STATEMENT FOR THE RECORD: FOUNDATION FOR DEFENSE OF DEMOCRACIES

House Financial Services Committee
Subcommittee on National Security, Illicit Finance, and International Financial Institutions

Better Investment Barriers:
Strengthening CCP Sanctions and Exploring Alternatives to Bureaucratic Regimes

ELAINE K. DEZENSKI

Senior Director and Head
Center on Economic and Financial Power, Foundation for Defense of Democracies

Washington, DC
January 30, 2024

FDD
FOUNDATION FOR DEFENSE OF DEMOCRACIES

www.fdd.org

United States and its democratic allies around the globe are in a protracted economic conflict with the People's Republic of China. While America seeks to build a global economy based upon rules, fair play, transparency, and economic competition, China seeks to construct one that supports authoritarianism, repression, surveillance, and military aggression towards its neighbors.

Over the last decades, the United States has kept a hands-off approach to capital entering China. As a result, Western investors have helped boost China's rise, funding advanced technology and know-how that have contributed to China building one of the world's most formidable militaries. As China signals its intention for conflict across the Taiwan Strait and in the South China — or, in some circles, with the United States directly — America must have a better sense of what Western funds are entering China and for what purpose.

The U.S. government is not the only one having second thoughts about investment in China. The private sector is concerned as well. Western capital, which previously flowed into China by the billions, is now streaming out. Foreign direct investment has nosedived over the last 18 months from more than $100 billion to a negative FDI of nearly $12 billion,[1] and Chinese officials seeking funding from Europe and the United States are, for the first time, coming home empty-handed.[2]

The markets understand the risks of funding an increasingly belligerent China that seeks to overthrow the world's democracies. The government should follow the private sector's lead — thinking strategically about the tools of economic security and resilience.

This begins with reinvigorating the tools of economic statecraft — sanctions, export controls, and inbound investment reviews. But none of those tools addresses the risks posed by outbound capital that might be used to support Chinese aggression or repression. To truly counter Beijing, we must address American capital flowing into China's state-owned entities and state-manipulated private companies in ways that support its push for civil-military fusion or allow its utilization of critical tech in ways designed to counter U.S. power. We know, for instance, that over the past several years, American companies have invested billions in artificial intelligence (AI) in China,[3] and yet we have very little visibility in the precise details of those investments, what the AI is being used for, and how the Chinese military might leverage it. That is bad for America. As Representative Michael McCaul has stated: "We know that in these high-tech, dual-use sectors, more U.S. investment only harms national security."[4]

That does not mean that America should take a heavy-handed approach to cut off all capital flows to adversarial regimes. But neither should Washington ignore the risks posed by funding powerful

[1] Peter Aitken, "China records lowest foreign investment on record, experts blame new laws for stifling much-needed growth," *Fox Business*, November 8, 2023. (https://www.foxbusiness.com/economy/china-records-lowest-foreign-investment-record-experts-blame-new-laws-stifling-needed-growth); Matt Phillips, "Foreign investment in China goes negative for first time in decades," *Axios*, November 7, 2023. (https://www.axios.com/2023/11/07/china-economy-negative-foreign-investments)
[2] Lingling Wei, "Xi Jinping Chokes Off Crucial Engine of China's Economy," *The Wall Street Journal*, July 13, 2023. (https://www.wsj.com/articles/xi-china-economy-capital-investment-3439d31a)
[3] Emily S. Weinstein and Ngor Luong, "U.S. Outbound Investment into Chinese AI Companies," *Center for Security and Emerging Technology*, February 2023. (https://cset.georgetown.edu/publication/u-s-outbound-investment-into-chinese-ai-companies/#:~:text=Collectively%2C%20observed%20transactions%20involving%20U.S.,that%20came%20from%20U.S.%20investors.)
[4] U.S. House Foreign Affairs Committee, Chairman Michael McCaul, Press Release, "Chairman McCaul Delivers Remarks Restricting Outbound U.S. Investment into Chinese Companies," November 30, 2023. (https://foreignaffairs.house.gov/press-release/chairman-mccaul-delivers-remarks-restricting-outbound-u-s-investment-into-chinese-companies)

technology that could easily be used to undermine U.S. interests — or the safety of our homeland. As Senator John Cornyn has said of his insights gleaned from serving on the Senate Select Committee on Intelligence, "we're seeing huge investment by the People's Republic of China and the Chinese Communist Party in [key technologies] because of their aggressive ambitions to dominate the world."[5]

The Biden administration has taken initial steps with a narrowly focused executive order on outbound investment, but Congress has a critical role in defining this essential tool of American economic statecraft — both for the current and for future administrations. Congress should be at the forefront of outlining how the tool should be implemented, for what types of risk, and against what types of adversaries. As former Deputy National Security Advisor Matt Pottinger has emphasized,[6] sectors of concern should be expanded to include any high-risk technologies currently under development and emerging technologies that may be developed in the future. Pottinger also makes the excellent suggestion that Congress should consider widening the scope of application beyond just investment vehicles like venture capital and private equity to also cover direct investment in publicly listed companies that serve the Chinese state.

At the very least, America must have a better sense of what funds are going *where* and *why*. Currently, the U.S. government has very little visibility on American cash, technology, and know-how that might be funding critical Chinese industries with military applications, like artificial intelligence, advanced semiconductors, hypersonics, and quantum computing. As a first step, America should be collecting basic information about such investments and coordinating with allies to ensure that we are not, inadvertently, funding China's war machine. As Senator Bob Casey has explained the risk of our current lack of visibility, "every month that goes by that we don't have eyes on [outbound investment flows] becomes an even greater threat to our national security."[7]

Increased visibility, however, should only be a first step. Building a meaningful outbound screening mechanism to rival CFIUS's inbound screening should be key part of America's defensive economic arsenal — used in a limited but meaningful fashion to align Western capital with American and democratic security. Doing so will signal to markets, investors, and authoritarian governments that critical sectors will be defended against adversarial regimes.

As the private sector has already indicated, a natural realignment of capital is underway — moving out of countries that seek to disrupt the global order and towards those that support the rules-based order. America should help that process along by passing meaningful outbound investment legislation.

[5] Elaine Dezenski, "Bolstering American Economic Statecraft: A Conversation with Senators Cornyn and Casey on Outbound Investments," *Foundation for Defense of Democracies*, September 27, 2023. (https://www.fdd.org/wp-content/uploads/2023/09/fdd-events-Bolstering-American-Economic-Statecraft-A-Conversation-With-Senators-Cornyn-and-Casey-on-Outbound-Investments-1.pdf)

[6] Matt Pottinger, "Examining the Flow of U.S. Money into China's Military Might," *Testimony Before the House Foreign Affairs Committee*, January 17, 2024. (https://www.fdd.org/analysis/2024/01/17/examining-the-flow-of-u-s-money-into-chinas-military-might)

[7] Elaine Dezenski, "Bolstering American Economic Statecraft: A Conversation with Senators Cornyn and Casey on Outbound Investments," *Foundation for Defense of Democracies*, September 27, 2023. (https://www.fdd.org/wp-content/uploads/2023/09/fdd-events-Bolstering-American-Economic-Statecraft-A-Conversation-With-Senators-Cornyn-and-Casey-on-Outbound-Investments-1.pdf)