Benchmarking performance: how large is large?

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China’s rapid rise as a source of international investment has certainly caused a great deal of anxiety in a number of countries where China is buying up big. But it is not always easy to understand the strong response that China’s economic rise has occasioned in developed countries like Australia or the US, and in regions like Europe, where openness to foreign investment and institutional and regulatory structures for managing it are fairly well entrenched. Japan is a little different.

Some of the anxiety has arisen because Chinese state-owned enterprises (SOEs)—about which the world is largely ignorant—are now the big players in international investment. But mostly it is the scale of it that has caught everyone by surprise and has elicited fear and xenophobia similar to the sentiments provoked by Japanese investment in the 1970s.

Foreign direct investment (FDI), flowing both in and out of China, is one of the most important dimensions of China’s economic engagement with the world and integration into the global economy. China is now the world’s largest exporter of goods, the second-largest trading nation, the second-largest FDI recipient and the second-largest economy globally. So it is no surprise that China is rapidly becoming a major source of FDI and is already the sixth-largest source of FDI for the rest of the world. The expansion of the Chinese economy has inevitably, and more or less commensurately, increased trade and investment flows, too.

Investment from China was an insignificant factor in the global economy until recently, but China’s rapid growth has changed all of that. A look at the raw numbers now tells us that annual investment flowing out of China into non-OECD countries increased from US$1.47 billion in 2003 to US$49.42 billion in 2008, while Chinese investment in OECD countries rose from US$364 million to US$2.99 billion.

But the question is whether current Chinese investment is unusually large or around expected levels, given China’s size, level of development, and its resource and other economic endowments. It is difficult to say without properly benchmarking performance.

In order to accurately conclude whether Chinese investment in particular destinations is larger or smaller than expected, economic fundamentals such as distance, scale, factor endowments and competition from neighbouring countries all have to be taken into account. Once these factors are considered, it is possible to compare actual Chinese investment flows with what we could reasonably expect them to be. A potential investment flow can be estimated using a technique that takes the characteristics of the most-liberal and free-flowing investment relationships globally, such that each bilateral relationship has a potential amount against which the actual investment can be compared.

With this properly calculated benchmark, inferences can be drawn about how Chinese investment fares in various markets, compared with how it might be normally expected to fare. It is then possible to judge whether Chinese investment is facing more or less resistance in particular markets, or indeed how open and attractive some...
destinations are once all measurable economic factors are accounted for.

Chinese investment has more open access to Australia—achieving 57 per cent of its potential (after accounting for Australia’s natural resource endowments)—than to any other country in the world. This includes Brazil (where China has achieved 40 per cent of its potential) and other target resource investment hosts. Despite the trouble that Chinese firms are perceived to have encountered while investing in Australia—with one or two highly publicised and politicised projects—Chinese investment has performed much better than in other countries.

Chinese investment throughout the world is also lower than might be expected, given its size and location in the global economy, compared with that of other major investment sources—mostly OECD countries. Chinese investment in the US is roughly on par with the levels that might be expected when considering China’s global average achievement of potential, standing at around 40 per cent. Despite this relative success in the US, China is not performing as well in Japan (30 per cent of potential), the United Kingdom (36 per cent) and Germany (31 per cent). These countries can expect much more investment from China in the future if the strong force of economic fundamentals is allowed to have its way without more policy frustration. How much they benefit from, and share in, the growth of Chinese investment will depend on policies and institutional responses. Whether they can attract more than their fair share of Chinese investment, as Australia has, will also depend on how their foreign investment regimes can manage, accept, influence and welcome investment from a very dynamic China.