Investments/The overseas destinations of Chinese capital

The Dragon Shops

Chinese investment worldwide has gone from USD 55.9 billion in 2008 to USD 196.15 billion in 2016. This increase is due to one main objective: acquiring know-how. The yuan now favors Singapore, Hong Kong and Africa over the United States

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The Chinese authorities' restrictions on capital outflow have made themselves felt, with Chinese overseas direct investment (ODI) falling by 40 percent year-on-year in the first ten months of 2017. This was noted in the recent report by the Economist Intelligence Unit (EIU, the think tank of the prestigious British magazine *The Economist*), ranking the 60 largest economies in the world in terms of attractiveness for Chinese enterprises. According to the EIU analysts, these are temporary measures, however. Chinese ODI flow remains consistent. Greater expansion of Chinese acquisitions around the world will continue in the coming months and years. Why is this?

Towards modern, advanced industry

The answer lies in Beijing's plans, which aim to transform the Chinese economy into a modern, advanced industry. "China is doing best in manufacturing. Focusing on an archaic sector has required its modernization," said Michele Geraci, Assistant Professor of Finance at the Nottingham University Business School China and Director of the Global Policy Institute. "That's how China came up with Made in China 2025, the plan to create an advanced manufacturing sector and focus on the environment and innovation. No more T-shirts. Artificial intelligence, robots and electric cars instead." Chinese investments are guided by a strict logic: acquiring the skills to assert leadership in the technology of the future. There are two types of skills: "On one hand, domestic capacity. On the other, acquiring know-how from foreign industries," Geraci explained. "Where that doesn't happen, China will need to go into M&A (Mergers and Acquisitions)." Beijing intends to direct investment along two main lines. Infrastructure, i.e., ports and railways. Put simply, the Silk Road, the Belt and Road Initiative (BRI or OBOR, One Belt One Road), USD 900 billion of infrastructure links by land and sea between Asia, Africa and Europe, as announced by Xi Jinping in 2013. This is the new "Chinese globalization" project, involving 60 countries (mostly developing countries). China is entering a "new era" of socialism with Chinese characteristics, with an ultimate aim of becoming a fully-developed economy by 2049, 100 years after the creation of the People's Republic of China (PRC). The Congress of the CCP in October added Xi Jinping's thought to the statutes, and reconfirmed him as General Secretary. Opposing Xi means opposing the Party. The statutes now also include an indication of the Chinese President's two main political strategies: the Belt and Road Initiative and supply-side structural reform. The latter is the key element of the "New Normal" strategy, aimed at improving productivity and the Chinese industrial fabric, with the objectives of cutting overcapacity and Made in China 2025 at its core.

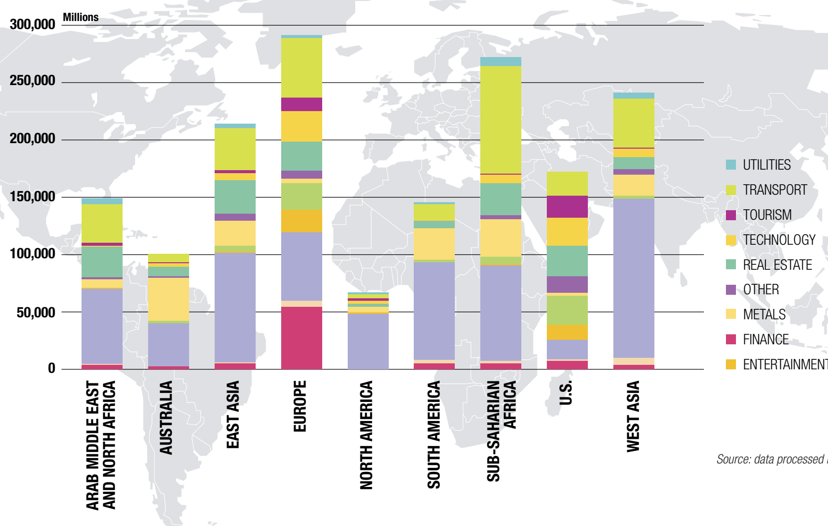
Beijing's restrictions

Chinese investment worldwide has seen an incredible increase, from USD 55.9 billion in 2008 to USD 196.15 billion in 2016. But concerns over the financial system led the Chinese authorities to impose restrictions. "Non-financial outbound Chinese investment at September 30, 2017 stood at USD 78.3 billion, down 41.86 percent on the first nine months of 2016," explained Alberto Rossi, an analyst at CeSIF – Centro Studi per l'Impresa, Fondazione Italia Cina (business think tank, Italy-China Foundation). In November 2016, the Chinese government imposed restrictions on overseas acquisitions, fearing an outflow of capital. The climate for Chinese investors has worsened. The policies controlling "unreasonable" investments have been strengthened, in what the head of the Chinese State Administration of Foreign Exchange (SAFE) Pan Gongsheng called "roses with thorns" (after the record USD 183 billion and USD 225 billion in acquisitions in 2016). In recent years, foreign exchange reserves have been drained, weakening the yuan. The latest restriction, ordered by the State Council on August 18, aims to place stricter limits on acquisitions in sport, hotels and entertainment. These fields give rise to speculation and are often used to hide capital outflow overseas. The Chinese authorities have classified investments into three categories: "prohibited," "restricted" and "supported." Concerns over the financial system, especially in terms of capital outflow overseas, have led the Chinese authorities to curb investment. This affects mainly private business conglomerates, also known as "white rhinos" and "financial crocodiles," which are hampered by restrictions on loans for overseas acquisitions," said Alberto Rossi. "As well as fears of capital outflow, there are now concerns over falling foreign exchange reserves. In January, for the first time since February 2011, the reserves fell below the psychological threshold of USD 3 trillion (compared to USD 4 trillion in June 2014)," Rossi noted. Two factors are pushing the Chinese giants to go shopping overseas: the prospect of increasing revenue by entering new markets and acquiring new technologies. Investments falling under OBOR are a third factor.

Bye-bye United States, hello to the new favorites, Singapore and Hong Kong

The EIU report shows that Singapore has overtaken the United States as the most important destination for Chinese investment. Then come Hong Kong, Malaysia and Australia. "Malaysia and Singapore are establishing themselves as attractive destinations for projects related to OBOR, based on an investment environment characterized by opportunity and low risk," the report said. Six industries were considered: auto, consumer goods, energy, financial services, telecommunications and healthcare. The Made in China 2025 plan identifies ten strategic sectors for investment to transform China into an industrial superpower (IT, robotics, aerospace, shipbuilding, electric cars, energy, agriculture, new materials, biopharmaceuticals), each requiring the massive investment typical of high-tech industries. The development of artificial intelligence also plays a major role. The Chinese internet giants, such as Tencent and Alibaba, are the main investors in e-commerce startups in Asia. (Tencent, the first Chinese high-tech →

CHINESE INVESTMENTS WORLDWIDE. The map shows total Chinese investments (debt and equity) from 2005 to date, dividing them by geographical region. Each column is divided by industry.



Source: data processed by Michele Geraci

company to break through the ceiling of USD 500 billion dollars in stock market value, together with Baidu and Alibaba makes up the BAT triumvirate of Chinese high-tech, an open challenge to Silicon Valley.) From the previous report published in 2015, while developed countries are the main destinations for Chinese investors, developing countries have recorded the greatest flows.
Why is this? Two factors make them attractive. On one hand, incentives for investment in OBOR-related infrastructure, on the other, the stabilization of raw material prices. The ranking rewards countries such as Malaysia (up from 20th to 4th), Kazakhstan (from 51st to 12th), Thailand (from 38th to 18th), and Iran (from 52nd to 19th), while it penalizes others, including the U.S. (down from 1st to 2nd) and India (from 28th to 36th), both of which are suffering from diplomatic tensions and trade frictions with Beijing. According to the Chinese Ministry of Commerce, non-financial direct investment in countries involved in OBOR projects grew by 18.2 percent to USD 14.8 billion in 2015, falling 2 percent to USD 14.5 billion in 2016, then dramatically dropped 13.7 percent in the first nine months of 2017. Of course, not all projects falling under OBOR have the same luck. An investigation conducted by the Financial Times and the Center for Strategic and International Studies (CSIS) revealed some of the issues faced by Chinese projects overseas. Failed railway projects in the U.S., Venezuela, Mexico, Myanmar and Libya were worth USD 47.5 billion according to *Financial Times* estimates, while ongoing ones in Laos, Saudi Arabia, Turkey and Iran come to USD 24.9 billion according to CSIS estimates. In total, the value of the eighteen high-speed projects, including those under construction, those that have been announced and one already completed, the Ankara-Istanbul line, is now more than the value of the Marshall Plan, now worth around USD 130 billion (USD 13 billion at the time).
But there are doubts over their financial viability. For example, Chinese standards don't seem to be welcomed everywhere. One of the most controversial projects is the railway line from Belgrade to Budapest, stopped first by the European Union in February to investigate alleged breaches of E.U. rules. According to the EIU report, Italy, in 35th place in 2015, has now fallen to 50th. Even so, the worst performer is the United Kingdom. Following the decision to leave the European Union, Britain has dropped from 28th to 40th place. The countries keeping high positions in all six sectors are the United States, Japan, India, and Iran. Although the United States and Japan remain attractive destinations offering opportunity to investors to acquire technology and brands through M&A operations, India and Iran are markets with high growth rates where Chinese companies can compete. For example, two giants are already in India: Huawei, the leading telecommunications company, and Xiaomi, the fifth largest smartphone manufacturer in the world. Among the BRICS countries (the emerging economies of Brazil, Russia, India, China and South Africa), Russia has moved from 24th to 10th place, based on commodity price increases, while South Africa has risen six places to 44th. Just like India drop in ranking mentioned above, Brazil fell 19 places to 53rd. In the automotive sector, Japan is 1st (of the E.U. countries, Germany comes in 9th). In consumer goods, the United States leads (in the E.U., Romania is 10th).
In the energy sector, India is the country that attracts the most Chinese capital. Things are changing in the oil and gas sector, with a greater flow of Chinese ODI in countries with large mineral deposits. The three largest Chinese oil companies – China National Petroleum Corporation (CNPC), Sinopec and China National Offshore Oil Corporation (CNOOC) – have invested mainly in North America (the biggest deal was the acquisition of 33 percent of Devon Energy in 2012), Central Asia (especially in Kazakhstan), Latin America (mainly in Brazil and Venezuela, where China invested $1.5 billion in PDVSA in 2016). However, there seems to be reluctance on the part of Chinese companies to invest in Latin American businesses, known for their high risk of default. In the Middle East, the two largest oil producers, Saudi Arabia and Iran, have attracted little attention from Chinese investors. Analysts note that the increase in sanctions should nevertheless increase investment in Iran. In the financial services sector, the United States takes first place, followed by Hong Kong, Singapore, Sweden, and several European countries: Switzerland, Slovakia, Poland, Norway, plus the UK and Canada. In the healthcare sector, the US and Japan lead, with the bottom five places taken by European countries: Germany, Sweden, Norway, Denmark and France. Telecommunications is dominated by Japan, the U.S. and India.

The importance of a precise definition of "investment"

For Michele Geraci, in the world map of Chinese investments the top spot is taken by Africa, followed by Europe and the United States. "Making a list of Chinese investments around the world is extremely complex," noted Geraci. Why is this? The definition of "investment" varies from organization to organization. The Organization for Economic Co-operation and Development (OECD), the Ministry of Commerce, People's Republic of China (MOFCOM) and the European Union all have different criteria. "Investments can be in shares, corporate debt, or government-issued bonds," the analyst noted. "China has invested USD 3 billion in the foreign exchange reserves of other countries—in Europe, Japan and the U.S.—where Beijing has bought a billion government bonds. Foreign exchange reserves are almost never taken into account." There are also green field investments, where a factory is opened with no investment in an M&A operation. For example, "The OECD also considers the 'retained earnings' of a company purchased many years earlier as an investment," Geraci went on. What does that mean? "Say a Chinese investor purchased a company last year or 20 years ago. In the current year, to which the hypothetical relationship applies, the company records profits of $1 billion and pays dividends of $300 million. The difference between profits and dividends ends up in 'retained earnings,' regarded as direct investments," Geraci explained. "This money should have gone back to the parent company, but remains within the organization. In other words, it is considered a non-return flow." Then there's a convention that applies to M&A operations. "It's only an investment if the proportion of share capital is more than 10 percent," the analyst continued. For example, the People's Bank of China (PBoC) holds almost 2 percent of the shares in Generali, Telecom Italia, Eni, Enel, Fiat and Prysmian. However, these holdings are not considered direct investments. "The paradox is that – say – if the Chinese central bank increased its holding by 1 percent per year, the day it reached 10 percent, it would suddenly be recorded as ODI," Geraci suggested. Michele Geraci has analyzed total Chinese investments (debt and equity) from 2005 to date, dividing them by geographical region: Middle East and North Africa (around USD 150 billion); Australia (around USD 100 billion); East Asia (around USD 210 billion); Europe (around USD 290 billion); North America (around USD 60 billion); South America (almost USD 150 billion); Sub-Saharan Africa (around USD 270 billion); United States (around USD 170 billion); West Asia (around USD 240 billion). Each column is divided by industry: utilities; transport; tourism; technology; real estate; other; metals; finance; entertainment.
"The region with the most Chinese investment since 2005 is Africa, with around $330 billion: $280 billion in Sub-Saharan Africa and $50 billion in North Africa," the analyst explained. "Investment is concentrated in Ethiopia, Algeria, and Nigeria. There is a high concentration in infrastructure: transport and energy. The numbers speak for themselves. In Africa, poverty started to reduce when China began to invest. By chance or cause and effect?" Geraci noted. Europe comes next, with USD 280 billion. The old continent "is interesting for Chinese investors especially for its know-how and manufacturing, driven by the need to acquire new technologies in line with the objects of the Made in China 2025 Plan."
The drive to acquire know-how is also behind the approximate USD 170 billion invested in the United States. China is essentially interested in two

THE EXPANSION OF TOURISM
The Chinese invest in Europe especially to acquire technological know-how they can transder to China. Tourism is also a large-scale sector. In the picture, Chinese tourists at the 34th Harbin International Ice and Snow Festival, in China.

things when investing in Africa: energy and transport (with companies taking orders for infrastructure developments). When investing in Europe, there is no need for new infrastructure, so the Chinese buy know-how. This is demonstrated in recent acquisitions from Germany's Kuka (USD 4.5 billion) to Switzerland's Syngenta (USD 43 billion), and the recent purchase of Esaote, an Italian gem in the manufacture of medical devices, by a consortium of six Chinese partners.

To Europe in search of know-how

Chinese investment in Europe from 2010 through 2016 rose from USD 20 billion to USD 35 billion. In 2016, Italy was confirmed as the third European country destination for investment from Beijing, with USD 12.84 billion in stocks. As noted above, the Chinese invest in Europe mainly to acquire know-how and transfer technological expertise to China, where it is needed to complete the move towards quality manufacturing. Chinese purchases in high added value technology sectors are reflected in the growth in overseas investment in the manufacturing sector, rising from 13.7 percent in 2015 to 19.4 percent in 2016, according to data from CeSIF, the think tank at the Fondazione Italia Cina. Compared with China's 2016 USD 35 billion investment in Europe, the USD 8 billion of European investments pale in significance. This clear distinction has revived the issue of reciprocity. A crisis point occurred in 2016 during the aforementioned purchase of 35 percent of Kuka, a German robot manufacturer, by China's Midea. The purchase was taken badly by Angela Merkel, resulting in an anti-predatory protectionist measure to defend the strategic interests of Europe, as announced by the President of the European Commission Jean-Claude Juncker at the request of Germany, France and Italy. "The right way, although an imperfect one," commented Alberto Rossi. "Discussing this matter is essential, although I think it would be almost impossible to achieve full reciprocity with the Chinese. The wind changed in Europe, wanting to go for more controls, and in China, where a restriction was imposed on capital outflow, which will result in increased monitoring of investments. Despite the central role of the Belt and Road Initiative, which should be fully implemented with a view to investment in the next decade, this is not the right time for mutual investments, both from China to Europe and from Europe to China." China has invested around USD 22 billion in Italy (including USD 7 billion in Pirelli alone) from 2008 to date. "The vast majority of this is acquisitions, with very few greenfield investments," Geraci commented. What does this mean? "That the Chinese have not opened factories or research centers in Italy, other than in very rare cases. Instead, they have bought existing companies. This USD 22 billion has added no value to our economy. In fact, it's only an exchange between shareholders. The Chinese just want to acquire our know-how," the analyst explained.

The Silk Road: A platform for relations

According to MOFCOM data reported by CeSIF, 12.3 percent of nonfinancial Chinese investments come under the Belt and Road Initiative. In the first nine months of 2017, overseas Chinese investment amounted to USD 78.03 billion, while investment in the OBOR was USD 9.6 billion. "It's important to note that investment in the Belt and Road Initiative is still not high compared to total overseas Chinese investment," said Rossi. "This means that, even before a major investment plan, OBOR is now mainly the construction of a platform for relations. Its main objective is not so much the development of new logistics and infrastructure platforms – this can only be the first stage, but a genuine new Chinese globalization plan, focusing on defending and protecting Chinese interests overseas. In terms of Sino-European relations, it will also be important to see if it's possible to identify how to develop for mutual benefit and win-win cooperation. "There's no win-win with the Chinese," in the view of Alberto Forchielli, managing partner of the Mandarin Fund. "The Sinocentric nature of the Chinese model brings no benefits to other countries." He emphasized the risks: "Becoming an imperial power has costs as well as benefits. From Venezuela to Ecuador, from Africa to Southeast Asia, the Chinese have invested with no real return. Anyway, it is more reasoned investment than America's, with them fighting wars in Afghanistan and Iraq, ending up giving their adversaries an advantage." The American model, especially in the last 20-30 years, is "fundamentally military," Forchielli noted. "Instead, the Chinese model is economic and political, with less investment, less risk and higher returns," he went on. The U.S. drop bombs and make many enemies. The Chinese do not bomb, they buy and spend less. The USD 63 billion loaned to Venezuela is the same amount that America spends in one day of war. The new Silk Road is a "priority," Xi Jinping has said. The objective is to "further open China through links towards the east and west, by land and sea." "OBOR is an instrument of soft power," Michele Geraci said. "The aim is to export manufacturing overcapacity to overseas markets, especially in certain industries (such as steel), and is linked to the reform of state-owned companies. However, the impact of OBOR on the Eurasian economy could be huge. Building infrastructure in poor countries produces immediate results, because it's a start from scratch. It is therefore positive investment. For example, in Africa, China is building by exchanging resources, contributing to the stabilization of the region," Geraci said. What about the impact on the European economy? "It will be interlocutory, after the protectionist measures announced by Juncker. And Italy? "At most, we can aim at promoting the port of Trieste," Geraci admitted. Alberto Forchielli thinks European protectionism won't be easy to apply. "For Eastern European countries, Chinese investment is like manna from heaven. Beijing wants to conquer Eastern Europe to expand westward. The liberal Northern European countries are hostile to protectionism, and do not view these kind of maneuvers favorably."