Hearing on "The Evolving U.S.-China Trade and Investment Relationship"
Testimony before the U.S.-China Economic and Security Review Commission
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The United States' trade and investment engagement with China presents myriad opportunities and challenges for the world's two largest economies. The items addressed in the most recent Strategic and Economic Dialogue, concluded on May 4, 2012, reflect the importance and complexity of this relationship. These include, among other items, China's agreement to participate in negotiations on export financing with the United States and other major exporting countries; efforts to ensure that U.S. firms may compete on a fair basis with Chinese state-owned enterprises; positive direction on Chinese efforts to join the WTO Agreement on Government Procurement; agreement to "intensify negotiations" for a U.S.-China Bilateral Investment Treaty (BIT); and various commitments related to intellectual property protection.

More broadly, the intricacies and challenges of the U.S. engagement with China on trade and investment issues range from significant macro-level policy matters — such as rebalancing the export-driven nature of the Chinese economy, and ensuring transparency and fairness in each country's rules governing trade and investment — to very practical obstacles, such as visa restrictions and differences in management experience, that can exacerbate the distance between the two economies.

The diversity and depth of these matters, in turn, underscores the complexity of the topic of this hearing, "The Evolving U.S.-China Trade and Investment Relationship." Within that broad subject, I have focused my testimony on three areas in particular:

- The benefits of foreign direct investment to the U.S. economy and job creation, and an assessment of Chinese foreign direct investment (FDI) to date;
- The regulatory and institutional environment in the United States for FDI from China, including the role of the Committee on Foreign Investment in the United States (CFIUS); and
- Other factors impacting Chinese outbound FDI, and the role that a U.S.-China BIT may play in attracting more Chinese direct investment in the United States.

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I. The Benefits of Foreign Direct Investment in the United States and the Role and Status of Chinese Investment

FDI has received long-standing, bi-partisan policy backing: every Administration since that of President Carter has issued formal policy statements or speeches expressing strong support for FDI. The most recent of these was President Obama's statement last June on the U.S. commitment to an open investment policy.

The reasons for this bi-partisan support are clear: there is an unambiguous record of FDI contributing to a stronger manufacturing base, creating higher-paying jobs, promoting investment in domestic research and development, and generating greater tax revenues. For example, the Council of Economic Advisers has reported that:

- Majority-owned U.S. affiliates of foreign corporations produced $670 billion in goods and services in 2008, accounting for about six percent of total U.S. private output that year;

- These same companies employed 5.7 million U.S. workers, accounting for five percent of the U.S. private workforce and 13 percent of the U.S. manufacturing sector, and were responsible for more than 18 percent of U.S. merchandise exports; and

- The capital expenditures of these firms accounted for more than 11 percent of total U.S. private capital investment, and contributed to over 14 percent of total U.S. private R&D investment.[2]

The data are even more attractive when considering the ancillary benefits of FDI. According to a study released last month by the Organization for International Investment:

- While U.S. subsidiaries of foreign companies directly employ 5.3 million people, they also are responsible for an additional 15.8 million jobs in the related supply chain or associated with the spending of the employees' paychecks, thereby indirectly accounting for a total of 21 million jobs (or 12.2 percent of total U.S. employment).

- The jobs related to foreign direct investment are higher-paying. The average compensation in the U.S. for all types of employment is $50,100, while the average compensation for a position with a direct U.S. subsidiary of a foreign company is more than 50 percent higher, at $77,590, and the average compensation for both direct and indirect jobs supported by U.S. subsidiaries of foreign companies is $58,500 (17 percent higher).

- Approximately 2 million jobs at U.S. subsidiaries of foreign companies are in the American manufacturing sector, accounting for about 17 percent of total American

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[2] Executive Office of the President, Council of Economic Advisers, *U.S. Inbound Foreign Direct Investment* (2011), *available at* http://www.whitehouse.gov/sites/default/files/microsites/cea_fdi_report.pdf.

manufacturing jobs. These subsidiaries also account for more than 21 percent of all U.S. exports, or $219.7 billion.

- Although U.S. subsidiaries of foreign companies account for less than one percent of all U.S. businesses, they account for $43.4 billion in annual spending on U.S. research and development activities; reinvest $93.6 billion annually in their U.S. operations; and pay $38 billion in annual U.S. corporate taxes, nearly 17 percent of total U.S. corporate tax payments.[3]

In light of these benefits from FDI *generally*, an important policy question for U.S. engagement with China is the extent to which Chinese investment *specifically* is contributing to the U.S. economy. The short answer is that while the last several years have seen improvements in Chinese FDI in the United States, the overall volume of such investment remains lower than it should be, especially by comparison to the strong equity investment flows from the rest of the world to the United States.

To start with the positive, there are encouraging signs of growth in the net U.S. benefit from Chinese investment. During the recent financial crisis, China's FDI stock in the U.S. grew nearly fivefold, from $1.2 billion in 2008 to $5.9 billion in 2010. U.S. subsidiaries of Chinese firms currently are estimated to own between $20 billion and $30 billion in assets on their books and to employ more than 10,000 people with higher-than-average wages. Chinese-owned firms, while still net importers, have been growing their exports, and have been steadily adding to U.S.-based R&D.[4] According to the China Investment Monitor, Chinese-owned firms have invested a total of more than $16 billion in greenfield and acquisition transactions in the U.S. since 2003.[5]

The recently-announced sale of AMC Entertainment Holdings to China's Dalian Wanda Group, which marks the largest Chinese acquisition of a U.S. company to date, is a tangible example of these positive trends. This $2.6 billion deal by a leading Chinese company includes a commitment to maintain AMC's U.S.-based headquarters, to retain AMC's U.S. management and to pursue the company's management-directed strategy, and to invest another $500 million in AMC. It also will help U.S. film companies increase their exports to China, the second largest theater market in the world. In short, the transaction not only provides the buyer with global synergies for its brand, but also provides the U.S. business with an important capital injection that will allow it to grow and expand. This is a great example of a Chinese firm investing in the U.S. economy in a way that will benefit businesses, workers, and consumers alike.

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[3] Organization for International Investment, *Chain Reaction: Global Investment Works for America* (May 2012), *available at* http://www.ofii.org/docs/OFII_CHAINREACTION_REPORT.pdf.

[4] These trends are reported by the economist Thilo Hanemann in a blog post, *It's Official: Chinese FDI in the U.S. is Soaring*, dated August 25, 2011 (reporting on data from the U.S. Bureau of Economic Analysis and the Rhodium Group's China Investment Monitor), available at http://rhgroup.net/notes/its-official-chinese-fdi-in-the-u-s-is-soaring.

[5] The China Investment Monitor is a report produced by the Rhodium Group, *available at* http://rhgroup.net/interactive/china-investment-monitor.

Notwithstanding these encouraging trends, the overall amount of FDI in equity investments from the world's second largest economy remains lower than it could be. Even with the positive growth in FDI stock to nearly $6 billion, China's direct investment pales in comparison to its well-publicized holdings of U.S. debt, and still represents well under one percent of foreign investment in the United States. Chinese FDI in the U.S. is "marginal compared to major investors such as the U.K. or Canada,"[6] and lower than other developing economies, such as Brazil or India, as well as other much smaller economies, such as Saudi Arabia.[7] Moreover, this lag also reflects the United States' relative positioning as a destination for Chinese FDI. While the United States historically has garnered approximately 15 percent of total global outward FDI flows, according to China's own figures, the U.S. ranked seventh as a destination for FDI in 2010 — behind Sweden, among others — and received only about two percent of China's outward FDI.[8] Indeed, a recent study on Chinese outbound FDI in the first quarter of 2012 reported a significant increase in investment across the globe, but lower investment in the United States compared to the same period a year earlier.[9]

The United States' relative positioning as a destination for outward Chinese FDI raises policy concerns for two reasons. First, as noted, there are immediate benefits from FDI, which the U.S. simply is not capturing in proportion to its status as the world's largest economy and the most popular economy for investment. Second, there is even greater potential for Chinese outbound FDI in the future: China is on the path to become a net exporter of FDI, with a conservative estimate of outbound FDI placing it at between $1 trillion to $2 trillion in the next decade.[10] It is important for the U.S. economy and the relative balance of U.S.-China economic relations that the U.S. capture a larger share of the forthcoming outbound FDI from China.

II. The Regulatory and Institutional Environment for Chinese Investment in the United States

Chinese firms often cite perceived regulatory and political obstacles in the United States, including the review process undertaken by CFIUS, to explain their cautious approach to investing here. Indeed, it is not uncommon for a Chinese company to ask not *how* it should invest in the United States, but *whether* it is even possible to do so. This fear factor acts as a self-imposed restraint on Chinese investment — although, as described below, it is certainly not the only, or even the principal, reason limiting Chinese investment in the United States.

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[6] Hanemann, *supra* note 4.

[7] *Id.*; *see also* Daniel E. Rosen and Thilo Hanemann, *An American Open Door? Maximizing the Benefits of Chinese Foreign Direct Investment*, Asia Society, at 27 (May 2011).

[8] Ministry of Commerce of the People's Republic of China, *2010 Statistical Bulletin of China's Outward Foreign Direct Investment* (2011), at 82-87, *available at* http://hzs.mofcom.gov.cn/accessory/201109/1316069658609.pdf.

[9] Aaron Back, "China Buys Overseas Assets," *Wall Street Journal* (June 6, 2012), *available at* http://online.wsj.com/article/SB10001424052702303296604577450053974933534.html.

[10] *See* Rosen and Hanemann, *supra* note 7, at 22.

The reality for Chinese investors, however, is quite different than the perception: there is a basic regulatory and institutional framework that applies equally to all foreign investors in the U.S., including Chinese investors, and this framework generally works to preserve and advance an open investment environment, not to hinder the prospective investors.

To start, the United States is generally open to greenfield investments, which, by their nature, are focused on the creation of a new business that adds to the economy and therefore may implicate different — and lighter — regulatory considerations. For instance, antitrust rules apply both to greenfield investments and acquisitions of existing businesses, but a greenfield investment may be less likely to raise monopoly or restraint of trade concerns.

Beyond the generic landscape of greenfield investments, there may be particular federal laws and regulations that apply to investments depending on the industry (e.g., telecommunications, energy, and banking), the size and scope of the transaction (e.g., Hart-Scott-Rodino), and the nature of the business (e.g., securities filings for acquisitions involving publicly traded companies), as well as other rules and regulations at the federal, state and local levels that, while not triggered by a transaction, are relevant to it. But these rules and regulations do not turn on the country of origin of the investment, and they accordingly are not geared to discriminate against investment from China or any other country; rather, they apply equally, if at all, to all foreign investors. The fact that the United States is the world's largest recipient of FDI also underscores the openness of the regulatory landscape to foreign investment.

The national security review process undertaken by CFIUS is a narrow — but important — overlay to this regulatory landscape. CFIUS operates pursuant to clear statutory authorities (i) to determine the national security effects of certain controlling foreign investments, and (ii) to take action, as necessary, to address national security risks when no other laws apart from certain Presidential emergency powers are sufficient to address the risk. Unlike many other countries, the U.S. does not apply an economic interest test when reviewing foreign investment. Rather, CFIUS is an appropriately tailored process focused strictly on *national security*, such that the vast majority of foreign investments — around 90 percent — are not subject to CFIUS review.

Thus, for many Chinese investments in the U.S., CFIUS will not be relevant, let alone an obstacle. For those investments that are subject to CFIUS review, the CFIUS process is not one to be feared. CFIUS acts within precise timeframes and under a defined regulatory process that, consistent with U.S. law and policy, appropriately balances the benefits of FDI with the protection of national security interests. The Committee conducts a thorough review of each case presented before it, operating from a premise — supported by the statute — that it should seek, if at all possible, to find solutions that enable transactions to proceed while protecting national security. CFIUS's record in this regard is strong; while not hesitating to take tough action to protect national security, CFIUS has an overwhelming record of approving transactions, including Chinese transactions, in a timely fashion.

This is not to ignore or diminish aspects of Chinese investment that may attract more attention from a regulatory and policy perspective. Of the United States' ten largest trading partners, China is the only one not considered an ally; Chinese state-owned enterprises have accounted for approximately 70 percent of its outbound investment; key U.S. institutions, including the Department of Defense and the U.S. intelligence and law enforcement agencies, view certain

Chinese investments with great suspicion; and U.S. concerns regarding the transfer of export-controlled technologies and other compliance matters can be especially acute with China.

Chinese transactions *can* receive comparatively greater scrutiny, and there *are* cases — frequently cited by Chinese firms and the Chinese government — in which political controversy or CFIUS action thwarted the investment from China. These include, among others, the failed bid by China National Offshore Oil Corporation (CNOOC) for Unocal in 2005; Huawei Technologies' failed acquisitions in 2007 and 2010; the divestiture of Emcore's fiber optics business to Tangshan Caofeidian Investment Corporation in 2010; and recent transactions in the mining sector in Nevada.

But these cases are the exception rather than the rule, and it is important to place them in context. First, much of the kindling that helped to spark and stoke the CNOOC-Unocal fire in Congress in 2005 was addressed in the Foreign Investment and National Security Act of 2007 (FINSA), which strengthened the CFIUS process and added energy security to the statutorily enumerated national security factors for CFIUS to consider. As a result of FINSA, Congress can have greater confidence in the thoroughness of the CFIUS process, and transaction parties in turn can help allay Congressional concerns by voluntarily notifying a transaction for CFIUS review.

Second, insurmountable CFIUS-related challenges, while rare, generally reflect miscalculations in the transaction planning, the parties' approach to CFIUS, or both. This is true regardless of the country of origin of the investment, and each of the foregoing transactions from China is no exception. Indeed, for each CNOOC-Unocal or Huawei-3Com deal, there are examples such as CNOOC-Chesapeake Energy, CIC-AES, Lenovo-IBM, and many other transactions that have proceeded without controversy, reflecting the careful planning of the transaction parties and their counsel. Moreover, while the overwhelming number of transactions reviewed by CFIUS are approved and non-controversial, China is not the only country to have its investors confront difficulty in CFIUS; even investors from our closest allies have, from time to time, failed to identify or anticipate hard national security issues that were identified by CFIUS.

The plain lesson of this history is that the U.S. is open to and encouraging of investment from China; that regulatory and political obstacles can generally be avoided through appropriate planning by the transaction parties; and that the review process undertaken by CFIUS is one in which both investors and national security hawks can and should have confidence.

III. Non-Regulatory Factors Impacting Chinese Investment and the Role of a U.S.-China BIT in Encouraging Investment Flows

Apart from the fears and misperceptions stemming from a minority of failed transactions, there are more practical, non-regulatory factors that have restrained Chinese investment in the United States. Differences in management style and structure, a lack of management experience in global business operations, and a pre-occupation with their domestic market have limited the scope of outbound Chinese investment. In addition, bureaucratic challenges, both within companies and in the Chinese political and regulatory scheme for obtaining required approvals to invest abroad, make it difficult for Chinese companies to mobilize quickly enough to participate in bidding processes abroad and can cause frustration for counter-parties and potential suitors of Chinese investment, leading potential transaction parties to turn elsewhere. On top of this, many

potential Chinese investors find the U.S. visa process lengthy and frustrating, further diminishing their enthusiasm for investment in the United States.[11]

There is no silver bullet solution to address these challenges and bring Chinese FDI more in line with what the world's largest economy should receive from the world's second largest economy, just as there is no single policy or action that will address completely all the market access considerations that U.S. investors confront with respect to their investment in China. However, a strong U.S.-China BIT is one sensible measure to pursue to open up greater investment opportunities in both directions, to the benefit of U.S. businesses, workers, and the economy.

A U.S.-China BIT would provide an important signal of both countries' commitment to boosting bilateral investment flows and would create greater confidence in Chinese investors in two important respects. First, it would underscore — symbolically and substantively — that the U.S. is open to Chinese investment and is a safe environment in which to invest. Second, equally important, it would signal to Chinese investors a comfort level and commitment from the Chinese government regarding investment in the United States.

In turn, several aspects of a U.S.-China BIT also would provide U.S. businesses with greater opportunities and protection for investments in China. First, a BIT is sure to include the principle of national treatment, which will require China generally to accord more equitable treatment to U.S. investors and their operations in China.

Second, the inclusion of a most-favored-nation clause, which now is generally accepted by the Chinese in their BITs, will ensure that U.S. investors going forward receive the benefit of any future liberalizations that China includes in other BITs.

Third, the BIT would include protection against expropriation. While that risk seems increasingly remote in China, it nevertheless is an important protection for foreign investors in any country.

Fourth, and arguably most important, the BIT would provide for investors of each country to bring their investment disputes to arbitration. This ability to take disputes to arbitration not only provides a measure of direct protection for investors; the threat of arbitration often can serve to temper conduct before it rises to the level of a violation. It functions to hold each party to the terms of fair and equal competition and access that are embodied in the BIT.

Importantly, while U.S. investors do not yet have these protections in place with China, investors from 120 other countries around the world do enjoy such protections. This is a potentially significant disadvantage to U.S. businesses, and the remedy for it should be pursued vigorously.

To be sure, there will be tough areas of negotiation with China over the BIT, and the U.S. should push hard in particular on key market access points. These include pressing China to provide

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[11] For an additional reference on the impacts on Chinese investment in the U.S., see David M. Marchick, *Fostering Greater Chinese Investment in the United States*, Renewing America: Policy Innovation Memorandum No. 13, Council on Foreign Relations (Feb. 9, 2012).

greater clarity in how laws and regulations apply to investors in China, to ease policies that tilt the playing field in China to domestic companies and to provide similar commitments to enforce principles of fair and equal treatment at provincial and local levels, and to reduce sector-based restrictions and equity caps.

As noted, even with progress on these fronts, a U.S.-China BIT will not solve all of the challenges that confront U.S. businesses looking to invest in China or that impact outbound Chinese investment. There will remain many other significant issues, including intellectual property protection, adherence to the Organisation for Economic Co-operation and Development rules on export and import financing, and accession to the WTO Agreement on Government Procurement, to be pursued through bilateral discussion and multi-lateral fora. There also is constructive unilateral action that the U.S. can take to encourage greater equity investment flows from China, such as making it easier for investors to travel to the U.S., continuing engagement by senior Administration officials with China on its concerns about the U.S. investment environment, and enhancing the efforts of the federal government's *Select USA* initiative to attract Chinese FDI to the United States.

In sum, a strong U.S.-China BIT should not be viewed as a cure-all for every consideration or concern that infuses the U.S.-China trade and investment relationship. However, it would be a very positive step that could enhance the opportunities for — and confidence of — investors on both sides.

IV. Conclusion

Chinese FDI can have a significant positive impact on the U.S. economy, but it has not yet flowed in amounts commensurate with the nature of the relationship between the two economies. Both sides should have confidence that the U.S. can be — and is — open to such investment without the U.S. sacrificing important national security interests and without the investor risking an embarrassing rejection. A strong U.S.-China BIT would help increase this confidence, as well as increase opportunities for U.S. businesses in China.