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China’s Tightening Grip on Foreign Firms Risks Hitting Investment

Some gauges suggest overseas inflows to the Chinese economy have stagnated

By Jason Douglas Follow

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Foreign investment in China will likely remain concentrated among a few big companies willing to maintain or expand their existing operations there. PHOTO: ROMAN PILIPEY/EPA-EFE/SHUTTERSTOCK

SINGAPORE—China’s moves to put pressure on foreign companies risk squeezing the flow of overseas capital its economy needs, as signs point to the country’s appeal waning as a destination for all but the largest global companies.

By one measure, foreign direct investment into China dropped by almost half last year from a year earlier, hitting the lowest level in five years as Covid-19 lockdowns mauled its economy, while other gauges suggest the world’s second-largest economy is struggling to attract corporate newcomers.

China continues to attract a sizable share of global investment, but the increases in the money flowing in haven’t kept pace with the expansion in China’s economy and are a far cry from the investment growth that followed Beijing’s accession to the World Trade Organization two decades ago.

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The outlook for foreign investment has become murkier as Beijing has broadened its espionage laws to potentially encompass routine corporate activities and targeted Western consulting firms that provide services to multinational corporations. Rising tensions with the U.S. also threaten to restrain investments, with the Biden administration readying new curbs on American investment into China.

Especially at risk are the kinds of investments that bring new arrivals to China with innovative ideas and cutting-edge technology, an important channel through which economies learn to be more productive and propel gains in living standards.

In the frostier business climate, “they are the ones who are going to think twice,” said Steve Cochrane, Asia-Pacific chief economist at Moody’s Analytics in Singapore, referring to companies considering their first foray into China. “If I’m not there now, do I really have to be in China?”

Economists say that maintaining foreign direct investment will be essential to enabling long-term growth in China, which despite its economy’s enormous size and Beijing’s geopolitical heft remains a middle-income country with a need for foreign technology and expertise to boost productivity and overcome challenges such as rapid aging.

“For China, FDI was never really about the money. It was all the things that came with the money,” said Eswar Prasad, a former China division chief at the International Monetary Fund who is now a professor of trade policy and economics at Cornell University. “China does not yet have the capacity to generate a great deal of innovation.”

Ralph Lauren is among foreign retailers launching new stores in China, eager to tap into the country’s vast consumer market. PHOTO: KEVIN FRAYER/GETTY IMAGES

Foreign direct investment into China tumbled 48% in 2022 from a year earlier to $180 billion, according to Chinese balance-of-payments data, a standard way for economies to track FDI.

That marked the lowest inflow since 2017, though it followed two strong years of FDI into China spurred by its economy’s initial resilience during the Covid-19 pandemic and investment in the auto sector, thanks to Beijing’s 2018 decision to phase out rules restricting foreign ownership.

China also calculates FDI by adding up the value of nonfinancial projects registered and approved by its Ministry of Commerce. Economists say both measures likely overstate foreign investment in China because they include inflows from Hong Kong, a significant chunk of which is, in fact, Chinese investment funneled through the financial center to get around China’s capital controls.

Seen from the perspective of countries making the investments, FDI into China is much more modest. The Group of Seven economies—the U.S., Japan, Germany, France, the U.K., Canada and Italy—together invested just $16.3 billion in China in 2021, down from $24.7 billion in 2020 and a peak of $35.3 billion in 2014, according to data from the Organization for Economic Cooperation and Development.

The broader picture, say economists, is that FDI flowing into China is stagnant when measured against its growing economy, at around 1% of GDP, while the overall stock of foreign investment in the country is around one-fifth the level of advanced economies and around one-third the level in developing economies, according to data from the United Nations Conference on Trade and Development.

Even before the latest corporate skirmishes, China’s appeal as a destination for foreign direct investment has been dented by clashes with the West over trade, technology and national security, as well as the growing attraction of lower-cost manufacturing destinations such as India and Vietnam.

The U.S., which in 2022 plowed $9.2 billion into China, the most since 2014, according to data from the Commerce Department’s Bureau of Economic Analysis, is planning new restrictions on American investment in the world’s

Analysis, is planning new restrictions on American investment in the world's second-largest economy, the latest step in efforts by the Biden administration to guard the U.S.'s technological edge over its strategic rival.

As well as changes to its espionage law, China in recent weeks spooked foreign executives by questioning staff at consulting firm Bain & Co.'s Shanghai office, launching a cybersecurity review of imports from chip maker Micron Technology, and detaining an executive of Japanese drugmaker Astellas Pharma.

China spooked foreign executives recently by launching a cybersecurity review of imports from chip maker Micron Technology. PHOTO: QILAI SHEN/BLOOMBERG NEWS

Authorities have also moved to assert greater control over the availability of information about China to the outside world, potentially making it harder for would-be investors to get the information they need. New restrictions or even bans have been placed on overseas access to some databases for economic indicators, corporate-registration information, patents and procurement documents.

Communist Party officials, nonetheless, say they welcome foreign capital, with the Politburo, the party's top policy-making body, saying in late April that attracting foreign investment should be "in a more important position."

Economists say the brittle political backdrop and frostier atmosphere mean foreign investment in China will likely remain concentrated among a few big companies willing to maintain or expand their existing operations there, especially those eager to tap China's vast consumer market. McDonald's and Starbucks have said they are opening hundreds of new restaurants in China, while retailers including Ralph Lauren and Tapestry, owner of the Coach and Kate Spade brands, are launching new stores.

"If you are a large, established global company, you have to play in China," said Fred Neumann, chief Asia economist at HSBC in Hong Kong.

Far less common will be new entrants, economists say. Research firm Rhodium Group in a September report found that European investment in China was overwhelmingly concentrated in just a handful of big companies, such as auto maker Volkswagen and chemicals giant BASF. "Virtually no new European firms have chosen to enter the Chinese market in recent years," the report said.

Data underline that split. Germany, for instance, reinvested 12.4 billion euros, equivalent to $13.7 billion, in China in 2022, up 3.4% from a year earlier, according to German central bank data, but divestments exceeded new investments in China by 1.2 billion euros.

"New investment and new market entrants—that has really slowed down," said Thilo Hanemann, a partner at Rhodium Group who leads its work on trade and investment. "I don't expect that to come back."

Starbucks's plans to open hundreds of new restaurants in China underscore the likely concentration of foreign investment among a few big companies. PHOTO: TINGSHU WANG/REUTERS

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