

Testimony before the U.S.-China Economic and Security Review Commission  
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In this paper, I would like to discuss various characteristics, trends and roles of U.S. and foreign direct investment (FDI) in China. First, we consider FDI and U.S. direct investment, using Chinese official statistics. While it is clear that the quality of U.S. direct investment data is much better than that of the Chinese data, the use of official Chinese data allows us to examine U.S. direct investment in China in a comparative perspective. Then, in the next section, we will utilize U.S. official data as well as surveys from foreign investors’ associations to study some characteristics of foreign and U.S. direct investment. Lastly, we will discuss the roles of foreign and U.S. direct investment in China, using U.S. official data and some relevant academic studies.

China continues to be a very attractive destination for foreign direct investors. In 2010, the amount of FDI in China amounted to US\$105.7 billion, up from US\$90.0 billion in 2009 (Table 1). The most popular mode of FDI takes the form of wholly foreign owned enterprises (Table 2). There may be two reasons that contributed to this trend. First, foreign investors used to lack detailed knowledge of the Chinese labor and consumer markets so that joint ventures with local partners make more business sense. However, over time, foreign investors, including U.S. investors, increasingly are able to operate in China without the need for Chinese partners. Second, at least until recently, the business environment in China has been increasingly open, which permits foreign investors to have more commercial freedom in their choice of modes of operations. The business environment for foreign investors however, may be changing for the worse since the Chinese

government announced the consideration of the so-called “indigenous innovation” policy.

In terms of FDI flows and using official Chinese statistics, the largest FDI came from Hong Kong, with US\$46.075 billion in 2009 (Table 3). This represents slightly more than half, with 51.2 percent of the total inflows for that year. The United States came in seventh, with US\$2.555 billion. This represents only 2.84 percent of total inflows into China. In terms of stocks (not shown in the appendix), Hong Kong again was the largest foreign direct investor in 2008, with US\$349.6 billion. The United States came in fourth in 2008, with US\$59.65 billion.

In recent years, tax haven economies such as Virgin Islands and Cayman Islands have become more and more prominent as sources of FDI into China. This makes the FDI statistics more difficult to decipher as funds from these tax haven economies originally come from other places. A popular interpretation is that these funds predominantly come from other Asian sources, particularly Taiwan. As a comparison, Table 4 lists the top ten destinations of Chinese investment abroad. Again, Hong Kong was the top destination for Chinese direct investment abroad, with a flow of US\$35.6 billion in 2009. The United States was the sixth most popular destination for outward Chinese foreign direct investment for that year.

Using official U.S. statistics, U.S. direct investment position in China amounted to US\$49,403 million in 2009. This represents only 1.4 percent of the total U.S. direct investment abroad. In 2009, the top five destinations for U.S. direct investment were Netherlands (13.4%), the United Kingdom (13.4%), Canada (7.4%), Bermuda (7.0%) and Luxembourg (5.0%). The United States invested more in Mexico (2.8%) and in Singapore (2.2%) than in China (Ibarra-Caton 2010). Of the U.S. direct investment in China, the bulk was in manufacturing, with 45.8 percent in 2009. 11.6 percent was in computer and electronic products and 10.1 percent was in chemicals.

According to Liu and Siu (2006), Hong Kong/Taiwanese firms and other foreign firms operating in China are estimated to have significantly higher rates of returns on capital compared to state-owned enterprises. According to Survey of Current Business (Bureau of Economic Analysis September 2010), the rate of return on

U.S. Direct Investment abroad to all destinations was 9.7%, using the historical-cost method. Using the same method, the rate of return of U.S. direct investment in China can be calculated to be 13.5% in 2009. Thus the rate of return of U.S. direct investment in China tends to be higher than the average rate of return of all U.S. direct investment abroad.

According to AmCham-China (2010), in 2009, 71 percent of the member firms surveyed reported that their operations were profitable or very profitable. In addition, 28 percent of the firms reported that China is their number one priority in global investment. In addition, 58 percent of the U.S. companies source and produce for the Chinese domestic market. Only 12 percent of the U.S. firms produce or source goods or services in China for the U.S. market. However, for the first time, U.S. companies reported “inconsistent regulatory interpretation” as the number one business challenge, replacing “management-level human resource constraints”, which was the number one business difficulty since 2008.

Only less than 3% of European Union FDI went to China in 2008. However, the European firms operating in China seem to have similar concerns about the trend of the regulatory environment in China. According to the European Union Chamber Business Confidence Survey, 36% of the firms surveyed said that the regulatory environment has become less fair towards foreign-invested enterprises in the last two years (European Union Chamber of Commerce in China 2010/2011).

What roles do FDI and U.S. direct investment play in China? There are several important economic functions. First, FDI and U.S. direct investment in China increase Chinese output. The value added of U.S. non-bank majority-owned affiliates in China was 0.6% of Chinese GDP in 2008 (Barefoot and Mataloni Jr. 2010). According to a study by Chantasasawat, Fung, Ng and Siu (2011), of all the foreign direct investment in China, the U.S. direct investment contributed most to the increase in Chinese output. The U.S. direct investment is estimated to be more potent than investment from Hong Kong, Japan, Taiwan or Republic of Korea.

Second, while much of the focus of U.S. companies in China seems to be on the domestic Chinese market, foreign-invested enterprises (FIEs) in general often act to serve as a part of the production network that ultimately sends the finished

products to consumers in the rich economies such as the United States and Europe. Much of the exports from China and imports into China have been conducted by foreign firms (Table 6). According to Naughton (2007), most of the recent largest exporters of high-technology products from China including Tech-Front Shanghai, ASUSTek Computer Suzhou and Motorola China have their parent companies in Taiwan or in the United States.

A recent study commissioned by the United States International Trade Commission (Dean, Fung and Wang 2008) concluded that foreign firms in China facilitated the creation of an Asian production network. Almost 32 percent of the imported intermediate goods that were incorporated in Chinese exports came from the four Asian tigers (Hong Kong, Taiwan, Republic of Korea and Singapore). 18.3 percent came from Japan and 10.3 percent came from the rest of East and Southeast Asia.

U.S. direct investment in China and in Asia facilitated the imports and exports of parts and components from one Asian economy to another. According to Fung, Iizaka and Siu (2011), a one percent increase in U.S. direct investment in China or in another Asian economy will increase exports of parts and components to another Asian economy by 0.37 percent.

Because of the production network facilitated by U.S. and other FDI in China and Asia, intra-Asian trade in parts and components has increased over the years. Much of such Asian trade- and FDI-led integration occurred initially without the presence of significant formal trade agreements. This de facto form of integration is quite different in origin compared to other regional groupings such as Latin America (Aminian, Fung and Ng 2008). In fact, East Asia seems to have a deeper degree of integration compared to integration among Latin America economies (Fung, Garcia-Herreño and Siu 2011).

Lastly, U.S. multinationals operating in China also increases employment in China. In 2008, non-bank U.S. affiliates in China employed 950,200 employees in China. On average, these U.S. affiliates paid US\$10,908.2 as annual compensations to their employees. The non-bank majority owned U.S. affiliates in China also spent US\$1,517 million in research and development expenditures. This compares to US\$582 million in India and US\$ 1,872 million in Japan.

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## Appendix

**Table 1. Total FDI in China**  
(\$US millions)

Year	Inflow	Inward Stock	Outflow	Outward Stock
2000	40,715	346,637	*916	*27,768
2001	46,878	393,512	*6,885	*34,654
2002	52,743	446,255	2,700	29,900
2003	53,505	501,474	2,855	33,222
2004	60,630	562,104	5,498	44,777
2005	60,325	622,429	12,261	57,206
2006	63,021	691,897	21,160	90,630
2007	74,768	760,218	26,506	117,911
2008	92,395	852,613	55,907	183,971
2009	90,033	942,646	56,528	245,755
2010	105,735			

Sources: China Statistical Yearbook, various issues

Invest in China [[www.fdi.gov.cn](http://www.fdi.gov.cn)]

2009 Statistical Bulletin of China's Outward Foreign Direct Investment, China's Ministry of Commerce

\*UNCTADstat

**Table 2. Modes of FDI**  
(\$US millions)

	Equity Joint Venture	Contractual Joint Venture	Wholly Foreign-owned Enterprise	FDI Shareholding Inc.	Joint Exploration	Others
<b>2007</b>	15,596	1,416	57,264	492	0	0
<b>2008</b>	17,318	1,903	72,315	859	0	0
<b>2009</b>	17,273	2,034	68,682	2,044	0	0
<b>2010</b>	22,498	1,616	80,975	646	0	0

Sources: China Statistical Yearbook, various issues

Invest in China [[www.fdi.gov.cn](http://www.fdi.gov.cn)]

**Table 3. Top 10 largest FDI investing economies in China (ranked by foreign investment actually utilized)**

Year 2007		Year 2008		Year 2009	
Economy	(\$US mil)	Economy	(\$US mil)	Economy	(\$US mil)
Hong Kong	27,703	Hong Kong	41,036	Hong Kong	46,075
Virgin Islands	16,552	Virgin Islands	15,954	Virgin Islands	11,299
Rep. of Korea	3,678	Singapore	4,435	Japan	4,105
Japan	3,589	Japan	3,652	Singapore	3,605
Singapore	3,185	Cayman Islands	3,145	Rep. of Korea	2,700
United States	2,616	Rep. of Korea	3,135	Cayman Islands	2,582
Cayman Islands	2,571	United States	2,944	United States	2,555
Samoa	2,170	Samoa	2,550	Samoa	2,020
Taiwan	1,774	Taiwan	1,899	Taiwan	1,881
Mauritius	1,333	Mauritius	1,494	Germany	1,217

Source: China Statistical Yearbook, 2009/2010



**Table 4. Top 10 destinations for China's outward FDI**  
(\$US millions)

Flow (2009)		Stock (2009)		
	Economy (\$US mill)		Economy (\$US mill)	
<b>1</b>	Hong Kong	35,601	Hong Kong	164,499
<b>2</b>	Cayman Islands	5,366	Virgin Islands	15,061
<b>3</b>	Australia	2,436	Cayman Islands	13,577
<b>4</b>	Luxembourg	2,270	Australia	5,863
<b>5</b>	Virgin Islands	1,612	Singapore	4,857
<b>6</b>	Singapore	1,414	United States	3,338
<b>7</b>	United States	909	Luxembourg	2,484
<b>8</b>	Canada	613	South Africa	2,307
<b>9</b>	Macau	456	Russia	2,220
<b>10</b>	Myanmar	377	Macau	1,837

Source: 2009 Statistical Bulletin of China's Outward Foreign Direct Investment, China's Ministry of Commerce

**Table 5. U.S. Direct Investment Position in China (Historical-Cost Basis) in millions of dollars**

2005	2006	2007	2008	2009
19,016	26,459	29,710	52,521	49,403

Source: Survey of Current Business, Bureau of Economic Analysis, "Table on U.S. Direct Investment Abroad: Selected Items by Detailed Country, 2005-2009", 2010.

**Table 6. Exports and Imports conducted by FIEs**  
(\$US millions)

	Exports	Imports	Total
<b>2007</b>	695,520	559,408	1,254,928
<b>2008</b>	790,620	619,956	1,410,576
<b>2009</b>	672,230	545,207	1,217,437
<b>2010</b>	862,306	738,001	1,600,307

Sources: Invest in China [[www.fdi.gov.cn](http://www.fdi.gov.cn)]