

Chapter 9

Investment

9.1 Until recently, China has not been an attractive prospect for foreign investors. IMF analysts noted that:

Capital inflows, in particular, were minimal in the 1970s and 1980s, impeded by capital controls and the reluctance of international investors to undertake investment in a socialist economy with weak institutions and limited exposure to international trade.¹

9.2 The investment environment in China, however, has gradually improved as reforms designed to entice foreign investors to its shores have taken effect. Although China now promises more and better investment opportunities for foreign companies, especially through an improved investment environment, substantial obstacles exist that discourage foreign investors. This chapter considers the investment environment in China. It looks at China's policy toward foreign investment, the nature and extent of Australia's foreign investment in China, the barriers to investment in China, China's 'go global' strategy and its approach to investment in Australia.

Foreign investment in China

9.3 Although the Chinese government places a range of limitations on foreign investment,² it is making a concerted effort to attract and make better use of foreign investment. On joining the WTO, China undertook to take significant measures to reform regulations with regard to direct foreign investment. In 2004, China approved the establishment of 43,664 foreign direct-invested enterprises, an increase of 6.3 per cent over the previous year. Contracted foreign capital through foreign direct investment stood at US\$153.5 billion, representing a 33.4 increase.³

9.4 China has also promulgated laws governing foreign direct investment (FDI) that offer generous tax treatment for foreign firms.⁴

1 Eswar Prasad and Shang-Jin Wei, 'The Chinese Approach to Capital Inflows: Patterns and Possible Explanations', *IMF Working Papers* WP/05/79, IMF, April 2005, p. 1.

2 See for example, the Australian Industry Group, *Submission P63*, p. 7.

3 National Bureau of Statistics, *Statistical communiqué of national and social development in 2004*.

4 According to Eswar Prasad and Shang-Jin Wei: 'In the first two years that a foreign-invested firm makes a profit, it is exempt from corporate income tax. In subsequent years, foreign companies are subject to an average corporate income of 15 percent, less than half the normal rate of 33 per cent paid by Chinese companies'. Eswar Prasad and Shang-Jin Wei, 'The Chinese Approach to Capital Inflows: Patterns and Possible Explanations', *IMF Working Papers* WP/05/79, IMF, April 2005, p. 20.

9.5 Mr Harrowell, Hunt and Hunt Lawyers, noted that China has progressed through a number of stages since the introduction of the open-door policy. He stated:

First and foremost, whilst the door was open to foreigners, when they went through the door there was very little commercial infrastructure, there were very few corporate laws and a very unfamiliar, alien environment, if you like, for foreign investors. China was perceived as a very high risk market for investors.⁵

9.6 Hunt and Hunt Lawyers told the committee about some of the more substantial steps taken by the Chinese Government to reform their regulatory system, maintaining that they 'represent significant relaxations on previous restrictions on foreign investment and trading in China'.⁶ They submitted that:

Regulations such as the 'Tentative Procedures' (of March 2003), the 'Administration of the Establishment of Foreign Investment Export Procurement Centres Procedures' (November 2003), the 'Procedures for Foreign Invested Commercial Enterprises' (April 2004) and new 'Franchising Regulations' (January 2005)⁷ demonstrate provisions, which allow increased direct foreign investment.⁷

Australia investing in China

9.7 Australian investors are likely to benefit from China's endeavours to attract foreign investment. They, however, have traditionally baulked at investing in Asia. The Governor of the Reserve Bank has remarked on the contrast between the closeness of Australia's trading relationship with Asia and the lack of closeness in Australia's financial integration into Asia. He noted that Australian enterprises have 'always been more comfortable running businesses in the United States, Europe (especially the United Kingdom) and New Zealand'.⁸

9.8 This observation has direct relevance for Australia's investment in China. Although Australia has strong and growing trade links with China, which is now one of Australia's major trading partners, the level of investment does not reflect this degree of engagement. It should be noted, though, that Australian investment in China has been rising since the 1980s. DFAT explained:

The upward trend in investment clearly supports increased trade flows with investment on the ground, but more generally is a response to China's improving business environment and the impact of numerous relatively small investments by small and medium sized Australian companies,

5 J. Harrowell, *Committee Hansard*, 29 June 2005, p. 40.

6 *Submission P24*, p. 15.

7 *Submission P24*, pp. 14–15. It also stated, 'Further, the 'Foreign Trade Law' (April 2004) sets a framework for the types of 'western' style regulations required by WTO, such as new competition laws'.

8 I. J. Macfarlane, Governor, Reserve Bank of Australia, 'Asia's Role in Australia's Economic Future', Tenth Annual Sir Edward 'Weary' Dunlop Asia link Lecture, Sydney, 16 October 2003.

chiefly in China's manufacturing sector. Large Australian companies have been making substantial investments in China for many years; the rising investment trend among smaller companies is a much more recent development.⁹

9.9 It was of the view that 'the upward trend in bilateral investment is likely to continue and investment flows are expected to start to become a better indicator of the scale of the bilateral economic engagement'.¹⁰

9.10 The Australian Industry Group observed, however, that while Australian investment in China totalled \$1.2 billion at June 2003, it had plateaued in recent years. Given the size and rapid growth in Australia–China trade, the investment figures are 'modest'. In 2003–04, Australia exported over \$9 billion worth of goods to China and over the same period imported over \$15 billion. Statistics provided in evidence clearly show the difference between the strong trading links in goods and the weaker ties in investment. While China is Australia's second largest export market and the second largest source of imports, it is the 18th largest investment destination for Australia and the 14th largest investor in Australia.¹¹ There is no doubt that investment has not expanded at the same rate as the trade relationship.

9.11 The Minerals Council of Australia attributes the relatively modest two-way direct investment to the barriers and practical obstacles to foreign direct investment.¹² Indeed, DITR advised the committee that some Australian businesses are wary about investing in China.¹³

9.12 The following section looks at the impediments that operate to discourage FDI in China.

Barriers to investing in China

9.13 As noted earlier, China has over the last two decades gradually improved its investment environment. Even so, China recently acknowledged that it needed to continue to utilise foreign capital energetically and rationally. In March 2005, it gave a commitment to:

...encourage foreign investors to invest in new and high technology industries, advanced manufacturing industries, modern services, modern agriculture and environment–friendly industries and to participate in the reorganization and technological upgrading of state-owned enterprises. We will encourage and attract multinational corporations to set up R&D and

9 *Submission P19*, p. 10.

10 *Submission P19*, p. 10.

11 Minerals Council of Australia, *Committee Hansard*, 22 June 2005, p. 3. See also Australia China Business Council, *Submission P40*, p. 11.

12 Minerals Council of Australia, *Committee Hansard*, 22 June 2005, p. 3.

13 *Committee Hansard*, 21 June 2005, p. 53.

purchasing centers, regional headquarters and advanced manufacturing bases in China.¹⁴

9.14 A number of impediments to trade identified in chapter 4, apply directly to the flow of Australian investment into China. They include the complex legal system, the level of government involvement in foreign investment, and the lack of consistency in applying and enforcing the law. The following section looks at these disincentives to foreign investors and other factors, particularly restrictions on travel that discourage Australians from investing in China.

Legal framework

9.15 Two IMF analysts concluded that 'in terms of the overall legal regime, it is not obvious that China makes for a particularly attractive FDI destination'. They pointed to explicit restrictions written into laws and regulations as well as other restrictions that are an important part of the overall investment climate in the minds of investors. They referred to corruption and bureaucratic red tape which raise business costs and are part of the implicit disincentives for investment.¹⁵ They concluded:

...while the Chinese laws and regulations offer many legal incentives to attract FDI, they should be placed in context along with many implicit disincentives as well as explicit legal restrictions in order to form a more complete assessment of the overall investment climate.¹⁶

9.16 In chapter 4, the committee described a multi-layered legal structure comprising a complex system of laws, rules and regulations in which governments at all levels had a presence. It identified shortcomings across a broad and diverse range of law, including bankruptcy or insolvency law, contract law and IP law. In some cases the regulatory regime and legal system discriminated against foreign firms especially in the enforcement of law.

9.17 The minerals and resources sector in particular highlighted the impediments to investment in China. In chapter 7, the committee found the disincentives to invest in the minerals sector particularly strong. It noted that, at almost every turn, Australian companies confronted obstacles to investment from restrictions on approvals for exploration and mining rights, limited trading rights and, as noted above, a lack of certainty with legal processes. Rio Tinto indicated that little FDI had gone into the minerals and energy sector, citing reasons related to 'the adequacy of legal systems, views on property rights and prospectivity'.

14 *Report on the Implementation of the 2004 Plan for National Economic and Social Development*, submitted to the Third Session of the 10th National People's Congress, 5 March 2005.

15 Eswar Prasad and Shang-Jin Wei, 'The Chinese Approach to Capital Inflows: Patterns and Possible Explanations', *IMF Working Papers* WP/05/79, IMF, April 2005, p. 21.

16 Eswar Prasad and Shang-Jin Wei, 'The Chinese Approach to Capital Inflows: Patterns and Possible Explanations', *IMF Working Papers* WP/05/79, IMF, April 2005, p. 22.

Multiple layers of regulation

9.18 The committee also found the interference by government at the municipal or provincial level a major hindrance to the operations of foreign companies in China. This applied equally to investment. Two IMF commentators concluded that market access and supplier access are 'the most important factors affecting FDI flows'. They wrote:

If China's central government is serious about redressing regional inequality, it must address the issue of local protection and high internal trade costs. Dismantling interprovincial barriers, and improving transport infrastructure will increase market and supplier access for both Chinese and foreign producers, attracting entry of new firms.¹⁷

9.19 Hunt and Hunt Lawyers cited the multiple layers of investment regulations by different levels of the Chinese Government as a major obstacle for Australian entities wishing to invest in China.¹⁸ It would 'encourage the reform of the different types of regulation affecting the establishment of operating companies to enable more direct investment' stressing that the regulations should be transparent and not subject to unilateral change.¹⁹

Mandatory use of local labour service companies and dispute resolution

9.20 Hunt and Hunt Lawyers also regarded the requirement for companies to use local labour service companies as a significant restriction on direct investment. As a cost to business, they suggested that the current restrictions should be revised so that direct employment would be 'liberalised to parties beyond those currently able to do so'.²⁰ They suggested that there should be an 'Investor/State dispute resolution provision to protect individual investors'.²¹

Committee view

9.21 In chapter 4, the committee concluded that there were grounds for Australian businesses in China to consider China a 'risky place to do business'.²² It found aspects of the legal and regulatory environment complex, time-consuming, expensive, uncertain and at times discriminatory. Corruption figured as a major concern for foreign companies in China. This environment also discourages Australian investors. In addition to these general hindrances, chapter 7 chronicled the long list of

17 Mary Amity and Beata Smarzynska Javorcki, 'Trade Costs and Location of Foreign Firms in China', *IMF Working Paper*, WP/05/55, International Monetary Fund, March 2005, p. 15.

18 *Submission P24*, Appendix 2, p. 32.

19 *Submission P24*, Appendix 2, p. 32.

20 *Submission P24*, Appendix 2, p. 32.

21 *Submission P24*, Appendix 2, p. 33.

22 See chapter 4, paragraph 4.52.

impediments for foreign businesses wishing to invest in the minerals sector in China. Indeed, the Minerals Council claimed that 'there are restrictions to minerals investment in China at nearly every point in the process'.²³ The committee reiterates its earlier findings that the Australian government must continue to work in both the bilateral, regional and multilateral context to encourage China to remove its barriers to trade and investment.

9.22 The committee has urged the government to increase its efforts in bilateral, regional and multilateral fora to encourage China to remove its barriers to trade and investment, especially 'beyond the border barriers'. It has also made recommendations to assist Australian companies establish and conduct business in China. These recommendations are relevant to investment in China. See recommendations 1, 2, 3, 7, 13, 14 and 16.

Restrictions on travel to conduct business in China

9.23 Australian business people also encounter difficulties in gaining entry to China. Hunt and Hunt Lawyers submitted that there needs to be some relaxation to the current visa restrictions to accommodate increased business investment and international provision of services. They stated:

There should be better accommodation in the provision of the visas. Applicants for business visas should not be obliged to wait in person for many hours in lines at [a] Chinese Consulate for their visas.²⁴

9.24 DIMIA also noted that Australian business people going to China face a number of hurdles.²⁵

9.25 Presently, the main scheme operating to facilitate the travel of business people is the APEC business travel card. It is a short-term business visa that allows for business activities such as feasibility studies, signing contracts and business meetings to be conducted. Both China and Australia belong to this reciprocal scheme which allows people to obtain a three year entry right to the respective countries for stays of up to 90 days.²⁶

9.26 Australia is a lead country in promoting the scheme and devising better ways to facilitate business travel in the region. DIMA works closely with Austrade and DFAT to ensure that the APEC business travel card is widely promoted.²⁷ It noted:

...we are in a fairly unique position because within the auspices of APEC there is a group called the business mobility group. Its charter...is

23 See chapter 7, paragraph 7.61.

24 *Submission P24*, Appendix 2, p. 33.

25 *Committee Hansard*, 21 June 2005, p. 14.

26 *Committee Hansard*, 21 June 2005, p. 15.

27 *Committee Hansard*, 21 June 2005, p. 16.

essentially to find ways in which we can promote the movement of business people across the region.²⁸

9.27 According to DIMIA, the business mobility group is chaired by Australia and is seeking not only to expand the number of countries participating in the scheme, but to achieve greater reciprocity in entry requirements for business people of APEC economies.²⁹

Committee view

9.28 The committee recognises the work being done through APEC to facilitate business travel throughout the region, especially by Australia as one of the lead countries in the business mobility group.

Opportunities for investment in China

9.29 The committee notes that, despite the impediments to trade and investment in China, many Australian companies are venturing into China. In noting the demands to be created by the 2008 Olympic Games, the Illawarra Regional Development Board (IRDB) can see opportunities for Wollongong-based companies to use their expertise in areas such as software development and heavy engineering with Chinese companies. The Board has taken the initiative and provides a model for other regions or business groups in developing business and investment connections with China. The Wollongong City Council submission explained that:

The IRDB has taken a pro-active role in fostering business and investment links with China and Chinese companies. Late in 2004 IRDB General Manager Peter Pedersen joined a delegation which included Wollongong City Council Economic Development Manager Bob Doyle and Illawarra Business Chamber President Terry Wetherall who presented a united front to press the region's interest in doing business with China.³⁰

9.30 They would also like to see Austrade officers take a more active role in linking Australian companies directly with potential Chinese partners. IRDB General Manager Peter Pedersen believes 'the Chinese market is so broad that it would be helpful to have assistance finding the "right" partners'.³¹

28 *Committee Hansard*, 21 June 2005, p. 15.

29 *Committee Hansard*, 21 June 2005, p. 16. For example, there is an APEC business travel handbook available on the internet to help people understand the different processes involved. The group is also looking to establish greater alignment between the entry conditions and to adopt common terminology, again to assist a better understanding of the scheme and processes involved. At the moment about 3,000 Australians have the card.

30 Wollongong City Council, *Submission P10*, p. 13.

31 Wollongong City Council, *Submission P10*, p. 13.

Committee view

9.31 Clearly, Australian businesses considering investing in China would benefit from further reforms in China that would make the investment environment more conducive to foreign investors. The Australian government could also take measures to assist Australian investors in China by increasing its efforts to make travel to China easier and to ensure that all Australian businesses are aware of and can take advantage of the associations that the various government agencies have established in China.

China's 'go global' strategy

9.32 China has adopted a 'go-global' strategy. It wishes to encourage Chinese enterprises to invest and do business in other countries and intends to accelerate the implementation of its 'go global' strategy.³² The 2005 report on China's economic and social development plan stated:

We will strengthen planning and industrial policy guidance for China's investment abroad, improve supporting fiscal, tax, financial, insurance and foreign exchange policies, and encourage qualified enterprises to invest abroad.³³

Chinese investment in Australia

9.33 Chinese investment in Australia has increased markedly in recent years, though from a low base. DFAT stated:

Chinese enterprises have invested in about 225 Australian projects up to the end of December 2003, with a cumulative contractual investment value of about \$2.2 billion and an actual value of \$59 million. Most of this investment is in resources, energy and processing commodities, but manufacturing and real estate also attract significant investment.³⁴

9.34 The interest from China has been across the board. DITR stated that, investment comes from state owned enterprises in areas like iron and steel, coal, engineering, construction, and railways as well as private companies in China, either alone or in various partnerships.³⁵

9.35 According to Invest Australia, the total stock of Chinese investment into Australia to the end of 2003 was \$2.86 billion. The investment was mainly in the mining, mineral processing, manufacturing, leather processing, wool processing,

32 *Report on the Work of the Government*, delivered by Premier Wen Jiabao at the Third Session of the 10th National People's Congress, 5 March 2005.

33 *Report on the Implementation of the 2004 Plan for National Economic and Social Development*, submitted to the Third Session of the 10th National People's Congress, 5 March 2005.

34 *Submission P19*, p. 10.

35 *Committee Hansard*, 21 June 2005, p. 48.

property and agricultural sectors.³⁶ Both state-owned enterprises and Chinese private companies, either alone or in partnerships, were investing in Australia. They included:

...the Channar iron ore mine in the Pilbara region of Western Australia and the Portland Aluminium smelter in Victoria. Investments are also diversifying into other sectors such as manufacturing, real estate, mineral exploration and wool processing.³⁷

9.36 The Australia Business Council, also noted that investment is mostly in the resource development, minerals processing, real estate and agriculture sectors. It anticipated that the Chinese 'will increasingly seek to invest downstream in resources ventures in particular in order to have an investment involvement in the different stages of the production chain'.³⁸ With regard to the minerals sector, the Chinese investor in Australia is interested not only in accessing supplies of raw materials to export to China, but 'extends down the value added chain into the processing of materials'.³⁹

9.37 Although interest is broad, Chinese investment in Australia was described as lumpy due mainly to its newness. Invest Australia explained:

...there is not much history of China as a whole investing anywhere, let alone in Australia. In fact, Chinese investments into Australia were the first major Chinese investments abroad in the world. The Chinese investment into the Portland aluminium smelter was the first major Chinese investment offshore anywhere.⁴⁰

9.38 Invest Australia is active in promoting Chinese investment:

We have people in China—we have officers in Beijing and in Shanghai—and we are working directly with companies in China to explain to them the benefits of investing in Australia and to help them to convert that interest in investing into reality here. We then help them to make visits to Australia. We make introductions to companies here. We make introductions to state governments here. We help to facilitate that investment flow wherever we can. Because the history of significant Chinese interest in investing abroad is reasonably short, they are taking some time to understand the investment environment in Australia and the opportunities available here, but we are starting to see a ramp up in our activity...⁴¹

9.39 At this stage, the committee notes China's interest in importing Australian uranium. The question arises whether Chinese companies would seek to invest in this

36 B. Jones, Invest Australia, *Committee Hansard*, 21 June 2005, p. 47.

37 *Submission P63*, p. 7.

38 *Submission P40*, p. 12.

39 B. Jones, *Committee Hansard*, 21 June 2005, p. 50.

40 *Committee Hansard*, 21 June 2005, p. 49.

41 *Committee Hansard*, 21 June 2005, p. 50.

industry and the impediments, if any, to do so. In answer to this likelihood, the Australian Treasurer, the Hon Mr Peter Costello, pointed out that Australia has a foreign investment approval process which requires that anyone seeking to buy an Australian company to operate in Australia must be 'screened and approved'. He stated further:

In addition to that, where it is a sovereign government, it's scrutinised even more carefully. So it's quite a difference between whether it's a private company or a sovereign government. Private companies are handled under FIRB and the existing law. Sovereign governments raise whole new policy questions which would have to be determined if it were a State-owned company that sought to engage in the activity.⁴²

9.40 It should be noted that China has cited the FIRB as a barrier to investment in Australia. It noted that the dominant criterion of foreign investment is 'Australian National Interests'. A Chinese report on Foreign Market access stated:

But it's considered that the 'Australian National Interests' criterion is enabling excessive discretionary power, and certain examination and approval procedures are short of transparency, which have impeded the access of foreign capital into Australia.⁴³

9.41 Mr Costello was of the view that there were no reasons for anyone to buy a uranium mine in Australia because 'they can buy uranium from an Australian company—BHP—subject, of course, to entering into nuclear safeguards which ensure that it's used for peaceful purposes.'⁴⁴

9.42 The Illawarra Regional Development Board is keen for Chinese companies already operating in Australia, and those considering doing so, to invest in the Illawarra region. The Illawarra Business Chamber (IBC) was also actively engaged in promoting local business. In November 2004, IBC President Terry Wetherall visited China with a Wollongong business, civic and tourism delegation to the Fijian International Friendship Cities Conference to publicise the diversity of opportunities for Chinese investment and trade in the Illawarra region.

9.43 As noted earlier, the Wollongong Council and associated boards and organisations provide an example of a region with the initiative, drive and enterprise to capitalise on the opportunities that China has to offer. They show clearly that there are gains to be made from China's prosperity, but that much planning and hard work are required for success.

42 The Hon Peter Costello MP, Treasurer of the Commonwealth of Australia, Doorstop interview, Beijing, 17 October 2005.

43 Ministry of Commerce, People's Republic of China, *Foreign Market Access Report*, 2005, p. 33.

44 The Hon Peter Costello MP, Treasurer of the Commonwealth of Australia, Doorstop interview, Beijing, 17 October 2005.

Restrictions on travel to conduct business in Australia

9.44 The committee discussed the ADS in the previous chapter and the APEC Business Card earlier in this chapter. Australia also operates the Sponsored Business Visitor Program. Under this scheme State, Territory and Commonwealth Government agencies, as well as specified business organisations, provide formal sponsorship for individuals and business delegations for short-term business visits to Australia.⁴⁵

9.45 According to DIMIA, China is Australia's largest source of business visitors. It stated that between 1 July and 31 December 2004, business visitor visas were granted to Chinese nationals 132 per cent more than the next highest source country (the US). It stated that 62,160 Business Visas were granted to Chinese nationals in 2003–04 which represented a 26 per cent increase over the previous year.⁴⁶ They told the committee that:

... if a free trade agreement is negotiated with China, the pressure on us to provide a visa service that is both fast and efficacious will increase. We are continuing to look at ways in which we can change our visa processing model with respect to business visitors from China, to make that process faster. Part of that is to look at possible electronic options in that area.⁴⁷

9.46 The Illawarra Regional Development Board expressed concern at the government's ADS regulations which in its view dampens the opportunities for Australian companies to do business with the Chinese provinces whose residents find it difficult to obtain visas to Australia.⁴⁸

9.47 DIMIA has indicated that Australia could do more to facilitate the travel of Chinese business people to Australia. The committee believes that the Australian government should not wait until a free trade agreement is reached to provide easier access to Australia for Chinese business people. It acknowledges the work that Australia has done in encouraging APEC members to support the APEC business card but believes that greater effort must be given to facilitating travel between China and Australia.

Recommendation 11

9.48 The committee recommends that the Australian government:

- **review the visa requirements for Chinese people seeking to conduct business in Australia with the intention of improving their access to Australia; and**

45 *Submission P51*, p. 13.

46 *Submission P51*, p. 13.

47 *Committee Hansard*, 21 June 2005, p. 13.

48 Wollongong City Council, *Submission P10*, p. 13.

- **confer with the relevant Chinese authorities to improve access conditions for Australians intending to visit China to conduct business. This matter of easier access to China for Australian business people should be a priority in the Free Trade Agreement (FTA) negotiations but Australia should not wait for the finalisation of this process to reach agreement with China.**

Conclusion

9.49 Australia and China are at a juncture in their trade relations that is leading them toward a much stronger and expanded relationship. Indeed, both countries are actively pursuing negotiations toward a bilateral Free Trade Agreement (FTA). This move signifies a desire to build not only a closer economic relationship but also a closer political one.

9.50 The following chapter examines this development toward a Sino–Australia bilateral trade arrangement, its implications for Australia's other trading partners in the region, and its commitment to multilateral free trade. It sets the scene for further discussion on the proposed FTA and its implications for Australia and Australia's trading partners in the region.

Part III

Building trading links through formal and informal trade arrangements

Trade agreements are a formal, structured and public way of improving trading relationships. This part of the report looks firstly at the proposal for a free trade agreement between Australia and China. It then examines other factors, including cultural differences, that influence the trading relationship. Finally it considers matters that have the potential to strain the relationship such as disagreements over human rights issues and labour standards.

