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Chinese SOE Investment: An Economic Statecraft

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China’s rising economic preeminence has been stunning, firmly ensconcing China as the second most powerful world economy replacing previously second-ranked Japan. In a remarkably short span, less than 15 years, the US economy has experienced a relatively huge decline vis-à-vis China on a nominal GDP basis.

China’s remarkable economic juggernaut has been fueled by an opening of markets, globalization and booming free trade which has provided immense financial benefit to Chinese companies. The free market open rules trading system “led to the establishment of China as a major global exporter. As China’s economy has boomed, China has looked increasingly abroad for investment opportunities to both employ its cash hoard and provide long-term growth for its citizens.

In China, many large companies are state-owned enterprises (SOEs), and are the most common form of entity that are involved investment. Chinese SOEs receive preferential treatment in terms of access to capital and obtaining regulatory approvals\(^1\) and are employed in the advancement of Chinese governmental aims “serv[ing] political goals, including fostering indigenous innovation, supporting social stability and crisis response in China, and advancing economic initiatives abroad such as ‘One Belt, One Road.’”\(^2\)

By definition, all SOEs raise concerns because of their connection to their home states. These anxieties over state-owned businesses are not unique to China and relate to all SOEs in general. Investments made by states trigger different regulatory sensitivities compared to considerations raised by private companies because of the possibility that in conducting business government owned or controlled entities may utilize non-profit motivations and substitute political ambitions instead of or in addition to profit-making.

Thus, these concerns are tied to any government-owned business which potentially subjugates (or at a minimum is an additional motivation) private market interests to the political interests of the state.\(^3\) Indeed, such concerns are not entirely new. As an illustration of prior concerns with respect to government-owned businesses and their investment decisions was the opposition over Dubai Ports’ attempt to invest in the U.S. In 2007, the Dubai government-owned Dubai Ports World sought to acquire port terminals located in the U.S. Members of the U.S.

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1 See Wendy Leutert, China’s Reform of State-Owned Enterprises, 21 ASIA POLICY 83, 86 (2016).

2 *Id.*

Congress, concerned about a foreign government controlling the flow of goods and people into the U.S. voiced strenuous opposition on national security grounds. In this respect, Chinese SOEs are no different than other state-owned businesses.

However, there are additional factors with respect to China's SOEs which increase national security concerns of FDI recipient nations; China's political structure and unique state dominance/control of SOEs presents a different type of investor. China is a communist economic order and the state is purposely directly involved in all critical economic sectors. “The way that the Chinese government exercises ‘state capitalism’ is that it directly or indirectly controls a large number of powerful SOEs, especially in the strategic and key sectors.”

The raison d'être of the Chinese SOE is the advancement of the CCP’s objectives thus amplifying the general “state-ownership” concerns. China is ruled by one political party, the CCP, and its domination of Chinese SOEs is of critical importance. The CCP wields near total non-financial control over its citizenry; singularly legislates the law of the land and CCP appointed judges rule on the interpretation of law in courts. These facts are not meant as a criticism of China which has expressed no intent of aggressively advancing such goals. Nevertheless, Chinese SOEs may have motivations that align with CCP goals and those aims may not necessarily correlate with other countries' national interests.

While the U.S. government also wishes to advance its geo-political goals, the key distinction is that the U.S. government's pursuit of policies is not part of private U.S. company investment decision making. In evaluating FDI from U.S. companies, the presumption is the decision to invest is 100 percent profit motivated; but the same cannot be said of Chinese SOE investment. It is thus crucial to internalize that Chinese SOEs related investments may very well harbor an agenda to advance strategic goals for the CCP. These concerns can be expected to grow. The CCP is apparently strengthening its control over SOEs.

The potential motivation to further the goals of an alternative vision of global governance by a private entity investing and buying companies is a very different context for review than traditional corporate acquirers. In addition, investments and joint ventures from SOEs may not be an efficient allocation of resources or be a profit-generator. If investments are not based upon pure economic motivations, the

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6 See, e.g., Debt risk for main state-owned enterprises is controllable: China, THE ECONOMIC TIMES (India) (Jan. 27, 2017), http://economictimes.indiatimes.com/articleshow/56806126.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst (“While many state companies are bloated and inefficient, China has relied on them more heavily over the past year to generate economic growth in the face of cooling private investment.”)
investments may prove to be less than stellar performers or at a minimum, fail to achieve the potential return. Crucially, such motivations bring potential economic risk/loss of potential into the calculus for a recipient nation.

China has acknowledged the crucial need to reform its inefficient SOEs and doing so would lend confidence to recipient nations and lower concerns. However, economic considerations have not trumped political considerations. Rather than utilizing pure economic factors as the benchmark for SOE reform, political factors are considered which may impinge on the profit-making calculus private sector companies engage in. In terms of enacting reforms to China’s SOEs, economic performance is surely a factor but not the controlling factor as it would be in a private sector business. This demonstrates that SOE investment in other countries may potentially be made based at least in part upon non-economic factors. The fact that some SOEs investments may not have pure economic profit as the driving factor may constitute an inefficient allocation of financial resources and economic potential in addition to raising security concerns.

Although FDI is acknowledged as beneficial and an important enabler of economic vitality, many governments are concerned about national security implications of FDI. Chinese FDI has come under more stringent scrutiny in recent years sparked by political concerns about foreign ownership in Europe and the U.S. Some in the U.S. have urged a complete ban on Chinese SOE investment. It is not only the U.S. that has signaled a reassessment is being considered. The EU has also expressed concerns regarding China’s FDI into the EU and the associated national security risks of OBOR-driven investment. EU diplomats gave expressed “suspicions ran deep over China’s geopolitical intentions in Europe, particularly with its massive trade and infrastructure plan, the ‘Belt and Road Initiative’.

In the U.S., CFIUS is the primary vetting mechanism and wields power to review a "covered transaction," defined as any merger, acquisition or takeover … by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States. The term “national security” is not strictly defined and CFIUS focuses on certain strategic national security spheres such as energy, defense and technology. The U.S. President is specifically empowered to "suspend or prohibit any covered transaction that threatens to impair the national security of the United States." In every other country, a CFIUS style review mechanism is an option that should be examined as a potential solution to the upcoming challenges of increasing Chinese investment worldwide.

7 For an excellent discussion of SOE reforms see Wendy Leutert, supra note 1.
9 See https://www.wsgr.com/CFIUS/pdf/section-721.pdf (noting the list of factors CFIUS will consider include defense, energy and technology). Note there are calls to expand the list of areas. See https://www.agriculture.senate.gov/newsroom/dem/press/release/senators-stabenow-and-grassley-introduce-bipartisan-legislation-to-protect-american-agricultural-interests-in-foreign-acquisitions (proposal to add food security to list).