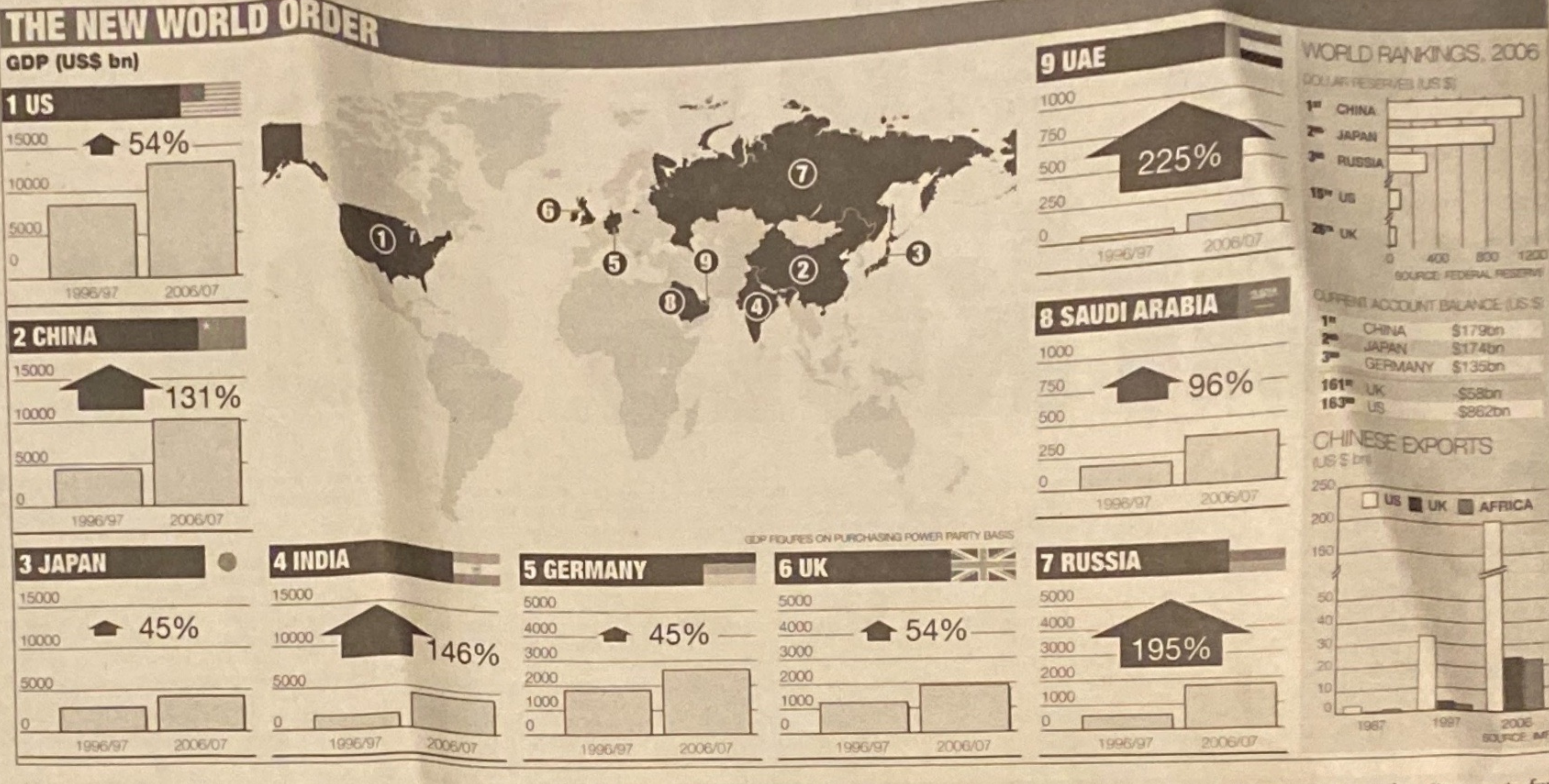
The Great Wall of money

China and the other emerging giants have started to use their colossal reserves to buy Western companies. **Liam Halligan** and **Helen Power** report



The idea of the Chinese state buying into a thoroughbred Western bank – and thereby gaining exposure to potentially the biggest banking merger in history – seems impossible. But that's precisely what happened last week, when the China Development Bank, an arm of Beijing's Communist government, took a sizeable stake in Barclays.

The City was caught off guard. At a stroke, China had re-ignited Barclays' multi-billion pound bid for ABN Amro, the Dutch bank, giving the British group fresh hope of pipping a higher offer from a rival consortium led by Royal Bank of Scotland. But the impact of this move goes way beyond the outcome of a single deal – however big that deal may be.

This latest foray into foreign ownership by China's government raises serious questions – about the role of the state, the future of East-West relations and, above all, the shape of the global economy.

Everyone knows that China, Russia and India are growing fast. But it cannot be stressed enough that these "emerging giants" are in the midst of the quickest industrial revolution the world has ever seen.

Since 1997, the British economy has expanded by 54 per cent. America has registered similar GDP growth, with Japan and Germany not far behind. While reasonably strong, this performance has been eclipsed by China, Russia and India – which have all easily registered triple-digit percentage growth over the past decade. Some smaller oil-rich nations have grown faster still.

Back in the late 1990s, such Eastern economies were highly precarious. During the so-called Russia-Asia crisis, their currencies and stock markets collapsed, sparking a fully blown global slump.

These days, a new world economic order prevails. Fuelled by supercharged growth, the likes of China, Russia and the rest are exporting in vast quantities – everything from commodities to finished goods. They have built up huge trade surpluses and foreign exchange reserves.

Expressed in dollar terms, these economies are still much smaller than their Western competitors. But when measured on a "purchasing power parity" basis, which takes account of local prices, the "emerging giants" are already huge. China is gaining fast on America, India is the world's fourth largest economy and Russia is the seventh.

Far from harming the global economy, such countries have instead been spending their reserves on Western government bonds, funding the deficits of "advanced" economies such as Britain – and in turn fuelling a worldwide boom in asset prices.

China now has the biggest reserves of all – a cool $1,100bn. Other previously weak countries are also sitting on piles of cash. That's why there's now a pressing desire in the East to diversify away from foreign debt and into tangible foreign assets.

In other words, as this Barclays deal shows, such governments are now moving from lending to the West to owning chunks of it.

"China now has all the reserves it needs for stability," says Gerard Lyons of Standard Chartered. "So it is now pursuing a go-abroad policy, establishing global ambitions."

Mohamed El-Erian, a former executive at Pimco, the bond giant, who now manages Harvard University's huge $30bn endowment, agrees. "For many of these countries," he says, "the issue is no longer crisis management but rather how to meet the challenges of success. Their mindset is shifting from traditional reserve management to wealth management."

This shift is reflected in the emergence of "sovereign investment vehicles", the most visible manifestation of what investors are now calling "state capitalism". With Dubai's purchase of P&O in 2005 and Qatar's recent bid for J Sainsbury, Western private sector assets are increasingly being targeted by the governments of the new economic elite.

Now China is taking this process to a higher level. Last month Beijing used $5bn from its reserves to form the Africa Development Fund, which will focus on developing the continent's oil and mineral wealth. At a time of growing anxiety over energy supplies, Western politicians will shudder to think of the Chinese influence such lavish sums will buy.

China has also earmarked a staggering $200bn-$300bn to fund further foreign acquisitions – the now famous "wall of Chinese money". Ever pragmatic, Beijing's leaders last month used the first slice of that cash to snap up 10 per cent of Blackstone, the US private equity house. Blackstone's finest minds are now advising China on its Barclays stake.

Does any of this matter? The British government, publicly, says not. The new Chancellor, Alistair Darling, last week said Britain had to resist calls to impede corporate acquisitions by foreign governments – as long as investing countries open their markets too.

Such sentiments are laudable but are they sustainable? Successive British governments, for example, have decided on principle that it isn't right for our state to take large holdings in our businesses. Should the same not apply to foreign states?

And what of strategic assets? Existing rules don't allow overseas holdings of certain British defence contractors to exceed 15 per cent. Should such rules apply to banks, given that, in the event of a failure, interested parties could end up being bailed out by British taxpayers?

With their stake in Barclays, the Chinese are trying hard not to frighten the horses. They have limited their holding to an unthreatening minority position below 10 per cent. They have shared it with Temasek, the investment vehicle of the government of Singapore, a country we Brits understand.

And Beijing has chosen to enter the foreign banking arena in the UK and, potentially, the Netherlands – two of the world's most liberal jurisdictions when it comes to foreign ownership.

On paper, the implications of this Barclays deal – and further overseas state-backed investments in UK companies – will depend on what we can secure in return in terms of access to overseas markets. In practice, though, even with such access, this country still needs the comparative advantage – the skills – to turn such opportunities into long-term prosperity.

"Global pressures mean the UK is about to experience some very big changes," says Lyons. "If we position ourselves well – in terms of training – we'll do fine. But if we don't, we'll face some massive economic problems."