THE UNIVERSITY OF NEW SOUTH WALES
SCHOOL OF LAW

Centre for Law, Markets and Regulation

CLMR
CENTRE FOR LAW, MARKETS AND REGULATION

What's the State of Play? The Effects of State Capital Investment in Australia and Regulatory Implications

George Gilligan and Megan Bowman

May 2013

CLMR RESEARCH PAPER SERIES

WORKING PAPER NO. 13-1

What's the State of Play? The Effects of State Capital Investment in Australia and Regulatory Implications

George Gilligan and Megan Bowman[1]

ABSTRACT

The growing size and significance of investments by Sovereign Wealth Funds (SWFs) and State-Owned Enterprises (SOEs), especially those of rapidly growing Asian economies, are having a profound impact on the dynamics of markets across the world. Better understanding global state investment capital is an increasingly important strategic priority for governments, regulators, finance sector participants and other stakeholders. This is particularly the case for Australia given the economic and political reality that its stability and economic well-being is increasingly intertwined with Asian jurisdictions that are active state investment actors. This paper draws on the early stages of a research project that seeks to map from an Australian perspective these transformational forces.

A INTRODUCTION
STATE CAPITAL AND THE CHANGING GLOBAL ECONOMY

The activities of state-related pools of capital have to be understood within the context of an era of globalisation, in which economic and political ties between many jurisdictions are deepening, and jurisdictions increasingly are playing a mediating role regarding the interests of much business that may be conducted within their spheres of influence.[2] One significant effect of globalisation 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 internationalised. 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

[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 for example: J.A. Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century*, W.W. Norton & Company, New York, 2006; J.A. Scholte, *Globalization: A Critical Introduction*, Palgrave Macmillan, Houndmills, 2005; and J. Stiglitz, *Globalization and its Discontents*, W.W. Norton & Company, New York, 2003.

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]

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 enormous 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 twenty one 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 two hundred 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 and 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 do 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).[8] SWFs and other state-related pools of capital such as State Owned Enterprises (SOEs),[9] State Pension Funds (SPFs) and Commodity Stabilisation 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

---

3 This paper is not focused on the GFC, but there is a substantial literature on its causes and effects including: C.J. Arup, "The Global Financial Crisis: Learning from Regulatory and Governance Studies", (2010), *Law and Policy*, Vol.32, No.2, 363; E. Avgouleas, "The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy", (2009), 9 *Journal of Corporate Law Studies* 23; P. Booth (ed), *Verdict on the Crash: Causes and Policy Implications*, Institute of Economic Affairs, London, 2009; Essential Information and Consumer Education Foundation, *Sold Out: How Wall Street and Washington Betrayed America*, Washington, D.C., 2009; G.B. Gorton, "Questions and Answers About the Financial Crisis", (2010), *NBER Working Paper No.w15787*, http://www.nber.org/papers/w15787; International Monetary Fund, *Global Financial Stability Report: Meeting New Challenges to Stability and Building a Safer System*, Washington, D.C., April 2010; International Monetary Fund, *Fiscal Implications of the Global Economic and Financial Crisis*, SPN/09/13, Washington, D.C., 2009; C.M. Reinhart & K.S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2009.

4 For a discussion of how various interest groups interacted in shaping the policy priorities of the East India Company see: H.V. Bowen, *The Business of Empire: The East India Company and Imperial Britain, 1756-1833*, Cambridge University Press, 2006.

5 East India Company, *Encyclopædia Britannica Eleventh Edition*, 1911, Volume 8, p.835

6 For a more detailed analysis of the VOC see: C.R. Boxer, *The Dutch Seaborne Empire: 1600–1800,* Taylor & Watson, London, 1977.

7 See B. George, The Remarkable History of the Hudson's Bay Company, B. Franklin, New York, 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 as SWFs are.

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 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 hybridisation of financial sector actors, products and services

These challenges have been heightened by GFC ramifications such as governments part-nationalising/saving failing banks, (e.g. Royal Bank of Scotland and Lloyds in the UK), or nationalising them, (e.g. Fannie Mae and Freddie Mac in the 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 comfortable 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 their strategic economic and political importance grows, it further accentuates the need to understand how international regulatory infrastructures need to evolve in order to accommodate such changes. Of particular importance are 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),[12] to $31,202 billion in 2012 (45% of its annual GDP).[13]

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 (Table 1.1) and are likely to make up half of the world's GDP by 2020.

---

[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. For example: D.A. Oesterle, "The Collapse of Fannie Mae and Freddie Mac: Victims or Villains?", (2010), *Ohio State Public Law Working Paper No. 127*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1645330; P. Aldrick, "RBS and Northern Rock to unveil radical strategies", *Telegraph.co.uk*, 22 February 2009, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/4782762/RBS-and-Northern-Rock-to-unveil-radical-strategies.html; R.A. Tomasic, "The Rescue of Northern Rock: Nationalization in the Shadow of Insolvency", (2008), *Corporate Rescue and Insolvency*, Vol.1, No.4, p.109; R.J. Rhee, "Nationalization of Corporate Governance and Purpose During Crisis", (2010), *George Mason Law Review*, Vol.17, 661.

[12] Z.M. Song, K. Storesletten & F. Zilibotti, (2010), 'Growing Like China', *CEPR Discussion Paper No. DP7149*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1345675

[13] K.Rapoza, 'China's Cash Hoard Nearly Half its GDP', *Forbes Investing*, 25 May 2012, http://www.forbes.com/sites/kenrapoza/2012/05/25/chinas-cash-hoard-nearly-half-its-gdp/

Table 1.1

	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**
Egs. *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**
Egs. *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

In particular, 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."[14] Indeed, as depicted in Table 1.2, the top ten biggest companies in the world (by revenue) now include three Chinese SOEs; this exceeds the number of European and UK companies, and comes just behind that of the US.[15]

[14] A. Wooldridge, 'The Visible Hand', *The Economist*, 21 January 2012
[15] 'Global 500', *Fortune Magazine*, July 23, 2012.

Table 1.2

Global 500 rankings 2011/12

	Company	City/Country	Revenue (mn)	Profits (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

Source: 'Global 500', Fortune Magazine (July 23, 2012) http://money.cnn.com/magazines/fortune/global500/2012/full_list/.

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, using a sample of 122 countries accounting for more than 95% of global GDP, Jorgenesen and Khuong have predicted that if current growth trends are maintained, then 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 & 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 & 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.[16] If these trends transpire into reality, and they do seem 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 the table below from a 2013 PwC Economics report which projects across a longer time span how the top 20 global economies based on Purchasing Power Parity (PPP) were ranked in 2011 and how they might look in 2030 and 2050.[17]

---

[16] D.W. Jorgensen and K.M. Vu, *The Rise of Developing Asia and the New Economic Order*, 2010, p.44, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1912362

[17] PwC Economics, *World in 2050, The BRICS and beyond: prospects, challenges and opportunities*, January 2013, p.2, http://www.pwc.co.uk/economic-services/global-economy-watch/index.jhtml

Table 1.3: *Actual and projected top 20 economies ranked based on GDP in PPP terms*

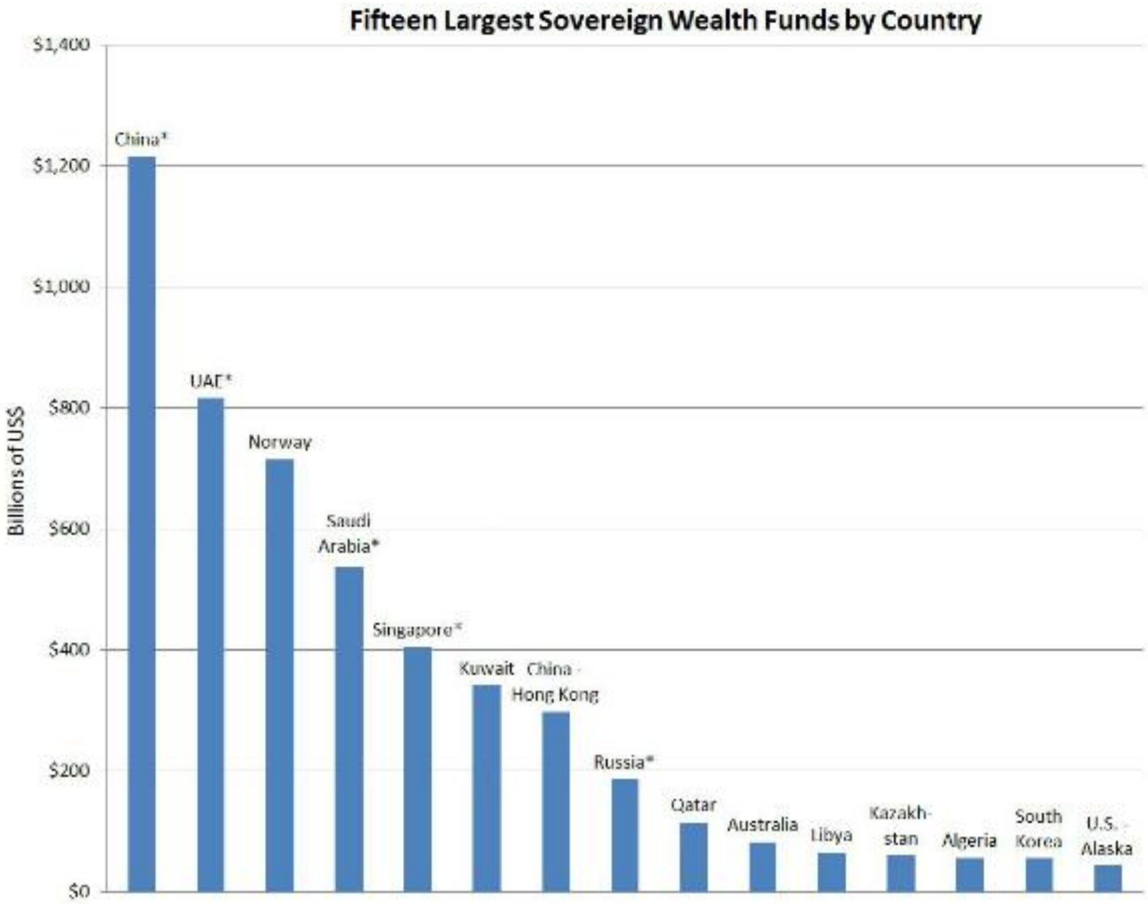
	2011		2030		2050	
PPP rank	**Country**	GDP at PPP **(2011 US$bn)**	**Country**	**Projected GDP at PPP (2011 US$bn)**	**Country**	**Projected GDP at PPP (2011 US$bn)**
1	US	15,094	**China**	30,634	**China**	53,856
2	**China**	11,347	US	23,376	US	37,998
3	India	4,531	India	13,716	India	34,704
4	Japan	4,381	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
11	**Mexico**	1,761	**Indonesia**	2,912	**UK**	5,598
12	Spain	1,512	Turkey	2,760	Turkey	5,032
13	South Korea	1,504	Italy	2,629	**Nigeria**	3,964
14	Canada	1,398	Korea	2,454	Italy	3,867
15	Turkey	1,243	Spain	2,327	Spain	3,612
16	**Indonesia**	1,131	Canada	2,148	Canada	3,549
17	Australia	893	Saudi Arabia	1,582	South Korea	3,545
18	Poland	813	Australia	1,535	Saudi Arabia	3,090
19	Argentina	720	Poland	1,415	**Vietnam**	2,715
20	Saudi Arabia	686	Argentina	1,407	Argentina	2,620

Source: World Bank estimates for 2011, PwC estimates for 2030 and 2050

If these estimates are correct then China is likely to be the dominant economic power globally before the middle of the century and of specific importance for this paper is that it and some of the other fastest-growing economies in the world featuring prominently in these tables have significant state capital investment actors. For example, in Table 1.4 below Coleman using Sovereign Wealth Funds Institute (SWFI) data shows the fifteen largest SWFs by assets under management at March 2013.[18]

[18] I. Coleman, *Graph: Sovereign Wealth Funds, Council on Foreign Relations*, 24 April 2013, http://blogs.cfr.org/coleman/2013/04/24/graph-sovereign-wealth-funds/

Table 1.4



(Numbers come from the Sovereign Wealth Fund Institute's Sovereign Wealth Fund Rankings (last updated March 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").

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 all quite hard 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 organisations. Truman defines SWFs as: '...a descriptive term for a separate pool of government-owned or government-controlled financial assets that includes some international assets.'[19] Lowery, at the time US Undersecretary for International Affairs, defined SWFs as: '..a government investment vehicle which is funded by foreign exchange assets, and which manages these assets separately from official reserves.'[20] 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.'[21] 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;[22] 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.[23] Jen believes 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.[24] 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.[25]

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/ADIC – Abu Dhabi), others are corporations (e.g. Temasek - Singapore) and others are not legal persons (e.g. Norway Government Global Fund).

---

19 E.M. Truman, 'A Blueprint for Sovereign Wealth Fund Best Practices', 2008, *Policy Brief Number PB08-3*, Petersen Institute for International Economics, Washington: D.C., p.1, http://www.iie.com/publications/interstitial.cfm?ResearchID=902.

20 *Press Room, US Department of Treasury, hp-471*, 2007, 'Remarks by Acting Undersecretary for International Affairs Clay Lowery on Sovereign Wealth Funds and the International Financial System', San Francisco, 21 June 2007, http://www.ustreas.gov/press/releases/hp471.htm.

21 Commission of the European Communities, (2008), *Communication from the Commission to The European Parliament, The Council, The European Economic and Social Committee and The Committee of the Regions*, Brussels, xxx, COM(2008) 115 provisional, p.3, http://ec.europa.eu/internal_market/finances/docs/sovereign_en.pdf

22 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.' 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. http://www.investorwords.com/1604/dutch_disease.html. See also: P. Krugman,. 'The Narrow Moving Band, the Dutch Disease, and the Competitive Consequences of Mrs. Thatcher.', (1987), *Journal of Development Economics* 27 1-2:50.

23 International Monetary Fund, *Sovereign Wealth Funds – A Work Agenda*, Washington, D.C., 2008, p.5, http://www.imf.org/external/np/pp/eng/2008/022908.pdf.

24 S. Jen, 2007, *The definition of a sovereign wealth find, Morgan Stanley Global Research*, October 2007, http://www.morganstanley.com/views/gef/archive/2007/20071026-Fri.html.

25 International Working Group of Sovereign Wealth Funds, (2008), *Generally Accepted Principles and Practices (GAPP) – The Santiago Principles*, p.3. http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf

Academic interest in forms of state capital such as SWFs appears to be a relatively recent phenomenon. For example, although some SWFs have been in existence for sixty years,[26] public recognition of the label SWF is quite recent.[27] 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 March 2013 at $5,368 billion and regarding the geographical origins of SWFs a: 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.[28]

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, i.e. 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 Australian Treasurer Wayne Swan described in 2009 as 'spectacular regulatory failure..' and Treasurer Swan has stressed 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.[29] 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 here in Australia and around the world.

---

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

[27] The term Sovereign Wealth Fund appears to have been introduced by Rozanov in 2005; A. Rozanov, 'Who Holds the Wealth of Nations?' (2005), *Central Banking Journal*, Vol. XV, No.4, p.52-57.

[28] Sovereign Wealth Fund Institute, *Sovereign Wealth Fund Rankings March 2013*, http://www.swfinstitute.org/fund-rankings/

[29] Franklin, M., "Wayne Swan calls for new controls on free market", *The Australian*, January 24 2009.

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 twenty first century 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.

B INTERNATIONAL REGULATORY ISSUES

Traditionally state capital actors, especially SWFs are seen as long-term investors that can be a true provider of liquidity in times of crisis and have large *holding power* but there is an increasing trend amongst 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.[30]

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.[31] 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 management of 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 spectre of *cross-border nationalisation* 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.[32] The controversy contributed to DPW in December 2006 selling the seaport management businesses to the American International Group.[33] 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% believed that foreign governments do not reveal enough about their investment portfolios, 68% of those surveyed opposed government investment from Saudi Arabia and similar scores were recorded for other jurisdictions e.g. Abu

[30] S.J. Weisman, "Concern about sovereign wealth funds spreads to Washington", *International Herald Tribune*, 20 August 2007.
[31] Some of the media coverage was quite hostile, for example: D. R. Francis, "Will Sovereign Wealth Funds Rule the World?", *The Christian Science Monitor*, 26 November 2007, p.16;
[32] For example: Senator Carl Levin, *Opening Remarks at the Senate Armed Services Committee Briefing on Port Security*, February 23 2006, *http://levin.senate.gov/newsroom/release.cfm?id=251838*; S.R. Weisman, "Concern about 'sovereign wealth funds' spreads to Washington", *International Herald Tribune Business*, August 20, 2007; R. Gay, US feels power of cashed-up foreign funds", *The Australian Financial Review*, 29 November 2007, p.1.
[33] WorldCargo news, *AIG buys DPW's US assets*, 11 December 2006, http://www.worldcargonews.com/htm/n20070118.117570.htm

Dhabi (62%), China (65%) and Russia (61%).[34] 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.[35] 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.[36]

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.[37] These concerns largely centred 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 *Generally Accepted Principles and Practices (GAPP) – The Santiago Principles* 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., twenty five 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, and as a partial response to some of the criticism about their investment activities and motivations. Composition of the IWG has been largely 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 *Generally Accepted Principles and Practices (GAPP) – The Santiago Principles*. IWG members committed to operate by the GAPP, which have as their core twenty four voluntary principles emphasising good governance, accountability, transparency and a commitment to financially motivated investment strategies.[38] Considering that twenty five 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, especially in 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.

---

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

[35] T. Walker, "Call to keep funds free of political bias", *The Australian Financial Review*, 22 October 2007.

[36] 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)*, http://cfius.us/modules/news/

[37] J.M.Barroso, J.M., *Statement by Jose Manuel Barroso President of the European Commission on sovereign wealth funds, Oslo*, 2008, http://ec.europa.eu/commission_barroso/president/press/releases/index_en.htm

[38] International Working Group of Sovereign Wealth Funds, (2008), *Generally Accepted Principles and Practices (GAPP) – The Santiago Principles*. http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf

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.[39] 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 organisations and capital markets actors.[40] 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. 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.[41] So, although the GAPP, the IFSWF and this 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.'[42] 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 with the *recipient* jurisdictions and the domestic regulation which inevitably impacts upon inward investment actors. This pragmatic stance is symbiotic with how investment norms are shaped and operationalised on international financial markets. Past attempts by international organisations to embed a top-down multi-lateral regulatory infrastructure to shape behaviour by investment actors have not been terribly successful. This was demonstrated by the OECD's failure regarding its proposed Multilateral Agreement on Investment (MAI) in the late 1990s.[43] The key reason why the MAI failed was its lack of process legitimacy to jurisdictions that were not committed or not bound by its central tenets. This obviously creates difficulties for organisations such as the OECD which are seeking to promote certain investment protocols as standard business practice. For example, the OECD Declaration

---

[39] Willson, S., (2008), *Wealth Funds Group Publishes 24-Point Voluntary Principles*, http://www.imf.org/external/pubs/ft/survey/so/2008/new101508b.htm

[40] International Working Group of Sovereign Wealth Funds, *"Kuwait Declaration": Establishment of the International Forum of Sovereign Wealth Funds*, 6 April 2009, www.iwg-swf.org/mis/kuwaitdec/htm

[41] International Forum of Sovereign Wealth Funds, *IFSWF Members' Experiences in the Application of the Santiago Principles*, 7 July 2011, www.ifswf.org/pst/stp070711.pdf

[42] S. Johnson, (2007), "The Rise of Sovereign Wealth Funds", *Finance and Development*, 44(3), p.56.

[43] Organisation for Economic Cooperation and Development, *Multilateral Agreement on Investment*, (1998), http://www.oecd.org/document/22/0,3343,en_2649_33783766_1894819_1_1_1_1,00.html. For an examination of the MAI and why it failed see: K. Tieleman, (2005), *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, http://www.gppi.net/fileadmin/gppi/Tieleman _MAI_GPP_Network.pdf

on International Investment and Multinational Enterprises[44] and the OECD Code of Liberalisation of Capital Movements. The latter has sought to counter protectionist activity such as establishing artificial barriers to market entry.[45] 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.[46] 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.[47]

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 organisations such as the Financial Stability Board (FSB)[48] under its G20[49] imprimatur or the OECD. As long ago as 2005 the OECD issued its guidelines on corporate governance of state-owned enterprises,[50] but political economy and commercial realities have limited the scale of influence of the OECD. The key avenue for multi-lateral regulatory progress post-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.'[51] 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.[52] They represent substantial changes in the calibration of international capital

---

[44] OECD, *OECD Declaration on International Investment and Multinational Enterprises*, 2011, www.oecd.org/daf/inv/investment-policy/declarationoninternationalinvestmentandmultinationalenterprises.htm

[45] OECD, *OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations*, 1961, browse.oecdbookshop.org/oecd/pdfs/product/2003021e.pdf.

[46] OECD, *OECD Code of Liberalisation of Capital Movements, 2013*, www.oecd.org/daf/inv/investment-policy/capitalmovements_webenglish.pdf

[47] For a critical analysis of the paramount importance of legitimacy in multilateral regulatory activity in the financial sector see: G. Gilligan, "Multi-lateral regulatory initiatives – a legitimation-based approach", (2005), Chapter Seven in J. O' Brien (ed), *Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets*, Chichester: John Wiley & Sons, pp.121-139

[48] See www.financialstabilityboard.org.

[49] 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.

[50] OECD, *OECD Guidelines on Corporate Governance of State-owned Enterprises*, 2005, www.oecd.org./corporate/corporategovernanceofstate-ownedenterprises/34803211.pdf

[51] *The G-20 Toronto Summit Declaration, June 26-27, 2010*, G20 Toronto Canada 2010, p.15, http://www.g20.org/Documents/g20_declaration_en.pdf

[52] For a discussion of these issues with a focus on initiatives in the UK and how they are affected by European Union responsibilities see: J. Black, "Managing the Financial Crisis – The Constitutional Dimension", (2010), *LSE Legal Studies Working Paper No. 12/2010*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1619784.

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 but also as 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 SWFs raise issues of the implications of cross-nationalisation 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 the 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.[53] 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: '..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.'[54]

C INWARD CAPITAL INVESTMENT TO AUSTRALIA

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 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.[55] 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.[56] However, FIRB's functions are advisory only and decision-making resides with the Treasurer.

---

[53] For example, the Australian Treasury released a discussion paper in June 2010: Australian Government, (2010), *Consultation Paper – Greater Certainty for Sovereign Investment – The Framework Rules*, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1842

[54] Parliament of Australia, The Senate, Economics References Committee, *Foreign investment by state-owned entities*, September 2009, p.47, http://www.aph.gov.au/Parliamentary_Business/Statistics/statsnet/documents/governmentresponses/2011

[55] Australian Government The Treasury, *Australia's Foreign Investment Policy*, 2013, www.firb.gov.au/content/_downloads/AFIP_2013.pdf

[56] See: www.firb.gov.au/content/default.asp

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 2010-2011, more than 94% of proposals were decided under this delegated authority.[57] 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. So, 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 and the context of where foreign investment is coming from and where it invests in Australia is discussed in more detail below. Rejection of foreign investment applications is not statistically a common event. For example, in 2010-2011, 10,865 applications for foreign investment approval were considered and of these 10,293 were approved 43 rejected, 390 withdrawn and 139 were deemed exempt. It is noticeable that real estate comprised the vast bulk of activity with 9,771 of the approvals and 42 of the 43 rejections.[58] 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.[59]

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. Not that a sense of jingoism has not always being 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 against Australia being sold off to the Japanese.'[60] Almost forty 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 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 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.[61] Eventually on 24 August

---

[57] Foreign Investment Review Board, *Annual Report (2010-2011)*, 6.
[58] *Ibid*, 10, 19.
[59] Australian Government The Treasury, *Foreign Investment Proposal – Shell Australia Investments Ltd (Shell) Acquisition of Woodside Petroleum Limited (Woodside)* 23 April 2001, www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/2001/025.htm&min=phc
[60] Glenda Korporaal, 'New FIRB boss keen to lift lid on agency', *The Australian*, (online), 12 May 2012, http://www.theaustralian.com.au/business/financial-services/new-firb-boss-keen-to-lift-lid-on-agency/story-fn91wd6x-1226353377917.
[61] Treasurer of the Commonwealth of Australia, (2008), *Government Improves Transparency of Foreign Investment Screening Process*, Media Release of 17/02/2008, No.009,

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.[62] 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.[63] 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.[64] 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 Prime Minister Julia Gillard that undertook trade and other inter-governmental negotiations. Trade Minister Craig Emerson: '..has 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.'[65] 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?

FIRB Annual Reports – An Investment Snapshot

Table 2.1 shows approved proposed foreign investment by FIRB in 2011/12. According to FIRB Annual Reports, approved proposed Chinese investment contracts in Australia in 2011/12 comprised nearly half of the total number approved for all foreign countries, making China the largest investor by contract *volume*. However, in dollar *value*, proposed Chinese investment into Australia 2011/12 was AU$16.19bn (out of total approvals by value of AU$ 170.71). This makes China the third largest inward investor to Australia behind the U.S (AU$36.613bn) and the U.K (AU$20.343bn) for 2011/12. Japan follows closely at AU$13.92bn with Canada rounding out the top five with AU$8.871bn.

---

http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/009.htm&pageID=003&min=wms&Year=&DocType=0

[62] Treasurer of the Commonwealth of Australia, *Chinalco's Acquisition of Shares in Rio Tinto*, Media Release of 24/08/2008, no.094, www.treasurer.gov.au/DisplayDocs.aspx?doc=pressrelease/2008/094.htm&pageID=003&min=wms&Year=&DocType

[63] Treasurer of the Commonwealth of Australia, *Foreign Investment*, 27 March 2009, www.treasurer.gov.au/DisplayDocs.aspx?doc=pressrelease/2009/029.htm&pageID=003&min=wms&Year=&DocType

[64] Treasurer of the Commonwealth of Australia, *Foreign Investment Decision*, 23 April 2009, www.treasurer.gov.au/DisplayDocs.aspx?doc=pressrelease/2009/043.htm&pageID=003&min=wms&Year=&DocType

[65] J. Kerin and N. Gerritsen, 'Curbs on state business stall China deal', *The Australian Financial Review*, 19 April 2013, p.9

Table 2.1

FIRB Approved Proposed Investment: 2011/12

Approved proposed investment	**Deal Value (AUD bn)**	**Number of Contracts number**
TOTAL	170.71	10,703
Top 5 countries by proposed investment value		
U.S.A	36.613	268
United Kingdom	20.343	1,018
China	16.190	4,752
Japan	13.920	324
Canada	8.871	131

Sources: FIRB Annual Report 2011/12

Table 2.2 below outlines China's proposed investment patterns *by value* for the period 2005/06 – 2011/12.[66] Looking longitudinally, we can see that the value of approved proposed Chinese investment into Australia has risen and fallen over the last seven years; however it has maintained a steady top 3 ranking for the last four years.

Table 2.2

FIRB Approved Proposed Investment for China by Value (AUD billions): 2005/06 - 2011/12

Approved proposed investment values	**05/06**	**06/07**	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**
TOTAL approval value	85.75	156.39	191.88	181.35	139.50	176.67	170.71
China's investment approval value	7.26	2.64	7.48	26.60	16.28	14.98	16.19
China's investment in Australia as a percentage of total approval value	8.5%	1.7%	3.9%	14.7%	11.7%	8.5%	9.5%
China's country rank by investment value	3	11	6	2	3	3	3

Sources: FIRB Annual Reports 2005/06 – 2011/12

[66] A time line comparison for the period 2005/06 – 2011/12 of contracts approved for single countries (eg 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. However, the figures for approval by value are consistent when cross-checked throughout the tables of each report for the period 2005/06 – 2011/12.

Table 2.3

FIRB Approved Proposed Investment for China by Sector (AUD millions): 2005/06 – 2011/12

SECTOR	05/06	06/07	07/08	08/09	09/10	10/11	11/12	TOTAL
Agriculture, forestry & fishing	-	15	-	-	-	4	27	
Finance & Insurance	-	-	420	43	-	558	60	
Manufacturing	223	700	-	82	198	416	538	
Mineral Exploitation & development	6,758	1,203	5,311	26,254	12,186	9,758	10,505	
Real Estate	279	712	1,491	-	2,421	4,093	4,187	
Resource Processing	-	-	137	162	760	132	240	
Services	-	10	101	54	717	16	634	
Tourism	-	1	20	5	-	-	-	
TOTALS	**7,259**	**2,640**	**7,479**	**26,599**	**16,282**	**14,976**	**16,190**	**91,425**

Sources: FIRB Annual Reports 2005/06 – 2011/12
Note: Not all columns equal totals due to rounding.

Table 2.3 above shows the total values of Chinese approved proposed investment in Australia by sector. As can be seen, total investment equals AU$91.425bn for the seven year period to June 2012. The outlier year of 07/08 peaked at AU$26.6bn – a substantial increase over previous years - before settling around AU$16bn as Australia's third largest capital investor in the subsequent two years.

Table 2.4

Chinese proposed sector investment breakdown (% of value): 2005/06 – 2011/12

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%	-	-	-

Table 2.4 above depicts sectoral investment as a percentage of total Chinese investment. At a glance, it is clear that 'mineral exploitation and development' has consistently been the prime locus of Chinese inward investment into Australia. It remains high at nearly 70% of total investment in 11/12, although that figure has *decreased* since 2005 (despite an anomalous year in 06/07 of less than 50%). 'Real Estate' is the second largest investment target, at approximately one quarter of total Chinese investment in 2011/12.[67] By 2011/12, 'Services' had gained third ranking at less than 4%; and 'Manufacturing', while experiencing a one-off surge in 06/07 to nearly 25%, sits now at around 3% of total investment. The areas of consistently least interest to China appear to be Tourism, Resource Processing, Agriculture/forestry/fishing, and Finance and Insurance.

When looking at the figures from Tables 2.2 – 2.4 in detail, we can discern a longitudinal ebb and flow of proposed Chinese investment to Australia. Significant proposed investment by China in 2005/06 (with approvals valuing AU$7.3bn) placed Chinese investment as the third largest by country. Mineral exploration and development accounted for a proposed 93% of total Chinese investment by value, which included two proposals that totaled over AU$6bn.

In 2006/07, China's ranking dropped significantly. Chinese proposed investment totaled AU$2.6bn, decreasing by almost AU$5bn from the previous year and accounting for less than 2% of total approved investment in Australia by value, thus ranking China as the eleventh largest investor in Australia by country. However, data for the next fiscal year, show that Chinese proposed investment increased by nearly three times to AU$7.5n, elevating China to the sixth largest investor. Significant investments in manufacturing by Germany and Singapore, and large Swiss investments in mining exploration and development precluded China from the top five investors in Australia by country. Together, mining exploration and development (71%) and real estate (20%) accounted for 91% of proposed Chinese investments.

Similarly, in 2008/09, mineral exploration and development investment accounted for AU$26.3 billion and 99% of Chinese investment in Australia, which was largely due to one proposed investment of AU$19.8bn. Overall, China increased its proposed investment by 3.5 times the previous period and ranked as Australia's second largest investor, contributing 14.7% to total approved investments in Australia by value.

However, by 2009/10, Chinese proposed investment fell by AU$10bn (38%), with China dropping to third largest investor in Australia (at AU$16.3bn). Concomitantly, mineral exploration and development investment decreased to 75% of China's proposed investment. Similarly, in 2010/11, China's proposed investment dropped a further 8% by value from the previous period, holding at third ranking at just under AU$15 billion. Mineral exploration and development fell again to 65% and real estate increased to 27%, the two sectors combining to attract 92% of total Chinese proposed investment.

By 2011/12, China's proposed investment had increased to pass the AU$16bn mark again, with mineral exploration and development at 65% and 26% respectively, accounting for 91% of total proposed investment.

The totals from these FIRB tables indicate that in the last seven years there has been something of an ebb and flow in approved inward Chinese investment, with possibly a plateau emerging at around 10% of total approved investment. This figure may be lower than that assumed by many

[67] Note however that figures can jump between years due to policy changes in thresholds per sector and factors such as screening in Real Estate. See notes to Table 3.4 in Section III below.

in the community given the high media coverage of China as Australia's most important trading partner.

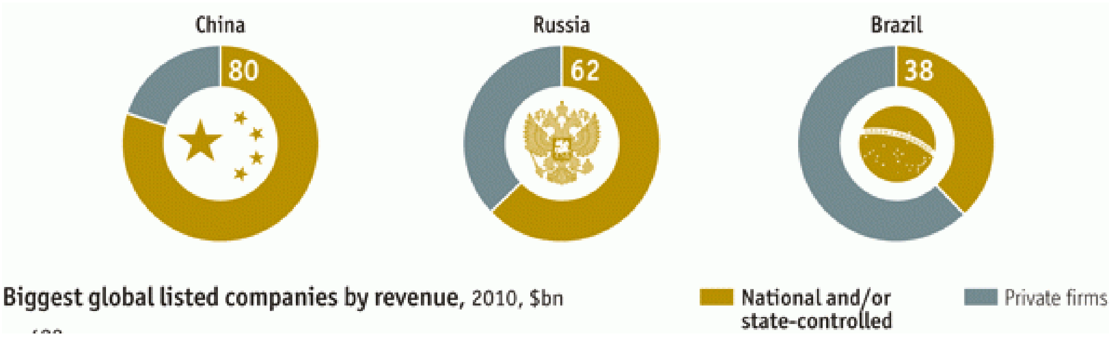
D RESEARCHING STATE CAPITAL: A SNAPSHOT FROM GROUND LEVEL

One contested issue in foreign investment and state capitalism discourse is that of foreign acquisition by SOEs.

According to *The Economist* in 2012, SOEs comprised 80% of the value of the stockmarket in China, 62% in Russia and 38% in Brazil, as depicted in Figure 3.1 below; and SOEs accounted for one-third of the emerging world's foreign direct investment from 2003-2010.[68] The weakened state of Anglo-American economies in the wake of the GFC combined with the strength of state capital investment by certain emerging economies has resulted in several high-profile acquisitions, partnerships, and bids in recent years. Notable examples include: approval by the Australian Competition and Consumer Commission of the partnership between Qantas airlines and Emirates (wholly-owned by the Government of Dubai) in 2013; Canadian government approval of the US$15.1bn takeover of Nexen by the China National Offshore Oil Corporation (CNOOC) in 2012; acquisition by the Abu Dhabi government of 90% of the Chrysler Building in New York City in 2008; and Nanjing Automobile's takeover of MG Rover assets in the UK in 2005.

Figure 3.1

Share of SOE capitalization on the MSCI national stockmarket index: % of total, June 2011



Source: *The Economist*, 21 January 2013.

In short, SOE capitalisation constitutes a significant element in three of the BRIC countries; and state-directed capital is flowing outward from emerging economies on a global scale. This is exemplified by China's 'Going Out 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.[69] The result of this SOE capitalization and mobilization is twofold: a serious questioning of liberal capitalism in the wake of the GFC; and potential diminution in home-state ownership of national entities and resources.

A third repercussion is the manifestation of concern within some Anglo-American nations about SOE acquisition. Concerns centre upon perceptions of risk to home-state national security,

---

[68] *Wooldridge, above n.14.*

[69] N.C. Howson 'China's Acquisitions Abroad – global ambitions, domestic effects' (2006) Winter/Spring *LQN* 73-84, 73.

energy security, economic security (control over wealth-creating assets), and/or fear of the other.[70] Concerns are exemplified in recent media headlines such as "China's state-owned enterprises obtain FIRB approval by stealth",[71] and "Don't mix politics and deals: FIRB in warning to state-owned investors".[72] They also manifest in policy guidelines (for example, Canada's recently revised foreign investment guidelines, discussed below) and political decisions such as the Australian government's exclusion of Chinese telecommunications manufacturer Huawei from bidding in the National Broadband Network in 2012, and President Barack Obama's Executive Order to prohibit Ralls Corporation from owning several wind farm projects in Oregon in 2013.[73]

The fear of one state owning another state's key resources or assets through strategic SOE corporate activity is not new: Anglo-American corporate law first emerged with state-promoted private companies engaging in quasi-public activities abroad, such as regional monopoly trading companies, and the rise of Japanese investment into Australia and the US in the late 1970s and early 80s is well-documented.[74] However, concerns have manifested recently due to the confluence of three phenomena outlined above, namely: (1) the vulnerability of Western economies post-GFC; (2) the legitimacy crisis of liberal capitalism; and (3) the rise of state capital-directed emerging economies that are now beginning to look outward.

The intrinsic nature of an SOE seems to capture media sensationalism and influence political discourse and policy. 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*.'[75] Accordingly, 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 commercially oriented and free from political influence.[76]

The intrinsic nature of an SOE is explicated clearly by Clarke and Howson who give valuable insight into the nature, definition and evolution of, specifically, Chinese SOEs.[77] The traditional Chinese SOE was an organisational form, not a legal form. It 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 its original *raison d'etre* was to pursue state purposes as opposed to market freedoms. 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, the change in SOE form did not change the nature of state control but merely augmented it. Now, an SOE

---

70 See, for example: L. Hurst, P Yuan Cai and C. Findlay, *Chinese direct investment in Australia: public reaction, policy response, investor adaptation*, 2012, paper prepared for the Roundtable and Public Forum on China's Global Investment, Australian National University, 4-5 September 2012; and *Howson, ibid.*
71 B. Frith, *The Australian,* March 13, 2013.
72 E. Curran and M. Sainsbury, *The Australian*, August 7, 2012.
73 *Order signed by the President Regarding the Acquisition of Four US Wind Farm Projects by Ralls Corporation*, The White House, 29 September 2012. Ralls Corporation is controlled by two executives of Sany Heavy Industry Co Ltd, a Chinese multinational listed publicly on the Shanghai Stock Exchange, which is *not* an SOE.
74 For more detail, see *Hurst, Yuan Cai and Findlay, above n.70*; and *Howson, above n.69*
75 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).
76 *Ibid.*
77 D.C. Clarke and N.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*, Puchniaki, Baum and Ewing-Chow, eds., 2012, 245-49.

is administratively *and* financially controlled by an entity of the state (central or local). Therefore, an SOE controlling shareholder has political as well as economic dominance, which has important implications for the nature of a state-directed corporation and who it seeks to serve.

But is there a documented cause for concern? From the media and political reactions outlined above, one might naturally assume that SOE inward investment from emerging economies is statistically dominating the Australian foreign investment landscape. However, the reality is that institutional data on SOE investing activities is disparate and requires patience to collate. Figures for *total* inward investment to Australia by foreign countries are readily obtained (see above Table 2.1); but there is a lack of readily accessible empirical data regarding where SOEs versus non-SOEs are investing: which jurisdictions, which sectors, which entities. That data is required in order to evaluate policy effectiveness.

Therefore, in order to contribute to the discourse on foreign investment policy that can genuinely serve the national interest, more substantive databases need to be constructed. Our aim is twofold: (1) to source empirical data on Chinese SOE vs. non-SOE inward investment to create readily-accessible databases and discussion documents; (2) research individual Chinese SOE companies to see where else (other than Australia) they are investing; (3) make well-founded predictions about the likely materiality of Chinese SOE investment into Australia over the mid-term. Our ultimate goal is to evaluate the current Australian regulatory regime, compare it with commensurate jurisdictions, and provide evidence-based recommendations for optimal regulatory design.

So, our intent during the first stage of this data gathering is to produce a series of tables showing incidence of Australian approvals of Chinese investment by sector differentiating between SOE and non-SOE investors from 2005/06 to 2011/12.

Schematically, it might look something like Table 3.2 below.

Table 3.2

Chinese inward investment into Australia by value (AUD mn)

	SOE						**Non-SOE**					
Sectors	**05/06**	**06/07**	**07/08**	**09/10**	**10/11**	**11/12**	**05/06**	**06/07**	**07/08**	**09/10**	**10/11**	**11/12**
Agriculture, forestry & fishing												
Finance & Insurance												
Manufacturing												
Mineral exploitation & development												
Real Estate												
Resource Processing												
Services												
Tourism												

However, the actual process of compiling this data has revealed some surprising gaps, inconsistencies, and methodological challenges for researchers of state capital.

(1) Datasets are not easily compared

The first place we started was the KPMG database, which has been compiled in partnership with the University of Sydney, and published in part via two reports in 2012 and 2013.[78] Using data within the KPMG 2013 report we were able to deduce certain statistics as depicted in Table 3.3.

From January to December 2012, SOEs completed 74% of all deals by number and 87% by deal value of the total Chinese inward investment (valued US$5mn and above) into Australia. Thus, in 2012, the share of capital invested by SOEs declined slightly when compared with SOE investment during 2006-2012.

Table 3.3

Chinese Investment into Australia: 2006-2012 vs. 2012

	2006-2012		**2012**	
	By deal number	**By deal value**	**By deal number**	**By deal value**
SOE share of capital invested	80%	94%	74%	87%
Private investment	20%	6%	26%	13%

Source: KPMG 2013, 1.

These deductions are certainly a useful starting point. However, the KPMG reports are also valuable for what they do *not* reveal. Specifically, the KPMG 2013 report does not provide: sources for the KPMG SOE figures; a breakdown of where SOEs are investing within Australia (state/territory; sector; industry/entity); whether SOE investment breakdown has changed over time since 2005/06.

As such, we are searching other sources - both Chinese and Australian – to supplement KPMG data and fill these gaps. The most obvious Australian source for foreign investment data is FIRB, the Annual Reports of which provide very useful breakdowns of: foreign investment applications considered and decided; and approvals by value, sector, and investor country. However, FIRB Annual Reports for 2005/6 - 2011/12 do not differentiate between SOE vs. non-SOE investments of China (or any other country for that matter). So in order to create our table we need to extract that level of information from multiple other sources, which include but are not limited to: the Australian Bureau of Statistics (ABS), Department of Foreign Affairs and Trade (DFAT), Heritage Foundation global investment tracker, Australian Financial Review (AFR), Deutsche Bank, International Monetary Fund (IMF), National Bureau of Statistics of China, 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).

[78] KPMG and the University of Sydney, *Demystifying Chinese Investment in Australia: Update March 2013*, (hereafter KPMG 2013); and KPMG and the University of Sydney, *Demystifying Chinese Investment,* 2012, (hereafter KPMG 2012).

The process of mining these many different sources has revealed the first challenge for researchers of state capital and SOE: different datasets are not easily compared. As exemplified in Table 3.4, various entities have compiled their data using different methodologies. As such, figures do not always match between data sources, contributing some practical complexity to this research.

Table 3.4

Examples of differences between sources

Source	**Currency**	**Year type**	**Nomenclature**	**Deal value min/max**	**Deal type**	**Geography**
FIRB	AUD	Fiscal	"approved proposed investment"	<$1mn to >$2bn However various threshold levels for exemptions	- Deals that require federal govt approval: ie. investment that would provide a foreign government investor 'with influence or control over the target investment'. - Does not list or differentiate types.	Excludes SARs and Taiwan.
ABS	AUD	Quarterly, Calendar	actual investment	All actual investment inflows	No types but 10% equity threshold to satisfy as a direct investment	Excludes SARs and Taiwan
KPMG	USD	Calendar	Appears to be actual investment, labeled "investment inflows".	> US$5mill	- M&A; - Joint ventures; Greenfield projects; - Chinese stock/bond acquisitions that only result in foreign ownership/ management/legal control of Aust. companies	Subsidiaries or SPVs based in HK, Singapore, and "other locations".
NBS	RMB	Quarterly, Calendar.		< 1mn RMB		- Excludes SARs and Taiwan. - Statistics focus on national level - Provincial Bureau of statistics has its own statistics.
MOFCOM	USD	Monthly, quarterly, calendar .	"Actualized Investment"		equity investments and "other investments"	Excludes SARs and Taiwan
Global Tracker	USD	Monthly	Actual investment	>$100 mn	All types of investments and contracts, excluding bonds.	

Special Administrative Regions (SARs) are territories that fall within the sovereignty of the People's Republic of China but do not form part of mainland China. There are only two SARs:

Hong Kong and Macao. These continue to possess their own governments, multi-party legislatures, legal systems, and substantial competence in external relations.

FIRB deal value is in two categories of less than AU$1mn and more than AU$2bn.[79] However, 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. For example, 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.[80] 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.[81] 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.[82]

In summary, FIRB figures:

- Record approved proposed investment, not actual investment (eg. approved deals may not actually proceed to fruition);
- Use estimates of expected expenditure (eg. development) as part of the investment, which is only an approximate guide to further injections/inflows;
- Exclude investment proposals below certain thresholds that do not require approval, and threshold policy changes make comparability with previous FIRB figures difficult;
- May include double counting if FIRB has received and approved more than one application for the same investment target; and
- Assume funding is offshore, with no contributions by residents.

By contrast, ABS figures are gathered quarterly for the purposes of Balance of Payment and International Investment Position figures. Statistics are compiled by way of the Survey of International Investment (SSI). The framework and standards utilised in the methodology of the SSI are in accordance with several guiding publications, including the Balance of Payments Manual (BPM5).[83] ABS figures record actual investment transactions and actual subsequent expenditure between residents of Australia and residents of the rest of the world (non-residents). Expected expenditure of any kind is not included.

ABS International investment is defined to include:

> The levels of Australia's foreign financial assets and liabilities at a particular date; capital transactions (investment flows into and out of Australia) which causes changes in the levels of these assets and liabilities other factors which affect the level of investment such as valuation and price changes and exchange rate variations; and the income receivable and payable on these foreign financial assets and liabilities.[84]

[79] Per *FIRB Annual Report 2011/12*.
[80] *Ibid*, xv.
[81] *Ibid*, 16
[82] *Ibid*, 16
[83] The ABS compilation methodology is also guided by the following publications: *1993 System of National Accounts*; 1995 *IMF Balance of Payments Compilation Guide*; *IMF BPM5 Textbook*; *OECD Benchmark Definition of Foreign Direct Investment*.
[84] ABS, *Information Paper: FDI Data Collection: Overcoming Hurdles and Obstacles in FDI Measurement and Collection*, No. 5370.0.55.001, August 2003 (hereafter ABS Information Paper)

As such, ABS figures:

- Include actual figures from investments that would be threshold exempt in FIRB statistics
- Ignore multiple applications for the same proposal and records only transactions from the proposal that actually proceed
- Have a wider scope than FIRB statistics, for example nets off capital outflows (say from the sale of shares by a non-resident back to a resident) with capital inflows.
- Do not include investment transactions in Australia where the investor and the target are both non-residents (ie. where there will be no change to the total level of foreign investment in Australia)
- Capture transactions that use offshore borrowings in investments that would be otherwise FIRB exempt.

Therefore upon deeper inspection, statistics used by FIRB and ABS have been derived using substantially different methodologies and are not in any way interchangeable.

Moreover, there are limitations with ABS figures. While the ABS has a wide-ranging conceptual framework, there is a lack of international standardisation for easier comparability between countries. The ABS itself has detailed difficulties where figures are compiled using different rationales, the most basic difficulty being measurement.[85] BPM5 recommends that direct investment flows, income transactions and stocks be valued at market value. However, in another country, an entity may choose to use cost measurement over market value, in which case the figures will not align.

Indeed, the ABS is explicit about the problem created by a lack of international standardisation for researchers who need to compile part of their dataset from international agencies in order to augment a dataset from domestic sources. It states simply: 'Users of the statistics often get confused when the official statistics from different countries cannot be aligned or compared because of differing standards applied in compilation…So far, attempts to reconcile data between countries have been unsuccessful.'[86]

An important corollary of the fact that datasets are not easily compared is the correct use of nomenclature. Using multiple sources in addition to FIRB documents will likely change our nomenclature from 'approved proposed investment' figures (via FIRB) to 'actual investment' figures (via, for example, ABS, Heritage Global Tracker, and MOFCOM). This may help to explain why KPMG figures are much lower than FIRB figures even accounting for currency and calendar year differences. Clearly, correct use of nomenclature will impact upon the accuracy and consistency of our own data gathering.

85 *Ibid.*
86 *Ibid.*

(2) SOE investment data for Australia: state/territory, sector, industry, entity?

Traditionally, SOEs by their nature tend to invest in areas of nation-wide priority, being natural resources, utilities, telecommunication services, and defence. However, KPMG figures reveal that Chinese investment overseas is diversifying towards energy and other sectors, and away from natural resources and mining (although these still dominate).[87] Moreover, Lee specifies that Chinese SOEs are now operating 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.[88]

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 overseas.[89] Indeed, 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.[90]

Specifically, Global Tracker identifies the largest Chinese (and other) foreign corporate investors (eg. CITIC) and specifies the sector (eg. energy) and subsector (eg. coal) and country in which individual deals have taken place. It is important to note, however, that Global Tracker is not a comprehensive one-stop database because it only tracks deals valued at more than US$100mn. Thus, data from Global Tracker still need to be cross-referenced with that of other sources, such as ABS, KPMG and MOFCOM, which triggers the methodological caveats discussed in detail above. Nonetheless, Global Tracker provides specific data that can be further investigated to reveal insights about SOE inward investment to Australia, as depicted in Table 3.5 below.

Table 3.5 Largest investors in Australia January 2005 – December 2012 ($US million)[91]

Ranking	Company name	Enterprise type	Sector (sub-sector) of investment	Accumulated Value
1	Chinalco	SOE	Metals (Aluminium)	$14,300
2	Yanzhou Coal	SOE	Energy (Coal)	$6,590
3	Sinopec	SOE	Energy (Oil & Gas)	$3,070
4	CITIC	SOE	Metals (Steel), Energy (Coal)	$3,020
5	Minmetals	SOE	Metals	$2,960
6	Guangdong Nuclear and China Development Bank	SOE	Metals	$2,280
7	CNOOC	SOE	Energy (Gas)	$2,200
8	Datang Power and Boading Tianwei	SOE	Energy (Alternatives)	$2,030
9	Sinosteel	SOE	Metals (Steel)	$1,460
10	China Metallurgical	SOE	Metals (Steel)	$1,090
11	CIC	SWF	Real Estate (Property)	$1,090
TOTAL				**$40,090**

Source: Heritage Foundation Global Tracker

[87] *KPMG 2013, above n.78*.

[88] J. Lee 'The Re-emergence of China: Economic and Strategic Implications for Australia' (2012) *The Australian Economic Review* 45(4) 484-7, 484.

[89] D.M. Marchick and D.R. Bowles *The State of Chinese Investment in the United States*, Conference on China's Economic & Trade Relations, Columbia University, 10 November 2011, 5.

[90] *Lee, above n.88*, 484.

[91] These eleven largest Chinese investors for the seven-year period 2005-2012 account for 79% of accumulated investment in Australia for the same period.

The preceding data and commentary demonstrate that some of the largest Chinese investors in Australia are SOEs[92] and that Chinese SOE sectoral investment is diversifying beyond natural resources.[93] As such, one can assume that any high-value investments by a large Chinese firm in Australia are being made via an SOE (central or local). From here we can begin to investigate large individual investor companies and deduce SOE-specific information to make assumptions at a more comprehensive (as opposed to individualistic) level.

Moreover, as analysts of this data, our challenge is to discern the degree of independence these firms have from the state that formally owns or controls them; for even SOEs may acquire foreign investments according to their own agendas and not that of the state. Indeed, Howson opines that the 'Going Out' strategy is mostly led by Chinese firms themselves rather than being (central) state-led.[94] Thus, we may need to look at each specific situation to determine whether the Chinese SOE is acting in its own interest or pursuing national/party interests in order to substantiate or dismiss the kinds of media and political reactions to Chinese investment detailed above. This in turn can assist our goal of policy evaluation.

(3) Further Issues for Discussion and Investigation

Some of the issues that we may be able to explore in our state capital research project include:

- comparing state capital investment patterns and decision-making over time to other investment actors, especially in relation to why they decide to invest and/or disinvest domestically or internationally;
- could state pools of capital be classified and measured in similar ways to other pools of capital that can be difficult to measure such as private equity and hedge funds, based on variables such as: asset portfolio make-up; capital ownership; executive control; institutional framework; investment strategies and source of funding;
- virtually all countries that operate state pools of capital are members of the IMF, so perhaps the IMF could be a valuable conduit for measuring the effects of state capital? The IMF through the International Finance Corporation (IFC) has 184 members, including all jurisdictions that have SWFs, so it does possess significant clearing house potential;
- comparative research between state capital actors, for example does it make a difference if they are located in a large or small country, or commodity funded (e.g. in comparison to general trade stimulated);
- issues of increased overlap of the spectrums of activity between central banks and state investment actors which in turn has implications for the likely increasing synergy between national economic well-being and the health and vitality of international finance;
- the potential for state capital actors to integrate into their investment decision-the concept of *social licence* – by which investment projects funded by foreign state capital actors should buy local products so that there is mutual benefit for local communities and the foreign firms. If these socially positive and potentially transformative investment strategies come to be construed as economically rational by investment actors and subsequently ingrained in business practice, they may help to reduce risks of trade protectionism in the future;

---

92 Global Tracker, Figure 3.1 in Section III above.

93 *KPMG 2013, above n.78*.

94 Howson makes this point in relation to the CNOOC bid for Unocal, which was opposed by Chinese central government actors: *Howson, above n.76*.

- examining custodianship relationships and the corporate governance roles that might be played by state capital actors including SWFs, for example what criteria should state capital actors give to fund managers regarding voting policies, environmental risks or governance systems.

For example, regarding custodianship and governance, the operation of Norway's Government Pension Fund Global (GPFG) could be informative, especially looking at the role of the Council of Ethics for the Fund. The Council of Ethics has a very limited mandate (eliminating the worst of what it sees as the *bad* companies, (for example: Rio Tinto, Walmart, Freeport) from the Fund's investment portfolios (there are more than 8,300 companies in the Pension Fund's investment portfolio)).[95] The key criteria for the activities of the Council are: Law of Human Rights; Law of Armed Conflict; Corruption; Environmental Issues. On average the Council would work with about 80 companies whose identity is kept secret and only the excluded companies are named (about 4/5 in an average year). The Council is appointed by the Government and not the Ministry of Finance (so in theory there may be less chance of regulatory capture) and the Ministry must publicise the Council's advice even if it disagrees with it. The value of the Council lies in its capacity to leverage reputational risk. The exclusion capacities of the Council give leverage to the Norges Bank to influence the governance of companies in which it invests and so there is an important synergy between the Council and the Central Bank.[96] It will be interesting to see in the future whether other jurisdictions equip their state investment actors with this *institutionalised ethical leverage* in the way that Norway has done.[97]

E CONCLUSION

In a post-GFC world as the twenty first century progresses and the economic power of Asian countries in particular 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 the changing trends in the composition of the global economy, especially how some countries are projected to be losers and others winners. This paper has highlighted these significant trends and the increasingly strategically important role that state capital is likely to play. Therefore it is vital that national and international policy development in this area is underpinned by accurate data. 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 interesting process to chart these developments.

---

95 See: Norway's Government Pension Fund Global (GPFG) Council of Ethics for the Fund., *Frequently asked questions*, http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/frequently-asked-questions.html?id=605599#OLE_LINK7

96 This notion is not as fanciful as might first appear because the GPFG has revealed that it holds around 1 per cent of the world's listed equities, so it is very much a player on global financial markets, see: Norges Bank, (2010), *Management of the Government Pension Fund Global*, 18 May 2010, http://www.norges-bank.no/templates/article____76831.aspx

97 See S. Chesterman, (2008), "The turn to ethics: disinvestment from multinational corporations for human rights violations – the case of Norway's sovereign wealth fund", *American University International Law Review*, Vol.23, pp. 577-615; C. Ochoa and P. Keenan, (2010), "The Human Rights Potential of Sovereign Wealth Funds", *Illinois Public Law Research Paper, No.08-27*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1374880