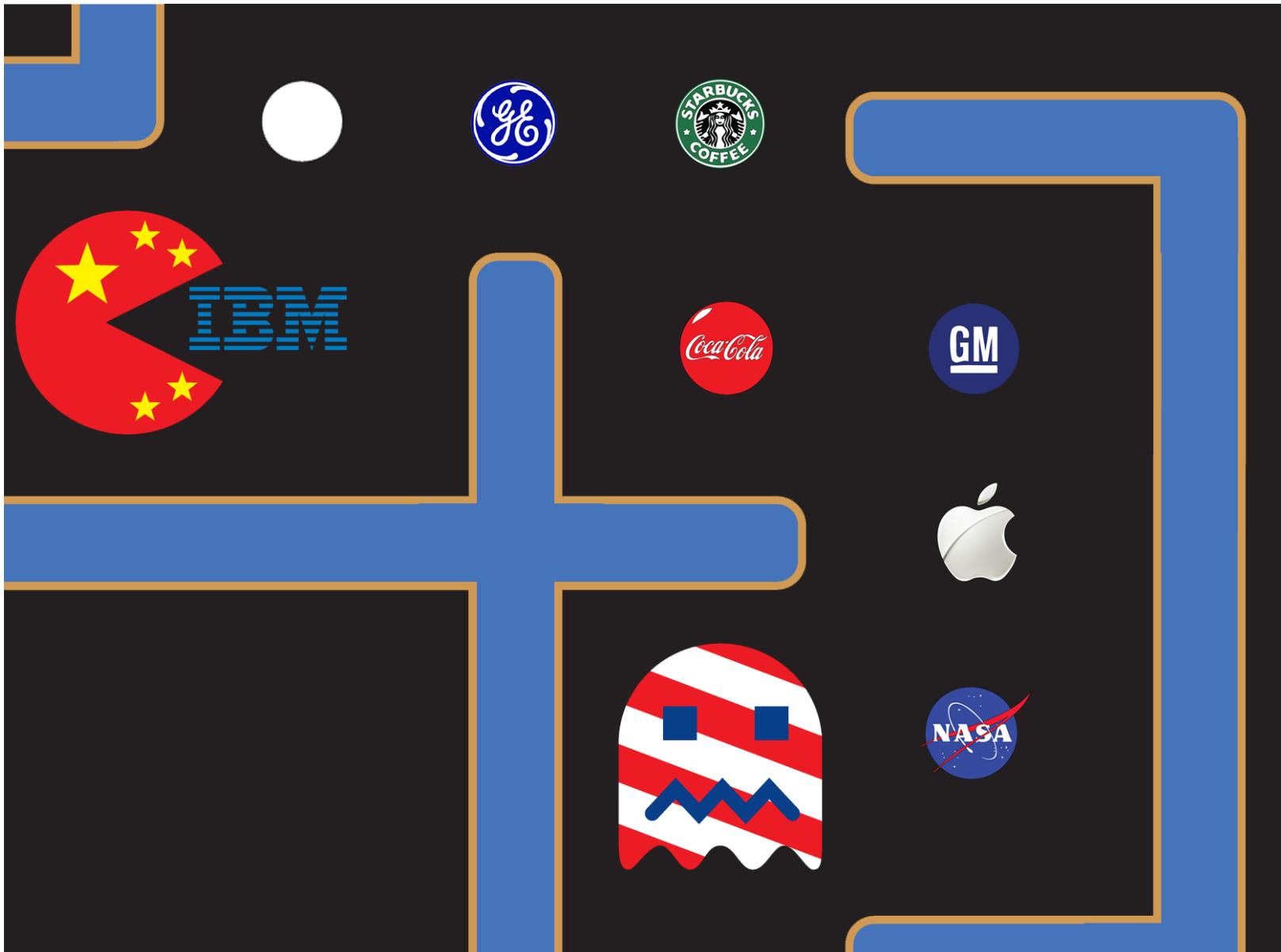


# ECONOMIC PATRIOTISM: HOW TO DEAL WITH CHINESE INVESTMENT



A report presented by the Princeton Task Force on Chinese Investment in the United States  
Woodrow Wilson School of Public and International Affairs, Princeton University

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The Princeton Task Force on Chinese Investment in the United States is a four-month project aimed at developing strategic policy responses to increasing Chinese foreign direct investment (FDI) in the U.S. Spearheaded by Professor Sophie Meunier, seven Princeton students at the Woodrow Wilson School of Public and International Affairs analyzed the extent of and motivations for Chinese investment in the United States to inform policy approaches directed at Chinese FDI. The task force also investigated Japan's investment in the US in the 1980s, as well as China's investment in Europe today. The Princeton Task Force on Chinese Investment in the US culminates with the release of this report and a briefing in Washington, D.C., on December 9, 2011.

Designed and produced by Charles Metzger and Colin Quinn  
Woodrow Wilson School of Public and International Affairs, Princeton University

## CONTRIBUTORS TO THIS REPORT:

Andrew Budnick

Thomas Gibbons

Michael Jiang

Andrew Sartorius

Thomas Tasche

Derek Wu

Bradley Yenter

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China is investing throughout the world, from Australia to Zambia, in industries from automobiles to zinc. Although most Chinese investment in the U.S. has thus far comprised inconspicuous portfolio investments through the purchase of American debt, direct investments in the form of greenfields and mergers and acquisitions in the U.S. will increase as China diversifies its holdings. The growth of Chinese FDI has already begun: Between 2007 and 2011, total Chinese FDI in the U.S. grew 400 percent, signaling an exponential upward trajectory. As these investments multiply, we can expect a few cases to attract negative attention and to provoke public backlash, especially if Chinese investors acquire treasured assets and national icons. How should the administration respond to such backlash?

This task force has addressed this question. We have tried to gain a better understanding of the potential consequences of Chinese investment in the U.S. by studying past FDI in the U.S., by analyzing Chinese FDI elsewhere, and by examining Chinese investment targets. From this in-depth examination, we have developed a course of action that the administration should take to encourage FDI growth while mitigating domestic backlash.

## **CHINA'S RISE**

To many Americans, it seems that the “post-American” world has already arrived: With unprecedented levels of economic growth, the world’s largest population and military, and more honors students than there are students in the U.S., China stands poised to overtake America as the world’s leading political and economic power. While the current economic crisis forces Americans to question the effectiveness of their country’s political and economic systems, Chinese firms are ramping up investment in the U.S., acquiring companies and undertaking greenfield projects all over the country.

Perceptions of China as an international investment juggernaut are greatly exaggerated, however. As of 2009, Chinese FDI accounts for 0.1 percent of the total stock in the U.S. and is responsible for the employment of approximately

10,000 Americans. But while Chinese investment in America is still marginal today, it will continue to grow as China diversifies its \$3 trillion in foreign exchange reserves by giving money to Chinese state-owned enterprises (SOEs) to invest abroad. Moreover, Chinese firms will pursue cross-border investment because of domestic resource scarcity, attractive foreign markets, and the opportunity to acquire new technology and know-how. Consequently, Chinese firms are projected to invest as much as \$2 trillion worldwide by 2020.

To put Chinese FDI in perspective, Singapore, a country with less than one millionth of one percent of China’s population and only 2 percent of China’s annual GDP output, had 10 times Chinese FDI stock in 2009. European countries have been heavily investing in the U.S. for decades, yet congressmen are not currently calling for increased restrictions on FDI from Europe or Singapore. Historical precedent suggests that FDI will gain mainstream acceptance as it leads to economic growth, despite initial domestic political resistance. But if China’s rise is unprecedented, should the United States be concerned?

## **WHAT MAKES CHINA DIFFERENT**

Much of the current rhetoric about Chinese FDI is interchangeable with anti-Japanese rhetoric during the 1980s. There are several similarities between contemporary Chinese investment and Japanese investment 30 years ago: rapid growth, ownership of U.S. debt, fear of American decline, a ballooning trade deficit, and public anxiety. But China today is significantly different from Japan three decades ago, and if U.S. policymakers follow the Japanese antecedent too closely, they run the risk of overlooking crucial differences.

For one, Chinese companies are predominately state-controlled. In many countries, a company’s investment in the U.S. would be a purely commercial decision. When the state owns a controlling interest in a variety of FDI-seeking companies, however, it is easy to suspect that these companies are acting to fulfill strategic, rather than profit-maximizing, goals. Some American politicians, such as former Republican Senate candidate Christine O’Donnell, have

suggested that Chinese firms, on orders from the Communist regime, are bent on buying up America and pushing U.S. firms out of their own market in a bid for strategic dominance.

When viewed alongside China's status as a military rival of the United States, the issue turns into a hot political topic. Unlike Japan, which has been an ally since 1945, the People's Republic of China (PRC) has always grated against the ideals of the U.S. with its communist ideology. In light of the possibility of future conflict, American policymakers are increasingly concerned about the motivation behind Chinese FDI and about what leverage these investments could provide a rival government.

### **TAKING ACTION**

Although the actual volume of investment does not suggest that the U.S. should fear Chinese FDI, the public remains wary, and politicians capitalize on this unease. An economically beneficial investment can easily be halted by a determined senator or lobbying group regardless of the findings of the Committee on Foreign Investment in the United States (CFIUS). This increase in investment should be addressed on a national level, or party politics and special interest groups will continue to dominate the discourse.

Given the sluggish state of the American economy and the positive effects of FDI—including the potential for increased domestic employment and economic growth—the U.S. should attract as much Chinese investment as is consistent with national security concerns. Otherwise, Chinese firms could just as easily invest in emerging economies such as Brazil or India, developed regions like the European Union (EU)—or even in America's enemies such as Iran or North Korea. At the same time, policymakers should guard against political or economic backlash arising from the suspicion that the U.S. has struck a Faustian bargain with Beijing by accepting money at the expense of our standards and ideals.

Presently, however, U.S. authorities should quickly and decisively combat the instinctive backlash against Chinese investment, inflamed by the media and political rhetoric. If domestic fear-

mongering and scapegoating escalate, congressional leaders might alter the U.S. investment review process, restricting the flow of capital and making the U.S. less open to investment. At the same time, however, American authorities must acknowledge that Chinese FDI is an unprecedented phenomenon in American history.

This report discusses seven aspects of the concerns raised by Chinese FDI. These are:

- An examination of China's motives for investing abroad and their consequences for the United States;
- An investigation into where China invests, what China invests in, and what we can reasonably expect for the future of Chinese investment;
- An analysis of Japanese FDI in the 1980s as a historical precedent for Chinese investment today;
- A comparison of Chinese FDI to FDI from the other BRIC nations (Brazil, Russia, India);
- A discussion of the implications of Chinese investment in the EU for the United States;
- An analysis of the case study of the solar industry and its implications toward technology transfer; and
- A discussion of the potential for Chinese FDI retaliation and possible U.S. responses

The report concludes with eight policy recommendations based upon the above analysis.

## II. MOTIVATIONS BEHIND CHINESE FDI

As one of the world's largest and fastest-growing economies, China globally ranks 3<sup>rd</sup> in total GDP, 2<sup>nd</sup> in exports, 3<sup>rd</sup> in imports, and 9<sup>th</sup> in inward FDI stock.<sup>1</sup> A world ranking of 15<sup>th</sup> in outward FDI (OFDI) stock therefore appears incongruous, a factor not so much of China's economic size or potential but a result of its late start in the global market. China entered the international economy in 1978, and it was not until the twenty-first century that Chinese companies began actively seeking outward cross-border investments. This was spurred by the government's "Go Out" policy in 1999, which encouraged SOEs to develop efficiency-seeking operations overseas with preferential long-term government loans. Having increased OFDI flows every year since 2002 at a seemingly exponential rate,<sup>2</sup> China is on track to invest \$1 trillion to \$2 trillion in OFDI stock by 2020 and become a net exporter of FDI within five years. China's recent and rapid rise in OFDI is both dynamic and durable, as evidenced in 2008, when China's OFDI flows almost doubled while global FDI flows fell by 20 percent. What are the factors, then, that motivate Chinese OFDI growth?

### CHINA'S CHANGING MACROECONOMIC LANDSCAPE

1. Diversification of Foreign Reserves: China is seeking to unload a significant portion of its \$3 trillion in official foreign exchange reserves through companies looking to invest abroad. This is especially profitable in the current economic downturn, when Chinese firms can purchase many internationally depressed assets.
2. Capitalizing on an Appreciating Exchange Rate: The appreciation of the Renminbi by more than 25 percent since 2005 has contributed to cheapening overseas (and by extension, American) assets for Chinese firms. Concomitantly, such appreciation amplifies

China's risk for capital losses from holding increasingly devalued U.S. Treasury bonds.

3. Enhancing Value-Added Production through Rebalanced Growth: OFDI can upgrade the business operations of Chinese enterprises in the value-added chain of their products. By increasing household and national income, this helps to achieve the country's ambitious transition from an export-driven growth regime to a more balanced consumption-based growth model.

### SOE-SPECIFIC MOTIVES

4. Resource Seeking by State-Owned Enterprises: China's self-sufficiency in natural resources such as oil and copper has been impeded by its rapid urbanization and expansion of heavy industry. In order to support its high growth while gaining a foothold in profitable upstream businesses abroad, Chinese firms are compelled to invest in raw materials and energy overseas. As a case in point, from 2007 to 2009, Chinese businesses struck the most mergers and acquisitions deals internationally in the energy and minerals sectors.
5. High Savings Rate: The historically high savings rate of Chinese enterprises has provided an ample supply of loanable funds for international growth opportunities, especially when domestic capital markets are insufficiently developed. To encourage FDI, the Chinese government has also disproportionately channeled national savings to SOEs.
6. Source of National Pride: The Chinese government wields enormous influence over the corporate management of SOEs, with CEOs often serving as members of the Communist Party. Consequently, the acquisitions of foreign companies by SOEs produce feelings of triumph for the government. Moreover, China's sensitivity to American political backlash against CNOOC's attempted purchase of Unocal in 2005 demonstrates its heightened regard for national honor and "face".

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<sup>1</sup> These rankings are compiled from the 2010 CIA World Factbook, which treats the European Union as a single entity.

<sup>2</sup> With the exception of 2007, when Chinese OFDI flows increased marginally.

## **FIRM-SPECIFIC MOTIVES**

7. Commercial and Productivity Interests: Rising competition in the domestic market forces profit-maximizing Chinese firms to look for earnings abroad. Chinese corporations investing in developed countries can sell at steeper prices to accommodate higher consumer incomes, while they can hire workers in developing countries at lower wages. In sectors where Chinese firms do not have a comparative advantage, production can also be incentivized to occur closer to areas of resource obtainment. Furthermore, by investing overseas instead of relying on exports, Chinese companies can circumvent existing and future trade barriers.
8. Acquiring Technology and Strategic Assets: In order to compete internationally with multinational enterprises, Chinese firms need to play catch-up by procuring advanced technology, managerial know-how, internationally recognized brands, and other strategic assets. This would allow Chinese businesses, through OFDI, to clear several stages of development that would otherwise take decades to build up while providing access to new markets.

## **POTENTIAL CONSEQUENCES FOR THE UNITED STATES**

Some of China's OFDI motives will undoubtedly have more relevance than others for investment in the U.S. The U.S. might need to attach greater emphasis on the effect of an appreciating Renminbi (especially coupled with a depreciating dollar) and its profusion of technological innovation and recognized trademarks (strategic assets that Chinese companies covet). Conversely, the U.S. need not belabor China's worldwide pursuit of natural resources or stress its investing as a means to commercially harness cheaper labor costs. These are factors for which other countries have a better comparative advantage than the U.S. in attracting Chinese OFDI. The U.S. should thus take care to not weigh China's motives equally, as they can have differential impacts on the direction and magnitude of Chinese OFDI.

As long as China does not suffer an economic slowdown (from a bursting of its property bubble) and its next generation of leadership remains open to investing abroad, the U.S. should expect to see a considerable influx of Chinese investment in the next decade. Under standards instituted by the Foreign Investment and National Security Act (FINSIA) of 2007,<sup>3</sup> a growth in Chinese FDI (especially from SOEs) will also lead to an inevitable increase in CFIUS investigations. While some firms will present clearer purposes for investment than others, the interconnectedness of their motives will make unraveling them difficult in a review process.

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<sup>3</sup> Which, among other stipulations, requires CFIUS to review deals involving any foreign government-controlled firms.

### III. DEMOGRAPHY AND COMPOSITION OF CHINESE FDI

Chinese investment resists any simple characterization. It comes in the form of both portfolio and direct investment from state-owned and private companies. The investment is spread over several sectors and present in most U.S. states. It is because of the diverse nature of the investment that there lacks any strong evidence that the Chinese are using FDI strategically against America. Furthermore, there is no evidence that Chinese investment is targeted at creating a monopoly in one industry or cutting off the United States' access to a resource, nor does it appear the Chinese government is orchestrating some strategy master plan behind a veil of corporations.

	Government	Private	Total
M&A	\$8 Billion	\$3.7 Billion	\$11.7 Billion
Greenfield	\$2 Billion	\$1.3 Billion	\$3.3 Billion
Total	\$10 Billion	\$5 Billion	\$15 Billion

#### WHERE IS CHINA INVESTING?

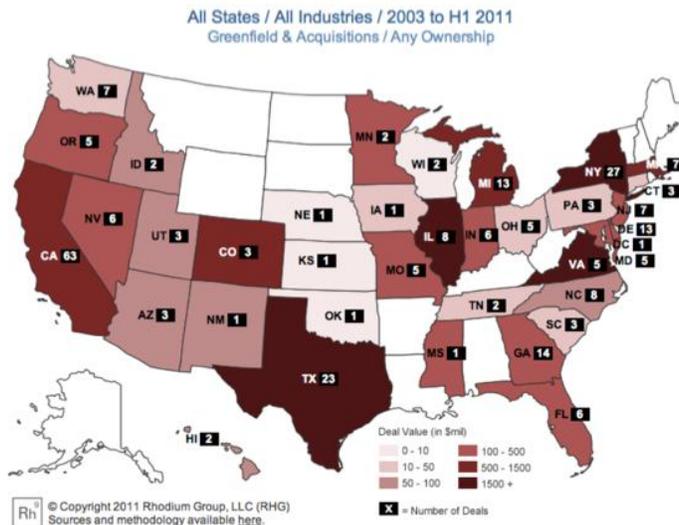
The states that receive the most Chinese investment are Texas, New York, Virginia, Illinois, and California. Each of those states has a large population, a diverse economy, an educated workforce, and contains major American cities and markets. States that receive little or no investment are located in the Mid-West, the Mountain West, the Rural South, and all of New England except for Massachusetts. Chinese

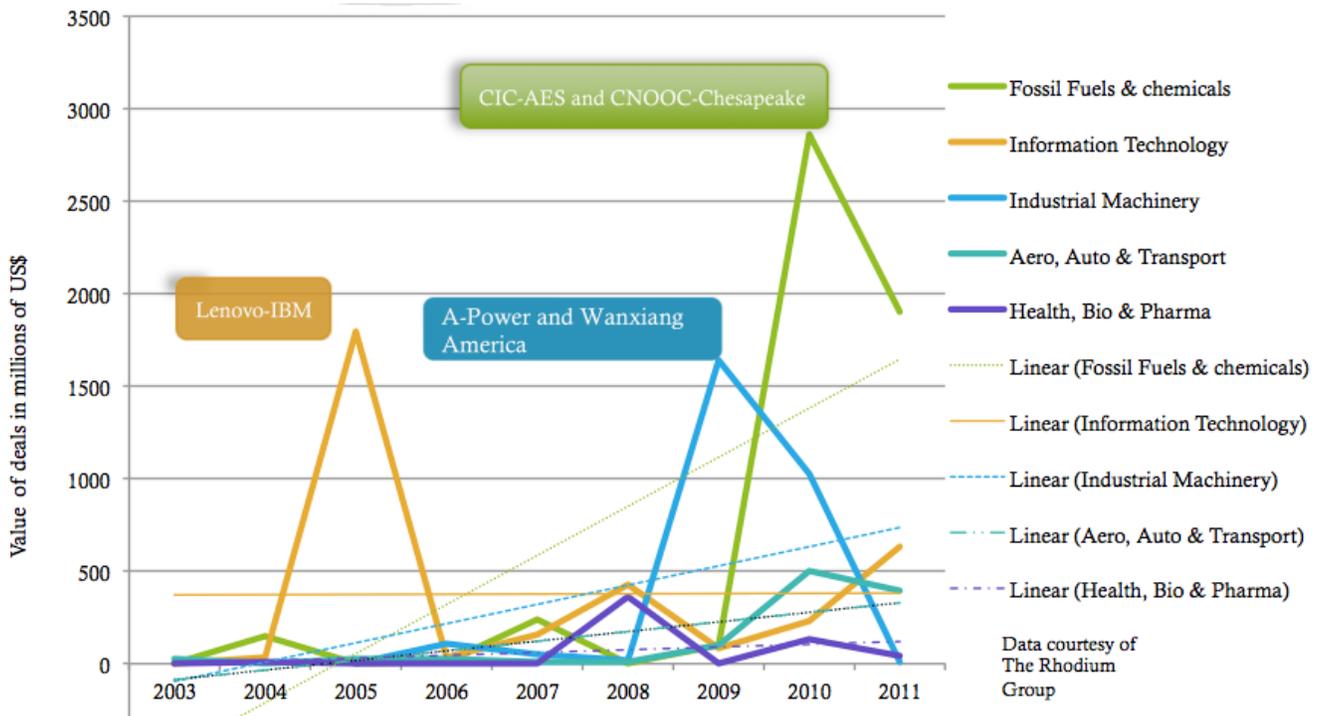
investment in these states tends to be focused in energy and raw materials. Even when considering the scale of these states, they are attracting unusually low amounts of investment.

#### WHAT IS CHINA INVESTING IN?

China invests in many different industries throughout America. The country's demand for raw materials resembles an economy in the less capital-intensive light-manufacturing stage with portions advancing towards heavy manufacturing. Until China's economy fully moves towards manufacturing products like automobiles and ultimately providing services, they will continue to produce and consume increasing amounts of cement, copper, steel, and aluminum. Although China is already home to large reserves of these raw materials, its rapid growth has necessitated that corporations invest abroad to acquire even greater quantities. From 2003 to present, 60% of China's FDI into the United States has been in energy, raw materials, and industrial machinery.

Although most inward investment has been focused on natural resources, there is significant investment in other sectors. Usually these investments are in industries in which America is uniquely advantaged. Besides energy and raw materials, most of China's investment is in the technology and information sectors. The West Coast remains the main location for technology deals along with New York mostly due to the magnitude of Lenovo's partial acquisition of IBM. There is an expectation that the tendency to invest in value-added sector industries will increase. Just as American corporations often subcontract manufacturing jobs out to Chinese companies, some Chinese corporations are relying on American employees and infrastructure for research & development, design, licensing, and branding. States like California, Florida, and New Jersey, all of which are home to companies that are well adjusted to the needs and obstacles faced by multinational corporations, have witnessed an influx in investment in these types of sectors.





## WHAT CHINA LOOKS TO GAIN FROM AMERICA

For some companies that are seeking to forge a global presence, the goal of gaining an international market share is as important as the competition for a domestic market share. Companies like Haier, Lenovo, and Geely have all taken visible steps to spread their brand presence outside China. Profit motives factor into choosing America as an investment destination. Government regulation in China limits potential profits in these markets making their foreign counterparts appear more lucrative. The Chinese electricity sector is fraught with price controls that make earning profits difficult. In response, the electric companies which are mostly state-owned have invested in international power generation as recently as the second quarter of 2011 with a 1.3 billion investment in Intergen, a global power company based in Burlington, Massachusetts.

Nevertheless, there are far fewer cases of Chinese companies attempting to buy companies overseas and then sell Chinese products in those overseas markets. It is unlikely that America will witness a Chinese auto company building a manufacturing plant to try to sell Chinese cars in America à la Japanese automobile companies Toyota and Honda did. Because Chinese markets are growing

at such an extraordinary rate, it is far more common to see Chinese companies expand overseas to help meet the current demand of the domestic markets or the niche markets created by Chinese living overseas.

## THE FUTURE OF CHINESE INVESTMENT

What lies ahead for Chinese FDI is contingent upon how the country develops. Should the Renminbi appreciate or the migration from rural provinces to urban areas with higher income levels continue, then a stable middle class would develop that would drastically increase the demand for household goods. In this scenario, a greater emphasis would be placed on acquiring foreign corporations that produce finished goods to ramp production up to meet demand. The political and ultimately financial power of the Chinese consumer will be one of the most influential developments. If the Chinese start to develop an economy that places greater emphasis on consumption, it would create a rise in consumer products and the companies that produce them, which to date have played a small role in Chinese FDI.

## IV. THE JAPANESE ANTECEDENT

The recent backlash against Chinese direct investment in the U.S. has its closest historical precedent in the experience of Japanese firms two decades ago. Beginning in 1980, the U.S. saw annual inflows of Japanese FDI rise from a modest \$1 billion to a peak of over \$20 billion by 1990. Underscored by high-profile deals such as the 1989 purchase of Rockefeller Center by Mitsubishi Group, the conspicuous spike in Japanese FDI took place against a political backdrop that bears striking similarity to that underlying Chinese investment today: trade friction, currency disputes, debates over state subsidies, and perceptions of economic threat. Most significant, Japan occupied a space in the American political consciousness that is today filled by China—the ascendant superpower in an age of American decline.

### THE BALANCE SHEET TODAY

Chinese investment today makes up a mere tenth of a percent of total FDI flows into America. When Japanese firms began investing in the U.S., however, they too played only a marginal role, with less than one percent of American inward FDI coming from Japan in 1980. Yet today Japan is the second largest source of FDI in the U.S., with an estimated investment stock of over \$260 billion. American affiliates of Japanese companies employ more than 700,000 American workers in all 50 states, paying high wages and increasing labor productivity. In 2009 alone, Japanese firms contributed in excess of \$55 billion to U.S. exports, and their outlays on research and development in the U.S. totaled nearly \$8 billion.

Despite the early fears raised by critics of Japanese FDI, its defenders now stand vindicated by a decidedly positive record. Before Japanese FDI had established itself, however, the early rise of inflows led Congress to tighten the U.S. regulatory regime for FDI through Exon-Florio.

Japanese FDI in the U.S. thus demonstrates two points. First, it suggests the potential of Chinese FDI to become a source of economic vitality in the U.S. But second, and more important, it forecasts the turmoil that a rise in Chinese FDI

will arouse, as well as the consequences of such turmoil. A closer examination of the similarities between Japanese investment in the 1980s and Chinese investment today, as well as the differences, sets this point in sharp relief.

### POINTS OF SIMILARITY

1. The trade deficit: Bilateral dialogues between Japan and the U.S. were dominated by the annual \$80 billion plus trade deficit the U.S. ran with Japan over the 1980s. Similarly, the \$270 billion U.S.-China trade deficit sours U.S. attitudes toward Chinese trade and investment today.
2. Currency disputes: The bedfellow of trade imbalance, an undervalued currency was a chief criticism leveled against Japan in the 1980s. Similarly, Congress today takes perennial issue with China's alleged manipulation of the RMB to flood U.S. markets with cheap Chinese goods.
3. State subsidies: In the 1980s, concessionary credit provided by Japan's "developmental state" to its *keiretsu* cartels fueled a perception that American firms were not on the same playing field as their Japanese rivals. Today, American companies decry the CPC's practice of providing subsidized loans to state-owned enterprises, giving them an unfair advantage in global markets.
4. Economic threat: After outperforming the U.S. over three decades of supernormal economic growth, Japan in 1990 posed an ipso facto threat to the American way of life. A majority of Americans surveyed in 1990 ranked Japan's economic power as the single greatest threat to American security. China today, having sustained an average annual growth rate of over ten percent of GDP since 1990, posits a similar image in the minds of many Americans, with the perception of China overtaking the U.S. as a global superpower widespread.
5. The liability of foreignness: In entering the American market, Japanese firms had to learn to adapt to a new cultural and regulatory environment. It took time for Americans to become accustomed to Japanese names in the marketplace. Chinese firms suffer the same

foreignness as Japanese firms did 20 years ago, and it will take time for them to root themselves in local communities across America and conform to American laws and norms.

6. Potential for xenophobia: A lack of shared cultural heritage, compounded by the legacy of World War II and a racialized sense of otherness, contributed to widespread American mistrust of Japan in the 1980s. Today many Americans regard China with similar apprehension, emblazoned by reports of human rights violations and memories of the Tiananmen Massacre.

### POINTS OF DIFFERENCE

7. Chinese state control: Despite the Japanese government's forays into industrial policy, Japan was still a capitalist democracy. China's authoritarian state and "capitalism with socialist characteristics" heightens sensitivity toward Chinese FDI in the U.S. While estimates vary over the extent of the CPC's control of private and quasi-private firms in China, over 60 percent of Chinese direct investment in the U.S. comes from state-owned enterprises.
8. Technology transfer: A prominent fear in the 1980s was that Japan would overtake the U.S. by means of superior technological innovation. Industries such as high-definition television and automobiles offered the possibility of positive technology transfer from Japan to the U.S. With China, however, where industry is much less developed, the flow of technology will be more one-sided in China's favor.
9. National security threat: China, unlike Japan, is both a U.S. military rival, having openly declared its intention to balance against American military power in the Pacific, as well as a heavy investor in rogue states such as North Korea and Iran. Chinese FDI in certain sectors runs the risk of enabling commercial and state espionage and creates the possibility of dual-use technologies transferring into the hands of the People's Liberation Army or pariah regimes.

### A THRESHOLD OF INVESTMENT

Despite the pushback generated by the influx of

Japanese direct investment in the 1980s, when inflows resumed a similar upward trend in 1995 after a precipitous drop in the early 1990s, there was virtually no criticism. Exogenous factors such as the bursting of Japan's real estate bubble, the emergence of the U.S. economy from recession, and America's Cold War victory undoubtedly factored heavily in the shifting of U.S. attitudes toward FDI. Also of importance, however, was a process of habituation set in motion by Japan's initial investments.

The five-year interlude from 1991 to 1995 provided Japanese firms time to adapt to the American market and root themselves in local communities. Brands like Toyota and Toshiba overcame the arresting liability of their foreignness. Japanese companies learned the importance of philanthropy and community outreach in establishing themselves as responsible corporate citizens. Crucially, the contributions of Japanese FDI to the U.S. economy also became acknowledged on a national level. With Japanese firms employing American workers in districts throughout the U.S., anti-Japanese grandstanding in Congress became less politically tenable.

Thus, by 1995 Japanese FDI had crossed a threshold beyond which it could increase without political incident. This threshold is particular to a given country, determined by factors such as the political sensitivities outlined above, as well as the nature of the investments themselves. Greenfield investments are generally welcomed, whereas acquisitions, particularly of American icons, sensitive technologies, and critical resources, lead to greater scrutiny in Washington. Japan also demonstrates the important role the earliest firms to enter the American market can play by establishing a positive track record that serves as a reference for future investment.

As Japan's historical precedent makes clear, a rise in Chinese direct investment is sure to arouse turmoil in the short-term, but over time FDI from China should reach a level at which the political mainstream has acknowledged its benefits. Until it crosses that threshold, however, it will navigate an investment climate in which it is particularly susceptible to political predation.

## V. CHINESE FDI VERSUS OTHER BRIC FDI

Over the past few years, the American media and a number of prominent politicians have shown far greater mistrust towards Chinese firms investing in the U.S. than to firms from other BRIC countries (Brazil, Russia, and India). This mistrust results from China's economic surge coupled with American economic stagnation, American perception of China as a trade and military rival, and China's authoritarian ideology. The American media and political sphere should not single out Chinese FDI as a serious national economic concern because it closely resembles other BRIC FDI in the U.S.: BRIC countries invest small, roughly equal amounts in the U.S. and ought to receive the same treatment in the American political process.

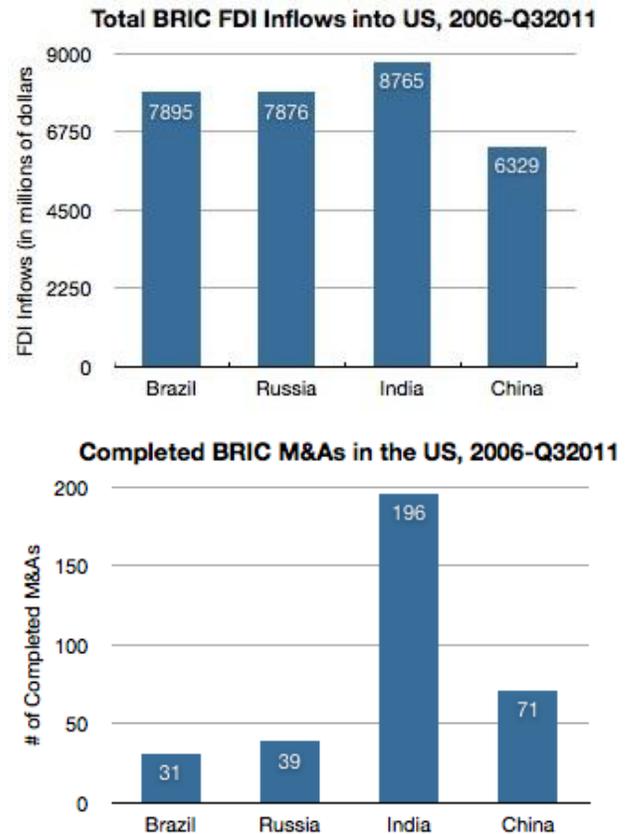
Instead, the U.S. government should encourage BRIC countries to invest in the US because of their sheer growth potential: the BRICs currently account for more than 25% of worldwide GDP and are expected to supply more than half the world's GDP growth by 2014. As BRIC growth accelerates rapidly, multinational firms based in these countries will begin to invest more heavily in the United States because of technology transfer opportunities, increased brand exposure, and location benefits. Thus, it is important for American authorities to both emphasize the positive economic benefits BRIC FDI brings to the struggling national economy as well as simultaneously debunk the myth that Chinese FDI threatens economic wellbeing.

### BRIC FDI IN THE US

BRIC FDI stocks and inflows in the U.S. are small compared to the FDI of longstanding U.S. trading partners. In 2009, for example, the BRIC nations accounted for less than 1% of the total yearly FDI inward stock into the U.S. This compares to the 11.7% of FDI stock that Japan alone contributed in 2009.

Despite receiving excessively negative media coverage, China has had the lowest FDI inflow (6.3 billion) of the BRIC countries for mergers and acquisitions; however, China did complete the

second-most M&A deals (71).<sup>4</sup> India has had the largest FDI inflows into the U.S. (\$8.7 billion) and has completed the most M&A deals (196) in the U.S. Overall, however, the BRIC countries have very similar FDI figures in the U.S.



BRIC FDI in the U.S. is concentrated heavily in the mining and metals sectors, both lagging sectors in which the U.S. has been losing its competitive advantage over the past few decades. From 2006 to 2011, the BRIC countries have invested over 11 billion dollars in American mining and metal firms.

### BRIC FDI IN THE AMERICAN POLITICAL PROCESS

Chinese firms have filed more CFIUS transaction notices than firms from the other BRIC nations, but not by a significant amount. From 2007 to

<sup>4</sup> No comprehensive data was available for BRIC countries' greenfield investments.

2009, 13 Chinese firms filed CFIUS notices, compared to eight Russian firms, six Indian firms, and three Brazilian firms (358 CFIUS transactions were conducted in total). According to CFIUS, there is no indication of any yearly national trends: the number of notices filed by a nation's firms one year does not affect how many notices will be filed the next year. Thus, there is no reason to believe that Chinese firms are investing in more security sensitive sectors in the U.S. than other BRIC firms or being examined more frequently by CFIUS.

While Chinese firms have stolen the American media spotlight, firms from Russia and India have also recently faced media and political scrutiny for their American investments. In 2007, the SEC urged CFIUS to investigate the Evraz Group's \$2.3 billion acquisition of Oregon Steel Mills. The SEC accused the Russian firm of failing to disclose financial statements, though the deal eventually passed. In 2005, multiple senators wrote to the Department of Energy to protest VSNL's acquisition of Tyco Global Network on grounds that the takeover would give India control of an advanced under-water cable system. This prompted investigations from CFIUS, the FCC, the FBI, the Department of Justice and the Department of Homeland Security but the deal still passed. Chinese firms, then, are not the only BRIC firms that have been subjected to close scrutiny from American authorities.

#### **WHY IS CHINESE FDI SEEN AS A PARTICULAR THREAT TO AMERICAN ECONOMIC WELLBEING?**

The U.S. considers China to be a leading strategic trade rival, a title that no other BRIC holds. Therefore, Chinese investment in the U.S. is treated in some government sectors as a kind of zero-sum economic challenge (their benefit is our loss, and vice versa).

Some American authorities are worried that Chinese SOEs investing in the U.S. will engage in discriminatory business practices, neglect human rights, and even attempt industrial espionage.

China holds \$1.3 trillion in American public debt, more than double the other BRICs combined.

Some politicians are concerned this debt ownership gives China a leveraged position in domestic politics, and worry further that Chinese FDI is another tool to consolidate economic and political leverage over the U.S.

China and the U.S. fundamentally disagree on the future of Taiwan: the U.S. has guaranteed Taiwan's security while China has vowed to bring the island under mainland control. Worryingly, it would seem that the only way this disagreement can be settled is through military force. While this issue of Taiwan remains uneasily resolved, some American authorities are wary of allowing a potential military adversary's firms to invest in the U.S.

China is also investing in America's enemies, including Iran and Venezuela. This has triggered warning bells in the U.S. security and intelligence communities: what if U.S. technology is being transferred to these countries through Chinese SOEs? And what if China is investing in the U.S. funds earned these rogue states? Chinese firms' double-faced nature, the ease with which they conduct deals in both democracies and dictatorships, troubles American authorities.

Under the guidelines of its twelfth five-year plan (2011-2015), China encourages its enterprises to acquire technology, patents, industrial know-how, and famous brands. In pursuing these assets, Chinese firms are investing heavily abroad, including in the EU, America's most direct economic competitor. Like the United States (with which it has a comparable size, population, and GDP), the EU has encountered a recent surge in inward Chinese FDI. Annual Chinese FDI flow into Europe grew from \$857 million to \$3.3 billion between 2004 and 2011. While this represents less than 0.2% of total inward FDI flowing into the EU, it illustrates a 1635% increase in total FDI inflow over seven years. As China seeks to diversify its portfolio assets, both the US and Europe will be attractive destinations for investment. With Europe being the U.S.'s chief rival for Chinese FDI, what insights can the US gain from analyzing current Chinese investment patterns in Europe?

### PROCESS FOR INVESTMENT IN EUROPE

The European Union currently does not have an investment regulatory regime analogous to CFIUS, but EU states are allowed to impose restrictions based on self-determined public security considerations. Consequently, legal regimes vary significantly from state to state. For example, in the UK, the government has the power to veto any deal, while in the Netherlands, the government legally bars itself from prohibiting investment. While the 2009 Lisbon Treaty explicitly mentions FDI as forming part of the EU common commercial policy, an area of exclusive EU competence, it remains uncertain as to whether the EU can lawfully create a CFIUS-like body. In the meantime, the EU can examine and block foreign investments from an anti-trust perspective, known as "competition policy." Anti-trust regulations provide an easy means of blocking Chinese deals, especially when they involve Chinese state-owned monopolies. From America's perspective, the EU investment process, and the lack of a CFIUS-equivalent organization, can be viewed as both a problem and an asset.

Why is it an asset? Compared to the EU,

America's CFIUS process is predictable and transparent, providing obvious benefits to informed foreign investors over oftentimes arbitrary processes elsewhere. However, in attracting Chinese FDI by comparing the EU process against CFIUS, a conscious effort should be made not to offend or alienate the EU, which will likely remain America's largest trading partner.

Why is it a problem? The EU is the U.S.'s most formidable competitor for Chinese investment, and Chinese investment has been growing more quickly in the EU than in the U.S.<sup>5</sup> China can capitalize on the lack of a EU review process and invest in states where regulatory processes do not exist. Because of this, there are many incentives to invest in states like Hungary and Bulgaria where initial investments can form the groundwork for presence in other EU states with more rigorous investment regulations. Furthermore, easy investment poses a larger problem for American national security. By bypassing national security concerns, Chinese firms can 1) get access to potentially threatening technology from Europe and 2) acquire firms that have US military contracts.

### WHAT CHINA IS INVESTING IN

Chinese firms have generally been investing in similar industries in the EU and the U.S. However, Chinese investment in the EU has been particularly both successful and large-scale in two industries that have largely been unexploited by Chinese companies in the U.S.:

Autos: Automotive investments make up the bulk of Chinese FDI into Europe, with almost \$2.9 billion invested across 30 deals between 2003 and 2011. China's primary automotive acquisitions in Europe have been Nanjing Auto's purchase of MG Rover's car making operations in 2005 and Geely's acquisition of Volvo in 2007. MG had been on the brink of collapse before Nanjing Auto's purchase, but by 2007, MG plants

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<sup>5</sup> Between 2010-2011, annual Chinese investment in the US decreased by 39%, whereas the same period saw a 3% increase in the EU.

reopened in the UK and new R&D centers were created. More recently, Great Wall Motor announced that it will open a plant in Bulgaria later this year to produce cars for the EU market, while Chery has plans to expand production to Catalonia and potentially create 10,000 jobs.

Logistics and Infrastructure: The presence of Chinese firms in maritime transports and logistics services is indicative of China's desire to control the logistical supply chain as it expands into Europe. Significant investments have been made in ports and cargo facilities, including Cosco's upgrade of the port of Piraeus in exchange for a 35-year lease. In Germany, Hungary and Italy, significant investments have been made in building, buying and upgrading airfields with cargo capacities. With China Investment Corporation's (CIC's) announcement on November 30 encouraging increased domestic infrastructural investment in the U.S. and EU, these types of investments will continue to grow.

## **FAILURES**

Using past Chinese failures in Europe as a basis, Chinese investment cannot be automatically viewed as a panacea for distressed industries in the U.S. According to Accenture, one-third of Chinese enterprises have lost money on their foreign investments and two-thirds of joint ventures have failed. Often inexperienced, Chinese companies may not have the managerial know-how to operate and turn around firms. Here we can examine two cases:

TCL: The acquisition of French Thomson by Chinese electronics manufacturer TCL created the world's largest TV company. However, TCL's inexperience and lack of insight into its purchase led to the end Thomson's operations in just two years.

Chalkis: Chalkis, a Chinese Ketchup manufacturer acquired French Les Conserves de Provence-Le Cabanon. Although the latter was not an ailing corporation, the merger did not bring the desired results. As such, Chalkis began downsizing and laying off Le Cabanon staff.

Why is it a problem? Given that there have been failures in Europe already, as investment in the U.S. grows, failures will likely result as well. Such failures would result in a domestic political backlash against Chinese investment.

Why is it an asset? The US can learn from the failures in the EU to ensure that there continue to be no large scale public failures of Chinese acquisitions in the U.S.

## VII. IMPLICATIONS OF CHINESE FDI FOR THE U.S. SOLAR INDUSTRY

China's growth in the solar industry (as shown in the figure below) demonstrates its interest and ability to become a major supplier in the global solar market, competing with the U.S. and Germany. Investment in the U.S. solar industry allows the Chinese to circumvent "Buy America" restrictions on government solar purchases, gives the Chinese access to the American solar market, and gives the Chinese access to new solar technologies under development in the U.S.

Such Chinese investments in the U.S. solar industry represent a concern to American policymakers in terms of national security, economic dominance and domestic politics. The consequences of these investments are discussed below.

### NATIONAL SECURITY

The threat: Chinese investment in solar is a national security concern if the military makes use of solar power and if the Chinese take advantage of technology gained through acquisitions by using it against the U.S.

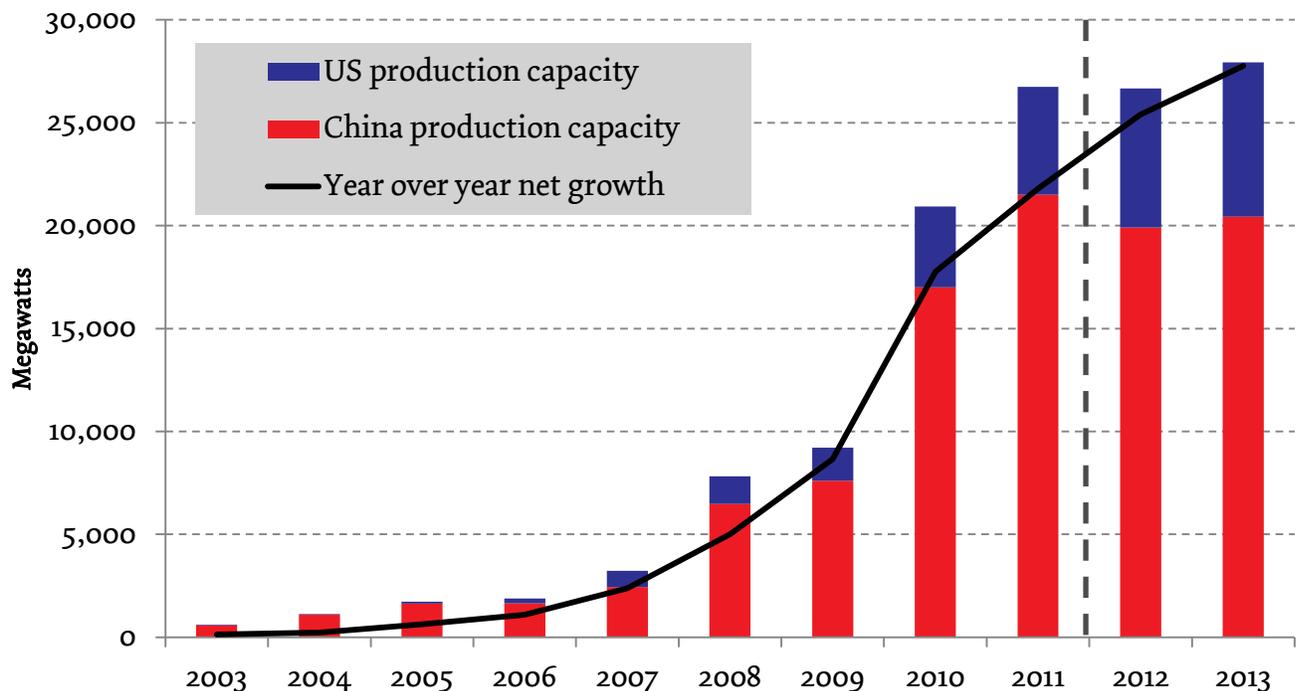
The analysis: The military use of Chinese-sourced solar does not represent a security threat to the

United States because the use of solar energy in the military is small (less than 1 percent of total energy use); pre-existing solar panels would not stop working as a result of Chinese-owned U.S. companies' hypothetical trade restrictions; and solar energy can always be substituted by conventional energy sources such as oil, the market for which is mature and stable.

The main advantage that U.S. solar firms hold over their Chinese counterparts is research and development, the vast majority of which occurs in U.S. institutions, an advantage that could be threatened by China's loose intellectual property laws. However, CFIUS can impose conditions on investments, and pre-existing restrictions such as deemed export clauses, when properly enforced, prevent undesirable technology transfer. The lax state of Chinese IP laws suggests that some transference will take place despite the best interests of the administration, but this risk is outweighed by the economic benefits that an investment relationship with China would bring.

### ECONOMIC DOMINANCE

The threat: While the U.S. holds dominance in domestic solar panel installation, mergers and acquisitions by Chinese firms in the solar industry



will increase China's involvement in these markets. Chinese companies have previously attempted to vertically integrate in many markets, and investment in U.S. solar will help them achieve that goal in solar energy.

Critics of foreign investment do not fear greenfield investments, which the Chinese have already made in the U.S. solar industry. Far more threatening is China's demonstrated ability to purchase existing U.S. companies at face value. Given China's already dominant position in the solar panel production value chain (up to 50 percent globally in some elements), too many acquisitions could allow China to control the chain and cut American companies out of this growing market.

The analysis: Concerns of Chinese dominance in the solar industry are valid, but restrictions in solar FDI will not go far in mitigating those concerns. If Chinese companies wanted to achieve an international monopoly, for example, in the production of silicon wafers, in which China had 50 percent dominance in 2010, purchasing all U.S. wafer production companies would only increase its market share by 2.8 percent, as a result of America's relatively small market share.<sup>6</sup> Chinese solar dominance is an international issue that cannot be solved with unilateral investment restrictions on the part of the U.S.

The U.S. faced a significant loss in solar market share over the past 10 years. If Chinese companies moved production to the U.S., as they have already begun to do, the production would be taking place on American soil. Increasing Chinese FDI may be the best way to prevent the U.S. from being left behind as the solar market booms. China can leverage its comparative advantage in mass production with the technology advances they gain from partnership with American firms. If these Chinese companies are hosted in the U.S., they will contribute to gross American exports, and U.S. companies, to remain competitive, can

adopt the efficient production techniques of Chinese companies just as the Chinese companies adopt U.S. technology.

## **POLITICAL BACKLASH**

The threat: Especially in light of the collapse of Solyndra, politicians are looking more carefully at solar as the future of American green technology. U.S. companies continue to lose market share to companies in other countries, which has reflected badly on the current administration's proposal that solar and other renewables will become critical U.S. energy sources.

The potential loss of jobs as a result of Chinese companies' acquisition of U.S. companies is currently a concern to politicians, as Chinese firms will appear more threatening if they are taking jobs away from American citizens.

The analysis: Large U.S. companies such as First Solar already have significant presence overseas. Such companies will not protest increased competition from Chinese companies given their present competitiveness.

Smaller local companies such as Evergreen Solar and Abound Solar that cannot compete with the mass-production capabilities of Chinese firms will resist, as similar conflicts in the oil and wind power industries have demonstrated. Representatives from the host regions of these companies will try to enact legislation, or at least spread bad publicity, to halt deals.

However, American energy companies and some politicians are already courting Chinese solar firms for investments and partnerships. If investments increasingly come in the form of mutual agreements rather than hostile takeovers, politicians focused on local issues who promoted a deal in the first place will not resist. Such cooperative deals are also less likely to result in layoffs, as the terms of the acquisition can be made clear at the outset.

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<sup>6</sup> The production of silicon wafers is one of the four main steps in the production of a completed crystalline solar cell and accounts for approximately 20 percent of the full value of the solar cell.

## VIII. POTENTIAL FOR CHINESE RETALIATION

The business world is abuzz with talk of a retaliatory game of investment protectionism being played by the U.S. and China. Yet despite a number of thwarted high-profile acquisitions—including CNOOC-Unocal, Huawei-3Leaf, and Coca-Cola-Huiyuan—the broader trends of bilateral investment do not justify the media uproar. From 2003 to 2010, the Chinese made over 200 investments in the U.S. Very few were subject to review by CFIUS, and the vast majority of those reviewed were cleared without incident. For its part, China's Ministry of Commerce (MOFCOM) has reviewed 267 mergers under a 2007 anti-monopoly law, and rejected only one.<sup>7</sup>

Most importantly, bilateral investment continues to grow. Cumulative U.S. FDI in China reached \$60.5 billion in 2010, a 22 percent increase from 2009, while Chinese FDI stock in the U.S. rose from \$3.3 billion to \$4.9 billion in that same period. Clearly, the U.S. and China are not locked in a FDI cold war, despite the media's insistence otherwise. That does not mean, however, that the U.S. investment review process does not have consequences abroad.

### RECENT CHANGES TO CHINA'S FDI REGIME

Surveys continue to show that private Chinese firms still see the U.S. as an open and attractive place for their investment. On the other hand, because investment from Chinese SOEs is subject to heightened scrutiny under the terms of FINSA, some within MOFCOM have claimed that the U.S. is using its regulatory process to hamper Chinese investment in the U.S. An American politician might thus interpret recent changes to China's FDI regime as “a direct response to prominent failures of proposed Chinese acquisitions in the face of the CFIUS process.”<sup>8</sup> The connection, however, is only tenuous, as the Chinese government has not made its motives

clear. What is clear is that the changes could have important consequences for American investment in China going forward.

For example, the 2007 anti-monopoly law also included a provision for national security review. In February of this year China finally took steps to establish the necessary procedural rules. Under the *Notice on Establishing a Security Review System for Mergers and Acquisitions of Chinese Enterprises by Foreign Investors*, an interministerial panel headed by the State Council can assess foreign acquisitions on grounds of national security. “National security” is broadly defined, however, and it remains unclear when a transaction could be subject to review. Many Americans therefore continue to support a Bilateral Investment Treaty (BIT) between the U.S. and China because it would require the Chinese government to treat U.S. investors similar to native ones.

### TRADE AND INVESTMENT LINKAGES

China is already the third-largest U.S. export market and one of the fastest growing. Between 2000 and 2010, total U.S. exports to China rose over 468 percent. That success has not been confined to large multinationals—small and medium sized American businesses, the main engines of job creation, have found growth in China too. U.S. FDI in China has played a critical role in this expansion, by opening new markets to American companies and providing them with the knowhow to compete in them. Furthermore, most U.S. investment in China is not export-oriented, but rather is focused on local sales. Hence it has hardly contributed to the growing U.S. trade deficit with China in the significant way some suggest.

Despite these positive developments, many areas of the Chinese economy, such as construction and telecommunications, remain closed to foreign investment and sales. Hypothetically, the Chinese government could move to close even more sectors to FDI. A recent report by the US-China Economic and Security Review Commission suggests China might actually erect such barriers. Given the state of the U.S. economy, and its need for export-oriented growth, that would be an

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<sup>7</sup> MOFCOM blocked Coca-Cola's proposed acquisition of juice maker Huiyuan in March of 2009, saying Coca-Cola already had a dominant position in the Chinese soft drinks market, which it could leverage into the juice market.

<sup>8</sup> Scott Flicker and Dana M. Parsons, “United States: Huawei-CFIUS Redux: Now It Gets Interesting,” Mondaq Business Briefing, (2011).

unwelcomed development. Of course, even if that were to happen, the U.S. would continue to benefit from an open FDI policy of its own, due to FDI's positive impact on productivity, competitiveness, and ultimately, economic growth.

### **THE POLITICAL ROAD AHEAD**

Nonetheless, the U.S. cannot formulate FDI policy without considering its implications abroad.

- Were the U.S. to blatantly restrict Chinese FDI, it could expect the Chinese to return the favor.
- The U.S. could also expect to appear hypocritical at a time when FDI protectionism is on the rise globally. The U.S. has long been the most vocal champion of free and open markets. Being seen as anything less would only legitimize the protectionist policies of others.
- U.S. protectionism could also have a demonstration effect, whereby it would lead developing countries to pursue protectionist policies of their own.
- American politicians should also be wary of using China as a scapegoat for the nation's economic ills. Voters may hold them to their hard-line policies once in office. This country could quickly find itself in not only an investment war, but in a trade war as well.

- Most importantly, U.S. policy makers must recognize the leadership change that is about to take place in China. Backlash against protectionist threats from Washington could hurt Chinese leaders with strong ties to the U.S., to the benefit of hardliners such as Bo Xilai, the party secretary of Chongqing. In October that city shut down 13 Wal-Mart stores for allegedly selling mislabeled pork, a minor infraction. Chongqing took these unusual steps only days after the U.S. Senate passed legislation aimed at punishing China for manipulating its currency. Many American business executives in China do not think that was a coincidence. Rather, they see the episode as a proxy for Chinese sentiment towards foreign companies, and worry that their businesses will be sidelined as native competitors emerge. U.S. protectionism would only provide an excuse for the Chinese government to marginalize American companies for the competitive sake of their own.

## IX. CURRENT U.S. POLITICAL CONTEXT

Our discussion on Chinese FDI in the U.S. would be incomplete without discussing the current political backdrop upon which the debate is cast. Leading up to the 2010 midterm elections, China was a heated topic of debate. With the recession at the forefront of the nation's consciousness, candidates and interest groups used China as a scapegoat for American economic woes. The "Chinese Professor" ad run by the Citizens Against Government Waste, in which a future lecturer in Beijing attributes the downfall of the United States to its indebtedness to China ("Now they work for us," the professor proclaims), was representative of such fear mongering. While such ads and arguments had little factual support, they seemed to resonate with an American public largely ill-informed about the complexity of the underlying facts. At the same time, many voters became convinced that an undervalued Renminbi was responsible for U.S. job losses through a large trade deficit, lending political credence to candidates who promised to address China's currency manipulation.

With the election year imminent, the discussion again becomes quite complicated. As President Obama's campaign and those of his Republican challengers have highlighted thus far, jobs will again be a major issue of the election. Fiery proclamations of job losses to China seem to resonate well with the American people, whereas more tempered opinions can be seen as soft. Whether or not for the right reasons, China will play a significant role in next year's election, and it is therefore useful to highlight the perspectives of several of the more notable candidates.

### DEMOCRATS

Barack Obama: During his tenure, President Obama established SelectUSA by executive order. Select USA is a government-wide effort to encourage both domestic and foreign investment in the United States. When the Senate introduced legislation aimed at pressuring China to revalue its currency, President Obama expressed reservations, only going so far as to say that China is "gaming" trade by keeping its currency weak. He has recently begun turning up the heat on

China's undervalued currency, echoing sentiments already expressed by Congress. The President has also drawn criticism for his comment during the Asia-Pacific Economic Cooperation conference that Americans have been "lazy" in their efforts to attract foreign investment. While more or less an accurate depiction, President Obama's word choice has and will continue to be taken out of context for political firepower.

### REPUBLICANS

Governor Mitt Romney: During a recent Republican debate, Mr. Romney said that, if elected, he would label China a "currency manipulator" on the first day of his presidency. Drawing on his business experience, Mr. Romney believes that we are currently seeing predatory pricing from the Chinese. Mr. Romney has indicated that he would consider tariffs on Chinese imports to level the playing field and take steps to punish China for violating intellectual property laws. Such stances are consistent with his view that President Obama's administration has been soft on China and has failed to utilize its powers to address these issues with the Chinese.

Speaker Newt Gingrich: Similar to Mr. Romney and most other Republican candidates, Mr. Gingrich views China as a major threat to U.S. national economic security and must be confronted with vigor. Mr. Gingrich is concerned in particular about intellectual property rights, which he notes have been at serious risk due to the actions of the Chinese.

Governor Jon Huntsman: Perhaps unsurprising due his background as U.S. Ambassador to China, Mr. Huntsman's views most accurately mirror the views of this report. Mr. Huntsman warns that aggressive action against China, such as labeling it a "currency manipulator," is dangerous and could spark a trade war. Rather, Mr. Huntsman prefers to work more diplomatically with the Chinese to resolve differences and maintain an open forum. Unfortunately for Mr. Huntsman, his views lack the more rousing and simplistic appeal of other candidates, while his current positioning in the polls makes his ultimate nomination unlikely.

## X. POLICY RECOMMENDATIONS

### 1. CFIUS SHOULD ISSUE A PUBLIC STATEMENT OF CONFIDENCE IN THE U.S. REVIEW PROCESS

Through the Department of the Treasury, CFIUS should issue a public statement expressing its confidence in the Committee's ability to fairly and thoroughly address the concerns associated with the hosting of FDI under its existing national security mandate. The statement should:

1. discourage competitors to parties of a deal from interfering in the CFIUS review process for commercial reasons;
2. apprise Congress of the perils of expanding the CFIUS mandate to include an "economic security" or "essential commerce" clause; and
3. reassure foreign investors of the apolitical nature of the FDI review process in the US by clarifying that CFIUS is the only body with legal authority to block cross-border investment and does so strictly on the basis of national security threats and without discrimination.

Benefits: Such a statement, by restoring faith in the CFIUS review process, should help to mitigate the tendency for certain deals to catalyze competitors and Congressmen to block deals for commercial reasons, unrelated to national security. It should reassure Congressmen of the ability of CFIUS to adequately address the concerns of hosting FDI under its extant mandate, lessening the potential for inordinate political reaction to a sensitive deal. In addition, it should have the effect of demonstrating to foreign investors the fairness of America's FDI regulatory regime and stymie the perception of discriminatory or arbitrary CFIUS hearings.

Costs: The costs of implementation are minimal, involving only the financial burden of distributing the statement and organizing a press conference. Though not anticipated by this report, one could argue that such a statement could lead to a political backlash from unsympathetic Congressmen.

Implementation: The statement should be delivered by the Office of the Secretary of the Treasury, the statutory chair of CFIUS. The

statement should also be widely distributed by Treasury officers abroad, as well as on SelectUSA's website, to reach a diverse audience of members of the international business community.

### 2. CONSOLIDATE INVESTMENT PROMOTION AT THE FEDERAL LEVEL

Currently, states spend valuable resources going abroad to attract investment into their states from around the world and especially China. They also offer highly lucrative incentives in order to solidify investments. Although these practices are effective in establishing better relationships between the states, they should be done on the national level.

Benefits: The benefit would be that the states would present a unified front to foreign nationals. The U.S. taxpayer would no longer fund multiple offices and trips for different states but have one consolidated organization dedicated to attracting investment. Under the current system, states compete with one another through incentives in a way that depletes their public finances and reduces the benefits they would receive from foreign investment. Companies have the ability to "shop" the states and allow them to compete to put together the best offer instead of investing where the money would get the most return before being distorted by state incentives. The process also lends itself to favoring the biggest states with the largest budgets, which have the ability to most aggressively incentivize and search for FDI. Finally, states are less concerned with national issues like currency manipulation, environmental and human rights protections, and intellectual property theft. By ending the states' advertising campaign, the U.S. allows for greater equality, profitability, and efficiency in deciding which state will receive FDI.

Costs: The costs are that states who have an especially healthy relationship with China may feel they are having this relationship interfered with. They might also argue that these relationships aren't just being forged for trade but for cultural exchanges between the people of the

state and the foreign country. There is also the threat that if the states aren't offering these deal "sweeteners", then Canada, Australia or Europe will.

In response, the states should realize they will now have the opportunity to receive FDI without the tax incentives they previously had to offer and will ultimately receive a better deal. Relationships for the purpose of culture exchanges are still free to be established but not on taxpayer money. Even though there is little evidence that investment in the United States is easily substituted for investment in other parts of the world, if the states feel that the incentives being offered on a national level aren't enough to attract the maximum amount of FDI, they are free to contribute state funds to the federal organization in charge of providing a favorable business climate for foreign nationals.

Implementation: The most effective way to nationalize the FDI incentives would be simply to ban state officials from going abroad on public money and offering tax breaks to foreign countries. However, because states may feel this interferes with their freedom to spend their money how they see fit, it may be more effective to explain to them that inter-state competition is depleting profit margins and consolidation is better for everyone. If this is still politically infeasible, an intermediate step could be to make regional efforts potentially through the regional federal banks instead of on a national level.

### **3. CONTINUE TO EXPLORE A BILATERAL INVESTMENT TREATY**

If crafted properly, a BIT would give both American and Chinese investors more certainty in the marketplace. Still, questions remain about enforcement and the amount of reciprocal access to markets. They must be addressed before the U.S. agrees to a BIT with China. So must disagreements over whether to extend protection to investment in the pre-establishment phase (China's current model BIT does not offer such protection, whereas the U.S. one does). That is not to say that China has not made significant free market progress on this front— its model BIT is

actually comparable to those of the major European countries. It does, though, fall short of the U.S.'s high standards, and would have to be further strengthened to gain U.S. approval. Nonetheless, the U.S. must be conscious of China's ambitious drive to expand upon the 100 BITs it is already a party to. For example, it recently began BIT negotiations with the E.U. This stands in stark contrast to the U.S.'s own slowdown in implementing BITs during the past decade. As a major capital exporter, but also as a country in need of foreign investment, the U.S. must be careful not to be left behind.

Benefits: Negotiations demonstrate an American commitment to maintaining an open investment environment. That is especially crucial given recent Chinese criticism of CFIUS. Were the U.S. and China to actually reach an agreement, it would presumably be largely on U.S. terms. American investors would have the most to gain from such a treaty, given their current exclusion from certain Chinese sectors.

Costs: The costs of negotiations, which began anew in 2008, are minor compared to the potential benefits of increased bilateral investment. Still, if an agreement were reached, it might become political fodder for American politicians wary of China in general. Such a backlash might sour the treaty's bid for Senate ratification.

Implementation: Upon the successful completion of BIT negotiations, Senate approval might prove elusive given the current domestic political landscape. The administration would have to be strategic with when it submits a BIT with China to the Senate. Even an unratified treaty would go a long way in improving the Sino-American investment climate.

### **4. INCREASE SELECTUSA FUNDING**

SelectUSA does not receive funding comparable to equivalent agencies in peer countries. While partially a product of individual states and private groups courting investment, under the tenets upon which SelectUSA was founded, SelectUSA should expand its operations, becoming a universal point of entry and reference for firms seeking to invest in the United States. Foreign investors—

particularly the Chinese—face few formal investment restrictions, but the process for investment can be daunting, with both bureaucratic red tape and cultural differences.

Improvements to SelectUSA should be focused on two main programs:

**Program 1:** SelectUSA needs to highlight that the CFIUS process is in fact the best of its kind in the world, and that it treats all countries the same way with an end result that is often more fair than in other countries. If necessary, SelectUSA should also direct firms to CFIUS and provide them with necessary information.

**Program 2:** SelectUSA needs to facilitate investment by cutting bureaucratic red tape and providing assistance to new foreign firms. Simple bureaucratic hurdles such as getting visas frustrate many investors. Moreover, Chinese firms once inside the US often face challenges operating in mature markets.

**Benefits:** We need to ensure that Chinese inflows of capital are not diverted to the economies of peer competitors. By having programs that target and assist investors—particularly the Chinese—we would pave the way for more Chinese investment. Furthermore, by helping Chinese firms adjust and adapt results in fewer failures of future investment, the cost may be justified by the benefit of no domestic backlashes to failed investments in the future.

**Costs:** Right now, SelectUSA is underfunded and minimally staffed. While the website does a good job of providing testimonials and referring firms to incentives, it does not do nearly as much as it was spelled out in its original mandate. For example, the Netherlands Foreign Investment Agency (NFIA), the Dutch equivalent of SelectUSA, offers services such as assistance in finding joint-venture partners and in establishment. Though the costs of expanding SelectUSA would likely be significant in order to compete with peer countries, the benefits that come with future investment greatly outweigh these costs.

**Implementation:** For Program 1, a PR campaign should target all Chinese firms, highlighting

CFIUS and the process, as well as the process in peer countries. It needs to be showcased that CFIUS does not target China, and that the process is regulated with predictable outcomes

For Program 2, SelectUSA should offer services for all foreign investors, but for Chinese investors specifically, SelectUSA should turn to groups like the Committee of 100—a group of prominent Chinese Americans—as well as other Chinese-American groups to help Chinese firms adapt to the local environment and culture. Additional services should also be offered at a rate slightly lower than the market rate, letting Chinese firms know that any services would be optional, but would only conceivably help them in establishing operations in the US and preventing future failure.

## **5. INCREASE AWARENESS OF DEEMED EXPORT LAWS**

Increase deemed export law awareness in companies that are potential targets for Chinese investment. The threat of unwanted technology transfer as a result of mergers and acquisitions is the primary threat to U.S. industry where the advantage U.S. firms hold over foreign rivals is a technological one (such as in the solar industry). Companies, especially smaller ones, might inadvertently export technology to visiting Chinese investors.

**Benefits:** Such a policy would prevent foreign companies from using an investment in a U.S. company to bring technology back to the home country where it can be used against the United States in an economic or military way. It would also reassure U.S. companies that might protest a merger in the solar industry that U.S. interests are being preserved.

**Costs:** The cost would be in developing PR materials to be distributed to target companies. Increased technology transfer restrictions would also hurt multinational corporations themselves, which would not be able to use (or would face increased bureaucracy when using) certain technologies in branches that operated under the control of foreign nationals, especially where the technology is seen as critical to U.S. national security.

Implementation: In practice, increasing awareness would involve a PR campaign at the business level, similarly to how businesses currently deal with confidential government contracts. If a business was partially acquired by a foreign firm, CFIUS could impose conditions that certain technologies are left out of the deal when those technologies were critical to national security, and the administration could inform the company of “deemed export” policy using the previously mentioned PR materials, especially when that company is small and does not have a policy in place to deal with foreign nationals.

## **6. RESIST CALLS FOR RECIPROCITY**

The U.S. must be careful to avoid incorporating reciprocity into the U.S. FDI review process. If China were to close itself to American investment that would certainly hurt U.S. exporters and American interests in China generally. The U.S., however, should avoid compounding these losses with protectionist policies of its own. Inward FDI, where no legitimate security issue exists, should be encouraged no matter its country of origin. Furthermore, as the largest economy in the world, it is in the U.S.’s own interest to encourage developing nations to pursue open investment climates. That would become especially difficult to do if the U.S. were to retaliate against China, for existing policies or new ones.

Costs: There are few direct economic costs to this proposal, though it might be difficult to defend politically. Some American policy makers may rightly worry that in taking reciprocity off the table, the U.S. will limit its ability to bargain with China. Still, the benefits of inward Chinese FDI outweigh that cost, which the administration will have to actively explain.

Benefits: The U.S. will continue to realize the benefits of inward FDI, whereas China, if it becomes even more protectionist, will not. Thus the U.S. would reap absolute gains, but also relative ones. The latter would be especially important given the American public’s fears about U.S. decline vis-à-vis China.

## **7. BETTER PUBLICIZE THE BENEFITS OF CHINESE FDI**

The US Commerce Department and SelectUSA campaign should encourage Chinese firms to showcase their investments’ contributions to the American economy and undertake a concerted media campaign to improve American perception of Chinese FDI and improve the current bilateral FDI relationship. Such measures can include, but are not limited to:

- supporting Chinese firms’ efforts to undertake philanthropic activities in the state and local community to build trust and establish a rapport with citizens and political authorities.
- encouraging Chinese firms to run television or newspaper ad campaigns outlining the positive economic benefits of their investments in the American economy (i.e. increasing jobs in a particular sector or stimulating growth rates in a lagging industry, etc.).
- placing billboards or placards near a Chinese greenfield investment, such as a newly built factory, to inform local citizens of the specific economic and regional benefits of the investment.

Benefits: These measures should begin to change the American public and media’s excessively negative perception of Chinese FDI. This will hopefully eventually lead to increased Chinese FDI in the US in the coming decades.

Costs: There is always the chance for potential political backlash from the “old guard,” those politicians and members of the media who have always distrusted Chinese FDI. Furthermore, there would probably be small monetary costs to subsidize Chinese firms’ outreach efforts in the local community.

Implementation: Chinese firms will naturally undertake implementation with some gentle nudging from the Department of Commerce/SelectUSA. Therefore, we can expect to see minimum expenditures from American government organizations. After all, the onus is on Chinese firms to overturn the existing, unwarranted biases against them. This motivation, coupled with Chinese firms’ desire for increased

investment in the US in the future, should prove powerful enough to ensure that they take active measures to improve American perceptions of Chinese FDI.

## **8. HOST AN INVESTMENT FAIR**

The U.S. Department of Commerce, in conjunction with the Ministry of Commerce of the People's Republic of China (MOFCOM), should establish a U.S.-China Bilateral Investment Fair for FDI-seeking companies. This event would present a mutual opportunity for companies to closely examine sellers or promote themselves to potential buyers, furthering the prospects for increased FDI flows between both countries.

Benefits: Such an investment fair would allow the United States to send a clear signal that it welcomes Chinese FDI. Furthermore, the event systematizes, at a national level, local efforts already being made to attract investment from China. This exhibition also allows market forces to dictate which companies choose to attend and thereby absorb FDI. In other words, underperforming companies in weaker sectors will more likely attend than strong companies in robust sectors, allowing the latter to avoid being crowded out in the current economic downturn. Thus this fair could help America achieve increased employment and economic growth without government intervention in the form of industrial

policy.

Costs: Monetary costs for the U.S. government would be minuscule, especially if they are being shared with MOFCOM. The Department of Commerce would only need to subsidize the publicity and logistical details of the trade show, whereas individual firms would take the lead in facilitating investment deals. There may also exist the possibility for political backlash from hawkish policymakers generally skeptical of Chinese FDI, but the bilateral and voluntary nature of the fair should address this concern.

Implementation: The American and Chinese governments should employ the help of nongovernmental and local organizations (e.g. chambers of commerce) to advertise the fair to companies. Each country could host and organize the event every other year, accordingly splitting the costs. The governments could also sell advertising space or seek private sponsors for the event, such as law and consulting firms, further minimizing public monetary costs. In terms of logistical planning, the United States could imitate the format utilized by China in its annual International Fair for Trade and Investment (multi-day event, companies setting up own booths, etc.)

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