Testimony before the U.S.-China Economic and Security Review Commission

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Patterns of Chinese Investment in the United States

Co-chairs, members of the Commission: thank you for the opportunity to testify today.

I am research director at Rhodium Group (RHG), a New York-based economic research firm supporting the investment management, strategic planning and policy needs of firms in the private and public sectors. My own research focuses on global cross-border investment flows and the implications of the rise of China, India and other emerging markets as global investors.

I have been closely following Chinese overseas investment for more than five years and have published several studies on the topic. I also manage a proprietary database tracking Chinese investments in the U.S., and I would like to offer some numbers from this dataset to help the Commission better understand the extent of Chinese firms' operations and investments in the United States and answer some of the questions laid out for this hearing.

This written statement summarizes some of these numbers. Charts representing the data graphically can be found in the Appendix.

1. Data on Chinese Investment in the U.S.

Analyzing Chinese investment in the U.S. is challenging due to lack of reliable and timely data sources. Neither the U.S. Bureau of Economic Analysis (BEA) nor Chinese statistical agencies offer a detailed breakdown of bilateral international investment positions. A rough picture of China's investments in the U.S. can be drawn using the BEA's international transactions data and the U.S. Treasury's International Capital System (TIC). The latest available data points are summarized in Figure 1 in the Appendix.[1]

[1] These charts are the best available snapshots; they are by no means complete, as no reliable statistics exist due to difficulties capturing financial flows.

BEA's latest available statistics on direct investment - which is traditionally defined as long-term ownership of 10% or more voting shares - put China's FDI stock in the U.S. at $3.8 billion at year-end 2011. Another data set from the BEA that is compiled after the ultimate beneficiary owner (UBO) principle puts the stock of Chinese investment at $9.5 billion at year-end 2011 - an indication that the extensive use of offshore financial centers and tax havens makes it difficult for statistical agencies to accurately track Chinese FDI. However, this is the latest available official data point, and it dates back 1.5 years. In addition to a significant time lag, official sources also do not provide detailed data on the distribution of those investments and important variables like ownership or employment, often for confidentiality reasons.

Seeking more accurate and timely data, researchers have developed alternative databases to capture Chinese capital outflows by collecting information from regulatory filings, media reports and commercial M&A databases. One such database is Rhodium Group's *China Investment Monitor* (CIM), which covers acquisitions and greenfield projects by Chinese-owned firms in the United States with a value of $1 million and higher. It only includes investments that qualify as direct investment, using the 10% ownership threshold. The CIM is not directly comparable to data sets compiled using the traditional balance of payments approach to collecting FDI data, as it neglects reverse flows and does not fully capture intra-company loans and other follow-up flows. However, the bottom-up approach overcomes many of the weaknesses of the traditional approach - such as the incomplete accounting for flows through offshore financial centers - and allows for a detailed, real-time assessment of Chinese investment flows and ownership in the United Sates. [2]

2. Annual Flows of Chinese FDI to the U.S.

The RHG China Investment Monitor (CIM) records 633 Chinese deals in the United States between 2000 and 2012, amounting to $23.1 billion. These 633 deals consist of 445 greenfield projects – factories, offices and other facilities built from scratch – and 188 acquisitions of existing companies and assets. Acquisitions account for 85% of total investment value ($19.6 billion) and greenfield projects for the remaining 15% ($3.5 billion).

The annual patterns (presented in Figure 2 in the Appendix) illustrate the recent growth spurt in inflows. Before 2008, Chinese FDI flows into the United States typically stood below $1 billion annually, with the singular exception of Lenovo's $1.75 billion acquisition of IBM's personal computer division in 2005. Since 2008, Chinese investment has gained momentum, growing to just under $2 billion in 2009 and $5.5 billion in 2010. In 2011 Chinese investment came in slightly lower at $4.7 billion, but reached a new record high of $6.7

[2] For a detailed review of existing data sets and their advantages and weaknesses, see Rosen and Hanemann (2011) or Hanemann and Rosen (2012).

billion in 2012. With announced deals worth more than $10 billion by the end of the first quarter, 2013 will likely be another record year for Chinese direct investment in the United States.[3]

Our numbers on Chinese FDI transactions are higher than the latest available official data but still just a small percentage of total FDI in the United States. A few large-scale transactions and alarming headlines have led to the impression that China is "buying up" America.[4] This is not the case. Using official BEA figures for total FDI inflows (since our data does not cover FDI from *other* countries into the United States), China's $6.7 billion accounted for less than 4% of total U.S. FDI inflows of $175 billion in 2012.[5] China also remains a small share (less than 1%) of total inward FDI stock in the United States of $3 trillion by the end of 2012.[6]

At the same time, it is important to note that China was one of the few bright spots in a deteriorating global FDI environment in 2012. Foreign direct investment into the United States dropped markedly during the 2008/2009 financial crisis and has never recovered to previous levels. In 2012, FDI inflows to the United States were down 25% compared to previous year, partially because European firms were investing less. The rapid increase of FDI from China goes against the global trend, highlighting China's potential to become a significant source of FDI for the U.S. in the future.

3. U.S. Industries Favored by Chinese Investors

The recent increase of Chinese FDI in the United States is driven by a mix of changing policy conditions and commercial motives. On the policy side, Beijing's official line flipped from opposed to highly supportive of FDI in overseas markets. This reversal was rooted in the interests of several bureaucracies, including awareness of the importance of global operations for firm competitiveness (MOFCOM and SASAC), fading concerns about maximizing foreign exchange reserves (MOF and PBOC), and increasing awareness of the strategic vulnerability entailed in a U.S. debt-heavy portfolio of external assets (NDRC, PBOC and others). While the ODFI approval process is still burdensome for many firms, it has been significantly relaxed in recent years.

While policy liberalization was an important prerequisite for growing Chinese outward FDI, the most important drivers of outward investment are changes in China's domestic economy that are pushing Chinese firms to invest overseas. The distribution of Chinese investment by industry (as presented in Table 1 in the Appendix) underscores those changes. Before the mid-2000s, Chinese FDI into the U.S. mostly consisted of

[3] See "Chinese FDI in the United States: Q1 2013 Update", Rhodium Group, http://rhg.com/notes/chinese-fdi-in-the-united-states-q1-2013-update

[4] See *Time*, "Will Asia "buy up" America?" August 30, 2011, available at: http://business.time.com/2011/08/30/will-asia-buy-up-america/.

[5] According to preliminary figures from the BEA, the U.S. registered $175 billion of inward direct investment flows in 2012.

[6] The BEA records an inward FDI stock of $3.07 trillion as of the end of 2012.

smaller-scale operations to facilitate trade in electronics and other consumer goods. Since then, a much broader set of motives drew Chinese firms to invest in the U.S. In 18 industries, we find more than $200 million in Chinese deals, of which about half are in industrial and half in service sectors.

The biggest recipient of Chinese FDI is the U.S. oil and gas industry. The unconventional energy boom has made the United States a prime frontier for global oil and gas investments, and is attracting Chinese firms eager to expand their overseas production bases and involvement in cutting-edge extraction techniques. The 2005 CNOOC-Unocal deal failure chilled Chinese enthusiasm about natural resource projects in the United States, but the boom in unconventional oil and gas extraction has revived interest in North American acquisitions, resulting in several larger-scale oil and gas plays since 2010 adding up to more than $5 billion.[7]

American technology and advanced manufacturing are also attracting Chinese investment, fueled by structural adjustment at home. Increasing competition, rising factor input costs (especially labor), environmental compliance and remediation costs, and local impediments to consolidation to achieve economies of scale have spelled the end of the old Chinese business model focused on domestic markets and exports. These operating realities are compelling Chinese firms to look at U.S. assets to increase their competiveness at home and preserve access to U.S. customers abroad. The growing number of investments in industrial machinery, electrical equipment and components, automotive, alternative energy, medical devices and communications equipment illustrates the strong desire to invest in technology, brands, human talent and other competitive assets.

A related trend is increasing investment in modern service operations such as research and development, 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.[8] In the last two years we also saw increasing interest in acquiring core service sector assets, as Chinese firms gear up to profit from a domestic service sector boom.[9] The most targeted sectors are software and IT, hospitality and financial services.

Finally, direct investment stakes are increasingly becoming part of the asset management strategies of Chinese individuals, firms and institutional investors. Traditionally, those investors have a mandated "home bias" and hold most of their assets in China. However, given the risks of an undiversified portfolio and the current uncertainties about the outlook for growth in China, those investors are increasingly looking to diversify their

[7] For example, CNOOC's acquisition of stakes in Chesapeake Energy projects in 2010 and 2011 worth $1.7 billion and Sinopec's acquisition of Devon Energy in early 2012 valued at $2.5 billion.
[8] Some prominent examples include Huawei and Yingli Solar establishing high-tech R&D centers in California in 2011 and Lenovo establishing a fulfillment center in North Carolina in 2008.
[9] For example Wanda's acquisition of movie theater chain AMC in 2012.

portfolio internationally. Safe haven economies with a sound legal system and property rights protection like the United States are naturally attractive for such flows. The drop in prices following the financial crisis has made U.S. residential and commercial real estate an attractive target for these investors.[10] Other industries that traditionally offer stable long-term returns such as utilities have also attracted significant Chinese interest.

4. Geographic Location of Chinese FDI in the U.S.

Unlike official FDI statistics, our dataset also provides a detailed breakdown of Chinese investment by state. Those data points (presented in Figure 3 in the Appendix) show that the recent increase in volume and scope of investment has brought Chinese firms to at least 43 of the 50 states. Mapping out Chinese investment flows by state reveals that Chinese money largely follows in the paths of other foreign investors, with traditionally strong economies on the east and west coasts being the top recipients of Chinese investment.

California is by far the number one destination for Chinese investment by number of deals, with more than 170 transactions between 2000 and 2012, or roughly one-quarter of all Chinese direct investments in the United States. The other top recipient states by number of deals are New York, Texas, Illinois, and North Carolina. In terms of total investment value, New York, Texas, Illinois and Virginia are leading the pack, followed by California. States with industry clusters that are attractive for Chinese investors have also received significant capital inflows, for example Michigan, Illinois and Ohio (automotive) or Texas (oil and gas).

5. Profile of Chinese Investors in the U.S.

Finally, our micro dataset allows for an in-depth analysis of Chinese investors in the United States by ownership and other variables. The first important finding here is that the pool of Chinese firms operating in the U.S. reflects the diversity of ownership in corporate China, ranging from sovereign investment entities (such as China Investment Corporation) to central state-owned enterprises (e.g., Sinopec) to firms with hybrid ownership structures (e.g., Lenovo), and wholly privately-owned firms (e.g., Wanxiang). Table 2 in the Appendix presents an overview of firms of different ownership types and their share in total Chinese investment in the U.S. from 2000-2012.

China's sovereign investment entities are making significant portfolio investments in the United States but have traditionally kept a low profile when it comes to direct investment. China's primary sovereign wealth fund, the China Investment Corporation (CIC), is an active investor in the United States, but has only made

[10] Both official statistics and our database underreport Chinese investment in U.S. real estate. However, recent examples of large-scale real estate grabs in the United States by Chinese firms include Shenzhen New World Group's dual acquisitions of Sheraton and Marriott hotels in Los Angeles in 2010 and 2011, and HNA Group's purchase of a New York City office building in 2011.

one investment in the U.S. that meets the direct investment threshold.[11] However, there are several investments by Chinese companies in which CIC has a significant ownership stake, for example the big state-owned banks. Several other high-profile government-controlled entities such as the State Administration of Foreign Exchange (SAFE) and the National Social Security Fund (NSSF) have portfolio investment positions in the United States, but have not yet ventured into FDI stakes.

State-owned enterprises account for only 27% of transactions from 2000-2012 but for 63% of total investment value in the same period. This reflects the fact that those SOEs are dominating capital intensive industries in China, and they are the ones closing the larger-scale deals in the U.S. too, for example in the extractive industry. Within the group of state-owned firms, central SOEs account for the majority of deals (73%) and investment value (75%) while firms owned by provincial and municipal governments play a smaller role (26% of deals and 25% of deal value).

Private firms - which we define as those having 80% or greater nongovernment ownership - account for the vast majority of transactions in the United States: 461 of 633 recorded investments between 2000 and 2012, or 73%. In terms of total investment value, private firms accounted for only 37% of total flows from 2000-2012 as they tended to invest in smaller and less capital-intensive projects than SOEs. However, private firms have lately been catching up with SOEs and are becoming an increasingly important driver of capital flows. They are now interested in medium and large-scale deals, not just the smaller transactions seen in the past, and they are increasingly capable of managing those investments. In the fifteen months from January 2012 to March 2013, private firms have spent as much money on FDI transactions in the U.S as in the eleven years before combined. In the same period, they accounted for 80% of transactions and close to 50% of total transaction value (as displayed in Figure 4 in the Appendix).

6. Employment Impacts of Chinese Investment in the United States

Our dataset also tracks the number of Americans employed by the subsidiaries of Chinese firms in the US. Chinese firms were negligible employers before 2008, with the exception of Lenovo's acquisition of IBM's personal computer division in 2005. Since 2009 the number or jobs provided has increased substantially on the back of greater annual investment flows and an increase in large-scale acquisitions. We find that the number of jobs provided by majority Chinese-owned subsidiaries has grown from fewer than 2,000 in 2000 to around 10,000 in 2007 and more than 30,000 at the end of 2012 (Figure 5 in the Appendix).

Our figures only refer to U.S. subsidiaries with a Chinese *majority* ownership, so they do not include employment provided by firms in which Chinese investors hold a minority interest. The latter account for more

[11] This refers to CIC's 2010 $1.58 billion investment of Virginia's AES Corporation. Details of the deal can be found at: http://investor.aes.com/phoenix.zhtml?c=76149&p=irol-newsArticle&ID=1402516.

than 40% of the total value of investments in our database from 2000-2012, including shale gas assets by Devon Energy or Chesapeake Energy. If we added jobs at firms with Chinese minority equity stakes, our figure would be higher by several thousands. Nor do we include indirect job creation related to the construction of facilities or at suppliers, which can be sizable; Tianjin Pipe Corporation's (TPCO) new steel plant in Texas, for instance, is estimated to employ 1,000-2,000 construction workers.

The most prominent greenfield investors are Wanxiang, which entered the U.S. market in 1994 and grew into a diversified business employing 6,000 Americans; Haier, which established its first production facility in South Carolina in the late 1990s and today employs about 350 people; Huawei, which employs around 1,500 people at its R&D centers in California, Texas and New Jersey and other U.S. facilities; and Sany, which runs a manufacturing facility employing more than 130 people in Georgia. Big manufacturing projects currently under construction include TPCO's steel pipe plant in Texas and a copper tube manufacturing facility by Golden Dragon in Alabama.

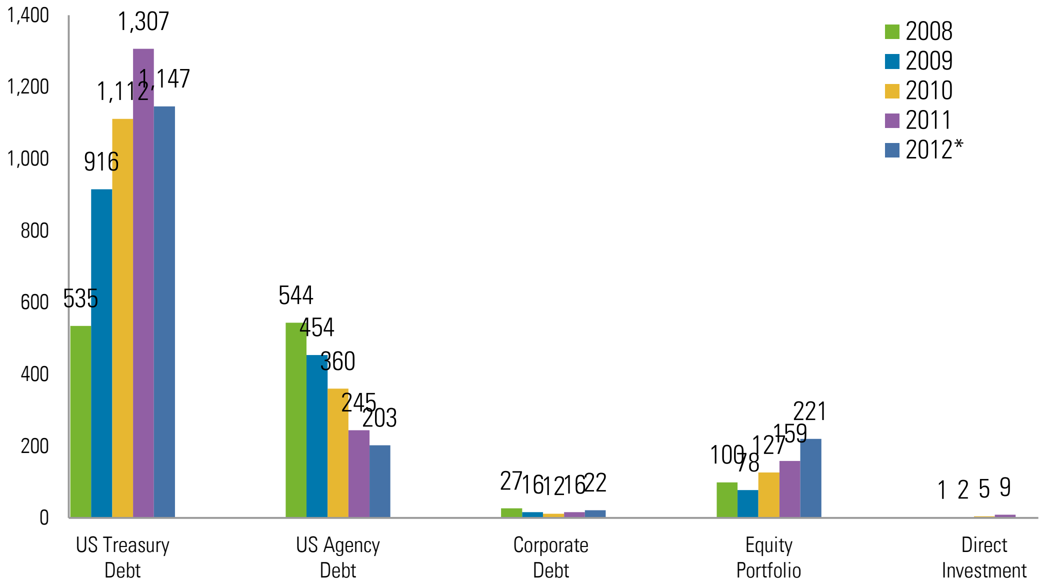
The impacts that mergers and acquisitions have on jobs are less clear. M&A deals can be positive for local employment if the investor saves the target from bankruptcy or hires additional staff after the acquisition. But the impacts could also be negative if the post-merger integration or restructuring results in the downsizing of local employment, or if the investor chooses to extract valuable assets and shut down local operations completely. Reviewing the M&A transactions in our data set that gave Chinese investors majority control of a U.S. company, we find that the jobs impact is overwhelmingly positive. We see no evidence of systematic "asset stripping" behavior and find that most Chinese parent firms have maintained or added staff after acquiring companies in the United States.[12]

[12] For more details, see Rhodium Group, The Employment Impacts of Chinese Investment in the United States, http://rhg.com/articles/the-employment-impacts-of-chinese-investment-in-the-united-states

Data Appendix

Figure 1: China's Investment Position in the United States, 2011/2012

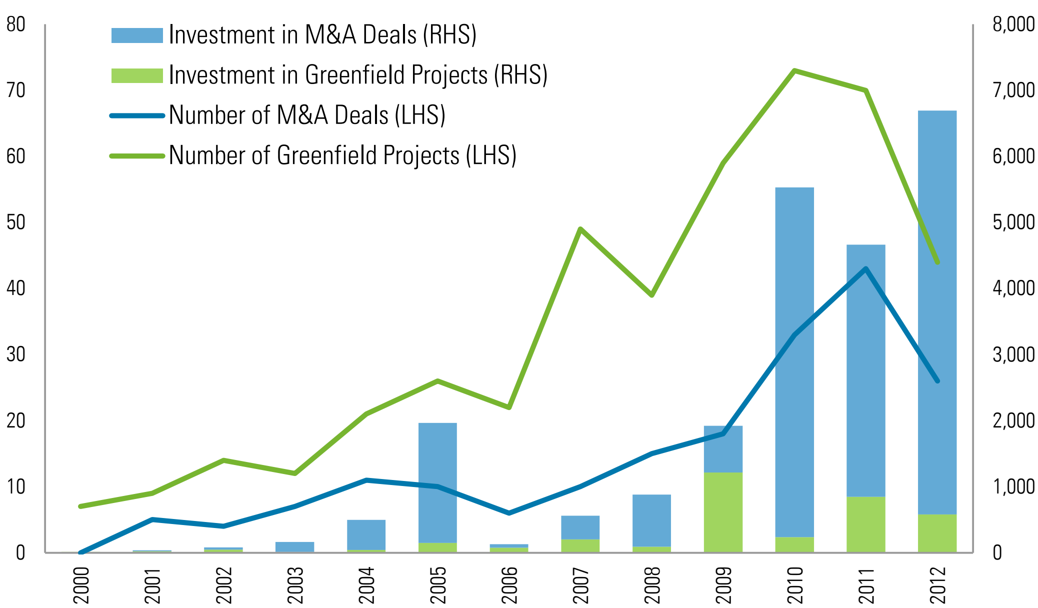
Billions of U.S. dollars, direct holdings only



Sources: FDI figures based on ultimate beneficiary owner data from the Bureau of Economic Analysis; other figures from the U.S. Treasury International Capital System (TIC). *2012 data are preliminary estimates.

Figure 2: Chinese Direct Investment in the United States, 2000-2012*

Number of deals and USD million



Source: Rhodium Group. *Numbers are preliminary and subject to adjustment. A detailed explanation of sources and methodology can be found at: http://rhg.com/interactive/china-investment-monitor

Table I: China's FDI in the U.S. by Industry, 2000-2012*

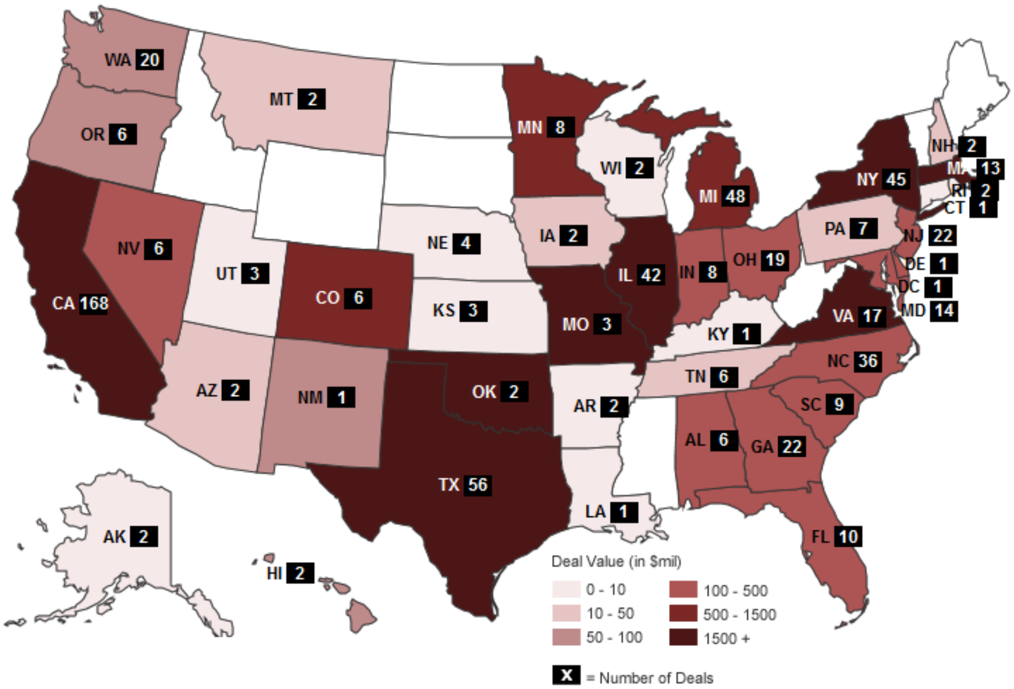
USD million and number of deals

			Value (USD mn)			Number of Projects		
			Greenfield	M&A	Total	Greenfield	M&A	Total
1	Coal, Oil and Gas	Primary	6	5,250	5,255	4	11	15
2	Farming, Logging and Husbandry	Primary	15	64	79	1	7	8
3	Paper, Rubber and other Materials	Primary	111	0	111	15	0	15
4	Aerospace Equipment and Components	Secondary	106	460	566	4	5	9
5	Automotive Equipment and Components	Secondary	422	739	1,160	45	22	67
6	Chemicals	Secondary	5	4	9	5	1	6
7	Consumer Products and Services	Secondary	189	2,050	2,239	56	18	74
8	Electronics and Electronic Parts	Secondary	55	88	143	33	9	42
9	Food Processing and Distribution	Secondary	8	33	41	6	2	8
10	Healthcare and Medical Devices	Secondary	13	279	293	7	4	11
11	Industrial Machinery and Tools	Secondary	197	1,711	1,908	39	13	52
12	IT Equipment	Secondary	221	190	411	36	6	42
13	Metals and Minerals	Secondary	1,256	70	1,327	14	4	18
14	Other Transportation Equipment	Secondary	51	5	55	9	1	10
15	Pharmaceuticals and Biotechnology	Secondary	65	192	257	20	6	26
16	Renewable Energy	Secondary	483	204	688	44	13	57
17	Semiconductors	Secondary	1	212	213	1	5	6
18	Business Services	Tertiary	43	318	361	20	15	35
19	Construction Services	Tertiary	6	0	6	4	0	4
20	Entertainment, Media and Publishing	Tertiary	9	2,614	2,623	4	5	9
21	Financial Services and Insurance	Tertiary	58	344	402	10	3	13
22	Hospitality and Tourism	Tertiary	13	345	358	1	5	6
23	Real Estate	Tertiary	0	992	992	0	10	10
24	Software and IT Services	Tertiary	176	612	788	45	21	66
25	Transportation Services	Tertiary	31	0	31	21	0	21
26	Utilities	Tertiary	1	2,813	2,814	1	2	3
	Total		3,540	19,590	23,130	445	188	633

Source: Rhodium Group. *Numbers are preliminary and subject to adjustment. A detailed explanation of sources and methodology can be found at: http://rhg.com/interactive/china-investment-monitor

Figure 3: Geographic Distribution of Chinese Direct Investment in the United States, 2000-2012*

Accumulated deal value from 2000-2012, USD million



Source: Rhodium Group. *Numbers are preliminary and subject to adjustment. A detailed explanation of sources and methodology can be found at: http://rhg.com/interactive/china-investment-monitor

Table 2: China's FDI in the U.S. by Ownership of Investing Company, 2000-2012*

USD million and number of deals

Number of Deals

	Greenfield	% share	M&A	% share	All Deals	% share
Government Controlled	131	29%	45	24%	176	28%
Central SOEs	*84*	*19%*	*23*	*12%*	*107*	*17%*
Provincial & Municipal SOEs	*29*	*7%*	*16*	*9%*	*45*	*7%*
CIC & Central Huijin	*10*	*2%*	*2*	*1%*	*12*	*2%*
Other	*8*	*2%*	*4*	*2%*	*12*	*2%*
Private and Public*	314	71%	143	76%	457	72%
	445		**188**		**633**	

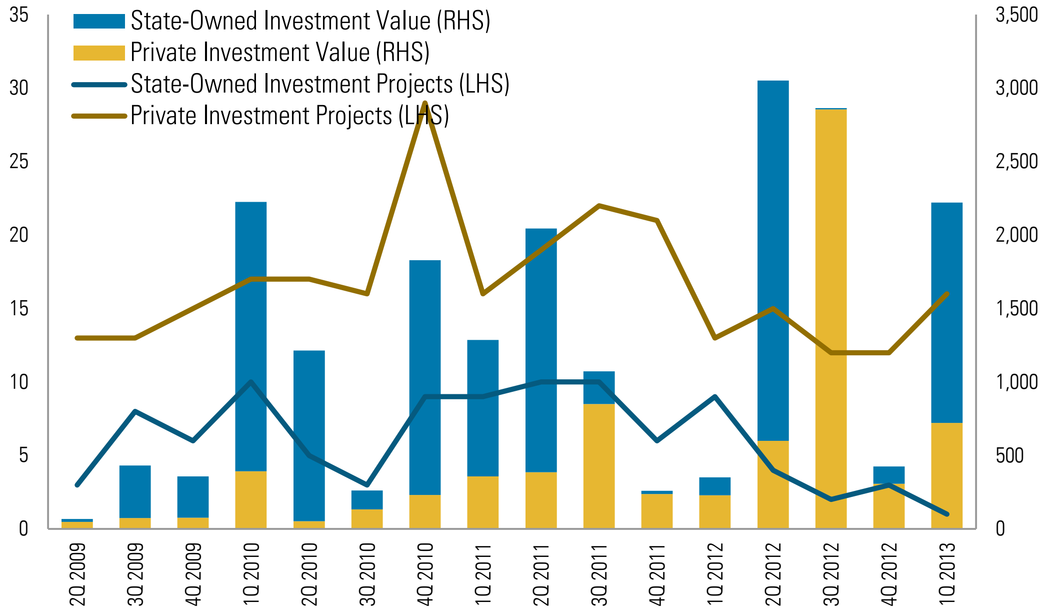
Value of Deals

	Greenfield	% share	M&A	% share	All Deals	% share
Government Controlled	2,227	63%	12,399	63%	14,626	63%
Central SOEs	*877*	*25%*	*6,667*	*34%*	*7,544*	*33%*
Provincial & Municipal SOEs	*1,188*	*34%*	*2,154*	*11%*	*3,342*	*14%*
CIC & Central Huijin	*49*	*1%*	*1,721*	*9%*	*1,770*	*8%*
Other	*113*	*3%*	*1,857*	*9%*	*1,970*	*9%*
Private and Public*	1,313	37%	7,191	37%	8,504	37%
	3,540		**19,590**		**23,130**	

Source: Rhodium Group. *Numbers are preliminary and subject to adjustment. A detailed explanation of sources and methodology can be found at: http://rhg.com/interactive/china-investment-monitor; **May include minority stakes by government-owned investors below a combined 20% of voting shares.

Figure 4: Chinese Direct Investment in the US by Ownership, Q2 2009 – Q1 2013*

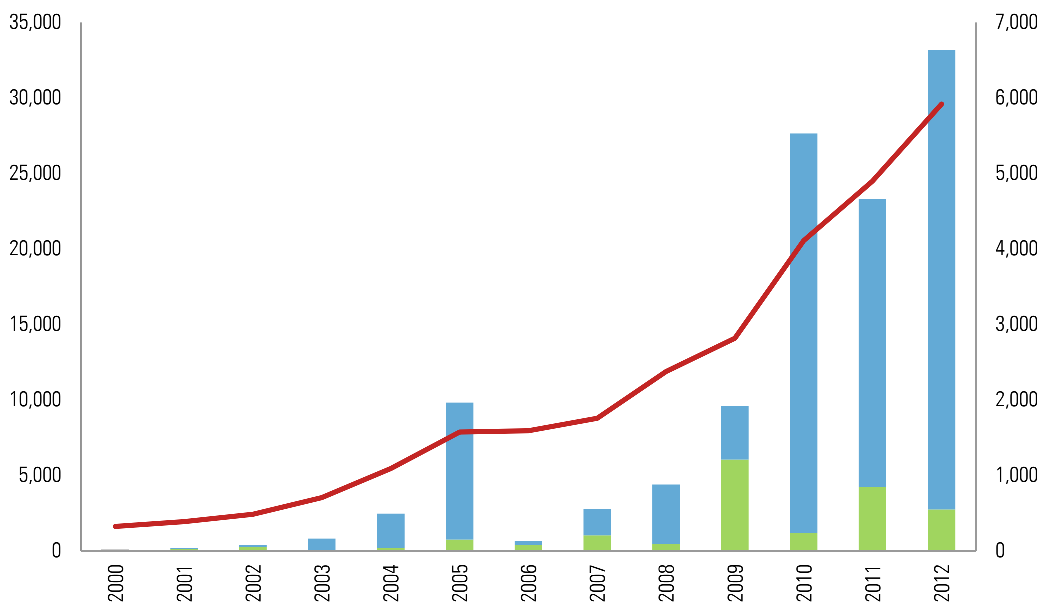
Quarterly figures, USD million



Source: Rhodium Group. *Numbers are preliminary and subject to adjustment. A detailed explanation of sources and methodology can be found at: http://rhg.com/interactive/china-investment-monitor

Figure 5: Chinese FDI and Employment at Majority Chinese-Owned US Firms, 2000-2012*

Value in USD millions (RHS); number of investment deals (LHS)



Source: Rhodium Group. *Numbers are preliminary and subject to adjustment. A detailed explanation of sources and methodology can be found at: http://rhg.com/interactive/china-investment-monitor