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## NOT SO FAST: BEIJING REINS IN OUTBOUND INVESTORS

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### Upcoming Events

- September 1–5: Second Round of NAFTA Renegotiation Talks (Mexico City, Mexico)
- September 3–5: 9th BRICS Summit (Xiamen, China)
- September 4–10: ASEAN Economic Ministers Meeting (Manila, Philippines)
- September 28: Competing Visions: How Infrastructure is Reshaping the Eurasian Supercontinent (CSIS)

HNA Group could be considered a gleaming example of a private enterprise success story in China. Established as a small regional airline in 1993, HNA is one of many private companies that embraced the government's push to "go global," taking out massive loans from the state-owned China Development Bank and Export-Import Bank of China. It has now expanded to a sprawling conglomerate of $90 billion in annual revenue, with stakes in Hilton Hotels, Deutsche Bank, and Swissport. Most recently, HNA has made a bid for a majority stake in SkyBridge Capital, previously owned by the now-infamous former White House Director of Communications Anthony Scaramucci.

But HNA's global shopping spree may be coming to an end. Over the past few months, the Chinese authorities have been casting a skeptical eye on deals linked to HNA and other global conglomerates such as Anbang Insurance Group, Fosun International, and Dalian Wanda Group. The China Banking Regulatory Commission has been asking banks to provide information about loans to these companies. The National Development and Reform Commission (NDRC) and Ministry of Commerce of the People's Republic of China (MOFCOM) have been scrutinizing deal agreements. And President Xi Jinping has publicly called for prioritizing management of financial risk. More ominous signs have also appeared: Anbang's CEO was detained by the authorities in June without official confirmation of his arrest. And in the latest move, the State Council released a guideline earlier this month with new rules on overseas investments, grouping them into three categories: banned, restricted, and encouraged.

The government's tightening of the reins on outbound foreign investment by Chinese companies is a distinct shift from the past decade, when private and state-owned firms alike were encouraged to "go global." The drivers of this reversal can be grouped into three broad categories: Beijing's concerns about financial stability, domestic political power struggles, and fears of international backlash.

At the heart of the first category is China's mounting debt, which is now almost 300 percent of its GDP. This is a product of the stimulus packages Beijing put in place during and since the global financial crisis. Most concerning is the rate at which this debt has accumulated: it was only 148 percent of GDP at the end of 2007 and now has almost doubled. Historically, such a rapid pace of credit expansion has led to increased risk of a banking crisis and/or much slower growth. China has implemented a few structural reforms to control the growth of debt, but many argue that these reforms are not being implemented at a fast-enough pace. Earlier this year, Moody's downgraded China's sovereign rating from Aa3 to A1 and warned that if debt keeps rising, further downgrades are likely.

While a significant portion of China's debt is in the hands of state-owned enterprises, the corporate sector in general is at the heart of the problem. Total credit extended to nonfinancial companies has risen from 120 percent of economic output to 166 percent since 2011. HNA alone said that it had around $104 billion in debt at the end of 2016. Most of its credit is borrowed from Chinese state-owned banks. Beijing believes this buildup of debt is being fueled by the foreign acquisition binge and is worried that it is creating broader risks of financial instability—despite that the amount of credit extended for foreign deals is far lower than that for domestic expansions, and is mainly coming from more stable banks.

These worries are compounded by concerns about the capital outflows associated with the overseas shopping spree. In January of this year, Bloomberg estimated that over $1.3 trillion had left China since the stock market break in August 2015. A significant portion was leaving through overseas purchases by individuals, but a growing share through company mergers and acquisitions. These outflows have put significant downward pressure on

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the renminbi, which fell 7.5 percent in 2016—raising the specter of criticism from Washington that Beijing is manipulating its currency to gain advantage in trade.

As a result, Beijing has been working since 2014 to stem capital outflows. At the beginning of this year, the People's Bank of China (PBOC) put in place a new restriction on cross-border capital movement, in addition to stricter vetting processes implemented in November for remittances of foreign currency, dividend payments by foreign investors, and foreign exchange purchases. These efforts appear to be bearing fruit. In February, the State Administration of Foreign Exchange released data that net outflows had narrowed, and in April, PBOC loosened capital controls imposed in January 2017, signaling that the government believes the risk of a further rush of outflows is, for now, minimal.

The domestic political environment leading up to this fall's 19th Party Congress is another factor behind the recent crackdown on companies like HNA. President Xi is trying to strengthen his role as the "core" of the party, and financial stability as an essential element of national security has become a key part of his platform. He has been leaning more toward making existing state-owned enterprises stronger and more efficient, while others in the party would rather see private enterprises flourish.

There is also an element of palace intrigue surrounding this issue. Companies like HNA appear to be targets because of the high-level people they are linked to. For example, Guo Wengui, an infamous Chinese billionaire exiled in New York, has accused Wang Qishan, a member of the Politburo's Standing Committee and the public face of Xi's anticorruption campaign, of benefiting from hidden shares in HNA Group. The upcoming Party Congress is an important benchmark for the 69-year-old Wang, who may be granted a second term on the Politburo Standing Committee, even though the standard retirement age is 68. Beijing's targeting of HNA Group indicates that Xi is either worried about the optics of HNA's overseas acquisitions following Guo's public accusations, or that Beijing believes there is some legitimacy in Guo's accusations and wants to put pressure on both HNA and Wang.

But perhaps the main explanation for the company crackdown relates to Chinese foreign policy. In the past decade, Chinese firms have been key players in Beijing's economic statecraft. The government has actively encouraged firms to compete with Western firms internationally and acquire intellectual property. However, some large international deals by Chinese firms have drawn unfavorable attention from governments and media in the United States, Germany, Australia, and elsewhere.

In some cases, the concern is about the national security implications of letting China acquire sensitive technology. This has prompted some countries, including the United States, to look at tightening their inbound investment review mechanisms. Other deals have touched a political nerve: HNA's attempted acquisition of SkyBridge Capital from Anthony Scaramucci was seen as an inept attempt to gain access to the White House and prompted a review by the Committee on Foreign Investment in the United States (CFIUS). Australia has recently been embroiled in a debate about massive donations by Chinese property developers to the country's leading political parties. And some deals simply raise concerns about China appearing frivolous or immoral: this month's guideline on overseas investment released by the State Council restricts investment in hotels, entertainment, and sports clubs, and prohibits investment in gambling and pornography.

All of this negative attention is harmful to the broader objectives of Chinese economic statecraft and foreign policy. Beijing closely links its economic strength to its national security and its global influence, and aims to become the preeminent science and technology power as laid out in its "Made in China 2025" plan. There is also significant strategic value in increasing its soft-power influence through the acquisition of global companies and expansion of its own brands internationally. Through increased regulation of Chinese firms' global activities, Beijing hopes to restore legitimacy to its foreign economic policy and future international deals by Chinese companies.

The result of Beijing's tighter controls on foreign acquisitions by Chinese firms is that the deals that do emerge will most likely be from companies that are more stable, financially secure, and less aggressive in their acquisitions. On the other hand, the mere fact that these deals will have more oversight from the Chinese government is a reason for concern in target countries. If anything, this may be an affirmation of a calculated "going global" strategy that advances China's broader interests, and a signal that the line between government policy and private business ventures is blurrier than ever.

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