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BACKGROUNDER

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China's Global Investment Rises: The U.S. Should Focus on Competition

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Abstract

In 2012, Chinese outbound investment set new records both in the U.S. and around the world. North America has jumped to the forefront of Chinese business activity, but this development is likely to be temporary: The pattern over time is for Chinese enterprises to move as a group from region to region. Energy and metals draw the most money. The outlook for Chinese investment in 2013 and beyond is positive, but setbacks will continue to occur, due in part to foreign suspicion of state firms. The U.S. in particular should formulate policy to ensure competition, with the Chinese firms that come here, in the Chinese market itself, and around the world through the Trans-Pacific Partnership and other agreements that liberalize market access.

This paper, in its entirety, can be found at **http://report.heritage.org/bg2757**

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Chinese outward investment broke records in 2012, both around the world and in the United States. Foreign distrust of state enterprises and other obstacles will serve as a check on the pace of growth, but the willingness to pay top dollar for energy and other assets ensures a higher profile for Chinese firms. The People's Republic of China (PRC) is hardly buying up Latin America or the world oil market, but it is expanding its share.

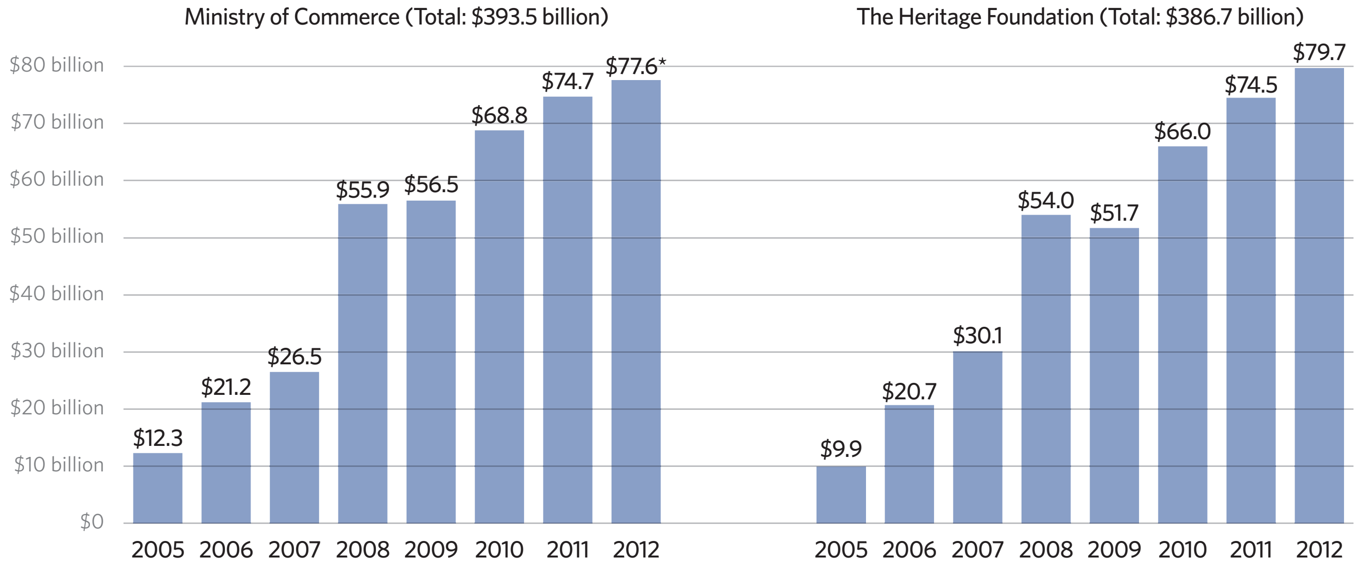
This expansion will eventually require a concerted American policy response—and an early start in crafting that response will be more effective. The response should emphasize competition: The U.S. should welcome Chinese investment but ensure that it does not undermine competitive markets here. The Obama Administration should make clear that Chinese complaints about market access cannot be considered in isolation from better-established American complaints about anti-competitive regulation and policies in the PRC. The U.S. should also compete with Chinese investments around the world, starting with the signing of the Trans-Pacific Partnership (TPP), which would create the basis for a broad transpacific free-trade area.

Key Points

- Chinese outward investment around the world set another record in 2012. The rate of increase was again moderated by foreign distrust of Chinese state enterprises.
- Energy continues to attract the most Chinese money, while North America became the most popular destination for Chinese firms.
- Chinese investment in the U.S. in 2012 shattered the previous annual record. This benefits American workers and households.
- The growing Chinese presence in the U.S. does require that attention be paid to Chinese activity to ensure that it does not undermine fair competition.
- The PRC's greater stake in the U.S. provides leverage for American negotiators to push for a more open Chinese market.
- The U.S. should meet the Chinese challenge around the world by negotiating high quality economic agreements, such as the Trans-Pacific Partnership.

CHART 1

Chinese Outward Investment Since 2005: Two Views



* Estimate based on extrapolating official figures for January through November.

Sources: The Heritage Foundation, China Global Investment Tracker dataset, updated January 2013, https://thf_media.s3.amazonaws.com/2013/xls/China-Global-Investment-Tracker2013.xls; Ministry of Commerce of the People's Republic of China, National Bureau of Statistics of the People's Republic of China, State Administration of Foreign Exchange, *2011 Statistical Bulletin of China's Outward Foreign Direct Investment*, China Statistics Press, August 2012; and Xinhua, "China's non-financial ODI grows at slower pace," December 18, 2012, http://english.peopledaily.com.cn/90778/8061743.html (accessed January 2, 2013).

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(The markets on the eastern side of the TPP already have free-trade agreements with the U.S.)

The China Global Investment Tracker

The Heritage Foundation offers the only public dataset of Chinese outward investment.[1] The China Global Investment Tracker includes over 400 investments of $100 million or more recorded from January 1, 2005, through December 31, 2012. It also includes over 250 engineering and construction contracts undertaken by Chinese enterprises overseas, which are a crucial part of the country's economic footprint. Finally, the tracker includes about 100 troubled transactions, where projects or acquisitions were impaired. The tracker does not include transactions valued at less than $100 million, loans, or aid. It also excludes bonds.

The investment totals in the Heritage dataset are similar to those published by the Chinese government, though the method of compilation differs. Annual results are affected by such differences but both series show clear growth in Chinese non-bond investment since the financial crisis. This growth continued in 2012, so that investment set another record and may have exceeded $80 billion (final government figures are not yet available). The time for rapid gains, seen between 2005 and 2008, has passed, but a continued climb toward $100 billion annually is likely.

Where China Invests

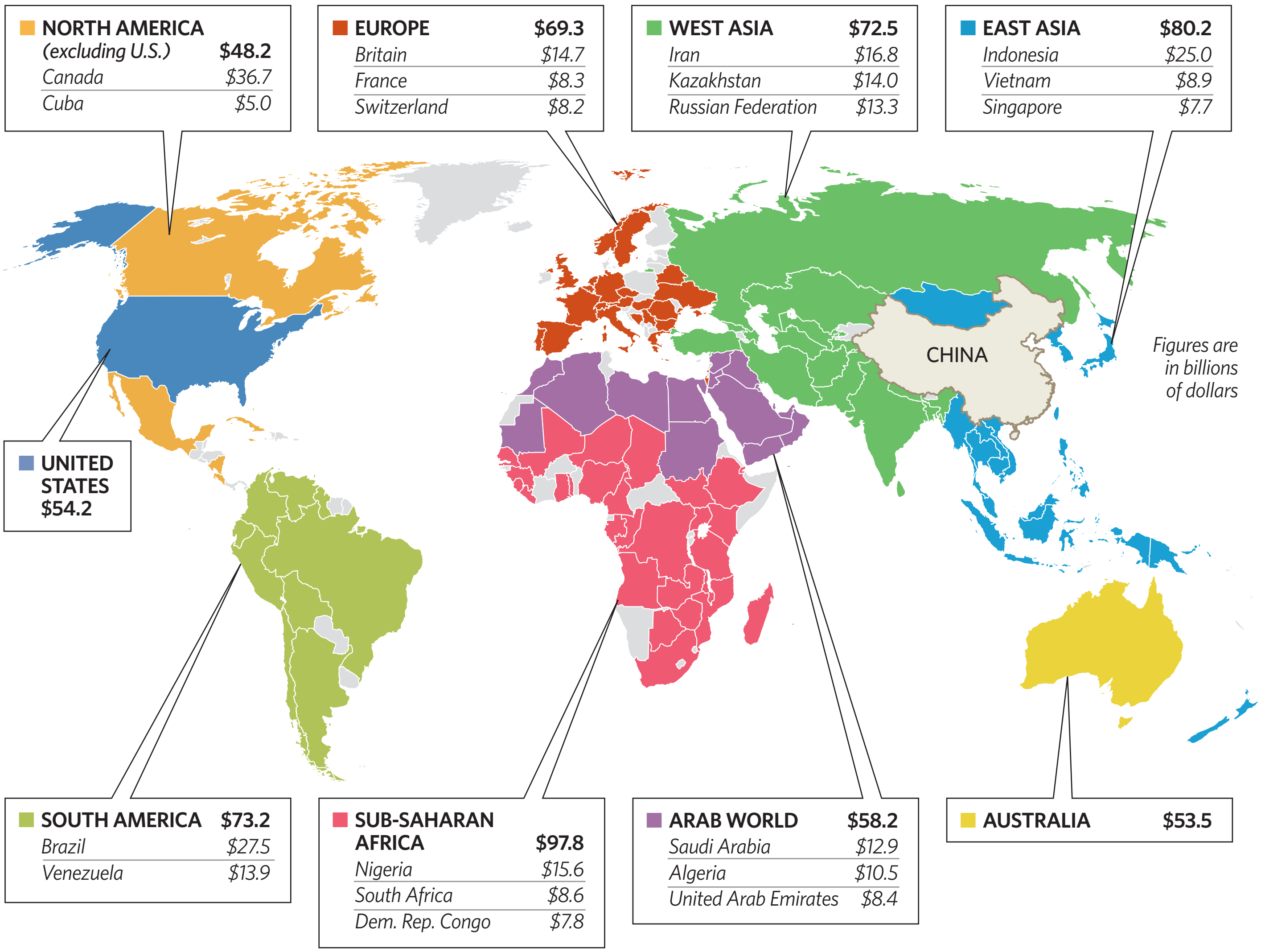
Official Chinese data are otherwise unhelpful. An obvious example is the treatment of Hong Kong as a final destination rather than a transit point. According to the PRC, Hong Kong attracts more than $35 billion in Chinese capital annually while

1. The China Global Investment Tracker dataset, January 2013, https://thf_media.s3.amazonaws.com/2013/xls/China-Global-Investment-Tracker2013.xls (accessed January 7, 2013). For an interactive version, see "China Global Investment Tracker Interactive Map: China's Global Reach," http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map. The dataset is open to public use with the appropriate attribution.

MAP 1

China's Worldwide Reach

North America drew the most Chinese investment in 2012 while sub-Saharan Africa had heavy engineering and construction activity by PRC firms.



Source: The Heritage Foundation, China Global Investment Tracker dataset, updated January 2013, https://thf_media.s3.amazonaws.com/2013/xls/China-Global-Investment-Tracker2013.xls.

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countries such as Germany have never reached the $1 billion mark. This is wildly inaccurate—the money is merely moving through Hong Kong to large economies, such as Germany's. The tracker uses corporate-level information, not national, to follow money to the final destination. The method reveals that the large majority of investment purported to go to Hong Kong ultimately ends up in foreign economies, and paints a far more accurate picture of where the PRC is truly investing.

The leading recipients of Chinese non-bond investment since 2005 have been Australia and the U.S. Other major recipients are Canada, Brazil, Britain, and Indonesia. In 2012 alone, Canada topped the list, thanks to the Chinese CNOOC's $15.1 billion acquisition of Nexen, the largest outbound investment to date. The U.S. was second: After a weak 2011, Chinese investment here shattered the old annual record with over $14 billion spent (including a $4.2 billion

TABLE 1

Sector Breakdown, 2005–2012

CHINESE BUSINESS ACTIVITY, IN BILLIONS OF DOLLARS

Sector	Investment	Engineering contracts	Troubled
Energy and power	$186.1	$97.2	$75.4
Metals	90.2	8.6	57.7
Finance	37.3	—	29.2
Real estate and construction	21.7	27.6	7.2
Transport	16.6	72.9	15.0
Agriculture	11.8	6.8	9.5
Technology	8.7	4.9	13.3
Chemicals	6.2	2.1	0
Other	8.2	0	0.3
Total	**$386.7**	**$219.9**	**$207.5**

Source: The Heritage Foundation, China Global Investment Tracker dataset, updated January 2013, https://thf_media.s3.amazonaws.com/2013/xls/China-Global-Investment-Tracker2013.xls.

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acquisition late in the year). North America drew a full 40 percent of Chinese non-bond investment in 2012.

The contemporary prominence of North America extends a pattern. Regarding overseas investments, Chinese enterprises have shown a clear tendency to move in packs. Large-scale investment started in Australia in the middle of the past decade. Sub-Saharan Africa received a rush of investment at the end of the past decade, then it was South America's turn in 2010–2011. Now the focus is on North America. If form holds, 2013 should be another strong year of Chinese investment in North America but, before year's end, a shift may have begun to another region. Europe and the oil-producing states in West Asia are possibilities.

Equally important is the fact that the PRC does more overseas than invest. The engineering and construction contracts included in the tracker are valued at more than $200 billion, and their inclusion offers a much more complete picture of China's role in the world. Compared to the investment leaders, an entirely different set of countries—such as Venezuela, Saudi Arabia, and Vietnam—has the heaviest engineering and construction activity. By region, the Arab world and sub-Saharan Africa receive more Chinese business in the form of contracts than in investment while East Asia is near balance. In the Americas, Europe, and Australia, engineering contracts are far fewer.

Considering investment and contracts together, a strong 2012 enabled North America to take the lead in drawing the most Chinese interest since 2005. Sub-Saharan Africa is now second. (Considering investment only, sub-Saharan Africa is much lower.)

Energy Draws the Most Attention

Chinese government figures are also unhelpful in determining which sectors are receiving the most investment. The categories that have been used, such as "business and leasing services," are unconventional at best. On the Heritage tally, unsurprisingly, energy leads in both investment and engineering and construction contracts. Oil continues to be the single largest subsector within energy but is no longer dominant, due to greater interest in gas and integrated operations.

Confirming the PRC's interest in resources, metals draw the most investment after energy, while finance has stagnated. Standing efforts at acquisitions have turned modestly successful in agriculture but are still largely unsuccessful in technology. In engineering and construction contracts, transport—rail, roads, ports—is second only to energy. Real estate has become more important recently both in terms of buying property and fixed-term construction and development contracts.

Pitfalls: The State Role

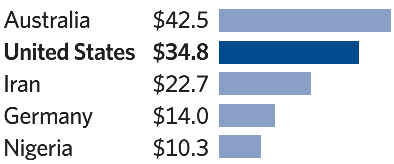
As a global phenomenon, Chinese outward investment started with a painful failure: CNOOC's attempt to buy Unocal in 2005. The Heritage Foundation dataset includes transactions that have been rejected by either host country or Chinese regulators, suffered sizable financial losses, or collapsed due to investor error. These are not merely transactions that never occurred because the parties could not agree on a price; they are deals that were signed but failed in part or in whole months later due to a nasty surprise of some sort.

In dollar terms, five countries—Australia, the U.S., Iran, Germany, and Nigeria—account for the majority of troubled transactions, typically headlined by a major failure. Australia saw aluminum giant Chinalco mishandle and lose a nearly

CHART 2

Troubled Transactions with China: Top Five Nations

IN BILLIONS OF DOLLARS



Source: The Heritage Foundation, China Global Investment Tracker dataset, updated January 2013, https://thf_media.s3.amazonaws.com/2013/xls/China-Global-Investment-Tracker2013.xls.

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$20 billion acquisition of an additional stake in diversified miner Rio Tinto and several sizable cost overruns in other mining projects.

For its part, the U.S. blocked the Unocal transaction and a variety of others, often in technology, for domestic political reasons. Germany saw one very large financial acquisition directly barred by Chinese regulators. Iran has seen the PRC's oil majors expanding global interests and sensitivity to international pressure cause them to refuse to move forward on multiple projects.

The value of the troubled transactions as a whole is over $200 billion. The volume of outward investment over the past eight years could have been half again as large as it was if host countries had been more receptive and Chinese enterprises had been more skillful. This is the primary reason why projections of an overwhelming tide of capital have been and will continue to be exaggerated. The pool of funds is present in the PRC's $3.3 trillion in foreign reserves, but that was also true in 2009, when outbound investment stagnated or declined. Just having the money is not enough to ensure it is spent.

A major reason to expect continued difficulties is the primacy of state firms in outbound investment. Most host countries are more suspicious of foreign state-owned entities than foreign private entities. The PRC's own regulators sometimes recoil from the possibility of risking funds that ostensibly belong to the people.

On government data, the largest 20 outward investors are all state-owned. The Heritage dataset identifies the parent company of the investing party and indicates that, by dollar value, state entities account for over 92 percent of investment by volume. It is true that the private role is greater when considering the simple number of transactions. It is also the case that outward investment by private firms set a record in 2012, thereby reducing the state share. Still, it should be anticipated that almost 90 percent of investments, by value, will be made by state entities in 2013. That will generate domestic political objections in host countries.

Anticipating China, Inc.

After years of trailing the much smaller Australian economy in terms of drawing Chinese investment, the U.S. caught up in 2012. If this year is similar, the U.S. will stand alone as the top recipient. This will prompt questions about whether the flow of Chinese money has become excessive. The answer is, no. American individuals and companies voluntarily engage in transactions with Chinese companies and benefit from them. At the national level, the stock of investment is barely $50 billion, negligible compared to a stock of American wealth of more than $60 trillion. Politically motivated exaggerations of a threat do not serve the national interest.

Even so, greater Chinese investment has multiple implications for American policy. The U.S. can easily absorb much more, and Beijing insists that it wants to invest more, continuously complaining about market access while the funds pour in. Reciprocity should not be taken too far—the American and Chinese economies are very different and it would make no sense for the two countries to adopt identical policies.

But reciprocity does bear on the priority that the U.S. should attach to Beijing's demands. American access to the Chinese market is a long-standing issue; if the PRC still cannot make discernable improvements in its anti-competitive behavior, such as regulatory protections for state firms, the U.S. has no obligation to respond to recently expressed Chinese unhappiness.

The U.S. government does have an obligation to protect its citizens' well-being. As ever, foreign entities should not be permitted to acquire technology that could harm American interests. The Committee on Foreign Investment in the United States (CFIUS) should continue to bar this kind of transaction, investigating quickly and with no political interference. If the present CFIUS mandate is inadequate to this task, it should be publicly extended, rather than relying on backchannel communication to scuttle deals.

Other regulatory bodies are now playing, properly, a greater role in monitoring Chinese corporate behavior. Chinese entities operating in the U.S. or selling stock here must follow American law or be forced to depart. There should be no tolerance of claims by Chinese companies or their American representatives that Chinese law supersedes American law. A new issue has arisen involving financing now being offered for projects in the U.S. by state arms, such as China Development Bank or state-owned Chinese banks. Below-market financing should not be allowed to subvert competition; this applies both to initial transactions and ensuing behavior.

The final dimension for American policy is global. Handwringing over expanding Chinese influence does not fit well with a slow, reluctant approach to American partners about trade and investment liberalization. The U.S. can and should compete with China for those overseas markets that both countries value. Moving quickly and decisively to conclude a high-quality TPP—rather than sacrificing a "21st-century trade agreement" in order to retain 19th-century tariffs—is the obvious first step. Chinese investment patterns suggest that another area for American action is negotiating improved investment access to South America.

The U.S. should therefore:

- **Make clear that Chinese enterprises that obey American law are welcome in the U.S.**

- **Ensure the Securities and Exchange Commission, the Federal Trade Commission, and other regulatory bodies enforcing commercial law closely monitor the behavior of Chinese enterprises active in the U.S.**, especially with an eye to ensuring a competitive market.

- **Improve the operation of CFIUS**, so that its mandate to protect national security is both sufficient and transparent and its actions are prompt and free from political interference.

- **Indicate at the first meeting** between President Barack Obama and the incoming Chinese leadership and at the Strategic and Economic Dialogue **that Chinese requests for better access to the American market will be considered in light of progress on more open competition in China.**

- **Compete with China overseas by concluding a sound TPP in 2013**, and open talks on improved investment access with other partners, perhaps starting in South America.

Competition at Home and Overseas

Chinese outbound investment continued its climb in 2012, setting another annual record and featuring a surge in North America. A record year for investment in the U.S. is positive for American companies and workers but offers several challenges for policymakers. Beijing can often appear as deeming competition to be something that is good for others. The U.S. should counter this tendency in the U.S., in China, and around the world.

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