Testing their metal

Chinese efforts to gain influence over a vital commodity have come to naught.

Eyevine

The offer that BHP Billiton, a mining conglomerate, made in mid-October to buy United Minerals, a prospecting firm with operations near BHP's iron-ore mines in the Pilbara region of Australia, came with one notable string attached: United must abandon plans to sell an 11% stake to China Railway Materials Group, a state-owned Chinese firm. If United's shareholders accept the A$204m ($187m) BHP is proffering, as their managers recommend, it will mark another defeat in the Chinese government's concerted but largely fruitless campaign to gain more influence over the market for iron ore.

The wares of Western mining giants, especially iron ore, are vital to the vast infrastructure projects that are transforming China. The government is nervous about this dependence, especially because just three firms—BHP Billiton, Rio Tinto and Vale—dominate the international trade in iron ore. So China's government, acting through state-controlled companies, has been trying to overturn this oligopoly by encouraging Chinese customers to negotiate purchases in unison, by hunting for alternate supplies and even by buying a stake in Rio, all to little effect.

Chinese firms have managed to make small investments in iron-ore firms, especially in the Pilbara, the closest big ore-producing region. Sinosteel, a state-owned steelmaker, snatched Midwest, a small Australian producer, last year. In August Baosteel, the partly state-owned firm that is China's biggest steelmaker, paid A$286m for 15% of Aquila Resources, a producer of iron ore and coal. Most notably, Chinalco, a state-controlled aluminium firm, bought 9% of Rio Tinto last year.

But when Chinalco subsequently agreed to raise its stake to 18% as part of a $19.5 billion deal to bolster Rio's finances, the Australian firm balked at the last minute thanks to recovering commodity prices and hostility from shareholders. Instead, Rio and BHP agreed to merge their iron-ore operations in the Pilbara through a joint venture, creating just the kind of titan that China had feared when it opposed BHP's ultimately unsuccessful attempt to take over Rio last year.

Even before BHP and Rio decided to team up, China had been trying to undermine the pricing power of the big iron-ore firms. For decades the annual price-setting negotiations between the big suppliers and leading steelmakers had been dull affairs: prices rose only gradually. But China's sudden emergence as a big buyer of iron ore (it now snaps up more than half of all exports) pushed prices up fourfold between 2002 and 2008.

In past years the price agreed between one of the mining giants and the first big Japanese or South Korean steelmaker to strike a deal became the benchmark for all other buyers and sellers. In 2005, as a mark of China's importance, Baosteel took over as the principal negotiator. But it was still forced to swallow a succession of big increases in prices—72% in 2005, for example, and 96% last year for Australian ore.

In an effort to counter what China regards as the undue power of the mining giants, negotiations this year were handled by the China Iron and Steel Association (CISA), a trade body that supposedly represents the country's entire steel industry. CISA made it clear early that it wanted a cut of around 40% to reflect the toll taken on steelmaking by the economic turmoil. But increasingly acrimonious talks dragged on past a succession of deadlines until South Korea and Japan pre-empted China and agreed to a cut of just 33%.

Meanwhile cracks had already appeared in Chinese solidarity. As the economy perked up steel mills bought ore first on the spot market and later from the big three at a "provisional price" that exceeded what CISA was demanding.

Further grist was added in July with the detention of Stern Hu, the head of Rio's marketing operation in China, and three Chinese colleagues. They were eventually charged with obtaining commercial secrets, although Rio maintains that they were merely collecting commonplace commercial data. The arrests were widely interpreted as a signal that China was fed up with the miners' intransigence over prices and as a rebuke to Rio for pulling out of the Chinalco deal.

As negotiations over next year's price begin, China faces a bigger threat: the end of the benchmark system altogether. BHP has long wanted to replace the annual changes in price with quarterly ones, based on the spot market. Rio has recently come round to BHP's view, doubtless because it agrees that prices will rise steadily in the coming years and a quarterly system will allow it to increase prices more often. China, meanwhile, will find itself with even less sway over the price than when it began its campaign.

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