Senate Standing Committee on Economics'

Inquiry into foreign investment in Australia by state-owned companies

The Australian Workers' Union

April 2009

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Executive Summary

The AWU supports foreign investment which, in a capital dependent country such as Australia, is important to generating wealth and jobs. A distinction however must be drawn between private foreign investment and the activities of sovereign wealth funds (SWF) and state owned companies which are by definition an extension of governments.

The AWU has a number of issues relating to the investment of SWF in the strategic assets of the nation which are covered by this inquiry. This concern has as much to do with the political, in addition to economic ,imperatives driving the decisions to invest in foreign assets.

In the context of both the global financial crisis (GFC) and future energy demands associated with both growth and climate change the AWU is keenly aware of the current interest in Australia's resource assets and prospectively in competitive manufacturing sectors such as steel. It is critical that the national interest test which guides FIRB decision making incorporates a broad view of the national interest in assessments of the benefits to the nation of investments of these kinds.

As seen during the commodities boom, control of strategic resources such as coal, iron ore and bauxite are critical in maintaining access to the key building blocks of production. These resources are key assets and advantages Australia must protect rather than dilute through investment by SWFs.

Wealth generation requires access to resources and to capital and labour. For too long, Australia has tendered to undervalue the true economic value of its resource endowment which has assisted the industrialization of trading partners (often with large populations and access to working capital) in addition to providing the effective basis for our own manufacturing base. Australia's economic development has been dependent on the other hand on the quality of our labour force (which has been in our control) and the access to capital (which has been dependent upon the willingness of foreign investors and lenders).

The global financial crisis (GFC) has put into sharp relief the vital role played by access to credit to maintain economic activity and growth. And Australia is not immune from the competition for international capital as an investment destination. However, Australia is better placed than many nations in terms of its attractiveness as an investment destination. We should not panic and be forced into accepting any offer for core and strategic businesses - and particularly not in the resources sector. In fact, such offers may be opportunistic and should be treated with great care and each considered on their merits. There is a role for government in dealing with market failure and facilitating access to credit for on-going operations and expansion.

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The AWU will never support the proposition that says that any foreign investment is better than none at all. It is a false premise. Australia has much to offer the rest of the world and has the responsibility to do so on terms that are mutually advantageous to its own industry and workers.

Of course, there have been important returns to the nation in national income from the development of the resources sector and the AWU has been front and centre in achieving these results. But resources are finite and it is critical that the national interest test applied to investments in our resources sector include a strict test of the "value added" to the nation by granting access in particular to SWF.

Introduction

This submission responds to an invitation from the Senate Standing Committee on Economics' inquiry into foreign investment in Australia by state-owned companies.

On 18 March 2009, the Senate referred the following matter to the Standing Committee on Economics for inquiry:

a) the international experience of sovereign wealth funds and state-owned companies, their role in acquisitions of significant shareholdings of corporations, and the impact and outcomes of such acquisitions on business growth and competition; and

b) the Australian experience of foreign investment by sovereign wealth funds and state-owned companies in the context of Australia's foreign investment arrangements.

This submission deals with investment by sovereign wealth finds (SWF) in Australia. Regarding international experience, the Committee's attention is drawn to a useful summary overview recently provided by the Lowy Institute.[i]

Australia's experience

As Edwin Truman has pointed out, SWFs 'are governmental entities, and governments are political.'[ii] Daniel Drezner agrees: 'SWFs are, by definition, extensions of the state. They are therefore viewed as maximising their country's long-term strategic interests rather than as profit-maximising actors.'[iii] It follows that sometimes decisions on whether to oppose such proposals will also be political decisions. And what applies for SWFs will also apply to other forms of government-controlled investment.

The AWU is acutely concerned at the potential negative impacts of investment by SWFs in Australian industry, in particular in the resources sector and in strategic industries to industrial development, such as the Australian steel industry essentially because such investments may be in *their* national interest rather than Australia's.

Foreign investment in Australia is regulated under the Foreign Acquisitions and Takeovers Act 1975 (the FATA) and by the Australian Government's Foreign Investment Policy (the Policy).[iv] The Australian Government's approach is to encourage foreign investment consistent with community interests. The Policy acknowledges up front community concerns about foreign ownership of Australian assets.[v] So one important objective of the Policy is to balance community concern about foreign ownership of Australian assets against what the government recognises as the *'strong economic benefits'* that the economy receives from foreign investment.

On 17 February 2008, the Treasurer released a set of guidelines for foreign government investment proposals – against a backdrop of growing media attention on Chinese investment applications in the resources sector.

The new guidelines state that while proposed investments by foreign governments and their agencies would be assessed on the same basis as private sector proposals, the fact that these investors were owned or controlled by a foreign government raised:

'additional factors that must also be examined' given that *'investors with links to foreign governments may not operate solely in accordance with normal commercial considerations and may instead pursue broader political or strategic objectives that must also be examined.*[vi]

The Treasurer listed six issues that would be examined when considering proposed investments by foreign governments and their agencies.

The Treasurer will look at the extent to which:

> **1.** An investor's operations are independent from the relevant foreign government.
>
> **2.** An investor is subject to and adheres to the law and observes common standards of business behaviour.
>
> **3.** An investment may hinder competition or lead to undue concentration or control in the industry sectors concerned.

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4. An investment may impact on Australian government revenue or other policies.

5. An investment may impact on Australia's national security.

6. An investment may impact on the operations and directions of an Australian business, as well as its contribution to the Australian economy and broader community.

In addition, Thirlwell notes that some commentators have detected a seventh criterion relating to proposed investments aimed at vertical integration.[vii] In a speech given in July 2008, the Treasurer noted that

'our predisposition is to more carefully consider proposals by consumers to control existing producing firms.[viii]

This seventh criterion is at the heart of the AWU's concerns regarding the intrusion by SWFs and state owned companies into the Australian economy and was the subject of an Opinion Piece by the AWU's National Secretary, Paul Howes published in *The Australian* (25 February, 2009).

This Opinion Piece focused on the proposed increased stake in Rio Tinto by Chinalco, and with it a controlling strategic stake in the world's second largest resources company with ramifications going well beyond the immediate investment affecting the national interest. (see boxes).

Rio's recent cuts in jobs makes the company's assurance regarding the future for investment and jobs in Australia ring hollow. These moves appear aimed at protecting their own board - rather than AWU workers' and national - interest.

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Incompetence and ineptitude at Rio hits 700 Queensland Workers

07 April 2009

The Australian Workers' Union has slammed the Rio Tinto Board for once again demonstrating their incompetent decision-making processes with the retrenchment of nearly 700 Queensland workers

"The price of aluminium is actually recovering now on the London Metals Exchange, but Rio Tinto has adopted a myopic, short-term solution," Paul Howes, AWU National Secretary, said.

Not looking at the best long-term interests of the company

"Rather than look at what is in the best interests of the company in the long-term they have adopted a stance which can only result in lost opportunities as they lose the skills and commitment of their workforce."

"Rio Tinto has run true to form – demonstrating the Board's incompetence and ineptitude," Paul Howes said.

Gov't should look at this poor performance before green-lighting Chinalco investment

The federal Government needs to look closely at the structure of the Board as a real problem, when they consider green-lighting the proposals by Chinalco to invest in Rio Tinto.

Mr. Howes said the Rio Tinto workforce, and their families, deserved a little more respect than for many to hear through the media that hundreds will be losing their jobs, just as Easter is about to start.

No consultation about possible alternatives

"Neither our members, or their union, were consulted about this shocking news."

"Decency would have demanded that at least the retrenchments would be discussed first – and maybe alternative scenarios offered," Paul Howes, AWU National Secretary, said.

"We've got members in Gladstone who have been told that one-in-three of you will go, but no one at the moment knows if they've lost a job, or if it is their mate. Not a nice way to go into Easter!"

http://www.awu.net.au/264_5.html?H|19|264|45645132

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It is therefore critical when assessing the investment worth of SWFs and state owned entities to the national interest that return on the investment equates to the full value of the opportunity cost of the resources which are "lost" to the investment (including value adding opportunities) and the number of additional jobs which occur as a consequence of the investment.

The AWU is also keenly aware of the value of Australia's assets and notes the observations of the Belinda Robinson, Chief Executive of the Australian Petroleum Production and Exploration Association:

The world's demand for energy is growing largely as a consequence of population growth and developing countries determination to attain the standard of living that most of us take for granted. The growth of global population means that 2030, 40 percent more energy will be needed.

Most of this increase will take place in our neighbourhood. China and India alone will account for half of that growth and developing countries in total will account for 87 per cent. Australia is well-positioned to meet a substantial portion of that demand.[ix]

The AWU will fight to ensure that during the current GFC and recession in Australia that the national interest is protected and not abused through the push for fire sale clearance of core strategic assets in the resources and manufacturing sectors.

It is vital that Australia retains control over assets which will ensure future prosperity in the days ahead as recovery from the GFC takes hold. In the meantime, competition for the preservation of the national interest is paramount. There is no alternative. Where GFC investments occur, the guiding principle for the AWU is the degree to which investment, jobs and industrial expansion are enhanced rather than curtailed by the SWF or state owned entity.

In addition, the presence of the SWF provides scope to exploit bilateral access opportunities for Australian industry which should also form part of the consideration of the impact on the national interest of investment. It is through partnership based on mutual obligation, rights and entitlements that progress can be made.

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Rio's China gambit a bad move (The Australian, 25 February, 2009)

NO one can blame Chinalco for seeking to increase its stake in Rio Tinto. On paper Rio is a great company. It has great assets. Great potential. The only thing that seems to be wrong with Rio is the way it's being run. My initial scepticism about the deal comes simply from the fact that the Rio Tinto board endorsed it so quickly. Looking back on the past performance of that board and management team, it's not hard to see why many others are also sceptical. After all, these are the people who, in 2007, when BHP Billiton came looking for merger talks, refused to answer the call and became the only listed company with a Not for Sale sign on the front door.

Then, in a stroke of genius, they paid $US42 billion for Alcan in a bid to once again stave off BHP Billiton. It's a company that has form in breaching commitments to governments. After the merger of CRA and RTZ it broke its primary commitment to the government when it promised the new merged company would be headquartered in Australia. A short time later it quietly slipped out the back door, moving HQ to London, and left a pin-doctoring outfit dressed up as an HQ in Australia.

I don't oppose the Chinalco deal outright. It may be the best thing for my members employed by Rio. It might be in Australia's national interest. But there are still many questions about this deal that need to be answered. On face value it seems that apart from Chinalco's long game, the deal simply serves the short-term interests of Rio's new chairman and chief executive, whose mismanagement has exposed the company and its workers in the midst of the global financial crisis and at the bottom of the commodities cycle.

Institutional shareholders should not be fooled by recent moves by Rio to offer similar terms to them as to Chinalco in the proposed bond issue. It is a sign of desperation. If this deal receives approval, it will become the standard test and precedent that will be applied for all future takeover deals. With the beachhead established, the national interest is imperilled well beyond Rio, with lasting implications for our place in the world.

The deal is structured crucial positions, including the insertion of personnel into key operational roles. Chinalco will inevitably have a strong say on pricing to minimise Foreign Investment Review Board scrutiny but maximise Chinalco's strategic hold on the company through a range of for our iron ore and over joint ventures and other resource developments, in addition to acquiring port and rail facilities.

The point should also be made that for increasing its stake to 19 per cent Chinalco will receive two directors on the board while at the same time this company, with more than half its profits coming from Australia, only has two Australian directors. Not a bad deal for Chinalco. Rio tells us it is the only solution to servicing a crippling level of debt following aggressive acquisitions. But the emperor has no clothes. It is a question not of longer term solvency but of short-term liquidity. There are other options for Rio still to raise capital and pay down debt. We heard the same arguments from many others at the height of the private equity takeover boom. We have moved on.

Threatening to throw 3000 workers on the dole unless the Government agrees to a carefully crafted deal designed not to trigger takeover limits is simply playing games. Already the Australian Stock Exchange has called for independent expert scrutiny of the proposed deal to enable full disclosure to shareholders. As I have previously said, this is not about our union being opposed to sovereign capital coming to Australia. It is about not playing games with the national interest. Having a foreign government simultaneously as the primary investor, making decisions as the primary producer and being the company's primary customer is a serious conflict that has to be looked at.

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Chinalco is not an independent entity. It is a state-owned corporation integral to Chinese economic policy. Clear evidence of the integration of the company with the Chinese state came just last week. It is widely expected that the Chinalco boss, Xiao Yaqing, who triggered this Rio deal, will be promoted to become deputy general secretary of China's State Council, the country's cabinet. Australia's aluminium, iron ore and copper resources are the building blocks of growth. These resources are key national assets that cannot be sold on the cheap. If private companies holding these precious assets as custodians are unable to self-correct through their shareholders taking control, the Government should step in. That is the role export licences can serve as a last resort.

A key weakness in the bid is no new investment by Chinalco beyond lifting its equity stake. And what our valuable resources give us is leverage to ensure that Australian industry has the fullest access to markets such as China's in return for our resources. New investment in Australian industry - including steel, aluminium and cement - to supply future growth in partnership with China should be our strategic vision. The Rudd Government has a range of policy tools at its disposal to assist Rio to remain competitive and thrive. For example, the Australian Workers Union has worked to ensure that Rio, as an emissions-intensive, trade-exposed company, is not disadvantaged through the implementation of an emissions trading scheme.

But we expect in return that Rio remains fully committed to our economy and jobs. We are also stressing the importance of providing essential infrastructure through nation-building projects to assist Rio's productivity. We stand ready to build on a shared common purpose but it is clear to me that the Chinalco deal is the last desperate action of a doomed management that has stopped at nothing to preserve itself, to the detriment of shareholders, employees and the national interest. *Paul Howes is National Secretary of The Australian Workers' Union.*

Conclusion

The AWU supports critical scrutiny of investment by SWF in Australian industry in order to protect the national interest. The guiding principle for the immediate future is the contribution which the investment makes in assisting Australia deal with the domestic recession and maximizes the national interest. In the event the investment is more opportunistic to the self-interest of the SWF rather than advantageous to the national interest, the AWU is fully supportive of rejecting such offers out of hand. Alternatively, where investment by SWF is based on a cooperative model with a clear plan in consultation with the workforce which ensures the expansion of local activities, over the long term it will find our support.

The national interest is best supported through a deliberate approach to dealing with SWF which is strong and confident and which provides clear guidance on the terms and expectations of the Government on SWF before granting approval. The AWU will always support decisions by the Australian Government which are made honestly and confidentially in the national interest.

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The challenge is ensuring that short term considerations such as the fallout from the GFC and recession do not outweigh a considered and measured stance which accounts for the risks to our assets and industries from an unnecessary sell off in the short term which cuts across their long term future developed on our own terms. Other options may be preferred to asset industry and workers in the short term, including credit arrangements and guarantees.

Responding and dealing with SWFs highlights the role for government to support our industries as required during this period. The AWU supports a strong activist approach in this regard at this time serving to displace the uncertainties associated with reliance upon SWF investment. Our own wealth funds have an important role to play in this regard.

The AWU stands ready to assist the Committee in its deliberations and thanks the Committee for the opportunity to make this brief submission.

Endnotes

[i] Mark Thirlwell, December 2008, *Program Director, International Economy, Lowy Institute for International Policy,* ***AOIF Paper 4***

[ii] Edwin Truman, *Testimony before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology, Financial Services Committee, US House of Representatives,* . Washington DC, 10 September 2008.

[iii] Drezner, *Daniel W. Drezner, Professor of International Politics, The Fletcher School, Tufts University, Testimony before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology, Financial Services Committee, US House of Representatives*,

[iv] Mark Thirlwell, December 2008, *Program Director, International Economy, Lowy Institute for International Policy,* ***AOIF Paper 4***

[v] Australian Treasury, *Summary of Australia's foreign investment policy*. Canberra, Foreign Investment Policy Division, The Treasury, April 2008

[vi] Attachment A in The Australian Treasury, *Summary of Australia's foreign investment policy*,

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[vii] See for example Peter Gallagher, Arbitrary approvals hurt us all. *Australian Financial Review*, 26 August 2008.

[viii] Wayne Swan. *Australia, China and this Asian Century.* Speech to the conference "The changing global financial environment: Foreign investment in Australia and China", an Australia China Business Council Forum in collaboration with The Lowy Institute for International Policy and the Faculty of Business and Economics, Monash University. Melbourne, 4 July 2008.

[ix] **NATURAL GAS – A STRATEGIC NATIONAL ASSET**

Address to the National Press Club, Canberra, by Belinda Robinson, Chief Executive, Australian Petroleum Production and Exploration Association.

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