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Chinese Direct Investment in the United States: Recent Trends and Policy Implications

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

As director and economist at the Rhodium Group, I have been closely following Chinese outbound investment for the past decade. I have built a unique database that captures all Chinese direct investment transactions in the United States since 1995, which gives me a very granular perspective on the activities of Chinese companies in the U.S.

Over the past decade, I have published numerous studies on Chinese investment in the US with the goal of contributing to a data- and facts-driven public debate about the benefits and risks of this new dimension of US-China economic relations.

In 2016, I co-authored a report for the U.S.-China Economic and Security Review Commission ("Chinese Investment in the United States: Recent Trends and the Policy Agenda"), which describes recent patterns of Chinese foreign direct investment (FDI) in the U.S., analyzes the policy environment in the US and China, and puts forward our view on the implications for policymakers.

This written statement summarizes the findings of that report, provides an update on the full year 2016 numbers, and discusses recent policies in China that tighten the administrative control over capital outflows. Charts pertaining to the statement can be found in the Appendix.

1. Patterns and Growth of Chinese Direct Investment in the United States

Public attention on Chinese FDI in the United States is at unprecedented levels, but available official statistics do not offer a coherent perspective on the level and recent patterns of these inflows. Figures 1 and 2 in the Appendix summarize available data points. Estimates of the total stock of total Chinese FDI in the United States range from $21 billion, according to the US Bureau of Economic Analysis (BEA), to $47 billion, according to China's Ministry of Commerce (MOFCOM).[1] Data points that try to capture the flows of China's U.S. FDI in the last

[1] FDI stock refers to the cumulative value of FDI flows at a given point of time, either at historical value or adjusted for market prices.

5 years also differ greatly and are sometimes contradictory. BEA's balance of payments (BOP) figures show annual flows fluctuating between $1 and $5 billion during 2011-2015; MOFCOM shows a steady increase from $1.3 billion in 2010 to $7.6 billion in 2014.

Given these discrepancies and other shortcomings, alternative datasets based on aggregating individual transactions are indispensable for properly understanding the latest trends of Chinese investment and metrics relevant for policy. These datasets record a higher stock of Chinese FDI in the U.S. and greater levels of investment in recent years than official statistics. The most detailed dataset available is Rhodium Group's China Investment Monitor (CIM), which includes more than 1,200 individual investments from 2000 to 2015, together amounting to $64 billion.[2]

The CIM dataset also offers a timely perspective on the growth of Chinese inflows in recent years. The combined value of Chinese FDI transactions in the U.S. has grown from an annual average value of less than $500 million before 2008 to $15.3 billion in 2015. In 2016, Chinese corporations spent a new record of $45.6 billion on acquisitions and greenfield projects in the United States. This is three times as much as in 2015 and pushed total cumulative Chinese FDI in the U.S. from $64 billion to $109 billion. Figure 3 in the Appendix displays the recent growth trajectory of Chinese FDI in the U.S., relaying on Rhodium Group's transactions data.

2. Industry Composition and Geographic Distribution

Chinese FDI is increasingly headed toward advanced manufacturing, services and safe haven assets. China's U.S. investments have broadened from trade facilitation and natural resource extraction to a more diverse set of activities. Since 2013, investment in unconventional oil and gas extraction has declined substantially from previous years. This drop was balanced by rapid growth of investment in technology and innovation-related activities and modern service sector assets. Chinese companies seeking to move up value chains, access U.S. markets directly, and capitalize on the U.S.'s research and development capabilities have led this charge. In recent years, we record fast expansion of investment in U.S. subsidiaries engaged in research and development as well as manufacturing.

In the past three years, Chinese investors have also ramped up their investments in commercial real estate and other safe haven assets that allow them to diversify away from China. Figure 5 in the Appendix provides an overview of Chinese FDI by sector for three different periods of time. Most Chinese capital is still entering the U.S. through the acquisition of existing assets, but greenfield FDI is growing fast and numerous large projects are currently under construction.

This investment is now spread widely across the U.S. Figure 4 in the Appendix shows cumulative Chinese FDI in each state since 2000, logged by the location of greenfield projects and headquarters of acquired companies. By the end of 2016, 47 out of 50 states had received

[2] http://rhg.com/interactive/china-investment-monitor.

investment from China. The top five recipients of Chinese capital were California, New York, Illinois, Kentucky, and Virginia.

3. Characteristics of Chinese Investors

The shift in investment patterns has also transformed the mix of Chinese investors in the U.S. economy (Figure 6 in the Appendix).[3] Before 2005, the mix of Chinese investors in the U.S. consisted of large state-owned investors as well as small privately-owned trading and manufacturing companies, but investment values were tiny. In 2005, then state-owned firm Lenovo made the first sizable investment in the U.S., which dominated cumulative investment until 2009. From 2009 to 2013, Chinese capital inflows were predominantly state-related, as state-owned enterprises (SOEs) in energy and a handful of other sectors expanded their footprints. At the peak in 2011, SOEs accounted for 53% of cumulative Chinese FDI in the U.S. Since then SOE investment has continued, but growth has been largely driven by privately owned companies. In 2015 and 2016, privately owned companies accounted for 78% and 79% of total investment, respectively. By the end of 2016 the share of state-owned entities in cumulative investment fell to 27%, and privately owned companies accounted for 73% of the total.

A table of the largest Chinese investors in the U.S. (Table 1 in the Appendix) shows that all of the top five and 12 out of the top 20 investors are private. The largest private investor is HNA, the parent of Hainan Airlines, and owner of Ingram Micro, a distributor of information technology products, as well as real estate and hotel assets. Second is Wanda, an entertainment and real estate conglomerate with major investments in the U.S. film industry. Insurance company Anbang is in third place through its investments in real estate and hospitality. Shuanghui (now WH Group), which acquired pork producer Smithfield in 2013, is fourth. Lenovo, an early investor in 2005 with two more major deals in 2014 (acquisitions of IBM's x86 server division and Motorola Mobility) is a close fifth. The largest SOE investors are oil companies Sinopec and China National Offshore Oil Corporation (CNOOC), Aviation Industry Corporation of China (AVIC), China Life, the insurance company, and China Investment Corporation (CIC), China's primary sovereign wealth fund.

While privately owned companies now dominate, recent Chinese restructuring plans suggest that SOEs will remain an important part of China's FDI flows in years ahead. More importantly, it is difficult to properly classify SOEs and the distinction between private and state-owned companies for policy analysis based on nominal equity ownership is problematic. China's state-dominated financial system and the lack of rule of law means that state involvement can be pervasive, even if a firm is nominally privately owned.

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[3] The category of state-owned investors includes central SOEs under the State-Owned Assets Supervision Administration and Commission, local SOEs controlled by provincial or municipal governments, sovereign investors, and any other entities that have more than 20% combined government ownership. The category of private investors includes companies that are at least 80% owned and controlled by non-state-related investors. We chose the 80% threshold because most listed companies have small, passive stakes from state-related entities such as commercial banks, which makes a 100% threshold for the category of private ownership problematic for our analytical purposes.

4. Chinese Outbound Investment Policy

Chinese government policies are important variables for explaining the patterns of China's global outbound investment and its FDI footprint in the United States. For most of the first two decades of China's economic reform period, Chinese companies were forbidden from investing overseas unless they had direct approval from the government. This restrictive stance changed only gradually starting in the early 2000s when the Chinese government began to liberalize and encourage outbound investment. In the past five years, China has further liberalized its outbound investment approval regime, so that most investments now only need to be registered with the two main regulators, MOFCOM and the National Development and Reform Commission (NDRC). This streamlined process, which is summarized in Figure 7 of the Appendix, has made it much easier for private companies to invest overseas, which partially explains the surge in private outbound investment.

In the past 18 months, outward FDI has grown so rapidly that Chinese leaders felt compelled to slow down outflows. Since mid-2014, China's balance of payments conditions have changed substantially with the financial account shifting from a surplus to a deep deficit. Net capital outflows accelerated after the one-off yuan depreciation in mid-2015, with more than $150 billion of net outflows per quarter in 3Q and 4Q 2015. The post-election spike in the U.S. dollar sent the RMB/USD exchange rate below the 6.90 level and further accelerated outflows in late 2016. Additional pressure looms with expectations of further Fed rate hikes in 2017. In response to these changing BOP dynamics, Chinese authorities have re-tightened administrative controls for outbound FDI. In early 2016, China's central bank began to ask banks to increase scrutiny on foreign exchange conversion. In November 2016, the State Council issued guidance that discourages outbound transactions with certain characteristics, among them large deals and investments that principally seek financial returns. At the same time, leaders and regulators reaffirmed support for legitimate outbound FDI transactions. The situation is currently in flux and new formal rules that bring greater clarity on which transactions are considered "illegitimate" are expected in the first quarter of 2017.

In addition to administrative measures allowing and discouraging certain types of transactions, the Chinese government also influences the patterns of outbound investment through broader economic policy as well as incentives and policies aimed at promoting overseas investment in specific industries, technologies and geographies. However, current data do not allow clear-cut conclusions about causality between industrial policy and outbound investment patterns. Examining Chinese investment into the U.S., it is impossible to determine whether investments in targeted sectors are directly driven by a specific policy, or whether they are the result of Chinese companies' own business interests. Additionally, Chinese industrial policy support is so broad as to render it difficult to classify. We do not find compelling evidence that Chinese industrial policy broadly explains outbound FDI in the U.S., but there are individual cases in which the relationship is qualitatively and anecdotally apparent.

The surge in global takeover offers in the semiconductor industry is the most notable example of the industrial policy-outbound investment nexus. Since 2014 Chinese private and state-affiliated

players have hastened to explore US semiconductor asset acquisitions following a central government initiative to strengthen China's domestic semiconductor capabilities. Cumulative Chinese investment in the US semiconductor industry amounted to only $200 million before 2014, but investment activity soared in 2014 and 2015, with more than $800 million of completed transactions (and several failed takeover attempts) in those two years (see Figure 7 in the Appendix).

5. U.S. Policy to Review Inbound Investment

The current U.S. system for screening inward FDI has generally handled the influx of Chinese investment well thus far, simultaneously permitting the benefits while addressing concerns. The U.S. government has identified and blocked acquisitions that could have threatened national security interests while allowing the vast majority of investments to proceed. Importantly, review by the Committee on Foreign Investment in the United States (CFIUS) is not the last opportunity to regulate the behavior of Chinese firms. Recent cases illustrate that the expansion of local presence and assets through FDI means that Chinese companies can be held accountable in U.S. courts in cases of non-compliance with laws or commercial disputes, which is good news for U.S. regulators and businesses.

While the U.S. system has generally worked well in the past, investment from China may require a re-assessment of traditional risks related to FDI because China is different than most other countries that have significant FDI stocks in the U.S. economy: it has a vastly different economic system with heavy state intervention, it has a non-democratic political system without rule of law, and it is emerging as a geopolitical competitor of the United States in the international system.

There is no prima facie reason to presume that FDI originating from China is not, on net, beneficial, due to these factors. Utilizing our database, we find little to no deleterious side effects thus far. However, atypical Chinese characteristics, such as state-directed collusion among firms in some concentrated sectors, may require new approaches to screening inward investment if those characteristics do not subside.

6. Priorities for Policymakers

Based on my understanding of Chinese investment patterns and related benefits and risks, I recommend Congress to focus on the following priorities:

First, national security screening and law enforcement need adequate resources. I do not see immediate urgency to change the CFIUS mandate or processes, but our data and case studies point to two important dimensions to ensure the efficiency of the current approach. For one, the Treasury Department and CFIUS as a whole need to have sufficient resources to fulfill their mandates. The increase of Chinese FDI means that the number of reviewed transactions has

grown rapidly in recent years, requiring additional resources to ensure an efficient process. Moreover, the growing local presence of Chinese companies and citizens means that U.S. regulators and law enforcement need to have the appropriate resources to monitor new developments and assess their implications for U.S. national security, for example local R&D cooperation with Chinese-owned companies, technology licensing by U.S. firms to local subsidiaries of Chinese companies, or early stage technology financing.

Second, lawmakers should explore options to address concerns about economic risks**.** The discrepancy between market access for Chinese investors in the U.S. and U.S. investors in China, and the potential transmission of distortions caused by state-owned enterprises, subsidies and other non-market elements in the Chinese economy are the two key concerns. Simple calls for reciprocity are misguided but we recognize the need for greater symmetry in the two-way U.S.-China FDI relationship as a bulwark against further erosion of mutual trust and perceptions. We also share concerns about competition policy fundamentals and the potential for market distortion if Chinese FDI continues to grow without clearer separation between political authorities and commercial entities at home. If the scale of China's participation in the U.S. reaches the levels we forecast, and the comingling of commercial and political motives is not resolved, then a new chapter in U.S. – and global – competition policy activism may be required.

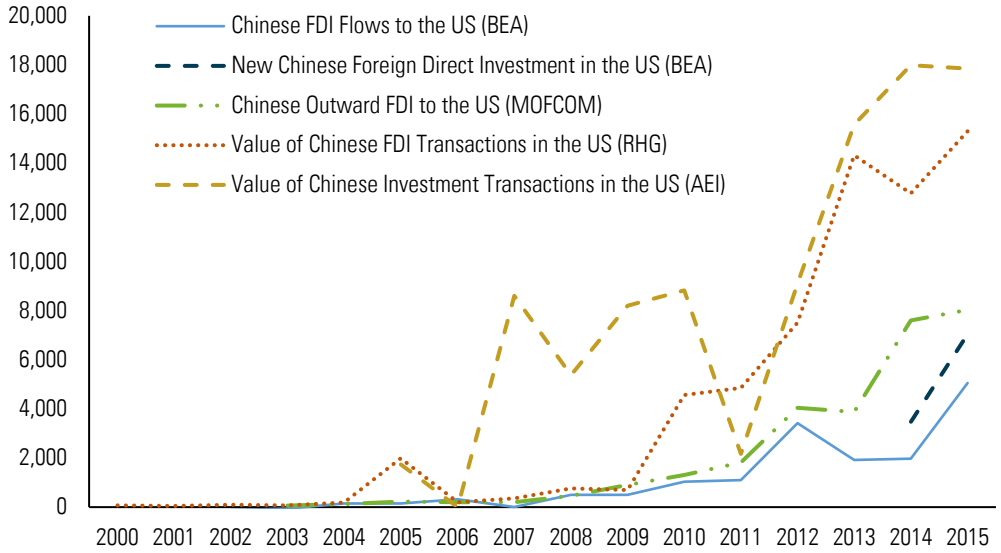
I also strongly believe that a bilateral investment agreement with China offers significant opportunities. A robust bilateral investment treaty (BIT) that gives U.S. investors pre-establishment rights in China limited only by a narrow list of restricted industries would help to level the playing field, which would contribute to avoiding the politicization of two-way FDI flows and thus sustaining the benefits of Chinese inflows into the United States for the long-term. At the same time, a BIT with China will not dilute existing U.S. authority to scrutinize Chinese investment for legitimate purposes.

Finally, recent attempts by Chinese SOEs to claim immunity have predictably triggered efforts to tighten loopholes, while firms place higher risk premiums on dealing with Chinese investors, showing that the system is functional. Lawmakers should further review and, if necessary, close potential loopholes that allow companies to escape accountability.

Appendix: Figures and Tables

Figure I: Comparison of Available Data for Chinese FDI Flows to the US, 2000-2015

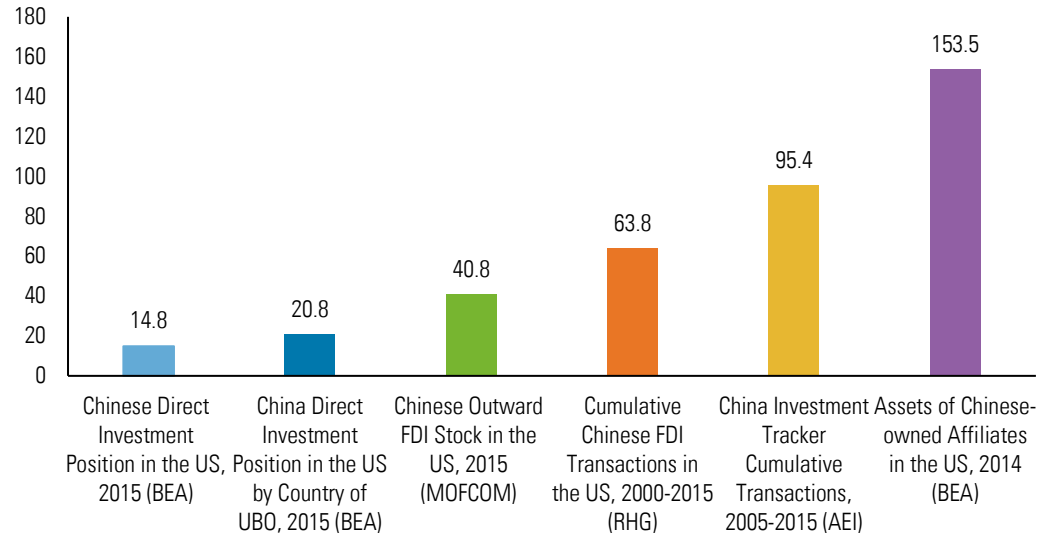
USD million



Source: "Balance of Payments and Direct Investment Position Data", Bureau of Economic Analysis, "China's Outward Foreign Direct investment", Ministry of Commerce, American Enterprise Institute, Rhodium Group.

Figure 2: Comparison of Available Data for Chinese FDI Stock in the US, 2015

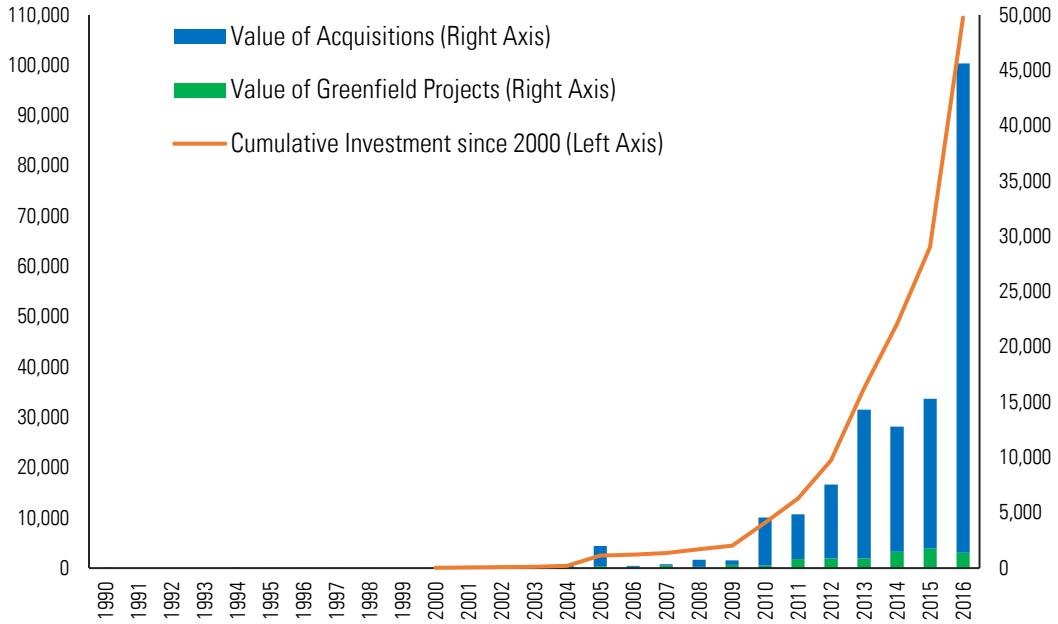
USD million



Source: "Balance of Payments and Direct Investment Position Data" and "Data on Activities of Multinational Enterprises", Bureau of Economic Analysis, "China's Outward Foreign Direct investment", Ministry of Commerce, American Enterprise Institute, Rhodium Group.

Figure 3: Chinese FDI Transactions in the U.S., 2000-2016

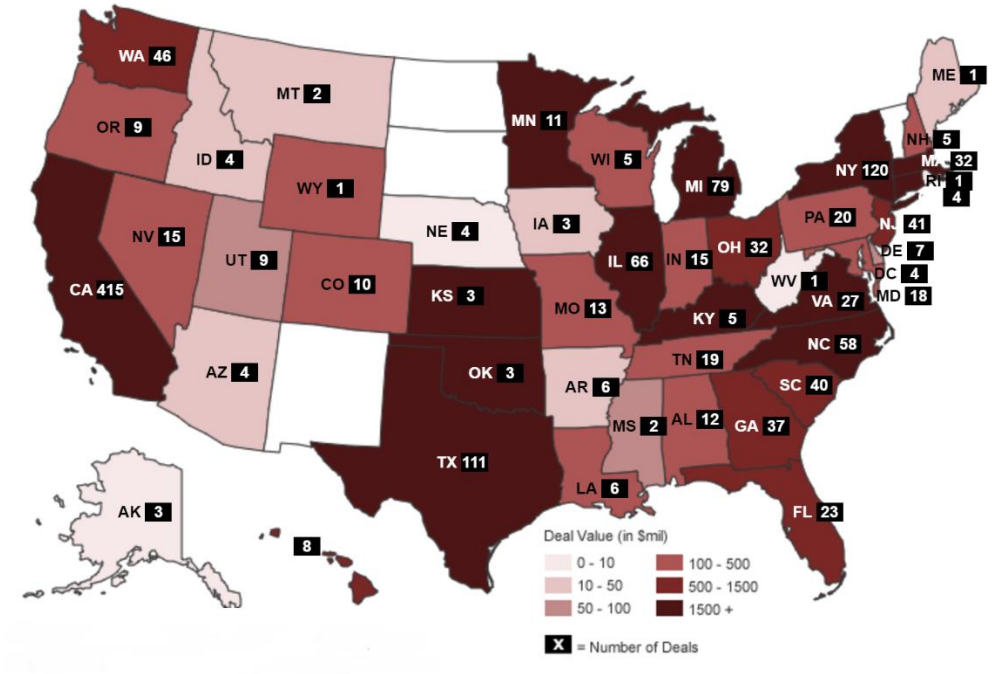
USD million



Source: Rhodium Group.

Figure 4: Geographic Distribution of Chinese Investment in the U.S., 2000-2016

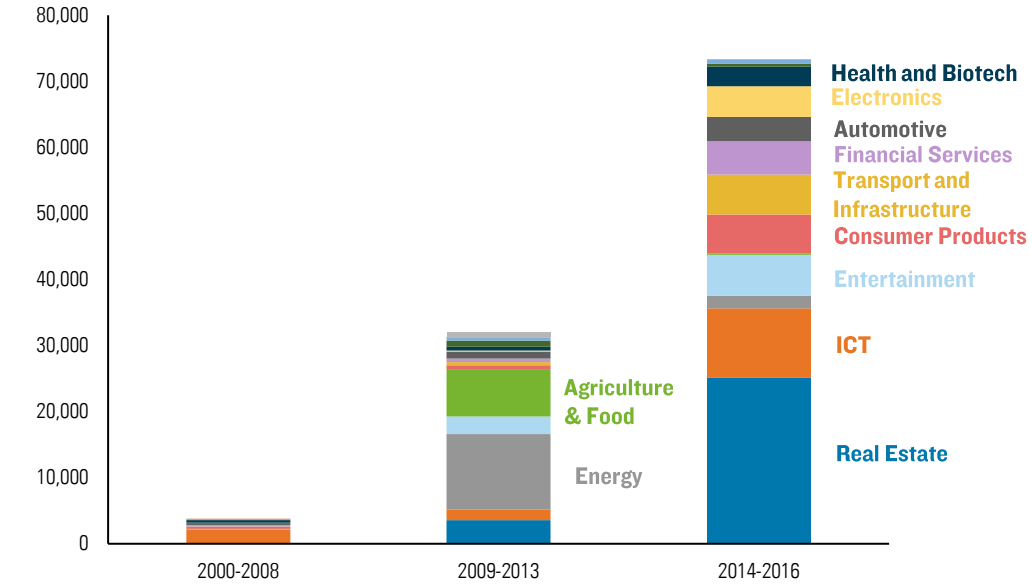
USD million; number of transactions



Source: Rhodium Group

Figure 5: Value of Chinese FDI Transactions in the US by Industry, Different Periods, 2000-2016

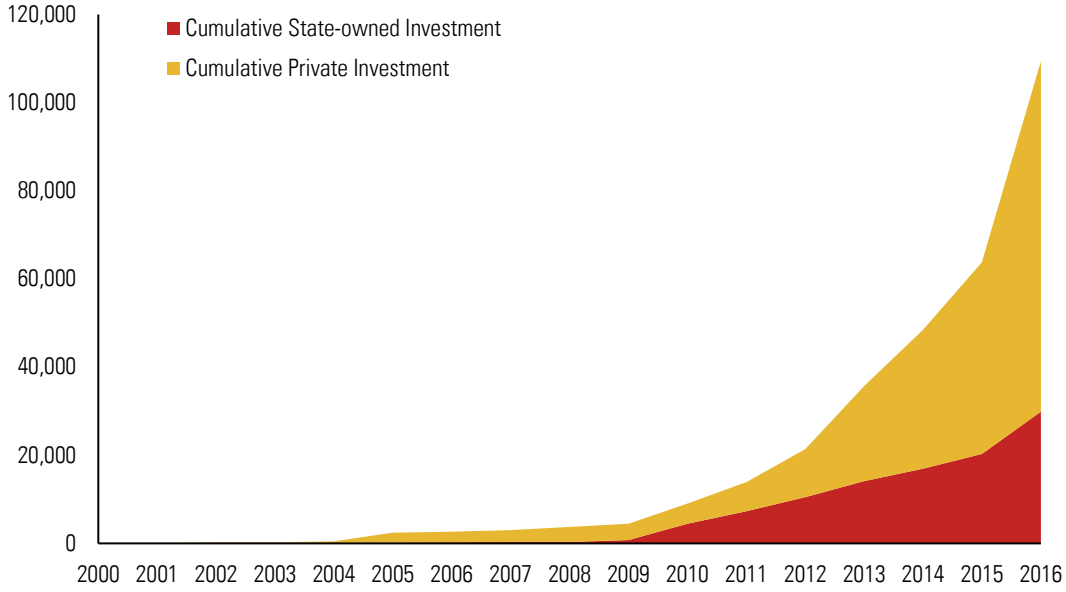
USD million



Source: Rhodium Group.

Figure 6: Cumulative Value of Chinese FDI Transactions in the US by Ownership of Investor, 2000-2016

USD million



Source: Rhodium Group.

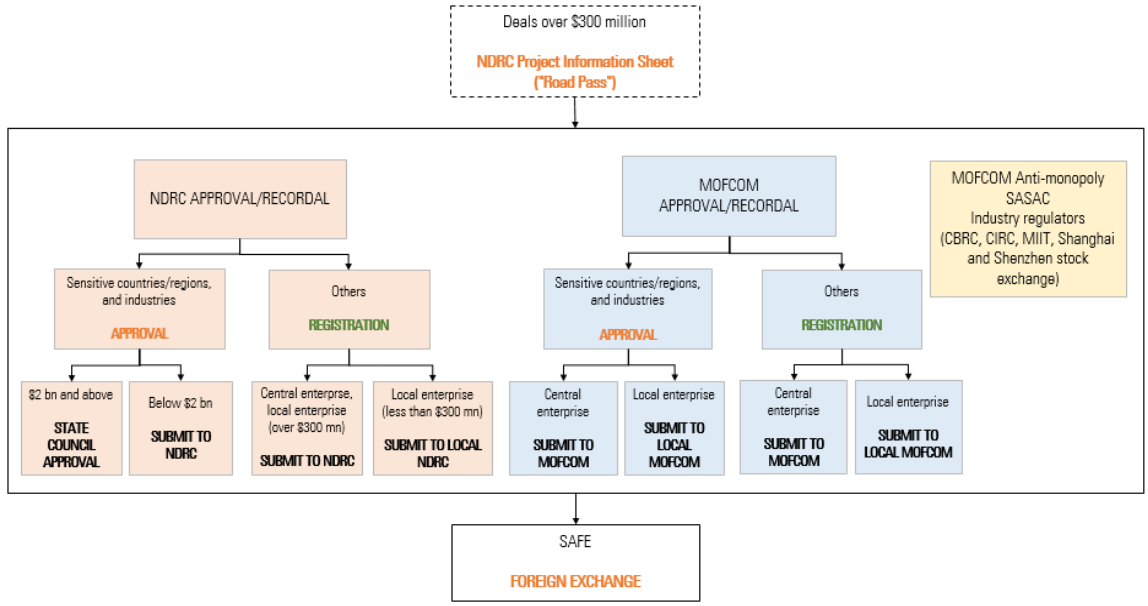
Table I: Ranking of the Biggest Chinese Investors in the United States

By cumulative investment from 2000–2016, USD billion

Rank	Investor	Ownership	Total Investment
1	HNA	Private	$10.0
2	Wanda	Private	$8.5
3	Anbang	Private	$7.9
4	Shuanghui/WH Group	Private	$7.1
5	Lenovo	Private	$7.0
6	Haier	Private	$5.7
7	Fosun	Private	$4.0
8	Apex Technology	Private	$3.7
9	Sinopec	State-Owned	$3.6
10	China Life	State-Owned	$3.3
11	China National Offshore Oil Corporation (CNOOC)	State-Owned	$3.3
12	China Investment Corporation (CIC)	State-Owned	$3.3
13	Aviation Industry Corporation of China (AVIC)	State-Owned	$2.2
14	Hua Capital consortium	State-Owned	$1.9
15	Yantai Xinchao	Private	$1.3
16	Zhang Xin family	Private	$1.3
17	Huaneng	State-Owned	$1.2
18	Wanxiang	Private	$1.2
19	Tencent	Private	$1.0
20	Greenland	State-Owned	$1.0

Source: Rhodium Group. This table is based on transactions since 2000 only and does not take into account divestitures.

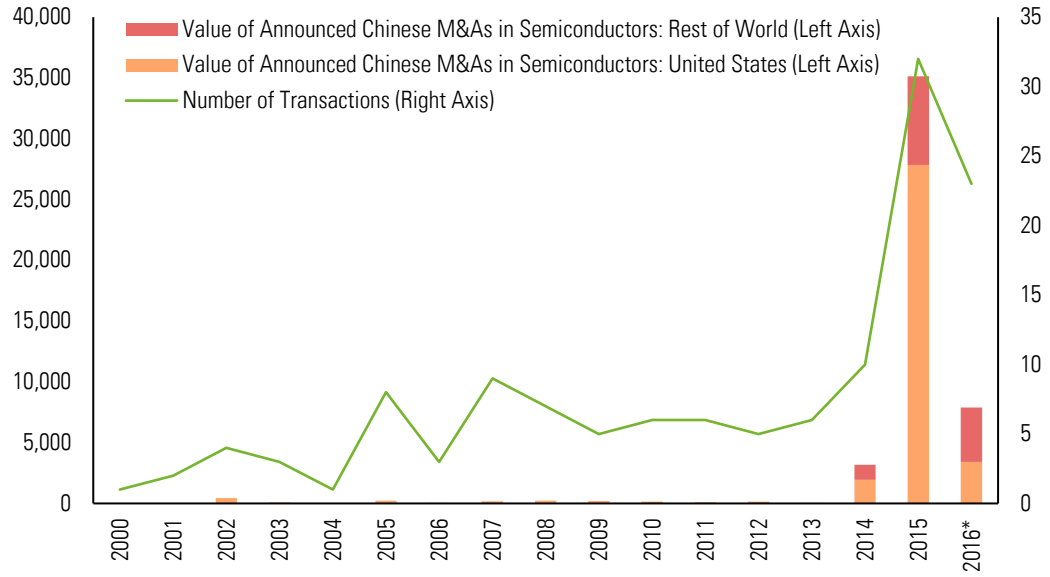
Figure 7: China's Regulatory Regime for Outbound FDI, June 2016



Source: Authors' compilation based on policy documents and expert interviews (June 2016).

Figure 8: Value of Announced and Rumored Chinese M&A in the Semiconductors Industry, 2000-2016*

USD million; number of transactions



Sources: Bloomberg, Rhodium Group. * 2016 through August.