

Targeting the giants comes at a price

February was not a good month for Chinese overseas investment. Amid a Foreign Investment Review Board investigation of Chinalco's bid for a stake in Rio Tinto, the Rudd government said it would more closely regulate investments by sovereign wealth funds from China and the Middle East.

In the United States, Chinese tech leader Huawei withdrew its offer to buy a part of American IT firm 3Com in frustration at the failure of the Committee on Foreign Investment in the US to approve the deal.

Chinese retaliation is unlikely to be far behind for what a senior official dubbed "financial protectionism".

Political tensions over trans-Pacific investment will only increase because the economic incentives for foreign investment are so powerful.

China wants to use its mountains of cash and stronger currency to buy up firms in other countries with the raw materials, technology and knowhow its economy desperately needs, from commodity producers in Australia to high-tech firms in the US.

Western companies salivate at the prospect of selling to hundreds of millions of new middle-class Chinese consumers. But they understand that to sell in China, it is much better to be in China than to export there.

Sovereign wealth funds are under scrutiny but keeping them out leads to costly protectionism, writes **Geoffrey Garrett**.

All this foreign investment requires host government approval and, unlike trade, there are no global rules stopping governments from building whatever barriers to foreign investment they choose.

Treasurer Wayne Swan has justified Australia's new scrutiny on sovereign wealth funds in terms of the differences between the profit motives of a company and the political motives of governments (especially non-democratic ones, such as China's Communist Party): "Investors with links to foreign governments may pursue broader political or strategic objectives that could be contrary to Australia's national interest," Swan's office says.

That Chinalco's president is an alternate member of the 17th central committee of the Communist Party is only grist for this mill.

Australia can disapprove of foreign government investments that adversely affect the "national interest". The US can void any foreign investment that harms "national security". China will not accept foreign investment that hurts "national economic security".

No one would deny that national

governments must defend national interests. The real question is when foreign investments legitimately threaten them.

The General Agreement on Tariffs and Trade and the World Trade Organisation system constrain the ability of governments to restrict trade in the name of the national interest. But there are no such multilateral constraints concerning foreign investment.

Australia can argue in the Chinalco-Rio Tinto case that it is not in the national interest to have a Chinese company, with apparently strong links to China's communist government, involved in mineral extraction. The US did just this a few years ago in not allowing China's CNOOC to buy a portion of oil and gas company Unocal.

The US doesn't look kindly on Chinese stakes in high-tech firms such as 3Com because of "dual use" technologies that can be redirected from civilian to military uses.

If minerals and technology are strategic national resources, the road for Chinese investment in Australia and the US looks rocky.

But this can be expected only to

raise the bar for Western investment in China, particularly given China's desire to create its own national champions to compete with global multinationals.

War stories of long, arduous and uncertain efforts to invest in China are legion. And the price to win the approval of the Chinese government is often high. Just ask Wal-Mart, which allows its Chinese workers to hold Communist Party meetings on company time and on the factory floor, or Yahoo!, which turned over private information on users to the Chinese government.

Creating an orderly, predictable and balanced environment promoting foreign investment in the Asia-Pacific region is in the interests of Australia and the US as well as China.

The US and Australia must resist the temptation to put too much heat on Chinese investment in their countries. If they succumb to this temptation, the costs will be very high. The last thing the struggling global economy needs is a downward spiral of investment protectionism with China.

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Australian Financial Review (2.03.2008)