# THE GREEN DRAGON MOVES WEST

## Opportunities for China FDI in U.S. Renewable Energy and Clean Technology


GreenWorld Capital, LLC

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# About this report

This report is the latest in a series of releases from GreenWorld Capital, LLC regarding cross-border opportunities for Chinese and U.S. stakeholders in renewable energy and clean technology. China and the U.S. are the world's two largest economies, the two largest energy consumers and two largest emitters of greenhouse gases. The cross-border opportunities are compelling and we expect them to remain so the remainder of the decade and beyond.

The topic of this release is opportunity for stakeholders in China and the U.S. as the result of the dramatic increase in outbound Chinese foreign direct investment ("OFDI") and the growth planned for renewable energy and clean technology reflected in China's 12th Five Year Plan.

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# Disclaimer



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# About GreenWorld Capital, LLC

GreenWorld Capital, LLC ("GreenWorld") is an international merchant bank focused exclusively on serving the financial and strategic needs of clean technology companies and investors in the U.S. and abroad.

GreenWorld's senior professionals have completed over 400 transactions with an aggregate value approaching $10 billion. We have an experienced, bi-lingual China business team focused exclusively on cross-border transactions involving renewable energy and clean technology in the U.S. and China.

Complementing this broad transaction experience is extensive clean technology industry knowledge backed by a network of international relationships and a suite of proprietary information tools. GreenWorld is well positioned to identify and implement effective strategic and financial solutions on behalf of public and private companies as well as their investors.

GreenWorld works diligently to anticipate industry trends, rather than simply react to them and is committed to being a creative source of innovative ideas and opportunities for our clients and partners. With offices in Philadelphia and Palo Alto in the U.S. and Nanjing in China, GreenWorld provides geographical coverage of North America and Asia while maintaining numerous relationships which provide the firm access to European and other overseas markets.

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# Contents

# I. OVERVIEW

China's Outbound Foreign Direct Investment ("OFDI") in 2012 increased to its highest level ever, at almost $80 Billion USD, and is poised for continued extraordinary growth in the coming years. The target of China's OFDI shifted dramatically West in 2012, with North America, for the first time, receiving the world's largest share of China non-bond investment, at 40%.

By 2020, China's economy is projected to be the largest economy in the world, with a GDP of $24.6 Trillion USD.[i] Assuming that China's OFDI stock grows to equal 15% of their GDP (the average worldwide percentage of OFDI stock in transitional economies), China's OFDI stock has the potential to approach $3.7 Trillion USD. While the prospect of such growth may seem astounding (and we expect the growth in China's OFDI stock to lag their GDP growth), it should be noted that the OFDI stock of the U.S. at the end of 2011 was 20% larger (around $4.5 Trillion) on U.S. GDP that was 40% smaller than China's projected GDP in 2020.

Inbound FDI is integral to the U.S. economy. The U.S. has historically been the world's largest recipient of global OFDI, at 17%. We believe that 2012 witnessed the beginning of a new era in China OFDI to advanced economies and expect that a combination of push and pull factors will result in a dramatic increase in China OFDI to the U.S. If the U.S. receives a percentage of China's OFDI equal to the historical receipt of global OFDI by the U.S., the investment potential could exceed $620 Billion USD.

The development and deployment of, renewable energy and clean technology has been confirmed as a national priority under China's 12th Five-Year Plan ("FYP") and has been targeted for substantial investment.. The U.S. is home to a significant percentage of the world's renewable energy and clean tech companies, many of which possess industry-leading technologies. In addition, renewable energy projects have been the favored target of worldwide FDI, with the U.S. being the #1 recipient global FDI focused on this sector. These factors suggest the U.S. renewable energy and clean technology sectors should be a major beneficiary of China's OFDI.

Chinese OFDI would provide a much needed source of capital for the U.S. renewable energy and cleantech industry as well as its stakeholders in both the public and private sectors. In addition to offering attractive investment returns to Chinese investors, this capital should accelerate deployment of renewable energy and clean technology projects in the U.S., preserve and create U.S. jobs, and facilitate access of U.S. companies to the huge Chinese market.

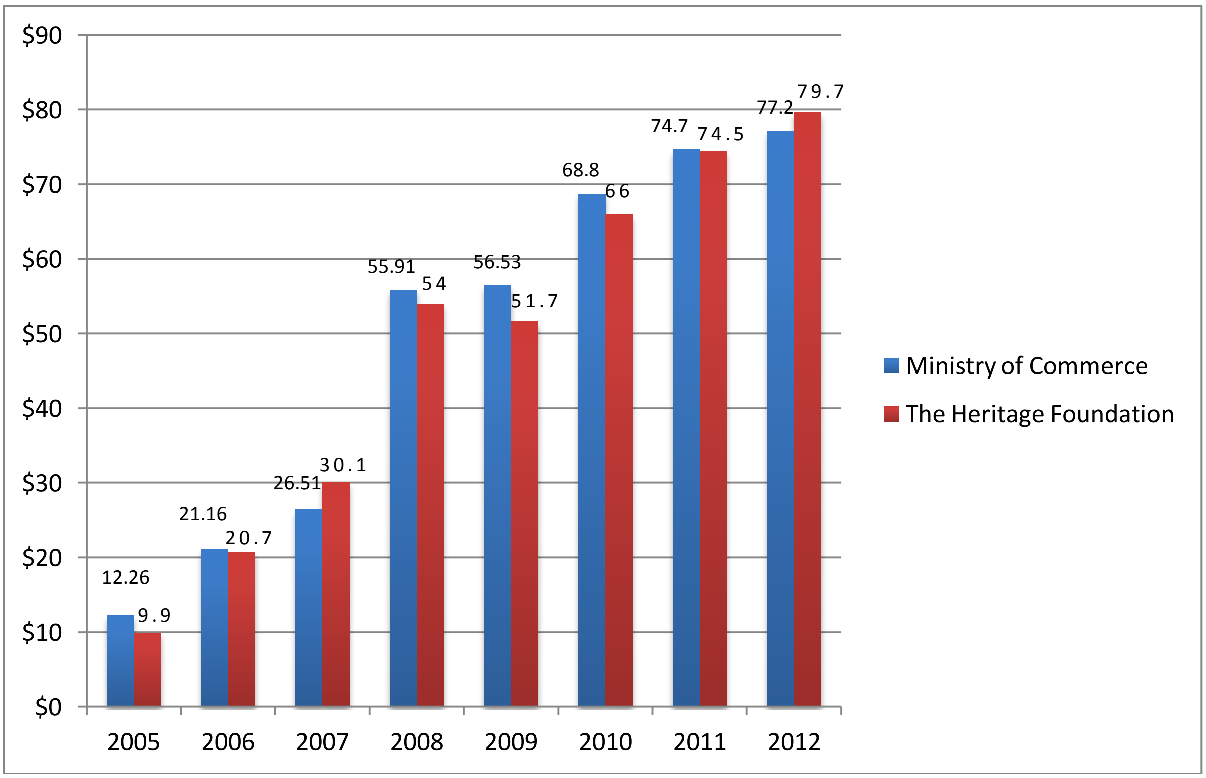
***NOTE: Many organizations publish economic data regarding China's current and projected GDP and other topics referenced in this report. While we have cited sources of data that we believe to be credible, our purpose is not to endorse any specific data source nor present a definitive forecast of the estimated level or trajectory of China OFDI. Our purpose is to make the case that we have entered a period that will likely show dramatic increases in China OFDI to the U.S., which***

***has the potential to provide substantial benefits to numerous industry stakeholders in both countries in the renewable energy and clean technology sector.***

# II GROWTH IN CHINA OFDI

Figure 1 depicts the considerable growth in China OFDI in recent years as separately reported by China's Ministry of Commerce ("MOFCOM") and The Heritage Foundation ("Heritage", which provides a public dataset of Chinese outward foreign investment). Although there are minor differences in the data reported by MOFCOM and Heritage, the expansion in Chinese outward foreign investment in recent years is clear.

**Figure 1: China's outward FDI flows and stock from 2002 to 2011 (Billions of dollars)**




Source: Statistical Bulletin of China's Outward Foreign Direct Investment by MOFCOM [ii] and Heritage.[iii].

According to the United Nation's Conference on Trade and Development ("UNCTAD"), China was the largest investor among the developing countries, the 5th largest investor in the world in 2011 and reached an OFDI stock of $365 Billion USD. Numerous factors support continued growth.

China's 12th FYP, adopted in 2011, placed significant emphasis on increasing outbound FDI. MOFCOM stated that the goal is to increase OFDI by 17% annually from 2011 to 2015, reaching $560 billion within five years. MOFCOM's goal for OFDI, while impressive, would still be considerably less than many independent forecasts for China's OFDI[iv] and the average of other G-20 countries and the OECD. Figure 2 below summarizes the percentage OFDI flows and OFDI stock of China, the G-20 and the OECD for 2011 and illustrates the strong growth potential for China's OFDI.

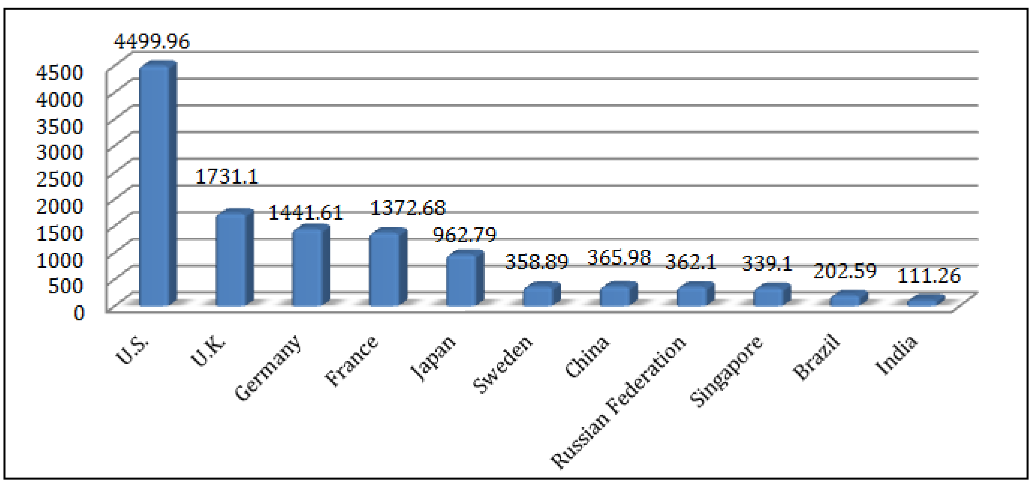
**Figure 2: OFDI Flows/Stock as a percentage of GDP**

| | 2011 OFDI Flows/GDP | 2011 OFDI Stock/GDP |
|---|---|---|
| China | 0.6% | 5% |
| G-20 | 2.0% | 26.4% |
| OECD | 2.8% | 38.4% |

Source: OCED Statistics [v] We estimate China's 2012 GDP at $7.87 Trillion USD, based upon The World Bank's report of China's 2011 GDP at $7.32 Trillion USD and China's 2012 GDP growth rate of 7.8%, as reported by China's Bureau of National Statistics in January 2013. Based on China's estimated 2012 GDP, China's OFDI flow in 2012 equaled approximately 1% of China's 2012 GDP.

As reported by UNCTAD, China's OFDI stock in 2011 equaled approximately 5% of China's 2011GDP of $7.3 Trillion USD. According to The Wilson Center's 2011 Report "An American Open Door", transitional economies, on average, maintain an OFDI stock equal to 15% of their GDP. Assuming that China's OFDI grows to equal the worldwide average OFDI stock percentage for transitional economies, China's OFDI stock would equal almost $1.1 Trillion USD, based on China's 2011 GDP, and roughly $3.7 Trillion, based on China's projected 2020 GDP. It should be noted, as reflected in Chart Figure 3 below, that an OFDI stock of $3.7 Trillion USD would still be approximately $800 Billion USD ***less*** that than the actual U.S. OFDI stock in 2011.

**Figure 3: Outward FDI Stock of China and other Major Home Economies 2011 (billions of US dollars)**




Source: UNCTAD World Investment report 2012. [vi] Reflects UNCTAD's estimate of China 2011 OFDI stock. MOFCOM reported China's 2011 FDI stock at $424 Billion USD. The difference is due, in part, to UNCTAD's data only including investments that reflect at least a 10% ownership in the foreign entity.

In commenting on China 2011 OFDI, Lu Zhengwei, chief economist at Industrial Bank, stated that he considered the figures showing that China is poised for a period during which its ODI would "explode".[vii] We believe that there is considerable data supporting Lu Zhengwei's prediction.

# III THE US WILL BE A MAJOR RECIPIENT

The United States has long been the world's leading recipient of FDI because of its market size, highly skilled workforce, physical infrastructure and open investment environment. As of Year 2011, the inbound FDI stock of the U.S. exceeded $3.5 Trillion USD, which was in excess of 17% of aggregate global inbound FDI stock and almost triple that of the next largest recipient, the United Kingdom, at $1.2 Trillion USD.

While the U.S. percentage share of global FDI flows has decreased in recent years, during 2011 it remained the world's largest inbound FDI recipient, at $227 Billion, (or almost 15% of the global FDI flows of $1.52 Trillion USD, with China the next largest recipient at approximately $124 Billion USD, or approximately 8% of global FDI flows).

**Figure 4. Top 10 countries/regions with most FDI Inward Stock/Flow in 2011**

| Country/Region | FDI Inward Stock (Million US$) | Country/Region | FDI Inward Flow in 2011 (Million US$) |
|---|---|---|---|
| United States | 3,509,359 | United States | 226,937 |
| United Kingdom | 1,198,870 | China | 123,985 |
| Hong Kong, China | 1,138,365 | Belgium | 89,142 |
| France | 963,792 | Hong Kong, China | 83,156 |
| Belgium | 957,836 | Brazil | 66,660 |
| Germany | 713,706 | Singapore | 64,003 |
| China | 711,802 | United Kingdom | 53,949 |
| Brazil | 669,670 | British Virgin Islands | 53,717 |
| Spain | 634,532 | Russian Federation | 52,878 |
| Canada | 595,002 | Australia | 41,317 |

Sources: UNCTAD Statistics [viii]

While only 0.6% of the U.S. inbound FDI flow in 2010 came from China[ix], it appears that 2012 ushered in a new era of China OFDI to advanced economies including the U.S., with Heritage reporting that North America received 40% of Chinese non-bond investment in 2012 OFDI flow. [x] Numerous factors suggest that China's OFDI to the U.S. has entered a period of dramatic growth. These include the following push factors from China and pull factors from the U.S:

**Diversification into Hard Assets.** The Chinese government has made a conscious decision to diversify its foreign currency assets into hard assets. This has led to the creation of several of the largest sovereign wealth funds in the world, with assets in excess of $3 Trillion USD. Although one of these funds, the China Investment

Corporation ("CIC", with assets in excess of $400 Billion), has made substantial investments in U.S. assets, China is considering the creation of another sovereign wealth fund, with assets of $300 Billion, focused specifically on investing in the U.S. and Europe. [xi]

**Targeting Investment in Advanced Economies.** Whereas China's government previously encouraged investments almost exclusively toward energy and resource acquisitions in developing countries, it now also encourages investments in advanced economies. North America's receipt of 40% of China's 2012 OFDI seems very consistent with this recent policy shift. The government's goals for these investments include securing energy and mineral resources and acquiring advanced technologies. [xii]

**U.S. Efforts to Attract FDI**. The U.S. federal, state and local governments are vigorously working to attract Chinese investment in the hope of creating jobs and jump-starting local economies.

FEDERAL - China is the largest mission of the U.S. Foreign Commercial Service (FCS) by a factor of three. Among other services, the FCS provides assistance to Chinese firms looking to invest in the U.S. The "Select USA" program, based in the U.S. Commerce Department, was created specifically to promote FDI in the U.S.

STATE - At the state level there are continuing efforts to attract China OFDI, with 30 states maintaining one or more trade representative offices China. [xiii]

In October 2011, eight Chinese provincial governors, six American governors, and hundreds of representatives, gathered in Beijing to attend the second China-US Governors Forum. As a platform to promote peer-to-peer discussions between U.S. governors and their Chinese counterparts, the forum explored opportunities in promoting practical cooperation between the two sides, especially with regards to local economic development.

LOCAL - Significant efforts to attract China FDI also exist at the local level in major U.S. cities. As a prime example of local initiatives, in December 2012 Philadelphia's Mayor Michael A. Nutter, President of the U.S. council of Mayors, visited Beijing to host a 2-day conference on urban sustainability – Cites of the Future – organized by the Paulson Institute and chaired by former U.S. Treasury Secretary Henry Paulson. While there, Mayor Nutter met with acting mayor of Beijing Wang Anshun and visited Philadelphia's Sister City Tianjin, where he met with Tianjin's Mayor Huang Xingguo (see Figure 5 below). In commenting on the economic potential of China OFDI for Philadelphia, Mayor Nutter stated "China presents huge investment and export opportunities for Philadelphia and I intend to be very aggressive in promoting our city and attracting new investment, all of which ultimately leads to more job opportunities for Philadelphians. My message for this trip is that Philadelphia – increasingly recognized as an international leader on sustainability, healthcare, education and the creative economy – is ripe for investment and open for business."[xiv] Accompanying Mayor Nutter on the recent trip were numerous business leaders from Philadelphia, including the CEO of the International Visitors' Council of Philadelphia and the China Partnership of Greater Philadelphia, a public private partnership focused on increasing collaboration between sustainability interests in China and those in the greater Philadelphia region.

**Figure 5. Mayor Nutter meeting with Tianjin Mayor Huang Xingguo in Dec 2012 in China**

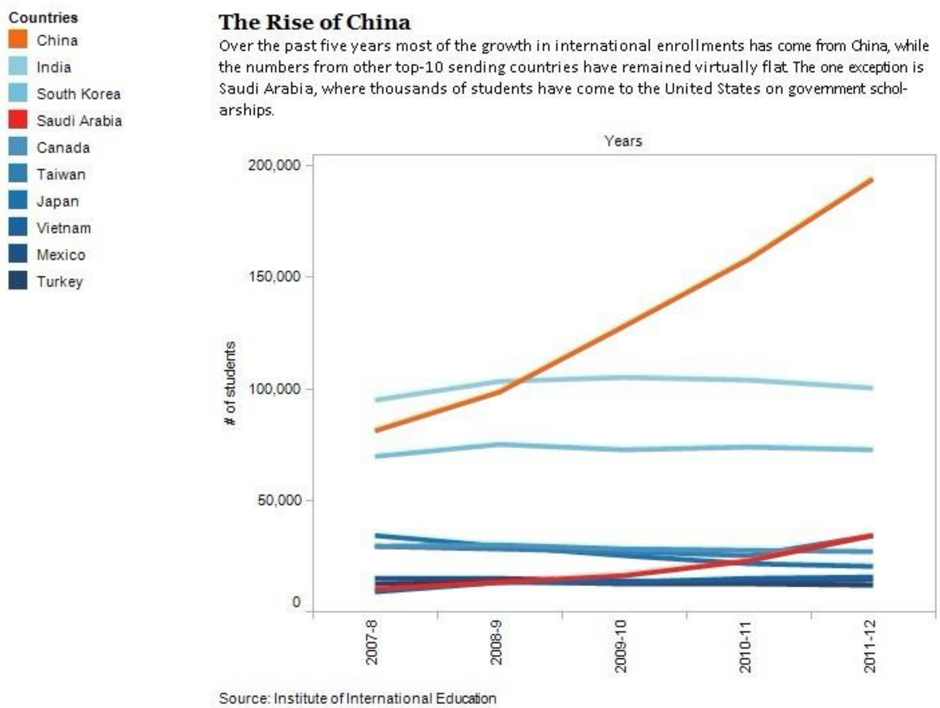
Numerous financial incentives and other assistance are available at the state and local level to attract foreign investment. These include grants, low-interest loans, tax-exempt bond financing and numerous tax credits. The specific incentives vary among various states and cities, as well as with the nature and potential economic and employment impact of the prospective business.

**Distressed Asset Pricing**. Some Chinese investment is being drawn to the U.S. by the availability of distressed assets, some of which include useful technologies for China. U.S. companies in bankruptcy as well as those companies unable to secure financing needed to sustain or grow operations are considered distressed assets. To date, Chinese companies have generally not been willing to act as quickly as necessary to comply with the time requirements mandated in the U.S. bankruptcy process. However, there is evidence that China is beginning to look more seriously at the acquisition of bankruptcy assets.[xv] In many cases, thanks to China's capital resources and domestic growth (particularly in the strategic emerging industries), buyers from China are willing to pay more for such assets than other potential buyers in the U.S. and elsewhere. For example, in December 2012 Wanxiang American Corp., a subsidiary of Chinese auto parts maker Wanxiang Group, was the winning bidder at a bankruptcy auction of the assets of car-battery maker A123. Wanxiang's winning bid was $256.6 million was considerably higher than the $125 million opening bid advanced by Detroit auto parts maker Johnson Controls. The transaction received CFIUS approval in January 2013.

**<u>Tariff Avoidance.</u>** Some competitive, forward-looking firms in China are investing in the U.S. in response to current or potential trade sanctions.

**<u>Chinese Students in the U.S</u>**.: As reflected in Figure 6 below, the number of Chinese students in U.S. undergraduate and graduate programs in the academic year 2011-2012 approached 200,000, almost double the number of students from the next largest source country (India, at approximately 100,000). China now accounts for one of ever four international students in the U.S. The number of Chinese students in U.S. academic institutions in 2011-2012 represented an increase of 23% over the academic year 2010-2011 and an increase of 139% over the academic year 2007-2008.

**Figure 6:. Top 10 countries with highest International enrollment in the U.S. schools**




Source: Institute of International Education xvi

As stated by Ann Stock, U.S. Assistant Secretary of State for Education and Cultural Affairs, “today’s youth are tomorrow’s leaders. International education creates strong, lasting relationships between the U.S. and emerging leaders worldwide”. Given the growth of Chinese students in the U.S., the above statement seems particularly applicable to the future of China – U.S. business collaboration. Indeed, of the nine members of the Politburo Standing Committee, the supreme decision-making body of Communist Party, at least five have children or grandchildren who have attended or are studying in U.S. schools. [1]

[1] The 9 members of the Politburo Standing Committee were replaced by 7 members in November 2012

# IV IMPORTANCE OF FDI TO THE U.S. ECONOMY

In June 2011, the President's Council of Economic Advisors released its report on U.S. inbound FDI. This report reveals the importance of inbound FDI to the U.S. economy and provides the contextual backdrop supporting federal, state and local efforts to encourage increased China OFDI in the U.S.

This report noted that U.S. "majority-owned" affiliates of foreign corporations: [xvii]

- Employed 5.7 million U.S. workers (5% of the private U.S. workforce and 13% in the U.S. manufacturing sector);
- Paid compensation that averaged more than $71,000 per U.S. employee in 2008 (as compared to average earnings of $54,000 for full-time annual workers in the economy as a whole);
- Owned $11.7 trillion in U.S. assets;
- Generated $3.5 trillion in annual sales;
- Invested $188 billion in capital expenditures (11.3% of total U.S. private investment);
- Invested $40.5 Billion USD in R&D (14.3% of total U.S. private R&D); and
- Were the source of 18.1% of U.S. exports

In conclusion, the President's Council of Economic Advisors stated "Inbound foreign direct investment has long played an important role in the U.S. economy. Foreign companies with operations in the United States invest billions of dollars here. They employ millions of U.S. workers and offer higher-than-average levels of compensation. Their investments help to modernize the U.S. capital stock, and they are important contributors to the U.S. manufacturing sector".

The historical importance of inbound FDI to the U.S. economy and the potential for employment and economic growth as the result of increasing China OFDI to the U.S. makes it highly likely that public and private interests across the U.S. will continue aggressive efforts to attract China OFDI.

# V CHINA OFDI IMPACT ON U.S. RENEWABLE ENERGY AND CLEANTECH

The 12th FYP identifies 7 "strategic emerging industries" ("SEI") deemed of social and economic importance to China's future: [xviii]

1. biotechnology
2. ***new energy***
3. high-end equipment manufacturing

4. ***energy conservation and environmental protection***
5. ***clean energy vehicles***
6. new materials, and
7. next-generation IT.

The potential economic impact of China's focus on the SEIs, three of which are in the areas of sustainability, and the opportunities for a broad range of industry stakeholders in the U.S. to benefit from OFDI in these industries are considerable. The 12th FYP has targeted investment of $1.7 Trillion USD in the SEIs and MOFCOM has set a goal that the SEIs shall constitute 8% of China's GDP by 2015 (up from 2% today) and 15% by 2020. Using the Standard Chartered's 2020 GDP estimate of $24.6 Trillion USD, the amount contributed by the SEIs to China's 2020 GDP could equal $3.7 Trillion USD.

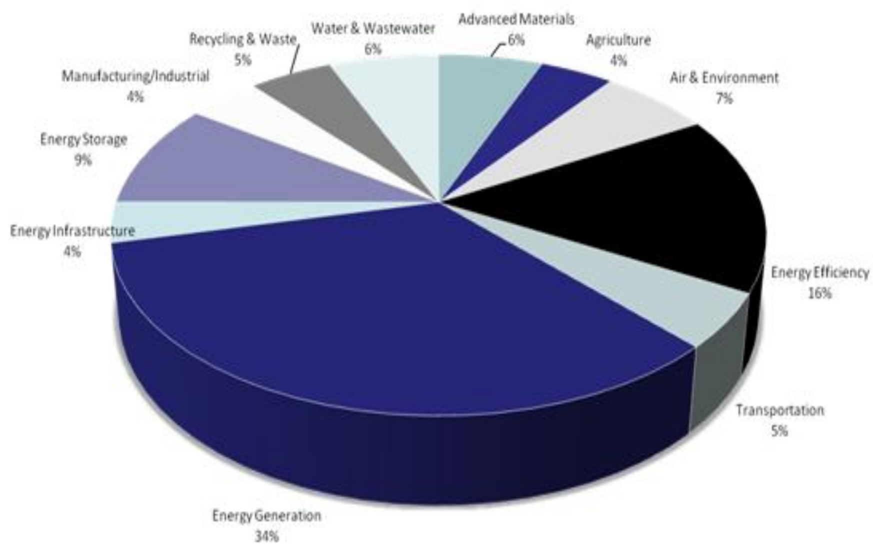
China's emphasis on sustainability makes it likely that the renewable energy and clean technology industries will be substantial beneficiaries of increasing China OFDI to the U.S. We believe this will include opportunities in both greenfield projects and M&A.

**Greenfield Renewable Energy Projects:** According to FDI Markets, a unit of The Financial Times, renewable energy was the fastest growing sector in the world for FDI from 2003 - 2011. In 2011, FDI in renewable energy was approximately $91 Billion USD (including investment in engines and turbines), almost 11% of worldwide FDI. The U.S., which received $12 Billion, or 11% of global FDI in renewable energy projects [xix] , ranked #1 among countries receiving FDI in this sector.

GreenWorld maintains a database of renewable energy projects across North America in a wide range of technologies. Due to legislative uncertainty in the U.S. and continuing financial market stress, many of these projects are stalled and in need of capital. This situation will be exacerbated by the expiration of the 1603 grant program, which awarded an aggregate of $11.6 billion dollars to more than 37,700 renewable energy projects from 2009 through May 8, 2012. [xx] In 2011 China emerged as one of the top 10 providers of global FDI targeted to renewable energy projects and is expected to become a major force in international FDI in renewable energy greenfield investments. [xxi] China's prowess in equipment manufacturing for solar and wind power enhances the prospects for their increasing OFDI in this sector. Given the persistent unemployment concerns in the U.S., we expect to see considerable effort at the federal, state and local level to attract greenfield investments from China to stimulate job creation.

**Operating Companies and Technology**: The U.S. is home to more clean tech companies than any other country in the world. According to the research of Cleantech Group, the U.S. is home to 7000 clean tech companies (or 36.5% of the worldwide total of 19,200). [xxii] GreenWorld's proprietary Portfolio Enhancement Database ("PED") provides a more coherent view of industry companies likely to be attractive to Chinese investors, tracking over 1000 clean technology companies that have been "professionally sponsored" (i.e. invested in by professional investors including venture capital, private equity and corporate investors) during the 2007-2011 period. As reflected in Figure 7, the companies in our PED cover each of the sustainability-focused SEIs plus advanced materials.

**Figure 7: PED Company Population by Segment**




Many of these companies possess important technologies, are in need of capital and are prime candidates for investment in or acquisition by, companies and investors from China.

## Committee on Foreign Investment in the United States ("CFIUS") [xxiii]

Recent action by CFIUS, an inter-agency U.S. government committee charged with reviewing foreign acquisitions of U.S. companies for national security implications, has generated considerable debate about the agency's potential chilling effect on China OFDI to the U.S. in renewable energy and other sectors. In September 2012 President Obama determined that national security interests warranted blocking Chinese-owned Ralls Corporation's acquisition of wind farm projects in northern Oregon near a Navy base where the U.S. military flies unmanned drones and electronic-warfare planes on training missions.

While the President's decision regarding Ralls Corporation has raised concerns over future scrutiny of Chinese OFDI in the U.S., this was the first time in 22 years that a U.S. president has blocked such a foreign business deal. Indeed, the Treasury Department issued a statement that "Obama's decision is specific to this transaction and does not set a precedent for other foreign direct investment in the U.S. by China or any other country". Given the volume of cross-border transactions involving Chinese investment that is expected to occur in the coming years, there will likely be additional instances where CFIUS and the President act to block transactions involving China OFDI. We, however expect those instances will be rare, and that most transactions that raise issues at CFIUS will be handled with negotiated mitigation measures that allow the transactions to be completed.

# VI CONCLUSION

Foreign Direct Investment has long been a cornerstone of the U.S. economy, and aggressive efforts are underway to increase China OFDI to the U.S. Numerous push and pull factors portend that these efforts will be very successful.

China's economic influence and importance to worldwide FDI in general, and U.S. inbound FDI in particular, will grow dramatically for years to come. China's imprint on the U.S. renewable energy and clean tech sectors will grow as the social and economic importance of sustainability under China's 12th FYP become increasingly visible to the world.

The U.S. is the largest open national market in the world. Renewable energy projects and clean technology are abundant in the U.S. and will be prime targets for China OFDI. We expect CFIUS review to be a minor factor for most transactions.

Chinese OFDI would provide a much needed source of capital for the U.S. industry stakeholders in the public and private sectors. In addition to providing attractive investment returns to Chinese investors, this capital could accelerate deployment of renewable energy and clean technology projects in the U.S., preserve and create U.S. jobs, and facilitate U.S. companies' access to the huge Chinese market.

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