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Chinese Outward Investment: Slower Growth in 2011

Derek Scissors, Ph.D.

Chinese investment has become a notable factor in the world economy and will continue to be for the indefinite future. As a whole, Chinese investment is now maturing in both positive and negative senses. As investment has matured, annual growth has slowed, with growth in some markets stagnating entirely. On the other hand, investment is becoming more regularized, and more non-state firms are now participating.

Chinese investment in the U.S. continues to underperform relative to the size of the American economy and growth in other major markets, including Canada. This is hardly a threat to the American economy, but it does follow in large part from America's failure to clarify its policy. Because Chinese investment will be a notable force for years to come, the U.S. needs to improve its response, both at home and around the globe.

The China Global Investment Tracker. The Heritage Foundation offers the only public dataset of Chinese outward investment. The China Global Investment Tracker includes nearly 300 transactions of $100 million or more from 2005 through the end of 2011.[1] Smaller transactions are not important in the totals, but they can matter a good deal to smaller economies that see less activity.

Heritage figures are similar to those published by the Chinese Ministry of Commerce, even though the transactions followed are not exactly the same. The official Chinese numbers also have a number of flaws, starting with the treatment of Hong Kong as the final destination for well over half of total outward investment when it is now almost entirely a transshipment point. The Heritage series shows clearly slower growth in 2011 after a strong 2010, which is also seen in official data through November.

The Heritage dataset also contains more than 120 large engineering and construction transactions conducted since the beginning of 2005, valued at more than $130 billion. This list is not complete, but it is necessary to provide a fuller sense of the People's Republic of China's (PRC) global activity. Finally, the tracker offers a list of more than 75 failed or seriously disrupted transactions since 2005, valued at more than $180 billion.

Where China Invests. Because Hong Kong and other financial centers are treated as final destinations, official Chinese data are not useful in determining the distribution of Chinese spending around the world. For example, the Ministry of Commerce puts investment in Brazil at less than $500 million in 2010, while investment in the Cayman Islands was said to be $3.5 billion. The Heritage series uses

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214 Massachusetts Avenue, NE
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(202) 546-4400 • heritage.org

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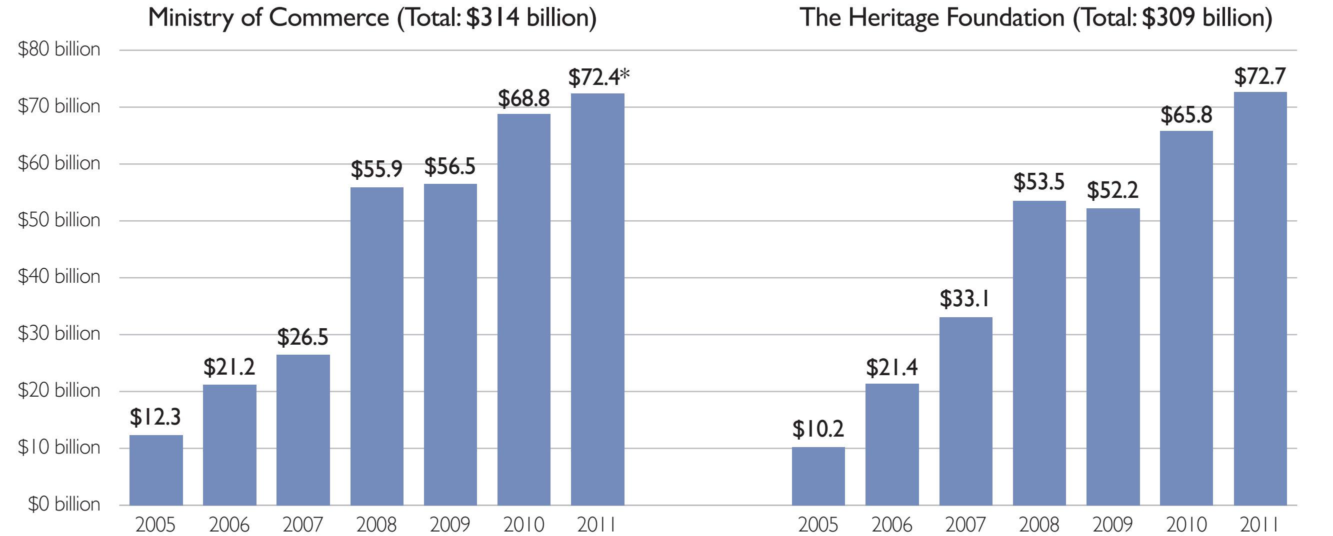
Chinese Outward Investment Since 2005: Two Views



* Estimate based on official 5.2 percent growth through November 2011. Actual figure is likely to be higher.

Note: The Heritage Foundation dataset does not include: transactions valued at less than $100 million, trade transactions, bonds, loans, or foreign aid.

Sources: The Heritage Foundation, China Global Investment Tracker dataset, January 2012, at *https://thf_media.s3.amazonaws.com/2012/xls/China-Global-Investment-Tracker2012.xls*; Ministry of Commerce of the People's Republic of China, Department of Outward Investment and Economic Cooperation, "2010 Statistical Bulletin of China's Outward Foreign Direct Investment," Beijing, September 2011, at *http://hzs.mofcom.gov.cn/accessory/201109/1316069658609.pdf* (January 6, 2012); "China's Jan.-Nov. ODI Reaches 50 Bln U.S. Dollars," *Xinhua*, December 15, 2011, at *http://english.peopledaily.com.cn/90778/7678364.html* (January 6, 2012).

Chart 1 • WM 3445 heritage.org

corporate-level information, not national, and can identify the true investment target, giving a far more accurate picture.

For the past two years, there has been a rush of Chinese money into South America, topped by Brazil. In late 2011, there were also several large deals in Canada, making the Western Hemisphere (excluding the U.S.) the leading target for Chinese companies. At the other end of the spectrum, political instability in the Arab world has all but halted Chinese business activity there.

Elsewhere, Australia continues to be by far the biggest single recipient of Chinese investment. Last year saw renewed interest in East Asia, led by engineering and construction contracts in Indonesia. There was a late surge of money into Europe, especially France and Portugal, that could continue in 2012 given the European Union's financial problems.

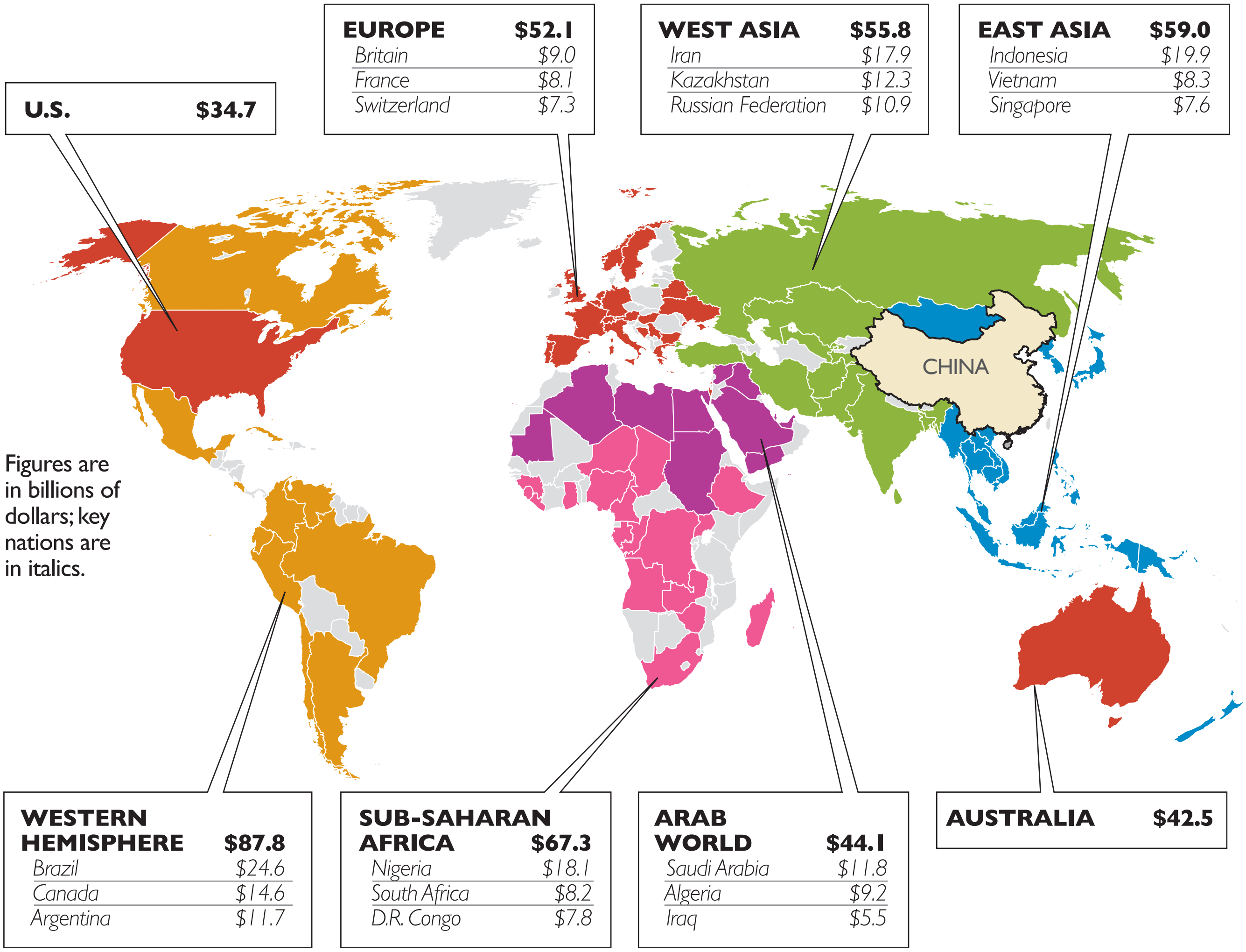
Crucial Features. Official Chinese data are also unhelpful in determining which sectors are receiving the most investment. The biggest category—"leasing and business services"—is difficult to interpret. Energy leads, unsurprisingly, on the Heritage tally. Oil is most important, especially when combined with integrated oil and gas investment and engineering.

The second most popular sector is metals, led by iron ore. Transport includes a large volume of construction contracts. Sectors that receive a great deal of global attention—agriculture and technology—have yet to see sizable Chinese investment.

1. Chinese Outward Investment, data compiled by The Heritage Foundation, 2005–2011, at *https://thf_media.s3.amazonaws.com/2012/xls/China-Global-Investment-Tracker2012.xls*. The dataset excludes bonds, trade, loans, and aid.

China's Worldwide Reach

The Western Hemisphere continues to draw the most attention from Chinese companies.



Source: The Heritage Foundation, China Global Investment Tracker dataset, updated January 2012, at *https://thf_media.s3.amazonaws.com/2012/xls/China-Global-Investment-Tracker2012.xls.*

Map 1 • WM 3445 heritage.org

There are signs of maturation in Chinese investment. The number of transactions worth $100 million or more increased in 2011, while the average value of these transactions declined for a fifth straight year. Mid-size deals are becoming less exceptional and more normal, and new firms are participating. As part of this, the share of non-state firms in investment volume, while still quite small, rose again last year after rising in 2010. Through 2011, the non-state share is about 6 percent, up from less than half that at the end of 2009.

A weakness in 2011 is a rebound in the number of troubled transactions. Slow investment growth last year may have been due to global economic weakness, or it may have been due to structural barriers to Chinese outward investment.

Turmoil in Libya may have been a singular event, but a large dam contract was unceremoniously

Sector Patterns

Chinese Business Activity for 2005–2011 by Industry, in Billions of Dollars

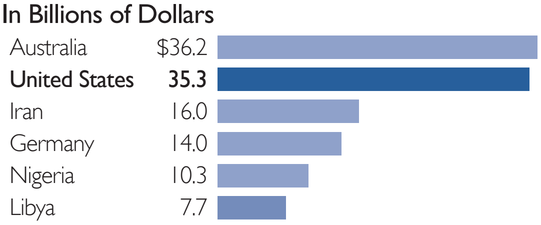
Sector	Investment	Engineering and Construction	Troubled
Energy and power	$144.6	$65.8	$67.2
Solely oil	*63.9*	*22.9*	*5.1*
Metals	79.9	5.2	45.8
Finance	35.2	n/a	30.4
Transport	10.1	50.1	14.5
Real estate and construction	19.7	5.4	5.1
Technology	6.3	4.1	13.0
Agriculture	6.6	1.8	9.2
Chemicals, other industry	6.6	2.1	0.3
Total	**$308.9**	**$134.4**	**$185.5**

Source: The Heritage Foundation, China Global Investment Tracker dataset, January 2012, at *https://thf_media.s3.amazonaws.com/2012/xls/China-Global-Investment-Tracker2012.xls.*

Table 1 • WM 3445 heritage.org

Troubled Transactions with China: Top Six Nations

In Billions of Dollars



Source: The Heritage Foundation, China Global Investment Tracker dataset, January 2012, at *https://thf_media.s3.amazonaws.com/2012/xls/China-Global-Investment-Tracker2012.xls.*

Chart 2 • WM 3445 heritage.org

rescinded in Burma, and large energy investments collapsed in Argentina and Canada. Commodities deals are the most subject to serious setbacks. Overall, Chinese companies have seen more than $150 billion in investments and at least $30 billion in engineering contracts suffer serious losses or fail entirely since 2005.

Implications for the U.S. There are two dimensions of Chinese outward investment and business transactions that the U.S. must consider: what to do about Chinese investment overseas and what to do about it in America. Chinese investment overseas is not a tidal wave threatening American interests, but Chinese firms will be major and durable players in both developed and developing markets. From offshore gas exploration in Brazil to auto production in India, American companies need to be able to compete.

In the U.S., the volume of blocked Chinese transactions since 2005 is about the same as the volume of completed transactions. This helps to explain a clear drop in the pace of new investment commitments in America last year. The U.S. has shown the most discomfort—for good reason—with very large deals by state-controlled enterprises such as CNOOC and Huawei.

Chinese companies have learned to take bite-sized pieces, such as Sinopec's early 2012 acquisition of minority stakes in Devon Energy projects,[2] but they consistently complain that they do not know the implicit rules for their American transactions: which sectors are truly open, how big transactions can be, and what will be reviewed by the Committee on Foreign Investment in the United States (CFIUS). Transparency is achieved only when all parties can see plainly, and the U.S. has not been transparent for Chinese investors.

More Trade and Transparency. The U.S., therefore, should:

1. Quickly push forward a strong Trans-Pacific Partnership (TPP) agreement to open Pacific markets and serve as a template for investment access around the world. The TPP could be par-

2. Anna Driver, "Sinopec, Devon in $2.2 Bln Shale Deal," Reuters, January 3, 2012, at *http://www.reuters.com/article/2012/01/03/devonenergycorp-idUSL3E8C36L720120103* (January 9, 2012).

ticularly helpful in establishing methods of treating investment by state enterprises.

2. Follow success with the Colombia Free Trade Agreement with more free-trade negotiations in South America and elsewhere.
3. Prioritize in the Strategic and Economic Dialogue the negotiation of increased U.S. market access for state-controlled enterprises in exchange for a clear reduction in the various kinds of subsidies for such enterprises.
4. Clarify the American investment review process, starting with the desired scope, timing, and criteria for CFIUS reviews. For example, CFIUS should work toward guidelines explaining why transactions are rejected even if, for national security reasons, the guidelines will be incomplete.

—Derek Scissors, Ph.D., is Research Fellow in Asia Economic Policy in the Asian Studies Center at The Heritage Foundation.