



Investment needs to be a two-way game if China wants to fully capitalise from its special relationship with Australia, writes Rowan Callick.

Australia's Foreign Minister Kevin Rudd has spoken recently – perhaps somewhat belatedly – on the shift in China's economy, which the central government announced half a dozen years ago, from a focus on manufactured exports and heavy infrastructure inputs, to one on domestic consumption and services.

He is calling the new model China 2.0, like a software update – which it is, in a massive manner.

He has launched a promising initiative which seeks to respond to this hoped-for shift in China, to which he is urging Australian business finally to wake up.

Rudd is promoting his concept of engagement, as Australia China 2.0. He was planning to lead a mission to the five bustling cities of Changsha, Chengdu, Chongqing, Guangzhou and Wuhan to launch it.

Instead, he is undergoing surgery at that time, in early August, and Trade Minister Craig Emerson is leading the mission, which was originally over-booked, with more than 100 businesspeople seeking to participate.

The persisting strength of the old Australia China 1.0 model at the same time, was underlined by the trade figures for 2010 released in July, showing that Australia's trade with China soared

to a record A\$ 105 billion, way above Japan in second place at \$66bn. An astonishing 60 percent of Australia's exports to China comprised a single product – iron ore.

The Australia China 1.0 model has become increasingly narrowly focused on a few resource commodities going to China, and on manufactured goods being shipped to Australia.

Thus the move to broaden the economic engagement, with design, environment, education and the finance industry highlighted as targets for the business mission, is coming at an appropriate time. For it is happening as debate about investment – which is today widely viewed as strategically important not only as an income earner in its own right, but also to gain much deeper understanding of a foreign market – is starting to heat up on both sides.

There has been an outcry about Chinese coal giant Shenhua buying up A\$ 200 million farmland in New South Wales' Liverpool Plains, and other Chinese interests becoming involved in Australian agriculture, while on the other side, complaints have continued that Australia discriminates against investment from China, with a strong hint that this is tainted with "Yellow Peril" racism.

Chinese diplomat Ouyang Cheng, second secretary at the embassy in Canberra, delivered a speech in Adelaide that provided a frank and useful overview of how China views this key economic component of the relationship.

He warned that Australia's two-speed economy – which the Gillard government has euphemised into a "patchwork economy" – risks ultimately damaging the relationship, which he views as narrow and too focused on mining.

Intriguingly like Rudd, he wants to broaden the economic partnership, with more engagement in finance, agriculture, telecommunications and civil aviation. He criticises Australia's Foreign Investment Review Board (FIRB) for taking too long to make decisions, and thus for holding up projects.

It's hardly China's fault, of course, that it has such an insatiable appetite for Australian

resources.

And economists consistently stress that it is not beneficial to make trade or investment contingent on reciprocity. There is much evidence that opening up creates benefits of itself. Thus it appears healthy that Chinese firms in many areas beyond mining are motivated to invest in Australia.

Within the mining sector itself, Chinese investors are becoming innovative, and are learning – as expected – fast. For instance the manner in which Minmetals Resources Ltd conducted its \$6.1 billion bid for Australian-Canadian copper giant Equinox in April can now be viewed as something of a triumph

The process of the bid demonstrated a remarkable truth to the many doubters: that when one of China's biggest state-owned corporations bought key assets from OZ Minerals and claimed it would use the Australian firm's expertise to go global via its new Aussie based, Hong Kong listed company Minmetals Resources Ltd, it really meant it.

It had been widely assumed that when it came to a big takeover, like that of Equinox, Minmetals – MRL's 71.6 percent shareholder – would make all the main decisions in Beijing, and also that it would use access to China's massive foreign reserves to outbid all-comers, whatever the business case, in order to save face and underline the country's new global ascendancy. Instead, the shots in this bid were called by Australian Andrew Michelmore, the MRL chief executive, and his headquarters team in Melbourne.

But if however Australia is constrained from engaging economically inside China itself, the relationship will necessarily remain unbalanced.

To date, Australia has invested just over A\$11 billion in China, population 1.3 billion – about the same as it has invested in the tiny European principality of Luxembourg, population 505,000.

In the last four years, Australia's FIRB has meanwhile approved 230 Chinese investments, with no outright rejections, only six with conditions, with a value of \$60 billion.

China likes Australia as an economic partner. It was one of the first places chosen when Deng Xiaoping decided 30 years ago to open up certain sectors of the Chinese economy. CITIC took a big stake in the aluminium smelter at Portland on Victoria's Great Ocean Road, and the predecessor of Sinosteel took 40 percent of Rio Tinto's Channar iron ore mine in the Pilbara.

At the same time, Foster's led a wave of Australian manufacturing investments into China. The thinking went, get in first, beat the competitors to the draw, then sort out what we're doing once we're there. If that's what it takes, embrace the local partner the authorities consign to us.

But since those pioneering efforts widely turned sour, Australian companies have been guarded about investing in Asia generally, and most importantly in China. At the same time, 70 percent of the Australian economy comprises services – and the Chinese government, while saying it is now seeking to modernise this key sector, has been reluctant to open it up to foreigners or to its own private sector in the way that Deng did with manufacturing.

The Australian businesses that directly sell resources to China, or service those companies – the corporate lawyers, finance houses, accountants – are for now far more focused on speeding up and enhancing the flow of Chinese resource investments into Australia than on the considerably more difficult task of gaining access to China's own markets.

Thus a recent statement from Frank Tudor, the chairman of the Australia China Business Council, that: "In an era of tightening capital markets, China is a welcome source of capital and its consistent appetite for a diversified portfolio of premium commodities continues to bode well for investment in Australia."

However, he complained, "the whiff of discrimination exists at the highest levels in China, and Australia must act to protect capital inflows."

In a follow-up discussion with me, Tudor expanded his remarks to welcome that both portfolio ministers Rudd and Emerson "are out there actively talking to Australian companies on a regular basis about the future of the bilateral trade and investment relationship," and bemoaned that "China only accounts for a small fraction of our total foreign direct investment output – and

it's places like Chongqing, Hunan and Hubei that are going to be critical in building this up going forward."

An Australian consultancy, Think Global, recently went a considerable step further, urging that "every entrepreneur, company or institution should be looking to position itself as an attractive target for Chinese investors," and listed some ways they might make themselves look good, ready for this "once-in-a-generation opportunity for everyone to participate in the next phase of China's development."

There are remarkably few people making the not-so-revolutionary step of reversing such thoughts, and asking whether Chinese businesspeople and institutions are making themselves attractive targets for Australian investors, ready to participate in the next phase of Australia's development.

For instance, the Chinese telecommunication giant Huawei recently set up an Australian advisory board that includes retired politicians John Brumby and Alexander Downer, respectively the former Victorian premier and foreign minister, as it seeks to become more acceptable in a highly strategic area of activity. Huawei is seeking a major involvement in the rollout of the federal government's NBN broadband.

But the company's true ownership details and structure remain elusive – while Australian telcos have no parallel opportunities in China.

Australia now has the fourth largest amounts of funds under management in the world, available to invest. It has considerable pools of modern technology, management skills and expertise available. How welcome is that in China?

It has long been hoped that free trade agreement negotiations between the countries would open the doors wider to mutual investment, especially in the very areas to which Rudd and Emerson are now drawing attention, and seeking to attract Australian business. But the opportunities within "China 2.0," while promising, remain limited compared with the doors to manufacturing involvement that Deng flung wide.

The 16th round of FTA talks took place in Canberra recently without discernible progress even after six years. Australia's department of foreign affairs and trade, when asked about the negotiations, replied desultorily: "FTA negotiations with China are constructive and ongoing."

Rudd spoke frankly about these matters at the Boao Forum offshoot in Perth in mid-July. Referring clearly to diplomat Ouyang Cheng's speech, he said: "I notice with our Chinese friends in recent days that a debate has emerged concerning the economic policy direction of Australia into the future. Of course, Chinese officials are always welcome to engage in these debates. We welcome such debates."

"I would add one thing. And that is, in the trade policy review body of the World Trade Organisation, when it concluded its 2011 review of the Australian economy, it said 'Australia is one of the most open economies in the world'...

"Also in the spirit of a good and open debate, I would note that we also need to engage in a debate about China's process of economic liberalisation as well. As our Chinese friends know, there are many sectors in which foreign investment is prohibited entirely, and there are some sectors where Australian companies face investment restrictions, equity caps, limits in the number of branches in representative offices, and restrictions in the types of business they are able to undertake."

"We welcome the debate on all these things. And that's of course why we are currently in the process of negotiating an FTA with our Chinese friends."

It is surely good news that this debate about investment is at last getting under way on a more even and useful basis thanks in part to Rudd's own intervention.

It is a sign that the relationship is moving ahead, for it is through truly mutual investment, above all, that Australia and China will learn more about each other and become more closely enmeshed. □

*\*Rowan Callick is The Australia's Asia-Pacific editor.*