



Two-Way Street

25 Years of US-China Direct Investment

EXECUTIVE SUMMARY

This report illuminates the volume, patterns and industry details of foreign direct investment (FDI) flows between the United States and China—in both directions—from 1990 to 2015. American companies have been active in the Chinese economy throughout the post-1979 reform period, investing hundreds of billions of dollars. In the past decade, Chinese investors have begun to expand their US presence as well, turning the FDI relationship into a two-way street with multi-billion dollar flows every year. This change has important economic and political implications, and has turned FDI into a first-order priority in the bilateral relationship.

Debate about the benefits and risks related to foreign investment is long-standing, and a copious body of literature exists on this subject. Many of those arguments are now resurfacing in the context of US-China FDI relations, including potential national security risks from foreign ownership, the role of reciprocity in investment market access, and the impact of FDI on innovation and long-term competitiveness. Much of the debate at the moment is predicated on claims about the pattern of investment that turn out to be untethered to any data.

It is essential that our discourse about FDI—to the greatest extent possible—be data-driven. However, current FDI statistics of both the US and Chinese governments are compiled with the primary goal of analyzing balance of payments-related questions; they are subject to significant distortions due to tax

optimization and other shorter-term considerations; they have long delays and many gaps; and they do not offer the granularity necessary to analyze many policy-relevant questions. This study sets out to create greater transparency on US-China direct investment flows to facilitate a fact-based and more productive policy debate.

US FDI IN CHINA

American firms have been leaders in overseas investment in Asia for the past century and a half, and China has been an important part of that story. Since the 1970s, US multinationals were key proponents of normalizing the relationship with China, and their operations in China have been central to ties between the two countries. Over the past quarter century these firms have transferred technology, created jobs and helped reshape the Chinese economy. In Chapter 1 of our study we review available official statistics on US FDI in China and introduce a new dataset that augments those data points.

The most commonly used official estimates of the US FDI stock in China suggest a modest value, reflecting the methodological shortcomings of balance of payments statistics. The U.S. Bureau of Economic Analysis puts the stock of American FDI in China at \$75 billion as of 2015. China's Ministry of Commerce counts \$70 billion of cumulative utilized FDI from the US to that date. Both datasets have limited utility for analyzing two-way FDI flows. We offer an alternative perspective on the scope and patterns of US FDI in

China, by introducing a new transactions-based dataset created by identifying, qualifying, and counting every single FDI transaction over \$1 million since 1990. We count nearly 6,700 American investments in China with a combined value of \$228 billion. Our dataset includes more than 1,300 US companies that have built significant operations in China, 430 of them investing more than \$50 million and 56 with billion-dollar bets.

We also provide details on a variety of other policy-relevant metrics not available in official statistics. For instance, we can discern that more than 71% of total US FDI by value went into greenfield projects, the majority of them small- and medium-sized. We describe investment patterns across industries over time, illustrating how the focus has shifted from exploiting comparative advantage in light manufacturing to serving local consumers and customers. Finally, our data indicates that American investment in China peaked in 2008 and has been largely flat since, with a declining trend since 2012.

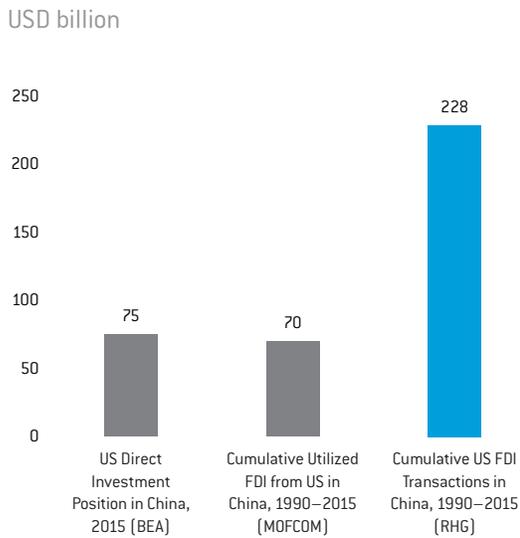
CHINESE FDI IN THE US

Chinese companies traditionally were not physically present in the US, but have expanded their footprint

rapidly over the past decade. While these flows are nascent, they have grown to significant levels in a brief span of time. The structure of China’s economy is evolving quickly—far faster than other major economies have in the past—and the nature of outbound Chinese FDI is changing quickly as a result, reflecting new motives, interests and aspirations. In Chapter 2 we review how this new trend shows up in official statistics and then take a more granular look using our transactions dataset.

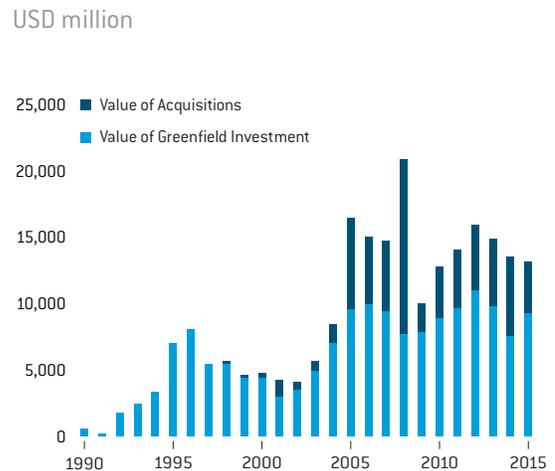
Official statistics are similarly problematic for describing the scale and patterns of Chinese FDI in the US. Official US estimates for the stock of Chinese FDI range from \$15 billion to \$21 billion. Official Chinese numbers put the figure at \$41 billion, more than twice the US estimates. Rhodium Group has maintained a transactional dataset on Chinese FDI in the US since 2011. For this study, we have updated this catalogue to include investments back to 1990, to provide a fully comparable count of Chinese FDI in the US for the past 25 years. For the entire period of 1990 to 2015, we count more than 1,200 individual transactions with a combined value of \$64 billion.

FIG ES-1: US FDI Stock in China, Various Measures



Sources: Bureau of Economic Analysis, Ministry of Commerce, and Rhodium Group.

FIG ES-2: Value of US FDI Transactions in China, 1990-2015 (RHG)



Source: Rhodium Group.

Our transactions data also clarifies details on the structure and patterns of this Chinese investment. We show that Chinese market entry in the US was dominated by acquisitions rather than greenfield FDI, and that Chinese companies have expanded their presence from urban coastal economies to a great number of US states. Another important finding is that Chinese investment in the US is now increasingly driven by private sector activity (an average of 77% in the past three years), and that the investor mix has lately evolved from large multinational corporations to include private equity firms, venture capitalists and other financial investors.

A COMPARATIVE PERSPECTIVE ON US-CHINA FDI

In Chapter 3, we put the two halves together and offer a comparative picture of the bilateral FDI relationship. Not surprisingly, a comparison of the aggregate cumulative transaction values shows that the American FDI footprint in China is still about four times larger than Chinese FDI presence in the US. For annual flows however, the tide has turned in recent years and Chinese FDI to the US has outweighed American FDI in China since 2015. Our comparative perspective also presents a unique picture of FDI ties between US states and Chinese provinces, and

it highlights important differences in deal flow both ways in terms of entry mode, transaction size, and investor mix.

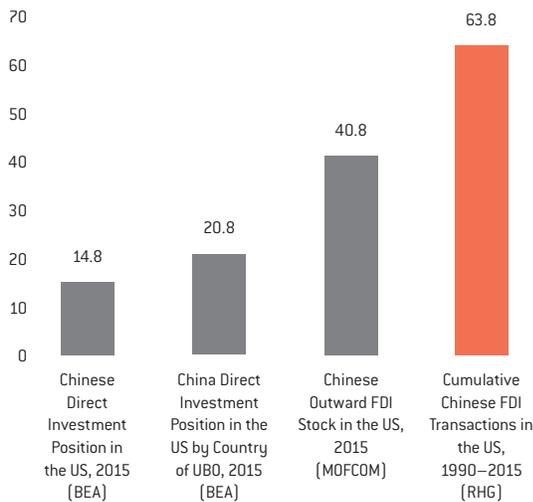
In addition to the comparison of aggregate metrics, our granular data allows us to offer snapshots of two-way FDI patterns for 14 broad industries and an even greater number of sub-sectors. These snapshots include cumulative investment totals, annual investment patterns, the breakdown between acquisitions and greenfield projects, the mix of private and state-owned investors, and the share of majority versus minority investment stakes. Each of these industries has its own cycles, and in many cases its own policy dynamics injected from one or both governments, which we briefly describe in each industry profile. This compendium of bilateral investment summaries by industry will be helpful for Beijing and Washington as they consider investment opening agreements that reach down to sector-by-sector concerns.

CONCLUSIONS

The review of official statistics and our novel dataset on two-way FDI transactions yields a range of findings about US-China FDI relations.

FIG ES-3: Chinese FDI Stock in US, Various Measures

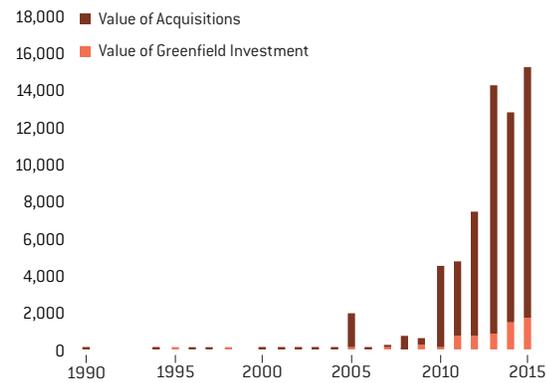
USD billion



Sources: Bureau of Economic Analysis, Ministry of Commerce, and Rhodium Group.

FIG ES-4: Value of Chinese FDI Transactions in the US, 1990-2015 (RHG)

USD million



Source: Rhodium Group.

The first set of conclusions center on assumptions about the degree of FDI integration between the world's two largest economies. We have demonstrated that the commercial stakes on both sides are two to four times higher than commonly used statistics suggest. Our data show that while some Americans are eager to talk about imposing reciprocity requirements for inward Chinese FDI, the cumulative value of US FDI transactions permitted in China to date is four times than that of China in the US. Similarly, while many Chinese complain about the lack of American openness, our data show that the US is open and welcoming to Chinese investment, and that Chinese companies are now investing more in the US annually than American companies in China. These observations emphasize that both sides need to reconsider the data before staking out new policy positions.

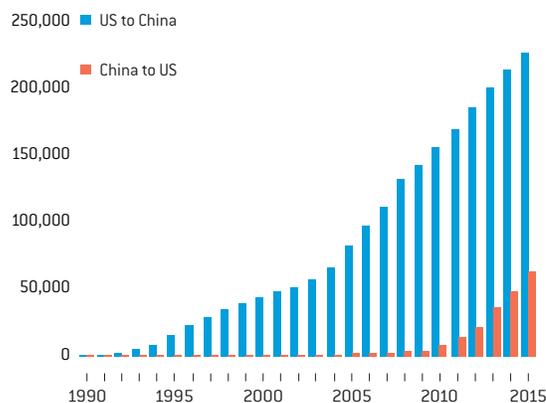
The data presented in this study also highlights the evolving nuances of two-way FDI flows beneath the aggregate picture, confirming that the new pattern of US-China FDI differs from the previous two decades in terms of industry patterns, motives, investor composition, and other dimensions. For example, the investor base on both sides is growing bigger and more diverse—with greater activity by small- and medium-sized companies and greater participation

of financial investors. The changing industry patterns illustrate fundamental adjustments taking place on both sides. For instance, early US FDI in China often sought out lower manufacturing costs, but investment activity today has shifted toward consumer-oriented objectives. Chinese FDI in the US was initially driven by companies seeking strategic assets, including technology, brands, and talent. That has expanded in recent years to include pursuit of financial returns and realization that manufacturers need to be closer to American consumers to defend market share in times of rising labor costs in China.

In addition to commercial factors, our chronology of 25 years of US-China FDI patterns also shows that policy and politics matter for those patterns. The US FDI trajectory in China closely mirrors China's FDI opening policy and continues to be defined by Chinese industrial policies today. The late start of Chinese outflows was principally a function of Chinese policy to keep foreign exchange at home, and outward FDI patterns even now remain under the shadow of potential re-imposition of capital controls. On both sides some sectors are subject to regulatory action—some reasonable and some less so—for example in banking and insurance, high-tech products with dual-use applications, and infrastructure.

FIG ES-5: Cumulative Value of FDI Transactions between the US and China, 1990-2015

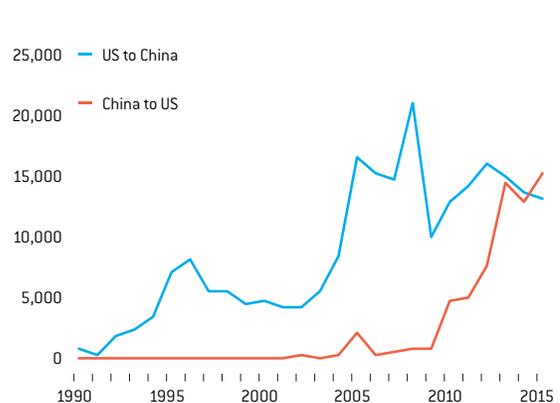
USD million



Source: Rhodium Group.

FIG ES-6: Annual Value of FDI Transactions between the US and China, 1990-2015

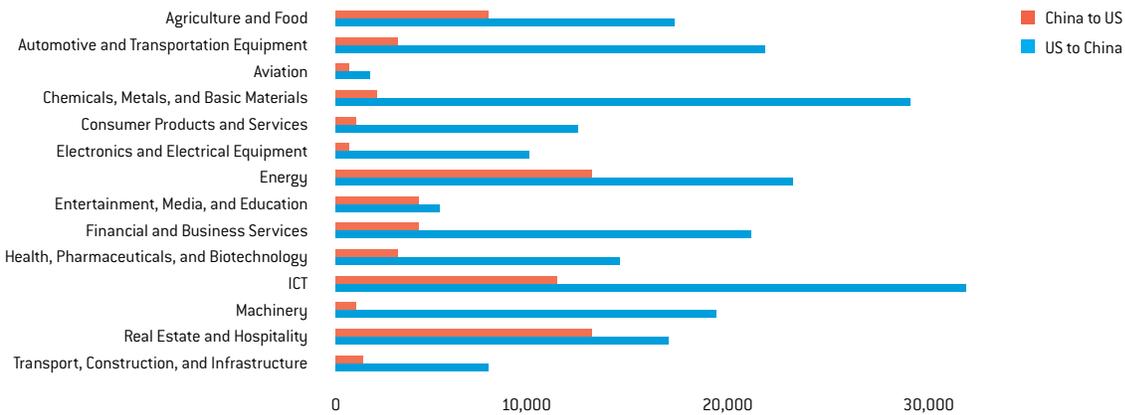
USD million



Source: Rhodium Group.

FIG ES-7: Cumulative Investment by Industry in China and the US, 1990-2015

USD million



Source: Rhodium Group.

Our numbers also further advance the understanding of the benefits from FDI, which is an important element of the policy debate. Benefits from FDI mostly occur locally, and that is where proponents of these inflows have been and will be most vocal. FDI was key to China's past economic success, and was central to the global model that so many US businesses embraced, generating benefits for Chinese and US consumers and competitiveness. The local benefits have been enormous, with US companies today employing more than 1.6 million workers in China. At an earlier stage, the benefits of Chinese presence in the US are showing up too, attracting much needed capital to the US while permitting Chinese companies to tap into US advantages and already provide more than 100,000 jobs today. These links also facilitate people-to-people relationships to a greater extent than trade and tourism. The benefits today are spread across more than 90% of US states and Chinese provinces. Our data allows mapping FDI ties between individual states and provinces, showing links between hundreds of pairs of communities.

Finally, a better count of how far along our investment relationship is also allows us to see how much more room it has to grow. US-China bilateral investment is nowhere near saturation. Chinese

companies have just started to operate overseas, and will invest hundreds of billions of dollars globally in the coming decades to catch up and adjust their business models, driven foremost by economic realities at home. US companies are more than ready to increase investment in China, especially to engage the Chinese consumer and compete in growth sectors such as healthcare, research and development and modern services. The assumption that FDI flows to China have peaked because it is wealthier today is mistaken.

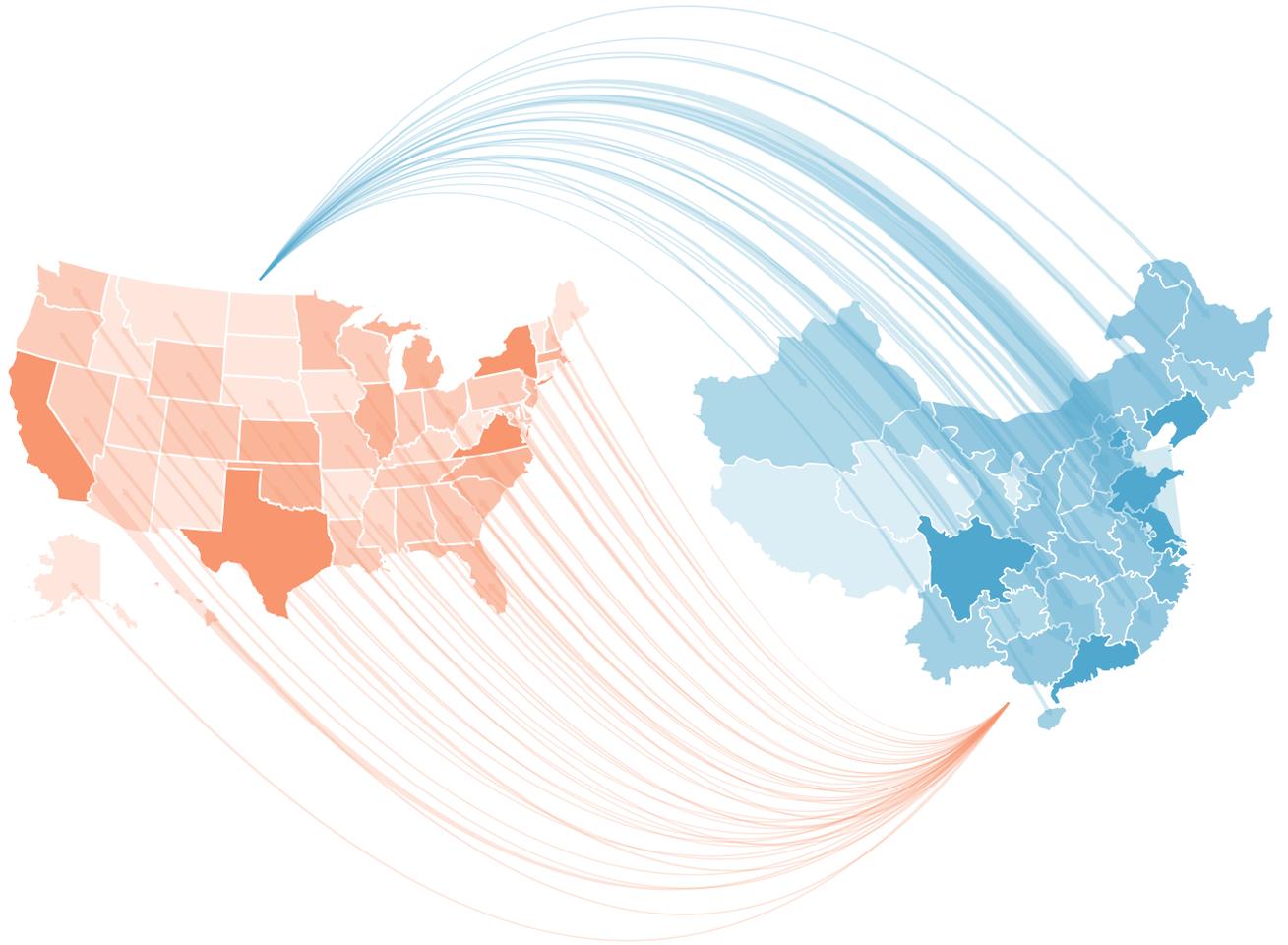
POLICY AGENDA

This study is intended to be of equal utility to both sides of the US-China relationship, and therefore we stay away from making normative recommendations. However, our research supports a number of general recommendations in light of the current US-China policy agenda.

First, policymakers are well advised to consider how much further along the relationship is than official data suggests. Doing so argues for upgrading the policy framework presently used to manage related opportunities and concerns. Upgrading US-China FDI policy is not just a noble long-term goal but a present necessity. US and Chinese officials are

FIG ES-8: FDI between China and the US: Geographic Patterns, 1990-2015

number of transactions (lines) and cumulative value (shading)



Source: Rhodium Group. For more detailed information on these two-way patterns, refer to www.us-china-fdi.com.

not negotiating a bilateral investment treaty out of sheer enthusiasm for liberalization (this has been discussed since the Reagan Administration), but because commercial interests on both sides make new frameworks necessary.

Second, in setting the bilateral agenda policy makers must be mindful of one another's internal timing. Current policy expectations have not only been set without a proper understanding of the data, but also without sufficient attention to domestic political processes and timing on each side. American politics can make it challenging to handle negotiations in a traditional, down-to-the-wire manner in which both sides hold their best offer back until late in a discussion. While China traditionally could stick to an official timetable, nowadays major policy reforms have been delayed due to domestic politics—some of them as much as three or four years. Based on our findings, there is less time for policy planning than both sides thought, and it may thus require high-level attention to get back on track.

Third, the data shows that the industry mix of two-way FDI flows has been evolving quickly, which naturally leads to worry about whether policy can keep up with national security issues. High-tech acquisitions will attract greater security scrutiny, and they are simply a bigger part of the mix nowadays, as the data show. While accepting that this trend will drive deliberations on both sides, our policy concern is that fundamental national security questions cannot be resolved by FDI screeners trained to quickly clear transactions based on a pre-determined set of criteria, who do not have the ability to make path-breaking judgments about the evolving nature of national security.

Fourth, our comparative perspective on two-way FDI flows show that questions of symmetry and reciprocity in US-China bilateral investment are complicated. China has traditionally hosted more investment from the US than vice versa; but this had mostly to do with its stage of development and Chinese firms' readiness to venture abroad. On an annual basis, Chinese firms are now investing more in the United States than the other way around, which naturally invites new questions. However, this is not (yet) true for

most industries. Furthermore, the annual balance is not just a result of policy restrictions (which are far more limited on the US side) but also due to changing propensity of businesses to invest in light of growth concerns, and many other factors. When framing the policy agenda, these complexities must be considered before either side embraces fashionable but vague notions such as reciprocity.

Fifth and finally, we encourage Beijing and Washington to think beyond the bilateral. The US-China FDI policy agenda does not exist in a vacuum. American and Chinese interests in maximizing the benefits of FDI cannot be guaranteed solely on a bilateral basis: the investment environment is inherently multilateral, and many of the policy issues extend beyond the bilateral US-China dimension. It is therefore in the interest of the world's two largest economies to propose renewed discussion of direct investment arrangements in the multilateral context, and to convene an initial scoping meeting for such dialogue in the near future. China's emergence as a principal player in global investment flows presents an opportunity to revive the prospect of a multilateral agreement on investment that was dashed two decades ago because some believed these flows were a one-way street.



A REPORT BY

National Committee on U.S.-China Relations

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Rhodium Group

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