March 30, 2011

Hearing before the U.S.-China Economic and Security Review Commission: Statement of Dr. Karl P. Sauvant

Karl P. Sauvant, *Columbia University*

STATEMENT OF DR. KARL P. SAUVANT
EXECUTIVE DIRECTOR, VALE COLUMBIA CENTER ON SUSTAINABLE INTERNATIONAL INVESTMENT, COLUMBIA UNIVERSITY
NEW YORK, NEW YORK

DR. SAUVANT: Mr. Chairman, distinguished Commissioners, ladies and gentlemen, it is an honor for me to testify before the U.S.-China Economic and Security Review Commission.

Like Dan, permit me, please, to focus my remarks on foreign direct investment. World foreign direct investment flows have grown from an average of about $50 billion during the first half of the 1980s to $2 trillion in 2007, before they declined to $1 trillion in 2009-2010 as a result of the crisis.

Traditionally, the United States has been the leading host and home country--in other words, the largest importer and exporter of foreign direct investment. And partly because of that, traditionally the U.S. has been a leader in establishing a strong and open international investment law regime that protects foreign direct investment and even encourages it, with the principle of nondiscrimination playing a particularly important role. The reason is that foreign direct investment plays an important role in strengthening the competitiveness of firms and in contributing to development.

This approach has gained widespread approval by virtually all countries in the world, and has indeed led to a strong international investment law and policy regime. And the U.S., as I have mentioned, has benefited particularly from it because it has been, for the reason that Dan indicated, the most attractive host and home country. It is, therefore, surprising to see that there is so widespread skepticism regarding Chinese FDI in the United States. This is all the more surprising since this investment is very small indeed, as we have heard. Inflows were around $1 billion in 2009, according to official U.S. Department of Commerce figures; U.S. flows to China that year were about $4 billion. With foreign direct

investment inflows into the U.S. amounting $129 billion in 2009, China's share was less, considerably less, than one percent.

However, and this is atypical if compared to other countries, some 80 to 90 percent of the value of foreign direct investment, not necessarily the number of foreign affiliates, from China is undertaken by state-owned enterprises. At the same time, though, there is little, if any, systematic evidence that state-owned enterprises, be they headquartered in China, Singapore, France, Germany, or any other country, behave differently from private multinationals when they undertake foreign direct investment projects abroad.

It is, of course, true that Chinese firms face considerable challenges when establishing and operating foreign affiliates in the United States that have little or nothing to do with any skepticism regarding foreign direct investment from China. Rather, they are the result of the inexperience of Chinese firms. After all, they became active in the world foreign direct investment market in a significant manner only since the year 2000 when China launched its going global policy.

Chinese multinationals, like all multinationals, face the "liability of foreignness" challenge, that is, the challenge of operating as foreigners in a foreign market. For Chinese firms, this challenge is particularly high given the regulatory and institutional differences and gap between China and the U.S. Chinese firms simply don't have the experience of how to become quickly accepted insiders in a host country that contributes to the economic and social development in the communities in which they are established.

This disadvantage can be accentuated by the "liability of the home country", that is, Chinese firms establishing themselves in the U.S. may be regarded differently than, say, UK firms that do the same.

Mr. Chairman, let me conclude by offering four recommendations. First, the U.S. should strive to maintain its role as a leader in establishing a strong and open international investment law and policy regime to make sure that the rule of law governs foreign direct investment between countries. In particular, the principle of nondiscrimination, the heart of the international investment law regime, should be respected and promoted. The Chinese-U.S. BIT that is under negotiation may offer an excellent opportunity to further strengthen this principle of nondiscrimination.

Two, at the same time, I suggest that the international law and policy regime (and the national FDI regimes require some rebalancing to allow governments to pursue legitimate public policy objectives regarding their own essential security interests or, broader, their national interests. But an effort needs to be made to define or circumscribe as clearly as possible what the concepts of "essential security interests" and "national interests" mean to avoid that they are being used--or abused--for protectionist purposes.

Three, outward investment from China is growing, as we have heard. In fact, China was in the year 2009 the world's fifth largest outward

investor. And the U.S. should seek to attract as much of this investment as possible, and in this I echo entirely what Dan has said. (It would, of course, face stiff competition from other countries that seek to attract the same investment, but it certainly is worth a try.) The U.S. should welcome Chinese foreign direct investment, but at the same time make sure that it, like foreign direct investment from any other country, obeys scrupulously U.S. laws and regulations. Such an approach by the United States and other countries would also contribute toward integrating China into the world economy and making it a responsible stakeholder in it.

Fourth and finally, given that China's multinational enterprises are young and relatively inexperienced, we should find ways of helping them to become good corporate citizens in the U.S., not only to avoid unnecessary frictions, but also to increase the contribution that Chinese foreign direct investment can make to the U.S. economy and society.

By way of conclusion, Mr. Chairman, let me remind us all that we had a similar situation some 25 years ago when Japanese firms emerged as major outward investors. Like today, vis-a-vis Chinese firms, there was a strong reaction against the new kids on the block, so to speak, in light of a range of concerns. In fact, CFIUS was created at that time and in reaction to incoming Japanese investment. We managed to integrate and accept Japanese foreign direct investment and benefit from it, and in fact, we are actively seeking it. I trust that over time we will have the same experience with Chinese foreign direct investment in the United States.

Thank you very much for your attention.

[The written statement follows:]

PREPARED STATEMENT OF DR. KARL P. SAUVANT
EXECUTIVE DIRECTOR, VALE COLUMBIA CENTER ON SUSTAINABLE INTERNATIONAL INVESTMENT, COLUMBIA UNIVERSITY
NEW YORK, NEW YORK

Mr. Chairman, ladies and gentlemen.

My name is Karl P. Sauvant, and I am the Executive Director of the Vale Columbia Center on Sustainable International Investment, a joint center of Columbia Law School and the Earth Institute at Columbia University in the City of New York. It is an honor for me to testify before the US- China Economic and Security Review Commission.

Permit me, please, to focus my remarks on foreign direct investment (FDI), i.e. investment that gives a company headquartered in one country control over a company in another country – in this case, a Chinese company control over an enterprise in the US.

World FDI flows have grown from an average of $50 billion during the first half of the 1980s, to $2 trillion in 2007, before falling back to $1 trillion in 2009/10 as a result of the crisis.

Traditionally, the US has been the leading host and home country, i.e. the largest importer and exporter of FDI. Partly because of that, the US has traditionally been a leader in establishing a strong and open international

investment law and policy regime (IILP regime) that protects FDI and even encourages it, with the principle of non-discrimination at its heart. The reason is that FDI can play an important role in strengthening the competitiveness of firms and in economic development.

This approach has gained widespread support from virtually all countries of the world and has led to a strong IILP regime. And, as I said, the US has always benefitted from this regime, being the largest host and home country. FDI has brought capital, employment and various other tangible and intangible assets to the US and helped the country's economic growth and development.

It is therefore surprising that there is so widespread skepticism regarding Chinese FDI in the US. This is all the more surprising since this investment in very small indeed: official data show that inflows were around $1 billion in 2009. (US flows to China that year were $3.6 billion, rising to $4.1 billion in 2010.) With total FDI inflows into the US amounting to $129 billion in 2009, China's share was less than 1% of the total.

However (and this is atypical if compared with other countries), some 80-90% of outward FDI flows from China are undertaken by state-owned enterprises (SOEs). At the same time, though, there is little if any systematic evidence that SOEs – be they headquartered in China, Singapore, France, Germany, or any other country – behave differently from private MNEs when they undertake FDI projects abroad.

The skepticism regarding Chinese FDI in the US appears to be reflected in the fact that the share of filings by Chinese firms with the Committee on Foreign Investment in the United States (CFIUS) is higher than the share of Chinese FDI in total FDI inflows into the US. And, of course, cases like the aborted takeover of UNOCAL by CNOOC received considerable attention in China.

It is of course true that Chinese firms face considerable challenges when establishing themselves in the US and operating foreign affiliates in that country that have little or nothing to do with any skepticism regarding Chinese FDI. Rather, they are the results of the inexperience of Chinese multinational enterprises (MNEs) – after all, they became active in the world FDI market in a significant manner only since 2000, when China launched its "going global" policy. Chinese MNEs, like all MNEs, face the "liability of foreignness" challenge, i.e. the challenge of a foreigner operating in a foreign market; for Chinese firms, this challenge is particularly high, given the regulatory and institutional differences and gaps between China and the US. Chinese firms simply do not have the experience of how to become quickly accepted in a host country, as good corporate citizens that contribute to the economic and social development of the communities in which they are established. This disadvantage can be further accentuated by the "liability of the home country", i.e. that Chinese firms having established themselves in the US may be regarded differently than, say, British firms that have done the same.

Mr. Chairman, let me conclude by offering four recommendations:

1. The US should strive to maintain its role as a leader in establishing a strong and open IILP regime to make sure that the rule of law governs FDI between countries. In particular, the principle of "non-discrimination", the heart of the IILP regime, should be respected and promoted. The China – US bilateral investment treaty that is under negotiation may offer an excellent opportunity to further strengthen this principle.
2. At the same time, I suggest that the IILP regime requires some rebalancing to allow governments to pursue their legitimate public policy objectives regarding their own essential security interests – or, more generally, their national interests. But an effort should be made to define or at least circumscribe these concepts as clearly as possible, to avoid that they are being used for protectionist purposes.
3. Outward FDI from China has grown rapidly and is likely to continue to grow. (China was, in 2009, the world's 5th largest outward investor.) The US should seek to attract as much of this investment as possible. (Naturally, efforts in this regard would meet stiff competition from other countries that seek to attract

the same investment.) The US should welcome Chinese FDI; at the same time, Chinese investors (like investors from other countries) need to observe strictly US laws and regulations. Such an approach – by the US and other countries – would also contribute toward the further integration of China into the world economy and making that country a responsible stakeholder in it.

4. Given that China's MNEs are young and inexperienced, we should find ways of helping them to become good corporate citizens – not only to avoid unnecessary frictions but also to increase the contribution of China's FDI to the US economy and society.

By way of conclusion, Mr. Chairman, let me remind us all that we had a similar situation some 25 years ago when Japanese firms emerged as major outward investors. Like today vis-à-vis Chinese firms, there was a strong reaction against the new kids on the block in light of a range of concerns. In fact, CFIUS was created at that time and in reaction to incoming Japanese investment. The US managed to integrate and accept Japanese FDI and, in fact, is actively seeking, it. I trust that, over time, we will have the same experience with Chinese FDI in the U.S.

Thank you very much for your attention.

PANEL IV: DISCUSSION, QUESTIONS AND ANSWERS

HEARING CO-CHAIR WESSEL: Thank you, both, for your thoughtful testimony and appearance here today.

I'd like to ask a question, Dr. Sauvant, and, Dr. Rosen, for your comment as well--regarding the last point you made. The last experience we had with concerns about foreign investment, foreign direct investment, in the United States, in the 1980s, the Japanese seeking to address some trade irritants and trade issues decided that investing here was to their advantage, both for the market but also to address, of course, some political issues. But in doing so, because they were advocates or proponents of just-in-time manufacturing and a number of other things, they brought their supply chains over with it.

So Toyota, Nissan and others over time built here the supply chain to support their U.S. facilities. As I look at, and for your comment, as I look at Chinese investments here, for example, the solar facility they're building in Arizona, to hire 1,000 employees, it's primarily a screwdriver facility. So that the bulk of the value that is going into those panels, solar panels, is going to be produced in China.

So as we've seen with brand acquisitions, because Chinese don't have international brands, with their foreign direct investment, the question is are we seeing a different quality of investment from what the Japanese did, that they are trying to create, if you will, indigenous demand for Chinese products that will create jobs here, which we welcome, but not as many as if they were truly following market forces and creating the supply chains that I think are being globalized day by day?

DR. SAUVANT: This is actually a very interesting issue and has found a

lot of examination in the academic research. The result is that if you look at the typical internationalization path of a company, you find (at least in the past and to a large extent still today) that firms start by exporting, and then they start to establish maybe distribution facilities, then they start assembly facilities, precisely as you describe the Japanese as having done, and eventually they moved on to manufacturing.

The Japanese have long moved on to manufacturing. In fact, the concept of screwdriver investment was invented in the context of Chinese automobile investment in the United States that consisted of--

HEARING CO-CHAIR WESSEL: Japanese.

DR. SAUVANT: Japanese--excuse me.

HEARING CO-CHAIR WESSEL: Yes.

DR. SAUVANT: --assembly facilities in the United States. I would expect the same thing to happen on the Chinese side. In other words, they are testing the market. They are, to a certain extent, established through exports, either direct or as suppliers. I would expect that they more and more test the waters through assembly, distribution, and other investment. In fact, I understand that the biggest single foreign direct investment company from China in the U.S. is actually Cosco, which is a distribution or shipping company.

Now, can we encourage that process, can we speed it up? I guess we can. One of the things would be precisely to be more active in terms of attracting Chinese investment by pointing out where possibilities exist, where greenfield investment or perhaps even mergers and acquisitions are possible.

HEARING CO-CHAIR WESSEL: But China has for our investments, for example, as I recall, and the facts may be somewhat off, when GM created their facility in Guangzhou, as I recall, they made a commitment to source within five years 80 to 90 percent of the parts indigenously, and to, in fact, teach Chinese firms how to reach ISO-9000, 9001, and Sigma Six and all the various other requirements.

Should we have something similar here? I wish I had the faith that you do that the Chinese are going to follow the Japanese path of slowly migrating to creating their supply chains here. I fear that because they are a non-market economy, they are trying to create, if you will, the distribution centers, the assembly facilities, but the rest of the value chain is not going to come through.

Should we be taking actions to ensure that?

DR. SAUVANT: Well, the Japanese did not move on to full manufacturing because they wanted to do a favor to the United States. They moved on to full manufacturing because over time it became economically more sensible to manufacture here as opposed to manufacture in Japan and export to the United States.

Now as to the question of can one encourage Chinese firms that are

established here to make an extra contribution to the economy by, for instance, establishing a local content requirement? Certainly not by making it mandatory, because that would violate the TRIMs Agreement under the WTO, but there may be other ways of doing that. For instance--and this is being done by a number of the countries that are members of the WTO and therefore subject to the TRIMs Agreement--instead of saying you must source locally, they encourage firms to source locally, for example, by making sure that foreign affiliates find appropriate suppliers that can produce at the cost and quality that foreign affiliates require. There are a number of programs that we can pursue in this respect. I think that is certainly something where in the U.S., at the state level and perhaps even at the federal level more could be done, and perhaps not only vis-a-vis Chinese firms, but others as well.

HEARING CO-CHAIR WESSEL: Dr. Rosen, for a very quick response or?

MR. ROSEN: I would only add to it that, you know, bear in mind the phenomenon you're talking about was what we called "tariff jumping" by the Japanese, in the 1980s, where they were coming here because they already were making a lot of money off us. Our tariffs threatened that, and that's the only reason they were coming over, and so they basically brought the family with them to keep doing the same thing.

Very few Chinese companies are coming to America for tariff-jumping reasons yet. We have a few cases that might be described that way. Mostly, it's because China is very weak economically at, say, three-fifths of the production chain. They're good in manufacturing as an OEM in the middle, which is a commoditized part of what we do to create value in the world today.

All the things that the profit margin is found in Cupertino and elsewhere, they don't do, which is why they're coming, and so it would be, we have to be mindful not to over-extrapolate from the Japanese behavior in the '80s to what the Chinese will do in the years ahead.

HEARING CO-CHAIR WESSEL: Okay. Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman. Thank you both for your testimony.

I'm particularly interested in the question of the adequacy of the screening process that you commented on. There are those who have come to us consistently knowing that the trend has been in the last ten years for larger and more powerful SOEs on the part of the Chinese that have, of course, a direct relationship with state policy coming to the United States.

We have a screening process, some say, that because it's voluntary, that those SOEs or those companies that might be interested in finding national security technologies and so on would be the ones that most likely would not voluntarily participate in the CFIUS process, and therefore we should have a mandatory CFIUS process.

Do you think that a mandatory process is egregious in general, or if

it's an open process and there's no attempt to invade the national security arena, what would be wrong with an open process? I'm just wondering why you're saying--are you characterizing, recommending a mandatory process with politicization of that or is that simply just good governance to understand what it is that's coming in the country in terms of monitoring those things?

So I just wanted to clarify how you felt about that.

MR. ROSEN: Thank you, Commissioner.

Let me share my perspective on this. I think having the process be voluntary is advantageous from the perspective of the U.S. government and the United States. It places the burden on the Chinese investor to, you know, come to God with themselves about whether they are vulnerable to being unwound and shut down.

After they invest potentially billions of dollars in a transaction, they can be summarily kicked out of that investment and all that learning that they've transferred and everything they've done if they are in a sensitive area and they have not voluntarily asked for a stamp of approval from us.

If, on the other hand, we make it mandatory, then we have to investigate and certify every bubble gum factory and investment in a Dairy Queen that takes place in Peoria, and I don't think we necessarily want to do that.

The voluntary standard is only voluntary in that the company can choose to get precleared as not being in noncompliance. If they don't do that, then they are immensely vulnerable to what almost would feel like an arbitrary unwinding of their operations here.

So I don't think that the question of mandatory versus voluntary investigation of a Chinese investment prejudices the national security in that sense.

COMMISSIONER D'AMATO: Do you have a comment on that, Dr. Sauvant?

DR. SAUVANT: I just wanted to tell you a little anecdote. About two or three years ago when I was in China, I had a chance to meet with a fairly high level official of the Department of Commerce whose job was to attract investment to China. She got paid for that. And she said, you know, we are seeing CFIUS in the United States. If the United States as the most powerful country in the world, and the most powerful economy in the world, feels it has to screen foreign direct investment, what about us? Shouldn't we also look at incoming investment and see to what extent it helps us or hurts us?

And the same message, my guess is, is also sent to other countries. I'm not so much worried about that CFIUS might do something that may not be the proper thing, but I'm more worried about if other countries emulate the CFIUS model and other countries are doing it. China, in fact, earlier this year actually promulgated regulations establishing its own review process. That process may not be as clean as it is in the United States.

So I'm really wondering what kind of example the U.S. is giving in this area to the rest of the world.

COMMISSIONER D'AMATO: Thank you.

HEARING CO-CHAIR WESSEL: Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: Thanks very much and thanks to both of our witnesses for appearing today, very thoughtful testimony.

A couple of comments, and then a question. My first comment, Dr. Sauvant, is that one of the differences between Japan and China, of course, is the size of the population. Japan has about 127 million people. What--China is 1.3--teetering on 1.4 billion. They need to keep people employed, and they have a much greater number of people to keep employed than Japan ever did. So I think you need to factor that in when you think about will that old model fit.

A second point, and Dr. Rosen, this gets to something you were mentioning, which is narrative. The Chinese government, of course, builds its narrative as if they are the aggrieved party. And, frankly, I think certainly when dealing with the Americans, that provides them leverage.

The Chinese are choosing which leverage to go, which narrative to go with, in terms of their investment here in the United States, and they're going to get a whole lot more traction out of saying, "woe is us, you are not allowing our companies in," than if they said, "hey, this is fine."

I think you need to think about that as you think about narrative, but the point, the question actually I had, is that I want to go to this issue of the principle of nondiscrimination.

We have indeed had an international global regime where for the most part people have signed on to that idea. But what are we supposed to do when the second-largest economy in the world is not practicing that same thing? The analogy people like to say in different arenas is we're playing checkers and they're playing chess, and I just wonder how you see this all working out when we aren't even convinced that the Chinese government is interested in participating in the international economic regime under the same terms and conditions that other parties have?

DR. SAUVANT: Well, thank you for very interesting points. Let me just add another issue to the differences between Japan and China, apart from the size of the population and, therefore, the need to create employment, and, of course, part of this employment is being created through exports--which incidentally I understand President Obama is also trying to do. So that's something which is common.

Perhaps what is equally important is also that, of course, the strategic relationship between Japan and the United States in the '80s was different from what is the strategic relationship as a potential competitor between China and the United States. So obviously one has to factor that in.

But, in the end, it comes down, at least to a large extent, I would argue, to the following question: do we believe what we have been

preaching for 50 years, namely, that attracting foreign direct investment is good for you? It's good for you because it helps you to acquire capital, technology, skills, employment, exports and all the rest of it, and if that is true, if that still holds, then if another country says I don't want to attract investment, i.e., I like to shoot myself into foot, go ahead. It doesn't mean that we have to do the same thing.

So I think it really comes down to do we believe that foreign direct investment contributes to our development, both inward and outward foreign direct investment? Certainly what the Chinese seem to be doing more and more is that they are becoming much more selective in terms of saying that they want to have certain investment and give you special incentives for it. They also have a number of sectors, of course, which they say you are not allowed to invest in every country has such sectors. China has probably more sectors than others, but every country has its protected sectors. Then China has sectors that are open, and it has sectors in which it is encouraging foreign investment. And, of course, that means that the Chinese, too, agree that certain foreign direct investment–or actually most foreign direct investment--is beneficial to their own economy and economic development.

COMMISSIONER BARTHOLOMEW: Dr. Rosen.

MR. ROSEN: If I may, just to elaborate on the topic of narrative also, because it's really, it's the same point that Karl just rightly made. it has to do with what principles we believe we are defending, and where we get to the point where we say you know what, being a Boy Scout on this one is just going to get us killed, and so we're not going to be here tomorrow to debate this any longer, it's time to move on past that point of principle and be pragmatic in some way or another.

Well, most of the time there really is a choice to be made about which way we go; what kind of American economy we're going to have tomorrow?

Likewise, on the Chinese side, right now, there is a battle going on in Beijing for the soul of China's reform directions and the choices it make. Some people are saying we got where we got because we took a pretty liberal tact 30 years ago, and it's worked, and we were the most open emerging economy in the world to foreign direct investment.

And it meant our own guys got killed in competition, but we got rich doing that. We should stay that course. Others are saying look at what the Americans are doing, look at the way the world works, this got us 30 years, but it's time to take a different approach. Now, we consolidate the state's power in the economy and take advantage of that.

So the choices and the debates that are being held in Beijing right now are affected by what we do, by whether we're willing to stand by the principles we've developed and imbedded into the international system or not.

If we abandon ship of these kinds of liberal principles, I can assure you

it will not be missed in the debate taking place similarly in a hall like this in Beijing.

HEARING CO-CHAIR WESSEL: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman, and thank you both for being here.

I want to put this in the context. I read an article by Warren Buffett in October 2003 in Fortune magazine, in which Warren Buffett said that the United States by running these massive trade deficits year after year is going to sell the country out from under itself.

His view was when you send out these dollars, they're claims on your economy, and they come back by purchasing our economy.

Secondly, my understanding, Professor, is we don't have a lot of rules, global rules, on investment. We have the TRIMs Agreement in the WTO. I know we tried at one point to get an OECD multilateral agreement on investment, but that failed. So there's not a lot of global rules that govern this system.

So countries can do pretty much what they want to do in regulating foreign investment. Is that correct?

DR. SAUVANT: The principal instruments governing foreign direct investment internationally are bilateral investment treaties, of which are about 2,700.

COMMISSIONER MULLOY: Yes, these are BITs. Those are not global rules. These are countries that are agreeing to these rules among themselves.

DR. SAUVANT: Otherwise you have the GATS agreement, but that only applies to services.

COMMISSIONER MULLOY: Right. Okay. So that's my understanding. So there really aren't WTO rules except for the TRIMs, and that's a very narrow thing. So countries can pretty much do what they want to do in this whole area unless they are tied up in these BITs, and we don't have a BIT with China; right?

DR. SAUVANT: Correct.

COMMISSIONER MULLOY: In our own CFIUS process, we make a distinction between government-owned companies buying here and private sector companies buying here, a more searching analysis when it's a government-owned company buying here.

And then we further understand that many of the companies coming here from China are either state-owned enterprises. How would you guys look at Huawei? Is that a private sector company or is that a government-owned enterprise or a government-influenced enterprise? What your take is on that.

Dan?

MR. ROSEN: We treat it as a private company. Our definition is if a firm has 80 percent or more private shareholding, we treat it as a private

company even if there's up to 19.9 percent government shareholding.

In the case of Huawei, as you know, they claim that they're 100 percent employee-owned and have no government shareholding.

COMMISSIONER MULLOY: Right.

MR. ROSEN: So the question really becomes in the case of China, it doesn't even matter. Aren't all companies from China under the influence of the government of China, and they very much are to a greater extent than firms are here.

Exactly where you draw the line on government control may or may not be the useful thing to settle at the end of the day. But that's another subject. I don't mean to take up your time.

COMMISSIONER MULLOY: No, that's helpful. Now, my further understanding is that 90 percent of investment coming into the United States--and we're going to have a lot of it because we have a massive trade deficit. There are a lot of dollars out there which can now come back and buy assets. 90 percent of the investment coming to this country is acquisition investment; ten percent is greenfield.

Is that about what you understand the situation to be?

MR. ROSEN: I can speak to the China numbers.

COMMISSIONER MULLOY: No, I know you did that already. You said about half and half, I think. But my understanding, I was at a program the other day where an official from Commerce spoke, who was in charge of the investment; he said it was about 90 percent acquisition; ten percent greenfield.

DR. SAUVANT: Could be true.

COMMISSIONER MULLOY: Right? Okay. So it's not like it's adding new things. It's purchasing things that are already here that are now going to be owned by somebody else rather than here, and the profits then can go out of the country rather than stay here, which you ought to think about as well.

My understanding is that China has certain sectors of that economy that foreigners cannot own, so-called "pillar industries," and that these are large chunks of the Chinese economy.

Would you believe it's best to have a reciprocal investment policy rather than just we throw ourselves open and what they can wall off sectors of their economy? What's your impression of that, Dr. Rosen and then Dr. Sauvant?

MR. ROSEN: And for the record, my wife is Dr. Rosen. I'm a mere Mister.

COMMISSIONER MULLOY: Thank you.

MR. ROSEN: Well, Commissioner, as usual, provocative and important questions. I would say, and I believe, on the record, last time I was before the committee, I said that I would not embrace Communism if Communism were batting better in that inning.

And I continue to take that view, that things which appear strengths in

China today will come with a massive butcher's bill, which in a few years' time will change the story that we are currently engaged in.

I think marking China to market now and giving them a full credit for the performance of their economy today under state planning would be a mistake on our part. We should not, we should not do this transaction based on their current valuation.

We should consider where they might be in a few years from now and stick by our principal guns about capitalism, is where I am. As Karl put it, if somebody wants to bring bags of money and overpay for an asset in the U.S. or just pay a fair price, I'm willing to take it.

While 90 percent of the investment transactions may be M&A, remember that many of those are already owned by foreigners so they might entail a change of control by two foreign parties as in the Dubai Ports World case; right? It didn't entail a U.S. asset for the first time being held by parties abroad.

And then finally on this, in the Chinese case, one of the nice things about the Chinese data we have today is that there's a much greater propensity by the Chinese investor to do greenfield investment, in fact.

So those firms are not just buying existing assets. They're also building new facilities around the country. We'll see whether that reverts to the norm, as they say, and becomes more like the typical pattern we've seen from other investors as well, but there is some, there is some good positive aspects to the Chinese story as it's unfolding thus far, as well as the concerns which you rightly raise and which require much lengthier consideration.

COMMISSIONER MULLOY: Thank you.

DR. SAUVANT: If I may also comment on the very interesting observations. On the question of global rules, you're absolutely right, there are none apart from the TRIMs and the GATS Agreement.

But I would not underestimate the importance of the network of bilateral investment treaties and for that matter the additional 300 or so free trade agreements that have an investment chapter because they really involve all the big economies of the world, even if there is no bilateral treaty between the U.S. and China. I think we have the strongest international investment laws regime that we ever have had. That's one thing.

On the merger and acquisition question, if I had a choice to attract a greenfield investment or a merger and acquisition, as a rule, I would take a greenfield investment. No question.

But then it becomes more complicated. If the company I would take over is failing, maybe it's not bad if somebody else rescues it or if the foreign investor injects new technology, new export markets, and so on, it may make the company more profitable.

And, also, the money paid for the company that is being acquired, is

presumably then released for investment in other parts of the U.S. economy or abroad. So after all, these are resources that can be used for other things. So I'm only saying that mergers and acquisitions, which are the predominant form of entry of foreign direct investment worldwide, do have also certain aspects to them which makes them desirable.

On the question of if the Chinese close certain sectors to foreign direct investment, should we do the same thing here, I have the same answer as before. If we think that foreign direct investment in certain areas is not good for us, then obviously we shouldn't let it in, let alone attract it.

But let's keep in mind that our policy with respect to the rest of the world and with respect to the U.S. has always been, and I would say for good reasons, that on balance, foreign direct investment helps economic growth and development.

COMMISSIONER MULLOY: Thank you.

HEARING CO-CHAIR WESSEL: Commissioner Shea.

COMMISSIONER SHEA: Yes. Dr. Sauvant, you forgot to mention that M&A investment in the United States also enriches U.S.-based lawyers and investment bankers, which is another positive thing, I suppose.

[Laughter.]

COMMISSIONER SHEA: Two obviously very intelligent individuals. Even though you might not have a doctorate, Mr. Rosen, but you're obviously a very smart man.

I have two questions. One, we have focused on potential U.S. barriers to foreign-direct investment. I would like you to both talk about what holds the Chinese back? Dr. Sauvant, you mentioned that they have a recognition that their managerial class may not be prepared to move out.

I also understand that every investment, proposed investment, by a Chinese company overseas has to get regulatory approval within China. I don't know if that is correct, but some sort of preapproval--if you could talk about that as a potential barrier.

And, then, finally, the other question I'd like to ask you--Mr. Rosen, you alluded to it at least--about the health of the Chinese economy. We had a little discussion this morning with Barry Naughton and Derek Scissors, and the notion was that there is such a misallocation of capital in the Chinese system. It's incredibly inefficient, and that the state dominance in the economy is ultimately unsustainable. I was just wondering if you have any comments on that?

MR. ROSEN: Thank you very much.

COMMISSIONER SHEA: Sure.

MR. ROSEN: Of course, companies going offshore creates almost as much work for U.S. lawyers as well. So they make money no matter what happens; right? Up market, down market.

In terms of what's holding Chinese companies back, well, the first part of my punch line that I want to make sure is driven home is that we can say

that actually nothing is holding them back anymore. That the notion that's become ingrained that somehow the Chinese are being held at bay is not correct.

America is welcoming foreign investment, direct investment, and we're open to and welcoming of Chinese foreign direct investment in the United States; hence, it's growing 130, 150 percent year- over-year for years on years in a row now.

So that's the new story, and now it's time to understand why that's now happening and it wasn't happening before.

But we still are talking, you know, early days, and the things that still make it difficult for Chinese firms to do this are, first and foremost, as a senior Politburo official said to a Chinese company two years ago, you don't even speak Mandarin. He said this publicly to the CEO of the company. How the hell do you expect to go to the United States and speak English?

You don't even know what a sexual harassment lawsuit from an employee is. How are you going to go to America and try to do business?

So the cultural issues, the burden of operating in a heavily regulated, mature, sophisticated economy, where there is full tax reporting expected of you, and you don't keep two sets of books, that's no small burden, and the Chinese firms that have been able to make the jump so far are really, in many cases, to be lauded.

Harvard Business School is doing case study work on Wanxiang, for example, to understand how they're getting over these tremendous hurdles to doing business in America when their home market is so alien to the marketplace, to the marketplace here.

Just another ten seconds on the regulatory, outbound regulatory burden they face. Until two or three years ago, despite all the pronouncements about go global, there were big regulatory hurdles for Chinese firms getting the-- especially the conversion of renminbi to dollars they needed to make outbound investments.

That, by and large, has been changed over to just a reporting requirement rather than a permission requirement. So up to, I think $100 million outbound investment now, Chinese firms are supposed to be able to just notify rather than get approval.

In practice, of course, if it's a state-related company, it's not going to get out of bed in the morning without making sure that that's what everybody expected them to be doing. But that's another part of the story.

DR. SAUVANT: I would also like to underline the importance of the lack of relative experience of Chinese companies in terms of international markets, and Dan has given some examples.

It's extremely difficult to make a merger and acquisition work. Think about it. Daimler Benz, not exactly one of the newest companies in the world, made a total mess out of its acquisition of Chrysler, and that was an experienced company.

So any Chinese firm--the CEO may not even be able to speak English--establishing itself in the United States, either through a greenfield investment or through a merger and acquisition, faces tremendous difficulties simply in terms of doing it and operating in this highly sophisticated and competitive environment.

In fact, one of the fears I have, given the climate, is that you have a major merger and acquisition by a Chinese firm going through, but then it goes busted. Everybody would jump on it and say, "you see"--and you fill in the dots. I think that is something where, again, we have a role to play, through our law firms, through seminars, through various mechanisms to help foreign companies, in this case, Chinese companies, really understand what it takes to operate here in the United States.

HEARING CO-CHAIR WESSEL: Thank you.

Chairman Reinsch.

CHAIRMAN REINSCH: Thank you.

I want to commend our panelists. I think you're both very wise. That is because you agree with me.

[Laughter.]

CHAIRMAN REINSCH: But in any event, I commend you on your wisdom. I think one of the things that's coming out here that you both made reference to is that it's probably useful for us to think carefully about how we proceed in this area because whatever we do to the foreigners is almost certainly going to be done to us.

Dr. Sauvant, you talked about the international regime, when it comes to control, these issues, TRIMs and what not. Can either or both of you comment on the extent to which or how many other countries or what other countries contain national CFIUS-like devices to control incoming investment?

Is this unique? This is not a unique phenomenon to the United States, I think.

DR. SAUVANT: Let me respond on two levels. If you look back 30 years or so, what you had in quite a number of countries were screening mechanisms for foreign direct investment, particularly in developing countries but also in a number of developed countries.

All of those were eventually turned into investment promotion agencies to do exactly the opposite. With the establishment of CFIUS in the late '80s, arguably, you could say that the trend is being reversed and we are going back to some screening because the example of CFIUS was followed by clarifications in Canada and in Australia; changes in the law in Germany, in France, in Russia; and now, well, China has its own approach toward reviewing mergers and acquisitions and a national security review.

So you have the reintroduction of screening mechanisms. What is ironic is that the United States, which had been the leader in liberalizing investment regimes and establishing a strong international investment law

regime, has become the leader of sorts in terms of reestablishing some sort of screening.

I'm not too worried about what the United States does because it's being done maybe not in an entirely transparent fashion because you don't really know what's happening within CFIUS, but I think it's a fairly clean process. But I'm not so sure that other countries having the same or similar institutional set-up will also proceed in the same clean manner as the U.S. does.

CHAIRMAN REINSCH: That's a good point. Dan mentioned losing control of the narrative, if you will, earlier. This is an area where I think the narrative has also changed. For 40 years, the narrative was how can the United States best protect the interests of its investors overseas from expropriation, arbitrary treatment, seizure of assets, et cetera, et cetera?

Over the last few years, aided in part by sovereignty concerns that the Bush administration Justice Department had, the narrative has become how can we protect ourselves from the foreigners, which is a very different narrative.

And for people that are engaged in foreign, U.S. outward investment, and think it's win/win in terms of job creation here and there, it's kind of a disturbing trend in the narrative.

Let me ask a question also for Dr. Sauvant. One more. You had a very interesting explanation of the transition from exporting to sales operations, assembly facilities, manufacturing, and you used Japan as an example.

I think that's an apt example and a good narrative. It seems to me that the Japanese case, all that was compressed in a relatively short period of time, and I think, as my colleague here would probably agree, partly for political reasons. Do you see that time period being that short in the case of China?

DR. SAUVANT: That's difficult to say. But certainly I would advise, and I have done so, Chinese companies that seek to invest in the U.S.--and everybody wants to invest, everybody I speak to in China says we want to get into the United States market to take the Greenfield approach Also, there seems to be now a bit of an increase in interest to invest in Europe, apparently at least in part in reaction to incidents in which Chinese investment in the U.S. have been stymied.

I certainly advise any Chinese firm if it has a choice, to take the greenfield route as opposed to merger and acquisition. That's clear. Given the speed with which everything happens these days, I would expect that the process in the case of China in terms of moving from exporting to actually manufacturing in the U.S. might go faster, maybe not much faster, than the case of Japan.

CHAIRMAN REINSCH: Thank you.

DR. SAUVANT: It's strictly a guess.

HEARING CO-CHAIR WESSEL: Commissioner Wortzel.

COMMISSIONER WORTZEL: Dr. Sauvant, I really enjoyed your anecdote about the Chinese commerce official, and I'd like to give both of you two back.

I have an article in front of me from the Los Angeles Times, provided by our staff here, and there's an interesting story about Shanghai Jinjiang International Hotel, a state-owned company, buying joint ventures in hotels here in the United States.

I've been traveling in and out of China since 1979, lived there for five years, stayed in loads of Jinjiang Hotels as a military officer, as an academic, and I have never been in a Jinjiang Hotel where I wasn't given a room in the northeast quadrant of the hotel on an upper floor, and I have never been in an Jinjiang Hotel where I didn't have very heavy technical audio and video surveillance, and physical surveillance when I left my hotel, and where everything I brought with me wasn't searched.

Now, that says to me that there's an awful lot of cooperation going on between Chinese intelligence services and the staff of the Jinjiang Hotel. So I don't think that it's incendiary politicization if I feel that when I know Jinjiang is buying hotels in the U.S., the FBI begins to look at who Jinjiang is putting into the United States. I think that's prudent security concerns about the practices of Chinese intelligence and security services.

Second anecdote. I used to follow fairly closely the General Political Department of the People's Liberation Army. It has two objectives. One, generally U.S. policy, influencing U.S. policy toward Taiwan and checking on what Americans think about China.

So when the General Political Department formed a real estate company--it was called Kaili-- and Kaili Real Estate immediately opened offices in Atlanta, and within a very short period of time, suddenly, students from China and Taiwan at universities in Atlanta were being watched by people who worked for Kaili.

So I guess I'd say to you that that's two anecdotes, but if you are seeing a country with such deep influence over its citizens because it has this dominant single party, and you've observed practices like that, isn't it just prudent to take a little harder look at China than Japan, which was an ally and a member of CoCOM?

MR. ROSEN: I'm not sure if that was directed to me or Dr. Sauvant.

COMMISSIONER WORTZEL: It was not directed to anybody.

[Laughter.]

MR. ROSEN: You quoted back some of my verbiage about incendiary politicization so let me make a comment in response.

I understand your reaction to that characterization. However, in my remarks, you won't find anything that suggests in any way that we should lighten the scrutiny of Chinese investment in the United States.

In fact, as you know, Commissioner, the FBI would in no way ever be able to scour through a Jinjiang facility in China because it's in China, and

the FBI can't do that.

I love the thought of having MSS- controlled assets in the U.S. subject to U.S. law enforcement, surveillance. It's against the law to privately spy on U.S. citizens without court authorization to do so.

So let's remember that the foreign direct investment screening process that we have evolved over the decades has a singular purpose: to identify specific national security threats. It is not meant to ensure that a company is going to obey U.S. national, state and local laws, regulations and code once they get here.

They are still obliged to do so. And espionage is very much against the law of the United States. That firm, if it were so easy to identify people tailing you coming out of Jinjiang Hotel in San Francisco, great, because we're going to round up an awful lot of assets very quickly and put them in U.S. jail.

So I think because there are so many other things that could be on the shoulders on the national security screening process, if we went down that road, I think we ought to expect it to do its part, which is to identify specific threats from a transaction, and then count on U.S. counterintelligence law and all the other things that we need to do to make sure that once the Chinese investors are here, they are not conducting espionage under the guise of commercial activity.

I feel, I, like yourself, but not to as great an extent, have every reason in the world to want and insist upon particularly careful scrutiny of Chinese investors in the United States.

DR. SAUVANT: I agree. I agree entirely with what Dan has said. All foreign investors have to obey by the laws and regulations of the United States, period. And that includes laws regarding espionage or anything else, and one has to keep a close eye on these matters.

To come back to my analogy with Japan, Japanese firms did not know much about nondiscrimination at the workplace, and one case actually went all the way to the Supreme Court. So what has to be done is to enforce the laws and regulations of the United States vis-a-vis all foreign investors, including, of course, Chinese.

HEARING CO-CHAIR WESSEL: Vice Chairman Slane.

VICE CHAIRMAN SLANE: Thank you.

One of the concerns that I have about Chinese foreign direct investment is that many Chinese companies have no or little source of capital expense, and let me give you an example. There's a company that was just started in China that is in the imaging business in which they are producing CAT scans, and the Chinese government funded the start-up of this company to the tune of $42 million.

The company had essentially no cost of capital. They now want to come into the United States and compete with General Electric and other companies that make imaging equipment in the United States. They told me

that they are able to sell their imaging equipment at half the price of General Electric's, and their equipment is comparable.

These subsidies given by the Chinese government seem to give them such an unfair advantage to ultimately dominate these industries. Is that of concern to either of you?

MR. ROSEN: This is a really important question you ask. I'm awfully glad it came up. Traditionally, our stance as far as inward direct investment to the United States has been that if the investing party has preferential access to capital or something like that back home, that's all to the good for us. The seller of a U.S. asset is going to get overpaid or paid more than they would otherwise get paid by that.

The problem would arise if a country with a distorted cost of capital, let's say, were not just a price taker in the world market where he could use that advantage to snap up a few companies, but was so big that they were going to distort pricing worldwide and kind of poison the way that markets are supposed to function; right.

If that's where we're going, then indeed we have a profound sort of problem which our whole kind of jurisprudence and history around this issue has never really had to address.

The case of Japan, there were concerns about the cost of capital that Japanese firms enjoyed by virtue of the nature of Japanese corporate structures, but in the case of China, it's an even larger phenomena which some people are concerned might eventuate.

For the time being, as Dr. Sauvant and I pointed out, Chinese direct investment in the United States is less than one-tenth of one percent of the total. So in no way can Chinese inflows be said to be distorting the functioning of markets in America now.

Ultimately, if that, presumably for that company to continue to enjoy its advantage vis-a-vis American producers, they will be importing to the United States the CAT scanners they're making in China, and they would be, they would be vulnerable to dumping or CVD at that point.

If they somehow got their intermediate inputs here under antidumping barriers, under different tariff lines, and assembled them here, the screwdriver case, then we get into that discussion about whether that is ultimately going to screw up the offsetting positives from generally being open to Chinese investment.

DR. SAUVANT: This is actually a very interesting question, and it could be expanded into other directions, namely, to what extent one offers incentives to foreign investors to come in? But I think what might eventually be an answer to that issue, if it is indeed widespread or becomes more widespread, would be that one would have to see to what extent one could have a sort of international agreement rewarding subsidies, in this case not for trade but for foreign investment.

But it's highly tricky, and subsidies are not only given by the Chinese

government to foreign investors, but by many European governments in all sorts of ways. And there is, as I mentioned, the question of to what extent do you subsidize inward foreign direct investment by actually providing all sorts of incentives?

The only problem is that when these issues were discussed in the WTO, or even in the OECD context, very few countries wanted to do anything about them because they wanted to keep their hands free in order to use incentives in both directions if and when they thought that would make sense.

HEARING CO-CHAIR WESSEL: Are there any other questions on the first round? If not, we have three for the second round, and since we only have a couple minutes left, if they could be very quick.

Commissioner Bartholomew, myself, and Commissioner Mulloy.

COMMISSIONER BARTHOLOMEW: Yes, I think it's probably more of an observation than a question this time around, but it seems to me, and this won't surprise my esteemed Chairman at all, that I actually disagree with him. And it strikes me as interesting that we are supposed to--

CHAIRMAN REINSCH: Oh, I'm shocked.

HEARING CO-CHAIR WESSEL: Chairman of the Commission, not the chairman of the panel.

COMMISSIONER BARTHOLOMEW: Yes--that we are supposed to accept the idea that what we do to them, they will do to us, but that we aren't allowed to accept or supposed to accept the concept that what they do to us, we will do to them, which, of course, is at the heart of a lot of this nondiscrimination we're talking about or reciprocity that we're talking about.

But for me there's a fundamental question about the paradigm. I think you both accept this paradigm that the way things have worked in the past on trade, they will work in the future. But I think when you have to look at the facts on the ground, that it's not working for the hundreds of thousands of American people who have lost their jobs because of the way that this global trade regime has been defined.

And, Mr. Rosen, I think we probably disagreed ten years ago. We very well might disagree ten years from now, but I think what troubles me a little bit listening to both of you is there's a distinction between the way things should work and the way things are actually working.

I guess I would say if you can address that there's a difference between theory and practice, and what I am really concerned about is the outcome, the results on the ground.

MR. ROSEN: Let me just say, because it is one reason why I embraced the opportunity to be with you today, that the singular objective of this piece of work that I previewed, which will be out in a month or so, is to accurately illustrate what's happening on the ground in real terms, that the issue you're grappling with as Commissioners, what's the significance of

Chinese direct investment in the United States, you have no idea. You have no idea. You are operating in the dark right now.

I promise you and I assure you that that's what you are doing. The best that you might have is data from 2008, which partially captures some of what China did previous to that year for the most part.

I am quite dedicated, in fact, to using the best available quantitative and qualitative methods to shine greater light on the actual trends taking place in the marketplace today in terms of real concrete investments in America.

You've got concerns with the global trading system, and I share some of them, in fact. For today, though, I really was confining the implications of my remarks not to the global trading system but to Chinese direct investment, M&A and greenfield, in the United States.

COMMISSIONER BARTHOLOMEW: That's fair.

DR. SAUVANT: If I may make just a very quick comment on your observation that hundreds of thousands of Americans have lost their job or have no job. In order to change that, the only way is more investment. If you get the investment from at home, absolutely fine. But if not, then I think you should take it from abroad: the investment dollar from China is as green as the investment dollar from France, provided everybody works within the system and applicable laws and regulations.

The bottom line of that is, and I go back to something that Dan also said, that the U.S. should make a bigger effort to attract investment from abroad, in general, and including China. That's where the investment is coming from. During the crisis, world investment flows declined by 50 percent. Outward investment from China remained level, and it will increase. That's where the investment dollars are. If U.S. is not going to get it, the Europeans are going to get them, and others will get them. They'll be happy if you scare the Chinese away.

COMMISSIONER BARTHOLOMEW: Thank you.

HEARING CO-CHAIR WESSEL: Thank you, gentlemen.

Mr. Rosen, we are looking forward to your discussion, your paper coming up. I can assure you we do look at this very carefully. We are not traveling in the dark, and there are a lot of facts and specific circumstances which economists are not necessarily aware of. So the trends you refer to do not always identify all the facts and specific instances.

I want to question whether there's a fundamental disconnect here because what you two are talking about and others have talked about is based on economic theory that relies on market forces. We heard earlier today on the SOEs in terms of the size of their involvement in the Chinese market. Many of the companies coming here, and you both identified the trends, coming here are state-owned, state-invested, state-influenced entities, and China is not a market economy.

So they are not responding by definition to all the market forces/all

the market signals that one would expect. It seems we're all hoping that China will be like us, but the trends over the last three years are for the strengthening of the state sector, not weakening, not their greater response to market forces, but just the exact opposite.

We see firms like Huawei and others coming here that are heavily subsidized, are state-controlled, even though they profess private ownership, and our security officials are responding appropriately to make sure that we have the proper screen. We want the foreign investment, but we should have some kind of scrutiny as it relates to governmental control and governmental involvement. This is not market-based investment, the large portion that's coming here.

Can you respond to that, the market signal issue?

DR. SAUVANT: Well, if I may start, very briefly, yes, one needs, at least to a certain extent, a mechanism that exercises some scrutiny concerning state-controlled entities that invest abroad. But it needs to be done in a nondiscriminatory manner, in other words, not only regarding China but also everybody else.

HEARING CO-CHAIR WESSEL: Singapore, Vietnam, you name it.

DR. SAUVANT: And so on.

HEARING CO-CHAIR WESSEL: Yes.

DR. SAUVANT: Yes. And if it is done--and this is where I see the biggest problem--if it is done within a framework which is clearly defined so that it cannot be misused for other purposes, especially protectionist purposes.

It's extremely difficult, of course, to establish such a framework, but it is needed because otherwise the predictability which the current international investment law regime provides will be impaired, and nobody benefits from that, least alone the United States.

One more thing about the possibility that state-owned enterprises act potentially on political impulse more than on commercial impulse. This seems to be something that one would expect on the face of it, at least to a certain extent, never mind whether state-owned enterprises are Chinese state-owned enterprises or French or German ones. But show me a few cases where a state-owned enterprise undertook a greenfield investment or a merger and acquisition that wouldn't have been made by a privately-owned enterprise in the same industry. In other words, what I am saying, is it's extremely difficult to show, and certainly for a number of cases, that state-owned enterprises are following political objectives as opposed to commercial objectives. On the surface, one would think so, but where is the evidence?

HEARING CO-CHAIR WESSEL: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you, Mr. Chairman, and thank you, again, both for being here.

An observation first. The United States at one point was the largest

creditor nation in the world, and we were looking to invest abroad, and we pushed these open investment regimes. The United States because it's run massive trade deficits year after year is now the largest debtor nation in the world, and that title is fast increasing because we're continuing to run massive trade deficits year after year.

So those dollars that are out there are claims on the American economy, and they can go back and buy portions of our economy.

Mr. Rosen, you say on page one of your testimony that you're going to talk about direct investment, and that's that very small portion you talk about.

There's also portfolio investment. China now has a sovereign wealth fund, which is a government-owned hedge fund essentially, which can buy chunks of American companies. My understanding is they bought about ten percent of Citibank, ten percent of J.P. Morgan, and ten percent of Morgan Stanley.

We've traditionally not wanted our own government owning big portions of the American economy, and that's why we're all upset that the Obama administration somehow ended up owning GM. I know that Mr. Cox when he was Chairman of the SEC talked about this problem. And he testified on sovereign wealth funds as being different. Mr. Bremmer has written a very interesting book about state capitalism, makes the same point.

Can a foreign government when it owns ten percent of a very influential political entity like J.P. Morgan, can that buy political influence in this country in terms of how we perceive of a lot of these issues? That's a new worry that some people have. I want to get your judgment on that. Is that something we should be worried about?

MR. ROSEN: So the CIC transactions that you spoke of are classed as portfolio investment in the United States. They came up at 9.9 percent or so ownership stakes, intentionally stayed south of the ten percent threshold so they would not be direct investments.

On the other hand, CIC last year took a greater than ten percent stake in AES Energy in the U.S. energy and infrastructure space south of the river in Virginia. That is a direct investment.

In all those cases, in both sets of cases, however, direct and indirect, CIC is investing in an extremely passive manner. If they knew how to be a direct investor in the United States, then they would work more independently. They are far more inclined to provide mandates to manage some of the dollars they've been tasked with putting to work to U.S. investment companies to help them do that.

There is, of course, the concern and danger that a sovereign wealth fund might try to, in addition to delivering a positive return on investment so that it's not embarrassed back home for squandering the country's wealth, which is CIC's real anxiety that keeps it up at night, that somehow a

government might to try to express some political intention through the fund managers who used to work on Wall Street and got recruited back to Beijing to staff CIC. That's extremely difficult to imagine that conspiracy to be an agent of influence in Washington working its way in through CIC's behavior.

Nonetheless, it's a concern. There are agents of foreign influence law. Again, I come back to not trying to ask the poor fellows on CFIUS to anticipate how an organization that might be government-related will behave in the future, but instead let's make sure we screen for discrete national security risks, and then we have domestic law, including national security law domestically, that monitors the behavior of foreign entities here to make sure they don't behave in a manner disadvantageous to the United States.

HEARING CO-CHAIR WESSEL: Thank you.

COMMISSIONER MULLOY: Thank you both.

HEARING CO-CHAIR WESSEL: That's the end of today's hearing. I want to thank our staff, Paul, Nargiza and Lauren, for their help in setting this up--and others who were involved. We appreciate it, and we stand adjourned until our next hearing barring a government shutdown.

[Laughter.]

[Whereupon, at 2:37 p.m., the hearing was adjourned.]

***

CHINESE STATE-OWNED ENTERPRISES AND U.S.-CHINA BILATERAL INVESTMENT

HEARING

BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

MARCH 30, 2011

Printed for use of the
United States-China Economic and Security Review Commission
Available via the World Wide Web: www.uscc.gov

UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

WASHINGTON : 2011

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

The Commission was created on October 30, 2000 by the Floyd D. Spence National Defense Authorization Act for 2001 § 1238, Public Law No. 106-398, 114 STAT. 1654A-334 (2000) (codified at 22 U.S.C.§ 7002 (2001), as amended by the Treasury and General Government Appropriations Act for 2002 § 645 (regarding employment status of staff) & § 648 (regarding changing annual report due date from March to June), Public Law No. 107-67, 115 STAT. 514 (Nov. 12, 2001); as amended by Division P of the "Consolidated Appropriations Resolution, 2003," Pub L. No. 108-7 (Feb. 20, 2003) (regarding Commission name change, terms of Commissioners, and responsibilities of Commission); as amended by Public Law No. 109-108 (H.R. 2862) (Nov. 22, 2005) (regarding responsibilities of Commission and applicability of FACA); as amended by Division J of the "Consolidated Appropriations Act, 2008," Public Law No. 110-161 (December 26, 2007) (regarding responsibilities of the Commission, and changing the Annual Report due date from June to December).

The Commission's full charter is available at www.uscc.gov.

CONTENTS

WEDNESDAY, MARCH 30, 2011

CHINESE STATE-OWNED ENTERPRISES AND
U.S.-CHINA BILATERAL INVESTMENT

PANEL I: CONGRESSIONAL PERSPECTIVES

PANEL II: STATE-OWNED ENTERPRISES IN CHINA

PANEL III: U.S. INVESTMENTS IN CHINA

PANEL IV: CHINEST INVESTMENTS IN THE UNITED STATES

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD