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China digs in

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AUSTRALIANS have long accepted that many of our big, familiar companies are owned, or at least controlled, by firms based in London or in New York. Now we need to get used to the idea that a growing number will be run from Beijing.

We already anticipate that almost anything we buy will be made in China, although 60 per cent of those exports are produced in that country by foreign companies.

China's new great leap is happening right now. Here, in Australia.

Sure, there's a global downturn. There's a worrying downturn in China, too, though it is an industrial rather than a financial crisis. China is expected to start emerging from it later this year. It is unlikely to return to its 13 per cent hyper-growth of 2007, but it will rebound. And if higher quality Australian resources are available more cheaply and in a secure flow, it will use these to replace some of its own depleted, costly domestic inputs.

Shanghai-based China investment consultant Paul Glasson says: "Australia has the resources China wants, the quality is good, the prices are low right now. The countries are close, relations are good."

Some of Australia's most strategic assets are thus coming into play, as is its relationship with the region's emerging giant.

China's desperate investment targets, such as Rio Tinto, are understandably lobbying that such deals are rapidly ticked through by Canberra. But at the same time a position is emerging that this is too important to leave to shareholders and financial institutions. For Australia is dealing here, essentially, not with diverse private firms with conflicting interests but with a cohesive state.

Australia can do great things with China. But to build a full partnership, Australia needs equivalent access in China.

And Canberra, if it chooses, can play a central role in obtaining the guarantees that will keep Australia in the centre of the frame, not sidelined as a price taker.

In the 20th century, a Rio Tinto or an OZ Minerals strapped for cash and driven into a corner would have sought a white knight in North America or Europe. But now the City of London and Wall Street have become financial rust belts and our salvation is instead coming from China. After years of knocking on Western corporate doors, China is at last gaining some traction.

It will not stop at Rio or OZ. It will keep buying, believing it has identified, as the leading consumer of resources, the bottom of the market. China has shifted its strategy in the past few months to bring its big corporate guns to bear in Australia, although its second-tier firms remain no less eager.

Melbourne lawyer Robin Chambers, former general counsel at CRA, says: "What's happening now is quiet amazing. And we're just seeing the tip of the iceberg."

Six months ago, it was the Chinese who had to bargain hard. But now the price of the assets China covets has slumped by 50 per cent to 80per cent, while the Australian dollar has also fallen against the US dollar - and thus the yuan - by 30 per cent to 40 per cent. China holds the cards.

It's not just mines that China is after. It is also seeking - and is being courted to bid for - a big role in the infrastructure provision that is needed, especially in Western Australia, to bring new resources projects to fruition.

Iron ore, though, is the lifeblood of the Chinese economy. It is at the core of residential and commercial buildings, infrastructure, machinery and vehicles. It has been traded through an annual system of benchmark price negotiations that have guided the creation of long-term supply contracts.

This system long favoured the buyers, but earlier this decade, as China boomed - alongside much of the world - the balance tilted. Contracted prices soared but the spot price for ore traded shipment by shipment climbed even higher.

Now, however, the market exuberance has evaporated and the spot price has slumped, leaving the benchmark price for contracted ore stranded in unrealistic territory. As a result, the benchmark is widely being abandoned or, as the more polite term has it, deferred. The steel mills are often simply refusing to send ships until they are assured a lower price. This may trigger a shift to a form of market trading common for other resources, as BHP Billiton has for years sought, which in turn will provide producers with much more discretion in setting the price - raising the inevitable questions about the risks involved in having proxy buyers play a big role in the selling team, as well as about whether this may affect the funding of new projects.

Under the new Chinalco-Rio deal, Chinalco will gain marketing rights to 30 per cent of Hamersley Iron's output. Securing such supply is at the heart of the mission the Chinese Government has assigned Chinalco as it develops into China's global mining house.

The rapidly growing relationship between Australia and China is often characterised as complementary. We supply each other with stuff the other country covets. But as this economic enmeshment intensifies, the stakes grow bigger and the strains increase.

Asialink, the Melbourne Institute of Applied Economic and Social Research at Melbourne University and PricewaterhouseCoopers have developed an Asia engagement index, launched last Friday by Trade Minister Simon Crean, which starts to quantify such relationships. The index assembles and calibrates data about trade, investment, research and business development, education, tourism, migration and humanitarian assistance. Since 1990 Australia's engagement with Asia has multiplied four times, that with the rest of the world three times and that with China an astonishing 16 times. Thus the award in 2002 of China's first contract for gas for a terminal in Shenzhen to the consortium that controls Australia's North West Shelf did not come out of the blue. But although the price for the long-term deal seemed impressive at $25 billion, Australia agreed on a price below the market rate, expecting more contracts to follow. There have been none.

China has failed to build brands of its own, in part because its growth has been driven so far by investment and by exports made to order, while local consumers, anxious about the lack of a welfare safety net, save instead of spending. The alternative is to invest overseas, buying brands or well-known corporations, using some of the money that has been stored away by the Government from export proceeds. China needs resources to fuel the industrial drive on which its ruling Communist Party relies for its legitimacy. Deng Xiaoping drafted the unwritten contract whereby the party keeps living standards rising while the people let it rule unchallenged.

In Papua New Guinea, China is building a $1billion nickel mine, and in Aurukun in Cape York Chinalco will develop a $3 billion bauxite project. China is using its growing soft power to secure commodities in Africa and elsewhere But in Australia it is generally taking the corporate acquisitions route.

British and American firms earlier roamed the world as national champions. When Japan soared, its companies bought US movie houses and real estate galore. China is also everywhere, but it is starting over at a higher level in Australia.

Our interest rate cuts have helped push down the Australian dollar and made our penurious companies more attractive to China's state-owned giants, for which the source of the funding is not really an issue.

Chinalco's vice-president Lu Youqing said last Friday he did not yet know in detail how the $30 billion deal - China's biggest foreign investment so far - is to be funded. The Government in Beijing will pay.

The deal's raison d'etre was explained in Global Times, owned by party mouthpiece People's Daily, in an article by Liu Jipeng, a professor, and Liu Yan, a researcher at the National Development and Reform Commission: "Chinalco's purchase has successfully prevented the merger of Rio and BHP, broken the monopoly of multinational giants and protected our nation's core interests. It has also explored a new path for the globalisation of state-owned enterprises, illustrating the capacities of government business."

It is crucial at the same time for Australia to understand precisely the nature of this new path. It is made harder because, except for ANZ, almost no leading company has direct Chinese or Asian experience on its board or among top management. Fortunately, we do have a Prime Minister with such experience and understanding. And that is important because China views this enmeshment as a matter of core interests.

Chinalco's executive president Xiao Yaqing, an alternate member of the Communist Party's central committee, is being promoted beyond the firm to the State Council or cabinet. People with extensive party credentials constitute a majority on Chinalco's board.

There is rivalry between Chinese companies and agencies, but when big issues emerge there can be only one outcome: that determined by the most senior party officials. When it comes to the crunch, there is only one owner, one employer, and all information is fungible.

It is the flow of information that marks out joint ventures from other forms of more passive ownership. Chinalco is gaining two board members thanks to its new joint venture role with Rio. Such arrangements are not the ideal form of corporate governance. They often end in rows. Despite the success of some such deals in Australia, including Channar and Portland, they are usually just provisional arrangements.

Most foreign companies now choose to enter China, if they are allowed, as wholly foreign owned ventures. Last year, after Sinosteel's hostile - and vastly overpriced - takeover of Midwest was ticked through and Chinalco omitted to seek Treasury's approval for its original foray into Rio, the Foreign Investment Review Board appeared to steer new deals towards a cap of 49.9 per cent Chinese ownership.

That now appears to be out of the window and some rapid rethinking is required, not least because the new Chinalco deal must be approved or rejected in four months.

Such arrangements are commonly viewed in China as deals between the two nations, raising the question of whether Australia needs a national debate about where this vital relationship is heading and where the national interest lies.

The federal Government is already reviewing its China strategy. Glasson is urging it to engage closely with the Australia China Business Council and with the corporate sector generally. Such a national approach would likely include Australia's seeking reciprocal access to invest in China, whether via the languishing free trade agreement talks or some other channel, not least for our vast funds under management.

Last month American China investment bull Jim Rogers said China was going to be "the new centre of the world, not just the financial but the political world". For China, the two worlds are inseparable. That doesn't mean Australia must align itself with China's politics - it needn't and can't - but it is starting to untangle what this means as the investment streams swell into rapid rivers.

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