When one big piggy was on the market

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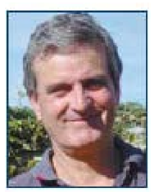
By Giles Chance (China Daily)

Trade relations between China and US tied to fate of pork giant's acquisition



Giles Chance

Who would have thought that pigs would play an important role in deciding the future of economic cooperation between China and the United States?

On May 29, the world's largest pork processor, Smithfield Foods, announced that it was recommending its acquisition by the Hong Kong-listed Shuanghui International Holdings Limited, China's largest pork producer, based in Central China's Henan province. The size of the transaction, $7.1 billion including debt, a premium of 31 percent over Smithfield's closing share price the day before the announcement, raised eyebrows in the US.

Initially, expert opinion was that the deal would pass the scrutiny of the committee for foreign investment in the US, to which the deal was referred by both parties. But since the end of May, sentiment in the US over the deal has changed. On June 20 the US Senate committee on agriculture, nutrition and forestry sent a letter to Treasury Secretary Jacob Lew saying Chinese involvement in US food supply required careful consideration and asked that the proposed acquisition of the largest pork producer in the US by a Chinese company should go before the Senate's agriculture committee for examination.

The government complied with this request. So on July 10, as the annual Sino-US Strategic and Economic Dialogue was beginning in Washington, the Senate committee on agriculture was holding a hearing on the purchase of Smithfield. The expert witnesses called to testify for and against the transaction included Larry Pope, the CEO of Smithfield, two professors, and a member of the US-China Economic and Security Review Commission.

The arguments around Chinese investment overseas are important, because China, with its huge population, needs the whole world to achieve its goal of becoming a high-income country by 2050. As China grows, and as its economy rebalances, inevitably Chinese companies will look increasingly outside China for the markets, the products and the know-how that can continue to raise China's productivity and drive its economic growth. If the largest economy, the US, resists China's natural expansion, how can China succeed? The testimony made before the committee in the Smithfield case illustrates the increasingly hot debate in the US, and elsewhere, over the welcome given, or denied, to Chinese investment overseas.

Some of the objections raised to the transaction, by Daniel Slane of the US-China Commission for Economic and Security Review Commission, and Usha Haley, of West Virginia University, were generic ones, often raised by Americans who fear increased Chinese economic interdependency. "The acquisition is evidence of the desire of China to use state-controlled companies to expand overseas markets The considerable Chinese financial firepower available for foreign acquisitions has been derived from unfair and illegal exchange-rate manipulation The acquisition is consistent with a concerted Chinese effort to acquire foreign 'strategic assets', as part of the restructuring of its economy away from low value-added manufacturing China wants to penetrate our economy while protecting many of its own domestic industries from foreign investment and imports."

Other objections were more specific. "The acquisition will bring about greater industrial concentration of the US and global food industry, and will reduce America's technological leadership in food science, specifically pig genetics The involvement of the Chinese government in the economy means that arguments for this acquisition based on economies of scale and greater efficiency cannot apply Higher value-added activities, like pig breeding, would move to China, so the US will lose its competitive advantage in food manufacture, and will become dependent for its food supply on China China's global price advantage in certain industries is based on subsidies from local and central governments, in the form of free land, cheap raw materials and energy and low-cost loans The penetration of Smithfield brands into China will lead to Chinese imitations of Smithfield brands."

Larry Pope of Smithfield and Professor Matthew Slaughter, a specialist in globalization at Tuck School of Business at Dartmouth College, New Hampshire, presented arguments in favor of the transaction. They tried to counter criticisms of Shuanghui and explained the overall favorable economic impact that they said the acquisition would have on the US.

They argued: "Foreign-owned companies in the US generate about 5 percent of employment, 6 percent of output, 14 percent of R&D and investment, and 18 percent of US exports They account for a large share of American productivity improvement. With over 22 million Americans unemployed or underemployed, the encouragement of foreign direct investment into the US is an essential means for raising economic growth and providing employment opportunities The acquisition is highly beneficial to Smithfield, its 46,000 employees, its suppliers, communities and customers, as well as to the acquiring company, Shuanghui, because it will drive US pork exports to China. Not just Smithfield, but the whole US pig industry will benefit by supplying the enormous and fast-growing Chinese demand for pork The senior management of Shuanghui have demonstrated their commitment towards maintaining existing high Smithfield production standards. Nothing will change after the acquisition. Owning Smithfield will help Shuanghui to improve its own production standards. In this way, the acquisition will contribute towards better global food safety The transaction will not result in any food imports from China into the US. In any case, US food imports are subject to a rigorous control mechanism There appears to be nothing inherently worrisome or unusual about the food aspect of the transaction. Global companies have long played an important role in the US food industry, as in many other industries. In 2010, US subsidiaries of foreign food companies employed 207,400 American workers and exported $6.8 billion of products."

Last year, Chinese overseas investment grew 14 percent, twice as fast as the Chinese economy, reaching $77 billion, and approaching that year's total foreign direct investment into China. Chinese direct investment in the US (both greenfield and mergers and acquisitions) grew 48 percent to $5.4 billion - still only a small fraction of foreign investment flows into the US, and a small part of overall Chinese foreign investment.

Differences between countries in terms of economic systems and cultures can present barriers to economic integration. The other big event going on in Washington at the time of the Senate hearing on the Smithfield Foods purchase, the Sino-US Strategic and Economic Dialogue, addressed this important issue when it brought back to life the idea of a China-US bilateral investment agreement covering all economic sectors, and all stages of investment. In 2008 the

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two countries had discussed such a bilateral agreement, with China keeping its services sector out of the discussions, but it was put on hold following the US credit crisis and Barack Obama's accession to the presidency in January 2009.

If the deal is approved, Chinese companies will feel encouraged to view the US as an attractive platform for expansion. If not, they will continue to prefer direct investment in Europe, which accounted for a third of Chinese overseas mergers and acquisitions last year, and where Chinese companies face fewer restrictions on investment. The US economy will suffer, and relations between China and the US will not benefit. Many Chinese see no good reason for preventing the acquisition and will view the rejection as another example of US protectionism. The stakes are high.

The author is a visiting professor at Guanghua School of Management, Peking University. The views do not necessarily reflect those of China Daily.

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