# CONTROL PORTFOLIO INVESTMENT

## By a Xenophobic Young Zealot

It is probably time that we gave careful consideration to the desirability of continuing to encourage foreign portfolio investment. It may be that we are overlooking some of the less desirable consequences which result from encouraging local shareholders to sell their existing holdings overseas.

The author argues that such actions are not encouraging the formation of a broadly based free-enterprise democracy. In such difficult times, it is probably somewhat unfair to criticise our stockbroker friends for trying to generate business wherever they can. However, it may be in the longer run interests of the private sector to be conscious of some of the ramifications of this selling off of the farm.

### FOREIGN INVESTMENT

Most will know the arguments put by both sides in respect of direct foreign investment and there would be little point in reiterating them here. As reasonable men, we would probably recognise merit in many of the points made on both sides. We would probably acknowledge that there is a need for balance between the benefits of access to investment capital and the willingness to take entrepreneural risk on the one hand, and the possible consequences of foreign control and subsequent need to service the investment on the other. Many will admit that there is a need for a continuation of some level of governmental control over direct foreign investment. This is not to say, of course, that it need not be encouraged in the appropriate circumstances. Concern about the sinister influence of multi-nationals can for the most part be left to the fantasies of those at the extreme of the political spectrum.

Foreign portfolio investment is largely overlooked in Australia. Most studies of foreign investment have tended to pass over portfolio investment as being of little significance. While foreign exchange approval is required, this does appear for the most part to be a bureaucratic formality. Companies which have one foreign shareholder having 15% or more of the capital or which have foreign shareholders holding an aggregate of 40% or more of the capital are deemed to be foreign corporations and can suffer some inconveniences as a result. The nomination of a company as a foreign company does not of itself restrict further foreign portfolio investment in that company.

### SOME STATISTICS

Statistics regarding foreign portfolio share investment appear to be somewhat inadequate. Figures are published regularly showing the combined net inflow of portfolio investment and institutional loans (defined as all overseas investments other than direct investment; besides investment in any public issues of shares, it includes investment in debentures and loans by unrelated financial institutions). The Treasury Economic Paper No. 1 on Overseas Investment in Australia published in May, 1972 gave a breakdown of the gross inflow of portfolio investment and loans. In the period 1968-1971 gross portfolio investment inflow approximated \$200m per annum.

As a very rough approximation it would appear that portfolio investment accounts for about one fifth of all foreign investment. All foreign investment is equal to approximately 10% of total investment in Australia.

In 1970-71 dividends payable on foreign portfolio investment in Australia amounted to \$56m while the total investment income payable overseas was \$673m.

### BENEFITS OF PORTFOLIO INVESTMENT

Foreign portfolio investment has served us well in the past. Listed below are some of the advantages which have accrued.

- The net inflow of portfolio investment has added to the supply of investment capital.
- Portfolio investment inflow has increased the level of our overseas resources. (Readers with longer memories will recall that it was once deemed desirable to build up overseas reserves.)
- It is said to have enhanced the liquidity of the market. It is also claimed that in assisting liquidity it will also aid the stability of the market. The overseas investor will be there to soak up larger quantities of stock that may accrue from time to time. It is generally held that a larger market is a better market.
- On the other hand, swings in the market caused by overseas investors have created trading opportunities for the astute local investor. One could claim that considerable invisible earnings were made during the boom when grossly over-valued investments were off-loaded to the gullible punters in London.
- Conversely the big sell off in recent years has enabled local investors to buy back some of the farm on terms far more favourable than those for which it was sold.
- For those who believe in the free market mechanism there is value in ensuring that Australian capital markets do not get out of line with world markets.

Australian stockbrokers have been able to make those reasonable profits which allowed them to provide those much valued services to which their clients became accustomed – gourmet luncheons, golf days, harbour cruises, . . . and some occasional research.

During periods of sustained net inflow of portfolio investment local investors enjoy higher portfolio values which greatly enhances their feeling of well-being.

### SOME DISADVANTAGES

Some of the benefits outlined above are not consistent with one another. For example the stabilisation claim is belied by the extravagant swings which have occurred from time to time as a result of foreign orders.

Liquidity may not be present at the time it is most needed. At the very time that local investors wish to liquidate their investments it is quite likely that overseas investors will also be selling in a falling market.

It is difficult to ascertain how important foreign investors are in the Australian market. Estimates vary greatly as to the proportion of Australian turn-over to which they contribute. However, it is generally accepted that they do have a very significant impact on price movements. Orders to deal large blocks of shares which are good for one day only have certainly not assisted the stability of the market.

A considerable proportion of foreign portfolio investors appear to be traders and fewer now appear to be respectable stolid investors like your local institutions.

The Government's economic policy can be made more difficult to implement when it has no control over capital flows. Capital will come in during a boom and so exacerbate the boom and conversely capital will outflow at a time when it is required.

To my mind the most serious consequence of foreign portfolio investment is that it is defeating the cause of free enterprise. There was a time when many non-socialists would advocate the concept of "people's capitalism" – this, as you will recall, was the process by which as many individuals as possible would be encouraged to own a stake in their country. In part this has not come to fruition because of the rapacious charges of the broking fraternity and the unscrupulous promotion of suspect ventures. But apart from these minor discouragements, the small investor has been scared off the market by unseemly wild swings in prices which have affected his confidence. In addition, at times when the market has been high, the long standing local investor has been enticed to cash in his investments for monetary gain which is frittered away and rarely reinvested in the market.

The big sell off over the last couple of years by foreign portfolio investors enabled some buying back of the farm. It also allowed some aggressive re-acquisition, such as the Australian Estates take-over. It does not seem a pity that some of our foremost proponents of private enterprise are so intent on encouraging the sale of our discounted assets to foreign investors. It is said that most major brokers are nightly 'phoning and telexing London and Europe to disseminate the day's intelligence and to tout stocks.

A company like Utah which has for political reasons placed some equity in the hands of Australian residents finds that the spirit of this arrangement is being openly flouted by the encouraging of overseas investors to purchase the stock through nominee accounts. Will other foreign companies now offer equity to Australian investors to enable them to on-sell to London?

## PATRIOTISM AND SELF INTEREST

A loyal nationalist should be discouraging the selling off of the farm. He should in fact be promoting the concept of enabling Australians to purchase a larger stake (or in many cases some stake) in the many foreign firms operating here. It may be that we should be advocating the reduction of foreign holdings at the rate of say 2% per annum. This might put some strain on our capital market and some of us may have to give us some otiose consumption to provide for part of the additional necessary savings. These moves would bring about a greater breadth and depth of the Australian capital market which would in time come to improve its liquidity. It would probably lead to a general lowering of the price levels in the market; but this would be a small price for existing investors to pay because it will enable them to acquire further holdings at better values. In addition, they will be assisted in the comfort of knowing that their own interests will be better protected through having more of their fellow Australians becoming small capitalists. The lowered price levels could raise the cost of finance for some companies but they would hopefully be compensated by having a more stably based local shareholding.

## THE REQUIRED CONTROLS

The author is prepared to concede that to date the overall benefits of foreign portfolio investment have made up for the disadvantages. However, for the reasons outlined above, it does not appear appropriate that a continuation of unfettered portfolio inflow should not be continued. A possible remedy would be for the Government to impose a variable deposit ratio which would vary according to our capital needs from time to time. Even though one may abhor further bureaucratic constraints upon the market mechanism, there is a time when the benefit exceeds the cost.

## CONCLUSION

We have gained much from portfolio inflow in the past. Investment capital and foreign exchange when it was needed, and the opportunity to off-load rubbish at a profit during the boom. The subsequent sell-off enabled the buying back of much of our equity at favourable levels. Our obligations to foreign portfolio investors are slight and it will now be to our benefit to control their activities before they take further advantage of our depressed equities.

Few readers of this journal would be unaffected by the imposition of controls on portfolio inflow and most would probably take indignant exception to such a proposal. However, how important is it to maintain a market for the benefit of international sharetraders? Are the invisible foreign exchange earnings resulting from brokerage payments sufficient to warrant encouraging those traders free rein in our market? Is a dollar in the pocket now more important than the promotion of a broadly based private enterprise system?