Submission from Patrick J Byrne National Civic Council

to the

"Inquiry into foreign investment by state-owned entities"

by the Senate Economics Committee,

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EXECUTIVE SUMMARY

Regarding the proposed Chinalco investment in Rio Tinto: the 600-page agreement proposed is designed to strategically place Chinalco, a Chinese government owned company, to take control of the company in the medium term. Therefore:

1. the Australian government should invest $20-30 bn from the Future Fund in Rio Tinto. The Federal government should take shares in the company. When the markets have improved in the future, the government can sell its shares in Rio back to commercial investors. It would be preferable to have the Australian government own a major stake in Rio Tinto rather than a foreign government-controlled company.

Further, the foreign investment rules should be tightened regarding investment in Australian companies by foreign government-owned sovereign wealth funds, and by foreign government-owned businesses. New rules should include:

2. Declaring a wider range of strategic industries in which foreign investment is limited or prohibited.
3. In the most important strategic industries, acquisitions should be prohibited.
4. In other important industries, foreign ownership by commercial companies should be restricted to 49 per cent;
5. In important industries where sovereign wealth funds and foreign government-owned corporations are seeking a stake, investment should be limited to say 14 per cent in non-voting shares.
6. Investment in the resource sector should be as joint ventures in new projects, not hostile takeovers of existing companies.
7. Careful examination should be made of operating agreements in any agreement to asses what degree of control of the company would be gained by the foreign investor over the longer term.
8. Anti-avoidance legislation is needed to ensure the intentions of the rules are not undermined by such devices as the transfer of ownership to offshore holdings.
9. The Treasurer needs to be given the power of divestiture to break up foreign ownership of a company when it is deemed that such foreign ownership is not in the national interest.
10. The Treasurer should have the power to prohibit/limit foreign investment in the case of creeping acquisitions leading to overly concentrated ownership by one company.
11. For serious breaches of the foreign ownership rules, forfeiture of ownership should be an option open to the Treasurer.

Foreign investment in the context of the global power shift and the world economic crisis: defending Australia's independence

> ***The world is witnessing a new form of strategic dominance. Countries that excessively depend on foreign borrowing risk losing their sovereignty, being "colonised by purchase rather than conquest".***
>
> — **Warren E. Buffett**, *Fortune*, 26 October 2003.

For 200 years Australia has depended on first the British and then the US strategic umbrellas for military protection. Over this period Australia welcomed foreign investment, first from Britain and later from the US and nations of the Western Alliance. This investment was vital to the development of Australia's resources, infrastructure and industries.

Today the economic and strategic climates are changing dramatically. Continued reliance on foreign investment and foreign borrowing put this nation at risk of losing its sovereignty, not by military takeover, but to economic colonisation by China which is ruled by a one-party dictatorship and has global strategic ambitions.

This emerging threat derives from the greatest shift in geo-political power since the beginning of the industrial revolution. The world's centre of economic power is shifting from the US and Europe to China, India and Russia.

China — with a rapidly expanding, resource-hungry economy, boasting massive domestic savings and huge government-controlled sovereign wealth funds — may find itself in a position to buy out Australia's biggest strategic industries. Such an economic buy-out would pose a serious threat to Australia's sovereignty.

This threat is made more immediate because the international financial markets are currently under threat of collapse from the worst financial meltdown since the Great Depression.

Geo-political shift of power

The distinguished *Foreign Affairs* journal is published by the US Council on Foreign Relations. Its editor, James F. Hoge, Jr, has noted: "Global power shifts happen rarely and are even less often peaceful." Only a century ago, the failure of the imperial order to adjust to the aspiring ambitions of Germany and Japan resulted in conflicts that devastated the globe.[1]

Today's major players in this power shift — China, India and Russia — make up about half the world's population and are growing in economic power at the expense of Australia's traditional allies, the UK and the US. These emerging economies are now the main drivers of world economic growth. According to Albert Keidel, of the Carnegie Endowment for International Peace, in 20 years, the economy of China will be larger than the US economy; in 50 years, India's economy could well be larger than China's.[2] As the world financial crisis has unfolded, the centre of the world's financial markets has gravitated towards China

Accompanying the shift in economic gravity will be a major shift in political and military power and influence. The 20th century belonged to the Americans. In the 21st century, China and

India will be contending world powers with economies eventually much bigger than those of the US and EU. These new powers will seek access to the world's resources and their place at the table on key world decision-making bodies. They will inevitably wield their new-found international military and political power in their own national interests. Competition between them and the West will be inevitable.

For example, the scramble for access to energy resources gives an indication of the potential for economic and possibly military conflict. Amy Myers Jaffe, an energy expert at Rice University, told a US Congressional hearing this year that in 1973 the United States imported 35 per cent of its oil. Today it imports over 60 per cent.[3] The Gulf states account for 23 per cent of US imports.[4] Currently, it is unclear whether in the future the US will maintain its dependence on Middle East oil, or increasingly rely on new fields opening up in South America and elsewhere.

A 2005 European Union Green Paper on energy stated that:[5]

- By 2030, the EU will be 90 per cent dependent on imported oil, compared to 45 per cent in 2000.
- Gas imports will have jumped from 40 per cent to 80 per cent over the same period.

Regarding China, Mikkal E. Herberg, of the National Bureau of Asian Research, in his submission to a US Committee on Foreign Relations hearing in 2005,[6] said that China will be:

- 80 per cent dependent on Persian Gulf oil by 2030;
- a net importer of coal by 2015; and
- importing 40 per cent of its natural gas by 2025.

India imports 70 per cent of its oil requirements today, and that is likely to increase to 91 per cent by 2020, with 45 per cent coming from the Middle East.[7] Australia will have shifted from importing only 20 per cent net of its oil in 2000, to importing 80 per cent by 2015.[8]

Competition or conflict?

Whereas the 20th century saw the US and Europe foster the spread of democracy as a moral obligation of the West, China's 21st century political example to the world is totalitarian rule. It has no ethical framework from which to begin shifting towards democracy. The communist system is built on 2,200 years of centralised, authoritarian rule over China.

Further, Beijing's leaders still regard China as "the middle kingdom" between heaven and earth. They intend to build China's economic and military strength so that it can retake its rightful place as the leading/dominant nation on earth.

Rapid economic growth is vital for the Communist Party to retain its legitimacy. Hence, rather than helping China move towards democracy, raw, unbridled, capitalist economic growth has helped entrench the communist political system and the drive to restore China to its middle kingdom status. In the process, rather than moving towards democracy, China has supported many of the world's most odious political regimes, like Burma, Sudan and North Korea.

In the second half of the 20th century, America and the West pursued international free trade principles as the means of allocating resources between countries. Resources and goods were traded to the highest bidder. This economic approach to distributing resources ensured that the world's resources were allocated peacefully. The international market trading system replaced the age of empires, when competition for resources was settled through carving up the under-developed world into European-controlled empires that were engaged in endless military conflict over access to resources, markets and trade routes.

For example, when the first world oil shock occurred in 1973, Western nations found that scrambling for control of oil resources was a zero-sum game which only worsened the problem by reducing market flexibility and efficiency and intensifying international rivalries over supplies. This led to the creation of the International Energy Agency to avoid the risk of national competition for supplies. Since then, Western policy has focused on promoting diversified sources of oil and letting the market determine the most efficient allocation of resources worldwide. This kept oil supplies flowing and prices down for all.

In a retrograde step, Herberg says that for Beijing:[9]

> ... [E]nergy has become a matter of "high politics" of national security and no longer just the "low politics" of domestic energy policy. Energy security is too important to be left entirely to the markets as China's economic prosperity is increasingly exposed to the risks of global supply disruptions, chronic instability in energy-exporting regions, and the vagaries of global energy geopolitics. Energy has become a central concern for Beijing and the global search to secure future energy supplies has taken on great urgency....
>
> China's rapid economic growth is highly dependent on finding the growing energy supplies needed to fuel this economic "Dragon". The erosion of the ability to rely largely on domestic energy supplies has created a powerful sense of energy insecurity rooted in a deep-seated fear among the leadership that energy supply disruptions and unpredictable price spikes could undermine China's rapid economic growth and job creation. To the leadership, slow economic and job growth raise the real spectre of social instability which, in turn, calls into question the continued power and political control of the Communist Party. Hence, there is a visceral and profound connection in the minds of the leadership between reliable energy supplies, political and economic stability, and continued Party control.

This mercantilist approach to foreign investment and trade by China has sparked nations like India and other emerging Asian nations to also move towards mercantilist trade and foreign investment policies, as they compete with China for supplies of essential resources around the globe.

For example, in 2006 China won the sole right to exploit one of the biggest untapped iron ore deposits in the world, an estimated one billion tonnes of reserves with an estimated iron content of 65 per cent in Gabon, west Africa. The Chinese will invest US$3 billion in the project. This mine will help China reduce its dependence on iron ore from Australia. Australian miners negotiated an iron ore price increase of over 80 per cent with China in 2008.

Mercantilism is fundamentally at odds with free trade principles. It has the potential for escalating economic tensions into military conflicts, as competing nations strive to ensure their control of vital resource supplies.

Resource-hungry nations like China and India view Australia as a nation with a huge landmass, abundance of all major resources and comparatively small population. Indeed, the old Chinese and Japanese written characters for Australia are the same, and broadly mean "land of plenty over the sea". Prophetically, Jane's *World Armies* warned in 1996 that it was Australia's good fortune — and lack of population — that "made it a glittering strategic prize" and that "in the longer term it would be surprising if during the next century, the country's defences were not tested".

That test could come more in the form of an economic buyout than from military threats.

China's economy: capitalism on steroids

Eamonn Fingleton is the former editor of *Forbes* and the *Financial Times,* and has been monitoring east Asian economics since he met former Chinese leader Deng Xiapoing in 1986. His recent book *In the Jaws of the Dragon: America's Fate in the Coming Era of Chinese Hegemony* (2008) warns that the West has not come to grips with the threat that China's new form of capitalism poses to Western economies like that of the US.

Two commentators reviewing the book say that "the ultimate source of the problem" described by Fingleton is "the rise of a fundamentally incompatible, aggressively mercantilist new economic model in East Asia". They continue:[10]

> Drawing on more than two decades of on-the-spot research, Fingleton traces the origin of this disturbing new model to radical economic experiments conducted by imperial Japan in Manchuria in the 1930s. Perfected in Japan proper in the 1940s, the Manchurian ideas were embraced by South Korea and Taiwan in the 1960s and, more portentously, by Communist China in the 1970s.
>
> The key to this model is a policy of ruthlessly suppressing consumption and thereby artificially boosting a nation's savings rate. Just the most obvious manifestation of this policy is that high barriers are imposed against imports of foreign luxury goods. The resulting torrential savings flows are channelled via government-controlled banks into a super-fast pace of investment in key industries, particularly export industries.... [T]he ability of nations to boost their savings at will through suppressed consumption constitutes the most momentous development in economics since Adam Smith and David Ricardo laid down the fundamental principles of market economics early in the Industrial Revolution. Ominously for the future of the existing world order, the East Asian model works best in such harshly authoritarian nations as China where top officials enjoy huge unaccountable powers to bend the economy to their will.
>
> In Fingleton's words, suppressed consumption is to economics roughly what steroids are to sport and thus is fundamentally incompatible with Western ideas of fair global competition. It is reinforced by an Orwellian system of political control that utilises an ancient East Asian bureaucratic tool called selective enforcement — a form of blackmail that instils a silent reign of terror throughout Chinese society. The idea is that laws are written strictly but are generally enforced laxly. The authorities tighten up enforcement selectively against those who for whatever reason are deemed to be getting in the way of the larger government agenda.
>
> Chinese society moreover is structured so that corporations cannot succeed without breaking many laws, not least (in a country where bribery is a pandemic cost of doing business) anti-corruption laws. To get on, corporations must do business "the Chinese way", which is to say they must explicitly compromise themselves. They thereby risk potentially large, selectively enforced penalties (stiff jail sentences are standard in bribery cases, for instance). For American policy-makers the big worry is that selective enforcement can readily, if virtually invisibly, be used to discipline any American corporation with interests in China — which is to say just about every member of the Fortune 500. Hence a pattern in which the Chinese tail is increasingly seen to wag the American corporate dog.
>
> The conclusion is that while the Chinese people's rising affluence is, of course, an occasion for wholehearted rejoicing, Uncle Sam is wrong to assume that prosperity will bring political liberalisation in Beijing. Still less should he assume that China is converging to American values. Quite the opposite: if there is to be convergence, it will be the United States that will do the converging.... [T]he two systems are not so

> much chalk and cheese as matter and antimatter. Absent robust firewalls to keep Chinese influence out of corporate America, US sovereignty will come under increasingly serious threat in the years ahead.

Risks to Australia

Australians have not awoken either to the aggressive nature of mercantilist Chinese capitalism and the global power shift that this is creating, or to the strategic challenges it poses to this nation's security.

Both the rapid growth of our foreign debt (now over $600 billion) and the heavy dependence on foreign investment in mining and other industries threaten to make Australia vulnerable to a major economic downturn. In current circumstances, they put Australia's economic sovereignty at risk.

If the foreign financial markets lose confidence in the Australian dollar, this could trigger a run on the Australian dollar and a flight of capital. As Joseph Stiglitz, one of the world's best-known economists, has warned, in such crises countries like Australia will repay their debts. This is because they have[11]

> the capacity to repay: they could presumably raise taxes and cut expenditures enough to generate the required revenue. The value of the country's assets exceeds by a wide margin the value of what is owed. But the cost to the country can be enormous, beyond what its citizens are willing to pay.

Part of that repayment process could involve allowing sales of more Australian assets to foreign buyers — including China.

Or Australia could face a worse scenario. Prophetically, Warren E. Buffett, the famous American investor and economic commentator, has warned in *Fortune* magazine that the world faces a new form of strategic dominance. He cautioned that any country that excessively depends on foreign borrowing would become a nation of wage-earners rather than property-owners. Such a nation risks losing its sovereignty, being "colonised by purchase rather than conquest".[12]

At the same time as our foreign debt has been mounting, Australia has also been heavily relying on foreign investment to develop the resource industries that are supplying the new global powers like China and India.

Under Beijing's "Go Abroad" policy — aimed at securing access to important raw materials, advanced technology and brand names — Australia has suddenly become a major target for Chinese investment. Chinese government-controlled investments in Australia have jumped from a trickle three years ago, to $6.8 billion in 2007, and was estimated to potentially reach $30 billion in 2008. The proposed 2009 investment in Rio Tinto is A$30 billion alone.

While no single investment in Australia poses any threat to our sovereignty, a flood of major investments over time could see the Chinese regime become a major player in Australia, with profound political and strategic ramifications. As Robert Gottliebsen has noted, "in a decade or two [China] may emerge as our 'protector' because they need to safeguard their raw material supply lines and because the US appears to be in decline." (See analysis of Chinalco's bid for Rio Tinto below)

China has amassed an estimated US$1.3 trillion in foreign reserves, while ordinary Chinese

have another US$2 trillion sitting in savings accounts earning negative interest. These funds are now being directed through the new State Investment Company, which is modelled on Singapore's Tamasek Holdings, to investment abroad.

World-wide, government-controlled sovereign wealth funds — state-controlled funds of big exporting nations, particularly oil exporters — are expected to grow from US$3.85 trillion to as much as US$15 trillion by 2015, according to the International Monetary Fund.[13]

Herein lies the emerging risk to Australia. The more the Beijing regime has invested in Australia at the moment of a major economic crisis, the greater the likelihood that China would literally buy out Australia using its massive savings pool, foreign reserves and sovereign wealth funds. It has the potential to bail out Australia's foreign debt, but the price could be China taking effective control of key national assets — minerals, energy, possibly banks and the retail sectors.

If this were to happen, Australia would have lost its sovereignty. Decisions affecting Australia's future would not be made in Canberra in Australia's national interest, but in Beijing in the interests of China. History has shown that foreign debt crises can develop rapidly, with little warning, as the current financial crisis gripping the US demonstrates. Similarly, a crisis that could threaten Australia's sovereignty could also develop rapidly.

Strategically, Beijing would find drawing Australia into its orbit, and away from the US, utterly irresistible. One of Beijing's deepest fears is the US policy of soft encirclement and containment of China, using economic, diplomatic and military means. Currently, the Beijing regime is expanding its political influence all the way to the Persian Gulf, and is seeking port facilities along that route. It is also developing an increasingly sophisticated military, particularly its naval power.

Australia's foreign investment dilemma

Australia's foreign SWF guidelines were reassessed at the end of 2007 and, according to a federal parliamentary briefing paper on the issue, SWF applications for investment would be reviewed around *"the question of how far the commercial agency of any foreign government operates independently and commercially and suggest if a proposal from a SWF is consistent with Australia's national interest."*[14] (The emphasis is theirs.)

Clearly, the new rules are inadequate to deal with the magnitude of the problem now facing Australia.

Other nations are becoming vigilant about investment by foreign government-controlled funds. For example, new foreign investment rules are being introduced in Europe, with Germany leading the way.

Germany has proposed that moves from non-European Union controlled investment groups or companies to buy a stake of 25 per cent or more in strategic parts of German industry can in future be blocked. This followed concerns over the Chinese attempt in 2007 to acquire[15]

> a 10-percent stake in the US private equity house Blackstone, which has a key holding in German-based Deutsche Telekom AG, Europe's biggest phone company. [It also] followed moves by Russian state bank VTB to carve an interest in Europe's sensitive aeronautic and defence sector by seeking out a stake in the European Aeronautic Defence and Space group (EADS), which is the parent company of the European aircraft maker Airbus.

How China and Russia restrict foreign investment

Ironically, some SWF nations — such as Russia and China — while complaining about new investment rules abroad, have imposed tight controls on foreign investment in their own strategic industries.

China's foreign investment policy has evolved. Under the recently revamped rules, China now restricts or prohibits investment in industries it has already mastered (like toys, furniture, shoes and clothing) or in industries with high usage of resources or energy (like steel, aluminium, paper, cement and other basic industries).

It has shifted its emphasis to quality rather than quantity of investment, with more emphasis on advanced technology and management. It maintains substantial restrictions on publishing, media, market and social research, and an absolute prohibition on investment in real estate and real estate brokerage firms.

Energy security expert Dr Vlado Vivoda has recently commented, "While foreign firms are lining up to invest in China, Beijing seems increasingly reluctant to let them in as several acquisitions of large Chinese firms by foreign companies have been stalled after a storm of public protest over the impact such sales could have on Chinese economic security.

"What the leadership refers to as 'socialism with Chinese characteristics' is a sustainable and competitive form of state capitalism." (Vlado Vivoda, "China challenges global capitalism", *Australian Journal of International Affairs*, Vol. 63, Issue 1, March 2009, p. 32.)

Russia, with its new-found oil wealth, recently declared 42 "strategic" sectors — including the nuclear industry, aerospace, armaments industries, oil, gas, fishing and the mass media — in which foreign companies cannot own more than 50 per cent and foreign companies owned by governments cannot own more than a 25 per cent stake. Investors now have to seek authorisation from a commission made up of economic and security advisors.

Australia should heed the advice of one senior Chinese official who, in commenting on his own country's restrictive foreign investment policy, said, "China intends to use foreign investment rather than be used by foreign investors."[16]

Triggers to a financial crisis that could threaten Australia's sovereignty

There are possible triggers for a financial crisis in Australia.

First, the current international financial meltdown could precipitate a deep, prolonged recession in the world's largest economy. If this contagion spreads, it could see Australia's source of foreign capital dry up. The risk is that the crisis will lead to a major credit squeeze. Already the markets are twitching.

While China drives its economy using forced savings, the Australian economy is heavily dependent on foreign borrowings. Several leading Australian bank officials have called on the Federal Government's tax inquiry to offer tax concessions for savings as the lack of Australian savings is a major reason for the banks borrowing offshore and running up the foreign debt. The National Australia Bank's chief financial officer, Mark Joiner, said, "We have a deposit-poor banking system because just about every other form of investment in Australia has a tax incentive.... We have got ourselves in a position with the Australian banks overly reliant on international wholesale funds because we don't have sufficient volumes moving around our domestic banking system." He said that when foreign debt investors compared banks across the world, Australian banks "stand out" because of this reliance on offshore funds. "That leads them down a path of saying, 'Is there something structurally wrong with the Australian economy? Should we have this much exposure?'"[17]

Should Australia find that capital inflows have diminished or dried up, the situation could quickly turn into a capital outflow. Then Australia could face a foreign debt repayment crisis.

Second, the rapid growth of China and other emerging economies has created a resources boom that has greatly benefited Australia. Now as the financial crisis slows demand for resources at the same time as new supplies are coming on line, prices of commodities have fallen and the value of the Australian dollar has come down dramatically. Prime Minister Kevin Rudd has warned that Australia faces “waking up with the mother of all hangovers” because of its failure to address “a multitude of economic weaknesses” hidden by the mining boom.[18]

Third, Australia is facing a huge rise in oil imports, as the nation comes to be 80 per cent dependent on imported oil by 2015 (see above).

Australians generally are also largely unaware of these issues. In part, this blindness comes from being lulled into a false security from the nation’s long trust in the US alliance and benign foreign investment. It also stems from the blind faith policy makers have placed in radical free trade theory over the past quarter-century.

Facing the challenges

Facing up to the problem requires an important intellectual debate.

The risk of growing foreign debt to Australia’s national interest, under current circumstances, has to be confronted. Three years ago, Chris Richardson, director of Access Economics, warned about the foreign debt risk. “OK, it’s panic-button time ... It will take longer than markets realise to rein in a current account deficit in the ‘banana republic’ range.”[19] Even Prime Minister Rudd has asked, numerous times, what will happen to the economy after the end of the mining boom?

In particular, Australia has to wake up to the potential threat of the People’s Republic of China (PRC). Beijing has its own strategic ambitions, using ownership and control of vital resource supplies around the globe to enhance its strategic power vis-à-vis the US and it allies. The degree of threat is proportional to Australia’s structural economic weaknesses and imbalances, and to the extent Beijing is allowed to gain ownership and control in Australian industries. Australia can mitigate this risk through policies that allow more of its investment to be financed from its own savings and by putting appropriate conditions on foreign investment.

Importantly, in dealing with China, Australian policy-makers need to draw a distinction between the Chinese people, who aspire to a way of life similar to Westerners, and the Chinese Communist Party dictatorship, which has an appalling history of oppressing its people and a record of associating with the most authoritarian regimes on the planet.

At the same time, to Beijing’ credit, it has adopted some crude market principles for its economy, so that by 2025 at the current rate of economic growth it will have dramatically reduced the nation’s poverty rate. It will have lifted more people out of poverty at a faster rate than any other nation in history.

Australia should not regard China as an enemy but as an emerging nation that has a very long way to advance before achieving democracy; before it starts encouraging democracies in other regions like Africa; before it understands and abides by broad market economy principles; and before it comes to respect universal human rights.

To this end, policies are required that strengthen the Australian economy so that it can survive

the global economic and strategic power shifts underway, and that engage and trade with China on Australia's own terms — from a position of economic strength and stability — not on Beijing's terms.

To achieve these ends, Australia must develop and pursue a strategy with integrated economic, foreign affairs, defence and social policies.

In particular, Australia's the foreign investment rules should be tightened regarding investment in Australian companies by foreign government-owned sovereign wealth funds, and by foreign government-owned businesses. New rules should include

- Declaring a wider range of strategic industries in which foreign investment is limited or prohibited.
- In the most important strategic industries, acquisitions should be prohibited.
- In other important industries, foreign ownership by commercial companies should be restricted to 49 per cent
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- Careful examination should be made of operating agreements in any agreement to asses what degree of control of the company would be gained by the foreign investor over the longer term
- Anti-avoidance legislation is needed to ensure the intentions of the rules are not undermined by such devices as the transfer of ownership to offshore holdings
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- The Treasurer should have the power to prohibit/limit foreign investment in the case of creeping acquisitions leading to overly concentrated ownership by one company.
- For serious breaches of the foreign ownership rules, forfeiture of ownership should be an option open to the Treasurer.

The world has never seen anything like Chinalco's bid for Rio Tinto

The Rio Tinto-Chinalco deal is the most important, and potentially dangerous, commercial venture the Australian Government has ever had to decide on.

Recently, veteran financial commentator Robert Gottliebsen has written three incisive articles on the issue in Australia's online business news outlet *Business Spectator*.[20] Although this submission disagrees with his strategic conclusions, Gottliebsen nevertheless provides and incisive analysis. He says:

> "As a nation [Australia] seems likely to play a role to assist China and the US reconcile their differences. At the same time, China has superior air, sea and land defence capability to Australia and in a decade or two may emerge as our 'protector' because they need to safeguard their raw material supply lines and because the US appears to be in decline.

> "Australians will not find it easy to see China taking the role that Britain and the US took, but within two decades it is a distinct possibility. Accordingly, a deal between Rio Tinto and Chinalco could be in Australia's long term interests ...".

To propose that China become this nation's new protector, and that Australia should resign itself to being financially dependent on Beijing, would be to surrender Australia's independence to the world's last major Communist dictatorship, which has scant regard for universal human rights, democracy, private property or personal freedom.

Investment from China comes with far more political strings than came with Japanese investment in Australian energy and minerals industries in the 1970s and '80s. Japan has been for decades a democracy and respects human rights. While its economy is a mixture of state capitalism and free enterprise, it respects the right to private property.

In his articles, Gottliebsen says that Chinalco is less interested in what percentage of shares it holds in Rio, as in the myriad of operating agreements that would deliver a high level of control to this Chinese government-owned company.

He says that "control" is the main game, focused on an incredible web of agreements covering every aspect of the key operations of Rio Tinto — production, marketing, strategy, executive performance, provision of interest-bearing capital and board representation.

> "That web is designed to be eventually owned by the relevant arm of the Chinese government that buys each product," he says.
>
> [For example] Chinalco will hold 50 per cent (repeat *50 per cent*) of the shares in ISA Sales Co. which will market 30 per cent of the Hamersley iron-ore output or more than 30 million tonnes ...
>
> "Chinalco (but more likely China's steel-makers) will nominate three of the six directors who can act as representatives of Chinalco and vote on matters where Chinalco has an interest.
>
> "Rio Tinto can appoint the chairman who has the casting vote ...
>
> "While Rio has the casting vote, anyone who has been involved in joint ventures that work understands that casting votes are rarely used and in this case the web of interlocking deals means that it may never be used."

This means that "the Chinese government will have power over Australian iron-ore pricing way beyond its 15 per cent Hamersley stake."

Furthermore, as Chinalco is an aluminium company, it's likely that it will eventually hand over its Rio iron-ore interests to the steel-making companies owned by the Chinese government.

Gottliebsen says that buried deep in the agreements is a provision, which actually explains the Chinese intent in the whole exercise. Chinalco (again, read Chinese steel-makers) will have consultation rights in relation to the performance of the Rio Tinto executives and key senior personnel of the iron-ore group. Rio will have to pay due regard to those views in completing management performance reviews.

In 10 years' time when the current Rio management has moved on, there will be a series of Rio Tinto executives competing for promotion.

Gottliebsen says:

> "They are a team, but like all executive teams they work out where the power lies and go with it. The Chinese are united and will review carefully the performance of those negotiating the iron-ore prices. They may also review executives' recommendations on expansion and many other areas.

> "In isolation this clause does not mean much. Combine it with the Chinese position on the board and the incredible rights it has in marketing and strategy and suddenly you see how it all works."

Gottliebsen says that there is a similar network of agreements for the aluminium, bauxite and copper areas of Rio. In essence, these agreements also are designed to deliver control over these areas of the company and over pricing, investment and supply.

Many other areas of the agreement are designed to give Chinalco control of Rio. For example, it will provide for Chinese financial institutions to develop relationships with the company so that Rio can access Chinese capital to refinance existing debt and secure future financing.

Hence, Chinalco will gain control not by any one move, but, as its 600-page proposal copiously spells out, by numerous operating conditions.

Gottliebsen warns:

> "My opinion on this is that Rio will have unlimited finance to buy prized assets and expand production ahead of demand. No other mining company will have that ability.
>
> "So what we are looking at is a transfer of global mineral power to customers of unprecedented proportions.... The world has never seen an agreement like this before."

It will also affect BHP. In the future, Chinalco's plan will likely see an expansion of production well ahead of demand so as to keep a lid on prices, setting the price for BHP minerals as well.

In conclusion, given the 600-page agreement proposed is designed to strategically place Chinalco, a Chinese government owned company, to take control of the company in the medium term. Therefore:

- the Australian government should invest $20-30 bn from the Future Fund in Rio Tinto. The Federal government should take shares in the company. When the markets have improved in the future, the government can sell its shares in Rio back to commercial investors. It would be preferable to have the Australian government own a major stake in Rio Tinto rather than a foreign government-controlled company.

Conclusion

Australia is yet to come to grips with the risks and dangers associated with the global power shift underway in the 21st century.

To this end, a first step should be a tightening of the foreign investment rules as outlined in this submission.

ENDNOTES:

1 James F. Hoge, Jr, "A global power shift in the making", *Foreign Affairs* (Washington, DC), Vol. 38, No. 4, July/August 2004.

2 *Australian Financial Review,* 10 July 2008.

3 "End to Middle East oil imports unlikely", *International Herald Tribune,* 29 August 2008.

4 "Brazil oil finds may end reliance on Middle East," *Bloomberg.com,* 23 April 2008.

5 "Geopolitics of EU energy supplies", *EurActive.com*, 18 July 2005.

6 Mikkal E. Herberg, of the National Bureau of Asian Research, "The emergence of China throughout Asia: security and economic consequences for the US". Submission to a US Committee on Foreign Relations hearing, 7 June 2005.

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