CHAPTER 4

Investment, human capital and labour movement

KEY MESSAGES

Two-way flows of investment, people and ideas are essential to advancing economic, political and social ties between Australia and China, and to realise the full potential for expanding trade in higher value-added goods and more sophisticated services. China has become a major supplier of international capital. Australia's resource endowments made it a natural destination for Chinese investment during the mining boom. Australia now faces global competition to attract the foreign capital it needs to service growth in agriculture, tourism and infrastructure.

China's domestic economic transformation is prioritising development of the services sector. In the same way that foreign investment into China's manufacturing sector made China a highly competitive goods producer, foreign investment into services industries will improve quality, reduce costs and further the Chinese reform agenda. The freer exchange of people and ideas will be crucial to strengthening bilateral investment and trade. More can be done to leverage diaspora communities in facilitating economic exchange and in ensuring that Chinese and Australian students, tourists and businesspeople enjoy greater freedom of movement.

The argument in the chapter concludes that:

- The ChAFTA framework opens the opportunity to upgrade the existing Australia–China Bilateral Investment Treaty (BIT) by adopting the principles of national treatment and a negative list on investment access. The early negotiations of a new Australia–China investment agreement in this framework will also assist the progress with RCEP investment protocols and China's BIT negotiations with the United States and the EU.
- Australia's current foreign investment review regime risks deterring beneficial Chinese capital by increasing the costs and the uncertainty of doing business in Australia — especially as capital looking to invest in manufacturing, agriculture, tourism and services is far more mobile compared to that seeking resources investment. Australia should institute a more predictable and transparent investment review process that focuses on ongoing risk management rather than a pre-approval process, and move to a 'notification and compliance' system for commercially certified state-owned enterprises. Foreign investment policy in China is in the early stages of liberalisation. China should approach foreign investment from the perspective of negative-listing and national treatment, and should reconsider sector-specific investment restrictions that apply to both domestic and foreign investors.
- Both sides would benefit from clear frameworks for cooperation on the bilateral movement of people and ideas. A bilateral working party consisting of official, business, tourism and education representatives should be convened to review the adequacy of visa arrangements on both sides. Existing initiatives, such as Australia's Significant Investor Visa program, could be more widely advertised to promote uptake. Both countries should consider making it easier for one another's citizens to live and work in either country.
- For example: Australia should consider relaxing the cap on Chinese working holiday visas; Australian students should be extended more opportunity to access Australian income contingent loans for degree study at top-ranking Chinese universities; and Australia should expand its network of bilingual English–Chinese schools.

Fully realising the potential for trade in higher value-added goods and more sophisticated services requires China and Australia to go beyond a transactional relationship based on resources and manufactured goods, toward a partnership that supports long-term two-way investment and the exchange of ideas and talent in building innovative and more productive economies. While the resources trade remains central, the future relationship cannot be focused only on resources or contained to prescribed sectors. Rather, it is a relationship that in future must encompass connections between all dimensions of the broader economic relationship — trade in goods and services, investment and people-to-people connections.

This chapter considers the benefits from direct investment and from people-to-people connections between the two countries (Box 4.1). Chapter 5 discusses the evolving framework within which portfolio investment and other financial flows will grow and capital markets will integrate more fully.

BOX 4.1: THE BENEFITS OF FOREIGN DIRECT INVESTMENT

Foreign investment helps meet the gap between what domestic residents are able to save, and the productive investment opportunities in the economy. It improves the global allocation of resources by increasing investment in the countries that have lower domestic savings and increasing returns in countries with excess savings.

Investors primarily seek a return on the capital they invest. But investment is also good for workers, as it equips them with more capital and therefore makes them more productive. This increases wages and living standards. Local asset-holders benefit from being able to sell to the highest bidder on the world market, making it more profitable to develop new assets.

The extent of this 'capital deepening' effect applies to all foreign investment, and will be influenced, among other things, by the rates of taxation on capital, the general business environment and the perceived political risk of investing offshore.

The benefits of direct investment go beyond simply providing loans or buying shares in a foreign company, to establishing or buying a controlling interest in the company, injecting not only capital, but also crucial linkages to foreign markets and technologies, which further expands export opportunities for producers and opens up a wider range of cheaper goods for consumers.

Unlike portfolio investment, which can be easily liquidated and transferred in response to financial market fluctuations, direct investment tends to build longer-lived assets that provide returns over years or even decades, including long-term investment in infrastructure. Foreign direct investment (FDI) creates powerful long-term commercial interests in maintaining good relations between countries.

Direct investment abroad delivers benefits that can spill over to the whole economy — including familiarising locals with new production techniques and bringing international standards into domestic production.

Australia's population is low relative to its land area and natural resources. Foreign investment in mines, ports, transport infrastructure, technology, land and factories is essential to transform resource endowments into real wealth. Foreign capital in Australia came first from the United Kingdom, but more recent waves have come from the United States, Japan and now China. Australia has historically run a small, but persistent, current account deficit. That means that Australians invest more than they save, with the difference made up by borrowing from abroad. Reducing foreign investment would mean that many productive investments in Australia could simply no longer be funded. That would lower productivity, and reduce the standard of living and the economic strength of the country.

Despite being a foundation of Australia's economic prosperity, the role of foreign investment is not always fully or widely understood in the community. Concerns in Australia about 'selling off the farm' and shifting profits overseas miss the point that foreign investment enhances the productivity of local labour, lifts wages and increases the value of domestic assets. Investment in infrastructure and better linkages to foreign markets further expand export opportunities for Australian producers, and open up a wider range of cheaper goods for Australian consumers. Australian asset-holders benefit from being able to sell to the highest bidder on the world market, making it more profitable to develop new assets.

Foreign investment has also played a crucial role in China's reform and opening since 1978. Investors from Hong Kong and Taiwan were the first to develop China's emerging coastal trading hubs. FDI helped transplant the rules and institutions of a modern market economy into China. For example, when a special economic zone was established in Shenzhen in 1980, that city was a small fishing town. It is now one of China's largest and wealthiest metropolises.

Despite phenomenally high rates of investment over the past two decades, China has run a current account surplus every year since 1994. This means that, unlike Australia, China does not depend on global savings to meet its investment needs because its own savings are very high. But China's economic growth, particularly in its export-oriented manufacturing sector, has relied heavily on the technology transfer and advanced labour skills that come with FDI.

One way of dealing with persistent current account surpluses was for the Chinese government to allow Chinese companies to invest abroad. This 'going out' policy was launched in 1999 and formally included in China's subsequent Five Year Plans. As well as providing a higher return on Chinese savings than that available on US government debt, the stated goals of this policy are to ensure that China can access the natural resources it needs for economic development, access export markets and acquire foreign technology needed to improve economic capacity in China (Government of China 2006).

More recently, China's OBOR initiative, and its leadership in establishing the multilateral AIIB, seek not just to connect China to foreign markets, but also to build connectivity — and therefore prosperity — across the region. This will provide investment opportunities to expand infrastructure investments in Australia, including reaping the benefits of agricultural investment in Northern Australia.

The benefits of opening up to foreign investment and services

To capture the gains from these policy initiatives, there will need to be further policy engagement of the kind recommended in the argument of this Report.

The economic benefits of China's opening up to foreign capital and to competition in the services sector are very substantial.

In order to give a rough quantification of these benefits, modelling can be used to simulate the effect of services sector and financial market reform that might be set in train by a strong policy commitment to opening up, utilising the GTAP model introduced in Chapter 3 (Gretton 2016).

Domestic reforms across the services sectors would improve the productivity of value-adding labour and capital in production and would be trade liberalising. The modelling suggests, for example, that for every 1 per cent improvement in the productivity of service provision in China, Chinese GDP could be increased by 0.68 per cent, with a small but positive flow-on effect to Australia. The same proportional increase in the productivity of service provision in Australia could generate an increase in Australian GDP of 1.13 per cent.

Barriers to the efficient functioning of the financial system arise for a variety of reasons, including ownership restrictions, government directives on the use of finance, domestic market practices and regulations favouring designated activities, as well as discrimination between foreign and domestic investors. Higher investment costs raise the price of an effective unit of capital used in production and reduce the competitiveness of capital-using activities and potential output. A reduction in the risk premium of investment in China achieved through domestic financial system reforms would lower the rate of return required by domestic and foreign investors to undertake new investment.

The modelling estimates suggest that a 10 per cent reduction in the cost of capital through financial market reform could increase China's GDP by 5.7 per cent above levels that would otherwise be achieved in the longer term. This projection does not necessarily represent the effects of a single policy, but rather a concerted effort to improve the operation of the financial system. The time horizon over which the benefits could be achieved would, in turn, depend on the pace of reform, the rate at which businesses took up new opportunities and the transition of labour to these new activities.

While these projections provide an indication of the potential economic benefits of trade liberalisation and economic reform towards better functioning markets for goods and services and a more efficient financial system in China and in Australia, they do not directly capture all effects. Beyond reducing the risks associated with investment, for example, a well-functioning and efficient financial sector in China should also allocate capital to the most profitable firms and exert pressure on those firms to maintain high standards of corporate governance, affording additional potential productivity benefits. Distributional effects within the Chinese economy could also follow, such as between government-owned or controlled sectors and other sectors within the economy, and between the Chinese economy and other economies. Overall, a lowering of investment risk in China would be expected to raise global economic activity and incomes.

These simulations of the effects of alternative policy directions illustrate the importance of leveraging broader regional and global trade liberalisation agendas to the bilateral agenda, and pressing ahead with a trade liberalisation agenda that goes beyond merchandise trade to include the services sector, the financial sector and investment reform. Capturing these gains will be central to realising the potential of the next phase of Australia–China economic engagement. The rest of this chapter considers in more detail the challenges that policymakers must navigate and the specific reforms that will be necessary for securing the benefits from liberalisation.

Adapting to Chinese FDI in Australia

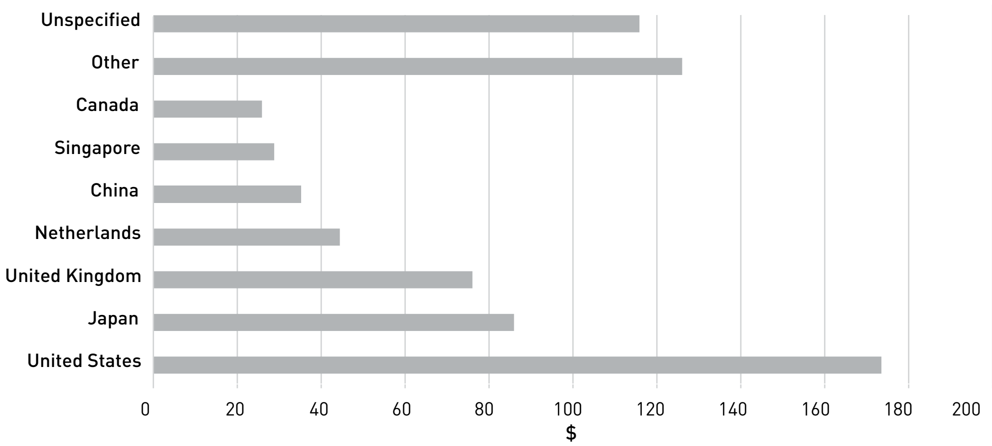
In the 1980s, China's two largest investments outside of Hong Kong were both in Australia — China International Trust and Investment Corporation (CITIC) invested in the Portland aluminium smelter, and the Chinese Ministry of Metallurgical Industry took a 40 per cent stake in a new iron mine with Rio Tinto at Mt Channar in Western Australia. These two investments operationalised important aspects of China's reform and opening trade and economic strategy. Today, investment from China into the Australian market has diversified into other sectors. Last year, China's outbound investment reached US$118 billion, an increase of 15 per cent on 2014. Australia is a major investment market for China. In 2015, Chinese investment in Australia amounted to US$11 billion — a 33 per cent increase on the year before (Figure 4.1).

The KPMG–University of Sydney database on Chinese direct investment in Australia details the changing trends. With the resource boom over, Australia has fallen back to be only the second-largest destination for Chinese direct investment after the United States. But relative to economic size, Australia is China's most important ultimate destination for foreign investment. With a reduction in Chinese investment in resources as the resources boom ends, 45 per cent of the recorded inbound investment in 2015 was in real estate. The shift away from resources saw private Chinese investors exceeding Chinese SOE investment for the first time in 2014 (KPMG 2016). The 2015 share was 49 per cent SOE, 48 per cent private, 3 per cent SOE–private joint venture.

MOFCOM and MFA identify opportunities for Chinese investment in Australian agriculture, aquaculture, dairy, iron ore, natural gas, coal, bauxite mining and aluminium smelting, shale oil, pharmaceutical production, trade, retail, transport, research, finance, telecommunications and tourism (MFA 2014). The promotion of bilateral investment gives momentum to the development of bilateral trade.

The legacy of the planned economy has meant that all major Chinese investments — whether private or state-owned, domestic or foreign — historically required government approvals. On top of project-level approvals, restrictions on the Chinese capital account have limited the ability of Chinese firms to invest offshore. However, the requirements for project-level investment approvals have been relaxed over time, and as restrictions on the capital account are removed, the flow of Chinese investment is likely to expand dramatically. According to ABS data for foreign investment stocks in 2015, China is only the fifth-largest direct investor in Australia behind the United States, Japan, the United Kingdom and the Netherlands. However, Chinese direct investment in Australia has been increasing rapidly from a low base, growing from A$3.6 billion in 2008 to A$35 billion in 2015 (ABS 2016f).

Figure 4.1: Stock of foreign direct investment in Australia by source (2014 A$ billion)



Source: ABS Cat. No. 5352.0, table 2, 2016f.

The speed with which China has expanded its global investment has raised some concerns in the Australian community. These concerns are not new, and not unique to Chinese investment (Box 4.2). The Foreign Investment Review Board (FIRB) process has helped allay popular concerns about new waves of foreign investment in Australia since 1976. But the discretion accorded to the Australian Treasurer to block certain proposals on 'national interest' grounds means that individual cases can become highly politicised. While in practice, the formal power is rarely used, it nevertheless adds to the uncertainty, and therefore the risks, for foreign companies seeking to invest in Australia.

As long as Australia was competing for investment to develop its rich natural resource endowments, this risk may have been trivial compared to the sovereign risks involved in many other resource-rich nations. International capital looking to invest in manufacturing, agriculture, tourism and services is much more mobile. In these sectors, Australia's competitors are advanced economies in Europe, Asia and North America. Amongst its OECD peers, Australia's regime ranks as the sixth-most restrictive based on the OECD's index of foreign equity restrictions, screening and other prior approval requirements, rules for key personnel and other restrictions on the operation of foreign enterprises (Figure 4.2). It is only slightly more liberal than the average of non-OECD members that are assessed. The Chinese inward investment regime, which is discussed later in this chapter, is the most restrictive of all countries surveyed on this measure.

BOX 4.2: POPULAR ATTITUDES TOWARD FOREIGN INVESTMENT

Successive waves of foreign investment in Australia from the United Kingdom, the United States, Japan and now China have all caused community anxieties (Groot 1990). A Gallup poll in June 1972, which referenced British and American investors, reported that almost 90 per cent of Australians would limit the shares that these foreigners could purchase in Australian companies. A survey conducted by the Japanese embassy in 1988 found that 36 per cent of Australians believed that their government should actively discourage Japanese investment. A 1996 Newspoll recorded 56 per cent of Australians agreeing that foreign investment levels were already 'too high'.

Annual surveys conducted by the Lowy Institute for International Policy from 2009 to 2014, after Chinese investment had become prominent in Australia, consistently found that more than half of respondents agreed with the proposition that the Australian government allows 'too much' investment from China (Lowy Institute 2015). An Essential Report from August 2012 suggests that most Australians are wary about investment from any foreign government-related entities — Chinese or otherwise (Lewis and Woods 2012).

A foreign investment study by UTS researchers in 2015 suggests that the Australian public is more concerned about how large the share of an Australian company being bought by a foreign investor is rather than whether that investor is a state-owned entity or whether the foreign investor is from a particular country — although China is preferred significantly less than the United States or Japan (Laurenceson et al 2015).

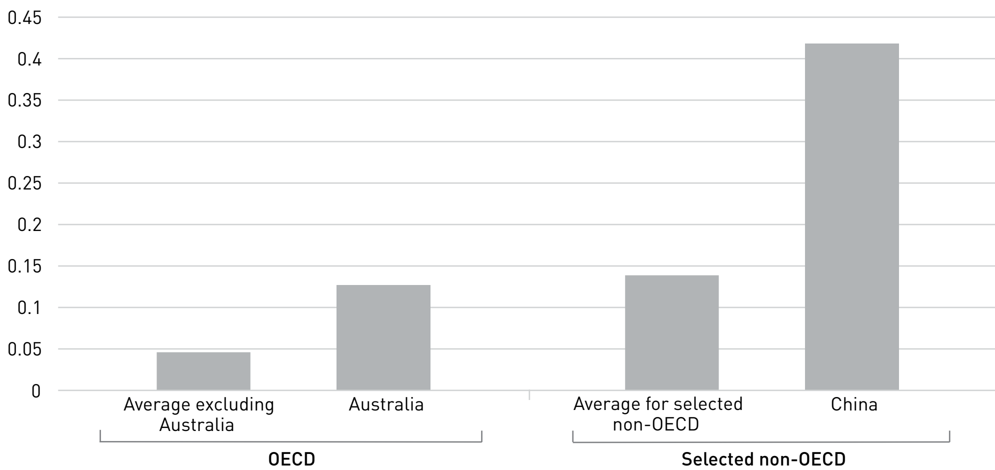
Community apprehension towards FDI is equally present in China — a Pew Global Attitudes survey found that 50 per cent of Chinese believe that foreign companies buying local companies is 'bad' (Pew Research Centre 2014). However, ACRI-Zogby polling in 2015 found that Chinese business elites view Australia as a more attractive place to invest than Germany, the United States, Singapore, Canada, New Zealand, South Korea and Russia (Zogby Research Services 2015).

Potential investors, and governments, have an important role to play in ensuring that the direct and indirect benefits of foreign investment projects are understood throughout wider communities.

Since ChAFTA came into force, private investments from China in most sectors only require screening when the total project value is above an A$1094 million threshold. This effectively removes much of Chinese private investment from screening. Nevertheless, there are exceptions on a sectoral basis, including media, airports, telecommunications, transport, defence and uranium mining, which are subject to more restrictive thresholds. All applications to invest in residential or vacant commercial land are reviewed, and investments in Australian agribusiness and purchases of agricultural land also have stricter thresholds.

Mandatory screening also applies to investors which are at least 20 per cent owned by a foreign government. This provision has been a longstanding feature of the FIRB process, and is not formally directed at Chinese SOEs. Given that China's resources sectors and public utilities are largely state-owned, these provisions are more likely to affect investors in these sectors who come from China.

Figure 4.2: OECD foreign direct investment regulatory restrictiveness index



Note: Averages are unweighted. Other non-OECD countries rated by OECD are: Argentina, Brazil, Colombia, Costa Rica, Egypt, India, Indonesia, Jordan, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Malaysia, Mongolia, Morocco, Myanmar, Peru, Romania, Russia, Saudi Arabia, South Africa, Tunisia and Ukraine.
Source: OECD FDI Regulatory Restrictiveness Index 2014b.

For projects subject to screening, the Treasurer may approve a project subject to conditions. In the past, this has included conditions that proscribe particular corporate structures on foreign investors. Investors who contravene these orders can face civil penalties and possible criminal prosecution, although investors can later apply to change the conditions.

After receiving approval, and subject to any conditions, Chinese investment receives the same treatment as a domestic investor with respect to domestic laws ('national treatment'). Chinese companies face the same competition, taxation, labour, environmental, and workplace health and safety regulations as Australian companies. Investments in publicly listed companies demand even higher standards of corporate governance and transparency. National treatment in this way is subject to robust protection under an impartial legal framework.

Very few foreign investment applications have been explicitly rejected (Australian Treasury 2015). Between 1 July 2008 and 30 June 2014, the Australian government approved 67,582 such applications (the majority being applications to buy real estate) and rejected only 65 applications, mostly relating to real estate. The value of rejected proposals is very low relative to the value of approvals, although in 2010–2011 the government rejected A$8.8 billion (5 per cent) worth of proposals compared to the A$176.7 billion it approved. In 2013–2014, China became the largest source country in terms of volume of investment approvals (14,716), as well as total value of proposed investment (A$27.7 billion).

While the formal rejection rate is low, it is not clear how many investment proposals are withdrawn before a formal rejection is delivered, or more importantly, how many potentially successful investment projects are deterred by the uncertainties of the screening regime. Such uncertainty is rooted in the discretion of the Treasurer to reject projects or apply conditions based on the 'national interest'.

The Australian Government's December 2015 foreign investment policy provides some guidance as to the factors that the government would typically consider. These include national security, competition, tax, the effect on the economy and the community, competition and the character of the investor, along with specific considerations for agricultural investment, investment in residential land and non-government investors (FIRB 2015). However, this policy is not binding on the Treasurer, and additional considerations can be included, as the policy is interpreted on a case-by-case basis. While this may be reassuring for the Australian community, it does so at the cost of uncertainty for potential investors. Specifically, it creates an application risk that does not apply to domestic investors. In particular, as a senior member of government of the day, the Treasurer may only consider the national interest in response to short-term political issues or popular pressure.

As Australia increasingly competes with other advanced economies on the basis of its business environment rather than its natural resource endowments, there is no benefit from the government creating regulatory uncertainty. For the most part, Australian competition law, labour standards, corporate governance and environmental regulations should be enough to ensure that foreign investors follow the same 'rules of the road' as domestic investors in the Australian economy.

The recent high-profile decision to reject an application for a Chinese company to acquire an 80 per cent stake in Australia's largest private land-holding, owned by S. Kidman & Co Ltd on account of its 'size and significance' creates uncertainty for Chinese and other foreign investors (Treasurer of Australia 2016). The property portfolio is Australia's largest in terms of total land area, including 10 cattle stations across four Australian states and territories, covering over 100,000 square kilometres and so collectively accounts for more than 1 per cent of Australia's total land area, and 2 per cent of its agricultural land (Treasurer of Australia 2015). The public explanation given by the Treasurer notes that foreign acquisitions of land this large would not be permitted in many other countries. This would include China.

This Report does not take a view on the merits of the argument in limiting the size of land parcels available for foreign investments. However, this case illustrates well the problem that the current FDI regime does not specify such limits clearly in advance, which would have allowed all parties to proceed with more certainty and avoid the additional costs, delay and uncertainty of the review process. It also suggests that consideration of the benefits of foreign investor acquisitions should be properly judged independently of the choices made by other countries on similar investment acquisitions: it makes no sense to replicate decisions that are damaging wherever they are made. A market environment that allows the free entry and exit of companies, together with sound market regulation and non-discriminatory enforcement of Australian laws, is likely a better guarantee of national economic wellbeing than one-time approvals of business transactions by FIRB in an ad hoc screening process.

Dealing with sensitive sectors

While national treatment for foreign investors looking to come to Australia is a sound principle, there will be some sectors where the Australian government might still reserve the right to impose sector-specific restrictions to guarantee national security or protect other legitimate public policy concerns. Australia already identifies the sectors in which additional restrictions to foreign investment apply (a 'negative list'), but there are no binding principles that the Treasurer must consider when deciding these matters.

The foreign investment regime should provide a clear line between sectors in which foreign investment is welcome (therefore removing application risk), and those in which the government retains discretion. In sectors where discretion is retained, the nature of the national interest considerations being applied should be well specified and defined as tightly as possible. Sector-specific regulators rather than the Treasurer might impose these considerations. Priority development areas might still be designated in which foreign investment in land and agribusiness is accorded less restrictive treatment.

Clearly defining boundaries and providing guidance for potential investors in Australian infrastructure is also important. Given the long-term nature and very large capital requirements of infrastructure investment, this is an ideal candidate for foreign direct investment (Box 4.3). Chinese investment in Australian infrastructure assets has been the cause of public debate in Australia on the grounds that some infrastructure assets may be critical to Australia's national economic and strategic security.

BOX 4.3: INFRASTRUCTURE INVESTMENT IN AUSTRALIA

Prior to 1945, neither the private sector nor the federal government were involved in the provision of infrastructure in Australia: state governments provided the vast proportion of infrastructure. In the postwar years, federal infrastructure investment underpinned Australia's rapid industrial expansion and urbanisation. Since the 1950s, the public investment share of Australia's total infrastructure investment has remained fairly stable at just under 6 per cent of GDP.

Since the mid-1990s, there has been a decline in public sector infrastructure investment. This has been more than offset by private sector investment in infrastructure.

Australia's population is expected to reach over 30 million people by 2031 — with three-quarters of this growth occurring in Sydney, Melbourne, Brisbane and Perth — which will put pressure on urban infrastructure that is already in high demand. In order to address some of these concerns, Infrastructure Australia released an Australian Infrastructure Plan in February 2016, which outlines reforms for improving investment, deliverance and usage of Australia's infrastructure.

The Australian Infrastructure Plan highlights the telecommunications, transportation and energy sectors as well as urban congestion and inter-urban connectivity as key areas for infrastructure investment (Infrastructure Australia 2016). The question for Australia, however, is where will the money come from?

Given the federal government's debt position is expected to worsen, the availability of public infrastructure funding will be increasingly limited. Funding for infrastructure investment from foreign investment should therefore be mobilised to play a much larger role.

This risk management is best approached as a matter of broad policy that ensures ongoing monitoring and mitigation of risks, regardless of the identity of the asset owner. Foreign operators in this area can be legitimately required to notify government of their involvement, and abide by all relevant laws and regulations, including licensing conditions for the operation of key infrastructure. Where the behaviour of a foreign investor breaks the law or threatens national security, then the Australian government should reserve the right to force divestment of the asset.

Such an ongoing, risk-management approach to managing Australian critical infrastructure would be more effective than one-off screening at the pre-establishment phase. Reforms along these lines would therefore enhance the security of Australian infrastructure assets, while reducing the uncertainty that otherwise deters foreign capital.

As more Chinese construction and public utilities look to expand abroad, there is a large opportunity to attract more Chinese capital in infrastructure. The policy direction suggested in this Report should not, of course, be restricted to Chinese investors, or be preferential to them. Where state governments choose to partner with international investors to build or upgrade state infrastructure assets, this can usually be presumed to be in the national interest. One option to explore would be to allow the state government to issue some form of 'conclusive certificate' that an investment is in the state's interest and therefore does not require the same foreign investment approvals that currently apply to for the sale of state government-owned infrastructure assets.

The United Kingdom might provide a useful model for Australia. There is no legislative framework distinguishing foreign from domestic investors in the UK. However, certain sectors have their own regulatory bodies, through which foreign investors may have to apply for authorisation. These sectors include water, gas, financial services, media and defence, all of which require permits to set up or acquire companies. These bodies do not restrict FDI in particular, but enforce a number of obligations, such as the need to notify substantial changes in shareholdings (Box 4.4).

BOX 4.4: FOREIGN INVESTMENT IN THE UNITED KINGDOM

In the last three decades, the UK has consistently been one of the most successful developed countries in attracting FDI (Driffield et al 2013). Rather than pre-screening investors, it relies on strong domestic legal and regulatory frameworks to protect the UK's national interests. In terms of its stock of FDI, the UK ranked third in the world in 2014, behind China and the United States. That year, while global direct investment flows fell by 11 per cent, the UK achieved a 50 per cent increase in its inflows. The UK led Europe in terms of the stock, flow and project volume of FDI (UKTI 2015).

In October 2015, UK Prime Minister and Chinese President announced a 'flagship' GBP6 billion Chinese investment in the Hinkley Point C nuclear plant in Somerset. A Chinese SOE, the China General Nuclear Power Corporation, would bail out the plant's main developer, France's EDF. In the same week, further investment projects were struck in areas as diverse as the automobile industry (Aston Martin), creative industries (BBC World) and property (the Advanced Business Park).

The UK's attractiveness for foreign investors can be partly explained by its low corporate tax rates, as well as additional tax incentives such as research and development and patent credits. The UK's corporate tax rate is under 20 per cent and is the lowest in the G20 and significantly lower than Australia's current 30 per cent company tax and the Australian government's announced target of 25 per cent by 2026–2027. Additionally, the UK does not impose exchange controls that affect FDI and there are no geographical restrictions on the establishment of foreign businesses in the UK (Smith 2012).

Investment from Chinese SOEs

While not explicitly targeted at SOEs from China, the effect of Australia's foreign investment regime to screen all foreign government investment proposals has a disproportionate impact on China. This is because of the still significant legacy of SOEs in all sectors of the Chinese economy, and their continued leading role in resources, finance and public utilities (Box 4.5). In addition to SOEs, China controls large sovereign wealth funds that seek financial returns as part of a diversified, global portfolio. These funds provide an additional and important pool of new international investment capital, whether they come with ownership control through direct investment or without ownership control through equity investment.

BOX 4.5: UNDERSTANDING CHINESE SOEs

Despite the emergence of a dynamic private sector in China that dominates its manufacturing economy, SOEs play an important role in key areas of the Chinese economy, including resources, energy, telecommunications, media and finance. Doing business with China in one of these sectors mostly means having to deal with SOEs.

SOEs are no longer mere instruments of the government, as they were when China began investing overseas in the 1980s (for example, in the Mt Channar project). SOE reforms in the 1990s and 2000s transformed SOEs from ministries and industrial bureaux into market-oriented operations with corporate governance, commercial goals and assessments based on financial performance. Many subsidiaries of SOEs are publicly listed on securities markets in China, Hong Kong or New York. Reforms announced in September 2014 require individual SOEs to be classified according to whether they are pursuing strictly commercial or broader public policy functions.

The largest SOEs in industries that are considered most vital to the national economy, including oil and electricity, are supervised by the central State-owned Assets Supervision and Administration Commission (SASAC). These 106 central SOEs are modern corporate structures with hundreds of subsidiaries. SASAC oversees their investment behaviour, and plays a role in preventing 'destructive competition' between central SOEs in their overseas investments. In practice this means dampening what can sometimes be fierce competition between two or more SOEs competing in the same market. China's provinces each have their own provincial-level SOEs that also operate in highly competitive sectors of the Chinese economy. There are thousands of SOEs that compete both among themselves and with the private sector.

One reason to pay closer attention to SOE investment might be the potential harm to the market environment in the host country. The ability of SOEs to borrow from state-owned banks and the potential for state bailouts leads to fears that SOEs might accept heavy initial losses to drive out private competitors in the host country. In reality, the commercial constraints on overseas investments by Chinese SOEs have become more stringent and the Chinese state is less willing to bankroll and subsidise unprofitable projects.

In addition, some SOEs have very large asset holdings and — in some sectors, including electricity, oil and tobacco — monopolise their segment of the Chinese domestic market. This can improve the credit worthiness of these companies even on purely private international lending criteria. However, this domestic position does not automatically flow through to their behaviour in overseas markets. For example, evidence from SOE investment behaviour in the resources market indicates that they have tended to increase competition and expand supply (Box 4.6). The general application of domestic anti-monopoly provisions regardless of ownership type is the most appropriate response.

But while SOEs do dominate some important sectors of the Chinese economy, state ownership is not synonymous with monopoly. Steel is one of China's largest industrial sectors and it is predominantly state-owned. But the most prominent players are local-level SOEs, which compete fiercely among each other. Using the same measure of industrial concentration as the United States applies to anti-trust provisions (the Herfindahl-Hirschman index), steel is not a concentrated market in China. Moreover, on account of the historic legacy of the planned economy in which almost all industrial production was done by SOEs, they still continue to operate in all kinds of industry sectors. Around half of the assets owned by local SOEs (which account for around half of total state assets) are in un-concentrated manufacturing sectors, in which SOEs compete with private companies (Hubbard 2016).

BOX 4.6: CHINESE GLOBAL INVESTMENTS IN IRON ORE

China's global investments in iron ore provide valuable information about how competitive neutrality works in practice. From 2002 to 2015, China made 30 overseas direct investments in iron ore, with 25 made by SOEs. Chinese state banking institutions provided credit based on international benchmarks, plus a margin, generally making this credit cheaper than international commercial finance.

But did this departure from competitive neutrality harm the market?

These Chinese iron ore investors increased rather than decreased partnership opportunities for non-Chinese iron ore investment. Of these 30 investments, 21 were made by firms with an operating competency in mining. Only one of the investments was made by a specialised iron ore miner. Chinese SOEs most often took minority equity positions in partnership with specialised non-Chinese iron ore miners. Joint ventures and minority acquisitions made up 22 of the 30 investments.

A related concern is that Chinese iron ore miners might attempt to 'lock up' supplies of iron ore using long-term contracts with Chinese buyers, in an attempt to reduce the supply to other steel producers in Japan, Taiwan and South Korea.

But an analysis of 50 Chinese iron ore procurement arrangements shows that only 63.8 per cent of projected iron ore output from Chinese projects was reserved through long-term contracts for Chinese buyers. The effect of China's overseas iron ore investments was therefore to increase supply to the global market (Hurst 2015).

According to FIRB's policy guidance, the Australian Treasurer considers whether a foreign government investment proposal is 'commercial in nature or if the investor may be pursuing broader political or strategic objectives' (FIRB 2015). The Australian government has already received and approved large-scale investments from some of the most strategically important central SOEs, including from the State Grid Corporation of China, China Power Investment Corporation, Minmetals and China's three national oil companies.

The differences between the Australian and Chinese systems of politics and governance (see Chapter 6) can generate community concerns in Australia about SOEs. An upfront and transparent account of ownership structures and corporate governance arrangements is important to showing that an investor has nothing to hide. Over time, good corporate behaviour on the part of SOEs, and familiarity on the part of local communities, should make Chinese investment in Australia's development easier, as it has in the case of other foreign investment from different sources.

This extends beyond companies that are formally state-owned. Private Chinese companies sometimes have close personnel ties or contractual relationships with state, political or military institutions. This is not in any way surprising. The Communist Party of China had 87.8 million members at the end of 2014 (China Daily 2015), including private entrepreneurs, who have been allowed to join the Party since 2002. All SOEs have Party Committees, as do the Chinese operations of many private and foreign companies, including global market leaders from the United States such as Wal-Mart (China Daily 2016).

Rather than apply different rules on the basis of formal ownership requirements, foreign investors in Australia should be judged according to their actual behaviour. Foreign government enterprises investing in Australia could still be expected to notify FIRB of their involvement. But SOEs should have the opportunity to prove their commercial credentials, possibly based on an historical accreditation model (BCA 2014), in which case there would be no need to treat them differently from privately owned Chinese companies. Alternatively, investment proposals from SOEs below the general review threshold could be granted an automatic approval, with automatic conditions imposed in relation to legal or corporate governance standards.

This approach would not provide Chinese SOEs with preferential access; rather it would remove discrimination currently in place that disproportionately deters an important class of potential Chinese investors.

Investment to transform Chinese services

In the 1970s, China's economy was closed to foreign investment. The regime is now significantly more open, and China has become the world's largest recipient of foreign direct investment after the United States. Foreign investment flows into China in 2014 totalled US$128.5 billion (UNCTAD 2015). But investment rules and treatment vary between industries, and the playing field between domestic companies and foreign enterprises seeking to enter Chinese markets is not yet even.

Foreign capital in China has been most welcome in the manufacturing sectors that fuelled China's export-led growth through the 1990s and 2000s. Almost three-quarters of foreign investment in China goes into the manufacturing, wholesale and retail sectors. The largest investors in China are its Asian neighbours, such as Japan, which have particular expertise in supply-chain manufacturing. There is also a large inflow of foreign capital into China's real estate sector.

Four-fifths of the investment from companies registered in China as foreign-funded firms or joint ventures are in coastal provinces. Half of the investment is in three provinces — Jiangsu, Guangdong and Shanghai. This reflects historical patterns in the opening and development of

China's export industries and industrial production. These are all important 'sister provinces' for Australian states (see Chapter 3), highlighting the huge opportunity for state governments to leverage these relationships further.

Foreign direct investment in Chinese companies is also important for China's industrial and regional development priorities. The NDRC and MOFCOM provide sector-based foreign investment guidance. As of 2015, there are 349 industries in which foreign investment is 'encouraged', 38 industries in which foreign investment is 'restricted', and 36 industries in which foreign investment is 'prohibited', with foreign investment in all other industries deemed 'permitted'. The status of new sectors is undefined. Restricted industries include key sectors of interest for Australia, such as finance, health and education. Foreign investment in Chinese media is prohibited.

In 24 of the restricted sectors, additional conditions are imposed that prevent wholly foreign-owned investors from entering the industry. This is usually in the form of a requirement that a Chinese partner must be the majority shareholder. Depending on the scale of investment, inbound investments can be approved or noted at the national and local levels. After this, ordinary business licences must be approved before registering for taxation, customs and foreign exchange.

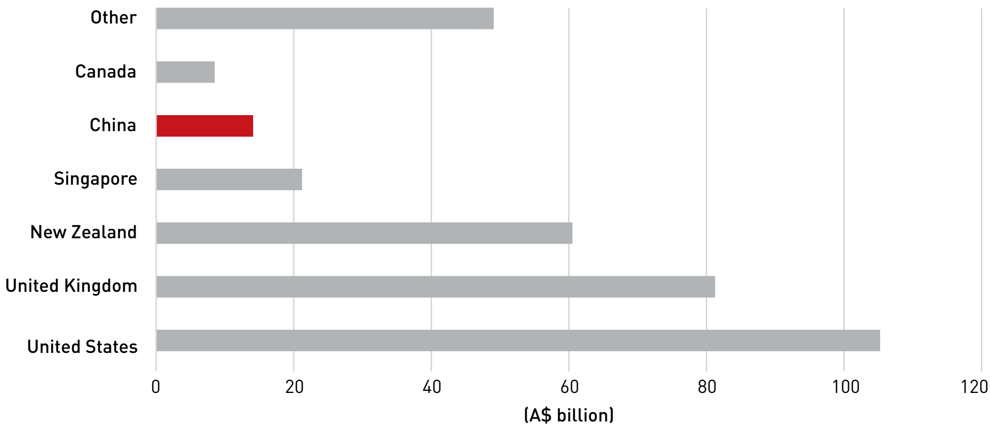
Businesses seeking to invest in China face a complicated regulatory environment. There are three separate laws that govern the creation of foreign enterprises — the *China Foreign Equity Joint Venture Enterprise Law*, the *Foreign Cooperative Joint Venture Enterprise Law*, and the *Foreign-Invested Enterprise Law*. There are also hundreds of subsidiary and local rules and regulations that affect foreign investors.

Sector- and region-specific barriers to investment, including 'behind the border' regulatory restrictions are treated comprehensively in the American Chamber of Commerce's 2015 (AmCham) White Paper, 'American Business in China'. This Report does not endorse specific recommendations made by AmCham, but instead encourages Australian investors in China to be vocal to both MOFCOM and DFAT to ensure that these provisions are on the radar for ongoing consultations under ChAFTA.

While investment in sophisticated services sectors, such as insurance, finance and law, is significantly more restricted, Australian banks have been in China for a long time (see Chapter 5). But despite China's WTO commitments to open up its banking system to competition, the largest Australian bank in China, ANZ, has just four Chinese branches, two sub-branches and one rural bank (AustCham 2012). Each of the banks, except Westpac, holds stakes in local banks but cannot increase their equity share above 20 per cent. These restrictions inhibit the cross-border financial infrastructure needed to underwrite more trade and investment.

Despite this, Australian direct investment in China has also grown significantly over the past decade. Successful Australian investment so far has been in niche areas including banking, medical devices, biopharmaceuticals and water management, and there is currently active investment in the renewable energy sector (Au-Yeung et al 2012). According to the ABS, there was less than A$500 million of Australian direct investment in China in 2004. By 2015, this stock had grown to over A$14 billion (ABS 2016f). This is well behind Australia's direct investment in the United States, the United Kingdom, New Zealand and even Singapore (Figure 4.3).

Figure 4.3: Recipients of Australian direct investment, 2014 (A$billion)



Note: An investment is deemed to be a 'direct investment' where the investor holds at least 10 per cent of equity in the invested entity.
Source: Calculations based on ABS Cat. No. 5352.0 2016f.

Investment in Chinese services sectors

In the same way that foreign investment in manufacturing made China an industrial powerhouse, China now wants to use foreign investment to help drive the transformation of its domestic services sector. Fostering foreign participation and giving full play to the market will help allocate capital more efficiently. This benefits China's economic development, and provides an opportunity for experienced Australian services firms to expand their market in China while contributing to its transformation.

China's overall policy direction in relation to inbound investment is clearly articulated in the November 2013 Decision of the Third Plenum of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deeping Reform ('the Decision'). The Decision commits China to 'stimulate the orderly and free flow of international and domestic factors of production, highly efficient allocation of resources and in-depth market integration, and foster new advantages in participating in and leading international economic cooperation and competition at a faster pace, in order to promote reform through opening up'.

The Decision acknowledges the important role that FDI can play in Chinese economic reform. Specifically, the Central Committee committed to apply 'the same laws and regulations on Chinese and foreign investment' (national treatment for foreign investors), as well as 'keep foreign investment policies stable, transparent and predictable'. Consistent with China's transition to a higher-income services-based economy, the Decision emphasised opening a range of services sectors, particularly 'finance, education, culture and healthcare'.

Chinese authorities have long trialled policy reforms in particular geographic areas as a way of testing them before nationwide implementation. The creation of a Pilot Free Trade Zone in Shanghai, followed by similar zones in Tianjin, Guangdong and Fujian, has provided an additional platform from which to trial the Third Plenum reforms. If these policies are judged to be successful, they should be expanded to a national scale.

The Decision also committed Chinese authorities to 'explore a management model for foreign investors with pre-entry national treatment plus the negative list'. If realised, this would effectively give foreign investors the same rights to invest in China as domestic investors, subject to specified exemptions ('the negative list'). To bring the greatest gains to China's economy, the list of exemptions should be as narrowly specified as possible to core areas of national security and other concerns. In January 2015, MOFCOM released a draft law on foreign investment that would consolidate and replace the existing laws.

This draft law would enshrine the 'negative list' principle and would move Chinese investment approvals away from lists of investments that are 'prohibited', 'restricted' and 'encouraged' toward a presumption that foreign investment is permitted, subject to a well-defined 'negative list' of industries where restrictions are maintained, and a high monetary threshold above which screening is still required. This 'negative list' has also become the basis of China's BIT negotiations with the United States and the EU. After a business is established in China, they are to be accorded national treatment.

The investment law would also introduce an explicit national security test, which would give the State Council the authority to approve, approve with conditions, or reject applications that touch on national defence, key infrastructure (including telecommunications), key commodity resources, investments controlled by foreign governments, or applications that threaten economic stability, public stability or 'any other factor' which the government considers necessary to address.

While these proposed screening arrangements impose restrictions, the law would for the first time allow free investment in and out of sectors that are not listed and that do not touch on broader national security questions. In the continuing revision of the draft law, and when it is implemented, it is recommended that thresholds for review are as liberal as possible and that the list of restricted and prohibited investments is as short as possible. This will maximise its positive effect on transforming China's services sectors.

But a new investment law will not remove all the obstacles to developing China's service industry. Investments in agriculture, energy, transportation, civil aviation, telecommunications, automobiles, tobacco, aerospace, urban infrastructure and large-scale tourism developments are still subject to various additional approvals hurdles that apply to both domestic and foreign investments. Nevertheless, it would be a significant milestone for China's economic development.

Opportunity for an enhanced investment agreement

Both Australia and China have their own domestic policy interests in reforming their treatment of investment flows. These could be pursued unilaterally. Cooperation in the spirit of the Comprehensive Strategic Partnership for Change gives each partner the opportunity to leverage reform through closer policy coordination.

Despite the progress ChAFTA has made, the agreement retains trade barriers in sectors of both the Australian and Chinese economies. These restrictions generally require firms wishing to enter these sectors (Table 4.1) to be owned or managed residents of that country, or run as a joint partnership. Liberalising these sectors can provide commercial opportunities in both countries.

Australia and China have had a BIT since 1988. This has provided the basic legal framework that governs bilateral investment to date. It was adapted to an earlier stage of Chinese development when China was still establishing its basic market system to support the development of its own export manufacturing sectors.

Table 4.1: Remaining barriers to investment

In Australia:	In China:
• Real-estate services • Telecommunications • Fishing • Professional services (patent attorney, trustee companies, auditor or liquidator, architect (NT), migration agent and customs broker) • Shipping/freight services • Aviation • Banking • Security services (NSW) • Public transport (NT, ACT and WA) • Biological research (QLD) • Wine production (QLD) • Tourism (QLD) • Alcohol and tobacco retail (NT)	• Legal services • Medical and dental services • Advertising/market research services • Technical testing and analysis services • Agriculture, forestry, hunting and fishing services • Mining/oil extraction • Photography services • Convention services • Telecommunications • Audio visual/cinema theatre services • Retail • Nature and landscape/environmental protection services • Insurance/banking/securities services • Hospital services (not including Beijing, Tianjin, Shanghai, Jiangsu, Fujian, Guangdong and Hainan province) • Maritime road and aviation transport services • Construction and related engineering services

Source: China–Australia Free Trade Agreement, Annex 3 Part 1: Schedule of Non-Conforming Measures 2015.

ChAFTA now provides an appropriate vehicle to foster China's services transformation, and to maintain Australia's status as a preferred destination for mobile investment capital. It also provides opportunity to develop closer linkages between the two countries' agricultural sectors. It includes an agreement to review the BIT within three years, and consider the 'negative list' principle that is the basis of China's BIT negotiations with other partners.

An enhanced investment agreement, which might proceed within the process set up by ChAFTA (though more expeditiously than foreshadowed), would provide commercial certainty to both sides, by removing some of the applications risks and the uncertainty around establishment of new enterprises that currently plague big investment decisions. Both parties would make commitments to undertake the reforms suggested earlier. And both parties would continue to be able to apply domestic laws to protect legitimate interests in sovereignty, public health and security on a non-discriminatory basis.

The conclusion of an enhanced investment agreement could be an appropriate milestone to mark the 30th anniversary of the original 1988 BIT.

There are two major benefits from adopting such an expedited timeline.

First, Australia is an advanced market economy with a highly developed services sector, although it is small relative to the EU and the United States. This makes Australia an ideal 'pilot economy' for China's 'negative list' and 'national treatment' approach before it concludes deals with much larger markets. A successful Australia–China investment agreement could therefore help break the logjam in China's negotiations with the EU and the United States.

Second, an enhanced Australia–China investment agreement, based on the mutual application of the 'negative list' principle, would set the pace for the development norms relating to foreign investment. Unlike trade in goods and services, which is governed by WTO disciplines, there are no well-developed disciplines and norms for FDI flows except those applied at a national level. The principles deriving from a new Australian–Chinese investment agreement could not only serve as a model for further bilateral negotiations with third parties, but also act as the pilot and the template for new multilateral investment liberalisation rules within RCEP. A multilateral arrangement governing investment flows would be superior to bilateral agreements because they establish consistent rules across multiple jurisdictions.

This could help create opportunities for China and Australia to cooperate in India and Indonesia, for example, and to assist regional growth by ensuring that investment flows according to economic productivity rather than political preference. This is a concrete example of the type of engagement envisaged by the Comprehensive Strategic Partnership for Change not just in the bilateral relationship, but also in the region and beyond.

Movement of people

From the earliest days of global trade, the movement of people has been essential to the movement of goods, services and finance. In the future, increased bilateral FDI and the provision of services require opportunities for the two-way exchange of skilled labour. There are currently around 15,000 Australians living, working and studying in the Chinese mainland, many of whom are Australian-Chinese (Australian Centre on China in the World 2015). There is a far greater number of Chinese citizens living, working and studying in Australia (see below). There are many benefits from expanding this two-way flow, both directly in support of trade and investment, and indirectly to build the social trust and cultural understanding that will be crucial to the deeper level of cooperation envisaged by this Report. This does not entail a policy of open borders or mass migration, as both Australia and China understand each other's sovereign right to control their borders and ensure social stability. But there are opportunities to make the bilateral flows of people more conducive to mutual prosperity.

This Report does not attempt to provide an exhaustive treatment of bilateral questions in relation to the issuing of visas and the granting of visa-free status for Australian and Chinese citizens in each other's country. It seeks only to note a few key areas that need to be considered in order to build up the harmonious and friendly social relations that will underpin the next stage in the relationship. There is already an official bilateral working group that considers tourism issues. A bilateral working group, led by government and involving representatives from business, education, tourism and community groups, should be commissioned to review visa issues more broadly and to come up with a specific timetable for the implementation of needed reforms. This would include considering the cost of visas, particularly tourist visas, to ensure that the price charged for visa applications does not exceed the expected administrative costs associated with processing the application.

Permanent migration and citizenship

Chinese have come to Australia since the gold rushes of the mid-19th century and have had a continuous presence ever since. Increased recent migration from China has grown the Chinese diaspora community in Australia (Box 4.7). The 2011 Census recorded 319,000 Australian residents who were born in China, and approximately 865,000 people in Australia reported that they had Chinese ancestry, or 4 per cent of the total population (ABS 2011). This diaspora is a valuable shared asset for the bilateral relationship.

Because of Australia's Chinese diaspora, Mandarin Chinese has become the second-most widely spoken language other than English in Australia. According to the 2011 Census, 336,410 people in Australia speak Mandarin at home. Significantly, the number of Mandarin speakers had increased by over 125,000 since the 2006 Census. More than a quarter-million people speak Cantonese, meaning that over 600,000 Australians already speak a Chinese language.

BOX 4.7: THE CHINESE DIASPORA IN AUSTRALIA

The Australian Council of Learned Academies' (ACOLA) 2015 report *Smart Engagement with Asia* and 2016 report *Australia's Diaspora Advantage* looked at the role of diaspora communities as one aspect of the long-term engagement needed for lasting social, economic and political benefits (Ang et al 2015; Rizvi et al 2016). ACOLA stresses that policymakers must engage with a broadly conceived 'diaspora' that includes migrants, subsequent Australian-born generations, those of mixed cultural heritage, and temporary residents in Australia for work or study.

Diasporas are important, not just because they contribute to social and cultural diversity, but also for the business and professional links that they maintain with their countries of family origin. Diasporas use their language capabilities, cultural understanding and global networks to circulate business, information and resources. Particularly in developing trading relationships with countries where legal protections and market norms are still developing, the informal networks of trust and reputation among diaspora communities are able to facilitate investment and exchange.

Since the days of the gold rush, Chinese diaspora communities have played a continuous role in Australian society. Since 2000, the number of mainland Chinese residing in Australia has grown dramatically — over half of the Chinese migrant population in Australia arrived after 2000. Today, Australia boasts one of the largest Chinese diaspora communities in the Western world. Projections estimate that Australia's Chinese-born population will reach 1.3 million people in 2031.

Four per cent of Australian residents report some kind of Chinese heritage (ABS 2011). This proportion is the same in New Zealand (4.0 per cent; 171,000), much smaller in the US (1.0 per cent; 3.14 million) and England and Wales (0.7 per cent; 393,000), and slightly greater in Canada (4.5 per cent; 1.49 million) (Statistics Canada 2011; Statistics New Zealand 2013). In 2014, 447,400 Australian residents, or 1.9 per cent of the population, were born in China. China is now the third most common country of birth for overseas-born Australians, behind the United Kingdom and New Zealand (ABS 2016d). In Canada, China is the second most common country of birth for recent immigrants, after the Philippines. In New Zealand, China is second to the United Kingdom on this measure.

Migration, tourism, education and investment to Australia all provide a route for Chinese to form permanent bonds with Australia. In 2014–2015, Australia issued 27,872 permanent migration visas to Chinese nationals, making China the second-largest source of new migrants after India (DIBP 2015a). China was Australia's fourth-largest source of newly naturalised citizens in 2014–2015, constituting 7549 (5.5 per cent) of 136,572 new citizens in that year, with more Chinese than New Zealanders taking up Australian citizenship (DIBP 2016a).

But the movement of people between Australia and China can sometimes be problematic. The Chinese *Law on Nationality* does not recognise dual nationality, and some new Australian citizens may not renounce their Chinese citizenship. This means that they may continue to be treated as Chinese citizens when in China, and therefore not be in a position to avail themselves of Australian status and consular assistance in the event of legal issues. This is particularly an issue for Australian businesspeople of Chinese origin conducting commercial activities in China.

Ultimately, it is the responsibility of individuals to ensure that their citizenship status is clear with respect to the laws of both countries, and it is in the interests of both countries to have clear understandings and agreements regarding the rights and legal treatment of their citizens in each other's country (see further discussion in Chapter 6).

Visas for significant investors

The Australian government also provides visas leading to potential residency and citizenship for business owners and investors. These programs are dominated by Chinese investors, who received almost 90 per cent of the Significant Investor Visas granted from 2012 to May 2016.

There are separate streams for business owners and investors in Australia (A$1.5 million investment threshold) and 'significant investors' (A$5 million investment threshold). Such investors need to be nominated either by a state government or by Austrade. A new Premium Investment Visa, available only on invitation from Austrade, provides a pathway to permanent residency in Australia after 12 months for an investment of A$15 million, and is initially targeted at US investors.

These visa types encourage wealthy Chinese to make a permanent connection with Australia. Australia is not the only country that does this. Other developed economies, included the United Kingdom (Box 4.8), also offer visas for potential investors, without trying to direct investment into particular sectors.

BOX 4.8: VISAS FOR INVESTORS AND TOURISM IN THE UNITED KINGDOM

There are numerous visa categories for people involved with FDI projects: investors (those outside the European Economic Area who want to invest GBP2 million in the UK); entrepreneurs (those who want to start a business in the United Kingdom); graduate entrepreneurs (graduates of UK universities with an approved business idea); representatives of overseas businesses; and general visas. Investors from within the EU have the right to live and work in the UK (UKTI 2011). Investment promotion programs such as those offered by UKTI serve to reduce the liability of foreignness faced by overseas investors (Driffield et al 2013). The United Kingdom also extends visas to 'maximise' the spending power of Chinese tourists (Inman et al 2015).

Since July 2015, Australia's investor visas have been linked to the government's innovation policy. This compels substantial investment in venture capital or private equity funds, managed funds or other vehicles that invest in emerging companies. This is intended to direct investment away from areas that already receive large capital flows into riskier and less-established areas.

While it is desirable to have a migration pathway that is open to talented entrepreneurs, managing investment decisions through immigration policy rather than general market provisions risks creating bubbles and distortions rather than developing a sustainable innovation agenda. Therefore, the Significant Investor Visa program should have regular reviews that continue to improve its implementation.

China also provides a visa for significant foreign investors to reside and work permanently in China. In line with China's foreign investment policy, investment thresholds are associated with whether an investment is an 'encouraged' sector and whether it is in Western China (US$500,000 threshold), Central China (US$1 million) or other regions (US$2 million). Permanent residency is also available after a time to high-ranking professionals and university researchers.

But uptake of this visa has been very low. In 2012, only 1202 residency permits were granted to all countries. Unlike Australia's investment visas, which are heavily promoted by Austrade, the website of the Chinese Embassy in Canberra does not provide information about permanent residency opportunities for significant investors. Better publicity and promotion of this visa program could help China attract foreign investment and encourage more investment in services.

Temporary skilled labour flows

One advantage of FDI is the opportunity to share knowledge, business practices and technology across borders by way of the movement of skilled labour. The 1988 Australia–China BIT secured the right of investors from each country to visit the other to carry on investment business, and provides for the appointment of key technical and management roles regardless of nationality. This provides practical support for direct investment on both sides, and provides enough time to allow business professionals to establish professional, personal and cultural bonds between the two countries. The Australian temporary skilled migration program is designed to meet only genuine skills shortages in Australia but given the issues that many Chinese investors encounter in Australia, thought could be given to encouraging more Chinese skilled professionals to utilise this program. The number of skilled Chinese professionals working in Australia under these arrangements, however, is very low. According to the Australian Department of Immigration and Border Protection (DIBP 2016b), from 1 July 2015 to 31 March 2016, 2080 applicants from China were granted temporary work visas. China was the third most popular source of workers after India (8320 grants) and the United Kingdom (5750).

ChAFTA provided more specific commitments, allowing four-year Australian visas to the executives, managers and specialists of Chinese firms operating in Australia, and three-year visas for the Australian executives, managers and specialists of Australian firms in China. In both cases, family visas are also offered. These numbers are also likely to expand through the operation of the Investment Facilitation Arrangement (IFA) that came into force with ChAFTA.

The IFA expanded the scope of temporary skilled labour movement to Australia to meet the labour needs of Chinese-registered companies involved in large infrastructure projects in priority industry sectors, including food and agribusiness, resources and energy, transport, telecommunications, power supply and generation, environment and tourism. Where the Chinese investor cannot meet their demand for skilled labour from the local labour market, they may negotiate with DIBP to import skilled labourers to work in Australia temporarily.

This is clearly a win–win arrangement. While temporary migrant workers are sometimes seen as depriving Australians of jobs, under the IFA they are contributing to projects that in many cases would not have gone ahead but for the foreign investment and the availability of skilled temporary labour. Importantly, the workers are subject to Australian employment standards and assurance of proper implementation of that provision is important. In addition, they create demand for other less-skilled local workers while the project is underway. To bolster community confidence in the scheme, regulating bodies need to have enough resources to be able to assess whether companies are compliant with safeguard obligations.

Tourism

The prospects for the Australia–China tourism trade are discussed in Chapter 3. To realise the potential of this market over the next decade, the promotion of Australia's natural environment needs to be combined with investment in facilities and labour that are adequate to meet the demands of Chinese tourists. An example of a major tourism investment is the A$900 million investment by Chinese companies Wanda and Ridong Group to build three hotel towers on the Gold Coast, an area that is now serviced by direct flights from Wuhan, a city of more than 8 million people.

In addition to increased investment, arrangements facilitating increased temporary movements of tourists are welcome. The Australian government's announcement of a 10-year multiple-entry tourist visa for Chinese tourists is an enabler of this. To facilitate business and tourist exchanges, the Chinese government should extend the same treatment to Australian citizens. At the least, provisions that provide short visa-free entry to China to citizens from Brunei, Japan and Singapore should be extended to Australian citizens on the basis of MFN treatment.

From 1 July 2014 to 30 June 2015, the Australian government granted over 226,812 temporary visas for young people from other countries to work and holiday in Australia for up to one year (these visas can be extended for one more year). These working holiday visas provide valuable opportunities for young people to learn about each other's cultures and gain work experience, often before finalising their longer-term study and career plans. They have been a seedbed of innovation and creativity in Australia's external economic and cultural relations (Figure 4.4).

Agreements were first signed with the UK, Canada and Ireland in 1975. Within Asia, Australia has bilateral agreements with Japan (1980), South Korea (1995), Hong Kong (2001), Taiwan (2004), Thailand (2005), Malaysia and Indonesia (2009) and Bangladesh (2010). At the same time as concluding ChAFTA, Australia and China signed a bilateral agreement allowing 5000 Chinese citizens to come to Australia on working holidays visa each year.

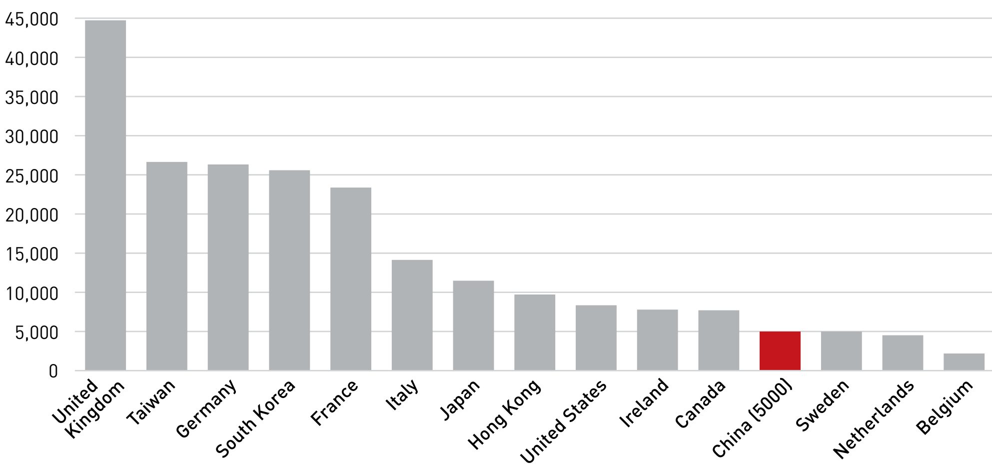
Almost 2900 work and holiday visas were granted to Chinese between the commencement of the program in September 2015 and the end of December (DIBP 2015b). There is enormous demand for the program in China, with the first 1500 visa applications 'filled in minutes' (Minister for Immigration and Border Protection 2015). But based on the grants of working holiday visas to applicants from other countries over the 2014–2015 financial year, the 5000 visa cap means that China would only be the twelfth-largest source of working holidaymakers, accounting for just over 2 per cent of the total.

The 5000 visa cap imposed on China is only around half the number of visas granted to Chinese from Hong Kong, and only one-fifth of the number granted to Taiwanese. Unlike mainland China, both Taiwan and Hong Kong offer reciprocal opportunities for young Australians, and are not subject to a quota.

The quota should be expanded at least six-fold to match the number of working holidaymakers currently accepted from Taiwan. Given the opportunities to expand Australia's domestic tourism industry and to meet the vacationing demands of the new Chinese middle class, this would be a sensible approach both to increase demand for tourism in Australia, and to supply a source of language-equipped and culturally aware seasonal workers to meet that demand.

China should make reciprocal opportunities available for young Australians to live, work and study in China. Steps toward this should commence immediately, and need not wait until the formal review of the bilateral agreement in 2018.

Figure 4.4: Working holiday visas granted from 1 July 2014 to 30 June 2015



Note: These statistics apply before the Work and Holiday agreement with China came into effect, so the Chinese figure based on the assigned quota is for comparison purposes only.
Source: DIBP 2015b.

Education

Australia and China have a long history of educational exchange. China's first academic exchange agreement with a foreign university after 1978 was established between Peking University and the ANU in December 1980. Since then, the relationship has expanded dramatically. Australian universities have signed over 1200 agreements with Chinese institutions, even more than with the United States (Universities Australia 2014). Scientific exchange and research collaboration is burgeoning (Box 4.9).

Export income related to international education is touted as Australia's third-largest export after iron ore and coal, worth almost A$20 billion per year (Department of Education and Training 2015). Australia is the third-most popular destination for Chinese students after the

United States and the United Kingdom. China has been the largest source of international students to Australia since 2011. Now one-fifth of foreign student visa holders are Chinese, most of whom study at high value-added universities rather than at language or vocational institutes (Figure 4.5).

An example of a new development is the recently established Global Business College of Australia launched in Melbourne by a private Chinese firm. This is the first Chinese-owned educational institution to open in Australia that has students from Australia, China and other countries. It demonstrates the potential for Australia to tap into the expertise (and access to capital) of Chinese educational investors to expand its own education sector.

By contrast, the largest source of foreign students to China in 2014 was South Korea (62,923 students), followed by the United States (24,203) and Thailand (21,296). Around 4700 Australian students studied in China in 2014 (Project Atlas 2016).

Australian education policy encourages both short and longer-term international study experiences. China was the third-largest destination for short-term experiences in 2013, with 2614 Australian undergraduates going, placing it behind only the United States and the United Kingdom. The Australian government's 'New Colombo Plan' mobility program supports over 1400 Australian undergraduates to undertake short educational or work-based placement in China. In 2016, China was the most popular of the 38 possible destinations.

The New Colombo Plan allows for overseas study of up to one year, in addition to six months of internship placements. However, there are fewer opportunities for Australians to access Chinese degree-granting institutions. The China Scholarship Council provides scholarships for overseas students to study degrees at Chinese universities. Private initiatives, such as the BHP Billiton Australia China Scholarships, which provide up to A$60,000 per year for Australians pursuing postgraduate education in China, are most welcome (FASIC 2016). Yet by their nature access to these scholarships will be very limited.

BOX 4.9: COLLABORATIVE RESEARCH AND SCIENTIFIC EXCHANGE

Collaborative research is facilitated through high-level programs such as the Australia–China Science and Research Fund. The Department of Industry, Innovation and Science and the Chinese Ministry of Science and Technology jointly manage this fund. It supports Joint Research Centres, the Australia–China Science Academies Symposia Series, as well as a Young Scientist Exchange Program. The most recent round of joint research grants, between Australian and Chinese universities and government research institutions, covers fields ranging from dairy manufacturing, oceanography, mineral sensing and agriculture. These initiatives concurrently support the Australian government's National Innovation and Science Agenda (Minister for Industry, Innovation and Science 2016), as well as the innovation strategy in China's 13th Five Year Plan.

In 2015, the Australia–China Young Scientist Exchange Program supported 13 Australian researchers visiting China, and 16 Chinese researchers visiting Australia for two weeks. This is intended to develop the potential of early and mid-career scientists as 'science ambassadors' and to catalyse future research collaboration (ATSE 2016).

In 2012, China overtook the United States as the nation with the most formal agreements between domestic higher education institutions and Australian universities.

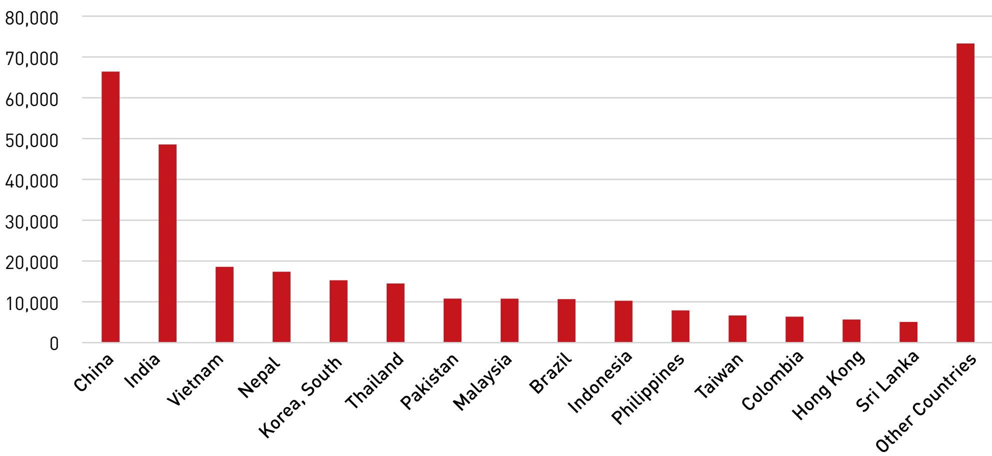
These agreements include student and staff exchange arrangements and research collaborations (Universities Australia 2014). In April 2015, Australia's Group of Eight universities became the first university umbrella group to sign an agreement with the China Scholarship Council, to increase two-way mobility of students and academics.

The importance of scientific and research exchange to staying abreast with the frontiers of innovation recommends the sharp elevation of these and other exchanges under the new bi-national Australia-China Commission proposed in this Report.

The Australian government's Higher Education Loans Program (HELP), which provides income-contingent loans to Australian tertiary students, also provides loans for expenses for up to two six-month study-abroad experiences that contribute to an Australian degree. To ensure that Australians with strong China skills build a strong foundation for future academic and business relationships with China, overseas HELP loans should be made available for Australian students to enrol in double-structured degree programs at highly regarded Chinese institutions.

This initiative recognises the continued progress of Chinese education. According to the QS World University Rankings, of the top 250 universities worldwide, 11 are in Australia and nine are in China. Because HELP loans are designed to be repaid at threshold incomes, regardless of whether the recipient lives in Australia or not, it would be a lower-cost way of equipping Australian students with China skills.

Figure 4.5: Student visa holders in Australia, 30 June 2015



Source: Based on data from DIBP 2015c.

Going the other way, the over one hundred thousand Chinese students who already study at Australian universities each year will continue to build a firm foundation for future bilateral education. Moreover, there are already 36 universities in China that have an Australian Studies Centre, providing an opportunity for ongoing scholarship in China concerning Australia. The proposed Australia–China (Ao–Zhong) Commission can serve to support and facilitate these institutions to develop capacities that allow them to be used as a source of new policy ideas for both governments in the areas of economics, trade, public policy, political science, international relations and the humanities.

Language

While many Chinese learn English throughout their school and tertiary education, Australia cannot expect to have a close relationship with China by relying on English alone. Establishing deep relationships for official, business and social levels requires mutual comprehension of language. This is difficult. Learning Chinese not only involves becoming proficient at the tones of the spoken language, but also committing to memory thousands of Chinese characters that are required for basic literacy. But there are very few young Australians who are involved in this course of study. By their final year of schooling, only 0.1 of Australian students study Chinese, and of these, only around 400 are from a non-Chinese background (ACRI 2016).

All students should have access to appropriate language streams to ensure their efforts and interest can be appropriately rewarded. Those who seek an opportunity to study Chinese in school or university but do not have a background in Chinese outside the classroom may find themselves at a disadvantage if they must compete for grades with students from Chinese backgrounds. By contrast, students who are already proficient in Chinese can be challenged further to ensure they have top-level language skills necessary for professional competence in business, government and education.

One way to help young students achieve proficiency is by attending schools that are formally bilingual in Chinese and English. Only a handful of Australian government primary schools offer bilingual education in which classroom instruction is split between English and Chinese. There are two Victorian primary schools, and one in each of the ACT, South Australia, New South Wales and Western Australia that teach bilingual Chinese–English programs (ACRI 2016). But these are insufficient and ad-hoc when compared to national policy goals — there are more bilingual Japanese–English schools in Victoria than there are Chinese–English schools nationwide.

Given the strategic importance of the Australia–China relationship, the network of bilingual schools teaching Chinese in Australia should be expanded. These could be networked and linked with an equivalent number of bilingual schools in China. It is estimated that in Australia the cost of a bilingual language-program in a primary school is around A$500,000 per year (ACRI 2016). Although running schools is not a functional responsibility of the Australian federal or Chinese central governments, it is appropriate given the strategic importance of this capacity, that a portion of these additional costs is provided from public funds.

The expansion of Chinese-language education suggested here — both through increasing the opportunities to study Chinese for non-native speakers through to high school and the expansion of bilingual school network — also requires an expansion of supply of talented Chinese teachers. ChAFTA does provide a provision for a limited number of Chinese language tutors on up to four-year contracts.

The gains from services and investment policy reforms are additional to, and potentially much more important than, the gains from merchandise trade liberalisation. Using the opening of services sectors in ChAFTA to leverage up productivity-enhancing reforms in these sectors in China and Australia domestically would add considerably to both countries' incomes. And, as discussed in Chapter 5 in detail, financial market reform within the services sector will help intermediate savings to investments where these savings are most productive, improve access to capital and reduce the risk premium on capital investment generally.

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