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Chinese FDI in Australia: drivers and perceptions

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Introduction

Australia has been remarkably successful at attracting Chinese investment in recent years. Australia has been the top destination for foreign direct investment (FDI) since the mid-2000s. Despite this, the investment relationship has not been without difficulties. In Australia, there is unease about Chinese investment in strategic sectors such as mining and agriculture. In China, there is a feeling that Chinese investment is discriminated against in Australia's screening of incoming investment applications. Because Chinese investment in Australia is a relatively new phenomenon and because the geographic and cultural distances between the two countries are wide, there is a high risk that misperceptions – both Australian and Chinese – will trump reality.

Australia and China have an obvious interest in managing these problems, both in terms of the economic relationship and the broader bilateral relationship. Australia has been a net importer of foreign direct investment (FDI) since Federation. China is new as a source of FDI in the Australian economy. It is still relatively small despite significant growth since the 2008 global financial crisis. In terms of stocks, Chinese FDI has grown from 0.92 per cent in 2008 of total FDI in Australia to 2.63 per cent in 2011.[1] Approved investment flows from China into Australia rose dramatically in 2008, to be followed by a downward pattern of fluctuations in subsequent years, until a new surge in 2012.[2]

Despite the comparatively small amount of Chinese FDI in Australia, understanding the drivers of Chinese investment is important. First, FDI in general is vital to Australia's economic wellbeing. Chinese FDI is likely to grow globally and at the same time there will be more competition for Chinese investment. Thus, to remain competitive in attracting Chinese FDI, it is important for Australia to understand how it is perceived by Chinese investors. Second, Chinese FDI has attracted significant attention in the media and broader public in Australia. A nuanced analysis of the drivers will serve as a good basis for informed discourse on Australia's national interest in regards to Chinese FDI.

For China, Australia is an attractive investment destination for a number of reasons. It is already a major resource provider to China and is a low risk destination for Chinese investment given its political stability and institutional strength at the government and business levels. It is also important in terms of helping Chinese companies gain experience investing in developed countries. This is not just important to the companies themselves. It also helps to build China's national reputation as global economic player, overcoming the country's long standing and pervasive image of being little more than a low-cost labour provider capable of succeeding in poor developing countries only.

The aim of my research was to identify a number of issues that do require greater attention in both countries' efforts to strengthen the investment relationship. It is by no means a comprehensive treatment of the relationship, but instead is concerned largely with Chinese perceptions of Australia as an investment destination. It is based on over forty interviews conducted in Canberra, Sydney, Perth, and Melbourne during my fellowship at the Lowy Institute from January through March 2013. The interviewees were selected on the basis of their expertise and experience with Chinese FDI. The interviewees can be broadly grouped into five main categories: Chinese investors in Australia; senior Australian managers in companies that have received significant Chinese investment; consultants, both Australian and Chinese nationals, who advise Chinese companies on Australian investments; senior Australian government officials at the state and federal levels; and experts in academia.

My research mainly focused on direct investment the resources sector. Investment in this sector accounts for 91% (79% mining; 11.8% oil & gas) of Chinese FDI in Australia.[3] The resources sector also tends to attract greater public scrutiny which often means that Chinese investment in this sector becomes a focus for political debate within Australia or even diplomatic discussions between the two countries.

The first section of the presentation addresses the structural factors driving Chinese FDI. The second section offers general observations about why Chinese companies see Australia as an attractive investment destination, particularly in the resources sector. The third section is my assessment of Chinese perceptions of the risks of investing in Australia.

What drives Chinese FDI?

A key theme in international observations of China's foreign economic policy is the perception that the central government in Beijing pursues a strategic approach to investing abroad, particularly in the resources sector. The term 'strategic' conjures images of a well-conceived, centrally-controlled and thoroughly coordinated strategy to achieve control of the world's resources.[4] Reference to the existence of a *Zou chu qu* program by academics and others who study Chinese FDI has become standard. The phrase, translated into English as 'go out', is a program run by the Chinese government to encourage Chinese companies to invest abroad. It is in reality part of a twin expression with *Qing jin lai* (invite in [foreign investment]). In other words, in Chinese foreign economic policy, for Chinese companies to invest abroad is as natural as for foreign companies to invest in China.

Prior to the enunciation of a 'go out' policy by the central government in 2000, there were three routes through which contemporary China pursued trade and investment interactions with markets overseas. One route was Hong Kong, which was both a destination for Chinese investment and a hub for linking Chinese companies with foreign counterparts, including those in the industrialized West. This dated back to the mid-1950s. Another route was to bid for labour and engineering services in the construction sector of some Middle Eastern and North African oil-exporting countries, taking advantage of increased demand for these services created by the rise in oil prices in the early 1970s. A third route came through the transformation of China's foreign aid projects into investments, most notably in Africa.

It took modern China over half a century to get to the stage where some Chinese companies were able to make investments in developed economies. In the early 1980s, Chinese companies were ill equipped to enter into competitive bidding for projects overseas. As China's overall economic situation improved, the basic attitude of the government toward outbound FDI also became more encouraging.

The Asian Financial Crisis of 1997-1999 strengthened the view among Chinese companies that the time had come for China to diversify its foreign investment portfolios. There was recognition of risks beyond the influence of Chinese companies such as volatility in world currency markets and resource prices. Then in 2008 after the global financial crisis broke out, the central and local governments as well as banks injected a stimulus package of 4 trillion Yuan into the Chinese economy.[5] This massive domestic investment, together with growing trade surpluses became the principle engines of expansion of Chinese FDI.[6] Thus, what seems to have been a wave of Chinese foreign investment in the past few years should not be misread as indicative of an unstoppable future trend.

Basic motivations for Chinese-owned production overseas, like that of other countries, include: to secure natural resources, new markets, improved efficiency and strategic assets. The economic goals and policy objectives include the following: [7]

- To support the exports of domestic manufacturers
- To help secure a reliable supply of resources and energy, particularly when they cannot be produced domestically in China
- To acquire information and learning about operating abroad
- To improve access to foreign technology
- To enhance the overall competitiveness of Chinese companies through the diversification of their business activities

The role of SOEs

A phenomenon that has contributed to international speculation about non-economic and non-commercial motivations behind Chinese FDI has been the way that large Chinese state-owned enterprises (SOEs) have been interested in either acquiring dominant majority share-holding of existing international corporations, or independently financing expensive green-field projects.[8] The widely publicized dispute between the Aluminium Corporation of China (Chinalco) and Rio Tinto around 2009 seemed to confirm a perception that Chinese companies preferred to seek whole acquisitions in Australia. This is different to the model pursued by earlier generations of Asian investors in Australia – particularly the Japanese – who tended, at least initially, to pursue minority share positions.

There is anecdotal evidence that the preference for majority shareholding on Australian projects by Chinese investors is reducing. There have been numerous cases of Chinese investors purchasing smaller shares in Australian companies or projects.[9] This is consistent with the views of a number of consultants and government officials who noted in interviews that there has been a trend towards Chinese investing in smaller shares on Australian projects. Due to the lack of available statistics on the shareholding positions of all Chinese investments in Australia, it is not possible to know what percentage of Chinese investments are operating under a majority (or minority) Chinese share.

This change has, however, had little impact on support for Chinese investment by Australians. According to the *Lowy Institute Poll 2013*, 57 per cent of Australians responded that the 'Australian Government is allowing too much investment from China'. This figure has remained consistent since 2010.[10]

Chinese investors in Australia seem to understand the sensitivities surrounding their investments. According to a well-informed Australian mining executive, 'a Chinese SOE executive is fully aware that his company's performance will be viewed as reflective of his country and even government.'[11]

In China, it is the company executives, not their government regulators, who initiate FDI projects. This applies to state owned enterprises (SOEs) as well as enterprises that have other forms of ownership. An SOE executive has certain performance indicators such as earning a profit, improving the technical and managerial skills of his team, and establishing a positive reputation for his/her company. These are the objectives that motivate SOE executives as they will dictate executives' promotion prospects inside the company, in other SOEs and even in the government. The movement of SOE executives between SOE and government roles leads some foreign observers to suspect executives of being Party agents. There is indeed a Chinese 'revolving door' in place. But, for an SOE executive to be successful on the job abroad, he/she must play by local rules.

On my interview trips, it appeared that 'SASAC' had become a household reference to Australian discussions about Chinese SOEs. Indeed, in China, SASAC (the State-owned Asset Supervision and Administration Commission) is a key regulatory body for SOEs. There is a SASAC at the central government level, while local (province, city and below) levels of government also have a local level SASAC for their respective jurisdictions. As of June 2013, there are only 114 SOEs under the administration of SASAC at the level of the central government.[12]

It is necessary to emphasize that under the Chinese system, an SOE is more a regulatory reference than anything else. There are SOEs that are 100% government owned but increasingly SOEs have a more diversified ownership structure. As part of China's economic reforms, significant changes in the structure and management of work organizations have taken place. In the mid-1990s, the Chinese government began to implement its 'modern enterprise system' and 'group company system' program. Basically, in China's legal and administrative systems, an SOE is an independent entity.[13] Under the group company system, an SOE is allowed to bring under its umbrella companies of virtually any form of ownership. When a Chinese company, SOEs included, initiates an investment abroad, it is subject to Chinese government approval. The main actors in the approval process at the central government level are SASAC, the Ministry of Commerce (MOFCOM), the People's Bank of China, the National Development and Reform Commission, and in some extraordinary cases, the State Council (China's cabinet). Those SOEs that are under SASAC administration below the national level are also subject to approval, based on locally set rules and regulations.

According to a 2009 MOFCOM document all companies 'making [an] overseas investment with the amount of investment of ... US$100 million or more' needs to apply for approval. Local enterprises (non-central enterprises) are additionally required to report all foreign investments between US$10 million and US$100 million to the provincial commerce department. [14]At the national level and below, the basic policy formula is for companies to 'report and register' their investment activities overseas.

China's 'reverse Midas touch'

One reason less experienced Chinese investors have tended towards majority shares is due to the country's 'reverse Midas touch': because of the scale of its manufacturing exports, whenever Chinese enterprises enter a market they make whatever they offer cheap and whatever they demand expensive.[15] The resulting situation is that the more finished products China exports, the cheaper per unit price it receives, but at the same time it needs to import more raw materials to manufacture these products, driving the price of raw materials up. So, Chinese companies have a built-in business incentive to be an investor and operator of raw materials, and not only a buyer of the end products.

Persistent rises in prices for oil, minerals, food, and other bulk commodities, which have in part been a result of this 'reverse Midas touch' during the past decade, has led to the idea among Chinese commentators of the need for *hua yu quan* or 'power to influence change' over an industry or product globally. As such, a continuation of efforts to acquire natural resources and/or the companies and facilities that produce them are justified on the ground that China must gain its *hua yu quan* in the global natural resource trade.[16]

According to interviews with Sydney-based Chinese business consultants that advise Chinese businessmen on Australian mining investments, the notion of *hua yu quan* is fairly prevalent among first-time Chinese investors, their government regulators, and domestic financiers. Chinese business thinking tends to imagine that the more output from their investment, the greater leverage they will have over the per unit price of affected minerals to be imported into China. Hence, there is an interest to acquire the greatest share possible in an established company or mine. In contrast, established mining interests in Australia tend to strongly resist Chinese attempts to maximise share-holding.

What is Australia's attraction to China as an investment destination?

To a significant degree China's interest in Australia as an investment destination simply reflects the law of supply and demand. In 1987 China's Sinosteel formed a joint venture with Rio Tinto to develop the Channar iron ore mine in Western Australia.[17] This project was China's first significant offshore investment and its first in a developed economy. When the project was first proposed four years earlier, Australian mining companies like Rio Tinto were looking for a stable source of demand for their products in China and saw Chinese investment in Australian mines as a way to reinforce this.

While there is some data available about the distribution of Chinese investment by state and industry, it is not easy to gauge the overall picture of Chinese investment in Australia in terms of average percentage shareholding, profit outcomes and perceptions by Chinese investors. As such, the following observations are based on my understanding of China's foreign economic policy and the China-Australia relationship in general, coupled with insights gained through interviews conducted in Australia.

Beyond basic supply and demand issues there are five key reasons why Australia is seen as an attractive destination for Chinese investment:

(1) Goodwill between Australia and China

(2) Trust in Australia as a low political-risk destination to operate a business

(3) A desire to prove a company's capacity to operate in a developed economy

(4) Stable supply of high quality resources

(5) Company profit

First, in April 2005, Australia earned much goodwill in China when it became only the second developed country to recognise China's market economy status (after New Zealand, which did so a year earlier). For China, being treated as a market economy removed one of the de-facto 'China exception' clauses it had to accept in its 15-year long negotiations to join the WTO.[18] As of 2013, China is still campaigning to be recognized as a market economy by the United States and most of the member states of the European Union. Wishful as it may seem in retrospect, Australia's move was expected to set a precedent for more OECD countries to follow.

Second, Australia is attractive when it comes to Chinese considerations of non-commercial risk. There are few if any historical issues or sources of tension to overcome. While Australians did fight Chinese troops alongside South Koreans and Americans in the Korean War, the two countries do not have territorial disputes. Moreover, in contrast to China's economic ties with many other countries (especially those in the developing world), Australia has a stable political system, a strong record in applying the rule of law to settle commercial disputes, and a safe social environment. Since the early 2000s, the risks associated with Chinese investments in resource extraction in a number of developing countries have become more widely known in Chinese society, thanks in part to the globalization of China's media services. The kidnapping and loss of life of Chinese employees has increased pressure on the Chinese government to rapidly and effectively ensure the safety of Chinese industrial workers overseas.[19] But the Chinese government is caught between its position on non-intervention in other countries' affairs and domestic demands for the guarantee of safety for its workers overseas. Investment in Australia offers China – its companies and government agencies – a way to avoid a host of risks it has to deal with in many other countries.

Third, Australia, like other developed economies, offers a useful testing ground for Chinese companies to establish a solid international reputation. Historically, a typical pattern of Chinese FDI projects, especially those in developing countries, was for the Chinese government to cooperate by offering economic aid as an enticement and frequently a necessary precondition. While such aid was useful and in many cases instrumental for a Chinese company to prevail in the bidding process, it was often an obstacle to improving the international competitiveness of Chinese companies. The use of aid to win bids does not provide any incentive for Chinese companies to upgrade their technological and managerial know-how. This is not conducive to their long-term growth. Furthermore, investment through aid often leads to more aid provisions since the recipient government frequently falls into a cycle of aid dependence. When Chinese workers are caught in social strife in an aid recipient country, the Chinese government comes under heavy domestic criticism for seemingly having wasted the country's resources and goodwill.[20]

By contrast, in a developed economy such as Australia, Chinese companies have to engage in genuine international competition to win investment bids. This often means that companies are forced to go through a process of engineering or managerial learning that improves their capabilities over the longer term. If a company can become successful in Australia, it adds to its ability to compete in other developed country economies as well.

Fourth, profit is also a driving factor. It is one of the key performance indicators for Chinese SOE executives. And it is executives, after all, who make the decision to invest abroad. The rapid rise in resource prices worldwide, fuelled in large part by China's economic growth, is what attracted Chinese investors to the Australian resource sector.

In my interviews, public rhetoric unfavourable to Chinese investment in the Australian resources sector was a less serious a concern than being able to maintain profit against the background of volatility in resource prices and the global economy. This is particularly true after the decision to invest has been made.

Entering the 2000s, as Chinese demand for iron ore and other minerals started to increase, and as traditional sources of demand for iron ore in Europe, North American and Japan started to decline or stabilize, there emerged an opportunity for Chinese companies to venture into green field and expansion projects overseas. As noted earlier, China's 'reverse Midas touch' means that Chinese resource extraction companies see an opportunity for themselves – high resources prices coupled with stable demand in China . In terms of destination, Chinese resource investment footprints cover not just Australia, but also Brazil, India, and South Africa, all major suppliers of resources.

Fifth, securing a reliable supply of resources is attractive to Chinese companies. This is a goal of both of Chinese SOEs and the Chinese government. A reliable supply of resources not only allows an SOE to meet demand from customers in China, it also allows companies to establish downstream networks in China because there is confidence that supply will not be interrupted. This also serves the national (government) interest of having materials and energy to develop the country.

China is a vast country and fairly rich in minerals. But, to use iron ore as an example, investing in its extraction in Australia is logical in an industry sense. Domestically in China, the iron ore industry faces a number of structural challenges. China's iron ore is low-grade, expensive to process, and its mines are being depleted. For many Chinese steelmakers, particularly in the coastal regions, the delivered cost of domestic iron ore is more than that of foreign ore. China has become a leading importer of iron ore worldwide.[21]

This has been reflected by a number of experienced Chinese investors in Australia pursuing off-take agreements, which allows the investor to take a large share of the production output while also maintaining a non-majority share in the company. For example, Sinopec holds a 25 per cent stake in the Australia Pacific LNG project in Queensland. The investment includes a majority off-take agreement for Sinopec.[22] At the smaller end the scale, the Anshan Iron and Steel Group Corporation (Ansteel) and Gindalbie Metals Limited 50-50 joint venture agreement allows AnSteel to take 100 per cent of the production from the JV's Karara mine.[23] By guaranteeing a destination market for the production output from these projects, Chinese investors help ensure project viability.

Chinese investment in Australia: reading through perceptions of risk

This section will explore the perceptions of risk in three main areas. First, operational issues will be considered. Then, the various perceptions of the foreign investment review process will be explored. Finally, I will comment on geopolitical considerations for Chinese investors.

It should be noted here that causes for the outcome of a committed investment are essentially impossible for a non-participant to ascertain, much less to assess. With this caveat in mind, the following presentation touches on issues that, in my mind, merit consideration in further discussions about Chinese investment in Australia, in a broadly general sense.

First, what 'gaps in expectation' arise for Chinese companies in Australia at the operational level?

Operating a cross-border investment project, after all, involves mastering the rules and norms on site of an approved project. The federal system of governance in Australia means that local rules and norms are as important as federal ones to master, and in many cases more so. From interviews, I see three 'gaps in expectation' that exist at the operational level for Chinese companies investing in Australia.

The first 'gap in expectation' – *in the sense of expectations of newcomer investors from China* – is the occasional *de facto* requirement for minority share-holding in pursuing a merger and acquisition (M&A) project. This is not a written rule, but rather a norm that has been intermittently enforced through the Foreign Investment Review Board (FIRB) at the federal level. It now appears to be widely understood that any purchase of over 50 per cent of either BHP or Rio Tinto would not pass FIRB. But there are other examples. When China Nonferrous Metal Mining Co (CNMC) attempted to purchase 51.66 per cent of Lynas Rare Earths, FIRB required CNMC to reduce its proposed ownership of Lynas to less than 50 per cent and to ensure its directors did not take more than half the board positions in the company. This condition was considered too onerous by CNMC, which then withdrew from the deal.

At the state level, there also seems to be a 'rule of thumb' for certain projects. For example following the extended delay of the Oakajee Port and Rail project in Western Australia, Chinese investors have shown a willingness to invest in the project, but as Padbury Mining chief executive Gary Stokes notes, 'the ownership has to be Australian' adding: 'It's the elephant in the room – the Chinese understand that.'[24] There also seems to be a preference for large resource companies to take Chinese investors on as a source of capital and a stable demand as opposed to a majority shareholder.

A recurrent point of reflection in my interviews with Chinese banking executives, who have operated in Melbourne and Sydney for over a decade, is that new Chinese investors generally do not fully understand the factors which may lead them to having to take a minority share in an investment. In China, foreign companies are allowed to hold a controlling share (51%) and even have 100% ownership of a project. Furthermore, when approving inbound FDI projects China does not demand declaration or clarification of state ownership. There is an expectation of reciprocal treatment. Following the FIRB rejection of the China Nonferrous Metal Mining purchase of Lynas Rare Earths, Foreign Ministry spokeswoman Jiang Yu said, 'For a long time, China has had an open policy when it comes to foreign companies investing here.'[25]

From an Australian perspective, this expectation is challenging because foreign investment in certain sectors in China is indeed restricted. However, from a Chinese viewpoint, the restricted sectors in China are clearly defined and not based on ownership structure. In Australia, there is no clear written definition on what enterprises, particularly SOEs, can or cannot invest in. Instead, there is an intentionally vague 'national interest test' with no legislated rules for what constitutes the 'national interest'.

The second 'gap in expectation' that came up in my interviews in Perth, focusing on the operational aspects of mining projects, is the need for the investor to provide major infrastructure such as roads, ports, electricity, and water for green field resource projects. In

Western Australia, that infrastructure is the responsibility of the mine operator. But in China, it is the local government that builds those facilities as a pre-condition for establishing a green field investment project. This applies to both foreign investors and Chinese investors from outside a particular administrative jurisdiction.

My interviews in Perth revealed that some experienced Chinese mining operators see the Western Australian government's approach as understandable. The interviewees noted that it is an established tradition for any mining operator to be responsible for enabling the whole process from mining to loading onto ships for trade. They also stated that basic infrastructure, given the extremely low population density, can have little public utility. Hence, from my perspective there is solid logic behind Australian norms. It is just that the standard practices between China and Australia are different.

Both of the two aforementioned 'gaps in expectations', as one Sydney-based Australian expert with a deep knowledge of both the Australian and Chinese environments emphasised, can be narrowed through 'learning-by-doing'. In fact, Chinese investors perhaps err by speaking to the media, either in Australia or in China, about their 'difficulty' in grappling with Australian norms. Those articulations tend to trigger negative media commentary, leading to concerns that Chinese investors are in Australia to demand change to long-established norms.

Finally, the third 'gap in expectation', is the 'rule of the thumb' practice for the engineering, construction, procurement, and management (ECPM) to be done by local operators. I do believe that, at least in the mining sector, this can be a source of real incompatibility. After all, one notable reason for a Chinese company executive to justify investing in Australia is to internationalize the company's managerial staff. On the one hand, productivity and efficiency in engineering requires synergy among the personnel and an engineer sent by a Chinese company may or may not fit in quickly enough. Preference for construction and procurement to be local can also be viewed through this lens.

On the other hand, if Chinese managers are not exposed to the operational process, one can question what added value the investment generates. After all, an investment limited to share-holding only – with uncertain returns – does not always assist a Chinese company executive, whose has to answer to questions from his home government evaluators about the added value earned. As mentioned in the previous section, one of the attractions of Chinese investment to Australia is that it provides a good chance to test and improve a company's capabilities and develop an investment brand.

Taken together, the three noticeable areas of incompatibility between Chinese and Australian practices are market-based in nature. But they could become a bigger issue as more and more Chinese companies enter the Australian investment environment unprepared.

Second, how do Australia's Foreign Investment Review Board (FIRB)'s requirements for approval of state-owned enterprise (SOE) investments affect Chinese assessments of risk?

FIRB as a topic frequently surfaced in my interviews. There were a wide range of views expressed, some of which were contradictory. These can be summarised as the following. First, Chinese investors with significant experience in investing in Australia mostly indicated that FIRB was not a serious issue and that over time they have come to understand the way

FIRB works. Second, Australian government representatives and some Australian business people said that establishment of FIRB dates back to 1976 (when Chinese companies did not even contemplate investing in Australia), operates transparently, and updates its criteria for review periodically. Third, Australian government and business people also said that the high rate of approved proposals demonstrates that media speculation about Chinese investments being discriminated against is unwarranted. Fourth, some academics working in Australia said that published approval rates can be deceptive because investors are sometimes advised in advance by FIRB that their applications would be unsuccessful, or that restrictions will be placed on the investment. Thus, some companies choose to withdraw their application; hence those cases are excluded in the official compilation. Fifth, numerous interviewees of different backgrounds said that Chinese investors are fast learners in navigating the process.

China's Ministry of Commerce (MOFCOM) does include the substance and procedure of FIRB in its country introduction of Australia as a foreign investment destination. This document is updated annually and lists the official websites of Australian government agencies that play a role in handling incoming FDI.[26]

Comments attributed by the *Australian Financial Review* to Jerry Jiao, president of China Minmetals Non-Ferrous, an SOE, whose partnership with the Melbourne-based MMG Limited is generally seen as a successful, provides a sense of Chinese executives' awareness of Western sensitivities about state ownership. 'We always say we can't choose our parent but what we can choose is to behave as a nice baby.'[27] During interviews with Australian and Chinese executives, it was generally acknowledged that once approved, the ownership structure of a Chinese investment is seldom an issue of concern.

The issue of state ownership may, instead, be read as a ‘China clause’. As I see it, examination of the ownership structure of an incoming Chinese investment should not be a substitute for an examination of a company’s previous performance. This is particularly true in the mining and agriculture sectors, which require proper understanding and handling of the engineering and technological aspects of a project. In China’s case, the most experienced companies tend to be SOEs.

Third, in what ways may Asia-Pacific geopolitical dynamics factor in Chinese assessments of Australia in terms of sovereign risk?

The topic of regional geopolitics was raised by a number of interviewees. An underlying theme in the discussion is Australia’s visible role in the United States’ ‘pivot’ or ‘re-balancing’ to Asia, which is widely accepted in Chinese quarters as mainly and almost exclusively aimed at China’s pursuit of prosperity and deeper engagement with its neighbours. Chinese investors’ disquiet centres on hypothetical Australian actions to protect their assets, should Canberra make a clear-cut geopolitical choice between Beijing and Washington. Australian business professionals, in turn, are concerned that China’s investment into Australia could be curtailed by geopolitical factors.

From Beijing's perspective, because of Australia’s close security relationship with the United States, it is difficult to ascertain the degree to which security ties between Australia and China derive from those between China and the United States. Australia’s relationship with the United States and its role in the ‘pivot’ does not currently affect the Chinese-Australian investment relationship. But if a downturn occurred in the broader Australia-China or US-China bilateral relationships, there is a potential that it could impact on the Australia-China economic relationship. FDI is always more sensitive and difficult than trade, so it is often more vulnerable to fluctuations in the wider security-diplomatic relationship.

It would be useful for Canberra and Beijing to bring their respective underlying senses of uncertainty about each other to the forefront of discussion and debate. Such an exercise can, for example, put into perspective Chinese apprehension about a return to the two decades of total trade embargo by the United States and its security allies that it experienced from the 1950s through the 1970s. The web of linkages which the Chinese economy has weaved with the rest of the world provides a level of assurance against repetition of the past. Still, this would make it more natural for Chinese regulators of investment outflows to have a clearer sense of seeing their foreign investment assets protected by the host government under scenarios of deep tension and in the worst case active hostility. It should also help address Australian worries about over dependence on China in both trade and investment.

Thus far, as I found on the basis of interviews with Chinese executives in Australia, that there is also a bureaucratic concern for Chinese SOEs operating in Australia. Chinese government regulators conduct reviews of profit-generation of investments according to a fixed timeline. This is a source of pressure on those executives who initiated and/or are managing investment projects abroad. An unintended consequence of this pressure to produce profit rapidly is that many Chinese SOE investment projects start off with defects that will prove costly to amend. These defects can range from insufficient due diligence in project and partner selection to competition against fellow Chinese investors. The desire to appear to get a project 'done fast' can result in face-saving posturing by citing lack of goodwill on the part of Australian parties as a cause of project failure that is 'beyond their control'.

Conclusion

Key outcomes of my research can be summarised as follows. First, there is less strategy in China's 'go out' policy than public rhetoric suggests. Chinese company executives, not their government regulators, initiate investment projects and the executives are evaluated on their performance in profit generation from established FDI projects. China has its own systems for approving both inbound and outbound FDI.

Second, Australia is an attractive destination for Chinese FDI. While profit remains a key driver, there are other factors that make Australia attractive. Some Chinese companies wish to turn from a buyer of industrial materials to an investor and operator of their production. Absence of residual security issues between the two countries is also an important factor, as it contributes to low concerns over sovereign risk. In addition, success in the Australian market can help a Chinese company enhance its credentials in becoming a truly global multinational corporation.

Third, questioning in quarters of the Australian society about ulterior motivations behind Chinese FDI reflects the short history of large scale inflow of Chinese investment capital. China's footprint in the Australian mining sector follows a historical pattern of investment activities from other countries in Northeast Asia. A key point of contention between Chinese attempts and Australian reactions is about the level of share-holding, at least in the project establishment phase.

The following issues, though certainly not exhaustive, merit further consideration, in the interest of building up a more stable relationship in investment and trade between China and

Australia in the future.

One, there is a need for comprehensive examination and wide publicity – conducted by authoritative agencies -- of the record of performance of established Chinese investments. Mining attracts much space in public discussion. However, when 'exports from China's biggest single mining investment in Australia [the CITIC Pacific Sino Iron project] had still not begun' (reportedly three years behind target date), sustainability of Chinese investor confidence may have been adversely affected.[28] After all, profit is the single most powerful driver when measuring investment success.

A necessary component of such an examination must include case studies of success and failure, together with an assessment of the practical lessons that Chinese investors and their Australian partners need to learn about doing business with each other. Doing so can help promote 'best practice' models for Chinese investors to benefit from, which in turn is conducive in the pursuit of a long term relationship among Australian and Chinese businesses.

Two, more effort needs to be made to familiarise aspiring Chinese investors with the laws and rules of Australia as an investment destination. This needs to be done before the border, i.e., before an investment application is conceived. Details matter, so does their publicity. Increasingly, Chinese companies with little or no prior experience in or exposure to business practices in a foreign (much less advanced) economy are trying their luck by 'going out'. Due to the evolving economic system in China there is no set model to pursue FDI.[29]

Doing so can be beneficial to Australian interests as it can help prevent misperceptions and even possible misrepresentations of FIRB at the national level, and regulations and rules at the state and local levels. More publicity of norms is also helpful. A particular case in point is that a Chinese investor may want to be directly involved in all phases of a project. In contrast, Australian interviewees indicated that the Chinese side needs to approach the Australian investment environment by accepting more local involvement in the ECPM to avoid cost overruns and project delays. Meanwhile, the author believes that the Australian side should make an effort to include as much Chinese involvement in the same process on the basis of compatible capacities, both technical and managerial. A strong commitment on both sides to pursuing 'good faith' interactions is needed to avoid misunderstanding of intent.

Third, geopolitical concerns lurking in the background need to be addressed early on and in a frank manner. China does not see Australia as a threat. Public discourse in Australia contains references to China as a possible threat. Continued stories of investment failure together with the question of sovereign treatment of assets should geopolitical dynamics in the region turn toward active hostility is not conducive to public support in China for prioritising Australia.

It is in the long-term interest of both Australia and China to treat the policy durability of two-way investment flows as seriously as they handle specific cases. Doing so would be a positive contribution to improving the overall bilateral relationship as well.

All in all, cross-border investment is, for all stakeholders, about choice. Investment flows go through a globally competitive process and there is a mutual need for a productive and predictable relationship, both for source and destination countries. Non-commercial risk, either from the Chinese or Australian side, is not yet a major issue. Yet, there is little justification for complacency.

[1] Australian Bureau of Statistics, 5352.0 - International Investment Position, Australia: Supplementary Statistics, Calendar Year 2011, Table 2, 3 May 2012: http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5352.0Calendar%20Year%202011?OpenDocument.

[2] Doug Ferguson and Hans Hendrischke, *Demystifying Chinese Investment: China's outbound investment in Australia*. Sydney, KPMG and China Studies Centre and University of Sydney, 2012.

[3] Ibid.

[4] Peter Drysdale, A New Look at Chinese FDI in Australia. *China and World Economy* (19) 4 2011, pp 54-73. See also, Peter Nolan, *Is China Buying the World?* Cambridge, UK, Polity Press, 2004.

[5] Geoff Dyer, Beijing offers just quarter of stimulus funds. *Financial Times*, 14 November 2008: http://www.ft.com/intl/cms/s/0/5560f88e-b2a4-11dd-bbc9-0000779fd18c.html#axzz2TDpyTJ7i.

[6] Daniel H. Rosen and Thilo Hanemann, *China's changing outbound foreign direct investment profile: Drivers and policy implications*. Washington, DC, Peterson Institute for International Economics, June 2009: http://www.iie.com/publications/pb/pb09-14.pdf.

[7] Peter J. Buckley et al., Historical and Emergent Trends in Chinese Outward Direct Investment, in Peter J. Buckley (ed.), *Foreign Direct Investment, China and the World Economy*. Palgrave Macmillan, 2009, pp 119-157.

[8] For a list of some of the transactions of larger SOE investors in Australia, many of which have majority stakes in their investments, see Doug Ferguson and Hans Hendrischke, *Demystifying Chinese Investment: China's outbound investment in Australia.* p 14. http://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/china-insights/Documents/demystifying-chinese-investment-2012.pdf.

[9] For example, Sinopec's first investment in Australia was a 60 per cent share in oil producer AED. The company's second investment was a 15 per cent (later increased to 25%) share of the Australia Pacific LNG gas-export joint venture (with Origin Energy and Conoco Phillips). In early 2013, CNPC bought a 10.2 per cent stake in the Browse liquefied natural gas (LNG) project in Australia for $1.63 billion from the mining company BHP Billiton. In late 2012 Chinese electricity supplier signed a $500 million deal to buy a 41 per cent stake in South Australian electricity supplier ElectraNet.

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[11] This interview was conducted with an Australian mining executive, based in Melbourne, who has over a decade of experience of collaboration with Chinese SOEs.

[12] For an official listing, see the SASAC website: http://www.sasac.gov.cn/n2963340/n2971121/n4956567/index.html.

[13] John Hassard, Jonathan Morris, Jackie Sheehan and Yuxin Xiao, China's state-owned enterprises: economic reform and organizational restructuring. *Journal of Organizational Change Management*, (23) 5 2010, pp 500-516.

[14] For a full text translation of the entire document, see Nathalie Bernasconi-Osterwalder, Lise Johnson, and Jianping Zhang, *Chinese Outward Investment: an emerging policy framework*. Winnipeg, Manitoba, Canada, International Institute for Sustainable Development, 2012, pp 83-89: http://www.vcc.columbia.edu/files/vale/content/Chinese_Outward_Investment_-_An_Emerging_Policy_Framework.pdf.

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