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Partners in prosperity: The benefits of Chinese investment in Australia

A report by Deloitte Access Economics for the Australia China Business Council and sponsored by ANZ

June 2017

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Foreword

By The Hon. John Brumby AO, National President, Australia China Business Council

"This report does an excellent job of spelling out exactly why foreign investment, and in particular Chinese investment, can play a very positive role in ensuring our ongoing economic security and prosperity."

Australia's quarter century of unbroken economic growth is a great achievement. If we are to enjoy a further long period of strong growth and rising standards of living we will need to unlock the potential new sources of growth in our economy, push deeper into growing export markets and lift our productivity.

Foreign direct investment (FDI) into Australia can help to achieve all of these goals—and the greatest potential source of new FDI lies in China.

Australia has long relied on capital from overseas to fund our development and growth, and for almost as long this has attracted controversy. Whether it was American FDI in the 1970s, Japanese in the 1980s and 90s or Chinese investment today, it has always been possible to raise the suspicions of Australians through talk of foreigners 'buying up the farm'. What is not as often talked about is the benefits that come with foreign investment—which is why this new Deloitte Access Economics report is so important.

In 2015 China's $75 billion investment in Australia represented less than three per cent of the total foreign investment in this country. Interestingly, around 70 per cent of Chinese direct investment went to consumption-related activities such as real estate, medical, transport and other services. As China's middle class grows not only will our trade in services with China grow considerably (potentially creating hundreds of thousands of new Australian jobs) but so will China's investment in the areas in which Australia has a competitive advantage: areas such as agribusiness, health products and services, tourism and education.

As Chinese investment flows in, unrealised value in Australian businesses can be unlocked and new capital expenditure will allow for productivity increases to in turn create more value, more growth and more jobs.

But we must not take this for granted. Countries around the world are competing for Chinese investment, and while Australia has a number of competitive advantages, unfavourable policy settings driven by a negative, anti-foreign investment narrative will compromise our ability to attract the investment we need to make the next quarter century as prosperous as the last.

This report does an excellent job of spelling out exactly why foreign investment, and in particular Chinese investment, can play a very positive role in ensuring our ongoing economic security and prosperity. I'd like to thank ANZ for having the vision to commission this important report in partnership with ACBC, and Deloitte Access Economics for their great work in producing it.

John Brumby AO
Chairman of the Board and National President
Australia China Business Council

Australia China Business Council
澳大利亚中国工商业委员会

Foreword

By Shayne Elliot, Chief Executive Officer, and Mark Whelan, Group Executive, Institutional at ANZ

"Looking ahead, we believe a continued commitment to open, two-way investment between China and Australia will continue to be key to the economic prosperity of both countries."

ANZ is pleased to be supporting this important and timely piece of research with our partners at the Australia China Business Council and Deloitte Access Economics.

The report – Partners in Prosperity – highlights the fact that foreign investment, specifically from China, is creating tangible benefits for both Australian businesses and the Australian community.

While Australia's focus on the implications of the Asian Century has waned somewhat from the heady days of the resources boom, this report serves to remind us that as China continues to shift to a services-led economy and the middle class continues to emerge, Australia's geographic position and highly skilled workforce put us in an enviable position.

Our relationship with China, our largest trading partner, is continuing to deepen through a growing bilateral trade relationship and now through growing investment. It will frame Australia's economic development for decades to come.

The Australia-China relationship, however, is not without its sceptics in the broader community. The aim of this report is to explore the benefits of this relationship, to Australia particularly as greater Chinese investment follows the large and established trade relationship.

As the report states: what's good for the investor is generally good for Australia too. This investment is shown to be improving Australian companies' access to global supply chains, while also supporting productivity, wage growth and competition – and therefore choice – for consumers.

At ANZ, we believe that free and open trade and investment within Asia Pacific and beyond stands to benefit all Australians, and ultimately contributes to thriving communities.

It's for that reason that ANZ, which has a 40-plus year history in Asia, maintains a strong presence in the region. We have built a significant institutional banking network which plays an important role supporting corporate and institutional customers driven by trade and capital flows.

Looking ahead, we believe a continued commitment to open, two-way investment between China and Australia will continue to be key to the economic prosperity of both countries.

Australia can't ignore our geographic presence within Asia and our proximity to China: it's these relationships with our neighbours that will help shape and define our future.

Shayne Elliott
Chief Executive Officer, ANZ

Mark Whelan
Group Executive, Institutional, ANZ

Executive summary

Investment is key to any country's growth. It fuels productivity, provides employment and expands the economy. These benefits flow through to the entire community, who benefit through higher wages, and greater choice of products.

The profits generated by the investment also create additional tax revenues that in turn lead to the provision of increased government services (or reductions in tax burdens elsewhere). When investment has a foreign source there are further benefits that can be generated, including the opening up of businesses to global supply chains and new international markets, as well as exposing firms to new technologies. Put simply, foreign investment has been, and will continue to be, fundamental to maintaining the standards of living that Australians enjoy.

At one level these statements are relatively uncontroversial: economists and policy makers accept the need for foreign investment to boost Australia's productive capacity and realise the natural comparative advantages we possess. Indeed, the current debate over the company tax rate explicitly recognises the need for Australia to be competitive in attracting global capital. However, the community more broadly has not always welcomed foreign investment uncritically.

This report seeks to inform this debate by highlighting the significant benefits that Australia receives from foreign investment. The report focuses on the opportunities presented from new sources of investment from China, a country that will continue to be key to Australia's prosperity into the future, and draws on three recent examples of Chinese investment to demonstrate how the in-principle benefits of foreign investment are realised in practice.

Australia is well placed to benefit from Chinese economic growth

As the Australian economy transitions away from resources, it is well placed to benefit from increased demand from China. Indeed, the growth of China's economy has already provided significant benefits to Australia. Chinese demand was a key driver of the resources boom that delivered a temporary but significant boost to Australia's income over the last decade.

Rising incomes and a growing middle class is supporting a new wave of growth in Australia. Increasing affluence among Chinese consumers has boosted discretionary spending on many items including quality food and health products, attractive holiday destinations and internationally esteemed education institutions. Australia is well placed to supply these goods and services because of our geographic positioning, highly skilled workforce, and regulatory and policy settings that support the perception of quality in our products.

Australia needs foreign investment to benefit from the Asia boom

Just as with the mining boom, increased demand for services and other consumption-based products will also require further investment to scale up Australian industries to meet these opportunities. Indeed, Australia needs to spend around 20 percent of GDP each year just to replace depreciation and maintain its capital stock at current levels.[1] Not all of this investment can be sourced domestically, while Australians have comparable saving rates relative to other advanced economies we simply do not save enough to fund our capital needs. This means that each year we see inflows of foreign investment to make up the gap.

In recent years foreign investment has helped Australia make the most of the resources boom. With the investment phase behind us, Australia will look to foreign investment to fund new sources of growth in the industries in which we hold a comparative advantage. While the majority of foreign investment in Australia continues to be held by the United States (27% of foreign investment or $861 billion) and the United Kingdom (16% of foreign investment or $516 billion), China has recently emerged as a significant new source of investment. Indeed, Chinese investment in Australia quadrupled in value between 2010 ($19 billion) and 2016 ($87 billion). Importantly, the majority of new Chinese investment is in services and consumption-led activities such as health, tourism and agribusiness, assisting Australia in its transition to towards broader sources of growth. This report notes that while Chinese investment may currently be at relatively low levels, if Australia is to continue to benefit from the growth of China (as we did during the mining boom) we will need to facilitate further capital inflows to ensure that our industries have the scale and 'China-readiness' to take full advantage of these opportunities.

1. Our current capital *stock* is around three times our GDP.

Australia receives significant benefits from foreign investment

When an overseas investor commits capital in the form of direct investment[2] they typically do so because they see an opportunity to unlock unrealised value in the business. This could include:

- Better linking the business into global supply chains or international markets not currently accessed by the business;
- Bringing strong management, industry, or technological 'know-how' to a business that allows it to realise greater value from its current operations; or
- Injecting capital that allows a business to efficiently and quickly scale up to meet growing demand for its output.

What's good for the investor is generally good for Australia too. The benefits listed above help create opportunities for Australian businesses, both those receiving the additional capital and those that benefit from the expansion of these businesses (such as upstream suppliers). Australian workers also benefit through more employment opportunities, higher wages and greater consumer choice.

Case study analysis showed that Australia benefits from Chinese investment

All of these potential benefits were present in the case studies included in this report. In these case studies we focus on three growth sectors where Australia's comparative advantage overlaps with growing demand from China. The industries considered here are agribusiness, health products and tourism. All three of these were identified by the Deloitte Access Economics report Positioning for Prosperity: Catching the next wave as being key to Australia's next wave of growth following the mining boom.

The case studies demonstrate that:

- Australian agribusinesses will benefit from increased demand for high quality food from China, but require capital to increase productivity and output, and to better compete with global players. Given low levels of domestic investment in agriculture, Chinese investment has become an important source of investment for domestic producers
- Australian health businesses are well positioned to benefit from China's growing demand for health products, but often require assistance when expanding into the China market. Indeed, the complexity of the Chinese market and the dynamics of consumer preferences, means that working with Chinese investors with established business relationships can be hugely beneficial for Australian businesses seeking to expand into the market.
- Australian tourism businesses are well placed to benefit from the rapid increases in Chinese visitations. But again, the know-how needed to both market products in China, and make Australian offerings "China ready" can be key to attracting additional visitors to Australia. Investments in high-end hotel offerings and, increasingly, bespoke regional attractions can also help drive increased visitation by target groups. These additional travellers benefit not just the immediate business owner, but the whole suite of tourism industries and regions in which visitors spend money on while in Australia.

In each sector we selected one example of a recent investment from China in an Australian business. What was perhaps striking about these case studies were there similarities. In no case was the existing management team replaced by the new owners, but rather the investors added value through a combination of capital investment to scale up activities, and the injection of managerial and market knowledge to better link companies to the Chinese (and other) markets. Further, in all cases the benefits of the investment flowed to a broader group within the community: whether it was the Queensland cattle farmers that supply to Kilcoy Pastoral Company, the universities and research institutions that are funded by Swisse, or the tourism and entertainment businesses benefitting from the additional visitors generated by Fu Wah's investment in the Park Hyatt in Melbourne.

Partners in prosperity

China's growth and transition to a consumption-led economy will therefore go hand in hand with Australia's own structural change towards these high value industries: the two countries will continue to be partners in prosperity.

But this is not an opportunity that can be taken for granted. Just as with the mining boom, realising this opportunity will require significant investment to scale Australian industry up to meet the demand. But perhaps more than the previous boom, success in these industries will require an understanding of the Chinese consumer and how Australian businesses can best position themselves for success in the Chinese market, and other global supply chains. Chinese investment is more than just a source of capital, it brings knowledge and connections. Australia has much to gain, but we cannot go it alone.

2. Defined as investment that leads to an ownership share of greater than 10%, a level indicative of providing the investor with some control in the direction of a business.

Chapter 1

The role of foreign investment

Australia has long been a beneficiary of open global capital markets. Flows of capital into Australia have helped our economy and its constituent businesses realise their potential, both by providing access to funds at cheaper borrowing rates than available domestically, or through bringing with it access to technology, managerial knowledge, and international markets and supply chains that would not otherwise be accessible to domestic businesses.

These benefits of foreign investment are generally well recognised. For example, the Reserve Bank of Australia Governor, Phillip Lowe, recently stated:

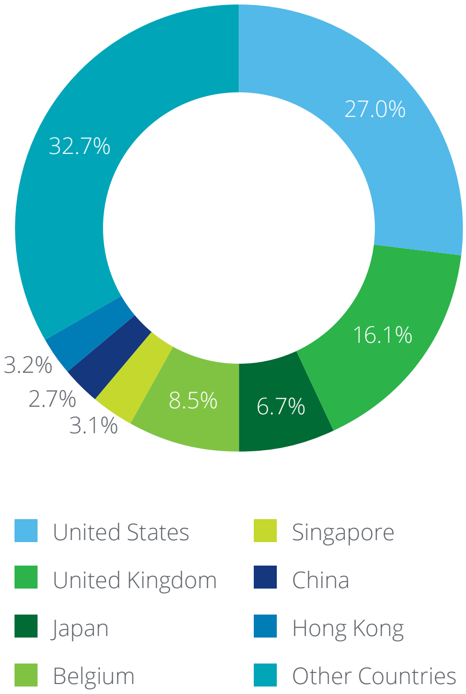
"Capital from the rest of the world has helped build our country. If we had had to rely on just our own resources, we would not be enjoying the prosperity that we do today. Our asset base and our productive capacity would be lower, and so too would our standard of living."[3]

This statement recognises that all Australians benefit from foreign investment. Rather than just increasing business profits (which it certainly does), investment increases employment and wages, consumption opportunities, and tax revenues that can fund public services.

But while exporting Australian goods (that is, selling goods and services to overseas buyers) is almost unanimously seen as a positive for the country, foreign investment (that is, selling assets to overseas buyers) in Australia has often been met with suspicion and questions of national interest. In recent years, several Chinese investments in Australia have brought these concerns to the fore.

Such concerns often ignore the national gains from foreign investment and overstate the prevalence of Chinese investment in Australia. The largest source of foreign investment in Australia is the United States, followed by the United Kingdom and Belgium (see Chart 1.1).[4] While China accounts for a relatively small proportion of the stock of foreign investment, it is growing at a substantial rate.[5] China's build-up of savings and appetite for expansion has facilitated the country's role as a supplier of capital for Australia and for many other economies.

Chart 1.1: Stock of foreign investment in Australia in 2016



3. Dinner Remarks to A50 Australian Economic Forum (2017) Philip Lowe, Governor Reserve Bank of Australia.
4. ABS 5352.0 International Investment Position (2015) Australian Bureau of Statistics
5. Foreign Investment Into Australia (2016) Australian Commonwealth Treasury

This report seeks to reinforce the benefits that foreign investment brings to Australia. It begins by providing an overview of the in-principle benefits that investment brings with it, and a snapshot of the current flows of investment into Australia, with a focus on China. It then seeks to go beyond these somewhat abstract in-principle benefits from foreign investment to draw on three case studies of recent investment from China in agribusiness, healthcare and the tourism sector. Through these three case studies this report provides concrete examples of the benefits that foreign investment can bring, and why Australia's ongoing prosperity will continue to rely on access to international, and particularly Chinese, capital.

1.1 Foreign investment raises living standards

Foreign investment provides a number of benefits for Australian households and businesses. Households benefit from more employment opportunities, a more diversified range of goods and services and increased business competition placing downward pressure on prices. Businesses benefit from increased productivity from technology spillovers and knowledge transfer, better linkages to global supply chains, and the opportunity to expand production (see Figure 1.1).[6]

Even small increases in foreign investment have substantial impacts on economic growth. In previous modelling for the Business Council of Australia, Access Economics estimated that a 10% increase in foreign investment over the period 2010 to 2020 would lead real GDP to be 1.2% higher at 2020 than it otherwise would have been had the additional foreign investment not occurred. Given the slow rate of productivity growth currently being seen in Australia, this would represent a significant gain.[7]

Figure 1.1: Benefits of foreign investment

Business expansion
Businesses benefit from the opportunity to expand their production

Productivity
Businesses benefit from increased productivity from technology spill overs and knowledge transfer

Global linkages
Businesses benefit from better linkages to global supply chains

Diversified economy
Households benefit from a more diversified range of goods and services

Employment opportunities
Households benefit from increased employment opportunities

Competition
Households benefit from increased competition among businesses which incentivises firms to improve service offerings and reduce prices

Changes to foreign investment have a range of impacts on the economy. Increases in foreign investment add to the capital stock, increasing the productive capacity of an economy, allowing firms to produce more with less, and ultimately increasing economic output. More productive workers increase firms' demand for additional workers, boosting wages and household income. Our previous analysis for the Business Council of Australia estimated that a 10% increase in foreign investment would not just raise GDP, but would increase wages by just over 1%, and employment by around 0.3%. In this, the economic benefits of foreign investment flow beyond simply the businesses that receive the capital.

20%

Australia needs to invest around 20% of GDP each and every year just to maintain our capital stock

6. Foreign Investment in Australia (2010) Access Economics
7. Ibid

1.2 Foreign investment increases productivity

Investment is vital to economic growth as it shapes the productive capacity of an economy. While in the short run economic growth can fluctuate with changing demand for goods and services, or external economic shocks, long run and ongoing growth depends almost entirely on the productivity of a country's factors of production (capital and labour).

Australia's productivity surged in the 1990s as a result of a range of economic reforms implemented by Australian governments in the earlier part of that decade. This underpinned sustained and strong growth over that period (see Chart 1.2).[8] Following this period of productivity-fuelled growth Australia's ongoing growth came to rely more on good fortune in the form of an unprecedented appreciation in our terms of trade as resource prices rose. Following the mining boom, Australia will once again need to rely on sustained and strong growth in productivity if we are to continue to enjoy the prosperity we have come to expect over recent decades.

One such source of productivity gain is through the investment channel. Investment creates greater capital for the labour force to use and thereby increases the productivity (and therefore wages) of workers. Indeed, the benefits of increasing the capital stock through investment lies at the heart of the current debate around company tax cuts: the benefits from such cuts are increased foreign investment and domestic wages, the cost is the lost tax revenue. The need for Australia to increasingly compete with other countries for global capital features strongly in this debate.

Investment is also needed to effectively maintain the capital stock. Government, household and business assets wear out over time and continued investment is required to ensure they continue to function effectively. The value of Australia's capital stock is three times larger than GDP and wears out at a rate of around 6% per annum, meaning that around 18% of GDP is needed each year just to maintain the capital stock.[9]

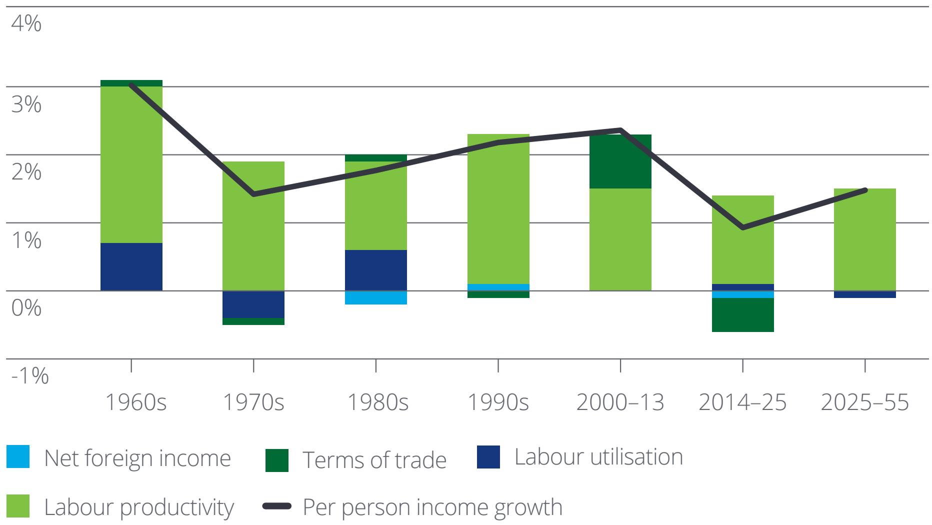
Investment must also keep pace with labour growth in order to maintain the ratio of capital stock per worker.[10] In Australia, the employment growth is around 1.2%.[11] This means that to maintain the amount of capital per worker over time, Australia in fact needs to allocated around 20% of GDP to investment each and every year.

The economic and productivity impact of an investment decision will differ according to the form and type of transaction. Investment projects that maintain the existing capital stock, such as reinvested earnings for the general upkeep of commercial equipment, help to retain our current living standards. Investment projects that add to the existing capital stock, such as finance for new infrastructure or business capital, have the potential to increase productivity and lift living standards.

To improve Australia's performance and boost productivity, further investment will be needed. Australia simply does not save enough to fund sufficient investment, and this 'savings gap' must be made up for by foreign investment.

8. Get out of your own way: Unleashing productivity. Building the lucky country 4 (2015) Deloitte Access Economics
9. Stagnation nation? Australian investment in a low-growth world (2016) Jim Minifie – Grattan Institute
10. Ibid.
11. ABS 3101.0 Australian Demographic Statistics (2016) Australian Bureau of Statistics

Chart 1.2: Component contributions to growth in national income per head, by decade



The remainder of this Chapter sets out the various mechanisms through which foreign investment has been found to boost economic performance at the firm and national level. It draws on research from the literature to demonstrate some of the more concrete conclusions that researchers have made on the impacts of foreign investment.

Foreign-owned firms can be more productive

Foreign firms are able to unlock value in domestic businesses that had not been previously realised, as evidenced by empirical studies that find higher levels of productivity among foreign firms relative to domestic firms. Lipsey (2004)[12] concludes in a review of the literature on foreign investment and productivity that:

The evidence on productivity, whatever the measure, is close to unanimous on the higher productivity of foreign-owned plants in both developed and developing countries. Some of that higher productivity, but not all in most comparisons, can be attributed to higher capital intensity or larger scale of production in the foreign-owned plants.

While most of the research has focused on developing countries, the findings of high productivity levels among foreign-owned firms have been replicated in a number of studies in developed countries, for example:

- Foreign-owned manufacturing firms in the US were found to be concentrated in industries where productivity is high and within a given industry tend to have larger plants, greater capital intensity and more skilled employees.[13]
- US and foreign multinational firms were found to have higher labour productivity and total factor productivity (a measure of output controlling for differences in capital and labour inputs) than firms which just do not operate across borders.[14]
- Firms that invest overseas were found to be 15% more productive on average than firms that simply export from their home country, which in turn are more productive than firms that do not export at all.[15]

These findings indicate that there is clearly something about foreign-owned firms that leads them to realise greater productivity. The following sections identify some of the factors that may be driving this outcome.

12. Home- and Host-Country effects of Foreign Direct Investment (2004) Robert E. Lipsey
13. Survey of Current Business, Characteristics of Foreign-Owned U.S. Manufacturing Establishments (1994) Howenstein and Zeile
14. Comparing Wages, Skills, and Productivity between Domestically and Foreign owned Manufacturing Establishments in the United States (1998) Doms and Jensen
15. Export Versus FDI with Heterogeneous Firms (2004) Helpman, Melitz and Yeaple

Foreign investors can offer improved management practices and access to global markets

It is entirely possible that foreign-owned firms are more productive simply because multinationals are better at selecting productive firms to begin with. That is, foreign investors may simply be better at picking winners. However, Arnold and Javorcik (2009)[16] show that although foreign investors do tend to favour investing in more productive domestic firms, even after accounting for differences in initial productivity, firms that receive foreign investment are significantly more productive than comparable firms that do not receive additional foreign investment. Indeed, the firms that received foreign investment had total factor productivity levels that were at least 10% higher than matched firms that did not and the difference in labour productivity was even greater.

In particular, their findings suggest that firms that received foreign investment had:

- Strong management practices and more productive workers
  - Multinational firms had higher employment and wages
- Opportunities to expand
  - Multinational firms had higher output and investment
- Access to global markets
  - Multinational firms were more integrated into global markets both in terms of exports and imported inputs.

This finding is consistent with other studies that find that foreign-owned firms pay higher wages than domestic firms for workers with a given level of education. Hence, the finding of foreign-owned firms being more productive is not simply down to foreigners making 'smart' investments, but rather due to the value these investors are able to bring to a firm: opening up new markets and supply chains and bringing management know-how that support firm growth in these markets.

Foreign investment benefits upstream suppliers and generates greater competition in the domestic market

While foreign investment is clearly linked to improvements in productivity for the firms that receive investment, benefits for domestic firms are likely to depend on the nature of their linkages with foreign firms. Foreign investment can generate:

- spillovers for upstream suppliers:
  - firms supplying to multinational firms may benefit from increases in demand for their product,
- competition spillovers:
  - firms and households may benefit from increased competition as it incentivises firms to reduce prices and improve service,
  - alternatively, the productivity of domestic firms could suffer as foreign firms may take some market share from domestic firms, thereby reducing potential economies of scale for domestic firms that do not receive foreign investment

Evidence suggests that firms supplying to foreign-owned firms receive positive spillovers[17] but that there is a mixed impact on productivity for domestic firms that compete with foreign-owned firms.[18] The latter finding is consistent with the possibility that any spillovers from foreign firms may be offset by greater competition which reduces the market share and scope for economies of scale for domestic firms.

Nonetheless, even where foreign investment does not result in positive spillovers for domestic firms due to increased competition, foreign investment is likely to increase productivity of the economy overall as noted by Lipsey (2004):[19]

The mixed story for spillovers, combined with the strong evidence for superior productivity in foreign-owned firms, suggests that overall productivity is improved by the presence of foreign-owned operations.

Hence, as with protectionist perspectives on trade policy there may be resistance to foreign investment from domestic businesses who perceive it as being a threat to their market position. But just like trade policy, the country as a whole benefits when this investment is facilitated. Further, these costs will be lowest, and the benefits of investment potentially highest, when foreign investment occurs with the intention of opening Australian businesses to global supply chains and new international markets.

16. Gifted Kids or Pushy Parents? Foreign Direct Investment and Plant Productivity in Indonesia (2009) Jens Arnold and Beata Javorcik
17. Spillovers from Foreign Direct Investment: Within or Between Industries (2005) Maurice Kugler & Does Foreign Direct Investment Increase the Productivity of Domestic Firms? In Search of Spillovers Through Backward Linkages (2004) Beata Javorcik
18. For example, Aitken and Harrison (1999) find that FDI reduced productivity of local firms in the same sector in Venezuela but Haskel et al (2007) find that FDI increases productivity of local irms in the UK.
19. Home- and Host-Country effects of Foreign Direct Investment (2004) Robert E. Lipsey

Chapter 1 summary

The benefits of foreign investment

This section has demonstrated the mechanisms through which the benefits of foreign investment are realised. These benefits include:

- **Households benefit** from increased employment opportunities with higher wages, and greater competition which incentivises firms to improve service offerings and lower prices.
- **Businesses receiving the foreign investment benefit from increased productivity**, as the investment provides the opportunity to expand, increased access to global markets and strong management practices.
- **Firms supplying to foreign-owned businesses benefit** from increased demand, and even non-supplying firms benefit from increased demand as foreign investment lifts the overall productivity and growth of an economy.

The recent mining boom in Australia has also shown that increased profits from investment can significantly boost Government revenues, and increase the provision of public services (or reduce the tax impost). In all these ways, the benefits of investment are spread broadly throughout the community.

These benefits have been repeatedly demonstrated in the empirical literature. However, it is interesting to note that despite the widespread support for foreign investment in principle, there have been no studies to our knowledge that have sought to draw out these benefits in an Australian context.

The rest of this report provides more detail on foreign investment in Australia, with a particular focus on Chinese investment, and the benefits that this has created. It does so by focussing on a few key sectors and some recent case studies to demonstrate how benefits have been realised in practice.

Chapter 2

Foreign investment in Australia

As a share of GDP, Australia's foreign direct investment is comparable to other advanced economies.

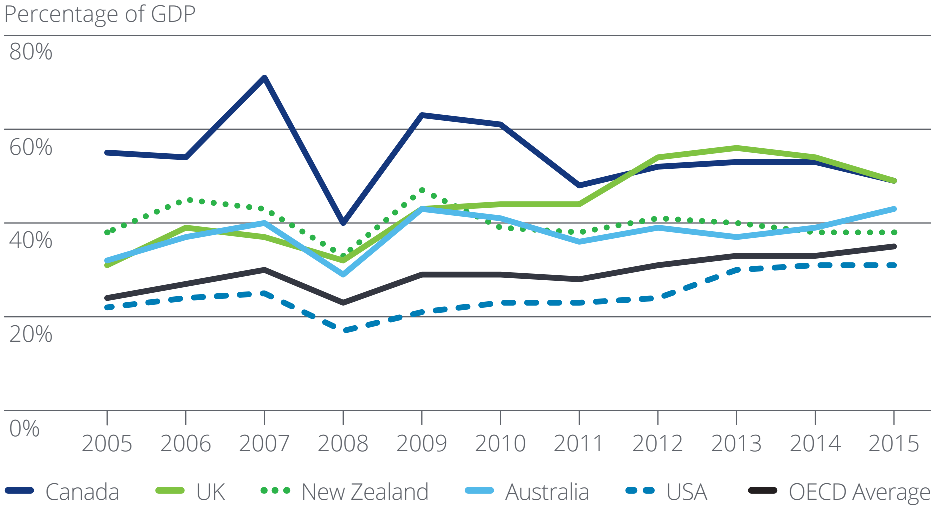
2.1 Foreign investment in Australia

Australia has a long history of openness to foreign investment. Indeed some of Australia's oldest businesses were established as a result of British investment. This includes the Australian Agricultural Company (established in 1824) and Van Dieman's Land Company (established in 1825).[20]

While Australia's attitude towards foreign investment during the 19th century remained largely ambivalent, concerns began to develop in the 1950s around foreign investment from the United States. Indeed, a takeover bid by American company IT&T for the iconic Australian "Chiko roll" in 1972 eventually led to the creation of the Foreign Acquisitions and Takeovers Act 1975. Public concern then gradually shifted to Japanese investment in Australian resources, particularly in cattle industry and real estate.[21] The current debate has shifted towards concerns over the rapid growth of investment from China.

Foreign investment in Australia is not, however, particularly high relative to other countries. As a share of GDP, Australia's foreign direct investment is comparable to other advanced economies. Indeed, Australia's foreign direct investment stock (measured as a share of GDP) is below Canada, which has a similar economic composition to Australia with a reliance on both services and resources exports. As shown in Chart 2.1 the level of inward FDI in Australia is comparable to the OECD average).[22]

Chart 2.1: Foreign direct investment stock as a share of GDP by country



Source: OECD FDI Stocks

2.2 Most foreign investment is passive portfolio investment

Australia's foreign investment stock reached $3.2 trillion or around 190% of GDP at the end of 2016.[23] The stock of foreign investment differs from the flow of investment, in that it refers to the level or position of investment at a given point in time, whereas the flow of foreign investment refers to the value of investment that occurs over a given period, usually a year. In terms of the flow of investment, Australia received around $153 billion in foreign investment over the course of 2016.

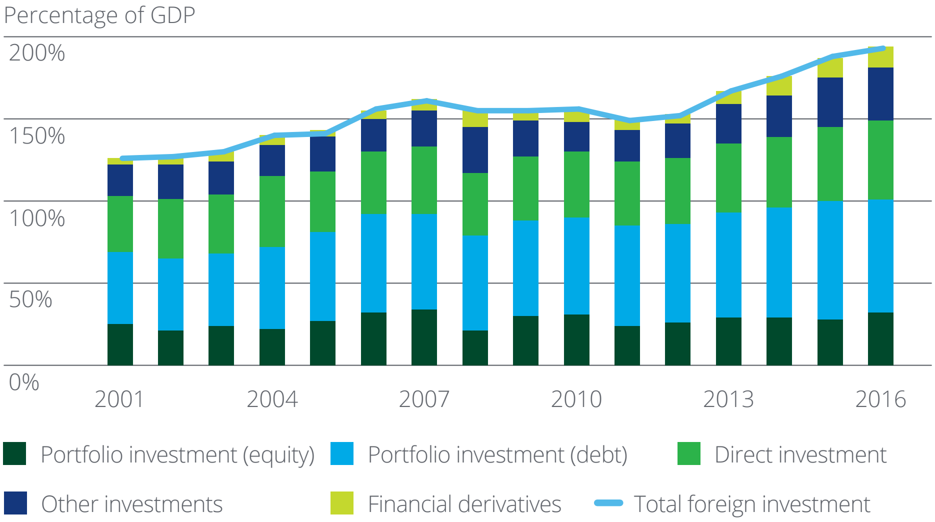
More than half of foreign investment in Australia is undertaken in the form of portfolio investment (see Chart 2.2).[24] Portfolio investment can take the form of debt or equity, in that it occurs when foreign investors buy bonds (debt obligation notes) or a less than 10% share in a domestic company. Portfolio investment is typically considered passive as investors are unable to significantly influence managerial decision making, and by extension the return on their investment.

A quarter of foreign investment in Australia is foreign direct investment (see Chart 2.2)[25], defined as an ownership level of 10% or more. The 10% cut off is used as a proxy for larger investors that have influence over management decision making. This investment can represent a range of transaction types, such as finance used by a foreign entity to establish a new project (greenfield investment) or investment to acquire an existing company. It also includes reinvested earnings or additional capital from a parent company to a subsidiary operating in Australia.

Both direct and portfolio investment provide economy-wide benefits. Portfolio investment helps to improve the functioning of domestic equity markets, as foreign investors increase the amount of capital available for Australian companies. Foreign direct investors support broader economic growth and development through the mechanisms described in Chapter 1.

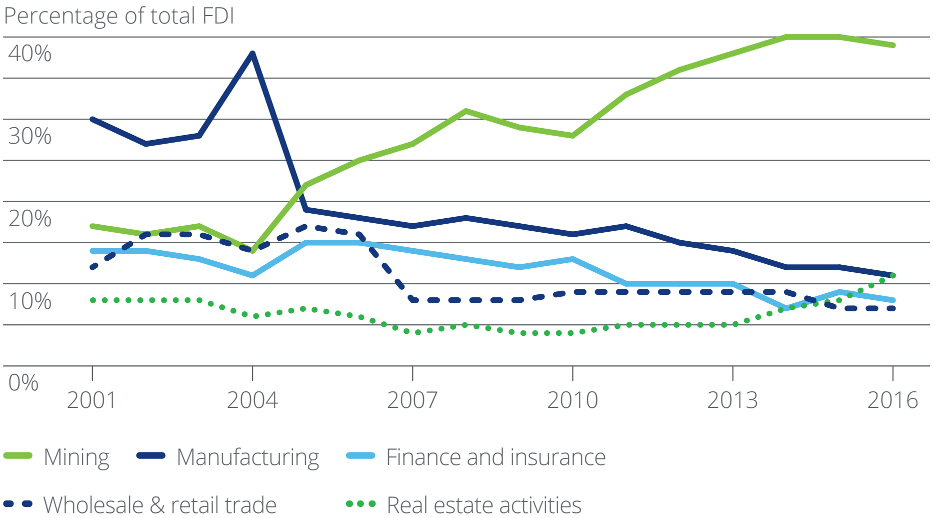
20. Regulation of Agriculture (2016) Productivity Commission
21. Takeover. Foreign Investment and the Australian Psyche (2015) David Uren.
22. FDI Stocks (2016) OECD
23. ABS 5352.0 International Investment Position (2015) Australian Bureau of Statistics.
24. 25. Ibid.

Chart 2.2: Stock of foreign investment in Australia



Source: ABS 5352.0

Chart 2.3: Sectoral composition of the level of foreign direct investment into Australia.



Source: ABS 5352.0

2.3 The composition of foreign investment is changing

The composition of foreign investment in Australia has evolved to reflect changes in the comparative advantage of Australian industry. Foreign direct investment in manufacturing has fallen sharply over the past decade, from a peak of 38% of total foreign direct investment in Australia in 2004 to 11% in 2016.[26] Reductions in manufacturing investment reflect structural changes in the Australian economy and the gradual decline in certain forms of manufacturing.

The level of mining investment has increased substantially over fifteen years, from 17% in 2001 to 39% of foreign direct investment in Australia in 2016.[27] During the resources boom, mining projects offered investors relatively high rates of return as unprecedented rises in our terms of trade boosted Australia's demand for investment so that firms could rapidly scale up production. Investment in mining has remained strong in recent years as many of the profits on the initial investments have subsequently been reinvested to drive further productive capacity. This reinvestment is measured as foreign investment despite the funds not necessarily leaving Australian shores.

While the majority of foreign direct investment continues to occur in mining, investment growth has slowed from increases of around $33 billion per annum in 2012-14, to increases of $18 billion in 2016.[28] A slowing of foreign investment in mining is consistent with a reduction in mining investment in the broader economy, with mining investment falling by almost 4 per cent of GDP since 2013, and likely to fall further.[29]

26. ABS 5352.0 International Investment Position (2015) Australian Bureau of Statistics.
27. 28. Ibid
29. Stagnation Nation, Australian Investment in a low-growth world (2017) Jim Minifie, Grattan Institute

Foreign direct investment growth in financial and insurance activities has also slowed in recent years. The share of foreign direct investment in financial activities has fallen from 14% of total investment in 2007 to 8% in 2016. This reduction is partly driven by the banking sector's shift towards less risky domestic deposits following the GFC.[30]

Conversely, foreign investment in real estate activities has increased significantly in recent years. The share of foreign direct investment in real estate activities recently doubled from 5% of total investment in 2013 to 11% in 2016.

This increase is driven by favourable conditions in the real estate sector, as low interest rate conditions helped fuel substantial increases in house prices in Sydney and Melbourne. Indeed, Deloitte's International Property Handbook showed that over half of the total property investment for Melbourne and Sydney was from foreign investors, and that inbound foreign investment in the Australian property market has increased substantially in recent years, representing 42% of total property investment (in value terms) in 2016, up from approximately 25% of total property investment in 2010 (see Figure 2.1:).[31]

Figure 2.1: Share of property investment by foreign investors in major Australian cities in 2016

Perth	Sydney
23%	50%
Brisbane	**Melbourne**
24%	53%

Source: Deloitte international property handbook

While the 'traditional' investment sectors remain strong, recent years have seen significant deals outside of these sectors, and in areas where Australia is well positioned to transition to following the resources boom. This includes investments in agribusiness, health products and services, tourism and education. These sectors were all identified as future growth areas in Deloitte Access Economics' report *Positioning for Prosperity: Catching the next wave*.[32]

2.4 Foreign investment funds our savings gap

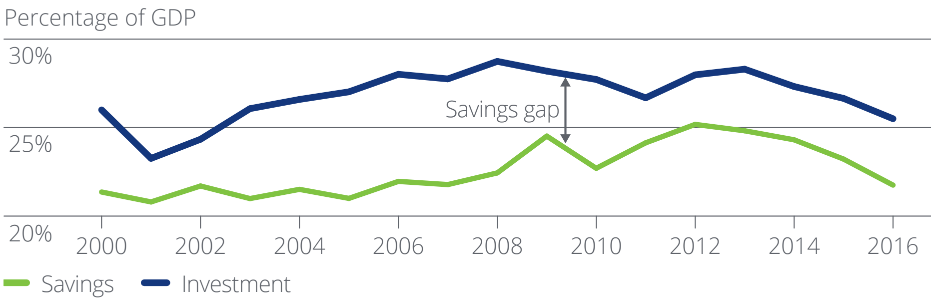
Australia requires foreign capital to finance the gap between national investment and national saving. Chart 2.4 shows the 'savings gap', the difference between national savings and total investment, for Australia over time. This gap increased slightly over the early to mid-2000s as the resources boom translated to an investment boom in Western Australia and Queensland. However, it has recently fallen back to levels closer to the pre-boom average.

The existence of the savings gap is due to domestic capital markets simply not being large enough to service the requirements of capital-intensive industries like mining, agriculture and, more recently, property. This is not to say that Australians are not savers, in fact our household savings rate is comparable to other developed countries. Rather, it shows that the investment opportunities here are greater still, and exceed what can reasonably be funded domestically. Of course, domestic savings could increase further to cover this gap and reduce the need for foreign inflows of capital, but this would come at the expense of reduced consumption and wellbeing of the population.

Australians also invest internationally. Each year billions of dollars of Australian savings flow internationally, both as portfolio investment (that is, investment in assets that amounts to less than 10 percent of the total asset's value) and as direct investment in overseas assets. Presumably this investment occurs because Australians see higher returns on it than would be available domestically: either through benefits in diversification, or through being able to bring knowledge, technology or other benefits to the assets owned overseas.

Similarly, foreign investment in Australia reflects overseas buyers expecting to realise greater value from investment in Australia than domestic investors can. Just like with exports, when foreign buyers are willing to pay more for an asset than its value to an Australian owner, both parties are better off.

Chart 2.4: Australia's savings gap



Source: ABS 5206.0 – Australian National Accounts: National Income, Expenditure and Product, Dec 2016

30. Recent Trends in Australian Capital Flows (2017) Reserve Bank of Australia
31. International Property Handbook: 2017 trends and a look back at 2016 (2017) Deloitte
32. Positioning for Prosperity: Catching the next wave (2014) Deloitte Access Economics

Chapter 2 summary

Foreign investment in Australia

Like other developed countries, Australia needs foreign investment to maintain the economic growth and living standards to which we have become accustomed. Indeed, Australia sits right in the middle of the pack relative to OECD countries when it comes to the amount of investment we receive from foreign sources.

In recent years foreign investment has helped Australia make the most of the resources boom. Investment helped mining production scale up quickly, and this saw Australia perform strongly through a time of unprecedented international economic turmoil. With the investment phase of the mining boom behind us, Australia will look to foreign investment to fund new sources of growth in the industries in which we hold a comparative advantage. Indeed, as later sections of this report show, we are already starting to see this.

Chapter 3

Chinese investment in Australia

3.1 China is a small but growing source of foreign investment in Australia

China is a relatively small investor in Australia, particularly when compared to Australia's other key trading partners. In 2016, China was the seventh largest country investor in the Australian economy with an $87 billion stock of investment in Australia that accounted for less than 3% of Australia's total foreign investment stock (see Chart 3.1).[33]

In comparison, the stock of investment from the United States was $861 billion (or 27% of foreign investment in Australia) and investment from the United Kingdom reached $516 billion (or 16% of foreign investment in Australia).[34] Consequently, there is still a long way to go before China's investment in Australia reflects its size in the global economy, and its position as a close trading partner of Australia.

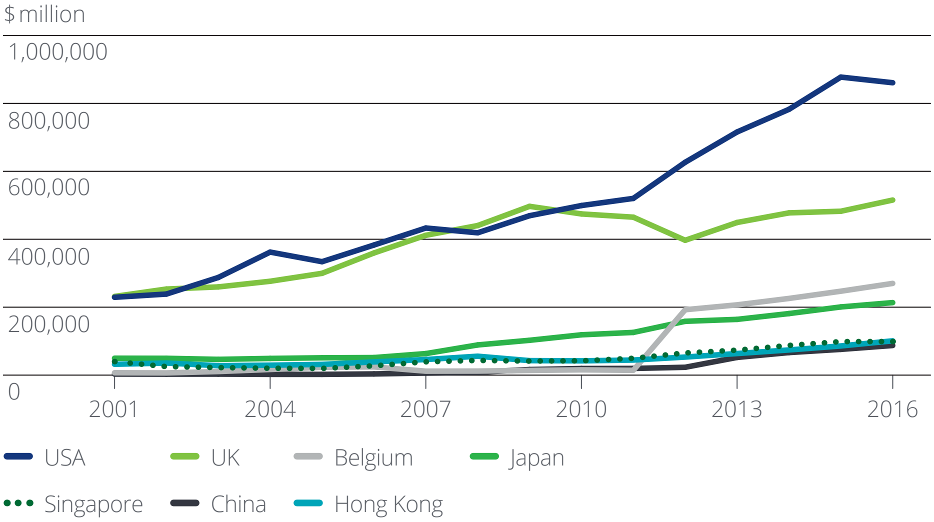
However, capital inflows from China have increased substantially in recent years, quadrupling in value from $19 billion in 2010 (or 1% of foreign investment in Australia) to $87 billion in 2016 (or 2.7% of foreign investment in Australia). Similarly, investment flows from Hong Kong have more than doubled from $42 billion in 2010 (or 2% of foreign investment in Australia) to $101 billion in 2016 (or 3% of foreign investment in Australia). Chinese investment thus represents a significant new source of foreign investment in Australia.

Chinese investors started to diversify the type of investments held in Australia. Portfolio and other investments, such as loans, currency and deposits, formed around half of all the Chinese investment in Australia in 2016, as compared to five years ago when non-direct investment represented a quarter of Chinese investment in Australia. Foreign direct investment, which is typically associated with foreign influence over management decision making, now represents less than half of Chinese investment in Australia.[35]

3%

China accounted for less than 3% of Australia's total foreign investment stock

Chart 3.1: Major country stock of foreign direct investment into Australia ($ millions)



Source: ABS 5352.0

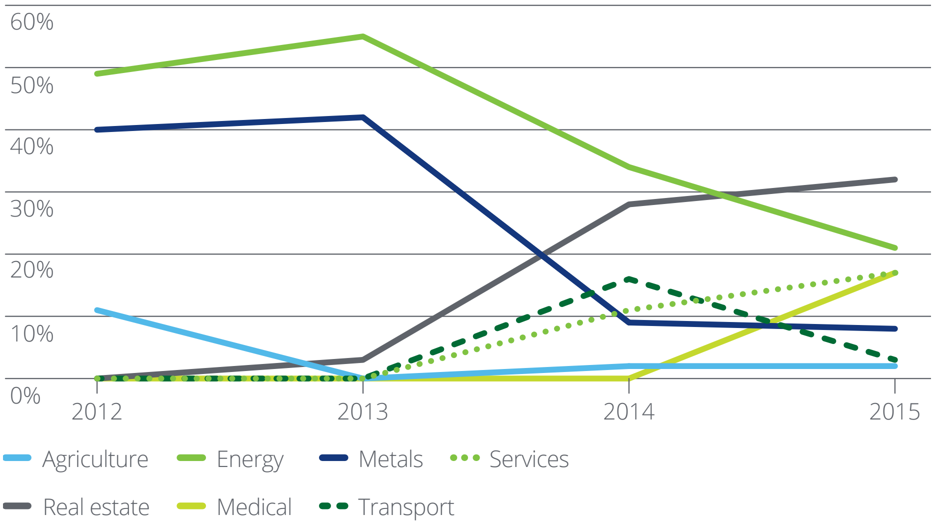
33. ABS 5352.0 International Investment Position (2015) Australian Bureau of Statistics
34. 35. Ibid.

3.2 Chinese investors are more focused on services and consumption-related activities

Chinese investment in Australia is increasingly focused on service and consumption-related industries, reflecting the growth in consumer spending in China and the transition in the Australian economy. In 2015, around 70% of Chinese direct investment occurred in consumption-related activities including real estate, medical, transport and other services. In comparison, Chinese direct investment in 2012 was almost exclusively focused on primary and secondary industries including energy, metals and agriculture (see Chart 3.2).[36]

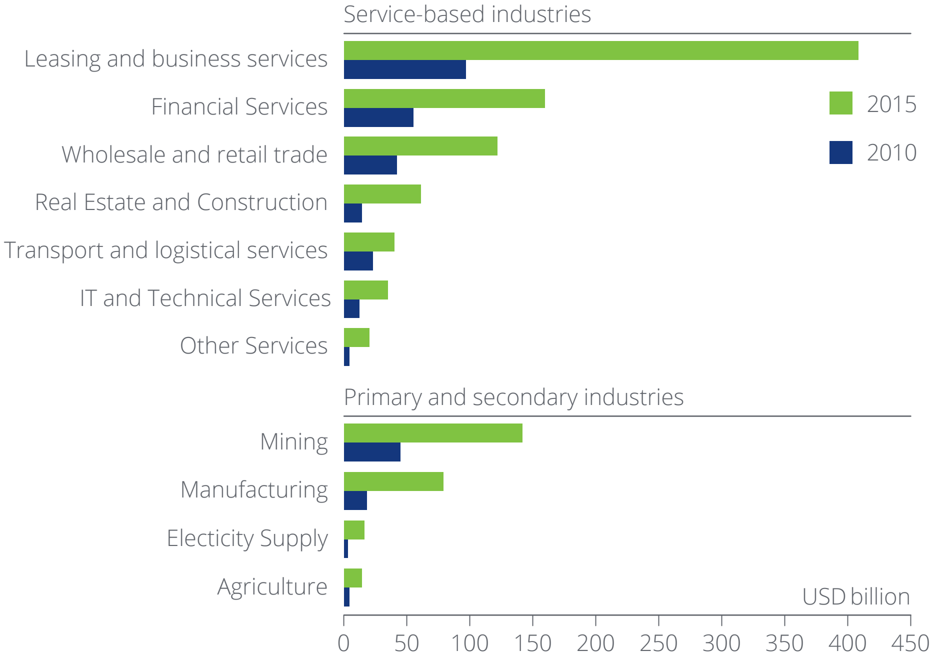
The growing importance of these industries reflects the transition of both the Australian and Chinese economies toward more services-led growth. As the Australian economy transitions it will continue to develop expertise and comparative advantage in these industries, while at the same time China will likely increasingly look to invest in these industries to service its increasing domestic demand. Australia's structural change and the rising middle class in China are in this sense natural partners.

Chart 3.2: Sectoral composition of Chinese investment flows into Australia



Source: China Global investor tracker. Services includes finance, entertainment and tourism. Real estate refers to the sale of large real estate companies as opposed to the sale of individual residential apartments and homes

Chart 3.3: Chinese net overseas direct investment stock by sector



Source: National Bureau of Statistics in China. Other services includes health, social services, education, household services, hotel services, cultural activities, entertainment and sports.

Note: Agriculture includes forestry, animal husbandry, fishery and water. Electricity Supply includes the production and supply of electricity, gas and water. IT and Technical Services includes Information Transmission, Computer Services, Software, Scientific Research, Technical Services and Geologic Prospecting.

36. China Global Investment Tracker (2016) American Enterprise Institute

Increased investment in Australia's services-based industries reflects Chinese outward investment globally. In 2015, more than three quarters of China's international investment stock was focused on services. The majority of services investment was in leasing, business and financial services, as these sectors represented USD$569 billion or more than half of Chinese investment abroad (see Chart 3.3).[37] This reflects shifts in China's economy more generally, with services now contributing over 50 per cent of GDP.[38]

China's outward investment in services-based industries has expanded significantly over the past five years. The greatest annual growth over the past five years has occurred in the 'others services' category, which includes education (64% growth per annum), sports and entertainment (57% per annum), hotel and catering (38% per annum) and health and social services (37% per annum). Albeit, these growth rates are off small base.[39] But it is telling that the greatest growth in both absolute and relative terms has come from China's services sectors.

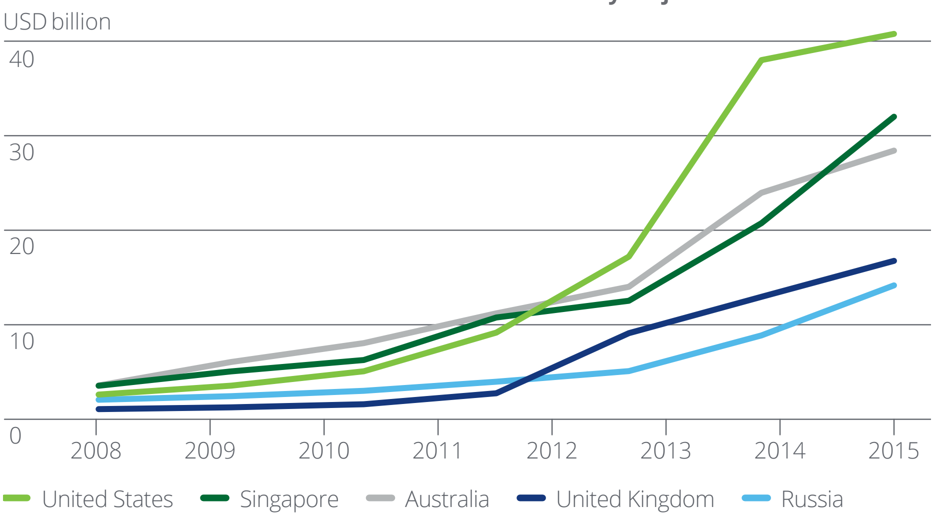
3.3 Australia as a recipient of Chinese investment

Australia is a relatively attractive destination for Chinese direct investment. After removing Hong Kong, Cayman Islands and the Virgin Islands from the analysis, Australia has the third largest stock of Chinese overseas direct investment (see Chart 3.5).[40] While Chinese investment in Australia has grown over time it has not kept up with the rate of growth of outward Chinese investment into the US and Singapore, with investment growth in those countries being close to exponential in recent years relative to the linear growth seen by Australia.

This demonstrates the international environment in which Australia competes for increasingly mobile capital. Growth in the Chinese economy will naturally lead to greater outflows on capital into global markets, but the extent to which this benefits Australia will depend both on the opportunities our industries create, and the regulatory settings we place on foreign investment.

In 2015, around 70% of Chinese direct investment occurred in consumption-related activities including real estate, medical, transport and other services.

Chart 3.4: Chinese overseas direct investment stock by major investor countries



Source: National Bureau of Statistics in China

37. General Survey (2017) Chinese National Bureau of Statistics
38. Budget Paper Statement 2: Economic Outlook (2017) Commonwealth Treasury
39. General Survey (2017) Chinese National Bureau of Statistics
40. General Survey (2017) Chinese National Bureau of Statistics. Australia had the second largest stock of Chinese overseas direct investment in 2014, however it was overtaken by Singapore in 2015.

Chapter 3 summary

Chinese investment in Australia

The Australian and Chinese economies are shifting towards services and consumption-led growth, and this has been reflected in recent trends in Chinese investment in Australia. While foreign investment in Australia has primarily been in the resources sector over the past decade, reflecting the huge demand for funds in order to ramp up mining production, more recent investment from China has been more diversified.

This reflects both the diversification of China's economy itself, and the need for Australia to find new sources of growth post-mining boom. The greatest growth has been in services and other consumer-oriented products: education, tourism, real estate, and health.

This investment has helped unlock Australia's potential in these industries, in part because the potential for growth lies in taking advantage of the rising demand from China. The following sections focus on Chinese investment in three growth sectors, namely agribusiness, health and health products, and tourism assets. A case study is selected in each sector to demonstrate the concrete benefits that Chinese investment can deliver.

Chapter 4

Chinese investment in agribusiness

4.1 Australia stands to benefit from Asia's increasing demand for high quality food products

Australia rode to prosperity on the sheep's back for most of the 19th century, and agriculture continues to be an important commodity today. Australian agriculture and food exports were valued at $46.5 billion in 2015 or 14% of the total value of Australian goods and services exports for that year.[41] The composition of our agricultural exports has, however, changed with the continuing shift of economic growth from the developed world to emerging economies.

When wool was our largest export, the agriculture industry was supported by demand and foreign investment from the United Kingdom. Increased demand for high quality food products from Asia's growing middle class has since shifted the composition of our exports towards high protein products with trading partners to our North. Not surprisingly, beef and other meat products are now Australia's largest agriculture export and were valued at $13 billion in 2015, and now the industry is supported by increased demand and investment from China, among other sources.[42]

While Australia's agricultural industry is well placed to meet increased export demand for high value foods such as animal products,[43] many agribusinesses will need additional capital to increase scale and productivity if they are to compete internationally. Attracting investment is thus critical to the agricultural industry, particularly for corporate style farms given their large capital expenditure requirements.

ANZ and Port Jackson Partners estimate that Australia will require an additional $600 billion in agricultural investment between now and 2050 to expand production. As well as a further $400 billion to support existing farm turnover and replace depreciated assets.[44] Given the relatively low levels of investment in agriculture from domestic investors, foreign investment has become an important source of capital. The vast majority of Australian farm businesses continue to rely on domestic investment and ownership, with 99% of all Australian farm businesses and 88% of Australian land being fully Australian owned.[45] This is a higher rate of domestic business ownership than any other industry.[46] Indeed, the superannuation industry only invests around 2% of its $1.7 trillion in domestic superannuation funds invested in agribusiness.[47]

Foreign direct investment in agriculture has increased in recent years as investors seek to capitalise on increased demand for Australia's high quality food products. The stock of foreign investment in agriculture increased from $1.5 billion (0.2% of foreign direct investment) in 2014 to $2.2 billion (0.3% of foreign investment) in 2016.[48] Several recent high value deals have been from China, including the sale of Tasmanian dairy farming business Van Dieman and the Kidman properties.[49]

Not only does foreign investment provide a much needed source of capital, Chinese investors also provide important assistance to agribusinesses expanding into the Chinese market. Working with a Chinese investor with existing business relationships and a strong understanding of the cultural and regulatory environment can provide significant benefit to agribusinesses seeking to export more product to China.

$600b

ANZ and Port Jackson Partners estimate that Australia will require an additional $600 billion in agricultural investment between now and 2050 to expand production.

41. Australian Agricultural exports (2015) Department of Foreign Affairs and Trade
42. Ibid
43. Food Consumption Trends in China (2012) Z. Zhou, W. Tian, J. Wang, H. Liu and L. Cao
44. Greener Pastures (2012) Port Jackson Partners and ANZ
45. ABS 7127.0 Agricultural Land and Water Ownership (2015) Australian Bureau of Statistics
46. ABS 8167.0 Selected Characteristics of Australian Businesses (2015) Australian Bureau of Statistics
47. AgriFood Skills Australia (2015) Contemporary business strategies & learning models in the agrifood industry
48. ABS 5352.0 International Investment Position (2015) Australian Bureau of Statistics
49. China Global Investment Tracker (2016) American Enterprise Institute.

4.2 Drivers of Chinese investment in agriculture

The demand for agricultural products is expected to increase in coming years as a result of growing demand from Chinese consumers and increased investor interest in alternative assets. The conditions surrounding Australia's supply of agricultural products are also favourable, as many of Australian corporate farms have experienced strong growth in size and profitability in recent years. For these reasons, Australian agriculture continues to be a popular destination for Chinese investment (see Figure 4.1).

Figure 4.1: Australia's comparative advantage in agriculture

Growing Asian middle class is increasing demand for premium agricultural products

Australia's reputation for safe and good quality food is an important demand driver from Chinese consumers

Agriculture's position as an alternative asset is driving demand from Chinese investors

Limited domestic investment provides opportunities for Chinese investors

Growth in size and profitability of corporate farms makes agriculture an attractive investment

The growing Asian middle class is expected to boost demand for Australian premium meat and other high end food products. By 2050, the demand for food is expected to increase by 60% when compared to 2005-06.[50] Much of this increase in demand is expected to come from Asia, as around two thirds of the global middle class are expected to live in the Asia-Pacific region by 2030[51] and higher incomes are typically associated with increased consumption of meat and other animal products.[52]

Australian agriculture is well placed to benefit from this growth while continuing to meet domestic demand. Australia produces enough food to feed around 60 million people, roughly three times the Australian population.[53] Australian farmers produce almost 93% of Australia's daily domestic food supply.[54] In 2015, the majority of agricultural exports were to the Asia-Pacific region and more than a quarter of our agricultural exports were beef and other meat products (see Chart 4.1).[55]

Australia's reputation for safe and good quality food products is also expected to support continued demand for Australian produce. Australia's quarantine and biosecurity systems are some of the best in the world, and involve pre-border, border and post-border regulation. The words "made in Australia" carry a strong brand in our export markets as the slogan is associated with the perception of Australian exports as clean, green and high quality. This perception has become particularly important in recent years due to concerns over the safety of foods produced in China.[56] A PEW Research Centre survey found that 71% of Chinese people saw food safety as either a moderately big or very big problem in 2015.

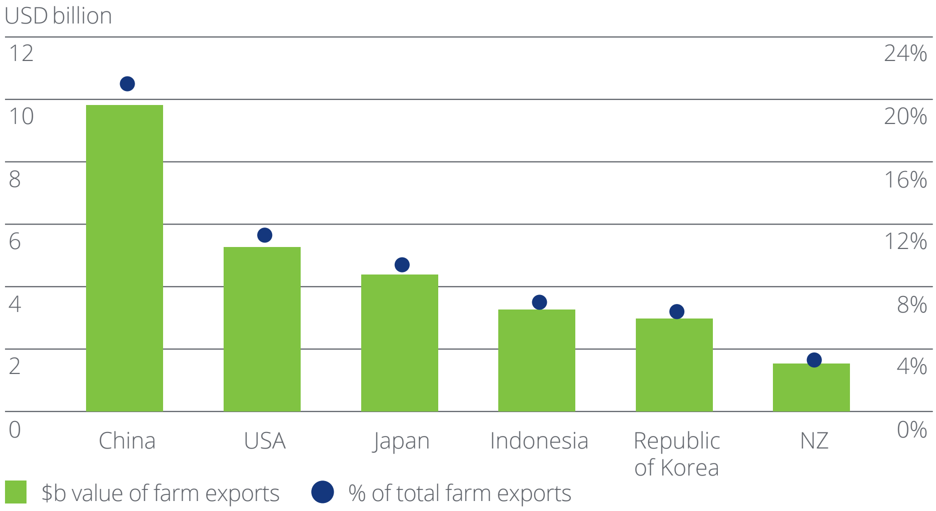
50. Greener Pastures (2012) Port Jackson Partners and ANZ
51. By 2030 two-thirds of global middle class will be in Asia Pacific (2013) EY
52. Greener Pastures (2012) Port Jackson Partners and ANZ
53. Millthorpe Lecture (2013) Professor Ian Chubb, Australia's chief scientist
54. Farm Facts (2012) National Farmers Federation
55. Australian Agricultural exports (2015) Department of Foreign Affairs and Trade
56. Food Consumption Trends in China (2012) Z. Zhou, W. Tian, J. Wang, H. Liu and L. Cao

Agriculture is an alternative asset making it increasingly popular with Chinese investors seeking to diversify their asset base. Returns on alternative assets are uncorrelated with market returns, such as movements in equity prices, and help to reduce portfolio risk. Research from Macquarie Bank suggests that agricultural investment represents a compelling, albeit untapped, opportunity for institutional investors as a diversified portfolio that includes agricultural assets has the potential to deliver positive uncorrelated capital returns as compared to other asset classes.[57]

Limited domestic equity investment means that foreign investment is particularly crucial to the agriculture industry. Despite considerable capital requirements, the vast majority of Australian farms continue to use family ownership structures[58] which typically limit the sources of capital-raising to family savings, farm-based returns and bank borrowings.[59] The lack of investable products is a barrier to the ease with which domestic investors can gain exposure to the agricultural sector.[60] By way of comparison, around 2% of Australian farms use a corporate non-family structure, whereas the proportion of United States farms with these structures is around 30%.[61] Foreign investment, including that from China, has therefore become an important source of capital for farms that have historically had to rely on debt funding to expand their production.

The growth of corporate farming presents a compelling opportunity for Chinese investors. Australian corporate farms, particularly those in cotton, grain and pig farming sectors, have experienced strong growth in size and profitability in recent years, providing more opportunities for investment. While only 2% of farms operate using a corporate ownership structure, corporate agribusinesses receive a considerable proportion of total farm earnings, with each business averaging over $4 million per annum in 2015.[62]

Chart 4.1: Australia's major agricultural export markets



Source: Department of Foreign Affairs and Trade STARS Database, based on ABS Cat No 5368.0.

57. Food for thought (2012) Macquarie Agricultural Funds Management
58. AgriFood Skills Australia (2015) Contemporary business strategies & learning models in the agrifood industry
59. Agricultural Competitive Issues Paper (2014) Australian Government
60. BDO and University of Queensland (2015) Analysis: Australian superannuation fund investment in agriculture
61. AgriFood Skills Australia (2015) Contemporary business strategies & learning models in the agrifood industry
62. Ibid.

4.3 Case study

Kilcoy Pastoral Company

In 2013, Chinese private equity firm Hosen Capital acquired Kilcoy Pastoral Company, a large cattle processing facility in Kilcoy, a small town an hour out of Brisbane. Kilcoy Pastoral Company sources all cattle from Queensland, within a 1,000 mile radius of Kilcoy, and exports the majority of its production.

Kilcoy Pastoral Company and the Kilcoy regional community have benefited significantly from the acquisition. Since acquisition, Hosen Capital has invested $115 million in upgrading the company's processing facilities. The investment has substantially increased production, from around 250,000 head of cattle in 2014 to an expected 500,000 head of cattle in 2018.

Figure 4.2: Benefits of Chinese investment in Kilcoy Pastoral Company

Chinese investment has created more jobs in the regional area of Kilcoy

Chinese investment has boosted regional incomes and opportunities for Kilcoy

Chinese investment has doubled Kilcoy's production while retaining local management and operations

The size and scale of expansion would not have been possible without Chinese investment

Chinese investment has provided more jobs and income for the Kilcoy community

Kilcoy Pastoral Company estimates that the facility expansion will result in an additional 250 jobs at the company, and is expected to create a further 250 jobs following its completion at the end of 2017. The benefits of this additional employment have predominantly flowed to the local community, with around 70% of the people who work in the Kilcoy processing facility living within the local area.

The facilities expansion will also boost incomes for Kilcoy's residents. Additional jobs at the processing plant will not only benefit those workers, it will also benefit other businesses in the region, with the additional employment opportunities boosting spending on goods and services and in the Kilcoy region. Increased production at the Kilcoy facility will also increase incomes for cattle farmers in the surrounding regions.

Chinese investment has increased their global presence while retaining local operations

Hosen Capital has committed to retaining Kilcoy's local management and operations. Since acquisition, it has instead focused on where it believes it can add most value: using its partnerships, capital and expertise to make Kilcoy a global player in the beef industry. Hosen Capital is focused on global export markets and supply chains, and own downstream processing and packaging plants in both the US and China, for which Kilcoy beef is now a key input.

While Kilcoy's exports to China have increased from around 17% of its total output in 2014 to around 28% post-acquisition, the Chinese market still only accounts for roughly a quarter of production. That is, much of the expansion of output has been to other international markets, reflecting the global perspective of its owners.

4.4 Economy wide modelling of Chinese investment in Kilcoy Pastoral Company

To demonstrate the potential economic impacts on the greater Kilcoy Region (defined as Kilcoy and its neighbouring areas of Lockyer Valley, Toowoomba, and South Burnett), Deloitte Access Economics has undertaken modelling of the impacts of the initial capital expenditure and ongoing production this creates, on the economy of the region. This modelling uses our in-house Computable General Equilibrium model to project the impact on gross regional product and employment.

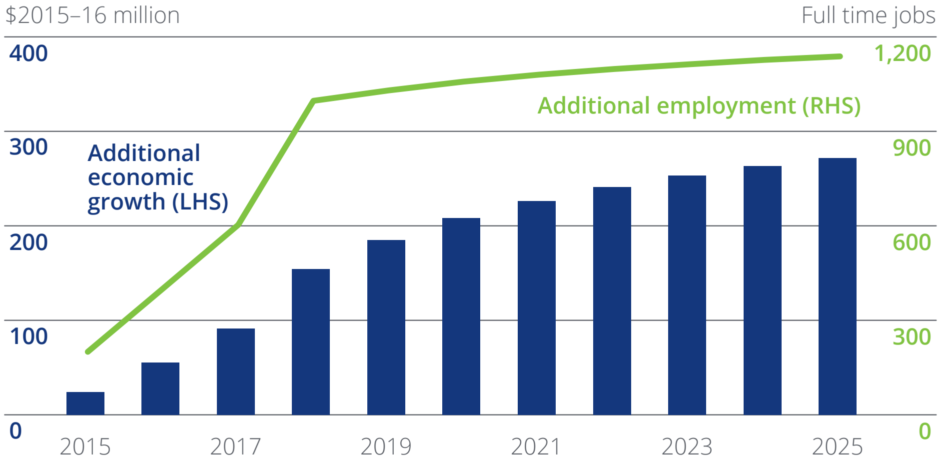
The initial $115 million in capital expenditure over 2015-17, and subsequent doubling of output from around 250,000 heads of cattle in 2014 to an expected 500,000 cattle in 2018, is estimated to lead to an increase in regional output of around $150-250 million per year once the facility is operational (Chart 4.2 below).

The increase in regional output reflects the additional production at the Kilcoy processing plant, and the positive spillovers it has to other businesses in the region. In particular, local cattle farmers will benefit with Kilcoy Pastoral Company sourcing all cattle from within a 1,000 kilometre radius of Kilcoy.

Employment will also increase significantly, reflecting the increase in output facilitated by the investment. Our modelling estimates an average net increase in employment in the greater Kilcoy region of just under 900 full time equivalents each year over the 10 year period from 2014-15 to 2024-25. Not all of these jobs are expected to come from Kilcoy Pastoral Company, rather the increase in employment includes cattle farmers and other regional businesses that receive flow-on benefits from the expansion in production.

The regional impacts outlined above demonstrate another dimension of the benefits of foreign investment. Particularly for smaller regions, or those with lower than average employment opportunities, foreign investment can provide a vital source of economic opportunities.

Chart 4.2: Change in gross regional product and employment in the greater Kilcoy region



Source: Deloitte Access Economics modelling

Chapter 5

Chinese investment in health products

5.1 Australia stands to benefit from Asia's increasing demand for health products

The healthcare sector is an important growth industry for the Australian economy. Healthcare and social assistance comprises a large proportion of government and consumer spending, and is the nation's largest employer, providing jobs for more than 1.5 million Australians.[63] Health expenditure grew faster than the rest of the economy to reach 10% of GDP in 2014-15, which is around $6848 per person and includes both government and private expenditure.[64]

While the majority of healthcare demand comes from domestic sources, niche healthcare products and services, such as vitamin manufacturing, are benefiting from increased demand from China.[65] This increase in demand is driven by the demographic and income characteristics of China, with older and wealthier populations demanding more and higher quality healthcare services.

While the increasing affluence among Chinese consumers presents a myriad of export opportunities, healthcare businesses require the capital and expertise to benefit from this increase in demand. Despite China's position as one of the world's largest economies, challenges remain for companies that export or invest in China without a proper understanding of the Chinese consumer or business environment.

While there is a growing focus on 'the Chinese middle class', China is a highly diverse market with a population of 1.38 million people.[66] Selling products to this diverse consumer group requires a strong understanding of the demand drivers, cultures and geographies of the target market, and the best retailers and marketing tools to reach these individuals. Working with Chinese investors with existing business relationships can present significant benefits for businesses seeking to expand into China.

Foreign direct investment in Australia's health and related industries has increased in recent years alongside increases in China's demand for health products, rising from $0.2 billion (0.03% of foreign direct investment) in 2012 to $3.5 billion (0.44% of foreign investment) in 2016.[67] Several recent high value healthcare deals have been from Chinese investors, including the sale of a substantial share of GenesisCare, Australia's leading provider of radiation oncology, cardiology and sleep treatments, as well as vitamin company Vitaco to Chinese buyers.[68]

Chinese investment has provided firms with the capital to increase their output, in turn providing jobs and income growth in health and related industries, while also funding medical research activities in Australia. The benefits of additional investment therefore extend beyond economic variables alone, with additional medical research helping to improve the health outcomes of all Australians.

While the increasing affluence among Chinese consumers presents a myriad of export opportunities, healthcare businesses require the capital and expertise to benefit from this increase in demand.

63. ABS 6291.0.55.003 – Labour Force, Australia, Detailed, Quarterly (2017) Australian Bureau of Statistics
64. Health Expenditure on Health and Welfare (2016) Australian Institute of Health and Welfare
65. Building Australia's Comparative Advantages (2014) Business Council of Australia
66. World Population Prospects (2015) United Nations
67. ABS 5352.0 International Investment Position (2015) Australian Bureau of Statistics
68. China Global Investment Tracker (2016) American Enterprise Institute.

5.2 Drivers of Chinese investment in health products

The demand for Australian healthcare products is expected to increase in coming years as a result of income growth, aging populations and increased health consciousness in both the Australian and Chinese populations. The supply factors in Australia are also favourable with its strong reputation for high quality medical research, while at the same time Australia and China have made efforts to reduce regulatory barriers with the China-Australia Free Trade Agreement. For these reasons, Australian healthcare businesses remain an attractive destination for Chinese investment (see Figure 5.1).

Figure 5.1: Australia's comparative advantage in healthcare

- Income growth is driving healthcare demand in nearby Asian countries
- An aging population is increasing demand for healthcare products
- Health consciousness among consumers is boosting healthcare spending
- Australia's reputation for medical research makes healthcare a popular choice for investors
- Reduced regulatory barriers between Australia and China are supporting trade

Income growth is an important determinant of health spending. As incomes increase, individuals demand more, and better quality, healthcare. Expenditure on healthcare services in Australia has grown strongly over the past 30 years alongside growth in national income.[69] Indeed health expenditure has increased from $81 billion in 2014-05 to $162 billion in 2014-15[70] or 10% of GDP. China's healthcare spending has also increased significantly in line with the rapid growth in consumer income.

China's health expenditure is projected to increase further from $511 billion in 2013 or 5.4% of GDP in 2013 to reach $892 billion in 2018.[71] Indeed, there is scope for China's demand for healthcare to increase further, as its healthcare expenditure as a proportion of GDP is relatively low compared to other countries.

Health consciousness of Australian and Chinese consumers has increased in recent years. Individuals are prioritising their health and wellbeing, and are spending more on preventative health measures and complementary medicines. Rising health consciousness has boosted the revenues of Australian vitamin and supplement companies, with a large part of this growth being driven by rising demand from Asia.[72]

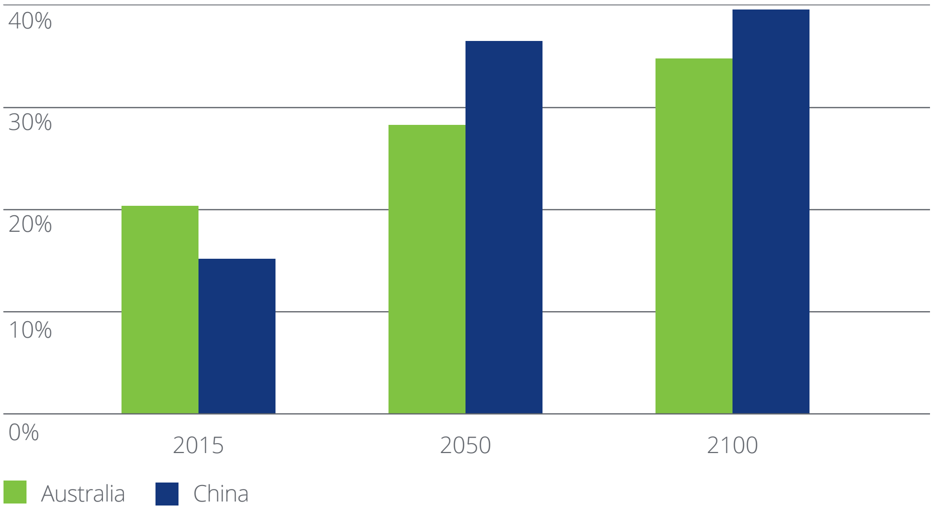
The 'typical' consumer in the dietary supplement market has changed significantly in recent years. Of the 29% of Australians that regularly took dietary supplements such as vitamins or oils in 2012, the majority were women in older age groups.[73] The market has however expanded in recent years to include younger people and men, as market segmentation, particularly with the introduction of sports nutrition supplements, has boosted sales. Similar trends have been witnessed globally as all age groups and genders have increased their focus on health, and with this has come an expansion in the market for health products.

69. Intergenerational Report (2015) Australian Commonwealth Treasury
70. Health Expenditure on Health and Welfare (2016) Australian Institute of Health and Welfare
71. Health care outlook, China (2015) Deloitte
72. Vitamin and Supplement Manufacturing (2016) IbisWorld
73. Australian Health Survey: Nutrition First Results – Foods and Nutrients (2012) Australian Bureau of Statistics

Demographic factors are a key driver of healthcare spending as the demand for pharmaceuticals and health services increases with age. The United Nations estimates that the number of older people in Australia and China will increase substantially over the coming decades. By 2050, there are projected to be 10 million Australians and 492 million Chinese aged over 60, compared with around 4.9 million Australians and 209.2 million Chinese in 2015. The proportion of the population aged over 60 is also expected to reach around 35-40% of both the Australian and Chinese populations by 2100 (see Chart 5.1).[74]

Australia's strong record for science and innovation along with our highly skilled workforce helps to make the health products sector a popular choice for Chinese investors. For example, it was Australian scientists that discovered that penicillin could be used as an antibiotic. Australian scientists also developed cochlear implants that provide a sense of hearing to deaf people.[75] Not only is Australia a world leader in medical research, Australia's R&D expenditure is growing at one of the fastest rates in the world.[76] Australia also has a reputation for a high quality and rigorously tested medical products and services, which provides further credibility to our reputation as a science and innovation hub.

Chart 5.1: Proportion of the population aged over 60 in Australia and China



Source: United Nations Population Statistics

Regulation of the health and pharmaceutical products and services can often prevent foreign investment as the industry is subject to various country-specific rules and trade restrictions around the manufacture, pricing, marketing and sale of health products. Such policies often incur high compliance costs that discourage companies from investing or exporting to certain markets.

Australia and China, however, have made efforts to reduce trade barriers on health products with the China-Australia Free Trade Agreement (ChAFTA). ChAFTA eliminates the 3-10% tariff on Australian pharmaceutical products exported to China, including vitamins and supplements. This reduction has provided a wealth of benefits for the industry as China is Australia's largest market for pharmaceuticals, with exports worth $628 million in 2015-16.[77] ChAFTA has also reduced barriers for the health services industry by providing Australian healthcare providers with the opportunity to establish wholly Australian-owned private hospitals and aged care institutes in China.

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5.3 Case study

Swisse Wellness

In 2015, Chinese company Biostime acquired a majority stake in health and wellness company, Swisse Wellness for $1.67 billion. The remaining minority stake was also acquired in December 2016. Swisse Wellness is a Melbourne based company that develops its products in Australia. The acquisition has accelerated Swisse's expansion into the Chinese market by providing the capital to rapidly scale up production potential.

Swisse contracts Australian companies to manufacture its products, and commissions domestic research institutions to undertake research and clinical testing of its products. In this way, the significant scaling up of activities have led to an expansion of both the company directly, and its suppliers (see Figure 5.2)

Figure 5.2: Benefits of Chinese investment in Swisse wellness

Chinese investment has created jobs in science and manufacturing

Chinese investment has boosted the output of research institutions

Chinese investment has accelerated Swisse expansion into China

Chinese investment has expanded production while retaining local operations

Chinese investment has increased jobs and revenues in science and manufacturing

Since acquisition, Swisse has invested significantly in scientific research on Vitamins, Herbs, Minerals and Supplements (VMHS). Swisse undertakes core scientific research in-house and furthers this with partners such as Australian research institutions including CSIRO, Swinburne University, and La Trobe University.[78] Not only does this funding increase output and employment of research institutions, it also increases the amount of publicly available information on the effectiveness and safety of VMHS – benefiting health professionals and the 29% of Australians that take dietary supplement such as vitamins or oils.[79]

Swisse has also increased production since the acquisition, which has had flow on benefits for Swisse and the Australian manufacturing companies that Swisse contracts to manufacture its products, as well as other businesses from which Swisse's inputs are drawn. Biostime recognise the importance of local expertise and has maintained operations in Australia, including the global support office / innovation hub in Melbourne, manufacturing partnerships in both Victoria and New South Wales and research partnerships across the eastern seaboard. In consultation, the firm decided that there was value in retaining Swisse's current management, culture and operations, and rather the value for the investors lay in expanding this existing model to allow it to better tap into global markets.

Chinese investment has accelerated Swisse expansion into China

Biostime has dramatically accelerated Swisse' expansion into the Chinese market. Before acquisition, Swisse had been slowly expanding into the Chinese market, but was yet to realise a number of product segments, geographical areas and online/offline markets. Nonetheless the market represented significant potential as the size of the online market in China is similar to both the online and offline markets in Australia, and the offline market in China is approximately 10 times that.

Biostime has a strong presence in China, and develops and markets premium nutritional products focused on infant nutrition, including infant formula, supplements, and care products made from high quality ingredients. This in-depth understanding of health and nutritional product retailers in China is critical given the importance of relationships when conducting business in China, and has substantially assisted Swisse's recent expansion into the physical on-shelf retail trade in China in April 2017. Not only has Biostime provided Swisse with the expertise to expand into China, it has also helped Swisse make significant progress towards its target of reaching 20 export markets by the year 2020.

The story is therefore one of an existing Australian success story that was able to realise its potential through foreign investment. Swisse was already slowly expanding into international markets and had a successful operating model and management strategy. What investment was able to deliver was capital and experience to accelerate this progress and expansion into the Chinese market.

Biostime has invested significantly in medical research, not only does this funding increase output and employment of research institutions, it also increases the amount of publically available information on the efficacy and safety of vitamins and supplements – benefiting health professionals and the 29% of Australians that take dietary supplements.

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Chapter 6

Chinese investment in tourism assets

6.1 Australia stands to benefit from increased Chinese tourism

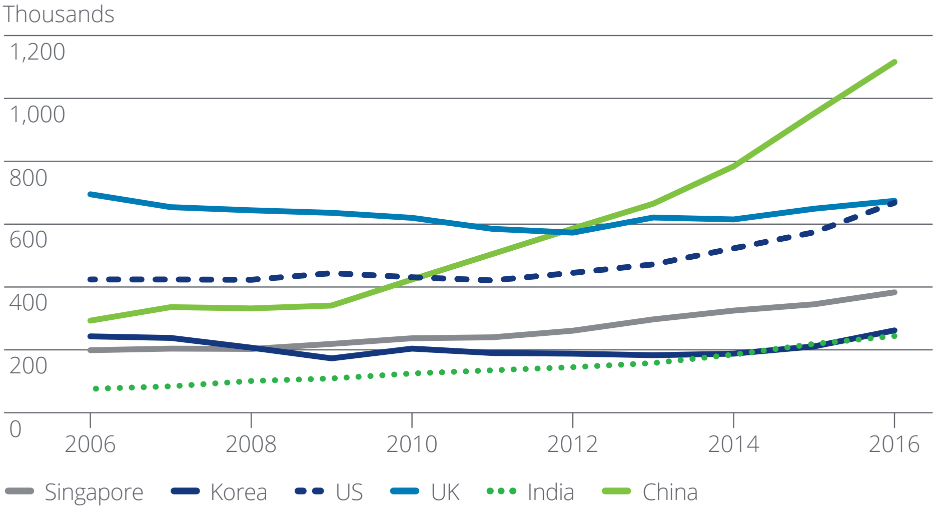
When Deloitte Access Economics looked at where Australia's future growth was likely to come from post the mining boom, it listed tourism as one of our Fantastic Five industries. Projections of the global growth of 20 key sectors of Australia's economy placed tourism second, with expected growth of just over 400% over the period 2013-2033.

Much of this growth will come from China, and indeed the growth in Chinese visitors to Australia over the last decade has been rapid (see Chart 6.1 below). The chart shows that visitor numbers from China have increased by around 380% over the last decade. Importantly, expenditure has increased even more rapidly, recording a 660% increase over this same period.

To take advantage of this increase in demand, Australian tourism providers have started to tailor their offerings to the Asian market, and Chinese visitors in particular. In some cases this has meant making hotels 'China ready', training staff in cultural aspects of treating guests, hiring mandarin speakers, and diversifying menu items. Providing items such as free wi-fi services is also important for the new Asian 'millennial' traveller (or for the broader group of 'FIT' – free and independent traveller), and can lead to marketing of attractions in real time via social media. This, and the fact that 2017 is the first China-Australia Year of Tourism, all demonstrates the seriousness with which the opportunities presented by Chinese tourism are being taken.

And rightly so. Tourism provides a huge boost to the Australian economy. An important feature of the sector is that when international visitors come to Australia, their expenditure benefits a large suite of businesses, differentiated by industry (transport, food and accommodation among others) and by region.

Chart 6.1: Rapid growth in Chinese visitation to Australia (2006 – 2016)



Source: Tourism Research Australia, International Visitor Survey, February 2017.

This means that the tourism market itself under-invests in marketing activities, because there is no simple mechanism for coordinating this activity. This is instead the role of Tourism Australia, and the various state and territory tourism organisations. These are government funded organisations charged with (among other roles) increasing visitation to Australia from target offshore markets. China is naturally a market that Australia has actively been courting.

With the forecast rapid growth in Australia's tourism exports, investment will be needed to ensure that supply keeps up with demand. As mentioned, the Australian Government has been actively encouraging and facilitating investment in order to ensure that the pipeline remains strong and that supply does not become a constraint on Australia meeting its tourism potential. This has resulted in an investment promotion partnership between Austrade and Tourism Australia to help the Australian tourism sector meet its goals under the National Long Term Tourism Strategy. The partnership seeks to facilitate international investment by 'removing barriers and making information and insight on Australian tourism opportunities more readily available to interested investors'.

Investment in tourism accommodation was around $7.6 billion in 2015, as noted in Austrade's Tourism Investment Monitor publication. The investment pipeline has picked up in recent years, with a large portion of this being from Chinese investors. Indeed, Colliers International estimates that investment in tourist accommodation represented around 37% of total foreign investment in Australia in 2016, up from just 6% in 2012.

Chinese investment in other Australian tourism assets has also been increasing in recent years. The marketing channels that exist within large tourism investors and hotel chains in China are powerful mechanisms through which growth in their Australian holdings can be generated. They are also finely attuned to the preferences of Chinese tourists, and well placed to grow this market. Most importantly for Australia, this marketing and investment activity leverages the existing targeted marketing and investment initiatives of Australian governments.

6.2 Drivers of Chinese investment in tourism assets

The number of Chinese tourists visiting Australia and demanding tourism services is expected to increase in coming years. Rising incomes amongst the Asian middle class has boosted their demand for international travel, and Australia is a popular option. Australia has a plethora of tourism attractions including beautiful urban areas and natural assets, such as our harbour cities, beaches, rainforests and the outback.

Figure 6.1: Australia's comparative advantage in tourism services

Growing Asian middle class is boosting the number of tourists that visit Australia

Reduced air fares between Australia and Asia has made travel more affordable

Australia's beautiful harbour cities and weather attract numerous tourists

Australia's natural tourist attractions such as Uluru bring many tourists to Australia

Increased visitor arrivals from Asia is expected to boost demand for tourism services over the coming years. As noted in the Queensland Government's Asia Tourism Strategy 2016–2025 three drivers of this rapid growth in tourism are:

- Population: around 60% of the world's population now lives in Asia, and this is expected to grow to just under 5 billion people by 2030;
- Urbanisation: with greater numbers living in cities, they now have better access to airports and therefore reduced travel costs. Problems with urban pollution also increases the demand for holidays to places with a 'clean and green' image; and
- Rising incomes: tourism is an inherent discretionary item and will therefore see an increasing share of incomes spent on it as incomes grow in Asian markets.

Australia's proximity to Asia and increased air access has also facilitated a boost in demand for tourism services. Greater levels of competition among low cost carriers has created many affordable options for the burgeoning Asian middle class to travel to Australia. Indeed, Australia is well placed geographically to capitalise on China's growing demand for tourism and entertainment.

Table 6.1: Recent Chinese investments in Australian hotels

Asset	Price	Date	Buyer
Park Hyatt Melbourne	$130 million	Jan 2014	Fu Wah Melbourne
Sheraton on the Park	$463 million	Nov 2014	Sunshine Insurance
Ibis Melbourne	$39.6 million	Nov 2014	Well Smart Investments
Holiday Inn Sydney Airport	$53 million	Dec 2014	Star Millenium Pty Ltd
Hilton Sydney	$442 million	May 2015	Bright Ruby Resources
Pullman Sydney Airport	$84 million	Aug 2015	Nanshan
Mercure Parramatta	$40 million	Jul 2016	Star Millenium Pty Ltd
Park Regis Sydney	$46 million	Aug 2016	Cornerstone
Novotel Glen Waverley	$73.6 million	Nov 2016	i prosperity

Source: Colliers International, *Trends in Australian hotel real estate*

Australia's beautiful harbour cities attract numerous overseas visitations every year. Indeed, the majority of tourism and investment has been to the larger cities of Sydney and Melbourne, with several recent landmark investments being announced for Sydney in particular (see Chart 6.1). This includes Primus, a large Chinese hotel chain, announcing the development of its first Australian hotel for Pitt Street, and Greaton's $700 million investment in the mixed use W Hotel and Ribbon Residences in Darling Harbour. For these investors, a prominent hotel in the Harbour City is seen as an important investment and one that can help drive their brand both in Australia and internationally.

Beautiful natural assets are drawing tourists to regional areas. Australia has a variety of beautiful land features including rainforests, beaches, desserts and the outback, as well as spectacular destinations like the Great Barrier Reef, Kakadu and Uluru that draw a myriad of tourists to our continent every year. Australia also has a great climate, with an average of 3,000 hours of sunshine every year and a range of climates to suit everybody, from sunny and tropical to snowy and Mediterranean.

The beautiful and diverse attractions in Australia's regions has attracted more tourism and investment to the areas outside the main cities. Austrade reports $830 million worth of investment in Australia's regional areas.

One example is Fullshare Holdings Group's various investments in Australia's regions, including the 2016 refurbishment of the Sheraton Mirage at Port Douglas, and the purchase of the Red Hill Estate winery in Victoria. Its total planned development in Australia amounts to over $2 billion, with the majority of this in regional areas.[80]

Another more recent trend has been foreign investment in mixed use developments. These typically include a mix of hotel accommodation and residential apartment space, along with retail, with the goal of diversifying returns across these different investment classes.

"Moving forward, our plan is to increase employment opportunities for Australians, support local communities using local contractors and suppliers, boost local economies through international tourism and create a 21st century health tourism model."[81]

80. Austrade, *Case Study: Fullshare*, Commonwealth of Australia, 2016.
81. Mr Yi Yu, Managing Director of Fullshare Australia.

6.3 Case study

Park Hyatt in Melbourne

In 2014, Chinese company Fu Wah, acquired the 5-star Park Hyatt in Melbourne for $135 million. This marked the first investment by Fu Wah in Australia in an increasingly competitive hotel investment market in Melbourne.

While Fu Wah owns the hotel, it has a hotel management agreement with the Park Hyatt group which operates the hotel.

Chinese investment has increased jobs and revenues in hotel management and trades

Since purchasing the hotel, Fu Wah has invested in some aspects of refurbishment and has a pipeline of around $11 million worth of capital planned for future upgrades. Upgrading the facilities has provided more work and income for local tradesmen and suppliers, and helped to increase hotel stays which has in turn provided more job opportunities for hotel workers. However, it is what Fu Wah has achieved in the Chinese visitor market that most clearly demonstrates the benefits that can be achieved through foreign ownership.

Figure 6.2: Benefits of Chinese investment in the Park Hyatt

Chinese investment has increased tourism numbers, benefiting a suite of businesses

Chinese investment has increased jobs and revenues in hotel services

Chinese investment has provided more work for tradesmen and women

Chinese investment has increased tourism numbers, benefiting a suite of businesses

Fu Wah has used its links to the Chinese market, particularly in the corporate traveller space to triple its share of visitation from Chinese travellers. This has been through a mix of targeted initiatives: the hotel provides additional services for Chinese tourists and corporate visitors, including translating services, Chinese food in the buffet, access to the business lounge area, and a range of other tourism services. More Chinese tourists benefit a large suite of businesses as international visitors typically spend money on a variety of different goods and services, such as transport, food and entertainment.

While domestic tourists remain the major guest group for the Park Hyatt and many other Australian tourism operators, the small but growing share of Chinese visitors demonstrates the benefits that can be achieved by investors who are attuned with the Chinese market.

Fu Wah has used its links to the Chinese market, particularly in the corporate traveller space to triple its share of visitation from Chinese travellers.

Chapter 7

Conclusion

Much of Australia's current prosperity is owed to the inflow of foreign capital. Over the last decade, foreign investment has helped Australia benefit from the mining boom, with inflows of capital helping build the sector's productive capacity rapidly in order to benefit from the unprecedented increase in demand for our resources.

As the economy transitions away from resources, and into other high value added sectors such as tourism, medical products and food processing, the need for foreign capital will not abate. Indeed, a common theme across the case study industries in this report is the need for capital investment to boost production in order to keep up with the enormous opportunities present in emerging markets, particularly in Asia. The injections of foreign capital in Kilcoy Pastoral Company and Swisse have been instrumental in reaching their scale potential in response to these opportunities.

With this increase in scale has come opportunities for other Australian businesses and workers. Increased production also boosts revenues for firms that supply to firms that receive foreign investment, which in turn provides additional income and employment opportunities for the Australian community. Nowhere is this more evident than in the tourism sector, where each additional international visitor spends on a wide range of goods and services while in Australia.

But it is equally clear from these case studies that investment means more than just capital. The investment has brought with it the knowledge, experience and expertise of the foreign buyer. In Swisse and Kilcoy's case this meant the integration of the existing Australian business into global supply chains and new markets, as well as managerial insights from those with existing experience in expanding businesses into the Chinese and other overseas markets.

Australia is fortunate in that its transition towards these high growth sectors has gone hand in hand with China's transition towards a consumption led economy, and a growing middle class with increasing discretionary expenditure and preferences for quality food, health and tourism products.

But unlike raw commodities, these products cannot simply be shipped overseas and consumed in bulk. Activating our potential in these industries requires an understanding of the foreign consumer: what they want, and how this should be marketed to them. This is another aspect to the benefit that Chinese ownership can bring to Australian businesses to complement increased effort and resourcing by Australian firms to better understand and capture growth opportunities in China. Fu Wah was able to triple the visitation from Chinese tourists to the Park Hyatt in Melbourne by understanding what they were looking for in hotel service.

Australia's economic future will continue to depend both on China, and Chinese investment.

Figure 7.1: How Chinese investment benefits Australia

- Chinese investment is helping Australia transition to broader sources of growth
- Chinese investment has flow on benefits, as it provides more income and jobs for Australians
- Chinese investment helps Australian businesses expand into international markets

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Limitation of our work

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