Beware of people bearing gifts

31 August 2022

Erik Britton

Do not look a gift horse in the mouth, so the saying goes, implying that if something is free there is no need to worry too much about its quality. Just take it.

I have always had a problem with that.

The most famous gift horse of them all was the giant wooden horse inside which Odysseus and his men hid to smuggle themselves inside the walls of Troy, inspiring the Roman poet Virgil to coin the phrase: ‘Timeo Danaos et dona ferentes’, which loosely translates as ‘Beware of Greeks bearing gifts’. I do not feel it is really a question of the nationality of the people giving the gift. It is more that if someone is giving you something for free, it is sensible to be cautious about accepting it. There might be more to the gift than meets the eye.

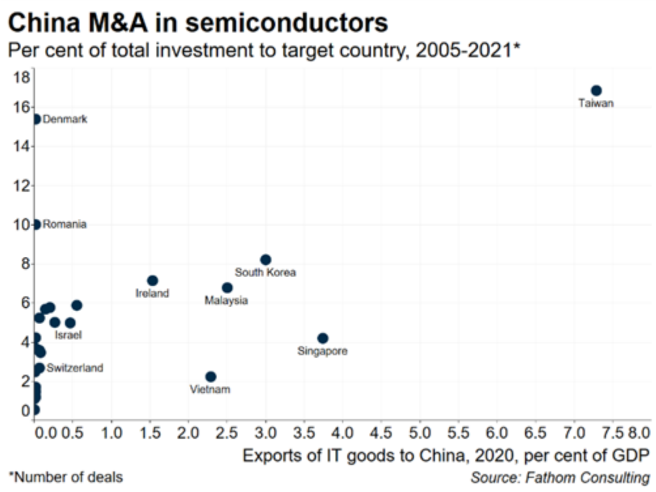
The same is true of foreign direct investment. Be careful about accepting inflows of FDI: there is often more to them than meets the eye.

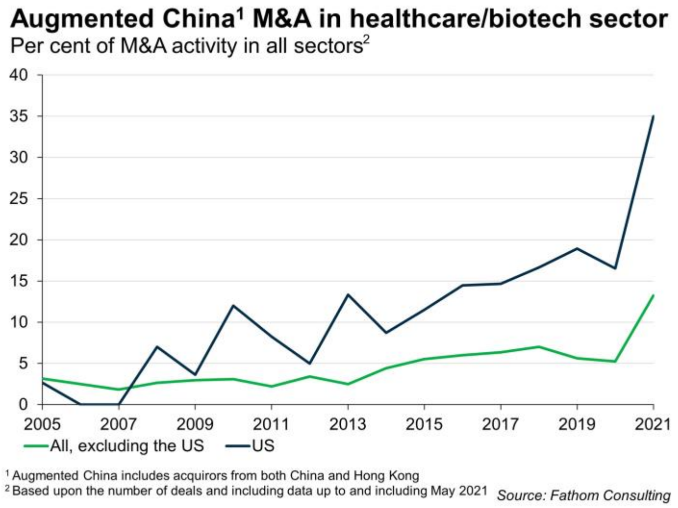
China’s outward FDI flows are shrinking. But within that general decline, they are becoming much more discriminating: fewer, often smaller, but better deals – better, that is, from the perspective of the PRC. All the more reason to examine them carefully, from the perspective of those on the receiving end – inside the walls of Troy, so to speak.

Foreign direct investment is still key to China’s development strategy, even though it is falling in total. Knowledge flows more readily into democratic nations than into countries with autocratic governments, and autocratic regimes also find it hard to innovate at the technological frontier themselves. Part of Beijing’s solution to this has been an attempt to acquire knowhow through mergers with, and acquisitions of, foreign firms — especially in sectors where China lags, and especially from countries at the frontier in those sectors. Data from Fathom’s proprietary Capital Flows Tracker [1]show targeted Chinese investments into semiconductors in Taiwan, the world’s leading exponent of that technology; and a steady, upward trend in the *share* of healthcare/biotech investments — especially into the USA, which is the country that is driving the global technological frontier forward in that sector.

[1] Fathom's Capital Flows Tracker accurately monitors China and Hong Kong’s financial footprint since 2005 by bringing together and combining a range of diverse datasets. It disaggregates capital flows into M&A and greenfield investment, and is available bi-laterally and by sector. It is updated through the year and includes the following details for each deal: country, company, sector, geo-location, deal status and deal value — including Fathom’s estimates where that information is not publicly available.

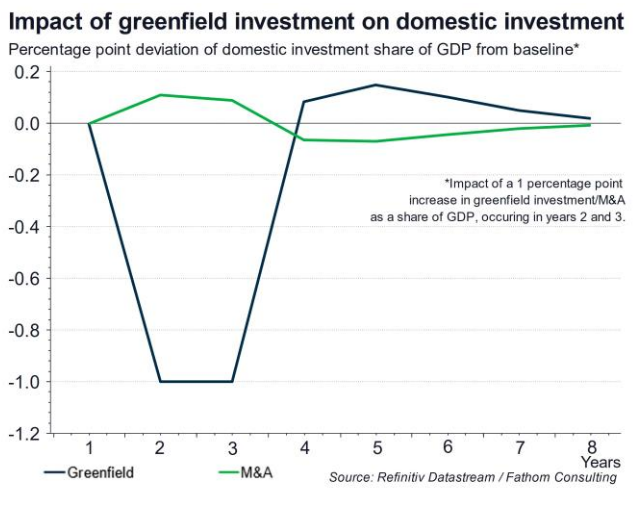
Continued





Blocking financial flows is likely to harm China but have little impact on the recipients in a macro sense. Mergers and acquisitions are typically found to have limited impact, either positively or negatively, on macroeconomic outcomes (Jude, 2019). Fathom has verified empirically that this result also holds true in the context of Chinese investment: M&A investment makes no difference, while greenfield investment – at least initially - crowds out domestic investment. Attempting to stifle this flow of funds is therefore unlikely to yield any direct material benefit or cost for the recipients, but it might slow technological progress in China and stifle its advance in the global race towards geopolitical hegemony. It is more than just a question of which country 'wins' the race for technology: also at stake is which is the world's dominant ideology.

The chart below illustrates the impact of FDI inflows on the recipient economy's fixed investment: flows of M&A have no effect, while flows of greenfield FDI crowd out domestic investment in the short and medium term. Recipient countries do not gain much, especially in the short term, from those flows. And if they come with strings attached (as, in the case of China, they do, in the form of transfers of technology back to China) then political leaders in the advanced economies should think seriously about restricting those inflows.



Continued

It would have served King Priam of Troy well to exercise a little caution when it came to the gift horse he received. The same applies to those countries that are recipients of inflows of Chinese FDI, especially in advanced or emerging technology. It doesn't make a lot of difference to macroeconomic outcomes; so there's not much to be lost in making sure it doesn't come freighted with risk for the tech race, and for global geopolitical outcomes too.

Further reading:

Lessons for China-Taiwan from Russia-Ukraine

Round up: Down, but not out? China's evolving economy

Fathom Consulting
47 Bevenden Street
London
N1 6BH
Tel: +44 (0)20 7796 9561

Contact information
erik.britton@fathom-consulting.com
www.fathom-consulting.com