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CHINA'S OVERSEAS INVESTMENTS IN  
EUROPE AND BEYOND

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## PROCEEDINGS

MS. SOLIS: My name is Mireya Solis. I'm a senior fellow at the Foreign Policy Program here at Brookings. It will be my pleasure to be the moderator for this launch event for the book, "China's Offensive in Europe", co-authored by Philippe Le Corre and Alain Sepulchre. This book offers a nuanced and insightful analysis of a key topic, as the authors put it, China's arrival into the world stage, especially as a global investor, as an overseas investor with expanding reach. And this book looks in particular at China's investment activities in Europe, a topic I may say we don't really know enough in Washington. Therefore, this is a very timely and needed discussion.

Today, Philippe Le Corre will start us off with a presentation of the main findings and implications of his research. So I would like to start first by introducing Philippe and then I'll introduce my Brookings colleagues who will act as discussants later on after Philippe is done with his presentation.

Philippe is a visiting fellow in the Center for United States and Europe here at Brookings. And prior to his time here he has had a very diverse and distinguished career. He has published extensively on political and economic relations between Asia and Europe. Philippe started his career as a foreign correspondent, then also was senior advisor of France's Ministry of Defense. He has worked in the private sector and he has also been a lecturer in very prestigious academic institutions here in the United States and in France. So it is with this wealth of expertise, with this broad perspective that he brings to us the analysis on Chinese investment in Europe. And I must add it is a pleasure to read the book. It is well written, it's very accessible, and again offers multiple insights.

Before I move to Philippe I just want also to point out to you there is another event on China coming up very soon that I would like to recommend. That is a question of food safety in China and that will take place this Thursday at 10:00 a.m. But today we talk about overseas investment by China in Europe.

Philippe, the floor is yours. Thank you. (Applause)

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MR. LE CORRE: Well, thank you very much, Mireya, and thanks to everyone for being here. I have to say the first thing I should do really is to thank Brookings, the Center on United States and Europe, and the China Center, both hosts of today's event, and also, last but not least, Brookings Press, which happens to be the publisher of this book. So there are a lot of Brookings today, but after all that's where I work now. I've had a very enjoyable 18 months and I have to say before we start -- and I should thank Mireya as well for accepting to moderate this, and my colleagues, David Dollar and Constanze Stelzenmüller, who will no doubt offer insightful comments and critical I hope -- but before we start let me just say that I bear full responsibility for the book's title, so if anybody is unhappy with the title I'll be happy to explain. And I was happy also to hear Mireya's word on the fact the book is quite balanced, I hope. But anyway the book is mainly about economics, but let me say a few words first why I did this book along with my co-author, who sadly cannot be here.

Having spent 15 years as a foreign correspondent in China, having worked in China as a government official, also as a consultant with Chinese, my first serious conversation about Sino-European relations was in 1994 with somebody I have a lot of respect for. You might know his name, some of you, Endymion Wilkinson, who is a very respected scholar of China and translation of Chinese works, and truly an impressive person who is still at Harvard's Fairbank Center. What a lot of people don't know is that Endymion was also the first EU ambassador to China and he was there for seven years. And he negotiated China's entry into the WTO on the European Union side and achieved quite a lot during his tenure as EU ambassador. And what did he have to say about Sino-European relations? Well, that it was primarily about business and about European companies talking to Chinese companies. And so much for us here covering international relations and diplomacy. But 20 years later, having met Endymion once again, I embarked on this project to find out in fact that a lot of things in China have to do with politics. So if the book is primarily about economics you'll find out, as I did, that you can never get away completely from the Chinese system.

The book is not claiming to be exhaustive, to talk about every country in Europe, to talk about every sector. It's more of an overview, and it's more about the trends and this new phenomenon,

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what is it all about. Sino-European relations have developed now over the last four decades, but mainly through bilateral relations really. You know, between China and France, China and the UK, China and Germany. But also, you know, thanks to the double digit growth that China has known in the '90s, mainly '80s, '90s and first part of the 2000s. And it's developed a very strong trade relationship with Europe. And today China is the EU's second trading partner after the United States. But I won't cover trade, first of all, because Mireya is one of our best trade experts here.

The story I want to talk about today is foreign direct investment, Chinese foreign direct investment. For many years European companies were dreaming of getting a share of the Chinese markets, the consumer markets, and some of them have been quite successful. But today western investments or multinational investment in general in China is slowing down. On the contrary, China has been investing abroad and this is a very recent phenomenon. As David will probably confirm, it's not just investing in Europe but pretty much everywhere on the planet. It started with Africa, Asia of course, Latin America, Australia. And of course the main reason for these FDI has been natural resources, the need for natural resources.

What happened during the '90s was very much a competition among western and Japanese firms for a share of the Chinese consumer markets. Well, today the competition is quite different. People are competing for a share of Chinese money, of Chinese capital. At least that's the case in Europe where you know we have the European Union, 28 members in addition of candidate members that also want to be part of this game. And I'll take a few examples later on.

In the '90s there was a prime minister who was very known to many of you, Zhu Rongji, who introduced under President Jiang Zemin in fact, a policy called *zouchuqu*, which means going out. So that was the starting point, if you want, of this overseas investment policy. And as I said earlier there wasn't very much of an area that wasn't targeted. So if you look at the map behind me, the graph behind me, you'll see the trend from the beginning of the 1990s to now. And now the figures of course, there are many figures from different organizations and overall it's a dramatic increase over the past five or six years. In 2015, last year, Chinese outbound direct investment overtook inbound investments into China.

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And in Europe, in the EU, it hit a new record of \$23 billion, an increase of 44 percent. Now this year, there's a huge deal with an agribusiness company called Syngenta. It could be \$62 billion in total, and this just April, so you can imagine. Seventy percent of the deals last year were made by state-owned enterprises in red. That's something I'll come back to in a moment. And although the U.S. as an individual country has attracted more foreign direct investments than any EU country, the Union as a whole is a bigger destination.

Now of course there is a combination of reasons why Europe became so attractive. First, in 2008, as you know, the debt crisis struck the EU and the Chinese government actually called upon the European Commission and offered to buy Euro bonds. It was at the time Prime Minister Wen Jiabao who contacted President Jose Manuel Barroso and offered to step in, to Mr. Barroso's astonishment actually. And that was an important moment. Until then there had been mainly individual companies, mainly private, who had not done very much and who were building their brands, still doing some of them, but the decision by the Chinese government to push into Europe due to this debt crisis the purchase of Euro bonds as well as the investment in infrastructure. And of course the most famous of all is perhaps the Piraeus Harbor in Greece, which is now pretty much run by COSCO as the sole company. That's a fairly new phenomenon.

The second reason, perhaps, is a deindustrialization of Europe, which has been taking place. Countries like Italy, Portugal, even France and the UK have had opportunities in many fields: automobile, food, energy, transports. The euro currency of course went down and the Chinese have been helped by this. And of course these FDIs, as I said earlier, are mainly, you know, due to a political decision by Beijing to deploy capital outside its borders, and particularly in the West.

So of course there are many reasons. One of them is the acquisition of brands. Very important. There are not many Chinese brands that are famous worldwide, but that's one of the reasons why acquiring brands has been one of the ways. It's been also about acquiring technology. But also more generally increasing China's footprint through state-owned enterprises with the help of state-owned banks and the help of state-owned sovereign funds. So you see where I'm getting.

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The story of Chinese FDI is also a story of bilateral relations. A few countries have had relations, very strong relations with China over the past many years, Germany, France -- France was the first European country to recognize the PRC in 1964. The UK of course has had a long-standing relationship with China since the 19th century, not always good, but anyway better now apparently. So there's no doubt that the diversity of countries part of the EU and the history that the relationship that's been built over the years has also helped the Chinese to play one country against the other. As I said, many of these countries are now fighting for a share of Chinese capital. China still has \$3.2 trillion in foreign reserves, and although 2/3 of this is held in U.S. bonds with low yields, they are huge opportunities for Chinese FDI.

So as I said, reasons for acquisition of brands and, for example, the Club Med, a leisure travel company that was bought as a concept for the Chinese consumer, the brand Volvo, the famous car factory which was acquired from Sweden and re-launched on the Chinese markets. There have been many opportunities really for China. And the RMB, the renminbi is now rising versus the euro and the dollar. It may actually change the situation. If you look at the group like Fosun which has decided to halt its foreign investment drive, for example. We'll see how long it lasts.

China wants to become a global player and you can see by the way the diversity of investments across the EU that is shown on this map. It has encouraged its brands to be quite aggressive, perhaps offensive. A good example is ChemChina which is, you know, originally a chemical company, that has invested in a company called Rhodia, a French company, actually one of the first investments, but also bought Pirelli, which is a tire manufacturer for 7 billion euro, and a domestic machinery supplier in Germany, Krauss Maffei. And now it's in the process of buying Syngenta, which is the biggest agribusiness company in the world. And another good example would be Dalian Wanda, which is originally from Dalian in the northeast of China, originally a company in real estate property which is now investing in entertainment.

Now let me turn to the problems that are caused by investments. First of all, job creation, that's one of the mysteries of Chinese FDI. I'm saying mysteries because when it comes to figures it's

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hard to track down the exact number of people that are employed by Chinese companies. In fact in this country, in the U.S., some people are talking about 90,000 jobs. And in the EU I would probably say perhaps about half, but I have to say in many cases there is no clear figure in individual countries because some Chinese employees didn't seem to be working in different countries.

Human resources is a critical point. Just like the Japanese in the 1980s -- and once again Mireya might have something to say about this -- the Chinese don't seem to trust their local employees, at least not to be at board level or to be in managerial positions. It's still very much a Chinese run, Chinese led company with a direct link to the headquarters in China. Many investments are state driven, as I said, and companies with good banking relationships of course get cheap credits. Companies, you know, they spend overseas but they have benefitted from special credit from state banks. As you know, in China all banks are state owned.

The financial aspect is also critical. You've all heard about the recent Anbang case with the Starwood Hotel which eventually -- so Anbang withdrawing in favor of Marriot. And the reasons that were given -- although this is more on the U.S. side -- but the reason that was given is because the financing part was somewhat obscure to the targets and to the financial analyst community. The properties, the financial side of Anbang was not properly documented.

There's another problem which is reciprocity. And I'm sure if there are U.S. business people in the room they know what I'm talking about. Western companies or foreign companies are complaining that the Chinese market is not as accessible as it was 15 years ago. There are a long list of sectors where foreign investments in China are not welcome. Well, it's not the case in Europe as you can see and it's relatively not the case in the U.S., although you could argue that there's a difference. In the U.S. there's a mechanism called CFIUS which deals with national security concerns, when in Europe there isn't a mechanism like this.

One word on China's image, which is one of the -- I've actually dealt with that in one of the book chapters, and I see there's a colleague from Pew Research in the room and I've used many of their charts here. It's quite interesting to see that many of the countries which are prime recipients of

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Chinese investments have actually the least favorable image of China. So whatever happens, the image of the country -- and it's not just China, but in this very case its China cannot get away from its image as a country. So it's, you know -- which is why it's working a lot on soft power, on its image, but there are problems there. Having said that, many countries don't have a choice. If you take Greece, for example, there weren't many candidates to take over the Harbor of Athens. And in fact they waited about a year before making the final decision early this year. But considering the situation, the financial situation of Greece today I think actually they were quite happy to have China. Just like Serbia, which is a candidate country to the EU, not a member of the EU currently, which is very happy to find company and a country happy to be build railways between Budapest and Belgrade. In fact the Prime Minister of Serbia was in this building last year being very proud of it.

Now, there is also perhaps one word on the more general aspect of the relationship between China and Europe. Of course China sees Europe as more approachable, has a better environment, more open. I don't need to say to people in this room that there are a few entities in this city that are slightly reserved about China as a possible competitor to the United States. Now of course in Europe we are in a very different situation with many crises, with the migration crisis, terrorism, the euro crisis, as I mentioned. In a way its good timing and the two entities are somewhat matching. But as I said there are also debates about this and one of the debates is taking place on the ground. For example, a lot of local officials, elected officials, are facing criticism for somewhat welcoming Chinese investments and putting at risk the factories or the jobs of some of their local companies. So you have a discrepancy between the national level of some of the leaders of these countries that are pretty much all favorable to Chinese investment and some of the local people, including small entrepreneurs or just members of the general public that are more reluctant to welcome Chinese investment. You might argue its just part of sort of a fear of globalization, but I have to say it does have a connection with the origin of the funds.

Now perhaps I should conclude with the big question that some of us are asking. Is there a strategy? And does China have a strategy to take over Europe? And I would say yes, the strategy has



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a name, it's called "One Belt, One Road". And as those of you who have been looking at China for the past year -- and in fact I believe two days ago an official document was released on One Belt, One Road by the three entities that are running this from China, the Ministry of Commerce, Foreign Ministry, and NDRC. And it's very clear. I'm sorry I don't have a map for One Belt, One Road, but it's very clear that the final destination of One Belt, One Road is Europe, is Western Europe. It goes all the way down to Portugal. And infrastructure is the key to this new development. And Europe does need new infrastructure. Not just Europe but the rest of the world. And China has an overcapacity problem. China wants to -- has knowledge of building infrastructure and that's the way China has decided to develop its international presence.

Now this is the strategy, but China is also opportunistic. So the Chinese are born entrepreneurs and of course there are many private entrepreneurs that are just deal makers and they are not part of this strategy. So, you know, I just wanted to distinguish the fact there is a kind of global concept from China, from the Chinese government, to interact with the rest of the world. But at the end of the day it also comes down to opportunities. And one opportunity will be the European Structural Investment Plan, also called the Juncker Plan, 315 billion euro, which is basically about revamping European infrastructure. And of course China is the only country I know of that has volunteered to take part, to join up with some of these countries, some of them, to help responding to tenders and to update some of the European infrastructures.

And, finally, I would say that this business of foreign direct investments from China is going to take a new step probably this year through the signature of a bilateral investment treaty, which is also something that's going on here as you probably know. And this would actually set the rules in many cases which are badly needed since, as I said, there's a problem of reciprocity which is lacking in Europe. And it's about time that things that get a bit organized.

Thank you. (Applause)

MS. SOLIS: Thank you so much, Philippe. That was a great overview. And before I introduce my colleagues I see a lot of people are standing in the back of the room and I just want to tell

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you there are six or seven seats here in the front. If anybody gets tired you're welcome to please come and sit here at the front.

So I'm going to just very briefly introduce my Brookings colleagues who have kindly agreed to provide comments. David Dollar, a senior fellow in the Foreign Policy and Global Economy and Development Program at Brookings. And he is of course an authority on China's economy, U.S.-China economic relations. He has 20 years of experience at the World Bank. He was the Treasury emissary in China working on economic and financial issues, and he has done extensive research on Chinese overseas investment, including in the United States. And David has kindly agreed to share some of those findings to draw comparisons and contrasts to Philippe's research on Chinese investment in Europe.

And Constanze Stelzenmüller is the inaugural Robert Bosch senior fellow at the Center on the United States and Europe, also here at Brookings. And before that Constanze was a senior transatlantic fellow at the German Marshall Fund where she directed the Transatlantic Trend Surveys. And Constanze has published widely on transatlantic relations, German foreign policy, defense policy, and international human rights. And she will offer a European perspective of China's economic presence in Europe.

So why don't we start, David and Constanze, with some reactions to Philippe's presentation and your own comments?

MR. DOLLAR: Okay. Thank you very much. It's a great pleasure to be here. Philippe, I enjoyed the presentation very much. I think there's a lot of important work here.

I was asked to complement Philippe's presentation by talking about China's investment in the United States. I might have one or two little disagreements that will emerge along the way, but I wasn't specifically asked to critique the book, which would be hard because we agree probably 85 percent. So I'm happy to complement in both sense of the word.

So I want to make three points. The first is a point from macroeconomics, so I think a slightly different perspective than what we heard, which I hope is insightful. I think there are very important macroeconomic reasons why China is emerging as such a big investor in the world. You know,

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China's growth model in the recent past has been very, very heavily dependent on investment. China has had an extraordinarily high investment rate, up as high as 50 percent of GDP. It's also a country with a very high savings rate, also in the ballpark of 50 percent of GDP. And a few years ago China was largely using that vast amount of savings to invest domestically and drive its growth, but when you invest at that level what I think inevitably happens is you get very serious problems of excess capacity. And that's what's happening in China's domestic economy now. They've overbuilt the capital stock, there's lots of empty apartments, enormous excess capacity in steel and other manufacturing sectors. They've overbuilt infrastructure. And in that environment it's natural that the profitability declines and investment growth slows down. So just think of there being a lot fewer good investment opportunities in China.

Now the savings rate is gradually going to come down as China turns to being more of a consumer society, but that's going to be very slow. So what's happening in the last couple of years is investment is slowing down a lot more than savings are changing. And so a lot of this savings now is looking for investment overseas. So I want to emphasize that economic fundamental. I see this as not primarily a cyclical phenomenon. It might be a little bit cyclical, but mostly this is structural. China is going to be investing a large amount of capital overseas every year. The Institute for International Finance estimates that last year the net capital outflow was \$676 billion, which is an extraordinary amount of money. And if these recent trends continue, China will replace Japan as the largest creditor in the world within five years, net creditor, largest net creditor in the world. So I first want to emphasize this macroeconomic foundation of what's going on and the need to invest vast amounts of money overseas.

That leads me into my second point, which is where we may have a little bit of disagreement. I see most of this capital outflow is commercial, not strategic or political. So you do have these strategic initiatives, like One Belt, One Road. It's defined in different ways. So if you define it to include all the investment in Europe then of course it's big. I've had officials in China tell me it includes investing in the U.S. and Canada, of course it includes Australia, of course it includes Africa. So if investing in the whole world is One Belt, One Road, then we can say what we're discussing is One Belt, One Road. But I think of the initial One Belt, One Road idea as much more narrowly an effort to build

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infrastructure in the nearby developing countries around China, Central Asia, also Southeast Asia, perhaps some in Russia. And so my second point is none of that is going to be big enough to absorb \$600 billion in investment. So most of this investment is going to go to the big capitalist economies. That's what's happening now. Aside from Hong Kong the U.S. is the number one destination, as Philippe said, as a nation. Australia is number two; the United Kingdom is number three. Germany, France are among the top ten, Canada is among the top ten. So if you look now, after a number of years where is this stock of Chinese investment? According to China's statistics, most of it is in the G7 countries, to be frank, and then you throw in Australia and you get a large fraction of that.

So I see it largely as commercial. Initially quite a bit of it, as Philippe said, was directed at natural resources. Frankly a lot of those early natural resource investments have not worked out well. China does not have as much need for natural resources as it did before. So the more recent trend is the diversification that Philippe emphasized. So if you look at the United States, which I said is the biggest destination, you've got investments like buying the Waldorf Astoria, a movie chain, a mid-sized bank in California, the largest U.S. pork producer. So I don't see much strategy there, I see diversification, which is a smart strategy for a very big investor.

Now it's true a few transactions into the U.S. have been interfered with by our Committee on Foreign Investment in the U.S. which looks at national security issues. But I would emphasize that while the Chinese get quite exercised about this, there's only a tiny number of transactions that are reviewed by CFIUS every year, about 120 from all countries. You know, maybe 20-25 of those are Chinese transactions. So I think in practice this is a pretty small interference. And according to most data the U.S. and Europe are both big open economies. So it's not surprising that a lot of this Chinese investment is coming to Europe and the United States.

The third point I want to make is I think the issue Philippe highlighted of lack of reciprocity; this is a big issue for the United States. The OECD carries out a ranking of investment openness and they do it by sector. Both the U.S. and the EU are measured to be extremely open, which I think is the reality. China is the most close of G20 countries, so it's not must more closed than the EU or

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the U.S., it's more closed than India, Russia, Brazil, South Africa -- just to name a few. And that's because China is pretty open in manufacturing, but it's largely closed in financial services, telecomm, logistics, a lot of agriculture. If you look at a lot of recent deals in the U.S., Chinese firms buying U.S. companies, the analogous deal in the other direction would not be allowed. So China bought the largest pork producer in the U.S. -- would have made more sense for our pork producer to invest in China. It has better technology, food safety, brand, but that's not allowed. So it's good acceptable second best, you know, to have the Chinese company take over the U.S. firm, but frankly it creates an unfairness in the market and I think it's a pretty serious problem, what's becoming the biggest investor in the world is actually quite closed itself in many important sectors.

It would help China's reform of it would open up those sectors. A lot of the sectors I mentioned are service sectors. This is the part of Chinese economy that's growing. So we've set a very good foundation for all our relations if China would open up. As Philippe said, China is negotiating bilateral investment treaties both with the EU and the United States, but my perception is this is moving very slowly and it's difficult to get a good offer out of China, an offer in which is promises or commits to opening most of these sectors, perhaps with some delay.

So I think that's an important issue we need to keep working on with China, getting them to open up, create a more level playing field among these big economies.

Thank you very much.

MS. SOLIS: Thank you very much, David. Constanze?

MS. STELZENMÜLLER: I am actually really not in a position to talk about the German-Chinese economic relationship much because that isn't my expertise. As those of you who know me know, that I'm just not credible in that. What I think I can usefully do is to talk a little bit about the political and geostrategic ramifications of this relationship which are considerable and which have produced some rather interesting wrinkles in the German-Chinese relationship in ways that I think are worth looking at more closely and that are perhaps unique in Europe.

I mean Philippe and I -- and again I commend you not to just read this book but go buy it

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in the bookstore which is on the other side of this room, and it is indeed a very good read. And as you will see from that and from the graphs that Philippe showed us, Germany is actually not the most important locus for Chinese investment in Europe. China has been luckier say in the UK or in Italy and other places. But the trade relationship is extremely important between the two. And the Chinese have moved up -- Germany's prime bilateral trade partner of course is the eurozone, always has been, presumably will be -- after that traditionally immediately came the United States, and that has been replaced a year or two ago by China. Those two have switched places. And as you would expect there is a bit of an internal correlation between Germany's trading and investment relationship and Russia and the Chinese. As in recent years in particular the relationship with Russia has gone down. The importance of the relationship with China has increased, both economically and politically as an export driven nation, which I mean literally its entire prosperity and indeed much of its soft power depends on exactly that. So you might say, to put it a little bit provocatively, that China after the EU and the transatlantic relationship is Germany's biggest power source and multiplier. That means something.

That said there is a great deal of ambivalence to the relationship and that also is worth exploring. Like in Russia the German business community has had some wakeup calls in its engagement in China. It's run into bureaucracy, into corruption, into all sorts of unpleasant experiences, many of which you can find detailed in German reports. And there is -- I brought a study with me which is published by none other than Huawei, which is perhaps unsurprising. It's called Germany and China - Perception and Reality. Presumably there's an English version of this as well. And it has some very interesting numbers on German and Chinese perceptions of each other. And corruption, bureaucracy, the general difficulties of doing business in China, figure quite largely in there. And the study is useful not least because it questions not just the general German and Chinese public, but also political deciders and business deciders. Huawei's European center of business is as some of you well know based in Düsseldorf. That's said I think that the -- we were discussing earlier about the role of Huawei in Europe. I think that there is still a certain degree of cautiousness in Germany, and particularly among German politicians on engagement with Chinese state-owned companies, particularly where the degree and the

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consequences of the state ownership aren't always entirely clear.

And that brings me of course to a very key point which is of enormous concern to German businesses, which they don't like to talk about in public, but they are quite voluble about in private, and that of course is economic espionage. I'm not going to suggest to you that German's never do espionage; we learned in the wake of the NSA scandal that Germans do espionage too. And I'm not going to be virginal about this, but the reality is that Chinese business espionage is extensive, in depth, creative, imaginative, and it is a source of enormous concern for German businesses. And not only that, the Germans in general I think were somewhat late in the day to recognize the importance of cyber security, not just in their business affairs but also in their government affairs. And part of that was in response not just to sustain onslaught of cyber attacks from parts east of the EU, but also from parts very Far East of the EU. So these things have begun to somewhat flow into each other in the mind of German policy makers. And as a result the Germans have upgraded their capabilities quite substantially from what was indeed a very low level of capability not very long ago.

The interesting aspect that I would like to reference, and my last point, about the German-Chinese relationship is of course an ambivalence about one's own power and the sustainability and viability of its sources and what that means for one's relationship in one's immediate neighborhood, but also in global affairs generally. I'm not going to suggest that Germany and China are exactly like each other in this respect. The differences here are more important than the similarities. But the degree to which there is a sort of a worried self examination, I think in both cultures is interesting. A degree of consciousness of the perhaps unsustainability of one's power sources or perhaps a degree of fragility. In Germany I think German policy makers are profoundly conscious of the fact that they were lucky in the last global economic crisis and it's not entirely clear to them that they would be this lucky again in the next one. And of course contagion, even if we come out well or came out well in the last one, contagion still has an impact within the European Union.

And we are of course conscious as well that China's role in its own neighborhood has an impact on our trading interests in that same neighborhood. So while we are rightfully accused of not

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being particularly geostrategic about Asia, we have a strong, strong sense that our trade flows there and our investment in the region are of crucial importance to German national interests and that we need to improve our strategic analysis and our strategic abilities on that account.

Finally, perhaps one last point about German perceptions with regard to China's global role. And again this brings me back to the Russia topic. There is a strong sense in Berlin I think in recent years that Russia has become from a country that could be a partner to a country that is mostly a challenger and dismaying, increasingly, a spoiler. China is in a different category. The Chinese clearly are challengers to our transatlantic partners in the Far East. To the extent that that has an impact on European on German trade interests that is of strategic interest to us as well. But there appears to be a willingness in Beijing to consider a Chinese role in the management of global affairs that appears to have disappeared in Moscow. And that I think is the key difference as seen from Berlin between Beijing and Moscow. Again, nobody I think is naive about China's activities in its neighborhood or about the state of the Chinese economy, or indeed of the state of Chinese democracy. But this perception of China as a strategic actor that is concerned about the viability of its own role is one that I think meets with great interest in Berlin and is one of the reasons why the Merkel government I think has already been to Beijing eight times, taking I think every time two or three government planes full not just of most of the cabinet, but of most of the DAX 30 CEOs.

And that's what I have to say for the moment.

MS. SOLIS: Thank you very much. This has already been a fantastic set of presentations. And before I ask some questions to the panelists I wanted to give Philippe the opportunity to react to the comments. And in particular I think that we already put the finger on what I think the question that's on everybody's mind, what is driving Chinese investment, is a commercial logic or is it geostrategic policy rational. And I think we have two different views here. So, Philippe, how would you respond to the comments made so far?

MR. LE CORRE: Well, to David I'd like to say that maybe it's largely commercial. Chinese have needs to invest and it's also part of their status as, you know the world's second largest



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economy. And the fact their companies have been growing, and as we know the Chinese GDP growth for the past 35 years has been stunning. And the general story of China for the past 30 years has been stunning.

On Europe the point I'm making is there's a region of 500 million consumers. The EU may have a lot of flows, but it's a trade block. Of course the problems of having regulations and taxes and things like that, you know. Many foreign entrepreneurs or many entrepreneurs may not like this, but once you're in this trade block, and once you're accessing this market, you can actually get quite a lot of benefits.

So I'll just take the example of Eastern and Central Europe, which is an interesting part. Now of course if you looked at my map earlier, as David said the top recipients of FDI are the top countries as well. But there's a story, there's an upcoming story which is this area -- first of all I'm going back to the Greek story because this area is going to be really interesting in terms of China developing a platform from on the Mediterranean Sea all the way up to the Balkans and part of Eastern Europe, and possibly North Africa. That's one thing. But if you look at central and eastern Europe and there is a new mechanism called the 16+1, which China has introduced, of engaging with 16 eastern and central European countries. Some of them are part of the EU, some are not, which is -- my dear colleague from the Europe Center might agree with me -- is slightly puzzling to some European officials. But anyway, what I'm saying is, by using some of these countries as manufacturing centers, and the target is really west Europe not east Europe, and One Belt, One Road, and in particular the idea that Central Asia and South Caucuses, these places might be of interest to China in terms of using the overcapacity for infrastructure. Yes, but what about the consumers, where are they? They are not in Kazakhstan with 17 million people, which is by the way the biggest Central Asian country, they are in Western Europe. And at the end of the day one would have to, you know, explain where all these trains and planes and ships are going to go to because we can go around circles, but One Belt, One Road, it might be a belt, but at the end of the day you won't sell Chinese products to someone.

And just one word on the perceptions. The German story is quite incredible. The fact

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that Germany and China have been such strong trade partners for 30 years, that the Germans have invested so much in China, not just in factories but also in human capital, in your sending students to Germany, engineers, doctors, and still it's the country that has the lowest approval rates of China as a country if you look at the Pew Research. And, you know, I've attended conferences in China with German colleagues and they still don't get the China story, if I can say. It's a bit simple but they still don't understand why China is China. And maybe after a week they get the idea, but there are a number of thoughts that are coming up to a highly educated German mind, which is the environment, human rights, one party rule, and all these kind of things that don't work well with welcoming Chinese investments.

Having said that, I mean it's still happening, but it's an interesting case.

MS. SOLIS: Thank you very much, Philippe. Let me ask all of you just one question, because I do want to bring the audience. I'm sure there are tons of questions from the people gathered here. And from everything that has been said today it just reminds me how important it is that we update our views of how China's integrated into the world economy because some of the conceptions we have are clearly outdated. China is no longer the lower end, labor intensive cog of a global supply chain, it has moved from there. China is not going overseas just for the search of natural resources. As we've learned from the presentations today China is investing in industrialized markets. And I like a phrase because I think it captures this very well, in the book, Philippe, you say that it has gone from made in China to made by China. And a driver of this investment strategy is acquisition of technology, to develop innovation potential.

So my question is, to all of you, what is the scorecard here? Is China really making significant progress? And in particular because I can think of very substantial inertias that militate against innovation, both country factors and corporate factors when I think about Chinese multinational corporations. What I have in mind, for example, is restrictions on inward FDI that David referred to. If you want to bring technology one natural way to do it is actually to invite foreign capital to their homeland. And it seems like China's not doing that as much as other countries are doing. Then insufficient protection of intellectual property, insufficient rule of law, limits to the data flow, information flow, all these

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things that we associate with innovation, with creativity, with dissemination of knowledge.

And then at the corporate level one of the things that I really enjoyed in your discussion in your book, Philippe, was this talk about corporate governance in China's multinational corporations and how some of these corporations that have gone overseas nevertheless remained very much in the family. You have familial structures and you have hierarchical corporate governance structures where you make reference to the fact that it's very difficult to have contestation of ideas within the corporation. And again that seems to me militates against innovation.

So we know that there's a new driver for Chinese investment. Is it paying off, is it enough to overcome these other factors that I have highlighted as obstacles to the achievement of that goal?

MR. DOLLAR: Okay, I'll lead off. So China has been spending a large amount on research and development in recent years and there are a number of achievements you can point to, there are lots of process innovations in China, you know, where China absorbs existing technologies and makes modifications. I think there's some product innovation in solar panels. So to be fair you've got some successes. But as a macroeconomist I feel the overall effort is unimpressive in the sense that China spends a lot on R & D, but the macro indicators we use, total factor productivity growth, or more micro, high value patents. It's just hard to find a lot of output from that effort. So without repeating what Mireya said, I share your concern that issues like intellectual property rights, freedom of the press, freedom of information, all of that hampers an innovative culture.

So the interesting question is as Chinese firms buy in some cases high tech firms in Europe and the United States, you know, will those firms continue to have innovative cultures, how will the Chinese management mesh. And I have an open mind about this, and to me it's too early to have any kind of conclusions about this. There can't be anything like a serious study because so much of this is just happening in the last two or three years. But it will be a really interesting thing to follow.

MR. SOLIS: Thank you.

MS. STELZENMÜLLER: I'm still thinking about what Philippe just said in response to my remarks and whether there really is sort of a distinct difference between Germany say on the one hand

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and France and the UK in their relationship with China. And again, you know, I think that German business is just as eager to get into bed with a non western big business opportunity as anybody else. I mean let's -- I don't want to be pompous about this. This is certainly again the more true the worse the relationship with Russia gets. That said, for all sorts of cultural reasons, most of which I think are blindingly obvious, the Germans have felt a need to emphasize things at the same time, like rule of law education, as it were, or rule of law conversations. And that I think is not just sort of airbrushed on top of what is essentially otherwise a geo-economic relationship, but that is a very sincere concern because there is a conviction in the German system, among German policy makers in particular, that an economic transformation that isn't accompanied by a real political transformation, even if you don't apply to it the standards say that you have applied to new European democracies post follow the war, even if you don't apply those standards there has to be also a political transformation, otherwise such economic transformation is liable to be both unstable and not reach enough people.

And there I think it's fair to say that Germans are concerned and do still voice a great deal of distrust. And one of the merits of this Huawei study is that it articulates that in numbers and shows just how little neutral trust there is. And that's been as you said reinforced by the Pew study and also by the study that I used to run for the German Marshall Fund for Transatlantic Trends.

I would like to make one additional point which hasn't been mentioned here yet, and that is that I find an interesting Chinese concern is the viability of the EU as such. While the Chinese are perfectly happy to play us all against each other in the bilateral trade relationship, to the degree that that is useful, they are also actually quite concerned that the EU might explode. And I'm not suggesting that this is for any particularly high minded reasons. You know, that this is because Beijing or policy makers in Beijing think that the EU, you know, is a shining city up on a hill, a Utopia to which one should aspire this kind of thing. But the reality of course is that if the EU continues to stick together, it continues to provide a single market. A single market is a good thing to trade with. And I can't tell you how often I was called when I was still living in Berlin by the people I knew at the Chinese embassy who said can you please come in and explain to use about Ukraine, and isn't that really dangerous to the whole EU, you

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know, project, and should you be as fussy about Ukraine as you are. And then I would explain that this is actually a fairly important concern. And it was clear that this was not persuasive. But I learned from that something rather interesting, which is that there is an interest in the survival of the EU as a functional entity that I think you don't get in Moscow and indeed quite the reverse. That's I think a significant point in our relationships with the Chinese.

MR. LE CORRE: Just one point on this and then I'll try to cover your question on corporate governance. It's interesting really that for the past year we've heard the Chinese Premier Li Keqiang speak about Grexit and the Chinese President Xi Jinping talk about Brexit. I'm sure you're all familiar with these terms, but one is about Greece staying in the EU -- staying in the Eurozone in fact, and the other one is about Britain staying or not in the EU through the referendum that's taking place on Jonathan Pollack's birthday, June 23. (Laughter) But it's very unusual for Chinese top leaders to comment on other country's important political events and especially when they have to do with, you know, elections or referenda or discussions among European leaders.

Anyway, on Mireya's question, I mean I do believe there is a problem of the corporate governance of China. The word governance is not understood the same way if you're in China or if you're elsewhere. And of course one of the reasons is that, as you saw earlier, the vast majority of OFDI from China are in fact from state-owned companies and some of them are pretty badly run, let's face it, and of course they are run as entities of the Chinese Communist Party or the Chinese state. And their leaders are appointed just like if they were senior officials in the provincial government or in the central governments. So it's difficult for some of these companies and some are well run, but some as we know have been merging for that matter. For example, COSCO, which is the largest shipping company, has recently merged with another entity, and it's the company that's running the harbor of Athens. But it's not going to change the fact that it's not going to be run with Greeks. And any takeover from Chinese entities into Europe has not led to having more Europeans as part of the board of directors or anything like that. In fact, I know some detailed cases of Chinese takeovers that have led to the European directors to be asked to leave and to be replaced by Chinese directors.

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So I mean this is going to be an issue. The major company I know of that is truly international perhaps is Lenovo. It has 50 percent of its board members international, including the CEO who is an Italian and who is based in Beijing but was previously the leader of Lenovo in Europe. This is going to take a long time and the Japanese were there before, and it's possible it will happen, but my feeling is that it's going to take a very, very long time.

MS. SOLIS: Thank you so much. So let me bring the audience. Thank you for your patience. I know there are tons of questions, so I'm going to take three questions, and please take note the problem with having so much expertise is that we may not get beyond those three questions. So please very concise questions. So Bruce and then Kawa-san and then the person next to Kawa-san. And if you can identify -- Bruce can you stand up so that he can see you? And please very concise questions, concise answers from my fellow panelists please.

MR. STOKES: Just a question for Philippe if he could -- Bruce Stokes the Pew Research Center -- Philippe, if you could speculate a bit about the implication, the political implications of Chinese investment in Europe on the forthcoming decision about market economy status for China, especially in light of at least the anecdotes that some European that get a lot from their perspective, or hope to get a lot of Chinese investment, have blocked in the past anti dumping measures by the European Commission.

MS. SOLIS: And then right here, Kawa-san. Can you raise your hand? And then --

QUESTIONER: Hi, my name is Kunihiko Kawa, Embassy of Japan. Thank you very much for very useful discussion today. Here I would like to refer to the newly announced Department of Common Statistics for the FDI in the United States 2015. The United States accepts \$380 billion in the year 2015. Out of this \$380 billion China's share, China invested \$2 billion, so \$2 out of \$380, why that Japan invested \$36 billion, Germany 25, France 25, UK 11. According to Mr. Le Corre's chart the Chinese share in the world FDI was at 10 percent. This is my understanding. So if both statistics are right, then the U.S. is much more lower than average. Assuming that the statistics are right, what might be the good explanation for that?

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Thank you very much.

MS. SOLIS: All right, thank you. And the gentleman next to you. Thanks

MR. FONG: Thank you. Allen Fong, China Daily. What effects would a Brexit have on Chinese investment in Europe? And are there any particular sectors that China has invested heavily in, and if so, which and why?

Thank you.

MS. SOLIS: Okay, so who would like to take first? Who will have comments for those questions?

MR. DOLLAR: Why don't you let Philippe go first? I'm happy to say something about the U.S. one in a moment.

MR. LE CORRE: Well, on the market economy status I mean obviously it's not going to be that easy. First of all because I think China is starting to realize that there's something called the European Parliament where lots of debates there. And now the big issue of course that it's on everybody's mind is the steel issue. I mean there are three factories that were closed in the UK, steel factories. And the fact that they will be job losses, an additional 15,000 job losses, would China get this market economy status. So I think it's going to take much longer than was expected. It's interesting to see how China behaves in that context. Originally they were just dealing mainly with the executive branch in Europe and now suddenly, you know, they've realized that it's not -- I mean despite all what I said, which is I hope overall positive about the Chinese presence in Europe, there's also a sort of downside that a lot of people feel worried about dumping and about -- I mean David spoke about the solar panels. I mean I'm not going to tell you the whole story of the solar panels, but that was a kind of war between Europe and China that has left some stains. And Constanze mentioned Huawei, which now has about 25 percent of the whole telecomm market in Europe, you know, with a lot of government help and not as a free market so to speak. So, you know, there is some concern about this.

And just one word on Brexit. Well, if Brexit takes place in June China will still be in London, but they will certainly reconsider I bet some of their investments, long-term investments because

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obviously they will not have the access to the European Union markets they would have if the UK was a full member of the EU and particularly the nuclear plant project might be in question. So I guess it's hard to speculate, but it's not good for foreign investment in any case, but the Chinese are, as I said, are interested in the European Union market because it's a large consumer market and, you know, it doesn't mean they'll give up the UK entirely, but it's not going to be the same story.

MR. DOLLAR: So I think we can agree that there are quite a bit of problems with Chinese statistics on their outward investment. Even if you look at their own sources, their Ministry of Commerce data, somewhat inconsistent with the balance of payments data that comes from the central bank. They report -- in the Ministry Commerce data they report half of their outflow of direct investment, 56 percent actually going to Hong Kong. And I'm sure there's a certain amount of Chinese investment in Hong Kong, but probably a vast majority of that is transit investment that goes on somewhere else. And again, if you look at their statistics big places for their investment are the Cayman Island, Panama, and probably a good -- probably most of that is actually transiting on. So the best I could say here is it really would be in the interest of U.S. and China to work together, get better statistics and find the ultimate beneficial owners of the investment coming into the U.S.

The \$2 billion figure you cited from the U.S. side that just seems too low frankly. Now you'll also see some accounts in the media where people just add up all the transactions they hear about. That's not scientific because some of those transactions fall apart. And the headline number, all of that's not direct foreign investment. So, you know, it is an area where the U.S. and China need to work together and probably EU and China need to work together to get better statistics because it hard to know exactly what's happening. It's higher than that figure you mentioned, but I'm glad you brought it up because somebody up here I think should have said that while it's large and growing, it's not that overwhelming amount of finance that you might get the impression that China is buying the whole world, and that's certainly not indicated by any of these different statistical sources.

QUESTIONER: \$4.1 billion just (off mic).

MR. DOLLAR: Well, that sound potentially closer to reality, okay. So, you know, it's



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significant, but as you say it's smaller than what Japan is doing and some of the others. I emphasize that China would end up being the biggest net creditor in the world. That's a pretty safe prediction. But I also emphasized that China itself is very closed and it's actually not getting that much inward investment anymore. Countries like Japan, most of the European countries, they get a lot of inward investment, they have a lot of outward investment. You know, that's the nature of advanced capitalist economies.

MS. SOLIS: Okay. Now let me go to this side of the room. I have this lady here. And if there are no questions on this side -- and the gentleman, and then if we have time this lady too.

QUESTIONER: Thank you. My name is Sharon Wu. So my question is we talk about different types of capital flows and here we talk about FDI, but FDI seems to be the most stable type of capital flows of all. And past experience shows that it is quite beneficial for receiving countries. So do you think that the capital flow, the FDI from China to U.S. and Europe is kind of different? Does it also promote the growth and employment and, you know, the spread of knowledge in these recipient countries?

And also I think maybe this kind of surge of Chinese investment is just cyclical because the exchange rate of China was very high before, but now it's kind of going down. So maybe it will naturally decrease in size so it's not a big concern.

MS. SOLIS: Thank you very much. So very concise questions please. From the gentleman with the glasses.

QUESTIONER: Thank you. (Inaudible) Carnegie Fellow Georgetown University. So my question -- it might be very generic so I hope it will be easy answer -- do Chinese leaders and financial leaders attach any ideological dimension to the growth and the international trade and investment? So one of the speakers mentioned about kind of compared China with Russia. In Russia I know it does attach, it has kind of this idea of (inaudible) based on orthodoxy. And is the Chinese growth generally -- can it be branded like anti-Western, just like is the case in Russia? And if it is, like to a certain degree what will be the implications for the future trade?

Thank you.

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MS. SOLIS: Okay. And last question from the lady in the front with the orange sweater. Please, very concise and we'll go to concise answers.

MS. WANG: This is Haiyan Wang from China India Institute. This first quarter we saw a massive rise. Even if you take out some of the big deals it's still very massive. What has been driving this surge and urgency and this rapid growth? Do you truly see this growth trend continue over the next five years given very high corporate debt ratio, given very rapidly rising non performance loans of the state banks? What do you believe could be, as you said, David Dollar, that China could become the biggest creditor -- do you truly believe that trend to continue?

MS. SOLIS: Thank you very much. So one minute answers from the panel.

MR. LE CORRE: Well, I'll just take the first question. I mean I agree with you. FDI, you know, is all for growth and it's beneficial to an economy, whatever it is. There's no doubt about this. I would say, you know, probably have to distinguish between M&A and Greenfield investments. It's not the same idea. The Chinese are very good at making deals and, for example, in this country they've been doing a lot of property deals. David mentioned the Waldorf and there are many, many others.

I think the real concern is really -- as you know in many countries employment is a great issue and to commit to the long-term economy of a country you need also to translate that into jobs and into long-term, you know, engagement. And I mean it's not just a Chinese issue, but since we're talking about Chinese FDI. At this very moment we're not sure whether job creation will follow this commitment, this interest, because if you look at other parts of the world, in fact, if you look at Africa which is arguably quite different, there haven't been that many job creations. There have been, you know, many projects and sometimes built by African workers, but more often built by Chinese workers. And a number of Chinese have stayed in Africa. But I'm not sure it's translated into concrete help for the African economy.

I think that's enough for me.

MR. DOLLAR: So the reason I think it's very likely China will emerge as the largest net creditor is that some of the uncertainty from last year has died down, capital flows have stabilized, they're not at the kind of alarming level we saw at the end of last year, but they're on target this year to be in the

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range of about \$500 billion net capital outflow. That's with China's economy stabilizing, doing pretty well. I think the bad scenarios all lead to more outflow. So I'm not sure if China will succeed in stabilizing. It may very well have a sharper slowdown. You mentioned the problems of debt. There are a lot of reasons why the economy could get worse in China. That would almost certainly lead to more capital outflow and that's why I feel pretty comfortable saying this is likely to happen because if things go well for China you'll probably see stable \$400 or \$500 billion per year flowing out. If things go south, then certainly over the next few years you'd see even bigger numbers. And all of that gets you to, you know, China being the largest net creditor at about five years.

MS. STELZENMÜLLER: All right. I'll focus on the second questions since nobody addressed that. I get the sense from my conversations in Beijing and with Chinese diplomats and think tankers that the Chinese, somewhat unlike the -- I mean the Russians like to think of themselves as still part of a bipolar relationship. It's Russia and America, nothing else matters, everybody else should get out of the way or, you know, fall into one of the two camps. I get the sense that the policy makers in Beijing think of themselves as part of a strategic triangle and that of course speaks to the global creditor role that's already been alluded to of Beijing by you, and in which of course the EU is of interest strategically as a way of balancing out America and possibly keeping America in check. Hence the interest in the sustainability and functioning of the EU.

Within the EU Germany is of interest and I think it fascinates the Chinese -- at least that's the impression that I get -- because of what they see as our success with what you could call -- and again I'm trying to put on a Chinese pair of glasses here -- managed capitalism, and managed growth and managed change. I think that is what we are seeing as the primary address for. There are other things that the French do or that the Brits do that are far more interesting than what we do, banking for example, certain kinds of state-owned industries, et cetera; other countries are of interest there. But the managed change part is what we're there for. But I fear that our Chinese partners refuse to see the role that cultural, social, and political democracy plays in that. It's the thing is routinely discounted in this conversation by our Chinese friends that they think is essentially sort of an appendix that can just be

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removed when translated to the Chinese strategic environment. And that is, I think, the fundamental misunderstanding, or if I want to be rude, the mistake that the Chinese policy makers are making. And that is in itself a limitation on the depth of the relationship.

MR. LE CORRE: Just one final word on this?

MS. SOLIS: Sure.

MR. LE CORRE: I mean it seems obvious to me that the Chinese leadership cares a lot about growth because in China everything is domestic and what the Chinese government is doing is primarily for its domestic audience. So it's possible that some of the deals that were done were done for opportunistic reasons, by a particular entrepreneur. But as I said many of these investors are state-owned enterprises.

So I think, you know, if you put yourself -- like Constanze said, if you put the glasses of Chinese leaders on your own nose you might want to ask yourself how am I selling these Chinese overseas investments to my audience, to the Chinese people at a time when the economic growth is actually much slower than it was and when, you know, as we know there are many problems in China, there are many problems everywhere. But it is an issue in the run up to the next Party Congress, in the way that China has been dealing with its population and, you know, number of people looking for jobs and things like that. It may not necessarily help the Chinese domestic economy. It could, but it could not. It's an open question.

MS. SOLIS: Thank you very much. We have come to the end of our time. The conversation will continue. I'm sure that Philippe wouldn't mind addressing some of your questions individually, but also because you can buy the book. It has come to you. I think there's a table with the book at the back of the room or the library as you exit Brookings.

I want to thank the panelists for sharing their insights and take the opportunity to congratulate Philippe for the publication of his great book. (Applause)

\* \* \* \* \*

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