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People and motorists are reflected on an electronic display panel showing video footage of Chinese President Xi Jinping near the central business district of Beijing, China, May 30, 2018 (AP photo by Andy Wong).

Why the U.S. and Others Are Casting a Wary Eye on Foreign Investment From China

Kimberly Ann Elliott | Tuesday, Aug. 14, 2018

While the U.S.-China trade war has been getting the headlines, investors from China are running into resistance in countries around the world, including the United States. Typically, governments welcome foreign investment, especially local governments, as a mechanism to create—or save—jobs, reinvigorate their economies and gain access to new technologies. Growing investment outflows from China, however, are pushing some national governments to take a more skeptical look at Chinese money.

In a measure aimed primarily at China, Congress strengthened (https://www.reuters.com/article/us-usa-defense-spending/massive-us-defense-policy-bill-passes-without-strict-china-measures-idUSKBN1KM5WT) the ability of the Committee on Foreign Investment in the United States, known as CFIUS, to review and block transactions that might threaten national security. Canada, Australia, the United Kingdom and other European countries are mulling (https://www.nytimes.com/2018/03/15/business/china-europe-canada-australia-deals.html) similar measures to increase scrutiny of Chinese investors. While protecting national security is the nominal excuse for these actions, other concerns lurk behind the scenes.

Worries about foreign investors “taking over” are nothing new. When Japan emerged as a major global competitor to the U.S. in the 1980s, there were cries of dismay about Mitsubishi buying a majority stake in American landmarks like the Rockefeller Center and Radio City Music Hall. As pointed out in a New York Times editorial (https://www.nytimes.com/1989/11/03/opinion/japan-buys-the-center-of-new-york.html) at the time, the purchase in fact reflected confidence in the American economy and was good for local investors in New York’s real estate market who saw property values go up. But there was still a sharp backlash against foreign direct investment from Japan, driven by a deep unease among some that these high-profile purchases by Japanese investors marked the decline of the U.S. and the rise of a new global leader.

Of course, the year after the Rockefeller purchase, the Japanese economy fell into a deep recession that turned into a “lost decade” (https://www.thebalance.com/japan-s-lost-decade-brief-history-and-lessons-1979056) of economic stagnation. A few years later, Mitsubishi cut its losses (https://www.nytimes.com/1995/09/12/business/japanese-scrap-2-billion-stake-in-rockefeller.html) and walked away from its investment in the Rockefeller Group.

Few experts expect a similar economic collapse in China. And while in the 1980s Japan’s critics alleged that it supported its major firms with unfair trade policies and practices, those firms were not state-owned, as many in China are today. So is Chinese foreign direct investment any different? Does it deserve an extra degree of scrutiny?

In just the past few years, Chinese foreign direct investment has grown rapidly, placing it in the top tier of global investors. According to estimates by the United Nations Conference on Trade and Development, or UNCTAD, China is the second-largest source of investment outflows, behind the United States. It is also the third-largest recipient of foreign direct investment after the U.S. and the U.K. The influx of outside money played a major role in China’s economic development, with foreign-invested firms accounting for 60 percent of China’s trade at its peak in the mid-2000s and nearly half today. China’s investment outflows, which were essentially nil until the mid-2000s, have grown rapidly in recent years, reaching $183 billion in 2016, when they exceeded inflows into China for the first time. According to the UNCTAD figures (http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx), Chinese outward foreign direct investment increased 50 percent in that one year. By 2017, it represented nearly 9 percent of global flows of foreign direct investment and 5 percent of the total stock value of that investment, up from around 1 percent for both just 10 years earlier.

The use of Hong Kong and foreign tax havens as conduits for all this Chinese investment make the bilateral data more difficult to track than the global flows. The Chinese government reports that, in 2015, Hong Kong, the Cayman Islands and the British Virgin Islands were the top three hosts for outward foreign direct investment, followed by the U.S., Singapore, Australia and the U.K. The

American Enterprise Institute and the Heritage Foundation have been tracking (http://www.aei.org/china-global-investment-tracker/) where those investments actually end up and the resulting rankings are quite different, with the U.S. receiving a total of $176 billion in Chinese direct investment from 2005 to 2018. Australia is next with $94 billion and the U.K. third with $73 billion in cumulative foreign direct investment over that period.

> *There are plenty of reasons to scrutinize Chinese foreign direct investment. But there are risks in being overly aggressive.*

According to the American Enterprise Institute and Heritage Foundation tracker and the Rhodium Group, a private consulting firm that focuses on foreign direct investment between China and the U.S., the flow of Chinese money into the U.S. tripled to somewhere around $50 billion in 2016. In the U.K., the annual flow of Chinese investment more than doubled to almost $30 billion (https://rhg.com/impact/china-investment-monitor/). The pace has slowed since then, in part because of new government restrictions on outflows aimed at preventing too steep a decline in China's foreign exchange reserves. The drop has been particularly steep (http://cim.rhg.com/notes/chinese-fdi-in-the-us-in-2017-a-double-policy-punch) in the U.S., however, where the increased scrutiny and President Donald Trump's trade war appear to be discouraging investors.

Just the size and the speed of the investment flows would be enough to cause some concern. But as noted, some of the Chinese firms doing this investing are state-owned, while Beijing retains a much greater degree of control over China's economy than governments in other countries. A Congressional Research Service report notes that the Chinese government is encouraging the boom in foreign direct investment as part of its efforts "to gain access to [intellectual property], technology, know-how, famous brands, etc., in order to move Chinese firms up the value-added chain in manufacturing and services"—and overall to help Chinese firms become global competitors, à la Japan in an earlier era. Other motives include (https://www.hsdl.org/?abstract&did=803891) diversifying the investment of its foreign exchange reserves beyond relatively low-yielding U.S. Treasury bonds, and ensuring access to petroleum and other natural resources, such as minerals, deemed essential to China's continued growth.

The other major break with the earlier American backlash against investment from an economic power in Asia is that China is also a military competitor, posing potential national security threats in ways that Japan, a close U.S. ally, never did. So there are plenty of reasons to scrutinize Chinese foreign direct

investment more carefully than money from elsewhere. But there are also risks in being overly aggressive. Next week, I'll look at how the U.S. and other governments are trying to address this challenge from China, while avoiding lost opportunities for economic growth.

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