

China sentences Rio Tinto executives to lengthy jail terms

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The harsh sentences handed out this month to four senior Rio Tinto employees underscore the importance that the Chinese government places on keeping a lid on commodity prices—especially for the iron ore supplied by the global mining giants such as Rio.

The four senior members of Rio's iron ore negotiating team working in China were jailed for periods of 7 to 14 years for bribery and commercial espionage. The court alleged that the misappropriation and misuse of commercial information had cost the leading government Chinese steel companies over 1 billion yuan (about \$US180 million) in 2009, apparently because Rio was able to use the information to demand higher prices for its iron ore.

The prosecutions are in part a warning shot fired over the bows of global mining companies against inflating their prices for iron ore. But the jailing of the four executives—including Rio's lead negotiator, Stern Hu, an Australian citizen—will not quell the underlying tensions between China and the foreign miners. The global iron ore price has jumped 90 percent in the past two weeks. The government-controlled China Iron and Steel Association (CISA) has reacted to news of the price explosion by calling on Chinese steel producers to boycott for two months the world's three largest iron ore miners—Rio, BHP Billiton (both headquartered in Europe) and the Brazilian company Vale. CISA has accused the three—which together control 70 percent of the world's seaborne iron-ore trade—of using monopoly tactics to force up prices.

Measures such as the boycott threat put China on a collision course with not only the three companies, but also the Australian government. Rio and BHP are both originally Australian companies and their key assets are located there. Iron ore exports are central to Australia's overall trade and thus to the economy as a whole. The Australian government is counting on tens of billions of dollars in additional annual tax revenues as a result of the recent price increases.

The four Rio employees were arrested in July 2009 immediately after the collapse of iron ore price negotiations between Rio and the Chinese government. The original charges were that the four had paid bribes and stolen state (as opposed to commercial) secrets. The reframing of the charges appears to have been a concession to Rio. If the charge had remained offering bribes, rather than taking bribes, Rio could have been directly implicated.

Rio appears to have distanced itself from the actions of Hu and his co-workers. An internal audit was carried out to exonerate the company of any wrongdoing. Rio provided no legal assistance to its employees and immediately sacked them after the verdicts were delivered. On the day of the sentencing, Rio's chief executive, Tom Albanese, was in China engaged in a new round of price negotiations. He denounced his former employees' conduct as "deplorable". Rio is apparently keen to demonstrate that the jailings are history and that in Shanghai it is business as usual.

Rio's decision to cut loose its employees to protect its vast commercial interests in China is replicated by the Australian government's reaction to the case. Foreign Minister Stephen Smith criticised the sentences as "tough" and the trial as lacking transparency, but Canberra has not pushed the issue. After Stern Hu's lawyers announced he would not appeal the sentences, the Australian foreign affairs department quickly declared that it "respected his decision". No criticisms were made of the secretive nature of the trials or any questions asked about the manner in which confessions were obtained—in some cases, after months in deplorable conditions.

The bribery accusations as eventually framed were that in 2009, Hu and his co-workers—Wang Yang, Ge Mingqiang and Liu Caikui—accepted money from small and medium-sized steel producers in exchange for agreeing to bypass the leading government-owned conglomerates and sell directly

to those smaller mills. In the process of sidestepping the middlemen, the companies and suppliers such as Rio undermined Beijing's efforts to keep down iron ore prices.

As Peter Lee explains in *Asian Times Online*, "in theory, China's 1,000 mills are supposed to present a united front to the three main suppliers—Rio Tinto and BHP Billiton for Australian ore, and Vale of Brazil—through the China Iron & Steel Association, under the leadership of Baoshan Iron & Steel. In practice, more than 100 Chinese mills and traders are licensed to import ore and exploit their advantage by assembling speculative inventory and compelling unlicensed mills to buy from them at double the original price. In a seller's market, the producers have ample opportunity to play divide-and-conquer and undercut the government negotiators."

Seen from this perspective, the prosecutions were apparently intended not only to discipline Rio, but to send a warning to the domestic steel industry itself. "Leakage" in price negotiations naturally undermines the bargaining position of the government-controlled firms and the steel industry as a whole. By prosecuting the Rio executives, the Chinese government was signalling to steel companies that they could face legal action if they continued to try to reach their own deals.

In his article, "More than bribery: Wealth, power and Rio Tinto", Peter Lee also raises the possibility that the prosecutions are related to infighting in Beijing. Du Shuanghang, China's second-richest billionaire and a man who made his fortune with the direct political support of Hu Yishi, a relative of Hu Jintao, was caught up in the case. He owns the increasingly powerful and profitable Rizhao Steel, which poses a direct threat to the steel industry's established plutocrats. Du allegedly gave millions in bribes to Rio's Wang Yang.

Whatever China's exact motivations, the prosecutions and the new threat of a boycott are both responses to skyrocketing iron ore prices, which are in part a product of hothouse economic conditions inside China. In response to the global economic crisis, Beijing implemented a huge stimulus package—much of it for infrastructure—and provided massive amounts of cheap credit that has fuelled a frenzied housing boom. As a result, the demand for steel has soared. China's crude steel output rose 13.5 percent in 2009. Iron ore imports surged 46 percent. China now accounts for 75 percent of the global iron ore trade, according to the Chinese government. But the scale and suddenness of this demand express the unstable and deeply contradictory character of

the Chinese boom. Rampant Chinese demand has pushed up global ore prices. But as the stimulus winds down, the dramatically higher prices will threaten to choke off growth and unemployment. China's smaller steel mills will be particularly affected.

Even if the Chinese government were able to bring its own steel makers to heel via CISA, controlling the global iron ore market is another matter. The 90 percent price increases reported last week are the outcome of negotiations between Korean and Japanese steel makers and BHP Billiton and Vale. As well as reflecting surging Chinese demand, the prices are the result of the miners successfully agitating for an end to long-established annual benchmark procedures. Prices will now be set quarterly and will be more closely linked to the far higher spot (immediate delivery) price. This break with the benchmark system reflects the fact that power relations in the iron-ore market have swung decisively in the miners' favour. It reflects too the sensitivity and volatility of the spot price. Price negotiations, including in China, are likely to be themselves more volatile and more frequent.

Conflict over prices will have direct political implications for China's relations with Australia. CISA's attack on the BHP-Rio-Vale monopoly is a coded reference to the Australian government's decision to approve a \$116 billion anti-competitive iron ore joint venture between BHP and Rio in Western Australia's Pilbarra region. The Pilbarra deal has been central to Australia's Labor government projection of a new, "endless" mining boom, providing a steady stream of China-derived riches and tax revenues.

This new phase in the Australia-Chinese commodity boom—up until now a lifeline preventing Australian capitalism sinking into deep recession—has delivered a 30 percent increase in China-bound exports in the year to February. China this week surpassed Japan for the first time to become Australia's leading export market. While the conviction of the Rio executives is likely to fade quickly into the background, the case is a reminder of the sharp tensions surrounding commodity price negotiations, which in turn reflect nervousness in Beijing over the future of China's expanding economy.



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