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Chinese Investment (Mostly) Welcome

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On consecutive days in September, China's State Administration for Foreign Exchange (SAFE) found itself in a tough spot: a headline. First, the *Financial Times* reported that SAFE agreed to buy Costa Rican bonds in exchange for a switch in recognition from Taiwan to China. The deal, however, was contingent on Costa Rica blocking public knowledge of the arrangement.[1] Then Thomson Reuters cataloged SAFE's small stakes in 45 British firms, including National Grid and British Energy—at least $17 billion in investments SAFE refused to discuss.[2]

These reports are only the tip of the iceberg. While the focus has been on sovereign fund China Investment Corp., SAFE is the much bigger entity. Its holdings of American bonds approach $1 trillion. It has also become active in global equities purchases. In addition, large Chinese state-owned enterprises swarm over Africa, the Middle East, and elsewhere searching for energy, metal ores, and construction contracts.

The buzz of activity has some feeling besieged. An examination of available information reveals no substantial threat regarding how much is spent or where it is going. The real problem is how much we do not know about the situation. What we do know with certainty, however, is that in many cases—as in the Costa Rican example—money is being directed according to non-economic objectives.

A Broad Sweep. Reports covering Chinese outward investment invariably mention $1.8 trillion in foreign reserves held by SAFE and their remorseless climb—$45 billion monthly in the first half of 2008.[3] Official American debt is estimated to account for over half. China's purchase of American bonds reached $504 billion in treasuries and perhaps $446 billion in agency debt at the end of June.[4] For currency balancing, official European and Japanese debt is held in significant quantities. There is also corporate debt of many stripes. The principal market worry is usually that this investment may come to an end.

In contrast, the fretting over China's other outward investment, in equities and physical assets, is that it will continue and intensify. Equity stakes are naturally concentrated in more developed economies, where more attractive companies are based.[5] Direct acquisition of physical assets is more evenly distributed. The expansion of Chinese business into Africa and the Middle East has received the most attention, but Australia has attracted more Chinese money than any other single country.[6]

It might be reassuring that direct investment is relatively small. The quality of the data provided by China's Ministry of Commerce is low, but outward "non-financial" investment was put at $25.7 billion for the first half of 2008, with an accumulated stock of perhaps $110 billion.[7] While American and Chinese numbers are not directly comparable, the

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former was $314 billion in 2007 with accumulated stock of $2.8 trillion.[8]

Non-Political Motives. Present financial problems show how too much liquidity breeds overspending. China is going to spend—and waste—a great deal of money simply because it has accumulated so much via trade surpluses and defense of the yuan. This undercuts the stated reason for more aggressive investment of reserves: higher returns.[9] Higher returns just add to a stockpile that, with a nonconvertible currency, now does little to enhance China's true wealth.

Hence, other motives for outward investment are at least as important. It can bring political good will from job creation. As Japan did, China will invest in part to protect lucrative trade links. Outward investment can also secure outright political gains in small countries, as in the Costa Rica example. Acquisitions of minority stakes bring exposure to better corporate practices; majority stakes bring unique assets.

This last relates to the main objection to Chinese spending: It is a resource grab, especially of physical assets such as oil fields.[10] There is certainly a non-commercial component to the behavior of state enterprises. Following national priorities in securing mineral supplies can trump proper valuation. This bids up global commodities prices beyond the additional demand introduced by China's rapid growth.[11]

Transparency Is Key. As China becomes an investment fixture, there will be more competition over broadly desired assets. If China wants free and fair access to American and European companies and what they own, it should grant the same access to its resources and corporate sector. This is much

1. Jamil Anderlini, "Beijing Uses Forex Reserves to Target Taiwan," *Financial Times*, September 12, 2008, at *http://www.ft.com/cms/s/0/22fe798e-802c-11dd-99a9-000077b07658.html* (September 24, 2008).
2. Dow Jones, "UPDATE: SAFE Steadily Building Stakes in UK—Thomson Reuters," MarketWatch, September 12, 2008, at *http://www.marketwatch.com/news/story/-update-safe-steadily-building/story.aspx?guid=%7B1CC7BF6C-F4FA-4E1C-A16E-AC9AAAFEA328%7D* (September 24, 2008).
3. "China's Foreign Exchange Reserves Top 1.8 Trillion Dollars," radio86 All About China, July 14, 2008, at *http://www.radio86.co.uk/china-insight/news-today/7118/chinas-foreign-exchange-reserves-top-1-8-trillion-dollars* (September 24, 2008).
4. "China may cut its dollar holdings—CICC," *China Daily*, September 12, 2008, at *http://www.chinadaily.com.cn/china/2008-09/12/content_7020656.htm* (September 24, 2008); U.S. Department of the Treasury, Treasury International Capital System, *Major Foreign Holders of Treasury Securities July 2007 to July 2008*, at *http://www.ustreas.gov/tic/mfh.txt* (September 24, 2008).
5. "Ping An Buys Stake in Fortis for $2.7 billion," International Herald Tribune, November 29, 2007, at *http://www.iht.com/articles/2007/11/29/business/insure.php* (September 24, 2008).
6. See, for example, "UPDATE 1-China Metallurgical to buy Australia Iron Mine," Reuters, February 25, 2008, at *http://www.reuters.com/article/rbssIndustryMaterialsUtilitiesNews/idUSSYD28851420080226* (September 24, 2008).
7. "China's Overseas Investments More Than Double in First Half: Govt," Agence France-Presse, July 23, 2008, at *http://afp.google.com/article/ALeqM5gv8GifdvuO9Q7RITM4jUiSWpJkQA* (September 24, 2008); China Daily, "Overseas Non-Financial Investment Rises 6%," China Cultural Industries, April 23, 2008, at *http://e.cnci.gov.cn/doce/news/news_detail.aspx?news_id=4455* (September 24, 2008).
8. U.S. Department of Commerce, Bureau of Economic Analysis, International Economic Accounts, US Direct Investment Abroad 2004-7, at *http://www.bea.gov/international/datatables/usdctry/usdctry.htm* (September 24, 2008).
9. Gao Weijie and Chang Song, "The China Investment Corporation: Keys to Success," APCO Worldwide, Spring 2008, at *http://www.apcoworldwide.com/content/newsroom/newsletter/2008-spring/sovereign_wealth_funds.cfm* (September 24, 2008).
10. Press release, "Sinochem to Buy SOCO Yemen for $465M," SOCO International, February 4, 2008, at *http://www.rigzone.com/NEWS/article.asp?a_id=56202* (September 24, 2008).
11. See, for example, Elaine Kurtenbach, "Alcoa, Chalco Buy Rio Tinto Stake," *International Business Times*, February 1, 2008, at *http://www.ibtimes.com/articles/20080201/alcoa-chalco-buy-rio-tinto-stake.htm* (September 24, 2008).

easier said than done, but given the amount of money involved, it is worth a protracted struggle.

What must be quickly achieved is greater transparency from SAFE as well as state firms. SAFE declines to discuss even the existence of offshore arms through which purchases are made. Just a quarterly report of SAFE's holdings would go far. If transparency can be achieved, China's outward investment would be a large net positive for business, reintroducing capital otherwise tucked away. Without transparency, the world will continue to be suspicious of China's intentions, and headlines exposing political or other dubious motives will generate increasing levels of political heat.

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