

THE POLITICAL ECONOMY OF INWARD FDI FLOWS: AN EXAMINATION OF OPPOSITION TO CHINESE MERGERS & ACQUISITIONS IN THE UNITED STATES

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Abstract

A great deal of political economy scholarship has focused on studying how countries can attract Foreign Direct Investment (FDI), and the effects that FDI has on growth and political stability. A related topic that has received almost no attention, however, is the divergent political reactions to inflows of FDI that occur in the countries receiving investments. This is an oversight because inward FDI flows are not equally welcomed by the host country, and, in fact, often receive strong political opposition. We study this phenomenon by examining political opposition to attempts by Chinese companies at mergers and acquisitions (M&As) with U.S. firms. This is especially important given rapidly expanding Chinese M&A activity. We hypothesize that although most legal barriers to foreign M&As are based on national security considerations, national security objections are often vehicles to channel other grievances, and economic distress and reciprocity are also key drivers of political opposition. To test this theory, we constructed an original dataset of 569 transactions that occurred between 1999 and 2014 involving Chinese acquirers and American targets. We find that there is more likely to be opposition to Chinese M&A attempts in security-sensitive industries, economically distressed industries, and sectors in which U.S. companies faced restrictions in China's M&A markets.

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1. Introduction

In 2005, a series of attempts by Chinese firms to acquire American companies made national headlines. In May of 2005, Chinese software giant Lenovo Group successfully acquired the personal computing division of IBM Corporation for \$1.75 billion. Although the sale was a voluntary market transaction that did not appear to violate any U.S. laws, the purchase triggered a backlash from Congress and the Pentagon over the transaction's national security implications.¹ At the time that this acquisition was completed, the House of Representative had already begun scrutinizing a concurrent \$18.47 billion bid by government-run China National Offshore Oil Corporation's billion to purchase Unocal Corporation, the United States' 9th largest oil exploration corporation—a deal that would ultimately also lead to widespread criticism. Then in June of 2005, Qingdao Haier Group—China's largest state-owned refrigerator manufacturer—raised many eyebrows in Congress when it offered \$1.28 billion to purchase all the assets of Iowa-based appliance maker Maytag Corporation, outbidding New York-based Ripplewood Holding's previous offer of \$1.13 billion.²

These examples highlight the political dimensions of an important and understudied dimension of international political economy: mergers and acquisitions (M&As). These are a form of foreign direct investment in which companies either combine operations (“merger”), or one company acquires a minority/majority equity stake in another company (“acquisition”).³ Although mergers and acquisitions are one of the primary mechanisms by which Foreign Direct Investments (FDI) are made, almost nothing has been written by IPE scholars about these

¹ Rahul Prabhakar, 'Deal-Breaker: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms,' *Working Paper*, (Cambridge, MA: Harvard University, March 13, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420790.

² Jessica Brice and Rob Delaney, 'Hayer, Buyout Firms' Bid for Maytag Tops First Offer,' *Bloomberg* (July 21, 2005), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=amvfWt5_13z8.

³ In contrast, a “Greenfield” investment involves an investment in a physical structure (i.e. building) where no previous facilities exist.

transactions. Instead, researcher studying investment flows have largely focused on topics like whether government policies increase FDI flows, or the impact on FDI flows on growth and stability. What this line of research has largely ignored is that not all inward FDI flows are equally welcomed by political leaders, especially in *developed* countries like the United States. As the opposition to these high profile M&A attempts illustrate, inward FDI flows may receive strong domestic opposition. What is not yet understood, however, is what factors determine whether M&A attempts from foreign firms are likely to be greeted by politicians with open arms (or at least indifference) and what attempts will be greeted with hostile opposition.

In this project, we develop and test a theory of what determinants are likely to produce political opposition to M&A attempts by foreign firms. Under the existing legal framework in the United States, the government is only able to block foreign entities acquiring of American firms when the transaction proposes a threat to “national security”.⁴ Although it is likely the case that members of Congress and the executive branch will react negatively to proposed M&A’s when the firms involved are in security sensitive industries, we theorize that other factors are also likely to cause deals to receive political opposition. We specifically hypothesize that when the target of a foreign M&A is in an economically distressed industry, or when the target firm is in an industry in which U.S. companies face restrictions from the acquiring firm’s government, American officials are likely to voice opposition to the transaction regardless of the national security implications.

We empirically test this theory by examining the factors that have produced political opposition to attempts by Chinese firms at mergers and acquisitions of U.S. firms. In the last fifteen years there has been a dramatic increase in the rise of Chinese M&A activity in the

⁴ David Zaring, 'CFIUS as a Congressional Notification Service,' *Southern California Law Review*, Vol. 83, No. 1, 2009-2010, pp. 81-133.

United States. In fact, as recently as the year 2000 the value of the annual M&A activity in the United States was less than \$1 million.⁵ In 2013 alone, however, the value of Chinese M&A activity in the United States was \$14 billion. This dramatic increase in investment activity is a clear indication of China's rising economic clout, and it is likely to increase as China's economic importance continues to grow. As a result, an examination of when this growing source of economic integration causes political tensions between China and the United States is necessary to understand how the relationship between these two economic powers is likely to evolve.

To undertake that project, we have built an original dataset of 569 transitions announced between 1999 and 2014 in which a Chinese-based firm attempted to acquire a company operating or headquartered in the United States. For each of these transitions, we surveyed a variety of sources—including executive branch press releases, statements in the Congressional Record, and local newspaper stories—to determine whether an attempted acquisition produced political opposition. We then estimate a series of regression models to explore the factors that predict whether a given transaction is likely to generate backlash. We find that U.S. political actors are more likely to oppose Chinese M&As in security-sensitive industries, as well as transactions in economically distressed industries. We also find that opposition towards Chinese inwards M&A investments is more likely in sectors in which U.S. companies faced similar investment restrictions in China. These findings suggest that Chinese M&As of U.S.-based firms often generate opposition even when the transaction does not run afoul of existing legal restrictions on foreign acquisition of American companies.⁶

⁵ This data is from the China Investment Monitor (available at <<http://rhg.com/interactive/china-investment-monitor>>) and Roberts. See Dexter Roberts, 'Chinese Investment in U.S. Doubles to \$14 Billion in 2013,' *Bloomberg Businessweek* (January 8, 2014), <http://www.businessweek.com/articles/2014-01-08/chinese-investment-into-u-dot-s-dot-doubles-to-14-billion-in-2013>.

⁶ Part 3 provides a discussion of the legal framework that regulates foreign acquisitions of American companies.

Our project makes several important contributions to the IPE literature. First, as China's economic clout and focus on outward investment increase, the M&A activities of Chinese firms are likely to continue to produce political backlashes within the United States. Our project gives insight into the factors that have produced such backlash over the last fifteen years, and helps to explain when political actors are likely to oppose Chinese attempts to acquire American companies going forward. These types of conflicts can affect the overall tenor of relations between China and the United States. Given that this relationship is becoming one of the most important for global stability, it is important to understand the causes of frictions in it. Second, although existing laws only give the United States government power to block M&A attempts by foreign firms if a proposed transaction creates a national security risk, commentators have speculated that American officials often couch their objections to M&As in national security terms even though the opposition is driven by other factors.⁷ Our project provides empirical evidence to support this claim by demonstrating that, even when controlling for national security sensitivity, proposed acquisitions of American firms are likely to generate political opposition when the target firm is either in an economically depressed industry or an industry that American firms have been blocked from investing in by the capital-exporting state. This not only suggests that domestic politics may affect the international relations between China and the U.S., but also puts a spotlight on reciprocity in international politics. Tit-for-tat relations have long been studied in the field, and have often been claimed as a source of stability and cooperation.⁸ Finally, the political economy literature has almost entirely overlooked the reactions in developed

⁷ Paul Connell and Tian Huang, 'An Empirical Analysis of CFIUS: Examining Foreign Investment Regulation in the United States,' *Yale Journal of International Law*, forthcoming.

⁸ Robert M. Axelrod, *The Evolution of Cooperation* (New York: Harper Collins: Basic Books, 1984); Deborah Welch Larson, 'The Psychology of Reciprocity in International Relations,' *Negotiation Journal*, Vol. 4, No. 3, 1988, pp. 281-301; Robert O. Keohane, 'Reciprocity in International Relations,' *International Organization*, Vol. 40, No. 1, 1986, pp. 1-27; David M. Kreps, Paul Milgrom, John Roberts and Robert Wilson, 'Rational Cooperation in the Finitely Repeated Prisoners' Dilemma,' *Journal of Economic Theory*, Vol. 27, No. 2, 1982, pp. 245-252.

countries to investment flows from developing countries. Our project demonstrates that there are valuable insights to be gained from researching this topic, and the importance of studying these phenomena will only increase as capital flows from the developing to developed world continue to grow.

The structure of this paper is as follows. Part 2 reviews existing literature on mergers and acquisitions by foreign companies from both a political economy perspective and a legal and institutional perspective, and generates hypotheses on when foreign M&As are likely to produce political opposition. Part 3 provides background on the legal framework that governs foreign M&As in the United States as well as historical and institutional background on Chinese outward investment policy. This helps to document the ways China's rise in the world economy has unfolded. Part 4 describes our research design and the original dataset that was built for this project. Part 5 presents our empirical results and considers limitations to the inferences that can be drawn from our project. Part 6 concludes by discussing our findings and proposing future research that could build on this project.

2. Literature and Theoretical Foundations

Why would a country resist inward merger and acquisition activity? Or, more broadly, why would a potential host country oppose direct foreign investment? Much research on this question has focused on developing countries' reactions to capital inflows from companies in the developed world. In this literature, concern over power relations and dependency has been foremost.⁹ The questions raised have centered on whether such investment promotes

⁹ F. Henrique Cardoso and Enzo Faletto, *Dependency and Development in Latin America* (Berkeley, CA: University of California Press, 1979); Robert R. Kaufman, Harry I. Chernotsky and Daniel S. Geller, 'A Preliminary Test of the Theory of Dependency,' *Comparative Politics*, Vol. 7, No. 3, 1975, pp. 303-330; Theodore H. Moran, 'Multinational Corporations and Dependency: A Dialogue for Dependents and Non-Dependents,' *International Organization*, Vol. 32, No. 1, 1978, pp. 79-100; Tony Smith, 'The Underdevelopment of Development Literature: The Case of

development or just greater dependency on rich countries and their firms.¹⁰ Another strand of the literature has focused on other important economic questions like what factors enable countries to receive FDI,¹¹ the effects of FDI on growth and stability,¹² and economic and distributional consequences of FDI.¹³ Within this literature political scientists have often focused on the role of political institutions, such as a country's degree of democratization, on FDI flows.¹⁴ For example, one recent paper that closely tracks our empirical interest is by Pandya.¹⁵ In a cross-national analysis of FDI restrictions, Pandya finds that democracies have fewer restrictions on FDI flows and that labor organizations see their political fortunes increase with less restrictive inward FDI

Dependency Theory,' *World Politics*, Vol. 31, No. 2, 1979, pp. 247-288; James A. Caporaso, 'Dependency Theory: Continuities and Discontinuities in Development Studies,' *International Organization*, Vol. 34, No. 4, 1980, pp. 605-628; James A. Caporaso, 'Dependence, Dependency, and Power in the Global System: A Structural and Behavioral Analysis,' *International Organization*, Vol. 32, No. 1, 1978, pp. 13-43; Peter B. Evans, *Dependent Development: the Alliance of Multinational, State, and Local Capital in Brazil* (Princeton: Princeton University Press, 1979); Peter B. Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton, NJ: Princeton University Press, 1995); Robert W. Jackman, 'Dependence on Foreign Investment and Economic Growth in the Third World,' *World Politics*, Vol. 34, No. 2, 1982, pp. 175-196.

¹⁰ G.K. Helleiner, 'Transnational Corporations and Direct Foreign Investment,' in Hollis Burnley Chenery and T. N. Srinivasan, eds. *Handbook of Development Economics* (Amsterdam: Elsevier Science, 1989), pp. 1441-1480.

¹¹ Sonal S. Pandya, 'Labor Markets and the Demand for Foreign Direct Investment,' *International Organization*, Vol. 64, No. 3, 2010, pp. 389-409; John H. Dunning, *Governments, Globalization, and International Business* (Oxford; New York: Oxford University Press, 1997); Richard E. Caves, 'International Corporations: The Industrial Economics of Foreign Investment,' *Economica*, Vol. 38, No. 149, 1971, pp. 1-27; Friedrich Schneider and Bruno S. Frey, 'Economic and Political Determinants of Foreign Direct Investment,' *World Development*, Vol. 13, No. 2, 1985, pp. 161-175; Mira Wilkins, *The History of Foreign Investment in the United States* (Cambridge, MA: Harvard University Press, 2004); Tim Büthe and Helen V. Milner, 'The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements?,' *American Journal of Political Science*, Vol. 52, No. 4, 2008, pp. 741-762.

¹² Jackman, 'Dependence on Foreign Investment and Economic Growth in the Third World'; Volker Bornschier, Christopher Chase-Dunn and Richard Rubinson, 'Cross-National Evidence of the Effects of Foreign Investment and Aid on Economic Growth and Inequality: A Survey of Findings and a Reanalysis,' *American Journal of Sociology*, Vol. 84, No. 3, 1978, pp. 651-683; Edward M. Graham and Paul R. Krugman, *Foreign Direct Investment in the United States* (Washington, D.C.: Institute for International Economics, 1995); Brian J. Aitken and Ann E. Harrison, 'Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela,' *American Economic Review*, Vol. 89, No. 3, 1999, pp. 605-618; Theodore H. Moran, Edward M. Graham and Magnus Blomström, *Does Foreign Direct Investment Promote Development?* (Washington, DC: Institute for International Economics, Center for Global Development, 2005); James R. Markusen, 'Multinationals, Multi-Plant Economies, and the Gains from Trade,' *Journal of International Economics*, Vol. 16, No. 3-4, 1984, pp. 205-226; Robert C. Feenstra and Gordon Hanson, 'Foreign Direct Investment and Relative Wages: Evidence from Mexico's Maquiladoras,' *ibid.* Vol. 42, No. 3&4, 1997, pp. 371-394.

¹³ Pablo M. Pinto and Santiago M. Pinto, 'The Politics of Investment Partisanship: And the Sectoral Allocation of Foreign Direct Investment' *Economics & Politics*, Vol. 20, No. 2, 2008, pp. 216-254.

¹⁴ Quan Li and Adam Resnick, 'Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment to Developing Countries,' *International Organization*, Vol. 57, No. 1, 2003, pp. 175-211.

¹⁵ It should be noted that Pandya's analysis does not include the United States.

flows.¹⁶ Yet, the examples in our introduction demonstrate, we know that democracies like the United States do not always welcome inward FDI; and so our paper helps to understand variation in support for inward FDI, here in the form of M&A attempts. Furthermore, less research has looked at the reactions of relatively rich countries to foreign investments by firms from developing ones.¹⁷

Rather than focusing on the influence that broad institutions have on inward FDI flows in a cross-national setting, we explore the variation in political reactions to inflows of foreign investment within a particular set of political and economic institutions. Given that previous work shows that democracies have more liberal FDI policies than non-democracies, we focus on a democratic country: the United States. This is a “tough” case for restrictions both because democracies generally have fewer restrictions to inward FDI flows,¹⁸ but also because the United States specifically has been uniquely open to foreign investment.¹⁹ Although American policy largely has been friendly to inward FDI flows, not all attempts by foreign entities have been equally well received. Instead, over the last forty years, political opposition to a series of controversial attempts by foreign firms to acquire American companies led to both legislation and executive orders that created a legal framework by which an executive branch body—the Committee on Foreign Investment in the United States (CFIUS)—reviews proposed transactions and reports to Congress.²⁰ Our project aims to explain the variation in political responses to transactions reviewed through this process; and by isolating the role of institutions in this way,

¹⁶ Sonal S. Pandya, 'Democratization and FDI Liberalization, 1970-2000,' *International Studies Quarterly*, forthcoming 2014; Stephen S. Golub, 'Measures of Restrictions on Inward Foreign Direct Investment for OECD Countries,' *OECD Economic Studies*, Vol. 36, No. 1, 2003, pp. 85-116.

¹⁷ One exception is recent research by Meunier, Burgoon, & Jacoby on political fears in Europe caused by the recent surge of investments from China. See Sophie Meunier, Brian Burgoon and Wade Jacoby, 'The Politics Of Hosting Chinese Direct Investment In Europe,' *Asia-Europe Journal*, Vol. 12, No. 1, 2014, pp. 109-126.

¹⁸ Pandya, 'Democratization and FDI Liberalization, 1970-2000'.

¹⁹ C. S. Eliot Kang, 'U.S. Politics and Greater Regulation of Inward Foreign Direct Investment,' *International Organization*, Vol. 51, No. 2, 1997, pp. 301-333.

²⁰ Zaring, 'CFIUS as a Congressional Notification Service'.

we try to reveal the determinants of whether political actors choose to express protectionist sentiments in response to foreign M&A attempts.

We also focus on the Chinese case because of its increasingly important role in the world economy, though of course future work could expand beyond this case.²¹ The literature on Chinese acquisitions focuses largely on the motives and behavior of Chinese firms; which includes investments for strategic assets and competitive advantages,²² and brand recognition and technology diffusion.²³ These supply side forces are important, but in this paper we focus on determinants of demand. By focusing on the demand side, we try to explain what M&A's are protested, and which are not. We explore three factors that have the potential to produce opposition to M&A attempts by foreign firms: national security sensitivity, economic distress, and reciprocity.

National Security Sensitivity

In the second half of the twentieth century, states have negotiated an increasingly dense web of international economic agreements that have removed domestic legal barriers to foreign trade and investment. Through these agreements, however, states have consistently reserved the right to restrict otherwise permitted economic activity if it would pose a threat to national security. In fact, the United States has worked to ensure that the General Agreement on Tariffs and Trade (GATT), the North American Free Trade Agreement (NAFTA), and the Bilateral Investment Treaties (BITs) that American has signed all have explicit provisions that allow it to

²¹ A notable example of M&A protests in the U.S. that did not involve Chinese companies is Dubai Port World attempted purchase of six ports in the United States in 2006.

²² Huaichuan Rui and George S. Yip, 'Foreign Acquisitions by Chinese Firms: A Strategic Intent Perspective,' *Journal of World Business*, Vol. 43, No. 2, 2008, pp. 213-226.

²³ Margot Schüller and Anke Turner, 'Global Ambitions: Chinese Companies Spread their Wings,' *Journal of Current Chinese Affairs*, Vol. 34, No. 4, 2005, pp. 3-14.

restrict transactions that would pose threats to national security.²⁴ Moreover, as previously noted, the only legal basis by which the federal government can block an attempt by a foreign entity to conduct an M&A with an American firm is if the transaction would pose a threat to national security. As a result, it is clear that attempts to acquire target firms in industries that are sensitive to national security are likely to produce opposition from political leaders.

The scope of the “national security” exception has never been precisely defined, however, has been subject to different interpretations even within Congress.²⁵ Instead of a precise definition, the current law regulating foreign investment in the United States defines national security sensitive industries to include those that implicate “critical infrastructure”, “critical technology”, “critical resources”, and the presence of any other factors the executive branch deems appropriate.²⁶ As some commentators have argued, this broad definition of national security—and the ambiguity that results from it—has left political actors with the ability to try and block proposed transactions in the name of national security, even if the link between the target firm and any tangible threat is obscure.²⁷ As a result, it is likely that there are other factors that are driving political actors to express opposition to proposed transactions.

Economic Distress

Another clear motivation that is likely to lead political leaders to oppose foreign M&As is the desire to protect local economic interests that might be hurt by M&A activity. Crystal

²⁴ Zaring, 'CFIUS as a Congressional Notification Service'.

²⁵ Prabhakar, 'Deal-Breaker: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms'; Mark E. Plotkin and David N. Fagan, 'The Revised National Security Review Process for FDI in the US,' *Columbia FDI Perspectives No. 2*, (New York: Vale Columbia Center on Sustainable International Investment, January 7, 2009), <http://hdl.handle.net/10022/AC:P:8776>.

²⁶ The current legal framework regulating foreign investments in the United States will be discussed in Part 3. See James K. Jackson, 'The Committee on Foreign Investment in the United States,' *CRS Report No. RL33388*, (Washington, DC: Congressional Research Service, February 4, 2010), p. 18.

²⁷ Connell and Huang, 'An Empirical Analysis of CFIUS: Examining Foreign Investment Regulation in the United States'.

advanced this view by stating that “to the extent foreign companies are able to exploit their firm-specific advantages within the host country – domestic capital specific to these affected sectors should react in a similar (negative) way toward IFDI and favor more restrictive or discriminatory policies”.²⁸ Firms in distressed industries—such as those that have experienced recent downturns or those doing substantially worse than the rest of the economy²⁹—may try to block foreign acquisitions in their industry through either lobbying Congressmen, or either having industry associations pressure the Federal government.³⁰ As described below, we tap distress by measuring abnormal rates of unemployment within the firm’s sector. Since economic interests are of primary concern for elected officials because of political pressures, then we would generally expect greater opposition for foreign direct investment in an area of “economic distress”.³¹ This was certainly the case during the 1980s when Congress began to grant the executive branch additional authority to block foreign M&As in response to the perception that Japanese firms were deliberately targeting vulnerable U.S. firms.³²

In fact, the economic distress of a given industry is likely to be a greater concern for foreign M&As than for greenfield investments because “M&As in industrial countries result in significant employment reductions in the acquired firm”.³³ This is driven by the fact that when a firm is acquired in an industry where there is high unemployment, the acquiring firm usually

²⁸ Jonathan Crystal, *Unwanted Company: Foreign Investment in American Industries* (Ithaca: Cornell University Press, 2003), p. 17.

²⁹ For examples of the negative effects on firms of being in distressed industries, see Viral V. Acharya, Sreedhar T. Bharath and Anand Srinivasan, 'Does Industry-wide Distress Affect Defaulted Firms? Evidence from Creditor Recoveries,' *Journal of Financial Economics*, Vol. 85, No. 3, 2007, pp. 787-821.

³⁰ U.S. Department of Commerce Representatives, Office of China Economic Area." Personal interview. Washington, DC: 18 Dec. 2009.

³¹ Robert E. Baldwin, 'The Political Economy of Trade Policy,' *Journal of Economic Perspectives*, Vol. 3, No. 4, 1989, pp. 119-135.

³² Kang, 'U.S. Politics and Greater Regulation of Inward Foreign Direct Investment'.

³³ Sanjaya Lall, 'Implications of Cross-Border Mergers and Acquisitions by TNCs in Developing Countries: A Beginner’s Guide,' *QEH Working Paper Series No. 88*, (Oxford: Oxford University, June 2002), http://www.wirtschaftssprachen.univie.ac.at/fileadmin/user_upload/wirtschaftssprachen/Englisch/Fitzsimons/Text4.pdf, p. 8.

eliminates jobs during the process of creating "synergies" between the aggregated businesses. Therefore, one would expect more political opposition toward foreign acquisitions of U.S. firms in industries that are economically distressed, even if the targeted firms are not in industries that are implicate national security concerns.

Reciprocity

Another factor that has the potential to influence where government officials oppose foreign acquisitions of U.S. firms is whether there is poor reciprocal access to foreign markets. While executive branch officials have denied that reciprocity would influence policy-makers' treatment of inflows of FDI from China,³⁴ Crystal emphasizes reciprocity as a major issue when assessing inward investment. Crystal argues that "the extent to which producers have an incentive to use domestic barriers as a bargaining tool to improve foreign market access" is paramount.³⁵ In fact, during the 1980s there was an effort in Congress to ban foreign investments in the United States unless American citizens were citizen reciprocal access to the foreign investors' domestic market.³⁶ Although this proposal was blocked by the Reagan administration out of concern that it would lead to retribution from other countries, it demonstrates that public officials have been concerned with whether American investors have received equal treatment.

Moreover, China has raised objections to American efforts to screen foreign investments,³⁷ and in 2011, created a "National Security Review" (NSR) process that mirrors the American system.³⁸ The NSR was created by the Chinese Ministry of Commerce, and requires foreign companies to report investment and acquisition of Chinese enterprises. Since access to

³⁴ U.S. Department of Treasury Representatives. Telephone interview. 28 Jan. 2010.

³⁵ Crystal, *Unwanted Company: Foreign Investment in American Industries*, p. 12.

³⁶ Kang, 'U.S. Politics and Greater Regulation of Inward Foreign Direct Investment'.

³⁷ Zaring, 'CFIUS as a Congressional Notification Service'.

³⁸ Lucas Xu, Hannah C. L. Ha, Timothy J. Keeler and Michael A. Wallin, 'China's New M&A Review Rules: A Comparison with the US,' *Practical Law* (March 1, 2011), <http://us.practicallaw.com/6-505-9049>.

Chinese markets is a crucial part of US-China economic policy,³⁹ it would be reasonable to expect more “reciprocal” opposition toward Chinese acquisitions in industries that face restrictions in investing in China.

More broadly, reciprocity is an extremely important concept for scholars of international relations and international political economy to study. Earlier theoretical work examined how punishment strategies could be used to support cooperation.⁴⁰ Subsequent empirical work has examined the role of reciprocity in a broad variety of domains, including security,⁴¹ and on issues like global warming.⁴² We add to this important literature by thinking about reciprocity between two large economies in the area of FDI.

Other factors

Aside from these three political economy factors—security, economic distress, and reciprocity—two other factors are likely to make U.S. politicians more likely to oppose M&A attempts by foreign entities which will be important to control for in our multivariate analyses. First, politicians are more likely to express opposition to “state-owned” enterprises attempting to acquire American companies. State ownership of the foreign firm—epically ownership by the Chinese government—is likely to increase fears that acquisition of an American target will create risks to both national security and economic competitiveness,⁴³ and the transaction is thus

³⁹ U.S. Department of Commerce Representatives, Personal interview. Washington, DC: 18 Dec. 2009.

⁴⁰ Axelrod, *The Evolution of Cooperation*; Larson, 'The Psychology of Reciprocity in International Relations'; Keohane, 'Reciprocity in International Relations'; Kreps, Milgrom, Roberts and Wilson, 'Rational Cooperation in the Finitely Repeated Prisoners' Dilemma'.

⁴¹ Joshua S. Goldstein and Jon C. Pevehouse, 'Reciprocity, Bullying, and International Cooperation: Time-series Analysis of the Bosnia Conflict,' *American Political Science Review*, Vol. 91, No. 3, 1997, pp. 515-529; Joshua S. Goldstein, Jon C. Pevehouse, Deborah J. Gerner and Shibley Telhami, 'Reciprocity, Triangularity, and Cooperation in the Middle East, 1979-97,' *Journal of Conflict Resolution*, Vol. 45, No. 5, 2001, pp. 594-620; Andrew M. Linke, Frank D. W. Witmer and John O'Loughlin, 'Space-Time Granger Analysis of the War in Iraq: A Study of Coalition and Insurgent Action-Reaction,' *International Interactions*, Vol. 38, No. 4, 2012, pp. 402-425.

⁴² Dustin Tingley and Michael Tomz, 'Conditional Cooperation and Climate Change,' *Comparative Political Studies*, Vol. 47, No. 3, 2013, pp. 344-368.

⁴³ Paul R. Krugman, 'Competitiveness: A Dangerous Obsession,' *Foreign Affairs*, Vol. 73, No. 2, 1994, pp. 28-44.

likely to receive greater scrutiny. Second, U.S. politicians are likely to express greater opposition to foreign acquisitions when the target firm has higher brand recognition. Transactions that involve well known firms are more likely to gain widespread public attention, and thus increase the likelihood that political leaders will feel compelled to express populist sentiments that the firm should be under the control of Americans.

3. Background on US/China Mergers and Acquisitions

This part provides background on the M&As that our project analyzes in two parts. First, we outline the legal framework that governs foreign M&As in the United States. Second, we briefly discuss the development of Chinese outward investment policy since the 1980s that has resulted in a dramatic increase in Chinese M&A activity in the United States.

United States Legal Restrictions on Foreign M&As

Although the United States is arguably the most open country in the world to inward foreign investment,⁴⁴ there are legal restrictions in place that regulate attempts by foreign entities to acquire American firms. In fact, there is a government body responsible for regulating attempts by foreign entities to conduct M&As with U.S. firms: the Committee on Foreign Investment in the United States (“CFIUS”).

The CFIUS was established in 1975 by President Ford after the energy crisis of 1972 to 1975.⁴⁵ At the time there was concern that members of OPEC would use the surpluses gained in the recent oil embargo on the United States to buy up American firms and assets. In response, the Ford Administration created the CFIUS as an independent Federal agency to monitor acquisitions in the United States. The Secretary of the Treasury was named the Chairman of this

⁴⁴ Kang, 'U.S. Politics and Greater Regulation of Inward Foreign Direct Investment'.

⁴⁵ Zaring, 'CFIUS as a Congressional Notification Service'.

inter-agency committee that carried the responsibility to monitor the “impact of foreign investment in the United States . . . for coordinating the implementation of United States policy in such investment”.⁴⁶ Given this vague mandate, it is perhaps unsurprising that the CFIUS did little to restrict foreign investment in the United States for the next decade.

During the 1980s, as Japan’s economy was forecasted to exceed that of the United States within a few decades, the increasing number of Japanese companies purchasing large US brands began to draw attention from members of Congress.⁴⁷ Although there were a number of M&As conducted by Japanese firms that produced criticism from American officials, it was electronics giant Fujitsu’s attempted \$225 million acquisition of Fairchild Semiconductor in 1987 that prompted Congress to expand the executive branch’s authority to regulate foreign M&As.⁴⁸ Even though Fairchild Semiconductor was in fact a subsidiary of the French firm Schlumberger, members of Congress argued that the transaction could lead to “industrial espionage,” and eventually forced Fujitsu to withdraw its transaction.⁴⁹ By this time, some members of Congress began to suspect that CFIUS was not fulfilling its mandate, and the controversy gave rise to the passage of the 1988 Exon-Florio provision.⁵⁰

The Exon-Florio provision gave the President the authority to block proposed or pending foreign mergers and acquisitions when there was “credible evidence” that a transaction would “impair” national security. Although Congress granted this power to the President directly, President Reagan issued an executive order that delegated the authority to review and block mergers into the hands of the CFIUS. The order transformed CFIUS from an administrative body

⁴⁶ Housing Committee on Banking, and Urban Affairs,, 'A Review of the CFIUS Process for Implementing the Exon-Florio Amendment,' (Washington, DC: United States Senate, October 20, 2005), p. 140.

⁴⁷ Curtis J. Milhaupt, 'Is the US Ready for FDI from China? Lessons from Japan's Experience in the 1980s,' in Karl P. Sauvant, ed. *Investing in the United States: Is the US Ready for FDI from China?* (Cheltenham (UK): Edward Elgar, 2009), pp. 185-208.

⁴⁸ Zaring, 'CFIUS as a Congressional Notification Service'.

⁴⁹ Milhaupt, 'Is the US Ready for FDI from China? Lessons from Japan's Experience in the 1980s'.

⁵⁰ Jackson, 'The Committee on Foreign Investment in the United States'.

that merely “review[ed] and analyze[d] data” to a significant authority that could advise the President and block certain transactions.⁵¹ What is perhaps most notable about this reform, however, is that although many of the transactions that gave rise to Congress granting the president additional authority to block foreign M&As of American companies did not pose national security threats,⁵² this reform only allowed transactions to be blocked when they imposed risks to national security.

Although the Exon-Florio amendment provided the President greater power—which was delegate to the CFIUS—to block foreign attempts to acquire American firms, in practice CFIUS only took steps to block a handful of transactions. This led to Congress passing legislation in 1992 that amended the Exon-Florio statute.⁵³ Known as the Byrd Amendment, this legislation required the executive branch to initiate more investigations, and also increased CFIUS obligation to report transactions to Congress. Fifteen years later, members of Congress again expressed displeasure that CFIUS was not blocking more transactions. This led to the passage of the Foreign Investment and National Security Act of 2007 (“FINSA”). FINSA codified the role of CFIUS (which had previously only been created by executive order), provided more detailed instructions on when to conduct investigations, granted CFIUS power to impose sanctions on foreign companies, and increased CFIUS congressional reporting requirements.⁵⁴

Yet despite these Congressional actions taken to force the executive branch to increase its

⁵¹ Jackson, 'The Committee on Foreign Investment in the United States'.

⁵² When discussing the Fairchild-Fujitsu controversy, Kang notes that it was “questionable” whether the product posed national security threats and that “[t]he real driving force behind the Controversy, then, was the political advantage many elected policymakers perceived in meeting the Japanese economic challenge.” See Kang, 'U.S. Politics and Greater Regulation of Inward Foreign Direct Investment', pp. 321-322.

⁵³ Zaring, 'CFIUS as a Congressional Notification Service'; Jackson, 'The Committee on Foreign Investment in the United States'.

⁵⁴ Zaring, 'CFIUS as a Congressional Notification Service'; Jackson, 'The Committee on Foreign Investment in the United States'.

scrutiny of foreign transactions, the CFIUS still has a great deal of discretion to determine how to regulate foreign investment.⁵⁵

Under the existing legal framework created by this series of executive orders and Congressional actions, foreign entities hoping to acquire American firms are required to submit their proposed transactions to the CFIUS for evaluation. This evaluation lasts a maximum of 30 days, and if the CFIUS chooses to do so, it can launch a longer 45 day investigation during this window. After an investigation, the CFIUS must make a recommendation to the President to either block the transaction or permit it to go forward. CFIUS is also required to report regularly to Congress, whose members often voice opposition to proposed transactions. Although the legal basis for opposition must be that the transaction threatens national security, commentators have noted that both executive branch officials and members of Congress are likely to claim that transactions threaten national security when they are actually motivated by other concerns.⁵⁶

Growth of Chinese Outward Investment and Attempted M&As

After its communist revolution in 1949, China was both largely closed to foreign investment from other countries, and also took few steps to invest capital abroad. Beginning in the 1980s under the leadership of Deng Xiaoping and a new reform-minded 11th Central Committee, China began transitioning to a state-led market-based economy. This process was known as “*Gai Ge Kai Fang*,” or literally “Reform and Opening Up.”⁵⁷ This policy change had a significant impact on China’s investment activity. Foreign direct investment into China increased

⁵⁵ Zaring, 'CFIUS as a Congressional Notification Service'.

⁵⁶ Connell and Huang, 'An Empirical Analysis of CFIUS: Examining Foreign Investment Regulation in the United States'.

⁵⁷ One of the first investment-oriented reforms of “Reform and Opening Up” was the 1979 “Law on Joint Ventures using Chinese and Foreign Investment.” The implementation of this law allowed foreign companies to operate in the mainland while taking equity ownership stakes in their projects with Chinese state-owned enterprises—hence a “joint” venture. See People's Republic of China, 'The Law of the People's Republic of China on Joint Venture using Chinese and Foreign Investment,' (Beijing: Fifth National People's Congress, July 1, 1979)..

dramatically from virtually \$0 in 1979, to \$4 billion in 1992, and to \$84 billion in 2012.⁵⁸ Simultaneously, Chinese state-owned enterprises began to make investments outside the country (although most of these investment projects were rather small and were on average less than US\$ 1 million each in the early 1990s).⁵⁹

Although this process started in the 1980s, the size and scope of China's outward investments began to increase dramatically just before the start of the twenty-first century. In 1999 the Chinese government formally announced the "Going Global" (*zou chu qu*) campaign to encourage its domestic firms to make investments overseas. Immediately after announcing this new investment policy, the Chinese government initiated a series of reforms that made it easier for Chinese firms to invest abroad. In 1999, the State Administration of Foreign Exchange ("SAFE") decentralized the right to approve access to foreign currencies for companies making investments abroad, thereby relaxing some of the foreign currency controls.⁶⁰ At the same time, the National Development and Reform Commission ("NDRC") granted direct and indirect subsidies targeted at industries that were deemed as crucial for China's national economy (provided primarily in the form of direct and preferential bank loans from Chinese state-owned banks).⁶¹ The Chinese government also established the State-Owned Asset Supervision Administration Commission ("SASAC"), which directly managed most state-owned enterprises in order to promote China's foreign investments abroad. Additionally, in 2004 the Chinese government simplified its approval process for outward foreign direct investment by enacting *The Verification and Approval of Overseas Investment Projects Tentative Administrative Procedures*.

⁵⁸ Data obtained from UNCTAD database.

⁵⁹ Schüller and Turner, 'Global Ambitions: Chinese Companies Spread their Wings'.

⁶⁰ Schüller and Turner, 'Global Ambitions: Chinese Companies Spread their Wings'.

⁶¹ Li Jia, MOFCOM. Personal Interview. Shanghai, P.R.C.: 15 Jun. 2009.

Taken together, these policies—as well as a number of other reforms—have created strong government support for outward foreign investment by Chinese firms. Despite these reforms, however, Chinese outward foreign direct investments still remain small in an absolute sense, with 1.1% of global FDI flows in 2007 but by 2012 they had increased to 6.1% in 2012.⁶² The increase in Chinese FDI outflows have thus been dramatic, and China’s clear policies facilitating foreign investment—as well as China’s amassing of foreign exchange reserve—are likely to boost China’s global “investment footprint” in the future.

In fact, the growth has been so dramatic that in 2013 China went on a “buying spree” and invested \$14 billion in the United States alone.⁶³ Of course, the buying spree that has taken place over the last 15 years has not been entirely free of controversy within the United States. Instead, in our sample 12% of M&A attempts by Chinese firms in the United States have met with political opposition. For example, in 2005 the Chinese National Offshore Oil Corporation was forced to withdraw its \$13 billion dollar bid for Unocal Corporation as a result of strong bipartisan Congressional pressure led by representatives like Nancy Pelosi who argued that “communist” ownership of America’s 9th largest oil firm posed a national security threat.⁶⁴ At the same time, even though the transaction did not pose national security risks for the United States, a Chinese multinational company, the Haier Group, withdrew its \$1.3 billion bid to purchase Maytag Corporation in order to avoid a political maelstrom.⁶⁵

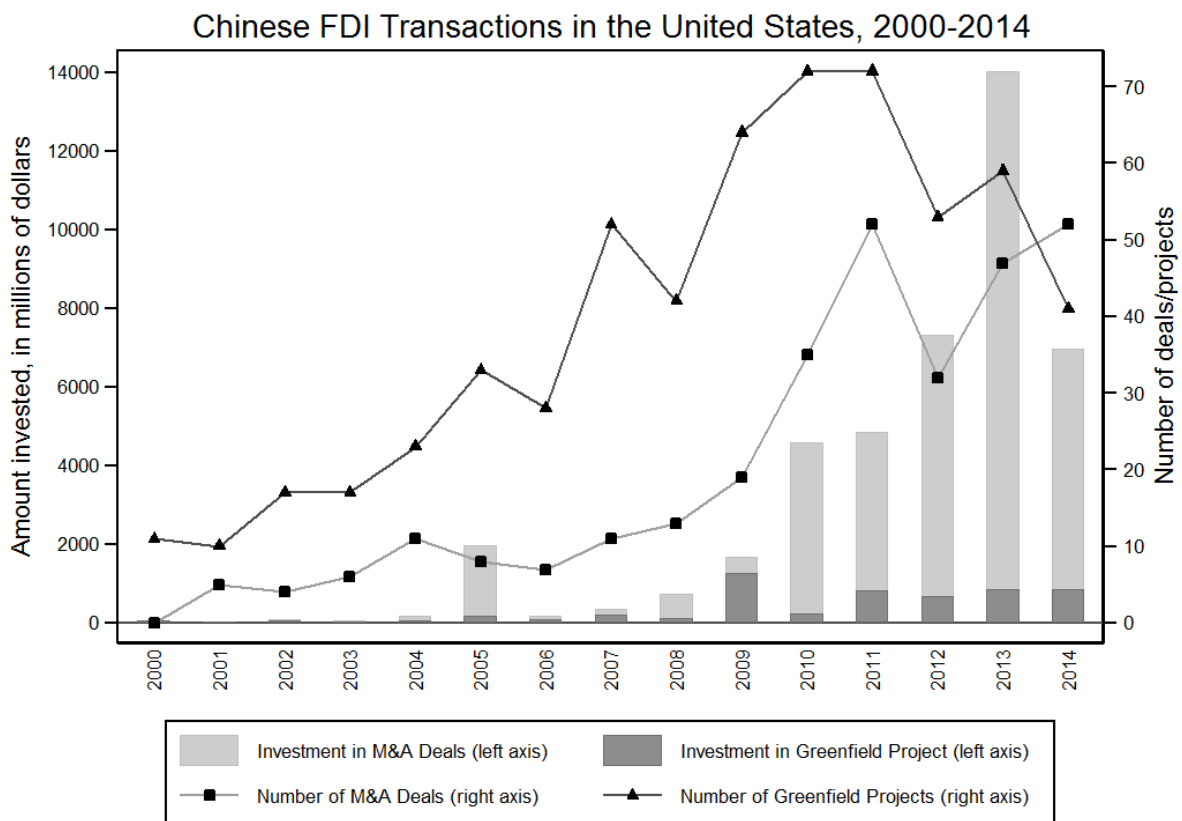
⁶² United Nations Conference on Trade and Development, 'Inward and Outward Foreign Direct investment Flows, Annual, 1970-2012,' *Foreign Direct Investment Database*, (New York, Geneva: United Nations, <http://unctad.org/en/pages/Statistics.aspx>).

⁶³ Roberts, 'Chinese Investment in U.S. Doubles to \$14 Billion in 2013'. For additional details, see Thilo Hanemann, 'Chinese FDI in the United States: Q1 2014 Update,' *RhG Research Note*, (New York: Rhodium Group, May 8, 2014), <http://rhg.com/notes/chinese-fdi-in-the-united-states-q1-2014-update..>

⁶⁴ Daniel H. Rosen and Thilo Hanemann, 'China's Changing Outbound Foreign Direct Investment Profile: Drivers and Policy Implications,' *IIE Policy Brief No. PB09-14*, (Washington, DC: Peterson Institute for International Economics, June 2009), <http://www.iie.com/publications/pb/pb09-14.pdf>.

⁶⁵ Peter S. Goodman and Ben White, 'Haier Withdraws Maytag Bid: Move is Sign of Caution in China's Pursuit of Foreign Firms,' *Washington Post*, July 20, 2005, p. D02.

These two examples are not an exhaustive list of propose Chinese investments in the United States that have generated political opposition, but instead merely representative of a myriad of transitions that have sparked political backlash. Our project seeks to understand the determinants of U.S. political opposition toward the whole span of Chinese M&A investments in America since the launching the “Going Global” campaign in 1999. The growth of these investments, alongside the much larger levels of Greenfield investments, is given in figure 1.



Source: Rhodium Group, China Investment Monitor

Figure 1: Evolution of Chinese Greenfield investments and merger and acquisitions in the United States over time.

4. Research Design and Data

Our study explores the determinants of resistance to inward FDI flows by examining political opposition toward Chinese firms' attempted and completed purchases of American companies from 1999-2014.⁶⁶ This part presents the original dataset that was constructed for this project.

Chinese Firms M&A Attempts of US Firms

To analyze Chinese firms' activities in the U.S. M&A market, we built a dataset of proposed acquisitions primarily using data from the *ThomsonOne Banker* database maintained by Thomson Financial. The *ThomsonOne Banker* database is superior to official and other commercial databases because it holds the greatest number of announced and completed deals.⁶⁷ The deals found using *ThomsonOne* included transactions with both publicly listed companies and private companies. This does not include private transactions that are kept confidential to both the U.S. Securities and Exchange Commission *and* the business community.⁶⁸ We would not expect that it would even be possible for there to political debate on these transactions, nor do we have any feasible way to measure them. Our criteria for the "targets" and "acquirers" were, respectively, companies operating or headquartered in the United States and companies likewise

⁶⁶ Our dataset includes transaction from 1/1/1999 to 6/20/2014.

⁶⁷ All relevant transactions found in the *SDC Platinum* database, Heritage Foundation database, and Chinese MOFCOM website were already included dataset extracted from *ThomsonOne Banker*. Of course, our data still lacks those transactions that were not approved by the Chinese Ministry of Commerce, or not brought to them, and were thus "never initiated." See Schüller and Turner, 'Global Ambitions: Chinese Companies Spread their Wings'. Because our study focuses on only U.S. domestic opposition toward Chinese M&As, we disregard any of these missing transactions that faced Chinese "political opposition." Of course a deeper issue is the set of deals that never get initiated because of expected opposition in the United States. Later on we discuss the implications of this sample selection issue.

⁶⁸ Only publicly-listed companies are required to report their M&A activity, including announcements and completions to the Securities and Exchange Commission.

in China, Hong Kong, or Macau.⁶⁹ From this comprehensive dataset, we filtered out M&A transactions in which the Chinese acquirer is a China-based subsidiary of a non-Chinese company (e.g., KPMG Hong Kong, Shenzhen Pepsi Cola, etc), or the target is an offshore subsidiary of a U.S. company (e.g., “Shanghai General Motors Company”).⁷⁰ There are 566 transactions that met these criteria in our dataset.

Dependent Variable

In order to determine the existence "political opposition" toward each of the 569 transactions, we conducted a comprehensive survey of Federal, Congressional and local government resources for discussion that pertains to the Chinese acquisition. We assess Federal government opposition by reviewing press releases of the United States Treasury Department, Commerce Department, Justice Department, State Department, U.S. Trade Commission, Securities and Exchange Commission, and the U.S. Federal Reserve. For Congressional opposition, we review *Congressional Research Services* reports, statements of Congressmen in Congressional Records and Hearings using the *Lexis-Nexis Congressional Research Digital Collection*, as well as statement hearings and reports published by the United States-China Economic and Security Review Commission (“USCC”).⁷¹ In addition, we also scope out any

⁶⁹ While many mainland Chinese private firms have located to Hong Kong for corporate governance reasons, other Hong Kong firms predating to the pre-1997 era may arguably be considered "non-Chinese" firms by some scholars. However, we decide to maintain general consistency and regard all firms based in Hong Kong and Macau after their dates of handover to the P.R.C. (1997 and 1999 respectively) as "Chinese". For the same reasons, we exclude Taiwanese firms. Below we discuss briefly how our results differ by firms headquartered in mainland China or Hong Kong.

⁷⁰ Our reasons for this exclusion is two-fold: First, the purchase of a U.S. target by an acquirer whose ultimate corporate owners are not Chinese could not be defined by our research as a U.S. asset acquisition by foreign entities of Chinese origin. Second, although a foreign purchase of an American-owned subsidiary operating outside the U.S, could technically be deemed as "inward foreign direct investment", the effects of such transactions on U.S. political debate is virtually insignificant for most industries.

⁷¹ Although the USCC is a non-partisan organization, its commissioners are selected by each of the Majority and Minority Leaders of the Senate, and the Speaker and the Minority Leader of the House of Representatives. Because of its close relationship with Congress and its leading role in influencing Congressional policy toward China, we include USCC's concern with any particular Chinese acquisition as a "Congressional opposition."

local government opposition towards Chinese acquisition by surveying local newspapers using *WorldBank/NewsBank* news services though there were very few of these. We found 59 cases of opposition.⁷² We pool all instances of opposition together because analyzing different sources, while interesting, leads to substantial sparseness.

Our criteria for determining the existence of political opposition towards a Chinese acquisition involves an expression of opposition or concern regarding the transaction. For example, the following passage from a statement by Representative McCotter would qualify as opposition towards the 2008 Huawei-3Com deal:

Mr. Speaker, the Committee on Foreign Investment in the United States must review and block Bain Capital and Communist China's Huawei Technologies' deal with the 3Com Corporation. If approved, Communist China's Huawei Technologies stake in the 3Com Corporation will gravely compromise our free Republic's national security.⁷³

We also include a few transactions in which opposition was expressed *after* the acquisition was completed (e.g. Cornerstone Overseas purchase of Wham-O in 2006), since these instances of opposition still illustrate the extent of US political opposition. Excluding these observations do not change our results.⁷⁴ In total we identified 60 instances of opposition.⁷⁵

⁷² We pool all instances of opposition together because analyzing different sources, while interesting, leads to substantial sparseness with respect to local (non-Congressional) opposition. Future research should explore in more qualitative terms any differences.

⁷³ Thaddeus McCotter, 'Communist China and CFIUS: Dropping the Shark,' *Congressional Record*, Vol. 153, No. 149, 2007, pp. 11226-11227, p. 11226.

⁷⁴ Overall, there are at least two potential criticisms to our approach. First, the produced list of "politically opposed" transactions might have large variation in their level of "contentiousness" (U.S. Department of Treasury Representatives. Telephone interview. 28 Jan. 2010). In other words, while many transactions were to some extent "politically unpopular", not all of them were blocked in the U.S. or had significantly affected U.S. policy. However, for the purpose of studying the presence of U.S. political attitudes toward the rise of Chinese M&A activity in the United States, we deem all instances of contention—including those considered by some scholars or politicians as "political noise"—to be significant and relevant in our empirical analysis. Second, some information, especially the decisions of CFIUS, cannot be legally disclosed for use in an academic study. In fact, talks with CFIUS representatives reveal that there does exist an informal process in which Treasury department officials can advise parties on the possibility of CFIUS rejection before the submitting of the application (CFIUS representative from U.S. Treasury Department. Telephone interview. 27 Jan. 2010).

⁷⁵ We recognize that there could be instances of "false-negatives" in our sample—that is, cases where instances of political opposition existed but we could not find any records indicating it. We tried to avoid this through exhaustive searches of a variety of government and media sources, such as NewsBank, Lexis-Nexus, the Congressional Record,

Independent Variables

The independent variables for this project correspond to the three factors that we hypothesized as driving opposition to inward FDI flows: national security sensitivity, economic distress, and reciprocity.

National Security Sensitivity

To measure national security sensitivity we create a binary variable (*Security*), with a 1 indicating that the U.S. target firm is national security sensitive and 0 otherwise. In order to determine whether a target firm is sensitive with regards to national security, we employ the CFIUS's "Guidance Concerning the National Security Review",⁷⁶ which delineates the rules for determining a national security threat in a foreign M&A. Using the "Factors for Consideration" in the report—with insights from talks with CFIUS representatives—we develop a list of instructions in coding the security sensitivity of a U.S. target (see Appendix).⁷⁷ In general, a company is deemed security sensitive if it has military/government contracts, has operations related to U.S. national security (i.e. key infrastructure, natural resources, IT, telecom, transportation, major banks), or conducts business in advanced technology subject to U.S. export controls. This definition is broad and includes a range of companies from "low" sensitivity (i.e. companies operating in security-related industries) to "high" sensitivity (i.e. companies with

etc. Furthermore, we have no reason to suspect that any miscoding would be systematically related to any of our explanatory variables.

⁷⁶ Department of Treasury, 'Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States,' *Federal Register*, Vol. 73, No. 236, 2008, pp. 74567-74572.

⁷⁷ In general, security sensitive items—as defined by the U.S. Federal government—fall under the following categories: (1) requirements for the manufacturing and production of national defense-related goods; (2) requirements for sources of energy and other critical resources and material; (3) requirements for critical high technologies; (4) requirements for national security and government related transportation; and (5) any other requirements related to "critical infrastructure" Department of Treasury, 'Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States'..

direct access to U.S. classified information, weapons, or systems). For example, businesses that meet this description span from small miners (e.g. Firstgold) and regional banks (e.g. UCBH) to major oil drillers (e.g. Unocal) and large financial institutions (e.g. Morgan Stanley).

Economic Distress

In order to test the economic distress hypothesis, we use measures of unemployment as a general proxy for the level of economic distress that a target company is facing. We have two justifications for this decision. First, it would not be possible to measure this at the firm level for non-publically traded companies (i.e., we do not observe stock prices, etc.). Second, in the U.S. there are often industry associations that speak on behalf of business sectors they are associated with. Therefore, assessing levels of distress based on macro industries will suffice for our analyses.⁷⁸

To create our economic distress variable, we collect aggregate and industry-level unemployment rates from 2000-2010 using the Bureau of Labor Statistics datasets from the Global Insight database.⁷⁹ Some studies use a measure of change in unemployment rates to determine trends across time.⁸⁰ However, such a variable does not take into account the performance of the overall economy. Obviously it is likely that an industry experiencing an

⁷⁸ We use the Bureau of Labor Statistics' scheme for labeling macro-industries (e.g. Nondurable, Mining, etc) in the Economic Distress variables. The labels are slightly different from and more varied than the macro-industry labels given by the data set extracted from *ThomsonOne Banker*. We use the *ThomsonOne Banker's* micro-industry labels (e.g., Automotive Parts, Drilling Equipment, etc) to incorporate the BLS macro-industry labels for each transaction.

⁷⁹ The *Bureau of Labor Statistics* database did not have pre-2000 industry-level unemployment rate data; for our 1999 transactions, we use 2000 data. For each industry and year, we also use each industry's January unemployment rate figure in order to maintain consistency. The data we use for the average unemployment rate for the entire U.S. economy also uses January unemployment figures.

⁸⁰ This could be percentage change in the unemployment rate in a macro-industry since the previous year, "% Change in Unemployment." For any given industry this would be "% Change in Unemployment" = (Unemployment Rate, Year T – Unemployment Rate, Year T-1) / (Unemployment Rate, Year T-1). This measure will isolate industries that have experienced more job loss over the previous year, and thus more economic distress. Using such a measure generally gives similar results to those we report below. Martin J. Conyon, Sourafel Girma, Steve Thompson and Peter W. Wright, 'The Impact of Mergers and Acquisitions on Company Employment in the United States,' *European Economic Review*, Vol. 46, No. 1, 2002, pp. 31-49.

unemployment rate higher than the U.S. average (e.g. manufacturing) to be regarded by politicians as more distressed than an industry performing better than the overall economy (e.g. financial sector) in terms of unemployment. Thus, we construct a variable to measure “abnormal unemployment” (which we label as *Economic Distress*), that measures the net unemployment rate that an industry is facing measured against the average unemployment rate for the entire U.S. economy in that year.⁸¹ A positive value for *Economic Distress* would indicate that an industry is performing worse than the entire economy. Of course, the failure of *Economic Distress* to control for variation in unemployment rate across time for a given industry may prevent us from measuring “intra-industry” trends in economic distress. Our results are robust to alternative measurement strategies such as using the year to year percentage change in unemployment within the macro-industry.

Reciprocity

In order to test the reciprocity hypothesis, we extract a dataset of American firms' activity in the Chinese M&A market from 1998 to 2014 using the *ThomsonOne Banker* database. We include all transactions involving acquirers that are based in the United States and targets that are based in China. Using the similar criteria for exclusion as in the Chinese dataset, we create a final dataset of several thousand transactions.

Like the Chinese dataset, each transaction included the official deal status of the U.S. company's acquisition bid (i.e., completed, pending, withdrawn, etc.). Unfortunately, neither *ThomsonOne* nor other commercial databases hold detailed information on the reasons for the failure of transactions given the status “withdrawn.” Soliciting such information from Chinese government sources and newspapers would be equally difficult. For example, many of these

⁸¹ For any given year “t”, “Abnormal Unemployment_{industry x}” = “Unemployment Rate_{industry x}” – “Unemployment Rate_{average}”.

decisions would involve Chinese government level decisions which are not currently available to us as researchers. Using the available data from *ThomsonOne Banker*, we constructed a measure of completion rate of U.S. deals (*Reciprocity*),⁸² which calculates the percentage of deals with status "Completed" for a given macro-industry in a given year.⁸³ We expect a greater probability of U.S. political opposition towards a particular acquisition of a U.S. target by a Chinese acquirer if domestic firms in the U.S. target's industry have faced higher barriers toward M&A completion in China in the previous year.⁸⁴

Control Variables

Along with our main independent variables, we assess two control variables that may be significant factors in influencing incentives toward opposing Chinese M&A activity.

Ownership Type of Acquirer

State ownership of multinational corporations has been cited by numerous scholars as a crucial factor in politicians' opposition toward inward FDI.⁸⁵ We follow Carlsten Holz in defining a Chinese company as a "state-owned [and/or] state-controlled enterprise" if the "state share is relatively large compared to the shares of other ownership categories."⁸⁶ In order to maintain uniformity and comprehensiveness in classification, we follow Delios et al. and other corporate governance scholars by focusing on the "ultimate owner" of a Chinese company as its

⁸² For any given industry "x" and year "t": "Completion Rate of US deals " = "Number of completed deals" / "Number of total announced deals".

⁸³ For the reciprocity variables, we employ *ThomsonOne Banker's* scheme for labeling macro-industries.

⁸⁴ We also collected data on the failure rate of U.S. deals "withdrawn" for a given macro-industry in a given year and failure count of US deals, which calculates the total number of deals with status "Withdrawn" for a given macro-industry in a given year. These measures are correlated and we get similar results with these alternative measures.

⁸⁵ Prabhakar, 'Deal-Breaker: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms'; Krugman, 'Competitiveness: A Dangerous Obsession'; Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton: Princeton University Press, 2001).

⁸⁶ Carlsten Holz, 'Note on the Definition of "State-owned and State-controlled Enterprises",' (Hong Kong: University of Science and Technology, September 29, 2003), <http://ihome.ust.hk/~socholz/SOE-definition.htm>.

"ownership type."⁸⁷ Because the ultimate owner is practically the last shareholder of a management chain, the Chinese government could theoretically exert its influence over its control as the ultimate owner of a firm.⁸⁸ We create the control variable (*GovtOwned*) for each transaction, with a 1 indicating a "state-owned" acquirer (i.e., ultimate owner is a government-affiliated institution) and 0 indicating a "private-owned" acquirer (i.e., private individual or institution). For a relatively small number of firms, we were unable to dispositively code this variable. We suspect that these firms are not government owned, and hence we create a second variable, *GovtOwned2*, where we set these observations to 0.

Size of Target

Other firm-specific attributes—namely, its brand recognition—may influence political actors' assessment of its acquisition by Chinese firms. We expect Chinese acquisitions of more well-known American companies to be more salient in public discourse, and thus be more likely to trigger political debate. We use its size as a proxy, and in particular the "Target's Enterprise Value at Announcement" since it represents the US market's determination of the target's size

⁸⁷ Andrew Delios, Zhi Jian Wu and Nan Zhou, 'A New Perspective on Ownership Identities in China's Listed Companies,' *Management and Organization Review*, Vol. 2, No. 3, 2006, pp. 319-343.

⁸⁸ In order to determine the "ultimate ownership" of the Chinese acquirers' shares for all transactions, we consolidate primary and secondary data from three different sources. Ownership data for most Chinese companies listed on the Shanghai Stock Exchange and Shenzhen Exchange is found using the *Chinese Stock Market Aggregate Resource Database (CSMAR)*. However, many times, the principal listed shareholder of a company might not be the "ultimate owner" of the company, since the listed shareholder might in fact be controlled by another larger organization. Therefore, we conduct additional searches on the listed shareholders of a company using our *CSMAR* datasets until we find the final owner, and cross-check our results using the dataset constructed by and used by Delios, Wu and Zhou, 'A New Perspective on Ownership Identities in China's Listed Companies'. To find ownership information for Chinese acquirers that are listed only on the Hang Seng (Hong Kong stock exchange), we use the *Worldscope* database on *ThomsonOne Banker*, and cross-check our results with the ownership data from a dataset constructed by and used by Stijn Claessens, Simeon Djankov and Larry H. P. Lang, 'The Separation of Ownership and Control in East Asian Corporations,' *Journal of Financial Economics*, Vol. 58, No. 1-2, 2000, pp. 81-112.. For every other public and private company, we cross-checked our results or extracted our data using the company's *Annual Reports* or SEC filings, searching for the "Substantial Shareholders" or "Major Shareholders" sections.

before its potential purchase.⁸⁹ Nevertheless, most of the private non-listed US firms did not report "Target's Enterprise Value at Announcement." We decided to assign all of these observations to be "nano-cap" size companies.⁹⁰ Because of this incompleteness of our target size data, we construct a binary variable *Large Firm* that proxies the name/brand recognition of the target firm, with a value of 1 indicating an enterprise value over \$200 million (small-cap to mega-cap) and thus a more well-known firm.

5. Empirical Results

Our binary dependent variable indicating political opposition is coded as a 1 indicating at least one instance of Federal, Congressional, and/or local political opposition toward a transaction. Overall 10% of our sample has a dependent variable of 1. Hence, if we had a baseline model with no explanatory variables, the constant would capture this baseline. Below we present changes in the probability of the dependent variable, and this baseline should be kept in mind in interpreting these changes. We estimate a series of standard logit models with robust standard errors. We also estimate models with year fixed effects. Year fixed effects account for any unobserved, or unmeasured variables that are constant at the year level. This includes the overall state of U.S.-Chinese relations, the partisan make-up of Congress, the party of the President, or other factors in China such as changes in the overall FDI regulatory environment that are constant for the year.⁹¹

⁸⁹ "Target's Enterprise Value at Announcement" is the average of all investment bankers' and financial analysts' valuations of the target firm on the announcement day of the transaction. Therefore, the "enterprise value" is the market consensus for this firm's size.

⁹⁰ Very few large and notable U.S. companies are private and non-listed (e.g. Wegmans, Koch, Cargill, etc), and no Chinese firms have ever attempted to acquire any of these companies.

⁹¹ Replacing these fixed effects with substantive variables that do not vary at the year level is an important thing to think about, but leads to a proliferation of such potential variables. Nevertheless, systemic variable such as those contained in the Tsinghua database on US-China relations would be one such source of data (<http://www.imir.tsinghua.edu.cn/publish/iis/7522/index.html>). Thanks to a reviewer we note that over time China

The first model, m1, includes our three main explanatory variables. Model m2 adds year fixed effects to this specification. Model m3 adds our control variables, and m4 adds year fixed effects to model m3. Finally, models m5 and m6 modify models m3 and m4 by using the alternative *GovtOwn2* measure. When we include year fixed effects, the sample sizes decrease slightly because in several years there was no variation in the dependent variable (i.e. no protests). Results are presented in Table 1. Additional results using an a linear probability model—which does not drop observations due to year fixed effects—are presented in Table 2. As the results in Table 2 show, our results are robust to this alternative specification.

DV: Political Resistance	m1	m2	m3	m4	m5	m6
Security	0.825** [0.293]	0.966** [0.309]	0.657* [0.300]	0.503 [0.359]	0.599* [0.295]	0.468 [0.355]
Economic Distress	0.187* [0.0764]	0.173* [0.0697]	0.235** [0.0906]	0.249** [0.0855]	0.206** [0.0790]	0.227** [0.0757]
Reciprocity	-1.991** [0.598]	-3.000** [1.078]	-2.095** [0.613]	-3.245** [1.077]	-2.028** [0.593]	-3.253** [1.059]
GovtOwned			0.375 [0.292]	0.912* [0.415]		
Large Firm			0.883* [0.375]	0.937* [0.425]	0.957** [0.371]	0.947* [0.424]
GovtOwned2					0.494+ [0.289]	1.020** [0.387]
Observations	566	514	535	486	565	513

Standard errors in brackets; + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$

Table 1: Determinants of political resistance to Chinese merger and acquisition attempts. Models m2, m4, and m6 contain year fixed effects. Differing sample sizes due to missing data for government ownership or no variation within a year in dependent variable in models with year fixed effects. All coefficients from logit model with robust standard errors.

has increasingly delegated control from the national to more local level over determining FDI outflow decisions. These dynamics might pose interesting temporal variation that we abstract away from in the current paper.

DV: Political Resistance	m1	m2	m3	m4	m5	m6
Security	0.0777* [0.0314]	0.0805* [0.0321]	0.0617+ [0.0322]	0.0473 [0.0334]	0.0536+ [0.0296]	0.0463 [0.0307]
Economic Distress	0.0179* [0.00798]	0.0140+ [0.00769]	0.0220* [0.00894]	0.0201* [0.00886]	0.0191* [0.00799]	0.0170* [0.00763]
Reciprocity	-0.183** [0.0596]	-0.185* [0.0740]	-0.201** [0.0633]	-0.237** [0.0838]	-0.185** [0.0588]	-0.197** [0.0721]
GovtOwned			0.0444 [0.0289]	0.0986* [0.0454]		
Large Firm			0.0965+ [0.0504]	0.0930+ [0.0497]	0.103* [0.0498]	0.0929+ [0.0496]
GovtOwned2					0.0533+ [0.0282]	0.0965** [0.0370]
Observations	566	566	535	535	565	565

Standard errors in brackets; + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$

Table 2: Determinants of political resistance to Chinese merger and acquisition attempts. Models m2, m4, and m6 contain year fixed effects. All coefficients from linear probability model with robust standard errors.

The results presented in Table 1 strongly reject the null hypothesis that political opposition toward Chinese acquisitions cannot be explained by a set of political economy factors. Government opposition toward a certain transaction can be systematically predicted on the basis of national security sensitivity, economic distress, and reciprocity factors.

Independent Variables

Security Sensitivity

Our results provide strong evidence in support for the security sensitivity hypothesis. The variable *Security* by itself is positively and significantly related to the probability of triggering political opposition, suggesting that a Chinese acquisition of a potentially security sensitive US asset would be seen as a “security threat,” and would likely lead to opposition from political

actors. This variable is positive and highly significant in all models except models 4 and 6 where the coefficient is close to statistical significance.

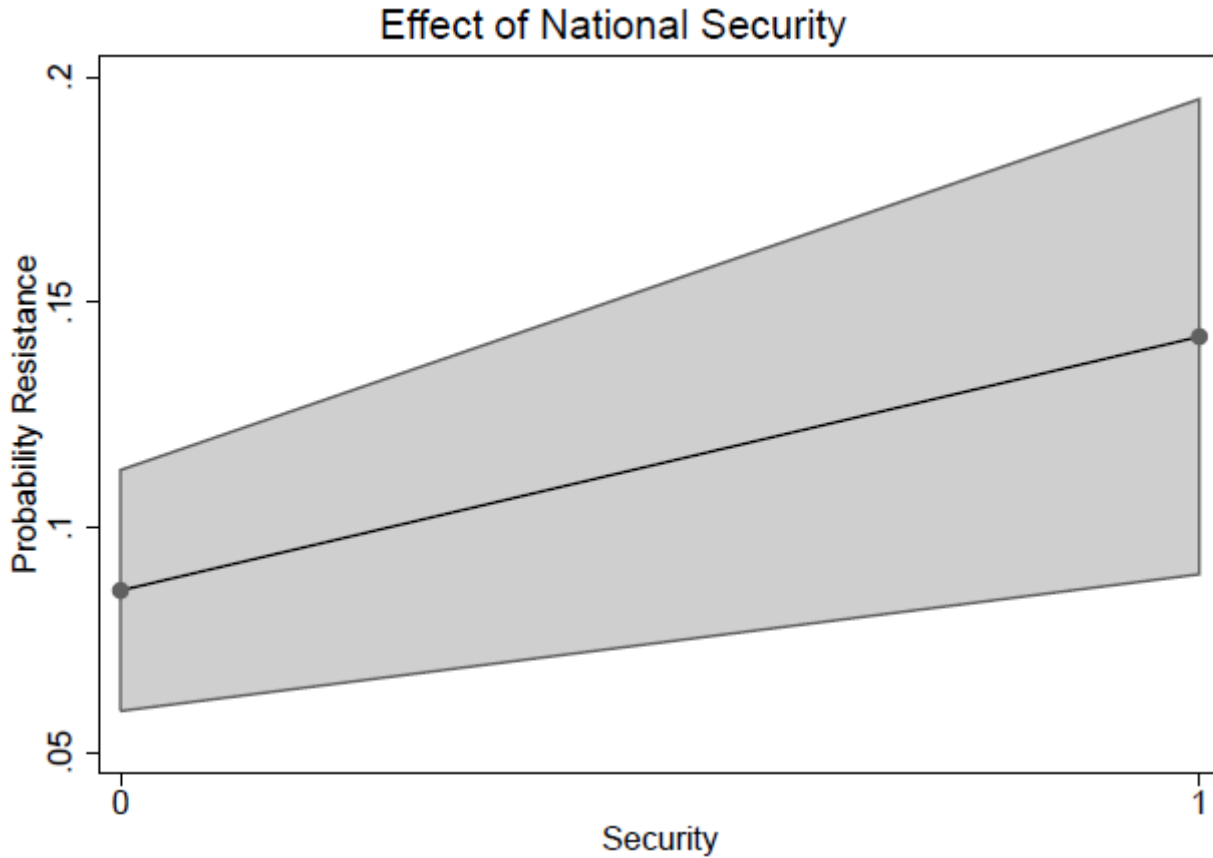


Figure 2: Effect of *Security* moving from sample minimum to maximum holding all other variables at sample mean.

The substantive effect of this variable is also important. In Figure 2 we present the predicted probability of resistance when the target firm is not security sensitive (0) and when it is sensitive (1), using model m5 and holding all other variables at their mean. The change in probability is nearly .06 on the 0 to 1 probability scale. This is substantively important in light of our baseline probability of political protest. Furthermore, in additional models not reported, this effect gets substantially stronger when we allow for an interaction between our measure of Chinese government ownership and our security sensitivity variable. This shows that the security

sensitivity of a target is amplified if the acquiring firm is government owned rather than a private firm.

Economic Distress

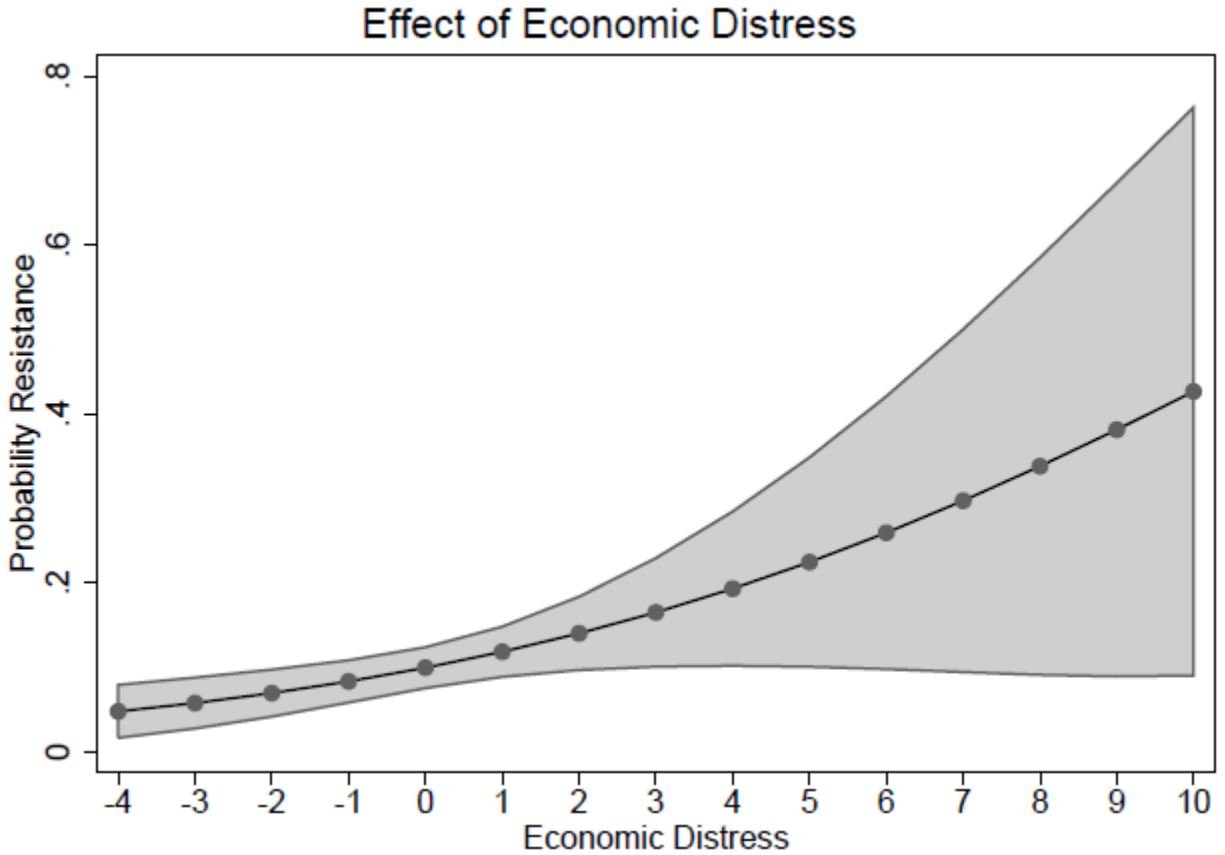


Figure 3: Effect of *Economic Distress* moving from sample minimum to maximum holding all other variables at sample mean.

Using the abnormal unemployment of the target industry as a proxy for the target industry's level of *Economic Distress*, we find a strong positive and statistically significant relationship with political opposition. Chinese acquisitions in industries that are underperforming the U.S. economy would likely trigger opposition. This variable is positive and statistically significant in each model, including those with year fixed effects and additional control variables. Substantively this effect is meaningful. As presented in Figure 3, the probability of resistance at

the lowest values of *Economic Distress* is 0.05 but at the highest level of distress in our data it is nearly 0.4. Most of the data though is in the region of -1 to 2 (the 25th and 75th percentiles, respectively), over which the changes are more modest: ranging from a 0.08 probability of resistance to 0.14. In short, higher levels of economic distress generally predict greater likelihood of political opposition toward a Chinese acquisition.

Reciprocity

Next we turn to our measure of reciprocity. Is protest more likely when U.S. M&A attempts in China fail within the same industry as the American firm targeted by Chinese M&A? Higher values of this variable indicate greater amounts of completed deals, and lower levels indicate less success. In Table 1 this variable is negative and statistically significant in each model. Greater levels of U.S. M&A success within industry in China are correlated with a lower probability of political opposition. This suggests that U.S. political responses are mindful of American successes overseas. If things are going well for U.S. firms in China, there is a lower need to protest, which could imperil U.S. firms overseas. Of course, as we discuss below, our quantitative research design is unable to identify who the “original” defector is. Our point, though, is that our evidence shows that there is a relationship within macro-industries. Merger and Acquisition success overseas impacts domestic protest at home.

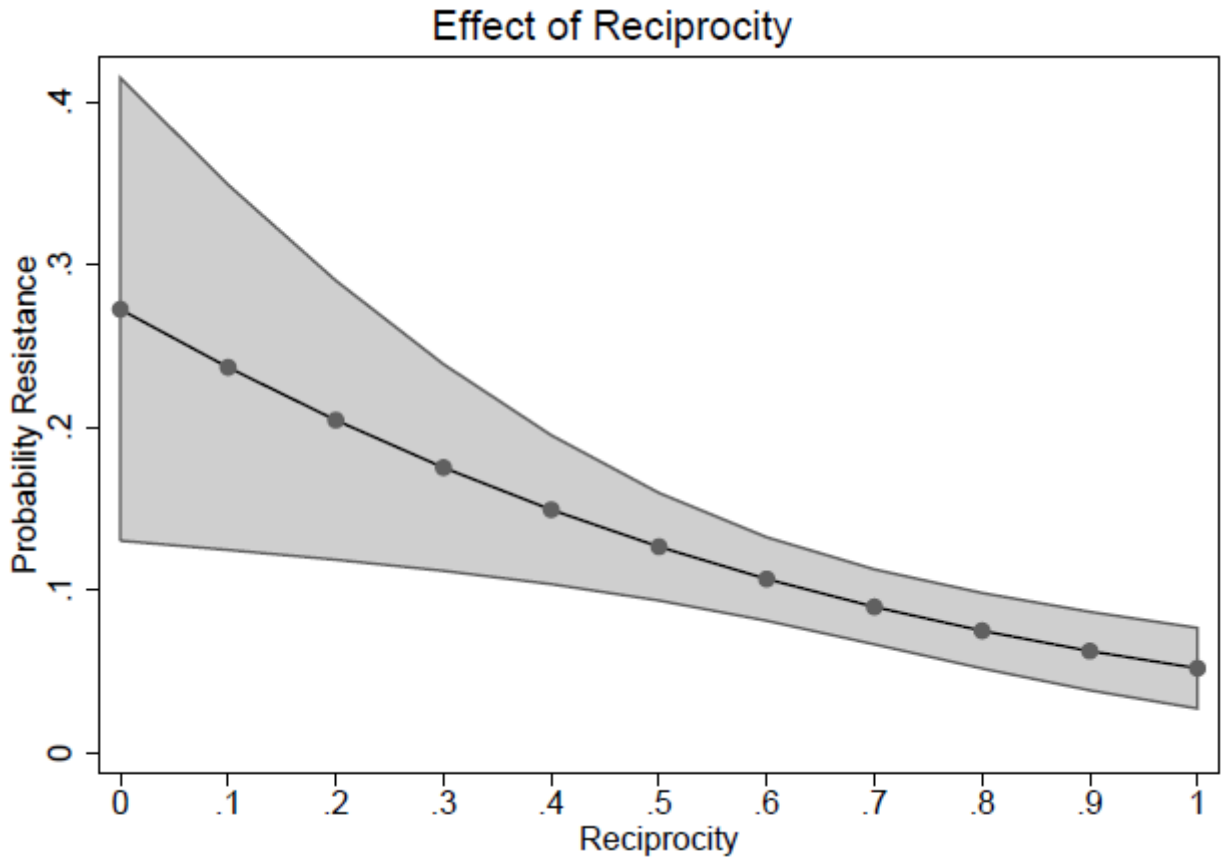


Figure 4: Effect of *Reciprocity* moving from sample minimum to maximum holding all other variables at sample mean.

To illustrate the magnitude of the effect of the *Reciprocity* variable, we again calculate substantive effects using model m5 from Table 1 and present the results in figure 4. Holding all other factors at their sample mean, changing the *Reciprocity* variable from its sample minimum (0) to its maximum (1) changes the probability of resistance from 0.27 to 0.05, or a change in probability of over 0.2 along the 0 to 1 probability scale. Moving from 0.5 to 0.8 (the 25th and 75th percentiles, respectively) decreases the probability of political opposition by 0.06 probability, or about a third of our baseline probability. Therefore, our results support the reciprocity hypothesis. This potentially suggests that U.S. firms who have experienced greater “success”

rates in conducting M&A deals in China—as reflected by the percentage completion rate—would be less likely oppose Chinese acquisitions in their industries.^{92 93}

Control Variables

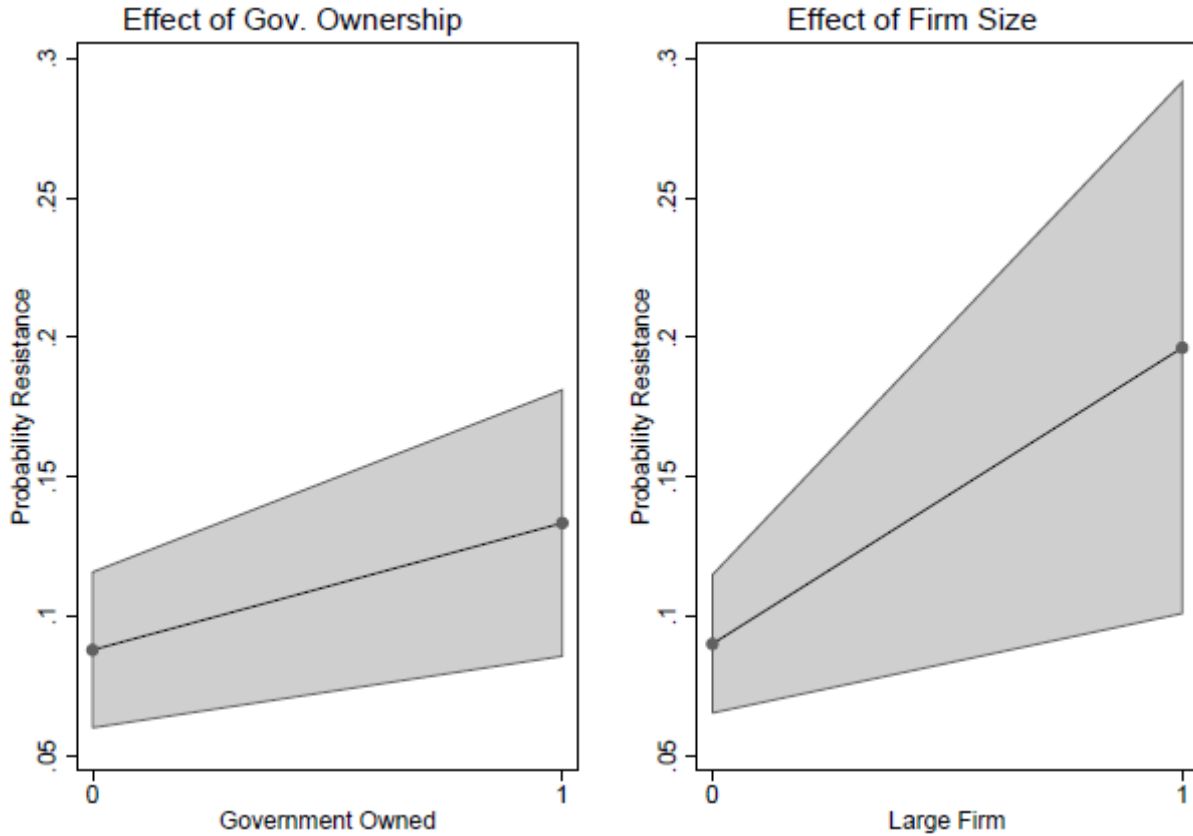


Figure 5: Effect of *GovtOwned2* and *Firm Size* moving from sample minimum to maximum holding all other variables at sample mean.

Government Ownership

On its own, ownership of the acquiring firm by the Chinese government was positively related to protest in every model. However, it was only statistically significant in the models with

⁹² However, we are unable to make this specific conclusion, because often the political resistance we code cannot be directly linked to representatives within an industry. However, this conclusion is reasonable if we assume that these firms have the greatest incentive to get political actors to mount a protest.

⁹³ We also investigated models that split apart acquiring firms by whether they were mainland China versus Hong Kong based. We find nearly identical results except that the *Security* variable is not significant for Hong Kong based firms. This is an interesting result that may warrant additional research in the future. Additionally, we are not able to include the government ownership variable for the Hong Kong model because no firms in Hong Kong were owned by the government. We thank an anonymous reviewer for raising these points.

year fixed-effects. As discussed before, when this variable is interacted with the *Security* the interaction term was positive and significant. Security considerations are most salient when the Chinese government is linked to the acquisition. This makes intuitive sense, and gives credence to our measures and results. This shows some evidence in support of Krugman and Prabhakar's hypothesis that state ownership is perceived to threaten national identity.⁹⁴

Firm Recognition/Size

Using our binary measure of firm size to proxy the public familiarity with the U.S. target, we find that there will be more political complaints with larger firms. Across models m3 to m5, this variable is positive and significant. Translated into substantive terms, the change in probability, holding other variables at the mean, is nearly 0.1. While it is important to control for this variable (it might, for example, confound one of our key explanatory variables), it has an important impact on the dependent variable.

Inference Concerns

Our research uses observational data that makes it difficult to establish clear causal inferences or to measure our key concepts in ideal ways. We briefly discuss some of these challenges.

As mentioned earlier, we do not control what deals are actually proposed. If Chinese firms, and perhaps the Chinese government, have expectations about what will or will not succeed, then we have a non-random sample from the set of potential M&A attempts. The effect of this concern is ambiguous, though. On the one hand, if our arguments are correct, this may lead to more restraint when a target firm faces economic distress, has national security linkages,

⁹⁴ Prabhakar, 'Deal-Breaker: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms'; Krugman, 'Competitiveness: A Dangerous Obsession'.

or is in an industry with little Chinese reciprocity. In turn, we would expect our coefficients to be biased towards zero. This effect might be most salient for national security considerations; certainly Chinese firms are not going to try and buy Lockheed Martin. This, of course, adds another challenge to comparing the relative importance of our core variables.

Another limitation of our study is that several of our variables are difficult to measure. The reciprocity measure suffers the most. In particular, we are less able to establish quantitatively whether American efforts in China are frustrated first, which leads to responses against Chinese attempts, or the other way around. Our reading of several cases suggests the former, but this evidence is not dispositive. Regardless, as in many aspects of international affairs, we feel like this variable still taps a diffuse sense of reciprocity at work as it does not appear to be the case that state decision-making is independent.

Additionally, in several of our empirical models we are able to use year fixed effects. However, we note that we do not use sectoral fixed effects as this would eliminate two of our key variables—*Economic Distress* and *Reciprocity*—because they are constant within sector. Firm level analogues would be difficult to impossible to collect for these measures.

Finally, our focus has been on political resistance rather than the ultimate outcomes. In our data, 22 attempts were withdrawn, of which 11 were tagged with our *Security* variable. However, our research design is ill-equipped to measure these dynamics as there could be many other variables that could affect the final outcome, including broader economic forces like inflation and local conditions such as privately known profitability considerations that would be difficult to measure. Furthermore, it was not always possible to observe what happened with a deal (was it finally dropped, pending but in a way only known to the investors, etc.). Future work may unpack these outcomes further.

6. Conclusion

This study focuses on how a developed country’s politicians treat inward investments by multinational firms from a developing country—a relatively recent phenomenon that is not yet covered extensively in academic or policy-oriented research. Indeed, the literature on direct foreign investment has focused much more on flows from developed to developing countries; and the research that has focused on FDI flows to developed states has not yet explored the variation in which inward investments are welcomed and which receive criticism.

Although our study speaks to these larger questions, the scope of our study was limited specifically to attempted “mergers and acquisitions” of U.S. companies by Chinese and Hong Kong firms between 1999 and the summer of 2014 (the fifteen year period after the Chinese government launched the “Going Global” campaign for Chinese enterprises). This is intentional given the massive increases in the importance of Chinese FDI in recent years. After analyzing political opposition to 569 transactions that met these criteria, we found that U.S. political actors are more likely to protest Chinese inward M&A investments in security sensitive industries, economically-distressed industries, and sectors in which U.S. companies faced restrictions in China’s M&A markets.

Of course, there are limitations that can be drawn from our results because of particular challenges in our methodology and the restricted set of transactions we analyzed. Our economic distress and reciprocity variables are certainly not perfect.⁹⁵ Our political opposition measure was coded using a qualitative review of publicly available government sources, a methodology that might not have accounted for certain Federal opposition due to the confidentiality of CFIUS

⁹⁵ “Abnormal unemployment” may not account for certain aspects of a target industry’s economic health, particularly intra-industry trends and firm-level performance. Likewise, a U.S. industry’s M&A completion rate in China did not precisely explain patterns of reciprocity from Chinese *political actors*. However, given the strong involvement of the Chinese government in its business sector, this measure was the most accurate proxy for reciprocity given data limitations in ascertaining “political opposition” by Chinese government officials.

proceedings. While some Federal-level policy-makers might also question the use of most Congress-related contention toward Chinese acquisitions as “political noise,” we consider even these scattered episodes of controversy as crucial evidence of political opposition for the purpose of our research. After all, our intention was to study the *nascent* formation of a US policy toward increasing inward M&A investments by Chinese firms before a potential and possibly controversial “era of Chinese buyouts”—reminiscent of America’s experience with Japanese firms during the 1980s. Finally, our research was devoted to a study of *political* economy—rather than *economics*—involving Chinese inward FDI. Needless to say, a descriptive analysis of the microeconomic effects of Chinese M&A in the U.S. would certainly be valuable in future research, and would provide an empirical perspective on the long-term implications of how U.S. politicians respond to Chinese investments.

Despite these limitations, our results both have important implications for U.S.-China foreign policy and highlight potential future avenues of research. Although the results may have implications for many aspects of U.S.-China relations, we will note three aspects of economic relations between these countries that our results speak to. First, our research most obviously helps to explain which Chinese M&As are most likely to produce political opposition in the future. This information can potentially be useful to both industry and government. Of course, it is important to note that just because a Chinese M&A generates political opposition it does not mean that it will not ultimately be successful.⁹⁶ For example, in 2013 a Chinese company bought Smithfield Foods in a deal worth \$7.1 billion. The company is the world’s largest pork producer, and a number of U.S. politicians raised concerns about security and reciprocity. This high profile deal was successful, however, despite political objections, and this may be in part

⁹⁶ Gabriel Palma, 'Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment?,' *World Development*, Vol. 6, No. 7–8, 1978, pp. 881-924.

due to the fact that the Chinese executives attempted to respond to the aspects of the transaction that would be likely to generate opposition.

Second, our research can help to explain some aspects of recent U.S.-China economic relations. For example, in 2011 “reverse-mergers” became a highly publicity concern. In these deals, Chinese companies were merging with American based companies in order to become publically traded. Regulators responded by cracking-down on these transactions out of concerns that the deals were inherently toxic. Recent research has suggested, however, that the Chinese Reverse-Merger firms may have actually performed better than similarly sized companies.⁹⁷ Our research indicates that political opposition may exist even in the absence of legal restrictions to Chinese M&As, which in part helps to explain the finding that Chinese Reverse-Mergers generated negative publicity despite performance on par, or better, than peer firms.

Third, our results have implications for one area of current U.S.-China economic integration: the current negotiations over a U.S.-China Bilateral Investment Treaty.⁹⁸ If completed, the treaty would expand the legal protections, and remove existing restrictions, for foreign investments in each country. If a BIT is not completed, the barriers to FDI flows between these countries could remain substantial. For example, the president of the U.S.-China Business Council recently said “China maintains ownership restrictions on American and other foreign companies in about 100 sectors, including manufacturing, services, energy, and agriculture”⁹⁹. Following up, Forbes magazine noted “What if they could have outright ownership? Or even just a little bit more? It would be a windfall for a number of companies that face tough growth

⁹⁷ Charles M. C. Lee, Kevin K. Li and Ran Zhang, 'Shell Games: The Long Term Performance of Chinese Reverse Merger Firms,' *Accounting Review*, Vol. In-Press, forthcoming 2014.

⁹⁸ Jiabao Li and Chen Mu, 'Baucus: Investment Pact Opens a New Chapter,' *China Daily USA* (June 26, 2014), http://usa.chinadaily.com.cn/2014-06/26/content_17615778.htm.

⁹⁹ Kenneth Rapoza, 'U.S. Financial Service Firms Push for Bilateral Treaty with China,' *Forbes.com* (April 5, 2014), <http://www.forbes.com/sites/kenrapoza/2014/04/05/u-s-financial-service-firms-push-for-bilateral-treaty-with-china/>.

restrictions in one of the world's most important consumer markets".¹⁰⁰ This illustrates the importance of reciprocity, and potentially how it could be facilitated by international agreements that remove restrictions to inflows of Foreign Direct Investment.

Our study also suggests several avenues of future research. Specifically, future research could consider other types of Chinese inward FDI like greenfield investment or joint ventures (although these cross-border investments have generally been welcomed and triggered relatively little controversy compared to M&A).¹⁰¹ A more general study of developed countries' treatment of FDI from emerging economies would be very valuable. Is U.S. political opposition toward Chinese inward M&A unique and dependent on the particular political economy of the United States, or are they generally representative of developed countries' reactions toward Chinese investments? Although some research has suggested that the United Kingdom may be more supportive of investment liberalization than the United States,¹⁰² more research will have to be done to determine if the factors that drive opposition to investment in the United States are the same in other countries. Finally, richer data including more countries could enable the investigation of more of a country level political relations story.¹⁰³

Another interesting next step would be to determine if the patterns of U.S. opposition toward Chinese inward M&A were particular to the *Chinese* character of the acquirer: Do the set of political economy variables—economic distress, national security, and reciprocity—also explain U.S. politicians' treatment of inbound investments from other developing countries? Answering these questions will require a new body of research focusing specifically on the rise

¹⁰⁰ Rapoza, 'U.S. Financial Service Firms Push for Bilateral Treaty with China'.

¹⁰¹ Unlike ThomsonOne Banker's M&A database, there does not exist a large-scale commercial database devoted to individual Greenfield investments or joint ventures in the United States—let alone in China. Thus, detailed and comprehensive dataset for Greenfield investments would actually be more difficult to construct than for M&A.

¹⁰² Nathan M. Jensen and René Lindstädt, 'Globalization with Whom: Context-Dependent Foreign Direct Investment Preferences,' *Working Paper*, (St. Louis: Washington University, July 19, 2013).

¹⁰³ Quan Li and Tatiana Vashchilko, 'Dyadic Military Conflict, Security Alliances, and Bilateral FDI Flows,' *Journal of International Business Studies*, Vol. 41, No. 5, 2010, pp. 765-782.

of FDI from developing nations into mature economies, a peculiar trend that might reflect dynamic shifts in the global financial system.

Finally, future researchers could also add substantial value to research in U.S.-China investment relations by further investigating the treatment of U.S. companies' M&A transactions in China, and perhaps construct a more precise measure of reciprocity that could test the robustness of our results. Such studies should also monitor China's application of the Anti-Monopoly Law as well as developments of the National Security Review Mechanism.

More broadly speaking, reciprocity is seen as a powerful means for inducing cooperation and stability into potentially contentious relationships. One question is whether that is true for foreign investment. In our case, it seems as if reciprocity may create more tensions as countries use punishment strategies. An interesting avenue of research would be to see if these foreign investment conflicts carry over to broader political relations and if so what impact they might have on them.

Appendix 1

List of Instructions in determining national security sensitivity variable (*Security* = 1)

- 1) If target company name falls under any of those that are “military contractors” or “government contractors” (see http://www.fas.org/man/target_company/index.html), code 1
- 2) If macro industry is in “Wholesale & Retail Trade”, code 0
- 3) If macro industry is in “TRANSPORTATION & UTILITIES”, check mid industry description to see if in “TRANSPORATATION” or “UTILITIES”.
 - a) If in “UTILITIES”, code 1.
 - b) If in “TRANSPORTATION”, check target company description.
 - i) If target company deals with “national transportation”, code 1.
 - ii) Otherwise, code 0
- 4) If macro industry is in “TELECOMMUNICATIONS”, code 1
- 5) If macro industry is in “PUBLIC”, check target company description
 - a) If target company deals with Federal, Congressional, or State government departments, code 1.
 - b) Otherwise, code 0
- 6) If macro industry is in “PROFESSIONAL & BUSINESS SERVICES”, check mid industry:
 - a) If target company deals with Consulting, code 0
 - b) Otherwise check target company description
 - i) If target company deals with high-tech or genetic products, code 1
 - ii) Otherwise, code 0
- 7) If macro industry is “PRODUCTION”, check mid industry
 - a) If mid industry is “AEROSPACE & DEFENSE”, code 1
 - b) Otherwise, code 0
- 8) If macro industry is “Nondurable”, check mid industry
 - a) If mid industry is “Energy & Power” or “Petrochemicals”, code 1
 - b) Otherwise, code 0
- 9) If macro industry is “Mining”, code 1
- 10) If macro industry is “LEISURE & HOSPITALITY SERVICE”, code 0
- 11) If macro industry is “INFORMATION”, check Mid industry
 - a) If mid industry is “broadcasting”, “Motion Pictures / Audio Visual”, or “Publishing”, code 0.
 - b) If mid industry is “telecommunications equipment”, “Other telecom” or “E-Commerce/B2B”, code 1
 - c) If mid industry is “Internet Software & Services”, check target company description
 - i) If target company deals with intelligence or infrastructure building, code 1
 - ii) Otherwise, code 0
 - d) If mid industry is “Software”, check target company description
 - e) If mid industry deals with e-commerce, database systems, or infrastructure, code 1
 - i) Otherwise (health care services, internet gambling, internet finance, etc), code 0
 - f) If mid industry is in “wireless”, check target company description
 - i) If target company provides general telecommunications services, code 1
 - ii) Otherwise (target company deals with testing wireless systems, code 0

- 12) If macro industry is “FINANCIAL ACTIVITIES”, check target company mid industry;
 - a) If target company is in “Alternative Financial Investments”, “Diversified Financials”, “Non Residential” (Real Estate), code 0
 - b) Otherwise, check target company description:
 - i) If target company is a large and notable national commercial or investment financial institution (i.e. Morgan Stanley, AIG, Blackstone, etc) code 1
 - ii) Otherwise, code 0
- 13) If macro industry is “EDUCATION & HEALTH SERVICES”, code 0
- 14) If industry is in “DURABLE”, check mid industry
 - a) If mid industry is “Automobiles and Components”, “Home furnishings”, “Garden Equipment”, code 0.
 - b) If mid industry is “Semiconductors”, “Metals & Mining”, code 1
 - c) If mid industry is “Construction Materials”, check target company description
 - i) If construction materials deal with primary goods (ie. Powders, etc), code 1
 - ii) Otherwise, code 0
 - d) If mid industry is “Electronics”, check target company description
 - i) If target company deals with “E-Commerce” or semiconductors, code 1
 - ii) Otherwise (i.e. consumer electronics), code 0
 - e) If mid industry is “Machinery”, check target company description
 - i) If target company deals with basic machinery and machine tools, code 1
 - ii) If target company deals with energy-related machines, code 1
 - iii) If target company deals with water, safety and sanitary equipment, code 1
 - iv) Otherwise (electronics, etc), code 0
 - f) If mid industry is “Other industrials”, check target company description
 - i) If target company deals with “e-commerce”, “semiconductors”, “basic machinery and machine tools”, “energy-related machines”, “water, safety and sanitary systems”, “metals and mining”, “construction dealing with primary goods” → code 1
 - ii) Otherwise, code 0
- 15) If macro industry is “Construction”, check target company description
 - a) If target company deals with energy and infrastructure related construction, code 1
 - b) Otherwise (i.e. engineering services, consumer products, buildings), code 0.
- 16) If macro industry is in “AGRICULTURE”, check company description
 - a) If company deals with national or state-level agricultural products, code 1
 - b) Otherwise (consumer products, etc), code 0