Australian government dilemma over Chinese investment

John Chan
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The Australian government is facing a dilemma over whether to allow Chinese investment in the country's key mining sector. On the one hand, the finance is needed and Canberra concerned at upsetting relations with Beijing, particularly in the midst of the global economic crisis. On the other, sections of the Australian ruling elite are worried about the long-term strategic implications, particularly for Canberra's alliance with Washington, which views China as a rising rival.

The focus is China's largest ever foreign investment: plans by the state-owned Aluminium Corporation of China (Chinalco) to invest $US19.5 billion in Anglo-Australian mining giant Rio Tinto. The deal involves $12.3 billion for joint ventures with Rio in aluminium, copper and iron ore operations in Australia and globally, and $7.2 billion to double Chinalco's stake in Rio to 18 percent. Four Chinese state banks have formed a syndicate to finance the arrangement.

In addition, China's EXIM bank has offered up to $20 billion in credit to Rio to develop future mining plans. Amid the global credit crunch, Rio is unlikely to find the funds elsewhere. Rio Tinto is struggling with $38.7 billion of debt after buying a Canadian aluminium company not long before the crash in commodity prices last year. Not surprisingly, Rio executives are lobbying for the deal, which requires government approval in a number of countries.

Yesterday, the German regulator formally approved the proposal. In Britain the deal is not a major issue. However, in Australia, which is heavily dependent on mining exports to China, Japan and South Korea, the arrangement has provoked sharp differences. Opposition politicians have attempted to whip up nationalist sentiment by condemning the plan for allowing Chinese control of Australian resources.

National Party Senate leader Barnaby Joyce, who has produced a "Keep Australia Australian" television ad, told the *West Australian* that allowing China "to buy our mines, it puts us in a weaker negotiating position when we are trying to get the best deal for the sale of our minerals". Former Treasurer Peter Costello declared that Australia would become a "branch office economy" of China.

The Greens have taken a particularly right-wing nationalist slant, declaring that the deal should be blocked on the grounds that the "communist bosses in Beijing will exert control" over mining operations in Australia.

These concerns are not about the 10,500 workers who have lost their jobs in the mining industry, but the prospect that Beijing could influence the pricing of mineral exports and thus affect the profits of Australian business and government revenues.

Last year Chinalco bought 9 percent of Rio in a bid to obstruct an ambitious takeover of the company by Australian mining giant BHP Billiton. Beijing was deeply concerned that the merged conglomerate would be able to demand higher prices for iron ore and other minerals. BHP Billiton pulled out of the takeover after the commodities boom burst.

Now the shoe is on the other foot. Three of the world's largest iron ore miners—BHP, Rio and Brazil's Vale—are currently negotiating with Chinese steel companies over iron ore prices. After being squeezed by high prices for years, the Chinese corporations are demanding a 40-50 percent price cut. The three miners are stalling talks, desperate to buy time in the hope of an economic rebound.

China is the world's largest steel producer, with an output greater than the US, Japan and the EU combined. Domestic mines are simply unable to produce the amount of iron ore required. Since the collapse of commodities prices, Beijing has encouraged Chinese companies to invest abroad in a "Go out" campaign to take advantage of the falling asset values of industrial and mining companies around the world.

Those supporting the Chinalco deal argue that the struggling mining sector needs new investment. The Australian government forecast in March that the value of mineral exports would fall by $A35 billion in 2009-10, led by sharp contractions of 42 percent for coking coal, 28 percent for thermal coal and 20 percent for iron ore.

Queensland Premier Ann Bligh urged Canberra to approve the proposal as it "is absolutely vital to the strength of the Queensland economy". Chinalco has acquired the right to develop an $A3 billion bauxite mine in the state. Several of the proposed joint ventures with Rio are in Queensland, which, like Western Australia, relies heavily on mineral exports.

Opposing Joyce's campaign, the *Australian* warned that protectionism would simply allow other competitors to erode Australian market share. "By the early 1980s, when Joyce was in high school, Japanese buyers had lost patience with Australia's unreliability as an iron ore supplier... In response, Japan developed Brazil as an alternative major supplier, dampening world iron ore prices... Brazil now equals Australia as the world's biggest iron exporter, ahead of India, South Africa and Canada."

The editorial continued: "Now China is making a big mining and infrastructure push into Africa, particularly for oil but also for iron ore, coal, copper and cobalt. A decade ago, Australia matched Africa's exports to China. On latest figures, we are now $13 billion a year behind."

Prime Minister Kevin Rudd's federal government has strong incentives to approve the deal. Rio Tinto has warned that it will axe 2,150 existing jobs and 750 planned positions if the proposal is rejected. Managing director Doug Ritchie noted that at a time when Canberra was concerned about capital outflows "here you have something that is unique at the moment, that could presumably be worked out by others, and that is going to have a massive future beneficially for Australia".

The Rio Tinto deal is just one of a number of Chinese investments awaiting approval by the Australian Foreign Investment Review Board (FIRB). The only one to be sanctioned is Hunan Valin Iron & Steel's investment of $A1.2 billion in the Fortescue Metals Group. A $A162 million application by Anshan Iron & Steel (AnSteel) to triple its stake in Gindalbie Metals has to be resubmitted.

Last Friday, Treasurer Wayne Swan rejected part of China Minmetals' $A2.6 billion bid for Oz Minerals, claiming that Oz Minerals' largest mine in South Australia was within a sensitive military area. Oz Minerals executives dismissed the claim as laughable, pointing out that a highway and a railway run through the Woomera Prohibited Area and that the Prominent Hill mine is nowhere near the zone's weapons testing range. Senior government officials are trying to reassure Chinese investors that the rejection was a one-off event.

The Oz Minerals decision does, however, highlight the strategic concerns in Australian ruling circles over Chinese investment. The same issue would simply not be raised if a huge American, British or Japanese corporation made a similar offer to Rio Tinto or another Australian mining company. A further indication of the same sensitivities emerged last week in the form of a "scandal" involving ties between Minister of Defence Joel Fitzgibbon and a Chinese businesswoman with political connections in Beijing. Fitzgibbon was compelled to make a public apology for not disclosing that he had accepted free trips to China while in opposition.

Since World War II, Australian strategic planning and defence relations have been centred on the ANZUS alliance with the US. At the same time, the Australian economy has become increasingly reliant on trade and investment with Asia. Since the 1990s, the most significant economic factor has been the rapid rise of China, which has become a huge importer of Australian minerals.

Successive governments have attempted to balance the necessity of closer economic ties with China against the longstanding US strategic alliance. A recent Australian Strategic Policy Institute study summed up Canberra's basic objective: "We would want our security partnerships with other regional states, for example, to be mutually compatible. And we would want our ANZUS alliance with the Americans to remain unfettered by any new agreement with Beijing."

This balancing act is becoming increasingly difficult as rivalry grows not only between China and the US, but among the major Asian powers—China, India and Japan. In a bid to head off conflicts, Rudd proposed the formation of an Asia-Pacific Community last year, but the plan attracted no support. In the lead up to the G20 summit, Rudd called for China to be given a more prominent role in the IMF, attracting criticism back home that he was sounding more like a spokesman for Chinese, rather than Australian, interests.

It is in this context that the Australian government has to make a series of major decisions on Chinese investments. While the money is welcome, its acceptance will be viewed in Washington in particular as evidence of growing Australian dependence on, and ties with, China. Canberra's obvious difficulty in choosing between unpalatable alternatives is one more sign of the rising tensions in the region and internationally.