SECTION 2: CHINESE STATE-OWNED ENTERPRISES AND U.S.-CHINA BILATERAL INVESTMENT

Introduction

The state's influence over China's economy takes many forms and covers a whole spectrum of companies from fully state owned to those that are nonstate but maintain close ties to the government. China's state-owned and state-controlled companies and industries are generally the largest ones in China and are operated and managed by the central government of the People's Republic. They are an instrument of state power as well as the centerpiece of China's industrial policy. They receive massive government subsidies and are protected from foreign competition. In addition, there are more than 100,000 smaller companies that are owned or operated by provincial and local governments. These companies also receive many benefits from their government ownership.

Because China's regulatory systems are opaque, it can be difficult to trace the real ownership of any enterprise in China. Though the number of state-owned companies has declined following years of reform and privatization, they continue to dominate major sectors of the economy, and in many sectors they have become stronger. There are also millions of firms whose ownership is unclear. These include enterprises where the state holds some, though not all, assets; joint venture arrangements involving state-owned enterprises (SOEs), private and semiprivate companies and foreign entities; and companies that, while nominally private, are still subject to the influence of the state because they are in the sectors the government has deemed strategically important.

During the 2011 hearing cycle, the Commission undertook a thorough examination of China's industrial policies, particularly the government's control of China's economy. In addition, this section examines the bilateral investment flows between the United States and China, where a new pattern is emerging. Flush with export profits and foreign exchange reserves, China is starting to flex its investor muscles. Though the cumulative Chinese investment in the United States remains very small, recent trends indicate a potential for great growth. This section will examine this and other issues and will conclude with the implications for the United States of the continued dominance of the Chinese economy by the state and of the growth in bilateral investment.

Chinese State-owned Enterprises

In its 2004 Report to Congress, the Commission noted that:

> *China was not a market-based economy at the time of its accession to the WTO [World Trade Organization] nor is it*

now. Because the structures of the WTO rely on the functioning of market-based economies, China's accession required a unique agreement allowing China's early entry in exchange for firm commitments to implement a broad range of legal and regulatory reforms as well as tariff reductions. China also agreed to special safeguard mechanisms that other WTO members could utilize to protect domestic industries significantly injured by surges of imports from China's nonmarket economy. Assuring that China implements its WTO commitments is a large and important task for the U.S. government.[81]

Ten years after joining the WTO, China has taken significant steps toward economic liberalization in order to meet the many obligations it assumed upon accession to the 153-member organization. But the process has reversed in the past five years. Rather than continue along a path of market reforms, Beijing has indicated that it has no intention of giving up direct command over large portions of the economy or of relinquishing its ownership of key industrial, financial, and high-technology sectors. China's approach is particularly apparent in the government's retention of control over a large number of SOEs and other state-favored actors and its strengthening of them through subsidies and other policies to create dominant domestic and global competitors.

The consolidation and concentration of power in a group of 121 very large SOEs represents a reversal of a trend toward reducing government control of the economy and greater market openness that had been the hallmark of China's economic policy since the 1978 reforms of Deng Xiaoping.* Though this shift has been gathering strength for half a decade, it has accelerated as a consequence of China's large-scale stimulus in 2008–2009, which directed massive loans from the state-owned banks to many state-owned companies. In 2009 alone, of the 9.59 trillion renminbi (RMB) ($1.4 trillion) in bank loans, 85 percent were granted to SOEs.[82] Meanwhile, China's less-favored private sector is struggling to compete. The trend has given rise to a catch-phrase among Chinese entrepreneurs: "The state advances, the private [sector] retreats."[83]

In its annual review of China's compliance with its obligations, the WTO reported in 2010 that SOEs have been "benefitting disproportionately from the [g]overnment's recent measures to boost the economy, particularly the economic stimulus. At the same time, domestic private enterprises are finding it more difficult to access credits from banks."[84]

The government also gives SOEs a variety of subsidies and favorable access to credit. The June 2010 *China Quarterly Update* from the World Bank shows SOEs crowding out private enterprises, following the introduction of the economic stimulus, which was heavily weighted toward the construction and infrastructure sectors already dominated by SOEs.[85] By some estimates, local governments established 8,000 state-owned investment companies in 2009 alone

*A list of major companies owned by the central government appears in Addendum I: SASAC [State-owned Assets Supervision and Administration Commission] Companies, Large State-owned Banks, and Insurance Companies (2011).

to take advantage of central government financing for business and industrial deals.[86] The World Bank also noted that a decline of the role of the SOEs in the Chinese economy earlier in the decade has reversed in recent years.[87] Two experts on China's industrial policy, Victor Shih of Northwestern University and Yasheng Huang of the Massachusetts Institute of Technology, have also noted that some of the reforms introduced in the past two decades to promote China's private sector are now being undone by the shift of government support to the state-owned sector.[88]

Overview of the Chinese State-owned Sector

The Chinese government continues to eliminate or consolidate the least profitable SOEs.[89] As a result, the current group of operating SOEs is composed primarily of very large and comparatively more profitable SOEs than in the past.[90] The number of Chinese SOEs, at both the central and provincial levels, has decreased significantly since 2000 as part of a policy to "grasp the big, let go of the small." * The overall effect has been to reduce the number of companies under government control while strengthening the remainder in order to produce global competitors to European-, American-, and Japanese-based multinationals.[91] This goal is part of an effort to create "national champions." The WTO noted in its 2010 *Trade Policy Review of China* that:

> *'guided' by the State Council's Opinions issued in December 2006, SOEs have been retreating from some of the more competitive industries, but remain concentrated in other industries with a state monopoly. . . . The associated monopoly position gives these SOEs competition advantage over private enterprises. Profits of SOEs continued to rise (they increased by 9.8 [percent] in 2009).*[92]

The largest 121 nonfinancial companies owned by the central government[93] are supervised by the government equivalent of a holding company, the State-owned Assets Supervision and Administration Commission (SASAC), which reports to the State Council.† These, however, typically each have dozens of subsidiaries, "including nearly all the Chinese companies most people are familiar with," according to testimony before the Commission by economist Derek Scissors of The Heritage Foundation.[94] There are an additional 114,500 SOEs owned by provincial and municipal governments, according to World Bank estimates.[95] Meanwhile, truly private firms number in the millions, though they are comparatively very small in size. There are also millions of firms whose ownership is unclear.[96]

* The "grasp the big, let go of the small" policy, adopted by the Communist Party Congress in 1997, remains the guiding principle for SOE restructuring. These reforms included efforts to corporatize SOEs and to downsize the state sector. The "grasp the big" component indicated that policymakers should focus on maintaining state control over the largest and most important SOEs, which were typically controlled by the central government. "Let go of the small" meant that the central government should relinquish control over smaller SOEs through a variety of means (e.g., giving local governments authority to restructure the firms, privatizing them, or shutting them down). See Barry Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge, MA: MIT Press, 2007), pp. 301–302.

† The State Council of the People's Republic of China is the chief administrative authority of the People's Republic of China. It is chaired by the premier and includes the heads of each governmental department and agency. For more information, see *People's Daily Online,* "The State Council." *http://english.peopledaily.com.cn/data/organs/statecouncil.shtml.*

How Big Is China's State Sector?

The opaque nature of ownership makes estimating the SOEs' share of China's gross domestic product (GDP) difficult. There is no definitive published value for SOEs. A 2011 study prepared for the Commission has noted that:

> *The Chinese government publishes several statistical measures which can be used to assess the size of state-owned enterprises relative to other forms of ownership according to various dimensions. In many cases, the measures of SOE activity consider only wholly-owned SOEs. That is, these SOE measures do not treat entities in which the state ownership share is less than 100 percent, but greater than 50 percent, as being state-owned. Further, the official estimates often do not track ultimate ownership, thereby ignoring enterprises that are not registered as SOEs or state controlled enterprises even when indirect state ownership is present.* [97]

In other words, in official statistics, the SOE category includes only wholly state-funded firms. This definition excludes shareholding cooperative enterprises, joint-operation enterprises, limited liability corporations, or shareholding corporations whose majority shares are owned by the government, public organizations, or the SOEs themselves.[98] A more encompassing category is "state-owned and state-holding enterprises." This category includes state-owned enterprises plus those firms whose majority shares belong to the government or other SOE.[99] This latter category, also referred to as state-controlled enterprises, can also include firms in which the state- or SOE-owned share is less than 50 percent, as long as the state or SOE has a controlling influence over management and operations.[100]

A 2009 study by the Organization for Economic Cooperation and Development (OECD), using data from 2006, estimated the SOE share of China's gross domestic product (GDP) to be 29.7 percent, implying that the nonstate sector is about 70 percent of the economy.[101] However, this does not mean that the private sector accounts for the remaining 70 percent of China's economy (see box on China's private sector). In his testimony before the Commission, Dr. Scissors suggested that the state sector accounts for 30 to 40 percent of China's economy.[102]

A study prepared for the Commission in 2011, which used various economic measures to estimate the true economic footprint of the Chinese state has concluded that the state's share of the economy exceeds 50 percent:

How Big Is China's State Sector?—*Continued*

The observable SOE sector under reasonable assumptions accounts for nearly 40 percent of China's economy. Given additional information on the prevalence SOE ownership in China's capital markets, anecdotal and observed data on the prevalence of SOE ownership among [limited liability corporations] and other ownership categories, the likely SOE role in round-tripped FDI [foreign direct investment], it is reasonable to conclude that by 2009, nearly half of China's economic output could be attributable to either SOEs, [state-holding enterprises], and other types of enterprises controlled by the SOEs. If the output of urban collective enterprises and the government-run proportion of [township and village enterprises] are considered, the broadly defined state sector likely surpasses 50 percent. [103]

The national or central SOEs can be further categorized. The first major grouping is the SASAC companies, which consist of the companies that provide public goods such as defense, communication, transportation, and utilities; the firms that specialize in natural resources such as oil, minerals, and metals; and the enterprises that concentrate on construction, trade, and other industrial products. The SASAC companies are the largest among these three groupings of national SOEs, despite the fact that the total number of the SASAC companies has fallen significantly over the past few years—from 196 in 2003 (when the SASAC was established) to 121 in 2010—as a result of mergers and acquisitions among themselves intended to enlarge and strengthen several flagship companies. The total assets of the SASAC companies, however, increased from 3 trillion RMB (about $360 billion) in 2003 to 20 trillion RMB (about $2.9 trillion) in 2010.[104] (According to the National Bureau of Statistics of China, in 2003 and 2010, China's GDP was $1.64 trillion and $5.88 trillion, respectively.)

The second grouping includes the companies that specialize in banking, finance (securities), and insurance under the administration of the China Banking Regulatory Commission (CBRC),[105] the China Securities Regulatory Commission (CSRC), and the China Insurance Regulatory Commission (CIRC),[106] respectively.

The third grouping consists primarily of companies specializing in broadcast media, publications, culture, and entertainment. These are administrated by the various agencies under the State Council and national mass organizations such as the All-China Federation of Trade Unions, which is itself controlled by the Chinese Communist Party (CCP).[107]

Most of these large companies are horizontally integrated and engaged in business activities that include more than one industry. Many of them are concentrated in the industries that are largely controlled by the state, but not exclusively.[108] For example, the SASAC reported in 2010 that about 74 percent of the SASAC-run companies are engaged in the real estate business.

In 2010, of 42 mainland Chinese companies listed in the Fortune Global 500, all but three were state owned.[109] By revenues, three Chinese state-owned companies ranked among the top ten in the

Fortune Global 500, compared to just two American companies.[110] China's own list of the 500 biggest Chinese companies showed that among the top 100 firms traded on the stock exchange, the government controlled the majority of the stock in 75.[111]

Chinese SOEs and Government Procurement

The U.S. government has taken the position that China's SOEs as well as provincial and local government agencies should be considered as part of the Chinese government when procurement decisions are being made. China has responded by insisting that central, provincial, and local SOEs, and provincial and local government agencies should not be considered as part of the government under the WTO's Agreement on Government Procurement (GPA). This would allow China to limit foreign companies' access to the lucrative procurement market. A country's accession to the GPA is subject to negotiation between the applicant and GPA members. China's refusal, so far, to include SOEs has been one of the impediments to China's accession to the 40-member GPA, despite China's promise in 2001 that it would sign the GPA "as soon as possible."

By refusing to consider China's state-owned sector as part of the government, China seeks to wall off a large portion of its economy from the GPA rules that members have agreed to abide by. These rules generally ensure foreign companies equitable access to central and local government procurement for goods and services. By seeking to exclude foreign firms from government and SOE contracts, China puts U.S. manufacturers and service providers at a disadvantage.

China's latest offer to join the GPA was issued in July 2010. While the latest offer made certain improvements, there remained significant shortcomings. For example, while the new offer expanded the coverage of central government entities, it still would not cover provincial or local government agencies or SOEs.[112] In 2009, the Chinese government estimated that its procurement market surpassed $100 billion, but this is a significant understatement of its true size. For example, the Chinese Ministry of Finance's limited definition of government procurement spending does not include most government infrastructure projects, and procurement by SOEs is not included, even when SOEs perform government functions.[113] Factoring in all of these considerations, the European Union Chamber of Commerce in China estimates the size of China's government procurement market at $1 trillion.[114]

Chinese SOEs and Government Procurement—*Continued*

The issue of Chinese SOE procurement is further complicated by the fact that projects undertaken by SOEs fall under the China Bidding Law rather than China's government procurement law, notes Gilbert Van Kerckhove, chairman of the Public Procurement Working Group of the European Chamber of Commerce. The China Bidding Law covers construction projects in China, including surveying and prospecting, design, engineering, and supervision of such projects, as well as procurement of major equipment and materials related to the construction of such projects—in other words, all projects, massive in scope and value, that are of significant interest to foreign companies.[115]

Membership in the WTO Agreement on Government Procurement is voluntary; a country can be a WTO member without ever acceding to the agreement. Until China signs the agreement, it is not a WTO violation for China to discriminate against foreign goods or services in its government procurement nor for other WTO members to discriminate against Chinese goods and services in their government purchases.

The Chinese state-owned sector derives important advantages from its government affiliations. China's largest banks are state owned and are required by the central government to make loans to state-owned companies at below market interest rates and, in some cases, to forgive those loans. Dr. Scissors testified at the Commission's March 30, 2011, hearing that every aspect of the financial system is dominated by the state:

> *All large financial institutions are state-owned, the People's Bank assigns loan quotas every year, and, within these quotas, lending is directed according to state priorities. Interest rates are also controlled, and last year real borrowing costs were barely above zero. Conveniently, then, loan quotas and bank practices strongly inhibit nonstate borrowing. Securities markets are also dominated by the state. As an illustration, the volume of government bond issuance utterly dwarfs corporate bonds and is growing relentlessly, crowding out private firms.*[116]

According to a 2011 study by the Beijing think tank Unirule Institute of Economics, the profits of state-owned industrial companies had increased nearly fourfold between 2001 and 2009, but their average return on equity was less than 8.2 percent, versus 12.9 percent for larger, nonstate industrial enterprises.[117] As more evidence that SOEs enjoy special advantages over private sector companies, Unirule found that the average annual interest rates charged to SOEs were 1.6 percent from 2001 to 2008, while those charged to private companies during the same period were 5.4 percent.[118] During that period, according to the report, subsidies to SOEs amounted to 6 trillion RMB—more than the profits generated by the companies. A 2009 study on Chinese subsidies prepared for the Commission likewise concluded that state-owned companies are less profitable, after adjusting for the cost of subsidies.[119]

Low interest loans, debt forgiveness, and access to credit are among the methods the government uses to subsidize its business sector.[120] Some of the other subsidies, frequently administered through the provincial and municipal governments, include regulatory barriers to competitor entry, special treatment from regulatory compliance monitors,[121] tax breaks,[122] preference in land allocation,[123] bankruptcy alternatives,[124] and de facto debt forgiveness.[125]

State Control vs. Private Control

The extent of the state's control of the Chinese economy is difficult to quantify. In addition to the companies held directly by the central government or local government (see above), there are a variety of enterprises whose ownership is unclear. A common mistake is to assume that any entity that is not an SOE belongs to the private sector.[126] In reality, the nonstate sector includes firms with other forms of ownership, including purely private ownership by domestic and foreign actors and mixed ownership entities in which SOEs are part owners and/or controlling owners.[127] There is also a category of companies that, though claiming to be private, are subject to state influence. Such companies are often in new markets with no established SOE leaders and enjoy favorable government policies that support their development while posing obstacles to foreign competition. Examples include Chinese telecoms giant Huawei and such automotive companies as battery maker BYD and vehicle manufacturers Geely and Chery.[128]

A Private Sector with Chinese Characteristics

China's National Bureau of Statistics defines private enterprises as "economic units invested or controlled (by holding the majority of the shares) by natural persons who hire laborers for profit-making activities."[129] Included in this category are private limited liability corporations, private share-holding corporations, private partnership enterprises, and private sole investment enterprises. Estimating the contribution of the private sector to China's economy is hampered by the same data problems affecting the state-controlled sector. The difficulty stems, too, from the fact that much of China's private sector is informal and exists in the gray area of mom-and-pop shops and subcontracting factories with ambiguous legal standing.

Some estimates are available, however. According to a 2011 China Europe International Business School study, China has 8.4 million private enterprises, accounting for 74 percent of the country's total number of firms.[130] A 2011 study on the Chinese state-owned sector prepared for the Commission had several estimates of the size of China's private sector (from 20 percent to 38.5 percent of the economy), based on various alterative indicators, including gross output value and fixed-asset investment.[131]

A Private Sector with Chinese Characteristics—*Continued*

Regardless of the total number of private enterprises, the state-owned or -controlled sector still dwarfs the private sector in size, with the average listed private company generating only about 25 percent of the total net profit of an average listed state-owned firm.[132] The rest of the economy is characterized by mixed and joint ownership arrangements and involves Chinese state-owned and private firms, as well as foreign enterprises. Even the firms that appear to be fully private, however, still are frequently subject to state interference.

In the mid-2000s, after more than 30 years of opening up the economy to private enterprise, the Chinese government reversed the policy, and the state began to reassert its economic control. In December 2006, the SASAC and China's State Council jointly announced the "Guiding Opinion on Promoting the Adjustment of State-Owned Capital and the Reorganization of State-Owned Enterprises." The guiding opinion identifies seven "strategic industries" in which the state must maintain "absolute control through dominant state-owned enterprises" and five "heavyweight" industries in which the state will remain heavily involved (see the box below).[133]

Industries that the Chinese Government Has Identified as "Strategic" and "Heavyweight"

Strategic Industries:	**Heavyweight Industries:**
1) Armaments	1) Machinery
2) Power Generation and Distribution	2) Automobiles
3) Oil and Petrochemicals	3) Information Technology
4) Telecommunications	4) Construction
5) Coal	5) Iron, Steel, and Nonferrous Metals
6) Civil Aviation	
7) Shipping	

This list "omits state dominance in banking, insurance, and the rest of finance, media, tobacco, and railways," which had long been owned by the government in China.[134]

Although the state's share of the economy has fallen since the start of the reforms, the government has kept these key industries for SOEs. The turn away from privatization was codified in 2011 by Wu Bangguo, chairman and CCP secretary of the Standing Committee of the National People's Congress, when he listed privatization with other intolerable developments:

> *We have made a solemn declaration that we will not employ a system of multiple parties holding office in rotation; diversify our guiding thought; separate executive, legislative and judicial powers; use a bicameral or federal system; or* carry out privatization *[emphasis added].* [135]

Foreign companies are not allowed to participate in the markets reserved for strategic industries and are heavily regulated in those designated for the heavyweight industries. "The requirement that the state predominate in so many sectors is meant to sharply confine competition, so that SOEs operate within markets but they operate primarily within state-controlled markets," said Dr. Scissors at a Commission hearing. "This regulatory protection is the most powerful subsidy many SOEs receive." [136]

Under the "grasp the big, let go of the small" policy, scores of state companies have listed their shares on foreign stock exchanges, while the Chinese government has kept about 70 percent to 80 percent of the equity in its own hands (see Addendum I for a list of the central Chinese SOEs). Many foreign observers "often mistook these sales of minority stakes to be privatization," because they assumed that the listing covered the entire ownership of the company. But the ultimate control remained in the hands of the state.[137] In addition, many companies in China whose stocks are traded on China's exchanges are also SOEs in which the government keeps a majority stake. By offering only a limited portion of ownership of an SOE on domestic exchanges, the Chinese government is able to raise capital and still maintain control of the firm. As Dr. Scissors testified before the Commission:

> *Neither specification of share-holders nor sale of stock by itself does anything to alter state control. The large majority of firms listed on domestic stock markets are specifically designated as state-owned. The sale of small minority stakes on foreign exchanges could be construed as recasting mainstays such as CNPC [China National Petroleum Corporation] (through its list vehicle PetroChina), China Mobile, and Chinalco as nonstate entities of some form. However, they are still centrally directed SOEs, as explicitly indicated by the Chinese government.*[138]

Moreover, the biggest private companies often get their financing from state banks and coordinate their investments with the government.[139]

Some analysts now believe that many of the early Chinese market liberalization reforms are being reversed. Zhiwu Chen of Yale University said during a presentation at The Brookings Institution that SOEs are crowding out private firms from various industries.[140] "The problem is that the reforms of the first 20 years, from 1978 to the end of the '90s, actually did not touch on the power of the government," said Yao Yang, a Peking University professor who heads the China Center for Economic Research. "So after the other reforms were finished, you actually find the government is expanding, because there is no check and balance on its power." [141]

Political Power of the State-owned Company Sector

While provincial chiefs, cabinet ministers, and military leaders constitute the bulk of the Chinese Communist Party, SOEs are an increasingly significant cultivating ground for party leadership. There are currently 17 prominent political leaders who have held management positions in large SOEs, and 27 prominent business leaders currently serve on the 17th CCP Central Committee or the Central Commission of Discipline Inspection.[142]

Political Power of the State-owned Company Sector—*Continued*

The most recent manifestation of this trend came with the announcement, in March 2011, that China Petroleum and Chemical Corporation (Sinopec) Chairman Su Shulin was set to become the next governor of Fujian Province. The *Financial Times* noted that "China's oil companies have been a breeding ground for state leaders, including current security chief Zhou Yongkang, formerly at CNPC. It is not uncommon for the heads of major Chinese state-owned companies to move in and out of government, and the role of energy companies underscores the role that China's state-owned oil companies play in national security." [143]

According to Cheng Li, senior fellow at The Brookings Institution, while the proportion of China's large enterprises in the national leadership is still relatively small, the rise of state entrepreneurs may broaden the "channel of political recruitment" in China and become a new source of the CCP leadership.[144]

U.S. Investment in China

Over the past three decades, China has been the largest recipient among developing countries of FDI,* with a cumulative $854 billion (stock)† by 2008. In just 2010 alone, the amount of FDI flowing into China jumped to $105.7 billion, up from $90 billion in 2009.[145] "In the modern history of economic development, no other country has ever benefitted, and continues to benefit, from FDI as much as China," notes a study by Yuqing Xing of the National Graduate Institute for Policy Studies in Tokyo.[146] The study estimates that "foreign-invested firms have been the major contributor to [China's] drastic export expansion" and have accounted for 40 percent of China's GDP since 1978.[147] "It is the technologies, product designs, brand names and distribution networks of multinational enterprises that have removed hurdles to made-in-China products, helped these products enter the world market, and strengthened the competitiveness of Chinese exports," notes Dr. Xing's study.[148]

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* FDI is investment to acquire a "long-term relationship and reflecting a lasting interest and control" in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. There are two types of FDI: inward FDI and outward FDI, resulting in a *net* FDI *inflow* (positive or negative) and stock of FDI, which is the cumulative number for a given period. FDI excludes most portfolio investment, which is usually investment through the purchase of shares of an insufficient number to allow control of the company or its board of directors. A foreign direct investor may acquire voting power or control of an enterprise through several methods: by incorporating a wholly owned subsidiary or company (e.g., a "greenfield" investment); by acquiring shares in an associated enterprise; through a merger or an acquisition of an unrelated enterprise; or by participating in an equity joint venture with another investor or enterprise. For more information, see UNCTAD [United Nations Conference on Trade and Development], *World Investment Report 2010: Investing in a Low Carbon Economy* "Methodological Note" (New York and Geneva: United Nations, 2010); and World Bank, "Foreign Direct Investment." *http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD.*

† FDI stock is the cumulative value of the capital and reserves attributable to the parent enterprise (the investor). FDI flows comprise capital provided by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign direct investor (these data are commonly compiled for a given period, usually per annum). For details, see UNCTAD [United Nations Conference on Trade and Development], *World Investment Report 2010: Investing in a Low Carbon Economy* "Methodological Note" (New York and Geneva: United Nations, 2010). *http://www.unctad.org/en/docs/wir2010meth_en.pdf.*

The largest FDI to mainland China flows through or from Hong Kong, with $67.5 billion in 2010, according to official Chinese statistics. This represents more than half of the total FDI inflows in 2010. The Ministry of Commerce of the People's Republic of China reported that in 2010 the United States came in fifth among nations investing directly in China, with $4.1 billion, which represents only 3.8 percent of total inflows.[149] In recent years, tax haven economies such as the Virgin Islands and the Cayman Islands have become more and more prominent as sources of FDI into China, although they are not believed to be the source of the actual investment. The large proportion of FDI flowing into China from Hong Kong and other tax havens can be attributed to round-tripping, the practice of taking money out of China and then "investing" it back as new investment in order to qualify for special tax breaks and other incentives reserved for foreign investment.[150]

Table 1: U.S. FDI to China, 2000–2010
(U.S. $ million)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Flow	1,817	1,912	875	1,273	4,499	1,955	4,226	5,243	15,971	-7,853	$9,565
Stock	11,140	12,081	10,570	11,261	17,616	19,016	26,459	29,710	52,521	49,403	60,452

Source: U.S. Bureau of Economic Analysis, *U.S. Direct Investment Abroad: Balance of Payments and Direct Investment Position Data* (various years) (Washington, DC: U.S. Department of Commerce).

Official U.S. statistics show that U.S. cumulative FDI in China was $60.5 billion in 2010 (stock), a 22 percent increase from 2009 (see table 1, above).[151] This represents only 1.7 percent of the total U.S. FDI abroad. Of the U.S. FDI in China, the bulk was in manufacturing, with 48.8 percent in 2010 (for a complete breakdown of U.S. FDI in China by Industry, see Addendum II). As with other statistics, the official U.S. and Chinese figures on U.S. investment in China do not match; the situation is similar for official statistics on Chinese FDI in the United States (see below). According to the U.S. Commerce Department's Bureau of Economic Analysis, U.S. majority-owned nonbank affiliates in China employed 774,000 workers in China in 2008 (latest figures available).[152] A significant number of people are also employed by joint ventures formed by U.S. companies with Chinese partners, though those figures are difficult to track.

The relative amount that Americans contributed to the Chinese pool of direct investment is not immediately clear from the raw statistics. The United States was an early investor in China, so its investment, still registered as book value, has had more time to appreciate in value. In addition, U.S. companies often reinvest profits in productive capacity in China, which does not show up in the statistics as FDI. The comparatively small size of U.S. investment flows to China can also be explained, in part, by the routing of investment by unnamed investors to China through Hong Kong and various tax havens (e.g., the British Virgin Islands, the Cayman Islands, etc.). These nations consistently appear among the top ten investors in China, but they are not the original source of the funds.

Some of the reinvestment of the profits of U.S.-based multinational companies in China is likely done to avoid paying U.S.

corporate income taxes, which come due when a U.S.-based multinational corporation repatriates the profits to the United States. U.S. companies invested abroad face a 35 percent tax rate, one of the world's highest, should they decide to repatriate profits to America. Keeping the money abroad allows a U.S.-based company to avoid the higher U.S. corporate rates. If these funds are reinvested in plant and equipment in China, they face lower rates and, often, additional tax breaks that the Chinese government offers to encourage foreign investment in China. Foreign investment in technology in particular receives special benefits. Such benefits include exemptions from taxes if qualified foreign technology is transferred to China, and a 150 percent tax deduction for foreigners making qualified research and development expenditures in China.[153]

Chinese Government Tax Incentives for Foreign Investment in China

Prior to 2008, profits of foreign investors in China were taxed at a 15 percent rate, while domestic investors faced a statutory income tax rate of 33 percent.[154] This disparity was eliminated with the implementation of China's 2008 Enterprise Income Tax Law, which saw tax rates unified at 25 percent in 2008. However, existing foreign investors were "grandfathered" in and will continue to receive preferential tax rates until 2012.[155] Many other incentives remain:

- Income from cultivating basic crops and agricultural products (including grain, vegetables, and natural Chinese medicines), animal husbandry, and certain fishery operations is exempt from the Enterprise Income Tax. Income from planting flowers, tea, other beverage crops and spice crops, seawater fish farming, and fresh water fish farming enjoys a 50 percent reduction in the Enterprise Income Tax rate.
- Preferential tax treatment for income earned by enterprises from transfers of technology is extended to foreign-invested enterprises. Specifically, the first 5 million RMB of income earned in a taxable year from transferring ownership of technology is exempted from the Enterprise Income Tax, and any excess amount is allowed to be taxed at one-half the normal 25 percent rate. The preferential tax rate of 15 percent applicable to eligible "high and new technology" enterprises is retained, but only if they receive priority support from the state and possess substantial or key ownership of core proprietary intellectual property rights.
- Enterprises are entitled to an extra income tax deduction of up to 100 percent of the current year's wages paid to disabled employees or other employees whom the state encourages enterprises to hire.

Chinese Government Tax Incentives for Foreign Investment in China—*Continued*

- Additional preferential tax treatment is granted to venture capital enterprises investing in medium- and small-sized high-technology enterprises (a deduction of 70 percent of the total investment is allowed against an enterprise's annual taxable income in the year after its initial two-year holding period) and to enterprises that utilize resources in an environmentally friendly and health-conscious way.

The pre-2008 system providing a host of preferential tax rates for qualified foreign-invested enterprises located in special zones and regions is abolished, with limited exceptions. One special dispensation is that enterprises located in more remote areas where the state has encouraged development (the Western Development Region) seemingly will continue to enjoy concessionary tax rates.[156]

According to the U.S. Trade Representative's (USTR) *2010 Report to Congress on China's WTO Compliance,* certain aspects of China's taxation system have raised national treatment concerns. China has used its taxation system to discriminate against imports in certain sectors (although the issue of discriminatory value-added tax (VAT) rates applied to imports of integrated circuits was resolved in 2004, others, like VAT policies to benefit domestic Chinese producers of fertilizer, remain).[157] U.S. industries continue to express concerns over the unfair operation of China's VAT system, which includes irregular VAT rebates for Chinese producers in favored sectors.

Foreign-invested enterprises (both joint ventures and wholly owned subsidiaries) were responsible for 55 percent of China's exports and 68 percent of its trade surplus in 2010.[158] Bureau of Economic Analysis estimates show that U.S. investment in China was responsible for 0.6 percentage points of the 9.6 percent increase in Chinese GDP in 2008.[159] Commission witness K.C. Fung estimated that in 2009, the rate of return on U.S. FDI abroad to all destinations was 9.7 percent, while the rate of return on investment for U.S. multinationals in China was 13.5 percent.[160]

China's Investment Regime for Foreign Firms

U.S. trade officials and business associations have long urged China to liberalize its investment restrictions, but Chinese officials have resisted. While some Chinese industries have become open to foreign investment and sales, huge swathes of the economy, such as construction and telecommunications, are reserved for Chinese firms, both state owned and private. Various government interventions, like "indigenous innovation" policies and catalogues guiding government and state-owned company procurement officers to domestically produced goods and services are used to discriminate against foreign competitors (for more on indigenous innovation, see chap. 1, sec. 3, of this Report). The American Chamber of Commerce in China's *2011 Business Climate Survey* complained of "regulatory obstacles that give local firms a competitive advantage."[161]

Addressing complaints about China's backtracking on promises to make its economy friendlier to foreign companies, Gary Locke, then U.S. Department of Commerce secretary and currently U.S. ambassador to China, said that U.S. firms are frequently shut out of the Chinese market or forced to share technologies to gain access.[162] Ambassador Locke said the "fundamental problem boils down to the distance between the promises of China's government and action." [163]

Over the last several years, the Chinese government has created new policies and government bodies to guide foreign investment and safeguard the domestic economy and national security in the face of FDI inflows:

The 2011 Catalogue Guiding Foreign Investment in Industry: The draft *2011 Catalogue Guiding Foreign Investment in Industry* identifies sectors and industries of the Chinese economy in which foreign investment is encouraged, restricted, or prohibited.[164] An update of the catalogue published in 2007, the *2011 Catalogue* is focused on encouraging foreign investment in industries related to China's goal of developing cutting-edge industries with higher-value-added ones, including sophisticated manufacturing, new technologies, and clean energy.[165] Book, newspaper publishing, audiovisual products, and "Internet culture businesses" (excluding music) are among those that will remain off-limits to foreign investment.[166] The U.S. Chamber of Commerce and the American Chamber of Commerce in China called China's use of catalogues to guide foreign investment "at odds with the ... principles of open and market-based economies."[167]

National Security Review Process: The State Council promulgated the *Notice of the General Office of the State Council on Establishment of a Security Review System for the Merger and Acquisition of Domestic Enterprises by Foreign Investors* (Notice) in February 2011. The following month, China's Ministry of Commerce issued interim provisions for implementing the notice.[168] The new foreign-investment security review regime sets up an interministerial panel under the State Council. The National Development and Reform Commission and the Ministry of Commerce are assigned lead roles in coordinating the ministries and agencies that would review proposed transactions.[169] Transactions in the following sectors or areas could be subject to review if they lead to foreign investors obtaining "actual control" of a domestic enterprise: military and military support enterprises; enterprises near key and/or sensitive military facilities; other entities associated with national defense and security; and domestic enterprises in sectors that "relate to national security," which are listed as "important" agriculture products, energy and resources, infrastructure, and transportation services, as well as key technologies and major equipment manufacturing industries.[170] A final rule published in August 2011 by China's Ministry of Commerce clarified certain aspects of the security review system but still utilized a broad definition of national security and provided little guidance in assessing whether a transaction could be subject to a review.[171]

The United States and China currently are negotiating a bilateral investment treaty with the goal of expanding investment opportunities. Supporters of the treaty hope it will improve the investment climate for U.S. firms in China by strengthening legal protections and dispute resolution procedures and by obtaining a commitment from the Chinese government to treat U.S. investors the same as Chinese investors. However, some U.S. groups have expressed reservations concerning a U.S.-China bilateral investment treaty, arguing that it will encourage U.S. firms to relocate to China.[172] Some also have raised questions about the treatment of the trade, investment, and competition issues posed by state capitalism. (For more information on the debate surrounding the U.S.-China bilateral investment treaty, see the report on "Evaluating a Potential U.S.-China Bilateral Investment Treaty," prepared for the Commission by the Economist Intelligence Unit.[173])

Chinese Investment in the United States

Chinese investment in the United States deviates from the patterns in other countries where China concentrates more heavily on securing natural resources. In the United States, Chinese investments have focused on manufacturing and technology and are also notable for their emphasis on brand acquisition.[174] China does not have to spend decades building up brand names, because it can acquire existing well-known brands through government-funded firms. For example, Geely Automotive, one of China's biggest automotive companies, acquired Ford Motor's Volvo unit in 2010 in a $1.8 billion deal.[175] A deal in 2009 involved Beijing Automotive Industry Holding Co, China's fifth-biggest automaker, acquiring the rights to three vehicle platforms from General Motor's Saab unit.[176] As in the natural resource sector (attempted acquisitions of Unocal and Rio Tinto are good examples), concerns over the involvement of the Chinese government can lead to failed transactions: In February 2011, the Committee on Foreign Investment in the United States (CFIUS) ruled that Huawei Technologies would have to divest its investment in 3Leaf Systems because of national security concerns about Huawei's ties to the Chinese government and military and the security implications of integrating their equipment into critical U.S. telecommunications infrastructure.[177]

Chinese government policies encouraging outward foreign direct investment are far more recent than those encouraging foreign investment in China. In its Tenth Five-Year Plan (2001–2005), the Chinese government in 2001 officially adopted a policy encouraging Chinese companies to invest abroad.[178] This "going out" policy has started to show results, although outward investment still pales in comparison to inward investment. According to the latest available Chinese government statistics, outward investment in 2010 amounted to $68.8 billion (an increase of 21.7 percent year on year), with the total accumulation at that time at $317.2 billion.[179] Chinese companies have made major acquisitions of mining and other natural resource companies in Australia, Canada, South America, and Africa, while Chinese brands like Haier (home appliances), Huawei (telecommunications), and Lenovo (personal computers) are seeking to tap global markets, in part through direct investment abroad.[180]

Table 2: China's Foreign Direct Investment in the United States, 2003–2010 (U.S. $ million)

	2003	2004	2005	2006	2007	2008	2009	2010
Flow	65.05	119.93	231.82	198.34	195.73	462.03	908.74	1308.29
Stock	502.32	665.20	822.68	1,237.87	1,880.53	2,389.90	3,338.42	4,873.99

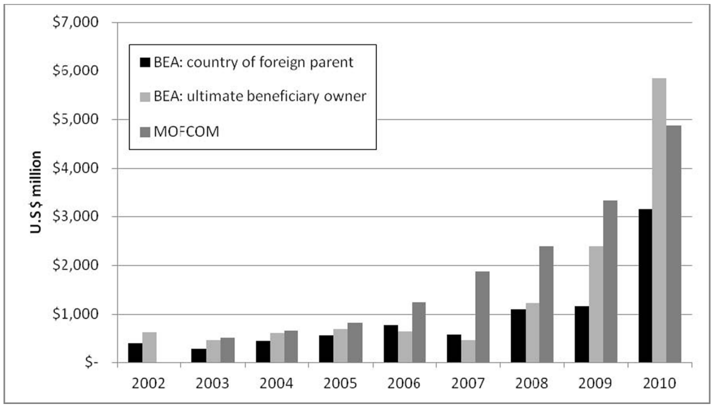
Source: Ministry of Commerce of the People's Republic of China, *2010 Statistical Bulletin of China's Outward Foreign Direct Investment* (Beijing, China: 2011).

Chinese overall nonbond investment has been very limited in the United States to date. China's Ministry of Commerce estimated that in 2010, cumulative Chinese FDI in the United States was $4.9 billion (see table 2, above). According to the U.S. Bureau of Economic Analysis, the cumulative level of Chinese FDI in the United States through the end of 2010 was $3.2 billion on a historical-cost (or book value) basis. According to the bureau, in 2009, China ranked as the 34th largest source of cumulative FDI in the United States. By comparison, China's investments in U.S. Treasury securities were an estimated $1.2 trillion by July 2011, making China the biggest foreign holder.[181]

Several analysts note that China often uses offshore locations (such as Hong Kong or tax havens) to invest in other countries. China also uses London exchanges to buy U.S. Treasuries, in which case the investment is registered as being from the United Kingdom. The Bureau of Economic Analysis also reports cumulative FDI data according to the country of ultimate beneficial owner, which puts Chinese FDI in the United States through 2010 at $5.9 billion (see figure 1, below).*

*The Bureau of Economic Analysis tracks geographic distribution of FDI in two forms: country of direct foreign parent, which attributes each investment to the direct parent company, and country of ultimate beneficiary owner, which tracks the investment to the country of the ultimate owner. The latter method generally is considered more accurate, as a large share of FDI transactions today are conducted through special-purpose vehicles in third countries. In this case, the $5.9 billion figure represents the Chinese FDI in the United States in 2010 on the ultimate beneficiary owner basis. On the country of foreign parent basis, the cumulative Chinese FDI in the United States was $3.2 billion by the end of 2010. For further information, see Daniel H. Rosen and Thilo Hanemann, *An American Open Door? Maximizing the Benefits of Chinese Foreign Direct Investment* (New York, NY: Asia Society Special Report, May 2011), pp. 81–88. For data, see U.S. Bureau of Economic Analysis, "Historical-Cost Foreign Direct Investment Position in the United States and Income Without Current-Cost Adjustment, by Country of Foreign-Parent-Group Member and of the Ultimate Beneficial Owner, 2002–2010" (Washington, DC: U.S. Department of Commerce). *http://www.bea.gov/international/di1fdibal.htm.*

Figure 1: Chinese FDI Stock in the United States, 2002–2010 (U.S. $ million; various official measures)



Source: U.S. Bureau of Economic Analysis; and Ministry of Commerce of the People's Republic of China [MOFCOM], *2010 Statistical Bulletin of China's Outward Foreign Direct Investment* (Beijing, China: 2011).

Despite China's substantial purchases of U.S. Treasury securities, China's role as a direct investor in the United States remains marginal. China's FDI stock of $5.9 billion in 2010 (using the ultimate beneficiary owner figures) accounted for a mere 0.25 percent of total foreign investment in the United States (it is also lower than investment stock of other developing countries such as Brazil and India).[182]

There are indications that outward foreign direct investment from China is on the increase. Stock of Chinese FDI in the United States grew from $1.2 billion in 2008 to $5.9 billion (on the ultimate beneficial owner basis) in 2010, an increase of almost 400 percent.[183]

Chinese Foreign Exchange Reserves

Over the last several decades, China has accumulated an enormous stockpile of foreign exchange reserves, around $3.2 trillion by September 2011. To date, the vast majority of these reserves, managed by the State Administration for Foreign Exchange, has been invested in U.S. Treasury securities. However, China has shown interest in diversifying its reserves by moving some of its foreign exchange out of U.S. debt securities and into higher-yield investments.

Chinese Foreign Exchange Reserves—*Continued*

China's official holdings of U.S. Treasury securities amounted to around $1.2 trillion by July 2011[184] and far eclipse China's cumulative global outward FDI, which was around $317.2 billion in 2010 (the latest figures available). For the purpose of comparison, Chinese holdings of U.S. Treasury securities at the time were $1.1 trillion. China's official holdings of U.S. Treasuries are likely underreported, because China purchases many of its U.S. bonds through third parties, and those securities are registered to the location of purchase rather than the eventual owner.

To manage and diversify China's foreign exchange reserves beyond the traditional investment in U.S. Treasuries, in 2007 the Chinese government established the China Investment Corporation (CIC).[185] Although CIC endured some criticism over its performance after investing all of its initial $200 billion (some of which resulted in paper losses during the global financial crisis), Chinese Vice Premier Li Keqiang endorsed CIC's role in diversifying China's foreign exchange reserves.[186] According to the latest financial reports available, CIC had total assets of $332 billion at the end of 2009 and is one of the biggest sovereign wealth funds in the world.

In addition to China's FDI in the United States and its holdings in U.S. Treasury securities, China (as of June 2010) held $127 billion in U.S. equities, up from $3 billion in June 2005. It also held $360 billion in U.S. agency securities, principally those of Fannie Mae and Freddie Mac.[187]

The Role of SOEs in China's Outward FDI

SOEs in the energy, raw materials, and metals sectors have been major participants in the "going-out" strategy.[188] In other sectors, non-SOEs, such as Haier and Lenovo, have also been active in the international mergers and acquisitions market.[189] Dr. Scissors of The Heritage Foundation says that SOE involvement in the "going-out" strategy is "utterly dominant," noting that four state entities "alone account for half of all Chinese investment" (see table 3, below).[190]

Table 3: Top Global Investments by Chinese SOEs[191]

Entity	**Global Investment (U.S. $ billion)**
CNPC	$34.48
Sinopec	32.21
China Investment Corporation (CIC)	25.67
Chinalco (Aluminum Corporation of China)	20.62
Subtotal	**112.98**
Chinese total FDI since 2005	**$215.9**

According to China's Ministry of Commerce, in 2009, SOEs provided about $38.2 billion (67.6 percent) of China's cumulative FDI abroad.[192] This is attributable to the head start SOEs had in getting approval to invest abroad in the past and the dominance of SOEs in natural resource acquisition deals.[193] These natural resource investors, however, are less involved in China's U.S. investment. Daniel Rosen and Thilo Hanemann of the Rhodium Group concluded in their research that between 2003 and 2010, 74 percent of the number of investment deals originated from private firms (which the authors define as having 80 percent or greater nongovernment ownership).[194] However, in terms of total deal value, the picture is reversed: SOEs account for 65 percent of the total.[195]

National Security Issues Related to Chinese Investment in the United States

The close ties between the Chinese government and Chinese corporations are relevant to Chinese companies' attempts to provide critical infrastructure to the U.S. government or to acquire U.S. firms that either perform work for the U.S. government or defense contractors that have intellectual property that would pose a national security risk if obtained by a foreign government. "The real concern—and it has to be case by case—is that many of these companies are so closely intertwined with the government of China that it is hard to see where the company stops and the country begins, and vice versa," Democratic Senator Jack Reed (D–RI) has noted.[196] Investigating the national security implications of mergers and acquisitions falls to CFIUS. Among other issues, CFIUS considers two elements when evaluating whether an investment warrants an investigation: (1) whether there is state control of the acquiring foreign company, and (2) whether the transaction could affect U.S. national security.[197]

For China, the question of state control can be particularly complicated, because the government's role is not always straightforward or disclosed. Despite economic reforms and moves toward privatization, much of the Chinese economy remains under the ownership or control of various parts of the Chinese government. In addition to outright ownership or direct control, the government or the Communist Party can also exert control by deciding the composition of corporate boards and the corporation's management team.[198] To some analysts, these questions are beside the point: Mr. Rosen told the Commission at its March 30 hearing that all Chinese companies were under the influence of Chinese government "to a greater extent than firms are here." [199]

In fact, the United States is relatively open to FDI, although some high-profile Chinese acquisition attempts have raised objections that have led to some investments being blocked or dropped. Most notable were the proposed investments by China National Offshore Oil Corporation (CNOOC) and two deals by Huawei (a bid for 3COM and for 3Leaf).

Despite some failures, recent investments, especially greenfield investments (new ventures), have been made without significant opposition. In many cases, such deals have benefitted from state and local government investment incentives.[200] For example, Tianjin Pipe is currently building a $1 billion steel pipe mill near Corpus Christi, Texas, benefitting from a variety of state and local incentives, including employment-based incentives, tax abatement, job training, and infrastructure.[201] A Suntech Power solar panel assembly plant was approved to operate in Arizona, which was attractive to the company because of the state's tax incentives to encourage renewables manufacturing in the state.[202] Late last year, state-owned China Huaneng Group Corp. agreed to buy a 50 percent stake in Massachusetts-based electric utility InterGen for $1.2 billion in cash. CNOOC came back to the United States in recent months as well, with joint venture investments in Chesapeake Energy Corp. shale projects.[203]

In response to CFIUS blocking some high-profile deals by Chinese firms, Chinese officials have called U.S. investment policies "protectionist." In his testimony before the Commission, Mr. Rosen criticized what he views as a U.S. loss of control over the narrative concerning American openness to Chinese investment:

> *Two years in a row of more than 100 percent year-on-year growth in Chinese investment, large Chinese investments across 16 U.S. industries, the story ought to be, 'my God, the United States is open to Chinese investment; we don't screw around with this the way some other countries do.' Instead, the narrative in China and here is why is the United States refusing to open up to Chinese investors, and what are we going to do to guarantee our friends in Beijing that we're going to play fair? It's just absurd, I think, that we've allowed the narrative to be lost in the way we have.*[204]

Implications for the United States

During the 2008 financial crisis, China's leaders reaffirmed their approach to economic management in which private capitalism plays only a supporting role.[205] "The socialist system's advantages," Prime Minister Wen Jiabao said in a March 2010 address, "enable us to make decisions efficiently, organize effectively, and concentrate resources to accomplish large undertakings."[206]

This approach by one of America's largest trading partners carries negative consequences for U.S. economic interests. Subsidies in China can easily overcome the actual and comparative advantages of their trading partners. A country following free market principles can lose companies, product lines, and entire industries if its private sector economy is forced to compete with a foreign government that can sustain continued financial losses. That is why the WTO discourages and, in some cases, prohibits subsidies to exporting industries. Moreover, notification of subsidies is required under the WTO rules, but since its WTO accession in 2001, China has done so only once, in 2006, and the list was judged by China's trade partners to be incomplete. In 2011, the Office of the U.S. Trade Representative submitted a notification to the WTO identifying nearly 200 Chinese subsidy programs, which China failed to notify.[207]

An assessment of Chinese subsidies prepared for the Commission concluded that "eliminating Chinese subsidies would increase U.S. output, exports, worker earnings and economic welfare." The study further noted that "the stagnant level of equipment stock of U.S.

manufacturers, rising U.S. capital expenditures in China and the rapid expansion of imports from China suggest that Chinese subsidies have been diverting equipment investments from the United States to China, or otherwise limiting U.S. manufacturing investments ... reversing this pattern would have a beneficial effect on U.S. manufacturers that compete with Chinese firms, and on the overall U.S. economy." [208]

SOEs have distinct advantages when competing internationally and within their home market. In addition to several varieties of subsidies that SOEs enjoy, Chinese companies benefit from government regulations that aid them to the detriment of foreign competition. Dr. Scissors testified on March 30 that "in most sectors, there is no market of 1.3 billion. Instead, there is what is left after the SOEs are handed the bulk. This applies, of course, to American companies looking to serve the Chinese market." [209]

The competitive challenge that SOEs pose for U.S. companies may soon intensify. The U.S.-China Business Council's 2010 report on company priorities named competition with SOEs as one of the top three concerns for its members in China.[210] The Obama Administration has also raised the issue of the effect on fair competition of Chinese government support provided to its state-owned enterprises. At the May 2011 Strategic and Economic Dialogue talks in Washington, the U.S. Treasury Department noted that:

> *China and the United States discussed the principle of equivalent treatment for state-owned, controlled, or invested enterprises (SOEs), private enterprises, and foreign enterprises with respect to access to credit, tax treatment, regulatory applicability, and access to factors of production. The two countries also discussed the desirability of ensuring that SOEs seek a commercial rate of return and steadily increase their dividend payout.*[211]

However, there were no formal commitments on the part of the Chinese government to stop or decrease subsidies to the state-owned or -controlled sector.

On the investment side, opinions vary on the net benefits of U.S. investment in China and Chinese investment in the United States. Many U.S. analysts contend that greater Chinese FDI in the United States, especially in greenfield projects that manufacture products or provide services in the United States, will create new jobs for U.S. workers.[212] At a discussion hosted by the Woodrow Wilson Center, Daniel Rosen and Derek Scissors agreed that Chinese FDI is a positive for the U.S. economy but differed sharply in their opinions about the appropriate U.S. policy response to these investment inflows. While Mr. Rosen discouraged strengthening policy impediments to Chinese FDI and lauded traditional U.S. economic openness, Dr. Scissors characterized U.S. market access as a powerful bargaining chip for encouraging reform within Chinese economic policy.[213]

Some critics of China's current FDI policies and practices contend that they are largely focused on acquiring and transferring technology and know-how to Chinese firms favored by the Chinese government for development but do little to help the U.S. economy. The U.S. Chamber of Commerce said China's "investment protectionism" serves as the "lynchpin" of its efforts to wring technology and other concessions from U.S. firms "in exchange for access [to] the Chinese market." [214] (For more information on technology transfers, see chap. 1, sec. 4, of this Report.)

Lack of transparency about Chinese firms' connections to the central government, through financial support or decision-making, is another major problem. Many U.S. policymakers are troubled by the possibility that Chinese SOEs' efforts to acquire U.S. company assets could be part of the Chinese central government's strategy to develop global Chinese firms that may one day threaten the economic viability of U.S. firms.[215]

Conclusions

- China's privatization reforms during the past two decades appear in some cases to have been reversed, with a renewed use of industrial policies aimed at creating SOEs that dominate important portions of the economy, especially in the industrial sectors, reserved for the state's control.
- The Chinese government promotes the state-owned sector with a variety of industrial policy tools, including a wide range of direct and indirect subsidies, preferential access to capital, forced technology transfer from foreign firms, and domestic procurement requirements, all intended to favor SOEs over foreign competitors.
- The value and scope of U.S.-China bilateral investment flows have expanded significantly in the past ten years. However, U.S. direct investment in China is more than 12 times greater than Chinese direct investment in the United States. Official U.S. statistics show that U.S. cumulative FDI in China was $60.5 billion in 2010. The Chinese Ministry of Commerce estimated that in 2010, cumulative Chinese FDI in the United States was $4.9 billion.
- The Chinese government guides FDI into those sectors it wishes to see grow and develop with the help of foreign technology and capital. Foreign investors are frequently forced into joint ventures or other technology-sharing arrangements, such as setting up research and development facilities, in exchange for access to China's market. Meanwhile, large swathes of the Chinese economy are closed to foreign investors. China's investment policies are part of the government's plan to promote the development of key industries in China through access to foreign technology and capital.
- Chinese FDI in the United States is a relatively recent phenomenon and remains very small compared to the U.S. investment in China, but there is great potential for growth. China has stated a desire to diversify its holdings of foreign exchange, estimated at $3.2 trillion in mid-2011, the majority of which is invested in dollar-denominated debt securities. As with other statistics, there are discrepancies between official U.S. and Chinese statistics on bilateral investment.
- Due to the considerable government ownership of the Chinese economy, provision by Chinese companies of critical infrastructure to U.S. government or acquisition by Chinese companies of

U.S. firms with sensitive technology or intellectual property could be harmful to U.S. national interests. The Committee on Foreign Investment in the United States investigates the national security implications of mergers and acquisitions by foreign investors of U.S. assets.

- In areas where there are no national security considerations, Chinese FDI has the potential to create jobs and economic growth.
- China has recently introduced a national security investment review mechanism similar to the Committee on Foreign Investment in the United States, although there are concerns among foreign companies that the Chinese government may use the mechanism to derail investment by foreigners in those companies and sectors it wants to remain under government control.

Addendum I: SASAC Companies, Large State-owned Banks, and Insurance Companies (2011) [216]

	Company name	Abbreviation
1	China National Nuclear Corporation	CNNC
2	China Nuclear Engineering & Construction Corporation	CNECC
3	China Aerospace Science & Technology Corporation	CASC
4	China Aerospace Science & Industry Corporation	CASIC
5	Aviation Industry Corporation of China	AVIC
6	China State Shipbuilding Corporation	CSSC
7	China Shipbuilding Industry Corporation	CSIC
8	China North Industries Group Corporation	CNIGC
9	China South Industries Group Corporation	CSGC
10	China Electronics Technology Group Corporation	CETC
11	China National Petroleum Corporation	CNPC
12	China Petrochemical Corporation	Sinopec
13	China National Offshore Oil Corporation	CNOOC
14	State Grid Corporation of China	SGCC
15	China Southern Power Grid Company, Limited	CSG
16	China Huaneng Group	CHNG
17	China Datang Corporation	CDT
18	China Huadian Corporation	CHD
19	China Guodian Corporation	CGDC
20	China Power Investment Corporation	CPI
21	China Three Gorges (Project) Corporation	CTGPC
22	Shenhua Group Corporation Limited	Shenhua
23	China Telecommunications Corporation	China Telecom
24	China United Network Communications Group Company	China Unicom
25	China Mobile Group	China Mobile
26	China Electronics Corporation	CEC
27	China FAW Group Corporation	FAW
28	Dongfeng Motor Corporation	DFMC
29	China First Heavy Industries	CFHI
30	China National Erzhong Group Corporation	Erzhong

Addendum I: SASAC Companies, Large State-owned Banks, and Insurance Companies (2011)—*Continued*

	Company name	**Abbreviation**
31	Harbin Electric Corporation	HPEC
32	Dongfang Electric Corporation	DEC
33	Anshan Iron and Steel Group Corporation	Ansteel
34	Baosteel Group Corporation	Baosteel
35	Wuhan Iron and Steel (Group) Corporation	WISCO
36	Aluminum Corporation of China	Chalco
37	China Ocean Shipping (Group) Company	COSCO
38	China Shipping Group	China Shipping
39	China National Aviation Holding Company	AirChina
40	China Eastern Aviation Holding Company	China Eastern
41	China Southern Air Holding Company	China Southern
42	Sinochem Group	Sinochem
43	COFCO Corporation	COFCO
44	China Minmetals Corporation	Minmetals
45	China General Technology (Group) Holding, Limited	Genertec
46	China State Construction Engineering Corp.	CSCEC
47	China Grain Reserves Corporation	Sinograin
48	State Development & Investment Corporation	SDIC
49	China Merchants Group	CMHK
50	China Resources (Holdings) Company, Limited	CRC
51	The China Travel Service (HK) Group Corporation	HKCTS
52	State Nuclear Power Technology Corporation	SNPTC
53	Commercial Aircraft Corporation of China, Limited	COMAC
54	China Energy Conservation Investment Corporation	CECIC
55	China Gaoxin Investment Group Corporation	Gaoxin Group
56	China International Engineering Consulting Corporation	CIECC
57	Zhongnan Commercial (Group) Company, Limited	Zhongnan
58	China Huafu Trade & Development Group Corporation	HFJT
59	China Chengtong Group	CCT

Addendum I: SASAC Companies, Large State-owned Banks, and Insurance Companies (2011)—*Continued*

	Company name	Abbreviation
60	China Huaxing Group	Huaxing
61	China National Coal Group Corporation	ChinaCoal
62	China Coal Technology & Engineering Group Corporation	CCTEG
63	China National Machinery Industry Corporation	SINOMACH
64	China Academy of Machinery Science & Technology	CAM
65	Sinosteel Corporation	Sinosteel
66	China Metallurgical Group Corporation	MCC
67	China Iron & Steel Research Institute Group	CISRI
68	China National Chemical Corporation	ChemChina
69	China National Chemical Engineering Group Corp.	CNCEC
70	Sinolight Corporation	Sinolight
71	China National Arts & Crafts (Group) Corporation	CNACGC
72	China National Salt Industry Corporation	CNSIC
73	China Hengtian Group Company, Limited	CHTGC
74	China National Materials Group Corporation Limited	SINOMA
75	China National Building Materials Group Corp.	CNBM
76	China Nonferrous Metal Mining (Group) Company	CNMC
79	China International Intellectech Corporation	CIIC
80	China Academy of Building Research	CABR
81	China CNR Corporation Limited	CNR
82	China CSR Corporation Limited	CSR
83	China Railway Signal & Communication Corporation	CRSC
84	China Railway Group Limited	China Railway
85	China Railway Construction Corporation Limited	CRCC
86	China Communications Construction Company Limited	CCCC
87	China Potevio Company, Limited	China Potevio
88	Datang Telecom Technology & Industry Group	Datang
89	China National Agricultural Development Group Company	CNADC
90	Chinatex Corporation	Chinatex
91	China National Foreign Trade Transportation Corp.	SINOTRANS

Addendum I: SASAC Companies, Large State-owned Banks, and Insurance Companies (2011)—*Continued*

	Company name	Abbreviation
92	China National Silk Import & Export Corporation	Chinasilk
93	China Forestry Group Corporation	CFGC
94	China National Pharmaceutical Group Corporation	SINOPHARM
95	CITS Group Corporation	CITS
96	China Poly Group Corporation	POLY
97	Zhuhai Zhen Rong Company	Zhzrgs
98	China Architecture Design & Research Group	CAG
99	China Metallurgical Geology Bureau	CMGB
100	China National Administration of Coal Geology	CNACG
101	Xinxing Cathay International Group Company, Limited	XXPGroup
102	China Travelsky Holding Company	Travelsky
103	China Aviation Fuel Group Corporation	CNAF
104	China National Aviation Supplies Holding Company	CASC
105	China Power Engineering Consulting Group Corporation	CPECC
106	HydroChina Corporation	HYDROCHINA
107	Sinohydro Corporation	Sinohydro
108	China National Gold Group Corporation	CNGC
109	China National Cotton Reserves Corporation	CNCRC
110	China Printing (Group) Corporation	CPGC
111	China Lucky Film Corporation	Luckyfilm
112	China Guangdong Nuclear Power Holding Corporation	CGNPC
113	China Hualu Group Company, Limited	Hualu
114	Alcatel-Lucent Shanghai Bell Company Limited	Alcatel-sbell
115	IRICO Group Corporation	IRICO
116	FiberHome Technologies	WRI
117	OCT Enterprises Company	OTC
118	Nam Kwong (group) Company, Limited	Namkwong
119	China XD Group	XD Company
120	China Gezhouba Group Corporation	CGGC
121	China Railway Materials Commercial Corporation	CRM

Addendum I: SASAC Companies, Large State-owned Banks, and Insurance Companies (2011)—*Continued*

	Company name	**Abbreviation**
122	Industrial & Commercial Bank of China	ICBC
123	China Life Insurance Group	China Life
124	China Construction Bank	CCD
125	Bank of China	BOC
126	Agriculture Bank of China	ABC
127	China Taiping Insurance Group Company	China Taiping
128	Bank of Communications	BOCOM
129	China Development Bank	CDB
130	People's Insurance Company of China	PICC

Notes and sources: The first 121 companies are listed in the order provided by SASAC. Data derived from *http://www.sasac.gov.cn/n1180/n1226/n2425/index.html*; *http://www.ceda.org.cn/china-500/*; and individual companies' websites.

Addendum II: U.S. Direct Investment Position in China on a Historical-cost Basis by Industry, 2000–2010
(U.S. $ million)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	11,140	12,081	10,570	11,261	17,616	19,016	26,459	29,710	52,521	49,403	60,452
Mining	1,404	1,791	1,179	1,263	1,966	2,039	1,958	1,772	3,022	3,648	3,595
Utilities	583	487	540	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.
Total Manufacturing	7,076	7,727	5,554	5,499	9,008	9,346	14,759	18,461	22,584	22,618	29,477
• Food	286	329	425	528	388	402	401	544	2,659	2,874	3,290
• Chemicals	1,122	1,062	1,132	1,338	1,811	2,335	3,308	4,402	5,266	4,987	6,459
• Primary and Fabricated Metals	157	139	151	115	286	432	471	588	672	691	1,252
• Machinery	218	203	335	298	564	386	796	1,269	1,447	1,186	1,258
• Computers and Electronic Products	3,500	3,993	1,275	721	1,719	1,689	5,325	6,965	6,416	5,745	7,963
• Electrical equipment, appliances and components	458	625	521	376	510	531	433	487	556	493	576
• Transportation Equipment	652	650	802	1,209	1,879	1,501	1,665	1,738	2,007	2,736	4,150
• Other Manufacturing	n.s.	n.s.	n.s.	915	1,850	2,071	2,361	2,468	3,561	3,904	4,530
Wholesale Trade	378	576	1,144	1,538	1,705	2,147	3,318	2,015	2,781	2,899	4,018
Information	79	112	218	544	604	801	357	546	427	459	789
Depository Institutions	64	151	319	413	563	757	1,095	850	(D)	10,856	13,413
Finance (except depository institutions) and insurance	43	–30	(D)	–49	1,299	1,480	1,661	1,798	1,877	1,834	1,898
Professional, scientific, and technical services	245	121	406	171	597	523	1159	227	359	605	890
Holding Companies (nonbank)	n.s.	n.s.	n.s.	1,063	1,452	1,159	1,220	1,644	3,099	3,882	3,445
Other Industries	1,267	1,146	(D)	819	422	763	932	2,397	(D)	2,602	2,928

Source: Bureau of Economic Analysis, *U.S. Direct Investment Abroad (USDIA): Operations of U.S. Parent Companies and Their Foreign Affiliates* (Washington, DC: U.S. Department of Commerce (Issues 2000–2010). *http://www.bea.gov/international/di1usdbal.htm.*

Legend:

n.s.—Not shown. Data may not be shown for several reasons:

1. The data appear on another line in this table.
2. The data are not shown in this table but may be available in detailed country- or industry-level tables in this interactive system or in other Bureau of Economic Analysis published tables on direct investment.
3. The data are not available, do not apply, or are not defined.

(D)—Indicates that the data in the cell have been suppressed to avoid disclosure of data of individual companies.