The Weaponization of Capital: Strategic Implications of China's Private Equity/Venture Capital Playbook

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Executive Summary

Private equity and venture capital — and the capital flows they represent — are relatively new and increasingly important vehicles for accessing innovation, information, and influence. China may be penetrating this realm in nuanced ways that the U.S. security apparatus has yet to fully understand, let alone address.

U.S. policy makers have long recognized the risks of capital flowing into the United States.[1] More recent efforts have also begun to grapple with national security risks related to capital flowing from the United States to China.[2] Regrettably, this recognition and related efforts have had minimal effect. They amount to little more than lip service, particularly when it comes to private market capital flows, which are less regulated than public market capital flows.

The strategic role of private market capital flows is a novel and largely overlooked aspect of geopolitical competition. Private equity and venture capital were not institutionalized asset classes during the Cold War. But Chinese political and economic leaders appear to grasp the importance of these fields and how they could have outsized influence in the current U.S.-China competition. Yet this is a field of widespread opacity, and it is difficult to reach definitive conclusions about exposure to foreign capital in these capital flows without first achieving greater transparency and improving frameworks for studying these risks.

This paper documents trends in Chinese participation in U.S. private market investments — and corresponding risks. Contrary to common assumptions, Chinese inbound investment has not decreased in the wake of heightened U.S.-China geopolitical tension.[3] And regardless of absolute deal flow, the avenues for inbound Chinese capital have expanded: The sub-surface space of limited partnership stakes in U.S.- or third-party-domiciled general

1. David Hanke, *Testimony Before the U.S.-China Economic and Security Review Commission*, September 8, 2021. (https://www.uscc.gov/sites/default/files/2021-08/David_Hanke_Testimony.pdf)

2. Gavin Bade, "'We're in an economic war:' White House, Congress weigh new oversight of U.S. investments in China," *Politico*, February 19, 2022. (https://www.politico.com/news/2022/02/19/china-investments-economy-us-congress-00008745)

3. Heather Somerville, "China Investors Keep Making Deals in Silicon Valley Amid Washington Pushback," *The Wall Street Journal*, October 28, 2019. (https://www.wsj.com/articles/chinese-investors-u-s-tech-entrepreneurs-continue-to-make-deals-11572275105); Heather Somerville, "Government 'SWAT Team' Is Reviewing Past Startup Deals Tied to Chinese Investors," *The Wall Street Journal*, January 31, 2021. (https://www.wsj.com/articles/government-swat-team-is-reviewing-past-startup-deals-tied-to-chinese-investors-11612094401) partnerships has grown steadily over the past decade. These investments are not subject to review by the Committee on Foreign Investment in the United States (CFIUS). As a result, they provide Chinese entities with access to private equity and venture capital funds that back high-growth technology companies. In addition to access to technology and innovation, these investments also offer tremendous influence.

This memo reviews examples of limited partnership stakes in private equity taken by the likes of China's largest sovereign wealth fund, China Investment Corporation. It also explores allocations of Chinese capital into leading venture capital funds in Silicon Valley. The report further provides clear examples of the access that Beijing's indirect capital allocations can provide.

China has updated its strategy for allocating capital for returns, technology acquisition, and influence to tap the strategic value of private market pools of capital. U.S. policy has not. This asymmetry raises several challenges that necessitate the following policy recommendations:

- The definition of covered transactions for CFIUS reviews should be amended to include limited partnership stakes that provide indirect access to critical and emerging technologies. Similarly, CFIUS and other regulatory tools for monitoring foreign influence and control should align the standard for "controlling investments" with the reality of today's critical technology. Informational rights afforded to investors today mean as much as board seats and operational control meant in decades past.
- The Securities and Exchange Commission (SEC) should expand disclosure requirements for private market investment vehicles to require, at a minimum, reporting on investments received from limited partners with ties to the Chinese Communist Party (CCP) or the Chinese entities that oversee Beijing's "military-civil fusion" strategy.
- Federal and state-level investment authorities, including but not limited to employee pension funds, should mandate that fund managers conduct due diligence to guarantee that public and public-employee funds are not supporting the CCP's military modernization, illicit technology acquisition campaign, or programs of surveillance and human rights abuses.
- New modes of public-private partnership should be explored to share information on Chinese investment patterns and objectives. Information sharing among U.S. and allied funds can serve to block inbound capital seeking influential limited partnership stakes. Over time, information sharing should also serve an offensive purpose in aiding both private- and public-sector resource allocators to fill vacuums that may result from the elimination of inbound Chinese capital.

Introduction

The People's Republic of China opened to the world in the 1970s. China has subsequently enjoyed unprecedented economic growth. From the outset, that growth has been championed by, and disproportionately benefited, the U.S. financial sector. However, the benefits to the financial sector have not augmented overall U.S. economic or relative national strength. The CCP's relative gains — in particular over the past two decades, since China joined the World Trade Organization — have coincided with U.S. losses in industrial strength.[4] The economic assumptions provided to justify China's opening did not account for Beijing's "state-led, enterprise-driven model" or its violation of the laws and norms of international trade and investment.[5] Now, almost half a century later,

4. Jennifer Harris and Jake Sullivan, "America Needs a New Economic Philosophy. Foreign Policy Experts Can Help," *Foreign Policy*, February 7, 2020. (https://foreignpolicy.com/2020/02/07/america-needs-a-new-economic-philosophy-foreign-policy-experts-can-help)
5. Emily de La Bruyère and Nathan Picarsic, "Two Markets, Two Resources: Documenting China's Engagement in Africa," *U.S.-China Economic and Security Review Commission*, November 2020. (https://www.uscc.gov/sites/default/files/2020-11/Two_Markets_Two_Resources_Documenting_Chinas_Engagement_in_Africa.pdf)

Beijing's long-standing asymmetric approach to economic engagement, and corresponding pursuit of coercive leverage, are finally recognized as strategic threats to the U.S.-led rules-based international order.[6]

The Biden administration, in its first days, appeared poised to acknowledge, and rein in, the role of finance in U.S. policy toward China. "Why, for example, should it be a U.S. negotiating priority to open China's financial system for Goldman Sachs?" National Security Advisor Jake Sullivan asked.[7] It is yet to be seen whether that was more than a flippant sound bite. Financial integration remains a core CCP objective — and one pursued with new gusto as global markets grapple with COVID-19, follow-on supply chain challenges, and inflationary pressures.[8]

The financial domain, including everything from global public equity markets to private investment, highlights the dichotomy between conventional assumptions about international integration and Beijing's approach. In U.S.-China relations, the financial realm has traditionally been prioritized as an area for cooperation and integration in terms of market access.[9] The past decades suggest that Beijing has weaponized that integration. Indeed, finance has become a determinative realm in strategic competition between nation-states.[10] Beijing's strategic maneuvering has allowed it, surreptitiously, to establish positions of access — including to technology, data, and infrastructure — and influence in the United States and in international systems.

This report aims to document Chinese views on the strategic utility of capital, as well as examples of China's extant positioning, based on data from private market investing. The investments reviewed in this report cover private equity and venture capital. These asset classes have been selected for their outsize impact in terms of global economic and strategic influence; proximity to sources of critical technology, infrastructure, and data; and corresponding value for defining the networks, standards, and platforms of the emerging industrial revolution.

Private equity and venture capital orient around private companies rather than public market equities. Tactically, private equity and venture capital investment provides access to high-growth sectors but also to critical technology, infrastructure, and data — core assets that carry national security importance. This is increasingly well understood.[11]

At a more strategic level, as private equity and venture capital investors have become vital for national economic development, employment, and research and development (R&D) over the past 20 years, they have also come to wield major influence. That influence is political as well as economic and financial. The global investments supported by the Chinese state track with financial motivations at a tactical level: These assets have grown because

6. The incongruity of the Chinese approach with norms of the operations of the U.S.-led global order have been well-documented in institutional cases. See, for example: Mark Wu, "The 'China Inc.' Challenge to Global Trade Governance," *Harvard International Law Journal*, 2016, Volume 57, pages 1001–1063, (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2779781)
7. Bob Davis, "Biden Team Promises New Look in Trade Policy," *The Wall Street Journal*, January 24, 2021. (https://www.wsj.com/articles/biden-team-promises-new-look-in-trade-policy-11611484201)
8. A key element of China's COVID-19 recovery plan is attracting foreign capital to Chinese public exchanges and private markets. This has continued even as China has reportedly "turned inward" and cracked down on overseas listings of Chinese companies such as Didi. For a discussion of the threat and priority for attracting inbound capital, see: Emily de La Bruyère and Nathan Picarsic, "Viral Moment," *Horizon Advisory*, March 2020. (https://www.horizonadvisory.org/coronavirus-series-viral-moment)
9. See, for example: U.S. Department of State, "S&D Opening Session Remarks," June 6, 2016. (https://2009-2017.state.gov/secretary/remarks/2016/06/258091.htm)
10. For the path-breaking and definitive academic treatment of these issues, see: Jonathan David Kirshner, *Appeasing Bankers: Financial Caution on the Road to War* (Princeton, NJ: Princeton University Press, 2007).
11. For relevant policy implications, see: Heather Somerville, "Government 'SWAT Team' Is Reviewing Past Startup Deals Tied to Chinese Investors," *The Wall Street Journal*, January 13, 2021. (https://www.wsj.com/articles/government-swat-team-is-reviewing-past-startup-deals-tied-to-chinese-investors-11612094401)

they deliver economic returns exceeding other assets. At the same time, China's centralized system for capital flows suggests that investments in U.S. funds might be guided by a strategic bid for integration and, with it, access to influence, innovation, and information.

This report does not grapple with the vast scope of China's financial system or its history of investment and trade globally. Nor does this report address the theoretical economic logics that inform monetary and fiscal policy decisions relevant to the sectors reviewed in this report. Rather, this analysis aims to advance awareness of China's economic engagement in select private market capital flows, and to highlight their national security implications.

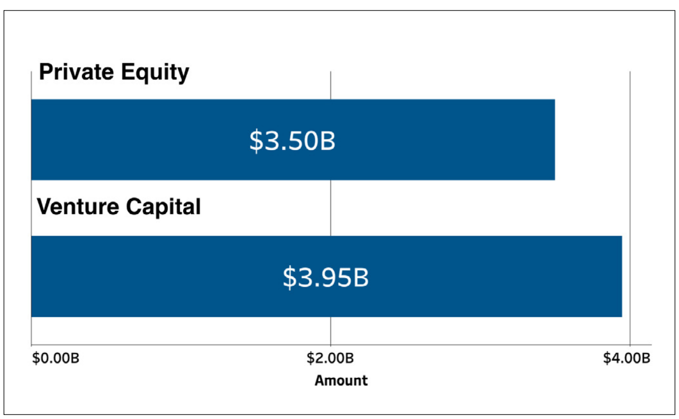
Private capital is relatively unregulated and opaque. This limits the report's scope and findings. At the same time, this methodological limitation constitutes an important finding: Lack of transparency in private equity and venture capital enables national security competitors and other actors with malign intent to subvert U.S. actors and systems — and to do so in ways that do not trigger defensive responses. Transparency is needed. Increased disclosure requirements should be a cornerstone of U.S. efforts to combat Beijing's weaponization of capital.

China poses a novel strategic threat. The role of private market capital in today's security environment — and China's strategic approach to competing with the United States therein — creates environmental conditions different from America's last great power competition, the Cold War. Despite increased attention on China's economic and technological ambitions, the U.S. national security community has not yet fully adapted to this change.

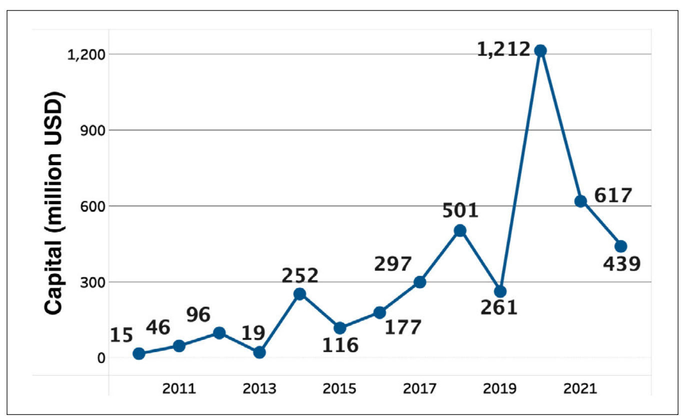
Scope of the Limited Partner Problem

Over the past 10 years, Chinese investors have secured limited partnership stakes in U.S.-domiciled funds exceeding \$7.4 billion.[12] This sum has increased since Congress passed recent reforms of the CFIUS process in 2018, which, at a minimum, suggests that those reforms have not sufficiently addressed the scope of means by which Chinese capital accesses American innovation.

Estimated Totals, Private Equity and Venture Capital, 2010–2022 (Billion USD)



Venture Capital Estimate by Year, 2010–2022 (Million USD)



12. This figure is an estimate based on documented cases of investment in private equity and venture capital funds by Chinese actors, as well as assumptions about historical investment terms for Chinese contributions to U.S. funds. A bottom-up methodology identified and collected information on dozens of fund managers that have collectively raised over 100 fund vehicles over the past 12 years, in which a fraction of limited partner backing came from Chinese sources. The sums reflected here are the aggregation of those fractions over time.

This is a low-end estimate. Yet there are no relevant U.S. government processes designed to protect against the risks of Chinese malign influence or to deter the acquisition of critical innovation and information through foreign investment. Existing defense mechanisms (such as CFIUS) are insufficient. Current threat monitoring efforts likely underestimate China's extant positioning. They also likely overlook its most impactful vectors.

This response could be elevated by addressing risks associated with Chinese capital deployments. If the United States is to compete with China, it must urgently adopt a new orientation toward public-private partnership. What is needed is a patriotic shaping of private investment and technology development. A range of U.S. government bodies should take immediate steps to regulate China's role in the global financial sector as a necessary response to the CCP's weaponization of capital.

A Different Peacetime Competition

The U.S. national security establishment has pivoted to address the threat posed by the People's Republic of China.[13] The Biden administration has committed to treating China as the orienting object of U.S. foreign policy, much like the Trump administration did.[14] The language currently used to describe China's threat — including "great power competition"[15] — is reminiscent of the Cold War.

At least rhetorically, the Cold War legacy continues to shape U.S. strategic thought.[16] And there are similarities to justify the comparison. In the Cold War, the United States also faced off against a communist regime intent on rewriting the global order. However, today's contest is not the Cold War. Whereas the U.S. response to the Soviet Union revolved around "containment,"[17] today's competitive environment is characterized by integration and unprecedented structural interdependence. Beijing's competitive strategy hinges on weaponizing that integration and interdependence.[18]

Of course, economic integration with the Soviet Union did exist before and during the Cold War. As early as 1930, before the Second World War, the United States was the Soviet Union's largest source of imports. Accordingly, some political and economic elites saw the Soviet Union as an opportunity — "the greatest undeveloped market in the world."[19] That sentiment lingered during World War II and even after the national security community recognized

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13. The 2018 National Defense Strategy declared as much by describing "inter-state competition" as the focus of U.S. national security and China as a "strategic competitor." U.S. Department of Defense, "Summary of the 2018 National Defense Strategy of the United States of America: Sharpening America's Military Competitive Edge," 2018. (https://dod.defense.gov/Portals/1/Documents/pubs/2018-National-Defense-Strategy-Summary.pdf)

14. Secretary of State Antony Blinken highlighted U.S. capacity to "outcompete China" in his written testimony for his confirmation hearing. Antony Blinken, "Statement for the Record before the United States Senate Committee on Foreign Relations," *Testimony Before the Senate Committee on Foreign Relations*, January 19, 2021. (https://www.foreign.senate.gov/imo/media/doc/011921_Blinken_Testimony.pdf)

15. For a critique of this terminology, see: Zachary Cooper, "Bad Idea: 'Great Power Competition' Terminology," *Center for Strategic and International Studies*, December 1, 2020. (https://defense360.csis.org/bad-idea-great-power-competition-terminology)

16. Charles Edel and Hal Brands, "The Real Origins of the U.S.-China Cold War," *Foreign Policy*, June 2, 2019. (https://foreignpolicy.com/2019/06/02/the-real-origins-of-the-u-s-china-cold-war-big-think-communism)

17. The roots of this strategy date back to George F. Kennan's Long Telegram from 1946 and shaped U.S. national security strategy for the four decades that followed. In retrospect, the U.S. victory was aided by the degree to which the Soviets "contained themselves."

18. Chia-Chien Chang and Alan Yang, "Weaponized Interdependence: China's Economic Statecraft and Social Penetration against Taiwan," *Orbis*, March 2020. (https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7102596)

19. A statement attributed to Senator William Borah in: John Lewis Gaddis, *Russia, The Soviet Union, and the United States* (NYC: McGraw-Hill Publishing Co., 1978), pages 97–104.

that the Soviet Union was a strategic adversary.[20] Similarly, technology cooperation and exchange between the United States and the Soviet Union continued well into the Cold War, and even included sensitive research areas such as non-military applications of nuclear research.[21]

This economic engagement led financial actors in the United States to exhibit interest in stability and in tempering rhetoric of conflict throughout the Cold War.[22] Technological exchange, and institutionalized assumptions about it, would challenge the policies of allies and other third parties necessary to apply technology export restrictions.[23]

Such economic and technological interaction — as well as the hurdles it raised for competition — bear obvious similarities to today's U.S.-China contest. But the degree of US-Soviet Union integration was orders of magnitude less than what we see today. The Soviet Union's designs on a self-sufficient national economy generated minimal international trade, around 5 percent of overall economic activity. Since the early 1990s, China has held a trade-to-GDP ratio above 30 percent.[24] The implications are clear: Today China is a larger trading partner than the United States for 128 countries, well over half the world.[25] China accounted for 24 percent of global transaction volume in equity capital markets in 2020.[26] The international economic stall caused by COVID-19 in 2020 prompted flows of capital into China to accelerate. The People's Republic of China overtook the United States as the top destination for foreign direct investment for the first time.[27]

In short, China is not the Soviet Union. China does not contain itself.

There are still other differences to highlight. Much of the exchange between the United States and the Soviet Union during the Cold War took place in well-regulated domains where governmental restrictions could be enforced when a national security imperative was invoked. Washington was able to escalate restrictions against cooperation and exchange when it deemed appropriate.[28] That is no longer the case.

The strategic environment has changed. As a result of proliferating information technology (IT) and the globalization it is has sparked, integration today often takes place in opaque areas difficult for the government to regulate or

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20. Awareness of the Soviet threat and its "international promotion of Communism" was codified in U.S. government policy as early as the 1920 policy of "non-recognition." See: U.S. Department of State, Office of the Historian, "Bainbridge Colby: Influence on American Diplomacy," accessed August 24, 2022. (https://history.state.gov/departmenthistory/people/colby-bainbridge)

21. See, for example: Brendan Thomas-Noone, "What the Cold War can teach Washington about Chinese tech tensions," *Brookings Institution*, January 12, 2021. (https://www.brookings.edu/techstream/what-the-cold-war-can-teach-washington-about-chinese-tech-tensions)

22. Jonathan David Kirshner, *Appeasing Bankers: Financial Caution on the Road to War* (Princeton, NJ: Princeton University Press, 2007).

23. For factors motivating the development of the Coordinating Committee for Multilateral Export Controls and its early efficacy, see: Ian Jackson, *The Economic Cold War America, Britain and East-West Trade 1948–63* (NYC: Palgrave Books, 2001).

24. World Bank, "Trade to GDP Ratio," accessed August 24, 2022. (https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS)

25. Alyssa Leng and Roland Rajah, "Chart of the week: Global trade through a US-China lens," *The Interpreter*, December 18, 2019. (https://www.lowyinstitute.org/the-interpreter/chart-week-global-trade-through-us-china-lens)

26. "China Yet to Crack Global Capital Markets," *Australian Financial Review*, January 7, 2021. (https://www.afr.com/chanticleer/china-yet-to-crack-global-capital-markets-20210107-p56scq)

27. Paul Hannon and Eun-Young Jeong, "China Overtakes U.S. as World's Leading Destination for Foreign Direct Investment," *The Wall Street Journal*, January 24, 2021. (https://www.wsj.com/articles/china-overtakes-u-s-as-worlds-leading-destination-for-foreign-direct-investment-11611511200)

28. For an input into such recognition, see: U.S. Department of Defense, "Soviet Military Power," October 9, 1981, pages 71–82. (http://edocs.nps.edu/2014/May/SovietMilPower1981.pdf) monitor. Private-sector supply chains[29] and academic exchanges present relatively tangible examples.[30] Positions in global capital markets, including private investment, are even more opaque, and likely more consequential.

The Strategic Value of Private Equity and Venture Capital

This paper addresses a segment of integration in global private markets: private equity and venture capital. These asset classes did not exist in the Cold War as the structured and substantial investment classes they are today. Until relatively recently, their pools of capital were not as internationally diversified. Their strategic and tactical national security implications are therefore very much emerging.

Private equity and venture capital are unique financial intermediaries. These funds invest in private operating companies at various degrees of maturity and risk, with a strategy focused on actively supporting individual companies that control a portfolio of investments. These portfolios generate financial returns for their ultimate investors — both the general partners operating an investment fund and the limited partners that provide that fund with capital — when portfolio companies are acquired or go public.[31] Unlike stock markets, private market investing is relatively unregulated. It is also relatively long-term and illiquid.

The cultural prominence of private equity and venture capital funds dates back to the leveraged buyout boom of the 1980s and the "Dot Com" bubble of the late 1990s. But their history as an investment class starts earlier. Private equity and venture capital financial intermediaries date back to the early post-World War II era. Georges Doriot, a Harvard Business School professor and World War II strategist, is often cited as the inventor of the practice of venture capital investing.[32] Doriot was among the founders and leaders of the Advanced Research and Development Corporation (ARD), launched in Boston in 1946. ARD was the first fund to manage and invest funds raised from external "nonfamily sources," namely insurance companies and investment trusts controlled by high-net-worth individuals and families. This distinguished ARD from other prominent funds started at the same time, notably J.H. Whitney, the Rockefeller Brothers Company, and the Bessemer investment vehicles launched by the Phipps family.[33]

Since the 1980s, private equity and venture capital have grown exponentially as asset classes. Today, they are a global and institutionalized feature of international finance. In 2000, private equity and venture capital funds held just over $500 billion in assets under management. By 2018, that figure stood at $3 trillion.[34] Private equity and venture capital funds draw from a diverse set of backers that span legacy pools of capital, public and private endowments and pension plans, high-net-worth individuals, corporate backers, and government investors, as well

29. Keith Bradsher, "Amid Tension, China Blocks Vital Exports to Japan," *The New York Times*, September 22, 2010. (https://www.nytimes.com/2010/09/23/business/global/23rare.html)

30. John Brown, "Securing the U.S. Research Enterprise from China's Talent Recruitment Plans," *Testimony Before the Senate Homeland Security and Governmental Affairs Committee, Permanent Subcommittee on Investigations*, November 19, 2019. (https://www.fbi.gov/news/testimony/securing-the-us-research-enterprise-from-chinas-talent-recruitment-plans-111919)

31. Andrew Metrick and Ayako Yasuda, *Venture Capital and the Finance of Innovation* (NYC: John Wiley & Sons, 2007).

32. Spencer Ante, *Creative Capital: Georges Doriot and the Birth of Venture Capital* (Boston, MA: Harvard Business Press, 2008).

33. The spirit, if not the practice, of venture investing draws from the 18th- and 19th-century American whaling industry. See: Tom Nicholas, *VC: An American History* (Cambridge, MA: Harvard University Press, 2019). For more recent history, see: Sebastian Mallaby, *The Power Law: Venture Capital and the Making of the New Future* (NYC: Penguin Press, 2022).

34. André Bourbonnais, "New Horizons for Private Equity," *BlackRock*, February 4, 2019. (https://www.blackrock.com/institutions/en-axj/insights/new-horizons-private-equity) as funds-of-funds that invest indirectly into the private equity and venture capital funds that in turn invest directly into private companies.

Private equity and venture capital investors also draw funds from the endowments of educational institutions. For example, Harvard allocates 23 percent of its $42 billion endowment to private equity strategies.[35] Yale's $31 billion endowment targets a 23 percent allocation to venture capital and 17 percent to leveraged buyout.[36]

The same holds for government and public pension investors. For example, the California Public Employees' Retirement System (CalPERS), an agency of the California state executive branch, allocates 8 percent of its assets to private equity. CalPERS boasts that private equity has generated the highest returns among asset classes in which it has invested over the past 20 years.[37]

This asset class is not solely built upon only domestic sources of capital: International capital from sovereign wealth funds (SWFs) have been an important contributor to the growth of the past two decades.[38] The term SWF was coined in 2005 to explain a shift in the way that reserve management had matured and diversified — to include investments into alternative asset classes and private market investments, directly and indirectly, through funds of funds.[39] Today, China accounts for the largest pool of capital managed through SWF vehicles, ahead of resource-rich countries such as the United Arab Emirates, Saudi Arabia, and Norway.

Private equity, and especially venture capital, is celebrated for its contributions to critical innovations spanning every sector of the modern economy, from the internet to biotechnology. For example, BioNTech, the team behind the first COVID-19 vaccine, received venture funding from a Munich-based firm. Venture capitalists point to the high-growth trajectories of internet darlings such as Google and Facebook as their greatest investment outcomes. A study of U.S. venture capital investments from 1974 to 2015 found that venture-backed companies contributed $115 billion in R&D to the U.S. economy and resulted in over $4 trillion in market value.[40] Those figures have continued to climb.

The meteoric rise of private equity and venture capital has granted these investment vehicles — and the ecosystems surrounding them — significant economic, political, and technological influence. The potential vulnerabilities or distortive effects are increasingly well recognized from a domestic perspective, such as the consequences for income inequality or the offshoring of jobs. Their strategic and geopolitical equivalents are not as fully understood — specifically their relevance to national security.

35. "Message from the CEO," *Harvard Management Company*, October 2020. (https://finance.harvard.edu/files/fad/files/fy20_hmc_letter.pdf)

36. "Investment return of 6.8% brings Yale endowment value to $31.2 billion," *YaleNews*, September 24, 2020. (https://news.yale.edu/2020/09/24/investment-return-68-brings-yale-endowment-value-312-billion)

37. "Exploring a New Private Equity Model," *CalPERS Asset Classes*, 2018. (https://www.calpers.ca.gov/page/investments/asset-classes/private-equity/new-private-equity-model)

38. SWFs are not a new concept, but their investments in alternative asset classes, including the private market actors discussed in this report, are a relatively recent phenomenon. For context, see: Jeffrey M. Chwieroth, "Fashions and Fads in Finance: The Political Foundations of Sovereign Wealth Fund Creation," *International Studies Quarterly*, Volume 58, Issue 4, December 2014. (https://www.jstor.org/stable/43868823)

39. Andrew Rozanov, "Who Holds the Wealth of Nations?" *Central Banking Journal*, May 2005. (https://www.centralbanking.com/central-banks/financial-stability/2072255/who-holds-the-wealth-of-nations)

40. Will Gornall and Ilya Strebulaev, "The Economic Impact of Venture Capital: Evidence from Public Companies," *SSRN*, June 2021. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841)

Private equity and venture capital, like today's financial markets more broadly, are internationalized. They exist not only across international borders but also beyond the oversight of most national governments, particularly when compared to public markets. These fields are not transparent. No public reporting requirements compel private equity or venture capital firms to make their investments public.[41] Market forces encourage both investment firms and their portfolio companies to do so — though exact terms of investments are rarely detailed publicly. Disclosure of external investors in private equity and venture capital funds, a fund's limited partners, are not required by any regulatory oversight.[42] Institutional investors and high-net worth-individuals, especially those with ties to governments outside the United States, have more reasons to seek discretion than to embrace transparency.[43]

These asset classes could provide opportunities for foreign nation-states to gain leverage in the United States and globally, namely through economic and strategic influence; proximity to sources of critical technology, infrastructure, and data; and the value those impacts serve for seizing networks, standards, and platforms in an emerging industrial revolution.

At present, venture capital and private equity largely fall outside of the rubric of national security assessment.[44] The risk is particularly acute in the context of the U.S.-China competition because of the increasingly pivotal role that China plays in global capital and private investment markets and in the technology fields that depend on private market capital flows for R&D funding.

Admittedly, the vulnerabilities created by alternative asset classes are largely theoretical. Due to widespread opacity in the industry, it is difficult to reach conclusions about exposure to foreign capital. A recent Harvard Business School study concluded, based on both theoretical modeling and empirical data on data on non-U.S. investments into U.S. startups from 1974 to 2015, that the risks of knowledge spillover suggest "it may be optimal for the U.S. government to raise their costs to deter investments."[45] Existing defensive tools and bureaucratic lines of effort exist and can be deployed to begin to address the economic impacts of knowledge spillover. At present, however, the U.S. national security apparatus is ill-suited to assess and respond to the strategic risk of Beijing's weaponization of capital, in part as a result of the influence that capital affords.

This report does not seek to prove with statistical certainty any causal relationship between private market investment funds and national security risks. Nor does it seek to prove a causal relationship between Chinese

41. Some private equity investments — and exits — involve publicly listed entities or public market listings. And market incentives do make it likely that individual operating companies or investors would want to disclose investments as a signal of legitimacy and to prepare for the path toward an exit — either by raising follow-on rounds of private financing, through acquisition by another private or public entity, or by listing directly on a public exchange.

42. Some institutional investors are required to disclose their investments as a result of their funding sources. For example, state-level freedom-of-information requirements often apply to state employee pension funds that serve as a limited partner fund source. The SEC requires registration of fund-level fundraising details but not at a level of detail itemizing individual limited partners.

43. Danny Chrichton, "Venture Capital's Red Flags: Growing investment in U.S. startups by China and other foreign players needs greater scrutiny," *City Journal*, Spring 2020. (https://www.city-journal.org/china-investment-in-us-startups)

44. While direct investments with dual-use, military relevance are regularly discussed in terms of security risks, the indirect exposure of limited partnership stakes is seldom detailed. For context and potential implications, see: Heather Somerville, "China's Penetration of Silicon Valley Creates Risks for Startups," *Reuters*, June 28, 2018. (https://www.reuters.com/article/us-usa-china-techinvesting-insight/chinas-penetration-of-silicon-valley-creates-risks-for-startups-idUSKBN1JP08V)

45. Ufuk Akcigit, Sina T. Ates, Josh Lerner, Richard R. Townsend, and Yulia Zhestkova, "Fencing Off Silicon Valley: Cross-Border Venture Capital and Technology Spillovers," *Harvard Business School*, Working Paper 21-043, 2020. (https://www.hbs.edu/ris/Publication%20Files/21-043_79187e1d-b709-48eb-8aac-198a99b664c3.pdf) capital and political, economic, or technological outcomes in the United States. It merely documents certain U.S. private market investment ecosystems' exposure to Chinese capital — with a focus on limited partner stakes held by Chinese institutional, fund-of-funds, and high-net-worth investors.[46] This domain of finance is new to strategic competition between nation states. This analysis underscores the degree to which transparency is needed in this realm, while also highlighting the reality that private capital flows present largely ignored avenues for influence and technology acquisition.

The Great Game: Private Equity

The activity of state-owned China Investment Corporation (CIC) reflects just one set of China's private equity investments in the United States. But this is a significant set. CIC is the world's largest SWF, managing nearly $1 trillion in assets on behalf of the Chinese state. Legally speaking, CIC exists as a state-backed partnership that invests into and through a web of fund vehicles that it owns wholly or in partnership with other key state-linked actors. By virtue of its scale and state mandate, CIC leads China's foray into the global private equity marketplace. CIC's investments and partners internationally allow the Chinese state to connect to control critical avenues for influence.

Launched in 2007, CIC was originally created to diversify China's foreign exchange reserves.[47] CIC's original investment allocation, derived from a special bond issuance, totaled approximately $200 billion. CIC's board of directors includes representatives from the State Administration for Foreign Exchange, the Ministry of Finance, the National Development and Reform Commission, the Ministry of Commerce, and the People's Bank of China.

CIC invests in a diverse set of domestic and overseas assets, including private equity, primarily as a limited partner in directly managed funds. CIC's two earliest investments were the public equity and public debt of Blackstone and Morgan Stanley, respectively. These investments were driven in part by the U.S. financial market's appeal. They were also a function of an underlying ambition for global integration. As China financial data analyst Chen Fang explained in remarks at Tsinghua University in 2018: "Cross-border private equity funds will become the mainstream, speeding up the integration of the global economy, including many companies that are now seeking a global layout."[48]

CIC's investments into private equity funds have generated a stable of connections, albeit indirect, to global investment deals. CIC has invested as a limited partner into the most prominent private equity funds in the United States (such as Blackstone, Goldman Sachs, and Carlyle) and globally. From 2007 to 2019, CIC-backed private equity funds invested in at least 613 overseas transactions.[49] The greatest concentration involved investments into

46. This is only one dimension of exposure or possible influence. Others include promotion of market access opportunities for U.S. or other non-Chinese portfolio companies; investment into China-domiciled operating companies; connections to research collaborations, commercial joint ventures, and educational, professional, and talent cultivation networks correlated with licit technology spillovers and illicit intellectual property theft; co-investment alongside Chinese state-linked actors; and management of RMB-denominated funds.

47. A harbinger of CIC's formation and mandate came at the January 2007 National Financial Work Conference, where a special investment vehicle for managing foreign exchange reserves was first considered by a high-level CCP organ.

48. "圆桌论坛| 2019年全球私募股权行业破局之道 [Roundtable Forum: How to Assess the Global Private Equity Industry in 2019]," *Phoenix*, January 12, 2019.

49. Data on these transactions can be discerned through press releases issued by funds and portfolio companies and in a range of international media.

private companies based in the United States: 177 deals, or roughly 29 percent of deals reviewed. The United Kingdom was a distant second with 78 deals, or 13 percent. Germany was the third-most frequent market for CIC investments reviewed, accounting for 51 deals, or 8 percent of the total reviewed. France (34 deals) and the Netherlands (31 deals) round out the top five, followed by Italy and Sweden.

Bilateral Investment Funds

The CIC's emphasis on the U.S. and European markets is also reflected in bilateral investment funds. These are CIC-led funds in which CIC manages pooled capital alongside other international private equity firms. To date, CIC's formal bilateral investment fund partnerships include the China-U.S. Industrial Cooperation Fund, established with Goldman Sachs in 2017; a similar arrangement in Japan with Nomura Holdings, established in 2018; and a fund established with BNP Paribas in France in 2019. CIC has also held discussions about an additional fund focused on the United Kingdom that would be launched with HSBC. These four bilateral funds would manage roughly $10 billion of investable capital.

It is unclear what share of that capital would come from Chinese limited partners. Regardless, Beijing would stand to benefit tremendously from the networks, deal flow, and material non-public information that Goldman Sachs and Nomura bring to their joint ventures with CIC. CIC has identified Germany, Italy, and Israel as markets where its bilateral fund approach could be replicated in the future — all are markets in which less formal bilateral deal-making occurs. CIC has also backed similar investment vehicles with investment mandates focused on Russia, Mexico, and Ireland.[50] Because they are not officially classified as bilateral investment funds in Chinese discourse, they may not entail the same imprimatur or degree of bilateral co-management as a formal CIC-led bilateral fund.

Official Chinese plans are not ambiguous about the purpose of bilateral investment funds: to improve China's high-tech capacities, to acquire resources to develop existing industrial capacity, and to meet the demands of a consumer-base moving up the value chain. CIC's Deputy General Manager Qi Bin describes the particular high-tech focus areas as "industrial manufacturing, TMT (technology, media, communications), and the advanced medical industry."[51] Within that overarching mandate, specific funds adopt specific priorities based on their partner country. Qi has explained that cooperation with developed economies — the United States, South Korea, Japan, Europe (namely Germany, France, and the United Kingdom), and Israel — is to be leveraged to obtain advanced technology, while emerging economies offer the opportunity to "export China's advantageous industries, especially infrastructure."[52]

50. Carmela Mendoza, "CIC's 1.5 bn European Bet is Latest in String of Bilateral Fund Tie-ups," *Private Equity International*, April 2, 2019. (https://www.privateequityinternational.com/cics-e1-5bn-european-bet-is-latest-in-string-of-bilateral-fund-tieups)

51. CIC Deputy General Manager Qi Bin, "创新对外投资方式推动全球经济协同增长 [Innovating Foreign Investment Methods to Promote Coordinated Growth of the Global Economy]," *Tsinghua Financial Review*, August 5, 2019.

52. Ibid. For a discussion of China's approach to technical standards and standardization strategy, see: Emily de La Bruyère and Nathan Picarsic, "China's Next Plan to Dominate International Tech Standards," *TechCrunch*, April 2020. (https://techcrunch.com/2020/04/11/chinas-next-plan-to-dominate-international-tech-standards). Chinese sources also emphasize the value of "third-party industrial cooperation" and using bilateral investment funds to enter third-party markets. This report does not treat that subject in depth, but there is significant documentation of China's practice — and intent — of leveraging overseas investments as a springboard for entering additional markets. See, for example: PRC National Development and Reform Commission, "第三方市场合作指南和案例 [Third-Party Market Cooperation Guidelines and Cases]," September 4, 2019.

Implications

How, economically and politically, could Beijing benefit from private equity investments?

First is the possibility of collecting strategically valuable and privileged information. Even limited partner investors typically receive some degree of informational rights as a part of their investment agreement with a fund operator or general partner. At a basic level, this enables the limited partner to verify that its selected managers are implementing an investment strategy consistent with the fund's advertised mandate and scope. It is not uncommon for those rights to include regular reporting on the performance and strategy of individual portfolio companies. Investors use this information primarily to track the performance of a fund or manager.

A nation-state investor such as China might use that information for other purposes. Portfolio details could hold national economic or intelligence value — particularly if those details were aggregated across disparate funds, geographies, and sectors into which different state-linked capital sources invested. China's relatively centralized economic development and planning apparatus is structured to share such information at a high-level. CIC's board observer representatives, drawn from across Chinese ministries and government organs, provide a prime example.

In other words, Beijing could leverage its ownership of CIC and CIC's relationship with, say, Goldman Sachs to develop a more direct and complete understanding of the investment theses, macro-economic assumptions, risk tolerances, and targeted investment candidates that motivate Goldman Sachs's private equity operation than the U.S. government has. It is all but guaranteed that CIC serves as a conduit of information for other Chinese governmental actors — though what Beijing does, or intends to do, with that information remains conjecture.

Such an asymmetry would provide enormous economic returns. It would also potentially promise strategic influence. For example, China could try to shape its economic prospects by directly injecting relevant information in reports published by the research arms of funds Beijing invests into or alongside.[53]

The 10x Opportunity: Venture Capital

The private equity story is one of access to mature and relatively developed companies and markets. Venture capital adds an additional angle to that story: This asset class provides unique access to innovation.

Venture capital orients around the high-risk, early-stage world of technological disruption. The world's largest and most active venture capital investors are concentrated in American tech hubs such as Silicon Valley. Individual venture capital firms reflect organizational cultures consistent with American conceptions of innovation: the "move fast and break things" ethos that has driven the likes of Facebook, Uber, and WeWork. Top-tier venture capital investors generate outsized returns for their investors by placing high-risk bets on unproven technologies, teams, or business models. Venture capitalists seek innovative breakthroughs that produce "10x returns."[54] By

53. For an example from private equity, see: Henry McVey, "China: A Trip to the Epicenter," *KKR*, August 7, 2018. (https://www.kkr.com/global-perspectives/publications/china-a-visit-to-the-epicenter). For a venture capital example, see: Michael Moritz, "Silicon Valley Would be Wise to Follow China's Lead," *Financial Times* (UK), January 17, 2018. (https://www.ft.com/content/42daca9e-facc-11e7-9bfc-052cbba03425). There is no shortage of similar examples from investors with conflicted interests that are not disclosed in their public commentaries.
54. Fred Wilson, "Venture Fund Economics: Allocating Follow-on Capital," *AVC*, August 25, 2008. (https://avc.com/2008/08/venture-fund-3)

nature, any individual portfolio of venture capital investments features a majority of failures offset by a small set of investments that deliver massive returns.

China's asymmetric strategy in its technology competition with the United States hinges on obtaining advanced technology from abroad.[55] Venture capital plays an important role in that approach. The director of the Chinese National Development and Reform Commission's Department of Finance made as much clear in a 2019 speech at Tsinghua University:

> Use venture capital to support the development and growth of high-end, innovative manufacturing and strategic emerging industries. Give full play to the national, policy, strategic, and basic role of venture capital in making up for shortcomings and establishing a strong positioning — with priority to supporting the development of strategic national security technology.[56]

Chinese capital appears to be doing as much, both through later-stage venture capital investments and by investing indirectly as a limited partner in established venture capital funds. The following examples reflect different degrees of potential exposure to, and value for proliferating, Chinese influence through venture capital funds.

Subversion of Existing Champions

Sequoia Capital

Sequoia Capital is perhaps the most successful venture capital firm in the world. Its leaders are often praised for carrying a Midas touch. They backed Apple and Oracle. A more recent generation of success stories includes Nvidia and Stripe. The firm has generated trillions of dollars in growth and steady returns to investors for decades.

Sequoia's limited partners consist primarily of U.S.-based public and private pension funds, endowments, and foundations. They reportedly range from the University of Southern California's endowment to Metlife Insurance to the pension of the University of Pittsburgh Medical Center. Sequoia invests globally, spanning the United States, China, and Southeast Asia. A common set of U.S. and European actors appears to back the range of Sequoia's funds, regardless of the individual vehicle's geographic focus.

Sequoia has also enjoyed financial backing from a range of Chinese actors, including government-linked entities such as the Chinese Academy of Sciences Holdings fund, technology investors such as Beijing Flourish Libra Venture Capital, and larger asset managers such as Gopher Asset Management. Sequoia's investment vehicles also include at least six funds dedicated to investing in China.[57] As measured by its recent raises, Sequoia's focus on the Chinese market is at least on par with its attachment to the U.S. market.

55. For a detailed analysis, see: Emily de La Bruyère and Nathan Picarsic, "Beijing's Innovation Strategy: Threat-Informed Acquisition for an Era of Great Power Competition," *Naval Postgraduate School Acquisition Research Symposium*, May 2020. (https://event.nps.edu/conf/app/researchsymposium/unsecured/file/697/SYM-AM-20-091_Panel#7_de-La-Bruyere_Paper_04-28-2020.pdf)
56. "创业投资的健康发展对经济发展意义重大 [The healthy development of venture capital is of great significance to economic development]," *Phoenix*, January 12, 2019.
57. Kane Wu and Julie Zhu, "Sequoia Capital China raising $2.2 billion in new yuan fund, say sources," *Reuters*, September 22, 2020. (https://www.reuters.com/article/us-sequoia-china-fundraising/sequoia-capital-china-raising-2-2-billion-in-new-yuan-fund-say-sources-idUSKCN26D0DI)

The firm's China operations are led by Neil Shen, a famous Chinese entrepreneur and highly successful venture investor.[58] He founded Sequoia's China business in 2005. He has also served as a representative to the National Committee of the Chinese People's Political Consultative Conference.[59]

Sequoia's investments have featured entities implicated by the U.S. government for their connections to Chinese human rights abuses or their contributions to the Chinese military or surveillance state,[60] as well as other players with connections to Beijing's military-civil fusion program. Sequoia's exposure to the CCP (for example, Shen's ties to the party) are rare among venture capital firms.[61] The risk factors have grown steadily over the past 15 years, primarily as a function of the fund's focus on the Chinese technology ecosystem.

Sequoia still stands as the paragon of Silicon Valley success. It continues to boast unparalleled access to the cutting-edge research and development generated at U.S. research institutes. Sequoia has developed corresponding influence in American politics: When the Trump administration launched an inquiry into potential security concerns associated with the TikTok application and its Chinese parent company, Bytedance, Sequoia was reported to have actively lobbied the administration in TikTok's favor.[62] Press coverage of the firm's potential influence points to the connections of Doug Leone, a managing partner at Sequoia, to the Trump administration and Sequoia's ties both to Bytedance and to reported suitors and partners for TikTok in the United States. Such coverage tended not to explore the firm's deep ties to the Chinese market and to Chinese investors in its funds.

Government-Guided Funds and U.S. Targets

Like most U.S.-domiciled investment funds, Sequoia's exposure to the Chinese government tends to be indirect. The Chinese government has developed an apparatus of "government-guided funds": These funds allocate state resources — like a SWF might — to pursue policy objectives as well as economic returns. [63] Chinese government-guided vehicles rarely invest directly in U.S.-domiciled funds. For example, Sequoia's limited partner base in China is composed of interconnected legal entities that — presumably for tax purposes — aggregate funds from governmental and non-governmental Chinese sources into special purpose investment vehicles created in tax-friendly jurisdictions that then invest in a Sequoia partnership.

58. It should be noted that the rise of U.S.-China geopolitical tensions and the risk of regulatory attention have led at least one industry observer to speculate that Sequoia could look to separate its U.S. and China operations: Kate Clark and Shai Oster, "Why Sequoia Capital Will Split from Star Chinese Partner," *The Information*, December 19, 2021. (https://www.theinformation.com/articles/why-sequoia-capital-could-split-from-star-chinese-partner)

59. "'The epidemic has stimulated our fighting spirit,' said Shen Nanpeng, a member of the National Committee of the Chinese People's Political Consultative Conference," *People's Political Consultative Conference*, March 13, 2020.

60. "US blocks 14 Chinese tech companies with top Silicon Valley funding," *Business Standard*, July 10, 2021. (https://www.business-standard.com/article/international/us-blocks-14-chinese-tech-companies-with-top-silicon-valley-funding-121071000185_1.html)

61. "CPPCC member on how to make better use of China's carbon goals," *CGTN* (China), March 7, 2022. (https://news.cgtn.com/news/2022-03-07/CPPCC-member-on-how-to-make-better-use-of-China-s-carbon-goals-18cF3aQE1kA/index.html)

62. Rolfe Winkler, Miriam Gottfried, and Cara Lombardo, "General Atlantic, Sequoia Capital Are Key Drivers in Oracle Bid for TikTok," *The Wall Street Journal*, August 24, 2020. (https://www.wsj.com/articles/general-atlantic-sequoia-capital-are-key-drivers-in-oracle-bid-for-tiktok-11598310734)

63. Tianlei Huang, "Government-Guided Funds in China: Financing Vehicles for State Industrial Policy," *Peterson Institute for International Economics*, June 17, 2019. (https://www.piie.com/blogs/china-economic-watch/government-guided-funds-china-financing-vehicles-state-industrial-policy)

IDG is one global venture capital fund that received direct backing from a Chinese government-guided fund. Like Sequoia, IDG enjoyed a storied history in the United States before launching a China-focused operation. IDG was founded in Boston in the early 1990s by International Data Group. Its first funds were U.S.-centric, but the firm moved into the Chinese market in the late 1990s and racked up immediate success. IDG was an early backer of Baidu and Tencent. In 2005, IDG expanded its set of funds focused on the Chinese market with the launch of the IDG-Accel China Growth Fund in partnership with the U.S.-based venture fund Accel. IDG-Accel's first China fund appears to have been backed primarily by legacy U.S. institutional investors (such as Adams Street Partners, an early fund-of-funds investor, as well as the State of Delaware and the Rockefeller Foundation). Subsequent iterations of IDG's China-focused funds — of which there have been at least seven[64] — have featured a host of Chinese limited partners. They appear to include the Chongqing Angel Investment Guided Fund, a provincial-level government-guided fund. They also include the National Social Security Fund, the China Development Bank's fund-of-funds investment platform, Chinese Academy of Sciences Holdings, the Beijing SASAC, and Gopher Asset Management.

Owning Cross-Border and New Bets

Sequoia and IDG began as U.S.-focused operations. In a different tack, Chinese limited partner backers have also invested in a range of funds designed to be bilaterally focused. For example, the Shanghai Yangpu Government-Guidance Fund invests as a limited partner in venture funds managed by Walden International. Walden is a prominent example of a venture investor with a presence in the United States and an explicit focus on cross-border U.S.-China investment.

Qiming Ventures and its U.S.-based office, operating under the name Qiming Venture Partners (USA), offers another example. Qiming has raised at least seven different dollar-denominated funds and five RMB-denominated funds since 2006. Its backers have included the National Development and Reform Commission, the China Development Bank, and other Chinese insurance firms, asset managers, and funds of funds. Qiming operates in the Chinese industrial policy ecosystem as a fund manager of industry park-specific investment vehicles — for example, Qiming manages the Suzhou Industry Park family of funds.

Other venture capital firms have emerged outside of China, including in Silicon Valley, with direct ties from the start to Chinese limited partner funds. Unlike Sequoia or IDG, these funds originated with Chinese backing. Unlike Walden and Qiming, they have not been explicitly focused on cross-border transactions and market access. They are unlikely to raise red flags for entrepreneurs seeking capital or regulators looking for national security risks.

11.2 Capital is an instructive example. 11.2 is a relatively small fund based in San Francisco. Its founders have been educated in the United States and feature stellar academic and professional backgrounds. The firm invests alongside prominent Silicon Valley players. But the source of its backing is unclear; its "Offering of Securities" filings with the U.S. Securities and Exchange Commission cites 30 investors in its 2014 vintage fund (11.2 Capital I, L.P.). However, no public documentation exists about the institutional or high-net-worth individuals who may have contributed.[65] And 11.2 is reported to receive strategic guidance from a Chinese technology company, Qihoo

64. For discussion of one later fund, see: Rolfe Winkler, "Jim Breyer and IDG Raise $1B China Fund," *The Wall Street Journal*, July 12, 2016. (https://www.wsj.com/articles/jim-breyer-and-idg-raise-1b-china-fund-1468335070)
65. U.S. Securities and Exchange Commission, "11.2 Capital I, L.P.," SEC CIK #0001591336, July 28, 2014. (https://sec.report/CIK/0001591336)

360.[66] Qihoo was added to the U.S. Commerce Department's Entity list in May 2020 for "activities contrary to the national security or foreign policy interests of the United States."[67]

TSVC stands out as another example. TSVC is similarly based in Silicon Valley. It appears to raise funds primarily from one Chinese source: Tsinghua Holdings. Tsinghua Holdings is a financial and commercialization arm attached to the prominent Chinese university Tsinghua. TSVC is a relatively smaller complement to other global venture capital plays backed by Tsinghua Holdings, including Tsing Capital. In 2011, TSVC placed its most successful bet, providing early backing to Zoom, the web-teleconferencing company.

Implications

These ties between Chinese capital and U.S. venture capital entities could provide Beijing with strategic value in a number of different ways. First, venture capital investments provide a licit path to technology and innovation. In some cases, venture capital investments might allow Beijing direct access to intellectual property. In other, more indirect cases, aggregated information about cutting-edge research and commercialization could be used to inform and direct Beijing's R&D bets.

Access to innovation and financial intelligence has clear national security implications. Critical and foundational fields such as artificial intelligence and robotics increasingly define areas prioritized for venture capital investment. And today, the private sector defines R&D spending in a different manner than it did in the Cold War. Global players that can access, shape, and benefit from private-sector innovation stand to gain real advantages. China's national-level R&D program and expenditures emphasize digesting, absorbing, and applying innovations proven abroad.[68] Capture of the U.S. venture capital ecosystem could power that asymmetric approach, while solving the challenge of innovation in an authoritarian system that may be ill-equipped to innovate organically.

China's backing of venture capital funds also offers an avenue for high-level political influence. This was evident during the Trump administration's deliberations over TikTok. As was reported at the time, Sequoia personnel were key to efforts to keep the Trump administration from banning the Bytedance-owned application from operating in the United States.[69]

Similar, perhaps even greater, influence returns may apply in other ways. For example, Chinese-backed venture capitalists and portfolio companies could be pressured to support Chinese-approved technical standards in international standards-setting bodies. The Chinese industrial policy apparatus strategically guides its own domestic champions to set international technical standards according to Beijing's preferences. Indirect stakes in global venture capital funds could allow Beijing to influence foreign companies toward the same ends. That could lead, for example, U.S. startups dependent (directly or indirectly) on Chinese capital to back Chinese technical

66. "11.2 Capital," *Crunchbase*, accessed August 24, 2022. (https://www.crunchbase.com/organization/112capital)
67. U.S. Department of Commerce, Press Release, "Commerce Department to Add Two Dozen Chinese Companies with Ties to WMD and Military Activities to the Entity List," May 22, 2020. (https://www.commerce.gov/news/press-releases/2020/05/commerce-department-add-two-dozen-chinese-companies-ties-wmd-and)
68. Emily de La Bruyère and Nathan Picarsic, "Beijing's Innovation Strategy: Threat-Informed Acquisition for an Era of Great Power Competition," *Naval Postgraduate School Acquisition Research Symposium*, May 2020. (https://event.nps.edu/conf/app/researchsymposium/unsecured/file/697/SYM-AM-20-091_Panel#7_de-La-Bruyere_Paper_04-28-2020.pdf)
69. Theodore Schleifer, "The TikTok drama shines a spotlight on the rare tech investor who backs Trump," *Recode*, August 10, 2020. (www.vox.com/platform/amp/recode/2020/8/10/21362401/donald-trump-tiktok-ban-sale-microsoft-doug-leone-sequoia)

standards at industry venues. Or it could manifest in a portfolio of U.S. startups in the fintech space aligning with, for example, an Alipay digital payment ecosystem. This could disrupt the dominance of legacy payment, processing, and trade settlement systems and could even redirect associated information flows to Beijing. The standards risk is particularly acute in light of new and advanced technologies being developed and promoted today.

The presence of Chinese investors in the U.S. venture ecosystem could also help the CCP control its population through means including, but not limited to, reproductive policy, patriotic education, propaganda, forced labor, and high-tech-enabled monitoring and policing. If China is able to use cutting-edge technology to perfect and automate elements of its surveillance state, Beijing's overall cost structure will benefit from an economy of scale. If China is able to obtain such cutting-edge technology through global venture capital networks, it could turn a profit in the process.[70]

Conclusion

China is an active and significant contributor to the global private market investment landscape. The true extent of the reach of entities tied to Chinese state-controlled capital is unknown. This is an opaque ecosystem. That opacity complicates attempts to assess the risk posed by Chinese capital — and to formulate a response.

The possibility that China might use its private market investments for strategic geopolitical ends could propel an unprecedented degree of information and influence in key technological domains and hubs of political and economic decision-making. Such an approach could power Beijing's perfection of "military-civil fusion" and techno-enabled societal control. And these investments may turn a profit in the process. This would create a cost-of-empire calculus drastically different from that of the Soviet Union — and, correspondingly, heighten the risks of relying on the Cold War model in competing with China. At a minimum, Beijing's technology acquisition strategy is likely far more effective than surface-level treatments that do not grapple with the influence of private market positions.

The U.S. government must better understand China's presence in capital markets, and the strategic returns thereof, to develop offensive and defensive mechanisms for the competition with China. The U.S. Department of Defense, for example, has several lines of effort focused on seeding commercial, dual-use technology. What happens if venture capital firms reliant on, or tied to, Beijing also invest in those same technologies?[71]

From a defensive perspective, the interagency CFIUS process is ill-prepared to address the weaponization of capital markets, which will require a degree of familiarity with Chinese tactics that may take time to cultivate. That may leave critical U.S. information and innovation exposed to Chinese leverage.

Lobbying disclosures do not account for the risks of capital dependencies, either, and may leave China well-positioned to influence the U.S. perception of, and response to, Beijing's strategic intent and novel means for competing with the United States. Sequoia Capital was one of China's strongest advocates when the Trump administration debated how best to understand and respond to potential security risks posed by TikTok and its Chinese parent, ByteDance.

70. Nathan Picarsic, "U.S. Investment in China's Capital Markets and Military-Industrial Complex: U.S. National Security and China's Stock, Debt and Venture Capital and Private Equity Markets," *Testimony Before the US-China Economic and Security Review Commission*, March 19, 2021. (https://www.uscc.gov/sites/default/files/2021-03/Nate_Picarsic__Testimony.pdf)
71. Kate O'Keeffe, "Pentagon's China Warning Prompts Calls to Vet U.S. Funding of Startups," *The Wall Street Journal*, May 8, 2022. (https://www.wsj.com/articles/pentagons-china-warning-prompts-calls-to-vet-u-s-funding-of-startups-11652014803)

These inadequacies cannot be resolved without improved transparency. As China continues to invest in private markets globally, both directly and indirectly, regulators should seek to clarify the nature of ties between Chinese investors, fund managers, and portfolio companies. Executives and entrepreneurs who lead companies raising funds in the private market should demand greater transparency from their investors around limited partner profiles. Reputational and operational risks will arise from connections to the Chinese military, surveillance state apparatus, and human rights abuses — risks that investors, co-investors, and entrepreneurs generally eschew. Increased transparency should also bring continued scrutiny and study of national security implications that may arise from China's outsize role in private markets and broader weaponization of capital.

The following recommendations may address some these challenges:

- The definition of covered transactions for CFIUS reviews should be amended to include limited partnership stakes that provide indirect access to critical and emerging technologies. Similarly, CFIUS and other regulatory tools for monitoring foreign influence and control should align the standard for "controlling investments" with the reality of today's critical technology. Informational rights afforded to investors today mean as much as board seats and operational control meant in decades past.
- The SEC should expand disclosure requirements for private market investment vehicles to require, at a minimum, reporting on the receipt of investment from limited partners with ties to the CCP or to the Chinese entities that oversee Beijing's military-civil fusion strategy.
- Relevant congressional oversight authorities should be activated to monitor for risks posed by co-investment of federal funds alongside Chinese limited partners in U.S.-based investment managers.
- Similarly, federal and state-level investment authorities, including but not limited to employee pension funds, should mandate that fund managers conduct due diligence to guarantee that public and public employee funds are not supporting the CCP's military modernization, illicit technology acquisition campaign, and programs of surveillance and human rights abuses.
- New modes of public-private partnership should be explored to share information on Chinese investment patterns and objectives. Information sharing among U.S. and allied funds can serve to block inbound capital seeking influential limited partnership stakes. Over time, information sharing should also serve an offensive purpose in aiding both private- and public- sector resource allocators to fill vacuums that may result from the elimination of inbound Chinese capital. Pilot efforts to develop channels of communication and processes for collecting and validating this information could, for example, be refined by NATO's Innovation Hub.
- Other federal government bodies that monitor restrictions and controls on technology exports should establish information sharing mechanisms that guarantee awareness of Chinese limited partnership stakes and indirect access to technologies of concern.

The United States has finally gotten serious about addressing both inbound and outbound investments that risk supporting China's military modernization and human rights abuses. But measures taken thus far are both insufficient and obsolescent, as they encourage new and different evasion methods on the part of Chinese capital. To stay ahead in this race, the United States, its private-sector entrepreneurs, and asset allocators need to internalize and act on the risks posed by Beijing's private capital — including limited partner — investments.

Foundation for Defense of Democracies (FDD)

FDD is a Washington, DC-based nonpartisan research institute focusing on national security and foreign policy.

FDD's Center on Economic and Financial Power (CEFP)

FDD's Center on Economic and Financial Power studies national economic security, with a focus on how the U.S. can leverage its economic and financial power to achieve its national security objectives. CEFP promotes greater understanding of how the U.S. government can employ its economic and financial authorities to best counter its adversaries.

FDD's China Program

Leveraging the full scope of economic, financial, military, political, cyber, and technology tools, FDD's China Program exposes and challenges the wide-ranging threats posed by the Chinese Communist Party. FDD's China team includes experts with Chinese-language skills, data-driven mining capabilities to examine Chinese-language sources, and experience in government, intelligence, the military, and the technology sector.

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