SECTION 2: TRENDS IN CHINESE INVESTMENT IN THE UNITED STATES

Introduction

China has amassed the world’s largest trove of dollar-denominated assets. Although the true composition of China’s foreign exchange reserves, valued at $3.66 trillion, is a state secret, outside observers estimate that about 70 percent is in dollars.* China’s concentration on accumulating dollar-denominated assets is unusual for another reason: China’s government has deliberately adopted a conservative investment strategy, even accepting low or negative returns on its holdings.

In recent years, China has become less risk averse and more willing to invest directly in U.S. land, factories, and businesses. This trend appears to be accelerating. In June 2013, China announced its largest purchase of a U.S. asset to date: a $7.1 billion acquisition of Virginia-based Smithfield Foods, Inc. Given China’s large holdings of U.S. dollars, China has a huge potential for foreign direct investment (FDI),† particularly if China should substitute or abandon portfolio investment for direct investment.

This section, which draws on the Commission’s May 9, 2013, public hearing, continues the Commission’s assessment of Chinese investment in the United States. It examines the motives and incentives driving Chinese investment, and the sectoral and geographical distribution of Chinese investment in the United States. The section also examines the mechanisms to screen and monitor such investments for threats to national security. Finally, it evaluates the proposals for reforming such mechanisms and amending them to include a net economic benefit test.

† 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.
China’s National Outward Direct Investment Strategy

While the Chinese government has been encouraging large amounts of inward FDI to foster domestic economic growth for decades, policies supporting outward FDI have only recently been put in place. The Chinese government explicitly adopted a policy encouraging Chinese companies to invest abroad in its 10th Five-Year Plan (2001–2005). The “go out” policy became one of China’s main development strategies and has focused largely on Chinese state-owned enterprises (SOEs). According to Derek Scissors, then-senior research fellow at The Heritage Foundation, state-owned and state-controlled entities dominate China’s global outward FDI: From 2005 to 2012, SOEs accounted for 86 percent of total outward investment, and private entities accounted for 14 percent.

The 12th Five-Year Plan (2011–2016) accelerated China’s “go out” strategy by calling for a three-pronged approach. First, competitive Chinese manufacturing companies should invest overseas in order to establish international sales networks and globally recognized brand names. Second, Chinese companies should invest in research and development (R&D) outside China. Finally, the plan set goals for shifting acquisitions from sectors that support resource-intensive and polluting manufacturing in favor of services and those sectors that promote a cleaner, high-tech economy.

The “go out” policy focused China’s outward investment goals on sectors in which domestic state-owned or state-controlled firms were already intended to be dominant by policy (the so-called “strategic and heavyweight industries”), such as energy, machinery, construction, and information technology (IT). The 12th Five-Year Plan expanded this list with the Strategic Emerging Industries, which the government has selected for special promotion and support. The seven Strategic Emerging Industries are energy conservation/environmental protection, next-generation IT, biotechnology, high-end equipment manufacturing, new energy, new materials (raw materials), and new energy automobiles. As part of its “go out” strategy, the Chinese government has developed specific investment funds to promote outward investment in natural resources and in fields with technological promise.

According to the 12th Five-Year Plan, the contribution of the Strategic Emerging Industries to China’s gross domestic product (GDP) is to grow from roughly 3 percent in 2010 to 8 percent by 2015 and 15 percent by 2020. The government promised to offer financial support, promote technical innovation and education policies, and to create a market environment to facilitate the development of the Strategic Emerging Industries. With this change, China’s outward FDI has expanded from securing natural resources to include helping Chinese companies “upgrade their technology, pursue higher levels of the value chain previously conceded to foreign firms, and augment managerial skills and staffing to remain globally competitive.”

Another important goal of Chinese outward FDI is creation and promotion of globally competitive brands. With some notable exceptions (such as technology firm Lenovo, telecommunications giant Huawei Technology Co. Ltd., and Haier Group, a home appliance and consumer electronics manufacturer), Chinese companies have stumbled in efforts to build home-grown brands that have global recognition. The alternative strategy for many Chinese companies looking to create global reputations has come to mean buying strong brands abroad that already have marketing power rather than attempting to build Chinese brands and businesses. The aim is to create multinational companies through acquisition, particularly in the areas that are critical to China’s economic development goals. Finally, investment can be a crucial tool of soft power and may be used by the Chinese government to link financial incentives to meeting political goals or simply to burnish China’s image abroad.

The Chinese government wields many tools to encourage and guide investment to favored companies or industries. Overseas investments by Chinese firms require permission from the government, because the country controls capital movements across its borders, and such clearances are easier to receive if the investment is in the area favored by the Chinese government, such as food, technology, and natural resources. Favorable industries also enjoy preferential access to financing and other benefits, making them more likely to have incentives and opportunities to go abroad. These more indirect policies are highly effective. For example, many Chinese investments in the United States reflect the Strategic Emerging Industries mentioned in the latest Five-Year Plan. In addition, evidence is growing that the Chinese government is using or sanctioning use of cyber espionage against private enterprises to give companies in favored industries a competitive edge.

Patterns of Chinese Investment in the United States

In contrast to China’s large holdings of portfolio investment, China is still a relative newcomer when it comes to FDI. According to official statistics from the U.S. Bureau of Economic Analysis (BEA), in 2012, the United States attracted $174.7 billion of global FDI, of which $219 million came from China. For 2011, BEA estimates that flows of Chinese FDI were valued at $576 million (with FDI stock of $3.8 billion). A better estimate—by country of ultimate beneficiary owner—put stock of Chinese FDI in the United States at $9.5 billion at the end of 2011. For the same year, China’s Ministry of Commerce (MOFCOM) estimates the flows of Chinese FDI to the United States at $1.8 billion, with stock of FDI es-

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†Unlike the standard reporting method, which attributes each investment to the direct purchaser of record, the method known as “country of ultimate beneficiary owner” tracks the investment to the actual owner.
The International Trade Administration (ITA), a bureau within the U.S. Department of Commerce, stated in a 2013 report on Chinese FDI in the United States that it is “important to be aware of different estimates” of Chinese investment. ITA noted that private sector valuations employ different definitions of FDI, data gathering mechanisms, and accounting methods that lead to differences in reported value of investments. See International Trade Administration, Report: Foreign Direct Investment (FDI) in the United States from China and Hong Kong SAR (Washington, DC: July 17, 2013). Private sector estimates help bridge a gap that currently exists in classifying FDI by ownership (for example, private vs. state-owned investor), as the U.S. Department of Commerce is unable to report on company-level data for FDI in the United States. BEA, which prepares the U.S. international transactions accounts, is required by law to keep such company-level data confidential.

Whether one uses the U.S. or Chinese figures, the official estimates are too low (for example, just adding together the value of the deals publicly announced in 2012, exceeds the U.S. government’s estimates for cumulative Chinese investment). One key reason is that the estimates do not account for flows of FDI through Hong Kong and other offshore financial centers, such as the Cayman Islands, which are likely transit points for Chinese money on the way to the real investment destination. Private estimates of Chinese FDI in the United States provide more up-to-date information but also vary depending on the methodology used.* Dr. Scissors estimates that in 2012, China invested over $14 billion in the United States, with cumulative FDI between 2005 and 2012 reaching $54.2 billion. According to estimates by the Rhodium Group, in 2012 Chinese firms invested $6.7 billion, for a total of $23.1 billion between 2000 and 2012.

Figure 1: Chinese FDI Stock in the United States, 2002–2011

At the Commission’s May 9, 2013, hearing, witnesses suggested a variety of reasons for Chinese FDI into the United States. According to Thilo Hanemann, research director of the Rhodium Group, the recent increase in Chinese FDI in the United States is

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driven by changing policies and commercial considerations. On the policy side, Beijing has become increasingly aware of the “strategic vulnerability” of having most of its foreign exchange reserves invested in low-interest-bearing U.S. Treasury securities and is looking to diversify its investments. On the economic side, U.S. leadership in technology and services has made the United States an attractive prospect for Chinese investors seeking to “increase their competitiveness at home and preserve access to U.S. customers abroad.” Mr. Hanemann noted that a related trend is growing investment in R&D and modern service operations such as customer service and retail: “Those investments complement the acquisition of advanced manufacturing assets and allow Chinese firms to tap into the U.S. talent base and move closer to their U.S. customers.”

Dr. Scissors concurred that the United States is an attractive destination for any investment, including Chinese investment, by virtue of its abundant land and energy assets, technology, and skilled labor. But Dr. Scissors has identified a more strategic dimension behind the interest of the Chinese government in foreign investment:

*There is almost surely a plan behind Chinese investment, both globally and in the U.S. state-owned enterprises dominate outward investment volume, making it feasible to have a coordinated strategy beyond simply seeking demand or higher financial return. More specifically, Beijing has repeatedly indicated that ownership of overseas commodities is a valuable means of ensuring the continuous imports the [Chinese] economy so badly needs.*

Andrew Szamosszegi of Capital Trade Inc. concluded in his testimony that Chinese investment in the United States was motivated both by market forces and by government policies and guidance, focusing, in particular, on the Chinese government’s role as a “gatekeeper” in the investment approval process. Mr. Szamosszegi also pointed out that a minor motivating factor may be the desire by private Chinese firms that have difficulty raising capital in China (because state-owned banks tend to favor SOEs) to come to the United States to take advantage of the U.S. stock exchanges. From 2007 to 2011, more Chinese firms entered U.S. capital markets through the purchase of listed U.S. shell companies, a technique known as a “reverse merger,” than through initial public offerings (IPOs) by a ratio of three to one. (See chap. 1, sec. 3, of this Report for fuller treatment of the reverse merger issue.)

**Distribution of Investment by Sector and Ownership**

In the United States, Chinese investments have emphasized services, energy, and technology and are also notable for their focus on brand acquisition. Examples include Lenovo’s purchase of IBM’s personal computer division, and a purchase by a unit of China Aviation Industry Corp., a state-run company, of Cirrus Industries, a Minnesota-based company famous for its very light jet aircraft.

Though Chinese FDI in the United States comes in a variety of shapes and sizes, by value, it is dominated by SOEs that closely follow the industrial policies of the Chinese government and that
tend to make far larger investments. Private investors, which Rhodium defines as having 20 percent or less government ownership, are more likely to be involved in smaller deals. According to Rhodium estimates, in the years between 2000 and 2012, state-owned companies concluded 149 deals valued at over $12.6 billion, while private companies made 444 deals, valued at $10 billion.

Energy and services have been primary targets for Chinese investors. Chinese FDI in the energy sector is dominated by a few major deals by state-owned energy giants, as they pursue know-how and technology such as fracking, which China lacks (see figure 2). Chinese energy majors have been particularly active in the last five years. In January 2012, Sinopec paid $2.5 billion to Devon Energy (of Oklahoma City) for a stake in about 1.3 million acres of drilling property in Michigan, Ohio, and elsewhere. In February 2013, Chesapeake Energy Corp. sold a stake to Sinopec for $1 billion in an oil and natural-gas field straddling the Oklahoma and Kansas border. In 2010 and 2011, China National Offshore Oil Corporation (CNOOC) bought stakes in Chesapeake's oil and gas shale assets in south Texas for $1.08 billion and in Colorado and Wyoming for $570 million, respectively.

**Figure 2: Cumulative Chinese FDI in the United States, by Sector, 2000–2013Q2**

(total deal value $27.9 billion)


Services are also playing a major role, accounting for over a quarter of China’s outward FDI value in the United States. In this segment, a burgeoning industry is real estate, which is favored by many Chinese investors as a more secure investment than Chinese equities. Last year’s purchases included major investments in U.S. cities, especially San Francisco, where China’s largest developer,
China Vanke Co., partnered with Tishman Speyer Properties, a U.S. real estate business, to build a $620 million apartment complex downtown. (Under the deal, Vanke provides 70 percent equity, and Tishman is responsible for the construction.)

High-tech manufacturing is another important component of China’s investments, particularly when measured in terms of the number rather than the value of deals. Industries such as IT and industrial equipment take top positions, reflecting Chinese interest in U.S. technology (see figure 3).

**Figure 3: Cumulative Chinese FDI in the United States, by Sector, 2000–2013Q2**

(670 deals total)


To date, the largest Chinese acquisition in the United States has been the 2013 Shuanghui International Holding Ltd.’s $7.1 billion bid (including debt assumption) for Virginia-based Smithfield Foods Inc., the biggest U.S. pork producer. Smithfield and Shuanghui submitted the deal voluntarily for review by the Committee on Foreign Investment in the United States (CFIUS), and it was cleared in early September 2013, according to the companies (Smithfield shareholders approved the deal on September 24, 2013). The agricultural sector has not been an important target for Chinese FDI in the United States so far, but it is a part of a broader trend of Chinese global investment in farm assets or food technologies. China’s acquisitions in agriculture and other sectors are being driven by the desire to secure higher volumes of safe products and, in the long term, access to advanced production and processing technologies. (For a discussion of China’s food security concerns and agricultural policy, see chap. 1, sec. 4, of this Report.)

Chinese FDI is present in most U.S. states, but states with certain industry clusters, such as oil, gas, and automotive, stand out among Chinese investors. According to Mr. Hanemann, California
is by far the number one destination for Chinese investment by the number of deals, with over 170 transactions between 2000 and 2012, or roughly one-quarter of all Chinese FDI in the United States. Other top recipients by the number of deals are New York, Texas, Illinois, and Michigan. These five states account for 352 deals out of 620 concluded between 2000 and 2012. By value of deals, New York, Texas, and Virginia lead, followed by California.18

China’s attempts to diversify its investment away from U.S. Treasury bonds are also evident in its investments in U.S. private equity. For example, the State Administration of Foreign Exchange (SAFE), which manages China’s foreign exchange holdings, has set up a New York operation to invest in private equity, real estate, and other assets.8 Unlike China Investment Corporation (CIC), China’s less publicity-shy sovereign wealth fund, SAFE has been very secretive, so little is known about the nature and magnitude of SAFE’s deals.19 SAFE has been active in buying United Kingdom (UK) property and infrastructure and Japanese equities, according to some analysts. Dr. Scissors estimates that SAFE’s non-bond investments in the United States total $4.5 billion, mostly in private equity funds and similar investments. For example, in 2011, SAFE invested $500 million in a real estate private equity fund managed by the Blackstone Group.20

Economic Security Issues Related to Chinese Investment in the United States

The potential economic benefits of investment are well known: job creation, expansion of the tax base, and improvement in productivity and overall competitiveness. This is especially the case for “greenfield” investments (i.e. investments in which entirely new factories or businesses are created). Mergers and acquisitions also can generate or save jobs if the new investors revitalize ailing firms or expand local capacities. An investment in the United States made by a Chinese company on market-based terms free from strategic considerations or political interference has the potential for providing the same benefits made by any other purely economic investor.

But as is evident from the figures, Chinese investment in the United States is more often than not undertaken with a nod to Chinese industrial policy goals, such as the acquisition of valuable technology to enhance China’s carefully chosen Strategic Emerging Industries (for example, Chinese investments in U.S. battery and solar technology). When such investments are made by Chinese companies owned or controlled by the government, they attract extra scrutiny for their apparent policy goals.

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Experts testifying at the Commission’s May 9 hearing agreed that the issue of the Chinese government’s role in promoting foreign investment was further complicated by the difficulty in separating truly private Chinese companies from those under government influence or control. For example, if a private company in China sees that the government favors investment in a certain industry, it will try to invest in that industry to curry favor and take advantage of subsidies provided by the government. Mr. Szamosszegi said that “it would be the same as if the government had said . . . we want you to invest a lot and we want you to invest in the U.S. industry.” Dr. Scissors pointed out that for private firms in China “there is no rule of law; there is no right of refusal for private firms” to reject government pressure to make an investment.

Furthermore, even genuinely private companies benefit from a slew of local and provincial government subsidies, creating an uneven playing field for their foreign competitors. A recent study by Usha and George Haley, U.S. researchers on China’s economy, found that Chinese steel, glass, paper, and auto parts producers turned into global players with the benefit of local subsidies. Another study, by Matthew Forney and Laila Khawaja from Fathom China, a research consultancy, found that most non-state-owned Chinese companies received some form of direct subsidy.

Witnesses at the Commission’s hearing pointed out that U.S. trade laws may not be sufficient to address negative aspects of state-driven Chinese investment. For example, when a U.S. firm has to obtain credit at market rates to finance its activities, but a Chinese firm can obtain financing at minimal or even zero interest from Chinese state-owned banks, it distorts competition in the U.S. market. According to Elizabeth J. Drake, partner at Stewart and Stewart, current U.S. law does not adequately protect U.S. workers and firms from this type of unfair competition. She noted:

Existing antitrust rules, for example, are based on assumptions about the profit-maximizing behavior of market actors that simply may not apply to certain Chinese firms. In the area of predatory pricing, the U.S. applies a recoupment test, under which pricing is only deemed anticompetitive if the predator is likely to eventually collect enough profits to make up for the losses caused by the predatory behavior. . . . A Chinese SOE, by contrast, may be able to rely on state support to maintain losses that may never be recouped, and engage in predatory pricing in order to gain U.S. market share in the furtherance of political or industrial policy goals. Such a firm could engage in predatory pricing behavior that causes severe damage to its U.S. competitors, but, under current law, such behavior would not be considered anticompetitive as long as the Chinese firm was not expected to recoup its losses.

Mr. Szamosszegi and Ms. Drake noted that one motivation for Chinese investment may be to access markets that are otherwise restricted by trade barriers such as tariffs or duties imposed to counteract unfair trade practices, such as antidumping and coun-
A company is considered to be operating under FOCI whenever a foreign interest has the power, direct or indirect, whether or not exercised, and whether or not exercisable, to direct or decide matters affecting the management or operations of that company in a manner that may result in unauthorized access to classified information or may adversely affect the performance of classified contracts. Defense Security Service, “Foreign Ownership, Control or Influence (FOCI)” (Quantico, VA). http://www.dss.mil/isp/foci/foci_info.html.

National Security Issues Related to Chinese Investment in the United States

Trade-related aspects of foreign investments may intersect with national security concerns. For example, foreign intelligence collection efforts and espionage that target U.S. technology, intellectual property, trade secrets, and other proprietary information can be concealed under the seemingly benign pretext of foreign investment in cleared government contractors. In order to protect classified national security information, the federal government created the National Industrial Security Program (NISP), a program administered by the U.S. Defense Security Service on behalf of the U.S. Department of Defense and 25 other government agencies. This program seeks to prevent unauthorized disclosure of classified information, and to mitigate the threat posed by companies determined to be under foreign ownership, control, or influence (FOCI).* The Defense Security Service can mitigate some dangers of such foreign investment using a specialized set of methods, which vary from case to case (for example, altering the terms of the deal or board membership).*

There may be gaps, however, in the ability of the Defense Security Service to identify and mitigate FOCI. Approximately 75 percent of NISP companies are privately held and are not required to disclose their ownership or investor information to an independent regulatory agency such as the Securities and Exchange Commission. When a company enters the NISP, it must fill out a special form,* and the Defense Security Service then attempts to verify this self-reported information. Such verification efforts are often hampered by limited resources and the lack of disclosure requirements to an independent regulatory agency. Furthermore, a foreign entity could be the primary investor in a U.S. private equity fund with ownership in a company in the NISP without this potential influence ever being disclosed. Such indirect ownership further complicates analysis of possible foreign influence.

The Committee on Foreign Investment in the United States

The United States has a limited FDI screening process. CFIUS is an interagency committee that reviews certain mergers, acquisitions, and takeovers of U.S. businesses by foreign persons, corporations, or governments for national security risks. Submitting the
details of an acquisition for national security review is voluntary, but CFIUS can also initiate an investigation on its own after a merger or acquisition of a U.S. company by a foreigner. CFIUS can demand that the deal be unwound or restructured on national security grounds if a deal is considered a security risk, even after the deal has been completed.

There is no definition of national security in the CFIUS legislation, which allows some discretion in initiating a review process. Screening only applies to potential mergers and acquisitions and does not extend to greenfield investments (i.e. a foreign entity is establishing a company or affiliate where none exists). CFIUS also does not assess economic costs or benefits to the United States of any given acquisition. Several other countries, including Canada, Australia, France, and China have screening programs similar to CFIUS that also apply a net economic benefit test.

Among other things, CFIUS considers two elements when evaluating whether an investment by a foreign entity warrants an investigation: the degree of foreign state control, and whether the transaction could affect U.S. national security. For China, the question of state control can be particularly complicated, because the government’s role is not always straightforward or even disclosed. Despite economic reforms and moves toward privatization, large swathes of the Chinese economy remain under control by various parts of the Chinese government.

In addition to outright ownership or control, the Chinese government or the Chinese Communist Party (CCP) can also control a publicly traded corporation by influencing the composition of corporate boards and the corporation’s management team. Finally, it remains debatable whether privately held Chinese corporations, especially in industries the government deems critical, such as the Strategic Emerging Industries, are free of state control or influence. For example, a report by the House Intelligence Committee flagged Chinese telecommunications-equipment makers Huawei and ZTE for potentially providing opportunities for Chinese intelligence services to tamper with U.S. telecommunications networks.

Chinese managers often complain that their firms face discrimination from regulators in the West. For example, Gao Xiqing, vice chairman of CIC, complained during a visit to Washington in April 2013 that his fund was being “singled out as a different investor” by the U.S. authorities, going as far as to say that certain people were “slapping [us] in the face and telling [us], OK, we don’t like you.”

The perceived bias against Chinese investment has been caused by a few failed deals and largely precipitated by Chinese investors’ confusion over U.S. regulatory structures. In China, deals are approved in a centralized, top-down process, but in the United States, the control and regulation of foreign investment are decentralized. Federal regulations are largely responsible for vetting deals on national security grounds, with local governments, private individuals, labor unions, nongovernmental organizations, and Congressional leaders weighing in on various aspects of the deal. Chinese investors often attribute the derailment of a deal due to political or activist opposition to purposeful discrimination by the U.S. gov-
There appear to be no federal laws or screening mechanisms that empower the federal authorities to evaluate whether a greenfield investment may pose a national security threat. In contrast, China has several major industries, including finance, agriculture and telecommunications services, walled off from foreign investors, often as part of a policy to promote domestic companies.

U.S. regulators have blocked at least six major acquisitions from China since 2005; however, there were hundreds of projects (including deals done by CNOOC, known previously for a failed 2005 bid for Unocal) that were not rejected. Overall, despite perceptions in China, to date, the number of Chinese deals reviewed by CFIUS has been very small and those rejected even smaller (see figure 4).

**Figure 4: Chinese Transactions Covered by CFIUS, 2006–2011**

![Figure 4](image_url)


According to the 2012 CFIUS report to Congress, in 2011, out of 111 covered transactions, 10 were from China. Out of 114 planned and completed critical technology transactions in 2011, China was linked to four. (For a list of select controversial Chinese investments, see Addendum I.)

**Proposals for Amending the CFIUS Mandate**

At the Commission’s May 9, 2013, hearing, witnesses debated whether CFIUS should be amended to address some of the perceived gaps in the current mandate (for example, CFIUS cannot investigate and block greenfield investments, even those that might pose national security threats). Investors and analysts frequently criticize CFIUS for the secrecy of its reviews, the opacity of its national security criteria and decision-making process, and its limited scope.

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*There appear to be no federal laws or screening mechanisms that empower the federal authorities to evaluate whether a greenfield investment may pose a national security threat.*
To address some of these concerns, Dr. Scissors proposed that CFIUS develop a very narrow definition of national security, which would make the reviews more predictable and make it easier to understand CFIUS’s actions.35 Dr. Scissors advocated expanding the CFIUS mandate to include any domestic transaction, including greenfield investments, involving a foreign entity. Under the expanded mandate proposed by Dr. Scissors, for example, CFIUS should be able to investigate equipment contracts, with a particular focus on telecom equipment in light of cybersecurity worries.36 Dr. Scissors also criticized CFIUS for its extreme secrecy, arguing that a more transparent review, with both Congress and foreign investors receiving more information about transactions, would enhance the credibility and accountability of the CFIUS process.37

Mark Plotkin, partner, Covington & Burling, agreed that the CFIUS review process could be made more transparent:

*CFIUS today will not even acknowledge that it is reviewing a ticket or transaction if asked. I do think it is important for the public to know that CFIUS is reviewing transactions. … The regulation of CFIUS could be enhanced to provide more information to foreign investors as to what kind of issues CFIUS takes into account when CFIUS is reviewing a transaction.*38

Ms. Drake proposed that the CFIUS review process be expanded to include a “net benefit test” to review “all investments that are subsidized by or owned or controlled by foreign governments. Such investment should be reviewed from the standpoint of competitive neutrality and be reviewed for their economic as well as national security implications.”39 In other words, under her proposed revision, CFIUS would not just screen foreign investment for national security concerns but also for any potential economic benefit or risk to the United States.

Mr. Plotkin, on the other hand, argued against an introduction of a clear definition of national security under CFIUS because it would impede CFIUS’s ability to address new or emerging problems:

*That flexibility [of the definition of national security] allows the CFIUS agencies the ability to weigh and address their individual equities and mandates during the course of a CFIUS review, and it also allows CFIUS to adapt to an ever-changing threat environment. I’d like to offer two examples of that adaptability: cyber security and state-owned enterprises.*40

Similarly, Mr. Plotkin said it would be a mistake to expand the CFIUS mandate to include a net benefit, or economic, test, because the “principles underlying an economic test are beyond the core competency of CFIUS. … Moreover, CFIUS operates in strict secrecy. Secrecy in the conduct of an economic benefit test risks being perceived as protectionist.”41

**Implications for the United States**

The federal government is responsible for national security and has put in place a system to review transactions with potential se-
curity implications. China presents new challenges, because investment by SOEs can blur the line between national security and economic security. The possibility of government intent or coordinated strategy behind Chinese investments raises national security worries. Recent investments by Chinese companies in global shale oil and gas projects match Chinese government interests in acquiring relevant technologies and diversifying its energy mix. More broadly, Chinese companies’ attempts to acquire technology track closely the government’s plan to move up the value-added chain. There is also an inherent tension among the different levels of government in the United States regarding FDI from China. The federal government tends to be concerned with maintaining national security and protecting a rules-based, nondiscriminatory investment regime. The state governments are more concerned with local economic benefits, such as an expanded tax base and increased local employment, rather than national strategic issues, especially as job growth has stagnated.

While Chinese FDI in the United States has been quite low so far, it has substantial room to grow. The United States needs to be prepared to harness the benefits and address the problems posed by Chinese funds flowing into our economy. Though estimates vary, even the most generous assessment shows that Chinese FDI constitutes less than 2 percent of total inward direct investment coming to the United States. Chinese companies are most interested in the U.S. energy, real estate, and service sectors, particularly financial services. In energy, as in other sectors, they are pursuing technology and expertise they do not yet have.

If current trends continue, much of China’s outward FDI, at least in value terms, will be made by Chinese SOEs. Chinese SOEs receive substantial benefits from the central and provincial governments, which are not available to their foreign competitors, including preferential policies and low cost of capital. These SOEs are increasingly active globally, seeking to expand China’s economic reach and power around the globe. They are involved in aerospace, autos, oil, steel, telecommunications, and other industries that the Chinese government has designated as strategic. U.S. companies face an uneven playing field when competing against Chinese SOEs in the United States and in the global market while enjoying none of the benefits afforded to SOEs by the Chinese government.

Chinese investments in the United States are subject to the same set of rules and regulations as investment from other foreign countries in the areas of foreign corrupt practices, export administration, sanctions, and antitrust. If Chinese firms run afoul of these rules, they will be subject to legal sanction. But gaps exist in the U.S. government’s ability to address the competitive challenges posed by SOEs.

Chinese SOEs commonly receive subsidies from central or local governments, such as low-cost loans, loan forgiveness, favorable regulatory and tax treatment, discounted land purchases, free infrastructure improvements, and such inputs as electricity or fuel at below-market rates—benefits that are not available to U.S. competitors. By contrast, U.S. affiliates in China operate at a distinct disadvantage in sectors where favored Chinese SOEs enjoy extensive government support.
When companies favored by the Chinese government invest overseas, the situation becomes more problematic. Often, Chinese SOEs do not have to worry about making a profit, because they can rely on government support. They need not worry about their fiduciary obligations to their shareholders. Instead, they are often encouraged by the government to pursue other goals. These include resource acquisition, technology transfer, and capturing market share, regardless of cost.42

Furthermore, SOEs investing in the United States may engage in particular predatory or anticompetitive behavior that U.S. trade remedies cannot address. For example, an SOE exporting goods below cost to the United States can be penalized through antidumping and countervailing duty laws. Such laws, however, do not apply to goods made in the United States by a competitor subsidized by the government, a practice that could leave U.S. companies at a disadvantage at home and in third-country markets.

Conclusions

• Chinese foreign direct investment (FDI) in the United States continues to grow, though from a very low base. According to official U.S. statistics, in 2012 the United States attracted $174.7 billion of global FDI, of which $219 million came from China. An estimate by country of ultimate beneficiary owner, which better tracks actual investors, put stock of Chinese FDI in the United States at $9.5 billion at the end of 2011. For the same year, China’s Ministry of Commerce put the flows of Chinese FDI to the United States at $1.8 billion, with stock of FDI estimated at around $9 billion.

• Official statistics underestimate the true volume of Chinese investment, because they do not account for flows of FDI through Hong Kong and other offshore financial centers, which are likely transit points for Chinese money on the way to the real investment destination. Official data are also provided after a significant delay, which hinders analysis.

• To date, state-owned enterprises (SOEs) have dominated Chinese FDI in the United States measured by the value of deals, though private companies lead by the number of deals. One reason is that the biggest investments so far have been made in the oil and energy fields, which are dominated by Chinese state-owned giants.

• Chinese investors have primarily targeted those sectors where China lacks know-how and technology, particularly in the Strategic and Emerging Industries identified in the 12th Five-Year Plan. Energy and services (in particular real estate and financial services) have received the most investment. High-end manufacturing is another important destination for China’s investments, particularly when measured in terms of the number rather than the value of deals.

• 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 (CFIUS) investigates the national security implications of mergers and acquisitions by foreign investors of U.S. assets.

- Investigations by CFIUS and other national security review and mitigation mechanisms may be hampered by limited resources or limited statutory authority.

- Investments made by Chinese state-owned or -controlled companies can also pose economic security threats. The Chinese government provides significant financial and logistical support. This puts U.S. firms, which receive no such support, at a competitive disadvantage. When Chinese SOEs invest abroad, they do not necessarily seek profit and may instead pursue government goals such as resource acquisition or technology transfer.

- Chinese investments in the United States are subject to the same set of rules and regulations as investment from other foreign countries in the areas of foreign corrupt practices, export administration, sanctions, and antitrust. If Chinese firms run afoul of these rules, they will be subject to legal sanction. But gaps exist in the U.S. government’s ability to address the competitive challenges posed by SOEs.

- In areas where there are no national security considerations, and when the investment is driven by economic rather than strategic rationale, Chinese FDI can benefit the U.S. economy through creation of jobs and other positive spillovers.
**Addendum I: Select Controversial Chinese Investments in the United States, 1990–2013**

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<th>Year</th>
<th>Investor</th>
<th>Target</th>
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<tr>
<td>1990</td>
<td>China National Aero Tech (CATIC)</td>
<td>Mamco Manufacturing Co.</td>
<td>CFIUS found that the acquisition of Mamco, which manufactured machines and fabricated metal parts for aircraft, would pose national security risks. Formally blocked by presidential order.</td>
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<td>1995</td>
<td>China National Non-Ferrous Metals Import &amp; Export Corp, San Huan, Sextant</td>
<td>Magnequench Inc.</td>
<td>The initial takeover of Magnequench, producer of high-tech magnets from rare-earth minerals, by a Chinese-led consortium and the following acquisition of Ugimag Inc. in 2000, received regulatory approval from the Clinton Administration. However, the deal drew widespread criticism in the U.S public for the transfer of technology and jobs to China when the firm’s facilities in the United States were shut down in 2002 and 2006, respectively.</td>
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<td>1999</td>
<td>China Ocean Shipping (Group) Company (COSCO)</td>
<td>Long-term lease of former Naval Base, Long Beach, CA</td>
<td>Congress banned COSCO from leasing a formal naval base in Long Beach through a provision in the 1998–1999 defense authorization bill. Legislators cited national security concerns as a reason for blocking the deal through ad hoc legislative action.</td>
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<td>2005</td>
<td>China National Offshore Oil Corporation (CNOOC)</td>
<td>Unocal Corp.</td>
<td>The deal was rejected by shareholders before a CFIUS determination was made. The 2005 bid attracted significant opposition from domestic interest groups and Members of Congress. After Congress threatened to enact an amendment that would have imposed significant additional costs and risks for the buyer (the Pombo Amendment: CFIUS would be prohibited from concluding its national security review of an &quot;investment in energy assets of a United States domestic corporation by an entity owned or controlled by the government of the PRC&quot; until after a period of 141 days—or 51 days longer than the maximum of 90 days established under the Exon-Florio Amendment), CNOOC abandoned the bid. The U.S. competitor Chevron ultimately acquired Unocal.</td>
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<td>2005</td>
<td>Lenovo</td>
<td>IBM’s personal computer division</td>
<td>Domestic interest groups, the security community, and Members of Congress voiced concerns after Lenovo’s plans to purchase IBM’s personal computer unit became public. The deal was cleared by CFIUS after the company signed extensive security agreements.</td>
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### Addendum I: Select Controversial Chinese Investments in the United States, 1990–2013—Continued

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<tr>
<td>2008</td>
<td>Huawei, Bain Capital</td>
<td>3Com</td>
<td>CFIUS signaled a negative recommendation based on national security risks posed by the sale of network gear. Huawei and Bain Capital withdrew the bid.</td>
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<td>2009</td>
<td>Northwest Nonferrous Interna-</td>
<td>Firstgold Corp.</td>
<td>CFIUS signaled a negative recommendation based on national security risks due to Firstgold's proximity to Fallon Naval Air Station, among other concerns. Northwest Nonferrous withdrew the bid.</td>
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<td>tional Investment Co.</td>
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<td>2010</td>
<td>Tangshan Caofeidian Invest-</td>
<td>Emcore</td>
<td>CFIUS expressed concerns over TCIC's acquisition of Emcore, a provider of photovoltaic and fiberoptic technology. TCIC withdrew its bid.</td>
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<td>ment Co. Ltd (TCIC)</td>
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<td>2010</td>
<td>Far East Golden Resources</td>
<td>Nevada Gold Holdings, Inc.</td>
<td>After investigating the transaction in 2012, CFIUS proposed that Hybrid Kinetic Group Ltd (the ultimate controlling entity of FEGRI) divest or break up its interests in Nevada Gold as related to the Tempo mine site in north central Nevada, located in proximity to U.S. Naval Air Station Fallon. Hybrid Kinetic and its subsidiaries agreed to divest all their interests in Nevada Gold.</td>
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<td></td>
<td>Investment Ltd. (FEGRI)</td>
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<td>2011</td>
<td>Huawei</td>
<td>3Leaf</td>
<td>CFIUS asked Huawei to submit its purchase of assets from bankrupt 3Leaf, which created technology for cloud computing. Huawei agreed to divest its 3Leaf assets after CFIUS signaled a negative recommendation.</td>
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<td>2012</td>
<td>Ralls Corp.</td>
<td>Terna Energy Holding USA</td>
<td>Ralls bought four Oregon wind farm assets without reporting the transaction to CFIUS. The U.S. Navy objected to the project’s proximity to the restricted Naval Weapons Systems Training Facility airspace, where the U.S. government tests drones. CFIUS asked Ralls to submit for review; upon review, CFIUS recommended that Ralls stop operations. Ralls challenged the CFIUS determination, so the president had to formally block the deal by executive order. Ralls challenged the rejection with a lawsuit alleging that the president acted unconstitutionally.</td>
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<td>2012</td>
<td>Wanxiang</td>
<td>A123</td>
<td>Wanxiang purchased the bankrupted A123 at auction for $256.6 million, and the deal was approved by CFIUS despite significant opposition from some Members of Congress. Wanxiang excluded A123’s defense contracts (A123’s defense division, which supplied cutting edge batteries to the U.S. military) from its bid at the auction. Those were sold separately to Illinois-based Navitas Systems for $2.25 million. A123 has never turned a profit and received a $249 million grant from the U.S. Department of Energy to develop lithium-ion batteries, although only about half of the money was used.</td>
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<td>2012</td>
<td>CNOOC, Ltd.</td>
<td>Nexen Inc. (U.S. assets)</td>
<td>In 2012 CNOOC agreed to buy Nexen Inc. (a Canadian company) for $15.1 billion as China’s largest foreign deal. The Canadian government’s Investment Canada Act was used to determine if the sale provides a “net benefit” to Canada. In December 2012, the sale was approved by the Canadian federal government. In addition to Canadian authorities, CFIUS needed to vet the deal because Nexen has U.S. interests. CFIUS approval came in February 2013.</td>
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<td>2013</td>
<td>Shuanghui International Holdings Ltd.</td>
<td>Smithfield Foods Inc.</td>
<td>In June 2013, Shuanghui, China’s largest meat processor, made an offer for Smithfield, the U.S.’s biggest pork producer, for $4.7 billion in cash (including debt, the deal values Smithfield at $7.1 billion). Smithfield and Shuanghui submitted the deal for CFIUS review, even though the food industry has not been traditionally among those relevant to national security. The proposed deal attracted opposition from some Members of Congress as well as farm, producer, consumer, and rural organizations, due to worries over food safety and the protection of U.S. technologies and intellectual property. CFIUS approved the sale in early September 2013. Smithfield shareholders approved the deal on September 24, 2013.</td>
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Source: Rhodium Group; various media reports.
ENDNOTES FOR SECTION 2


27. For a list of FOCI mitigation instruments, see http://www.dss.mil/isp/foci.mitigation.html.


