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UNEASY ENGAGEMENT

Australia Feels Chill as China's Shadow Grows

By MICHAEL WINES

SYDNEY, Australia — If outlanders tend to associate Australia with kangaroos, broad-brim leather hats and an opera house, many Australians are different. They think of iron ore and bauxite, copper and coal, nickel, gold and uranium, a trove of mineral riches that is their nation's birthright and the bedrock of its prosperity.

Which explains much of the breast-beating that has ensued since the Chinese announced plans this year to buy a big chunk of it.

Since three state owned Chinese companies said they would buy stakes in Australia's storied mining industry totaling $22 billion — as much as China's entire investment here in the last three years — some of this nation's 21.3 million people have reacted with aggrieved nationalism.

The government of Prime Minister Kevin Rudd, which generally favors the sales, has been savaged as naïvely cozy with China, a view some in his own military appear to share. Opposition politicians have flogged the specter of an Australian future more or less as a giant open-pit mine in which the locals toil, but Beijing takes the profits.

"It's the Communist People's Republic of China, 100 percent Communist-owned, buying up sections of the country and minerals in the ground which they will then sell to the Communist People's Republic of China," said Barnaby Joyce, who is a leader of the National Party in Parliament. "And we're going to live off the commission on the way through. They'll try to make sure we get as little as possible."

But a few months after the first of the deals was announced, a sharp initial backlash has given way to a more subtle queasiness over whether Australia's place in the region, anomalous but secure for so long, is about to be altered by the new Chinese giant looming over its horizon.

Nor is Australia alone. From the Philippines to Vietnam, China's neighbors are recalculating the benefits — and potential deficits — of life in the shadow of a newly dominant nation.

Australia has always been the West's outpost in the East, the British penal colony with American spunk and European joie de vivre. But seemingly overnight, China has become Australia's biggest trading partner, one of its biggest tourism customers, the largest single buyer of its government debt, a major buyer of farmland and real estate.

China's hunger for steel gobbles up half of Australia's iron ore exports, and its textile factories buy more than half of Australia's wool. Over 120,000 Chinese students throng to Australian schools and universities.

Although China’s purchases remain dwarfed by cumulative investments of the Americans and the British, they are growing much faster.

And suddenly, Australians are stepping back, realizing that their new best friend is someone they really do not know very well, much less trust.

“The momentum has shifted from being broadly receptive to these deals to having a hard think at this,” said Alan DuPont, who heads the Center for International Security Studies at the University of Sydney. “This is not just about China and Australia. It’s about how the world sees China playing its role in the future as a great power.”

Surviving Corporate Invasions

This is not a new question. More than a century ago, Australians fretted about becoming vassals of the resource-hungry British Empire; then, in the mid-1900s, they feared becoming an American subsidiary. When Japan Inc. began snapping up companies in the 1970s, suspicion of Tokyo ran rampant.

The British and Americans proved good corporate citizens, however, and Japan’s expansion faded amid economic problems. Now, Australians are asking whether China will be different.

In one way, it assuredly is. Western companies, if at one time equally ravenous for Australia’s resources, are not direct appendages of their national governments. The dominant shareholder in major Chinese resources companies is the Chinese government.

China has 115,000 state owned companies; the cream are more than 150 giants controlled by the central government. Those corporations — in mining, steel, finance, communications and other crucial areas — seek to make profits much as Western companies do. Government boards audit them, appoint their top executives and evaluate their performance, but in general, the companies insist, Communist Party leaders do not meddle in business strategy.

Even if that is true, China has long insisted on maintaining state control over companies in crucial industries, blurring the line between national and corporate interests.

Take steel. China makes more steel than any other nation, but it is highly dependent on iron ore imports to keep its mills humming. That raises suspicions that China may want big stakes in mining companies now to help ensure stable prices in the future.

But if China works to keep iron ore prices stable, that might benefit steel producers more than it does Australian mining companies. That concern has only grown in recent months, as China’s largest steel producers have rejected as insufficient offers of lower prices from Australian mining companies.

There is also the question of whether China’s stake in strategic industries — like its investment in United States Treasury bonds — could one day morph from a business deal to an instrument of diplomatic influence.

The Chinese bids for parts of the three Australian mining companies — Fortescue Metals, Oz Minerals and Rio Tinto Ltd. — have been raptly watched for Australia’s answers. So far, they are mixed.

The smallest deal, an $840 million bid for part of Fortescue, a struggling iron ore miner, won Australian regulators’ quick approval. But Australia’s foreign investments review board, the central gatekeeper for overseas purchases, vetoed part of a $1.8 billion bid for Oz, the world’s second largest zinc miner. The reason: Australia’s military raised the prospect of Chinese espionage at an Oz mine not far from an aerospace test site. A pared-down deal was approved after the suspect mine, the core of Oz Minerals’ assets, was excised from the deal.

But it is the proposed purchase by the Aluminum Company of China, or Chinalco, of $19.5 billion in Rio Tinto stock, bonds and mining rights — China’s biggest investment in a foreign company — that has caused the most angst.

Chinalco, which bought 9.3 percent of Rio Tinto in 2008, proposed taking a larger stake after the global economic collapse drove Rio into financial straits. If approved, the new investment would give China an 18.5 percent share of the world’s third largest mining company.

Chinalco unequivocally asserts its independence. “Chinalco operates as a commercial entity, at arm’s length from Chinese political processes,” the company’s Australian spokesman said in a written response to questions.

Many Australian experts agree. Modern Chinese corporations are state-run in name only, Ross Garnaut, an economist, former Australian ambassador to Beijing and himself the head of a gold-mining company, said in an interview. In practice, he said, they are just like their Western counterparts — fiercely competitive, and focused on profit.

“You don’t know anything about the dynamics of relations between major corporations in China if you think a major aluminum company like Chinalco would sacrifice its profits to increase profits for one of its rivals in the steel industry,” he said. Even Australia’s antitrust regulators have concluded that the Chinese would be unable to influence the price of iron ore, a crucial Rio Tinto product, were the Rio deal to go through.

Intentions Arouse Suspicions

Yet other experts have a much different view of China’s intentions. Paul Glasson, a Shanghai-based Australian who brokers deals between Chinese and Australian businesses, notes that China’s domestic reserves can meet demand for fewer than half of 45 strategic minerals. By 2020, it will have sufficient supplies of only six.

“In a nation of 1.3 billion people, with the complex issues they face, with such resource deprivation, would it be wise for the government to abdicate that responsibility to S.O.E.’s?” he asked, using the abbreviation for state owned enterprises. “Claiming the head doesn’t know what the body is doing just makes the situation difficult.”

Mr. Glasson says state ownership actually brings advantages — among them, deep pockets and a focus beyond the next quarterly statement — that any merger partner might find attractive. But Beijing’s denial of a role in its state owned companies, he said, is creating a credibility problem.

In fact, Chinalco would be very much a junior partner if the Rio deal were to go through, with just two seats on a 17-seat board of directors. Chinalco would have to recuse itself from any Rio issues that posed a conflict of interest.

Chinalco would also not be able to guarantee a supply of ore to other Chinese companies, although the companies envision new efforts to market iron and aluminum ore inside China.

Shareholders at Rio's annual meeting in April were unimpressed. They denounced the proposed deal as a fire sale of assets to a government buyer whose interests were starkly at odds with their own. As if to underscore the point, Rio's share price has risen sharply since the Chinalco agreement was announced, suggesting that Chinalco shrewdly struck a deal at the nadir of the financial crisis. With every gain in Rio's stock price, the Chinalco deal looks less attractive.

Some institutional investors have suggested that they will oppose the bid, which requires shareholder approval, even if regulators approve it this year. And that seems in some question.

Allies of Prime Minister Rudd argue that increased Chinese investment pumps money into Australia's economy and opens new trade opportunities. But Mr. Rudd's opponents say he does Beijing's bidding. Among a drip of well-timed news leaks were claims that Chinese spies sought to hack into Mr. Rudd's laptop during last year's Olympic Games, and that his defense minister had failed to disclose gifts from a Chinese friend with ties to Beijing's military establishment.

Those allegations have been flying even as the Australian military has become more focused on China as a potential rival. A newly issued defense strategy proposes the biggest Australian military buildup since World War II, driven in part by a forecast of rising Chinese economic and military power, and a slow American fade in the Pacific.

And recently, a wealthy Australian businessman began a television advertising blitz opposing the Rio-Chinalco deal, featuring Mr. Joyce, an opposition leader. The theme — that Australia is selling its mineral wealth to a "foreign government" that may not have Australians' interest foremost — is unlikely to affect regulators' deliberations. But it stokes a larger disquiet of which Mr. Rudd's government is acutely aware.

Mr. Rudd, a Mandarin-speaking ex-diplomat in Beijing, has not helped his cause: after an unannounced meeting with China's propaganda minister in Canberra, Australia's capital, he lobbied for a greater Chinese role in global finance at the Group of 20 economic meeting in London, leading critics to dub him China's "roving ambassador."

Mr. Rudd shrugged off the gibes, but seemed stung: in London, his staff quietly asked that he not be seated next to Beijing's ambassador to Australia during a television broadcast (the request was refused).

Australia's foreign investments board has given itself an additional 60 days to consider the Chinalco-Rio deal. But hopes that some of Australians' unease might ebb during that breather took a hit in May, when another state owned Chinese company, China Nonferrous Metal Mining Group, proposed a $184 million purchase of 51.6 percent of another miner, Lynas Corporation.

Lynas, which mines rare-earth minerals, also has been left short of cash by the global economic crisis. Critics were quick to note that China Nonferrous operates huge nickel and iron ore mines in Myanmar, widely denounced as one of the world's most repressive nations, and has extensive gold-mining operations in North Korea.

"So Lynas would become part of a group which makes hay in Burma. Can the government live with that?" The Australian, one of the nation's major newspapers, asked. "What are the rules about ethical investments?"

The executives at Chinalco, which also has operations in Myanmar, might be expected to rue the bad timing of China Nonferrous. On the other hand, it could be promoted as evidence that the government does not stage-manage corporate strategy.

But at least one Chinalco executive no longer has those worries. The company's chairman, Xiao Yaqing, the architect of both the 2008 and 2009 purchases of Rio assets, left the company in March after being promoted — to deputy head of the State Council, the team of cabinet ministers that sets policy for all China.

Meraiah Foley contributed reporting.