

*Committee of 100*

# Issue Brief

June 2007

## Chinese Foreign Direct Investment in the United States

In May 2007, the Chinese government purchased a \$3 billion stake in Blackstone, one of the preeminent private equity firms in the U.S. and one of the largest in the world. Prior to this agreement, mainland China's investment in the U.S. was only \$481 million, according to 2005 figures.<sup>1</sup> China has indicated its intent to expand overseas investment. Meanwhile, the U.S. government has increased its attention to growing Chinese investments abroad, particularly in critical infrastructure. Is Chinese investment in the U.S. a matter of concern?

### The Background

The 2005 \$1.25 billion acquisition of IBM's PC division by Lenovo, China's leading maker of personal computers (PCs), generated political and economic attention to Chinese investment in the U.S. Later in 2005, in response to the growing skepticism, Congressional opposition in Washington blocked an \$18.5 billion bid by China National Offshore Oil Corp (CNOOC) to buy US-based oil company Unocal.

Although looking to invest, China does not seem to be following the high-profile merger and acquisition pattern that Japan established in the 1980s, but instead has adopted a more cautious model, according to the *San Francisco Chronicle*. The United States and China remain crucial trading partners and in the year 2005, China had \$481 million and Hong Kong had \$2.6 billion in Foreign Direct Investment in the United States.<sup>1</sup>

Just last month, the Chinese government agreed to buy a \$3 billion stake in Blackstone, a leading U.S. private equity firm. Nonetheless, the transaction transfers less than 10% of Blackstone's equity to the Chinese and is a nonvoting stake. This purchase shows that the Chinese government and private firms view smaller investments as a key part of their international expansion plan in addition to full acquisitions.

In 2005 China invested 39.4% of its FDI in Asia, 18.3% in African countries, 16.0% in all of Europe and only 14.3% in North America as reported by the World Bank.<sup>2</sup> China's outbound direct investment, excluding the financial sector, reached \$16.1 billion in 2006, up 32% over 2005.<sup>3</sup> About 30 percent--or \$4.74 billion--of China's 2006 outbound direct investment involved overseas acquisitions.<sup>3</sup> By the end of 2006, China's cumulative outbound FDI had reached \$73.3 billion.

### Concerns about Chinese Investment Foreign Direct Investment in the U.S.

#### *Chinese Perspective*

According to the China Finance Centre, Chen Jian, the Assistant Minister of Commerce, issued a statement that Chinese outbound foreign direct investment will exceed \$60 billion annually by 2010.

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Surveys of Chinese business leaders indicate that Chinese companies intend to continue investment in the U.S. and other foreign countries – an *Economist* survey showed that 90% of Chinese companies expect to invest in or acquire a foreign company over the next year.<sup>5</sup>

Chinese companies are highly interested in investing in the United States, but are concerned about political obstacles in the completion of international transactions, according to the results of a survey published in the *Financial Times*.<sup>6</sup> At the same time, the Chinese government and Chinese companies feel that they have much to gain from investing in the U.S. China already has a cheap, effective manufacturing base at home, but lacks widely-known brands. Thus, a scholar from the Institute for International Economics (IIE), an American think tank, predicts that China's primary goal in many cases is to expand its already established brands to a wider global market.<sup>7</sup>

Furthermore, another scholar from the IIE points out that Chinese investments are not a unified government-led strategy, but rather, individual decisions made by Chinese companies.<sup>8</sup> The results of these decisions are often very strategically beneficial to U.S. companies eager for increased capital. Some of these transactions are organized through events such as the China International Fair for Investment & Trade, an annual event bringing together Chinese and foreign business leaders to facilitate both investment in China and investment abroad by Chinese firms.

A recent survey of Chinese executives conducted by the Economist Intelligence Unit found that telecommunications and financial services companies were among those most likely to be planning overseas acquisitions or other major investments.<sup>6</sup>

### *U.S. Perspective*

Currently, China is the only one of America's top ten trading partners that is not also a strategic and political ally. This has heightened American concerns, particularly as China shows a propensity to invest in strategically sensitive sectors such as energy and infrastructure. These fears are aggravated by the fact that nearly all Chinese companies are state-owned. Given national security concerns, the U.S. government is wary about giving another government access to its technology.<sup>7</sup>

Even so, business groups maintain that Chinese investment is projected to bring a number of benefits to the U.S. economy. *The Economist* reports that Chinese investment should not be feared because it actually provides a benefit to U.S. companies.<sup>9</sup> Some local government officials are eager for the boost of capital that foreign investment will bring to their economies. For example, the commissioner of the Minnesota Department of Employment and Economic Development says that foreign investment will keep Minnesota's economy strong by further diversifying its economy and providing a buffer against cyclical downturns of the local economy.<sup>10</sup>

### *Europe vs. U.S. Attitudes toward Chinese Investment*

China has also demonstrated a strong interest in investing in Europe, evidenced by the fact that investment in European projects and firms has increased 500% since 2000. This investment includes everything from full acquisition of European companies to the establishment of subsidiaries of Chinese companies. Chinese investors have been attracted to Europe for two reasons in particular: (1) Chinese investors do not face many of the political pressures present in the US; and (2) European governments have actively courted Chinese investment.

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However, there are indications that the sentiment is changing in Europe as Chinese investors more actively pursue investments. One such example is a case reported in the Chinese magazine *Modern Weekly* of a town in Italy which has been a traditional manufacturer of textiles.<sup>11</sup> Many Chinese entrepreneurs have established businesses in this town, potentially threatening a historically local industry.

## The Laws Governing Chinese Outbound Investment

### ***Investments by Domestic Financial Institutions***

On April 13, 2006, the People's Bank of China (PBOC) issued *People's Bank of China, Announcement [2006] No. 51* (Announcement 51), pursuant to which qualified Chinese financial institutions (including commercial banks, securities companies and investment funds) may invest in specified overseas financial products.<sup>12</sup>

The China Banking Regulatory Commission (CBRC) and State Administration of Foreign Exchange (SAFE) retain joint oversight over such offshore investment activities.<sup>12</sup> The CBRC is charged with overseeing banks' prudential qualifications, while SAFE oversees foreign exchange quota issues. Regulations related to Announcement 51 provide certain disclosure and transparency requirements for the financial institution to follow in interactions with regulators and its investors.<sup>12</sup>

### ***Foreign Exchange Regulations on Overseas Investment***

On July 1, 2006, the SAFE-issued *Circular on Revision of Certain Foreign Control Policies Relating to Overseas Investments* (SAFE Overseas Investment Circular) became effective, and liberalized foreign investment by Chinese entities.<sup>13</sup> The SAFE Overseas Investment Circular accelerates the timing of currency conversion and remittance for early stage expenses incurred by Chinese entities in connection with overseas investment projects.<sup>13</sup>

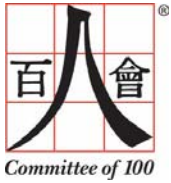
The SAFE Overseas Investment Circular also sets forth application requirements for Chinese entities to follow when obtaining and remitting foreign exchange, including providing a new letter of commitment from a local SAFE office that foreign exchange would only be used in connection with approved projects.<sup>13</sup> Pursuant to the new circular, there is no longer any limit on the amount of foreign exchange that may be approved on a nation-wide basis for use in outward foreign direct investment transactions.

### ***Overseas Investment by China's National Pension Fund***

Related to other developments easing the ability of Chinese entities to invest overseas, the *Tentative Provisions for the Administration of Overseas Investment by the National Social Security Fund* (NSSF Provisions) became effective on May 1, 2006. The NSSF Provisions, issued jointly by the Ministry of Finance, the Ministry of Labor and Social Security, and PBOC, provide a framework for China's National Social Security Fund (NSSF) to invest up to 20% of its total assets in investments outside of China.<sup>14</sup>

The NSSF Provisions detail the requirements for fund managers to be able to manage NSSF overseas investments. For example, managers must have more than six years experience and have more than US\$5 billion in assets under management in the most recent fiscal year.

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## The Outlook

Recent Chinese investments in the United States signal that Chinese investors are becoming increasingly interested towards acquiring foreign assets. *The China Daily* noted that this trend was evidenced during the second annual Security

Economic Dialogue, when Vice Premier Wu Yi attempted to alleviate Treasury Secretary Paulson's concerns over the large trade deficit allegedly caused by the undervaluation of the yuan, by promising Chinese investment in American businesses.

Given that China has over \$300 billion in reserves, it has the potential to play a more active role in international commerce.<sup>15</sup> The continued growth in outbound foreign direct investment, whether through the purchase of stakes in foreign companies or shifting of investments from U.S. Treasury bills to U.S. stocks, shows the determination of China's private sector and state owned entities to accomplish this goal.

Although China faces fewer political obstacles when investing in other Asian countries, these countries do not offer the same economies of scale, brand recognition, and other qualities that make America attractive to Chinese investors.<sup>5</sup>

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Prepared by Michael Burke, Tovah LaDier and Williams Mullen Strategies

**About the Committee of 100**

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