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## Australian Journal of International Affairs

Publication details, including instructions for authors and subscription information:

<http://www.informaworld.com/smpp/title~content=t713404203>

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Online publication date: 19 May 2011

**To cite this Article** Wilson, Jeffrey D.(2011) 'Resource nationalism or resource liberalism? Explaining Australia's approach to Chinese investment in its minerals sector', Australian Journal of International Affairs, 65: 3, 283 — 304

**To link to this Article:** DOI: 10.1080/10357718.2011.563779

**URL:** <http://dx.doi.org/10.1080/10357718.2011.563779>

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# Resource nationalism or resource liberalism? Explaining Australia's approach to Chinese investment in its minerals sector

JEFFREY D. WILSON\*

*Since 2005, a burgeoning wave of Chinese investments has set off a new 'minerals boom' in the Australian iron ore and coal mining sectors. While normally a welcome development, the state-owned and strategic nature of the investors has raised concerns in Australia about how these should be regulated. As a result, in February 2008 the Australian government declared an intention to more closely screen foreign direct investment (FDI) from state-owned sources, which both supporters and detractors alike have claimed is evidence of 'resource nationalism' in Australia's approach towards its trade and investment relationships with China. This article challenges this understanding through an examination of the characteristics of Chinese mining FDI, the dilemmas these present to the Australian government, and the relatively restrained nature of its response. Through this, Australia's FDI policy is explained as a defensive move against the potential for strategic behaviour by Chinese investors resulting from their state ownership, rather than any national program to subject minerals trade and investment to political control. On this basis, the article argues that Australian government policy instead evidences a 'resource liberalism' approach, which intends to ensure that the governance of Australia's minerals trade and investment with China remain market-based processes.*

**Keywords:** Australia–China relations; foreign direct investment; mining industry

## Introduction

For the first time in over a decade, foreign ownership of the mining industry has again become a political issue in Australia. Set off by a massive rush of foreign direct investment (FDI) from Chinese companies, and a governmental tightening of FDI screening made in response in February 2008, Australia has reopened a debate last settled in 1992<sup>1</sup> on how best to manage foreign firms operating in the mining industry. Unlike previous debates, however, the contemporary controversy is focused solely on one kind of investor—Chinese state-owned

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enterprises (SOEs)—and concerns perceived as economic risks associated with their state ownership. Despite disagreement over the appropriateness of the newly tightened FDI regime, both supporters and detractors have characterised it as an example of ‘resource nationalism’ targeted against Chinese firms. The issue has also quickly escalated to the top of the agenda in the ongoing Sino-Australian free trade agreement negotiations and diplomatic relations more broadly. Notwithstanding repeated attempts by the Australian government to dispel the notion, the belief that resource nationalism is on the rise in Australia has not abated—with debate being over the appropriateness, rather than the existence, of such a change.

But is resource nationalism an appropriate way to understand Australia’s recent approach to Chinese mining investments? This article disputes this interpretation, and instead offers the perspective that recent changes to the Australian FDI regime are essentially ‘liberal’ in character. First, this article will consider nationalistic and liberal methods of natural resource management, and outline the contours of the debate over Australia’s recent approach to Chinese investment. Then, an analysis of the political-economic context of Chinese mining FDI, the formal content of Australia’s 2008 FDI policy, and the means by which this policy has been implemented will be offered. Through this analysis, it will be argued that Australian FDI screening can be explained as defensive regulations made to solely mitigate the risk of ‘strategic’ behaviour by state-owned Chinese investors. Finally, an explanation of these policies as consistent with a liberal, rather than nationalistic, approach to FDI will be offered.

### **National management of natural resources: resource nationalism and liberalism**

In a globalised world economy, natural resource endowments pose choices for resource-rich states. A consequence of economic globalisation is that the spatial link between patterns of production and consumption is increasingly broken—particularly in natural-resource-based industries, where owing to the arbitrary spread of resources, production and consumption centres are often located in different national spaces. In this context, resource-rich states must make decisions regarding how the natural resources over which they have control are managed. On the one hand, owing to the necessity of international trade and investment for the development of export-oriented resource industries, states must allow for a degree of openness to international markets for goods and capital. On the other, the economies of resource-rich states are often underdeveloped and/or dependent on the exploitation of natural resources, and pressures exist to leverage these endowments through the use of various forms of interventionist economic policy that maximise the national gains accruing from natural resource exploitation (Moran 1992). Put another way, resource-rich

countries face choices between competing political-economic methods for the management of natural resources—as Gilpin (1987) has put it, a choice between *state-based* and *market-based* systems of economic allocation. We can divine two contrasting types of state management of natural resources, defined by their employment of such political- or market-based mechanisms—resource nationalism and resource liberalism.

*Resource nationalism* involves a state-directed and mercantilistic approach to the management of natural resources. It occurs where a natural-resource-endowed country uses its legal jurisdiction over these resources to achieve some set of national development goals that would otherwise not obtain if their exploitation were left to international market processes. It is rationalised by the idea that natural resources are scarce assets, which, if left by laissez-faire policies to market processes, will not be developed in ways that offer maximum benefits for the national economy; and instead argues that states should use selective, interventionist policies to achieve higher levels of local pay-offs (Moran 1971). While a wide range of national pay-offs might in principle be pursued, three specific goals have historically been pursued by states engaged in resource nationalism:

- enlarging the profits from resource exploitation by mandating increases in the traded prices of commodities through the use of export controls and/or participation in international commodity cartels (Gilbert 1995);
- the capture of these profits by requiring minimum levels of local ownership, either through FDI controls or, in extreme cases, nationalisation (Mares 2010);
- the establishment of downstream manufacturing activities by requiring the local processing of resources by multinational corporations (Moran 1971).

Despite pursuing different goals, all three forms of resource nationalism are united by their political economy characteristics. They all involve states taking the economic processes of resources extraction, processing and distribution ‘out of the international market’ by subjecting them to some kind of nationally oriented state control for politically defined goals. While such efforts are likely to be resisted by both customer states and the multinational corporations involved, in situations where a resource-rich state possesses bargaining power over these partners, it may be able to use such policies to extract greater benefits from natural resource exploitation than would have otherwise been the case (Moran 1992).

*Resource liberalism* provides a competing method of natural resources management and, in one sense, can be defined simply as an eschewal of such nationalistic policies. However, it is more than just a negation of the resource nationalist approach and instead involves a state relying on international market mechanisms for the development of its natural resources through relatively liberal trade and investment policies. In the contemporary setting, it draws on

neo-liberal economic ideas regarding the efficacy of 'free' markets (Hay 2009), and argues that the maximum benefits from natural resources are enjoyed when they are developed to serve international markets with a minimum of state intervention (Haselip and Hilson 2005). Resource liberalism involves an alternate range of policies, including:

- eschewing restrictive trade policies (such as export controls) which will limit the ability of firms to compete effectively in international markets and may deter foreign investors (World Bank 1992);
- maintaining an open FDI regime and actively pursuing multinational corporations (MNCs), which bring packages of capital, technical skills and marketing channels, and can better develop natural resources than local firms (Kumar 1990);
- avoiding placing conditions (such as for local ownership or processing) on firms which might encourage MNCs to locate in other countries (Maponga and Maxwell 2001).

Thus, the defining political economy characteristic of resource liberalism is that it places the processes involved in the development of natural resources squarely 'in the international market' rather than under some form of state-mandated political control. While this involves the state eschewing opportunities to extract greater economic gains, its advocates argue that in cases where resource-rich countries are in competition for global markets and sources of capital, such a range of policies will achieve better results than their corresponding nationalistic alternatives (see World Bank 1992).

Of course, these articulations of nationalistic and liberal formulations exist as ideal types of possible state- or market-based approaches and, in practice, few states fully express either, usually mixing combinations of the two. Historically, the 1970s saw the apogee of resource nationalism as resource-rich states' bargaining power increased in buoyant world markets, evident in the formation of the OPEC (Organization of the Petroleum Exporting Countries) cartel, the development of various international commodity agreements, and a 'nationalisation wave' in the Latin American mining industries (Rodrik 1982). As world markets deteriorated during the 1980s, supplier countries had to work harder to attract capital and win markets, and these policies generally gave way to more liberal approaches (Haselip and Hilson 2005). However, some observers fear a recent renaissance of resource nationalism, led by Venezuelan and Russian approaches to oil and gas, respectively (Bochkarev and Austin 2007), and a new round of Chinese 'energy diplomacy' that has actively cooperated and rewarded such efforts emanating from supplier countries in Africa and Latin America (Kreft 2006; Zweig and Bi 2005). Indeed, after two decades of relatively liberal policy, others have argued that Australia's approach to its gas and uranium sectors is, consistent with this world trend, also taking a turn back towards nationalism (Hay 2009).

In light of such competing approaches to natural resources management, and the context of a possible resurgence of resource nationalism at a global level, this article is concerned with a recent case of purported resource nationalism—Australia's 2008 tightening of its FDI regime targeted at minerals investments by Chinese companies. Where does this tightening sit on the spectrum of natural resources policies? As an inherently 'political' intervention into otherwise market-based investment flows, is this evidence of growing resource nationalism in Australia? Or, given the context of the state-owned Chinese investments that it has sought to regulate, might it be better understood as an inherently 'in the market' liberal approach?

### **The Australian controversy: debates over Chinese investment in the mining sector**

In recent years, the question of Australia's regulation of Chinese FDI in its mining sector has become a significant political issue—both in Australian debates over economic policy and at the international level of Sino-Australian bilateral relations. The controversy is relatively new, and was catalysed by a rush of Chinese FDI into the Australian mining industry beginning from 2005. Much of this investment has been driven by iron ore and coking coal demand from China's rapidly growing steel industry, and is part of a broader Chinese effort to secure foreign sources of minerals and energy to meet industrial demand, which increasingly cannot be met by domestic reserves (Moran 2010).

While normally a welcome development, these investments have become a source of disquiet owing to the state-owned nature of the Chinese investors—which have typically been either SOEs or sovereign wealth funds. Concerns have thus been raised by both the Australian government and some business interests over the risk that these state-owned firms would act in a policy-driven manner and distort market processes by prioritising the economic interests of the Chinese state; as well as fears that these would give the Chinese government some measure of 'control' over the Australian mining industry. Following several high-profile investments in 2007, such concerns reached fever pitch in January 2008 when Chinalco, a Chinese state-owned mining conglomerate, attempted to prevent the takeover of Rio Tinto by BHP Billiton through a massive AU\$15.5 billion 'dawn raid' on Rio Tinto shares, made with the backing of China's State Council but without the required approval of Australia's Foreign Investment Review Board (FIRB) (*Sydney Morning Herald* 2008a).

A governmental response quickly followed, coming 17 days later with the issuing of an updated set of foreign investment review guidelines. While not formally changing existing FDI screening rules, the new guidelines promised that closer scrutiny would now be applied to investments made by SOEs in light of perceived risks associated with their state ownership (Department of Treasury 2008). Despite not explicitly mentioning either Chinese SOEs or the

minerals sector, it was widely interpreted as targeted at these investors, a view reinforced when the Treasurer reiterated and emphasised the new policy in speeches on Sino-Australian economic relations to audiences in both Australia and China in June and July 2008 (Swan 2008a, d). These new guidelines sent both Chinese and Australian investors a clear signal that the government was concerned about the issue of Chinese state-owned investment in its minerals sector, and would be stepping up its regulatory scrutiny in turn.

Making good on this promise, the screening of Chinese investments was immediately tightened by Australia's FIRB, which in April 2008 required 10 Chinese mining investment applications to be resubmitted in order to provide additional information on their state ownership (*Australian* 2008a). While the bulk of these applications were ultimately approved, between April 2008 and June 2010 some four Chinese investments in the minerals sector were rejected, and another four approved subject to government-mandated behavioural conditions. Thus far, these new FDI screening guidelines have only been applied to Chinese investors, though this is accounted for by the fact that the only state-owned investors in the Australian mining sector have come from Chinese sources. This heightened scrutiny of Chinese investment has proven controversial in both Australia and China. Some involved parties have argued that the regime fails to adequately protect Australia against the intrusion of the Chinese government, while others have denounced the policy as discriminatory against Chinese investors, and/or potentially putting Australia's participation in a new China-driven minerals boom at jeopardy.

Groups within Australia calling for greater scrutiny of Chinese investment on nationalistic grounds come from a disparate range of political and ideological backgrounds. At the federal parliamentary level, both the Opposition Liberal-National Party (to the right of the government) and the Greens (to its left) have argued that allowing the Chinese investment has resulted in a loss of national control over mineral resources; and, in March 2009, the two groups formed an ideologically rare alliance to force the government to call a Senate inquiry into the issue (*Bloomberg* 2009b). An attempted second investment by Chinalco in Rio Tinto in 2009 proved extremely contentious, with Barnaby Joyce, an Opposition parliamentarian, appearing in a series of television advertisements lobbying against the investment entitled 'Keeping Australia Australian' (*Sydney Morning Herald* 2009e). The premier of Western Australia—a state traditionally dependent on mining—also joined these calls, claiming Australia could be overwhelmed by unregulated Chinese investment which could take control of the state's mining sector (*West Australian* 2009). Such attitudes also appear to be widespread among the business community, with a survey conducted in early 2010 finding that most Australian investors were wary of allowing additional Chinese investment due to its state-owned nature (*Sydney Morning Herald* 2010b). What unites these groups is an understanding of the issue as one regarding the national control of the Australian mining industry, with a clear 'resource nationalistic' preference for restrictions aimed against China.

Opponents of Australia's new approach to Chinese investment similarly understand it as an instance of emerging resource nationalism, though they have deployed this argument as part of calls for less state regulation. In mid 2008, the Australia China Business Council argued that the heightened regulatory scrutiny was deterring Chinese investors from Australia, whose capital was much needed in the context of the 2008 global financial crisis (*Australian* 2008h). Many mining firms have also joined these calls for less regulation, in particular Rio Tinto, which has argued that nationalistically inspired restrictions on Chinese investment may hurt the growth potential of the Australian mining industry (Rio Tinto 2009b). More radical accusations were made by Clive Palmer, a Queensland mine developer, who argued that the government's approach was driven by Chinese-targeted xenophobia rather than any economic policy logic (*Age* 2009). No less critical has been the response from affected parties in China. Many involved Chinese firms have publicly claimed their investments are commercially oriented, and rejected the suggestion that their investment activities have been driven by Chinese governmental priorities (for examples, see *Sydney Morning Herald* 2008d). Additionally, while the Chinese government has expressed unease about Australia's FDI screening process for some time (MOFCOM 2005), it appears to have escalated its concerns over the issue since the announcement of tighter screening. Chinese negotiators made the issue their top priority during the Sino-Australian free trade agreement negotiating rounds conducted in June and September 2008 (DFAT 2009), and the Chinese ambassador took the unprecedented step of publishing an opinion piece in an Australian newspaper disavowing the notion that Chinese FDI was in any way politically motivated or controlled (Zhang 2009).

In response to these criticisms from both local and Chinese sources, the Australian government has consistently denied that its policy is nationalistic in orientation or application (Swan 2008a, d). However, the criticisms have refused to abate, and have recently been picked up by academic commentators joining the growing disquiet over perceived regulatory discrimination against Chinese investors (see Drysdale and Findlay 2009; Thirlwell 2008). While occupying the opposite end of the debate from those arguing for further scrutiny, these groups share an understanding of the Australian government's post-2008 FDI regime as one motivated (if unwisely) by resource nationalistic concerns.

The belief that the Australian government's recent approach to Chinese foreign investment embodies a move towards resource nationalism has thus achieved wide currency amongst both its supporters and detractors. However, upon closer examination of the evidence, this interpretation becomes difficult to sustain. It can be argued that the post-2008 controls are neither motivated by nor result in resource nationalism—in the sense of being an attempt to take the Australia–China minerals trade 'out of the market' and subject it to political control. Rather, they largely appear to be defensive regulations, aimed at neutralising potential non-commercial behaviour by Chinese state-owned investors. By considering the political-economic context from which Chinese



foreign mining investments originate, the principles enumerated in the Australian government's 2008 policy, and their subsequent application, a clearer picture emerges, which demonstrates that Australia's approach more closely aligns with a liberal, rather than nationalistic, approach to natural resource management.

### The characteristics of Chinese minerals FDI

As analysis of Australia's FDI regime should place the policy in the context to which it responds, it is important to begin with an understanding of the investments targeted for scrutiny. Recent Chinese FDI into the Australian mining industry is qualitatively unlike investment from other sources. First, it is driven primarily by demand from the Chinese steel industry for raw materials, and thus is concentrated in just two mining sectors—iron ore and coking coal. Second, these investments have largely been made by SOEs and are usually backed by governmental financial assistance. Third, they arguably originate from a state-directed agenda that aims to use FDI to influence transactions in international minerals markets.

Like many Chinese industries, the origin of its contemporary steel industry dates to Deng's 1978 reforms, which promoted the gradual replacement of command administration with a 'socialist market economy'. However, unlike many industries that were subject to a process of gradual marketisation and privatisation, given steel's role as a critical industrial input, the state opted to maintain ownership (Naughton 2006). Privatisation was explicitly ruled out, and significant state subsidies were extended to promote the expansion and modernisation of SOE steelmakers (Price *et al.* 2007). While management autonomy was devolved from the state to enterprises in 1993, governmental oversight was retained by requirements demanding the placement of Communist Party officials in all top management positions (Bai and Bennington 2007). State control of the industry was further cemented by rationalisation plans that aimed to create a small group of state-owned 'national champions', first undertaken in 1997 (Sutherland 2001) and again in 2005 (NDRC 2005).

The effects of these policies have been twofold. First, the steel industry expanded at an extremely rapid pace, with China rising to a position of global dominance in steel, producing 568 million tonnes and accounting for some 47 percent of world production in 2009 (World Steel Association 2010). The second has been to base this growth on a group of six core enterprises with annual production over 20 million tonnes, five of which are predominantly state-owned (Price *et al.* 2007). However, because of the success in increasing output, the Chinese steel industry since the mid 2000s has faced increasing difficulties in securing supplies of steelmaking raw materials. China was self-sufficient in the supply of iron ore and coking coal in the 1980s, but during the 1990s its steel industry outgrew available domestic reserves of iron ore, leading to a climbing

import dependency ratio of around 50 percent today (China Steel Yearbook Editorial Board 2009). Its more abundant coal reserves served domestic needs somewhat longer, but owing to competition from domestic users in the electricity industry, steelmakers were forced to begin coking coal importation for the first time in 2009 (*Bloomberg* 2009e). Thus, while the steel industry itself has remained under state ownership and managerial control, the production of raw materials it requires has increasingly relied on foreign sources of supply.

Difficulties associated with raw materials importation were further exacerbated by the structure of international iron ore and coking coal markets. Prior to 2005, international trade in these minerals was conducted under long-term contracts made between steel and mining companies. The prices for contracts were historically determined by annual closed-door negotiations between two informal cartels of relatively equal bargaining power: a Japanese steel buyers' cartel and a producers' cartel comprised of the 'Big-3' mining companies—Australia's BHP Billiton and Rio Tinto, and Brazil's CVRD (Companhia Vale do Rio Doce) (Sukagawa 2010). However, the involvement of Chinese buyers in the negotiation process carried the effect of weakening the bargaining power of Japanese firms on the buyers' side and, in the context of booming Chinese demand, delivered the Big-3 scope to push for rapid price increases. As a result, prices for internationally traded iron ore and coking coal started to boom, with the price of iron ore alone increasing four-fold in six years between 2004 and 2008 (UNCTAD 2008).

It is in this context that the recent wave of state-led minerals investment from China has occurred. Spurred into action by a 71.5 percent increase in the price of iron ore in 2005, the Chinese government issued an Iron and Steel Industry Development Policy in the middle of the year that included various elements to support the industry in the face of new cost pressures (NDRC 2005). Central amongst its policies was a commitment to offer state financial support to steel firms for the development of foreign mining projects, either wholly owned or as joint ventures. Such financial support for the outward investment program was soon forthcoming as loan financing from two state-owned policy banks (the China EXIM Bank and China Development Bank), who provide 'policy finance' on concessional rates, and four state-owned commercial banks, whose purpose is to finance SOE activities in line with state-mandated industrial plans (Cousin 2007).

Given a ready access to state financing, the results of this foreign investment program have been dramatic, and are summarised in Table 1. Between 2002 and August 2010, Chinese firms made 49 investments in foreign iron-ore- and coking-coal-related projects; and of those for which data is publicly available, their cumulative value is AU\$40 billion. Given Australia's advantages as an investment site (owing to its proximity to China and comparatively stable investment climate), some 36 of the projects, with a value of AU\$27 billion, have been located in Australia. In terms of the ownership and financing, all but six

Table 1. Chinese investments in foreign iron ore and coking coal projects, 2002–10

Firm	Project	Date	Equity acquired (percent)	Source of financing	Size (mtpa) and contracts (percent of output)	Value (AU\$)
<b>In Australia</b>						
Baosteel	BaoHI	2002	46	SCB	7.0 (100%)	N/A
Yanzhou Mining	Austar*	2004	100	SCB	2.0 (100%)	31
Tangshan	Jimblebar	2004	40	SCB	12.0 (100%)	N/A
Wugang				SCB		N/A
Magang				PB		N/A
Jiangsu Shagang				Private, state grant		N/A
SOE Consortium	Yilgarn Resources	2007–8	50	PB	Infrastructure	250
CITIC Pacific	Macarthur Coal*	2007–9	20	SWF	None	1000
Rockcheck	Aurox	2007–8	12	SCB	Plan 6.0 (100%)	15
Ansteel	Gindalbie	2007–9	36	SCB	None	200
Ansteel	Karara	2007	50	PB	Plan 10.0 (100%)	530
Tonghua I&S	Cairn Hill	2007–10	10	SCB	Plan 7.0 (100%)	14
Sinosteel	Midwest	2008	100	PB	Plan 15.0 (100%)	1400
Sinosteel	Murchison Metals	2008–9	5.8	PB	None	15
Wugang	Eyre Iron	2008	60	PB	Plan 10.0 (80%)	260
Wugang	Centrex	2008	15	PB	N/A	10
Shougang	Balmoral South	2008	18	PB	Plan 12.0 (100%)	58
Jiangsu Shagang	Grange Resources	2008	45	Private, state grant	2.5 (100%)	N/A
Shougang	Mt Gibson	2008	40	SCB	Plan 10.0 (60%)	N/A
CMG	Cape Lambert	2008	100	SCB	None	400
Hunan Valin	Golden West	2008	11	SCB	Plan 10.0 (45%)	27
CITIC Pacific	SinoIron	2008	100	SWF	Plan 27.6 (100%)	560
Xinwen Mining	Coal	2008	100	SCB	None	1500
	Exploration Permits*					

Table 1. (*Continued*)

Firm	Project	Date	Equity acquired (percent)	Source of financing	Size (mtpa) and contracts (percent of output)	Value (AU\$)
China Western Mining	FerrAus	2008	10	SCB	Development (100%)	21
Chinalco	Rio Tinto	2008	9	SCB	N/A	15500
Hunan Valin	Fortescue Metals Group	2009	15	SWF	Plan 50.0 (100%)	1200
Baotou	Bungalow	2009	50	SCB	Plan 3.0 (33%)	40
China Metallurgical Investment Company	Beyondie	2009	50	SCB	Plan 3.0	200
Yanzhou Mining	Felix Resources*	2009	100	SCB	5.0 (100%)	3500
Chongqing Minerals Development	Extension Hill	2009	60	Local government	Plan 10.0 (100%)	N/A
China Railway Materials Corporation	FerrAus	2009	12	SCB	Development (100%)	13
Jinchuan Group	Fox Resources	2009	11	SCB	None	18
Baosteel	Aquila Resources	2009	15	SCB	Development ( > 50%)	240
Sichuan Taifeng	IMX	2010	20	Private	None	47
Huaxi	Lincoln	2010	13	Private	Development (50%)	8
Shenhua	Centennial*	2010	10	SCB	None	200
<b>In other countries</b>						
Baosteel	Baovale (Brazil)	2002	50	SCB	8.0 (100%)	38
CNMIEC	Belinga (Gabon)	2008	85	SCB	Development	955
Shunde Rixin	Unnamed (Chile)	2009	70	Private	Development	N/A
Wugang	Consolidated Thompson (Canada)	2009	25	PB	8.0 (50%)	360
China Investment Corporation	Teck Resources* (Canada)	2009	17	SWF	None	1875

Table 1. (Continued)

Firm	Project	Date	Equity acquired (percent)	Source of financing	Size (mtpa) and contracts (percent of output)	Value (AU\$)
Wugang	MMX (Brazil)	2009	21.5	SCB	11.0, Plan 40.0 (50%)	435
China Railway Materials Corporation	Africa Minerals (Sierra Leone)	2010	12.5	SCB	Plan 25.0 (30%)	275
Shandong	Africa Minerals (Sierra Leone)	2010	25	SCB	Plan 25.0 (50%)	1710
CIF	Kaila (Brazil)	2010	N/A	Private	Development (100%)	2914
ECE	Itaminas (Brazil)	2010	100	Provincial government	3.0 (100%)	1316
Wugang	Bong (Liberia)	2010	60	SCB	None	75
Chinalco	Simandou (Guinea)	2010	45	SCB	None	1481
Wugang	Zambeze (Mozambique)	2010	40	SCB	Development (40%)	950
<i>Subtotal to Australia</i>					27257 (69%)	
<i>Subtotal to others</i>					12384 (31%)	
<b>Total</b>					<b>39641</b>	

Notes: SCB refers to state-owned commercial bank; SWF to sovereign wealth fund; and PB to two policy banks (the China Development Bank and China Export-Import Bank); mtpa = million tonnes per annum. For comparison, investment values are converted to AU\$ millions at the then current exchange rates with reported currency. All projects are in iron ore, except those marked with an asterisk (\*), which are in coking coal.

Source: Author's compilation, from: *ABC News* 2010; *ABN Newswire* 2009; *American Metals Market* 2001; *Australian* 2004, 2008b, 2008c, 2008d, 2008e, 2008f, 2008g, 2008i, 2008j, 2008k, 2008l, 2009a, 2009c, 2009d, 2009e; *Australasian Resources* 2007; *Bloomberg* 2009a, 2009c, 2009d; *Caijing* 2008a, 2008b, 2008c; *Centrex Metals* 2010; *China Daily* 2008, 2009; *CITIC Pacific Mining* 2010; *Financial Times* 2004, 2008; *IMX Resources* 2007; *Mineweb* 2010; *Mining Weekly* 2009, 2010; Price *et al.* 2007; *Reuters* 2008, 2009, 2010; *Rio Tinto* 2001, 2009a; *Sinosteel Midwest* 2010; *Steel Business Briefing* 2009; *Steel Guru* 2008, 2009, 2010a, 2010b, 2010c; *Sydney Morning Herald* 2008b, 2008c, 2009b, 2009c, 2009d, 2009g, 2009h, 2010a; *WA Business News* 2009; *Wall Street Journal* 2009b, 2010; *Yilgarn Infrastructure* 2009.

were made SOEs and financed either by policy or state-owned banks. This program is still in its infancy—as of early 2010, only seven of these projects were in production<sup>2</sup>, with the combined development plans of the rest calling for the installation of some 230 million tonnes of iron ore capacity by 2015. While these projects cover the bulk of Chinese investment in the Australian minerals industry to date, in the context of its broader global resources investment strategy, this list of steel-related investments is only the tip of the iceberg, with similar patterns of state-financed investment also occurring in the oil, gas, copper, bauxite and nickel sectors (see Moran 2010).

Several goals motivate this state-financed foreign investment program. The first, emphasised in the 2005 steel policy, is a simple intention to increase the supply of needed raw materials by providing finance for new mine development. However, analysis of the investments made under the program suggests that an additional two motivations of a strategic and non-market nature are at play. One has been the stated goal of developing ‘captive mines’ owned by Chinese firms, with the intention of diluting the bargaining strength of the Big-3 miners in annual price negotiations. For example, describing its 2009 investment in Australia’s Aquila Resources, the chairman of Baosteel claimed: ‘[The investment] will strengthen Baosteel’s control over strategic resources, weaken the monopolistic grip over global iron ore supplies and lower purchasing costs’ (Cang and Klamann 2009); and Chinalco’s second attempted investment in Rio Tinto in 2009 was publicly rationalised by the firm on the same grounds (*Sydney Morning Herald* 2009a). The connection between the investments and bargaining power in international minerals markets is also highlighted by the fact that the Chinese government has publicly blamed recent price rises on the ‘monopoly status’ of the Big-3 miners (*Steel Business Briefing* 2006). A second strategic goal is also evident in the practice of supply contracting with joint ventures, where the Chinese party makes investment conditional on acquiring long-term contracts for the bulk of a project’s output. While long-term contracts with Chinese steel mills have been signed by most projects, in 21 cases contracts have covered most or all of planned output, far in excess of the minority ownership stake taken by the Chinese partner (see Table 1). In a handful of other cases, investments have also been made conditional on special pricing agreements, whereby minerals would be supplied to the Chinese partner at discounts to the prevailing world benchmark price.<sup>3</sup>

These practices demonstrate that the strategic goals of increasing the market power of Chinese firms vis-à-vis major mining companies, and securing lower-cost minerals supply independent of them, have loomed large in the recent wave of Chinese FDI. Such strategic priorities arguably dilute normal commercial goals—particularly profit considerations—and indicate a Chinese intention to use FDI to shift minerals imports out of existing international market structures. Given that all foreign investment by SOEs requires the prior approval of both the National Development and Reform Commission and the Chinese Cabinet (Wu 2005) and, in the case of steelmaking raw materials, has consistently

been financed by state-owned banks with a policy orientation, this strategic agenda has at least the imprimatur, if not active support, of the Chinese government.

This wave of foreign investment and its state-backed and strategic characteristics provide the context of Australia's recent change in FDI policy. This context is crucial in explaining the nature of Australian regulatory response, as it is this Chinese program, and its potential to shift the Sino-Australian trade in steelmaking raw materials out of existing international market structures, to which Australia's regulatory response has primarily been oriented.

### **Examining the Australian government's response**

The regulation of these Chinese investments has posed a number of dilemmas for the Australian government. While FDI is generally welcomed, and the recent boom in Chinese minerals imports and FDI has been argued to have helped Australia escape the worst of the global financial crisis of 2008–9<sup>4</sup>, their state-led and strategic nature have nonetheless given cause for concern. One concern regards the priorities and behaviour of the Chinese investors—whether they are motivated to invest in ways that support the development of the Australian mining industry (expanding output and employment) or would instead serve Chinese governmental goals for its steel industry (preferentially supplying customers at discounted prices). A second concern regards the control of the Australian mining industry—whether Chinese firms would move to control the operation of firms they invest in or would participate as minority partners and leave control with the majority (non-Chinese) owners. Both concerns essentially relate to whether the minerals trade between Australia and China would remain 'in the market'. Importantly, a close examination of the Australian government's regulatory scrutiny of Chinese minerals investments post 2008 shows that it is precisely these issues that catalysed the initial change in approach and have since informed how foreign investment screening rules have been applied.

At the level of formal controls, the concern that Chinese investment might shift Australia's minerals trade with China out of the market appears to be the motivating feature behind the new FDI screening guidelines. The bulk of the guidelines restated the content of the FDI regime in place since 1979, where a range of investments (including those undertaken by foreign government-owned entities) would be screened by the FIRB according to 'national interest' criteria, and then referred to the Treasurer for approval or rejection. The only new information included in the policy was a clarification of the six national interest criteria to be applied to SOE investments, which included whether:

- the investor's operations are independent of the relevant foreign government;
- the investor is subject to and adheres to the law, and observes common standards of business behaviour;

- the investment hinders competition, or leads to undue concentration or control in an industry;
- the investment impacts on Australian government revenue or other policies;
- the investment impacts on national security;
- the investment impacts on the operation or direction of an Australian business, including its contribution to the economy and wider community (Department of Treasury 2008).

A concern with strategic SOE behaviour is plainly evident, particularly in the first three criteria, which address issues of whether an SOE is independent of its government, behaves like other private businesses, and the degree to which it would acquire market power. That these criteria were designed to ensure 'market-conforming' rather than strategic behaviour was reinforced by the Treasurer in a speech to the Chinese Communist Party in June 2009, where it was explained the policy was intended to ensure that investment and sales decisions by Chinese SOEs would be 'driven by market forces' (Swan 2008d). Furthermore, in mid 2009, the FIRB indicated it was pursuing this goal through the application of an informal '15/50 guideline', under which investments would be considered market-conforming if below thresholds at which the risk of strategic behaviour is deemed to become acute, set at 15-percent ownership of an existing firm or 50 percent of a new project (*Wall Street Journal* 2009a).

Thus, the content of the policy suggests the primary Australian governmental concern with Chinese investors lay in the potential for non-commercial behaviour stemming from their state ownership, with screening intended only to prevent such behaviour. Nonetheless, given that individual approvals remain at the Treasurer's discretion, critics have alleged that other more nationalistic motives are also present (if unacknowledged) in the policy (see Age 2009). However, the manner in which this policy has been applied through subsequent regulatory decisions confirms that it has largely been confined to defensively attempting to neutralise the potential for non-commercial behaviour by Chinese SOEs, rather than any broader efforts to either restrict their entry into the Australian mining industry or to distort the operation of international market mechanisms in line with politically mandated national goals.

A first dimension concerns the Chinese mining FDI approvals made since February 2008, which have consistently been quite liberal, with 36 Chinese investments in iron ore and coking coal approved. The FIRB's 15/50 guideline has also been flexibly enforced, with three investments over the 15-percent rule and five over the 50-percent rule approved<sup>5</sup>, usually in situations where the rejection would result in the failure of a project entirely, such as China Minmetals' 2009 acquisition of the bankrupt Oz Minerals (*Australian* 2009b). Here, it is clear that in cases where Chinese SOEs do not acquire ownership shares large enough to influence firm behaviour, approval has been unproblematic and that, in cases of economic necessity, even larger acquisitions have been allowed.



Second, a consideration of rejected applications tells a similar story. Of the four rejections issued by the Treasurer, two (Oz Minerals and Hawks Nest) were rejected due to the proximity of mines to remote defence facilities (*ABC News* 2009); and the latter was subsequently approved when the sensitive mine was removed from the deal (Swan 2009b). These decisions were arguably the result of extraneous security factors unrelated to the FDI regime itself. In the other two cases, the rejected applicants were asked to resubmit applications below a 50-percent level due to concerns that they would result in excessive control of the highly concentrated rare earth minerals sector (Lynas Metals) (*Wall Street Journal* 2009a) and the newly developing Midwest iron ore region (Murchison Metals); with the latter also approved when the Chinese investor agreed to this request (Swan 2008c). Again, these decisions show only a desire to maintain a diversity of ownership in industry subsectors with competition concerns and, in the context of the far greater number of approvals granted, would appear to be competition policy-related exceptions to an otherwise open regime.

Finally, more significant than rejection has been the use of conditional investment approval. In cases where a proposed investment is either large in size or is in a major firm, posing high risks of non-commercial behaviour, the Australian government has made approval conditional on legally binding commitments that the investor will behave in a market-conforming manner. This has occurred in four cases, and included commitments to:

- market output on an ‘arm’s length’ basis: Hunan Valin–Fortescue Metals Group (Swan 2009a) and Yanzhou Mining–Felix Resources (Sherry 2009);
- not seek a director’s position in the target firm: Chinalco–Rio Tinto (Swan 2008b);
- support the development of new local infrastructure providers: Ansteel–Gindalbie (Swan 2009c);
- publicly list a portion of the company to ensure operations are subject to shareholder scrutiny: Yanzhou Mining–Felix Resources (Sherry 2009).

While small in number, such instances of conditional approval have occurred in the largest investments, and thus cover some AU\$21 billion of the total AU\$27 billion approved. In each case, the Chinese firm has complied, if after a somewhat lengthy negotiation process. This conditionality highlights a novel use of FDI screening, where a bargaining process is undertaken to extract behavioural commitments to neutralise the risks associated with state ownership and strategic behaviour. Indeed, had rejection instead been used in these high-risk cases, Chinese FDI in the Australian iron ore and coking coal sectors would, *ceteris paribus*, be only one-fifth of the level that was ultimately allowed.

Regardless of the reception given to it by both commentators and the involved parties, what does this analysis reveal regarding the Australian government’s

post-2008 control of Chinese FDI in its minerals industry? By considering the characteristics of the investments targeted for regulation, the content of Australian policy, and the method in which it has been applied, a more informed understanding of its motivations and implementation becomes apparent.

To begin with, it is clear what the policy is not. Contrary to the claims of both its detractors and supporters, it is demonstrably evident that these controls are not motivated by, or result in, any degree of resource nationalism. First, there is no evidence of the use of FDI controls to leverage a greater share of 'Australian' ownership, with policy containing no provisions for it and application not resulting in it. Second, there is also no evidence of using FDI screening to pursue the two 'non-ownership' goals of resource nationalism—restricting the export activities of firms to influence international markets or requiring firms to engage in downstream manufacturing activities. Third, neither is there any evidence of a targeting of Chinese investors on the specific basis of their nationality, with Chinese SOE applications in the main approved, and the minority of rejections accounted for by extraneous factors relating to security and competition concerns. State intervention into market processes to prioritise national developmental goals—a defining characteristic of resource nationalism—is simply not evident. The characterisation of the Australian government's approach to Chinese investment as resource nationalism may well be a useful political device, used in the current debate to build support for, or opposition to, the post-2008 regime. However, and regardless of their political utility, such claims lack sustaining evidence.

Second, and perhaps more importantly, this analysis suggests that Australia's regulation of Chinese FDI in fact embodies an avowedly liberal approach. The intention to place minerals trade and investment patterns squarely 'in the market'—an inherently liberal commitment—appears as the central concern both of the 2008 policy and its subsequent application. SOE investments that pose a low risk of non-market behaviour have been consistently approved; and only when a proposal carries a meaningful risk of strategic behaviour has FDI screening been used with consequence. Even then, outright rejection has been eschewed in favour of behavioural conditionality, which has demanded commitments for market-oriented behaviour from Chinese SOEs but gone no further. Such behavioural conditions do not appear to have deterred Chinese investors, with Australia continuing to enjoy large FDI inflows and clearly remaining China's preferred minerals investment host internationally. These patterns of FDI regulation are consistent with the liberal approach; and it can be argued that Australia's heightened scrutiny of Chinese SOEs owes more to the recent intensification of China's state-led and strategically motivated minerals investment program than any major change in Australia's approach to mining FDI itself. Thus, the control of Chinese FDI by the Australian government appears at most a defensive tactic, employed to strike a balance between the benefits of FDI and risks of strategic behaviour associated with state ownership and control of the Chinese investors. That the primary criterion

informing such a balancing is the goal of ensuring market-oriented behaviour highlights the inherently liberal, rather than nationalistic, character of the approach.

## Conclusion

Claims of resource nationalism in recent Australian policy towards Chinese FDI in its mining industry fail to properly understand its context, goals or application. Despite such a belief becoming widespread among both Australian and Chinese parties, if resource nationalism is understood as an attempt to take trade and investment in minerals out of international market processes, there is little evidence that this is going on. Rather, it would appear that Australia's intention has been to selectively and defensively regulate investment by Chinese SOEs in order to ensure its trade with China remains firmly in the market—an inherently liberal commitment. In the application of FDI controls, it has consistently pursued this goal but gone no further; and as long as Chinese SOEs are willing to behave in a market-oriented manner, Australia's FDI regime provides them with an open investment climate in which to seek minerals supply for the Chinese steel industry. While claims to the contrary may be made by the affected parties, a characterisation of Australia's policy as inherently liberal provides a better explanation of the outlook and application of contemporary Australian policy towards Chinese investment.

## Notes

1. The last major change to Australian FDI policy regarding mining occurred in 1992, when the Keating government removed special FDI rules for the industry. Since this time, the only Australian governmental intervention into foreign investment in the natural resources sector was the 2001 rejection of a Shell takeover bid for Woodside Petroleum.
2. Austar, Fortescue Metals Group, Jimblebar, BaoHI, Murchison, Mt Gibson and Rio Tinto. See Table 1 for details.
3. This is evident in sales agreements made with Chinese investors by Fortescue Metals and Mt Gibson (*Sydney Morning Herald* 2008e, 2009f).
4. Such arguments have been made both by the Australian government (Swan 2009d) and several business economists (see *Australian* 2010).
5. Grange Resources, Felix Resources and Oz Minerals (over 15 percent of existing firms); and Midwest, Cape Lambert, SinoIron, Macarthur Coal and Extension Hill (over 50 percent of new projects). See Table 1 for details.

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