China's investment in the world increasing, not soaring

By Derek Scissors

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KEY POINTS

- *The United States again led all countries in receiving Chinese investment in the first half of 2015. It is the leader historically, as well.*
- *China may be replacing its previous geographic diversity of investments with a new sector diversity. Energy investment has faded, while real estate, finance, and transportation are increasing.*
- *Engineering and construction contracts are a vital part of China's global economic footprint. They go overwhelmingly to developing economies, such as Nigeria and Pakistan.*
- *For the US, in particular, the biggest step in improving the investment climate is progress on cyberespionage. Chinese firms with a clean record should be welcomed, while those benefiting from cybertheft should be barred.*

The American Enterprise Institute and Heritage Foundation's China Global Investment Tracker is the only fully public record of China's outward investment around the world, as well as of its engineering and construction contracts. Unlike government data and other information on Chinese activity, individual transactions are published, not just totals.[1] Speculation and generalizations about what China is doing are interesting, but facts are better.

For the first half of 2015, the China Global Investment Tracker (CGIT) documents outward investment of $55.9 billion, a 14 percent increase over the first half of last year. This is an impressive gain in light of declining global commodities prices and the related, stark absence of heavy outlays by energy and metals titans such as Sinopec.

China's Ministry of Commerce reported a nearly 50 percent increase in spending through May. This growth rate looks to be exaggerated. Nevertheless, the true level of China's global spending is likely to rise, if unsteadily, for years to come. There will be more money to spend and fewer attractive investment options at home as the economy there slows.

The countries receiving the most Chinese investment in the first half of this year were, in order, the United States, Italy, the Netherlands, Australia, and South Korea. Large commodities producers such as Brazil, once popular with investors, are well down the list. This change in investment focus is reflected in sector allocations. Metals and, especially, energy spending showed pronounced weakness. This was offset by dramatic pickups in finance and transportation, along with continued real estate purchases.

Chinese firms are also prominent in global engineering and construction, and the CGIT is the only project documenting these activities. Such contracts are made public more slowly than investments. Still, in the first half of the year, 30 countries awarded a Chinese firm a local contract worth $100 million or more. Since 2005, the combined value of CGIT-listed Chinese investments and construction transactions around the world stands at $1.1 trillion.

This figure embodies a number of important developments. The newest is the rise of private equity, with Chinese characteristics. The first half of 2015 saw almost $10 billion in Chinese private equity deals. However, some of the entities taking equity stakes in privately held assets are state-owned. Along with cyberespionage, this is yet another wrinkle for host country policymakers contemplating increasing Chinese investment, especially the top recipient, the US.

CGIT versus Ministry of Commerce

The CGIT starts in 2005 because spending skyrocketed that year, starting with the first large investment in foreign technology. The tracker now includes more than 750 investments of $100 million or more, excluding bonds. It also includes 800 engineering and construction projects and more than 150 troubled transactions, where projects or acquisitions were impaired or failed for nonmarket reasons. (Loans and aid are not tracked.)

Until the middle of 2014, CGIT totals were close to those of the Ministry of Commerce (table 1). The extent of this similarity is somewhat odd because the deals counted are not identical; for example, the CGIT does not include transactions of less than $100 million. Moreover, the CGIT is revised every six months, while the ministry rarely revises and never reveals the constituent transactions. Over the past year, the ministry seems to have worked to count outward investment more thoroughly, starting with what seemed to be a catch-up period for previously missed deals. This is positive. But official data still can strain credulity.

For example, official figures show investment in European Union nations more than quadrupled in the first five months of the year, featuring a mysterious $2.9 billion outlay supposedly involving petrochemicals.[2] China's investment in Europe did increase, but it did not quadruple. In an ongoing problem, official data simply assume a fixed amount of reinvestment each month. This has been $1.4 billion monthly in 2015, or about 15 percent of total investment being added without being measured in any way.

Most discouraging, outward investment has become politically prized. The government boasts, unwisely, that China now sends more capital overseas than it takes in.[3] Spending

Table 1. Two Views of Annual Chinese Outward Investment ($ Billion)

	CGIT	Ministry of Commerce
2005	10.2	12.3
2006	19.8	21.2
2007	30.4	26.5
2008	57.9	55.9
2009	55.9	56.5
2010	66.8	68.8
2011	73.9	74.7
2012	80.1	77.2
2013	86.0	90.2
2014	92.8	102.9
2015, H1	55.9	54.5*
Total	**629.7**	**640.7**

Note: *Extrapolated from official figure for January–May.

Sources: American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, July 2015 update, www.aei.org/china-global-investment-tracker; 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, *2013 Statistical Bulletin of China's Outward Foreign Direct Investment*, China Statistics Press, August 2014; "China 2014 Outbound Investment Tops 100 Bln USD," Xinhua, January 16, 2015, http://news.xinhuanet.com/english/china/2015-01/16/c_133925108.htm; and "China's ODI Surges 47.4 Pct in Jan-May," Xinhua, June 18, 2015, http://news.xinhuanet.com/english/2015-06/18/c_134337573.htm.

commitments to the Belt and Road global trade, financing, and infrastructure initiative have become a diplomatic priority, such that it is difficult to imagine the government admitting to poor results.[4] Beijing declines to publish unpleasant numbers on jobs and other indicators, and outward investment is at risk of falling into the same trap.[5]

Where China Inc. Is Heading

Beyond the totals, the CGIT is more useful than the official data. The Ministry of Commerce treats Hong Kong as a final destination for outward investment, and Hong Kong is said to receive one-third or more of official annual investment. Almost all of this money just passes through, which means official data can underestimate spending for some countries by billions of dollars over time. The CGIT treats Hong Kong as just a transit point, using corporate information to follow spending to its true destination.

The US was again the top recipient of Chinese investment in the first half of 2015, in both the number of transactions and total value ($11.1 billion). Befitting its economic diversity, the US saw sizable outlays continue in real estate and technology but also emerge in finance and autos. In terms of spending volume, Italy was second, thanks to ChemChina's giant acquisition of tire-maker Pirelli. Australia was second in the number of $100 million+ transactions. The Netherlands and South Korea rounded out the top five because of unusually large transactions there.

Over the past decade, the large, developed countries lead in investments, still followed by large, developing counties with energy or metals resources (table 2). The latter group, however, is starting to be displaced as Chinese investors become interested in a broader range of assets, including farmland and food processing. Longtime standouts Brazil, and Russia (as well as Canada) each failed to crack $1 billion in new investment in the first half.

Table 2. Investment by Country since 2005 ($ Billion)

Country	Investment Volume
United States	90.1
Australia	70.7
Canada	41.8
Brazil	30.5
Britain	28.5
Russian Federation	21.6
Kazakhstan	17.5
Peru	17.1
Italy	16.7
Indonesia	15.0
Subtotal for top 10	**349.5**
Total for all countries	**629.6**

Source: China Global Investment Tracker, www.aei.org/china-global-investment-tracker.

Table 3. Construction by Country since 2005 ($ Billion)

Country	Contract Volume
Nigeria	24.6
Venezuela	20.8
Pakistan	18.9
Saudi Arabia	18.8
Algeria	18.6
Vietnam	17.3
Indonesia	16.6
Ethiopia	16.5
Malaysia	13.9
Iran	13.7
Subtotal for top 10	**179.7**
Total for all countries	**471.3**

Source: China Global Investment Tracker, www.aei.org/china-global-investment-tracker.

Engineering and Construction

Though investments involve ownership and are thus more valuable dollar for dollar, engineering and construction projects can utilize thousands of workers and provide decades of benefits. The CGIT tracks slightly more engineering and construction transactions than investment transactions, and more countries host Chinese construction projects than investments.

The countries with the highest value of construction projects are revealing with regard to Chinese foreign policy (table 3). The top three see multinationals generally shy away because of domestic instability in those nations. These and other Chinese favorites can be difficult operating environments, resulting in project fits and starts for even determined firms. China's neighbors to the southeast, which are reliable economic partners but sometimes politically suspicious, take up three more spots in the top 10. Projects in Vietnam have already become sensitive for all parties involved, and the same is possible in Indonesia.[6]

The difference between investment and construction is also evident in sector comparisons (table 4). Energy remains predominant, though recently this has been because of construction, as energy investment dropped off a cliff in the first half of the year. Metals and finance see little and no construction activity, respectively. Transportation—airports, highways, ports, and railways—is growing in investment but has always been a vital part of construction. The building of housing and commercial properties substantially complements currently frenzied real estate acquisitions.

Cautionary Tales

Clashing forces are at work with regard to China's global footprint. The increasing size and experience of China's corporate sector, not to mention the needs of recipient countries, argue strongly for many years of expansion to come. But there have already been instances of countries balking not only at particular projects but also at China's economic presence, period. The world certainly wants Chinese money and

Table 4. Sector Allocations since 2005 ($ Billion)

Sector	Investment	Engineering Contracts	Troubled Transactions
Energy and power	261.0	216.2	92.3
Metals	117.7	20.4	68.9
Real estate and construction	61.5	46.2	10.6
Finance	53.6	—	26.3
Transport	41.0	141.1	29.7
Agriculture	28.2	14.9	9.5
Technology	25.8	12.9	15.0
Chemicals	8.2	5.2	1.9
Tourism	7.9	3.6	5.6
Utilities	2.7	5.6	0
Other	22.1	5.1	1.1
Total	**629.7**	**471.3**	**260.8**

Source: China Global Investment Tracker, www.aei.org/china-global-investment-tracker.

construction expertise, but how much, how fast, and on exactly what terms?

At the national level, after a wave of Chinese investment crested in 2013, Canada passed a law restricting foreign state-owned enterprises (and may be coming to regret it as investment dries up). Multiple countries have seen violent reactions, sometimes to comparatively limited Chinese activity.[7] Antipathy toward Chinese investment does not seem to be the trend, but the Chinese outbound economic surge is still building.

There are also less dramatic problems. The CGIT documents more than $250 billion in troubled transactions—with more than $200 billion in investments alone—that see cost overruns, lengthy delays, or just fail outright for nonmarket reasons (table 5). Some of the troubles are because of local objections and some because of mistakes by Chinese firms.

It takes time for a transaction to qualify as "troubled," so the results for the first half of 2015 are incomplete. The most prominent example may be the abrupt rescinding of a large rail contract in Mexico. Over the long term, huge sums cannot be spent without a hitch, whether Chinese money or anyone else's. Australia and the US, therefore, see the most troubled transactions. In addition, international sanctions against Iran pushed China to pause activity there. Germany's appearance stems from one very large investment failure, and Libya's from construction halted by civil war.

Table 5. Most Troublesome Countries since 2005 ($ Billion)

Country	Troubled Transactions
Australia	46.8
United States	39.8
Iran	25.2
Germany	13.9
Libya	13.4
Subtotal for top 5	**139.1**
Total for all countries	**260.8**

Source: China Global Investment Tracker, www.aei.org/china-global-investment-tracker.

All outward investors face such challenges, but Chinese firms face an additional risk. CGIT data show they generally prefer countries with a strong rule of law. Yet these firms do not operate under the rule of law at home. An event that could block another decade of expanding Chinese investment would be a high-profile firm's flouting the law in a country with an internationally credible legal system and media. If the case was strong enough, other Chinese companies would be found guilty simply by association, and political opposition within host countries would spike.

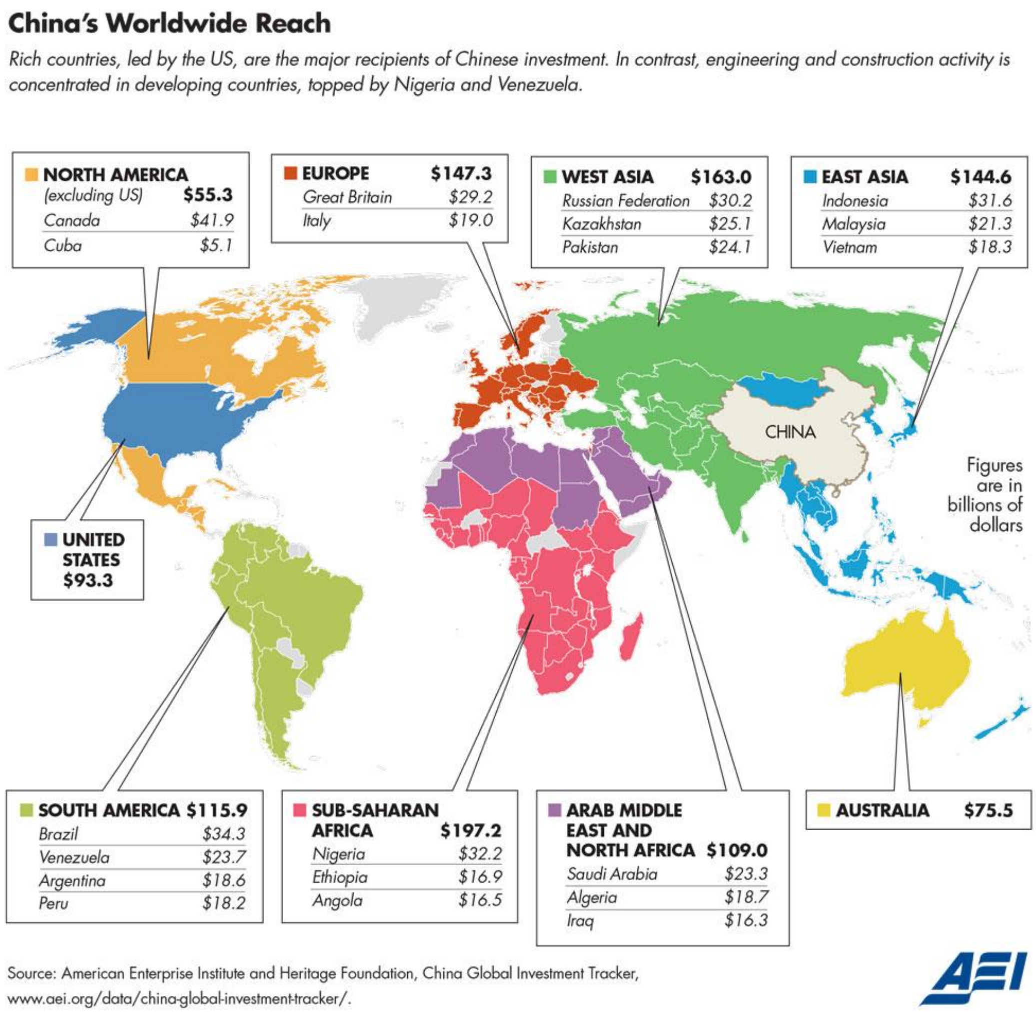
What to Watch For

Last year's CGIT-derived forecast of $1.25 trillion in investment over the next decade still seems reasonable, especially since it was later echoed by Communist Party General Secretary Xi Jinping.[8] Engineering and construction contracts could be worth $750 billion over that period. What is behind those numbers, though, is shifting considerably.

The sector pattern has already changed and will continue to. Chinese power companies will build plants all over the world, featuring nuclear reactors. But the stunning Chinese energy investment surge is over, thwarted by slower economic growth, lower valuations for energy assets, and suspected corruption in the oil majors.[9] Spending over time will still be notable, but conventional oil will share the spotlight with tight oil, natural gas, and alternative energy. Another commodity, metals, is seeing investment move from thriving to occasional.

Transportation is moving in the opposite direction, toward more dynamism. The recent flood of property acquisitions will give way, after losses inevitably accrue, to more selective purchases focusing in part on tourism. Construction of buildings is a more durable trend. Technology investment has surged but remains vulnerable politically. Chinese banks face pressing needs to boost their return on assets. It is a question not of if they venture out again (which they did in 2007–08, disastrously) but of when, and the outflow may have already started.

Figure 1



The geographic pattern of construction contracts over time indicates clearly that diplomatic initiatives such as the Asian Infrastructure Investment Bank will determine where Chinese engineers head. With commodities less important, the locus of activity may shift away from troubled oil producers and toward South and Southeast Asia.

For investment, 2006–12 saw Chinese firms spend intensively in single regions at a time—first Australia, then Sub-Saharan Africa, then South America—for about two years, then move on (figure 1). Small countries lacked sufficient opportunities or were uncomfortable with a rapidly growing Chinese presence. This pattern could recur. The EU's diversity means some members will always be attractive, but others are too small or struggling economically, capping Chinese spending there. East Asia wants to embrace China economically, but not too closely. While fossil fuels remain plentiful, West Asia's appeal is limited.

In the past three years, the US has thus become the predominant recipient of Chinese funds. If America's door remains open, Chinese money will flow into agriculture, finance, property, shale, and tourism. Cumulative Chinese spending in the US is still insignificant compared to American household wealth of approximately $85 trillion.[10] The size of the economy means a great deal of investment can be absorbed without fear of undue influence, which is not true anywhere else.

Politics is the main barrier. An obvious issue is cyberespionage; two more subtle ones involve a bilateral investment treaty (BIT) and private equity.

The investment climate would be considerably improved if progress is made on cyber. A comprehensive solution does not have to be found, but it is unrealistic to expect distrust of Chinese enterprises to wane while Chinese cyberactivity waxes.[11] Chinese firms must decide whether access to the US is worth changing their behavior. Ninety billion dollars in cumulative spending says that, for some, it should be. (To a lesser extent, the same is true in other countries.)

The US must offer clear carrots and sticks to encourage better behavior. The Committee on Foreign Investment in the United States (CFIUS) should work with the intelligence community to identify cyber aggressors as well as recipients of stolen intellectual property. Such firms should be blocked from the American market. The vast majority of Chinese companies will not be implicated and should be welcomed. For companies with a clean track record on cyber, CFIUS reviews of proposed deals should be quicker and more transparent and the threat of congressional interference reduced.

A BIT is not needed for any of this and is also increasingly impractical. How to win congressional approval has never been clear, and a brutal political battle over free trade with American treaty ally Japan makes a China BIT seem an impossible climb for years to come. On the Chinese side, recent enactment of a broad, vague national security law sharply reduces benefits to the US since actions taken in the name of national security are not restricted in economic agreements.[12]

Perhaps more relevant for American policymakers is the changing role of state-owned enterprises (SOEs). Even before the Chinese resource giants slowed their investment, the US had limited SOEs, with the majority of spending since 2012 coming from private firms. A newly important component of Chinese investment, though, is direct acquisition of stakes in unlisted assets—private equity. Some of this is done by private entities, but SOEs such as CITIC and the China Investment Corporation are also heavily involved.

It is increasingly untenable for the US to treat Chinese private and SOE investment as fundamentally different. Instead, the crucial distinction is between Chinese companies that fully obey American laws, including with regard to cybertheft, and those that do not. Investment and construction activities by firms respecting the rule of law will bring sizable benefits to both countries and should be encouraged.

About the Author

Derek Scissors (derek.scissors@aei.org) is a resident scholar at AEI.

Notes

1. See American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, July 2015 update, www.aei.org/china-global-investment-tracker. The entire set of transactions can be found at www.aei.org/data/china-global-investment-tracker/.

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3. State Council of the People’s Republic of China, “China’s Outbound Investment Set to Pass FDI,” news release, January 16, 2015, http://english.gov.cn/news/policy_briefings/2015/01/16/content_281475039991506.htm.

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12. Edward Wong, "China Approves Sweeping Security Law, Bolstering Communist Rule," *New York Times*, July 1, 2015, www.nytimes.com/2015/07/02/world/asia/china-approves-sweeping-security-law-bolstering-communist-rule.html.