Reversing the Incentives Cycle

Foreign investment in China has long been sweetened by tax breaks and incentives. Some U.S. states are now adopting the same tactic.

By Maria Trombly

In July, Nanjing Automobile Corp. held a ceremony announcing that it was building a new plant. Chinese companies build plants every day, taking advantage of the country's cheap labour pool. But this plant's employees wouldn't be taking jobs away from American workers: the plant is being built in Ardmore, Oklahoma – just a couple of hours north of Dallas.

The new plant, in addition to an assembly plant in Birmingham, England and a plant in Nanjing, will be used to build new MG-branded vehicles. MG's sales and marketing will be headquartered in Oklahoma City and research and development will be based in the city of Norman, at the University of Oklahoma.

At full capacity, MG Motors is expected to create more than 500 jobs in Oklahoma, with an estimated payroll exceeding USD30m. The assembly plant at the Ardmore Airpark will employ 325 people, the global headquarters in Oklahoma City will employ 150, and the R&D component at Norman will employ about 35, the company says. The total project will cost around USD2bn.

Oklahoma's competitive incentive package played a critical role in bringing MG Motors to Oklahoma, says Amy Polonchek, Interim Executive Director of the Oklahoma Department of Commerce. "Oklahoma's incentives are competitive with any throughout the world, but our ability to create partnerships is Oklahoma's competitive advantage," Polonchek said in a statement. The incentives included USD20m from a newly-created Opportunity Fund, USD15m of which will be used to extend a runway at the local airport.

Turning Tide

MG isn't alone in Oklahoma, which has been busily recruiting business from China, Oklahoma International Trade Office, China Director Wei Zhibin tells Shanghai Business Review. "To increase employment is one of the basic missions for the Oklahoma Department of Commerce," says Wei. It's still early for China, though – out of some 500 foreign businesses with foreign investment in Oklahoma, "very few" are from China, Wei says.

But the tide is starting to come in. Last year, Chinese companies more than doubled their overseas investments, to USD12.3bn, up 123 per cent on 2004, according to China's Ministry of Commerce and the National Bureau of Statistics. Significantly, more investment was coming from private Chinese firms. In 2004, state-owned enterprises accounted for 35 per cent of foreign direct investment. In 2005, that dropped to 29 per cent.

More than half of the investment was in manufacturing industries – textiles, shoes, computers, machinery and pharmaceuticals. Hong Kong took 16 per cent of the investment, the single largest destination. Another 30 per cent went to the United States, Japan and Russia.

One of the first Chinese brand-name companies to make a significant U.S. investment was Qingdao's Haier group, which opened a refrigerator factory in South Carolina six years ago. Nonetheless, China's overseas FDI accounted for just 1.68 per cent of the global total international foreign investment flow last year, reports the United Nations Conference on Trade and Development. That's not surprising, given that foreign investment is new to Chinese companies.

Destination Denver

Until two years ago, for example, the Denver Shanghai Trade Office was almost completely focused on exports from Colorado to China. Then, two years ago, China began to liberalise its overseas investment policies.

"It's still not a huge opportunity for us, but I would say that every month I talk to five or six good companies that are beginning to look at investing in the United States," says Office Director, Paul Taylor. "Just last week, I met with a truck company that is looking for a distribution facility in the United States."

Taylor says that Colorado is a good bet for a distribution company – costs, taxes and wages are lower than in other parts of the United States, and the area is centrally located, with access to major highways and a major airport. "Denver is really well suited for distribution facilities," he says.

In addition, the city can throw in a few perks. For example, there's a USD3m job creation fund for high-paying jobs. For every job created, a company can get between USD1,000 and USD1,500 a year. There are also tax deductions, he adds. For a very major company – like Boeing or United – Denver will really roll out the red carpet, including land set-asides. "But those are on a case-by-case basis, for very large companies," he says.

Other U.S. states are following suit. "We are promoting from now on," says Cao Guoli, Chief Representative of the State of Idaho USA Shanghai Trade Office. "There is potential." Idaho offers tax credit for new investment, job creation, R&D and broadband communication equipment, he says. In addition, there's a new employee training reimbursement of USD2,000 per employee – rising to USD3,000 in some rural counties.

Other states offer particular advantages to Chinese firms. Florida is popular with Chinese companies looking to set up a Latin American headquarters, says Anne Torres, spokeswoman for Development Counsellors International, which helps cities and states attract investors. Jialing Motorcycle America, Mandarin Oriental, Swire Properties, Oriental Logistics, WoWo AgDev and Hecny Transportation all have offices in Miami, she says.

The fact that Chinese companies want to move to the United States doesn't surprise George Haley, Director of the Center for International Industry Competitiveness and an international business professor at the University of New Haven in Connecticut. The idea that foreign investment always flows to the cheapest labour source is a misunderstanding, says Haley, who is also the author of a recently-released book, The Chinese Tao of Business. "If you track total U.S. investment, for instance, 80 per cent of direct investment is in Canada, Western Europe and Japan," he says. "The vast majority of investment goes to the market where the products are being sold."

With so many Chinese products being sold in the United States, it's no surprise that mainland firms are starting to set up shop there. That doesn't mean that they're greeted with open arms. There are political concerns, Haley says. "A warning just went out from the Bush administration about economic nationalism."

And Chinese companies are also less well-known than, say, better established Korean or Japanese brands. "Toyota, for example, tends to be put on a very high plain," says Haley. "When it was looking for a place to build its Tundra pickup truck, it was really competed for by several cities. San Antonio included such things as putting in a new rail line to the Toyota plant, put in additional roads and bought multiple pieces of land to put together to make it easier for Toyota to purchase it."

Seeking Southern Success

When Greg Burkart opened the State of Michigan's representative office in Shanghai in the late 1990s, it wasn't to attract Chinese companies to move to his state. In fact, Burkart says, the Chinese government didn't give its blessing to foreign investment until a couple of years ago. "Most of the activity we had was trading activity," says Burkart, "and helping U.S. automotive companies going to China select business partners." Burkart is now an attorney with Squire, Sanders & Dempsey L.L.P. and helps corporate clients choose communities and negotiate incentives from governments.

Despite the benefits of having Chinese companies move in, there are political considerations. "Depending on where you go in the United States, you'll find very receptive communities for investment from Chinese companies or you can find just the opposite," he says. It doesn't help that most of the big Chinese firms are still majority-owned by the government.

"I've received some calls from secretaries of commerce in the southern states," Burkart says. "Their governors want to go to China and visit with government and party officials and industry officials to woo investment. But those are southern states. If you contrast that with governors of some of the traditional auto-manufacturing states, they feel some political pressure not to be visiting with Chinese companies."

Benefits for the State

When a company builds a new plant in a state, especially an automotive plant like Nanjing Motors, the state gets job creation and a tax base, not just directly from the plant but also from the spin-off business that goes to its suppliers. "In terms of economic multipliers, an automotive assembly plant is probably one of the largest multiples of economic activity because it spins off so much subsidiary manufacturing activity," Burkart says. "And then there's the service sector – dry cleaners, retailers, groceries and banks."

States compete to get the biggest plants. Some incentives that companies can get include free land, tax credits and cash to improve roads, add utilities, train employees and buy equipment. Some states even offer refundable tax breaks – if you get, say, USD1,000 tax credit but you don't owe any taxes because you're still starting out and not making any money, the state will actually give you the cash. "Even though you didn't pay any tax, you get a refund back," Burkart says. "States like Michigan, Indiana, Kentucky, North Carolina and South Carolina offer these refundable types of credits."

Of course, incentives aren't the main reason that companies decide to move to the United States. The main motivation is to get close to the customer. "America is the biggest market in the world," Burkart says. "If you like cars, it's a great place to be because of the size of the market."

There are three stages to foreign investment, Burkart says. First come sales and marketing offices. Then R&D facilities. Finally, manufacturing. It can take five to seven years to reach that last stage, and most Chinese companies looking to the west are still in the earliest stages of foreign investment. "I see a lot of sales and marketing offices," he says. "And a few engineering offices, but not many."

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