advise the Treasurer on foreign investment with the Foreign Investment Review Board (FIRB), which was composed of two businessmen and one full-time Treasury official. The Foreign Investment Division of Treasury (FoID) was to serve as the secretariat for the new institution.

This administrative set-up and basic control philosophy have been maintained since then, also by the Hawke Government elected in 1983. But there have been some substantial changes in policy

implementation. Foreign investment, especially in the minerals sector, has played an important part in the modest recovery of economic growth since the mid-1970s, and capital inflows into Australia have accelerated dramatically even after allowing for inflation (Table 1). However, the share of foreign direct investment in total foreign investment has fallen steadily from 78 per cent in the early seventies to 23 per cent in the early eighties. Australia now seeks foreign capital mainly in the form of loans, despite the fact that the high real interest rates of recent years make loan capital now more expensive than it was in the 1960s and early 1970s.

Table 1

FOREIGN INVESTMENT IN AUSTRALIAN ENTERPRISES

Annual averages in constant 1979-80 prices[1]

	1971-72 to 1973-74		1974-75 to 1976-77		1977-78 to 1979-80		1980-81 to 1983-84	
	$m	share(%)	$m	share(%)	$m	share(%)	$m	share(%)
DIRECT INVESTMENT								
Equity[2]	}	}	129	8	39	2	205	3
Undistributed income	1431	78	737	44	924	39	150[4]	2
Liabilities + borrowings	}	}	255	15	534	23	1085	16
Subtotal	1431	78	1120	67	1497	64	1440	21
PORTFOLIO INVESTMENT AND INSTITUTIONAL LOANS								
— Equity in Aust-owned enterprises[2]	}	}	−64	−4	250	11	}	}
— Equity in foreign-owned enterprises[2]	405	22	−12	−1	41	2	584	10
— Other borrowings	}	}	612	37	560	24	4164	68
Subtotal	405	22	536	32	851	37	4748	78
TOTAL[3]	1838	100	1660	100	2349	100	6189	100

1. Published current-price figures were corrected for inflation by using the implicit deflator for gross fixed capital expenditure.
2. 1971-72 to 1973-74, equity was included under 'liabilities and borrowings'.
3. Totals may not add due to rounding.
4. Excluding 1983-84.

Source: Australian Bureau of Statistics.

Public discussion reflected a number of concerns with foreign ownership and control, including its absolute size, its involvement in certain sectors (especially mining), and the resulting distribution of rents and economic opportunities between Australians and foreigners. These concerns were expressed by a wide range of the

general public, from the anti-capitalist left, which spoke of 'transnational corporate cannibalism' (Crough and Wheelwright, 1982:13), to big Australian businesses like CSR, which urged parliament to enforce the 50 per cent local equity rule (Crough and Wheelwright, 1982:27). And the Chairman of CRA, Sir Roderick Carnegie, warned on ABC television ('Faces of the Eighties') against 'our reliance on international oil companies for sources of capital' because this would create a future repayment problem and impair future economic and employment opportunities for young Australians.

The Fraser Government tried to reconcile these nationalist pressures with an economic growth policy in a way that could be called either hypocritical or highly sophisticated — depending on one's standpoint. Overseas, the Government projected the view that, unfortunately, some minimal constraints were necessary to ensure bipartisan support for growth by foreign direct investment; whereas at home, it presented itself as fostering Australian participation and control. The Fraser Government was successful in this strategy and the Hawke Government struggled to achieve the same public relations success, despite an ALP Platform that voiced much sharper anti-foreign investment attitudes (Australian Labor Party, 1982).

During the Fraser years, direct foreign investment accelerated considerably. Mining and investment recovered from the depressed level of the Whitlam-Connor era, largely because of higher mineral prices and because overseas industries were eager to gain access to secure supplies from Australia. In addition, considerable overseas resources went into the tertiary industries (Table 2).

Table 2

INFLOW OF DIRECT FOREIGN INVESTMENT IN AUSTRALIAN ENTERPRISES

Including profits retained by overseas interests

Annual averages, $A million[1]

	Mining + rural[2]	Manufacturing	Other industries	Total
1956-57 to 1959-60	66	497	231	794
1960-61 to 1964-65	118	707	457	1283
1965-66 to 1971-72	595	598	640	1833
1972-73 to 1975-76 (approx.the Whitlam years)	102	385	529	1016
1976-77 to 1982-83 (approx.the Fraser years)	433	371	707	1516

1. Converted to fixed prices by using the implicit deflator for private gross fixed capital expenditure (1979/80 = 100).
2. Predominantly mining until 1977-78, mining only since then.

Sources: Australian Bureau of Statistics, and Bank of New South Wales, *Review*, (July) 1976.

The Hawke Government

During the first months of the Hawke Government in 1983, there was considerable doubt about the future of foreign investment policy. The business community was aware of the ALP Platform and the Government appeared to tighten up controls, although the official rhetoric at home and overseas stressed continuity and revealed some anxiety not to repeat the policies that had lead to the capital flight of the Whitlam-Connor era. Many of its early foreign investment decisions spoke a rather assertive language. Of 47 applications announced in Treasury Press Releases between 5 March 1983 and February 1984, 36 per cent were rejected, often in an apparent reinterpretation of existing guidelines; and the Treasurer frequently gave only conditional approval. Whether this was a new line of policy by the Treasurer and his advisers who took a cue from the 1982 ALP Platform, or whether it was the consequence of a coincidental 'bunching' of difficult cases is not clear. More recently, since about August 1983, a more open attitude to foreign investment seems to be apparent, with a higher approval rate. One path-breaking approval increased foreign ownership to 100 per cent because economic benefits were deemed sufficient to justify this (APV Bell Bryant case); another decision allowed a 100 per cent foreign takeover although it was openly recognised that the economic benefits did not offset the loss of Australian ownership and control. In the latter case (acquisition of the Lane hardware business by the Emhart Corporation of the US), approval was granted after unsuccessful attempts to find an Australian buyer. It now appears that the Hawke Government does not want to tighten its foreign investment policy.

Much attention was focused on foreign investment in banking during the first year of the Hawke Government. The Campbell Committee had argued for deregulation of the financial system and for opening up Australia's highly protected banking industry on the grounds that such regulations reduce economic welfare. The Hawke Government appointed a new committee (Martin Committee) to look at banking policies in light of the new Government's objectives. The Martin Committee was much less competition-oriented than the Campbell Committee and recommended that the Government issue up to six new banking licenses, but that overseas owners be limited to 50 per cent of the voting stock of these new banks (Review Group, 1984). In August and September 1984 the Treasurer announced that applications for a number of new bank licences were being sought, including banks with substantial foreign ownership participation. More licences to trade in foreign exchange were issued, and the Government let it be

known that a rationalisation in foreign ownership of merchant banks would be approved almost automatically. This amounts to a move towards liberalisation in the financial sector. However, the banking industry will still be protected from genuine, open international competition. There have also been announcements (September 1984) that existing restrictions on foreign ownership of stockbroking firms will be eased. All this signals that some further liberalisation of the financial sector is intended, yet stopping short of full foreign participation.

In late 1983 Treasury modified the foreign investment *Guidelines*, but it became apparent in 1984 that an updated version of the *Guidelines* would not be printed. In essence, the ALP Government's policy continues the broad thrust of the Fraser Government with only a few modifications: more emphasis is to be placed on the 'opportunities test'; acquisitions of urban and rural real estate by foreigners will be more restricted; the Government will try to get agreements to a timetable on the 'Australianisation' of 'naturalising firms'; and even more criteria will be added to the catalogue of what constitutes economic benefit to Australians, e.g. scrutiny as to possible export limitations, business for Australian consultants and better resource utilisation (Department of the Treasury, 1983). However, calls for a general 50 per cent limit to foreign capital ownership of any one industry were not included in the new set of *Guidelines*. In the case of foreign bank entry into the Australian market, rigid rules for a 50 per cent Australian participation would — it was feared — lead to banks too weak to stand up to international competition, because there are only limited numbers of sizeable Australian partners in new banks available. So the 50 per cent limit will not be rigidly enforced.

All this appears to indicate a slight tightening in selected aspects of foreign investment policy, but it also indicates a clear rejection of the xenophobic thrust of the platform of the ALP when it was in opposition. The platform had spoken of 'increasing foreign domination' that 'endangers our national sovereignty' and reduces 'the authority of the elected government'. It had proposed that Australia reserve key sectors for exclusive Australian ownership and control, impose close monitoring provisions on multinational enterprises, and share in their international supervision, e.g. by United Nations bodies (Australian Labor Party, 1982:44-45).

II. HOW INVESTMENT CONTROLS WORK

Australia's current foreign investment policy (as of late 1984) is based on the *Foreign Takeovers Act* 1975 and is elaborated and expanded on in periodic ministerial policy statements, the

Treasury's occasional *Guide for Investors* and the annual reports of the Foreign Investment Review Board, as well as in the numerous case-by-case decisions that may or may not become widely known and whose basic rationale is often not fully provided.[5] These are administrative decisions made by the Treasurer as the result of confidential negotiations with private citizens, not decisions of judicial courts. This causes widespread uncertainty in the business community about which projects are permitted and which not. Uncertainty increased considerably after the Hawke administration came to power and after a number of decisions on foreign investment were seen by the Australian and foreign press as signifying substantial changes towards a more nationalistic policy (e.g. *The Australian*, 1983; *Far Eastern Economic Review*, 1983; *Australian Business*, 1983). With the benefit of hindsight we can see that these concerns were possibly exaggerated, but reactions to the perceived policy changes still reflected the shock of the Whitlam-Connor era, whose rhetoric was echoed in the 1982 ALP Platform.

The present Australian policy tries to minimise the conflict between economic growth and job creation, which require free capital inflows, and making sure that Australians share in the benefits, which is deemed to require controls. The policy of control applies both to foreign takeovers of established Australian businesses and to new business investments by foreign interests. The latter case is not covered by the law but by policy statements. The government relies on voluntary compliance, which was monitored through Foreign Exchange Control while it existed. Since late 1983 there has been no formal Foreign Exchange Control, only informal monitoring (which will show up sizeable capital inflows). In essence, the government has no sanctions for violations of its investment controls but relies on voluntary compliance.

Application for Permission to Invest

Foreign investment control is the responsibility of the Treasurer, who normally relies on the advice of the Foreign Investment Division of Treasury and the Foreign Investment Review Board, a quasi-independent body currently composed of five appointed citizens. Four of them have business or trade union backgrounds

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5. See: Australian Parliament, House of Representatives, *Foreign Takeovers Bill* 1975 (*Hansard* 22 May 1975), Hayden (1975), Lynch (1976), Howard (1978, 1982), Department of the Treasury (1982, 1983), and the Foreign Investment Review Board annual *Report* of various years.

and the fifth is a Treasury official known as the Executive Member. He heads the FIRB's Secretariat, which is the Foreign Investment Division (FoID) of Treasury and employs no fewer than 40 officers to control foreign investment. The main tasks of the FIRB are to give advice on general foreign investment matters, to promote awareness and understanding, to guide investors, to suggest amendments to policy, and to monitor the activities of foreign-controlled firms.

In practice, most applicants recognise the decisive influence of the bureaucracy in decision making. In any event, applicants are advised to turn directly to Treasury officials in the Foreign Investment Division. This is normally done through a government-relations specialist in big companies, or through go-betweens like accountants, legal firms or merchant banks. The costs of employing an adviser for informal and formal contacts (that may or may not lead to approval by the Treasurer) are estimated by businessmen to average between $20,000 and $50,000 per case. This does not include the cost of the management time of potential foreign investors or the target firms of a takeover. The time and effort needed for preparing applications to the FIRB and for informally negotiating with relevant Treasury officials (and politicians) are quite considerable, but — as we shall see in Chapter 8 — were not rated by Australian business leaders among the most serious problems caused by investment control. By contrast, the time lags in negotiations, estimated at two to six months, were considered a problem. Once a formal application is accepted, an official decision is made quickly in most cases.

Most businessmen who responded to our inquiries perceive these informal negotiations with Treasury officials as decisive, although they appreciate that the bureaucracy cannot commit itself in those contacts. The ultimate decision is with the Treasurer. At least those firms that are not in a position to apply top-level political leverage believe that applications without prior negotiation have a low success rate. The case of a British-controlled food group that filed an application on a take-it-or-leave-it basis and got an outright rejection is widely quoted in the business community. Applicants who want to be successful are therefore advised to go through the niceties of polite, informal negotiation with the bureaucracy. In the case of foreign takeovers, public companies must announce their intentions and private companies are asked to make their intentions publicly known. Apart from making these announcements, companies are advised not to inform the press while the negotiations last.

Experienced applicants to the FIRB go through the negotiation ritual even when they have obtained permission for foreign

investment at the political level. In our interviews with firms, the pattern was that big, well-established firms that will make repeated approaches to the FIRB tend to first approach the Treasurer, Prime Minister or other political contacts if their ventures are important. Quite a few firms rely on a political decision, often even before formally applying to FIRB. By contrast, smaller foreign investment projects normally do not go to the political level and are negotiated directly with officers of the relevant industry branches in the FoID who are delegated to do so. But even in this type of project some leverage can be applied by hiring a well-connected adviser from a merchant bank, legal firm or accounting firm. It is impossible for an outsider to tell how much of the leverage of specialised 'application getters' depends on helping to compile the relevant information and how much on 'playing' the right contacts.

The FIRB must be notified of investment projects if they result in foreign ownership and control, which is presumed to exist when 15 per cent of the voting stock is in the hands of one non-resident person or 40 per cent in the hands of two or more non-resident interests. Notification is required irrespective of whether the target firm is already foreign-owned. Thus, when Citibank planned in 1983 to exchange its 49.9 per cent equity share in CitiNational with the National Mutual Life Association in order to fully control Grindlay's Australia, these moves would not have led to any rise in foreign ownership (*Australian Financial Review*, 1983a). But the transactions were subject to foreign investment reviews and were subsequently rejected by ALP Treasurer Keating, in a move widely interpreted at the time as a harbinger of more stringent control by the Hawke Government (*Australian Financial Review*, 1983b, 1983c).

Foreign Control Defined

Foreign companies must file notification of projects that result in 'foreign control' (normally 40 per cent in the hands of non-resident interests). Exemption from review in these cases is usually granted for small ventures ($2 million or less in gross assets) and when foreign interests can demonstrate that they will not be able to exert control.[6] Foreign investments are subject to particular control measures if they will occur in sensitive key industries, such as finance, the media or civil aviation, which are covered by special legislation barring or limiting foreign participation. Insurance, mining and real estate are also subject to special controls, and there

6. This assumption does not apply to the mining sector where even very small ventures are examined.

are expectations that the food and drinks industry might in the future be declared as another 'key sector'. In these 'key industries', the government tries to enforce an industry quota of 50 per cent Australian ownership. Some businessmen expressed the general opinion that the share of foreign ownership of an industry was an important though unpublicised criterion for approving individual investment proposals. If foreign ownership exceeds 50 per cent in an industry, applications for further foreign takeovers were deemed by businessmen to have a low chance of success.

Controls also apply if established foreign-controlled firms expand into new activities with investments of $5 million or more. In this regard, it is not true that foreign companies, once admitted to Australia, are treated like Australian firms. As we shall see in Chapters 7 and 8, these limitations on the natural expansion of foreign-controlled companies were one of the most frequent criticisms of respondents to our questionnaire.

The Federal Government grants licences to non-nationals only for specific, narrowly circumscribed activities. This requires Treasury to continuously monitor the activities of foreign capital, and also highlights the questions — long debated in law and economics — of what is the relevant market and what are 'new activities'. In 1976, the Treasurer gave the fairly narrow though imprecise definition that an activity is described by a grouping in the statistical ASIC code (Lynch, 1976). In practice this may mean extremely fine distinctions between categories of the four-digit ASIC codes. For example, if a foreign-controlled bottler of gaseous drinks wants to use past profits to expand production and employment by bottling fruit juice, he may get a warning from the Treasury's FoID that this is a new activity and requires a renewed application. In interviews, businessmen were of the view that FoID had become more 'Napoleonic' in controlling business expansion of foreign companies. Such intervention is perceived by many long-established firms as an intolerable shackle on enterprise and competition, and it biases them towards taking their profits out of Australia. This weakens not only effective competition, but also job opportunities and growth.

Whenever a relevant case for foreign direct investment is filed, two distinct tests are made by FoID.

(a) It must be established that the proposed venture is not against the national interest; and

b) it must be established that the proposed venture cannot reasonably be taken up by Australian interests ('opportunities test').

The 'National Interest Test'

Treasury publishes guidelines indicating what factors are normally taken into account in the 'national interest test'. These include effects of the foreign investment on competition, prices and productivity; on technological change and skills; on market structure and product range; and on potential exports. The FoID also looks at implications for local processing of materials; export opportunities for Australian-made products; opportunities for Australian citizens to serve on boards of firms; research and development; royalty, licensing and patent arrangements; and effects on industrial relations and employment opportunities (Department of the Treasury, 1982:6-7). In 1983 the Hawke Government added further criteria, including opportunities for Australian consultants or contractors and whether a foreign takeover would lead to export limitations. This impressively long list of criteria for an informal cost-benefit analysis (of about 1200 formal applications annually) is supplemented by catch-all criteria, such as the effects on the Government's overall economic and industrial policies and even on national policies as a whole. It would be impossible to give weights to the various criteria. Treasury Press Releases are always avidly studied to detect the latest shift in the importance of certain criteria. In all of our interviews business leaders felt this long list gave the decision-makers too much discretion in advising acceptance or rejection of proposals. In particular, small businesses and legal firms were at a loss to understand the Treasury's rationale in determining what is 'not against the national interest'.

The 'national interest test' may involve not only FoID officials but also officials from other departments and government instrumentalities, e.g. the Tax Commissioner, the Trade Practices Commission or even the CSIRO (in a case where a CSIRO patent was involved). Such references are understandable since the FoID could not possibly acquire the wide range of expertise needed to judge all the criteria listed for foreign investment proposals. Given the wide range of possible interdepartmental references, the time lags in official decision making appear admirably short.

However, the delay to dynamic business development caused by capital regulations can be considerable and critical. Delays are widely seen as one of the biggest problems with Australia's capital control policy. A telling example of how systematic administrative negotiation and consultation can clash with competitive, innovative development was the application by CRA to become involved in the production of partially stabilised zirconia (PSZ). This case became public in August 1983 after the usual 30-day period for approval

had been extended by the Treasurer (*The Age*, 1983:21). It was one of the cases during 1983 that appeared to signal a dramatic change in official policy. The informed public was unable to understand why a proposal was not speedily approved that would enable Australian-invented technology with considerable market potential to be developed to production maturity in Australia. Other parts of the Government openly recognised the need to promote research and development in Australian manufacturing and to inject new growth industries into the declining industrial sector. The failure of the Treasurer to explain why he withheld approval for this novel venture within the standard 30-day limit was also widely intepreted as a sign that the Government does not understand that — in technological innovation where competition is keen — time is money. On 22 November 1983, it was reported that CRA had finally received approval for a joint venture to produce PSZ (*Australian Financial Review*, 1983d).

Businessmen also expressed considerable concern about the possibility that details of delicate business deals might become public because of references to other government departments. Some businessmen feared that this procedure might give a wide range of government departments a *de facto* veto over foreign investment proposals. While perceptions do matter, it is my impression that the public probably has an exaggerated view of the influence of a broad range of government departments on foreign investment applications.

Many businessmen also believe that future tax receipts play an important role in many reviews of investment projects. In particular, cases are closely examined where overseas companies might gain tax advantages over comparable Australian-owned companies. This might happen if foreign owners set debt-equity ratios with low equity and high debt financing by the overseas owner. Such a company's gross earnings would be used to a large extent to repay interest and principal to the foreign owner, leaving little profit to be taxed under the Australian company tax. In practice, the average debt-equity ratios of the industry are taken as a guide. Proposals where debt-equity ratios deviate greatly from the industry average attract attention. More generally, the concern with taxation matters suggests that one unstated purpose of foreign investment controls is to overcome imperfections in Australian tax laws.

The 'Opportunities Test'

The 'opportunities test' aims to ensure that potential Australian buyers are not 'crowded out' by foreign capital. Before a foreign

takeover is approved, it has to be established whether the target company could be purchased by a national. Australians, including competitors, are allowed to make representations against a foreign takeover. These representations are attached to the report that the FoID forwards to the Treasurer. If Australian interests want to bid, Treasury will put them into contact with the intending sellers. Australian offers to buy company shares will have to be made on 'reasonable terms and conditions', i.e. they will generally have to match the offer of the intending overseas buyer to be seriously taken into account when the 'opportunities test' is conducted.

This protection of Australian capital allows its owners to be more risk-averse than foreigners. For example, government regulation allows Australian investors to avoid providing venture capital for technological innovation or risking capital for minerals exploration. This is officially recognised in mining, where 100 per cent foreign-owned companies are allowed to take up exploration contracts. If they do not find resources, they bear the loss. If, however, they do find resources and plan to exploit them, the venture becomes subject to foreign investment control. Successful explorers are then faced with the rule that mining ventures must be at least 50 per cent Australian-owned and controlled, and they must find sufficiently capitalised Australian partners to be able to proceed. Given the limited number of Australian companies that are capitalised and equipped to qualify as eligible partners, this may allocate considerable short-term rents to a few Australian capitalists. This effect is probably welcomed by advocates of controls with nationalistic-Mercantilist ideologies; but it should not be welcome to the socialist/anti-capitalist defenders of capital controls because it benefits national capitalists.

Those in favour of controls argue that Australian companies are on average smaller than multinationals and thus less able to distribute their risks over a wide range of projects. But shifting risk away from them through government intervention affects their profit-risk calculations and inevitably means that they engage in fewer ventures or expect to earn higher profits. To the extent that this occurs, it denies the Australian nation as a whole the full utilisation of its potential for economic growth and job creation. Moreover, economic history has always shown that protectionism has adverse long-term effects by depriving the protected groups of competitive dynamism. The long-term health of Australian capitalism is no exception.

One issue that arises in connection with the 'opportunities test' is that FoID has to explore whether there are willing Australian buyers. Takeovers are announced publicly. The 'opportunities test'

has raised doubts in the public's mind about whether the confidentiality of applications can be safeguarded. Whether these doubts are justified or not, it is relevant that many businessmen identified this as an important issue. It is virtually impossible to remedy the problem as long as the 'opportunities test' is required. In any case, it explains why companies are somewhat cagey about sharing relevant information with FoID.

It is not absolutely necessary that a project pass the 'opportunities test'. Projects may be approved even if they fail this test and Australian buyers emerge. The Hawke Government has announced that the opportunities test will be given greater weight in future.

'Naturalising' Companies

During the 1970s when foreign capital controls were first widely implemented, companies that had been long-standing corporate citizens of Australia and had some Australian participation began to exert considerable political pressure to gain exemption from foreign investment controls. This led to the concept of a 'naturalising company'. The conditions for qualifying as a naturalising company are that at least 25 per cent of the company's voting stock is presently owned by Australians, that Australian citizens (not simply residents) constitute a majority of the board of directors, and that the company enters an undertaking to raise the Australian equity share to 51 per cent. Originally, the time in which this undertaking was to be fulfilled was open-ended. The Hawke Government has now announced a time limit on such 'honorary corporate citizenship'. Naturalising companies are still obliged to notify the FIRB of intended projects, but otherwise they seem to be treated like Australian-owned companies. Many observers who favour investment controls have been critical of this rather transparent modification of the basic principles of control.

Approval

If applicants for foreign investment have not heard from Treasury within 30 days, the proposal is deemed acceptable. However, Treasury has the right to give notice within the 30-day period that it requires a further period for investigation of 90 days (the total maximum is 120 days). Normally the Treasurer gives his approval explicitly and sometimes press statements are released. These press releases may or may not give full reasons for a decision. One gains the feeling that, in case of doubt, the principle of bureaucratic caution prevails over a commitment to transparency, especially when the Treasurer rejects applications. Confidentiality requirements are often used to avoid making more explicit announcements, even when

it would be possible to clear explicit public statements with the companies involved. A detailed explication of the reasons for rejection would help the public to understand the policy and would protect the Treasurer from rumours and possible misinterpretations.

Since decisions by the Treasurer are administrative, applicants normally have no right of appeal. Unlike many other administrative interventions in economic life (e.g. the Trade Practices Commission, which is supplemented by the Trade Practices Tribunal), foreign investment control decisions are final and not subject to regular scrutiny. The only realistic way of appealing seems to be to mount a public press campaign, engage political support, and then reapply. It is not surprising that the business community as a whole has a sense of being helpless subjects of regulation.

Chapter 7

Australian Capital Controls and the Concept of Transparency

It soon became obvious in our research that the crux of most complaints about Australia's foreign investment policy is its administration. One cannot design detailed regulatory policies on the assumption that they will be implemented by disinterested philosopher kings of the finest Platonian breed. Regulations have to work when they are implemented by normal, fallible human beings. That is why many idealistic schemes of social engineering end in administrative failure. Indeed, we frequently observe that quite plausible policies fail because they cannot be implemented as their designers had imagined. When this happens to market intervention policies, their advocates often claim 'market failure'. And we then come to observe 'administrative failure' - simply because certain problems are hard to solve by whatever mechanism we may design.

In the face of the administrative problems of implementing Australia's foreign investment controls, we cannot simply take refuge in Adam Smith's timeless observations on the practicalities of implementing Mercantilistic regulation — though they seem highly relevant. Neither would it suffice to confine the discussion to the best solution, namely total decontrol. We therefore decided to collect diffuse, often hard-to-obtain, piecemeal information about how Australian capital controls really work. This was done on the assumption that Australian controls over foreign direct investment will be in place for a considerable time in the future, simply because they are probably based on fairly wide-spread

public support and because the economic costs of these controls are not easily visible to the average citizen and voter.

Collecting and evaluating relevant information about how Australian foreign investment controls are implemented means dealing with a number of formidable obstacles, which have their roots in the very nature of how these controls are designed and administered. Dealings between businessmen and the FoID do not normally become public knowledge. And since the Treasurer's decisions on foreign investment proposals are administrative, they do not constitute 'case law' that creates binding precedents. Moreover, those bits of information that do become public may not always reveal the full story or may be biased towards the views of one side in the negotiations. After all, substantial commercial and political interests are involved, and the issue of foreign capital is an emotional one.

Transparency Defined

In 1983 the OECD issued a major report titled *Transparency for Positive Adjustment, Identifying and Evaluating Government Intervention* (OECD, 1983a). The report was written because it was realised that proliferating regulations in most OECD member countries impede economic initiatives and often have contradictory and unintended side effects on overall economic performance. Transparency is defined in the report as 'the extent to which the direct and indirect consequences of policies are made known to affected parties' (OECD, 1983a:9). Transparency is an essential ingredient of efficient and constructive government regulation.

Our research has shown that the Australian investment review process is not clearly understood by the affected parties. Despite the clearly formulated annual reports of the FIRB, a number of Treasury publications and fairly frequent press releases, the affected business community is frequently not sure what the policy really is. This confusion is promoted by the rather vague formulations in the Foreign Takeovers Act, which leave a wide scope for interpretation. And many aspects of foreign investment control are subject to policy only, where the scope for bureaucratic interpretation is very wide indeed. As a result, the policy on foreign investment control in Australia lacks transparency.

There seems also to be a perception in the business community that decisions on foreign investment change over time and differ between various branches of industry and various branches of the FoID that advise the Treasurer. The businesses subjected to regulation are inevitably confused. Detailed regulation that is meant to be flexible always faces that dilemma. And the confusion

seems to increase in proportion to the bureaucratic detail, the number of evaluation criteria, and the number of staff who have to handle the growing number of submissions.

It frequently seems that the Treasurer and his advisers do not analyse the full ramifications of their foreign investment decisions or the effects of an intervention beyond the first impact. Yet, providing this sort of 'transparency is one of the most important preconditions for positive adjustment policies . . . Comprehensive economic analysis alone can avoid the "fallacy of misplaced concreteness" where only the first impact . . . [is] . . . taken into account but not the final incidence' (OECD, 1983b:60-61). Of course, it is sometimes doubtful whether the bureaucracy could possibly know the full incidence of a complex regulatory decision — even if they tried to find out.

There are various other factors that make for poor transparency in Australia's present foreign investment policy. It is not always clear who really decides a proposal: the officials of the FoID, someone else in Treasury, the FIRB, the Treasurer, or another minister. Other government departments are involved in many investment reviews, and they may exert a *de facto* veto in specific cases.

Besides not knowing who really makes the decision, the business community does not always know what the rules are. Ministerial and administrative policy pronouncements are sometimes not very specific and have been changed over time. In addition, direct political intervention may override the recommendations of the FIRB on the advice of the FoID and may introduce yet further inconsistencies into the policy.

How to Shed Light on the Practice of Investment Control

One way to shed more light on investment controls would have been to conduct case studies. Some of the more interesting ones have been discussed in the press. The business leaders involved in such cases were candid and helpful in interviews, but the practical problem arises when it comes to documenting the evidence. Much of the relevant evidence on company files is private and is not willingly released by companies that will have to deal again with the FoID and the Treasurer. Businessmen who may have to apply frequently for approvals are aware that cases are treated with flexibility and that bureaucrats and politicians are only human beings who may not always be able to control instincts of vindictiveness. For this reason, it seemed impossible to adequately document relevant and often highly technical cases. The danger is

having to report anecdotal evidence in a way that would not lend itself to objective replication by other researchers.

Another obstacle to research in this area is that there are very few independently compiled statistics. The most relevant statistics available are those published in the annual reports of FIRB (e.g. FIRB, 1982). These data must be interpreted with caution. For example, the published statistics indicate that once an official application has been lodged, decisions are made in less than 30 days, including many unimportant decisions made in a few days. This creates the impression of admirable speed in decision making. However, the outsider may not know that decisive negotiations with the FoID normally take place before a formal application is even lodged. These informal negotiations often stretch over two to six months, so that the real delay caused by the regulations is not one month but closer to four months.

Because of these difficulties, this study proceeded in two stages: first, interviews were conducted with business leaders and other persons who have had practical experience in dealing with the FoID and the FIRB. Much of the information gained there colours the account in these chapters. We also held two seminars for business executives, where individual perceptions and experiences were compared. Information gained in these discussions was crucial input to the second stage of research: the development of a questionnaire that was to cover particular gaps in the available evidence.

The questionnaire (reproduced with results in the Appendix) was designed to elicit some details about the respondents and their exposure to the FIRB (questions 1 to 6), their perceptions of the key problems with investment control that had emerged in the preceding interviews (questions 7 and 8), their experiences with applications to the FIRB and evidence of whether controls discourage foreign investment (questions 9 to 11), their attitudes to controlling foreign direct investment (question 13), and judgments on possible policy changes (questions 14 and 15).

Chapter 8

Results of the Questionnaire

One hundred seventy questionnaires were mailed in February 1984 to companies likely to have had exposure to foreign investment policy over the preceding three years. We focused the respondents' minds on this period in a covering letter. Respondents were chosen from three groups of firms. About 50 of the 100 biggest companies in Australia were selected at random. The rest of the companies were selected from about 1000 members of the American Chamber of Commerce in Australia and from the Australian British Trade Association (ABTA). In the last two samples, some judgment was exercised about whether addressees might have had relevant experience. These samples contained not only firms that were directly involved in foreign investment proposals (either as new investors, target firms in a takeover or prospective acquirers), but also firms whose experience with the FIRB was derived from dealings on behalf of their clients, e.g. merchant banks, accountants or legal firms.

Ninety-three responses were received — a response rate of 54.7 per cent. Given the short response time (3-4 weeks) and general experience with such social science questionnaires, this rate has to be considered rather high and indicative of business interest in this matter. Of the 93 responses, five gave reasons why the particular firm did not want to participate. Eighty-eight respondents filled in the questionnaire.

Profile of the Respondents

Not surprisingly, the majority of firms and individuals that responded were foreign owned (78.3 per cent). But about one-fifth

were Australian owned, and their answers do not vary systematically from what foreign-owned firms had to report. The response rate among foreign-owned companies was higher — possibly a reflection of the fact that these firms are more deeply concerned with foreign investment policy and were keener to help introduce some measure of transparency in this area of regulation.

The vast majority of respondents had acted on their own behalf in their dealings with the FIRB; 11.5 per cent had acted on behalf of clients. But interestingly, nearly half of those who had contacts with the FIRB felt it necessary to seek the help of outside specialists (such as accountants, lawyers or merchant bankers) to cope with foreign investment control; and over 50 per cent sought political support to cover their dealings with the bureaucracy (refer to questions 5b and 6 in the Appendix).

Most of the companies we approached were not newcomers to the Australian scene: the average age of their operations in the Australian market was 36.5 years; only 8 per cent had been here less than six years; and more than 20 per cent had been corporate citizens of Australia for 50 years or more.

Our sample of respondents is fairly representative of the various sectors in the national economy, although mining/mineral processing and banking/finance were more heavily represented than their shares in gross domestic product (question 3).

Although we tried to identify a sample that was likely to have had recent and repeated contacts with the FoID and the FIRB, more than a quarter of respondents replied that they had had no such contacts, and hence dropped out of the sample for all subsequent questions. Of the remaining 72 per cent, about half had had fairly infrequent dealings with the FIRB; the other half had had more than five contacts over the past three years. A substantial minority had dealt with the administration on more than ten occasions over that period. We conclude from this that our respondents have had sufficient exposure to the regulation of foreign investment to offer well-founded judgments and perceptions.

Gaining objective information through such a questionnaire has its limits. We had no control over who responded and do not know whether those who volunteered to respond were biased compared to the business community as a whole. However, the evidence cannot be dismissed despite obvious statistical limitations. Moreover, confidence in the questionnaire replies was reinforced when the picture that emerged from the questionnaire answers was in line with impressions gained in the preceding interviews with businessmen, many of whom had supported their information with detailed but confidential documentation.

Practical Problems of Investment Control

Table 3 lists the main problems that investors perceive when they have to cope with foreign investment controls in Australia. This list of problems was derived from the earlier interviews, in which the issues in Table 3 were frequently mentioned.

Table 3

PROBLEMS WITH FOREIGN INVESTMENT CONTROLS:
Relative Importance

	Index*
Uncertainty about the outcome of applications	227
Lack of clarity about the rules on foreign investment	173
Delays in negotiations and decision making	167
Imposition of unacceptable conditions for approval	156
Uncertainty because the rules are changing	155
Undue restrictions on Australian firms that want to sell	125
Doubts about confidentiality of business information (e.g. fear of cavalier treatment of business secrets by the FIRB secretariat when it contacts Australian interests to conduct the "opportunity test")	109
Gives undue business advantage to Australian-controlled firms	102
Difficulty in proving your case	91
Costs (including own management time)	87
Undue political interference	70
Unnecessarily antagonistic attitude of FIRB officials	60
Gives undue advantages to big, well-connected companies	47

*Respondents were asked to rate each problem as Highly Important, Important, Often Relevant, or Unimportant. The index was constructed by giving these responses the weights of 5, 3, 1, and 0, respectively.

The responses are weighted into an index and ordered according to the perceived importance of the problem. Lack of clarity about the rules, uncertainty caused by political and administrative changes in the rules, and consequent uncertainty about the outcome of foreign investment applications were the dominant concerns of investors. This is clear evidence that foreign investment controls as administered in Australia do not meet the most important principle of good administration and regulation in a democratic society, namely, transparency. No control can work well and achieve its purpose if it is not clearly understood by the concerned public (OECD, 1983a). Improvement in this respect must be high on the agenda of reform of foreign investment control.

Another problem that disturbed our respondents was that administrative procedures introduce troublesome delays into business dealings. In this respect, there is a clear clash between the cultures of business and Canberra. No less than 71 per cent of respondents identified delays in negotiations with Treasury and

decision making by the Treasurer as an important or very important problem. The average reported delay between a first contact with the FIRB or the FoID and the time when it is opportune to lodge a formal application was nearly three months (question 10). A substantial minority reported much longer negotiation lags. Fifteen per cent had to negotiate with the administration for four months or more. Of course, some of these delays are caused by the applicants themselves, who may change their minds in response to what they learn in the preliminary negotiations. Still, for whatever reason, a foreign investor must count on costly negotiations and uncertainty lasting on average at least four months in order to put capital into an Australian firm.

Another important problem respondents identified was restrictive conditions on approvals. In the interviews, we gained a clear impression that the number of conditional approvals has increased and that some conditions make the projects hardly worth pursuing. Such conditions will have more serious effects when the economic climate is less buoyant than in 1983 and 1984. An analysis of 25 cases decided by the Treasurer and covered by press releases between 5 March 1983 and late February 1984 (roughly the first year of the Hawke Government) showed that 32 per cent of approvals were conditional. Presumably, these conditions oblige the foreign investor to make certain arrangements against the best business judgment. Imposing conditions may give the administration the feeling that it has a real impact on economic life, but such conditions cost profits, jobs and economic growth. The consequences of this will in all likelihood become more pronounced as knowledge of these conditions becomes more widespread and other potential investors are discouraged before they start. Nor will potential overseas investors be attracted by the widely held view that controls give undue advantage to Australian competitors (see Table 3).

Considerable concern was expressed in interviews and through the questionnaire about confidentiality of business information. Individual firms expressed suspicions in interviews that officials of the FoID treated business secrets cavalierly, e.g. when they undertook the 'opportunities test' trying to find out whether a certain takeover might be made by an Australian company. We also learned of concerns with cavalier treatment of information by politicians and other government bodies. To some extent these fears were borne out by the questionnaire responses: only 28 per cent of respondents thought that this was an unimportant problem (question 7). In recent years, firms that supply confidential information to Treasury in support of an application must also face the prospect that their competitors or others will obtain this information under the Freedom of Information Act. Treasury has

gone to court to prevent disclosure in such cases, but it has lost.

Over one third of repondents also believed that negotiations with FoID exposed them to unnecessary scrutiny by other government agencies, e.g. the Tax Commissioner or the Trade Practices Commission. To the extent that such concerns are justified, they illustrate the well-known principle that government interference breeds more interference. In the interviews a number of businessmen expressed the view that the Tax Commissioner occasionally made comments on foreign investment proposals that were outside the strict letter of the law when he commented on the effect of specific business proposals on future tax revenues. This implies forecasts and guesses that cannot be proven and are not based on business data supplied for taxation purposes.

Relatively few respondents were concerned about undue advantages to big firms, difficulties in proving their cases to the FIRB, the costs of lodging an application (including the loss of management time), or an unnecessarily antagonistic attitude of Treasury officials. Although over 50 per cent of respondents at times sought political patronage for their applications, relatively few thought that political interference posed a problem. This may indicate either that Australian politicians are fairly accommodating when approached for help by businessmen, or that the business community on the whole accepts political interference in the handing out of investment permits.

Further Criticisms

Table 4 gives statistical backing to some further criticisms of foreign investment controls that had originally surfaced in the interviews. One of the most frequently heard criticisms was that the present controls limit the normal expansion of foreign-controlled businesses. Foreign-controlled firms hold licenses to operate only in fairly tightly defined markets and must apply for renewed approval if they want to invest more than $5 million of their profits made in Australia to expand into related but new product lines. Especially long-established British-owned businesses that want to reinvest their profits in Australia complain about this inhibition, which undoubtedly leads to the loss of socially valuable and constructive competition in many of the protected and cartelised Australian markets and sometimes encourages overseas-owned firms to take capital and earnings out of Australia. In our interviews, we came across various cases where this limitation had led directly or indirectly to disinvestments. In a number of cases, expatriate capital did not return to its original country but was invested in less xenophobic economies like the new industrial

countries of East and South Asia, where investment deals can be negotiated much more flexibly. Potential real income is thus irretrievably lost to Australians.

Table 4

CRITICISMS OF PRESENT CONTROLS

Frequency of affirmative responses in %

Do the present controls, in your opinion and experience,	YES(%)
— impose limitations on the legitimate expansion of your/your client's company (e.g. because foreign-controlled firms cannot expand beyond traditional markets without seeking renewed approval)	82.8
— inhibit the provisions of venture and risk capital in areas of promising market growth	71.9
— cost jobs and training opportunities for Australians	71.9
— limit competition (e.g. because foreign firms fear upsetting patterns of market shares)	68.8
— limit the introduction of technical innovations	60.9
— force companies into irrational joint ventures and messy management arrangements	57.8
— force overseas companies to sell below market value when they have to 'Australianise' some assets	53.1
— impose unnecessarily narrow limits on who qualifies as an Australian partner in a joint venture (e.g. sufficient capitalisation)	53.1
— allow Australians to 'rig' the market and/or to inhibit competitors	40.6
— unduly influence debt-equity ratios	39.1
— raise the price of wholly or largely Australian-owned companies	35.9
— expose your company/client to unnecessary scrutiny by other government agencies (e.g. the Tax Commissioner or the Trade Practices Commission)	34.4
— unduly constrain the hiring of top management personnel	18.8
— interfere with the ongoing management of businesses once they have been approved	12.5

Another problem frequently identified by businessmen was that overseas companies who pioneer ventures in Australia (e.g. in mineral exploration) are eventually forced to 'Australianise' some of their assets at less than what they consider the world market price. One reason given for this problem was that the number of eligible Australian partners is relatively small and eligible Australian companies are offered many more assets than they can take up. Thus they can bargain from a quasi-monopolistic position. Even granting that vendors are rarely happy with the price they get for their assets, we must be concerned that more than half the respondents thought this was a real problem (question 8).

Most respondents believed that capital controls inhibit the provision of venture and risk capital to areas of promising market growth. This is understandable because foreign investors feel they do not receive the full market value for their assets if they take the initial risks and are successful; and Australian investors are

guaranteed relatively risk-free opportunities by foreign investment controls. Why put your shareholders' funds into risky ventures when the government ensures reasonable growth opportunities in already developed ventures with proven track records? This conclusion that government protectionism by investment control or tariff secures sufficient rents to Australian investors seems fairly solidly based in economic theory. We certainly do not have to assume that Australians — out of 'a fundamental diffidence' in their character — are simply not prepared to take investment risks (Jones, 1982:223).

A substantial majority of respondents stated that foreign investment controls cost jobs and training opportunities for Australians, limit market competition, and restrict the introduction of innovations. As economic theory tells us (see Chapter 3), these three concerns are closely interrelated and help explain the comparatively poor performance of the Australian economy.

We invited respondents to comment on problems and experiences other than those referred to in the questionnaire. This produced a rich crop of observations covering the spectrum from praise to hostility. Some commentators stated that they 'never had any problems', that the officials in FoID were 'efficient and sensitive', 'correct and helpful'. But a considerable number were openly critical: 'They don't know the value of time', 'they are socialist, protective and not business-orientated', 'short-sighted', 'unrealistic', and 'inexperienced' are examples. A number of comments suggested that firms feared vindictiveness, that they had to be careful not to offend Treasury personnel, and that relatively inexperienced officials were often decisive in reviewing a case. Several commentators underlined that the existence of controls inhibited competition and allowed market and price domination by established Australian companies.

The 'Discouragement Effect'

One elusive effect of controls is that their very existence discourages entrepreneurial activity. Many people who could make a valuable contribution to job and wealth creation shy away when they are forced to apply for permits or study regulations. Those who quietly go elsewhere or enter the 'underground economy' are rarely noticed by the public and the regulators. Companies seldom make it known that they are disinvesting because regulations inhibit their scope for entrepreneurial expansion, as was the case when Volkswagen withdrew from Australia two decades ago.

It is hard to measure the 'discouragement effect' of controls, although much anecdotal evidence should deeply concern

Australians interested in economic growth and job creation. Australia's foreign investment controls discourage new ventures and the expansion of going concerns at various levels. First, some viable projects are never seriously pursued by internationally mobile entrepreneurs who do not want to operate in an interventionist economy and do not enjoy lobbying and other activities necessary for business success in a Mercantilist environment. Second, there are those who come and examine the Australian scene in consultation with some local businessmen or advisers but decide not to proceed with a planned investment. This type of 'casualty' does matter: 50 per cent of respondents had knowledge of many or at least a few cases where seriously interested overseas investors were turned away by the mere existence of investment controls (question 11). Third, many potential foreign investment ventures die in the offices of specialist advisers simply because these specialists know that certain applications are unlikely to be approved. Why invest money, time, expertise and commitment when Singaporean, Malaysian or Taiwanese authorities openly encourage foreign investment in their countries?

It is also relevant in this context that only 31 per cent of our respondents reported that all of the ventures they had seriously considered led to formal FIRB applications. A further 30 per cent of respondents reported that half or fewer of the ventures seriously considered ever made it to a formal application (question 9). It seems that many potential ventures are abandoned during the often decisive informal negotiations with Treasury, which precede a formal application. Less than one third of our respondents stated that all of their informal approaches to the FIRB and the FoID led to formal applications; and a remarkable 26 per cent reported that less than half the projects on which they had informally approached the authorities eventually led to formal applications (question 10). This implies a considerable informal rejection rate before projects ever reach the stage where the matter is dealt with officially by the Treasurer rather than the bureaucracy. It certainly suggests that Australian investment controls have a considerable discouragement effect.

In these circumstances, it is no wonder that the official rejection rate has traditionally been quite low. For 1981/82, the FIRB reported an official rejection rate of only around 4 per cent (FIRB, 1982:1).

Well over half the respondents (in February 1984) believed that foreign investment policy had changed under the Hawke Government (question 12), despite official assurances to the contrary (e.g. see Hurford, 1983:62-72). The consequences of this

change in perceptions for Australian growth and job creation cannot yet be fully determined.

Business Attitudes Towards Controls

The most surprising outcome of the questionnaire was that responding businessmen approved of some form of foreign investment control, despite their awareness of considerable shortcomings and problems with the present regulations. Anderson's observation (1983:19-22) about this apparent paradox is validated by our respondents. Most businessmen are quite obviously too pragmatic to share our conclusion that the best solution would be to do away with all controls and the FIRB.

Only 17 per cent of respondents agreed with the view that all foreign investment controls should be abolished if they cost long-term economic growth and job creation (question 13). Thirty-six per cent of respondents thought capital controls are necessary to prevent economic disadvantage to Australians. By contrast, a very large majority (83 per cent) agreed that it is only reasonable for the Australian Government to exert some control over foreign investment, although an equally large majority thought that there are better means than controls to ensure economic opportunities for Australians.

A minority of 23 per cent thought that foreign capital controls should be confined to the exploitation of exhaustible resources — a view with which, incidentally, 33 per cent of respondents from the Australian mining industry agreed.

Whatever the problems with the regulation of foreign ownership, the vast majority of businessmen seem to accept the controls imposed on them. Perhaps the Australian business community has the controls that it deserves (or secretly desires).

Views on Reforms

When asked to choose between three possible schemes for the control of foreign investment (question 14), 42 per cent of respondents preferred the present system of case-by-case evaluation. One quarter opted for a key-sector approach, which would be administratively simpler; another quarter wanted clear-cut 'black and white' statutes. Despite the uncertainties and delays that respondents saw as the most important problem with investment control, they favoured the case-by-case method in which such uncertainties and delays are inherent.

However, most respondents suggested some improvements to the present system of case-by-case assessment. Nearly all supported more frequent publication of guidelines and more explicit public

explanation of the reasons for rejections by the Treasurer (question 15). There could be problems with confidentiality if the Treasurer were to explain the reasons for rejections more fully, but this argument should not be used as an excuse for what is widely perceived as unnecessary secretiveness.

In view of the experiences reported by firms and the widespread concerns with many practical aspects of foreign investment policy, it is not surprising that a majority (55 per cent) would like the FoID of Treasury to have less discretion in its dealings with businesses. Presently, discretion in giving advice to the Treasurer is very wide. Advisers are faced with the nearly impossible task of having to weigh numerous, often conflicting factors in establishing what constitutes economic benefit, and then having to relate this to political objectives of national ownership and control of a business.

Chapter 9

Some Further Consequences of Investment Control

Like all government interventions into the decisions of private citizens, Australian foreign investment controls have a host of unexpected and cumbersome ramifications. Although this is not the place to describe the side effects of investment controls in individual cases, there are certain practical issues that must be mentioned. First, it is often not ownership (which is easily identified by regulators) but control of an enterprise that matters. If government intervention is based on ownership as the relevant variable further problems arise, e.g. controls may be circumvented, and it may be difficult to determine the 'just price' for certain assets. There are also concerns that government intervention may be biased in favour of the big, well-connected and well-versed company as against the inexperienced one-time applicant and the small firm. Furthermore, we cannot disregard altogether the morality and equity aspects of these interventions and the general social costs of such political and bureaucratic interference.

Ownership versus Control

What matters for most practical purposes is the control of companies — not some share in the ownership of the voting stock. But control is frequently very difficult to determine for outsiders, including the bureaucracy that intervenes to ensure some equitable share of the business for Australians. Minority shareholders may have influence far beyond their share in capital stock, e.g. because they hold formal or informal control over technology, market access or management expertise. On the other hand, some foreign

investors may treat their Australian investments as portfolio items, leaving the running of the business largely to their Australian partners and managers.

Many international companies prefer decentralised management structures because they have found from experience that decentralisation suits their particular business best. Once one gains some insight into the Australian operations of multinationals, one cannot but be impressed by the weight of decision making that is left to the 'local boys'. If these companies were run by telex from New York — as some of the xenophobic folklore would have it — they would not be able to attract the necessary local management talent nor retain the dedication of creative managers. In the day-to-day life of many multinational businesses, it is not always clear whether certain controls run from the centre to the subsidiaries, or whether the subsidiaries exert considerable control over the centre. Many companies in the old industrial countries gradually transfer their business to new locations like Australia and gradually relinquish control to the managers in the new locations once they have proven their worth. And in a team effort, the location of control often does not matter anyway. But how can a young Canberra official, looking at an investment proposal, disentangle the sociological and psychological web that determines *de facto* control?

The issue of control also raises the almost philosophical question of who is an Australian, touched upon above. Whatever dividing lines may be invented are open to dispute and are somewhat artificial in a nation like ours, which has taken a bigger percentage of immigrants since 1945 than any other nation except Israel. Uncertainty about what really is Australian is certainly not a good reason for turning to the bureaucracy to create artificial boundaries where in reality there are smooth, gradual transitions.

Circumventing Controls

Where controls create an opportunity for legal or illegal gain, that opportunity will be taken. Wealth can be passed between parties not only in the form of asset transactions (which may be subject to investment control by the Treasurer if they involve foreigners), but also in the form of current transactions. For example, long-term sales contracts imply transfer prices different from market prices. The term 'buying a Koala skin' is well known in the business community. It describes agreements by which Australians give foreign firms a sufficient Australian ownership identity so that they qualify for the Treasurer's approval to come into Australia or approval is not required at all. In exchange, the

foreign firm provides advantageous long-term sales or employment contracts. It is in fact quite easy for a foreign investor to take over an Australian firm without the Treasurer's approval, if the Australian-owned company is agreeable. Mutually beneficial private arrangements can be made. For example, the Australian partner may concede *de facto* control over a branch of the firm to a foreign company in exchange for a profitable long-run sales agreement for his products. Or a retiring businessman may concede control to a foreign minority partner in exchange for a lucrative but not very onerous long-term contract as an adviser. In certain circumstances, all this is perfectly legal.

Such transactions may also involve illegal transfers, e.g. distorted transfer prices in export and import deals or exaggerated fees for licences and services, whose sole purpose is evading high Australian taxes. Capital controls are a very poor substitute for more circumspect tax legislation.

The 'Just Price' for Assets

In most cases where a foreign investment proposal is assessed, the bureaucracy has to make implicit or explicit judgments about the value of business assets. Where market prices are known or where alternative bidders can be found, this is not a major problem. But in many instances it is extremely difficult for people outside the business to estimate an asset price. Normally, the value of an asset is its yet untested future profit potential. How can Treasury officials assess future profits? What assumptions should they make in such forecasts?

This problem can be illustrated by an example that arises frequently in the mining industry. As we have seen, risky exploration may be undertaken in Australia by foreign-owned companies that have no Australian participation. If these companies are successful in establishing and assaying a mineral deposit, they are normally forced by our foreign investment policy to enter into a partnership with Australian firms before they invest in developing the mine. Before major investments into mining development are made it is customary to seek long-term sales contracts for the minerals. If a foreign-owned mining company approaches the FoID of Treasury for approval for a joint venture with Australian partners, the thorny issue arises of how to value such a long-term sales contract. It may be very valuable in certain circumstances and may thus greatly increase the capital share of the foreign joint venturer. But if the market turns, the contract may be virtually worthless. How is anyone to establish in these circumstances what constitutes a 50:50 ownership that qualifies

under Australian foreign investment policy?

This is but one example of many problems in asset valuation that are virtually unsolvable and certainly unprovable, and that ultimately require almost arbitrary decisions by the Treasurer and those who advise him.

Controls and the 'Foreign Investment Club'

In our interviews we noticed certain potential biases towards big firms. However, the majority of respondents to our questionnaire did not believe that controls created a problem by giving big firms an advantage. Despite this, the existence of controls does create fixed costs for firms irrespective of their size. Controls are always changing. It may even be hard to find out what the rules are, making it necessary for firms to invest in research to keep their knowledge up-to-date. In a small company this may cost the valuable management time of the key manager, whereas big companies can follow the development of government controls through their 'government relations department'. The relative impact on profitability may therefore vary dramatically between big and small firms in a control-ridden environment.

Controls create influence, not only for the controller but also for those in the controlled firms or their outside advisers that become the experts on controls. Just as Australian wage arbitration has created a fairly exclusive 'Melbourne arbitration club', so have foreign investment controls created a club of influential insiders. The members of that club include certain politicians who may be called in to help and whose party may thus gain good will with business, bureaucrats who owe their jobs to the controls, and the managers of firms that seek approval for projects. Managers who can return from Canberra and report to an eagerly waiting meeting of fellow directors what they discussed with the Prime Minister about a project that is to go before the FIRB receive an inestimable boost to their prestige and ego. The 'club' also includes legal advisers, accountants and bankers, whose role it is to interpret the rules and latest modifications to paying customers and to lobby on their behalf. Mercantilist economies cannot live without such clubs, and as long as the economy is control-ridden they fulfil crucial functions. The question is how to value the social productivity of this arrangement as compared to a state of affairs without controls.

Controls and Social Equity

All government intervention that discriminates between people raises questions of equity and natural justice. We may of course be

more tolerant if controls discriminate against foreigners. This is probably one reason why tariffs and foreign investment controls are widely accepted in Australia. But controls at the international border also discriminate among nationals, which raises some intractable questions.

When a small entrepreneur wants to sell out before he retires, is it equitable to limit the market for his assets to Australian buyers? A foreign bidder might pay him much more for the life-time effort of setting up his firm.

Is it equitable that an Australian partner in a part-foreign firm should find fewer and lower offers from overseas when he wants to sell out because his sale to a foreigner would attract a foreign investment application? Minority shares in wholly Australian firms are frequently made more valuable by foreign investment controls because they can be sold overseas without the need to undergo a foreign investment review, whereas a similar sale in a part-foreign company may push the transaction into the purview of the Foreign Takeovers Act (i.e. when more than 15 or 40 per cent of the assets are already overseas-owned — see Chapter 6).

What is the rationale of imposing controls that do not give all Australians equal opportunities of benefitting from them? Policies that favour 50 per cent Australian participation in banks are of no value to any but a few big and highly capitalised Australian partners and possibly those Australians affluent enough to own shares in them. Only relatively rich Australians will benefit from many of the well-meaning interventions to promote direct Australian participation in banking or large-scale mining.

What is the social equity of controlling real estate investments by foreign-owned general insurance companies that want to channel Australian contributions into Australian real estate? They are prevented from doing this because real estate purchases by foreign-controlled general insurance companies are considered an expansion into new business and are proscribed by controls.

What is the social equity of discriminating between two long-term corporate citizens that employ Australians, simply because one of them has some ownership ties with a headquarters overseas? Australian workers are disadvantaged if controls prevent the introduction of foreign technology or negate the export market access that a foreign takeover may offer. Shop stewards of a number of firms have come out strongly in favour of foreign takeovers, because they saw that this would enhance job security.

What is the equity of imposing severe uncertainties on the careers of Australian staff during long, drawn-out negotiations over a foreign investment proposal? It is no secret that firms whose future is in balance while they await a decision from Canberra tend to lose

staff. Those involved in preparing or making foreign investment decisions do not always realise the human cost, the uncertainties over careers and the job insecurity they impose on fellow citizens during the process of public scrutiny of a project.

What is the morality of imposing controls that frequently cannot be enforced? What is the morality of rejecting certain applications when other foreign-owned companies — out of ignorance or chutzpah — can get away with not applying for government permission to do the same thing? We found a case where one control-conscientious foreign company applied for approval to expand into new business, whereas its equally foreign-controlled competitor simply went ahead and was never noticed by the authorities. Companies that cannot read all the regulations in a control-ridden economy are apparently better off.

Such nagging questions concerning the social equity of controls can be easily dismissed as moralising and inappropriate to business policy. But historic experience has shown time and again that governments and bureaucracies cannot dismiss such basic equity considerations for long if the entire social fabric and the respect for the state is not to suffer. Overregulation contains the seed of anarchy.

Chapter 10

An International Perspective

The Australian public and the business community sometimes seem to believe that Australian foreign capital controls are roughly in line with those of other countries and in many respects less restrictive. Much depends on the basis of comparison. If we compare Australian foreign investment controls with those of newly independent, less developed countries or Canada, we can indeed be satisfied that our controls are fairly liberal.[7]

But if we compare Australia to other developed countries in the OECD, quite a different picture emerges (Table 5). As mentioned in Chapter 2, OECD countries adopted a code for the liberalisation of international capital flows in 1961 and have since opened the doors considerably for international investors. Most industrial countries now do not have controls on foreign direct investment comparable to Australia's.

OECD countries fall into three categories as far as foreign investment policies are concerned (OECD, 1982b:20-35):

Group A: The United States and most European countries either do not require any authorisation for foreign investment or grant it freely, except in a few circumstances like the defence industries or some key sectors like post and telecommunication. The governments of these countries actively encourage direct foreign investment.

Group B: France, the Scandinavian countries and Japan adhere to the spirit of the OECD liberalisation code but have made fairly

7. D.L. Anderson (1983) came to the conclusion that Australian controls look fairly liberal compared to those of Canada.

Table 5

RESTRICTIONS AND REGULATIONS OF DIRECT FOREIGN INVESTMENT:
A Summary for International Comparison

(as of mid-1981)

General adherence to OECD Liberalisation Code	Procedure for foreign direct investment	Treatment of establ. foreign firms (different from local firms)	Specific restrictions on local borrowing	Sectoral controls: Obstacles to foreigners	Sectoral controls: Exclusion of foreigners
AUSTRALIA Full reservation of national right to control.	Prior authorisation after case-by-case assessment.	Authorisation of take-overs by these firms. Authorisation of new businesses.	Incoming foreign interests cannot borrow. Encouragement of local equity.	Banking and other financial intermediaries, insurance, media.	Internat. & domestic aviation, Post & telecom, mail services, water & electricity & gas, distrib. of certain primary products, lotteries.
AUSTRIA Yes	Authorisations freely granted.	Nil	Share and bond issues examined.	Defence industries.	Real estate in some provinces.
BELGIUM-LUXEMBURG Yes	No authorisation needed, except takeovers by non-EEC interests.	Nil	Nil	Foreign exchange dealing.	Transport, Post & telecom, broadcasting, water & gas.
CANADA Does not adhere to OECD code (changed in 1984)	Prior authorisation of takeovers and new businesses reqd., granted only if it offers significant benefits to Canada.	Need permission to expand into new activities.	Nil	Approval to broad-casting, mining in NW Territories. Licences for banks on reciprocal basis. Oil and gas.	
FRANCE Yes, sectoral reservations	Prior authorisation for non-EEC investors for large investments. Applications (normally) by EEC investors.	Nil	Authorisation of loans at initial establishment.	Primary industries, mining, real estate, transport, finance, publishing, hotels.	Public order, health, security, defence industries, Post & telecom, alcohol trade, transport, lotteries.

GERMANY Yes	Nil requirement.	Nil	Nil	Banks to register for legal supervision, civil aviation.	Post & telecom, broadcasting.
ITALY Yes	No prior authorisation, registration for foreign exchange purposes.	Nil	Foreign exchange controls on loans and share issue.	Ships & aircraft ownership, scheduled civil aviation, bank headquarters, licences for insurance.	Post & telecom, electricity, gas, water, nuclear energy, roads and transport, TV, lotteries.
JAPAN Yes	Prior notification and automatic approval, if public interest safeguard is met.	Nil	Nil	Primary industry, mining, oil, leather industry.	Broadcasting, cable TV, aviation, coastal shipping, Post & telecom, tobacco industry, salt industry.
NETHERLANDS Yes	Nil requirement.	Nil, acquisitions of share comp. by public offer supervised.	Bond issue subject to licence.	Transport, banking, insurance.	Post & telecom, railways & buses, electricity, gas, water, broadcasting.
NEW ZEALAND Full reservation	Prior authorisation for takeovers, case-by-case assessment.	Authorisation for subsequent takeovers required.	Prior authorisation required.	Fishing.	Post & telecom, rail & air transport, electricity, broadcasting.
SWITZERLAND Yes	Nil, except that joint-stock comp. must have majority of Swiss resident directors.	Nil	Limits on security issue in money market.	Real estate in certain areas, oil & nuclear energy, transport, banking, insurance.	Scheduled passenger transport, telecom, alcoholic beverages, armaments, broadcasting.
UNITED KINGDOM Yes	Nil, reserve powers for defence reasons.	Nil	Nil	Air transport, broadcasting, insurance.	Post & telecom, electricity, water, gas, rail transport, coal production.
USA Yes	Nil requirement.	Nil	Nil	Land-ownership in some States, coastal shipping, electric power, communication, uranium mining, fishing, banking, insurance.	International shipping, domestic aviation, broadcasting, nuclear energy, space satellite operation.

Source: OECD, Controls and Impediments Affecting Inward Direct Investment in OECD Member Countries (Paris: OECD, 1982), pp 20-35.

important reservations. The authorities must be notified of foreign investment proposals and prior application is required in a fairly large number of cases. The number of key sectors reserved for domestic investors or public monopolies tends to be higher and the policy in practice tends to be less open than in Group A.

Group C: Until recently Canada did not adhere to the OECD liberalisation code.[8] Australia and New Zealand adhere to it only formally, having reserved fully the right to intervene. Public authorities scrutinise virtually all proposed foreign investments, including the expansion of existing businesses to new areas of activity (something unheard of in the countries of Groups A and B). These governments impose a number of limitations on local borrowing by foreign-controlled firms, and have defined key sectors that are more or less reserved for nationals.

The information in Table 5 highlights Australia's position in a very small group of mature, affluent economies that are relatively interventionist by international standards when it comes to foreign investment. Australia does not share the spirit of capital liberalisation that prevails in most developed economies. It is true that Australia has been able to attract fairly large capital investments from overseas despite these controls, but it would have attracted more and cheaper resources without them. International comparison also makes it clear why foreign investors often show great impatience with Australian investment controls. They are not familiar with such controls in their home countries and assume that OECD countries do not make general reservations to the Code of Liberalisation the way Australia does.

The example of the OECD countries that have been more open to foreign investment than Australia shows that international competition for capital and free capital inflow can raise living standards considerably. The most dramatic example of this is probably Switzerland, where even the passing visitor can see how pleasant it is to live in a society that has attracted much foreign capital and has thus lowered the cost of capital. The Swiss have shown that foreign capital need not endanger national independence, but can offer many jobs and amenities in the workplace and in private and public life. And the United States

8. In 1984 the new Canadian government deregulated foreign investment and — in a dramatic move — began to actively seek foreign capital. The Canadian counterpart of the FIRB was converted to an investment-promotion body, Invest Canada.

would not enjoy its high living standards without a long tradition of welcoming foreign capital, much of which has long become American capital. The economies of Singapore and Hong Kong appeared to have little hope and few assets in the mid-1950s, but they have grown into buoyant, creative and innovative societies within a remarkably short time and against formidable odds, in part because they attracted as much cheap, direct foreign investment, expertise and technology as possible.

The ultimate decision for Australians is whether they want to develop an open, competitive, achievement-oriented society or remain Mercantilistic, protected, and regulated, gradually and irrevocably overtaken by others, clinging to xenophobic attitudes and the illusory security of a wall of tariffs and foreign investment controls.

Chapter 11

Whither Foreign Investment Control?

The Deregulation of Foreign Investment

The time has come for a complete reappraisal of Australia's foreign investment policy. After fifteen years of practical experience with controls over the inflow of foreign capital, it is not clear whether the controls have achieved any of the objectives their protagonists had in mind in the late 1960s. The amount of foreign investment has certainly increased, and there have been no tangible benefits for the average Australian that one can attribute to the controls. Indeed, there must be serious concern that the controls have cost growth and jobs and have limited the structural flexibility of the Australian economy. An apparatus of considerable size and complexity has been built up to implement controls; and public controversy has not ceased as to their merits or otherwise.

Control of foreign capital was set up in the late 1960s when Australian nationalism was asserting itself and attitudes favoured interventionism. It has not been dismantled since because capital controls are seen by the broad public as measures against two groups — capitalists and foreigners — that are not all that popular and can be attacked easily without fearing excessive backlash.

But economic and social conditions have changed. Economic growth slowed in the 1970s and policies must adjust to changed conditions. A new climate of deregulation has been sweeping Western industrial countries. To some extent, the movement to let market forces replace government control has set the stage in which Australia could decontrol its financial system and open up the long-

protected banking sector to more international competition. It seems a logical progression from deregulated financial markets to the admission of free foreign competition in long-term capital markets. The floating of the Australian dollar has made it unnecessary to control short- or long-term capital flows to defend the exchange rate — a factor that may have favoured investment controls in the late 1960s.

In the present climate of deregulation, when decontrol of markets is showing positive results (from US airlines to the Australian financial system) and when none of the negative effects that protagonists of regulation and social engineering forecast are apparent, Australia should follow the British example by simply repealing the Foreign Takeovers Act and disbanding the Foreign Investment Review Board. The vague bipartisan support for investment controls would evaporate as readily as the support that once was claimed for the regulation of trading banks. In any case, public concern about the activities of multinational corporations as registered in public opinion polls is low and waning. Of 24 simple social and economic issues covered by the Gallup Poll, restricting multinationals has been rated as the least important, with only 4 per cent of Australians polled rating it as an issue (*The Bulletin*, 1984:27).

Some Partial Improvements

If policy makers are not prepared to go the best route of totally removing all foreign investment controls, at least some partial reforms to the present policy seem highly desirable.

Most urgently, the Australian Government must make the implementation of foreign investment policy more transparent. The purpose of the policy is not understood; the general principles it is based on are vague; and its implementation is inefficient and unnecessarily costly. It also tarnishes the standing of the Treasury in the business community, on which many other Treasury policies — e.g. taxation and monetary policies — have to rely for their effectiveness. Greater external transparency — understanding of the policy by the affected public — might result from greater internal transparency — research by the policy maker on the full-system effects of interventions. It is possible that such research is being carried out inside Treasury's FoID, but little has been published on the principles of foreign investment policy since Treasury Paper No. 1 over a decade ago. It would be helpful if officials were less cautious in explaining aspects of the policy to the public or in analysing the costs and benefits of the controls for the public's information.

It would also be desirable to update the published *Guidelines* more regularly and to issue regular 'practice notices', as is done in other areas of regulation. Transparency would also be enhanced if the *Guidelines* were simplified. For example, the long and expanding catalogue of criteria for the test on economic interest could be replaced by the requirement that a takeover proposal should not be in conflict with the general economic objectives of price level stability, high employment, adequate growth, external equilibrium, and equitable income distribution. The controversial 'opportunities test' should be abolished altogether to simplify administration, remove doubts about confidentiality and speed up decision-making.

Foreign investment control could be simplified by abandoning the case-by-case approach and by regulating only a limited number of key industries. One could begin with a list of key industries where foreign investment is regulated that is fairly long, with a view to shortening the list progressively once the success of deregulation becomes apparent.

It is urgent that the rules on 'new business' by old, established foreign firms be reviewed. Controlling the natural business expansion of firms that have been in Australia for a long time and want to reinvest profits made here conflicts with the sort of structural change, enterprise and competition that would return this country to adequate economic growth and high employment. As a first step to reform, the limit for a general exemption for investment into 'new business' could be lifted from the present $5 million. As a second step, the definition of what constitutes 'new business' could be widened, so that expansion beyond a given ASIC code is not automatically considered 'new business'. However, all such partial reforms raise problematic questions and underline the fact that the full benefits of growth and job creation can be realised only when new business by foreign-controlled firms is completely decontrolled. This in turn would require the decontrol of business by new companies.

At the moment, the Foreign Investment Review Board seems to have no great authority to give directives to its secretariat. It would be useful to strengthen the authority of FIRB over its secretariat, the Foreign Investment Division of Treasury. This could be done by making FIRB into a quasi-independent commission that advises the Treasurer directly. Transparency would be enhanced if advice on the **principles** of the policy (not necessarily the individual cases) from an independent FIRB to the Treasurer were made public, similar to advice from the Industries Assistance Commission. This would certainly enhance public awareness.

It might also be useful to have in the FoID a mix of civil servants

seconded from various parts of the government, and people with business backgrounds. Such a mix of expertise, which is quite common in certain regulatory institutions of the US Government, would introduce more business experience into the process of investment control and would surely enhance the internal and external transparency of foreign investment policy.

Because there is virtually no right of appeal against decisions on foreign investment matters, Australia's policy has a rather autocratic character. In this way it is different from other important regulatory activities. For example, the decisions of the Trade Practices Commission are subject to review by the Trade Practices Tribunal. An informal mechanism for quick appeals against the advice of officials or FIRB would remedy this shortcoming. Applicants should be informed of the advice to the Treasurer before he makes a final decision. This procedure would not relieve the Treasurer of his ultimate responsibility to make political decisions on foreign ownership.

Finally — Not to Lose Sight of the Best

The best solution to all the problems with controlling foreign investment would be for Australia to adopt the OECD Code of Liberalisation without reservations and to simply abolish all controls over capital inflows and outflows. There is no reason why Australia should not follow the example of other mature economies like the UK, the US, Germany, Switzerland or Canada. This would do away with the pretence that **political** benefits can be weighed against **economic** costs in foreign ownership. Nations that have adopted genuine open door policies towards internationally mobile capital have discovered that they can tap considerable resources for the benefit of their citizens. Capitalists — foreign and national alike — can behave in socially undesirable ways only if governments first grant them quasi-monopoly positions by protecting them in capital and product markets. Societies open to international competition tend to suffer less from concentrations of economic and social power, and therefore tend to be better societies.

Conclusions

This study has tried to achieve two objectives: to analyse rationally the arguments for and against controlling foreign direct investment in Australia; and to shed light on the present practice of administering controls over foreign investment.

We conclude that there are no rational arguments in favour of general controls of foreign investment. Australia can use its good credit rating, social and political stability and attractive living conditions to attract cheap and stable investment. To exploit its ample development opportunities Australia also needs expertise, technology and market access, which the 'foreign investment package' normally contains. It is only natural for a country that has long had a tradition of immigration also to favour the 'immigration' of the complementary production factor, capital. The flexibility of factor supply offered by capital inflows from overseas would enhance the constructive and competitive response of the economic system when new market opportunities appear and when social, economic and technical conditions change. Like the removal of tariffs and other artificial obstacles to international trade, the removal of controls over international capital flows could help Australians exploit the full growth potential of their economy and remedy the slow growth performance of the past.

While we found no good general economic reasons for controls (and considerable long-term costs to the community), we acknowledge that there is a political temptation to intervene in free international capital movements in the hope of securing rents for Australians at the expense of foreigners. This hope is founded on theories similar to the 'scientific tariff' argument, which is based on a purely **static** and short-term model of intervention and ignores the overriding **dynamic** effects of protection: any intervention distorts market signals and erodes the innovative creativity of private enterprise. The most serious cost of intervention is that the market economy loses its dynamism almost imperceptibly. The greatest contribution to social welfare that the market system can make is its spontaneous capability to create wealth and jobs and to exploit new opportunities where they arise. Australian experience supports the general observation that socially beneficial enterprise works efficiently only in openly competitive markets. In small industrial markets like Australia, this requires undistorted competitive impulses from the world market to domestic product and capital markets. This is why Mercantilistic arguments have costly

consequences. They stress possible short-run redistributional gains at the expense of long-run economic performance (Tullock, 1967).

Many economic and political arguments for controlling foreign investment are really only a cover to obtain government protection for rents that particular interest groups could not enjoy if they were exposed to free and honest competition. Australians have traditionally been very tolerant of particular pleading at the expense of the common economic interest. And they have paid the price of an overall economic performance that falls far short of the country's economic potential.

Mercantilistic arguments against 'selling out Australia' are compatible with nationalist attitudes that favour the protection of Australian society against foreign influences and aim to achieve national homogeneity and cohesion by protectionist means. But we have to be careful not to use nationalist sentiment as a mantle for rent-seeking at the expense of the national economic interest and economic opportunities for our children. It is particularly hard to see the rationale behind socialist pleas for capital controls. Although these controls may have the side effect of irritating some capitalists and multinationals, their main consequence is to make capital scarcer and to secure rents for Australian capitalists and those foreign companies that are admitted to Australia — and this at the expense of the worker and the consumer!

The discussion of how foreign investment controls are implemented shows that the regulation of foreign investment lacks transparency and is poorly understood by the business community. We found evidence of inconsistencies and numerous changes over time.

The ultimate judgment on the merits and costs of foreign investment controls depends largely on whether one shares the Mercantilist view that it is the state's role to license entrepreneurs to create wealth and jobs, or whether one adheres to the liberal view that it is the right of individuals to pursue their happiness by legal means, including seeking material gain. Those who favour the Mercantilist maxim will consider every permit granted to foreign investors as a contribution to Australian economic growth. This attitude is frequently revealed in official press releases on foreign investment approvals. On the other hand, those who share liberal views are bound to be perturbed by the restrictions to enterprise and economic progress that controls impose, and must be concerned with the inequities that regulations often cause.

It seems that the basic moral and economic problems that Adam Smith discussed are still with us!

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Appendix

QUESTIONNAIRE
ON CONTROLS OF FOREIGN DIRECT INVESTMENT

(Responses: 93; response rate: 54.7%)

THE QUESTIONS:	THE ANSWERS: %
1. Is your company	
— Australian controlled	20.5
— foreign controlled	78.3
— 'naturalising' (as defined by Foreign Takeovers Act)	1.2
— acting on behalf of clients?	11.5
2. How long has your company operated in Australia?	average: 36.5 yrs
3. Is your company predominantly engaged in	%
— agriculture	1.1
— mining/mineral processing	13.6
— manufacturing	38.6
— construction	10.2
— transport/communication	4.5
— banking and finance	18.2
— business services	17.0
— real estate	4.5
— other?	22.7
4. How often has your firm had contacts with FIRB over the past three years?	%
— never	27.3
— once or twice	17.0
— 3 to 5 times	23.9
— 6 to 10 times	15.9
— more than 10 times	15.9
5a. Have your contacts with FIRB been	%
— on behalf of your company	71.9
— on behalf of clients	15.6
— both?	12.5

5b.	If you ticked 'on behalf of your company', do you *normally* seek the assistance of specialists outside your firm when you explore joint ventures with FIRB?	
	No	55.6%
	Yes	44.4%
6.	When you deal with FIRB, do you seek to support applications by political contacts, e.g. with the Treasurer or Members of Parliament?	%
	— regularly	4.7
	— in more than 25% of all cases	4.7
	— in rare and very important cases	43.8
	— never	46.9
7.	What are in your experience important problems in having to apply to FIRB? (Responses are weighted according to the importance indicated: 5 = highly important 3 = important 1 = often relevant 0 = unimportant or don't know For details refer to Table 3 in text.)	
	— Costs (including own management time)	87
	— Uncertainty about the outcome of applications	227
	— Lack of clarity about the rules on foreign investment	173
	— Uncertainty because the rules are changing	155
	— Undue political interference	70
	— Delays in negotiations and decision making	167
	— Undue restrictions on Australian firms that want to sell	125
	— Imposition of unacceptable conditions for approval	156
	— Doubts about confidentiality of business information (e.g. fear of cavalier treatment of business secrets by the FIRB secretariat when it contacts Australian interests to conduct the 'opportunity test')	109
	— Difficulty in proving your case	91
	— Unnecessarily antagonistic attitude of FIRB officials	60
	— Gives undue business advantage to Australian-controlled firms	102
	— Gives undue advantage to big, well-connected companies	47

8. Do the present controls, in your opinion and experience,

	YES	NO	DON'T KNOW
		%	
— force overseas companies to sell below market value when they have to 'Australianise' some assets	53.1	32.8	14.1
— raise the price of wholly or largely Australian-owned companies	35.9	48.8	15.6
— allow Australians to 'rig' the market and/or to inhibit competitors	40.6	46.9	12.5
— impose limitations on the legitimate expansion of your/your client's company (e.g., because foreign-controlled firms cannot expand beyond traditional markets without seeking renewed approval)	82.8	9.3	7.8
— cost jobs and training opportunities for Australians	71.9	23.4	4.6
— limit the introduction of technical innovations	60.9	29.7	9.4
— limit competition (e.g., because foreign firms fear upsetting patterns of market shares)	68.8	20.3	10.9
— inhibit the provision of venture and risk capital in areas of promising market growth	71.9	20.3	7.8
— unduly influence debt-equity ratios	39.1	46.9	14.1
— force companies into irrational joint ventures and messy management arrangements	57.8	29.7	12.5
— unduly constrain the hiring of top management personnel	18.8	65.6	15.6
— impose unnecessarily narrow limits on who qualifies as an Australian partner in a joint venture (e.g., sufficient capitalisation)	53.1	32.8	14.1

	YES	NO	DON'T KNOW
		%	
— expose your company/client to unnecessary scrutiny by other government agencies (e.g., the Tax Commissioner or the Trade Practices Commission)	34.4	54.7	10.9
— interfere with the ongoing management of businesses once they have been approved?	12.5	71.9	15.6

9. Of the ventures with foreign participation that your company/client(s) seriously considered:

	YES (%)
— Have *all* resulted in applications to FIRB?	35.1
— Have more than 80% gone formally before FIRB?	28.1
— Have less than 50% gone formally before FIRB?	31.6

10. It seems fairly common that the relevant negotiations on foreign investments occur before FIRB receives a *formal* application.
    - What is in your experience the average time lag between the first, informal approach to FIRB and the lodging of the formal application? Average: 2.9 months
    - What percentage of cases on which FIRB was approached informally lead to a formal application?

	%
100%	31.0
80-99%	20.7
50-79%	22.4
less than 50%	25.9

11. Are you aware of seriously interested overseas investors that were turned away from investing here by the mere existence of capital controls?

	%
Yes, many	14.1
Yes, a few	35.9
None/almost none	43.8
Don't know	6.3

12. Have you noticed substantial changes in foreign investment policy and in the implementation of the Foreign Takeovers Act in the course of the past 12 months?

YES: 54.1%

13. Do you agree/disagree with the following statements?

	AGREE	DON'T KNOW
	%	
— It is only reasonable that the Australian government should exert some control over foreign investment.	82.8	3.1
— Controls on foreign capital participation should only apply where exhaustible resources are exploited.	23.4	3.1
— Accepting that controls impose costs in terms of long-term growth and job creation, Australian governments should abolish all controls over foreign investments.	17.2	7.8
— There are better means of ensuring economic opportunities for Australians than capital controls.	82.8	7.8
— If there were no controls over foreign capital, Australians would be economically disadvantaged.	35.9	6.3

14. If some form of foreign capital controls are to be maintained: Which control mechanism would you prefer?

	%
— A system of simple 'black and white' statutes	25.0
— The reservation of sensitive key sectors (like the media or transport) for Australian ownership/control	24.7
— A general screening process of all foreign investment with case-by-case discretion (similar to the present system)	42.2

15. If *marginal* changes in the present practice were possible,

	YES	NO	DON'T KNOW
		%	
— Would you prefer no change?	10.9	78.2	10.9
— Would you prefer less discretion for the Foreign Investment Division of Treasury?	54.7	32.8	12.5
— Would you prefer FIRB to publish up-to-date guidelines more frequently, e.g. in the form of 'practice notices' by other regulatory authorities?	89.1	7.2	3.7
— Would you prefer the public to be informed in greater detail of the rationale behind FIRB rejections of application?	89.1	3.1	7.8