United States Senate
Committee on Agriculture, Nutrition, and Forestry

"Smithfield and Beyond: Examining Foreign Purchases of American Food Companies"

Hearing Testimony of Matthew J. Slaughter

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Introduction

Committee Chairwoman Stabenow, Ranking Member Cochran, and fellow Members, thank you very much for inviting me to testify on these important and timely issues of how foreign purchases of American companies affect U.S. jobs and overall economic strength.

My name is Matt Slaughter, and I am currently Associate Dean for Faculty and Signal Companies' Professor of Management at the Tuck School of Business at Dartmouth, Research Associate at the National Bureau of Economic Research, and adjunct Senior Fellow at the Council on Foreign Relations. From 2005 to 2007 I also served as a Senate-confirmed Member on the Council of Economic Advisers, where my international portfolio spanned topics on the competitiveness of the American economy and included my active service on the Committee on Foreign Investment in the United States (CFIUS).[1] More recently I was a founding member of the Squam Lake Group, a non-partisan group of 15 academics who came together in the fall of 2008 to offer guidance on reform of financial regulation amidst the World Financial Crisis.[2]

The topic of today's hearing is extremely important. The purchase by Chinese conglomerate Shuanghui of Smithfield Foods, the world's largest pork processor and hog producer, would be the largest acquisition of an American company by a Chinese one. There are indeed legitimate concerns about China's economy and China's economic policies—e.g., intellectual-property theft and cyber-espionage. But there is much to welcome about rising foreign direct investment (FDI) from China and other emerging markets. Based on all publicly available information, I without hesitation endorse the Shuanghui purchase of Smithfield as a welcome, beneficial transaction for Smithfield stakeholders and for the broader U.S. economy overall.

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[1] In the past two years, I have not received any Federal research grants. Currently, in addition to the affiliations listed above I serve as a member of the academic advisory board of the International Tax Policy Forum; a member of the Congressional Budget Office's Panel of Economic Advisers; and a member of the U.S. State Department's Advisory Committee on International Economic Policy. For many years I have consulted both to individual firms and also to industry organizations that support dialogue on issues of international trade, investment, and taxation. For a listing of such activities, please consult my curriculum vitae posted on my web page maintained by the Tuck School of Business at Dartmouth.

[2] The book our Group co-authored that discusses the challenges in understanding and aiming to prevent financial crises is *The Squam Lake Report: Fixing the Financial System*, with Kenneth R. French, Martin N. Baily, John Y. Campbell, John H. Cochrane, Douglas W. Diamond, Darrell Duffie, Anil K Kashyap, Frederic S. Mishkin, Raghuram G. Rajan, David S. Scharfstein, Robert J. Shiller, Hyun Song Shin, Matthew J. Slaughter, Jeremy C. Stein, and Rene M. Stulz; Princeton University Press, June 2010.

In my testimony, I will stress three main points that together help explain the many benefits of the Shuanghui acquisition of Smithfield Foods.

1. Merger-and-acquisition transactions have long been the main strategy the long-standing strategy by which global companies establish and expand operations in America.
2. The U.S. affiliates of global companies—despite accounting for far less than 1% of U.S. businesses—have long performed large shares of America's productivity-enhancing activities that lead to high average compensation for millions of American workers.
3. All public information about the Shuanghui-Smithfield transaction indicates it will benefit Smithfield stakeholders—including, importantly, its employees—and the broader U.S. economy. There is nothing inherently worrisome or unusual about the Chinese and food aspects of this transaction. Chinese purchases of American companies will help strengthen both China's own development efforts and its commitment to market- and rules-based engagement with the global economy. The United States already has substantial inward FDI in agriculture and food processing.

M&A Transactions: The Main Mode of Inward FDI into America

Acquisitions of U.S. companies by foreign entities are practically an everyday reality in the modern global economy. Indeed, there have been nearly 500 such acquisitions just this year—about three every business day. Smithfield notwithstanding, China is still a small fraction of this total. So far in 2013, only 10 U.S. companies have been purchased by Chinese companies. While Chinese investment in the United States has dramatically increased since 2008—rising from less than $1 billion to $6.7 billion last year—the absolute level is still quite low.

Mergers and acquisitions have long been the main way in which global companies start their U.S. operations. These transactions have long been critical for the United States to benefit from inward FDI, and they constitute an important share of all U.S. M&A activity.

In principle, there are two methods by which a global company can undertake new FDI into and thereby create a new affiliate in the United States. One way is to establish a new U.S. company—i.e., undertake a "greenfield" investment that creates a new U.S. business. The other way is to merge with or acquire an existing U.S. company via an M&A transaction of all or part of that company.

Actual M&A transactions take many forms in what is often called "the market for corporate control": e.g., two peer companies merge as full equals; one company purchases particular assets, divisions, or lines of business of another; one company takes a stake in another but keeps it separate; or one company buys all of another outright and merges the two into one. There are well-known tradeoffs between the two options of acquiring or establishing a new affiliate. For example, acquisitions often yield quicker presence in a foreign market than building new operations from scratch. Acquisitions can also build on target-firm assets such as advanced technologies, brand equity, and managerial talent. Greenfield investments, in contrast, often make more sense if successful market presence requires the parent to transfer into the affiliate new and/or proprietary technology.

How much new FDI into the United States arises through these two channels of acquiring or establishing new affiliates? For decades, the vast majority of new FDI has come in the form of M&A. From 1987-2006, the United States received $2 trillion in new FDI — of which 88.8% ($1.78 trillion) was accounted for by inward M&A, i.e., by foreign companies buying U.S. companies, rather than by greenfield activity establishing new businesses.

This predominant role of inward M&A belies the idea that new FDI into the United States arises only from breaking ground on establishing new companies at ceremonies with leaders wearing construction helmets and wielding shiny shovels. Greenfield investment does happen, and it is important. But the very large majority of new FDI into the United States has long been via M&A.

The same is true worldwide. Around the world, as in the United States, M&A transactions account for the large majority of FDI inflows. Each year since 2000, M&A has accounted for somewhere between 67.1% and about 85% of total global FDI inflows. Looking farther back in time shows a similar picture: e.g., in 1990 cross-border M&A was 74.8% of the global total. Around the world, establishing new affiliates via greenfield investment is important—but M&A transactions account for the large majority of total new FDI.

Some commentators look askance at M&A transactions and argue they destroy rather than create economic value. This is not the case. Yes, not every single transaction ends up performing as envisioned by the parties involved. But a large number of academic studies have examined the performance consequences of M&A transactions in the United States, and the repeated finding is that most M&A transactions improve the productivity and overall performance—such as employment—of acquired companies.

Consistent with this evidence that M&A improves the performance of acquired U.S. businesses, other academic studies of many countries around the world have repeatedly found that plants and/or companies acquired by foreign multinationals tend to subsequently enjoy faster growth in employment, wages, investment, and productivity. As the next section of this testimony discusses, an important reason for these productivity improvements is that global multinational companies tend to be very high-productivity companies at the frontier of knowledge, innovation, and investment.

One final M&A point to emphasize is that acquisitions of U.S. companies by companies headquartered in emerging markets such as China are part of a long-term trend that is likely to continue. Last year there were 132 U.S. companies in the Fortune Global 500 largest companies. As recently as 2005, there were 176. During this period, the number of China-headquartered companies on the Global 500 list has increased to 73 from just 16.

With companies in China and other developing countries seeking new ideas, new brands, and new customers beyond their fast-growing home markets, the trend of investment into the United States from fast-growth emerging markets like China is likely to continue.[3]

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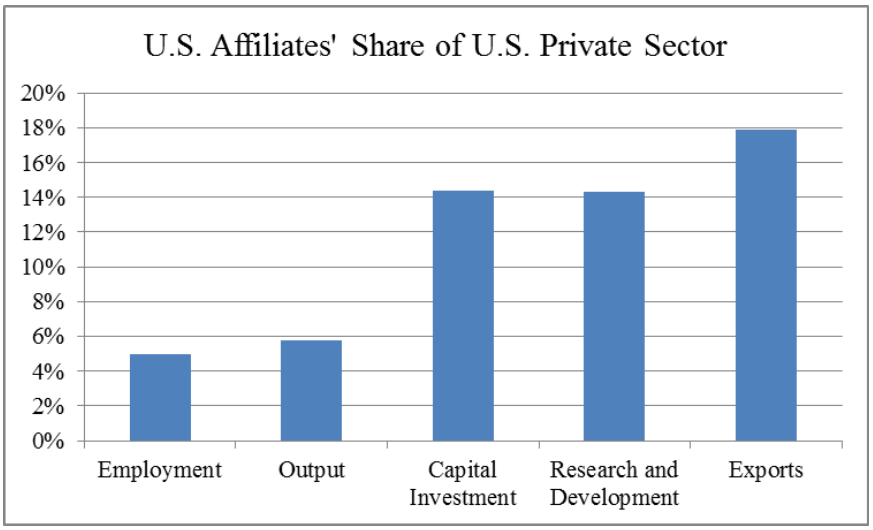
[3] Many of the statistics on M&A transactions cited in this section come from the analysis and discussion in my white paper, *Insourcing Mergers & Acquisitions*, Organization for International Investment, Washington, D.C.

Inward FDI Accounts for Millions of High-Quality, High-Paying Jobs in America

Research for the United States and many other countries has documented that globally engaged companies—both the U.S. parents of U.S.-based multinationals and also the U.S. subsidiaries of foreign-based multinationals —tend to perform better than purely domestic companies. Globally engaged companies enhance the American economy by their capital investment, their exports, their research and development, and by supporting good-paying American jobs.[4]

The U.S. affiliates of global companies—despite long accounting for far less than 1% of U.S. businesses—perform large shares of America's productivity-enhancing activities that lead to high average compensation for American workers.

While making up a relatively small share of the U.S. business community, the American operations of foreign companies account for a disproportionately large share of critical economic activities whose benefits accrue throughout the country. The following figure documents these shares for the most recent year of data, 2011 for employment and 2010 for all other items.[5]



- *Output*: U.S. subsidiaries of global companies produced $649.3 billion in output (measured in terms of value added), approximately 5.8% of all private-sector output.
- *Capital Investment:* U.S. subsidiaries of global companies purchased $149.0 billion in new property, plant, and equipment—14.4% of all non-residential private-sector capital investment.

[4]See, for example, "A Warning Sign from Global Companies," by Matthew J. Slaughter and Laura D'Andrea Tyson, *Harvard Business Review*, March 2012. See also *American Jobs, American Infrastructure, and American Global Competitiveness*, by Matthew J. Slaughter, Organization for International Investment research report, spring 2011. See also *American Companies and Global Supply Networks: Driving U.S. Economic Growth and Jobs by Connecting with the World*, by Matthew J. Slaughter and U.S. Council Federation, Business Roundtable research report, January 2013.

[5]All data cited in this passage come from data available on-line at www.bea.gov from the Bureau of Economic Analysis of the U.S. Department of Commerce. The data all refer to majority-owned affiliates. In 2009 there were in America 4,662 majority-owned affiliates of foreign-headquartered multinationals.

- *Research and Development:* To discover new products and processes, in U.S. subsidiaries of global companies performed $41.3 billion of research and development. This was about 14.3% of the total R&D performed by all U.S. companies.
- *Exports:* U.S. subsidiaries of global companies exported $229.3 billion of goods to the rest of the world, 17.9% of the U.S. total.
- *Intermediate Inputs:* To produce their goods and services, U.S. subsidiaries of global companies purchased over $1.9 trillion in intermediate inputs from other U.S. companies, which was about 78.7% of their total input purchases.

All these activities contribute to millions of well-paying jobs in America. In 2011, these U.S. affiliates employed 5.6 million U.S. workers, 5.0% of total private-sector payroll employment. In 2010 their total compensation was $408.0 billion—a per-worker average of $77,409, more than a third above the average for the rest of the private sector. Of these jobs, 37.7%—nearly 2.0 million—were in manufacturing, far higher than manufacturing's 10.5% share of all jobs in the overall U.S. private sector today. And U.S. subsidiaries of global companies have long had relatively high unionization rates. In 2007 12.4% of these firms' U.S. employees were covered by collective bargaining, versus just 8.2% of all private-sector workers.

In the late 20th century the U.S. presence of these global companies expanded considerably. Between 1987 and 2002 their U.S. employment more than doubled, from 2.6 million to 5.6 million—an average annual rate of growth of 5.25%. Over this period many of their other activities, such as capital investment, at least doubled as well. The last part of the 20th century, then, was a period where the U.S. economy enjoyed a steadily rising presence of and benefits from the foreign direct investment (FDI) of U.S. subsidiaries of global companies.

The Many Likely Benefits of the Shuanghui-Smithfield Transaction

All public information about the Shuanghui-Smithfield transaction indicates it will benefit Smithfield stakeholders—including, importantly, its employees—and the broader U.S. economy by maintaining a high-productivity, high-innovation enterprise.

A primary motivation for Shuanghui is to access and learn from Smithfield's global expertise in a number of related areas. In the words of Shuanghui Chairman Wan Long, "Shuanghui will gain access to high-quality, competitively-priced and safe U.S. products, as well as Smithfield's best practices and operational expertise. We were especially attracted to Smithfield for its strong management team, leading brands, and vertically integrated model."

This motivation accords with much of the broader pattern of inward FDI into America. The United States historically offers several strengths that are well suited to many high-value, firm-wide functions for global companies: e.g., highly educated workers, deep capital markets, and a culture of innovation and risk-taking. These American advantages can be well matched with a variety of global strengths: world-class technology, know-how, and components in other advanced countries; abundant labor well-suited to labor-intensive tasks in many emerging markets. Thus do companies operating in America connect to the world with well-paying U.S. jobs that involve some of the most integrative, innovative, and technologically advanced parts of global supply networks such as R&D, skilled production, logistics, management, and marketing.

Consistent with this overall pattern, post-acquisition Smithfield Foods plans to operate largely as it does today. Mr. Larry Pope will continue as president and CEO; all key management teams will remain in place; all collective-bargaining agreements will be honored with Smithfield's represented employees; all wage-and-benefit arrangements will be honored with all non-represented employees; no Smithfield plants or facilities will be closed; Smithfield's headquarters will remain in Smithfield, VA; and current philanthropic and sustainability initiatives will continue.

There is nothing inherently worrisome or unusual about the Chinese aspect of this transaction. Chinese purchases of American companies will help strengthen both China's own development efforts and its commitment to market- and rules-based engagement with the global economy.

Because of China's ongoing current-account surpluses, the country on net needs to acquire assets from the rest of the world. Much of this buying has traditionally been focused on U.S. Treasury securities. The Smithfield acquisition suggests a desire of key Chinese actors to diversify away from U.S. debt—something that should be welcomed by those who fear the size of China's Treasury holdings. Chinese firms operating in the U.S. employed fewer than 10,000 people five years ago. By the end of last year, the number had risen to 30,000.

What about the risks of state-owned enterprises? Although SOEs remain prominent in China's economy, Shuanghui isn't one. In fact, its stakeholders include Goldman Sachs and Singapore's sovereign wealth fund. And this reflects recent trends. A recent analysis published prior to the Smithfield deal being announced, reported that since the start of 2012, private Chinese firms accounted for 50% of the value transactions involving the acquisitions of U.S. companies—up from 30% during the 2000-2011 period. And in the 17 deals recorded in the first quarter of 2013, 16 involved private Chinese firms.[6]

What about possible risks to Smithfield's intellectual property? IP theft in China has quickly become one of the gravest threats to the global economic system—and, as part of this, to American jobs. A recent report by the U.S. International Trade Commission surveyed 5,051 U.S. companies in industries such as high-tech manufacturing, publishing, and software to gauge the incidence and extent of infringement of their copyright, trademark, and other intellectual property rights in China. Firms say infringement there is widespread, and it affects not just large multinational firms but many small and medium-sized U.S. companies as well. Extrapolating from survey responses, ITC estimates all U.S. IP-intensive firms lost about $48.2 billion in 2009—perhaps even as much as $90.5 billion—from foregone sales, royalties, and license fees.

Surveyed companies further reported that improved IPR protection in China could boost their revenue there by as much as 20%—over $100 billion—thanks to both higher U.S. exports and higher local-market sales by their Chinese affiliates. More revenue, in turn, would expand their U.S. labor demand by as much as 5%—which could mean over 900,000 new U.S. IP jobs. And thanks to supplier linkages, expansion by IP-intensive firms would boost sales and hiring in dozens of U.S. industries. ITC economists calculate that up to 2.1 million new U.S. jobs could be created in total if China raised its IPR protection to U.S. levels.

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[6] See the Rhodium Group, at http://rhg.com/notes/chinese-fdi-in-the-united-states-q1-2013-update.

All the analysis in this careful ITC report underscores that America today retains a comparative advantage in knowledge-intensive activities, thanks to its ongoing strengths that include outstanding universities and a culture of risk-taking.[7] For American IP-intensive companies, weak IPR protection abroad curtails their sales and hiring opportunities every bit as much as do traditional trade barriers like tariffs and quotas.

In the context of America's legitimate concerns about IP theft from China, it is important to see that the Shuanghui-Smithfield transaction offers Exhibit A of the ideal solution: American companies being paid by Chinese companies billions of dollars for their ideas (per the statement from Mr. Wan quoted above stressing Smithfield's IP assets) in a transparent, market-based deal—and at a 31% premium above Smithfield's pre-announcement stock-market value.

Indeed, Shuanghui seeks to deploy Smithfield's expertise, products, and brands in China largely through boosting Smithfield's exports to China: exports into Shuanghui's network there to better meet surging pork demand in China driven by rising household income growth. This enhanced export intensity of Smithfield accords with the economy-wide evidence of U.S. exports by global companies presented in the previous section. More generally, higher U.S. pork exports to China will help reduce the U.S.-China bilateral trade imbalance that last year reached a record $315 billion.

Stronger IP protection in China would help not just America but China as well. China has achieved remarkable productivity and income gains since its liberalization began in 1978, and its current five-year economic plan wisely aims to expand employment in knowledge-intensive "strategic emerging industries." To continue expanding its technologies towards the global frontier, China will need to continue strengthening its IP laws and practices—for not just U.S. firms but Chinese firms as well. China will not become a global leader in innovation if its government does not adequately safeguard the fruits of knowledge discovery.

There also appears to be nothing inherently worrisome or unusual about the food aspect of the Shuanghui-Smithfield transaction. As with many other industries, in food manufacturing global companies have long played an important role in the U.S. economy. In 2010, the U.S. affiliates of global companies in food manufacturing employed 207,400 U.S. workers—10.4% of total manufacturing jobs at U.S. subsidiaries—at an average annual compensation of $59,426. These food affiliates that year invested $33.1 billion in property, plant and equipment; spent $486 million in research and development; and exported $6.8 billion of goods.

Given the size of the proposed Smithfield acquisition and the desire of both parties, it will likely be subject to review by CFIUS. I see no obvious national-security implications of this food-company acquisition, in part because Smithfield's U.S. operations post-acquisition will still fall within the regulatory purview of agencies such as the U.S. Food and Drug Administration and U.S. Department of Agriculture. That said, a timely and efficient CFIUS review seems like an additional U.S. regulatory check that makes good sense.

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[7] This ITC report is, "China: Effects of Intellectual Property Infringement and Indigenous Innovation Policies on the U.S. Economy."

Conclusion

America today continues to confront a competitiveness challenge of too few jobs and too little economic growth. Over 22 million Americans remain unemployed or underemployed; rates of job creation are little ahead of population growth; and real earnings for most of those working are not rising.

The good news is there is a future in which America can create millions of good jobs connected to the world via international trade and investment. Doing so will require bold and thoughtful U.S. policies, however, that extend beyond fiscal and monetary stimulus whose viability and impact are questionable. Greater FDI into the United States holds great potential to spur growth in output, jobs, and incomes for American workers.

Should it ultimately go through, the acquisition of Smithfield can serve as an example of a large U.S. company being acquired by a Chinese entity without controversy. Inbound foreign investment has long benefitted the U.S. economy, and a smooth Smithfield purchase would send a valuable signal to China and to the broader world that the United States welcomes such investment at a time where that investment is especially needed. Beyond the economic benefits of this transaction itself, this broader symbolic benefit matters as well.

Thank you again for your time and interest in my testimony. I look forward to answering any questions you may have.