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HOW ISRAEL HAS BECOME UNINTENDED BENEFICIARY OF INCREASED CHINA-FOCUSED US REGULATION

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The rising trade hostility between the US and China wherein America has imposed $200billion tariffs on goods imported from the world's potential next superpower has led to Beijing forming new equations with the rest of the world, including one very important one with Israel.

RECENTLY, THE US FEDERAL GOVERNMENT HAS TAKEN ACTION WHICH HAS LED TO A DRAMATIC DECREASE IN FOREIGN DIRECT INVESTMENT BY CHINESE ENTITIES INTO THE US – PREDOMINANTLY IN TECHNOLOGY-RELATED INDUSTRIES INCLUDING SATELLITE, AI, ROBOTICS AND AUTONOMOUS VEHICLE TECHNOLOGIES.

On 6 July, 2018, the US imposed further tariffs on Chinese goods entering the US valued at $34billion as part of a new policy ostensibly to protect and safeguard national security interests and American IP rights. China then accused the US of instigating a trade war and introduced retaliatory tariffs.

In addition, the US Committee on Foreign Investment has blocked several potential high-profile Chinese acquisitions of US-based companies, further affecting the decline of Chinese investment into the US. According to recent data, Chinese FDI into the US in 2017 amounted to $29billion, a substantial decline from $45billion in 2016. As of the end of Q2 2018, Chinese FDI into the US is estimated to be approximately $2billion.

Increasing regulations in both the US and China has also triggered this reduction. For instance, to control and stabilise its currency, the Central Bank of China published regulations in 2017 requiring banks and other financial institutions to report all monetary transfers outside of China above certain thresholds, including all transfers of funds of amounts greater than the equivalent of $7,500. These currency control restrictions crippled outbound Chinese investment even in high priority sectors. Regulation has been increasing and in November 2017, these types of currency control restrictions were further extended to offshore companies controlled by mainland China.

In July 2017, the Chinese government published a 36-point code of ethics affecting Chinese private companies seeking to invest funds overseas and, among others, obligate such companies and investment funds to share their investment plans in advance with the applicable Chinese authorities. Under such legislation, prior approval is required for investments and transactions in certain sectors deemed to be 'sensitive'. Chinese officials stated that much of this increase in regulation and specifically with respect to currency control, relate to fear of overseas investments which the Chinese government views as irrational or less desirable and may lead to money laundering and other illegal activities.

Israel has also seen a sharp decrease in Chinese FDI during 2017 compared to 2016.

Despite such decrease, however, several important China-Israel transactions took place during this period including the listing of Sisram Medical which became the first Israeli company to list directly on the Hong Kong Stock Exchange. As part of this process, regulators in Hong Kong recognised Israel as an 'approved jurisdiction' enabling Israeli companies to list directly on the HKSE.

In addition, in the last few years, significant Israeli infrastructure projects were completed with Chinese involvement including the Carmel Tunnel project in Haifa, the Tel Aviv light railway project and the expansion of the ports in Haifa and Ashdod. These clearly fall within China's 'Belt and Road' initiative (BRI) and are considered of national and strategic importance to the PRC. Additionally, some very large M&A and PE investment transactions were executed between both countries, namely, Giant Interactive's acquisition of Playtika, Alibaba's acquisition of Visualead and the recent late stage investment by China Minsheng Financial in Israeli Fintech company, eToro Group. Jack Ma, founder of Alibaba also visited Israel recently and met with numerous early-stage technology companies and leaders from the Israeli economy – testament to the abiding Chinese interest in Israel's technology sector.

At a time when the US government is involved in a tariff war with the PRC, the Israeli government is not taking similar steps with respect to Chinese investment into Israel and in fact is continuing to encourage further investment. In a trip to China earlier this year, Prime Minister Netanyahu met with many Chinese political and business leaders to advance Chinese investment into Israel and signed bilateral trade agreements valued at approximately $2billion. The establishment of a potential free trade zone between China and Israel was also discussed.

While Israel is not a highly-regulated state, there are key industries of national importance which are carefully regulated and monitored by local authorities.

For instance, in the financial services sector and particularly the insurance sector, the Israeli Commissioner of Capital Markets, Insurance and Pension, thwarted the potential takeover bid of the Clal and the Phoenix insurance companies by Chinese buyers. It seems that the Israeli regulator was concerned about the possibility of having the pension savings of most Israelis controlled by Chinese entities, especially entities which are less familiar to the Israeli market and where the ultimate beneficial owners of such entities may not be entirely clear.

Recently, the Delek Group announced that their potential sale of their interest in the Phoeneix insurance company to the Chinese controlled Sirius International Insurance Company was cancelled after an extended period as the regulator in Israel did not approve the transaction.

Despite the dramatic increase in China-Israel trade, such growth has not been reflected in the areas of defence and homeland security – where Israel remains cautious about transacting with the PRC, perhaps due to the failed attempt to sell the Phalcon airborne early warning radar system to China back in 2000 which was aborted following US opposition.

Israel is a young and dynamic country, rich with technology and an international innovative powerhouse. Many sectors are not highly-regulated but are of strategic importance to China such as medical technology, autonomous vehicle technology, and also areas within Fintech particularly in relation to anti-fraud related technologies where Chinese investors and strategic players have recently shown strong interest. In these industries, it is currently easier for Chinese players to access strong world-class technologies from Israel compared to the US where regulatory barriers and hurdles are constantly increasing.

While both Israel and the US have seen a significant decrease in Chinese direct investment in 2018, we believe that the underlying economic and political basis for the long-term trading relationship between China and Israel is very different from the deteriorating relationship between the US and China which are in the midst of a growing trade war.

While Chinese investment into Israel has decreased similar to all other outbound China investments globally on account of currency control regulation, Israel remains a very attractive investment partner to China because of its rich technology and innovation, which is of strategic importance to China. There also continues to be strong potential for cooperation and partnership between both countries with respect to large Israeli-based infrastructure projects due to the BRI.

We, therefore, believe that Chinese FDI into Israel will increase over time and there may be interesting opportunities for Israelicompanies to increase collaboration with Chinese partners and attract investment at a time when US competitors in similar sectors are restricted due to economic and political uncertainties. ●

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