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REVIEWS

Economic and strategic considerations surrounding Chinese FDI in the United States

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Abstract The growth of outward investment from China has generated expressions of concern from policymakers in the United States regarding the economic and national security impacts of such investments. While inward foreign direct investment (FDI) has come to be viewed by most observers as generally imparting net economic benefits to the host economy, acquisitions of US companies by Chinese multinational companies (MNCs) have been criticized on several grounds. One is based on the mode of entry itself: some critics believe that entry by acquisition brings lower benefits than greenfield entry. A second and more prominent concern is that acquisitions of US companies by Chinese state-owned enterprises (SOEs) may be motivated by non-commercial objectives which, in turn, make those acquisitions of questionable value to the host economy. In this paper, we argue that Chinese FDI in the United States is more likely to take the form of acquisitions than greenfield investments for the foreseeable future. However, there is no strong case to be made that the host country economic benefits from Chinese FDI would be larger if entry took place primarily through greenfield investments. Furthermore, most of the alleged costs to the US economy from inward FDI from China are either unlikely to occur or are already anticipated by existing US laws and regulations, thus necessitating no additional, specific legislation.

Keywords Chinese foreign direct investment · Acquisition · Greenfield · Multinational companies · State-owned enterprises

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Notwithstanding its rapid and sustained economic growth over the past two decades, China has not yet emerged as a major source of foreign direct investment (FDI). Outward FDI flows from China since 2000 have rarely accounted for more than 1% of global FDI flows, and China's stock of FDI represents less than 1% of global stocks. By way of illustration, outward FDI flows from China were approximately US$16 billion in 2006 with accumulated outward FDI stocks reaching US$75 billion (Cheng & Ma, 2008; Morck, Yeung, & Zhao, 2008). Moreover, the vast majority of China's FDI occurs in Asia, Latin America, and Africa, with less than 10% of outflows typically flowing to Europe and North America. Nevertheless, outward FDI from China is increasing rapidly, and that country is emerging as one of the top FDI exporters among developing countries. Outward FDI growth is expected to accelerate in the future given, among other things, China's large and growing holdings of foreign exchange reserves and the apparent determination of Chinese authorities to diversify holdings of foreign exchange reserves away from fixed income assets towards equity assets.

Chinese outward FDI has historically concentrated on greenfield and joint venture investments, although the pace of acquisition activity has picked up in recent years. For example, Hemerling, Michaels and Michaelis (2006) estimate that since 1986, Chinese companies have invested some $30 billion in non-Chinese companies, and nearly a third of these acquisitions occurred in 2004 and 2005. Indeed, several recent attempted acquisitions of US companies by multinational companies (MNCs) headquartered in emerging economies, including China, raised a storm of political protests in the United States.[1] One such acquisition was the attempted takeover of Unocal by the Chinese National Offshore Oil Company (CNOOC) in 2005. Strong opposition to this takeover on the part of some US politicians, along with the prospect of a prolonged approval process, led CNOOC to withdraw its takeover bid. While the rationale for the opposition was (arguably) never clearly articulated, the opposition signaled suspicion and concern about takeovers of domestically owned companies by MNCs headquartered in China and other emerging economies populated by state-owned enterprises (SOEs) or state-supported companies. Moreover, there is some indication that the strong opposition to the attempted Unocal takeover might be discouraging inward FDI to the US from emerging economies. In this regard, the CEO of Abu Dhabi National Energy Co. recently indicated that it is targeting Canada for takeovers in the oil and gas sector because of its political stability and its location next to the United States, a market in which it would like to participate but in which it perceives FDI from the Middle East being frustrated by tight rules (Cattaneo, 2007).

While there has always been political opposition to inward FDI, particularly when it takes the form of large acquisitions of host country firms, legal barriers to inward FDI have been substantially weakened in both developed and emerging economies in recent decades reflecting a broad assessment, supported by research, that the economic benefits of inward FDI to the host economy generally exceed any

[1] In 2006, the proposed sale of six major US ports to DB World, a state-owned company based in the United Arab Emirates, also precipitated a storm of controversy in the United States. The specific concern was that the sale would compromise port security in the United States. DB World subsequently sold its US operations to a North American company.

associated economic costs. Hence, the growing opposition to inward FDI from China and other emerging economies—viewed from the perspective of a developed host economy, notably in this case the United States—presumably reflects a perspective that the net benefits of such FDI differ substantially from the net benefits of earlier generations of outward FDI, mainly originating in developed countries.[2] In addition, while acquisitions of US companies by Chinese MNCs can be reviewed by the US government, there is currently no procedure for reviewing greenfield investments, although there have been calls for reviewing all foreign investments by SOEs, as well as by government-owned investment funds (Scannell, 2007).

The broad purpose of this paper is to discuss and assess the economic and strategic implications of outward FDI from China to the United States from the perspective of both Chinese investors and US policymakers. In particular, we consider whether there is any rationale for Chinese MNCs to favor foreign acquisitions over greenfield investments. We conclude that in the future more Chinese entry will be via acquisition. From the US perspective, we evaluate whether US policymakers should be particularly concerned with such acquisitions, and in particular whether relevant issues raised by Chinese FDI are addressed by existing legislation and regulations or whether new policies are required. Finally, we consider how political opposition to acquisitions of US firms might be addressed by Chinese managers.

Greenfield versus acquisitions: The foreign investor's perspective

A critical strategic issue for investors is whether to enter a foreign market by building a new subsidiary (greenfield) or buying an established domestic business in part or whole (acquisition). Presumably, the investor will choose the mode that is potentially most profitable in the specific circumstances surrounding an investment.

The existing literature identifies a set of factors that conceptually influence the profitability of greenfield investments versus acquisitions (Slangen & Hennart, 2007). Perhaps the most obvious advantage of an acquisition is that it allows relatively quick entry into a foreign market. In turn, speed of entry will have greater financial value to the international investor when there are strong first-mover advantages to early foreign entrants. First-mover advantages can be thought of as profit opportunities that are available to early entrants but that will not be available to later entrants because of entry barriers that are created by prior entry. An acquisition might also be preferred in relatively slow growing markets because with greenfield entry no new capacity is created, thus limiting downward pressure on prices, all other things constant. Such downward pressure is likely to be more pronounced when market demand is growing slowly. Hence, acquisitions are likely preferable to greenfield investments in markets that are either growing relatively slowly and/or where there are strong first mover advantages.

[2] Concern is also being expressed in the United States and elsewhere about equity investments made in those countries by sovereign wealth funds headquartered in China and other emerging markets. See, for example, Davis (2007).

Motives for investing in foreign markets will also condition the relative advantages of acquisitions versus greenfield investments (Meyer, Estrin, Bhaumik, & Peng, 2008). One major motive for investing abroad is to acquire assets that are complementary to those already possessed by the foreign investor in order to enhance the efficiency and competitiveness of the investor. In principle, complementary assets can be acquired "piecemeal" or embodied in an existing organization. Examples of complementary assets include marketing and distribution networks in the host country and technological and managerial knowledge resident in the host country. In practice, complementary assets of specific value to the foreign investor are consolidated under the ownership of one or more host country companies, such that acquiring the relevant assets piecemeal for purposes of establishing a greenfield business is not a viable option.

A second motive for investing abroad is to exploit the investing firm's competitive advantages in the host market. Where those advantages are rooted in firm-specific knowledge or other intangible assets, they are typically best exploited by internalizing their utilization within a wholly owned affiliate. However, profitable exploitation of intangible assets usually requires knowledge about local market conditions and other aspects of the host country environment. When the foreign investor enters a market that is unfamiliar or culturally distant, it is particularly advantageous to acquire knowledge about how best to operate in the unfamiliar environment by acquiring an established host country firm rather than by undertaking a greenfield investment.

If acquisitions are a more advantageous way to enter foreign markets, one might expect foreign acquirers to pay a financial premium in order to acquire host country firms. If capital markets are relatively efficient, the average takeover premium for host country firms should offset whatever specific advantages accrue to entering the host market through acquisitions rather than greenfield investments. Nevertheless, specific foreign investors may enjoy relatively low costs-of-capital which enable them to outbid other investors for foreign acquisition targets. In this regard, Chinese SOEs are suggested to enjoy financing advantages via their access to relatively low-cost government funding. While such access might be an advantage to Chinese SOEs, it is seen as problematic by US policymakers, as shall be discussed in more detail in a later section.

This brief discussion of the determinants of the net advantages of acquisitions versus greenfield investments suggests that Chinese companies are typically more likely to find acquisitions rather than greenfield investments as the advantageous mode to enter the US market. In particular, the cultural distance between the US and China is relatively large and Chinese companies have relatively limited experience, to date, with managing affiliates in the US market. Hence, gaining access to the experience of US managers within specific corporate contexts is quite valuable to Chinese investors. Furthermore, the acquisition of technological and managerial resources is likely to be an important motive for Chinese FDI in the United States, and, as noted above, the acquisition of host country firms possessing those resources is a more favorable mode of FDI than attempting to acquire those resources on an arms-length basis to incorporate into greenfield affiliates.[3]

[3] In an evaluation of preferred modes of FDI for Indian pharmaceutical companies, Prakash and Alakshendra (2006) conclude that acquisitions are typically more advantageous than greenfield investments. The attributes and motives of Indian companies may be similar to those of Chinese MNCs.

Potential economic benefits to the United States

While inward FDI can take the form of either the establishment of new operating businesses (greenfield) or the acquisition of existing domestic businesses, most FDI takes the form of acquisitions. Among OECD countries, some 80% of FDI occurs via mergers and acquisitions (UNCTAD, 2000). As noted earlier, it seems likely that Chinese MNCs will find acquisitions of US companies rather than greenfield investments as the preferred mode of FDI for the foreseeable future. Hence, it is relevant to consider the main economic and strategic issues raised by such acquisitions.

Spillover efficiency benefits

It has long been recognized that spillover efficiency benefits are a major host country benefit from inward FDI (Blomstrom, Koko, & Zejan, 2000). Spillover efficiency benefits encompass productivity improvements enjoyed by host country firms resulting from the presence and activities of foreign-owned MNCs in the home country. For example, innovations introduced to the host economy by foreign-owned MNCs can be imitated by domestically owned firms. Likewise, skills and expertise of host country workers and managers can be upgraded by working in foreign-owned affiliates.

Increased competition provided by newly entering foreign-owned MNCs can be an important spur to domestically owned firms to improve efficiency. In this regard, it is sometimes argued that acquisitions of existing firms reduces competition compared to greenfield investments, since the number of separately owned businesses in the relevant market is more likely to increase in the latter case than in the former. As a result, it is often presumed that increased competition is more likely to arise from greenfield investments made by foreign investors than from foreign acquisitions of domestically owned firms. However, this presumption is simplistic. In particular, foreign acquirers may be willing and able to make investments in the acquired companies which make the latter more formidable competitors than they were under domestic ownership. Furthermore, acquisitions may facilitate quicker and more comprehensive entry into the host economy, so that increases in competition occur earlier and encompass a broader range of product or geographic markets than would be the case if foreign investors were obliged to enter through greenfield investments.

To the extent that firms undertaking greenfield investments differ from those acquiring local firms in terms of their underlying productivity and other firm-specific advantages, host country spillover benefits from inward FDI might be indirectly conditioned by the nature of the FDI undertaken (i.e., greenfield versus acquisition). For example, if foreign companies undertaking greenfield investments are, on average, more efficient than those acquiring local firms, host country spillover benefits might be greater in the former case than in the latter. This is because the superior efficiency of firms undertaking greenfield investments suggests a greater availability of technical and managerial expertise that, in turn, might be transferable to domestic firms.

To be sure, available evidence suggests that host country spillover benefits are also a function of the absorptive capacity of local firms, where absorptive capacity is essentially the ability of local firms to adopt and exploit information and technology spillovers made available through the activities of foreign-owned affiliates in the host country. To the extent that absorptive capacity itself depends upon the nature of accumulated inward FDI, the linkage between spillover benefits and the mode of FDI is likely to be subtle and complex. For example, local firms might be better able to absorb technology transferred from foreign firms that enjoy comparable levels of productivity rather than substantially higher levels.

In sum, from the host country's perspective, the primary expected economic benefit of inward FDI is the spillover efficiency gains enjoyed by domestically owned firms. Conceptually those spillover efficiency gains can arise from either greenfield investments or acquisitions by foreign investors. Some empirical evidence on the economic benefits to the host country from the two modes of FDI will be reviewed below.

Other consequences of inward FDI for the host country

Benefits from inward FDI can also be experienced by domestic owners of assets acquired by foreign investors, as well as by host country consumers. To the extent that foreign owners can operate acquired assets more efficiently than incumbent domestic owners or any other potential domestic investors, they can afford to bid higher prices for those assets than would be the case in the absence of foreign investment. Competition among foreign investors should therefore result in some or all of the anticipated direct improvements in efficiency being captured by the prior (host-country) owners in the form of an acquisition price premium.[4] In principle, an acquisition price premium can be paid for an already existing enterprise or for individual assets such as land or skilled management that are assembled into a greenfield operation. In practice, the need to pay a takeover premium for an already existing acquisition target likely means that domestic shareholders will be beneficiaries of any efficiency advantages that foreign investors enjoy relative to domestic investors associated with acquiring and operating host country firms.

It also seems likely that at least some portion of any productivity gains associated with ownership changes will be passed on to domestic consumers in the form of lower prices. The stronger the degree of domestic competition, the more likely it is that consumers will be beneficiaries of any productivity improvements associated with a change of ownership from domestic to foreign investors. As noted above, it is not necessarily true that greenfield investment leads to more effective competition than do acquisitions. As a consequence, it seems likely that both modes of inward FDI will contribute, at the margin, to host country benefits in the form of lower prices for consumers.

[4] Direct improvements in efficiency should be distinguished from spillover (or indirect) efficiency benefits to non-acquired host country firms.

Acquisitions versus greenfields: The evidence

Our discussion in the preceding sections suggest that there are no compelling theoretical reasons to expect the host country benefits of greenfield investments to exceed those of acquisitions. While the available evidence is fragmented and limited, it tends to support the conclusion that host country governments should not systematically discriminate in favor of one mode of FDI relative to another.

Perhaps the most important factor conditioning the host country benefits of inward FDI is the degree to which inward FDI increases competition in the host country's product markets. In this regard, Claeys and Hainz (2006) study a sample of banks from ten transition countries of Eastern Europe and find supportive evidence for the inference that greenfield investments have stronger competitive effects than do foreign acquisitions. On the other hand, Chung (2001) finds no identifiable difference in the competitive impacts of FDI depending upon whether the mode of entry is greenfield versus acquisition.

There is also no consistent evidence that greenfield investments have a greater competitive impact on host country labor markets compared to foreign acquisitions. For example, with respect to domestic wages, Heyman, Sjoholm, and Gustafson (2004) find that foreign-owned firms entering Sweden through greenfield investments have to pay higher wages to attract new workers.[5] Conversely, Bloningen, and Slaughter (2001) find that Japanese greenfield investment in the United States in the 1980s was associated with lower, not higher, relative demand for skilled labor.

Ambivalent evidence on the effects of greenfield FDI versus foreign acquisitions exists with respect to other manifestations of behavior and performance. For example, while Mata and Portugal (2000) find that greenfield entrants are more likely to be shut-down than acquisition entrants, McCloughan and Stone (1998) report that greenfield entrants face a lower risk of failure than acquisition entrants. With respect to innovation, Bertrand, Hakkala, and Norback (2007) show that controlling for parent, affiliate, industry, and country characteristics, acquired affiliates of Swedish multinational firms are, on average, more likely to do R&D and have a higher level of R&D intensity than affiliates created by greenfield investments. They interpret their findings as suggesting that discriminating against cross-border acquisitions in order to promote greenfield investments may be counter-productive for a host country aiming at increasing R&D investments.

Ferrett (2005) shows that when an acquisition prompts R&D investment that would not otherwise occur, acquisitions dominate greenfield investments in terms of their economic welfare effects for the host country. This is because there are gains in consumer surplus in the home country, as well as higher industry profits associated with the concentration effect. While Brouthers and Brouthers (2000) offer evidence that organizations which have developed strong intangible capabilities may be more able to "leverage" those capabilities through greenfield start-ups than through acquisitions, Vermeulen and Barkema (2001) argue that acquisitions, unlike greenfield expansions, broaden a firm's knowledge base and enhances the viability of its later ventures.

[5] However, Huttunen (2007) finds for a sample of Finnish establishments that foreign acquisitions result in a decreased share of highly educated workers in the plant's employment.

Given the ambiguity of the available evidence, we tend to agree with the OECD (2007: 86), that "it makes little economic sense for policymakers to distinguish greenfield investments from cross-border acquisitions."

Relevance for US policies toward Chinese FDI

The potential for host country economic benefits associated with foreign acquisitions of domestic companies to exceed those associated with foreign greenfield investments should caution US policymakers against systematically discouraging Chinese acquisitions of US companies. However, an economic case in favor of host country benefits from Chinese acquisitions of US companies would be strengthened by empirical evidence documenting the host country economic benefits described above. Unfortunately, there is virtually no empirical evidence identifying the magnitude of the host country economic benefits associated with Chinese acquisitions of host country firms.

An exception is Mathieu's (2006) analysis of several Chinese acquisitions of large French companies. In one acquisition, Marionnaud was taken over by A.S. Watson Group, part of the Hutchison Whampoa Corporation, a Hong Kong-based MNC. The French company was struggling to stay in business prior to the acquisition. After the acquisition, its operations expanded at a brisk pace with the opening of new stores and the hiring of a substantial number of new employees. In a second acquisition, Blue Star acquired Adisseo, a world-scale producer of animal-feed supplements. In association with this acquisition, Blue Star announced plans to set up an R&D center in France specializing in biotechnology for the production of amino acids used in animal feed. Apparently the French experience with Chinese acquisitions has been sufficiently favorable that the Invest in France Agency is increasing the number of employees at its office in China to raise awareness of opportunities in the French market.

Mathieu's case study evidence therefore suggests that Chinese acquisitions of US companies can impart host country economic benefits of the type summarized in Table 1. Nevertheless, it must be conceded that more empirical evidence bearing upon this issue would help better inform US policies toward inward FDI, not only from China but from other countries that have not been traditionally large foreign investors in the United States. In the absence of persuasive evidence of significant host country economic benefits from inward FDI from China, US policymakers

Table 1 Host country economic benefits of foreign acquisitions.

	Benefits
Direct	Takeover premia for shareholders of acquired domestically owned companies
	Higher wages for workers in acquired domestically owned companies
Indirect (spillover efficiencies)	Increased competition in host country markets promotes improved efficiency in non-acquired domestically owned companies
	Introduction of new technologies/management skills to non-acquired domestically owned companies
	Improved trade and investment access to foreign investors' home markets

might err on the side of being overly restrictive towards Chinese acquisitions of US companies. This is particularly relevant to the extent that unique costs and risks to the US economy are associated with acquisitions of US companies by Chinese MNCs.

US concerns about Chinese acquisitions of US companies

The conceptual concerns surrounding inward FDI from China as expressed by US policymakers, as well as policymakers in other developed economies, primarily relate to government ownership or control of the acquiring companies. Specifically, government ownership of large companies, or effective control through other means, is seen as allowing Chinese MNCs to pursue non-commercial objectives that, in turn, impose costs and risks on the United States. In effect, the motives of Chinese MNCs lie at the heart of concerns about Chinese acquisitions of US companies.

Motives of acquirers

In most economic models of merger and acquisition activity, it is assumed that the acquiring firm is driven to maximize the wealth of the firm's owners. Hence, firms will attempt to acquire other firms only if the acquiring firm's management believes that the acquisition will increase the long-run profitability of the firm. To be sure, principal-agent problems in large, widely held public companies can encourage and allow management to pursue acquisitions that are not necessarily consistent with long-run profit maximization. However, competitive capital markets provide a potentially strong disciplinary force on managers who systematically fail to make efficient decisions. Ultimately, managers who sacrifice the interests of shareholders in favor of other goals face the prospect of being replaced through takeovers of their companies. In contrast, managers of SOEs, as well as family owner-managers of diversified businesses face no such threat from capital markets. The takeover threat is not relevant for SOEs because the state is usually the controlling shareholder and sometimes the only shareholder.[6] As a consequence, financial losses can be subsidized from other sources of government finance. In the case of family-owned businesses, continued financial losses may ultimately force a sale of the business; however, there is no necessary compulsion for owner-managers to be ruthlessly efficient if they are willing to trade off profits for other goals such as employment of family members.

Several other differences characterize principal-agent problems in SOEs relative to those characterizing publicly traded companies. For example, an SOE cannot have its board of directors changed via a proxy contest and most SOEs cannot go bankrupt. The absence of proxy contests, like the absence of the threat of takeover,

[6] State ownership is present in most large Chinese-owned companies, though it may not involve majority ownership. Ownership can be held by national or local government. According to China's Economic Census 2004, there were 192,000 firms with state ownership at the end of 2004 including SOEs, state-owned joint ventures and state-owned holding companies.

reduces the incentives of board members and managers to maximize the value of the company. The irrelevance of bankruptcy effectively introduces a "soft budget constraint" which reduces pressures to contain costs. Furthermore, an SOE generally has a higher body or bodies that oversee it. This can be one or more ministries, a dedicated government entity, parliament or frequently a combination of overseers. The complex agency chain through and across various levels of government may present difficulties not present in the relationship between a company's board and managers on the one hand and its shareholders on the other.[7]

Where companies are not owned by private shareholders, or where most of those shareholders have little or no ability to influence managerial decisions, and corporate capital markets are not very competitive, there is no reason to believe that managers (or majority owners) will be disciplined, even in the long-run, for decisions that are inconsistent with efficient allocation of the organization's resources.[8] To the extent that goals unrelated to wealth maximization may dominate in Chinese MNCs, those MNCs enjoy the leeway to make financially unprofitable foreign acquisitions and to operate acquired foreign companies inefficiently. By itself, the latter outcome raises no concerns for the host country, since the subsidies required to perpetuate the inefficient performance of Chinese affiliates in the domestic US economy are presumably provided by China and not by US residents. However, other manifestations of inefficient behavior might have damaging consequences for the host country.

Resource utilization and access

Specific characteristics of large firms headquartered in emerging economies underscore concerns about managers pursuing goals other than wealth maximization. As noted earlier, SOEs are presumably not under pressure to earn profits in order to have the government continue to finance their operations. Hence, SOEs are under relatively little direct pressure to operate efficiently in order to maximize profits.[9] Indeed, SOEs are widely perceived as pursuing public policy goals that may sacrifice efficient performance as conventionally measured. For example, SOEs in China have been seen as maintaining employment in order to reduce social tensions that might arise through massive layoffs of workers. However relevant this behavior might be for the Chinese economy, it is unlikely that the Chinese government would make "employment preservation" a goal of SOE affiliates operating in the US and other developed countries. That is, there is no reason to believe that affiliates of

[7] For a discussion of the unique governance problems facing SOEs, see The World Bank (2006).

[8] Goergen (2007) and Young, Peng, Ahlstrom, Bruton, and Jiang (2008) point out that, for most of the world, conflicts of interest are not likely to emerge between management and shareholders but between the major shareholder and the minority shareholders; however, in many emerging market MNCs, major shareholders are either family members or the state, and family members or government bureaucrats are often senior managers.

[9] This assertion has been disputed by some SOEs. For example, the CEO of the Abu Dhabi National Energy Company recently stated that the company, while formed by the government in 2005 to diversify the emirate's portfolio globally, is "run like a private concern." See Cattaneo (2007).

Chinese SOEs operating in the US would employ US workers whose wages exceeded their contributions to profit.

A more relevant concern about takeovers of western companies by Chinese SOEs is that they are targeted at acquiring "critical" natural resources, and that resources are meant to provide long-run security of supply for the Chinese economy. As such, in the event of an unexpected short-run or long-run disruption of supply for one or more of those natural resources, Chinese owners would presumably refuse to make supply available to non-Chinese buyers, even if the latter are willing to pay more than competing Chinese buyers. In contrast, a wealth maximizing owner of the resource in question would presumably sell to the highest bidder regardless of the nationality of the buyer.

The dependence of China on the global supply of raw materials and energy, along with China's FDI in natural resources, has been noted by numerous observers. While the first and foremost resource for China is oil, the country also has great demand for other minerals such as copper, bauxite and uranium. While Hong and Sun (2004) conclude that access to natural resources is an important motive for outward FDI from China, in the late 1990s increasingly more Chinese firms used FDI to acquire advanced foreign technologies, as well as managerial skills. Furthermore, since the mid-1990s, more and more Chinese firms have listed on overseas stock markets (Hong Kong and New York) to raise equity capital (Hong & Sun, 2004; Woo & Zhang, 2006). In short, as the growth of outward FDI has proceeded, it has been accompanied by an increasing range of motives including a desire to gain access to expertise and other inputs.

The range of motives of Chinese companies undertaking outward FDI is underscored by surveys. For example, Wu (2005) reports the results of a survey of Chinese companies regarding their motivation for outward FDI. Three main motivations were identified: (1) seeking new markets (56%); (2) obtaining technology and brands (16%) and (3) securing resources (20%). While it is difficult to assess how much reliance one should put on such surveys, as well as how much to infer about the likely host country impacts of Chinese FDI, at least one inference might be drawn. Specifically, concerns expressed about outward FDI from China leading to dominant ownership of critical natural resources on the part of Chinese SOEs seem unrealistic based upon the apparent relative unimportance of the "securing resources" motive. Furthermore, given the relatively dispersed sources of supply for natural resources, outward FDI from China to this sector would have to be massive indeed to create any real threat of control of supply in the hands of Chinese companies.

National security

Another broad concern surrounding acquisitions by Chinese SOEs is that they may impose a national security threat upon the host economy. Indeed, national security concerns have been raised by a number of proposed foreign takeovers of companies operating in the United Sates. One notable example was the proposed acquisition by Dubai Ports of a UK company with an affiliate operating a number of major US shipping ports. While the Middle Eastern background of the would-be acquirer certainly figured prominently in the security argument, it is highly likely that a similar "national security" concern would have been expressed by US politicians had a Chinese company proposed the same acquisition. More recently, a proposed buyout of network equipment maker 3Com by Bain Capital Partners was scuttled after Bain was notified by the Committee on Foreign Investment in the United States (CFIUS) that it intended to block the deal which would have given China's Huawei Technologies Co. a minority stake in 3Com. The specific concern was that Huawei would gain access to the telecommunications equipment maker's technology which is used by the US Defense Department, among others.[10]

The basic notion underlying a national security concern about acquisitions by Chinese SOEs is that the latter have no political loyalty to the host country while domestically owned shareholders presumably do. Equivalently, Chinese SOEs will be less willing than domestically owned companies to sacrifice their organizational objectives for the sake of the national interests of the host country, including national security. Indeed, in the extreme case, SOE affiliates might be seen as agents of an "unfriendly" government whose primary objective may be to damage the economic infrastructure of the United States and other Western countries.

While the potential relevance of national security concerns arising from Chinese FDI certainly cannot be dismissed, the extent to which such concerns warrant giving "special treatment" to acquisitions made by Chinese companies is much less obvious. The rationale for doing so is presumably that political objectives dominate economic objectives in the case of foreign acquisitions made by Chinese MNEs, whereas that is less so the case for acquisitions made by MNEs based in other countries. Whether or not this is true is simply unanswerable based upon available evidence.

Woo and Zhang (2006: 4) assert that, since 1980, the emphasis on political objectives in determining Chinese outward FDI policy has gradually given way to the primacy of commercial interests. At the same time, the approval process for outward FDI has been greatly simplified with decision-making authority delegated first from the central government to local governments, and more recently to the enterprise itself. The "devolution" of decision-making authority to the MNE managers is consistent with an increasing emphasis on commercial objectives. Woo and Zhang (2006) describe the results of a survey carried out in May–June 2005 by the Asia Pacific Foundation of Canada in partnership with the China Council for the Promotion of International Trade (CCPIT). The survey covered 296 member companies of CCPIT. The survey results suggest that respondents' current investments overseas were driven as much by pure business considerations as by the Chinese government's Stepping Out policy and related incentives. When asked about future investments, however, the importance of government policy direction and incentives is given much less weight by respondents. Rather, "business potential" is seen as the primary motivation. Related to this latter point, Li (2007) discusses several cases of Chinese MNEs listing their stocks in Hong Kong not only to raise financial capital but also to seek legal protection of the stock ownership for their top management team and to overcome the ambiguous property rights of either state or collective ownership. In short, for at least some Chinese MNEs, outward FDI might be part of the process of becoming more "market-oriented."

[10] See *The Wall Street Journal*, 2008. Bain capital drops its bid for 3Com, March 21: B6.

Transparency

Another specific issue raised about Chinese SOEs is their lack of transparency of structure and organizational form. In particular, many Chinese SOEs both make losses and do not comply substantively with codes of corporate governance and transparency to which OECD companies largely adhere.[11] Firms acquired by Chinese companies may experience financial difficulties under a politically appointed and motivated management pursuing non-profit motives. To the extent that financial losses and other adverse consequences of inefficient management are borne solely by the parent Chinese company, no broader externality costs are presumably imposed upon the host economy. However, if a lack of transparency makes it relatively difficult for input suppliers, employees and lenders to assess relatively accurately the likelihood of the Chinese-owned affiliate carrying out its contractual and non-contractual agreements, unanticipated financial losses may be suffered by host country entities doing business with the Chinese-owned affiliate. Indeed, the financial failure of relatively large Chinese-owned companies might generate relatively broad-based economic dislocations that affect a wide range of parties in the host economy besides the failing companies.[12]

The potential for third party costs to arise from reckless or even fraudulent behavior exists in the case of domestically owned companies as well. Indeed, current and widespread financial distress in the US banking sector associated with defaults on what appear to be, in retrospect, an excessively lax and, in some cases even fraudulent extension of sub-prime mortgages and consumer loans highlights the potential for systemic economic costs to arise from the activities of domestically owned firms operating in even relatively highly regulated industries. The Enron fiasco further underscores the difficulties in preventing corporate financial misbehavior having widespread economic implications, even when the corporation is subject to public accounting rules and regulations associated with a New York Stock Exchange listing. As such, it is unclear that the potential consequences of inappropriate governance practices and limited corporate transparency are particularly acute in the case of SOEs operating in developed countries.

Unfair competition

Yet another concern about Chinese FDI is that the investment activities of Chinese MNEs are directly or indirectly subsidized by the Chinese government. Hence, Chinese MNEs may have an “unfair” capital cost advantage with respect to US-owned companies that must finance their investments at market costs of capital. Put in this context, the complaint is quite similar to concerns expressed about predatory pricing (or dumping) by foreign exporters. However, as Antkiewicz and Whalley

[11] For a discussion of the appearance versus the reality of compliance with OECD codes, see Peng (2004).

[12] One thinks here of the recent bankruptcies of several large mortgage brokers in the United States that contributed to a reluctance to lend on the part of other financial institutions with attendant disruptions to the normal functioning of capital markets. For a more extensive discussion of this possibility, see Antkiewicz and Whalley (2007).

(2007) point out, it is difficult to apply arguments of predation to cross-border investment and acquisition activities because asset acquisitions are one-time transactions. Furthermore, foreign subsidization of acquisitions might simply lead to domestic sellers of assets receiving a higher price. From a US public policy standpoint, therefore, no compelling unique cause for concern exists with respect to the costs of capital for Chinese SOEs.

Summary

A number of fundamental conceptual concerns have been raised regarding acquisitions of US companies by Chinese MNCs. At the same time, it can be argued that those concerns are either substantially overstated or not uniquely relevant to acquisitions by Chinese MNCs. Furthermore, to the extent that policies are in place in the US to deal with any significant issues that are raised by takeovers of US companies by Chinese MNCs, those issues might be moot from a policy perspective. The next section of the paper considers whether existing US laws and regulations seem adequate to deal with concerns raised by Chinese acquisitions of US companies, however speculative the issue.

Assessing the policy environment

Before evaluating whether existing laws and regulations in the United States are sufficient to deal with the realistic risks and concerns associated with takeovers of domestic companies by Chinese companies, it is useful to make two policy-related observations. One is that there is no strong conceptual or empirical basis for discriminating against investments by Chinese MNEs as distinct from investments by MNCs based in other emerging economies. Specifically, there is no evidence that the economic performance of Chinese SOEs is likely to be worse than the performance of SOEs and non-SOEs based in other emerging economies. A second point is that no global rules apply to interventions in factor flows by government regulators. Issues of subsidization, mutually agreed upon bindings on barriers to foreign acquisitions and transparency of organizational form of acquiring firms are, therefore, relatively new issues for the international community. Hence, while the US government is relatively unencumbered by international treaties in how it addresses these issues, it also needs to be concerned about establishing policy precedents that might be adopted by other countries which, in turn, might prove to be serious impediments to acquisitions of foreign companies by US MNCs—in this case, acquisitions of Chinese companies by US MNCs (Peng, 2004).

Monopolizing resources

As noted in an earlier section, concerns about China using FDI to monopolize world supplies of raw materials seem unrealistic. This is not to say that individual acquisitions cannot raise market power issues. However, US antitrust laws can address and prevent anti-competitive mergers, as well as abuses of dominance, such as refusal to supply, that might result from anti-competitive mergers that are not prevented. Hence, it would not seem that any new laws or regulations are required to deal with the industrial organization consequences of Chinese acquisitions of US companies.

Threats to national security

More problematic are national security concerns surrounding inward FDI. The Exon–Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988, along with recent amendments to the Act under the Foreign Investment and National Security Act of 2007 (FINSA) makes it possible for the federal government to intervene in virtually any acquisition in the domestic economy for reasons of "national security."[13] Additional legal safeguards limiting foreign control of certain categories of domestic assets deemed vital to national defense also exist. For example, if a foreign investor wishes to establish a new communications line, it would be subject to licensing authority from the FCC which would, in turn, seek input from the Department of Defense, among other government agencies (Fagan, 2007).

Essentially any foreign acquisition of a US company can be subjected to screening by the CFIUS. Kang (1997: 304) asserts that the Exon-Florio amendment created a de facto screening mechanism that not only can bar foreign investment but also has the power to set performance requirements for foreign investment in virtually all sectors of the US economy based on vague national security grounds. Indeed, Kang states that prudent mergers and acquisitions advisors recommend that investors report acquisitions of any domestic company that has cutting edge technology or products, even if it does no defense-related business. They also advise reporting investments that the public might construe as being related, even indirectly, to national security.

Greenfield investments, in principle, escape the scrutiny of the Exon-Florio amendment, although CFIUS can find foreign control even when the foreign entity owns only a small minority stake in the US business, as is typical in the case of investments by SWFs (Fagan, 2007).[14] As a practical matter, it is difficult to see how greenfield or pure portfolio investments could raise national security concerns, since ownership control over existing corporate infrastructure in defense and defense-related industries would not change. However, as in the aforementioned 3Com case, concerns have been raised that even passive foreign investors might be able to acquire "sensitive" information from a national defense standpoint by "pressuring" management for access to information that is ordinarily not supplied to shareholders. In other cases, it might be argued that a physical presence in the United States, say

[13] A comprehensive discussion of the Exon-Florio Amendment and FINSA is provided in Fagan (2007).

[14] As Fagan (2007) notes, greenfield investments at the outset will not involve contracts or assets that are inherently central to national security. By contrast, an existing business may have contracts with the US government or access to sensitive or classified information.

through a greenfield investment, might facilitate foreign companies' efforts to engage in military or industrial espionage.

It is extremely difficult to assess the potential issues identified in the preceding paragraph. For example, while espionage has been a long-standing concern of US defense and intelligence agencies, well-known public cases of Chinese espionage have involved individuals working for US-owned companies or government agencies (Wortzel, 2008; Rowan, 2008). Most greenfield and portfolio investments will have no national security implications, and the majority of foreign acquisitions will also likely have benign national security consequences. Reviewing both greenfield investments and acquisitions will obviously increase the administrative costs surrounding the FDI review process. Whether or not greenfield investments are reviewable, it seems good public policy to make the relevant legislation governing FDI reviews explicit with respect to the criteria used to evaluate threats to national security. The criteria should define national security narrowly and the reasons for CFIUS recommendations should be public information.

In short, there is certainly legislation to address acquisitions by Chinese MNCs that may potentially threaten national security. A more realistic concern is that the main legislative instrument available is insufficiently precise and excessively vulnerable to abuse from domestic economic and political interest groups to serve the interests of Americans. While it may never be possible to define national security with precision, it does seem possible to make explicit whether the Exon-Florio amendment is meant to address national security concerns or whether it is fundamentally a screening mechanism with the goal of extracting "concessions" from foreign investors as a condition of approval. If the former, it would also seem possible to circumscribe the sectors and markets in which foreign acquisitions raise prima facie national security concerns. Acquisitions which fell outside these designated sectors and markets, including acquisitions by Chinese MNCs, would not be subject to review under the Exon-Florio amendment.

Transparency and systemic financial failures

As noted in an earlier section, concerns that poor corporate governance and limited transparency may lead to systemic economic failures are not limited to investments made by Chinese MNEs or other emerging market MNEs. Indeed, recent episodes of financial crises in the United States have been precipitated by actions of domestically owned companies. Moreover, the appropriate policy response to the relevant concerns is unclear. One possible approach is to require firms engaged in acquisitions of US companies to follow internationally agreed upon standards of governance and accountability as set out by organizations such as The World Bank or the OECD. If this approach is implemented, it would clearly be in the interest of the United States to have other developed countries adopt the same policy in order to discourage "investment diversion," whereby investments are made in geographic regions without the policy, even though the resources involved could be more efficiently used in regions that have implemented the policy.

Another possible approach to problems raised by limited transparency is to impose financial reporting and corporate governance measures mandated by domestic regulators such as the New York Stock Exchange, even in the case of foreign acquisitions by non-listed entities. Clearly, any such approach would represent a substantial additional cost of acquiring US companies and would presumably have to be applied to all foreign acquirers and not just China-based acquirers. One can imagine that the economic costs of such a measure would substantially exceed any benefits given the presumption that foreign acquisitions, on balance, have net economic benefits for the US economy.

In addition, such measures could well provide a deterrent to capital inflows from China and elsewhere. There is already concern that as a result of Sarbanes Oxley US exchanges are having trouble attracting global IPOs, and are losing listings to London and Hong Kong.

In sum, the United States economy theoretically might face an irreducible risk of corporate misbehavior that has the potential in a worst case scenario to impose substantial system-wide costs. However, this risk is not unique to Chinese affiliates operating in the United States. In this regard, the situation facing the United States also confronts other countries. To the extent that a minimum standard of corporate governance can be agreed upon by major host countries for foreign investors, requiring the adoption of this standard as a condition of approval for taking over a large domestic company might be a pragmatic, if not especially robust, policy response to the transparency concern.

To be sure, major host countries may well disagree about the appropriate standards for financial reporting and other accounting matters as exemplified by regulatory differences that exist across national stock market regimes. Political pressure exerted on emerging market MNEs by developed countries for the former to adopt some common denominator standard of governance, such as the OECD's Principles of Corporate Governance might be tractable, although the associated benefits of conditioning approval of foreign investments on a company's adoption of those principles are speculative. As noted above, even companies that are subject to stringent reporting requirements of the New York Stock Exchange have engaged in behavior that has led to adverse and substantial third-party financial impacts.[15]

The US Treasury has urged the adoption of a voluntary code of "best practices" with respect to the activities of SWFs (Davis, 2007). Others have suggested that the issue of corporate governance be made a part of global trade negotiations. Still others have called for institutions such as the IMF and The World Bank to examine issues related to the activities of SWFs including the transparency of their operations.[16] As in the case of FDI, transparency issues surrounding the activities of SWFs are arguably part of a global economic agenda, and it is neither theoretically optimal, nor practical, for the United States to impose its own specific

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[15] At the same time, the rapid economic growth of China's economy is encouraging economists and investment analysts to study Chinese companies more intensively, thereby mitigating some of the transparency problems associated with the activities of those companies (McMahon, 2007).

[16] It was recently announced that the US and officials from Abu Dhabi and Singapore have agreed to basic principles that call for, among other things, strict disclosure and governance standards for sovereign wealth funds. The agreed-upon guidelines are aimed at complementing efforts under way at the International Monetary Fund and the OECD to write voluntary codes of "best practices" for sovereign wealth funds (Barkley, 2008). The guidelines developed for SWFs can conceptually be applied to SOEs, as well.

Table 2 Concern raised by Chinese acquisitions of domestically owned companies and existing laws and regulations to address concerns.

Concerns	Relevant laws/regulations
Hoarding resources	Clayton Act (Antitrust Law)
National security	FINSA (Exon-Florio)
Transparency	None, but there are codes of conduct
Governance	None, but there are codes of conduct

governance standards as a condition of allowing inward investment from China or other emerging economies.

As summarized in Table 2, we conclude that existing US legislation and regulations seem appropriate to address the main concerns surrounding Chinese FDI in the United States, with the possible exception of limited financial transparency and deficiencies in corporate governance. Issues surrounding financial transparency and corporate governance seem best addressed at the international level, since both foreign investors based in emerging countries and governments of developed countries have a mutual interest in finding efficient agreements that meet basic goals while preserving open capital markets. In other words, there is no compelling need to develop China-specific legislation in the United States for the purposes of limiting/constraining inward FDI from China.

This point appears to have been recognized in the most recent round of the US-China Strategic Economic Dialogue (SED), concluded in June 2008, where the United States affirmed that the CFIUS process would apply equally to all countries. At the same time, China affirmed that investment by its state-owned investment firms would be based solely on commercial principles.[17]

Conclusions

From a strategic US perspective, imposing additional restrictions on inward FDI from emerging economies, including China, heightens risks that US firms will be subjected to reciprocal increases in restrictions on investments in the same emerging economies. In this regard, Chinese government authorities have made it known that direct and indirect access to China's domestic market extended to US-based companies might well be influenced by the legal ability of Chinese companies to make investments in, and construct alliances with, US-based companies. As a strategic matter, therefore, the benefits of inward FDI from China for the US economy may derive in no small part from the de facto linkage between acquisitions of US companies by Chinese MNCs and the openness of China's domestic economy to US trade and capital exports. The large size and rapid growth of China's domestic market makes it a particularly beneficial trade and investment partner for the United States. As such, it seems feckless on the part of US policymakers to stigmatize Chinese investment in the United States based upon imprecise and likely exaggerated estimates of the relevant costs and risks of that investment.

[17] See US Treasury Department Office of Public Affairs, 2008. Joint US-China Fact Sheet, June 18. SED took place after a draft of this paper was written.

At the same time, Chinese MNCs should do more to mitigate growing political pressures in the United States to discourage acquisitions of US companies, particularly by Chinese SOEs. For example, Chinese managers might be more open and candid about the motives for acquiring specific US companies after the acquisitions have been consummated, as well as how they intend to operate the acquired companies differently than had been the case before the takeovers. Such transparency might help mitigate concerns that most or all acquisitions of US companies by SOEs are motivated by non-commercial objectives. Voluntary initiatives on the part of Chinese MNCs to improve corporate governance practices and meet transparency standards recommended by international organizations such as The World Bank would presumably also help to counteract lobbying pressures on the US government to discourage inward FDI from China.

Voluntary initiatives to improve governance and transparency should be seen by Chinese managers as investments in maintaining secure access to the US domestic market for both exports and capital investments. Given a relative dearth of reliable information on the part of US policymakers regarding how Chinese MNCs are organized and managed in practice, Chinese managers are advised to take greater pains to ensure that initiatives designed to have Chinese MNCs operate in closer accord with developed economy practices for public companies are recognized and understood by US policymakers.

Chinese managers should also make greater efforts to identify and articulate the bilateral benefits of closer economic integration between the United States and China. Even relatively well-informed US politicians face populist pressures to restrict expansion by Chinese companies in the United States. To the extent that broader segments of the US population was better informed about the full impacts of Chinese FDI in the United States, a stronger countervailing influence on protectionist lobbying initiatives might be brought to bear on the US political process.

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