THE UNIVERSITY OF NEW SOUTH WALES
SCHOOL OF LAW

CLMR

CENTRE FOR LAW, MARKETS AND REGULATION

State Capital: Global and Australian Perspectives

George Gilligan and Megan Bowman

July 2013

SEATTLE UNIVERSITY LAW REVIEW (FORTHCOMING)

CLMR RESEARCH PAPER SERIES

State Capital:
Global and Australian Perspectives

George Gilligan and Megan Bowman[1]

ABSTRACT

This paper examines how swiftly core characteristics of the global economy are changing and the implications for Foreign Direct Investment (FDI) into Australia, especially FDI from China. The paper focuses on how state investment capital is an increasingly important strategic priority for governments, regulators, finance sector participants and other stakeholders. This is of the utmost strategic significance for Australia, given that its stability and economic well-being is increasingly intertwined with Asian jurisdictions, many of whom are active state investment actors.

I. INTRODUCTION
STATE CAPITAL IN A GLOBAL CONTEXT

The activities of state-related pools of capital need to be understood within the context of an era of globalization, in which economic and political ties between many jurisdictions are deepening, and jurisdictions increasingly are playing a mediating role regarding the interests of business that may be conducted within their spheres of influence.[2] One significant effect of globalization has been to further elevate deficits and surpluses run by countries and the subsequent macro-economic trade imbalances that they bring. As ever with regard to international trade the political context remains crucial and almost inevitably it is intertwined with expectations regarding vested interests. These developments are affecting the sovereignty of jurisdictions as local political priorities become more intertwined with international politics and the requirements of international business. The regulatory world reflects the realities of those domains which it purports to influence and so a major consequence of these developments is that regulatory structures and processes have become more internationalized. A variety of modes of governance are emerging that have a capacity for impacts of broad international scope. This political reality interacts with how state-related pools of capital have been increasing in recent years, not only in their number, but also in the scale of their effect. The rising influence of more proactive state-led investment capitalism is one of the shaping variables in how the global economy has been changing swiftly in recent decades and these structural shifts arguably have been accelerated by the effects of the Global Financial Crisis (GFC).[3]

---

[1] Senior Research Fellow and Research Fellow, Centre for Law, Markets and Regulation (CLMR), University of New South Wales. We acknowledge the financial support of the Centre for International Finance and Regulation (for project Enter the Dragon: Foreign Direct Investment and Capital Markets, E002), which is funded by the Commonwealth of Australia and NSW State Government and other consortium members (*see* www.cifr.edu.au).

[2] *See*, *e.g.*: Jeffry A. Frieden, GLOBAL CAPITALISM: ITS FALL AND RISE IN THE TWENTIETH CENTURY (2006); Jan A. Scholte, GLOBALIZATION: A CRITICAL INTRODUCTION (2005); and Joseph E. Stiglitz, GLOBALIZATION AND ITS DISCONTENTS (2003).

[3] This paper is not focused on the GFC, but there is a substantial literature on its causes and effects, including: Christopher J. Arup, *The Global Financial Crisis: Learning from Regulatory and Governance*

Recent developments regarding rising investment activity by state actors have a sense of *Back to the Future* about them. For example charter companies such as the East India Company (EIC) bear similarities to many contemporary state capital actors with their close linkages to state power and in many cases an emphasis on trading in commodities.[4] The first manifestation of the EIC was established in 1600 during the reign of Queen Elizabeth I as the *Governor and Merchants of London trading with the East Indies*. The EIC evolved through several forms, received monopoly trading advantages and other support from the Crown, including five Acts in 1670 during the reign of Charles II which accorded regal legitimacy to the EIC to command troops, make war and peace, mint money, annex territory and administer criminal and civil justice over the territory they controlled.[5] Similarly the Dutch East India United Company, the *Verenigde Oostindische Compagnie* (VOC), was founded in 1602 when the States General of the Netherlands granted the charter company a 21 year monopoly to trade and develop Dutch influence in Asia. Like the EIC it was enormously successful in these ventures and they were dominant actors in Asia for 200 years.[6] The EIC equivalent in North America was the Hudson Bay Company (HBC), which was incorporated by English royal charter in 1670 to administer trade in the Hudson Bay region and beyond, effecting a monopoly on the fur trade; for many years the HBC acted as a *de facto* government across large swathes of territory.[7]

Contemporary state capital actors obviously do not play the same militaristic and governmental roles as the EIC, VOC or HBC but they do have close linkages to their national governments and play important roles in facilitating their sovereign's economic and political influence in foreign territories. As is discussed below, concern has been voiced in recent years in many quarters about these growing levels of influence and there has been multi-lateral regulatory innovation regarding Sovereign Wealth Funds (SWFs) in particular.[8] SWFs and other state-related pools of capital such as State Owned Enterprises (SOEs),[9] State Pension Funds (SPFs) and Commodity Stabilization Funds (CSFs) are acknowledged as increasingly valuable sources of liquidity in capital markets that have been drained of liquidity in recent years. Many of the intrinsic challenges associated with regulating the international finance sector in a post-GFC era have come into play in recent years in multi-lateral efforts to mediate the increasing levels of activity and influence exercised by the diverse constituency of financial sector actors that have been bundled together under the state

---

Studies, 32(2) LAW & POL'Y, 363 (2010); Emilios Avgouleas, *The Global Financial Crisis: Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy*, 9 J. CORP. L. STUDIES 23 (2009); Philip Booth (ed.), *Verdict on the Crash: Causes and Policy Implications*, INSTITUTE OF ECONOMIC AFFAIRS (2009); Essential Information and Consumer Education Foundation, SOLD OUT: HOW WALL STREET AND WASHINGTON BETRAYED AMERICA (2009); Gary B. Gorton, *Questions and Answers About the Financial Crisis*, NBER WORKING PAPER NO.W15787 2010, available at http://www.nber.org/papers/w15787; International Monetary Fund, GLOBAL FINANCIAL STABILITY REPORT: MEETING NEW CHALLENGES TO STABILITY AND BUILDING A SAFER SYSTEM (2010); International Monetary Fund, FISCAL IMPLICATIONS OF THE GLOBAL ECONOMIC AND FINANCIAL CRISIS, SPN/09/13 (2009); Carmen M. Reinhart & Kenneth S. Rogoff, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY (2009).

[4] For a discussion of how various interest groups interacted in shaping the policy priorities of the East India Company *see* Huw V. Bowen, THE BUSINESS OF EMPIRE: THE EAST INDIA COMPANY AND IMPERIAL BRITAIN, 1756-1833 (2006).

[5] 8 *East India Company*, ENCYCLOPÆDIA BRITANNICA ELEVENTH EDITION 835 (11 ed. 1911).

[6] For a more detailed analysis of the VOC *see* Charles R. Boxer, THE DUTCH SEABORNE EMPIRE: 1600–1800 (1977).

[7] *See* Bryce George, THE REMARKABLE HISTORY OF THE HUDSON'S BAY COMPANY (1968).

[8] The regulatory innovation regarding SWFs is discussed in more detail below and this paper employs a working definition of SWFs as state owned investment funds comprised of financial assets.

[9] A working definition of SOEs is that they are widely deemed to be state-owned operating companies rather than investment mechanisms such as SWFs.

capital label.[10] These mutual challenges include: balancing the interests of state and private actors; the transnational nature of much financial sector activity; creating market regulatory conditions that can deliver appropriate balances between liquidity supply and opportunity for profit; the need to protect the national interest of jurisdictions but not encourage protectionism; and the increasing hybridization of financial sector actors, products and services.

These challenges have been heightened by GFC ramifications such as governments part-nationalizing/saving failing banks (e.g. Royal Bank of Scotland and Lloyds in the United Kingdom (UK)), or nationalizing them (e.g. Fannie Mae and Freddie Mac in the United States (US), Northern Rock in the UK), which continue to impact heavily on political, economic and legal agendas.[11] An effect of the GFC-induced emergency measures is that the entwined regulatory/investment role of the state becomes more cloudy as jurisdictions that might previously have slotted comfortably into the category of recipients of state capital have become more active state capital investment actors themselves. This raises questions about how the state can manage simultaneously the potential conflicts of being an active investment actor, a detached and independent regulator, a recipient of inward investment from both state and non-state sources, and the promoter of the national interest. The increasing investment role of SWFs, SOEs and other state-related pools of capital reflect changing relationships in the global economy, especially the economic rise of the BRIC countries (Brazil, Russia, India and China). As the strategic economic and political importance of these countries increases, so does the need to understand how international regulatory infrastructures must evolve in order to accommodate such changes. For example, it is highly significant that SOE capitalization constitutes a significant element in three of the BRIC countries. According to *The Economist* in 2012, SOEs comprised 80% of the value of the stock market in China, 62% in Russia and 38% in Brazil, as depicted in Figure 1 below; and SOEs accounted for one-third of the emerging world's foreign direct investment from 2003-2010.[12] And according to Chinese government records, Chinese FDI is set to increase by 15% in 2013.[13]

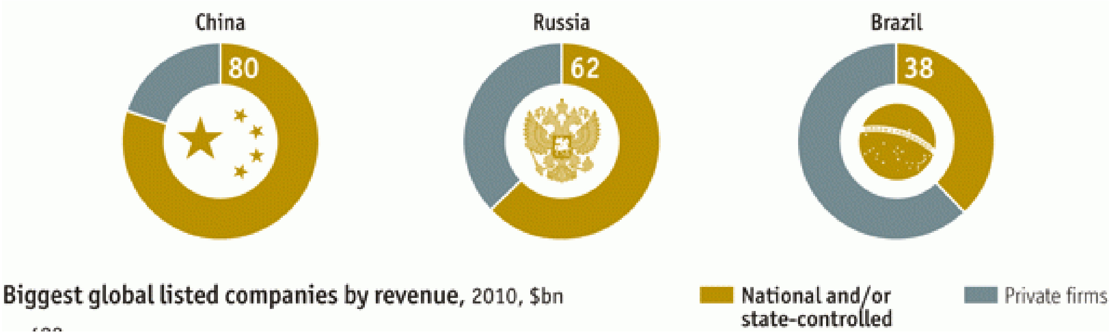
[10] The definitional difficulties of unpacking this label and the practical dilemmas of researching in this area of state capital are an ongoing theme of this paper.

[11] There has been significant academic and media coverage of these events and their implications. *E.g.*: Dale A. Oesterle, *The Collapse of Fannie Mae and Freddie Mac: Victims or Villains?* OHIO STATE PUBLIC LAW WORKING PAPER NO. 127 (2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1645330; Philip Aldrick, *RBS and Northern Rock to Unveil Radical Strategies*, TELEGRAPH.CO.UK (February 22, 2009), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/4782762/RBS-and-Northern-Rock-to-unveil-radical-strategies.html; Roman A. Tomasic, *The Rescue of Northern Rock: Nationalization in the Shadow of Insolvency*, 1(4) CORPORATE RESCUE AND INSOLVENCY 109 (2008); Robert J. Rhee, *Nationalization of Corporate Governance and Purpose During Crisis*, 17 GEO. MASON L. REV. 661 (2010).

[12] Adrian Wooldridge, *The Visible Hand*, THE ECONOMIST (January 21, 2012), http://www.economist.com/node/21542931.

[13] National Development and Reform Commission (NDRC), REPORT ON THE 2013 DRAFT PLAN FOR NATIONAL AND SOCIAL DEVELOPMENT (2013), submitted to the National People’s Congress on 5 March 2013.

Figure 1 **Share of SOE Capitalization on the MSCI National Stock Market Index: % of total, June 2011**[14]



This rapidly rising pool of SOE investment capital is part of the story of the decoupling effects of contemporary fundamental changes in East: West capital flows with attendant global imbalances regarding the management of exchange rates and reserves. The most obvious example of this is the rapidly increasing global economic influence of China. For example, China has increased its foreign reserves from $21 billion in 1992 (5% of its annual GDP)[15] to $31,202 billion in 2012 (45% of its annual GDP).[16] These decoupling effects are fuelled by the fact that emerging markets have been growing at an average of 5.5% (in contrast to 1.6% for developed nations) in recent years and the activity of these emerging markets is projected to make up half of the world's GDP by 2020 (see Table 1 below).

Table 1 **GDP Growth: Advanced vs. Emerging Economies**[17]

	Actual average annual percent change							***Projected***	
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2018**
Total Advanced Economies	**3.0**	**2.8**	**0.1**	**-3.5**	**3.0**	**1.6**	**1.2**	**1.2**	**2.5**
E.g. *United States*	2.7	1.9	-0.3	-3.1	2.4	1.8	2.2	1.9	2.9
Euro Area	3.2	3.0	0.4	-4.4	2.0	1.4	-0.6	-0.3	1.6
Japan	1.7	2.2	-1.0	-5.5	4.7	-0.6	2.0	1.6	1.1
Australia	2.7	4.6	2.7	1.4	2.6	2.4	3.6	3.0	3.2
Total Emerging Economies	**8.3**	**8.8**	**6.1**	**2.7**	**7.6**	**6.4**	**5.1**	**5.3**	**6.2**
E.g. *Brazil*	4.0	6.1	5.2	-0.3	7.5	2.7	0.9	3.0	4.2
Russia	8.2	8.5	5.2	-7.8	4.5	4.3	3.4	3.4	3.6
India	9.4	10.1	6.2	5.0	11.2	7.7	4.0	5.7	7.0
China	12.7	14.2	9.6	9.2	10.4	9.3	7.8	8.0	8.5
Qatar	26.2	18.0	17.7	12.0	16.7	13.0	6.6	5.2	6.5
Saudi Arabia	5.6	6.0	8.4	1.8	7.4	8.5	6.8	4.4	4.3

[14] Wooldridge, *supra* note 12.

[15] Zheng M. Song, Kjetil Storesletten & Fabrizio Zilibotti, *Growing Like China*, CEPR DISCUSSION PAPER NO. DP7149 (2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1345675.

[16] Kenneth Rapoza, *China's Cash Hoard Nearly Half its GDP*, FORBES INVESTING (May 25, 2012), http://www.forbes.com/sites/kenrapoza/2012/05/25/chinas-cash-hoard-nearly-half-its-gdp/

[17] International Monetary Fund, WORLD ECONOMIC OUTLOOK: HOPES, REALITITES, RISKS, Statistical Appendices Tables A1, A4 (2013).

A key feature of many emerging markets is that state-directed capital is flowing outward from emerging economies on a global scale. This is exemplified by China's 'Going Out'[18] or 'Going Global'[19] strategy, pursuant to which state-owned entities actively seek to *acquire* foreign assets and equity interests as opposed to merely *trading* in global commodities and raw materials.[20] Indeed, China has emerged to rival the US as the most important economy in the world. Wooldridge of *The Economist* writes: "Over the past ten years [China's] GDP has more than trebled to $11 trillion. China has taken over from Japan as the world's second-biggest economy, and from America as the world's biggest market for many consumer goods."[21] As depicted in Table 2, the top ten biggest companies in the world (by revenue) under 2012 rankings include three Chinese SOEs; this exceeds the number of European and UK companies, and comes just behind that of the US.[22]

Table 2 Global 500 Rankings 2011/12[23]

	Company	**City/Country**	**Revenue (US$mn)**	**Profits (US$mn)**
1	Royal Dutch Shell	The Hague/Netherlands	484,489	30,918
2	Exxon Mobil	Irving/US	452,926	41,060
3	Wal-Mart Stores	Bentonville/US	446,950	15,699
4	BP	London/Britain	386,463	25,700
5	Sinopec Group	Beijing/CN	375,214	9,453
6	China National Petroleum	Beijing/CN	352,338	16,317
7	State Grid	Beijing/CN	259,142	5,678
8	Chevron	San Ramon/US	245,621	26,895
9	ConocoPhillips	Houston/US	237,272	12,436
10	Toyota Motor	Toyota/Japan	235,364	3,591

The huge increases in China's economy and its foreign reserves are testimony to strong underlying growth trends which commentators and analysts expect to continue. For example, in Table 3 below, using a sample of 122 countries accounting for more than 95% of global GDP, Jorgensen and Vu have predicted how shares of global trade between major trading blocs may change if current growth trends are maintained.[24]

---

[18] Per Nicholas C. Howson, *China's Acquisitions Abroad – Global Ambitions, Domestic Effects* (Winter/Spring) LQN 73, 73 (2006).

[19] KPMG and the University of Sydney, DEMYSTIFYING CHINESE INVESTMENT 5 (2012) (hereafter 'KPMG 2012').

[20] Howson, *supra* note 18, 73.

[21] Wooldridge, *supra* note 12.

[22] *Global 500*, FORTUNE MAGAZINE (July 23, 2012), http://money.cnn.com/magazines/fortune/global500/2012/full_list/

[23] *Id*.

[24] Dale W. Jorgensen & Khuong M. Vu, *The Rise of Developing Asia and the New Economic Order*, LEE KUAN YEW SCHOOL OF PUBLIC POLICY RESEARCH PAPER NO. PP11-21 (July 7, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1904716.

Table 3 Percentage Share of Global GDP[25]

	2010 (%)	2020 (%)
China	13.92	20.08
US	20.14	17.44
G7	40.62	33.30
Asia 7	25.16	33.18
China as % of Asia 7 GDP	55.35	60.52
US as % of G8 GDP	49.59	52.39

By 2020 China will have replaced the US as the world's largest economy with 20.08% of global GDP (up from 13.92% in 2010). In the same period the US share of global GDP is expected to fall from 20.14% to 17.44%. This *changing of the economic guard* as it were in terms of the global economy is not confined merely to China and the US because there are regional forces at work as well, especially in Asia. For example, the G7 (Canada, France, Germany, Italy, Japan, UK and US) share of global GDP is expected to fall from 40.62% in 2010 to 33.30% in 2020 and the Asia 7 (China, Hong Kong, India, Indonesia, Singapore, South Korea and Taiwan) share to rise from 25.16% in 2010 to 33.18% in 2020. The US and China dominate their respective groupings. The US share of G7 GDP is estimated to be 49.59% in 2010 and 52.385 in 2020. China's share of Asia 7 GDP is estimated to be 55.35% in 2010 and 60.52% in 2020. If these trends transpire into reality, which seems likely, then it represents a direct 7%+ transference of total global GDP from the G7 to the Asia 7 in only ten years and further concentration of the strategic significance of the China and the US in their respective groupings. This constitutes a dramatic shift in economic power; and history demonstrates that these economic shifts influence change in other arenas such as foreign policy, strategic alliances and regulation in multi-lateral contexts. The economic significance of China and the US is also clear in Table 4 below, in which a 2013 PwC Economics report projects across a longer time span how the top global economies based on Purchasing Power Parity (PPP) were ranked in 2011 and how they might look in 2030 and 2050.[26]

[25] *Id*. at 25.

[26] PwC Economics, WORLD IN 2050, THE BRICS AND BEYOND: PROSPECTS, CHALLENGES AND OPPORTUNITIES, 2 (2013), available at http://www.pwc.co.uk/economic-services/global-economy-watch/index.jhtml.

Table 4 Actual and Projected Top 20 Economies Ranked Based on GDP (in PPP)[27]

	2011		2030		2050	
PPP rank	**Country**	**GDP at PPP (2011 US$bn)**	**Country**	**Projected GDP at PPP (2011 US$bn)**	**Country**	**Projected GDP at PPP (2011 US$bn)**
1	US	15,094	China	30,634	China	53,856
2	China	11,347	US	23,376	US	37,998
3	India	4,531	India	13,716	India	34,704
4	Japan	4,381	Japan	5,842	Brazil	8,825
5	Germany	3,221	Russia	5,308	Japan	8,065
6	Russia	3,031	Brazil	4,685	Russia	8,013
7	Brazil	2,305	Germany	4,118	Mexico	7,409
8	France	2,303	Mexico	3,662	Indonesia	6,346
9	UK	2,287	UK	3,499	Germany	5,822
10	Italy	1,979	France	3,427	France	5,714

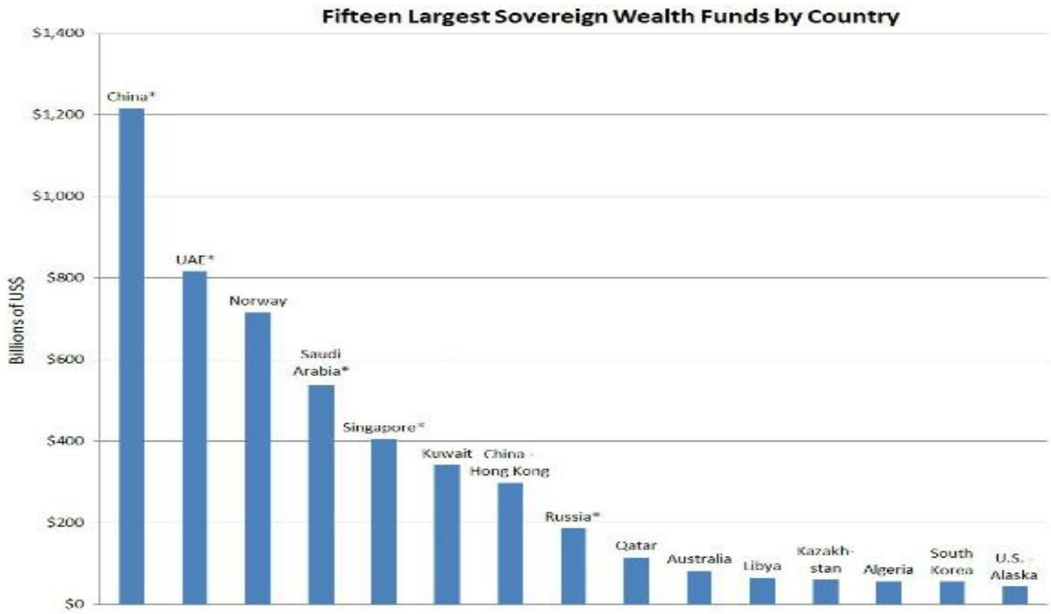
If these estimates are correct then China is likely to be the dominant economic power globally before the middle of the century. Importantly, China and some of the other fastest-growing economies that feature prominently in these tables have significant state capital investment actors. For example, in Table 5 below, Coleman shows the fifteen largest countries with SWFs by assets under management at March 2013 using Sovereign Wealth Funds Institute (SWFI) data.[28]

---

[27] *Id*.

[28] Isobel Coleman, *Graph: Sovereign Wealth Funds*, *Council on Foreign Relations*, COUNCIL ON FOREIGN RELATIONS (April 24, 2013), http://blogs.cfr.org/coleman/2013/04/24/graph-sovereign-wealth-funds/.

Table 5 Sovereign Wealth Fund Rankings 2013[29]



SWFs are increasingly important and valued players in global financial markets, but even for those with extensive resources and a continuous focus on state capital actors such as SWFs there is a substantial reliance on *best guesswork*. In this sense the discourse on state capital has some parallels with the discourses on white collar crime and financial crime, labels which like state capital have become accepted into everyday lexicon. They are difficult to define in a prescriptive sense and it can be problematic gathering hard data because often powerful actors are involved who do not welcome scrutiny, thus leading to difficulties in not only measuring the scale of the activity and its effects, but also in evaluating regulatory responses to such activity. Compounding this empirical uncertainty is the ambiguity that can sometimes surround white collar crime, financial crime and also state capital investment because their effects can be more diffused. It is this diffusion of effect, especially in geo-political contexts, which accentuates some of the criticism of state capital, discussed in more detail below.

There is definitional uncertainty about forms of state-related capital and how they should be classified partly because numerous types of actor have been collapsed into popular understandings of the term. For example, SWFs have probably received more academic scrutiny than other forms of state capital but there are a wide range of definitions put forward by commentators and organizations. Truman defines SWFs as 'a descriptive term for a separate pool of government-owned or government-controlled financial assets that includes some international assets.'[30] Lowery, at the time US Undersecretary for International Affairs, defined SWFs as 'a government investment vehicle which is funded by foreign exchange

[29] Sovereign Wealth Fund Institute, SOVEREIGN WEALTH FUND RANKINGS (2013). Asterisks indicate where the assets of a country's multiple SWFs have been added together. The Sovereign Wealth Fund Institute notes that one of the Russian funds 'includes the oil stabilization fund of Russia' and that the figure for China's largest fund 'is a best guess estimation': *id*.

[30] Edwin M. Truman, *A Blueprint for Sovereign Wealth Fund Best Practices*, *Policy Brief Number PB08-3* PETERSEN INSTITUTE FOR INTERNATIONAL ECONOMICS, 1 (2008), available at http://www.iie.com/publications/interstitial.cfm?ResearchID=902.

assets, and which manages these assets separately from official reserves.'[31] The European Commission (EC) notes that SWFs are 'generally defined as state-owned investment vehicles, which manage a diversified portfolio of domestic and international financial assets.'[32] The IMF sees SWFs as a heterogeneous group with five sub-categories based on their main objective: (i) stabilization funds whose primary objective is to help insulate the economy from the effects of commodity (usually oil) price swings; (ii) savings funds for future generations and so mitigate the effects of Dutch disease;[33] (iii) reserve investment corporations; (iv) development funds; and (v) contingent pension reserve funds which provide for unspecified pension liabilities on the government's balance sheet.[34] Jen believes that SWFs have five basic ingredients: (i) sovereign; (ii) high foreign currency exposure; (iii) no explicit liabilities; (iv) high risk tolerance; and (v) long investment horizon.[35] A number of SWFs themselves combined as an interest group in 2008 and offered their own definition as part of their Generally Accepted Principles and Practices (GAPP):

> SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets.[36]

So, it can be seen that SWFs are difficult to classify and there are many grey areas, for example between central banks' foreign reserves management and other types of investment vehicles. Pension funds are not SWFs even though they may be government sponsored, but they do have a clear link to the beneficiaries via fiduciary duties. Some SWFs are legal entities (e.g. ADIA – Abu Dhabi), others are corporations (e.g. Temasek - Singapore) and others are not legal persons (e.g. Norway Government Global Fund).

Academic interest in the forms of state capital such as SWFs appears to be relatively recent. For example, although some SWFs have been in existence for sixty years,[37] public

---

[31] U.S. Department of the Treasury, Remarks by Acting Undersecretary for International Affairs Clay Lowery on Sovereign Wealth Funds and the International Financial System, WWW.TREASURY.GOV (21 June 2007).

[32] Commission of the European Communities, *Communication from the Commission to The European Parliament, The Council, The European Economic and Social Committee and The Committee of the Regions*: *A common European approach to Sovereign Wealth Funds*, Brussels, xxx, COM(2008) 115 provisional, 3 (2008), available at http://ec.europa.eu/internal_market/finances/docs/sovereign_en.pdf

[33] Dutch disease is defined by Investorwords.com as: 'The deindustrialization of a nation's economy that occurs when the discovery of a natural resource raises the value of that nation's currency, making manufactured goods less competitive with other nations, increasing imports and decreasing exports': http://www.investorwords.com/1604/dutch_disease.html The term originated in the Netherlands after the discovery of North Sea gas in the 1970s and is an ongoing concern for resource-rich jurisdictions, prompting several to establish SWFs. *See* Paul Krugman, *The Narrow Moving Band, the Dutch Disease, and the Competitive Consequences of Mrs. Thatcher*, 27(1-2) J. DEV. ECONS. 50 (1987).

[34] International Monetary Fund, SOVEREIGN WEALTH FUNDS – A WORK AGENDA, 5 (2008), available at http://www.imf.org/external/np/pp/eng/2008/022908.pdf

[35] Stephen Jen, *The Definition of a Sovereign Wealth Fund*, MORGAN STANLEY GLOBAL RESEARCH (2007), http://www.morganstanley.com/views/gef/archive/2007/20071026-Fri.html

[36] International Working Group of Sovereign Wealth Funds, GENERALLY ACCEPTED PRINCIPLES AND PRACTICES (GAPP) – THE SANTIAGO PRINCIPLES, 3 (2008) (hereafter 'GAPP'), available at http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf

[37] The Kuwait Investment Office (KIO) was established in London in 1953 as an asset manager for Kuwait's Foreign Ministry.

recognition of the label SWF is quite recent.[38] The jurisdictions that operate SWFs and other forms of state capital are extremely diverse, some are authoritarian one party states, others are sophisticated democracies, and they range from highly developed oil/gas exporters in Europe (e.g. Norway, Russia) to less developed ones in the Middle East (e.g. UAE, Kuwait) to large and small manufacturing/trading entrepots in Asia (e.g. China, Korea Singapore) to broad-based commodity exporters (e.g. Australia, Chile) to smaller emerging economies (e.g. Mauritania, Uzbekistan). The SWFI estimated total SWF funds in July 2013 at $5,473.3 billion and specified their geographical origins as follows: 40% are in Asia; 35% in the Middle East; 17% in Europe; 3% in Africa; 3% in the Americas; and 2% in other areas of the world.[39]

It seems inevitable that state capital actors including SWFs will get bigger and become increasingly important vehicles for the recycling of global finance, namely, channelling capital from surplus (balance of payments) generating countries, to deficit countries. However their size, number, growth and scale of activity will still be influenced by the corresponding size and trends in global macroeconomic imbalances themselves. Exchange rate regimes, namely the prevalence or otherwise of dollar-type pegs and domestic inflation issues will also have an influence on their size, growth and number. Real and nominal rates of return on benchmark sovereign assets in the major advanced economies will also have an influence in as far as sovereign wealth portfolio shifts are affected. The public accumulation of assets by energy exporting countries is expected to continue if constraints on energy supply relative to demand remain, which does seem likely over the medium to longer term. It is highly likely that state capital actors including SWFs increasingly will be seen as favoured pools of available liquid capital. Continuing relatively low growth rates and subsequently low returns on investment capital can be expected in major advanced economies, so investment will be channelled increasingly into emerging markets and state capital actors will be an important conduit in such processes.

The last five years have seen a dramatic re-casting away from the pre-dominant philosophy that has driven financial markets development and their regulation in the last three decades. That is, a commitment to free market ideology underpinned by light-touch regulation under the canvas of regulatory competition in order to attract increasing amounts of inward investment. Since 2008 liquidity in global markets has reduced and concerns about sovereign debt have grown as appetite for risk has diminished globally. Interwoven with this a new era of more proactive state-led investment capitalism that is emerging with state-related pools of capital key to this process. This drastic change has been driven by what the then Australian Treasurer Wayne Swan described in 2009 as 'spectacular regulatory failure', stressing the new prevailing international consensus that the state must be a more active investor in markets as well as a more active overseer of their design and regulation.[40] This is the new international financial environment and geo-political reality in which existing and future state-related pools of capital are likely to become increasingly proactive and influential, contributing to financial markets and the broader economy in Australia and around the world.

State capitalism is undeniably on the rise, but reflecting geo-political and geo-economic realities, US concerns have been pivotal in shaping the discourse on what capitalism is and how it should be constituted. In a post-GFC world, as the 21st century

[38] The term Sovereign Wealth Fund appears to have been introduced by Rozanov in 2005: Andrew Rozanov, *Who Holds the Wealth of Nations?* XV(4) CENTRAL BANKING JOURNAL 52 (2005).

[39] Sovereign Wealth Fund Institute, *supra* note 29.

[40] Mark Franklin, *Wayne Swan Calls for New Controls on Free Market*, THE AUSTRALIAN (Jan. 24, 2009), http://www.theaustralian.com.au/business/breaking-news/swan-calls-for-reform-of-markets/story-e6frg90f-1111118652144

progresses and the economic power of Asian countries in particular grow, market perceptions about appropriate levels of activity by the state as an investor in capital markets may well change. Much of the post-GFC global financial reform agenda has been focused on leverage and systemic risk issues, and increasing the capability of jurisdictions to know what levels of investment, leverage and systemic risk are in their markets. In terms of state-related pools of investment activity there remains considerable uncertainty and ambiguity about their levels of investment, but in general they tend to be less leveraged than many of their private sector counterparts and therefore perceived by some as less of a threat to market stability.

II. REGULATORY REGIMES AND STATE CAPITAL

The traditional view of state capital actors (especially SWFs) is as long-term investors that can provide liquidity in times of crisis and have large *holding power*. However, there is an increasing trend amongst state capital actors, including SWFs, towards investment diversification and a growing desire and capacity for risk which has implications for cross-border foreign exchange liquidity. If SWFs are taken as an example of the changing significance of the broader pools of state-related capital, then in recent years they have become more varied and aggressive in their investment strategies, raising fears that forms of financial protectionism will be thrown up by some nation states to defend against such activity.[41]

A. Multi-lateral Regime for SWFs

Broader macro-economic factors seem to play an important role in heating or cooling the debate and arguably the most strident and high profile criticism of SWFs and SOEs came before the GFC from elements of the US Congress and media.[42] For example, protectionist sentiment was stoked by the takeover in 2006 by Dubai Ports World (DPW) - a state-owned company in the UAE, of the port management businesses of a number of seaports in the US that were already in foreign ownership by the UK firm P&O. Even though the Bush Administration gave approval for the deal, protectionism sentiment stimulated the specter of *cross-border nationalization* because state-related capital was behind DPWs and this gained public and Congressional traction, including the House Panel voting 62-2 on 8 March 2006 to block the deal.[43] The controversy contributed to DPW in December 2006 selling the seaport management businesses to the American International Group.[44] The DPW controversy attests to sensitivities in the US towards investment by foreign government entities. One survey of 1,000 registered US voters (weighted by race and education in an effort to be a representative sample) conducted by Public Strategies Inc. revealed significant levels of distrust about foreign investment in the US in general and state pools of capital in particular. 72% of respondents believed that foreign governments do not reveal enough about their investment portfolios; 68% opposed government investment from Saudi Arabia; and similar scores were

[41] Steve J. Weisman, *Concern about Sovereign Wealth Funds Spreads to Washington*, INTERNATIONAL HERALD TRIBUNE (August 20, 2007).

[42] Some of the media coverage was quite hostile, *e.g*. David R. Francis, *Will Sovereign Wealth Funds Rule the World?*, THE CHRISTIAN SCIENCE MONITO, Nov. 26, 2007 at 16.

[43] *E.g*. Senator Carl Levin, *Opening Remarks at the Senate Armed Services Committee Briefing on Port Security*, WWW.LEVIN.SENATE.GOV (February 23, 2006), http://levin.senate.gov/newsroom/release.cfm?id=251838; Robert Gay, *US Feels Power of Cashed-up Foreign Funds*, THE AUSTRALIAN FINANCIAL REVIEW (November 29, 2007) at 1.

[44] WorldCargo news, *AIG Buys DPW's US Assets*, WWW.WORLDCARGONEWS.COM (December 11, 2006), http://www.worldcargonews.com/htm/n20070118.117570.htm

recorded for other jurisdictions e.g. Abu Dhabi (62%), China (65%) and Russia (61%).[45] The sample of course was not comprehensively representative of the US population in general but ongoing public pressure of this sort contributed to legislative change in the form of *H.R. 556: Foreign Investment and National Security Act of 2007*, which passed in the House 423-0 and was signed into law by President Bush on 26 July 2007. The pressure in the US continued during 2007 with former US Treasury Secretary in the administration of President Bush, Mr. Henry Paulson voicing concern about political motivations influencing the investments of SWFs and calling for a multi-lateral regime to monitor their activities.[46] Also in 2007, the Committee on Foreign Investment in the United States (CFIUS) raised the requirements around inward sovereign investments and increased the numbers of examinations of such investment.[47]

Similarly, the EC stated that it 'cannot allow non-European funds to be run in an opaque manner or used as an implement of geo-political strategy' and reserved the right to introduce specific European legislation if increased transparency from SWFs was not achieved through voluntary means.[48] These concerns largely centered on whether the investment activities of these actors could lead to distortions in asset prices or excessive risk-taking. Such anxieties on both sides of the Atlantic are testimony to the fact that it seems inevitable that there will be a geo-political security element to reporting about SWFs and that there will be some level of anxiety in the West about the rising influence of SWFs and other forms of state capital. The establishment of the International Working Group of Sovereign Wealth Funds (IWGSWF) and the development of the GAPP can partially at least be seen as a response to such political pressures.

The gathering global recession of 2008 coincided with some interesting multi-lateral developments regarding SWFs and how they chose to present themselves as a grouping to the world. In May 2008 in Washington D.C., 25 SWFs from jurisdictions as varied as Australia, Botswana, Chile, China, Norway, Russia, Singapore, Trinidad and Tobago, the United Arab Emirates and the US formed the International Working Group (IWG) in cooperation with especially the IMF, but also the World Bank, as a partial response to some of the criticism about their investment activities and motivations. Composition of the IWG largely comprised representatives of finance industries and central banks. The IWG established a small secretariat and gave it the task of developing a set of principles that reflected the investment practices and objectives of SWFs. The IMF's role was as a facilitator of the process and recipient countries were involved. Only five months later, at a meeting in Santiago Chile in October 2008, the IWG formally declared the GAPP. IWG members committed to operate by the GAPP, which have as their core twenty four voluntary principles emphasizing good governance, accountability, transparency and a commitment to financially motivated investment strategies.[49] Considering that 25 very different countries were involved, a range of highly technical complex issues were covered in a short space of time. A key role was played behind the scenes by the IMF in moderating media perceptions of SWFs, particularly in

[45] Public Strategies Inc., *Survey Reveals Voters Wary of Foreign Government Investment*, WWW.PSTRATEGIES.COM (February 21, 2008), http://www.pstrategies.com/index.php/survey-reveals-voters-wary-of-foreign-government-investment.htm

[46] Tony Walker, *Call to Keep Funds Free of Political Bias*, THE AUSTRALIAN FINANCIAL REVIEW (October 22, 2007).

[47] US Department of the Treasury, COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS), SECTION 721 OF THE DEFENSE PRODUCTION ACT OF 1950, NOTICE (OCTOBER 2007), available at http://cfius.us/modules/news/

[48] Jose M. Barroso, *Statement by Jose Manuel Barroso President of the European Commission on Sovereign Wealth Funds, Oslo, Norway, 25/02/2008* (2008), Discours_Barroso_fonds_souverains.pdf

[49] GAPP, *supra* note 36.

calming anxieties surrounding China's state capital investment policies that had put much of the intensity into contemporary debates about SWFs, especially as discussed above in the US.

At the media conference formally announcing the Santiago Principles, the IWG drafting Chair Mr. David Murray (at the time Chairman of Australia's Future Fund) stated that the key task was to establish trust in recipient countries based on notions of openness and legitimacy. His sentiments were echoed by Joaquin Almunia, European Commissioner for Economic and Monetary Affairs, who also added that the long-term investment horizons of state-related pools of capital like SWFs would be extremely important in preserving mutual trust across international financial markets and their associated regulatory environments.[50] The IWG evolved into the International Forum of Sovereign Wealth Funds (IFSWF), the latter being formally established by the IWG in Kuwait City in April 2009 to meet and exchange views, facilitate the GAPP and encourage cooperation with recipient countries, international organizations and capital markets actors.[51] Since then the IFSWF has met in Baku Azerbaijan (October 2009), Sydney (May 2010), Beijing (May 2011), Mexico City (September 2012) and is scheduled to meet in Oslo in October 2013. The IFSWF operates in a fairly discreet manner with very limited published material but in July 2011 it did publish a report about IFSWF Members' Investment and Operational Practices with a particular emphasis on the GAPP.[52] The report reveals that approximately 80% of Members participated in the IFSWF surveys, that their investment activities are commercially motivated, that there were differing levels of compliance with the GAPP amongst Members and that in the view of the IFSWF it was not reasonable or possible to expect uniform compliance with the GAPP from all IFSWF Members. So, although the GAPP, the IFSWF and the report demonstrate some progress in transparency regarding SWFs, the comments in 2007 of the IMF still carry weight: '..there's a lot we don't know about sovereign funds. Very few of them publish information about their assets, liabilities, or investment strategies.'[53] Some state capital actors may be a little more open but with a significant number of sovereign states involved having authoritarian political regimes it is unsurprising that it can be hard to easily evaluate levels and locations of investment activity.

In considering the issue of how state capital actors such as SWFs might be regulated in multi-lateral contexts it is not feasible or probably desirable under pragmatic political realities that responsibility should lie with any international regulatory body. Rather, any exercise of regulatory fiat should be exercised by the *recipient* jurisdictions and the domestic regulation which inevitably impacts upon inward investment actors. This pragmatic stance is consistent with how investment norms are shaped and operationalized on international financial markets. Past attempts by international organizations to embed a top-down multi-lateral regulatory infrastructure to shape behavior by investment actors have not been notably successful. This was demonstrated by the OECD's failure regarding its proposed Multilateral Agreement on Investment (MAI) in the late 1990s.[54] The key reason why the MAI failed was

---

[50] Simon Willson, *Wealth Funds Group Publishes 24-Point Voluntary Principles*, IMF SURVEY ONLINE (October 15, 2008), http://www.imf.org/external/pubs/ft/survey/so/2008/new101508b.htm

[51] International Working Group of Sovereign Wealth Funds, 'KUWAIT DECLARATION': ESTABLISHMENT OF THE INTERNATIONAL FORUM OF SOVEREIGN WEALTH FUNDS (April 6, 2009), available at www.iwg-swf.org/mis/kuwaitdec/htm

[52] International Forum of Sovereign Wealth Funds, IFSWF MEMBERS' EXPERIENCES IN THE APPLICATION OF THE SANTIAGO PRINCIPLES (July 7, 2011), available at www.ifswf.org/pst/stp070711.pdf

[53] Simon Johnson, *The Rise of Sovereign Wealth Funds* 44(3) FINANCE AND DEVELOPMENT 56 (2007).

[54] Organisation for Economic Cooperation and Development, MULTILATERAL AGREEMENT ON INVESTMENT (1998) (hereafter MAI), available at

its lack of process legitimacy to jurisdictions that were not committed or bound by its central tenets. This obviously creates difficulties for organizations such as the OECD which are seeking to promote certain investment protocols as standard business practice via, for example, the OECD Declaration on International Investment and Multinational Enterprises[55] and the OECD Codes of Liberalisation of Capital Movements.[56] The latter has sought to counter protectionist activity such as establishing artificial barriers to market entry. OECD Members are bound by these level playing field protocols and not unexpectedly a certain amount of *gaming* of these protocols has been engaged in by many countries who are not members of the OECD, some of which have significant state capital actors. In response to these political and commercial realities the OECD is engaging in new strategies in this area. For example, in July 2012 it delegated full decision-making powers on the Codes of Liberalisation to the Investment Committee which would be enlarged to include non-OECD Members prepared to meet the same obligations as OECD Members, but in return would have the same rights as those Members.[57] It will be interesting to see how many jurisdictions consider such an initiative a sufficiently attractive inducement. However, if international regulatory mechanisms are to emerge for SWFs, then inherent process legitimacy will be essential.[58]

If further SWF and other state capital actor-related regulatory initiatives are to emerge it is unlikely to be through specialist regulatory agencies, but rather through initially codes of best practice such as the GAPP and thence multi-lateral agreements brokered by international organizations such as the Financial Stability Board (FSB)[59] under its G20[60] imprimatur or the OECD. As long ago as 2005 the OECD issued its guidelines on corporate governance of state-owned enterprises,[61] but political economy and commercial realities have limited the scale of influence of the OECD. The key avenue for multi-lateral regulatory progress post-

---

http://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm For an examination of the MAI and why it failed see: Katia Tieleman, *The Failure of the Multilateral Agreement on Investment (MAI) and the Absence of a Global Policy Network*: *Case Study for the UN Vision Project on Global Public Policy Networks*, UN VISION PROJECT ON GLOBAL PUBLIC POLICY NETWORKS (2005), available at http://www.gppi.net/fileadmin/gppi/Tieleman _MAI_GPP_Network.pdf

[55] Organisation for Economic Cooperation and Development, OECD DECLARATION ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES (2011), available at www.oecd.org/daf/inv/investment-policy/declarationoninternationalinvestmentandmultinationalenterprises.htm

[56] Organisation for Economic Cooperation and Development, OECD CODES OF LIBERALISATION OF CAPITAL MOVEMENTS AND OF CURRENT INVISIBLE OPERATIONS (1961), available at browse.oecdbookshop.org/oecd/pdfs/product/2003021e.pdf

[57] Organisation for Economic Cooperation and Development, OECD CODE OF LIBERALISATION OF CAPITAL MOVEMENTS (2013), available at www.oecd.org/daf/inv/investment-policy/capitalmovements_webenglish.pdf

[58] For a critical analysis of the paramount importance of legitimacy in multilateral regulatory activity in the financial sector *see* George Gilligan, *Multi-lateral Regulatory Initiatives – A Legitimation-based Approach, in* GOVERNING THE CORPORATION: REGULATION AND CORPORATE GOVERNANCE IN AN AGE OF SCANDAL AND GLOBAL MARKETS 121 (Justin O' Brien ed., 2005).

[59] *See* www.financialstabilityboard.org

[60] The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was established in 1999 to bring together systemically important industrialized and developing economies to discuss key issues in the global economy. The inaugural meeting of the G-20 took place in Berlin on December 15-16, 1999, hosted by the German and Canadian finance ministers. The G-20 is made up of the finance ministers and central bank governors of 19 countries: Argentina; Australia; Brazil; Canada; China; France; Germany; India; Indonesia; Italy; Japan; Mexico; Republic of Korea; Russia; Saudi Arabia; South Africa; Turkey; United Kingdom; United States of America. The European Union, who is represented by the rotating Council presidency and the European Central Bank, is the 20th member of the G-20. *See* http://www.g20.org/about_what_is_g20.aspx

[61] Organisation for Economic Cooperation and Development, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2005), available at www.oecd.org./corporate/corporategovernanceofstate-ownedenterprises/34803211.pdf

GFC has been the G20, which at its summit in Toronto in June 2010 announced that its financial sector reform agenda is based on four pillars: (i) a strong regulatory framework; (ii) effective supervision; (iii) resolution and addressing systemic institutions; and (iv) transparent international assessment and peer review. The G20 Declaration stated: 'that the core of the financial sector reform agenda rests on improving the strength of capital and liquidity and discouraging excessive leverage.'[62] However, with regard to multi-lateral arenas the constitutional and jurisdictional challenges for post-crisis regulatory reform are obviously much greater than in national contexts.[63] They represent substantial changes in the calibration of international capital frameworks and are intended to militate against future global financial crises. Political economy factors have been, and will continue to be, crucial in shaping these international reform processes. This emphasis on intermediation rather than new regulatory institutions and an evolutionary approach is not only congruent with market realities and also constitute a more legitimate exercising of regulatory power.

Most recipient countries including the US have foreign investment regimes to help in monitoring and partially controlling inward investment, but they are of course sensitive to the ongoing need to balance the national interest with trade openness and the inevitable regulatory competition between jurisdictions as they seek to attract capital. In addition most countries are capital dependent and it is not feasible to screen all inward investment, so most will inevitably be approved. It is also important to note that many jurisdictions with SWFs such as Australia and Norway are not only recipient countries of SWF investment but also have high levels of foreign investment generally. The activities of state capital actors including SWFs raise issues of the implications of cross-nationalization of assets and industries for jurisdictions all over the world. For example, states that are downstream consumers of commodities potentially could use their state-related pools of capital and investment vehicles to acquire the foreign companies that produce or own the rights to such commodities, leading to possible entrapments of governance in some domestic contexts. Scenarios of this nature could have far-reaching implications for securities regulation, corporate governance, competition and tax policies in the recipient countries of such investment, and governments around the world are increasingly taking note of these issues.[64] There is an understandably strong desire across political party lines within most recipient countries to protect national interests. For example, the Economics References Committee of the Commonwealth Senate of Australia has stated that: '..the committee believes that the best way for Australia to regulate the conduct of foreign investors (be they SWF, SOE or private commercial operator) is through developing robust domestic legislation.'[65]

B. The Australian Foreign Investment Regime

Foreign investment in Australia is regulated under the legislative framework of the *Foreign Acquisitions and Takeover Act* 1975 (Cth) (FATA). The other key component of Australia's foreign investment regime is Australia's Foreign Investment Policy (the Policy), which acknowledges the need that Australia has for foreign capital, reviewing foreign

---

[62] G20 Toronto Canada, THE G-20 TORONTO SUMMIT DECLARATION JUNE 26-27, 2010, 15 (2010).

[63] For a discussion of these issues with a focus on initiatives in the UK and how they are affected by European Union responsibilities *see* Julia Black, *Managing the Financial Crisis – The Constitutional Dimension*, LSE LEGAL STUDIES WORKING PAPER NO. 12/2010 (2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1619784.

[64] *E.g.* Australian Government, CONSULTATION PAPER – GREATER CERTAINTY FOR SOVEREIGN INVESTMENT – THE FRAMEWORK RULES (2010).

[65] Parliament of Australia, The Senate Economics References Committee, FOREIGN INVESTMENT BY STATE-OWNED ENTITIES 47 (2009).

investment proposals in relation to the national interest on a case by case basis, and setting out its approach in terms of who needs to apply, when they should apply, what the Government is looking for and how long before a decision is made.[66] The Australian Federal Treasurer has ultimate responsibility for decision-making under Australia's foreign investment regime and has a broad discretion to decline any foreign investment applications that he or she considers to be against the national interest. FATA defines foreign persons but does not define the national interest. The Treasurer receives recommendations on specific foreign investment proposals from the Foreign Investment Review Board (FIRB) which is a non-statutory body that administers FATA and the Policy.[67] However, FIRB's functions are advisory only and decision-making resides with the Treasurer. Notwithstanding, the substantial proportion of activity under Australia's foreign investment regime is handled by the conventional civil bureaucracy, specifically the Foreign Investment and Trade Policy Division of the Treasury (the Division), which provides secretariat services through approximately twenty staff to the FIRB. Under an ongoing authorisation from the Treasurer (effectively a delegation), the Division evaluates proposals and makes decisions on those that are Policy conforming and/or do not have special sensitivity. The vast majority of foreign investment applications fall into this category; for example, in 2011-2012, more than 92% of proposals were decided under this delegated authority.[68] Nevertheless, the FIRB is an advisory body and not a policymaking entity. It is the Government of the day which decides and expresses the Policy and which provides guidance on national interest in relation to foreign acquisitions through that Policy. Thus, Australian inward foreign investment and politics, and on occasion unfortunately, populism, are linked, especially it would seem in more recent times.

For the most part there is little controversy surrounding the overwhelming majority of foreign investment applications. The context of where foreign investment is coming from and where it invests in Australia is discussed in more detail below in Part III. Rejection of foreign investment applications is not statistically a common event. For example, in 2011-2012, 10,703 applications for foreign investment proposals were approved with 5,803 subject to conditions and 4,900 without conditions being imposed, 13 were rejected, 534 proposals were withdrawn and 170 were deemed exempt. It is noticeable that real estate comprised the vast bulk of activity with 10,118 (94.5%) of the approvals and all of the 13 rejections.[69] Until relatively recently, there had been only one rejection of a substantial corporate transaction and that occurred in 2001 when Shell proposed that they acquire 100% of Woodside Petroleum, a proposal that was rejected by then Treasurer Peter Costello.[70]

However, in recent years the increased desire of state capital actors to invest in Australia, especially regarding the acquisition of Australian resources assets, has seen politics and populism assume a higher profile in the discourse on Australian foreign investment. Arguably, a sense of jingoism has always been lurking in the DNA of this discourse, as admitted in a 2012 interview by the Chair of the FIRB Brian Wilson: 'The Foreign Acquisitions and Takeovers Act was put in place in 1975, when there was a huge backlash

---

[66] Australian Government, The Treasury, AUSTRALIA'S FOREIGN INVESTMENT POLICY (2013), available at www.firb.gov.au/content/_downloads/AFIP_2013.pdf

[67] *See* www.firb.gov.au/content/default.asp

[68] Commonwealth of Australia, FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2011-12, 6 (2012).

[69] *Id.* at 19, 20.

[70] Australian Government, The Treasury, FOREIGN INVESTMENT PROPOSAL – SHELL AUSTRALIA INVESTMENTS LTD (SHELL) ACQUISITION OF WOODSIDE PETROLEUM LIMITED (WOODSIDE), Press Release No. 025 (April 23, 2001), www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/2001/025.htm&min=phc

against Australia being sold off to the Japanese.'[71] Almost 40 years later Australia is of course not a Japanese outpost and it is likely that some of the scaremongering about inward Chinese investment to Australia in recent years may similarly have been overplayed.

Nevertheless, there have been specific Australian regulatory responses to this spectre of Chinese state capital inflows. For example, during 2008 a Chinese SOE Chinalco first sought to take a significant stake in major Australian miner Rio Tinto and there was heated public debate about potential threats posed by state capital interests owning strategically important Australian entities. Two weeks later on 17 February 2008, the then Treasurer Mr. Wayne Swan released six principles to improve the transparency of foreign investment screening processes that more clearly distinguish between investments by private entities and by foreign governments.[72] Eventually on 24 August 2008 the Treasurer did grant approval to Chinalco to acquire up to 14.99% of Rio Tinto because Chinalco had undertaken to the Treasurer not to raise its holdings without seeking fresh approval from the Australian Government and would not seek to appoint a director to Rio Tinto plc. or Rio Tinto Limited.[73] Similarly, on 27 March 2009, the Treasurer announced that China Minmetals Non-Ferrous Metals Co Ltd could not make a 100% acquisition of Oz Minerals if it included the Prominent Hill mining operations located within the Woomera Prohibited Area in South Australia.[74] On 23 April 2009, the Treasurer did give approval, but with the Prominent Hill mine not included and numerous other undertakings from China Minmetals Non-Ferrous Metals Co. Ltd.[75] These are just a couple of the decisions made in recent years under Australia's foreign investment regime that Chinese interest have felt have been discriminatory towards them. This disquiet has received media coverage recently following the high-profile Australian Government delegation to China in April 2013 led by then Prime Minister Julia Gillard that undertook trade and other inter-governmental negotiations. At that time, Trade Minister Craig Emerson 'admitted that talks on a free-trade deal with China have stalled because of a dispute over restrictions on investment in Australia by Chinese state-owned enterprises.'[76] It is clear that this issue will play a prominent role in Sino-Australian relations for years to come but what is the picture in recent years regarding inward foreign investment into Australia?

---

[71] Glenda Korporaal, *New FIRB Boss Keen to Lift Lid on Agency*, THE AUSTRALIAN (May 12, 2012), http://www.theaustralian.com.au/business/financial-services/new-firb-boss-keen-to-lift-lid-on-agency/story-fn91wd6x-1226353377917

[72] Treasurer of the Commonwealth of Australia, GOVERNMENT IMPROVES TRANSPARENCY OF FOREIGN INVESTMENT SCREENING PROCESS, Media Release No.009 (February 17, 2008), http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/009.htm&pageID=003&min=wms&Year=&DocType=0

[73] Treasurer of the Commonwealth of Australia, CHINALCO'S ACQUISITION OF SHARES IN RIO TINTO, Media Release no.094 (August 24, 2008), www.treasurer.gov.au/DisplayDocs.aspx?doc=pressrelease/2008/094.htm&pageID=003&min=wms&Year=&DocType

[74] Treasurer of the Commonwealth of Australia, FOREIGN INVESTMENT (March 27, 2009), www.treasurer.gov.au/DisplayDocs.aspx?doc=pressrelease/2009/029.htm&pageID=003&min=wms&Year=&DocType

[75] Treasurer of the Commonwealth of Australia, FOREIGN INVESTMENT DECISION (April 23, 2009), www.treasurer.gov.au/DisplayDocs.aspx?doc=pressrelease/2009/043.htm&pageID=003&min=wms&Year=&DocType

[76] John Kerin and Natalie Gerritsen, *Curbs on State Business Stall China Deal*, THE AUSTRALIAN FINANCIAL REVIEW, April 19, 2013, at 9.

III. CHINESE INVESTMENT IN AUSTRALIA

Parts I and II pinpointed the global momentum of state-directed capitalization and mobilization from emerging economies, particularly China, which has important implications for FDI into Australia. Indeed, Chinese investment into Australia represents a national strategic issue given that, first, China has become Australia's most significant two-way trading partner and, secondly, Australia's stability and economic well-being is increasingly intertwined with neighboring jurisdictions in the Asian region. Table 6 below, using official Department of Foreign Affairs and Trade (DFAT) data, demonstrates this economic reality very clearly. In terms of two-way trade China is top with 19.9%, followed by Japan (11.9%), the US (8.9%), South Korea (5.4%) and Singapore rounds out the top five with 4.6%.

Table 6 Australia's Top 10 Two-way Trading Partners 2011 (US$ billion)[77]

	Goods[(a)]	**Services**[(b)]	**Total**[(c)(d)]	**% Share**
1 China	113.6	7.4	121.1	19.9
2 Japan	68.4	4.0	72.5	11.9
3 United States[(e)]	38.1	16.1	54.2	8.9
4 Republic of Korea	30.4	2.2	32.7	5.4
5 Singapore	20.5	7.1	27.7	4.6
6 United Kingdom	14.3	8.7	23.0	3.8
7 New Zealand	15.3	6.3	21.6	3.5
8 India	17.5	2.9	20.3	3.3
9 Thailand	15.2	3.3	18.5	3.0
10 Malaysia	13.1	3.0	16.0	2.6
Total two-way trade[(b)]	**499.1**	**109.1**	**608.2**	**100.0**

Part III of this paper will track the flow and pattern of Chinese state capital investment in Australia over time utilizing data from Australian and international sources. It demonstrates that China is an increasingly significant investor in Australia albeit not the largest, and that investments are predominantly made in natural resources with emerging diversification toward energy and agriculture. Moreover, data in this Part evince a particular hallmark of Chinese investment, being SOE mobilization as the dominant investment modality. As outlined in Part II, this modality has raised specific concerns and questions for investee nations, including Australia, about the motivations of investing corporations. Accordingly, this Part clarifies the inherent characteristics of SOEs which capture media and policy imagination, details SOE-specific investment data, and raises some key issues to help researchers of state capital better investigate the purpose of SOE-led Chinese investment.

A. Investment from China: Flows, Patterns, Sectors

This section details general Chinese investment flows and patterns in Australia in order to highlight the volume, value and sectors of such investment, particularly in light of total and cross-comparative direct investment flows. Tracking these investment patterns shows the evolution over time and growing significance of Chinese investment in Australia.

---

[77] (a) Recorded trade basis; (b) Balance of payments basis; (c) Excludes imports of aircraft from regional import total from Sept 2008 onwards (excluding the US - *see* (e)). This has a significant impact on import totals for France; (d) Total may not sum due to rounding; (e) Based on unpublished ABS data and includes confidential aircraft imports for the US only: Australian Government, Department of Foreign Affairs and Trade, TRADE AT A GLANCE 2012, 5 (2012).

(1) FIRB: Approved Proposed Investment from China

Part II outlined the role of FIRB as the federal government's advisory body and delegated decision-making authority for specific foreign investment proposals. FIRB Annual Reports provide breakdowns of foreign investment applications considered and decided by value, sector, and investor country per fiscal year. However, these reports track only approved proposed investment, and proposals may not necessarily proceed to completion. Thus FIRB data are limited as a lone tool of investment analysis and must be supplemented with further data regarding actual investments, as detailed in the next sub-section. Nonetheless, FIRB data provide a useful means of tracking government agency decision-making outcomes on foreign investment, as demonstrated below.

According to FIRB Annual Reports, approved proposed Chinese investment contracts in 2011/12 comprised nearly half of the total number for all foreign countries, making China the largest proposed investor by contract *volume* (Table 7). However, in dollar *value*, proposed Chinese investment into Australia during that same period equated to AU$16.19billion, making China the third largest proposed investor to Australia behind the United States (AU$36.613bn) and the UK (AU$20.343bn). Indeed, looking longitudinally at proposed Chinese investment patterns, the value of approved proposed Chinese investment into Australia has risen and fallen since 2005/06 yet China has maintained a steady top three ranking during the past four years (Table 8).[78]

In terms of specific investment targets, Mineral Exploitation and Development has been the consistent prime locus of proposed Chinese inward investment into Australia (Table 9). Proposed investment in this sector remains high at nearly 70% of total investment in 2011/2012, even though it has decreased since 2005 (despite an anomalous year in 2006/07 of less than 50%). Real Estate is the second largest proposed investment target, at approximately one quarter of total proposed Chinese investment in 2011/12.[79] The areas of consistently least interest for proposed Chinese investment are Tourism, Resource Processing, Agriculture/Forestry/Fishing, and Finance & Insurance.

[78] A timeline comparison for the period 2005/06 - 2011/12 of contracts approved for single countries (e.g. China) is skewed by an aberrative figure in the 2008/09 FIRB Annual Report. Table 2.11 in that report lists number of all approvals per country. The total for all approvals is given as 568 contracts. But then Table 2.1 in the same report lists the same total contract approvals for the period as 5,352. Table 2.11 is the only FIRB table in the annual reports that gives a breakdown of contracts per country. The figure (in total, and therefore by aggregate country) is extremely low and inconsistent with other contract numbers in the same report. *See* Commonwealth of Australia, FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2008/09 (2009). However, the figures for approval by value are consistent when cross-checked throughout the tables of each annual report for the period 2005/06 – 2011/12.

[79] Note however that figures can jump between years due to policy changes in thresholds per sector and factors such as screening in Real Estate. Different sectors have different capital threshold levels, and proposals below sector threshold levels are not recorded. Various changes to FIRB threshold procedure policies over the years mean that comparability across periods using FIRB statistics can be misleading. *E.g*. the reintroduction from 24 April 2010 of screening temporary residents purchasing residential real estate is largely responsible for the jump to 9,771 approvals in the real estate sector in 2010/11, compared to 3,897 approvals in 2009/10: Commonwealth of Australia, FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2011/12, xv (2012). Furthermore, while all deal types are recorded in FIRB statistics, not all necessarily reflect a change in foreign ownership. In some cases both the investor and the target are foreign persons: *id*. at 16. Moreover, FIRB figures are based on the assumption that all investment funds will be sourced from overseas. In reality, however, Australians may contribute some funds, for example where they are in partnership with foreign interests or where the investment is financed from existing Australian operations: *id*.

Table 7 FIRB Approved Proposed Investment: 2011/12[80]

Approved proposed investment	Deal Value (AU$ billions)	Number of Contracts
TOTAL	170.71	10,703
Top 5 countries by proposed investment value		
United States	36.613	268
UK	20.343	1,018
China	16.190	4,752
Japan	13.920	324
Canada	8.871	131

Table 8 FIRB Approved Proposed Investment by Value (AU$ billions): 2005/06 - 2011/12[81]

	05/06	**06/07**	**07/08**	**08/09**	**09/10**	**10/11**	**Total**
TOTAL approved value	85.75	156.39	191.88	181.35	139.50	176.67	**1102.25**
China approved value	7.26	2.64	7.48	26.60	16.28	14.98	**91.43**
China percentage of total approval value	8.5%	1.7%	3.9%	14.7%	11.7%	8.5%	
China's country rank by investment value	3	11	6	2	3	3	

Table 9 Chinese Proposed Sector Investment Breakdown (% of value): 2005/06 – 2011/12[82]

SECTOR	**05/06**	**06/07**	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**
Agriculture, forestry & fishing	-	0.57%	-	-	-	0.03%	0.17%
Finance and Insurance	-	-	5.62%	0.16%	-	3.73%	0.37%
Manufacturing	3.10%	26.5%	-	0.31%	1.22%	2.78%	3.32%
Mineral exploitation & development	93.10%	45.57%	71%	98.70%	78.84%	65.16%	64.90%
Real Estate	3.80%	26.97%	19.94%	-	14.87%	27.44%	25.86%
Resource Processing	-	-	1.83%	0.61%	4.67%	0.88%	1.48%
Services	-	0.38%	1.35%	0.20%	4.40%	0.11%	3.92%
Tourism	-	0.04%	0.27%	0.02%	-	-	-

80 *Id*.

81 *Id*.; Commonwealth of Australia, *supra* note 78; Commonwealth of Australia, FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2005/06 (2006); FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2006/07 (2007); Commonwealth of Australia, FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2007/08 (2008); FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2009/10 (2010); and FOREIGN INVESTMENT REVIEW BOARD: ANNUAL REPORT 2010/11 (2011).

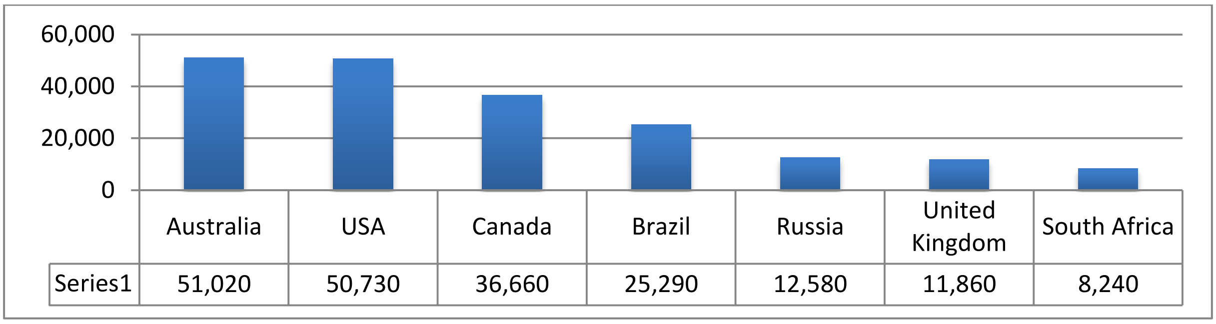
82 *Id.*

(2) Actual Investment Flows from China

Proposed investment flows, as documented above, give a good snapshot of FIRB approvals/decision-making outcomes and projected investment patterns. However, proposed investment data do not accurately reflect the investment environment in real terms. For example, for the period 1 January 2006 to 31 December 2012, ABS figures provide that total *actual* Chinese investment into Australia equaled AU$57.3 billion (Table 12 below), which is a very different figure to FIRB's total approved *proposed* investment of AU$91.4 billion (Table 8 above). More specifically, for that same period, 196 Chinese investments were announced in the energy and resources sectors, amounting to a *proposed* value of AU$100.7 billion.[83] However, 83% of those deals were completed, which equates to *actual* investment into Australian mining and energy worth AU$50.4 billion;[84] that is, around half of the proposed figure. Accordingly, actual investment data rather than proposed investment figures provide a more reliable evidentiary basis for analysis and discussion of Chinese investment into Australia.

Australia is currently the top destination for actual Chinese investment, narrowly ahead of the US (Table 10 below). However, while Australia is the largest recipient of Chinese FDI, China is not Australia's largest investor (Table 11 below). ABS data for the calendar year period 2006 to 2012 show that accumulated actual direct investment in Australia from the US equated to AU$747 billion, being a 24% share of Australia's total foreign direct investment stock.[85] This compares strikingly to China's direct investment for that same period which equated to only AU$57.3 billion or 2% share of the total. Accordingly, by the end of 2012, China was Australia's ninth largest direct investor, which may be lower than that assumed by many in the community given the high media coverage of China as Australia's most important trading partner.[86]

Table 10 Accumulated Chinese Investment by Country for Deals Above US$100 million: 1 January 2005 - 31 December 2012 (US$ millions)[87]



[83] Clayton Utz, DIGGING DEEP: CHINESE INVESTMENT IN AUSTRALIAN ENERGY AND RESOURCES, 8 (2013).

[84] *Id*. Clayton Utz data comprise only the energy and resources sectors, which includes renewables but excludes power generation: *id*. at 28.

[85] Australian Bureau of Statistics, 5352.0 - INTERNATIONAL INVESTMENT POSITION, AUSTRALIA: SUPPLEMENTARY STATISTICS 2012, Table 2 (2012), available at http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5352.02012?OpenDocument

[86] Indeed, Clayton Utz asserts that the value of completed Chinese investment in mining and energy sectors would 'likely amount to considerably less than 10%' of the total value of resources and energy projects in Australia: Clayton Utz, *supra* note 83, 9.

[87] The Heritage Foundation, *Chinese Outward Investment*, CHINA GLOBAL INVESTMENT TRACKER, Dataset 1 Investments (2013), available at http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map. *See* also KPMG and the University of Sydney, DEMYSTIFYING CHINESE INVESTMENT IN AUSTRALIA: UPDATE MARCH 2013, 2 (2013) (hereafter 'KPMG 2013').

Table 11 Accumulated Direct Investment in Australia for All Deals: 1 January 2006 – 31 December 2012 (AU$ millions)[88]

	Value	**Percentage of Total**	**Investor Ranking**
TOTAL - all countries	**3,099,195**		
Top Countries			
United States	746,792	24.1%	1
UK	443,804	14.3%	2
Japan	303,638	9.8%	3
Netherlands	196,334	6.3%	4
Switzerland	136,602	4.4%	5
China (excluding SARs & Taiwan)	57,340	1.9%	9
Hong Kong (China SAR)	47,992	1.5%	10

Nonetheless, Table 12 below reveals the pattern of actual Chinese investment in Australia over the six year period 2006 to 2012: it shows that investment has increased significantly year on year. This increase is partly due to resurging energy and metals investments[89] and, while natural resources and mining sector investments dominate, Chinese investment in Australia is diversifying towards energy (gas and renewables) and agriculture (Table 13 below).

Table 12 Chinese Investment in Australia: 1 January 2006 – 31 December 2012 (AU$ millions)[90]

2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**Total**
550	not published	3,643	9,058	12,944	14,404	16,741	**57,340**

[88] Australian Bureau of Statistics, *supra* note 85.
[89] The Heritage Foundation, *supra* note 87.
[90] Australian Bureau of Statistics, *supra* note 85.

Table 13 Chinese investment in Australia by Industry of deals above US$5 million: September 2006-December 2012 vs. 2012 (US$ millions)[91]

	2006 - 2012		2012	
	By volume	**By value**	**By volume**	**By value**
Mining	73%	$36,874.95	48%	$5,471.46
Gas	18%	$8,867.01	42%	$4,785.20
Renewable energy	4%	$2,212.60	2%	$182.60
Agriculture	>2%*	>$843.16*	2.6%	$24.56
Other (e.g. logistic equipment & services; finance; architecture)	<3%*	<$1994.16*	5.4%	$919.64
TOTAL	**100%**	**$50, 791.88**	**100%**	**$11,383.46**

Indeed, patterns of investment diversification are evidenced over time. According to the Heritage Foundation, 46 Chinese investment deals valued above US$100 million were completed in Australia during the last seven years:[92] of this number, deals in the steel and aluminum industries occurred only during 2005-2009;[93] and energy deals in the gas and coal industries commenced from 2008 and 2007 respectively.[94]

These investment patterns correspond to a number of external economic and internal Chinese policy factors. The period 2008-2009 marked the financial vulnerability of Australian companies due to the GFC and also China's increased domestic measures to stimulate its economy.[95] It is not surprising that during this period China completed 96% of announced energy/resources deals; however, as the GFC receded, the completion rate dropped markedly to only 22%.[96] Moreover, the diversification away from mining and toward energy reflects an increased global demand for LNG in conjunction with China's plan to diversify its energy consumption structure beyond coal.[97] Further, all large agriculture deals occurred only in the past two years[98] with increasing Chinese investment in Australian agriculture and real estate sectors predicted for 2013.[99]

---

[91] KPMG 2013, *supra* note 87, 6-7, 12-13. Note that KPMG data comprises deals valued US$5 million and above, hence the slight disparity in total value 2006-2012 between ABS and KPMG figures. *Figures are not exact because agriculture sectoral investment for South Australia is not specified in the report.

[92] The Heritage Foundation, *supra* note 87.

[93] *Id*.

[94] *Id*. *See* also Clayton Utz, *supra* note 83, 12.

[95] Clayton Utz, *id*.

[96] *Id*. at 9.

[97] KPMG 2013, *supra* note 87, 9.

[98] The Heritage Foundation, *supra* note 87.

[99] KPMG 2013, *supra* note 87, 18.

B. Primary Modality of Chinese Investment: SOEs

The preceding section showed that actual Chinese investments are being made predominantly in mining/natural resources sectors with diversification emerging toward energy and agricultural sectors. But how and by whom are these investments being made? The data indicate that a notable aspect of Chinese FDI is the mobilization of SOEs as China's preferred investment modality.

The data show clearly that SOE-led investments dominate the Sino-Australian investment landscape. According to recent KPMG reports, total Chinese inward investment (valued US$5million and above) to Australia from the period September 2006 to June 2012 comprised 116 deals by volume of which nearly 80% were made by 45 SOEs; and over 95% of deal *value* involved SOEs during this same timeframe (Table 14 below).[100] Those percentages are notably higher than average SOE investment figures of deal value in the US (65%) and Europe (72%).[101] More specifically in the Australian mining and energy sectors, Clayton Utz reports that for the slightly longer period of January 2005 to December 2012, SOEs accounted for 76% of deal volume and 100% of *all* deals greater than AU$250 million; and 97% of the accumulated *value* of those actual investments.[102]

Table 14 Chinese Investment into Australia: September 2006-December 2012 vs. 2012[103]

	2006-2012		**2012**	
	By volume	**By deal value**	**By volume**	**By deal value**
SOE share of capital invested	80%	94%	74%	87%
Private (non-state) investment	20%	6%	26%	13%

The above figures reflect two key factors: first, that traditional areas of investment concern for SOEs are mining, energy and resources; and secondly, Australia has a relative abundance of natural resources, giving it a comparative advantage as an investment destination in these sectors.

Moreover, the SOE investment figures in Australia echo the momentum of SOE-led investment from emerging economies throughout the world as depicted in Part I. And emerging economies' strong SOE capitalization and mobilization has instigated concern within some Anglo-American nations about SOE acquisition in contrast to other investment modalities. Concerns about one state owning another state's key resources or assets through

[100] KPMG 2012, *supra* note 19, 9. In 2012 alone, SOEs completed 74% of all deals (valued US$5mn and above) by volume and 87% by deal value of the total Chinese inward investment into Australia: KPMG 2013, *supra* note 87, 1. Note, however, that the KPMG reports do not reveal original sources of their SOE figures.

[101] *See*: Daniel H. Rosen and Thilo Hanemann, AN AMERICAN OPEN DOOR? MAXIMIZING THE BENEFITS OF CHINESE FOREIGN DIRECT INVESTMENT 33 (2011), noting that SOE investment in the US by deal *volume* is much less at 26%; and Thilo Hanemann & Daniel H. Rosen, CHINA INVESTS IN EUROPE: PATTERNS, IMPACTS AND POLICY IMPLICATIONS 4, 45 (2012), noting that SOE investment in Europe by deal *volume* is only 33%. Chinese statistics of SOE-led outward foreign investment is approximately 70%: Ministry of Commerce, China, 2010 STATISTICAL BULLETIN OF CHINA'S OUTWARD FOREIGN DIRECT INVESTMENT (2011).

[102] Clayton Utz, *supra* note 83, 4.

[103] KPMG 2013, *supra* note 87, 1, 15.

strategic SOE corporate activity is not new; however, concerns have manifested recently due to the confluence of two phenomena outlined in Parts I and II, namely: the vulnerability of some Western economies and the legitimacy crisis of liberal capitalism post-GFC; and the rise of state capital-directed emerging economies that are now beginning to look outward. These concerns center upon perceptions of risk - to national security, energy security, economic security (control over wealth-creating assets) - and/or fear of the other.[104]

Part II demonstrated that foreign investment, politics and populism are increasingly linked in recent times. Nowhere is this more evident than in relation to SOE-directed foreign investment. The intrinsic nature of an SOE seems to capture media sensationalism and influence political discourse and policy. For example, recent media headlines in Australia include 'China's state-owned enterprises obtain FIRB approval by stealth',[105] and 'Don't mix politics and deals: FIRB in warning to state-owned investors'.[106] FIRB did in fact amend Australia's Foreign Investment Policy on 4 March 2013 to extend the concept of direct investments of less than 10% to cover scenarios in which investor consortia that include foreign investors may be amassing strategic stakes in target investments.[107] Yet concern is not limited to Australia. For example, the revised Canadian investment policy guidelines to the *Investment Canada Act* provide explicitly that: 'investors will be expected to address in their plans and undertakings, *the inherent characteristics of SOEs, specifically that they are susceptible to state influence*'[108] and entities that are 'owned, controlled or influenced, directly or indirectly by a foreign government' must satisfy the Canadian Minister of Industry that the project is commercial and free from political influence.[109] Similarly, political decisions are not immune, as illustrated by the Australian government's exclusion of Huawei from the National Broadband Network bidding on the basis of security concerns in 2012,[110] and President Barack Obama's Executive Order to prohibit Ralls Corporation from owning several wind farm projects in Oregon in 2013 for similar reasons.[111]

But why is there such concern about SOE-led investment over and above other modalities of investment? Clarke and Howson[112] and Ruskola[113] give valuable insight into the

---

[104] *See, e.g.* Luke Hurst, Peter Yuan Cai and Christopher Findlay, *Chinese Direct Investment in Australia: Public reaction, policy response, investor adaptation*, ROUNDTABLE AND PUBLIC FORUM ON CHINA'S GLOBAL INVESTMENT (Australian National University, September 4-5, 2012); and Howson, *supra* note 18.

[105] Bryan Frith, *China's State-Owned Enterprises Obtain FIRB Approval by Stealth*, THE AUSTRALIAN (March 13, 2013), http://www.theaustralian.com.au/business/opinion/chinas-state-owned-enterprises-obtain-firb-approval-by-stealth/story-e6frg9kx-1226595937750

[106] Enda Curran and Michael Sainsbury, *Don't Mix Politics and Deals: FIRB in Warning to State-Owned Investors,* THE AUSTRALIAN (August 7, 2012), http://www.theaustralian.com.au/national-affairs/foreign-affairs/dont-mix-politics-and-deals-firb-in-warning-to-state-owned-investors/story-fn59nm2j-1226444324395

[107] Foreign Investment Review Board, AUSTRALIA'S FOREIGN INVESTMENT POLICY (INCLUDES THE 'POLICY STATEMENT: FOREIGN INVESTMENT IN AGRICULTURE') (2013), available http://www.firb.gov.au/content/policy.asp?NavID=1

[108] Government of Canada, GUIDELINES – INVESTMENT BY STATE-OWNED ENTERPRISES – NET BENEFIT ASSESSMENT (Revised December 2012), available at www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html (emphasis added).

[109] *Id.*

[110] Maggie Lu Yueyang, *Australia Bars Huawei from Broadband Project*, THE NEW YORK TIMES (March 26, 2012), http://www.nytimes.com/2012/03/27/technology/australia-bars-huawei-from-broadband-project.html?_r=0

[111] The White House, ORDER SIGNED BY THE PRESIDENT REGARDING THE ACQUISITION OF FOUR US WIND FARM PROJECTS BY RALLS CORPORATION (Sept. 29, 2012). Ralls Corporation is controlled by two executives of Sany Heavy Industry Co. Ltd., a Chinese multinational listed publicly on the Shanghai Stock Exchange that is *not* an SOE.

[112] Donald C. Clarke & Nicholas C. Howson, *Pathway to Minority Shareholder Protection: Derivative actions in the People's Republic of China, in* THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH 243 (Dan W. Puchniak, Harald Baum & Michael Ewing-Chow eds. 2012).

[113] Teemu Ruskola, LEGAL ORIENTALISM: CHINA, THE US AND MODERN LAW (2013).

multi-faceted dimensions of Chinese SOEs and how they link into the shifting political economy of center-province and intra-province relations. The traditional Chinese SOE was an organizational form, not a legal form. The economic reforms from the 1970s first took place in rural China whereby agricultural industry was decentralized to local governments, and commercial 'township and village enterprises' (TVEs) emerged as an early form of SOE. Thus, historically, state players in SOE control were local or provincial governments, not central agencies.[114] Moreover, an SOE did not have separate legal personality nor issue stock or equity ('ownership') in itself; instead it was administratively controlled by the state, which had the right to appoint management and appropriate revenues or profits. One can assume therefore that an SOE's original *raison d'etre* was to pursue state purposes as opposed to market freedoms; yet to what purpose remains clouded. Since commencement of the Chinese corporatization program, as expressed in the 1994 Company Law and 2006 PRC Company law, Chinese companies can take one of three legal forms: (i) a company limited by shares (CLS); a company limited by liability (LLC); or (iii) a company wholly owned by a state agency (WSOC). However, Howson is clear that this legal process has not resulted in wide-spread private corporate ownership; rather Chinese companies are now corporatized, not privatized.[115] Indeed, an SOE is now administratively *and* financially controlled by an entity of the state (central or local), whereas in the US or Australia for example that entity would more likely be owned by private institutional investors. Consequently, a controlling shareholder of an SOE in China has political as well as economic dominance, which has important implications for the nature of a state-controlled corporation and who it seeks to serve.

Yet is there a documented cause for the type of concerns that have manifested in media and policy circles? SOE-specific data, over and above data about general Chinese investment flows and patterns as depicted in Part IIIA, are required in order to accurately answer this question.

FIRB Annual Reports for 2005/6 - 2011/12 do not differentiate between SOE and non-SOE investments in Australia (whether from China or elsewhere). Thus, SOE-specific information must be extracted from multiple other sources, which include government agency sources (e.g. Australian Bureau of Statistics (ABS), Department of Foreign Affairs and Trade (DFAT), Ministry of Commerce of the Republic of China (MOFCOM), China State Asset Supervision and Administration (SASAC), and the National Bureau of Statistics of China (NBS)) as well as industry sources such as Clayton Utz, KPMG, and The Heritage Foundation.

It is important to note at the outset that these different datasets are not easily compared due to a number of differences between the sources regarding deal value,[116] deal type,[117] investor location,[118] and compilation methodology.[119] Being mindful of disparities between data collection methods enables more accurate SOE investigation.

---

[114] *Id*. at 60-107.

[115] Clarke & Howson, *supra* note 112, 245-249.

[116] *E.g*. the Heritage Foundation tracks deals only above US$100 million; KPMG tracks deals above US$5 million; and the Clayton Utz Merger & Acquisition (M&A) database tracks deals only above AU$50 million. *See*: The Heritage Foundation, *supra* note 87; KPMG 2013, *supra* note 87, preamble; and Clayton Utz, THE REAL DEAL: M&A TRENDS AND DEVELOPMENTS, 72 (2013).

[117] *E.g*. FIRB collates 'approved proposed investment' figures; whereas sources such as ABS, the Heritage Foundation, MOFCOM, and Clayton Utz produce 'actual' or 'completed' investment figures. Moreover, different sources tend to cover different methods of investment, being M&A, joint ventures, greenfield projects, and/or Chinese stock/bond acquisitions.

[118] That is, most sources do not include deals by investors located in Special Administrative Regions (SARs) - being Hong Kong and Macao - or Taiwan. One exception is KPMG, which tracks investments by

Traditionally, SOEs by their nature have tended to invest in areas of nation-wide priority, being natural resources, utilities, telecommunication services, and defense. However, Lee specifies that Chinese SOEs now operate in *all* major sectors except export manufacturing:

> every important sector in the economy - from commodities, utilities, chemicals and heavy industry to infrastructure, construction and shipping, to banking, finance and insurance, to media and education, to renewable, information technology (IT) and advanced IT platforms and technologies - these are SOE-dominated.[120]

Moreover, Marchick and Bowles note that the Chinese economy is becoming populated with privately-held companies; however most of these companies are very small and lack the wherewithal to invest heavily overseas.[121] Certainly, private enterprises have not accounted for any energy/resources investments in Australia above AU$250 million.[122] Further, Lee evidences that SOEs comprise 950 of the 1000 largest firms in China; and that all but 100 of the 2037 firms listed on the stock exchange in 2012 were SOEs.[123] These empirical realities place SOEs at the heart of not only China's economy, but also the social, political (including foreign policy) and cultural infrastructures that are dependent upon that economic substructure.

Table 15 below identifies the ten largest Chinese corporate investors in Australia, which all happen to be SOEs. These ten SOEs accounted for US$39,000 million out of a total accumulated direct investment of US$51,020 million for 1 January 2005 to December 2012, which equates to 76% of accumulated Chinese direct investment into Australia over the past seven years.[124]

---

subsidiaries or special purpose vehicles (SPVs) based in Hong Kong and Singapore: KPMG 2013, *supra* note 87, preamble.

[119] The ABS has noted a lack of international standardization in this regard, detailing difficulties where figures are compiled using different rationales, the most basic issue being measurement. The Balance of Payment Manual 5th edition (BPM5) recommends that direct investment flows, income transactions and stocks be valued at market value. However, an entity may choose to use cost measurement over market value, in which case figures will not align at all. *See*: Australian Bureau of Statistics, INFORMATION PAPER: FDI DATA COLLECTION: OVERCOMING HURDLES AND OBSTACLES IN FDI MEASUREMENT AND COLLECTION, NO. 5370.0.55.001 (August 2003); and International Monetary Fund, REVISION OF THE BALANCE OF PAYMENTS MANUAL FIFTH EDITION (ANNOTATED OUTLINE) (2004).

[120] John Lee, *The Re-emergence of China: Economic and Strategic Implications for Australia* 45(4) THE AUSTRALIAN ECONOMIC REVIEW 484, 484 (2012).

[121] David M. Marchick & Daniel .R. Bowles, *The State of Chinese Investment in the United States*, CONFERENCE ON CHINA'S ECONOMIC & TRADE RELATIONS, 5 (Columbia University, November 10, 2011).

[122] Clayton Utz, *supra* note 83, 9.

[123] Lee, *supra* note 120, 484.

[124] The Heritage Foundation, *supra* note 87. Note that these figures comprise deals valued at US$100 million and above.

Table 15 Largest investors in Australia: 1 January 2005 – 31 December 2012 ($US millions)[125]

Ranking	Company name	Enterprise type	Level (%) of State Ownership	Managing Owner	Sector (sub-sector) of investment	Accumulated Value
1	Chinalco (Shining Prospect Pte. Ltd.)	SOE	Central (100%)	Chinalco	Metals (Aluminium)	$14,300
2	Yanzhou Coal Mining Company	SOE	Shandong (52.86%)	Yankuang Group	Energy (Coal)	$6,590
3	Sinopec Corp.	SOE	Central (75.84%)	Sinopec Group	Energy (Oil & Gas)	$3,070
4	CITIC[126]	SOE	Central (100%)	CITIC Group Corporation	Metals (Steel), Energy (Coal)	$3,020
5	Minmetals Resource Ltd	SOE	Central (71.56%)	China Minmetals Corp.	Metals	$2,960
6	Taurus	SOE	Central (100%)	Guangdong Nuclear Group	Metals	$2,280
7	CNOOC Ltd.	SOE	Central (64.43%)	CNOOC Group	Energy (Gas)	$2,200
8	China Datang Corp Renewable Power Co.	SOE	Central (88.4%)	China Datang Corp.	Energy (Alternatives)	$2,030
9	Sinosteel	SOE	Central (100%)	Sinosteel Corp.	Metals (Steel)	$1,460
10	China Metallurgical Corporation	SOE	Central (64.18%)	Metallurgical Group Corp.	Metals (Steel)	$1,090
TOTAL						**$39,000**

The vast majority of these SOEs are central government controlled to varying degrees but all above 50%. Only one firm in the top ten largest Chinese investors, Yanzhou Coal, is a local SOE (Shandong). As such, we can infer that any high-value investment by a large Chinese firm in Australia is being made via an SOE whose majority shareholder is a central state entity.

C. Chinese Investment or 'China Incorporated'?

The preceding data and commentary demonstrate that the largest Chinese investors in Australia are SOEs and that sectoral investment continues to focus on resources (particularly in metals and mining) but is diversifying into energy (particularly gas) as well as food production. These sectors clearly represent China's national interest in supporting a rapidly urbanizing population that exceeds indigenous resources on a per capita basis.

Yet, one challenge for commentators of state capital is to discern and appreciate the impacts on foreign investment of intra-China tensions: first, between the goals of central and provincial state entities; and secondly, between the goals of central state actors and SOE boards. On the first point, Ruskola's depiction of local (not central) government actors as

[125] *Id.*; KPMG 2012, *supra* note 19, 14; KPMG 2013, *supra* note 87, 23; individual company websites.
[126] The accumulated value for 'Citic' is an aggregated total of investments by different subsidiaries of the CITIC group, namely CITIC Pacific, CITIC Resources, CITIC Construction, and CITIC Group.

germane to the commercial success of traditional TVEs/SOEs is relevant. Fragmentation of SOE ownership and thus potentially competing priorities between levels of government adds internal complexity to SOE investment behavior. However, nine out of ten of the current largest Chinese corporate investors in Australia are central government controlled SOEs. Therefore, such complexity is less compelling in this jurisdiction.

On the second point, SOEs may be exercising independence from the government entities that formally own or control them. SASAC provides the operating framework for SOEs. In March 2012, SASAC issued new regulations requiring central state-controlled SOEs to: register with SASAC before undertaking 'key investment projects' in their core businesses; obtain SASAC approval prior to investing overseas in non-core areas of business; and lodge details with SASAC of sources of investment and financing for proposed non-core area investments.[127] Despite the SASAC framework, there is some evidence to suggest that the Going Out strategy is being led by Chinese firms rather than central government. The Peterson Institute for International Economies asserts that SOEs operate and make investment decisions not as agents of the state but similar to any other corporation.[128] Howson makes a similar claim, citing the action of CNOOC in bidding for Unocal in 2005 despite central government opposition.[129] Similarly, KPMG argues that 'Chinese SOEs abroad have shown strong commercial motivations, similar to those of multinational corporations from developed countries'.[130] Commercial motivations are evinced by SOE capital investments to secure stable and high-quality supplies of natural resources, mergers and acquisitions to acquire new brands and technology, accessing new markets, and exporting Chinese brands.

Moreover, multiple external parties are involved in Chinese SOE investment decision-making abroad, including domestic consultants, corporate partners and financiers, such that decisions cannot be made solely by a government entity. Importantly, statistics show that Chinese investors rely heavily on local talent to manage Australian companies in which the investor gains a controlling interest. For example, during the period 1 January 2005 to 31 December 2012, Chinese nationals were appointed as Chief Executive Officer only in 32% of acquisitions in the energy and resources sectors, and Chief Operating Officer in only 10% of same.[131]

This evidence gives rational cause to seriously question a 'China Inc.' central domination strategy as sensationalized in Western media and feared by politicians. Specifically, data detailed and discussed above show that: China is an increasingly significant investor in Australia but not the largest investor; Chinese investments are occurring predominantly in mining/natural resources with emerging diversification toward energy and agriculture; and corporate control of acquired companies tends to remain with local actors.

[127] State-owned Assets Supervision and Administration Commission, INTERIM MEASURES ON THE SUPERVISION AND ADMINISTRATION OF OUTBOUND INVESTMENTS BY CENTRAL SOES, Circular No. 28 (2012) (hereafter 'Circular No. 28). It was issued on 18 March 2012 and came into force on 1 May 2012. Circular No. 28 builds on extant SASAC regulations: State-owned Assets Supervision and Administration Commission, INTERIM MEASURES ON THE SUPERVISION AND ADMINISTRATION OF OVERSEAS STATE-OWNED ASSETS OF CENTRAL SOES, Circular No. 26 (June 14, 2011) and State-owned Assets Supervision and Administration Commission, INTERIM MEASURES ON THE SUPERVISION AND ADMINISTRATION OF OVERSEAS STATE-OWNED EQUITY INTERESTS OF CENTRAL SOES, Circular No. 27 (June 14, 2011). These measures regulate: foreign investments by central SOEs from their initial decision-making through to project management and operation; and the way in which equity interests in foreign investment projects are managed and monitored by central SOEs and SASAC.

[128] Petersen Institute for International Economics, CHINESE INVESTMENT IN LATIN AMERICAN RESOURCES: THE GOOD, THE BAD, AND THE UGLY (2012).

[129] Howson makes this point in relation to the CNOOC bid for Unocal, which was opposed by Chinese central government actors: Howson, *supra* note 18, 73.

[130] KPMG 2012, *supra* note 19, 13.

[131] Clayton Utz, *supra* note 83, 25.

Thus, one can make a compelling argument that China is behaving like a nation that seeks to secure resources, energy, and food for growing domestic demand that will soon far exceed domestic supply, as opposed to embodying a politically-charged and malevolent avarice. Certainly, the data evidence that SOEs are the primary modality of Chinese investment in Australia and that the largest Chinese investors are central government-controlled. However, these SOEs appear to be pursuing commercial opportunities in source-rich foreign jurisdictions in much the same way as Western multinational corporations have done abroad and continue to do so.

Concrete conclusions about the intent of Chinese governments and their corporate champions as investors in foreign jurisdictions can only be formed after further empirical investigation is undertaken in light of these issues. Thus far, however, the data tend to indicate that media and policy concerns have been overplayed in Australia. Given the growing importance of Chinese trade with and investment in Australia, and Australia's need to retain competitive advantage in the region for the long-term, pursuing evidence-based conclusions ought to be a priority of national interest.

IV. CONCLUSION

In a post-GFC world, as the 21st century progresses and the economic power of certain Asian countries grows, market perceptions about appropriate levels of activity by the state as an investor in capital markets may well change. These changes are likely to reflect trends in the composition of the global economy and projections regarding which nations will be losers and others winners. In recent years Australia has been a winner. However, given the extent to which Australia's economic wellbeing is tied to China's future growth, determining how to manage inward capital investment - particularly from state pools of capital - has significant corporate, legal and policy implications.

The release in May 2013 of the report *Energy in Australia* by the Commonwealth Government's Bureau of Resources and Energy Economics (BREE) fuelled the debate about whether Australia's so-called 'resources boom' has peaked.[132] BREE is the key forecaster on commodities for the federal government and it delivered a number of chilly messages on the near-term projections for Australia's resources and energy sector, despite the current rosy picture. For example, on the plus side, Australia's energy sector accounts for 6% of Australia's total industry value, and has provided $77 billion of energy exports in 2011-2012; currently it has committed and potential projects totaling $350 billion (approximately 18% of GDP). However, on the negative side, the value of committed and potential projects is expected to fall to $25 billion in 2018. This dramatic downturn has already been signaled during the last year by the setting aside of $150 billion in energy and mining projects including Aquila's West Pilbara iron ore mine in Western Australia, BHP's Olympic Dam expansion in South Australia and Woodside Petroleum's Browse LNG project in Western Australia. The bad news concerning shelved projects such as these is amplified by revelations of cost blowouts of more than $29 billion regarding existing projects. A 96% fall in large-scale investment in energy and resources in only five years is a massive slide and prompted a flurry of headlines proclaiming that Australia's resources boom has indeed ended.[133]

---

[132] Australian Government, Department of Resources, Energy and Tourism, Bureau of Resources and Energy Economics, ENERGY IN AUSTRALIA, May 2013 (2013), available at http://www.bree.gov.au/publications/energy-in-aust.html

[133] Paul Garvey, *Resources Boom is Truly over Says Focus Minerals Chair Don Taig*, THE AUSTRALIAN (May 15, 2013), http://www.theaustralian.com.au/national-affairs/treasury/resources-boom-is-truly-over-says-focus-minerals-chair-don-taig/story-fnhi8df6-1226642524237; Gemma Daley, *The Party's*

These gloomy statistics may be preemptorily negative; time will tell. However, it is certain that Australia will remain a net importer of capital in a world in which competition for that investment dollar is increasing from many countries. How much the twin pressures of increased investment capital competition and Australia's seemingly reduced attractiveness as a target for that inward investment capital will impact upon the *realpolitik* of Australia's foreign investment regulatory regime over the coming years is unknown. Nonetheless, the inevitable political influence on that investment regime was clear in the June 2013 Final Report of The Senate Rural and Regional and Transport Committee which had a particular focus on foreign investment into Australian agriculture.[134] The Committee made 29 general recommendations and highlighted the limitations of FATA in a contemporary investment setting.[135] The Committee's key findings and recommendations included that: there is a significant lack of detailed and accurate information regarding foreign investment in the Australian agricultural sector; there are significant shortcomings in the transparency of the FIRB process and in the scrutiny of the national interest test; the current investment threshold of AU$248 million to trigger a FIRB review of proposed private foreign investments in the agriculture industry is far too high; and there are problems with current legislative definitions of 'rural land', 'urban land' and 'direct investment'. Importantly, the Committee recommended certain steps that the federal government ought to take in order to develop a more rigorous and transparent system for examining cases of foreign agricultural investment in Australia by establishing an Independent Commission of Audit into Agribusiness to develop a comprehensive policy approach to Australian agriculture investment, and by creating a national register for foreign ownership of agricultural land as the primary mechanism for collecting and publishing information about such foreign investment. Specifically, the Committee recommended forensic examination of: company structures (including management relationships in joint Australian/foreign ventures); the relationship between a foreign government's acquisitions strategy (such as food security) and the commercial operation of their subsidiary businesses in Australia; and ways of setting clear and auditable ongoing undertakings that are in the 'national interest'.

This paper has examined many of the factors that underpin debates on these specific issues and foreign investment in general, in particular the increasingly strategic role that state capital is likely to play in global and Australian contexts. Therefore it is vital that national and international policy development in this area is underpinned by accurate data, as stressed by the Committee in relation to foreign investment in Australian agriculture. The discussion on the methodological difficulties associated with evaluating the extent and impact of investment by state capital actors illustrates that it will be a challenging yet essential process to chart these developments.

Over: Resources boom has peaked says chief commodities forecaster, BUSINESS REVIEW WEEKLY (May 23, 2013), http://www.brw.com.au/p/business/forecaster_party_over_resources_xmIAuQKUh2Iq3Yx4cbYtlN;

[134] Commonwealth of Australia, Senate Standing Committees on Rural and Regional Affairs and Transport, FOREIGN INVESTMENT AND THE NATIONAL INTEREST (2013).

[135] The Committee released an interim report in November 2012 in which it made 6 recommendations specific to tax arrangements for foreign investment in agriculture: Commonwealth of Australia, Senate Standing Committees on Rural and Regional Affairs and Transport, EXAMINATION OF THE FOREIGN INVESTMENT REVIEW BOARD NATIONAL INTEREST TEST: INTERIM REPORT: TAX ARRANGEMENTS FOR FOREIGN INVESTMENT IN AGRICULTURE AND THE LIMITATIONS OF THE *FOREIGN ACQUISITIONS AND TAKEOVERS ACT 1975* (2012).