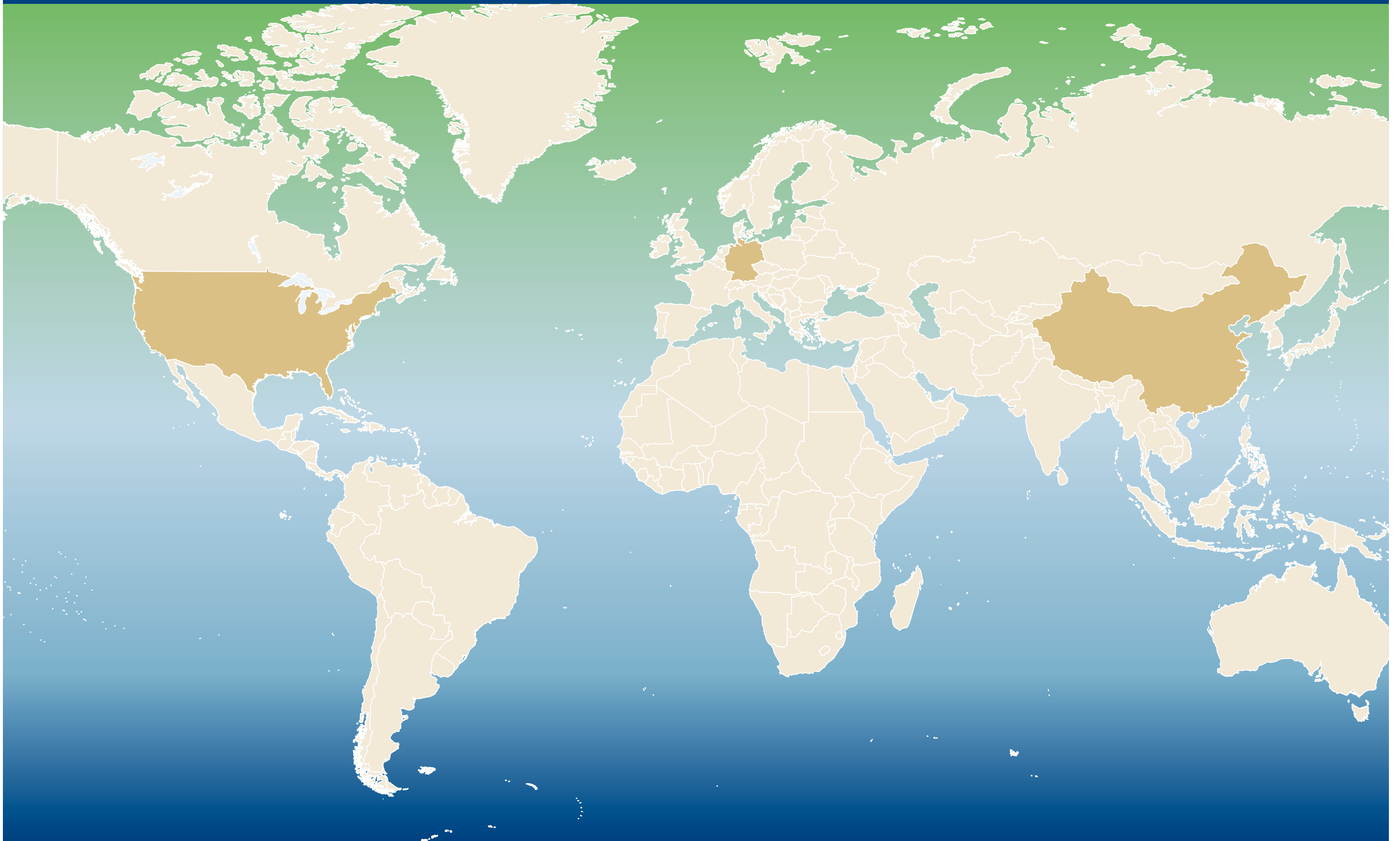
Cash in Hand

Chinese Foreign Direct Investment in the U.S. and Germany

Ting Xu, Thieß Petersen and Tianlong Wang



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Second Edition

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Executive Summary

In this study, we offer a comparative analysis of Chinese FDI growth in two developed country destinations: Germany and the United States. An analysis of the data establishes a sharp upward trend in FDI into both of these countries. The current trajectory indicates that Chinese FDI into developed countries like the U.S. and Germany will have a profound impact on the global economy in the future.

As it stands, however, current levels of Chinese FDI into these countries have been quite small: China still holds less than 0.2 percent of the FDI stocks in both Germany and the U.S. This fact does not match up to the status of the three countries' leading roles in the global economy. The report therefore raises key questions about the regulatory climate for Chinese FDI both within China – which has seen substantial liberalization as part of the government's "going-out" strategy – and within Germany and the U.S.

Our findings indicate that, first, FDI controls in the United States are comparatively more restrictive than those in Germany – which offers tax advantages, lower labor costs, and a greater general openness to Chinese FDI. While China currently invests more in the U.S. than in Germany, these conditions could potentially reverse given the differing investment environments. This could be a particularly important consequence as Chinese FDI grows not only in volume but in relevance to both U.S. and German growth. The U.S. will therefore need to build on the work currently being done to make the U.S. a more attractive FDI destination for Chinese investors.

Second, public pressure to limit or restrict Chinese FDI for political reasons – particularly acute in the U.S. but also present in Germany – should be resisted. For both countries, this means adhering to an objective, nondiscriminatory, and transparent standard for assessing the security implications of FDI and the use of Sovereign Wealth Funds (SWFs) – and recognizing that the vast majority of these transactions will benefit growth and spur job creation.

Third, better across-the-board coordination and cooperation are needed. Officials and entrepreneurs in all three countries need to work to promote an accurate public image of the impact of Chinese foreign direct investment, while U.S. and German leaders should send a strong welcoming signal to Chinese investors. Such cooperation involves creation of more direct platforms for interaction, such as an outward investment promotion agency in China, a U.S.-EU-China investment fair, and initiation of a regular consultation process for negotiating a trilateral investment treaty.

Finally, a key impediment to analysis continues to be a lack of uniformity in FDI data across countries, which seems to spring from a lack of uniform standards for how FDI is measured. Such uncertainty in the data may lead to suboptimal or mistaken policy prescriptions. Better coordination is therefore needed among the three countries to provide comparable datasets based on commonly agreed standards.

Cash in Hand: Chinese Foreign Direct Investment in the U.S. and Germany

China's outward foreign direct investment (FDI) is on the rise. According to China's Ministry of Commerce, the National Bureau of Statistics, and the State Administration of Foreign Exchange (2011), China's net outward FDI flows reached US$68.81 billion in 2010, increasing by 21.7 % (MOFCOM et al. 2011), as compared to US$56.53 billion during the previous year. China's net outward FDI has expanded almost 70 times when compared with a value of just US$1 billion in 2000 (See Figure 1). Due to China's outstanding economic growth, its outward FDI is due to reach a new high point. The Asia Society (2011) estimated that China's FDI outflows would be between US$1 trillion and US$2 trillion by 2020 (Rosen and Hanemann 2011).

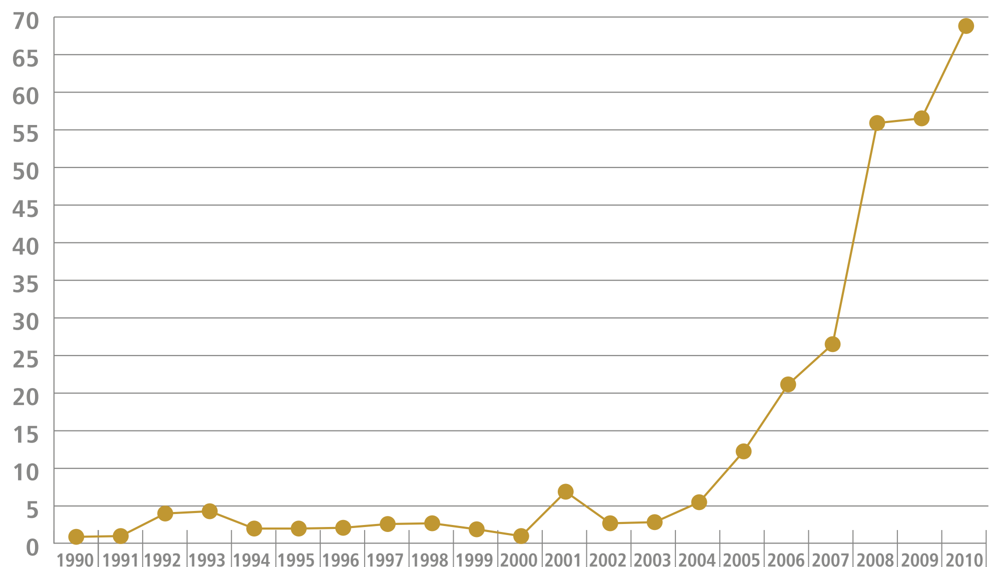
The "2011 World Investment Report" by the United Nations Conference on Trade and Development (UNCTAD) has shown that total FDI outflows were US$1.24 trillion around the world from 2009 to 2010 (UNCTAD 2011). According to the report, China's outward FDI flows made up 5.1 % of that total in 2010. China's outward FDI was the highest out of all developing countries and was the fifth largest worldwide, exceeding those of Japan and the United Kingdom. Thus, China is a middle-income country, which is classified as any country with outward FDI of more than $50 billion.

The profound impact of these changes on the global economy is likely to expand as Chinese FDI increases, as the current trajectory suggests. Many have studied the evolving patterns of Chinese FDI into developing countries, and it is not until recently that Chinese FDI in the developed world started to draw more attention. In this paper, we give an analysis of the evolution of Chinese FDI in recent years, reasons and policy basis, look at the available FDI data sources, and then focus on the experience of Chinese FDI in two of its major developed country destinations, the U.S. and Germany. We compare the role Chinese FDI has played in these two economies and the way it has been received. Based on the comparison, we draw some reflection points that contribute to a fuller picture of the performance, future trends, and needs of Chinese FDI in developed markets.

Characteristics and Trends of Chinese Outward FDI

First, the rapid growth of China's outward FDI has been stable and resilient. China was able to maintain a rapidly growing economy even with the effects of the 2009 global economic crisis. Chinese enterprises' cooperation around international investment in 2009 helped contribute to China's outward FDI flows reaching US$56.53 billion. In 2010, its outward FDI net flows reached a record level of US$68.81 billion. The country's outward FDI has averaged an annual growth rate of 49.9 % from 2002–2010 (MOFCOM et al. 2011).

Figure 1: China's outward FDI flows 1990–2010 (in Billions of Dollars)



Source: 2010 Statistical Bulletin of China's Outward Foreign Direct Investment

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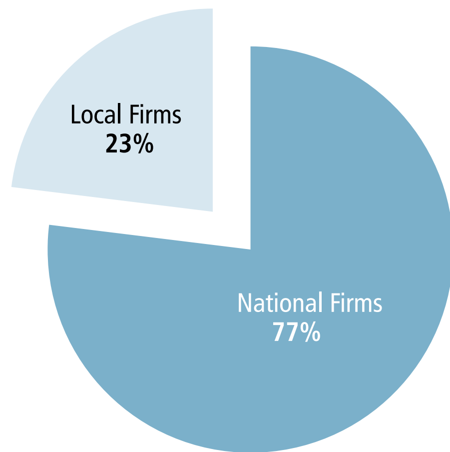
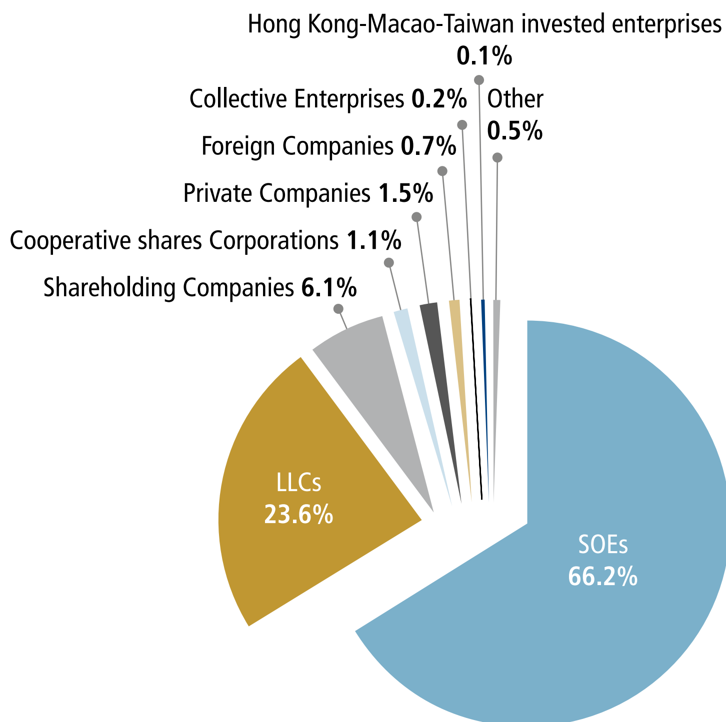
Second, China's State-Owned Enterprises (SOEs) have been the main driver of FDI. Although the share of large investments by SOEs appears to have dropped noticeably in recently years, state entities still dominate outward investment by volume. China's FDI outflows by SOEs have accounted for more than two-thirds of total Chinese FDI, and still continue to rise. Private Chinese companies' capabilities for outward FDI are relatively low due to their limited access to funding, technology, and market influence. According to data released by the Chinese Ministry of Commerce (MOFCOM) in 2011, SOEs accounted for the largest share of China's FDI stock at 66.2 % (decreasing by 3 % from the previous year), with limited liability companies following at 23.6 %

Figure 2: Breakdown of Chinese FDI by Types of Investors

FDI by National & Local SOEs, 2010



Chinese FDI by Ownership Structure

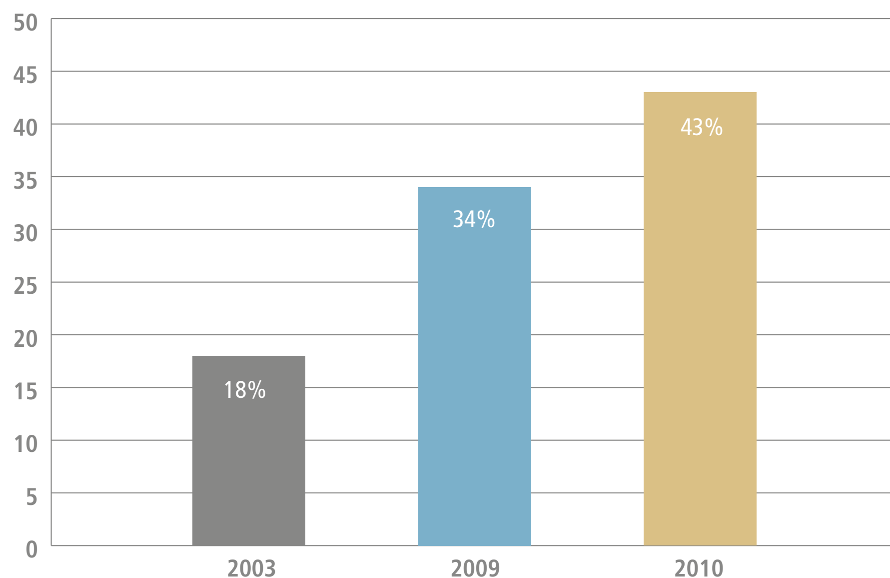


Source: 2010 Statistical Bulletin of China's Outward Direct Investment

(increasing 1.6 % over the previous year), and shareholding companies at 6.1 %. The rest of the total is composed of cooperative shares corporations at 1.1 %, private companies at 1.5 %, foreign companies at 0.7 %, collective enterprises at 0.2 %, Hong Kong-Macao-Taiwan invested enterprises at 0.1 %, and others at 0.5 % (See Figure 2). Out of the total FDI contributed by Chinese SOEs, 77 % of that was made by national SOEs, while 20.3 % was made by the local SOEs (an increase of 3.2 % over the previous year).

Third, cross-border mergers and acquisition activity (M&A) by Chinese enterprises has been drastically growing. Although greenfield investment is the main FDI method used by Chinese firms, the number of those firms engaged in outward cross-border M&A activities is on the rise during recent years. Cross-border M&A investment accounted for 34 % of China's outward FDI in 2009, and just 18 % in 2003. In 2010, FDI made by Chinese enterprises through mergers and acquisitions accounted for 43.2 % of the total (See Figure 3). The future cross-border M&A investments of Chinese companies will continue to rise, because those companies are increasingly willing to invest abroad, driven by the need to access new resources and technology, to acquire global brands and to diversify operations internationally. According to the National Development and Reform Commission (NDRC), Geely Group, a Chinese car manufacturer, successfully completed the acquisition of Volvo Car Corporation from Ford Motor Company for more than US$2.5 billion. One year after Geely Group bought the Swedish brand, Volvo had achieved profitability with car sales up 15 % or more. Employee satisfaction was at the highest level in a decade (84 %) and 1,500 more employees were hired (Zhang 2011).

Figure 3: Mergers and Acquisitions as a Percentage of Total FDI



Source: Statistical Bulletin of China's Outward Foreign Direct Investment, 2003, 2010

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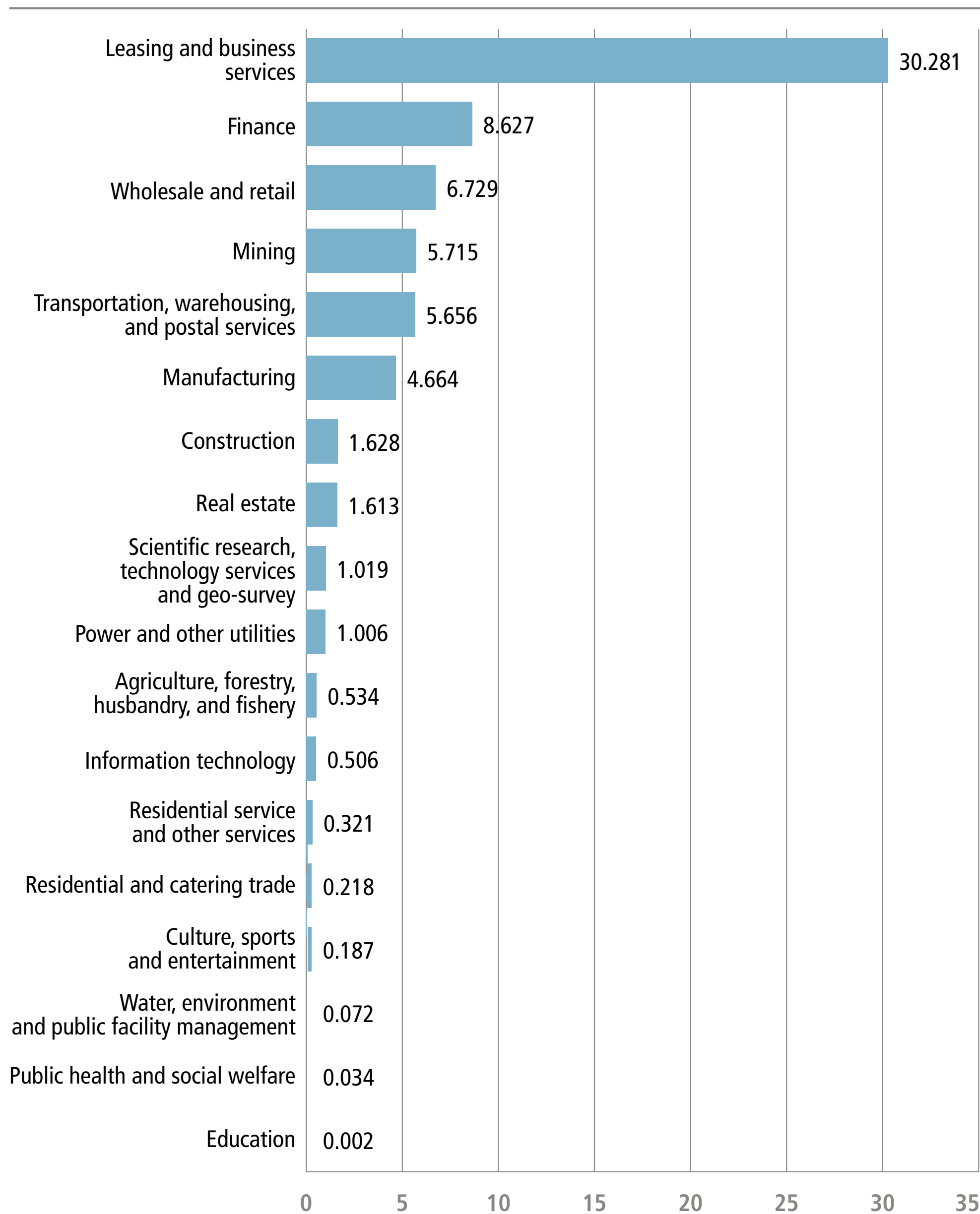
Figure 4: 2010 Outflows of Chinese FDI by Industries (in Billions of Dollars)



Source: 2010 Statistical Bulletin of China's Outward Foreign Direct Investment

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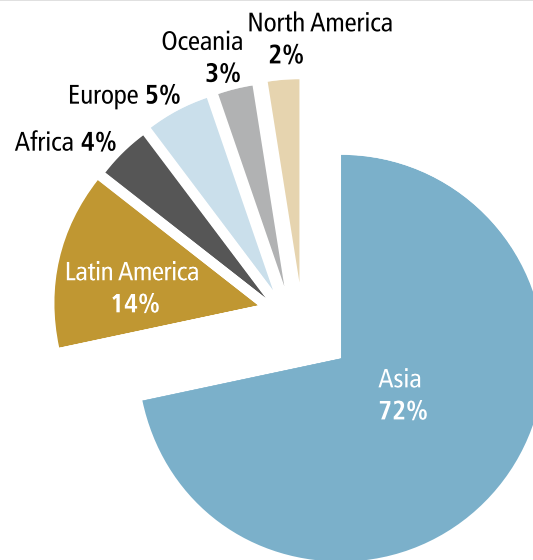
Figure 5a: Chinese Outward FDI Stock by Region



Source: 2010 Statistical Bulletin of China's Outward Foreign Direct Investment

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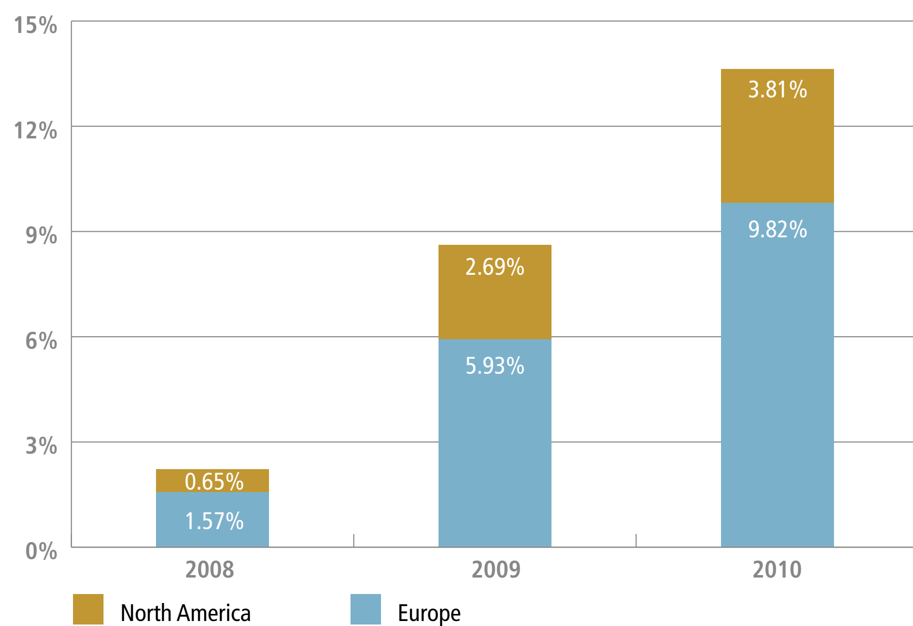
Figure 5b: Chinese Outward FDI Flows to Europe and North America, Percentage of Total



Source: 2010 Statistical Bulletin of China's Outward Foreign Direct Investment

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Fourth, composition of China’s outward FDI has gradually diversified. Because of the increasing number of motivations for Chinese companies’ global expansion, the country’s foreign investment began covering most sectors of the national economy. Out of China’s total FDI flow, 90% went into leasing and commercial services, mining, finance, wholesale and retail, manufacturing, transportation, warehousing, and postal services. Financial sectors experienced the most rapid growth in FDI (See Figure 4).

Fifth, the regional distribution of China’s FDI has been concentrated in Asia and Latin America, but the quantity going to Europe and North America has increased rapidly in recent years. At the end of 2010, concentration of China’s forward FDI stock in Asia, Latin America, Africa, Europe, Oceania, and North America has been 72%, 14%, 4%, 5%, 3%, and 2%, respectively (See Figure 5a). Because of relative political stability, fewer risks of changes in policy and law, well-developed consumer markets, as well as other factors, Chinese FDI has found growing traction in Europe and North America. In 2010, China’s FDI flows into these two regions were significant at US$9.54 billion, almost double the US$4.9 billion invested in 2009 and more than quadruple the level in 2004 (US$2.2 billion). In 2010, Chinese FDI into Europe and North America accounted for nearly 14% of total Chinese FDI flows compared with just over 2% two years earlier (See Figure 5b). Chinese FDI to the European Union (EU) alone accounted for nearly 10% of total Chinese ODI flows – experiencing the fastest growth in the EU area in 2010.

Reasons Behind the Increasing Chinese FDI

The motivation behind China’s rapid growth in FDI has been a subject of much speculation and concern throughout the world. The most likely explanation, however, is simply grounded in China’s domestic and international environment, its present stage of economic development, and its economic status in the world. China’s FDI strategy is geared toward a myriad of goals: access to natural resources; reduction of the costs of production; access to new technologies, patents, trademarks, and skilled labor; access to new business markets abroad; reduction of its currency reserves; diversification of assets and optimization of the return on investment; and a greater capacity to provide for the aging Chinese population.

In executing its FDI strategy, China has encountered a favorable domestic and international environment, owing to three contributing factors. The first has been the current global trend towards peace. Although regional turbulence remains an ongoing concern worldwide, no major war has significantly disrupted the favorable conditions for development of China’s FDI. A second contributing factor has been the global financial crisis. Many countries addressed the problem of soaring asset prices caused by the crisis by loosening foreign investment restrictions, thereby facilitating a great deal of Chinese FDI. In addition, China’s foreign exchange reserves grew from

US$165.57 billion at the end of 2000 to nearly US$3.2 trillion in June 2011 (SAFE 2011). This growth created both the favorable conditions and the necessity for China's FDI portfolio to become more diversified in assets. Currently most of China's tremendous currency reserves are invested in government bonds, especially those issued by the U.S. government. Moreover, China started to buy bonds from deeply indebted members of the Euro area. Acquiring foreign companies is a way to diversify the entire portfolio and to optimize the return on investment (Söhn 2010, 525). A third factor contributing domestically has been the country's adoption of its "going-out" policy, which not only has allowed Chinese enterprises to accumulate investment experience, but has also laid the groundwork for the Chinese government to gradually relax its approval process for outward FDI projects.

The unbalanced development of Chinese enterprises was the main reason that Chinese SOEs dominated FDI. After more than three decades of economic reform and liberalization, Chinese enterprises have strengthened their competitiveness in both domestic and international markets. Through additional ongoing reforms, Chinese SOEs have upgraded their competitiveness and overall quality. A number of large, internationally competitive companies and enterprise groups are currently being formed. In 2002, only 11 SOEs held total assets of more than a hundred billion dollars, while in 2009 that number reached 53. By 2009, thirty Chinese SOEs were selected as finalists for Global Fortune 500 companies (SASAC 2009). The strength of SOEs greatly enhanced their multinational operations and global expansion capability. Currently, Chinese state-owned and state holding enterprises have diversified their business interests in order to increase the value of assets, to cope with pressure to expand their business into international markets, and to deal with fierce competition. Conversely, China's private enterprises, especially small- and medium-sized private enterprises (SMEs), suffer from a widespread lack of core technology, innovative ability, and management talent. Moreover, because the domestic market can meet the profit needs of Chinese SMEs' development, these companies lack strong motivations for investing outward.

The reason for China's increased cross-border M&A activity is that Chinese enterprises have gained a competitive advantage by optimizing their industry structure. Chinese outward FDI is still dominated by greenfield investment, but the proportion of cross-border M&A has been on the rise, mainly due to a strong demand for Advanced Manufacturing Technologies (AMT) and for extending the value chain. According to research by Yao and Li (2011), China's manufacturing sector has been involved extensively in cross-border production networks. However, China's manufacturing and export enterprises depend, to a large extent, on Original Equipment Manufacturer (OEM) production and the development of trade intermediaries such as Hong Kong, instead of controlling the external markets network and service distribution channels themselves (Yao and Li 2011). Chinese enterprises are highly dependent on external markets, but are unable to establish strong international sales, due to the increasing risk of foreign investment and production expansion. With the growth and

development of Chinese export enterprises, these companies have increasingly requested control over the risks and benefits of further investment. Thus they are gradually asking for their own external markets network and service distribution channels. Cross-border M&A provides a fast way to accomplish this and enables Chinese enterprises, in combination with other companies, domestic or international, to optimize their industry structure and gain competitive advantage.

In order to maintain the stability of a world energy supply system, Chinese enterprises needed to expand their overseas energy investments. The world's mineral resources are rich but unevenly distributed. No single country can rely completely on its own energy resources to meet all of its production processing needs. China's economy has rapidly become involved in regional and global production networks. The country has become a "world factory", producing a variety of products for global consumption. Meanwhile, in regional and international production networks, Chinese enterprises are more engaged in making products with resource intensive, highly polluting manufacturing techniques that are low value-added and low in capital and technology requirements. China's own natural resources are not enough to satisfy its huge energy resource demand as a "world factory", so it needs to use global energy resources to maintain the stability of the global supply chain. Only a few enterprises have ever been able to exert some control over the supply and pricing of global resources. There has also been an increasing tendency to politicize the international energy issue. With the rapid development of international capital markets and the virtual economy, financial derivatives targeted at energy resources increased dramatically. Because of increasing speculation, the price of energy resources has not adhered to the laws of supply and demand and has grown increasingly volatile. In order to reduce the fluctuation and uncertainty of international energy prices, Chinese enterprises leverage FDI to create joint ventures, make acquisitions, or purchase shares of companies involved in overseas energy and resource exploration, development, and production. In this way, Chinese enterprises increasingly seek to engage in FDI.

The geographical distribution of China's FDI is influenced by countries that need its investment the most. According to the British scholar Rao's research (Zhou 2009), enterprises of developing countries tend to channel their investments in the following order: countries and regions at the same level of economic development, neighboring countries, other developing countries, and finally developed countries. Chinese FDI has mostly targeted developing countries because Chinese enterprises are not yet equipped to compete effectively with developed countries' enterprises, because Chinese enterprises so far have primarily relied on low labor costs and cheap pricing advantages. In addition, Chinese FDI targets developing countries because these countries are usually rich in energy resources that are crucial to China's economic development and they also need China's capital to develop their own economy. However, with China's massive investments in developing countries in Africa, Latin America and elsewhere, risks have increasingly come to light.

Meanwhile, resource-intensive development models have put an enormous environmental burden on Chinese society. As the Chinese population ages and income levels increase, the advantage of cheap labor – which its impressive economic development has relied on – is diminishing quickly. China's economic policies have gradually shifted to encourage industries to move up the global value chain. Investing in the developed market helps Chinese companies access the technological and managerial know how, the high-reputation goods and technologies, and the large purchasing power of customers in the host countries. For example, German technology and brands have a high reputation in China and FDI is one main instrument to import these technologies to China (Bundesministerium für Wirtschaft und Technologie 2009, p. 9). Moreover, Germany possesses a large volume of skilled labor. Investing in Germany enables China to profit from this labor force. In addition, German consumers have higher purchasing power. China could use its FDI in Germany to capture new shares of German markets. For all the above-mentioned reasons, Chinese FDI is shifting more and more towards developed countries such as the U.S. and Europe (see Figure 5b).

The Evolution of Chinese FDI Policy[1]

China's foreign investment policy has evolved from a focus on attracting foreign capital toward a more balanced approach that equally stresses inward and outward foreign direct investment. The main reason behind this change is the Chinese government's gradual relaxation of the controls for foreign investment.

The "two-gap" model, introduced by Harvard professor Hollis B. Chenery in the 1960s, can, to a certain extent, explain China's investment policy adjustments (Chenery 1969, 446–9). When China was just opening up to the world in the 1980's, its main problem was a shortage of capital, including a shortage of domestic savings and foreign exchange. These two gaps could be narrowed by attracting foreign investment. Government control of overseas investment was seen as more effective at preventing the widening of the two gaps. In the late 1990s, as China's economy developed and its foreign exchange reserves jumped, the "two gap" pattern gradually changed into the "two surplus" pattern: a surplus of both domestic savings and foreign exchange reserves. The Chinese government again adjusted its economic policy according to economic growth patterns. Starting in 2000, China entered its current stage of FDI development. Even though there was no systematic strategy for China's FDI, the Chinese government began to gradually relax controls on FDI. Liberalization of FDI was embodied by three aspects: enacting China's initial "going-out" strategy, relaxing strict approval procedures and management systems around FDI, and enacting policies to encourage FDI.

1 The authors benefit a lot from Yao and Li (2011) research.

• The "Going-Out" Strategy

The Chinese government had long ago begun incorporating the importance of foreign direct investment into its strategic business plan. As early as 1992, the Chinese government proposed to actively expand Chinese enterprises' foreign investment and multinational operations. In 1997, during the fifteenth Congress of the Communist Party, the Chinese government put forward its policy to encourage Chinese enterprises with comparative advantages to participate in foreign investment. The 1998 government report, "Report on the Work of the Government", recommended that China invest overseas cautiously. In 1999 and 2000, the same publication, "Report on the Work of the Government", proposed to encourage "eligible enterprises" and "Chinese enterprises with comparative advantages to invest overseas and develop a global manufacturing industry." These recommendations, however, were only the prototype. In October 2000, the "going-out" strategy was promoted to a national strategy that encouraged capable Chinese firms in more industries to engage in five main activities: (1) to expand their international finance abilities and technological cooperation; (2) to continue the development of projects that promote the export of domestic technologies, products, equipment, and labor; (3) to explore for international resources to mitigate the domestic shortage of natural resources; (4) to create overseas research and development (R&D) centers to utilize advanced international technologies, managerial skills, and professionals; (5) and to enhance the international competitiveness of Chinese enterprises and accelerate their entry into foreign markets.

In March 2011, China's 12th Five-Year Plan stated that it would continue combining its policies to encourage FDI and attract foreign investment, placing equal emphasis on the need to attract foreign capital and to invest overseas and the need to better use domestic and international markets and resources safely and efficiently. The Plan did not mention clear support and promotion systems for Chinese FDI. It stressed that the Chinese government would guide different types of enterprises to invest overseas with a primary emphasis on autonomous, market-oriented decision-making. This emphasis ensured that Chinese enterprises would have more freedom over their international investment strategies. The Chinese government's guide on Chinese enterprises investing overseas can be summarized in four points: (1) deepen international cooperation around energy resource development and manufacturing; (2) support overseas technical R&D cooperation, encourage manufacturing enterprises to invest overseas effectively, and create an international marketing network and a world famous brand; (3) expand international cooperation in agriculture, develop foreign project-contracting and labor services cooperation, and help to improve the livelihoods of local people; (4) gradually enhance the growth of large Chinese multinational companies and financial institutions and their capabilities in international business.

• Evolution of the Chinese Government's Approval Procedures and Management System of FDI

Major obstacles for Chinese FDI included China's strict foreign exchange management system and cumbersome, lengthy approval procedures, which severely limited the growth of Chinese FDI. As the Chinese government adjusted its foreign direct investment policy, FDI's improved approval and management system helped the promotion of Chinese FDI. The milestone policy issued by China's State Council in 2004 was the "Decision on Reform of Investment Structure". This document clearly stipulated that the Chinese government will implement a registration and approval system instead of an inspection system. In August 2008, China enacted the "Regulations of the People's Republic of China on Foreign Exchange Administration", which stipulated that the foreign exchange settlement process change from mandatory settlement of all foreign exchange in Renminbi (RMB) to a voluntary settlement process.

The Chinese government's approval and registration regulations have been simplified and improved, mainly in the following three aspects:

First, a substantial increase in the amount of Chinese enterprises' overseas investment has been observed. Before 2004, Chinese outbound investment projects valued at more than US$1 million had to be approved by the State Council or relevant ministries. After 2004, the National Development and Reform Commission (NDRC) approved Chinese FDI on resources projects valued between US$30 million and US$200 million and Chinese FDI on non-resources projects valued between US$10 million and US$50 million. The State Council approved Chinese FDI on resources projects valued over US$200 million and FDI on non-resources projects valued over US $50 million. For resource projects valued under US$30 million and non-resource projects valued under US$10 million, Chinese SOEs only needed to register with NDRC instead of getting approval from the Chinese government. Since February 2011, NDRC has relaxed limitations on foreign investment in mineral resources valued from US$30 million to US$300 million. "The Administrative Measures Concerning Outbound Investment" promulgated by the Ministry of Commerce (MOFCOM) in March 2009 said that China's overseas investments valued under US$100 million do not need to get an approval from the MOC, and local enterprises investing abroad in projects valued between US$10 million and US$100 million only need to obtain approval from their provincial commerce departments.

Second, the Chinese government shortened the approval time for FDI. The new regulations prescribed that the approval and review process of foreign investments should be accelerated to about 20 to 30 working days. For non-energy outbound investments valued under US$10 million, the MOC and the provincial commerce departments shortened the approval and review time to three working days from the previous range of 15 to 20 days.

Third, use of foreign exchange was liberalized. On July 13, 2009, the State Administration of Foreign Exchange (SAFE) promulgated the act, "Regulations on Foreign Exchange Administration of Outbound Direct Investment by Domestic Institutions." According to the Foreign Exchange Regulations act, domestic Chinese companies and institutions may make outbound direct investments by utilizing five different sources: foreign exchange owned by the Chinese investor, domestic foreign exchange loans conforming to relevant Chinese laws and regulations, foreign exchange purchased using the investor's own Renminbi (RMB), intangible assets, and profits from outbound direct investments that the investor has retained overseas. At the same time, SAFE examinations of outbound direct investments were no longer required. However, relevant parties had to submit a "Certificate of Outbound Investment." The new regulations streamlined the approval process for Chinese companies and institutions that wanted to make investments overseas.

- ### The Evolution of the Chinese Government's Services and Policies encouraging Outbound Investment

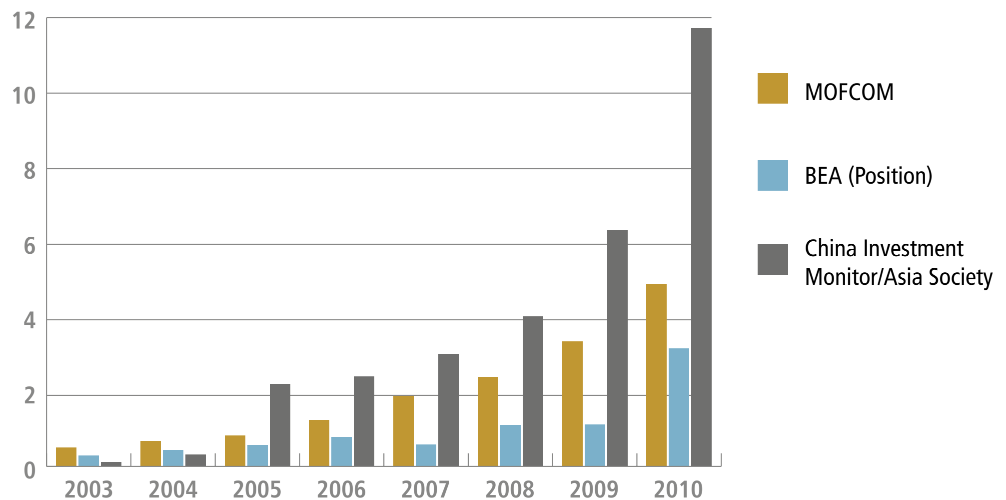
The Chinese foreign investment service system has been gradually improving. Regarding a comprehensive and effective service system for FDI, the 10th Five-Year Plan briefly mentioned that the Chinese government should create conditions for the implementation of a "going global" strategy in finance, insurance, foreign exchange, taxation, human resources, legal, information services, immigration, and the like. A 2004 report entitled "Report on the Work of the Government" emphasized the Chinese government's services to strengthen the coordination and guidance of outbound investment. Since 2005, the Chinese government's service system has been divided into two roles: providing supports on (1) credit, insurance, and foreign exchange and (2) coordination and guidance. The 11th Five-Year Plan stressed improving the promotion and protection system for investment overseas. In addition to continued emphasis on coordination, the 11th Five-Year Plan also proposed to enhance the risk management. The 12th Five-Year Plan proposed plans to strengthen research on investment climate and to protect overseas interests. These were two aspects that were added to the government services system on top of previous proposals of coordination and risk management.

Since 2000, the Chinese government has set up four special government funds to promote Chinese enterprises' foreign investment. These include the Market Developing Fund of Small and Medium Sized Enterprises (2000), the Special Fund for Foreign Economic and Technical Cooperation (2005), the Special Fund for Risk Exploration of Mineral Resources (2005), and the Special Fund for Textile Industry (2006). The size of each of these funds, however, was small. The China Development Bank (CDB) has helped launch four funds since 1998: the Sino-Swiss Cooperation Fund (1998), the ASEAN China Investment Fund (2003), the China-Belgium Direct Equity Investment Fund (2004), and the China-Africa Development Fund (CADFund)(2007). Funding volume for the first three funds was small and funding commitment to the CADFund was only US$5 billion.

Impressive Growth in Recent Years

The data sources for Chinese FDI in the U.S. are not gathered consistently. We have consulted multiple sources of data, including the Chinese Statistical Bulletin, the U.S. Bureau of Economic Analysis, and some researchers' own bottom-up data collections. However, by any type of measure, it is clear that despite uncertainty around absolute amounts, Chinese FDI in the U.S. is experiencing particularly fast growth in recent years. The official Chinese account of annual flow of Chinese FDI to the U.S. was US$65 million in 2003, and this number jumped to US$909 million in 2009. Some other data sources have shown figures that are more than double the official one in 2009; the Rhodium Group, for example, shows a US$5.2 billion FDI flow in 2010 (See Figure 6). The U.S. has been among the top destinations for the last decade. From 2003 to 2007, the U.S. was ranked as the number four recipient of Chinese FDI stock, just behind Hong Kong, the Cayman Islands, and the British Virgin Islands (the latter two are more likely tax havens than investment targets). From 2007 onward, the Chinese FDI stock has at least tripled, with stock count over US$11 billion in 2010 according to one calculation (See Figure 6).

Figure 6: Chinese FDI stock to the U.S. in billions of dollars – Comparison among the Statistical Bulletin of China's Outward Foreign Direct Investment (China), Bureau of Economic Analysis (the United States), and China Investment Monitor Database (The Rhodium Group)



Source: Statistical Bulletin of China's Outward Foreign Direct Investment, 2003-2010; Bureau of Economic Analysis Database; China Investment Monitor Database.

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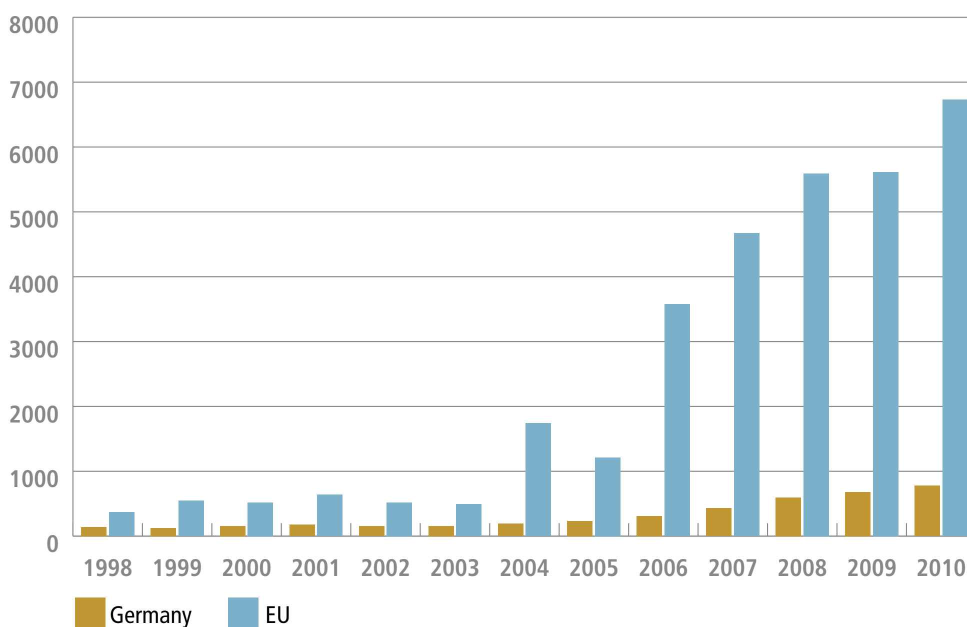
There is a similar picture of Chinese FDI in Germany and the European Union in general. From 1993 to 2003, China's FDI stock in Germany stayed more or less constant. But from 2003 to 2010, this stock roughly quintupled from 156 million Euros to 775 million Euros (See Figure 7). From 1998 to 2010, China's FDI stock in the European Union grew tremendously from 368 million Euros to 6.728 billion Euros, especially in the years after 2005 (See Figure 7). From 2005 to 2010, the value of China's FDI within the European Union grew by more than 450 %.

Figure 7: China's FDI Stock in Germany and in EU-27 (Data are for EU-15 until 2000, for EU-25 2001–2003 and for EU-27 as from 2004), in Millions of Euros



Source Germany: Deutsche Bundesbank, Statistik "Zeitreihen" (download: 30 April 2012). Note: FDI according to the German Central Bank ("Bundesbank") include new investments by foreign investors as well as foreign mergers and acquisitions and foreign credits or loans. Source EU: Eurostat, Data on "Balance of payment statistics", (download: 15 March 2012).

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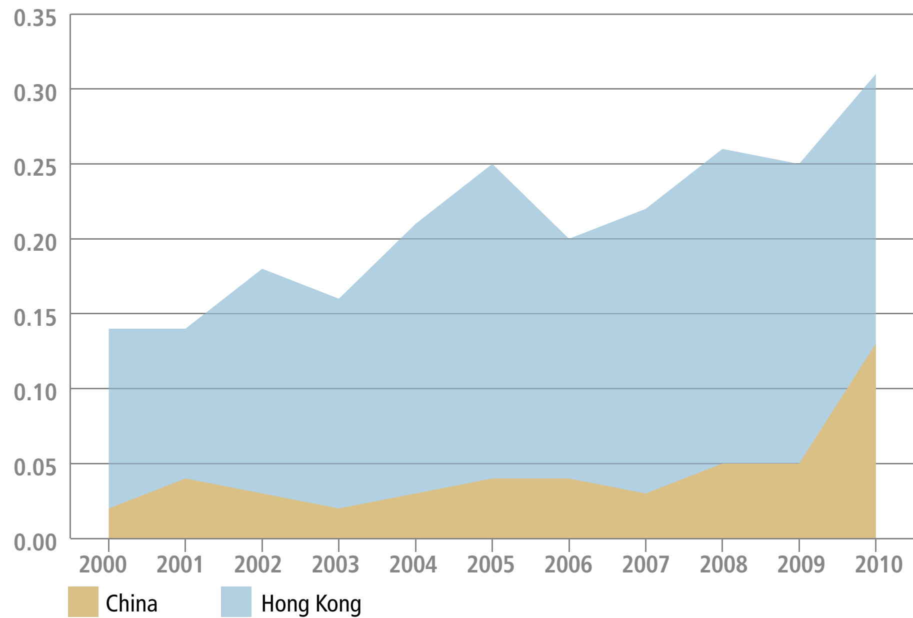
However, despite the fast growth of Chinese FDI to the U.S., Germany, and the European Union, it is important to point out that these flows still play negligible roles in the respective economies. As the world's largest recipient of foreign direct investment, U.S. FDI stock reached US$2.58 trillion in 2010 (CIA fact book). It is true that the growth rate of Chinese FDI's share in the U.S. has been impressive: growing five-fold from 2003 to 2010 (See Figure 8). But still, Chinese FDI to the U.S. constitutes a very small fraction of what the U.S. attracts in total. Some have estimated that much of Chinese FDI has used Hong Kong as a launching platform (Invest HK), thus there should be much more Chinese FDI to the

Figure 8: Chinese FDI as Percentage of Total FDI in the United States (Position/Stock on Historical Cost Basis)



Source: U.S. Bureau of Economic Analysis (BEA)

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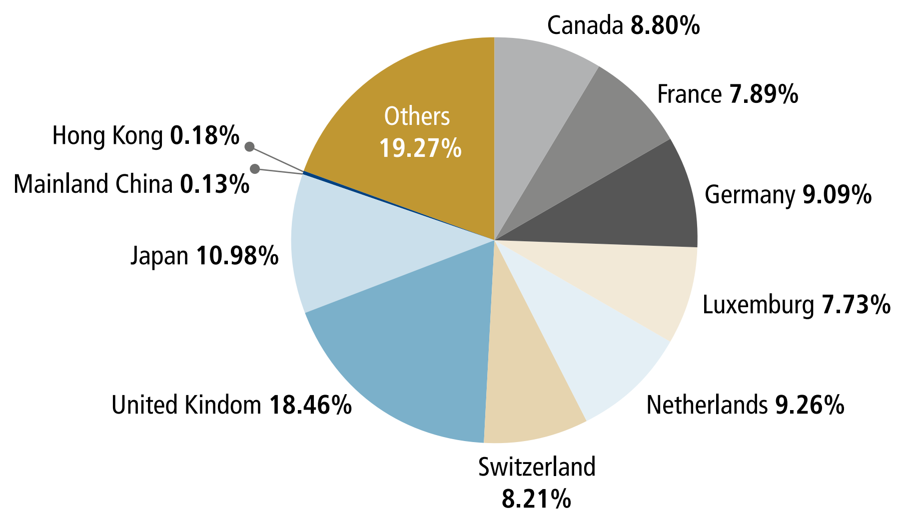
Figure 9: Foreign Direct Investment Position in the United States by Country, On Historical Cost Basis, 2010



Source: Bureau of Economic Analysis (BEA)

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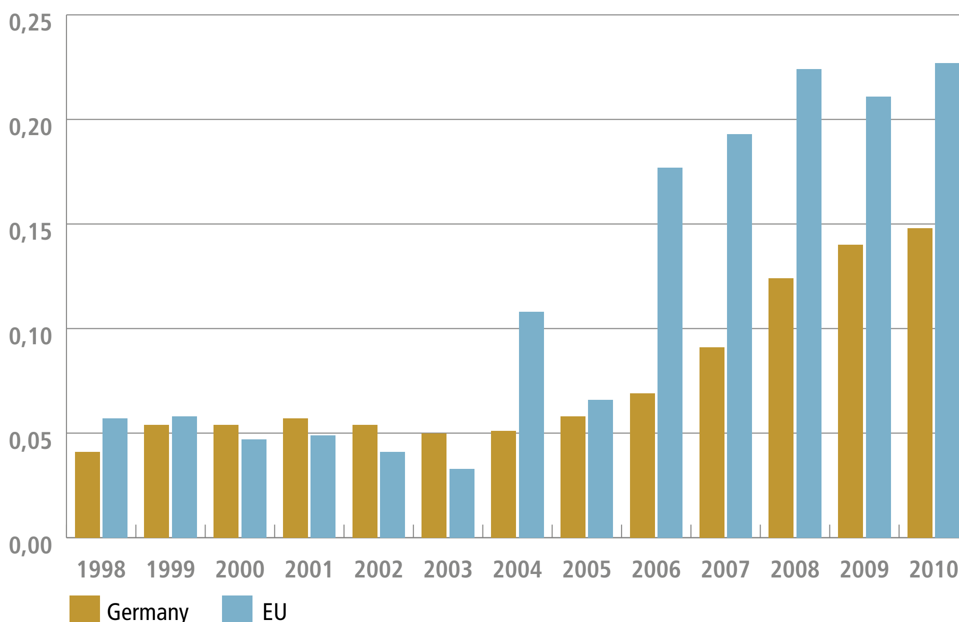
U.S. than reported via Hong Kong as well. However, even when including Hong Kong FDI to the U.S., at the highest point, the Chinese mainland and Hong Kong FDI holds less than half a percentage point of U.S. inward FDI total. This is a clear contrast when compared to traditional industrial powers in Europe, including some much smaller economies, and Japan (See Figure 9).

The significance of Chinese FDI in Germany and in Europe is also growing rapidly while remaining very limited still (See Figure 10): From 1989 to 2004, Chinese FDI accounted for about 0.05 % of the FDI stock in Germany. After that, data show a growing share of Chinese FDI in Germany. By 2010, China held 0.15 % of the 522.5 billion Euros FDI stocks in Germany (see Table 2). This growth rate of its share in Germany has been impressive, but it still lags far behind Germany's main investors such as the Netherlands, Luxembourg, and the U.S. The same applies to the European Union where China owns only 0.23 % of the 2.964 trillion Euros of foreign FDI stocks in 2010 (See Figure 10). Meanwhile, FDI from Hong Kong plays an even more marginal role in Germany than in the U.S. In fact, Hong Kong's investment activities in Germany are even smaller than those of mainland China (See Figure 11). Looking at the European Union, things are a little bit different. Hong Kong's FDI into Europe is much larger than Chinese FDI (See Figure 12). Nevertheless, even if China's and Hong Kong's FDI in Europe are combined, their share in all Extra-EU-FDI stocks is still small and somewhere around 1 % and at most 1.6 %. (see Table 8 in the appendix).

Figure 10: Share of China's FDI Stock in Germany and in the European Union (Data are for EU-15 until 2000, for EU-25 2001–2003 and for EU-27 as from 2004), Percent



Source Germany: Deutsche Bundesbank, Statistik "Zeitreihen" (download: 30 April 2012), own calculations. Note: FDI according to the German Central Bank ("Bundesbank") include new investments by foreign investors as well as foreign mergers and acquisitions and foreign credits or loans. Source EU: Eurostat, Data on "Balance of payment statistics", (download: 15 March 2012), own calculations.

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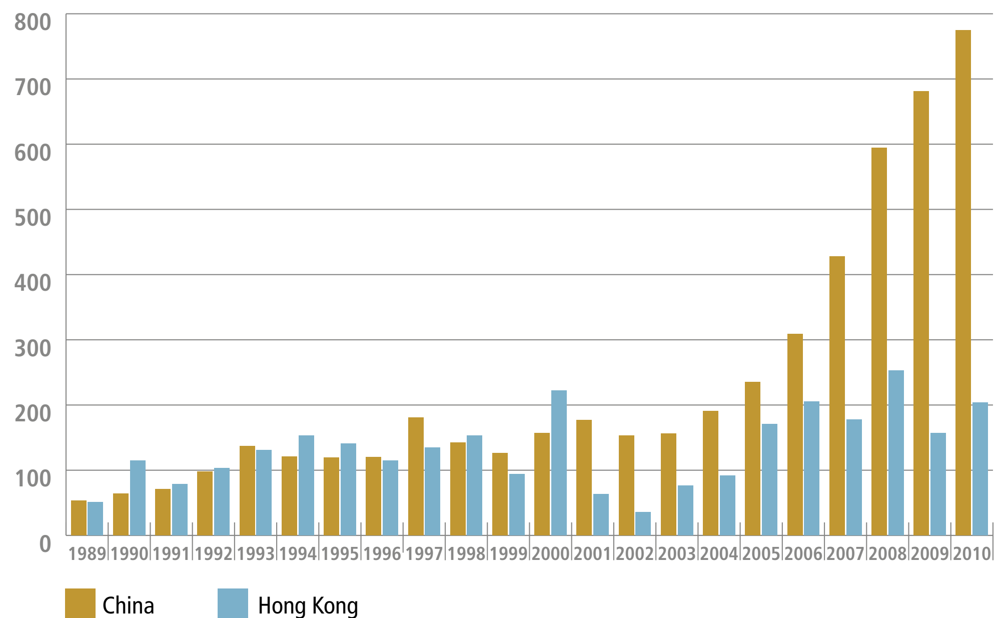
Figure 11: China's and Hong Kong's FDI Stock in Germany (primary ("unmittelbare") and secondary ("mittelbare") FDI, consolidated, Millions of Euros)



Source: Deutsche Bundesbank, Statistik "Zeitreihen" (download: 30 April 2012). Note: FDI according to the German Central Bank ("Bundesbank") include new investments by foreign investors as well as foreign mergers and acquisitions and foreign credits or loans.

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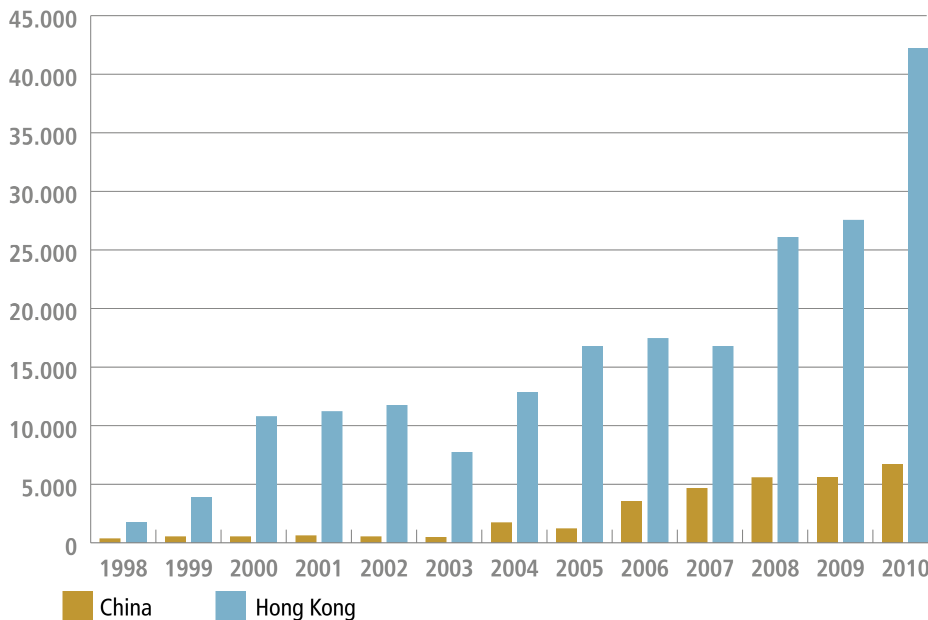
• Changing Features of Chinese FDI to the U.S. and Germany

There are some differences in how sectorial investment and business activities are categorized in the U.S. and in Germany with regard to Chinese FDI. In addition, the data of the German Central Bank, which include both greenfield investment and M&A, only include 44 Chinese companies in Germany in 2010. This number is too small for the German Central Bank to separate the FDI figures by sectors and business activities. However, we do have sectorial and business activities based on greenfield projects recorded by the Germany Trade and Invest Agency. Moreover, the most recent Chinese Ministry of Commerce data on FDI show some trends of Chinese FDI in Europe in general. The MOFCOM does not separate by country in the data, but does attribute certain weight to Germany in its analysis. Combining the available data, some common themes emerge for comparing Chinese FDI in the two economies.

Traditionally, Chinese companies' investment in both the U.S. and Germany more often takes the form of sales offices and servicing branches for the product supplied. Almost 60 % of China's

Figure 12: EU Direct Investment Inward Stocks by Extra EU Investing Countries: China's and Hong Kong's FDI Stock (Data are for EU-15 until 2000, for EU-25 2001–2003 and for EU-27 as from 2004, Millions of Euros)



Source: Eurostat, Data on "Balance of payment statistics", (download: 15 March 2012).

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greenfield FDI stock in Germany applies to sales, marketing, and support. If we combine Chinese FDI stock sales, leasing, and commercial services in the U.S., it comprises about 35 % of total Chinese FDI stock by the end of 2010 (MOFCOM et al. 2010).

Manufacturing is a key sectorial target for Chinese FDI in both the U.S. and Germany. In 2010 and 2009, manufacturing took 25.4 % and 41 % of the total Chinese FDI to the U.S. (the share of manufacturing in Chinese FDI stock is 27 % in 2010)(MOFCOM et al. 2010). Manufacturing's share of total Chinese greenfield FDI is shown as 9 % in 2009, which may not represent the whole picture because much manufacturing investment by China is in the form of acquiring local manufacturers. In the Chinese government data, manufacturing takes 24.6 % of the total FDI stock to the EU, and in 2010, the share in FDI flow was 33.9 %. Germany is also listed as one of the main destinations of manufacturing-based Chinese FDI.

Chinese FDI in both the U.S. and Germany has focused heavily in sectors such as industrial machinery; auto and transport; and information and communication technology. There were

changes in the number of deals annually accomplished in the U.S. for each of the sectors, so the investment values vary. But these sectors no doubt have played a major role in attracting Chinese FDI to the U.S. in recent years. Particularly large was industrial machinery investment flow, which was $US1.642 billion in 2009 and $US1.028 billion in 2010 (China Investment Monitor, 2011). With regard to Germany, 30 % of Chinese outbound greenfield investment is related to automotive, industrial machinery, and equipment. The second-largest sector is the electronic and semi-conductor sector (16 %), followed by information and communication technologies including software (13 %, see figure 13).

Since the U.S. is also a resource rich country, one luxury that the German market does not offer to Chinese investors is fossil fuels and chemicals. There have been several large-scale investment projects proposed from China to the U.S. related to fossil fuels, steel, and chemical industries in recent years. Particularly in 2010, investment in these industries has taken the largest share of Chinese FDI to the U.S. (See Figure 14) On the other hand, Germany is becoming an attractive destination for renewable energy-related investment from China. Though the share in this area is still low at 2 %, industry insiders have witnessed the rapidly growing presence of Chinese investors in this industry recently.[2] One street in Munich where many Chinese renewable energy sector investors set up offices is being called the “Solar Street”.

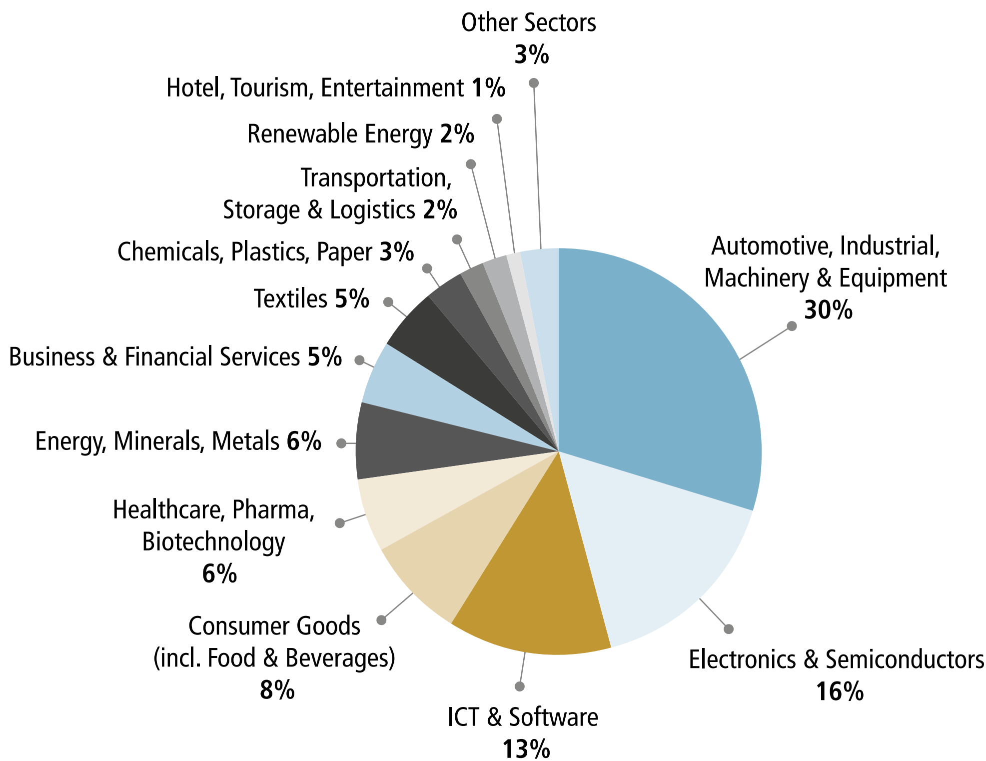
Meanwhile, much of Chinese FDI to the U.S. in recent years also went to financial services, which comprised 46.1 % of total FDI flow in 2008, 15.5 % in 2009, and 9.6 % in 2010. The share of Chinese FDI stock in the financial sector in Europe was 11.6 % in 2010, but the share of the flow in 2010 was only 5.4 %. Germany’s significance in financial sector FDI from China ranks after the U.K., Luxemburg, and France in 2010.

Chinese FDI in the automotive industry

China is on the way to replicating the Japanese dominance of the automotive world markets. Although China’s exports of automobiles are still small, China breaks into global automotive markets via less developed countries. China’s most important target markets are Algeria, Iran, Vietnam, Syria, and Egypt. In order to compete in the automotive world markets, China has bought know-how. Some well-known acquisitions of international automobile manufacturers are Rover, Saab, and Volvo. In addition, China has acquired component suppliers. The largest automotive component supplier, the Wanxiang Group with more than 40,000 employees, owns shares of at least ten U.S. automotive component suppliers, which produce amongst others axles, driving shafts, wheel hubs, and steering systems. As far as is known, there has been just one Chinese acquisition of a German automotive component supplier: in 2007 the Fuyao Glass Industry Group bought Fürmotec GmbH from Heilbronn (for more details see Söhn 2010).

2 interview with German Trade and Invest Agency

Figure 13a: Chinese Projects in Germany by Sector (2003–2009)



Source: fDi Markets, Oct. 2010

Note: FDI projects refer to greenfield and expansion investment projects. M&A projects are not included.

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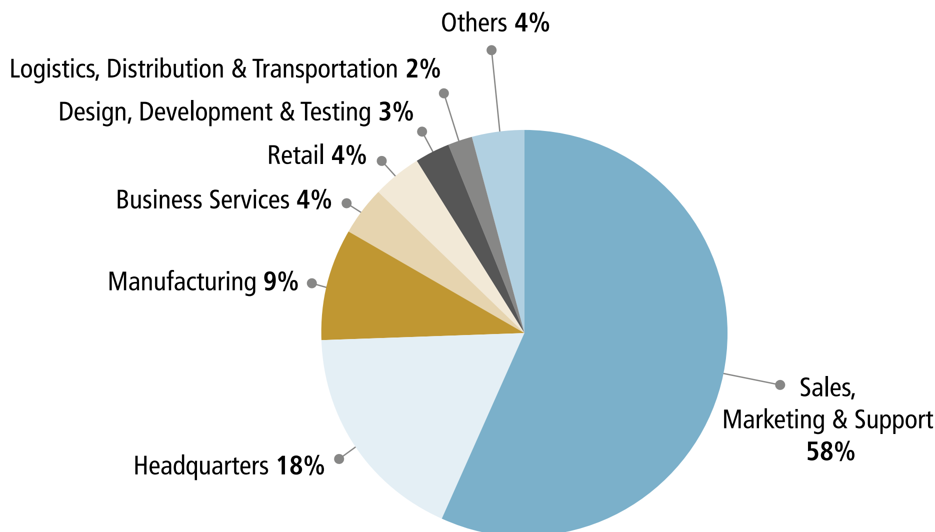
Figure 13b: Chinese Projects in Germany by Business Activity (2003–2009)



Source: fDi Markets, Oct. 2010

Note: FDI projects refer to greenfield and expansion investment projects. M&A projects are not included.

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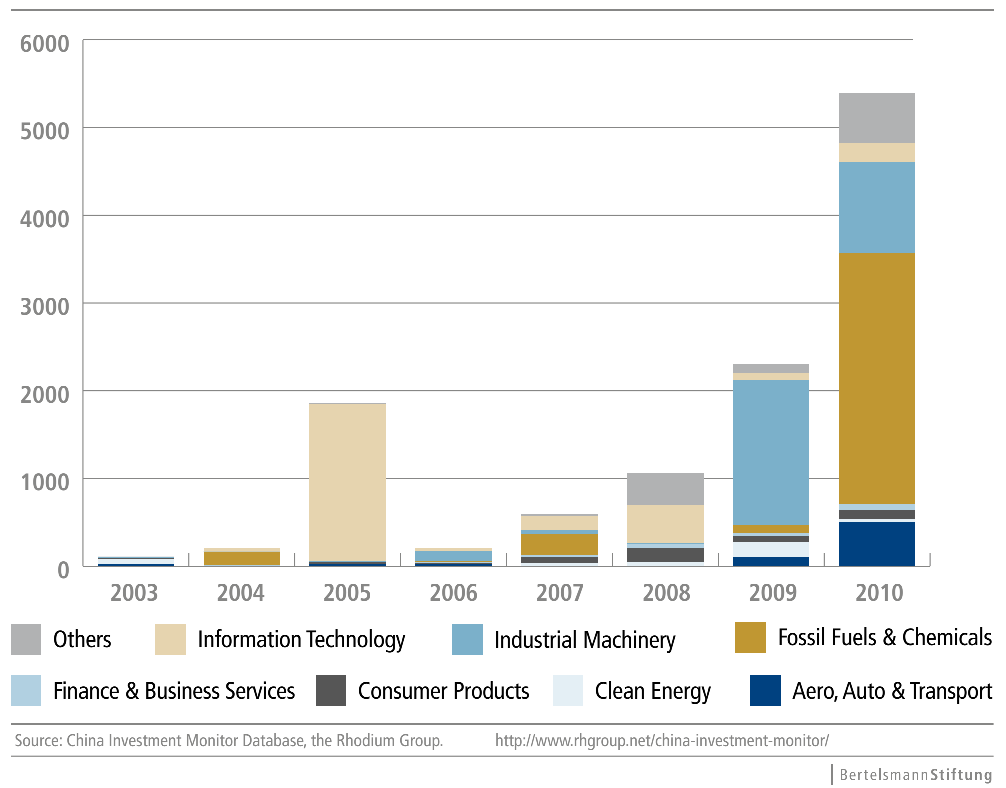
Figure 14: Chinese Direct Investment in the US by Industry (in Millions of Dollars)



Source: China Investment Monitor Database, the Rhodium Group. http://www.rhgroup.net/china-investment-monitor/

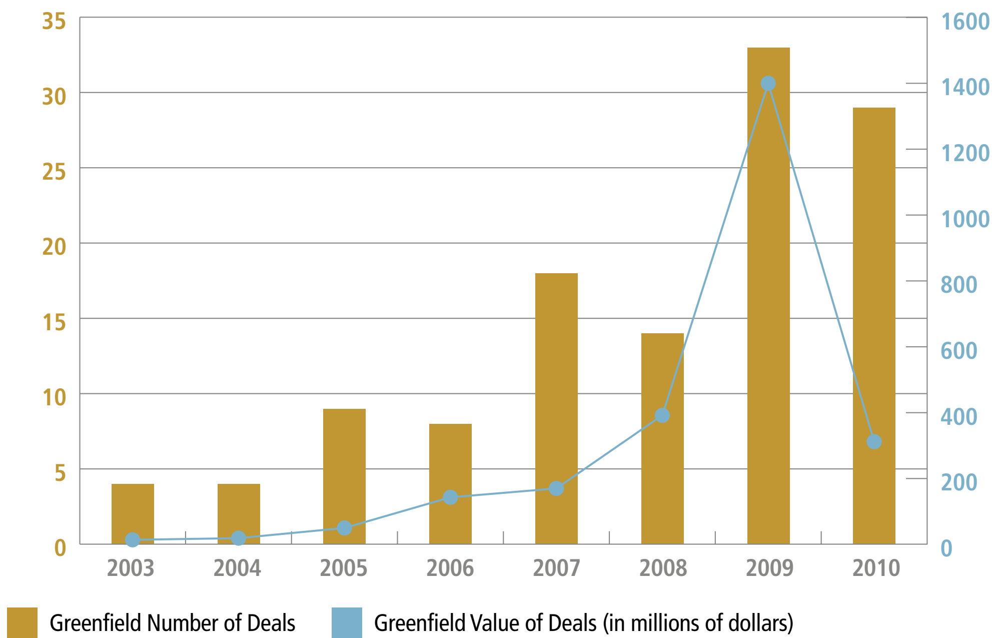
A final important note is that Chinese private investors in the U.S. have conducted many more deals than state owned enterprises. For example, China Investment Monitor tracked 40 private investor deals in 2009 and 45 in 2010. The respective number of government-backed deals was 14 in 2009 and 18 in 2010. However, the scale of the deals was much larger by government investors than by private investors. In 2010, government backed deals averaged $US262 million, contrasting to a $US15 million average for private investors' deals.

Greenfield vs. M&A

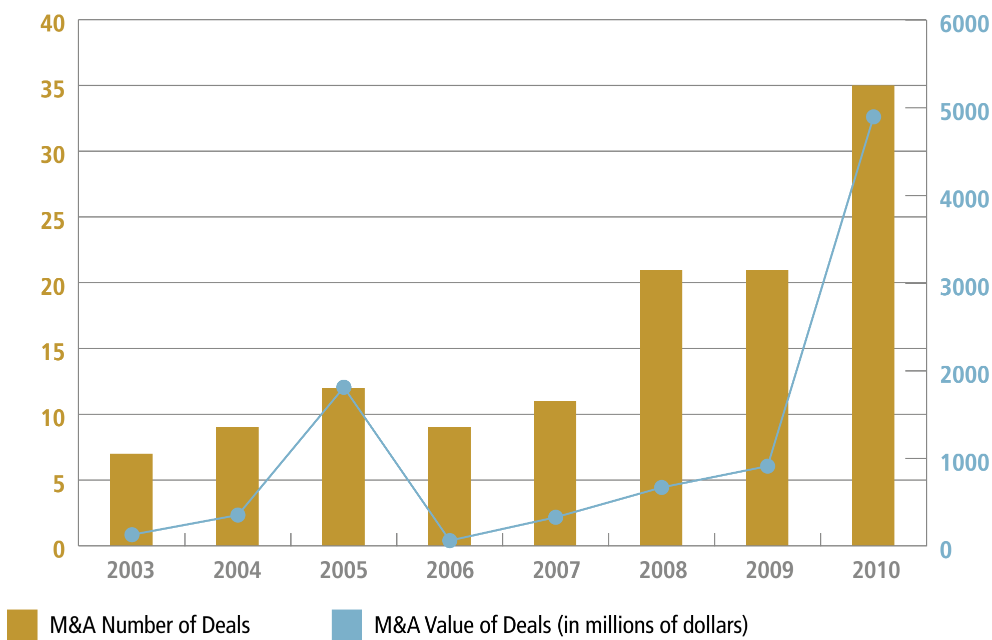
The format of Chinese FDI in the U.S. is also becoming increasingly diversified and sophisticated. Traditionally, Chinese companies have focused more on greenfield investment, but mergers and acquisitions (M&A) – which can help a company gain faster access to local technology and market – are starting to play a much larger role in Chinese FDI. M&A increased from US$60 million in

Figure 15: Greenfield and MA

Greenfield Chart



M&A Chart



Source: China Investment Monitor Database, the Rhodium Group http://www.rhgroup.net/china-investment-monitor/

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1999 to US$30.2 billion in 2008, accounting for 54 % of total Chinese FDI in that year. In the U.S., Chinese FDI in both greenfield and M&A has increased remarkably in value in recent years (See Figure 15). By the third quarter of 2011, there had been 147 greenfield projects with $US3.26 billion total capital expenditures announced from China. The growth in the amount put in M&A is particularly noticeable: in 2003, M&A deals in the U.S. were valued at $US132 million, and this number grew to $US4.9 billion in 2010. On average, the value of Chinese M&A deals in the U.S. are usually much larger than greenfield deals (See Figure 16).

There is a lack of data to separate Chinese FDI in Germany into greenfield and M&A. However, looking at preliminary data for the end of 2010 and the beginning of 2011, it seems that a change also has taken place with respect to China's FDI strategy toward Europe. From October 2010 to March 2011, Chinese firms and banks expended $US64 billion for greenfield projects, mergers, and acquisitions, and trade and cooperation agreements in Europe. Although these figures incorporate more activities than pure FDI, the increase is remarkable because these $US64 billion represent "more than half of the total investment and trade facilitation flows in Europe since early 2008" (Godement and Parello-Plesner 2011, 4). Godement and Parello-Plesner thus make the following case: "Admittedly, these figures include soft loans and deals that have been signed but not yet implemented, and therefore may be overestimated. Yet even the size of mergers and acquisitions suggests that, along with the U.S., Europe is suddenly overtaking Asia and the developing world – the first two targets of China's "going-out" strategy – as the top destinations for Chinese investment."

Figure 16: The Average Value per Deal (in Millions of Dollars)

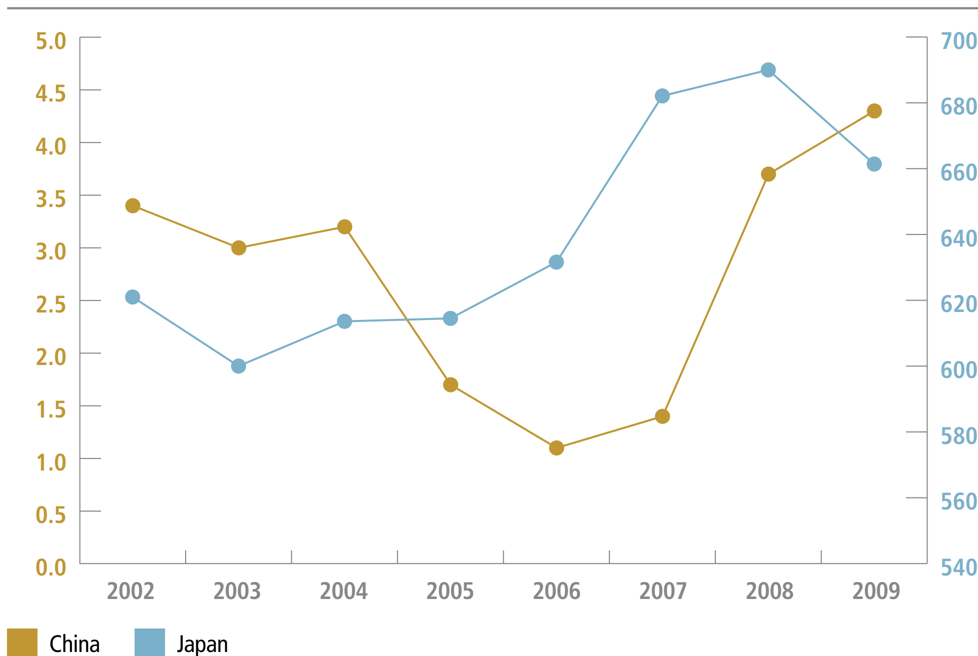
Source: China Investment Monitor Database, the Rhodium Group http://www.rhgroup.net/china-investment-monitor

Impact of Chinese FDI: Jobs and Value Added

When examining the impact of Chinese FDI in Germany and the U.S., it is important to refer to the negligible role mentioned before of Chinese FDI in the German and U.S. economies. Just as the stock of Chinese FDI is experiencing rapid growth in Germany and the U.S. with a small share in the respective markets, the impact of Chinese FDI on German and U.S. economies is growing rapidly, with negligible significance as of yet.

With respect to Germany, China also plays a minor but increasingly important role. The same holds true with respect to the number of companies owned by foreign investors, the number of employees who work in these companies, and the volume of sales of these companies. According to statistics of the German Central Bank, in 2010 about 14,000 companies in Germany were owned by foreign investors. China held just 44 companies (See Table 1 in the appendix). All employees of these 14,000 companies totaled about 2.5 million. Only about 3,000 personnel were employed by the 44 Chinese companies (see Table 2 in the appendix). The volume of sales of all foreign companies in Germany equaled almost 1.26 trillion Euros in 2010, Chinese companies totaling 1.5 billion Euros (see Table 3 in the appendix).

Figure 17: Jobs created by Chinese and Japanese FDI. Chinese left axis, Japanese right axis



Unit: thousand

Source: Bureau of Economic Analysis http://www.bea.gov/international/di1fdibal.htm

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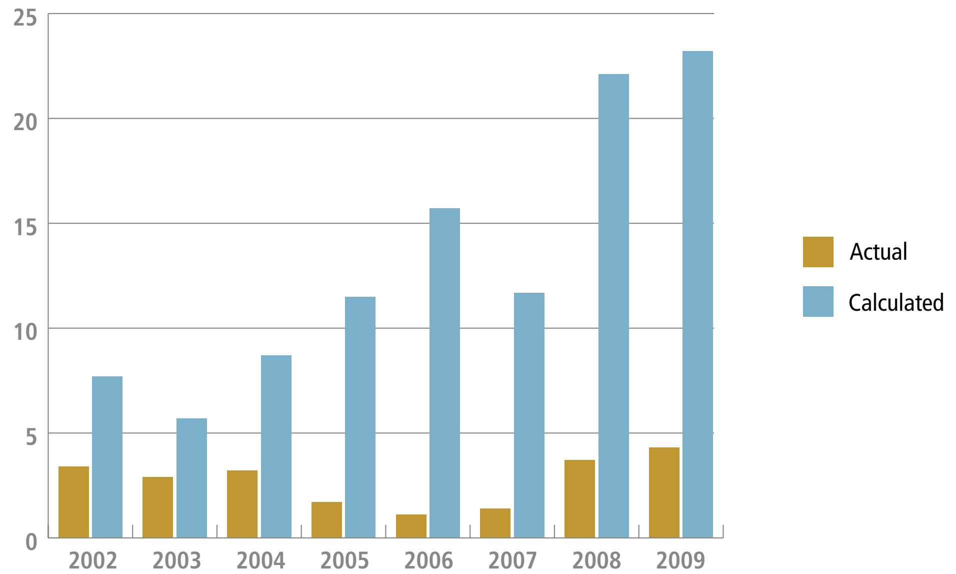
Figure 18: Comparison of the Recorded Employment and Estimate (Thousands of Employees)



Source: Source: Bureau of Economic Analysis for recorded employment http://www.bea.gov/international/di1fdibal.htm

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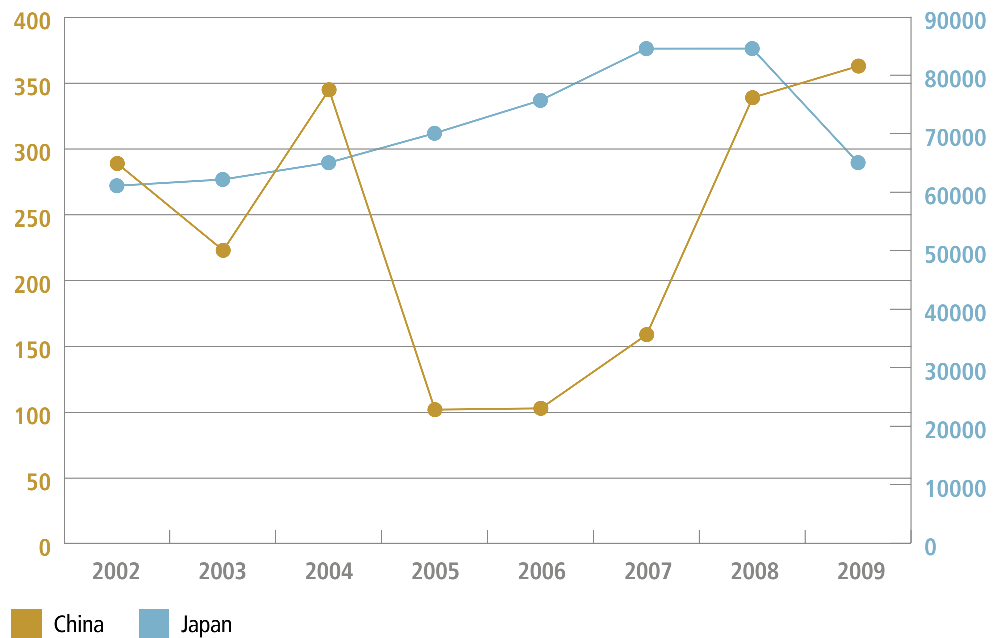
Figure 19: Value Added (Gross Product; in Millions of Dollars)



Source: Bureau of Economic Analysis http://www.bea.gov/international/di1fdiop.htm

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Since small and medium companies play an essential role in Germany, the statistics of the German Central Bank underestimate the number of foreign companies and their employees in Germany. Thus we add the data of another source that includes companies with a balance sheet total of less than 3 million Euros. According to this definition there are about 700 companies owned by Chinese investors with 6,600 employees (see table 1). Other experts even think that there are about 1,000 Chinese companies in Germany – not counting Chinese restaurants and travel agencies (Bundesministerium für Wirtschaft und Technologie 2009,11). Nevertheless, even when using a broader definition of FDI, the number of new jobs created by Chinese FDI projects is still pretty small. Since 2003, the largest number of new jobs created by one single FDI project was 100 (see Table 4 in the appendix).

Meanwhile, the impact of Chinese FDI on American jobs and the added-value in the U.S. economy follow similar trends. The U.S. state trade office estimates about 10 new American jobs are created directly or indirectly by every $US500,000 in Chinese investment. In this calculation, the number of jobs created by Chinese FDI would be slightly more than the BEA report of job creation (See Figure 18). When using this measure to compare the possible jobs created so far, one can clearly see the upward trend, just as the total amount of FDI from China is increasing. But still the absolute number is a fraction of what the other larger FDI partners have been creating (See Figure 17) and compares to the 5.2 million total jobs generated by U.S. affiliates of foreign firms in 2009 (U.S. Department of Commerce Data). The same applies to the value-added of Chinese FDI to the U.S.: it enjoys about 10 % average annual growth, but the overall contribution to the U.S. economy is still negligible (See Figure 19).

Table 1: Foreign Companies and Employees in Germany in 2010

Country	Number of Companies (Approx. Value)	Number of Employees (Approx. Value)
Netherlands	8000	476000
USA	6200	741000
UK	5200	303000
France	3700	328000
Sweden	1300	151000
Spain	1100	71000
Japan	980	95000
Russia	950	4600
China	700	6600
Canada	390	18700
Poland	370	4700
India	280	13000
Czech Rep.	250	2100
South Korea	125	4700

Source: Germany Trade & Invest, Germany's Major Investment Partners – China, Berlin/Bonn 2011, p. 12.

As mentioned before, China's growing FDI toward the U.S. fits as part of its "going-out" strategic goal. Also, the outward push is generated by its internal economic situation. However, the U.S. as a prime FDI destination for China is not a coincidence. The U.S. has a wide-open and attractive business environment in general. It was ranked No. 1 in the Venture Capital and Private Equity Attractiveness Index (Germany No. 10), No. 2 in the At Kearney FDI Confidence Index (Germany No. 5), No. 4 in the World Economic Forum's Global Competitiveness Rankings for Innovation (Germany No. 5) and No. 5 in the World Bank 2010 Ease of Doing Business Report (Germany No. 22). For companies looking for local consumption expansion, the U.S. has the strongest consumer market in the world; for those looking for technological innovation, the U.S. houses 34 % of global R&D and 50 % of developed world researchers. (OECD)

This is the basic frame of reference for FDI's entrance to the U.S. market. However, in the post 9/11 years, there has been an ongoing adjustment to ensure national security while maintaining market openness in the U.S. This has led to a set of policy incentives to attract further FDI, as well as new provisions to ensure national defense capabilities.

In the Trade Act of 2002, the U.S. government tried to clarify its FDI policy through a list of objectives that are intended to direct the U.S. trade negotiators to reduce or eliminate artificial or trade-distorting barriers to foreign investment. The Act specified eight ways to reduce barriers of investment, clarify policy standards, and improve dispute resolutions (Jackson 2010).[3]

In 2007, the Bush administration began a new Invest in America initiative led by the International Trade Administration. In June 2011, it was incorporated into President Obama's SelectUSA initiative. This is currently the primary U.S. government mechanism to promote foreign investment by facilitating business inquiries and providing policy guidelines to investors. The Invest in America program acts as the ombudsman, among the U.S. Departments of State, Agriculture, Homeland Security, and the Environmental Protection Agency. It also develops tailor-made events to promote certain states as FDI destinations. For example, the program publishes guidelines on federal investment incentives and programs, including the Clean-Energy Manufacturing Tax Incentives from which the Chinese Yingli Green Energy Company is receiving $US4.5 million in credits. It also held an investment promotion event in Louisiana and facilitated meetings with Chinese companies that the state identified as important investors (Invest America).

Germany's major intentions associated with inbound FDI are the creation of jobs, positive effects on German FDI abroad and German exports, financial facilities, and – due to demographic change in Germany – finding successors capable of leading companies. Because Germany itself is an export-oriented economy, staying open for foreign investors is important in its request for reciprocity. If Germany starts to constrain investments from abroad – and especially from certain countries

3 The act specifies eight issues, including reducing or eliminating exceptions to the principle of national treatment; freeing the transfer of funds relating to investments; reducing or eliminating performance requirements, forced technology transfers, and other unreasonable barriers to the establishment and operation of investments; establishing standards for expropriation and compensation for expropriation; establishing standards for fair and equitable treatment; providing meaningful procedures for resolving investment disputes; improving mechanisms used to resolve disputes between an investor and a government; and ensuring the fullest measure of transparency in the dispute settlement mechanism.

such as China – it is most likely that those countries would react with restrictions on imports from Germany. Restrictions on FDI thus would cause protectionism, and for an export-oriented economy, protectionism causes high costs (see Dohse 2011). Hence, partly to better access foreign sales markets, Germany has retained a very open attitude towards Chinese FDI. Meanwhile, even though there is no general credit crunch in Germany, it is getting more difficult to finance certain investments, particularly during the current debt crisis in Europe. Thus financially strong partners such as China are particularly welcome in recent years.

In order to support foreign investors and thus increase their FDI in Germany, the German government created a special organization called "Germany Trade and Invest." This organization is the economic development agency of the Federal Republic of Germany. It promotes Germany as a business and technology location and informs foreign investors about investment opportunities in Germany. Germany Trade and Invest supports international companies from market entry to business start-up in Germany with the aim to increase the number of jobs in Germany. In doing so, the organization operates according to the principle of equal treatment: No matter how large the potential investor or this investment is, which industrial branch is affected, and from which country the potential investor comes, every investor is treated in the same way. The German FDI policy is entirely nondiscriminatory with respect to every aspect of an investment in Germany from a foreign investor. In particular, FDI policy in Germany has no reservation against FDI from special countries. This becomes especially apparent when looking at the German laws concerning FDI in Germany.

Although there are no tax privileges or subsidies for FDI in Germany, the "New Laender" in eastern Germany offers various options in order to promote economic development (investment assistance, tax relief, infrastructure improvements, financial assistance and more). All these offers are available for any investor, German or foreign, and Chinese investors have been taking great advantage. In July 2011, the Chinese company Greatview Aseptic Packaging (GA Pack, formerly known as Tralin Pak) started to build a manufacturing plant in Halle (Saxony-Anhalt). The volume of investment adds up to 50 million Euros. Through the end of 2013, 110 new jobs will be created. Amongst others, government aid of Saxony-Anhalt was one main reason for this investment (Expo Real 2011). The relevance of this investment becomes apparent by comparing its volume with the entire Chinese FDI stock in Germany (See Table 2): In 2010, this stock had a value of 775 million Euros. Hence this FDI accounts for about 6.5% of China's FDI stock in Germany.

Table 2: Foreign FDI Stocks in Germany (primary (“unmittelbare”) and secondary (“mittelbare”) FDI, consolidated)

Regions/Countries of origin	FDI Stocks in millions of Euros (in 2010)
Europe	440 019
Netherlands	121 925
Luxembourg	77 206
United Kingdom	44 931
France	44 523
North America	51 270
United States	49 096
Canada	2 174
Central America	3 607
South America	283
Asia	24 015
Japan	14 541
Korea	4 060
Iran	1 337
United Arab Emirates	1 023
China	775
Rest of the World	3 335
Sum	522 529

Source: Deutsche Bundesbank 2012, p. 48–54. Note: FDI according to the German Central Bank (“Bundesbank”) include new investments by foreign investors as well as foreign mergers and acquisitions and foreign credits or loans.

Case Study: Dürkopp Adler AG (Germany, Bielefeld)

Dürkopp Adler AG is a medium-sized company in East Westphalia that has been producing sewing machines since 1860. On 30 June 2005, the Chinese SGSB GROUP CO. LTD took over the majority of shares. Before that the workforce had been dwindling for decades. The number of employees at the Bielefeld plant had fallen from about 2,500 to approximately 450. Chinese investors bought this company with the long-term goal of gaining significant share in the European market and the world market for sewing machines. They expected to obtain more esteem with this well-known German brand and thus increase the volume of sales. In addition, the SGSB GROUP had little international experience and thus hoped to profit from the international management of Dürkopp Adler AG. The common fear of workers that they would lose their jobs wasn’t realized. Not a single production machine was dismantled from the plant in Bielefeld. Within three years the number of employees grew from 450 to 555 (for more details see Sohm, Linke and Klossek 2009, p. 16 to 19 and Bundesministerium für Wirtschaft und Technologie 2009, p. 12). Thus this investment is beneficial for both sides: Chinese investors and the German workforce.

Regulations and Concerns in the U.S. and Germany

On the other side, there also has been strengthening of national security measures on investment policies. One of the most widely reported, sometimes controversial regulatory bodies on foreign investment is the Committee on Foreign Investment in the United States (CFIUS). The root of CFIUS can be traced back to the Defense Production Act of 1950. The Exon-Florio amendment, which is section 721 of the Defense Production Act, was adopted in 1988 amid concerns over Japanese investment. The provision granted the president authority to prohibit proposed or pending foreign M&A or takeovers inside the U.S. that might threaten national security. The act did not specify what kind of presidential action is appropriate and it gave a broad definition of national security. After the September 11th attacks, Congress passed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT Act of 2001). This act provided a certain degree of clarity regarding the industries that are considered critical infrastructure for national security: telecommunications, energy, financial services, water, transportation sector, and certain cyber and physical infrastructure services (Jackson 2010, 6). Congressional oversight of foreign investment reached a new level of intensity in 2006 when lawmakers blocked Dubai Ports World's acquisition of Peninsular & Oriental Steam Navigation Co., a British firm that ran important port operations in the U.S. through a U.S. subsidiary. The vote to block the deal came under national security concerns, after CFIUS had already approved the deal and the president threatened to veto the congressional action. In light of this controversy at the end of 2006, the Bush administration, through arrangement for the acquisition of Lucent Technology by the French company Alcatel SA, made a significant change that allows CFIUS to reopen a review of a deal and to overturn its approval at any time should it believe the companies failed to comply with some specific national security arrangements. In 2007, the Foreign Investment and National Security Act of 2007 (FINSA) was adopted, which provided greater clarity on the CFIUS process and additional factors related to national security reviews and strengthened congressional oversight of FDI (Fagan 2008, 10) This act also changed the presumption of the harmless nature of foreign investment by requiring CFIUS to investigate all foreign investment transactions in which the foreign person is owned or controlled by a foreign government, regardless of the nature of the business (Jackson 2010, 11).

China had a taste of CFIUS as early as 1990, when the acquisition of Mamco Manufacturing (a Seattle-based aircraft parts manufacturer) by China National Aero Tech was blocked by President Bush after CFIUS cited significant national security risks. Encounters with CFIUS increased in the past decade. In 2005, China's National Offshore Oil Corporation (CNOOC) offered a cash bid of $US18.5 billion to buy shares of Unocal Corp., an American oil company. CNOOC voluntarily subjected the deal to CFIUS review, which became extremely complicated by fierce political resistance from the U.S. Congress over national security concerns. CNOOC eventually withdrew

the bid, which was more than $US1 billion higher than the eventual deal winner Chevron. Following this, the Chinese telecommunication giant Huawei failed to convince CFIUS that its bid to purchase network gear-maker 3Com in 2009 or its purchase of server technology company 3Leaf in 2011 were of no threat to U.S. national security. The list of such encounters continues, and mostly involves proposed Chinese takeover of U.S. companies that are in the energy and resources, banking, or high-tech sectors (Rosen and Hanemann 2011) These experiences have led many in China to believe that Chinese investors are been treated unfairly and that Chinese M&A transactions are among the most likely to receive the greatest scrutiny (Fagan 2008, 9).

While the media has mostly concentrated on controversial Chinese FDI to the U.S. involving CFIUS, it is important to point out that CFIUS only investigates and regulates foreign investors that take control or purchase significant shares of existing U.S. businesses, and it does not have jurisdiction over greenfield investment. In addition, CFIUS is not the only hurdle for FDI related to national security concerns. For example, the National Industrial Security Program was established in 1993 to safeguard industrial information held by contractors, licensees, and grantees of the U.S. government that are critical to national security. In 2006, the Strategic Materials Protection Board, composed of representatives from several offices in the Department of Defense, was created to examine materials critical to national security and recommend strategy for the president to ensure domestic availability of these materials. Their recommendation could prevent foreign investment in business tied to critical material such as specific types of steel (Jackson 2010, 8) In additional, export-control regulations can have significant impact on a foreign company's acquisition investment in certain industries in the U.S. For example, the Export Administration Regulations under the Commerce Department determine "dual–use" items, many of which are not accessible for China; the International Traffic in Arms Regulations under the State Department controls export or foreign transfer of U.S. Munitions List articles and services, which are currently prohibited by law to be exported or re-exported to China; and the Office of Foreign Assets Control under the Treasury Department manages sanctions programs, which make it illegal for any foreign nationals in the U.S. or U.S. citizens abroad to facilitate trade or financial transactions with a sanctioned country. These regulations further complicate Chinese investment in the U.S., because China itself is subject to many export-controlled businesses, and many of those countries on the sanction list are the ones Chinese companies frequently trade with, such as Burma, Cuba, and Iran. So when Chinese businesses attempt to acquire U.S. companies or make greenfield investments in sensitive industries related to the aforementioned regulations, they are likely to come under extra scrutiny by U.S. authorities.

Several key concerns have been voiced in the U.S. against Chinese investment projects. First, if the Chinese company is owned by the communist government or the company personnel are related to the Chinese military, accessing certain U.S. high-tech industries (such as the aerospace sector)

will facilitate buildups of the defense sector, which might be a main adversary of the U.S. Second, the company may have incentives to infiltrate the U.S. government or defense system for sabotage, in sectors such as telecommunication. A third concern is whether the company might try to control access to key resources critical to U.S. national security, such as oil. A final criticism is that China receives exceptionally cheap credit, which gives it unfair competitive advantage in the U.S. market. Similar concerns apply when the company is privately owned, maybe to a lesser degree, but it might still be seen as a hostile foreign predator trying to take over a famous U.S. brand. Of all these concerns, some are more grounded in reality than others.

Many U.S. experts recognize the potentially enormous future benefit from growing Chinese FDI to the country's economy. Some blame U.S. political interference in the FDI screening process as attempts to protect special interests from economic competition or to pursue a "Fortress America" vision of national security, and they believe a more open and political influence-free environment needs to be created to encourage Chinese FDI (Rosen and Hanemann 2011). Others see the growing Chinese FDI as a necessary and beneficial step for the U.S. to be able to demand reciprocity of openness from China for U.S. FDI (Graham and Marchick 2006, 130) Meanwhile, extensive media coverage of problems encountered by some Chinese companies investing in the U.S. has led many in China to believe that Chinese investment is not particularly welcomed. The controversy has been so hyped that it became one of the key discussion points during top-level bilateral meetings. During the U.S.-China Security and Economic Dialogue in 2011, Chinese official made a point of asking the U.S. to welcome Chinese investment and in particular, to treat the SOEs equally.[4]

One popular fear associated with FDI is the threat that a company takeover by a foreign investor has negative consequences for production and employment at the absorbed company. As a matter of fact, empirical studies show that this fear is ill-founded, on the whole. Studies in Germany illustrate that takeovers by a foreign investor have no noteworthy impact – neither positive nor negative. The same holds true for other industrial countries (see Görg 2011). For example, according to the European Investment Monitor of Ernst & Young, in 2010 FDI projects created more than 12,000 jobs in Germany (Ernst & Young 2011, p. 16). Thus Germany should not be afraid of Chinese FDI. The same holds true for Europe. According to the European Investment Monitor, FDI projects created more than 137,000 jobs in Europe (Ernst & Young 2011, p. 16). In a paper on the European international investment policy, the European Commission states: "Conversely, the overall benefits of inward FDI into the EU are well-established, notably in relation to the role of foreign investment in creating jobs, optimizing resource allocation, transferring technology and skills, increasing competition, and boosting trade. This explains why our Member States, like other nations around the world, make significant efforts to attract foreign investment" (European Commission 2010, p. 3).

4 This concern has been raised by multiple high-level Chinese officials, including the commerce minister and vice-finance minister during the S&E Dialogue in May 2011

Nevertheless, in 2007 there was an intense debate in Germany on the question of whether Germany needs safeguards against Sovereign Wealth Funds (SWF). This debate was raised by China's announcement to carry over parts of Chinese currency reserves to a Sovereign Wealth Fund. In its Annual Economic Report 2007/2008, the German Council of Economic Experts (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung) wrote one chapter dealing with this topic, coming to the conclusion that it is not necessary to tighten the laws concerning investment controls in Germany. Some months later the Commission of the European Communities published a report on the same topic, titled "A common European approach to Sovereign Wealth Funds." The report came to a similar conclusion. Its core message is: "Various suggestions have emerged in the public debate as possible avenues to step up the European response to SWFs. These have included an EU committee on foreign investments to mirror arrangements in the U.S., an EU-wide screening mechanism or some "golden shares" mechanism for non-EU foreign investment. All these suggestions run the risk of sending a misleading signal – that the EU is stepping back from its commitment to an open investment regime. They would also be difficult to reconcile with EU law and international obligations. Instead, the Commission considers that the right approach is to promote a cooperative effort between recipient countries and SWFs and their sponsor countries to establish a set of principles ensuring the transparency, predictability, and accountability of SWFs investments. "The EU and the Member States already have specific instruments that enable them to formulate appropriate responses to risks or challenges raised by cross-border investments, including investments by SWFs, for reasons of public policy and public security" (Commission of the European Communities 2008, p. 7–8). In summary, neither Germany nor the entire European Union thinks that it is necessary to intensify FDI controls with respect to the investment activities of Sovereign Wealth Funds.

Laws concerning the handling of inward FDI in Germany result from three main legal frameworks: the European Treaty, the German Law on Foreign Trade and Payments, and so-called "Bilateral Investment Treaties" (BITs) (see Hirdina and Jost 2010, p. 4).

Being a member of the European Union, Germany takes an important framework from the European treaties for its FDI policy. As mentioned above, the European Commission is convinced that inward FDI is favorable for Europe in terms of job creation, productivity gains, and sustainable economic growth and thus altogether have a positive effect on welfare in Europe. Therefore the main objective of the European Commission connected with inward FDI is to facilitate stable employment and stable growth (see European Commission n. d. and European Parliament 2011, p. 5). The main European legal foundations in this context are Article 206 and 207 of the "Treaty on the Functioning of the European Union" (TFEU). According to these Articles, FDI is an exclusive competence of the European Union. A recent report of the European Parliament from March 2011 outlines its recommendations for the European Union's future FDI policy. The four main principles of the recommended policy are the following (see European Parliament, p. 7–12):

- Long-lasting investments, since the main object of inward FDI is the creation of stable employment and stable economic growth.

- Investor protection, which remains the first priority of investment agreements. This protection covers non-discrimination, a fair and equal treatment, and a protection against direct and indirect expropriation.

- The ability for the European Union, at the same time, to protect itself against potentially aggressive foreign investment. The European Commission should decide on a case-by-case basis which sectors need special protection and thus should not be covered by future agreements. These sectors could be strategically important for national defense and sensitive sectors such as culture, education, and public health.

- Sustainable investment, which the European Parliament recommends that European Union's future FDI policy promote. Sustainability refers to the environment and to good quality working conditions.

The main German law in this context is the Law on Foreign Trade and Payments ("Außenwirtschaftsgesetz"). Until 2009, Germany limited its controls of foreign investments to armaments manufacturers. A foreign investment in such a company required notice. It could be forbidden by the Federal Ministry of Economics in order to safeguard German security interests or foreign relations of Germany or the peaceful coexistence of the people of the world (see Thal and von Eyb 2011, p. 4). In April 2009, an amendment concerning the legal regulation of FDI in Germany took place. According to this amendment, FDI can only be forbidden if public order and safety are endangered and if the foreign investor gains a proportion of voting rights in the company of at least 25% and if the foreign investor is based outside the European Union as well as Norway, Iceland, Lichtenstein, and Switzerland (see Thal and von Eyb 2011, p. 4). In this context, Germany – as does the U.S. – uses a broad national-security review mechanism and does not identify specific sectors for which reviews are required (see Marchick and Slaughter 2008, p. 37). Beyond these regulations, there are no further restrictions. Thus there are no special regulations for FDI from China or FDI executed by Sovereign Wealth Funds. In practice, most Sovereign Wealth Funds own less than 25% of a company. Furthermore, Germany has no interest in discouraging any investor to carry out FDI in Germany. Thus, up to now, the German government has never used this law to forbid any Chinese investor from acquiring a German company (see Söhn 2010, p. 531).

In a supplementary way, Bilateral Investment Treaties (BITs) are an important tool of Germany's FDI policy. In general, BITs are used in order to promote and attract foreign investments. In August 2005, an "Agreement between the Federal Republic of Germany and the People's Republic of China

on the Encouragement and Reciprocal Protection of Investments" was signed. The intention of this BIT was the creation of favorable conditions for investment by investors from one contracting party in the territory of the other contracting party. The most important articles of this agreement are Article 2 (Promotion and Protection of Investment) and Article 3 (Treatment of Investment). These articles ascertain that each partner "shall encourage investors of the other Contracting Party to make investments in its territory and admit such investments in accordance with its laws and regulations," that "investments of the investors of either Contracting Party shall enjoy constant protection and security in the territory of the other Contracting Party" and that "neither Contracting Party shall take any arbitrary or discriminatory measures against the management, maintenance, use, enjoyment and disposal of the investments by the investors of the other Contracting Party" (Article 2). Furthermore Germany and China agreed that "investments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party" and that "each Contracting Party shall accord to investments and activities associated with such investments by the investors of the other Contracting Party treatment not less favorable than that accorded to the investments and associated activities by its own investors" (Article 3, see Bundesgesetzblatt 2005, p. 734). Although the main intention of this BIT is the protection of German FDI in China – especially the guarantee of prompt, adequate, and effective compensation in the case of expropriation – it also protects Chinese investors from unfair or discriminatory treatment in Germany (see European Commission 2010, p. 5).

The policy of mutual support of FDI and non-discrimination was affirmed at the Chinese-German intergovernmental consultations that took place at the end of June 2011 in Berlin. On the occasion of these consultations, Germany and China signed a declaration about mutual facilitation of investments. Both sides appreciated the growing interest of Chinese companies to invest in Germany in order to create jobs in Germany and in order to enter the German and the European market. In addition, both sides confirmed that they are considering installing a one-stop-shop in order to facilitate investments (see Bundesministerium für Wirtschaft und Technologie der Bundesrepublik Deutschland 2011).

On the Quantity and Outlook of Chinese FDI

Although Chinese FDI has drawn increasing attention in the U.S. and Germany, China still holds less than 0.2 percent of the FDI stocks in both Germany and the U.S. This fact does not match up to the status of the three countries' leading roles in the global economy. As China continues its economic development and its per-capita income grows, it will enter a new stage of foreign direct investment where its FDI in the U.S. and the EU will continue to experience strong growth. There will be profound implications to the trend, particularly given the current stage of global financial recovery. While the banking sector institutions continue to deleverage as a result of the financial crisis, unleashing investment potential from China can potentially play a much bigger role in bringing those countries that are facing a credit crunch back to growth.

On the data

Lack of clear data from all three parties, China, Germany, and the U.S. merits comment. First of all, the difference in absolute numbers of Chinese FDI toward the U.S. is remarkably wide (See Figure 6). One explanation is that the U.S. only records the immediate source as the origination of FDI, so Chinese FDI toward the U.S. through another country is not counted by BEA. Also, full completion of quarterly and annual surveys is mandatory only for companies that have in excess of $20 million in assets, annual sales, or annual net income. Some other data calculations, such as the China Investment Monitor, are based on a bottom-up survey, which includes more of those investments that are not reported to BEA, so they are generally much larger. Nevertheless, the China Investment Monitor has been tracking FDI flows into the U.S. only since 2003, as is the case with the official Chinese data. In the case of Germany, the single most important official database for FDI is the statistics of the German Central Bank; therefore we concentrate on this database in our analysis. Unfortunately, these statistics neglect FDI projects of companies with a balance sheet total of less than 3 million Euros. Since small and medium companies play an essential role in Germany, it is useful to include FDI projects of companies with a balance sheet total of less than 3 million Euros. Meanwhile, there are many different focuses when a certain organization collects FDI data, making it hard to compare industry attractiveness for Chinese investors. For example, the German Invest and Trade Agency compiles data based on Chinese greenfield FDI projects, because these are the ones that create jobs, and they rank attractive countries by project numbers instead of the amount. In this measurement scheme, Germany attracted more Chinese FDI than the U.S. in 2010. The lack of uniform data across and within countries makes it difficult to fully evaluate the magnitude or character of Chinese FDI in the U.S. and Germany. The importance of this issue will increase significantly in the future given the sharply upward trend in Chinese FDI in the industrialized world.

Different Gestures in the U.S. and Germany toward Chinese Investment

There is some divergence between the U.S. and Germany toward Chinese FDI in some industries regarding national security concerns, such as telecommunications. Compared to the investment controls in the U.S., Germany seems to be less worried that FDI could have a negative impact on national security, because Germany's FDI controls are less restrictive and no investment-veto has yet occurred – unlike in the U.S. According to the OECD's FDI Restrictiveness Index, Germany is more open to FDI than the U.S. and ranked 8th with respect to openness on the FDI Restrictiveness Index in 2010, which compares 48 countries based along four types of measures: foreign equity restrictions, screening and prior approval requirements, rules for key personnel, and other restrictions on the operation of foreign enterprises such as limits on the purchase of land or repatriation of profits and capital. The U.S. ranked 33rd (for more details see Kalinova, Palerm and Thomsen 2010).

As a result of the different regulatory environment for Foreign Direct Investment and different considerations of sensitive industries for national security purposes, some Chinese firms have had quite different experiences in their investment activities in the U.S. and in Germany, resulting in divergent perceptions. The U.S. has been widely perceived, fairly or unfairly, in China as lacking transparency towards Chinese FDI. The complaint has been brought up to the top-level leadership in China. In May 2011, the Chinese commerce minister openly questioned the credibility of the U.S. investment investigation process: "Even though those who were rejected were the minority, the possibility of being rejected by the U.S. has scared away Chinese companies that are taking the initial steps to invest abroad. We hope that American government and mediate institutions can tell us more clearly where we can invest and where we cannot." (Caixin News 2011) This complaint seldom is heard about Germany.

Particular Uncertainty for U.S.-bound Chinese FDI

The lack of transparency surrounding the CFIUS process–particularly the lack of a clearly defined industry blacklist or a set of credibility criteria guiding review of investments—has created uncertainty among investors. This in turn may deter otherwise benign and mutually beneficial FDI from China. However, the emphasis on CFIUS and on the deterred deals by media is largely overblown and it taints the image that in general the U.S. wants to attract Chinese FDI. CFIUS has covered 313 transactions from 2008–2010, only 16 of which involved Chinese acquirers compared to 91 transactions of UK origin. That said, it is understandable that Chinese companies are under heavier scrutiny, given that Japan over the same period had roughly the same number of covered transactions, while the Netherlands and Finland combined had fewer than China (CFIUS 2011, 18). These countries take a far more significant share in FDI in the U.S. than China (See Figure 9).

Even so, most of the Chinese transactions covered by CFIUS moved forward without any problem. Although CNOOC hit a wall in 2005 trying to acquire Unocal, its acquisition of offshore fields in the Gulf of Mexico in 2009 was unopposed and the company successfully closed on a multi-billion dollar investment in Chesapeake Energy Corp in 2010. While Huawei was not able to acquire network gear maker 3Com, Lenovo's acquisition of IBM's personal computer division was cleared by CFIUS. In 2011, the Chinese Aviation Industry General Aircraft Co. also successfully acquired U.S. aircraft maker Cirrus after CFIUS review.

The U.S. lacks a clear strategy toward Chinese FDI. There is some credibility in the complaint from China that it is not clear which industries are no-go in the U.S., and which are welcomed. At the same time, some apparently grounded suspicions of Chinese FDI projects in the U.S. are mainly politically driven. For example, 50 members of the Congressional Steel Caucus urged CFIUS to investigate the investment of the Chinese Anshan Iron and Steel Group in a 14 % share of the American Steel Development Company for a greenfield project (Visclosky 2011) Their arguments were based on loss of American jobs and on U.S. national security. However, this greenfield investment project is not covered by CFIUS jurisdiction, which only covers M&A projects, and is projected to create 1,000 construction jobs and 150 permanent plant jobs (Zhang 2010). This contrasts to the picture in Germany, where the most important objective associated with inbound FDI is the creation of jobs: any foreign investment which creates new jobs or safeguards employment in Germany is highly welcomed.

Obstacles for Large Chinese SOEs

Similarly, while many large Chinese SOEs have the ability to manage cross-border M&A, many SOEs find state ownership to be a burden as they venture abroad because of the suspicion it elicits in host countries. When looking at the U.S. suspicion of the unfair advantages enjoyed by SOEs from China, it is very similar to its claim against large Japanese enterprises, which were believed to have received government backing 20 years ago. These concerns about Japanese companies' potential destruction of the U.S. economy have proven to be overblown, because these very companies are now important building blocks of the U.S. economy, contributing to job creation and added value (see Figures 17–19). Since SOEs and other large companies are the major drivers of Chinese FDI, and many large companies in China have some linkage or history with the government, there is an important need to clarify or agree upon what constitutes SOEs, and the nature of Chinese SOEs. Also, as private companies from China grow, and more of them join in direct investment, there needs to be clarification of how they would be separated from SOEs facing investment regulations.

Large Chinese SOEs that invest in the U.S. and Germany also face enormous challenges even if cross-border M&As are successful. There may be problems in integration with local companies, resulting in operational difficulties and an ultimate failure of the M&A deal. According to a survey about Chinese FDI conducted by the Development Research Center of the State Council (DRC), Chinese FDI is facing a number of obstacles, including lack of fundraising ability, information asymmetry, international talent shortages, and insufficient policy support from the Chinese government. (See Table 3) These challenges highlight many of the indigenous future obstacles for China to further increase its FDI.

Table 3: The Main Obstacles to Chinese ODI

Obstacle	Proportion of Enterprises Experiencing Issue
Lack of fund-raising ability	62.395 %
Information asymmetry	35.93 %
Shortage of international talent, including foreign language professionals	31.19 %
Insufficient policy support from the Chinese government	27.37 %
Lack of self initiative among business executives	25.54 %
Limited number of policies that support ODI	24.77 %
The culture gaps and different management philosophy during investment processes	24.01 %
High barriers to market entry within host countries	20.64 %
Excessive strictness of China's foreign exchange management	15.44 %
Complex Chinese trade and investment regulations that slow the ODI process for Chinese businesses	13.91 %
Lack of trust among host governments and enterprises of Chinese enterprises	11.93 %
Source: Survey by the Development Research Center of the State Council	

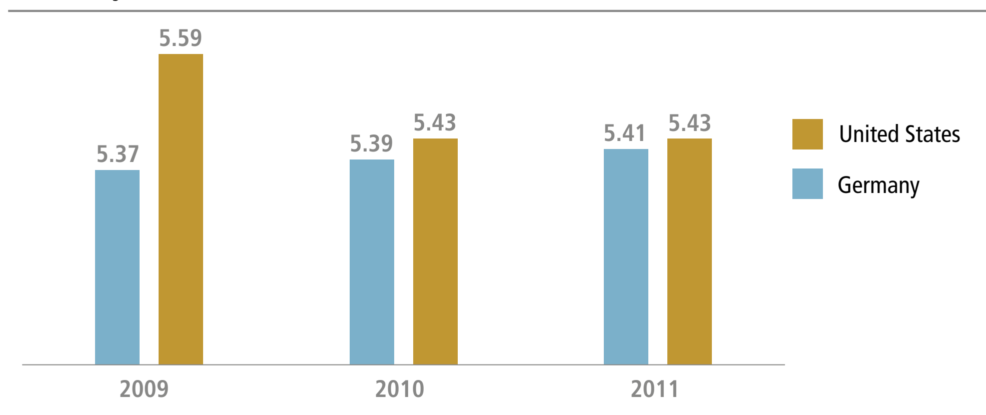
Is Germany Overtaking the U.S. as the Top Investment Destination?

The U.S. faces growing competition from other developed countries such as Germany to attract rapidly increasing FDI from China. It may be that a sense of inertia and complacency with the historical U.S. position as a top destination for FDI has blunted the urgency and slowed implementation of the reforms necessary to compete in a changing environment. One of the possible consequences of the different investment environment when handling Chinese FDI is that Germany can substitute for the U.S. as a more attractive destination for Chinese investors with its less restrictive FDI controls. This could be a particularly important consequence if Chinese FDI were to increase as predicted and the reliance of U.S. and Germany on Chinese investment increases to further encourage economic growth. At the moment, China invests more money in the U.S. than in Germany. Nevertheless, there are some arguments that suggest Germany could

become more attractive for Chinese FDI. In terms of the number of FDI projects in Germany, China has recently taken the lead: In 2011 there were 827 FDI projects in Germany, 158 of which had Chinese investors, followed by 110 from the U.S. and 91 from Switzerland (see Germany Trade & Invest 2012). The main arguments for an increasing attractiveness are a greater openness in Germany than in the U.S. toward Chinese FDI, the equally high reputation of German goods and technologies as the U.S. ones, a more favorable general trend in terms of global competitiveness, a favorable trend in the development of labor costs per unit in Germany, and lower effective tax rates on capital income in Germany than in the U.S.

For more than 30 years, the World Economic Forum has published a Global Competitiveness Report in order to compare the productivity and competitiveness of different economies. Since 2005, the analysis has been based on a Global Competitiveness Index, which covers 12 metrics, ranging from institutions, infrastructure, and education to market efficiency, market size, technological readiness, and innovation. The Global Competitiveness Report 2011–2012 contains the results for 142 countries. According to this report, the U.S. and Germany have almost the same level of competitiveness: On a scale from 1 to 7, with 7 representing the highest competitiveness, the U.S. ranks 5th with an overall score of 5.43 and Germany ranks 6th with an overall score of 5.41. However it is quite remarkable that the U.S. has declined in rank for three years, whereas Germany continues an upward climb (See Figure 20). In 2001, Germany ranked 17th, in 2003 and 2004 13th, 2006–2007 7th and now Germany is ranked 6th. The U.S. on the other hand was placed 1st or 2nd between 2001 and 2009. In the report 2010–2011, the U.S. was ranked 4th and in the current report 5th[5]. If global competitiveness is an indicator of the attractiveness of a country as a location to invest and if the recent trends concerning the competitiveness of Germany and the U.S. continue, Germany should become a more attractive location for foreign investors.

Figure 20: Trends in Global Competitiveness Index Scores in the US and Germany



Source: World Economic Forum

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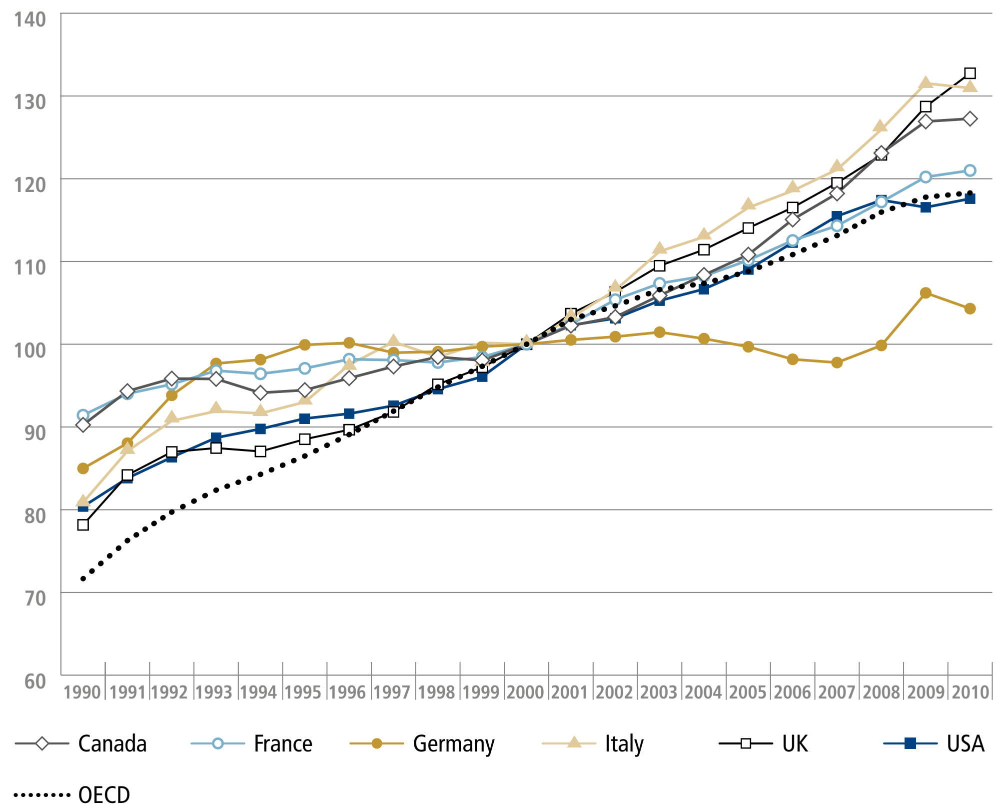
5 For more details see World Economic Forum 2011, particularly p. 14 to 24, 184 to 185, and 362 to 363

Another trend favoring Germany is the development of labor costs per unit over the last fifteen years. While Germany is a high wage country, since the mid-nineties – and especially since the beginning of the new millennium – the growth of wages has been markedly lower than in other developed economies. The main reason for the low growth of labor costs per unit in Germany has been a shift toward greater wage restraint. This is first of all caused by a weakening of the bargaining power of the German unions. In 1990, more than 11 million people were members of unions. By 2011, that number had dropped to 6.15 million. Additional wage pressure was caused by high unemployment rates. From the mid-nineties to 2006, Germany's unemployment rate ranged between 9.5 and 11.5 per cent. Only since 2007 has this rate been declining, reaching 7.7 per cent in 2010 and 7.1 percent in 2011. Thus, from 1996 to 2008, labor costs per unit remained more or less constant. Illustrating labor costs per unit as an index (value of the year 2000 = 100), Germany's labor costs per unit grew by just five percentage points from 1995 to 2010. In contrast, in the U.S. labor costs per unit increased by almost 30 percentage points over the same period (see Figure 21). As a result, in terms of labor costs, Germany is becoming comparatively more attractive for foreign investors.

Figure 21: Labor Costs per Unit Across Countries and Times (index: Labor Costs per Unit in the Base Year 2000 = 100)



Source: OECD, calculations of the Institute for the Study of Labor (IZA), Bonn.

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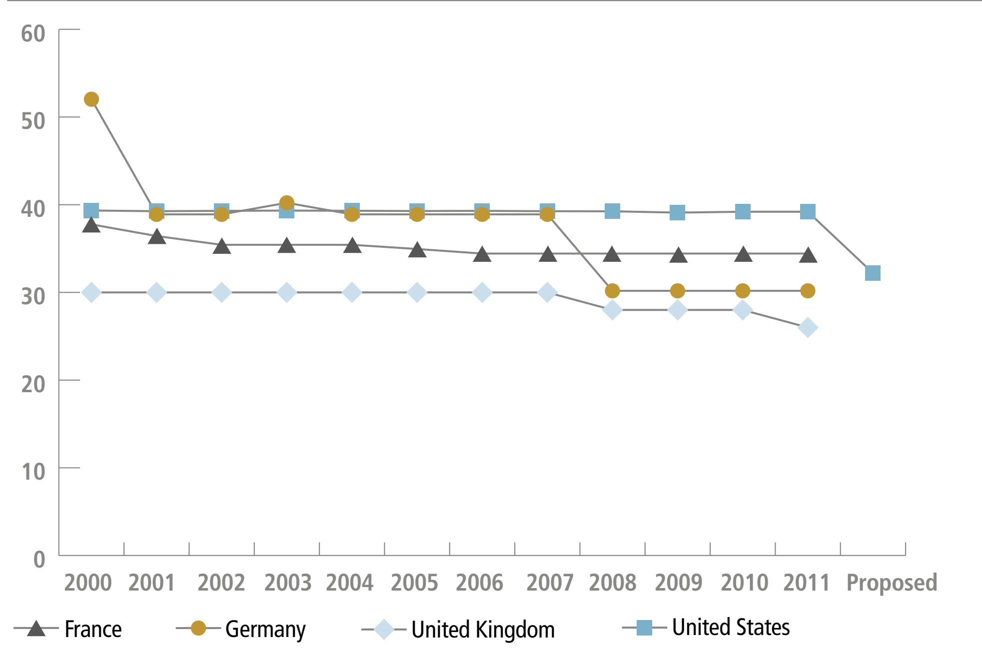
Along similar lines, Germany offers tax advantages relative to the U.S. for potential investors. In 2000, Germany had a corporate tax rate of more than 50 %. From 2001 to 2007, this tax rate was 40 %, and in 2008 it fell to 30 %. In the U.S., corporate tax remained constant at a rate of 40 % (see Figure 22). Although a current proposal would lower corporate taxes by 7 %, this would still place the U.S. combined rate above that of Germany. This holds true as well when looking at effective tax rates[6]. The effective tax rate on capital income is significantly lower in Germany than in the U.S. In a study covering the years 1995 to 2007, Mathias Trabandt and Harald Uhlig calculated the effective tax rates for capital incomes in fifteen countries. In the U.S., these tax rates varied from 32.9 % to 38.3 % with an average rate of 36.4 %. In Germany, tax rates varied from 21.6 % to 27 % with an average rate of 23.4 % (see Trabandt and Uhlig 2009 and Figure 9 in the appendix).

Figure 22: Comparison of Corporate Tax in Main Industrialized FDI Destinations



Source: The Guardian Datablog

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Finally, the central position in the heart of Europe and its critical role in the European economy make Germany especially attractive for investors seeking a base to access opportunities in the larger EU market.

6 The concept of effective tax rates refers to the combined effects of all elements of taxation such as statutory rates, tax deductions, and tax credits. Effective tax rates for different economic functions are calculated by dividing the total tax revenues of a certain category (for example capital) by a proxy for the tax base (for example capital income according to the national accounts, see for details European Commission 2011, p. 392)

First of all, empirical studies show that on the average, the fear that FDI reduces jobs is ill-founded. Quite the contrary: FDI creates jobs in almost all industrial countries. Officials and entrepreneurs in all three countries need to work to promote an accurate public image of the impact of Chinese foreign direct investment while U.S. and German leaders should **send a strong welcoming signal** to Chinese investors.

Second, it is important to provide better platforms of communication for Chinese investors to have a better grasp of the investment environment. There should be further coordination between U.S., German, and Chinese investment promotion bodies. To strengthen trust and encourage further Chinese FDI, a central task is to promote understanding of each country's differing economic and social governance models, governance concepts, and ideologies.

- **The U.S. should expand the federal role in attracting FDI and create a more direct platform for interaction with investors.** While many states have well-developed investment promotion programs, efforts to coordinate FDI promotion at the federal level have historically been lacking if not non-existent. The recent establishment and increased budget of SelectUSA is an encouraging first step. Greater funding is needed, as is better coordination with state initiatives and better linkage of investors to potential recipients of FDI. The government may also serve to facilitate closer peer-to-peer engagement between U.S. MNCs and their Chinese partners to help shepherd foreign investors through the procedures for setting up operations in the U.S.

- **The Chinese government should consider setting up an outward investment promotion agency with local branches in order to collaborate with its U.S. and German counterparts in providing support to its investors.** It can help Chinese investors to gain a better practical understanding of the different commercial, legal, and political environment in the U.S. and Germany. For example: Chinese investors should be more attuned to the important role Congress plays in investment policy formation. Many Chinese companies hoping to invest in the U.S. need a better understanding of the interplay between the legislative and executive branch in shaping FDI policies – particularly the autonomous position of the former relative to the latter. A more proactive strategy for dealing with Congress implies responsibility for Chinese companies to gain greater know-how in government relations by connecting with those in the U.S. who can best provide it. For the U.S., it implies providing investors with a better mechanism for understanding the legislative branch's role. Also, Chinese investors should further familiarize themselves with the legal procedure and legal resources in the U.S. and Germany for conducting business. This is not only to help them play by the rules, but also to help them protect their businesses in the long term.

- **Chinese government and companies should seek to further clarify the management structure of SOEs and their relationship to the government.** Since a lot of uneasiness surrounds large Chinese SOEs, which make up a significant share of Chinese FDI, this is particularly important to help build confidence and support in the U.S. and Germany for promoting Chinese investment. Meanwhile, China should put forth policies that encourage more outward investment by private Chinese companies, including SMEs (e.g. by providing policy information, relaxing capital control, etc). This could help expand the variety of investments and foster deeper cross-border investment linkages between China and its target markets.

Third, to the extent possible, the U.S., Germany and China should seek to further clarify the rules for their investment markets.

- **There should be better coordination among the three countries to provide comparable datasets based on commonly agreed standards.** This flows from a similar logic as general accounting standards; particularly as FDI from China grows, a lack of uniform agreement on what constitutes FDI and where it originates clouds the accuracy and efficacy of analysis and may lead to suboptimal or mistaken policy prescriptions.

- **Germany should not yield to public pressure to impose Sovereign Wealth Fund (SWF) controls.** A special discussion applies to the role of SWF. In the public debate, various suggestions call for stronger controls of SWF investments. Germany should not accede to these requests, because such restrictions offend against the idea of an open investment regime, which is vital for Germany. On the other hand, Germany needs to cautiously deal with increasing calls for the EU to set up a similar institution to CIFUS. Being free from political influence of vested interests is vital but could be hard to achieve for such an entity, particularly in the EU.

- **CFIUS should develop and make public both a list of strategic industries and a set of objective guidelines for determining the credibility of security threats.** Despite high-profile cases, in reality the vast majority of acquisitions from China and elsewhere do not represent a credible security threat. CFIUS should therefore seek to expedite and standardize the process so that it does not deter would-be investors who do not pose a security threat to the U.S. The emphasis should be on industry analysis – and key variables such as industry concentration and barriers to entry – that can serve to protect security interests while insulating the process from political considerations based solely on the nationality of firms.
  Finally, the three countries should seek to utilize bilateral and multilateral channels of engagement to make improvements and upgrades to the investment climate.

- **The U.S. should seek to ease regulatory barriers by building on positive initial steps to reform visa rules, tax policies, and reporting requirements.** To reap the gains FDI confers – including more and better jobs – the U.S. should seek to attract investment with less restrictive regulations for foreign investors. The currently moribund negotiations over a new bilateral investment treaty (BIT) could be resurrected as a springboard for such reform and greater certainty of the regulatory environment.

- **Investment promotion agencies should consider hosting a regularly convened U.S.-EU-China investment fair supported by the respective investment promotion agencies and including as participants potential investors, project managers, and legal experts, among other stakeholders.** The experience in multilateral trade promotion has shown that similar multilateral efforts in investment could help establish an effective information platform and promote increases in investment volume.

- **Moving forward, the U.S., China, and the EU should consider starting a regular consultation process to further coordinate U.S.-China and EU-China bilateral investment treaty negotiations.** The three parties should consider a "China-U.S.-EU Foreign Direct Investment Treaty" which would be based on equal mutual benefits and seek to further consolidate the different sets of standards and rules in each country regarding foreign direct investment.

Table 1: Number of Foreign Companies in Germany (Absolute Number)

Year	all countries	US	Japan	China
1989	10664	1851	445	16
1990	11475	1913	485	20
1991	12271	1940	545	21
1992	12783	1984	597	22
1993	11741	1875	579	28
1994	11795	1850	575	31
1995	11866	1890	566	32
1996	11906	1909	563	32
1997	12093	1940	547	30
1998	12458	1994	540	28
1999	13343	2090	527	36
2000	13818	2059	520	35
2001	13979	2034	505	34
2002	9462	1429	388	19
2003	9300	1338	378	18
2004	9225	1278	366	18
2005	9605	1237	373	17
2006	10213	1226	374	25
2007	12629	1409	392	27
2008	13646	1459	416	33
2009	14234	1484	421	40
2010	14094	1428	421	44

Source: Deutsche Bundesbank, Statistik "Zeitreihen" (download: 30 April 2012). Note: FDI projects according to the German Central Bank ("Bundesbank") do not include companies with a balance sheet total of less than three million Euros in which foreign investors hold more than 10 % of shares or voting rights.

Table 2: Number of Employees of Foreign Companies in Germany (in Thousands)

Year	all countries	US	Japan	China
1989	1674	486	74	0
1990	1789	505	78	1
1991	1871	510	53	0
1992	1861	503	56	0
1993	1758	484	56	0
1994	1686	469	52	0
1995	1684	486	52	0
1996	1662	480	51	0
1997	1706	495	49	0
1998	1745	487	52	0
1999	1998	530	50	0
2000	2130	506	51	0
2001	2165	501	50	0
2002	2143	475	48	0
2003	2162	450	47	0
2004	2280	518	43	0
2005	2196	388	45	0
2006	2331	349	43	1
2007	2560	332	42	1
2008	2664	346	49	3
2009	2587	314	50	3
2010	2565	296	49	3

Source: Deutsche Bundesbank, Statistik "Zeitreihen" (download: 30 April 2012). Note: FDI projects according to the German Central Bank ("Bundesbank") do not include companies with a balance sheet total of less than three million Euros and in which foreign investors hold more than 10 % of shares or voting rights.

Table 3: Volume of Sales of Foreign Companies in Germany (Billions of Euros)

Year	all contries	US	Japan	China
1989	732.7	219.3	49.5	0.6
1990	806.2	237.2	55.3	0.3
1991	886.4	254.7	52.8	0.5
1992	903.0	263.6	57.6	0.7
1993	879.0	256.1	53.6	0.9
1994	919.2	269.4	52.3	0.6
1995	965.0	285.6	57.8	1.0
1996	993.4	292.9	60.5	0.7
1997	1086.0	314.7	61.3	0.7
1998	1142.9	296.9	68.5	0.8
1999	666.1	150.8	32.7	0.3
2000	762.9	146.4	36.8	0.5
2001	795.1	159.0	39.8	0.5
2002	808.2	147.0	36.3	0.4
2003	845.5	133.7	36.7	0.6
2004	953.3	187.6	36.0	0.6
2005	1030.1	142.6	38.8	0.7
2006	1134.1	132.0	40.1	0.9
2007	1261.0	132.6	40.4	1.3
2008	1346.0	143.2	45.8	1.5
2009	1180.4	117.2	42.7	1.2
2010	1263.0	139.1	40.2	1.5

Source: Deutsche Bundesbank, Statistik "Zeitreihen" (download: 30 April 2012). Note: FDI projects according to the German Central Bank ("Bundesbank") do not include companies with a balance sheet total of less than three million Euros and in which foreign investors hold more than 10 % of shares or voting rights.

Table 4: Ten Important Chinese Projects by Jobs Created in Germany Since 2003

Company Name	Destination State	Jobs created	Sector
Goldwind Science and Technology Co Ltd	Saarland	100	Engines & Turbines
Evoc Intelligent Technology	North Rhine-Westphalia	80	Business Machines & Equipment
Cosco	Hamburg	80	Transportation
Huapeng	Brandenburg	46	Industrial Machinery, Equipment & Tools
Hangzhou Donghua Chain Group	North Rhine-Westphalia	40	Metals
ZTE	North Rhine-Westphalia	30	Communication
Sany	North Rhine-Westphalia	30	Industrial Machinery, Equipment & Tools
ZhongQiang Electric Tools	Bavaria	20	Industrial Machinery, Equipment & Tools
Xi An Typical Industries	Rheinland-Pfalz	17	Industrial Machinery, Equipment & Tools
Zoje	Rheinland-Pfalz	15	Industrial Machinery, Equipment & Tools

Source: Germany Trade & Invest, Germany's Major Investment Partners – China, Berlin/Bonn 2011, p. 17.

Table 5: The Most Important FDI Partners of the European Union in 2010: EU Direct Investment Inward Stocks by Extra EU Investing Countries (Billions of Euros)

Extra EU-27 (total)	2964.150
U.S.	1201.378
Switzerland	365.425
Canada	143.069
Japan	129.056
Singapore	67.346
Brazil	67.322
Norway	64.508
Hong Kong	42.228
Russia	41.994
Australia	29.627

Source: Eurostat, Data on "Balance of payment statistics", (download: 15 March 2012).

Table 6: Extra-EU FDI Stocks (EU inward FDI) by Economic Activities (Billions of Euros), End-2008

Agriculture, hunting and fishing	1.4
Mining and quarrying	40.0
Manufacturing	330.3
Food products	53.3
Textiles and wood activities	33.2
Petroleum, chemical, rubber, plastic products	124.5
Metal and mechanical products	46.1
Machinery, computers, RTV, communication	14.1
Vehicles and other transport equipment	22.9
Electricity, gas and water	18.2
Construction	13.4
Services	2088.4
Trade and repairs	139.0
Hotels and restaurants	13.4
Transport and communications	41.8
Financial Intermediation	1356.9
Real estate and business services	514.3
Other services	23.0
Other sectors	30.7
Total	2522.3

Source: Eurostat: Foreign direct investment flows still influenced by the crisis, Statistics in focus 25/2011, p. 6.

Table 7: FDI Intensity (= Average Value of Inward and Outward FDI Flows of a Country Divided by the GDP of this Country) of Selected Countries in 2009 and 2010 (Percent of GDP)

	2009	2010
EU-27	2.3	1.0
Spain	0.6	1.7
Greece	0.7	0.2
Portugal	0.8	–1.5
Italy	1.0	1.0
Germany	1.8	2.3
United Kingdom	2.7	1.9
France	2.6	2.3
Switzerland	5.7	8.1
Ireland	11.8	10.7
Luxembourg	417.4	365.8
U.S.	1.6	1.9
Japan	0.9	0.5

Source: Eurostat, Data on "Balance of payment statistics", (download: 3 May 2012).

Table 8: Share of China's and Hong Kong's FDI in the EU-27

	Share of China's FDIs	Share of Hong Kong's FDI	Share of China's plus Hong Kong's FDI
1998	0.057 %	0.274 %	0.331 %
1999	0.058 %	0.418 %	0.477 %
2000	0.047 %	0.973 %	1.020 %
2001	0.049 %	0.865 %	0.914 %
2002	0.041 %	0.930 %	0.971 %
2003	0.033 %	0.521 %	0.554 %
2004	0.108 %	0.799 %	0.907 %
2005	0.066 %	0.916 %	0.982 %
2006	0.177 %	0.862 %	1.039 %
2007	0.193 %	0.696 %	0.889 %
2008	0.224 %	1.045 %	1.269 %
2009	0.211 %	1.037 %	1.249 %
2010	0.227 %	1.425 %	1.652 %

Source: Eurostat, Data on "Balance of payment statistics", (download: 15 March 2012), own calculations.

Table 9: Effective Tax Rates for Capital Income (Capital Income Taxes in Percent Across Countries and Time)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
USA	37.8	37.3	37.1	37.5	37.3	38.3	36.1	32.9	33.6	34.0	36.4	36.4	38.2
EU-14	29.6	30.9	32.6	33.3	35.2	34.7	33.7	31.7	30.6	31.0	32.7	34.8	34.4
GER	23.1	22.8	22.8	23.9	25.9	27.0	21.6	21.4	22.0	21.6	22.3	24.4	24.8
FRA	27.9	30.3	32.2	34.9	37.5	36.9	38.0	36.0	34.6	36.6	37.1	40.1	39.2
ITA	32.7	34.0	36.2	32.3	35.1	32.2	33.7	32.9	31.7	31.8	32.8	37.4	39.1
GBR	40.3	39.9	42.8	45.9	47.4	52.1	52.5	45.8	42.4	42.5	46.9	49.2	45.1
AUT	20.4	23.5	25.6	25.6	24.0	23.6	28.7	24.4	24.0	23.6	22.9	22.3	23.2
BEL	38.1	40.4	41.9	44.9	44.9	44.3	46.6	45.3	42.8	41.4	40.8	40.5	39.6
DNK	43.3	44.6	44.9	52.5	47.8	46.2	49.5	50.7	51.5	52.3	57.3	58.3	59.3
FIN	28.2	32.0	32.4	33.3	33.3	39.2	31.4	31.1	29.3	29.5	30.1	28.4	29.3
GRE	NaN	NaN	NaN	NaN	NaN	20.1	17.1	16.7	15.0	14.8	15.5	14.5	14.5
IRL	NaN	NaN	NaN	NaN	NaN	NaN	NaN	17.5	19.0	20.3	21.0	24.2	22.5
NET	27.6	30.4	30.3	30.9	31.4	30.3	31.3	29.5	26.9	27.4	30.8	28.2	26.1
PRT	18.9	20.6	21.2	21.0	23.4	26.1	24.4	25.2	23.4	23.2	24.0	25.6	27.6
ESP	NaN	NaN	NaN	NaN	NaN	25.9	24.8	26.6	27.1	29.1	32.6	35.0	36.2
SWE	30.1	36.2	39.0	39.8	41.5	49.8	47.2	40.4	40.3	40.7	44.0	40.8	41.8

Source: Trabandt and Uhlig 2011. Supplementary Documentation. p. 19.

Data on FDI are hardly to be compared, because there are no commonly agreed accounting standards. Thus there are vast differences in FDI statistics. In this report, we used the following FDI data:

U.S.

For the American Data on FDI we used two main sources: The Statistics of the U.S. Bureau of Economic Analysis (BEA) at the Department of Commerce and Statistics of Rhodium Group's China Investment Monitor.

- **Statistics of the U.S. Bureau of Economic Analysis (BEA) at the Department of Commerce:** The Bureau of Economic Analysis collects data based on mandatory surveys of foreign affiliates that are then aggregated and published by country and industry. However, full completion of quarterly and annual surveys is mandatory only for companies that have in excess of $20 million in assets, annual sales, or annual net income and that have more than a 10% foreign ownership share. The BEA also distinguishes between Ultimate Benefical Owner (UBO) and Foreign Parent FDI – the latter recording only direct capital links to a foreign investor and the former accounting for indirect capital links that might be channeled through a holding company. Both sets of data are published.[7] In addition to foreign investment position data, the BEA also compiles a number of useful financial and operating data, including R&D spending, value-added, employment and wages. However, for much of this data, there is a greater than two-year lag in availability.

- **Statistics of Rhodium Group's China Investment Monitor:** This is a relatively new dataset that tracks acquisitions and greenfield investment by Chinese firms based on information in commercial databases, news reports, and on-the-ground information from Rhodium Group contacts in China. The main advantage of this dataset is the comprehensive real-time information it provides on Chinese investments. However, data are only available since 2003, and since it only includes information about Chinese FDI into the United States, the dataset is not directly comparable with those involving other countries.

China

FDI statistics compiled by the Ministry of Commerce of the People's Republic of China encompass those investments in which domestic investors hold a 10% or greater equity share of a foreign enterprise in terms of cash, fixed assets or intangible assets. Data are culled from reports by local

7 In BEA data, Chinese FDI through UBO is more than twice as high as FDI through Foreign Parent. We are in the process of researching why this might be – and to what extent the use of holding companies in tax havens may contribute to the wide disparity we see in the data.

departments that are then aggregated at the Ministry of Commerce, and the basic approach is to ensure that qualifying enterprises fill out the statistical statements regularly. The SAFE (State Administration of Foreign Exchange) is in charge of the financial sector statistics of Foreign Direct Investment. The typical survey is also frequently used by the Ministry of Commerce, National Bureau of Statistics and SAFE to collect and collate the relevant information.

Germany

The main source for FDI data in Germany is the German Central Bank (»Bundesbank«). In addition, we also refer to the FDI database of fDi Markets:

- **Statistics of the German Central Bank (»Bundesbank«):** The German Central Bank has on the one hand a broad understanding of FDI. FDI stocks include new investments by foreign investors, foreign mergers and acquisitions, and foreign credits or loans. On the other hand, FDI Statistics of German Central Bank include only companies whose balance sheets total at least 3 million Euros and cases in which foreign investors hold more than 10% of shares or voting rights. Furthermore, the German Central Bank distinguishes between primary ("unmittelbare") and secondary ("mittelbare") FDI. Primary FDI consists of direct capital links between a foreign investor and a company in Germany: the investor holds the shares himself or lends the capital himself. Secondary FDI consists of indirect capital links between a foreign investor and a company in Germany: the shares are held via a dependent holding company. The German Central Bank consolidates primary and secondary FDI (see also Germany Trade & Invest 2011, p. 5). According to a special edict ("Außenwirtschaftsverordnung") every domestic company with a balance sheet total of 3 million Euros and more is obliged by law to report each year to the German Central Bank, if any foreign investor owns 10% or more of its shares or voting rights (see Deutsche Bundesbank 2012, p. 65–66).

- **FDI database of fDi Markets (a commercial database):** fDi Markets collects FDI data from investment announcements by different sources (official sources, investor information, press releases) for the entire world. FDI projects according to fDi Markets include greenfield investment projects (new operations) and brownfield investment projects (expansion and re-investment). Since this FDI definition does not include foreign mergers and acquisitions, and foreign credits or loans, this FDI definition is smaller than definition of the German Central Bank. Otherwise fDi Markets has no restriction in terms of balance sheet totals or minimum shareholder shares or voting rights. Thus this FDI definition is larger than the definition of the German Central Bank with respect to this aspect.

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