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Chinese Investment and State Economic Development

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As a result of the 2008 global financial crisis and the Great Recession, states are confronting fierce fiscal challenges and the job market is weak. In addition, the U.S. economy is not recovering as it has in past economic downturns. In response to these increasingly bleak prospects, states have become more aggressive in the global marketplace. Fostering corporate investment from China is seen as one of the major strategies for job creation in the United States.

One problem is that, whereas states need foreign investments, federal government policies are still viewed by foreign investors as barriers to such investments. The federal government is becoming more supportive of states as they expand their international economic development efforts.

Along with President Barack Obama's revived export push, his newer international investment initiatives are reaffirming traditional U.S. open investment policies. These policies intend to remove regulatory uncertainties restricting the acquisition of domestic firms by foreign firms, that is, foreign direct investment (FDI) in the United States.¹

The following observations are particularly important with regard to Chinese investment and state economic development in the United States today.

Investment Growing

First, Chinese firms will make between \$1 trillion and \$2 trillion in direct investments globally over the next 10 years. Investment by Chinese firms abroad is growing between 20 percent and 30 percent annually. Chinese corporate investments abroad have increased dramatically, with huge investments recently in Europe and Brazil.

Chinese companies were among the fastest growing overseas investors in 2010.² Chinese investment in the U.S. in 2010 was \$5 billion.³ China has already invested in 35 of the 50 states, with the largest investments in Texas, New York, and Virginia.⁴ New York City alone has more than 60 Chinese companies (private and state-owned) registered with the city,⁵ and New York is the top city for Chinese FDI in the United States. The China International Capital Corporation, the respected investment bank, has recently opened offices in New York.

The China Investment Corporation, a sovereign wealth fund, has invested its initial \$200 billion worldwide.⁶ Merely holding U.S. government debt and retaining large corporate and national dollar reserves is becoming unacceptable and overly risky for China and its corporations. Investment by Chinese firms abroad are expected to overtake investments into China by foreign firms within three years.⁷

Second, Chinese operating firms are reorienting their global business strategies to avoid domestic trade restrictions and to more fully participate in the global economy to enhance their corporate transactions

through acquisitions.⁸ China has been the world's largest target for anti-dumping investigations, primarily in the U.S. and the European Union. As Chinese firms mature, they are clearly interested in developing strategies to overcome trade restrictions,⁹ Buy America provisions, a falling dollar, and rising wages in China, as well as servicing their own domestic markets and developing newer global markets.

Publicly listed Chinese companies in the U.S., which often use reverse mergers that avoid the scrutiny of an initial public offering (IPO), have raised issues of corporate transparency, fraud, and corporate governance. Chinese firms often use foreign shell companies that issue American Depositary Receipts (ADRs) to attract U.S. investors. The SEC, the Public Company Accounting Oversight Board (PCAOB), and other bodies can ensure financial propriety by exercising diligent oversight of Chinese companies and their auditors. Various rules under Sarbanes-Oxley¹⁰ and Dodd-Frank¹¹ are specifically applicable extraterritorially and are useful in policing foreign investment in the U.S. in an era of cross-border transactions from a wide range of foreign companies.

Chinese companies are joining the global marketplace because of internal corporate dynamics to gain greater market access and profitability. As a result of these newer global strategies, market forces are forcing the Chinese companies to comply with national rules governing business transactions. This parallels China's general observance of trade decisions against it in the WTO's dispute resolution system.¹²

Federal Restrictions

Third, recent legislation, the Foreign Investment and National Security Act (FINSAs), requires the Committee on Foreign Investment in the U.S. to investigate all foreign transactions involving a foreign corporation that is owned by a foreign government.¹³ This provision seems to be aimed at China and sets the wrong tone in encouraging foreign investment. It is interesting to note that China ranked as only eighth in takeovers of critical technology companies in the U.S. from 2007 to 2009.¹⁴ The Financial

Times recently declared, "The Chinese rightly warn against protectionism wrapped in national security."¹⁵

President Obama's declaration in June 2011 supporting a "fair and equitable" approach to foreign direct investment¹⁶ is most welcome, as is his establishment of "SelectUSA" as the first coordinated federal effort to promote FDI in the U.S.¹⁷ But federal policies could further remove regulatory and congressional uncertainty relating to review of foreign mergers and transactions that are seen as risk factors restricting FDI.

Fourth, whereas federal enforcement of export controls on the transfer of technology to foreign affiliates in the U.S. is necessary, as is securities review concerning any publicly listed foreign companies in the U.S., they do not need to be discriminatory. The conclusion of more bilateral tax and investment treaties with foreign countries by the federal government is an additional incentive for foreign firms to invest in the U.S. Nevertheless, states must ensure that their tax and regulatory systems provide parallel rights.

State Restrictions

Fifth, although the public and many policymakers do not generally realize it, states have become major players in international trade and global investment. This is despite the fact that the U.S. Constitution gives Congress the exclusive right to regulate foreign trade and prohibits states from entering into treaties. The competition for new business takes place at the state level, one corporation at a time. States that are not aggressive or have regulatory and tax disincentives lose in the global marketplace.

Simply put, being competitive in the global marketplace is the answer to the economic and business distress at home. States should expand their global outreach by opening more offices overseas to market their jurisdictions. Attracting Chinese corporations will not likely raise complaints of corporate welfare because they probably will not require expensive state incentives. Similarly, attracting such corporations will preclude the complaints of beggar-thy-neighbor and the race-to-the-

bottom mercantilism that are often heard when one state persuades a firm from another state to relocate.

In conclusion, after assessing the legal and policy issues concerning Chinese investment in the U.S., I have several suggestions.¹⁸ First, states need to follow an aggressive economic development policy focusing on attracting Chinese and other FDI. States ought to assess their business and regulatory environments to ensure equal treatment for foreign corporations. Second, the federal government ought to remove unnecessary legislative and regulatory barriers to foreign investment in the name of national security that promotes protectionism. The federal government should adopt a systematic and aggressive policy of promoting foreign investment. It should also promote greater use of bilateral investment and tax treaties.

A new report by the Council on Foreign Relations concludes that "increased Chinese investment should be a top U.S. priority."¹⁹ Foreign corporations and sovereign wealth funds have the money and desire to invest in the United States, which is good for the U.S. job market. Vice President Joseph Biden wrote recently, "China can make our country more prosperous, not less. As trade and investment bind us together, we have a stake in each other's success."²⁰

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Endnotes:

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