

CHINESE INVESTMENTS IN ISRAEL: HONING U.S. POLICY TO MITIGATE ISRAEL'S RISK

RAPPORTEUR SUMMARY

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On January 31, 2020, the Foundation for Defense of Democracies (FDD) conducted a simulation with 30 U.S. national security practitioners to review Chinese investments in Israel.¹ Like the United States and its allies, Israel has developed significant commercial ties with China. At a time when the United States is reviewing its own ties with China because of threats to American technology and supply chain security, Israel is undergoing a similar process.

FDD's exercise sought to establish a framework by which Israel can continue to do business with China while addressing U.S. and Israeli national security concerns. Those security concerns have only compounded since the COVID-19 pandemic began. The crisis has afforded Beijing with the opportunity to pursue distressed but important national security assets around the world. As the great power competition between Beijing and Washington escalates, Israel would likely benefit from enhanced dialogue to protect U.S.-Israel bilateral interests.

METHODOLOGY AND FRAMEWORK

FDD invited a diverse group of experts to participate in a half-day simulation. The participants included analysts deeply concerned about the threat from the Chinese Communist Party (CCP) as well as a number of scholars with more optimistic perspectives on U.S.-China ties. While the experts participated in their private capacities, their perspectives were shaped by years of U.S. government and/or private sector experience.

The experts were invited to outline concerns that have emerged as Chinese investments in Israel have expanded, including in technology and critical infrastructure projects. These investments fit within Beijing's Belt and Road Initiative, which aims to increase control over global trade, maritime, transportation, and communications networks.

There was a consensus that some Chinese investments in Israel could pose a threat to U.S. interests as Beijing challenges American leadership. However, the experts noted that unlike many U.S. allies, Israel has taken important steps to mitigate this threat, such as creating a voluntary foreign investment review board and blocking Huawei from Israel's 5G network. The experts also broadly acknowledged that U.S. policy has shifted rapidly under the Trump administration, intensifying discussions with allies about how they can make substantial and rapid changes to their dealings with China.

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1. This summary captures the majority sentiment and consensus positions. It does not include minority dissenting views. If a consensus was not reached, this summary does not note a position or recommendation.

The experts also noted that the United States could do a better job working with Israel and other allies to help them find alternative partners to displace Chinese investment in cases where they are being urged to break contracts, reject Chinese companies in infrastructure tenders, or downgrade commercial ties. Moreover, to increase Israeli confidence, the United States should be humble about its own shortcomings relating to Chinese investment. The United States will have more success in working with its Israeli counterparts if it leads by example. One recent example, consistent with the participants' recommendations, was the decision by the Trump administration to divest U.S. government pensions from Chinese stocks.²

Israel should, in the participants' view, more actively acknowledge Washington's concerns about Chinese investment in Israel, particularly in ventures that might apply to artificial intelligence and other advanced technologies. While Israel has already taken some important steps to displace Chinese investment, it should ensure that it does not inadvertently contribute to Chinese advancements in ways that harm American interests or security concerns.

Israel and the United States already enjoy a historically strong alliance and shared interests. While discussions on this matter continue, given the sensitivity and urgency of the issue, a formal and confidential bilateral working group could strengthen joint efforts. This may be even more important as the CCP exercises its leverage against Western interests in the wake of COVID-19.

FINDINGS

The experts reviewed a range of Chinese investments in Israel across five sectors.³ They agreed that some Chinese investments in Israel would benefit from immediate review. These include investments by state-owned enterprises (SOEs) or private Chinese companies believed to collaborate with the Chinese government, such as Baidu, Huawei, and Tencent. A company's efforts to obfuscate or obscure beneficial ownership or other deal terms also triggered red flags.

While the experts largely agreed that contracts with Hong Kong-based companies may be safer than contracts with companies headquartered in mainland China, they also cautioned that Hong Kong-based firms could still pose a risk, particularly those with close connections to the CCP. This risk will likely grow as Beijing imposes increasing restrictions on Hong Kong's commercial and political freedoms. The experts noted that under U.S. law, any transaction with an SOE is immediately subject to increased scrutiny. Israel should do the same.

Among the experts, there was a consensus that different projects in the same sector may warrant different levels of concern. For example, Chinese construction of an international port could threaten U.S. naval interests, but the construction of an urban light rail may be of concern only to Israel. Still, Chinese investment in Israel's water resources and other critical infrastructure could give the CCP substantial political leverage over Jerusalem, undermining both Israeli security and U.S. interests.

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2. "Trump administration orders federal pension fund to scrap plan to invest in Chinese stocks," *Associated Press*, May 12, 2020. (<https://www.marketwatch.com/story/trump-administration-orders-federal-pension-fund-to-scrap-plan-to-invest-in-chinese-stocks-2020-05-12>)

3. Experts reviewed Chinese investments in five sectors: artificial intelligence, infrastructure and construction, venture capital, agriculture, and pharmaceuticals. The investments reviewed involve the following Chinese companies: Baidu, Hangzhou Wahaha Group, Shanghai International Port Group, China Civil Engineering Construction Corporation, Horizon Ventures, China Investment Corporation, Tencent, Anhui Luhan Construction Group, and Harbin Pharmaceutical Group.

Participants noted that even projects involving civilian technology could raise red flags. Advanced technological solutions related to agriculture or pharmaceuticals could pose national security challenges because that technology can be transferred to other sectors. Investments that include access to data should be heavily scrutinized as well.

KEY POLICY RECOMMENDATIONS

The simulation exercise resulted in the following policy recommendations:

1. **Strengthen foreign investment oversight.** Israel's newly established review body is an important step, but it is not yet sufficient to screen and block problematic investments. Israel should expand its efforts to protect itself from predatory practices and should more actively address U.S. concerns. By limiting its scope to matters of national security, Israel's foreign investment screening system could be designed to limit cumbersome processes that deter investors. Experts recommended that Israel implement the following four components to enhance its review process:
 - **Strengthen interagency collaboration.** This would mitigate the tendency of entrepreneurs to rely exclusively on personal, military, or intelligence contacts to vet foreign investment. The Committee on Foreign Investment in the United States comprises 11 cabinet secretaries, and representatives from several other agencies maintain observer status.⁴ Israel may seek to create a process to determine which agencies will be involved in its foreign investment screen, and aim to include the key finance, trade, foreign relations, and security ministries so that security concerns are balanced with economic considerations. Experts noted that while this process will be onerous, it will conduce to a comprehensive review of the risks associated with each Chinese investment.
 - **Review high-tech sector investments.** This will not be popular given Israel's understandable aversion to government oversight over its high-tech sector. However, data has become a strategic commodity, and there are many ways adversaries can repurpose data for military or other purposes. Experts also noted that the United States and Israel should come up with a shared understanding of what constitutes "dual-purpose" technology.
 - **Conduct a retroactive review of past investments.** A time limit for reviewing past investments would be advisable. The experts suggested that looking back at contracts signed five years ago would likely be effective. Flagging problematic past investments should not automatically trigger an action, but would not preclude one, either.
 - **Review tenders prior to awarding bids.** A number of participants suggested that Israel should consider scrutinizing tenders in its foreign investment review process prior to awarding a foreign bid. This would prevent Israel from having to backtrack on bid awards that are deemed problematic. This will reduce the likelihood of incidents such as the controversy over the tender submitted by the Chinese-owned company Hutchinson to build Soreq B, a \$1.5 billion desalination plant.⁵

4. "Overview of the CFIUS Process," *Latham & Watkins LLP*, 2017. (<https://www.lw.com/thoughtLeadership/overview-CFIUS-process>)

5. Barak Ravid, "U.S. pressure over China leads Israel to review infrastructure bid," *Axios*, May 12, 2020. (<https://www.axios.com/israel-sorek-b-desalination-bid-hong-kong-pompeo-b5b6e72b-e38c-4710-8e13-d067a98289f3.html>)

2. **Identify alternatives to business with China.** The United States should work with Israel and other allies to facilitate alternatives to help Israel pivot away from China. Other Indo-Pacific countries, such as Japan, Canada, India, Australia, South Korea, and Taiwan, already invest in Israel and may be eager to increase their engagement to replace Chinese investment. The United States could encourage these commercial ties through bilateral foundations between Israel and these allies (or trilateral foundations that include the United States). These could be modeled on the Binational Industrial Research and Development (BIRD) Foundation, which is designed to encourage technology cooperation; the Binational Agricultural Research and Development fund; and the Binational Science Foundation.⁶ The India-Israel Research and Development Cooperation Initiative is a successful cooperation mechanism based on the BIRD model.⁷
3. **Consider a U.S.-Israel Operations-Technology Working Group.**⁸ Such a group could coordinate and catalyze combined military research and development efforts. Since the FDD simulation, Senators Tom Cotton (R-AR) and Gary Peters (D-MI) have led a bipartisan effort to legislate this initiative. While there is strong bipartisan support for this, Israel may need more oversight of Chinese investments to protect joint projects emerging from this working group.
4. **Establish a U.S.-Israel bilateral working group.** Experts noted frustration that some in the Israeli establishment do not yet appear to be sensitive to the CCP threat. At the same time, Israelis doing business with China are concerned that they are held to a higher standard than other U.S. allies. To address these concerns, the United States and Israel should establish a bilateral mechanism that meets regularly to discuss issues of mutual concern and importance. This ongoing dialogue could involve decision makers in the economic, security, and trade bureaucracies. It could be modeled after the regular dialogue held between Washington and Jerusalem to counter the Iranian threat. Another model is the U.S.-Israel Strategic Dialogue, which was convened in 2014 at the Department of State and was at the time the highest-level regularly scheduled diplomatic meeting between the two countries.⁹ A Track II dialogue comprising former U.S. and Israeli government officials and stakeholders could serve as a useful complement to official bilateral engagements.

CONCLUSION

The United States and China are entering into a new phase of overt competition as the CCP challenges the liberal, rules-based international order. Israel, like other U.S. allies, is working closely with the United States to adjust to this new reality. Israel's business ties with China are bound to come under additional scrutiny. FDD's simulation aimed to help identify concrete steps that both the United States and Israel can take to address their respective concerns. As Israel mounts an effort to strengthen its framework for screening foreign investments, the United States should help by identifying alternatives to Beijing and by formalizing components of an already strong U.S.-Israel alliance.

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 6. "The Growing U.S.-Israel Economic Relationship," *American Israel Public Affairs Committee*, November 15, 2018. (<https://www.aipac.org/news-hub/articles/us-israel-economic-cooperation>)

7. Cherian Samuel, "India, Israel, and the US Factor," *US-Israeli Relations in a New Era: Issues and Challenges After 9/11*, Eds. Eytan Gilboa and Efraim Inbar (New York City: Routledge, 2010), page 209. (https://www.google.com/books/edition/Us_Israeli_Relations_in_a_New_Era/prVeyvFpa68C?hl=en&gbpv=0)

8. Bradley Bowman, "Senators Call for U.S.-Israel Operations-Technology Working Group," *Foundation for Defense of Democracies*, March 3, 2020. (<https://www.fdd.org/analysis/2020/03/03/senators-call-for-u-s-israel-operations-technology-working-group/>)

9. U.S. Department of State, "Joint Statement From the U.S.-Israel Strategic Dialogue," June 16, 2016. (<https://2009-2017.state.gov/r/pa/prs/ps/2016/06/258590.htm>)