China as a new foreign investor in Australia’s resource sector

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The surge of Chinese investment into the Australian resource sector focused attention worldwide on the issue of China as a new investor abroad.

Three particular investment projects have excited controversy in the Australian and international press—Chinalco’s investment in Rio Tinto; Sinosteel’s takeover of Midwest and its bid for Murchison; and Minmetal’s purchase of OZ Minerals. This controversy was catalysed by the issue of Chinese investment more generally. Had it succeeded, the Chinalco deal, involving an 18 per cent (US$19 billion) stake in Rio Tinto, would have been the largest single Chinese corporate acquisition overseas to date.

There are five important points to make about these developments.

The first is about the motivation for Chinese foreign direct investment (FDI) projects in Australia and elsewhere. The motivation for Chinese FDI is twofold. Firstly, Chinese investors in the resources sector aim to secure stakes in projects that are linked to supplying rapidly growing markets in China. Secondly, Chinese investors perceive going into FDI as an investment in their future, as the Australian (or other foreign) projects and firms in which they invest bring management know-how and technology, and have a positive impact on Chinese firm operational efficiency and corporate standing. The ‘going out’ strategy for Chinese enterprise promoted by the Chinese government over the last few years has encouraged this. Chinese enterprises need to go abroad to compete against foreign competition in the home market and internationally. On the other side, FDI in the resource sector offers various advantages to host countries including the provision of capital, technology, know-how and access to markets. These benefits are substantial to Australia, for example, given the scale, longevity and technological complexity that typify resources investments.

The second point is about state-ownership of Chinese enterprise. What is different about the new wave of Chinese investment is that it emanates largely from state owned enterprises (SOEs). China is a partially reformed economy. The character of SOEs in China is evolving very rapidly. For example, when China invested in the Channar iron ore mine in the 1980s, it did so through the Ministry of Minerals and Metallurgical Industry. Steel and other enterprises under that umbrella have now been fragmented into several competing entities and corporatized, with some listed on both the Chinese and international stock exchanges. Changes in corporate governance include the establishment of non-executive boards and
executive independence in the day-to-day operations of most state owned enterprises. Some SOEs, however, are more independent in their operations than others.

Since 2003, the State-Owned Assets Supervision and Administration Commission (SASAC) has been responsible for exercising the ownership of SOEs on behalf of the Chinese government. SASAC has two roles. It supervises the key state enterprises and their management. It also carries forward the reform of SOEs, their governance, consolidation and privatization. This is an active and ongoing process aimed at making SOEs conform to normal commercial market disciplines. Still, some believe that ownership of enterprise by the state and the presence of political cadres in the senior management of these enterprises in China should disqualify them from being subject to the normal rules and regulations applied to other foreign investors in host countries like Australia and elsewhere. This is not only a matter of public comment. It has been a policy consideration in Canada for some time, and is also now a matter of explicit policy consideration in Australia.

Other distinctions are also made in respect of Chinese foreign investors. The political system in their home country, political or strategic motives that are putatively attributed to them and the ethnicity of their principals play a role. These are not high order issues although, at the margins, they encourage hasty inferences about Chinese firm behaviour and they do colour the political process surrounding the management of policy towards Chinese FDI.

The third point to make is that China is now the most important new source of FDI globally. Whereas global FDI fell by at least 20 per cent last year, Chinese FDI doubled. Much of the new Chinese investment activity abroad has been directed at resources. China is a key to successful engagement of foreign investment in the foreseeable future. To keep that in perspective, Chinese FDI is still less than 1 per cent of total FDI in Australia, so China has a long way to go to catch up.

The fourth point to make is that anxiety over the growth of foreign investment in resources by China is as unfounded as it was over the earlier growth in foreign investment by Japan. Australia has perhaps the most efficient mining sector in the world. This is due to its openness to foreign investor competition and participation, because that brings with it, and fosters, the technology, management know-how and market links that are essential ingredients in the development of a world class, internationally competitive industry. This is significantly because Australia has a strong policy regime, managed by FIRB, and characterised by openness towards foreign investment in its resource industries. Also, it is strategically important that Australia and other developed market economies welcome participation of Chinese state-owned firms rather than remain cautious about it. Domestically, SOEs in China are increasingly subject to
the disciplines of the market. They enjoy preferred access to domestic credit through the state-owned banking system but on terms that are increasingly commercially based.

Many countries spanning different economic and political systems have implicit and explicit state involvement in enterprises (for good or ill) and the state is often actively engaged in representations on behalf of its national enterprises (especially but not only in developing economies). When Japanese investors took a stake in Australian resources some were state owned and most made decisions and received significant subsidised funding within a framework closely constrained by the state. Most large financial institutions in developed market economies (including Australia) are now bound to the state in various ways. State ownership is a fuzzy issue, and it would seem unwise to stereotype state ownership in China when it is in fact changing rapidly and has fewer and fewer of the negative characteristics popularly attributed to it.

Finally, practical engagement recommends welcoming investments from Chinese SOEs because through their fuller participation in the Australian market and other developed markets abroad they subject themselves to the disciplines of robust and well-governed market institutions. Applying special conditions for these investments would reinforce the perception of the primacy of regulatory solutions over market solutions, and help sustain the dominance of the bureaucracy over the market in China and drive Chinese investment to other destinations in Africa or Latin America where there are less robust institutions to host it.

The rapid rise of China caught many by surprise including policymakers in Australia, although Australia has been on the leading edge of the wave. The intensification of Chinese investment activity in the Australian resource sector and right around the world has also come swiftly. These developments alone do not explain the recent elevation of policy interest in Chinese investment in the Australian resource sector or the discomfit of governments in developed countries in dealing with the issue, as suggested above.

There is a complex of political economy issues that will have to be resolved both within China, and in cooperation between China and her major economic partners. In aiming to guarantee for itself the resources and technology it needs as a developing nation and to transform its industrial giants into truly globally competitive players, China has fallen victim to misapprehension about the dangers that Chinese SOEs may pose to other states’ national sovereignty. It is important to avoid investment protectionism and establish a cooperative framework—bilaterally, regionally and globally—where these issues can be resolved.
Increased international cooperation on them will bring benefits to both the investor and the host-nation alike, especially because granting FDI market access to a transitional market economy like China has scope to influence positively the dynamics of institutional change beyond the mere matrix of pecuniary and fiscal opportunity.