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## U.S.-China Economic Relations

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**INTRODUCTION**

This paper investigates the avenues accessible to U.S. policymakers seeking to take advantage of China’s recent economic prosperity in their efforts to assist the recovery of the U.S. economy from the 2007 Global Economic Crisis. More specifically, this paper assesses the present state of U.S.-China trade and investment relations, identifying obstacles and possible remedial measures. Additionally, this paper looks at the potential for investment-based or fee-based immigration policies as a source of economic stimulus for the United States.

***A Primer on Trade and Investment***

Trade and investment are two of the most prominent forms of financial transactions between parties. Trade is the business of buying and selling or bartering of commodities. Investment, on the other hand, may be defined much more narrowly. Investment in a financial context is defined as putting money into something with the expectation of gain within a certain period of time, where there is a high degree of security for the investment capital and for a return.<sup>1</sup>

Investment is distinguishable from trade most notably in its involvement of a temporal element. For example, whereas a single trade transaction in its simplest form can be visualized as two parties standing face to face, each handing over to the other a package containing the goods or commodities agreed upon, a single investment transaction cannot be similarly characterized. Given the definition of investment, *supra*, a single investment transaction in its simplest form involves two separate performances between the two parties. The first performance is the actual “investment” part of an investment transaction. It involves an investor providing a certain amount of money to finance a project, with the expectation that this money (i.e., the investment capital) will provide the investor with some financial gain (i.e., the returns) within a certain period of time. A period of time, however, is typically required before the investor

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<sup>1</sup> See generally BENJAMIN GRAHAM & DAVID DODD, SECURITY ANALYSIS (1934).

can realize his financial gains, during which the project is expected to grow and profit. Once this period of time has transpired, the second performance involved in an investment transaction can take place. In the second performance, the investor liquidates his interests in the project, returning to the investor a sum of money equal to the investment capital and the returns. This is commonly known as divestment.

In the context of trade and investment between parties belonging to different sovereign states, the temporal aspect involved in investment provides an added layer of legal complexity. A key aspect of investment is that the investor reasonably seeks security for the investment capital provided between the time when he finances the project with the investment capital and the time when he gets back the investment capital plus returns.<sup>2</sup> Where the investor and the investment project belong to different sovereign states, the investor must consider the governing laws of the state in which the investment project is located, or more plainly stated, the legal environment to which the investment capital will be subject during the ordinary course of business.

For state policymakers, the added complexity involved with international investment is a principal reason why policies relating to international trade are often considered prior to those relating to international investment. Moreover, the trade-related policies and the experiences gained during the negotiation of said trade-related policies often provide the groundwork upon which subsequent investment-related policies build. U.S.-China economic relations follow this pattern.

### ***Modern History of Sino-U.S. Relations***

In understanding the history of economic relations between the United States and China, it is valuable first to get an overview of twentieth century Sino-U.S. relations and recent Chinese history. The present day Chinese government, headed by the Chinese Communist Party (CCP), came to power in 1949 after seizing control from the then U.S.-backed government led by the Chinese Nationalist Party (KMT) in what is known as the Chinese Civil War. For over two decades after 1949, the CCP-led Chinese government and the United States had no diplomatic relations. This can be attributed to a myriad of factors. A few worth mentioning include United States support of

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<sup>2</sup> *Id.*

the KMT, adversaries to the CCP during the Chinese Civil War, CCP-led China's support of North Korea in the Korean War, and CCP-led China's support of the North Vietnamese Army during the Vietnam War. Then, in the early 1970s, then President Richard Nixon made a visit to China. He was among the first Americans to visit China after the establishment of the CCP-led government in 1949. Several years of informal Sino-U.S. diplomacy followed, finally resulting in the establishment of formal diplomatic and trade relations between Communist China and the United States near the end of the 1970s.

## I TRADE

China's early domestic economic policies designed to encourage foreign trade provided the building blocks that eventually permitted China to become the United States' second largest trading partner. Trade between the United States and China in 2011 totaled over \$500 billion.<sup>3</sup> Notably, nearly eighty percent of that total trade value is attributable to exports from China to the United States.

While the historical significance of trade-related policies cannot be denied, the present-day economic impact of trade policies is substantially diminished in comparison; instead, investment-related policies are taking center stage. This is in accordance with the globalizing investment trend and the reduced impact of geographic boundaries.<sup>4</sup> Nonetheless, it is imperative to gain an understanding of how U.S.-China economic policies, initially motivated by a mutual desire to improve trade relations, laid both the legal groundwork, and no less significantly, the international relations groundwork, for their progressively deepening bilateral economic relationship.

### *A. The Mao Era (1949–1976)*

The undeniably protectionist and economically isolationist policies advanced by CCP China's then supreme leader Mao Zedong dominated China's economic policy between modern China's founding in 1949 and Mao's death in 1976. The CCP's emergence as the victor of the Chinese Civil War over the U.S.-backed KMT left China in the hands of a government with a distrust of the United

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<sup>3</sup> *Top Trading Partners—December 2011*, UNITED STATES CENSUS BUREAU, <http://www.census.gov/foreign-trade/statistics/highlights/top/top1112yr.html> (last visited Nov. 11, 2014).

<sup>4</sup> RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 9 (2008).

States and of the West in general. Moreover, Mao's vision of Chinese prosperity was undoubtedly shaped by his own life experience, which saw much of China under *de facto* colonialism rule since the Opium Wars of the mid-nineteenth century. For example, for much of the early half of the twentieth century, China's preeminent port city of Shanghai was carved up into numerous (predominantly European) foreign concessions, each of which was administered and governed by a foreign power. Similarly, in the wake of the fall of the Qing dynasty in early twentieth century, Japan took control of China's Northeast, occupying a territory the Japanese formed into a puppet state called Manchukuo. The Chinese Civil War and the Sino-Japanese War left Chinese domestic industry in shambles. As such, it was Mao's position that China under CCP governance could not afford to permit any subsequent foreign physical or economic incursion. Consequently, for the substantial majority of China's governance under Mao, China's foreign economic policy was with few exceptions, dominated by strict isolationism.

#### ***B. China's Road to WTO Accession (1976–2001)***

During the twenty-five years following Mao's death in 1976, China's domestic economic policies underwent a period of significant liberalization. An about-face from Mao era isolationism took place almost overnight, as progressive CCP member Deng Xiaoping fought off significant political adversaries to become China's new *de facto* supreme leader. China, under Deng's leadership, adopted a new position on foreign economic relations, wherein it opened its doors to the West. This new policy, however, was not without its share of challenges. China's former leader Mao Zedong was not completely unwarranted in his belief that China's fledgling domestic industries could not withstand the vigor of international trade. China, as it stood subsequent to the Chinese Civil War, had little bargaining power with respect to any prospective trade partners. To be a viable trade partner, one must have something that another party wants. Pure barter aside, this assertion means that a viable trade partner must have goods that someone else is willing to pay money for, or alternatively, money to purchase someone else's goods. China, however, possessed neither of these in the late 1970s and early 1980s. Having operated for over two decades as a closed-off, state-run economy with no meaningful use for currency, Chinese citizens had no money with which to purchase foreign goods. Additionally, China's state-run industries had little technology or practical expertise and produced goods that were

frequently undesirable, or were of inferior quality compared to alternatives that potential trade partners could obtain overseas.

Over the next twenty-five years, Chinese policymakers steadily and incrementally improved China's appeal as a trade partner. Starting with little more than a blank slate, policymakers determined that China first needed to produce goods desirable to the export market to generate profits for Chinese businesses and the Chinese government.

*1. China's Special Economic Zones (SEZs) and the Influx of Trade-Related Foreign Direct Investment (FDI)*

Special Economic Zones (SEZs) designated by the Chinese government attracted the attention of many foreign multinational companies, and headlined China's approach to increasing the role it played in international trade. For most foreign companies considering business with China in the 1970s, the overwhelming desire was to access China's cheap labor force for the specific purposes of mass production. In return, China would benefit from the foreign capital, technology, and practical expertise provided by the foreign investors incident to their establishment of manufacturing operations in China.

The SEZs consisted of a series of cities (or in the case of Hainan, an entire province) designated by the Chinese government where foreign investors would enjoy special preferential treatment.<sup>5</sup> Two key benefits that encouraged foreign investment in China's SEZs were the preferential tax treatment associated with SEZ businesses and reduced interference by China's central government.<sup>6</sup> Most early foreign investments in SEZs were related to export-oriented projects, as the government sought to generate an influx of currency for foreign exchange.<sup>7</sup>

Foreign investments in SEZs were also significant in that they were among the first times private property interests were recognized in China under CCP governance. More specifically, the Chinese government recognized investment by foreign corporations as direct investment rather than portfolio investment. Direct investment involves the purchase or acquisition of interest in a business that permits active control of the company.<sup>8</sup> By contrast, portfolio

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<sup>5</sup> Jian Zhou, *National Treatment in Foreign Investment Law: A Comparative Study from a Chinese Perspective*, 10 *TOURO INT'L L. REV.* 39, 52 (2000).

<sup>6</sup> *Id.* at 54.

<sup>7</sup> *Id.* at 52.

<sup>8</sup> *Direct Investment*, INVESTOPEDIA, <http://www.investopedia.com/terms/d/direct-investment.asp> (last visited Nov. 11, 2014).

investment is generally limited to passive investment in securities, which does not involve active management or control of a company.<sup>9</sup> The primary avenue for foreign ownership of business interests in China through foreign direct investment (FDI) was through the formation of a joint venture (JV) with a Chinese company. Given the near absolute absence of privately owned property interests in CCP-led China in the late 1970s, it should be no surprise that early FDI into China was used to form JVs with state-owned enterprises (SOEs) owned and operated by the Chinese government.

By the late 1980s and early 1990s, the relative success of the initial FDI-funded, export-producing JVs, many of which were located in China's SEZs, affirmed a central tenet in the Chinese central government's economic plan. To a limited extent, the Chinese government had succeeded in using FDI to finance the Chinese manufacture of exportable goods, the overseas sale of which provided China with an injection of foreign exchange.<sup>10</sup> This manufacturing-centric, trade export-oriented, foreign-exchange-generating strategy would dominate Chinese foreign economic policy for much of the next two decades.

## 2. Trade-Related Investment Measures (TRIMs) and World Trade Organization (WTO) Accession

The central role played by FDI in China's industrial transformation and consequent role as a global trade juggernaut provides a fitting backdrop for a discussion about the significant role played by China's foreign investment-related policy changes in securing China's membership in the World Trade Organization (WTO). Joining the WTO was key for economically export-dependent China. Among the many consequences, China's membership in the WTO would mean that many "Made in China" goods would be charged lower tariffs by other WTO member trade partners, as well as be protected from nontariff barriers such as quotas otherwise applied to Chinese goods by many WTO member trade partners.<sup>11</sup>

The United States, on its own behalf and *de facto* on behalf of the WTO, negotiated with China through much of the 1990s, ultimately

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<sup>9</sup> *Portfolio*, INVESTOPEDIA, <http://www.investopedia.com/terms/p/portfolio.asp> (last visited Nov. 11, 2014).

<sup>10</sup> See Zhou, *supra* note 5, at 52.

<sup>11</sup> See Raj Bhala, *Enter the Dragon: An Essay on China's WTO Accession Saga*, 15 AM. U. INT'L L. REV. 1469, 1479 (2000).

playing a pivotal role in China's eventual 2001 WTO accession.<sup>12</sup> In 1992, the United States and China signed a bilateral Memorandum of Understanding, wherein the United States agreed among other things, to support China's goal of becoming a WTO member in return for China's phasing out of certain trade-related barriers hindering U.S. access to the China market.<sup>13</sup> Despite valiant early efforts, however, China was unable to secure a seat as a founding WTO member in 1995.<sup>14</sup> Rather, the United States continued working with China throughout the remainder of the 1990s, further paving the path to China's eventual 2001 WTO accession with the signing of the U.S.–China Bilateral WTO Agreement signed November 15, 1999.<sup>15</sup>

The 1999 U.S.-China Bilateral WTO Agreement was aptly named because it included a substantial number of key obligations China was required to accept in order to secure its 2001 WTO accession.<sup>16</sup> To avail itself to WTO membership privileges, China was required to fulfill a series of reciprocal trade and trade-related investment policy obligations.<sup>17</sup> WTO membership demanded that China reduce or completely phase out various protectionist policies with respect to the penetration of foreign goods in the Chinese market.<sup>18</sup> These included tariffs, quotas, subsidies to domestic industries, state-fixed pricing on goods, and preferential regulatory treatment of domestically produced goods.

At least equally significant, however, was the WTO's requirement that China comply with a number of investment-related obligations relating to the operation of foreign-invested businesses in China. A first set of obligations comprised general improvements to the Chinese legal system, including increased legal rights, legal transparency, and legal uniformity.<sup>19</sup> A second set of obligations in the Agreement on Trade Related Investment Measures (TRIMS) may be characterized as a progressive effort towards a national treatment policy with respect to foreign-owned business interests (i.e., afford to foreign-owned business interests treatment no less favorable than that afforded to Chinese-owned business interests).<sup>20</sup> Among others,

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<sup>12</sup> *Id.* at 1487.

<sup>13</sup> *Id.* at 1485.

<sup>14</sup> *Id.* at 1490.

<sup>15</sup> *Id.* at 1511–12.

<sup>16</sup> *Id.* at 1511–19.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 1511–19.

<sup>20</sup> *Id.*



obligations included increasing the foreign-owned stake permitted in Chinese-Foreign JVs and granting to foreign investors access to industries formerly limited exclusively to domestic investment.<sup>21</sup> Also included were a series of highly specific measures concerning trade-related investment, prohibiting any requirement that a foreign enterprise use or purchase domestic products, quotas on an enterprise's use or purchase of imported products based on the volume or value of the enterprise's export trade balancing requirements, restriction of an enterprise's ability to import by limiting its access to foreign exchange, and restriction of an enterprise's exports relative to the amount of goods it produces for the Chinese domestic market.<sup>22</sup>

The TRIMs obligations that China was required to accept prior to admission to the WTO is consistent with the ever-increasing impact of foreign direct investment (FDI) on global trade transactions. In the China context, the United States and western European nations sought to use FDI to establish export producing manufacturing facilities in China, a nation with low labor costs.<sup>23</sup> This trend perhaps also reinforces the global push towards an increase in the financial volume of foreign investment relative to the financial volume of traditional trade.<sup>24</sup>

## II INVESTMENT

This paper was motivated by a desire to investigate the avenues accessible to United States policymakers seeking to take advantage of China's recent economic prosperity in their efforts to assist the recovery of the United States economy from the 2007 Global Economic Crisis. A combination of the comparatively advanced developmental state of U.S.-China trade policies and the significantly greater financial volume of foreign investment in comparison to foreign trade<sup>25</sup> suggest that inquiry ought to be made with respect to means of advancing United States policies governing U.S.-China investment relations.

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<sup>21</sup> *Id.*

<sup>22</sup> *Trade-Related Investment Measures*, JAPANESE MINISTRY OF ECONOMY, TRADE AND INDUSTRY (2012), <http://www.meti.go.jp/english/report/data/gCT9908e.html> (last visited Nov., 2014).

<sup>23</sup> Bhala, *supra* note 11, at 1507.

<sup>24</sup> DOLZER & SCHREUER, *supra* note 4, at 2.

<sup>25</sup> *Id.*

Investment treaties are perhaps the most important tool policymakers use to either to pave the path toward or stimulate international investment. No analogous multilateral investment organization to the WTO presently exists. One key reason for the absence of a multilateral investment analog to the WTO is the strategic nature of investment itself. As discussed earlier, trade can be simply visualized as a concurrent exchange of commodities between two parties, whereas the typically longer duration involved in investment presents additional complexities.<sup>26</sup> These complexities are exacerbated when the investment transaction being considered involves a project located in a foreign sovereign state. For at least the reasons stemming from these fact-specific and situation-specific complexities, bilateral investment treaties between two specific parties seeking to develop or advance an investment relationship, rather than a single, overarching, multilateral WTO-type agreement, constitute the principal legal document defining the rights and obligations concerning international investments.

***A. Negotiating a Bilateral Investment Treaty (BIT) to Promote FDI***

Bilateral investment treaties (BITs) provide the treaty parties with a better opportunity to tailor an agreement to their respective national interests.<sup>27</sup> The principal purpose of the BIT is little different than that of any other economically motivated agreement. The parties seek an agreement that will yield both nations some economic benefit. History has shown, however, that the terms in many (if not most) BITs tend to favor the more the developed, economically dominant nation, who uses its greater bargaining power to secure said favorable terms.<sup>28</sup>

A key objective shared by almost all BITs is to protect the interests of an investor where the investor belongs to one treaty party and he seeks to invest in an enterprise located within the territory of the other party to the treaty.<sup>29</sup> While the specific provisions and the precise degrees of protection differ with each BIT, typical BITs include provisions addressing the document's scope of applicability, equal or fair treatment of the foreign investment, protection against

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<sup>26</sup> *Id.* at 3–4.

<sup>27</sup> *Id.* at 4.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

expropriation, and alternative dispute resolution mechanisms through international arbitration.<sup>30</sup>

No BIT currently exists between the United States and China. Scholars and commentators have suggested that a BIT would have a significant, positive economic impact on the respective economies of the United States and China.<sup>31</sup> To that end, however, it is this author's opinion that significant economic impact would be indirect rather than direct, and perhaps more attenuated than expected. One reason for this conclusion is that China and the United States do not fit the traditional BIT mold. Historically, BITs frequently involved one more developed "investor" party and one less developed "investee" party, wherein the terms of the BIT generally contemplate single direction capital flow.<sup>32</sup> The investor party, who seeks strong protection for its investments in the investee party, typically drafts such BITs predominantly.<sup>33</sup> Generally, the investee party is willing to accept terms favoring the investor party because the investee's primary objectives during negotiations are to establish a BIT to encourage inbound investment capital and to acquire the technology and business expertise incident to foreign investment projects.<sup>34</sup> As a consequence of the strong investment protection for investor party assets conceded to by the investee party, such a BIT justifiably results in strong investor confidence, which in turn tends to produce significant increases in the volume of investor party investments in the investee party.<sup>35</sup>

The type of BIT described above that contains terms offering strong protection of foreign investment, however, is significantly less likely to be agreed upon when the parties involved are not a traditional capital-exporting investor party and a capital-importing investee party. In cases where only single-direction capital flow is anticipated, strong protection for investment is highly favored by the capital-exporting investor, and generally acceded to by the capital-

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<sup>30</sup> 2012 U.S. Model Bilateral Investment Treaty, U.S. DEP'T OF STATE, <http://www.state.gov/documents/organization/188371.pdf> (last visited Nov. 11, 2014) [hereinafter U.S. Model BIT].

<sup>31</sup> Daniel Michaeli, *Let's Negotiate an Investment Treaty with China*, COUNCIL ON FOREIGN RELATIONS (Apr. 8, 2011), <http://www.cfr.org/china/lets-negotiate-investment-treaty-china/p24630>.

<sup>32</sup> See DOLZER & SCHREUER, *supra* note 5, at 18–19.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 22–23.

<sup>35</sup> *Id.*

importing investee who needs the money.<sup>36</sup> BITs, however, are generally drafted to provide reciprocity and investments from either party are governed by the same terms and subject to the same protections.<sup>37</sup> Where neither nation is exclusively capital exporting or capital importing, the protection offered to Party A's investment in a venture located in Party B's country is similarly afforded to Party B's investment in a venture located in Party A's country. In such a case of dual-direction capital flow, parties may be less likely to bargain for such strong terms because while such terms offer protection for outbound investments, the terms obligate the party to afford the same protection to inbound investments originating from the other treaty party. For this reason, where parties contemplating a BIT contemplate dual direction capital flow, the degree of investment protection offered by the BIT ultimately agreed upon by both parties is likely to be reduced. Coincidentally, due to the reduced investment protection offered by the terms of the BIT, the resulting impact on investment volumes is likely to be diminished.

The U.S.-China case at the present time may arguably be characterized as such a situation where dual direction capital flow is contemplated. Historically, as described above in the context of trade-related investments, the United States clearly played the role of the capital exporting investor nation, and China that of the capital importing investee nation. Coincidentally, the traditional concern was the protection of United States investments in China.<sup>38</sup> But there exists at least a modicum of evidence to suggest that what perhaps was the most relevant economic dynamic between the United States and China in the late twentieth century is gradually changing. With respect to the potential U.S.-China BIT, commentators are beginning to consider the potential BIT implications of issues arising from Chinese investment interests in the United States.<sup>39</sup>

### ***B. The Appeal of Inbound Chinese Foreign Direct Investment***

Economic relations between the United States and China have changed drastically in the past several decades. Following the unprecedented and predominantly export-driven economic growth

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<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 22.

<sup>38</sup> See Zhou, *supra* note 5, at 49.

<sup>39</sup> Duncan Hollis, *What will a U.S.-China BIT do to Investor-State Arbitrations?*, OPINIO JURIS (Mar. 22, 2010, 9:06 AM), <http://opiniojuris.org/2010/03/22/what-will-a-us-china-bit-do-to-investor-state-arbitrations/>.

China experienced between 1980 and the early 2000s, China currently is no longer in desperate need of FDI. A significant amount of export-related foreign exchange is presently available in China, largely as a result of prodigious exports by China's state-owned and privately owned enterprises.<sup>40</sup> China is currently the largest capital surplus economy in the world, with foreign exchange reserves last tallied at well over three trillion U.S. dollars.<sup>41</sup> Coincidentally, it perhaps should not be surprising that Chinese are questioning whether additional inbound FDI is necessary, or for that matter, desirable.<sup>42</sup> China's newfound wealth notwithstanding, however, what has not changed is that China is still seeking out technology and expertise,<sup>43</sup> much as it was when, under Deng Xiaoping's leadership, it opened its doors to foreign investment over three decades ago.

In contrast to China's capital surplus and arguably excess FDI, inbound FDI is likely to be beneficial to the United States. In contrast to China's three trillion dollar capital surplus, as of 2012 the United States has an existing public debt of over sixteen trillion U.S. dollars.<sup>44</sup> This is despite the recent financial success of U.S. companies such as Apple, Google, ExxonMobil, Chevron, and Wal-Mart, all of whose stocks charted near all-time highs as recently as 2012. This seeming contradiction makes slightly more sense upon recognizing that the principal means for the United States to generate governmental revenue is through tax dollars,<sup>45</sup> or more specifically, from income tax.<sup>46</sup> Following the 2007 global economic crisis, the

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<sup>40</sup> *Instant view: China's Foreign Exchange Reserves Hit \$3.2 Trillion*, REUTERS (Oct. 14, 2011), <http://www.reuters.com/article/2011/10/14/us-china-economy-inflation-iv-idUSTRE79D18E20111014>.

<sup>41</sup> *Id.*

<sup>42</sup> Kevin Davies, *Inward FDI in China and its Policy Context*, VALE COLUMBIA CENTER ON SUSTAINABLE INTERNATIONAL INVESTMENT 5 (Oct. 18, 2010), [http://www.vcc.columbia.edu/files/vale/documents/China\\_IFDI\\_final\\_18\\_Oct\\_0.pdf](http://www.vcc.columbia.edu/files/vale/documents/China_IFDI_final_18_Oct_0.pdf).

<sup>43</sup> Nargiza Salidjanova, *Going Out: An Overview of China's Outward Foreign Direct Investment*, U.S.-CHINA ECON. AND SEC. REVIEW COMM'N, GOING OUT 19, <http://origin.www.uscc.gov/sites/default/files/Research/GoingOut.pdf>.

<sup>44</sup> Galen Moore, *U.S. National Debt Surpasses \$16 Trillion*, BOSTON BUS. J. (Sept. 5, 2012, 6:16 AM), [http://www.bizjournals.com/boston/blog/mass\\_roundup/2012/09/us-national-debt.html](http://www.bizjournals.com/boston/blog/mass_roundup/2012/09/us-national-debt.html).

<sup>45</sup> Robertson Williams, *The Numbers: What are the Federal Government's Sources of Revenue?*, TAX POLICY CENTER (Sept. 13, 2011), <http://www.taxpolicycenter.org/briefing-book/background/numbers/revenue.cfm>.

<sup>46</sup> JOHN A. MILLER & JEFFREY MAINE, *THE FUNDAMENTALS OF FEDERAL TAXATION* 4 (2d ed. 2010).

United States experienced record levels of unemployment.<sup>47</sup> It is not unreasonable to infer that the elevated levels of unemployment in the United States contributed to a reduced volume of income taxable by the federal government. This suggests at a very high level the finances of the U.S. government would benefit from a reduction in unemployment in the United States.

Reducing the unemployment rate has a direct effect on those who regain jobs and salaries. The significance for the U.S. government, of course, is not limited to tax revenues derived from ability to tax that income. Job creation will result in equally significant intangible consequences, namely the indirect confidence in the domestic economy gained by the rest of the population and the consequent consumers' desire to spend. This stimulation of capital flow has significant tax consequences at each successive financial transaction. For example, consider a scenario where Raw Material Corporation sells raw material to Component Corporation to manufacture a component using said raw material. Component Corporation sells its components to End Product Corporation, who assembles said components into an end product that is sold to consumers. Assuming that all parties are located in the United States, the business profits of each corporation are subject to federal taxation. Consequently, the more money each corporation makes, the greater the tax revenues. Therefore, it is not unreasonable to suggest that one of many parallel avenues that may help reduce the U.S. public debt and improve the U.S. economy may be effected through the creation of jobs, which in addition to directly providing tax revenues, is also likely to elevate consumer confidence and result in elevated and taxable corporate profits.

### *C. National Security as an Obstacle to Inbound Chinese FDI*

Given the combination of China's seemingly bottomless foreign reserves, China's continued desire to procure technology and expertise, and the potential job-creating benefit of inbound FDI to the United States, it is not unreasonable to contemplate permitting or even encouraging the sale of U.S. enterprises possessing such technology and expertise sought by China, to Chinese businesses and investors, as a means of stimulating the current U.S. economy. The involvement of the Chinese government in a vast number of the more

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<sup>47</sup> *Labor Force Statistics from the Current Population Survey*, BUREAU OF LABOR STATISTICS, [http://data.bls.gov/pdq/SurveyOutputServlet?request\\_action=wh&graph\\_name=LN\\_cpsbref3](http://data.bls.gov/pdq/SurveyOutputServlet?request_action=wh&graph_name=LN_cpsbref3) (last visited Feb. 24, 2014).

significant Chinese-outbound FDI projects, however, has seemingly proven to be an unfortunate deterrent to such sales. A number of individuals in the United States are concerned that Chinese FDI will have adverse effects on U.S. national security.<sup>48</sup> It appears that these concerns are only exacerbated by the Chinese government's encouragement of Chinese-outbound FDI through mergers and acquisitions for the strategic purposes of acquiring natural resources and high technology.<sup>49</sup>

In recent history, there have been several notable investment attempts by Chinese-controlled entities that were foiled by the U.S. government's Committee on Foreign Investment in the United States (CFIUS) on the basis of national security concerns.

*1. Background Information: The Committee on Foreign Investment in the United States*

The Committee on Foreign Investment in the United States (CFIUS) is a committee of the executive branch formed pursuant to President Gerald Ford's Executive Order 11858 in 1975.<sup>50</sup> From the start, one of CFIUS's principal functions was to review pending foreign investments in the United States that may have implications for U.S. national interests.<sup>51</sup> In contrast to CFIUS's humble origins as one of many executive committees whose primary responsibilities consisted mainly of "monitoring," "coordinating," "analy[zing]," and "guid[ing]" the U.S. President,<sup>52</sup> subsequent statutory amendments have steadily increased CFIUS's role with respect to U.S. foreign economic policy. Notably, the Exon-Florio Amendment enacted by Congress in 1988 granted to CFIUS the power to review all foreign investments that may affect national security.<sup>53</sup> The President now has the power to unilaterally block any investment CFIUS deems to pose a security threat to the United States.<sup>54</sup> In 1992, the Byrd Amendment

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<sup>48</sup> See, e.g., *The President's Decision to Order a Chinese Company's Divestiture of a Recently Acquired U.S. Aircraft Parts Manufacturer: Hearing Before the Subcomm. on Commerce, Consumer Protection and Competitiveness of the H. Comm. on Energy and Commerce*, 101st Cong. (1990) [hereinafter Mendelowitz] (statement of Allan I. Mendelowitz, Director, International Trade, Energy, and Finance Issues), available at <http://archive.gao.gov/t2pbat11/140886.pdf>.

<sup>49</sup> Salidjanova, *supra* note 43, at 3.

<sup>50</sup> Exec. Order No. 11,858, 40 Fed. Reg. 20,263 (May 9, 1975).

<sup>51</sup> *Id.*

<sup>52</sup> JAMES K. JACKSON, CONG. RESEARCH SERV., RL33388, THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS) 2 (June 12, 2013).

<sup>53</sup> 50 U.S.C.A. § 2170 (West 2013).

<sup>54</sup> *Id.*

further required CFIUS to investigate all proposed foreign investments where the investor is acting on behalf of a foreign government.<sup>55</sup> By 2007, CFIUS's increasing role in U.S. economic relations was deemed important enough to warrant the Foreign Investment and National Security Act of 2007 (FINSA), which provides, among other things, that CFIUS activities thereafter be subject to broader Congressional oversight.<sup>56</sup>

## 2. *CFIUS Effects on China FDI Attempts*

In recent years, CFIUS has arguably scrutinized investments of Chinese origin more so than investments originating from anywhere else. This is attributable at least in part to the publicity generated by China's unparalleled economic growth over the past several decades, the pervasive and frequently murky involvement of the Chinese government in purportedly private industries, and the Chinese government's encouragement of outbound FDI for strategic purposes through mergers and acquisitions. Since the Exon-Florio Agreement granted the President the power to block foreign investment pursuant to CFIUS national security concerns in 1988, only two foreign investment attempts have been explicitly blocked by the President of the United States.<sup>57</sup> Both of those investment attempts involved investment capital originating from China.<sup>58</sup> Other investment attempts by Chinese investors were voluntarily terminated by the investing parties upon facing CFIUS opposition and, at times, political pressure from Congress.<sup>59</sup> We look at a few of the more prominent of these cases in turn.

In 1990, President George H.W. Bush was the first U.S. president to exercise his CFIUS/Exon-Florio power to block foreign investment on the basis of national security considerations.<sup>60</sup> The thwarted deal involved China National Aero-Technology Import & Export Corporation's (CATIC) attempt to acquire Seattle-based MAMCO

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<sup>55</sup> See JACKSON, *supra* note 52, at 6.

<sup>56</sup> CFIUS Reform: The Foreign Investment & National Security Act of 2007 (FINSA), U.S. Dep't. of the Treasury (Nov. 14, 2008), <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/Summary-FINSA.pdf>.

<sup>57</sup> See Mendelowitz, *supra* note 49, at 1–2.

<sup>58</sup> Dinny McMahon, *China's Sany Group: U.S. Discriminates Against China Firms' Investments*, WALL ST. J., <http://online.wsj.com/news/articles/SB10000872396390444734804578064183506227980> (last updated Oct. 18, 2012).

<sup>59</sup> See Jackson, *supra* note 52, at 9–13.

<sup>60</sup> See Mendelowitz, *supra* note 48, at 2.



Manufacturing.<sup>61</sup> CATIC was (and is) a Chinese state-owned enterprise whose principal business is the manufacture of military aircraft intended for use by the Chinese government. MAMCO, the target of the acquisition, was a small, U.S.-based aircraft component manufacturer that supplied components to U.S. military aircraft manufacturers Boeing and McDonnell Douglas.

In 2012, President Barack Obama was the second U.S. president to exercise his CFIUS/Exon-Florio power to block foreign investment.<sup>62</sup> President Obama ordered Ralls Corporation to divest its holdings in several wind farm projects located in Oregon, citing the wind farm projects' proximity to a U.S. Naval Weapons Training Facility as posing a national security threat.<sup>63</sup> The Ralls Corporation is a U.S. company incorporated in the state of Delaware.<sup>64</sup> Ralls is privately owned by two executives of Sany Heavy Industry Co., Ltd. ("Sany" hereinafter), a Chinese company that is one of the world's largest heavy equipment manufacturers.<sup>65</sup> Sany's primary business involves the manufacture of machinery related to concrete, coal mining, pile driving, road construction, wind power, port operations, and other assorted hoisting machinery.<sup>66</sup> Ralls' intention was to install Sany-manufactured wind turbines at the Oregon wind farm sites.<sup>67</sup>

In addition to the two investment attempts that were expressly blocked by the President of the United States describe above, several other investment proposals involving investment capital of Chinese origin were withdrawn by their respective Chinese investors subsequent to less direct U.S. opposition. In 2005, China National Offshore Oil Corporation's (CNOOC) attempted acquisition of American oil company Union Oil Company of California (Unocal) for \$18.5 billion was foiled by CFIUS-related national security concerns.<sup>68</sup> CNOOC is a Chinese state-owned oil company. CNOOC withdrew its bid after significant political tension in Congress relating to a general concern with the Chinese acquisition of such a significant volume of oil assets.<sup>69</sup>

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<sup>61</sup> *Id.*

<sup>62</sup> *See* McMahon, *supra* note 58.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> DICK K. NANTO ET AL., CONG. RESEARCH SERV., RL33093, CHINA AND THE CNOOC BID FOR UNOCAL 15 (2005).

<sup>69</sup> *Id.*

In 2008, renowned U.S. private equity company Bain Capital, in conjunction with China's Huawei Technologies Co. Ltd.'s ("Huawei" hereinafter), attempted to acquire U.S. technology company 3Com for \$2.2 billion.<sup>70</sup> Huawei is a privately owned company whose business is the design and manufacture of telecommunications and networking equipment. Its products also include multimedia technology, smartphones, and tablet computers. 3Com is a (now defunct) U.S. company whose business was the design and manufacture of networking equipment. Bain Capital and Huawei ultimately withdrew their bid subsequent to significant CFIUS opposition. Huawei's status as a private (i.e., not state-owned) company notwithstanding, CFIUS was concerned about Huawei's relationship with Chinese military and intelligence agencies.<sup>71</sup> CFIUS cites as its basis for this concern that Huawei's founder was an officer in China's People's Liberation Army twenty-some years ago prior to his founding Huawei.<sup>72</sup>

Each of the four failed investment attempts involving China FDI discussed above (i.e., CATIC's attempted acquisition of MAMCO, Ralls wind farms projects in Oregon, CNOOC's attempted acquisition of Unocal, and Bain/Huawei's attempted acquisition of 3Com) were foiled, at least in part, on the basis of CFIUS opposition citing somewhat amorously defined "national security concerns." From these cases, a few general trends can be drawn. First, with respect to the admission of investment, Chinese investors are not treated the same as U.S. domestic investors when it comes to the defense industry. Second, a scenario generally arousing U.S. concern is an investment attempt by China state-owned enterprises (SOEs); some people fear that the principal purpose of the investment is to advance China's global political interests as opposed to the SOE's economic interest.

As discussed previously, CFIUS opposition to all four investment attempts involving China FDI was purportedly on the basis of U.S. "national security concerns." Of the four cases, President George H.W. Bush's block of the CATIC's attempted acquisition of MAMCO Manufacturing is probably the most justifiable on national security grounds. MAMCO was an aerospace component manufacturer supplying components for companies engaged in the

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<sup>70</sup> Bruce Einhorn, *Huawei's 3Com Deal Flops*, BLOOMBERG BUSINESSWEEK (Feb. 21, 2008), [http://www.businessweek.com/globalbiz/blog/eyeonasia/archives/2008/02/huaweis\\_3com\\_deal\\_flops.html](http://www.businessweek.com/globalbiz/blog/eyeonasia/archives/2008/02/huaweis_3com_deal_flops.html).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

production military aircraft for the U.S. military (e.g., Boeing, McDonnell Douglas).<sup>73</sup> CATIC, the Chinese state-owned company who sought to acquire MAMCO, was, and still is, engaged in the business of manufacturing military aircraft for the Chinese military.<sup>74</sup> A Chinese state-owned company's most senior executives are typically appointed by the government. At least circa 1990, it is not unreasonable to infer that CATIC's corporate goals were closely tied to those of the Chinese government. The acquisition of a U.S. defense industry manufacturer by a foreign state-owned company is precisely the type of FDI attempt that CFIUS was established to flag.

We next look at CNOOC's attempted acquisition of Unocal in 2005 and Huawei and Bain Capital's attempted acquisition of 3Com in 2008. CNOOC is a Chinese state-owned oil business that sought in 2005 to acquire assets relating to oil exploration. Huawei is a privately owned Chinese enterprise that sought to acquire significant assets relating to computer networking in 2008. Congressional delays and calls for extensive inquiries with the investing parties significantly impeded the progress of both deals. With respect to the CNOOC deal, there is little evidence that CNOOC's acquisition of Unocal's U.S. and foreign oil interests would pose any significant national security threat. CNOOC is indeed a Chinese state-owned company, and is thus inevitably tied to the Chinese government in at least that respect. There is ample evidence in this case, however, that CNOOC's desire to acquire Unocal was motivated primarily by a desire to acquire sufficient oil assets to provide for, and profit from, China's increasing domestic demand for petroleum products,<sup>75</sup> and not by a strategic, governmental interest of the Chinese central government adverse to U.S. security interests.<sup>76</sup>

With respect to the 2008 attempt to acquire 3Com, Huawei is not a Chinese state-owned company. CFIUS cites as basis for its "national security concern" only that the founder of Huawei was a member of the People's Liberation Army prior to founding Huawei twenty-plus years ago.<sup>77</sup> At the time of this writing, there is little evidence in the public record suggesting that 3Com was in possession of any technologies or business contracts essential to U.S. national security. Given that many Chinese citizens other than Huawei's founder served

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<sup>73</sup> See Mendelowitz, *supra* note 48.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> See NANTO ET AL., *supra* note 68.

<sup>77</sup> See Einhorn, *supra* note 70.

in the Chinese military at some point in their life prior to transitioning to civilian life, this association alone absent other evidence is at best weak support for the contention that Huawei's desire to acquire 3Com was motivated by Chinese governmental strategic interests.

Finally, we turn to President Obama's 2012 CFIUS-backed divestment order directed at Ralls Corporation. Ralls is a privately owned corporation registered and incorporated in the United States. The owners of Ralls are Chinese executives of a heavy industry manufacturer who sought to develop wind farms in Oregon using Chinese-manufactured wind turbines; they have no affiliation with the Chinese government. President Obama's CFIUS order mandating that Ralls completely divest its interests in the wind farm projects reportedly could cause Ralls to incur up to \$20 million in losses.<sup>78</sup> The divestment order cites as basis for its "national security concern" the wind farm's proximity to a nearby U.S. Naval Weapons Training Facility.<sup>79</sup> This assertion is intriguing because prior to Ralls' involvement, the proposed wind farm sites were not subject to any special treatment. The land was held by Terna Energy USA Holding Corporation, a subsidiary of a Greece-based consortium,<sup>80</sup> who then sold its interests to Ralls. President Obama's divestment order nullified the aforementioned transaction, returning possession to Terna. In regards to the fairness of President Obama's rejection of Ralls' ownership of wind farm interests in favor of Terna's ownership, we do not comment. As evidenced by the failed CNOOC deal in 2005 and the failed Huawei deal in 2008, however, CFIUS rulings are rarely referred to the president before being resolved some other way.<sup>81</sup> Thus, President Barack Obama's decision to invoke his CFIUS powers to order divestment of Chinese interests in the Ralls wind farm project at the height of his 2012 Presidential Campaign, suggests at the very least that CFIUS "national security concerns" are not completely removed from the demands of domestic U.S. politics.

The above critique, of course, is offered subject to a significant caveat. Namely, the analysis is offered from the perspective of a layperson without access to critical, possibly classified information

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<sup>78</sup> Jasmine Wang, *Sany Affiliate May Lose \$20 Million on U.S. Wind-Farm Ban*, BLOOMBERG (Oct. 3, 2012, 7:03PM PT), <http://www.bloomberg.com/news/2012-10-04/sany-affiliate-may-lose-20-million-on-u-s-wind-farm-ban.html>.

<sup>79</sup> *Id.*

<sup>80</sup> Andrew Zajac, *Ralls Loses Bid for Court Order to Block Wind-Farm Sale*, BLOOMBERG (Mar. 1, 2013), <http://www.bloomberg.com/news/2013-03-01/ralls-loses-bid-for-court-order-to-block-wind-farm-sale.html>.

<sup>81</sup> See JACKSON, *supra* note 52.

available only to policymakers in the U.S. Federal Government. Securing the national security of the United States is undoubtedly one of the few unquestioned responsibilities of the U.S. government. The government, however, should be ever wary of the use of national security as an umbrella term to justify policies motivated principally by other considerations, and perhaps only collaterally, if at all, by national security.

#### ***D. The Impact of a U.S.-China BIT on Inbound China FDI***

President Barack Obama's arguably shaky "national security" foundation pursuant to which he ordered divestment by Ralls of its Oregon wind farm interests illustrates the purpose that a U.S.-China BIT could serve. While it is highly unlikely that any U.S.-China BIT could completely remove all obstacles to inbound Chinese FDI, political or otherwise, even a slightly incremental improvement in investor confidence is likely to result in multibillion dollar capital injections into the United States. In view of China's \$1.6 trillion cumulative investment in U.S. securities,<sup>82</sup> the relatively paltry sub-ten billion<sup>83</sup> value of cumulative inbound Chinese FDI (from 2005 to 2011) is not due to a shortage of available investment capital. Nor is it, in view of the failed FDI attempts described previously, attributable to a lack of investor interest. Rather, China-adverse political attention frequently forces potential Chinese investors to voluntarily withdraw or at least significantly reduce investment amount.<sup>84</sup> This position is bolstered at least by one commentator's observation that China's sovereign wealth fund and other investment entities have attempted to avoid political controversy in the United States by limiting its investment, such that its consequent ownership shares amount to less than ten percent.<sup>85</sup>

There are certain cases, such as those closely related to national security, where controversy and heightened attention on behalf of the United States government is unavoidable, and perhaps even at times warranted, in view of the U.S. government's responsibility to its citizenry. Arguably, President George H.W. Bush preventing CATIC (a Chinese state-owned manufacturer of military aircraft for the Chinese military) from acquiring MAMCO Manufacturing (a

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<sup>82</sup> WAYNE M. MORRISON, CONG. RESEARCH SERV., RL33536, CHINA-U.S. TRADE ISSUES 14 (2013).

<sup>83</sup> *Id.* at 16.

<sup>84</sup> See, e.g., NANTO ET AL., *supra* note 69; Einhorn, *supra* note 70.

<sup>85</sup> MORRISON, *supra* note 83, at 20.

component supplier to manufacturers of military aircraft for the U.S. military) presents one such case. There are arguably other cases, however, where “national security concerns” have served as little more than mere rhetoric purposed to stir up political animosity and effect thinly-veiled discrimination. It is this latter behavior that a U.S.-China BIT, partly through the treaty’s literal language and partly through the symbolic “stamp of approval” effect, has the potential to preempt. A stable developmental business relationship between the United States and China has the potential for significant consequential impact on the global economy, and is arguably too important to be left fully exposed to the demands of U.S. politics. To that end, the United States and China have been hard at work on refining the terms of a U.S.-China BIT.<sup>86</sup>

### *1. Admission of Investment*

A U.S.-China BIT may have significant effects on the admission of Chinese investment into the United States. As discussed above, admission of Chinese investments has in recent decades been subject to close scrutiny on the basis of national security. Pursuant to the Byrd Amendment of 1992, CFIUS is to afford exacting scrutiny to state-affiliated investments.<sup>87</sup> A U.S.-China BIT containing the National Treatment and Most-Favored Nation (MFN) Treatment clauses such as those found in Articles 3 and 4 of the U.S. Model BIT,<sup>88</sup> respectively, however, may compromise said national security protection efforts unless appropriate legal accommodations are made.

Most nations reserve certain industries in which ownership and control is required to be domestic. Defense-related industries, for example, are commonly off-limits to foreign investors. For this reason, a BIT containing a general National Treatment clause, stating to the effect that foreign investment interests will be treated no less favorably than a domestic interest, will likely be accompanied by a carve-out provision excluding certain industries from foreign investment on the basis of national security. The MFN Treatment clause of the U.S. Model BIT is another area of interest. A U.S.-China BIT containing a MFN Treatment clause such as that provided in the U.S. Model BIT would compel the United States to extend to Chinese

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<sup>86</sup> Doug Palmer, *US lawmaker urges investment treaty pact with China*, REUTERS (Apr. 26, 2012, 6:06 PM), <http://www.reuters.com/article/2012/04/26/usa-china-trade-idUSL2E8FQ3M220120426>.

<sup>87</sup> Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49 (2007).

<sup>88</sup> See U.S. Model BIT, *supra* note 30.

investments the same degree of latitude that it does with longtime U.S. allies, such as United Kingdom. Such an obligation seems at odds with the seemingly heightened scrutiny of investments originating from China historically advocated by some guardians of U.S. national security interests. Given China's status as a government master-planned economy and the fact that a substantial portion of China's outbound FDI is provided by Chinese SOEs,<sup>89</sup> national security concerns with regard to Chinese investment are not completely unwarranted. For at least this reason, any U.S.-China BIT including a MFN Treatment clause is likely also to contain a national security "escape hatch" clause of some sort, expressly permitting the United States to block Chinese investments on the basis of national security concerns without breaching its treaty obligations.

Another aspect of BITs is the issue of standing. When the government of one party to a BIT (i.e., a sovereign state) acts in a manner inconsistent with its National Treatment or MFN Treatment obligations, an injured *individual* belonging to the other party to the BIT, whether a real person or a corporate entity, will typically have standing to file for arbitration under the dispute resolution provisions of the BIT.<sup>90</sup> In contrast, in the absence of such BIT providing for dispute resolution proceedings accessible to the injured party, the aforementioned forum would not be available. Historically, under multilateral treaties such as the WTO, the standing to bring a claim is available only to the treaty parties (i.e., the sovereign states). With a U.S.-China BIT in place, investors (e.g., CNOOC, Huawei, Ralls) subjected to U.S. Government treatment that is inconsistent with the U.S.'s National Treatment or MFN Treatment obligations under the BIT would likely have an opportunity to challenge the legality of their treatment via arbitration before a neutral, third-party tribunal. In the absence of the BIT, the injured investor may, for example, be relegated to withdrawing its investment following the first sign of U.S. political or media opposition.

Potential legal consequences stemming from a U.S.-China BIT aside, it is incontrovertible that it is economically prudent for the U.S. government to exercise discretion in use of its CFIUS powers. China's outbound FDI has gone to very limited areas including tax havens and acquiring technology, natural resources, and recognized brand names.<sup>91</sup> While the FDI being deposited in tax havens may

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<sup>89</sup> See JACKSON, *supra* note 52, at 6.

<sup>90</sup> See, e.g., U.S. Model BIT, *supra* note 30.

<sup>91</sup> See generally Salidjanova, *supra* note 43.

have numerous motivations and justifications, the FDI being invested for acquisition of technology, natural resources, and recognized brand names has a definite strategic component. The challenge is discerning whether (1) the FDI attempt is predominantly motivated by business strategy (arguably not invoking CFIUS oversight), or (2) the FDI attempt is predominantly motivated by military strategy or will significantly undermine U.S. military effectiveness (e.g., where CFIUS supervision is necessary). Critics of Chinese FDI in the United States frequently try to find some tie between the Chinese investor and the Chinese government to make the argument that whatever U.S. interests the investor is seeking to acquire has some strategic value to the Chinese government.<sup>92</sup> Additionally, adverse media attention frequently accompanies any sizable investment by China's SOEs (e.g., CNOOC).<sup>93</sup> Recent challenges faced by Chinese FDI attempts, such as the occurrences described earlier, suggest that any significant interests acquired through the use of investment capital of Chinese origin causes anxiety in the United States that the increase in global interests under the direct or indirect purview of the Chinese government somehow undermines the global influence and power of the U.S. government.

The other side of the argument is that the increasingly mutualistic relationship between the United States and China suggests that it is in the United States' best interest to carefully weigh the costs and benefits associated with invoking CFIUS powers to block Chinese FDI. While a large portion of the China outbound FDI is provided by China SOEs, there also exists a substantial and ever-increasing amount of Chinese-sourced FDI provided by successful, private (i.e., non-SOE) Chinese companies (e.g., Huawei, Sany, etc.). To the extent that the admission of China inbound FDI that is closely connected to the Chinese government sometimes warrants heightened scrutiny, and in limited circumstances, even governmental intervention, over-application of this general rule inevitably hinders the United States from benefitting from large scale, business-driven Chinese investments in the U.S. economy.

In view of the above, it is this author's opinion that a definition of "national security" that is in line with the term's narrower, militaristic roots must be adopted. Consistent with such a definition, a proper determination of whether CFIUS should intervene in a business transaction involving FDI should hinge on the outcome of a case-

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<sup>92</sup> See NANTO ET AL., *supra* note 68.

<sup>93</sup> *Id.*



specific and fact-dependent balancing of the likelihood that FDI result in *physical* harm to the United States or significantly undermine the U.S. military's effectiveness in an armed conflict against the likelihood that the FDI will benefit the U.S. economy and the magnitude of such economic benefit. More specifically, as discussed earlier, the United States may benefit from an injection of foreign capital that has the potential to create and maintain jobs, bolster U.S. domestic consumer confidence, and increase U.S. government tax revenues.

In review of the four failed FDI attempts involving investment capital of Chinese origin discussed earlier, applying said balancing test, albeit with only the facts accessible to the general public, yields some interesting conclusions. Of the four deals, arguably only Chinese state-owned CATIC's 1990 attempted acquisition of MAMCO, the U.S. military aircraft component manufacturer, can be reasonably claimed to involve a sufficiently high degree of likelihood of adverse impact to the United States military to outweigh the economic benefits of the FDI.

With respect to the FDI attempts involving CNOOC, Huawei, and Ralls, however, the facts available to the general public do not paint scenarios wherein the likelihood of physical harm to the United States is of sufficiently high degree to outweigh the economic benefits of the FDI. CNOOC and Huawei involved multibillion dollar acquisition attempts of oil assets and non-state-of-the-art networking technology, respectively.<sup>94</sup> In neither case did the facts made available to the general public establish sufficient nexus between the acquisitions and actual, non-speculative harm to the United States.

The Ralls deal involved CFIUS's objection to the acquisition of land and subsequent construction of wind farms on said land using investment capital of Chinese origin.<sup>95</sup> CFIUS cited the land's proximity to a U.S. Naval Weapons Training Facility as the reason for issuing the divestment order.<sup>96</sup> The irony, however, is that Ralls' predecessor in interest in the land was in fact the subsidiary of a foreign company, who also intended to use the land to build a wind farm, but CFIUS never paid them any attention.<sup>97</sup> Given the absence of significant connection between Ralls and the Chinese government, the mere involvement of investment capital of Chinese origin is

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<sup>94</sup> See NANTO ET AL., *supra* note 68; Einhorn, *supra* note 70.

<sup>95</sup> See Wang, *supra* note 78.

<sup>96</sup> *Id.*

<sup>97</sup> See Zajac, *supra* note 80.

arguably insufficient to establish sufficient nexus between the FDI and a tangible harm to U.S. security interests.

## 2. *Fair Treatment and Protection Against Expropriation*

A U.S.-China BIT would likely also contain provisions governing the treatment of foreign investments post-admission. A BIT drafted pursuant to the U.S. Model BIT will typically include terms addressing fair treatment of the foreign investment once admitted, including protection against expropriation and specific dispute resolution mechanisms through international arbitration.<sup>98</sup> As applied to a discussion on inbound Chinese investment, these fair treatment provisions of a potential U.S.-China BIT are interesting in that they could potentially be invoked *against* the U.S.

Given the longtime U.S. adherence to the rule of law and the United States' comparatively mature judicial system relative to the rest of the world, one might conclude that a fair treatment treaty provision is superfluous. The facts of *O'Keefe v. Loewen*, however, suggest that the potential unfair treatment of foreign businesses and investors should not be completely ruled out.<sup>99</sup> *Loewen* involved a simple breach of contract suit between an American plaintiff and a Canadian corporate defendant tried in Mississippi trial court.<sup>100</sup> The proceeding involved countless inflammatory, anti-foreign statements by the American plaintiff as well as a prevalence of erroneous jury instructions by the judge.<sup>101</sup> The net value of damages at issue in the purported contract breach was \$2.5 million.<sup>102</sup> When the dust settled, the Mississippi jury returned a verdict for the American plaintiff in the amount of \$500 million.<sup>103</sup> Mississippi law, which required the Canadian defendant to pay \$200 million within seven days to stay collection of the \$500 million jury verdict, served for the Canadian defendant as a *de facto* bar to appealing the decision.<sup>104</sup>

The Canadian defendant in *O'Keefe v. Loewen* subsequently initiated an arbitration action against the United States pursuant to Article 1116 of the North American Free Trade Agreement (NAFTA),

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<sup>98</sup> See U.S. Model BIT, *supra* note 30.

<sup>99</sup> *O'Keefe v. The Loewen Group Inc.*, 91-67-423 (Cir. Ct., Hinds Co., Miss. 1995).

<sup>100</sup> TODD WEILER, INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW 686 (2005).

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 687.

<sup>104</sup> *Id.*

alleging that the United States breached its obligation under NAFTA to secure a minimum standard of treatment to investors from other NAFTA treaty parties, here Canada.<sup>105</sup> Specifically, Loewen, the Canadian defendant, claimed that its treatment by the Mississippi trial court was a failure by the United States to comply with its NAFTA Article 1105 treaty obligation to provide “fair and equitable treatment” to investors from other NAFTA treaty parties.<sup>106</sup> The NAFTA arbitration tribunal ultimately dismissed Loewen’s case on jurisdictional grounds, but the tribunal nevertheless acknowledged Loewen’s unfair treatment, admitting candidly that “the [Mississippi] trial . . . was a disgrace . . . the tactics of [the American plaintiff] . . . impermissible.”<sup>107</sup> “[T]he whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment [as required by NAFTA Article 1105.]”<sup>108</sup>

A U.S.-China BIT is likely to contain some variation of the NAFTA “fair and equitable treatment” clause discussed in the *Loewen* arbitration, such as that provided by Article 5 of the 2012 U.S. Model BIT.<sup>109</sup> In the context of Chinese FDI, fair treatment provisions in a U.S.-China BIT would provide Chinese investors with additional protections beyond the U.S. justice system for their investments in the United States, as well as financial compensation if the United States violates its BIT obligations. These protections offered by a potential U.S.-China BIT seem particularly applicable in view of the Ralls wind farm project where President Obama invoked his CFIUS powers and ordered the wind farm project’s Chinese interest holders to completely divest their interests, causing the Chinese to incur losses purportedly in excess of twenty million. In some ways, this ordered divestment might be construed as indirect expropriation of foreign owned investment interests. The Chinese stakeholders have chosen to pursue legal action in U.S. courts,<sup>110</sup> an avenue that may be of limited success given the classified nature of facts underlying CFIUS decisions. Were a U.S.-China BIT containing fair treatment and expropriation provisions in place, however, the

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<sup>105</sup> *Id.*

<sup>106</sup> *Id.* at n.81.

<sup>107</sup> *Id.*

<sup>108</sup> In the Proceeding Between The Loewen Group, Inc. and Raymond L. Loewen (Claimants) and United States of America (Respondent), ICSID Case No. ARB(AF)/98/3, (June 26, 2003) at 8, <http://www.tjsl.edu/slomansonb/Loewen.pdf>.

<sup>109</sup> See U.S. Model BIT, *supra* note 30.

<sup>110</sup> See Zajac, *supra* note 80.

Chinese interest holders in Ralls would at least have at their disposal an alternate forum (arbitration) and an alternate legal basis (U.S. treaty obligations) for their case.

### III IMMIGRATION

The encouragement of U.S. immigration for the newly wealthy Chinese provides yet another possible avenue available to U.S. policymakers who seek to take advantage of China's recent economic prosperity to assist the recovery of the U.S. economy from the 2007 Global Economic Crisis. The Ralls Corporation divestment order provides a fitting segue into this discussion. Besides providing a backdrop for our discussion of the potential effects of a U.S.-China BIT, the reaction by Ralls' Chinese interest holders amidst the CFIUS intervention serves as a reminder that in certain respects, the perception of the United States as a desirable place to live and raise a family is largely untarnished, its appeal undiminished. One of the Chinese executives who was ordered to divest his interests in the Ralls wind farm projects pursuant to U.S. national security concerns is quoted as saying, "[r]egardless [of the ordered divestment of my interests in Ralls], I personally feel that the U.S. is a great nation."<sup>111</sup> Additionally, he stated that he still hopes to send his son to study in the United States someday.<sup>112</sup>

China always looked to the United States, perhaps more so than any other Western nation, as its developmental role model. To illustrate this point, consider the issue of education. In the 1980s, the Chinese government sponsored thousands of Chinese to travel to the United States (and to a lesser extent, Japan and western European nations) to pursue graduate education in science and engineering.<sup>113</sup> While some of these scholars returned to China immediately following their education, many chose to put down roots and start families abroad.<sup>114</sup> As China's development accelerated in the 1990s, China began to look more and more appealing to these overseas scholars now accustomed to Western standards of living. In the late 1990s and early 2000s, many returned to China, often with their

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<sup>111</sup> See McMahon, *supra* note 58.

<sup>112</sup> *Id.*

<sup>113</sup> *China: return of the 'sea turtles,'* NEW ECONOMIST (Feb. 16, 2006, 8:31 AM), [http://neweconomist.blogs.com/new\\_economist/2006/02/china\\_return\\_of.html](http://neweconomist.blogs.com/new_economist/2006/02/china_return_of.html).

<sup>114</sup> *Id.*

families and children.<sup>115</sup> These frequently highly educated scholars that the Chinese call *hai gui* are in high demand by China's domestic employers.<sup>116</sup>

The return of China's state-sponsored education recipients during China's development boom did not signify to the Chinese populace that the United States was somehow no longer worthy of its role model status. Rather, the return of *hai gui* to China and their rapid rise to prominence in Chinese industry removed any remaining inkling of skepticism towards the value of an innovation-promoting and leader-producing U.S. education. Millions of Chinese, particularly those inhabiting the "first tier" cities of Beijing, Shanghai, and Shenzhen, intend to send their children to pursue secondary and post-secondary education overseas. Of China's over one million millionaires, over 85% plan to send their children overseas for education.<sup>117</sup> The United States is frequently among these millionaires' top choices.<sup>118</sup>

From the perspective of U.S. policymakers, the favorable Chinese predisposition toward the U.S. education system can be used to produce tangible economic benefits for the U.S. government both indirectly and directly. Pursuant to the U.S. government's reliance on tax revenues, an influx of wealthy Chinese immigrants is inevitably accompanied by an injection into the U.S. economy of Chinese-origin capital to support the maintenance of the luxurious lifestyle to which these wealthy immigrants are accustomed. Another not insignificant, albeit more attenuated, indirect benefit is the general fostering of relations between the United States and China through this sharing of cultures, and the subsequent economic fruits of future collaborative efforts between parties from both countries. The less attenuated and more direct revenue generating pathways, however, are likely to be what is on the minds of U.S. policymakers and hence is what we focus on here.

The principal obstacle for Chinese seeking to procure overseas education opportunities for their children is the difficulty of U.S. immigration. While student visas are granted liberally to the foreign scholars themselves, younger students and students who seek post-education work experience in the United States encounter unique

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<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Meet the Average Chinese Millionaire*, FINANCIAL POST (Aug. 1, 2012, 2:13 PM), <http://business.financialpost.com/2012/08/01/meet-the-average-chinese-millionaire-39-plays-golf-and-owns-an-ipad/>.

<sup>118</sup> *Id.*

challenges. With respect to the former, while U.S. boarding schools are a viable option, the child-centric Chinese family culture attributable in part to China's one child policy undoubtedly makes shipping off a preteen to a foreign country somewhat unappealing. As the age of the children sent to study overseas get progressively younger and younger, wealthier parents frequently prefer to purchase secondary homes in close proximity to where their child is studying.<sup>119</sup> Frequently, it is desirable for the mother or grandparents to be relocated to look after the young child. Thus, notwithstanding the liberal granting of student visas to a child student, immigration of the child's caretakers presents its own challenge. Additionally, there is an increasing emphasis by potential employers on the relevant employment experiences of newly graduated candidates. The U.S. student visa system generally bars the visa recipient from attaining most forms of legal employment,<sup>120</sup> limiting the value of a U.S. diploma in securing post-graduate employment for students who relied on the student visa for U.S. immigration.

#### A. *EB-5 Investment Immigration*

EB-5 Investment Immigration provides an existing avenue for foreign families seeking to secure U.S. immigration.<sup>121</sup> EB-5 is a policy instituted in the early 1990s to create jobs and help the U.S. economy recover from the then-existing recession.<sup>122</sup> Nearly twenty years later, China's newly rich are utilizing the EB-5 Investment Immigration program to secure immigration to the United States for their children and their families.<sup>123</sup> The EB-5 program grants foreigners permanent residency in the United States provided that they invest in the United States a certain amount of money and a meet a series of other investment conditions.<sup>124</sup> The first requirement is

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<sup>119</sup> Morgan Brennan, *Real Estate Tourism: Who's Really Buying America's Homes?*, FORBES (Aug. 10, 2012, 9:00 AM), <http://www.forbes.com/sites/morganbrennan/2012/08/10/real-estate-tourism-whos-really-buying-americas-homes/>.

<sup>120</sup> *Students and Employment*, U.S. CITIZENSHIP AND IMMIGR. SERV. (July 29, 2013), <http://www.uscis.gov/working-united-states/students-and-exchange-visitors/students-and-employment>.

<sup>121</sup> *EB-5 Immigrant Investor*, U.S. CITIZENSHIP AND IMMIGR. SERV. (July 3, 2012), <http://www.uscis.gov/working-united-states/permanent-workers/employment-based-immigration-fifth-preference-eb-5/eb-5-immigrant-investor>.

<sup>122</sup> *Id.*

<sup>123</sup> Jason Chow & Angus Loten, *More Wealthy Chinese Said to Prepare Exits*, WALL ST. J. (May 11, 2012), <http://online.wsj.com/news/articles/SB10001424052702304203604577393841014313050>.

<sup>124</sup> *EB-5 Immigrant Investor*, *supra* note 121.

satisfied if the foreign investor invests in the United States a minimum investment of either \$500,000 or \$1,000,000, depending on the geographic location of the recipient of the investment.<sup>125</sup> The required amount of investment is dictated by the unemployment level of the investment location.<sup>126</sup> Places with higher unemployment levels require the smaller of the two investment amounts, while places with lower unemployment and presumably better economies require the larger of the two amounts. With respect to the second EB-5 requirement regarding investment conditions, the principal investment condition is that the foreign investment creates or maintains at least ten full-time jobs.<sup>127</sup>

The principal shortcoming of the EB-5 immigration program is the difficulty of satisfying the job-creation requirement. By requiring that the investment finance the start or maintenance of a business in the United States, EB-5 implicitly requires that the investor or his partners possess a certain degree of expertise and experience with respect to conducting business in the United States. This is a difficult obstacle to surmount, as many potential investor immigrants do not possess these qualifications. Taking on one or more U.S.-based business partners may provide a viable solution, but some may be fearful of being swindled by a business partner located half a world away. For at least these reasons, EB-5 investors may be relegated, for example, to setting up small businesses such as a restaurant, café, or the like, to be managed by one or more family members who relocate to the United States for the purpose of accompanying a minor child. Given the questionable success rates of U.S. small businesses in recent years, however, the proposition of operating a business in a foreign country is undoubtedly a daunting one for an individual just off the plane from China. Irrespective of a Chinese investor's moneymaking success in China and elsewhere, there is little guarantee that this success translates into an ability to successfully operate a business in the United States.

### ***B. Alternative Immigration Policies for High Net Worth Individuals***

While the EB-5 objective of creating U.S. jobs to stimulate the U.S. economy from the bottom up through the use of foreign investment capital undoubtedly deserves applause, the daunting task of operating a U.S. business is likely to undermine the program's

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<sup>125</sup> *EB-5 Immigrant Investor*, *supra* note 121.

<sup>126</sup> *EB-5 Immigrant Investor*, *supra* note 121.

<sup>127</sup> *EB-5 Immigrant Investor*, *supra* note 121.

appeal to potential Chinese investors, and in turn diminish the intended stimulus effects on the U.S. economy. EB-5 sought to provide a direct link between the grant of U.S. immigration and the creation of U.S. jobs. For the U.S. government, salaries paid for using foreign investment capital means U.S. tax revenues at least in the form of federal income tax derivable from said foreign investment capital, as well as other taxable transactions. This scenario is undoubtedly ideal for the U.S. government. Unfortunately, for at least the reasons described above, its feasibility is limited.

There do exist, however, less direct, immigration-oriented policies that the U.S. government could potentially enact to derive economic benefit from wealthy individuals seeking immigration to the United States. For avenues in which the principal economic objective of job creation is more attenuated, a lesser standard of immigration such as a long-term visa with no employment restrictions may be more appropriate (in contrast to the permanent residency provided by the EB-5 program). One option would be to condition immigration on the purchase and holding of a certain value of U.S. bonds. Another option would be conditioning immigration on the purchase and holding of real property of a certain value. Yet another option would simply be to charge a high application fee for the long-term visa with no employment restrictions.

The shared premise behind these alternative immigration policies is that they are self-selecting for high net worth immigrants and their families. The spending of high net worth immigrants necessary to sustain the luxurious lifestyle to which they are accustomed injects foreign capital directly into local U.S. economies. Chinese immigrants are from a background where automobiles, jewelry, high fashion, and other forms of conspicuous consumption are still subject to high tariffs and middleman markups. A weekend walk through any outlet mall in any major city in the United States will reveal the hordes of Chinese tourists descending from tour busses ready to spend like there is no tomorrow. This spending can have nothing other than a positive effect on the U.S. economy. Thus, while jobs are not directly created pursuant to the immigration of a wealthy investor, jobs and substantial tax revenues will be indirectly generated as a consequence of the exorbitant spending in the United States.

### CONCLUSION

In summary, it is unlikely that China's near future economic plans will veer from the historical government-shaped master development plan. While some in the United States are concerned with China's



rapid rise and perhaps eventual overtaking of the United States as a global superpower, joint efforts by progressive members of both China and U.S. governments continue to advance mutual trust in the relationship that has taken over thirty years to build. Perhaps some more years, however, are required before the U.S. population as a whole is comfortable with strategic acquisitions by Chinese multinational companies in the United States. The U.S.-China BIT that is currently under negotiation will hopefully have favorable effects in furthering the economic relationship between the two nations, and allow for further mutual prosperity. In the short term, the United States should seriously consider policies to take advantage of the existing U.S.-favoring personal dispositions of China's Generation X. Policies that condition a grant of U.S. immigration upon a sizable injection of foreign capital into the United States would ensure an influx of wealthy Chinese immigrants eager to spend their hard-earned foreign cash in the United States.

