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Chinese global investment growth pauses

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Key Points

- Chinese foreign investment declined through mid-2014 for the first time since the financial crisis.
- By sector, energy draws the most investment, but a slump in energy spending means that metals and real estate have been more prominent so far in 2014.
- The United States has received the most Chinese investment since 2005, followed by Australia, Canada, and Brazil. China invests first in large, resource-rich nations but has also diversified by spending more than $200 billion elsewhere.
- Chinese investment benefits both China and the recipient nation, but host countries must consider thorny issues like Chinese cyberespionage and subsidies.

The mid-2014 update of the China Global Investment Tracker sees the first decline in investment since the financial crisis. This is due primarily to a dearth of energy spending and could be reversed by a single large deal. But it is a useful reminder that China is not buying the world. The amount of investment documented in the China Global Investment Tracker (CGIT) now exceeds $500 billion. Over the same period, the stock of American investments overseas rose by $2.2 trillion.[1]

The pullback in energy highlights diversification in Chinese spending, with the first half of 2014 seeing noteworthy activity in real estate, technology, and transportation. By country, the United

States is the largest recipient, having seen heavy investment since January 2012. But from January through June of this year, Great Britain drew almost as much money as the US.

Mutually agreed-upon Chinese investment benefits both China and the recipient country. Nonetheless, there are policy questions to consider—for example, how host countries should respond to commercial cyberespionage. For the US in particular, higher Chinese interest in the American market offers the opportunity to change incentives for cybertheft and, to some extent, Chinese subsidies.

The China Global Investment Tracker

The CGIT offers the only fully public data set of Chinese outward investment. It includes almost 600 nonbond investments of $100 million or more recorded from January 1, 2005, through June 30, 2014. It also includes more than 500 engineering and construction projects of $100 million or more undertaken by Chinese enterprises overseas, a crucial part of the country's global footprint. Finally, the CGIT includes well over 100 troubled transactions of that size where projects or acquisitions were impaired for nonmarket reasons. (It excludes aid and loans.)

The investment totals in the CGIT are very close to those published by the Chinese government (table 1). The two series should match fairly well, but the somewhat remarkable extent of their similarity is odd because the transactions included are not exactly the same. The CGIT is usually published first, lists all transactions, and is revised every six months. The Chinese government does not publish transactions (one partial list provided by the National Development and Reform Commission was not useful) and explicitly revises totals only occasionally.

Table 1
Chinese Outward Investment since 2005: Two Views ($ Billion)

Year	China Global Investment Tracker	Ministry of Commerce
2005	10.1	12.3
2006	19.8	21.2
2007	30.4	26.5
2008	58.2	55.9
2009	54.4	56.5
2010	66.2	68.8
2011	72.1	74.7
2012	78.7	77.2
2013	86.3	90.2
2014H1	39.2	40.6*
Total	**515.3**	**523.9**

*Extrapolated from official figure for January–May.

Sources: Heritage Foundation and AEI, China Global Investment Tracker, June 2014, at http://thf_media.s3.amazonaws.com/2014/xls/China-Global-Investment-Tracker-2014.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, *2012 Statistical Bulletin of China's Outward Foreign Direct Investment*, China Statistics Press, August 2013; Ministry of Commerce of the People's Republic of China, "Brief Statistics," January 17, 2014, http://english.mofcom.gov.cn/article/statistic/foreigntradecooperation/201401/20140100464237.shtml; and Xinhua, "China's Non-financial ODI Drops Jan-May," June 17, 2014, http://news.xinhuanet.com/english/china/2014-06/17/c_133413610.htm.

Investment allocations are lumpy, so dating them is somewhat arbitrary. It appears Chinese outward investment contracted in the first half of 2014 compared to the first half of 2013. Although this may come as a shock to those anticipating limitless growth in Chinese spending, it should not because a break after a strong 2013 is entirely normal. While China's $4 trillion pile of foreign reserves, with perhaps $800 billion more at state banks, suggests an unstoppable tide, investment cannot occur without opportunities in foreign markets.[2] And the availability of these opportunities ebbs and flows. Annual investment should still reach $100 billion no later than 2016.

Where Chinese Money Is Headed

The CGIT offers an enormous advantage over official data in terms of country allocations. The Chinese government treats Hong Kong as a separate economy, and the territory is said to receive 40–60 percent of Chinese investment annually. Almost all of this money just passes through Hong Kong's economy. As a result, official data underestimate Chinese investment in many countries, sometimes by billions of dollars. The CGIT uses corporate-level information to follow capital to its final destination.

The prime target for Chinese investment in the first half of 2014 was again the US, driven by technology acquisitions. Close behind was Great Britain, which saw intense Chinese interest in property development and is now easily the most popular investment destination in Europe. China also made a single large investment in copper mining in Peru that drove it up the list (table 2).

Table 2
Investment by Country since 2005

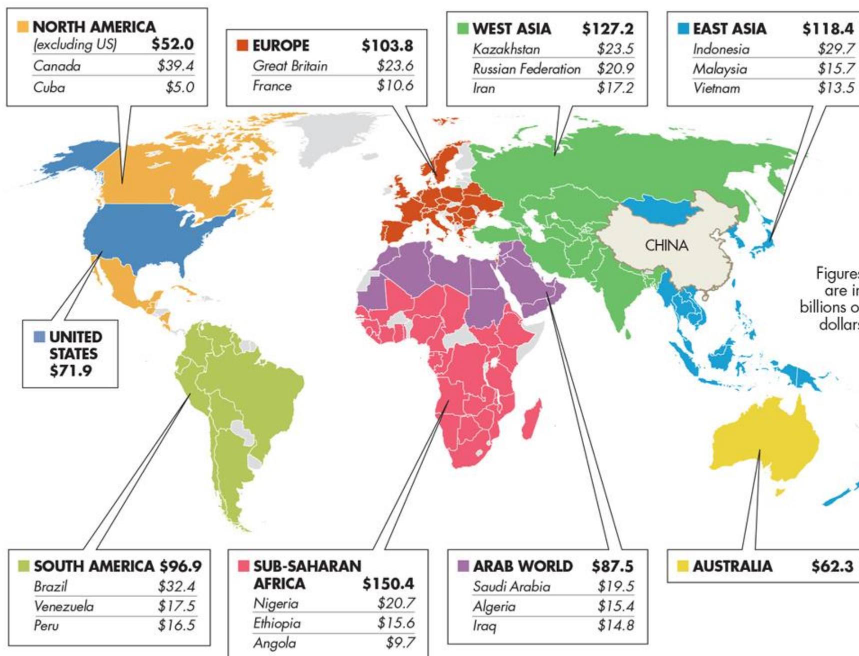
Country	Investment Volume ($ Billion)
United States	67.9
Australia	59.8
Canada	39.3
Brazil	29.4
Great Britain	23.4
Kazakhstan	16.6
Russian Federation	16.5
Peru	16.4
Indonesia	11.3
France	10.6
Subtotal	291.2
Total for all countries	**515.3**

Source: China Global Investment Tracker.

Since 2005, the US has drawn the most Chinese investment, followed by Australia. Canada and Brazil are in the next tier, and the top 10 makes clear that Chinese spending goes first to resource-rich countries, especially larger ones. Nonetheless, more than $200 billion has been spent outside the top 10, showing notable diversification.

Perhaps as important as investment are engineering and construction services provided by Chinese firms and often implemented by Chinese workers. The CGIT list of such contracts is incomplete and in the process of being augmented. Even so, it already includes more than $350 billion worth of transactions since 2005. The dominant players here are not the US and Australia but developing countries. Sub-Saharan Africa and the Arab world both see far more in the way of Chinese engineering and construction activity than they do investment, with Ethiopia and Algeria the most prominent examples. Indonesia is the leader among all countries, with Pakistan and Saudi Arabia rounding out the top five recipients of these services. (See figure 1.)

Figure 1



What the Money Is Buying

The sector breakdowns in official Chinese data, such as "business and leasing services," are unhelpful. The CGIT classifies according to standard industry designations. China's interest in commodities is well known, and energy easily tops all sectors in both investment and construction (for example, power plants). The sector receiving the second-highest investment is metals, while transport is second for engineering and construction contracts (for example, ports, rail, and roads).

Table 3

Investment Breakdown by Sector, 2005–2014H1 ($ Billion)

Sector	Investment	Engineering Contracts	Troubled
Energy and power	231.7	164.2	86.9
Metals	111.2	13.3	65.4
Real estate and construction	44.7	40.8	9.0
Finance	40.7	N/A	27.3
Transport	26.6	108.1	23.4
Agriculture	23.3	9.1	9.5
Technology	17.1	10.3	14.2
Chemicals	6.9	3.4	0.0
Utilities	1.9	3.7	0.0
Other	11.6	2.4	0.4
Total	**515.8**	**355.2**	**236.0**

Source: China Global Investment Tracker.

The overall weakness in investment in the first half of 2014 can be traced to weakness in energy. Energy typically sees the most spending by far, but metals instead topped the list for January through June. And the highest number of transactions exceeding $100 million was in real estate.

The atypical sector pattern also means relatively less investment by state-owned enterprises (SOEs), which utterly dominate the energy sector, and more by private entities seeking opportunities outside a troubled domestic real estate market. This will make the Chinese presence more palatable to many host countries. In terms of engineering and construction

contracts, transport was the most active sector, led by state giants such as China Communications Construction.

Obstacles

China has more foreign currency than it can spend. Host governments sometimes face heavy domestic pressure to forbid what are seen as sensitive acquisitions, typically of land and natural resources. Newer Chinese investors can lack the capacity to complete deals even after agreement has been reached. Several completed resource and finance transactions have seen heavy losses, and the same could eventually prove true for some of the recent property purchases. If all the impaired transactions since 2005 had been completed, Chinese investment would have been almost $200 billion higher.

In six countries, impaired investment or construction contracts surpass $10 billion in value (table 4). Unsurprisingly, the headliners in terms of problems are the countries that see the most investment—Australia and the US. It is normal for some investment projects to be unsuccessful. International sanctions against Iran inhibited several Chinese investments there. The results for Germany and Nigeria are due to single large failures, and Libya's high total is due to construction stopped by civil war.

Table 4
Most Troubled Countries since 2005

Country	Troubled Transactions ($ Billion)
Australia	44.9
United States	39.9
Iran	25.2
Germany	13.9
Libya	11.2
Nigeria	10.3
Subtotal	145.4
Total for all countries	**236.0**

Source: China Global Investment Tracker.

Global Decisions

China's huge pile of foreign currency and need for resources mean that, barring international conflict, the contraction in investment is temporary. It is still reasonable to expect something like $1.25 trillion in Chinese outward investment over the next decade. That figure constitutes a dilemma for countries all over the world: how much of it do they want? What should they do to draw more Chinese investment or, perhaps, to limit it?

It is no longer necessary to have fossil fuels or metal ores to lure Chinese enterprises; the heyday of investing in these commodities may have passed. Rich countries with advanced technology and deep property and financial markets are increasingly attractive. But almost any government can lure Chinese money if it is willing to offer incentives for clean energy production, allow Chinese workers to build transportation links, or lease farmland.

The flip side is receiving too much attention from Chinese firms. Small economies can be overwhelmed by Chinese acquisitions, financing, or workers. Even Canada became uncomfortable with open access to SOEs after the $15 billion Nexen deal in 2012. Extensive Chinese cyberespionage may heighten such reluctance. Chinese cyberespionage is not restricted to stealing technical information but also includes attempts to learn negotiating positions so as to win better terms.[3] This can influence any deal with any country.

American Policy

Prior to 2014, there was a clear pattern among Chinese firms, in which high regional activity lasted 18–24 months before they targeted new countries for investment. This occurred because the best projects were snatched up quickly and host countries became uncomfortable with the tide of Chinese money. The US may be disrupting this pattern. After two years of intense investment, Chinese companies do not appear to be shifting their sights away from the US to Europe or West Asia.

The unique aspect of the American market is its size—$20 billion of annual Chinese investment would be an economic issue anywhere else, changing the nature of targeted industries. For the

US, annual Chinese investment of $20 billion would clearly be valuable, creating jobs and lowering production costs, but would not be especially important. An illustration: the National Association of Realtors puts Chinese purchases of American housing (almost entirely transactions that are too small for the CGIT) at $22 billion from April 2013 to March 2014.[4]

The behavior of China's government, not its firms, is what matters in American decision making regarding investment. Troublesome behavior includes Chinese subsidies and cyberespionage, which US popularity as an investment destination gives it increasing leverage to address.

Chinese subsidies—guaranteed market shares at home, costless borrowing, and so on—cast doubt on SOEs' status as commercial entities and engender competition concerns in host countries. The SOE share of investment in the US has dropped toward 60 percent—versus a global share still above 90 percent—but energy investment will continue to be almost exclusively from SOEs, as will activity in transport and chemicals.

Subsidies also pertain to reciprocal market access. Even if Chinese industries are formally open to American companies, reciprocity does not exist when SOEs cannot go bankrupt or enjoy much lower costs for capital, land, and other inputs. The absence of true reciprocity has plagued the investment relationship in the past and will continue to do so until the Communist Party pushes major SOEs much closer to commercial status.[5]

Another component of reciprocity is protection of intellectual property (IP), in particular with regard to cyberespionage. China must close the gap in IP protection, not just talk about it, which will be difficult until Beijing stops being dishonest about its cyber programs. On the US side, the insistence that cybersecurity cannot be discussed in connection with commercial cyber is somewhat justified but entirely unhelpful.

A helpful American action would be to improve the investment review process for its own benefit and to provide a benchmark for China's own review. The Committee on Foreign Investment in the United States (CFIUS) should be responsive to complaints, conducting evaluations quickly and as transparently as possible. It should halt any business activity, not just

the acquisitions it assesses now, that may pose a risk, certainly including cyberespionage. Congress should evaluate CFIUS, but it should not evaluate individual transactions.

The increasing importance of the US as an investment destination offers Washington leverage in changing Chinese behavior to some extent. CFIUS should identify Chinese investors as either IP thieves or recipients of stolen IP, making the findings available to Congress. In contrast, good IP citizens should be welcomed by the US in all but the very few genuinely sensitive sectors. Similarly, American negotiators in bilateral forums should tie political support for Chinese energy SOEs taking majority stakes in American companies, for example, to less subsidization of these firms. The US has been successful in encouraging private Chinese investment; this success can be extended to encourage both better Chinese investors and larger amounts of spending.

Notes

1. American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, July 2014, http://thf_media.s3.amazonaws.com/2014/xls/China-Global-Investment-Tracker-2014.xls; and United States Department of Commerce Bureau of Economic Analysis, "Direct Investment and Multinational Corporations," www.bea.gov/iTable/iTable.cfm?ReqID=2&step=1#reqid=2&step=1&isuri=1.
2. Derek Scissors, "China Invests Somewhat More in the World," American Enterprise Institute, January 13, 2014, www.aei.org/files/2014/01/10/-china-invests-somewhat-more-in-the-world_151254764847.pdf; and "China May Forex Purchase Slows Sharply," Xinhua, June 16, 2014, http://news.xinhuanet.com/english/china/2014-06/16/c_133411649.htm.
3. Wendy Dobson, "China's State-Owned Enterprises and Canada's FDI Policy," University of Calgary School of Public Policy Research Papers, March 2014, http://policyschool.ucalgary.ca/sites/default/files/research/dobson-china.pdf; and Mark Clayton, "US Indicts Five on China's Secret 'Unit 61398' for Cyber Spying on US Firms,“ *Christian Science Monitor*, May 19, 2014, www.csmonitor.com/World/Security-Watch/Cyber-Conflict-Monitor/2014/0519/US-indicts-five-in-China-s-secret-Unit-61398-for-cyber-spying-on-US-firms-video.
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