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Chinese FDI in the United States is taking off: How to maximize its benefits?

by
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China's outward foreign direct investment (OFDI) grew rapidly in the past decade, but flows to developed economies have been limited. Now China's direct investment flows to the United States are poised to rise substantially. This new trend offers tremendous opportunities for the U. S., provided policymakers take steps to keep the investment environment open and utilize China's new interest productively.

China's OFDI flows grew from an annual average of below US$ 3 billion before 2005 to over US$ 60 billion in 2010, bringing China's total global OFDI stock to more than US$ 300 billion.[1] This investment was concentrated in developing countries and a few resource-rich developed economies. Chinese investments in the U. S. were few and far between.

Since 2008, that story has begun to change. A new dataset allowing a real-time assessment of FDI patterns shows that Chinese FDI in the U. S. is taking off. Direct investment expenditures by Chinese firms in that country have grown more than 130% a year over the past two years. In 2010 alone, Chinese firms spent more than US$ 5 billion in the U. S. on 25 greenfield projects and 34 acquisitions. Today, Chinese firms have investments in at least 35 of the country's 50 states, across a wide range of industries.[2]

This new momentum in Chinese FDI in developed economies is driven by changing economic realities forcing firms to look abroad. In the past, a fast-growing domestic economy and booming export markets overshadowed overseas opportunities. The shift of China's growth model is now forcing Chinese firms to upgrade technology, move up the value chain and

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[1] Data from China's balance-of-payments (BOP) statistics, Peoples' Bank of China, available at: http://www.safe.gov.cn

[2] See Daniel H. Rosen and Thilo Haneman, *An American Open Door?* (New York: Asia Society and Woodrow Wilson International Center for Scholars, 2011), available at: http://rhgroup.net/china-investment-monitor.

augment their managerial skills and staff base. We expect Chinese firms to place US$ 1-2 trillion in OFDI worldwide over the coming decade. Developed economies will receive a big share of this investment.

Japan exemplifies the potential. Japanese firms played a minor role in the U.S. economy when they started to invest there in the 1970s. Today, they employ more than 700,000 workers in that country, with an annual payroll of US$ 50 billion, account for more than US$ 60 billion of U.S. exports and spend more than US$ 5 billion annually on research and development in the U. S.[3] However, China will not inevitably replicate Japan's success. Policymakers must take the right steps to ensure these flows materialize and benefits are maximized.

In particular, U.S. leaders must guard against protectionism and defend investment openness. China's modest OFDI has already stoked political fires, and there is a danger that anti-China sentiment may further increase if OFDI levels surge. Washington must work on protecting the national security review process from politicization, improve decision-making transparency and reject calls to expand the reviews to include economic security issues.

The U. S. should not only keep the door open but should actively encourage FDI from China, starting with a clear and bipartisan message that this investment is welcome.[4] Growing FDI from China and other emerging markets is changing the game. The U. S. might lose out in competition with other developed countries if it fails to adapt.

Finally, policymakers need to think how best to leverage China's new overseas investment interest. Threatening to block access to sectors in which foreign firms face restrictions in China would choke off badly needed investment -- while having little effect on foreign investment rules in China. However, the increasing presence of Chinese firms in their jurisdiction gives developed countries greater leverage to demand openness, transparency and adherence to global business norms from those companies and their domestic regulators. The U.S. Government should explore bilateral and multilateral options for using this new leverage.

Formulating a coherent policy response to growing Chinese investment is crucial in preparing for a major shift in the patterns of global capital flows. From 2000 to 2009, the share of emerging markets in global OFDI flows jumped from less than 2% to more than 14% as the rest of the world has started to catch up with developed countries in global FDI flows.[5] China will serve as a test case for how the United States deals with these new realities.

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[3] Data points refer to all U.S. affiliates of Japanese companies in 2008. Source: U.S. Bureau of Economic Analysis.

[4] The Obama administration's reaffirmation of the country's open investment policy and the new SelectUSA program that bundles investment promotion efforts were steps in the right direction.

[5] UNCTAD's global FDI database. Figures refer to the broadest available definition of emerging markets (Dow Jones EM Index, 35 countries), available at: http://www.djindexes.com/mdsidx/downloads/brochure_info/Dow_Jones_Total_Stock_Market_Indexes_Brochure.pdf

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