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Chinese Technology Acquisition Is Not About Investing In the US

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One-page Highlights

The Foreign Investment Risk Review Modernization Act (FIRRMA) is vague with regard to the "critical" technology, materials, and infrastructure to be shielded, vagueness the business community rightly finds worrisome. Investors are generally averse to uncertainty, for instance a justified but as yet unstated mandate to protect personal data. And CFIUS is not a magic wand to wave at the economy or even just foreign investment. It is a considerable challenge just to engage in CFIUS reform that better protects national security while not causing economic harm.

However, some approaches to CFIUS reform do not seem to take the Chinese threat to national security seriously. There has been discussion of time limits on a reform bill, as if the PRC will change its mind about acquiring foreign technology in 2026. Rather than sun-setting CFIUS reform, the emphasis should be on speeding it up, given that technology loss has occurred for many years and the harm to national security is ongoing.

The evidence shows Beijing engaged in a global campaign to offer money to achieve its aims, in part by simply buying foreign assets but also using such tools as below-market lending when there is no formal PRC ownership. Direct Chinese acquisition of technology through investment in the US has always been minor in scope and is probably declining. Yet IP theft has remained heavy, extending first to cyber and later to personal data. Export controls to date have not been effective. And the Chinese government's goals are certainly unchanged – it believes it can continue to acquire desired technology despite minimal technology investment in the US.

Taking the Chinese threat seriously thus means investment review cannot only occur here. A stricter process here will just relocate the entire problem of PRC technology acquisition elsewhere, rather than most of it being located elsewhere, as is the case now. The Trump administration might expand the national security review process, since Section 301 explicitly targeted the coercion of American companies using access to the Chinese market. But even if the administration does do so, a law passed by Congress is much preferable to executive order.

Finally, with regard to export controls, the existing regime has failed to inhibit China's global acquisition of technology. It's certainly reasonable to argue that better export controls can play an important role, keeping CFIUS from discouraging investment or being overstretched. However, improved export controls must be actionable, not merely asserted as the superior option. The Export Control Reform Act of 2018 (H.R. 5040) is a positive step, but any progress toward its passage should not be used to justify more delay in upgrading CFIUS.

Chinese Technology Acquisition Is Not About Investing In the US

It may seem contradictory for bills restricting foreign investment to open with findings of its benefits. But that is the right framework – foreign investment has spurred innovation and created jobs in the US. It follows that any policy changes should, as much as possible, be applied with scalpels rather than sledgehammers. Even if the US were to go to the extreme of banning investment from a country, it would be wise to minimize the impact on other foreign investors.

All of this applies to our most controversial economic partner, the People's Republic of China (PRC). In 2005, China started investing sizable amounts of money overseas, including here.[i] At that point, the policy environment shifted. The US faced a security competitor with money and (eventually) had to weigh on a much larger scale the economic gains from investment against national security risks. The trade-off was not immediately apparent because the next decade was calm, the amount of Chinese investment in the US and its perceived risk remaining moderate.

In 2015, however, Beijing twice surprised American decision-makers. It announced the now infamous "Made in China 2025" development plan, where long-standing practices of technology acquisition and heavy subsidies were aimed for the first time at advanced sectors like robotics. Then it unintentionally triggered a surge of money out of the PRC, with one consequence being soaring Chinese investment in the US in 2016.[ii] These changes added fuel to political-military differences in the South China Sea and elsewhere, prompting US consideration of new policies.

In the process of crafting new policy, Congress and the administration should start with the premise that China is a unique challenge. This is not only accurate (there is no Made in Canada 2025), it will make for sharper choices. Restrictions imposed on the PRC should not be imposed on others due to vague language like "countries of special concern."[iii] Beyond that, restrictions on the PRC should be crafted to actively minimize the impact on everyone else. The US should seek to prevent Beijing from acquiring technology and other assets that pose a national security risk, while minimizing economic harm to ourselves and our partners.

The difficulty lies in that sweeping action is needed to limit China risk to national security. The PRC does not just acquire technology by investing in the US. In fact, independently compiled data show no large-scale acquisitions of advanced technology through Chinese investment in the US. All Chinese investment in the US, including technology, has slowed sharply in the past 18 months. Yet Beijing has hardly renounced its industrial policy aspirations or methods.

Chinese technology acquisition via theft, both cyber and conventional, calls for preventive and punitive American responses. The other major avenue for Beijing to acquire technology is business transactions outside the U.S. especially in the PRC itself While the benefits of investment mean great care must be exercised, *Chinese technology acquisition cannot be controlled without restricting US investment in China and ventures with Chinese entities elsewhere*. Among other things, this observation is the foundation for the Trump administration's well-justified Section 301 inquiry into the PRC's coercive practices.[iv]

The last requirement for useful policy, including all bills to reform the Committee on Foreign Investment in the United States (CFIUS), is far less controversial but even more vital. Whatever Congress decides must incorporate the needed budget and staff, or it is little more than posturing.

China's Global Footprint

The limited role played by the PRC's technology investment in the US proper becomes evident through comparisons utilizing the China Global Investment Tracker (CGIT) from the American Enterprise Institute, the only fully public record of China's outbound investment and construction.[v] The CGIT lists all verified investment and construction transactions worth $100 million or more from 2005 through 2017. It is updated every six months and features over 1300 worldwide investments totaling more than $1 trillion.

The CGIT shows China's 2017 global investment rising 8 percent, driven by the $43-billion acquisition of Swiss agro-tech giant Syngenta (see table 1). Absent this one deal, spending would have fallen 17 percent. The total number of investment transactions slid in 2017, as did outlays in many countries and sectors. But the top CGIT story was change rather than decline, change to

larger deals made by state-owned enterprises and new sectors, such as logistics. This led to heavy Chinese investment in Britain, for example.

From 2005-2016, the annual gap between CGIT investment data and those published by China's Ministry of Commerce (MOFCOM) was below 10 percent. In 2017, the numbers diverged. MOFCOM last year reported a 33-percent spending drop, purporting to curb "irrational" investment after a record-setting 2016.[vi] The ministry does not disclose individual transactions but direct queries and its monthly figures indicate the bulk of the Syngenta deal was not counted, on grounds it was financed outside the PRC. This is unlikely and, in any case, yields the dubious result of excluding China's biggest-ever foreign acquisition. It's always possible for some deals to be placed a year earlier or later but MOFCOM's 2017 total is unreasonably small.

Table 1: Two Views of Chinese Outward Investment ($ Billion)

	CGIT	**Ministry of Commerce**
2005	10.2	12.3
2006	19.8	21.2
2007	29.9	26.5
2008	54.7	55.9
2009	57.6	56.5
2010	65.5	68.8
2011	68.8	74.7
2012	80.3	87.8
2013	83.8	92.7
2014	104.3	107.2
2015	113.2	121.4
2016	170.4	181.2
2017	185.4	120.5
Total	1044	1037

* Sources: American Enterprise Institute, China Global Investment Tracker, January 2018 update, http://www.aei.org/china-global-investment-tracker; National Bureau of Statistics of the People's Republic of China, State Administration of Foreign Exchange, 2016 Statistical Bulletin of China's Outward Foreign Direct Investment, China Statistics Press, September 2017; and Xinhua, "China 2017 FDI rises to record high, ODI falls," January 16, 2018, http://www.xinhuanet.com/english/2018-01/16/c_136900334.htm

Prior to 2017, the main problem with Chinese numbers has been a national policy to treat Hong Kong as an external port. Funds flow through on the way to their final destination but MOFCOM is required to stop following them in Hong Kong and Hong Kong is then assigned more than half of Chinese outward investment. Other bilateral numbers, such as for Chinese investment in the US, can therefore be far too low. The CGIT follows money to the true recipient country.

In the first quarter of 2018, MOFCOM may be compensating for its exaggerated 2017 decline, boasting of a 24% investment increase.[vii] The as yet unverified CGIT total for the first quarter is close to the raw MOFCOM number, with a different growth rate due to the different base number. This suggests the ministry has declared success in its loud, politicized rectification campaign and is again willing to report accurate figures.

In many countries, Chinese construction trumps investment. Construction services are provided in the host country but do not involve ownership. The CGIT covers China's global construction with almost 1400 projects totaling over $700 billion. Construction of power plants, rail lines, ports and so on is the heart of the well-known Belt and Road Initiative and there are more large ($100+ million) construction deals than large investments.[viii] PRC construction is not important in the US. But Beijing's pattern of winning influence through financing and executing construction projects without any equity stakes bears directly on American policy choices.

Investment and construction dollars do not have the same economic value but combining them illustrates the PRC's range. Investment is concentrated in developed economies and construction in developing. Chinese companies thus have a presence in every corner of the globe, including places and activities most multinationals shy from. An illustration: 20 countries have received at least $20 billion in investment or seen $20 billion in Chinese construction since 2005.

Table 2: China's Sector Patterns, 2005-17 ($ Billion)

Sector	Investment	Construction	Troubled
Energy and power	354.8	310.6	117.6
Transport	95.1	230.1	44.4
Metals	123.9	32.4	74.9
Real estate	97.7	70.0	19.1
Agriculture	79.5	16.7	10.9
Finance	75.2	-	36.5
Technology	51.1	15.6	27.7
Tourism	36.3	6.6	7.4
Entertainment	38.8	2.0	1.6
Logistics	33.0	4.5	1.0
Chemicals	11.7	14.3	1.9
Other*	47.8	33.7	5.0
Total	1044	736.5	347.9

* In other investment the leading sector is health care; in other construction it is utilities.

Source: American Enterprise Institute, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker.

It is no surprise that energy is the biggest draw for PRC investment and construction. Among subsectors, oil draws the most investment, by itself on par with second-place metals. In construction, coal and hydro plants lead while transportation is a fast-rising second sector. Property investment had been growing strongly until Beijing imposed restrictions in 2017.[ix] Perhaps most telling, while technology receives a great deal of publicity, it accounted for only five percent of China's worldwide investment from 2005-17.

Chinese Investment in the US, 2005-present

The PRC likes making deals with advanced economies and their firms. The CGIT's properly calculated bilateral figures make clear that neither the Belt and Road nor Hong Kong draws the bulk of Chinese investment. Eight of the top national 10 recipients are wealthy, plus resource-rich Brazil and Russia (see table 2). While the US easily leads in total investment attracted, the American figure is not so impressive when adjusting for population or economic size.

Table 3: Top Recipients of Chinese Investment 2005-17 ($ Billion)

Country	Investment Volume
United States	170.4
Australia	91.0
Britain	72.4
Switzerland	60.0
Brazil	54.6
Canada	49.4
Russian Federation	38.2
Singapore	30.8
Germany	25.5
Italy	21.5
Subtotal for top 10	613.8
Total for all countries	1044

Source: American Enterprise Institute, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker

Other than the possible 2017 blip, China's global investment has been steadily rising. Not so its spending in the US, which is much choppier. China's global investment was basically launched with the acquisition of IBM's personal computer unit and hit its first bump with the American

rejection of CNOOC's bid for Unocal, both in 2005. From 2007-2010, total Chinese spending in the US was nearly $30 billion. There was a sharp drop in 2011 due to clashes over Huawei.[x] 2012-2015 saw $58 billion in Chinese investment in the US, a substantial amount but one showing only modestly faster growth than Chinese spending globally. That was just the warm-up for the high-wire act to come.

In 2016, Chinese investment in the US rocketed passed $50 billion,[xi] accounting for 30% of the global total. Then in 2017 the figure dropped by half. Thus far in 2018, spending is on pace to drop further, below $20 billion for the year. While boundaries between years can be artificial – some 2016 investment may be better counted as 2017, for example – the trend is clear: Chinese investment in the US is well off its peak and still falling as of now.

The reason for the initial and sharpest decline was not found in Washington, but in Beijing. In August 2015 and again in January 2016, the People's Bank of China pushed down the value of the yuan against the dollar and hinted at more weakening to come. This was at least in part a response to a PRC economic downturn that was most serious in the fourth quarter of 2015 and first quarter of 2016.[xii]

The response of many Chinese companies and rich individuals was immediate: get money out of the RMB and out of the country. The single best place to go was obviously the US, which had the dollar rising against the RMB, a large enough economy to easily absorb investment, and attractive opportunities in many sectors. This turned into the 2016 boom, starting in the second half of 2015 with companies scouring America for spending outlets.

Beijing had no response for a shocking amount of time, possibly due in part to corruption. Meanwhile, the PRC's foreign exchange reserves burned. From July 2015 to December 2016, official reserves fell $680 billion.[xiii] When Chinese policy-makers finally acted, they targeted the biggest overseas spenders, which were privately-owned firms such as Dalian Wanda. The idea was to deter the rest and it worked.[xiv] The share of private investment in China's global total rose from almost nothing in 2006 to nearly half in 2016, but dropped the most on record in 2017.

The US has consistently seen more private Chinese participation than the rest of the world enjoys. From 2010-2017, the private share of Chinese investment in the US was almost 60 percent, above the global average for any year**.** Chinese spending in the US plummeting last year in large part stems from the PRC attacking its own private firms to stop capital outflow.

That's ownership, another element in the rise and fall of Chinese investment in the US is the sector pattern. If you want to switch large amounts of money from a weaker currency to a stronger one, the quickest purchase is expensive buildings, which do not require the same depth of evaluation as a corporation. In 2016, Chinese money swept into American real estate, with $15 billion spent on hotels alone. In 2017 that figure was zero. A ban on investment in hotels and tight limits on property in general was first informal then made formal.[xv]

The most controversial sector is technology. Small-scale acquisitions of American technology assets are a legitimate concern. But there has been no large-scale Chinese investment in truly advanced US technology. In 2016, Chinese investment in US technology as a whole exceeded $10 billion, but the bulk was a $6-billion acquisition of Ingram Micro, which is an IT distributor not an engineering or research firm. [xvi] Since Oceanwide took over International Data Group in January 2017, there are no $100+ million Chinese technology investments in the US at all.

General US Investment Policy

In considering the full Sino-American investment relationship, the US faces unavoidable trade-offs. In the most pointed of these, policy-makers are rightly unhappy with Made in China 2025 but the PRC is also likely to invest north of $1 trillion globally by 2025.[xvii] Using Table 3, the American share of this could approach $200 billion. Chinese spending patterns over time also make clear that, if the US is closed, money will instead flow to Australia and Europe. Do we want our share or does it come with too much bad behavior?

Money has already been left on the table. The CGIT lists over 200 troubled transactions worth $350 billion in business impaired after commercial agreements were signed. China's investment alone sees an annual average of $20 billion impaired. Beijing has belatedly unraveled deals and

local or transnational security confrontations have halted them. But the main obstacle is objections by host governments, so it is no surprise that the top recipient of the PRC's investment also leads in terms of lost spending. It can take time for a deal to founder and more troubled China transactions are coming for the US.

Table 4: Most Troublesome Countries 2005-17 ($ Billion)

Country	Troubled Transactions
United States	65.4
Australia	59.1
Iran	25.2
Germany (mostly one deal)	15.4
Libya	12.7
Nigeria	11.5
Subtotal for top 6	189.3
Total for all countries	347.9

Source: American Enterprise Institute, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker.

The US has always filtered Chinese investments but obviously did so lightly during the 2016 expansion. American policy shifted sharply when a seemingly innocuous Chinese bid for logistics firm Global Eagle was stalled in the middle of 2017. This was quickly followed by a disingenuous claim from Lattice Semiconductor that it was being acquired by an American company, one which was entirely funded by the PRC. The choice to bar the Lattice deal was correct, and raised the ongoing issue of identifying when an investor is China-controlled (below).[xviii] A rising number of Chinese bids for US assets have stumbled over the past year.

That is the situation on the ground. The ensuing American policy choices should consider three factors, none of which necessarily involve CFIUS reform. First, "good Chinese investment" is in short supply. Beijing has blacklisted property and hotels and private firms are being hounded by PRC authorities.[xix] A bigger problem stems indirectly from Chinese policy. Because Beijing

seeks foreign assets, including technology, greenfield investment has faded to less than 15 percent of the total. Greenfield spending creates new jobs, while mergers and acquisitions may not and also represent greater potential loss of competitiveness. The US may welcome private greenfield investment, but little is available.

A second factor is lack of reciprocity. Beijing plainly sees competition as good for everyone else; the simplest illustration is centrally-controlled state-owned enterprises being heavily subsidized to make acquisitions overseas but entirely off the table to foreign bidders. Nonetheless, there is little value in simple investment reciprocity. The US does not want to close the same sectors the PRC does, nor would it be useful for Beijing to actually open (much less falsely promise to open) massively overcrowded industries such as steel. In addition, the Trump administration is not especially interested in better conditions for American companies in the PRC.

The third matter is most important: rule of law. Even well-intentioned Chinese companies with a solid record cannot always be trusted to obey American law. They have a good reason for being untrustworthy – all PRC firms are beholden to the Communist Party for survival and their executives' freedom. The distinction between private and state-owned Chinese enterprises is limited here. The latter are far more heavily subsidize but, with regard to rule of law and national security, there is no difference in Party control. Private Chinese companies have no courts or media through which they can resist Party orders to ignore US law or steal technology. They are equally beholden.[xx]

In other countries, the ugliest manifestation of lack of rule of law has been corruption for the sake of social and political influence. This is no longer limited to poorer countries: both Germany and especially Australia have recently accused Beijing of interfering in their domestic affairs.[xxi] If they are not immune, neither is the US.

For now, though, the main violation of American law concerns intellectual property (IP). This is commonly associated with technology but also includes trade secrets and simple data theft. American policy falls far short on this score. Estimates of loss to the US from Chinese IP theft can run in the hundreds of billions of dollars yet no PRC firm has been sanctioned even

indirectly, pending Section 301. [xxii] Even if CFIUS is left untouched by Congressional and administrative action, Chinese companies shown to have benefited from IP theft should face heavy sanctions, or IP theft will only continue.

CFIUS in Particular

In addition to the three issues possibly outside CFIUS' remit, two more are crucial to its operation. The first is dull, technical, and vital. For CFIUs to claim jurisdiction, an investor or partner must be identified as foreign-controlled. And whether such a partner is Chinese must be accurately determined for almost any CFIUS reform to be helpful. Canyon Bridge briefly pretended it was American when trying to buy Lattice. Another example: the PRC's biggest 2017 investment in the US was routed through Avolon, an Irish firm.[xxiii]

There are ongoing debates over what equity stake constitutes control and how to treat passive investment. These are unwise distractions. CFIUS should determine who controls a firm by identifying how it is financed. Money ultimately traced backed to the PRC guarantees Chinese influence, no matter the company name or location of its headquarters. American policy-makers are now correctly concerned about countries becoming Chinese satellites due to excessive borrowing.[xxiv] The same applies to companies. One that borrows heavily from a PRC bank, for example, is vulnerable to technology coercion even if there is no formal Chinese ownership.

A last consideration is evolution in the view of national security. The headline event is the US determination that personal data, along with technology and trade secrets, can be a national security concern. This was not an issue as recently as 2014, with a shift prompted by the breach of Office of Personnel Management files along with Chinese companies showing greater interest in acquiring American firms which hold personal data. This interest can be entirely commercial at first, only to have the Party later make demands. Such logic motivated, for example, the CFIUS denial of an Alibaba unit's bid for Moneygram.[xxv]

All this should not add up to "anything goes" in curbing Sino-American investment. Foreign cooperation is needed if the US is to partly reindustrialize. Investors are averse to uncertainty, for

instance a justified but unstated mandate to protect personal data. The Foreign Investment Risk Review Modernization Act (FIRRMA) is vague with regard to "critical" technology, materials, and infrastructure to be shielded, vagueness the business community rightly finds worrisome. Finally, CFIUS is not a magic wand to wave at the economy or even just at foreign investment. There is a great deal yet to do while limiting CFIUS reform to better protecting national security.

However, some objections to FIRRMA's goals do not seem to take the threat seriously. There has been discussion about time limits on changes to CFIUS, as if Beijing will in 2026 end its program of acquiring foreign technology. Rather than sun-setting CFIUS reform, the emphasis should be on speeding it up, as technology loss has occurred for many years and harm to national security is ongoing.

Speed is also required if export controls are to play a more constructive role. The existing export control regime has failed to control PRC acquisition of technology. It's certainly reasonable that better export controls could play a complementary role to CFIUS, keeping that body from discouraging foreign investment or being overstretched in terms of resources. However, improved export controls must be actionable, not merely asserted as the superior option. The Export Control Reform Act of 2018 (H.R. 5040) is a step in the right direction but its future improvement and passage must not be used to delay pressing CFIUS reform.[xxvi]

The evidence shows the PRC engaged in a legitimate global campaign to offer money to achieve its aims, in part by buying foreign assets but also when there is no formal Chinese ownership. Direct Chinese acquisition of technology through investment in the US has always been minor in scope and is probably declining. Yet IP theft has remained heavy all the while, extending first to cyber and later to personal data. Export controls have not been effective to date. And Beijing's goals are certainly unchanged – the Chinese government clearly believes it can continue to acquire desired technology without just buying it in the US.

The conclusion is unavoidable: taking the Chinese threat seriously means investment review cannot be confined to the US. A stricter process here will merely relocate the entire problem of the PRC's technology acquisition elsewhere, rather than most of it being located elsewhere as it

is now. The Trump administration might undertake the needed expansion of national security review, since Section 301 explicitly targeted Beijing's coercion of American companies through access to the Chinese market. But even if the administration does hold course, which is hard to be sure of, a law passed by Congress is much preferable to executive order.

China's program is sophisticated, intense, and has been global for more than a decade. The American response will naturally require additional resources, is already overdue, and must also be global.

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