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Chinese Investment in the U.S.: Facts and Motives

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Now and for some time to come, the bulk of Chinese investment in the United States will take the form of Treasury bond holdings. Excluding bonds, Chinese investment in the U.S. is a $50 billion issue that could have been a $75 billion issue already and will be a $100 billion issue within a few years. When flowing out of an economy still largely centrally directed, this spending naturally raises questions about whether the investment strategy or strategies involved could harm American interests.

The answer is yes, but not to the extent and apparently not in the way some critics fear. There is plainly a strategic dimension to Chinese outward investment, and it has harmful elements. State-owned enterprises are instructed to acquire assets perceived as valuable by Beijing. They are heavily subsidized, posing questions about whether the clear benefits of investment in the U.S. are offset by anti-competitive influences. But these features are not hidden, much less insidious. Nor is Chinese strategy especially wise or effective.

Unfortunately, this answer is incomplete. Indirect purchases by PRC entities do occur, as do clandestine attempts at technology acquisition. The U.S. should ask for voluntary disclosure of investments routed through third parties and sharpen disclosure requirements if the response is unsatisfactory. Dual-use technology should be protected by an enhanced Committee on Foreign Investment in the United States. To be genuinely productive, any steps the U.S. takes should themselves be transparent.

What American policymakers should avoid is discouraging Chinese investment on the basis of exaggerated hearsay. The facts on the ground indicate what are now well-known policy challenges and immediately useful steps to increase transparency. They do not come close to justifying protectionist actions.

The Heritage Tracker

The Heritage Foundation's China Global Investment Tracker is the first public dataset in the field, including the limited offerings from the PRC government. It covers outward investment excluding bonds. The Tracker is global and extends back to 2005, the start of large-scale Chinese investment in the U.S. and the world. It utilizes corporate data and is updated semiannually.

The Tracker presently contains over 400 investment transactions of $100 million or more dated between January 1, 2005, and December 31, 2012. The total value of these transactions approaches $390 billion. The Tracker also contains an auxiliary dataset of over $200 billion worth of investments which have lost more than $100 million in value. Finally, it contains supplementary data on Chinese construction and engineering contracts worth well over $200 billion. (This list is incomplete and contains very few U.S. transactions to date.) [1]

The trend for Chinese outward, non-bond investment is to increase, if unsteadily. (See Appendix 1.) Investment in 2012 was close to $80 billion. Outbound investment will likely breach $100 billion annually by 2015 or 2016.

Official Chinese sector categories are topped in investment volume by "business and leasing services" and seem designed to draw attention away from an obvious bias to commodities. On the Heritage tally, energy is the top investment target. (See Appendix 2.) Within energy, oil leads but it is no longer dominant due to surging investment in integrated oil and gas projects. Metals is next; energy and metals together account for over 70 percent of Chinese outward investment since 2005. The heyday for finance was before the global crisis. Agriculture, real estate, and technology are other areas of high interest, while transportation is an area of high expertise.

Official Chinese data purport that Hong Kong receives at least 40 percent of annual investment and sometimes a good deal more. In fact, this money moves through Hong Kong on its way elsewhere. According to the Heritage tracker, the U.S. has pulled essentially even with Australia in the total amount of non-bond investment received since 2005. In 2012 alone, Canada led, via a $15 billion energy acquisition. Unsurprisingly, the European Union as a whole receives more than any individual country, though it is often the case that acquisitions are of European-headquartered companies and the bulk of the actual assets is located elsewhere.

Chinese firms have moved overseas in packs. Australia was the first destination, followed by sub-Saharan Africa, South America and, beginning in 2012, North America. It may be that the end of 2013 and start of 2014 will see another shift, perhaps to the oil-producing states in West Asia or assets physically located in Europe.

U.S. Facts

The Tracker includes 58 Chinese investments of $100 million or more in the U.S. since 2005, totaling about $50 billion. This is 13 percent of China's global total. In 2012 alone, the U.S. was second to Canada in attracting investors, drawing a record $14.7 billion on the Heritage tally. This was nonetheless only the equivalent of less than 0.1 percent of 2012 GDP. Looking forward, Chinese investment in the U.S. could outpace investment growth globally, but there will undoubtedly be fits and starts. Cumulative investment should reach $100 billion within five years, still a relatively small amount.

The leading sector for investment in the U.S. has been finance, at a bit over $20 billion. This constitutes over half of Chinese non-bond investment in finance worldwide. Multiple large

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[1] For a global overview, see Derek Scissors, "China's Global Investment Rises: The U.S. Should Focus on Competition," Heritage Foundation *Backgrounder* No. 2757, January 9, 2013, http://www.heritage.org/research/reports/2013/01/chinas-global-investment-rises-the-us-should-focus-on-competition. For an interactive tool, see "China Global Investment Tracker Interactive Map," http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map.

acquisitions occurred before the financial crisis and therefore lost considerable value. More active recently is energy and power, at $11.4 billion. This is just 6 percent of Chinese energy investment worldwide, indicating the American market has considerable potential in this regard.

Surprisingly, transport is the third-largest recipient in the U.S. at close to $6.5 billion, which constitutes almost 40 percent of China's global investment in transport (construction contracts are the more popular form of overseas transport business). But this is driven by a single transaction: the acquisition of AIG's aircraft leasing unit in December 2012.

Real estate and agriculture qualify as promising. Due partly to political and economic conditions in the PRC, there has been a surge in real estate purchases in the U.S. during the past two years and more are coming. Most are small-scale, but large-scale spending has also begun to appear. Agriculture is a missed opportunity: U.S. farmland should be more highly prized. In technology, despite the restrictions, the PRC's $2.5 billion investment in the U.S. is almost 30 percent of its global total. (The total does not include technology equipment contracts, where the U.S. is not involved.) Finally, the U.S. accounts for only 1 percent of Chinese metals investment.

With the leading role played by finance, the state of New York has drawn over two-fifths of Chinese investment in the U.S. If New York were a separate country, as some allege, it would be the fifth-largest recipient of Chinese investment. Next is Texas at 12 percent; no other state stands out. Only 17 states have drawn a Chinese investment of $100 million or more to date. This will change—more states are actively seeking investment and they will be successful. The American political debate over China policy will shift as a result.

The leading Chinese investor also follows directly from the emphasis on finance. China Investment Corporation (CIC), the smaller of the two sovereign wealth funds, is the undisputed king. CIC was created in part to diversify Chinese investments in the U.S. away from bonds, and aside from Hong Kong, the U.S. is its most important market. By itself, CIC accounts for over two-fifths of Chinese investment in the U.S. It was far less active in 2012, though, and may be seeking to reduce the U.S. weight in its holdings.

The larger wealth fund, the State Administration for Foreign Exchange (SAFE), is the next-largest investor at a bit under 10 percent of non-bond investment. SAFE is also the principal vehicle for purchases of American bonds. It is extremely secretive, and it would not be at all surprising if SAFE vehicles held more in American assets than can be documented. A small group of companies is in the $2 billion–$3 billion total investment range through end-2012. Oil major Sinopec is perhaps most notable among these, since it also is involved in large construction contracts here. As yet, very few Chinese companies have made the U.S. their top investment destination. If the environment remains stable, this will change.

The Heritage Tracker identifies parent companies, not subsidiaries. In terms of the volume of investment in the U.S., state entities predominate. From 2005 to 2012, they accounted for 86 percent of total investment, private entities 14 percent. However, in 2012 alone, the private share was almost double that, possibly indicating a new trend.

Why and Why Not

Outward investment by any firm seeks something relatively lacking at home: additional demand (new market), physical assets, technology, labor force qualities, or simple financial return. The value of these is judged against the risk imposed by the political and regulatory environment.

Energy and metals—physical assets—have drawn by far the most Chinese investment globally. Farmland is similar but has not yet been made widely available. Finance and real estate are the next largest in size and aimed primarily at simple financial return. In transport, Chinese firms are looking to exploit their expertise by finding demand beyond the home market. Acquisitions of technology have been largely stymied. Across sectors, Chinese firms have long sought particular skills in foreign labor forces and now may seek cheap labor as the home labor market tightens.

On paper, the U.S. has everything an investor could want. It is by far the world's largest market. The U.S. has abundant land and energy assets, coal as well as shale. It is the world leader in technology and, arguably, skilled labor. The American real estate market has been more lucrative than China's for the past three years (Chinese investment in the U.S. has only an eight-year history). And American demand for transportation infrastructure is potentially quite high. The U.S. government does not need to do anything to make the country more attractive; the fundamentals are more than enough.

However, Chinese firms have not yet sought on a large scale to serve the American market through investment here. The U.S. does not permit most Chinese technology investment, with the medical sector an exception. This also reduces the scope for utilizing skilled labor. Energy assets were initially blocked, then perceived as blocked, and even now there is uncertainty over the acceptability of majority ownership in shale and any investment in coal. Banking drew heavy investment before the crisis; now real estate is drawing heavy investment. In practice, the main drivers of Chinese investment in the U.S. have been limited to perceived financial returns in banking and then real estate, supplemented by rising interest in American shale extraction.

One way to quantify the gap between the potential of the U.S. market for Chinese investment and its realization is Heritage's data on troubled transactions. The Heritage tally for the value of troubled Chinese investments in the U.S. between 2005 and 2012 is 15 transactions for about $30 billion, the most famous being CNOOC's attempted $18 billion acquisition of Unocal. (A $5 billion equipment contract was also blocked.) Had all of these been successful, total Chinese non-bond investment in the U.S. would have already reached at least $80 billion and probably more, since the Unocal failure was followed by an almost two-year lull in spending.

There are multiple reasons for the partial or complete transaction failures: (1) the inexperience of many Chinese firms; (2) American barriers; and (3) the role of the Chinese state. The first will fade over time. As more PRC firms become more knowledgeable about the U.S. market, they will be able to cater more to American consumers. Other PRC companies will learn which opportunities in land and transport are genuine. Parts of the American labor force will become more appealing. Sustained Chinese investment in the U.S. began only in 2007 and was carried by financials until 2010; there is still a great deal of space for learning.

The second explanation for the unrealized market potential is U.S. government policy. In addition to CNOOC-Unocal, there are six cases of U.S. government actions that hampered or prohibited over $4 billion in investments. There are also potential projects that, in light of these failures, never moved forward. The latter point is critical both from a simple reading of the data and the clear consensus of Chinese executives: By far the most important U.S. government action to discourage investment is policy uncertainty.

For example, how exactly should other investors read the treatment of Huawei? American policymakers might think telecom has been clearly differentiated from any other sector, but the Chinese side does not. And there are matters that no American policymaker can possibly believe are transparent. Where does CFIUS's role end and Congress's begin? More narrowly, why did the $440 million acquisition of Nexteer's auto parts business sail through in 2010 but a $170 million minority investment in Steel Development's low-technology rebar production see sharp criticism a year later?

In general, what is available for investment and what is not? This is the most basic question for any investor, and the U.S. has failed to answer clearly with respect to many Chinese enterprises.

Strategic Behavior by Chinese Entities

The third factor influencing Chinese investment choices in the U.S. is the Chinese state. There is almost surely a plan behind Chinese investment, both globally and in the U.S. State-owned enterprises dominate outward investment volume, making it feasible to have a coordinated strategy beyond simply seeking demand or higher financial return. More specifically, Beijing has repeatedly indicated that ownership of overseas commodities is a valuable means of ensuring the continuous imports the PRC's economy so badly needs. It is therefore no surprise that commodities investment by state firms dominates spending.

For the U.S., investment from 2007 to 2009 was almost entirely by a very small number of state financials. This certainly looks coordinated. The interest of the state oil majors in U.S. shale matches perfectly the interest of their government in diversifying energy sources and finding techniques to extract shale at home. More broadly, China's national interest in and corporate attempts to acquire technology to move up the value chain in production are no secret.

This is an important aspect of China's global investment strategy: it is not mysterious. Beijing perceives economic needs and strongly encourages state enterprises to meet them. The desire for resources and technology is well-known, as is the desire for national champions who can expand overseas. The foundations for Chinese outward investment are neither subtle nor, except for advanced dual-use technology, dangerous. They are also not especially sound. Metals investment feeds industries the central government constantly cites as suffering from sustained overcapacity. The PRC can catch up by buying foreign technology; by definition, it can never lead.

More specific sets of policies are equally unimpressive. The 12th Five-Year Plan discovered new strategic industries, adding them to the pile of old industries that should be fading but are still treated as strategic due to lack of political will. As a matter of economic development, the central government has shown little aptitude for identifying sectors to support, much less to abandon. In terms of outward investment, the loose guidance means most Chinese investments can be labeled strategic in policy terms, and the label thus has almost no real significance.

The challenge for the U.S. is not that Chinese industrial policies are especially effective; it is merely that the policies exist. Designated and aspiring national champions are handed the internal market and further subsidized in order to win global market share. They cannot go bankrupt and so no competition with them can be entirely fair. How to respond to the basic fact of state subsidization is a vital, well-established issue for the U.S. in dealing with the PRC; the additional matter of a grand investment strategy employing the subsidies is far from vital.

A second genuinely important issue concerns a second absence of transparency, this time on the Chinese side. SAFE in particular is a remarkably opaque organization and very likely has substantial indirect investments it is attempting to keep hidden.

The slim evidence of indirect acquisitions—an opaque Australia-based investor buying Japanese equities, a conspicuously timed surge in Cayman Islands purchases of U.S. Treasuries—indicates SAFE is probably interested in diversification and secrecy rather than dual-use technology. Indirect transactions by SAFE and others in the U.S. have focused on real estate and, to a lesser extent, autos. But SAFE's secretiveness plus several unwise choices by Chinese companies mean there are transactions whose nature was or is intended to be opaque, fueling suspicion.

The U.S. government can partly address this problem. Specific disclosure requirements can be formulated for financing vehicles, whether domiciled in the U.S. or elsewhere, receiving large sums from government arms or state firms. An example is SAFE's $2.5 billion contribution to one of TPG's funds in 2008. Stringent requirements, of course, will tend to reduce the capital inflow from SAFE and perhaps other entities. It would be better to have information voluntarily provided by the Chinese side and to take regulatory action only if such reasonable cooperation is not forthcoming.

Beyond additional disclosure, the Committee on Foreign Investment in the United States (CFIUS) must have clear authority to monitor indirect investments by any foreign entity, through foreign or domestic financial vehicles. A slow, unclear process will reduce investment, so the CFIUS mandate must also include strict operational guidelines. An intrusive CFIUS would be an unintended protectionist barrier, and also risk undermining the American goal of greater investment access to foreign markets.[2]

Conclusion: Tweak Rather Than Twist

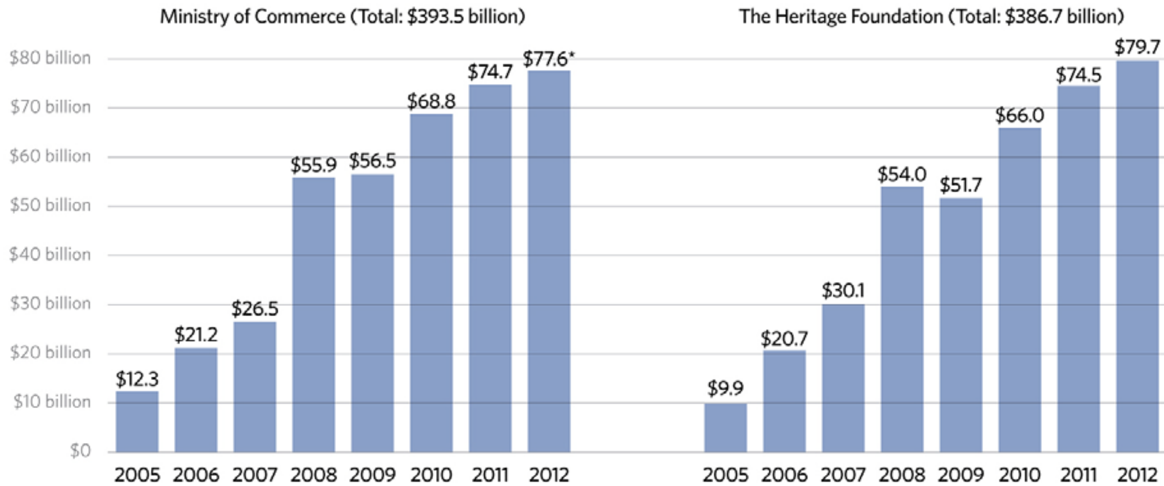
[2] The proper role for CFIUS is an important issue deserving of separate discussion. See, for example, Derek Scissors, "A Better Committee on Foreign Investment in the United States," Heritage Foundation *Issue Brief* No. 3844, January 28, 2013, http://www.heritage.org/research/reports/2013/01/enhancing-the-committee-on-foreign-investment-in-the-united-states-cfius.

The U.S. does not desperately need policy steps to lure Chinese investment and avoid missing out on hundreds of billions of dollars in spending this decade. Nor does it need to embrace mercantilism to halt insidious Chinese technology acquisition for which there is precious little evidence. Chinese entities should be more transparent, preferably of their own accord but, if required, through regulation and quick, well-defined CFIUS action. This will ensure protection of sensitive technology, and the attractiveness of the American market will do the rest.

Appendix 1

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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Appendix 2

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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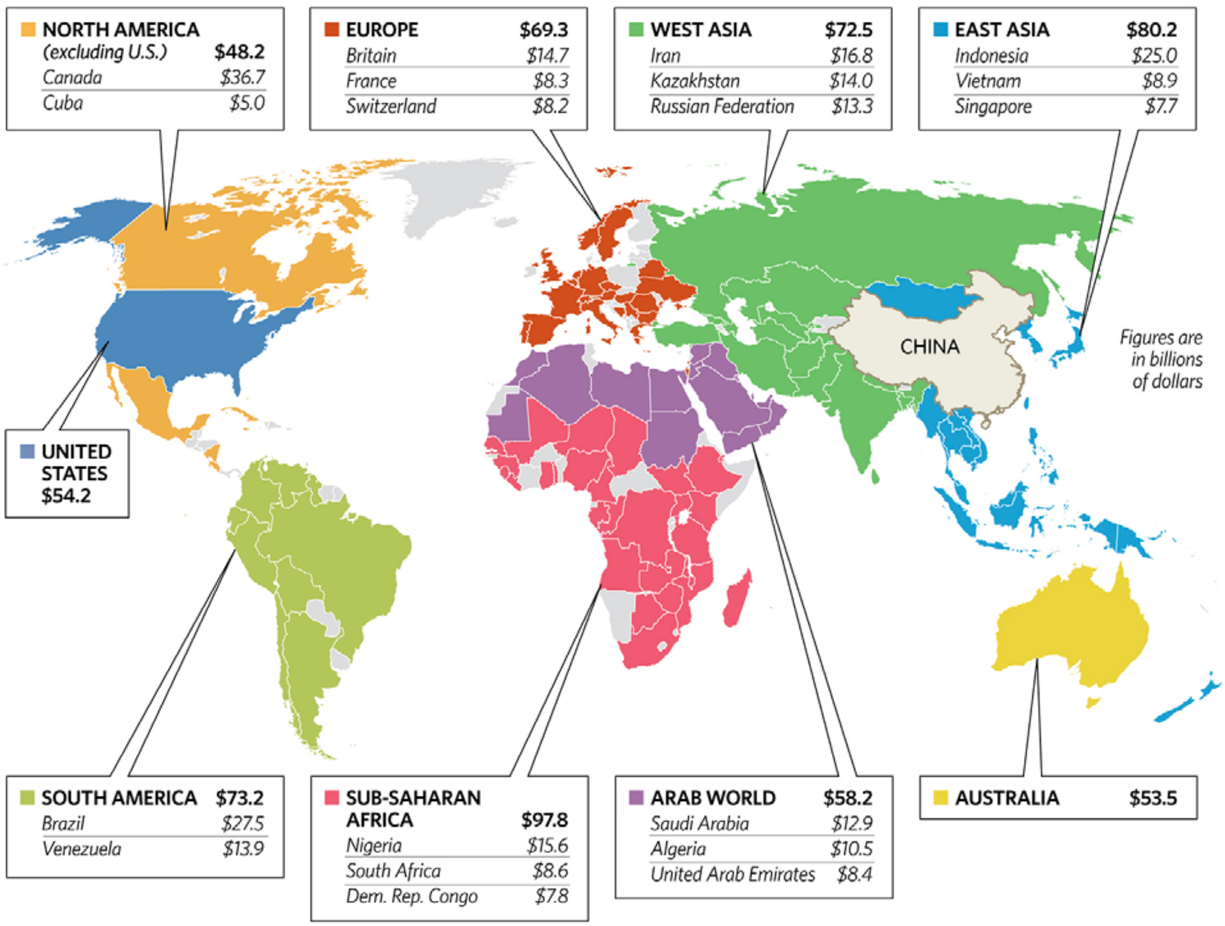
Appendix 3

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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