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# Examining the Flow of U.S. Money into China's Military Might

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## Introduction

Chairman McCaul, Ranking Member Meeks, and distinguished members of the committee, I am grateful for the opportunity to speak before you today. We're here to peel back the layers on a matter that strikes at the core of our national security — how some of our financial engagements with China are actually strengthening its military and its intelligence services.

The unchecked flow of U.S. investments and technology to China has far-reaching implications for our national security and that of our allies. We're at a juncture where the scales of global power are tipping toward America's adversaries, not by chance, but in part because of the leverage we provide them.

## 'Military-Civil Fusion'

American know-how and capital are seeds and fertilizer from which China's formidable military might has sprouted. U.S. companies, financial institutions, and investment funds have — sometimes inadvertently, sometimes carelessly — helped underwrite and expedite the modernization of the People's Liberation Army (PLA) and China's high-tech surveillance police state. Our ingenuity and money are supplying so-called dual-use technologies: ones with civilian as well as military or other national security uses. These range from advanced semiconductors and cutting-edge artificial intelligence (AI) applications to unmanned aerial vehicles and next-generation communications systems, all of which have been integrated into Chinese military and intelligence programs. American money and the transfer of knowledge that often accompanies it allow Beijing to circumvent many of the costs and risks associated with research and development. In other words, they act to subsidize Chinese leader Xi Jinping's national ambitions at a time when China's economy is weakening.

China has built a business and regulatory ecosystem to facilitate, and even mandate, the acquisition and transfer of dual-use technologies to military and intelligence programs. China's "military-civil fusion" strategy, for example, exists to convert civilian innovations for military purposes.[1] This means that outwardly commercial entities that receive American capital can be, and, in fact, routinely are, linked to the PLA and that many U.S. investors seeking a return on their capital are blind to the strategic costs to our country.

China's strategy is exemplified by the saga of semiconductor manufacturing, where Chinese firms, backed by U.S. funds and expertise, have made significant inroads. Chips are dual-use linchpins, as essential to stealth fighters as they are to smartphones. Artificial intelligence (AI) offers a similarly sobering view of dual-use technology's potential. American investments have helped propel Chinese AI firms that are now at the forefront of commercial innovation. Yet many of those same innovations are just as useful at equipping the PLA with capabilities ranging from autonomous weapons systems to advanced surveillance.

American educational and academic research institutions have also become conduits of expertise and innovation to Chinese firms supporting China's military-industrial complex. Collaborative

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[1] Emily de la Bruyere and Nathan Picarsic, "Defusing Military-Civil Fusion," *Foundation for Defense of Democracies*, May 26, 2021. (https://www.fdd.org/analysis/2021/05/26/defusing-military-civil-fusion)

research, born out of a quest for academic advancement, is being co-opted to advance Beijing's military objectives. Chinese companies with military ties — like Megvii, SenseTime, and even Huawei — have in recent years forged partnerships with U.S. universities, effectively transforming these bastions of learning into outposts of the Chinese government's technological ambitions.[2] Left unregulated, such partnerships will contribute to the PLA's modernization in ways we won't fully understand until those capabilities are used against Americans at home and on distant battlefields.

**The Myth of the Chinese 'Private' Company**

The idea that we can easily distinguish between Chinese private enterprises with strictly commercial aims and state-backed entities that harbor military ambitions is increasingly illusory.[3] Corporate independence in today's China is a façade that tries to hide the Chinese party-state's pervasive influence over all entities, whether "private" or state-owned, civilian or military, domestic or even foreign. The Chinese regime's grip on industry is multi-faceted, intertwining regulatory and legal mandates with Chinese Communist Party (CCP) doctrine and the objectives of its "core leader" at the top. CCP party cells and party secretaries now keep watch and influence decisions within nominally private companies across China, including many foreign joint-ventures.

The CCP's omnipresence within these firms is enshrined in Chinese law. The National Intelligence Law of 2017, for instance, compels "all" organizations and citizens to secretly support, assist, and cooperate with state intelligence efforts.[4] This law, among others, like China's recently revised Counter-Espionage Law, has transmuted Chinese companies into espionage vectors for China's military.[5] The CCP's strategy of military-civil fusion has further obliterated any pretense of separation, as it systematically mandates that all technological advancements, irrespective of their origin, must be at the disposal of China's military and intelligence services.

Look no further than the case of ByteDance, the parent company of the Chinese social media platform TikTok, which has come under scrutiny for its role in amplifying pro-Beijing and antisemitic propaganda.[6] ByteDance's investors include Goldman Sachs, SoftBank Group,

[2] Craig Singleton, "The Middle Kingdom Meets Higher Education," *Foundation for Defense of Democracies*, December 9, 2021. (https://www.fdd.org/analysis/2021/12/09/the-middle-kingdom-meets-higher-education)
[3] Craig Singleton, "Beijing's Power Play," *Foundation for Defense of Democracies*, October 23, 2023. (https://www.fdd.org/analysis/2023/10/23/beijings-power-play)
[4] National Intelligence Law of the People's Republic of China, (Adopted at the 28th session of the Standing Committee of the 12th National People's Congress on June 27, 2017), (China), accessed on January 12, 2024. (https://www.chinalawtranslate.com/en/national-intelligence-law-of-the-p-r-c-2017)
[5] "China: Counterespionage Law Revised," *Global Legal Monitor*, Library of Congress, accessed on January 11, 2024. (https://www.loc.gov/item/global-legal-monitor/2023-09-21/china-counterespionage-law-revised)
[6] "Discourse Power: CCP's Strategy to Shape the Global Information Space," Select Committee on the Chinese Communist Party, U.S. House of Representatives, accessed on January 15, 2024. (https://selectcommitteeontheccp.house.gov/about/events/hearing-discourse-power-ccps-strategy-shape-global-information-space)

Sequoia Capital, Morgan Stanley, and Susquehanna International Group.[7] In 2018, ByteDance, with backing from China's Ministry of Science and Technology and Beijing's municipal government, established the Beijing Academy of Artificial Intelligence.[8] This program was part of a broader effort to use civilian AI research for military purposes and involved collaboration with three military-linked Chinese universities on research initiatives involving critical technologies.[9]

Publicly available Chinese government documents also directly link ByteDance to the Chinese government's surveillance state, including at least five Chinese surveillance companies. These companies, including iFlyTek and SenseTime, have been implicated by the U.S. government in the CCP's severe repression of the ethnic Uyghur people and were added to a U.S. government blacklist in 2019.[10] Dawning Information Industry Company, also known as Sugon, another company collaborating with ByteDance, has contributed to the simulation of nuclear weapons and testing of hypersonic glide vehicles, activities highlighted in reporting from *The Washington Post*.[11] And yet, American investments into ByteDance continue unimpeded, even to this day, and its subsidiary TikTok entrenches itself ever more deeply as a dominant source of news and information for tens of millions of Americans.

ByteDance is just one example of U.S. capital in companies tied to China's military modernization. Some others include the following:

- **4Paradigm:** Goldman Sachs and Sequoia Capital China invested in this Chinese AI firm, which reportedly sold software to China's military for "battalion command decision-making and human-machine learning."[12]

- **Microsoft Research Asia:** This Beijing-based center is a key example of how U.S. investment backs research collaboration that ends up assisting China's military modernization. It has been one of the most important institutions in the development of

[7] "Principal Investors in ByteDance," *Crunchbase*, accessed on January 12, 2024. (https://www.crunchbase.com/search/principal.investors/field/organizations/num_investors/bytedance)
[8] Rachel Lee, Prudence Luttrell, Matthew Johnson, and John Garnaut, "TikTok, ByteDance, and Their Ties to the Chinese Communist Party," Submission to the Senate Select Committee on Foreign Interference through Social Media (Australia), March 24, 2023.
[9] The three Chinese universities are: Huazhong University of Science and Technology, People's Public Security University of China, and Tsinghua University.
[10] David Shepardson and Josh Horwitz, "U.S. Blacklists Chinese Tech Firms Over Treatment of Uighurs," *Reuters*, October 9, 2019. (https://www.reuters.com/article/idUSKBN1WM25M)
[11] Greg Timberg and Ellen Nakashima, "U.S. Expands Tech Battle with China, Barring More Technology Sales," *The Washington Post*, June 21, 2019. (https://www.washingtonpost.com/technology/2019/06/21/us-expands-tech-battle-with-china-barring-more-technology-sales)
[12] Ellen Nakashima and Jeanne Whalen, "Biden administration concerned about U.S. investments in Chinese tech companies with military or surveillance ties," *The Washington Post*, December 16, 2021. (https://www.washingtonpost.com/national-security/us-investments-china-biden/2021/12/15/835876a0-5772-11ec-a808-3197a22b19fa_story.html)

China's artificial intelligence sector.[13] In 2018, academics from the lab co-authored three papers on AI with China's National University of Defense Technology.[14]

- **Biren Technology:** Biren, one of China's most advanced semiconductor designers, hopes to compete with Nvidia in China. It is on the Commerce Department's Entity List for its technology's potential ties to "weapons of mass destruction, advanced weapons systems, and high-tech surveillance."[15] Walden International and GREE VR Capital have invested in Biren.[16]
- **DJI:** This heavyweight of drone manufacturing represents some 70 percent of the global consumer drone market.[17] Some of its lead investors have been American.[18] DJI's key role in arming both sides in the ongoing war in Ukraine shows how critical a nominally civilian company could be for China's military.[19]

**Today's Limited Toolkit**

Existing tools, while seemingly robust on paper, are ill-suited or inadequate for this challenge. The only active regulatory regime that limits the flow of U.S. capital into China today is a Treasury Department blacklist called the Chinese Military-Industrial Complex Companies List. But this tool has barely been used since it was created more than three years ago.

Established by a presidential executive order in November 2020, it originally allowed the Defense Department to bar U.S. persons from investing in public securities of certain companies tied to the Chinese defense industry. The Trump administration listed 44 companies, along with 1,108 subsidiaries.[20]

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[13] Karen Weise, Cade Metz, and David McCabe, "Microsoft Debates What to Do with A.I. Lab in China," *The New York Times*, January 10, 2024. (https://www.nytimes.com/2024/01/10/technology/microsoft-china-ai-lab.html); Jeffrey Ding, "ChinAI #37: Happy 20th Anniversary to Microsoft Research Asia," *Substack*, accessed on November 19, 2018. (https://chinai.substack.com/p/chinai-37-happy-20th-anniversary)
[14] Madhumita Murgia and Yuan Yang, "China's Tech Ambitions May Upset the Global Trade Order," *Financial Times* (UK), April 10, 2019. (https://www.ft.com/content/9378e7ee-5ae6-11e9-9dde-7aedca0a081a)
[15] Entity List Additions, U.S. Department of Commerce, 88 Federal Register 71991, October 17, 2023, page 71991-71994. (https://www.federalregister.gov/documents/2023/10/19/2023-23048/entity-list-additions)
[16] "Investor Financials for Biren Technology," *Crunchbase*, accessed on January 12, 2024. (https://www.crunchbase.com/organization/biren-technology/investor_financials/investors)
[17] Nessa Anwar, "World's largest drone maker is unfazed — even if it's blacklisted by the U.S.," *CNBC,* February 7, 2023. (https://www.cnbc.com/2023/02/08/worlds-largest-drone-maker-dji-is-unfazed-by-challenges-like-us-blacklist.html)
[18] "Company Financials for DJI," *Crunchbase*, accessed on January 11, 2024. (https://www.crunchbase.com/organization/dji/company_financials)
[19] Greg Myre, "A Chinese drone for hobbyists plays a crucial role in the Russia-Ukraine war," *NPR*, March 28, 2023. **(**https://www.npr.org/2023/03/21/1164977056/a-chinese-drone-for-hobbyists-plays-a-crucial-role-in-the-russia-ukraine-war)
[20] "Communist Chinese Military Companies Listed Under E.O. 13959 Have More Than 1,100 Subsidiaries," *U.S. Department of State*, January 14, 2021. (https://2017-2021.state.gov/communist-chinese-military-companies-listed-under-e-o-13959-have-more-than-1100-subsidiaries/index.html)

In 2021, the Biden administration expanded the authority to also target surveillance technology companies linked to human rights abuses. The order, however, took a narrower approach toward subsidiaries, removing more than 1,000 impacted firms.

An even more important change was to move the authority for designating blacklisted companies away from the Department of Defense and to give it to the Treasury Department. Since then, the list has grown to a mere 68 companies. The last time Treasury added any new firms was in December 2021.[21] I will go out on a limb and posit that China has more than 68 companies involved in its military modernization and its surveillance apparatus!

Frankly, giving the Treasury Department additional authorities to target *specific* Chinese firms is unlikely to succeed when Treasury has already demonstrated insufficient will and ability to use existing tools. In fairness, even if leaders at Treasury had the will to enforce these authorities, the fact remains that it is hard to target China's military modernization company by company — as opposed to sector by sector. It is highly taxing in terms of manpower and other resources. This is particularly true given China's recent clampdowns on independent research and due-diligence firms. Simply put, acquiring accurate information about Chinese corporations, business relationships, and supply chains has never been more difficult — and is growing more difficult by the day. This opacity is a deliberate feature of Xi Jinping's China.

Fortunately, last August, the Biden administration unveiled its draft outbound investment rules that aim to take a *sector-by-sector* approach to the problem. In its current draft form, it would bar certain categories of U.S. investment — private equity, venture capital, greenfield projects, joint ventures, and some debt financing — from flowing into China's semiconductors, quantum computing, and AI sectors and require investors to notify the Treasury Department about certain investments into those sectors.

**Recommendations**

Congress has an opportunity to build on the approach taken by the Biden administration last year. As Congress considers how it should move forward in taking on this important issue of U.S. capital and know-how funding the growth of China's economy, I respectfully recommend the following:

**1. Washington should take a sectoral, not entity-based approach.** As mentioned above, the Treasury Department has demonstrated since 2021 its disinterest in using its authorities to limit investment in Chinese firms. Chinese companies also commonly dodge U.S. controls with shell firms and subsidiaries. It would instead be better to apply new rules to entire sectors.

**2. Rules should cover all strategic and military technologies.** The Biden administration's draft rules are set to impact semiconductors, artificial intelligence, and quantum computing. Proposed bipartisan legislation also seeks to strengthen outbound investment screening in the field of hypersonics. Congress and the administration should also consider other technologies listed as

[21] "NS-CMIC List - NS-CCMC List - Consolidated Sanctions List," *U.S. Department of the Treasury's Office of Foreign Assets Control*, accessed on January 12, 2024. (https://ofac.treasury.gov/consolidated-sanctions-list/ns-cmic-list)

"critical and emerging technologies" outlined by the National Science and Technology Council, such as biotechnology, directed energy, space technologies, advanced manufacturing, autonomous systems and robotics, and green energy technologies.[22]

**3. Apply rules to all kinds of investments.** The administration's rules, as currently written, will impact venture capital, private equity, greenfield, joint ventures, and certain debt financing transactions. Congress' bill should also cover investments in publicly listed companies.

**4. Impact existing transactions, not just future ones.** Biden's draft rules only apply to future investments. This leaves out investments that Washington should see every reason to unwind, including all of those listed above — into ByteDance, 4Paradigm, Biren, and Microsoft Research Asia.

**5. Block investments — don't only review them.** Mandating transparency into U.S. investment into China is a strong start to better understand the scope of the issue. Congress should also consider broadening transparency to full prohibitions of investments into targeted sectors.

Thank you for inviting me to deliver this testimony.

[22] The White House, "Critical and Emerging Technologies List Update," February 2022. (https://www.whitehouse.gov/wp-content/uploads/2022/02/02-2022-Critical-and-Emerging-Technologies-List-Update.pdf)