China’s global investment and its regulation

Mills Room, Chancelry Building, Australian National University

10 July 2013

Session 1 – The characteristics and performance of Chinese ODI

China’s outward direct investment (ODI) has grown rapidly over the past decade, and annual flows are now close to matching inbound investment flows. Notwithstanding difficulties in assembling accurate data on Chinese ODI, the roundtable heard that Chinese investment in Australia has grown, by one measure, from 18 per cent to 50 per cent of its potential over the last decade, and that Australia is relatively open to Chinese investment as well as investment in general. Chinese investment into Australia is achieving more relative to potential than Chinese investment elsewhere; Chinese ODI to the world as a whole is, by this measure, at 25 per cent of potential.

The Chinese government has taken an active role in promoting ODI, assisting firms investing overseas through bilateral treaties, investment insurance, information for investors, consular support and incentives. There are two reasons for this support. First, the Chinese government wishes to create a leading group of internationally competitive Chinese firms, and recognises that a network of foreign affiliates, by improving access to tangible and intangible assets, is an important source of international competitiveness. Second, rightly or wrongly, building internationally competitive firms is assumed to help the development of China itself. It contributes to the structural transition of the economy, and China as a whole is thought to gain access to the tangible and intangible assets that Chinese firms gain access to by investing overseas.

In spite of this desire to promote ODI, the current approvals process is cumbersome and fragmented, involving many different agencies, and the requirement to gain approval kicks in at a low level of investment. To better promote ODI, the process could be consolidated, and the threshold for approval raised. Likewise, the assistance that the Chinese government provides, though theoretically available to all firms, appears to disproportionately benefit state-owned firms. Such a situation may not be compatible with current norms relating to competitive neutrality, and will certainly be a point of contention in future discussion on the international investment regime. Ultimately, it would appear that policy strategists were in a following, rather than leading role in the growth of Chinese ODI.

It is not clear that the current system governing Chinese ODI will remain sustainable as Chinese ODI continues to grow, with 25,000 large investment projects expected over the next decade, an increasing share of which is likely to be carried out by private firms. First, such a large degree of government oversight colours perceptions of Chinese ODI abroad, with the government’s emphasis on resources contributing to the difficulty that some Chinese firms have faced investing abroad. Second, it has made the government overly responsible for the...
behaviour of Chinese investors abroad, requiring it to provide more and more services. Again, as investment grows ever larger, the government may well no longer be able to bear this responsibility. The government if fact already appears to be losing control, as the bureaucratic load grows too great.

Discussion in the final part of this session examined Chinese interests in the international investment regime. These include a reduction in barriers to Chinese ODI, greater protection for Chinese investment, and recognition of the differences between the Chinese model and ordinary state capitalism when assessing investment carried out by Chinese state-owned firms.

This official position does not seem to adequately distinguish between access for Chinese investors, which is China’s current priority, and questions of post-access regulation. In addition to this conflation of interests, the Chinese government has attempted to further these desires through the negotiation of bilateral investment treaties, where it has so far been singularly unwilling to reciprocate the concessions it has demanded of other parties, with access for foreign investors to the Chinese internal market still restricted. The contribution that China might make to greater liberalisation of the international investment environment remains to be defined, and when it is, it could place much more emphasis on multilateral action that it currently does, instead of bilateral negotiations.

Session 2 – China’s ODI experience and policies

As things currently stand, China is certainly different from other large sources of ODI. First, its size, and the speed with which Chinese ODI has grown are unmatched, meaning that the capacity to analyse and understand proposed Chinese investment may not (yet) exist. Second, it is the first time that a country with China’s mix of political and economic institutions is a large source of ODI, with a consequently large role for state-owned firms, whose preponderance in ODI is an extension of the privileged position they enjoy in the domestic economy. Third, the interplay between economic exchange and strategic concerns is perceived to have no analogue in past experience.

The appropriate response to the growth of Chinese ODI therefore depends in part on how long Chinese ODI retains its exceptional character. If the reform program to be announced later this year is as comprehensive as some are predicting it will be, the differences between Chinese economic institutions and western ones may soon narrow drastically, with state-owned firms losing their central position.

If on the other hand the reforms do not dislodge state-owned firms from their central position, other questions are raised. How should western governments respond to investment from Chinese state-owned firms? Concerns were raised that such firms might be unfairly powerful, because of the explicit and implicit support they received from the Chinese government, unduly reducing competition. Another argument is that, as public firms, they could be a drag on host economies, as such firms tend to underperform relative to their
private competitors. It was argued that the current model of state-owned firms leading the growth of ODI is unsustainable, and that, rightly or wrongly, it drives western countries to protect private firms until a new model, led by private firms, emerges. The suggestion was also made that Chinese state-owned firms could be a tool for the Chinese government in meeting its global responsibilities, say to provide global public goods. This suggestion was however questioned on the grounds that China should meet its global responsibilities through treaties and rules, not investor behaviour.

**Session 3 – Foreign investment regulation and China**

Given these characteristics of Chinese investment, the final session compared regulatory responses for assessing and approving Chinese investment proposals. The first regulatory response presented was the ‘three threats’ framework implicit in the approach used by the Committee on Foreign Investment in the United States. These threats are 1. An acquisition making the host country dependent on foreign-controlled supplies of a good or service crucial to the functioning of the home economy and that there is a credible likelihood that supply might be withheld; 2. The leakage of sensitive technology or expertise, when there is a transfer of technology or expertise that might be deployed in a manner harmful to the national interest (with no special mention of the ownership status of the potential acquirer); and 3. Infiltration, surveillance or sabotage of the provision of a good or service crucial to the functioning of the host economy.

This framework is detailed when compared with other western economies’ regulations governing access of potential Chinese investors to domestic markets, although there are clearly questions about the rigour in its application. Canada’s *Investment Canada Act* (1985) operates on the basis of a ‘net benefit’ test. Special guidelines for assessing investment by state-owned firms (later extended to ‘government-influenced firms) were later added to the Act, the guidelines cover whether or not these firms operate like commercial entities and whether government ownership influences their behaviour.

European policy is based on the principle of the free movement of capital, but allows derogations based on public security, so long as such derogations are not arbitrary and do not amount to hidden restrictions to trade. Intra-European divergences appear at the level of national policy-making, where a tension exists within countries between a desire to attract greater levels of foreign investment, as a source of economic growth, and a view that there is already “enough” Chinese investment. Different states also have different interpretations of what sectors are strategic, leading to further national divergences. A unified European approach to reviewing investment proposals is therefore a remote prospect.

Finally, foreign investment in Australia is approved or rejected by the federal Treasurer on the basis of ‘national interest’, who receives advice from the Foreign Investment Review Board and the Treasury. There is no legislative definition of national interest, though policy statements do single out investment by foreign state-owned companies for particular scrutiny. Australia’s investment review process might be improved by making the decision-making
process more open to scrutiny, and including a process for reviewing decisions, granting applicants a right of appeal.

Public sentiment in different countries has played a major role in shaping the operation of investment review processes. In Canada, this is seen in the attention paid to the ownership of prospective investors; the public is far more hostile to state-owned investors than it is to Chinese investors per se. In Europe and elsewhere the lack of reciprocal access to the Chinese domestic market is seen as a reason for not opening the domestic economy up to more foreign investment. But the economic benefits of greater openness to foreign investment largely exist regardless of whether or not that openness is reciprocated. There can be no real economic argument for an additional review process for foreign investment, only political and ‘national security’ ones. Indeed, in all countries discussed here, the process of reviewing investment proposals is an inherently political one. Given the positive economic costs of restrictions on the flow of ODI, greater scrutiny is therefore needed of the investment review processes, carefully weighing up whether the political and security benefits really outweigh the economic costs, as any economic concerns about foreign investment are ultimately best addressed in domestic regulation.

**Agenda for further research**

The final session made it clear that there is a need for more research on (1) regulatory processes, and on the integrity of regulatory regimes governing foreign investment. The connection of political questions to the regulatory regime requires further study independent of developments in Chinese ODI, with the aim to derive general rules for such regulatory structures. (2) An assessment of policy impact: how does the regulatory regime governing the foreign investment assist in optimising the amount of foreign investment? (3) In the context of Chinese ODI more specifically, firm-level analysis in China will be required in order to conduct an extensive quantitative analysis of Chinese firms investment behaviour. (4) The time has come to think about the global governance for FDI. The interaction between trade and investment is importantly driving global economic integration and trade is governed by the global trading system yet governance of investment is missing at the global level. How bilateral investment treaties, roles for regional institutions and the global governance fit together are key questions.