SECTION 2: CHINESE INVESTMENT IN THE UNITED STATES

Key Findings

- Chinese government policies, coupled with increased investor uncertainty in China, have contributed to increased investment flows to the United States in recent years. In 2017, Chinese investment flows to the United States are expected to decline relative to 2016 as the Chinese government seeks to limit capital outflows and fend off risks from mounting corporate debt.
- Sectors of the U.S. economy deemed strategic by the Chinese government are more likely to be targeted by Chinese firms for investment, while Chinese investments in nonstrategic sectors like entertainment, real estate, and hospitality are declining amid Chinese Communist Party efforts to limit capital outflows and reduce corporate debt.
- Some Chinese firms seek to obscure their dealings in the United States through U.S.-based shell companies or attempt to drive down the value of U.S. assets through sophisticated cyber espionage campaigns. These firms are becoming more sophisticated in their attempts to circumvent Committee on Foreign Investment in the United States (CFIUS) reviews and other U.S. investment regulations.
- Greenfield investments in the United States are not subject to the CFIUS review process, which may raise national security risks. Although the number of Chinese greenfield investments in the United States remains limited compared to acquisitions of U.S. assets, federal laws and screening mechanisms do not sufficiently require federal authorities to evaluate whether a greenfield investment may pose a national security threat.
- The application of the sovereign immunity defense to commercial cases presents a potential risk for U.S. businesses and individuals, allowing Chinese state-owned enterprises (SOEs) to conduct unlawful activity in the United States without legal consequences. Some Chinese SOEs are evading legal action in the United States by invoking their status as a foreign government entity under the Foreign Sovereign Immunities Act.
- The opaque nature of China's financial system makes it impossible to verify the accuracy of Chinese companies' financial disclosures and auditing reports. Chinese businesses continue to list on U.S. stock exchanges to raise capital, despite operating outside the laws and regulations governing U.S. firms.
- U.S. regulators have struggled to deter Chinese fraud schemes on U.S. exchanges, with Chinese issuers stealing billions of dol-

lars from U.S. investors. Efforts to prosecute the issuers of the fraudulent securities have been unsuccessful, with Chinese regulators choosing not to pursue firms or individuals for crimes committed by Chinese companies listed overseas.

- Some Chinese companies operate with little oversight under China's opaque financial system, leaving U.S. investors exposed to exploitative and fraudulent schemes perpetrated by China-based issuers. Negotiations between the Public Company Accounting Oversight Board and its counterparts in China have resulted in little progress toward securing increased cross-border transparency and accountability.

Recommendations

The Commission recommends:

- Congress consider legislation updating the Committee on Foreign Investment in the United States (CFIUS) statute to address current and evolving security risks. Among the issues Congress should consider are:
  - Prohibiting the acquisition of U.S. assets by Chinese state-owned or state-controlled entities, including sovereign wealth funds.
  - Requiring a mandatory review of any transaction involving the acquisition of a controlling interest in U.S. assets by Chinese entities not falling under the above class of acquiring entities.
  - Requiring reviews of investments in U.S.-based greenfield assets by Chinese-controlled entities to assess any potential harm to U.S. national and economic security.
  - Expanding the definition of "control" to include joint ventures, venture capital funds, licensing agreements, and other arrangements or agreements that enable Chinese entities to access and/or determine the disposition of any asset.
  - Prohibiting any acquisition or investment that would confer "control" with regard to critical technologies or infrastructure. The U.S. Departments of Homeland Security, Commerce, and Defense shall prepare and regularly update a list of critical technologies or infrastructure that would not be eligible for acquisition or investment by any Chinese entities to ensure U.S. economic and national security interests are protected.
  - Including a net economic benefit test to assess the impact of acquisitions by Chinese entities in the United States to ensure they advance U.S. national economic interests.
  - Requiring that any proposed acquisition of a media property by a Chinese entity be assessed in terms of the acquiring entity's history of adhering to Chinese Communist Party propaganda objectives and its potential to influence public opinion in the United States.
  - Authorizing an independent review panel, appointed by Congress, to review the actions and activities of CFIUS on a continuing basis.

  - Allowing any CFIUS member agency to bring a transaction up for review and investigation.
- Congress consider legislation conditioning the provision of market access to Chinese investors in the United States on a reciprocal, sector-by-sector basis to provide a level playing field for U.S. investors in China.
- Congress amend the Foreign Sovereign Immunities Act (FSIA) of 1976 to:
  - Allow U.S. courts to hear cases against a foreign state's corporate affiliates under the commercial activity exception.
  - Require Chinese firms to waive any potential claim of sovereign immunity if they do business in the United States.
- Congress consider legislation to ban and delist companies seeking to list on U.S. stock exchanges that are based in countries that have not signed a reciprocity agreement with the Public Company Accounting Oversight Board (PCAOB).

Introduction

China is increasing its investments in the United States, particularly in sectors deemed strategic by the Chinese Communist Party (CCP). These investments support the global competitiveness of Chinese firms by allowing them to access capital and technologies not available in their home market. Chinese mergers and acquisitions in the United States present a new set of challenges, not just for U.S. businesses and economic interests, but also for regulators protecting vital U.S. national security interests.

Chinese companies are also increasing their presence on U.S. stock markets. Today, around 130 Chinese companies are listed on major U.S. stock exchanges, including Chinese Internet giants Alibaba, Tencent, and Baidu. However, the complex legal structures of these U.S. listings, as well as China's state secrecy laws and opaque auditing practices allow some Chinese companies to shield themselves from U.S. legal and regulatory jurisdiction. As a result, these listings could pose significant risks for unsuspecting U.S. investors who buy into U.S.-listed Chinese companies.

This section examines trends and implications of increased Chinese investment in the United States, and the activities of Chinese companies listed on U.S. stock exchanges. In doing so, it draws from the Commission's January 2017 hearing on Chinese investment in the United States, contracted research, consultations with economic and foreign policy experts, and open source research and analysis.

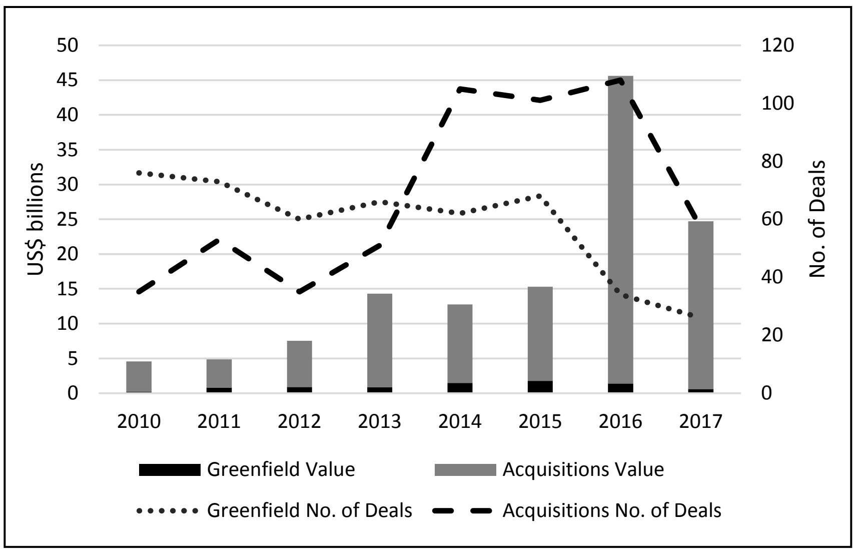
Chinese Investment in the United States

Chinese annual foreign direct investment (FDI) flows to the United States have increased significantly in recent years, fueled by the pursuit of higher returns abroad amid China's economic slowdown and government policies encouraging investment abroad. Official statistics from the U.S. Bureau of Economic Analysis indicate the United States attracted more than $373 billion of global FDI flows in 2016, of which around $27.6 billion, or 7.4 percent, came from

China.[1] However, official estimates do not include Chinese entities based outside China, suggesting the actual level of FDI flows from China is much higher.* From 2010 to 2016, the private U.S. economic consultancy Rhodium Group estimates annual Chinese investment in the United States rose from $4.6 billion to $46.2 billion.[2]

Through the first half of 2017, Rhodium Group estimates Chinese FDI flows to the United States totaled $24.7 billion.[3] Based on January to August 2017 data, Rhodium Group estimates Chinese investment will total between $25 and $30 billion by the end of the year.[4] The expected slowdown in China's FDI flows to the United States in 2017 is the result of Beijing's efforts to tighten controls on capital outflows, limiting Chinese firms' ability to invest money abroad (this emerging trend is discussed in greater detail in "Drivers of Chinese Investment," later in this section).[5]

Figure 1: Chinese Investment in the United States, 2010–H1 2017



Source: Rhodium Group, "China Investment Monitor." *http://rhg.com/interactive/china-investment-monitor.*

*Unless noted otherwise, this section relies on private estimates of Chinese FDI in the United States from Rhodium Group. Both U.S. and Chinese official statistics underestimate the volume of Chinese investment because they do not fully account for flows of FDI, including investment routed through Hong Kong and other offshore financial centers. Official data are also provided after a significant delay, hindering analysis. For example, as the International Trade Administration (ITA), a bureau within the U.S. Department of Commerce, stated in a 2013 report produced at the Commission's recommendation, estimates from Rhodium Group showed $6.5 billion of FDI flows from China to the United States in 2012, while U.S. government estimates showed only $219 million for the same year. ITA noted that private sector valuations employ different definitions of FDI, data gathering mechanisms, and accounting methods that lead to differences in reported value of investments. U.S. Department of Commerce, International Trade Administration, *Report: Foreign Direct Investment (FDI) in the United States from the China and Hong Kong SAR*, July 17, 2013.

Rhodium Group's 2016 Report Highlights Increasing Chinese Investment

In the 2016 report *Chinese Investment in the United States: Recent Trends and the Policy Agenda* contracted by the Commission, Rhodium Group assessed recent patterns of Chinese investment in the United States. The report's key findings include:

- Chinese global outbound investment has increased rapidly in recent years, but there remains significant room for additional growth. If China's outbound investment follows the historical trend of other emerging economies, its global outbound FDI stock will increase by hundreds of billions of dollars in the next decade.
- Chinese government policies impact Chinese outbound FDI indirectly (through economic policies) and directly (through financial incentives and other policies encouraging foreign investment in strategic sectors).
- Chinese investment in the United States presents unique economic and national security challenges because China has a non-democratic political system without rule of law and allows the state to intervene heavily in the economy.
- The discrepancy between market access for Chinese investors in the United States and U.S. investors in China remains a key concern, particularly in industries dominated by large Chinese state-owned enterprises (SOEs).*

There are potential economic benefits of investment: Chinese FDI can help U.S. firms secure the capital necessary to grow their business and hire more workers (or save workers' jobs), leading to an expansion of the U.S. tax base, improving productivity, and raising overall competitiveness.[6] In 2016, Rhodium Group estimates Chinese companies added approximately 50,000 U.S. jobs, bringing the total number of U.S. jobs provided by Chinese companies to 141,000.† However, Chinese investment can also pose risks to the United States, with Chinese FDI targeting sectors of strategic importance to the United States. Given the state's controlling position in the Chinese economy and the opaque nature of its role in business activities, these investments raise concerns about the ability of U.S. regulators to manage the risks of investment from state-influenced entities. Chinese investments, for example, raise concerns about the transfers of valuable U.S. technologies to China.[7] They can also make it more difficult for U.S. firms to compete in international markets due to the anticompetitive practices of many Chinese firms.[8]

*For the full report, see Thilo Hanemann and Daniel H. Rosen, "Chinese Investment in the United States: Recent Trends and the Policy Agenda," *Rhodium Group* (prepared for the U.S.-China Economic and Security Review Commission), December 2016.

†These employment figures only account for full-time jobs provided directly by U.S. subsidiaries of Chinese companies. The majority of U.S. jobs provided by Chinese firms were acquired during mergers and acquisitions. Daniel H. Rosen and Thilo Hanemann, "New Neighbors 2017 Update: Chinese FDI in the United States by Congressional District," *Rhodium Group*, April 2017, 4.

Drivers of Chinese Investment

A combination of Chinese government policies and increased investor uncertainty in China contributed to the rise of investment outflows to the United States from 2010 to 2016. Some factors driving China's increased investment in the United States during this period include:

- *Pursuit of advanced technologies:* China's industrial policy seeks to enhance indigenous innovation and develop the country's high-technology and environmental industries (including biotechnology, high-end manufacturing equipment, and new-generation information technology).[9] To this end, the government laid out policies in its 13th Five-Year Plan* and other state plans offering a combination of tax incentives and subsidies to encourage investment in research and development (R&D) and advanced technologies while boosting market demand for Chinese products and firms (for more on China's policies relating to the development of advanced technologies, see Chapter 4, Section 1, "China's Pursuit of Dominance in Computing, Robotics, and Biotechnology").[10]
- *Higher returns abroad:* With the renminbi's (RMB) depreciation in recent years and rising concerns over the stability of China's economy, Chinese investors increasingly look for returns abroad, particularly in low-risk environments like the United States.[11] According to data from China's State Administration of Foreign Exchange, capital outflows from China totaled around $647 billion in 2015 and $640 billion in 2016, up from $118 billion in 2014.[12]
- *Reduced bureaucratic red tape:* In 2013 and 2014, China's State Council updated its regulations for outbound FDI, raising outbound investment approval limits and removing regulatory requirements for nonstrategic investments.[13] As a result, the threshold for approving overseas investments by local firms and deals increased from $300 million to $1 billion, with most deals under the threshold not requiring approval from the National Development and Reform Commission (NDRC).[14] In 2015, the State Administration of Foreign Exchange also streamlined the review process for foreign exchange approvals, giving local bank branches the authority to verify exchanges for outbound investments.[15] These measures aim to decentralize investment management and deepen the role of markets in resource allocation, leading to reduced investment review periods and increased outbound flows, particularly for private companies investing in nonstrategic sectors.[16]
- *Political uncertainty:* Chinese President and General Secretary of the CCP Xi Jinping's anticorruption campaign began in 2013, and has spurred capital outflows as many Chinese officials and businesspeople move their wealth abroad in hopes of avoiding government scrutiny and having their assets seized.[17] According to China's Central Commission for Discipline Inspection, in the first half of 2017 more than 210,000 Chinese officials were punished for corruption.†

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*For more information on China's 13th Five-Year Plan and related state plans and their targets, see Katherine Koleski, "The 13th Five-Year Plan," *U.S.-China Economic and Security Review Commission*, February 14, 2017.

†Among those convicted of graft and other corruption charges were eight provincial and ministerial officials in June 2017, whose sentences included terms of up to life in prison. Xinhua,

More recently, the Chinese government is attempting to limit capital outflows and fend off risks from mounting corporate debt, making it unlikely Chinese FDI in 2017 will reach 2016 levels.[18] In the final months of 2016, FDI flows became more restricted as Chinese regulators began cracking down on "irrational" FDI outflows (or investments that do not support government objectives) and ramping up measures to stem capital outflows amid fears of capital flight.[19] Government measures to limit investments include:

- *Capital controls:* In November 2016, Reuters reported China's State Administration of Foreign Exchange had begun reviewing capital transfers abroad worth $5 million or more and would be increasing scrutiny of all outbound deals as well as re-reviewing deals that already received government approval.[20]
- *Reviews of large overseas deals:* In the first half of 2017, Chinese banking regulators began increasing regulatory scrutiny of deals by large overseas investors like Anbang Insurance Group, HNA Group, and Dalian Wanda Group as part of a government effort to limit capital outflows and fend off risks from mounting corporate debt.[21] New regulations include barring state-owned banks from making loans to large private firms investing overseas, a decision that was approved in June 2017 by President Xi.[22] The China Banking Regulatory Commission is also taking the lead on investigating whether certain companies used high-interest financial products and overseas loans to finance foreign deals.[23]
- *Restrictions on extralegal forms of financing:* Since June 2017, Chinese companies that rely on extralegal forms of funding—including high-interest financial products and overseas loans—to finance overseas deals have been temporarily banned from selling new products and are undergoing reviews of their past financial filings and records of past deals. The ban came after Chinese firms like Wanda, Fosun, HNA Group, and Anbang increased their investments abroad using offshore financing and money raised by issuing financial products that are not controlled by the Chinese government.[24] In response to the new policy, Wanda's founder Wang Jianlin has pursued what he describes as an "asset-light" strategy, selling off properties that require loans to operate; in June 2017, Wanda sold off 13 of its China theme parks to the real estate firm Sunac China for $6.5 billion and 77 of its hotels to the Chinese property developer R&F Properties for $3 billion.[25]
- *Crackdown on "irrational" investments:* In August 2017, China's State Council announced new policies to discourage what it refers to as "irrational" foreign investments.[26] According to the NDRC, some Chinese firms were pursuing imprudent foreign deals that resulted in significant financial losses and did not advance Chinese government objectives.[27] To crack down on these practices, the Chinese government divided outbound investment into three categories—encouraged, restricted, and banned.[28] Encouraged investments include deals that promote the One

"China Focus: Conviction of 8 'Big Tigers' Heralds Prolonged Anti-Graft Fight," June 1, 2017; Xinhua, "210,000 Officials Punished for Discipline Violations in H1," July 20, 2017.

Belt, One Road initiative, export excess domestic production capacity, and build up China's technology and innovation capacity. These deals will receive government support, including accelerated regulatory review processes and financial support from state banks. Restricted investments—such as deals in real estate, hotels, entertainment, and professional sports teams—will be subject to closer government scrutiny, and may be rejected or delayed indefinitely under the new guidelines.[29] Banned investments, meanwhile, are those that may impede China's national interest and national security, including deals seeking to export core technologies.[30] Deals that that do not fall into these categories will be subject to normal regulatory review processes.[31]

Trends in Chinese Investment

In 2016, acquisitions accounted for 96 percent of Chinese investment in the United States by value.[32] Meanwhile, capital-intensive greenfield investments—including manufacturing plants, real estate developments, and R&D-intensive projects—accounted for only 4 percent of all U.S.-bound Chinese investments in 2016.[33] This trend continued in the first half of 2017, with acquisitions comprising 97.6 percent of the total value of Chinese investment in the United States.[34]

As seen in Table 1, Chinese FDI in 2016 primarily targeted U.S. real estate, consumer products and services, and transportation, with combined investments in these sectors accounting for nearly 63 percent of China's total 2016 FDI in the United States.[35] Between 2010 and 2016, Chinese investment in these three sectors combined increased by nearly $27 billion.[36] In the first half of 2017, the leading targets of Chinese investment included U.S. transportation ($10.4 billion), real estate ($10.3 billion), and biotechnology ($1 billion).[37]

Table 1: Chinese FDI Flows to the United States by Sector, 2010 and 2016
(US$ billions)

Sector	2010	2016
Real Estate & Hospitality	0.22	17.33
Transportation	0.04	6.04
Consumer Products & Services	0.05	5.65
Entertainment	0	4.78
Electronics	0.01	4.24
Information and Communication Technology	0.22	3.30
Other	3.87	2.94
Finance	0.18	1.93
Total	**4.6**	**46.2**

Source: Rhodium Group, "China Investment Monitor." *http://rhg.com/interactive/china-investment-monitor.*

According to the U.S. Bureau of Economic Analysis, China accounted for 7.4 percent of U.S. investment inflows in 2016, making it the fifth largest source of FDI behind Canada (15.6 percent), the United Kingdom (14.6 percent), Ireland (9.5 percent), and Switzerland (9.3 percent).[38] Many Chinese investments in the United States have come in the form of multimillion-dollar deals (see Table 2), some of which warrant close scrutiny by U.S. regulators because of the CCP's central role in Chinese firms' foreign investment decisions and the potential national security risks posed. Several of these large Chinese acquisitions have drawn congressional attention, with lawmakers urging caution over Chinese bids for Lattice Semiconductor, Legendary Entertainment, and Syngenta AG, among others.[39]

Table 2: Chinese Investments in the United States of $1 Billion or More, Jan. 2016–Jun. 2017

Chinese Buyer	U.S. Target	Price (US$ billions)	Status	Industry
Dalian Wanda	Legendary Entertainment	$3.5	Deal closed, Mar. 2016	Entertainment
Zhuhai Seine Technology	Lexmark (*70% stake*)	$3.4	Deal closed, Apr. 2016	Electronics and IT
Haier Group	General Electric appliance division	$5.4	Deal closed, Jun. 2016	Home appliances
Didi Chuxing	Uber (*2% stake*)	$1.0	Deal closed, Aug. 2016	Transportation
Orient Securities	AppLovin	$1.4	Deal closed, Sept. 2016	Electronics and IT
Anbang	Blackstone Group Strategic Hotels & Resorts Inc.	$5.7	Deal closed, Oct. 2016	Real estate
HNA	Hilton Worldwide (*25% stake*)	$6.5	Deal closed, Oct. 2016	Real estate
HNA	Carlson Hotels	$2.0	Deal closed, Dec. 2016	Real estate
HNA	Ingram Micro	$6.0	Deal closed, Dec. 2016	Electronics and IT
Chian Investment Corp.	Invesco	$1.0	Deal closed, Dec. 2016	Real estate
Tencent	Tesla (*5% stake*)	$1.8	Deal closed, Mar. 2017	Transportation
HNA	245 Park Avenue	$1.6	Deal closed, Mar. 2017	Real estate
HNA	CIT Group	$10.4	Deal closed, Apr. 2017	Transportation
Zhongwang USA LLC	Aleris Corp.	$2.3	Pending, agreed to acquire Aug. 2016	Aluminum

Table 2: Chinese Investments in the United States of $1 Billion or More, Jan. 2016–Jun. 2017—*Continued*

Chinese Buyer	U.S. Target	Price (US$ billions)	Status	Industry
Oceanwide Holdings	Genworth Financial	$2.7	Pending, agreed to acquire in Oct. 2016	Insurance

Source: Various.[40]

Chinese Investment by Ownership

The Chinese government maintains significant influence over private firms' investment decisions—including encouraging, modifying, or banning deals based on the specific industries, geographies, and technologies involved—by utilizing a mix of financial incentives, political arrangements, and agreements among company shareholders.[41] Through these measures, the CCP maintains influence over the activities of public and private firms alike, offering direct and indirect subsidies and other incentives to influence business decisions and achieve state goals.* As Rhodium Group's director Thilo Hanemann testified to the Commission, "the notion of a private enterprise is a very different concept in China. … I do believe that we should assume that any company, whether it's nominally state-owned or private, can be influenced and to some extent controlled by the Chinese government and ultimately by the Communist Party."[42]

SOEs previously accounted for the majority of Chinese FDI flows to the United States, making up 58 percent of annual Chinese investment in the United States as recently as 2011.[43] By 2016, that share was down to 21 percent, with private companies (defined by Rhodium Group as companies with less than 20 percent state ownership) becoming the leading source of Chinese FDI in the United States.[44] This reflected a global trend as private Chinese companies increased their outbound investment due to the growth of the private sector in China, rising uncertainty over the future investment return of Chinese assets, concern for the future political climate in China, and the easing of policies limiting investment outflows.[45] This trend continued in the first half of 2017, with Chinese companies that call themselves privately owned accounting for 98.4 percent of Chinese investment in the United States.[46]

Although the Chinese government's influence extends to all sectors of the economy, Beijing is primarily focused on firms operating in strategic sectors that advance the government's political and economic interests (for more on China's industrial and technology development policies, see Chapter 4, Section 1, "China's Pursuit of Dominance in Computing, Robotics, and Biotechnology").[47] Along with investment in U.S. real estate, sectors of the U.S. economy that serve a strategic purpose for the CCP are more likely to be targeted by the Chinese government for investment, with Beijing exercising its influence to coordinate investment efforts in both the private and public sectors.[48]

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*For more on the role of SOEs in China's economy, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 2, "State-Owned Enterprises, Overcapacity, and China's Market Economy Status," in *2016 Annual Report to Congress*, November 2016, 92–103.

U.S. Reviews of Chinese Investment

With Chinese FDI flows to the United States on the rise, reviews of foreign investment have become an increasingly important tool for safeguarding U.S. national security interests. The Committee on Foreign Investment in the United States (CFIUS) is the primary government body tasked with reviewing any merger, acquisition, or takeover that would result in "foreign control of any person engaged in interstate commerce in the United States."[49] CFIUS, an executive interagency committee chaired by the U.S. Department of the Treasury, determines whether a covered* foreign investment transaction (1) poses a threat to the national security of the United States; (2) involves a foreign entity controlled by a foreign government; or (3) would result in control of any critical infrastructure that could harm U.S. national security interests. If a determination has been made that an acquisition jeopardizes national security, the transaction can be exempted from review only by the Secretary of the Treasury, in concert with any other specified officials relevant to the investigation.[50]

CFIUS comprises nine members and two ex officio members,† as well as other secretaries or heads of relevant U.S. agencies appointed by the president for a given investigation. For any covered transaction, CFIUS is allotted 30 days to conduct its review and, if necessary, 45 days to conduct an investigation and make a recommendation. During the review period, the Director of National Intelligence carries out an analysis of the deal's national security implications in consultation with all affected or relevant intelligence agencies. After the CFIUS review and investigation period is completed, the president of the United States has 15 days to decide whether to suspend, make changes to, or prohibit the investment.[51] There is also an informal review period for an unspecified length of time prior to the start of the formal review process, which allows both the Committee and the firms involved to identify potential issues before the formal review process begins. The review process has evolved to allow companies to refile with CFIUS if no decision is reached within this timeframe.[52] On occasion, CFIUS members also negotiate conditions with firms to mitigate or remove assets that raised national security concerns. A single lead agency modifies, monitors, and enforces mitigation agreements to account for the nature of the threat posed by a given transaction.‡

The CFIUS process is voluntary, so companies may choose not to file a transaction with CFIUS even if the deal involves potential national security concerns.[53] However, CFIUS can also initiate an investigation on its own, and can demand that the deal be unwound

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*Covered transactions are defined as any merger, acquisition, or takeover resulting in "foreign control of any person engaged in interstate commerce in the United States." Defense Production Act of 1950 § 721 (Amended by the Foreign Investment and National Security Act of 2007), Public Law No. 110–49, 2007.

†The nine permanent members are the Secretaries of State, Treasury, Defense, Homeland Security, Commerce, and Energy; the Attorney General; the United States Trade Representative; and the Director of the Office of Science and Technology Policy. The nonvoting, ex officio members are the Director of National Intelligence and the Secretary of Labor. Defense Production Act of 1950 § 721 (Amended by the Foreign Investment and National Security Act of 2007), Public Law No. 110–49, 2007; James K. Jackson, "The Committee on Foreign Investment in the United States (CFIUS)," *Congressional Research Service*, June 13, 2017, 14.

‡For more on the CFIUS review process, see James K. Jackson, "The Committee on Foreign Investment in the United States (CFIUS)," *Congressional Research Service*, June 13, 2017, 20.

or restructured on security grounds if a deal is considered a security risk, even after the deal has been completed.[54] CFIUS can initiate a review and investigation of a given transaction if there is a consensus among the Committee's constituent agencies.[55] Yet in practice, the frequency of cross-border transactions in the United States* makes it difficult for CFIUS and its member agencies to identify all transactions with national security implications. In 2015 (the most recent data available), CFIUS reviewed 143 transactions and proceeded to investigate 66 deals.† Between 2009 and 2015, CFIUS reviewed a total of 770 transactions, of which 310 resulted in an investigation.[56]

Because CFIUS does not have the resources to review every cross-border deal, a list of "non-notified transactions"—deals that have not been voluntarily notified to CFIUS but may present national security concerns—is maintained by CFIUS member agencies.[57] According to Giovanna Cinelli, a partner at the global law firm Morgan Lewis, "These non-notified transactions remain within the Committee's purview and may, at times, be used by the Committee to reach out to parties to request a notification. Given that thousands of cross-border investments occur each year, it is not unexpected that the Committee is aware of, and maintains a list of, these types of investments."[58] Rather than review every transaction with potential national security risks, CFIUS member agencies use the list of non-notified transactions to monitor deals and assess whether a full review and investigation is necessary.[59]

According to Robert Atkinson, founder and president of the Information Technology and Innovation Foundation, CFIUS has been an effective tool for regulating foreign investment, particularly in high-technology industries.[60] For example, in the U.S. semiconductor industry, CFIUS either outright rejected or caused investors to withdraw from at least seven deals involving Chinese companies between 2015 and September 2017.[61] Mr. Hanemann also believes CFIUS has "generally handled the influx of Chinese investment well thus far," arguing the Committee has largely succeeded in permitting beneficial investments while addressing concerns about acquisitions that may pose risks to U.S. national security interests.[62]

Yet other experts and some members of Congress believe CFIUS can no longer adequately protect the United States's most sensitive industries or economic interests. For example, in a June 2017 speech, Senator John Cornyn (R-TX) discussed CFIUS's weaknesses—including that it does not appropriately examine the motivations of foreign governments investing in key U.S. technology companies—and warned that China is "stealing and copying [U.S.] technology to modernize its arsenal and erode our military superiority [and] strategically investing in key sectors of the U.S. economy."[63] In August 2017, Senator Charles Schumer (D-NY) unveiled a proposal to create an American Jobs Security Council with the authority to review and block foreign purchases of U.S. companies based on their potential economic impact.[64] Senator Schumer billed the proposal as

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*According to the United Nations Conference on Trade and Development, in 2016 the United States was the top recipient of FDI in the world. UNCTAD, *World Investment Report 2017*, July 2017, 222–229.

†In 2015, China alone initiated 173 investments in the United States. American Enterprise Institute, "China Global Investment Tracker." *http://www.aei.org/china-global-investment-tracker/*.

a way to limit the detrimental impacts of Chinese investment in the United States, including taking U.S. jobs and intellectual property.[65] Although the number of Chinese greenfield investments in the United States remains limited compared to acquisitions, greenfield deals may also pose a risk to U.S. national security because they are not included in the CFIUS review process.[66]

Chinese Firms Obscure U.S. Investments

Chinese firms are becoming more sophisticated in their attempts to circumvent CFIUS reviews and other U.S. investment regulations. Some Chinese companies may take advantage of the voluntary nature of the CFIUS process to avoid scrutiny. For example, in November 2015, the Chinese investment firm Fosun International acquired Wright USA, a liability insurance provider to senior U.S. officials at the Central Intelligence Agency and Federal Bureau of Investigation, without notifying CFIUS. It was not until a month after the acquisition was complete that CFIUS expressed concern about the purchase and began reviewing the deal to determine whether it had granted Chinese agencies access to the personal information of tens of thousands of U.S. intelligence and counterterrorism officials. One of the national security issues raised was that Fosun's chairman, Guo Guangchang, was a representative in the Chinese People's Political Consultative Conference and had deep connections to the CCP—connections the firm neglected to mention to its policy holders even after the CFIUS review process was initiated.[67] Fosun ultimately divested from Wright USA in September 2016, leading to speculation the CFIUS review prompted the divestiture.[*][68]

Other Chinese firms attempt to obscure their dealings in the United States via U.S.-based shell companies. One notable example is Canyon Bridge Capital Partners' failed November 2016 bid to acquire U.S. chipmaker Lattice Semiconductor for $1.3 billion.[69] Canyon Bridge was a newly created private equity firm based in California and funded solely by China Reform Holdings, an investment holding company controlled by China's State Council with indirect links to the Chinese government's space program.[70]

China Reform Holdings entered into initial talks with Lattice in April 2016, a few months before Canyon Bridge was created.[71] However, China's ties to Lattice started as early as 2004, when Lattice paid a $560,000 civil fine for illegally exporting products to China.[72] In 2012, two Chinese nationals were indicted for violating export controls after trying to smuggle Lattice chips to China.[73] Four years later, Chinese state-owned chipmaker Tsinghua Unigroup purchased a 6 percent stake in Lattice—around the same time China Reform Holdings first contacted Lattice about a potential deal—before selling off its shares a few months later, just weeks before the Canyon Bridge deal was announced in November 2016.[74] The Chinese government's repeated attempts to access Lattice's technologies raise national security concerns, with the acquisition potentially motivated by political factors (such as furthering industrial policies laid out by the CCP) rather than commercial considerations. Although

* For more on the national security risks presented by the Wright USA acquisition and other Chinese acquisitions of U.S. assets, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 1, "Year in Review: Economics and Trade," in *2016 Annual Report to Congress*, November 2016, 63–64.

Lattice does not sell chips to the U.S. military, it manufactures a type of military-grade microchip that its two biggest rivals, Xilinx Inc. and Intel Corp.'s Altera, sell to the U.S. military, making Lattice's acquisition a potential national security concern (for more on China's pursuit of semiconductor technology, see "Investment in U.S. ICT," later in this section).[75]

Canyon Bridge's ties to the Chinese government attracted congressional attention, with 22 lawmakers writing to then U.S. Treasury Secretary Jack Lew in December 2016 to voice concerns that the deal could disrupt U.S. military supply chains and pose national security risks.[76] Canyon Bridge resubmitted the deal for review in March 2017 and again in June 2017 after the 75-day limit for CFIUS to conduct its assessment expired.[77] After CFIUS recommended the deal be blocked in August 2017, Canyon Bridge appealed directly to President Donald Trump to approve the deal.[78] The next month, President Trump blocked the deal on national security grounds, including concerns over "the potential transfer of intellectual property to the foreign acquirer, the Chinese government's role in supporting this transaction, the importance of semiconductor supply chain integrity to the United States Government, and the use of Lattice products by the United States Government."[79]

Duress Acquisitions of U.S. Companies

There is some evidence that the rise of Chinese investment in the United States might also be accompanied by alleged attempts to drive down the value of U.S. assets through sophisticated cyber espionage campaigns. According to Jeffrey Johnson, chief executive officer (CEO) of the cybersecurity firm SquirrelWerkz, Chinese actors are using a combination of cyber espionage and human infiltration tactics to penetrate strategic U.S. R&D-intensive and advanced technology industries in order to steal their intellectual property (IP), sabotage operations, and reduce their market value. After these coordinated campaigns lower the target company's value, the company is acquired by a Chinese entity at a dramatically reduced price.[80]

In testimony to the Commission, Mr. Johnson alleges that in the early 2000s the Chinese government waged one such cyber economic campaign against the U.S. mobile phone industry.[81] The campaign, led primarily by actors seeking to benefit Chinese telecommunications firms Huawei and ZTE, allegedly sought to sabotage U.S. mobile provider Motorola, which Mr. Johnson described as "heavily infiltrated" by Chinese actors as early as 2001.[82] These activities were not detected until more than a decade later, in 2013, when a U.S. federal court found a former Motorola employee guilty of stealing trade secrets and attempting to deliver them to China.[83] A little more than one year before the trade secrets case, Motorola had come under financial duress and sold off a segment of its operations, called Motorola Mobility, to Google for $12.5 billion.[84] In January 2014, Google sold the struggling Motorola business to the Chinese technology firm Lenovo for less than $3 billion.[85]

Mr. Johnson believes this strategy is not unique to the case of Motorola, but can be seen in similar campaigns waged in at least 20 other key industries, including media and entertainment, banking and financial services, and semiconductors.[86] His research indicates the CCP seeks to sabotage and degrade the value of high-tech U.S. industries through espionage and the introduction of market barriers in China. This strategy puts U.S. companies at risk of losing billions of dollars in critical technologies to Chinese competitors, and threatens to equip foreign actors with access to classified and sensitive engineering documents and dual-use technologies that pose a direct threat to U.S. national security.[87]

Chinese Government Conducts Coordinated Cyber Economic Espionage Campaigns against U.S. Companies

In testimony before the Commission, Mr. Johnson provided several examples of the methods and tactics Chinese companies allegedly use to conduct cyber espionage campaigns against U.S. industries. According to Mr. Johnson, China has engaged in a cyber economic campaign against the United States since the 1990s, allegedly relying on aggressive investments in industry capacity abroad, Chinese government-assisted duress on Western semiconductor competitors operating in China, and threat actors working in Western microchip manufacturers and investment entities.* The key elements of China's alleged cyber economic espionage campaigns include:

- *A coordinated, cross-government effort to apply duress on U.S. firms operating in strategic industries:* Mr. Johnson alleges the NDRC plays a particularly active role in applying strategic duress on U.S. competitors, including seizing and sharing sensitive IP from foreign companies during investigations into perceived anti-trust violations.[88]
- *Chinese strategic infiltration into U.S. companies and industries:* The forms of infiltration allegedly include traditional investment, joint ventures, and embedded insider threat actors working in U.S. firms. Mr. Johnson said Western microchip manufacturers and investment entities in particular are targeted by actors working in support of the Chinese government.[89]
- *Duress acquisitions of U.S. assets:* As was the case with Motorola, Chinese actors suppress the value of a U.S. firm they want to acquire by first investing in, gaining control of, or otherwise accessing U.S. assets, products, IP, and critical U.S. supply chains, and then executing cyber-economic schemes to suppress the value of U.S. assets. These efforts often occur with coordinated support from the Chinese government, and allow Chinese entities to purchase U.S. assets below their market value price.[90]

*TE Subcom, one of the firms Mr. Johnson alleges has been penetrated by Chinese interests, wrote a letter to the Commission denying Mr. Johnson's claims.

Sovereign Immunity

In several instances, Chinese SOEs have evaded legal action in the United States by arguing their status as a foreign government entity exempts them from U.S. lawsuits under the Foreign Sovereign Immunities Act (FSIA).[91] FSIA, which was passed by Congress in 1976, affords foreign-controlled companies and their subsidiaries protection from U.S. lawsuits, known as "sovereign immunity."[92] There are six exceptions to FSIA,* but the most litigated is the commercial activity exception, which states:

> *A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case … in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.*[93]

Determining how and when these exceptions are applied has proved difficult for U.S. courts, however, with Chinese claims of sovereign immunity testing the limits of legal precedent in the United States.[94] Although Chinese sovereign immunity claims are uncommon, two recent cases were discussed at the Commission's January 2017 hearing:

- *AVIC v. Tang Energy Group:* In December 2015, an international holding subsidiary of China's state-owned aerospace and defense company Aviation Industry Corporation of China (AVIC) was ordered to pay $70 million to U.S. wind firm Tang Energy Group Ltd. for failing to fulfill the terms of a joint venture. Three months later, AVIC asked the court to vacate the judgment, arguing the decision should be overturned because the subsidiary enjoys sovereign immunity as a state-owned company.[95] A final ruling on the case is pending.
- *CNBM Group drywall case:* In March 2016, China's state-owned building materials and glass manufacturer China National Building Material Company (CNBM) successfully argued for sovereign immunity against U.S. homeowners who alleged the company's drywall had caused health problems. CNBM was the parent corporation of the firms that produced and sold the drywall, so it was able to argue it was not directly involved in commercial activity in the United States. The judge dismissed the case and ruled CNBM's status as a foreign government entity granted it sovereign immunity, with the plaintiff failing to prove the company had conducted drywall-related commercial activity in the United States.[96]

Because of the nature of the Chinese government's control over the state sector, Chinese FSIA claims pose a particular challenge to U.S. laws. Although Chinese firms arguing for protection under FSIA

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*FSIA exceptions include waivers, commercial acts, expropriations, rights in certain kinds of property, non-commercial torts, and enforcement of arbitral agreements and awards. Foreign Sovereign Immunities Act, 28 USCC § 1605, Public Law No. 94–583, 1976.

are few in number to date, Tang Energy Group CEO Patrick Jenevein believes the application of sovereign immunity to commercial cases presents a dangerous trend for U.S. businesses. In testimony before the Commission, Mr. Jenevein stated that Chinese SOEs use FSIA "as a tool to skirt their legal responsibilities and delay legal proceedings"—effectively allowing them to conduct unlawful activity without consequences.[97] Senator Charles Grassley (R-IA) agrees, stating foreign SOEs are using FSIA "as a litigation tactic to avoid claims by American consumers and companies that non-state-owned foreign companies would have to answer."[98]

The crux of FSIA cases often lies in whether the Chinese firm qualifies as state-owned, with courts struggling to identify the company's ultimate beneficial owner.[99] In these cases, the burden tends to fall on the U.S. plaintiff to prove that one of the exceptions of immunity applies.[100] Many of the U.S. firms involved in FSIA litigation do not have access to the same financial resources available to Chinese SOEs; thus, these cases disproportionally impact the U.S. entity and have what Mr. Jenevein describes as a "chilling effect" on the plaintiff's case in court.[101]

James Stengel, a partner at the New York office of Orrick law firm, disagrees, testifying before the Commission that FSIA is working as intended.[102] Although the Chinese economic and political system presents SOEs with inherent advantages, FSIA explicitly requires courts to "recognize the sovereign immunity of appropriately structured enterprises."[103] The law's commercial activity exception, which Mr. Stengel believes has been broadly interpreted by U.S. courts, prohibits any FSIA claims that arise in a commercial contract.[104] Thus, any cases of Chinese SOEs receiving sovereign immunity have passed this broad test and "reflect an unexceptional application of this decades-old statutory framework for adjudicating claims against foreign sovereigns."[105]

Chinese Investment in Strategic Sectors of the U.S. Economy

Although Chinese companies invest in a broad range of U.S. industries, Chinese deals are mainly focused on high-value acquisitions in technology, agriculture, modern services, and commercial real estate.* This reflects a shift from as recently as 2013, when the majority of Chinese investment targeted natural resource extraction (China invested $3.2 billion in the U.S. oil and gas industry in 2013).[106] Three sectors that have seen significant Chinese FDI include information and communications technologies (ICT), agriculture, and biotechnology, all of which are tied to U.S. economic and national security interests.

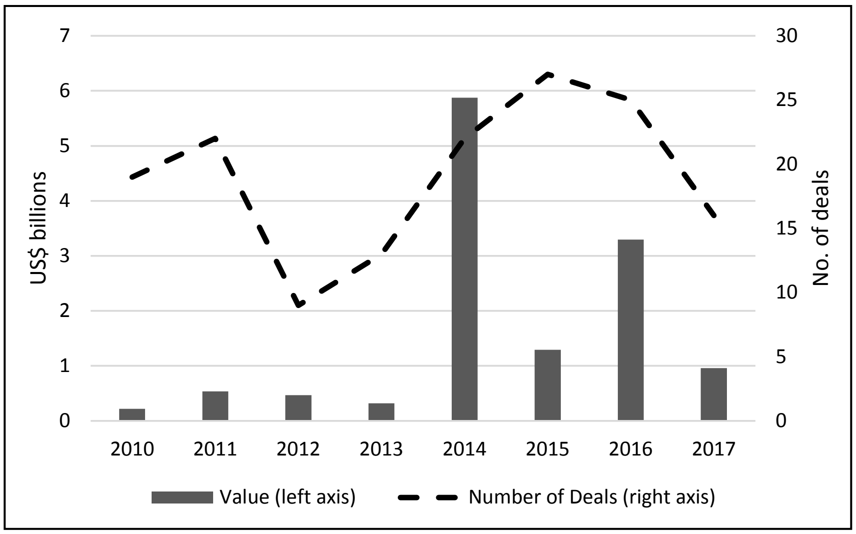
Investment in U.S. ICT

From 2000 to the first half of 2017, China completed 231 investment projects in U.S. ICT worth a combined $15.1 billion.[107] Chinese ICT investment in the United States (by value) peaked in 2014 with Lenovo's acquisition of a division of IBM for $4.7 billion and

* Certain Chinese real estate investments in the United States could pose national security concerns due to the property's proximity to U.S. military bases, weapons stations, and other military assets. In 2012, President Obama blocked a Chinese acquisition of Oregon wind farms because they were located too close to a naval weapons station. Michael Hiltzik, "Chinese Investments in U.S. Hotel Companies Spur National Security Scrutiny," *Los Angeles Times*, March 18, 2016.

Motorola Mobility for $2.9 billion.[108] That year, investment in ICT accounted for about half of all Chinese FDI in the United States, reflecting the importance of Chinese industrial policies prioritizing the acquisition of foreign technologies.[109] In 2016, Chinese investment in that sector reached $3.3 billion, an increase of 155 percent from 2015 (see Figure 2). Through the first half of 2017, however, Chinese FDI in U.S. ICT was less than $1 billion, well below 2016 levels over the same period amid increased regulatory scrutiny in the United States and efforts to curb capital outflows in China.[110]

Figure 2: Chinese Investment in U.S. ICT, 2010–H1 2017



Source: Rhodium Group, "China Investment Monitor." *http://rhg.com/interactive/china-investment-monitor.*

China is seeking to develop its semiconductor industry by aggressively investing abroad—particularly in the United States—and restricting global firms' access to the Chinese semiconductor market.* The CCP has created government funds to finance foreign acquisitions that accelerate China's high-tech development, including $107.5 billion in national and regional semiconductor investment funds established by the Ministry of Industry and Information Technology in 2014.[111] According to data from the Rhodium Group's 2016 contracted report for the Commission, Chinese firms leveraged this state funding to attempt to acquire or invest in at least 27 U.S. semiconductor firms from 2013 to November 2016.[112]

Then U.S. Commerce Secretary Penny Pritzker warned in November 2016 that the U.S. semiconductor industry is "seeing new attempts by China to acquire companies and technology based on their government's interests—not commercial objectives."[113] The next month, U.S. President Barack Obama blocked a Chinese

*For more information on China's pursuit of U.S. semiconductor assets and its implications for the United States, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 3, "China's 13th Five-Year Plan," in *2016 Annual Report to Congress*, November 2016, 155–161.

deal to acquire the U.S. business of Aixtron, a German semiconductor company. A Treasury Department statement indicated the deal was blocked because the "national security risk posed by the transaction relate[d], among other things, to the military applications" of the firm's technology, indicating the U.S. government's concern over China's attempts to acquire sensitive U.S. technologies.[114]

Chinese investments in the U.S. semiconductor industry not only help China move up the value-added chain and meet market and security demands, but also threaten U.S. economic and national security interests.[115] A January 2017 report from the U.S. President's Council of Advisors on Science and Technology warned China's increased semiconductor investment represents "a concerted push by China to reshape the market in its favor ... [and] threatens the competitiveness of U.S. industry and the national and global benefits it brings."[116] According to John Adams, former brigadier general for the U.S. Army, semiconductors are "central to U.S. military and economic strength."[117] Losing semiconductor technology to China would endanger the U.S. military's technological advantages in surveillance, communications, and propulsion, and erode U.S. institutional and technological know-how and the ability to design and commercialize emerging defense technologies.[118]

China's ICT investments are in line with the country's emphasis on telecommunications as a strategic interest. According to Dr. Atkinson's testimony "the main purpose of most Chinese technology companies buying U.S. technology companies is not to make a profit, but to take U.S. technology in order to upgrade their own technology capabilities."[119] These goals are manifested in several Chinese government policies, including the Chinese government's so-called "De-IOE" campaign, which pressures Chinese companies to replace products from IBM, Oracle, and Dell EMC (abbreviated as "IOE") with Chinese-made alternatives.[120]

There are also questions about the lack of reciprocal treatment for U.S. ICT firms in China, with U.S. firms forced to disclose valuable technologies and source code to gain access to the Chinese market. In January 2015, China announced new regulations to ensure foreign ICT in China remain "secure and controllable," including intrusive security test requirements, compliance with Chinese national standards, and—potentially—forced disclosure of valuable source code.[121] China's broad cybersecurity law also seeks to further tighten state control over information flows and technology equipment, including naming telecommunications a "critical information infrastructure" subject to mandatory security checks (for more on China's cybersecurity law, see Chapter 1, Section 1, "Year in Review: Economics and Trade").[122] According to Dr. Atkinson, these policies, coupled with increased investment activity in the United States, represent "an aggressive by-hook-or-by-crook strategy that involves serially manipulating the marketplace and wantonly stealing and coercing transfer of American knowhow."[123] The January 2017 report from the U.S. President's Council of Advisors on Science and Technology echoes Dr. Atkinson's concerns, finding that "Chinese policies are distorting markets in ways that undermine innovation, subtract from U.S. market share, and put U.S. national security at risk."[124]

Investment in U.S. Agriculture and Biotechnology

Since 2000, cumulative investment in U.S. agriculture has accounted for around 6 percent of total Chinese FDI in the United States, a significant though relatively small share compared to sectors like real estate (30 percent) and ICT (11 percent).[125] Although China has made 35 agriculture deals in the United States since 2000, the deal for Smithfield Foods Inc., the largest U.S. pork producer, accounts for nearly 95 percent of the value of China's investments in U.S. agriculture.[126] In July 2013, Shuanghui International Holdings Limited, a subsidiary of Shuanghui Group (now WH Group), proposed to acquire Smithfield in a $4.7 billion deal (worth more than $7 billion including Smithfield's debt).[127] The acquisition gave China control of nearly 26 percent of the U.S. pork market, helping to ensure the stability of Chinese food imports.[128]

In April 2017, the state-owned China National Chemical Corporation (ChemChina) gained approval from U.S. and European regulators for a $43 billion bid to buy the Swiss company Syngenta, one of the world's largest producers of crop protection products, including pesticides, fungicides, and genetically modified seeds.[129] Although Syngenta is a Swiss company and is thus excluded from Rhodium Group's calculations of Chinese FDI in the United States, the firm does have significant operations in the United States, with a plant in North Carolina that employs more than 1,100 people.[130] Syngenta also has chemical plants in Louisiana and Texas that the U.S. Department of Homeland Security categorizes as "high-risk" facilities under the Chemical Facility Anti-Terrorism Standards program,* leading to concerns that foreign ownership could pose national security risks.[131]

Patrick Woodall, research director and senior policy advocate at Food & Water Watch, argues China's foreign investment strategy in agriculture and biotechnology raises concerns over technology transfer to China.[132] Biotechnology firms like Syngenta, for example, utilize valuable technologies and processes that could give Chinese agribusinesses a competitive advantage over other global firms.[133] In a July 2016 letter to members of President Obama's cabinet, Food & Water Watch and the National Farmers Union warned against what they describe as China's efforts to "secure and control worldwide food production resources," stating that the acquisitions of Syngenta and Smithfield could lead to the transfer of valuable assets, IP, and technology from the United States (for more on China's biotechnology development policies, see Chapter 4, Section 1, "China's Pursuit of Dominance in Computing, Robotics, and Biotechnology").[134]

China's agriculture and biotechnology acquisitions continue a system of restricted market access that exists for foreign firms operating across several strategic Chinese industries. Acquiring foreign agribusinesses is one way Chinese importers circumvent State Council restrictions on imports of genetically modified prod-

*The Chemical Facility Anti-Terrorism Standards program, authorized by Congress in 2007 and updated in 2014, is responsible for protecting hazardous chemical facilities from terrorist infiltration. U.S. Department of Homeland Security, *Chemical Facility Anti-Terrorism Standards (CFATS)*.

ucts in China. Although these restrictions are ostensibly meant to protect the public from consuming harmful chemicals, they limit the import of foreign agriculture products and expand Chinese firms' share of the domestic agriculture market.[135] For example, after ChemChina acquired Syngenta, China is in a position to begin approving imports of biotechnology crops, potentially favoring the use of products produced by Syngenta over U.S. biotechnology and agriculture firms.[136]

Chinese agriculture acquisitions also limit foreign firms' market access in China. The Smithfield acquisition, for instance, has fulfilled China's growing demand for pork imports. After it was acquired by Shuanghui in 2013, Smithfield (which is one of a few U.S. pork producers that does not use the feed additive ractopamine*) saw its exports to China increase 50 percent by 2015. Today, Smithfield accounts for 97 percent of all U.S. pork exports to China.[137]

Other experts contend Chinese investments in agriculture benefit the U.S. economy overall. U.S. Ambassador to China Terry Branstad is one supporter of increased Chinese agriculture investment in the United States, saying the United States has "seen just the tip of the iceberg of the potential investments here" and calling agriculture investment "beneficial to both [China and the United States]."[138] Some experts also remain convinced the benefits of the Smithfield and Syngenta deals outweigh their risks. Both deals received CFIUS approval, which indicates to some experts like Stephen McHale, a partner at Squire Patton Boggs, that the U.S. government has "not yet reached the point where [it has] found an acquisition in the food and agriculture sectors to threaten national security."[139]

Chinese Companies on U.S. Stock Exchanges

Although the number of Chinese firms listed on U.S. stock exchanges has declined in recent years, the total market capitalization of Chinese issuers in the United States has continued to grow (see Table 3), which may lead to increased risks to U.S. investors. For the last decade, U.S. negotiators have sought to protect investors by ensuring all public accounting firms, both domestic and foreign, disclose their clients' financial information as required under U.S. law. However, some Chinese firms have refused to divulge their accounting and financial practices to U.S. investors, exposing the limits of U.S. regulators' ability to protect investors.

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*China has banned the use of ractopamine due to alleged health and food safety concerns. Shirley A. Kan and Wayne Morrison, "U.S.-Taiwan Relationship: Overview of Policy Issues" *Congressional Research Service*, April 22, 2014, 34–36. U.S.-China Economic and Security Review Commission, *Hearing on Chinese Investment in the United States: Impacts and Issues for Policymakers*, oral testimony of Patrick Woodall, January 26, 2017.

Table 3: Chinese Firms Listed in the United States, 2012 and 2017

	2012	2017
Number of Listings	188	130
Total Market Capitalization (US$ billions)	$119	$536

Note: These figures represent only Chinese firms listed as American depository receipts on the New York Stock Exchange, NASDAQ, and American Stock Exchange. 2017 figures are from February 1, 2017.
Source: Heng Ren Partners, e-mail with Commission staff, February 7, 2017.

Foreign Private Issuers in the United States

A foreign private issuer (FPI) is a company incorporated or organized under the laws of a jurisdiction outside of the United States and listed on U.S. stock exchanges with less than half of its securities directly or indirectly held by U.S. residents. If more than 50 percent of its securities are held by U.S. residents, a company can only qualify as an FPI if the majority of the firm's executive officers and directors are not U.S. citizens or residents, less than 50 percent of the firm's assets are located in the United States, and the firm's business is not primarily conducted in the United States.[140]

Foreign companies around the world rely on U.S. financial markets to raise capital and establish a trading presence for their securities.[141] Many of these companies list as FPIs, allowing them to eschew U.S. financial regulations in favor of the laws of their home country.[142] FPIs are entitled to several advantages over domestic firms, including exemptions from publishing quarterly financial reports, exceptions from disclosure requirements for details on executive compensation, and longer deadlines for releasing annual financial reports.* Additionally, some FPIs registering for the first time with the U.S. Securities and Exchange Commission (SEC) may submit their draft registration statements confidentially, unlike domestic issuers, which must file their registration statements publicly.[143]

Since 2000, many FPIs listing in the United States have been incorporated in offshore locations, where underdeveloped financial standards and disclosure requirements allow issuers to operate with relative anonymity and circumvent U.S. regulations.[144] As of May 2017, tax havens like Switzerland, the Cayman Islands, and Luxembourg were home to 94 FPIs listed on the New York Stock Exchange (NYSE)—21 percent of all FPIs listed on the NYSE—and boasted a combined market capitalization of nearly $900 billion (see Figure 3).[145] Tax havens are the third-largest source of FPIs listed on the NYSE by total market capitalization, trailing the United Kingdom ($1.2 trillion) and Canada ($1.1 trillion).[146] China, meanwhile, is the fourth-largest source of FPIs, with a total market capitalization of $742 billion.[147]

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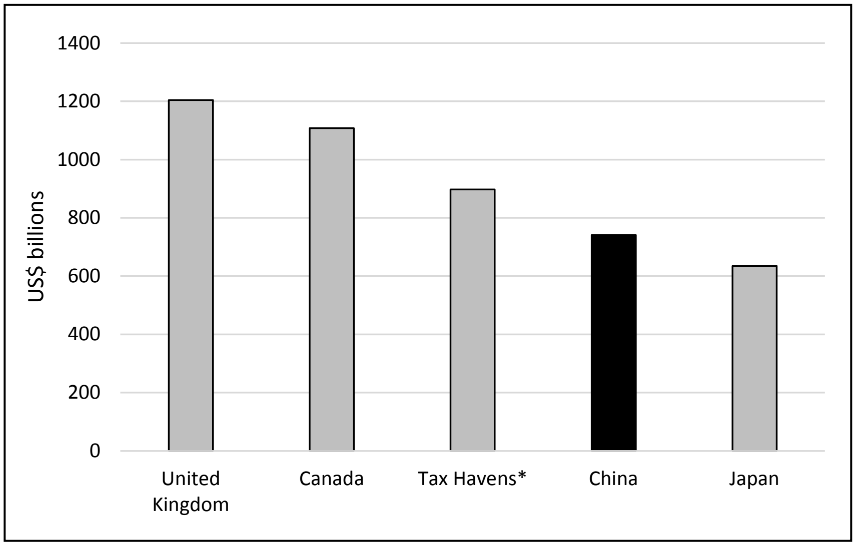
*FPIs must file annual financial reports within four months of the start of the fiscal year, compared to just 60 or 90 days for domestic firms (depending on the firms' capitalization and other factors). Morrison & Foerster, "Frequently Asked Questions about Foreign Private Issuers," 4–5.

Figure 3: Combined Market Capitalization of FPIs on the NYSE by Country of Origin, May 2017



Note: Tax havens include Bermuda, the British Virgin Islands, the Cayman Islands, Ireland, Luxembourg, Puerto Rico, and Switzerland.
Source: NASDAQ, "Companies on NYSE."

Chinese Companies Listing in the United States

Although the risks posed by Chinese FPIs are generally no different from those of other foreign issuers based in offshore jurisdictions, Chinese laws present some particular challenges for U.S. regulators. Chinese firms utilize three approaches to access U.S. markets:

- *American depository receipts (ADRs):* ADRs are certificates issued by U.S. banks that trade in the United States but represent shares of a foreign stock.[148] ADRs are the most common choice for Chinese firms (and other foreign companies) looking to list in the United States: out of the 126 U.S.-listed Chinese companies in March 2017, 90 companies were listed as ADRs.[149] Most Chinese issuers (and foreign issuers generally) prefer ADRs because they are easier to transfer and manage than foreign shares directly listed on U.S. exchanges.[150]
- *Ordinary shares:* Some foreign companies list their stock directly in the United States through an initial public offering (IPO). The most notable Chinese IPO occurred in September 2014 when China's e-commerce giant Alibaba raised $25 billion in its public offering on the NYSE.[151] Following the Alibaba IPO, however, many Chinese companies abandoned IPOs on U.S. exchanges in favor of IPOs in China, where their securities, particularly for Internet companies, commanded higher sales.[152] Chinese IPO activity rebounded in the second half of 2016, led by the Shanghai-based logistics company ZTO Express Inc.'s $1.4 billion IPO on the NYSE.[153]

- *Reverse mergers:* Reverse mergers occur when a U.S. public shell company already registered in the United States—often bankrupt or near bankruptcy—merges with a foreign firm. The foreign company's shareholders then gain a controlling interest in the public shell company, thereby becoming an SEC-registered company rather than an FPI. Firms involved in a reverse merger are not reviewed prior to the transaction, making it an inexpensive way to quickly list a company in the United States. An influx of Chinese reverse mergers in 2010 led to a series of scandals involving Chinese companies defrauding U.S. investors.[154] Between 2011 and 2012, an SEC crackdown on reverse mergers led to more than 100 U.S.-listed Chinese companies being delisted or having their trading frozen as a result of fraud allegations and other violations of U.S. securities laws. However, few U.S. investors were compensated for their losses because the SEC lacks the jurisdiction necessary to punish foreign companies beyond their activities in the United States.[155]

Like other foreign private issuers (FPIs), Chinese businesses list on U.S. stock exchanges to raise capital while operating largely outside the laws and regulations governing U.S. firms.[156] Chinese firms first started listing in the United States in the 1990s, when Chinese regulators encouraged larger firms to list in the United States to secure greater capital and higher governance standards.[157] By 1998, nine Chinese FPIs had listed in the United States, all on the NYSE.* Fifteen years later, around 100 Chinese companies were listed in the United States, including many firms from China's growing technology sector like Baidu, JD.com, and Weibo.†

As of July 2017, a total of 126 Chinese companies were listed on the NASDAQ, NYSE, and American Stock Exchange (AMEX), with a total market capitalization of $960 billion.‡ As shown in Table 4, the sectors with the highest combined market capitalization include services ($433.6 billion), energy and power ($239 billion), and technology ($148.6 billion).[158] Estimates from the asset management firm Heng Ren Investments also indicate that, as of February 2017, U.S. mutual funds, pension funds, government retirement fund, and exchange-traded funds invested at least $123 billion in U.S.-listed Chinese firms.§ This creates risks for U.S. citizens with money in these investment funds.

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*The nine Chinese companies listed are Beijing Yanhua Petrochemical, China Eastern Airlines, China Southern Airlines, Guangshen Railway, Huaneng Power International, Jilin Chemical Industrial, Shandong Huaneng Power Development, Shanghai Petrochemical, and Yanzhou Coal Mining. U.S. Securities and Exchange Commission, *Foreign Companies Registered and Reporting with the U.S. Securities and Exchange Commission*, December 31, 1998.

†For more on Chinese Internet firms listing on U.S. stock exchanges, see Kevin Rosier, "The Risks of China's Internet Companies on U.S. Stock Exchanges," *U.S.-China Economic and Security Review Commission*, September 12, 2014.

‡The list of Chinese companies listed on the NYSE, NASDAQ, and AMEX includes only U.S.-listed companies based in China, not offshore Chinese companies in Hong Kong or elsewhere. The actual number of Chinese companies listed on these exchanges is higher. NASDAQ, "Companies in China."

§This estimate includes only the 13 largest U.S.-listed Chinese ADRs by market capitalization. Peter Halesworth, Founder, Heng Ren investments, interview with Commission staff, February 7, 2017.

Table 4: Chinese Companies on U.S. Stock Exchanges, 2017

Sector	No. of Firms Listed	Market Cap (US$ billion)
Services	24	433.6
Energy and Power	5	239.0
Technology	36	148.6
Finance	14	89.5
Transportation	4	28.5
Industrial	12	14.3
Health Care	7	4.7
Capital Goods	10	0.8
Consumer Goods	13	0.5
Other	1	0.4
Total	**126**	**960**

Source: NASDAQ, "Companies in China."

Challenges Posed by Chinese Companies Listed in the United States

The opaque nature of China's financial system presents unique challenges for U.S. regulators and investors.[159] Foremost among these are China's foreign ownership restrictions and state secrecy laws.

Foreign Ownership Restrictions

The Chinese government enforces limits on foreign ownership of Chinese companies, which restricts the ability of those companies to list on foreign exchanges. These limits are particularly stringent for Chinese companies operating in strategic sectors, such as Internet and technology firms. To get around these limitations, Chinese companies in restricted industries facilitate foreign investment through a complex mechanism known as a variable interest entity (VIE).[160]

The VIE structure consists of several entities—essentially holding companies, usually based in tax havens—linking foreign investors and Chinese firms together through a mix of legal contracts and equity ownership.[161] These structures create effective foreign ownership of Chinese companies while still complying with Chinese foreign ownership laws.[162] Paul Gillis, professor of practice at the Guanghua School of Management at Peking University, calculates that 56 percent of all Chinese companies listed on the NYSE and NASDAQ use the VIE structure (up from 42 percent in 2011), including Alibaba, Baidu, and Weibo.[163]

In addition to circumventing Chinese regulations, the VIE structure operates largely outside the jurisdiction of U.S. courts and regulatory agencies.[164] Because the legal structure of a VIE is only enforceable in the haven where it is based, U.S.-listed securities issued from offshore locations are not subject to U.S. laws.[165] As a result, VIE issuers that defraud their U.S. investors cannot be held to account, with attempts to enforce contractual arrangements with VIEs typically failing.[166]

Chinese regulators acknowledge the use of VIE structures by Chinese firms. In March 2017, a decision by China's Supreme Court ruled that transactions facilitated through VIE structures are legal regardless of whether the VIE in question violates Chinese foreign investment restrictions.[167] The Chinese government has not made any serious efforts to adjust the relevant laws and ensure Chinese companies listed abroad through the VIE structure have a legal responsibility to their foreign investors.[168] Chinese regulators proposed legislation in January 2015 to outlaw VIEs, but the law would have excluded firms controlled by Chinese nationals.[169] This provision has not appeared in subsequent regulations issued by the Chinese government, allowing VIEs to continue operating in a legal gray zone in the United States.[170]

State Secrecy Laws

China's state security laws also limit the U.S. government's ability to properly regulate and oversee Chinese companies operating in the United States. Chinese laws governing the protection of state secrets and national security limit foreign access to Chinese companies' audit reports.[171] As a result, when Chinese-based firms list on U.S. stock exchanges, the audit work papers of these companies often cannot be accessed by U.S. regulators as required under U.S. law.[172] When audit work papers are provided, the veracity of their financial statements and disclosures cannot be verified by U.S. regulators.[173]

In 2012, the SEC charged five China-based subsidiaries of U.S. auditors—BDO China Dahua CPA Co. Ltd., Ernst & Young Hua Ming, KPMG Huazhen, Deloitte Touche Tohmatsu Certified Public Accountants, and PricewaterhouseCoopers ZhongTian—with breaking U.S. securities laws for refusing to turn over requested audit work papers.[174] These accounting firms could have been blocked from auditing U.S.-listed companies, but because they are the largest auditors of Chinese firms listed in the United States, deregistering them would greatly limit the ability of Chinese companies to list on U.S. stock exchanges.[175] Instead, the SEC imposed $500,000 sanctions on four of the five firms,* along with an admission from each firm that it had failed to turn over proper documentation.[176] The weak ruling prompted China's state-owned media outlet Xinhua to declare China-based auditors "too big to ban."[177]

Because the Chinese government restricts some Chinese companies from providing financial information to foreign auditing firms, inspections of U.S.-listed Chinese companies are conducted entirely by Chinese auditors. There are around 100 accounting firms in both China and Hong Kong that conduct audits of U.S.-listed Chinese companies.[178] China's Ministry of Finance, the Chinese Securities Regulatory Commission, and the China Institute of Certified Public Accountants are granted responsibility for oversight of these ac-

*The case against Dahua remains ongoing.

counting firms, and are responsible for conducting quality control procedures and inspecting audit papers.[179]

U.S. regulators are attempting to increase their access to China's auditing reports.[180] However, Beijing has shown little inclination to improve disclosures for foreign-listed firms. In July 2017, the Public Company Accounting Oversight Board (PCAOB) blocked Crowe Horwath HK, a Hong Kong-based auditor, from auditing U.S.-listed firms because the auditor was unable to secure the audit papers of its China-based clients. This is the second Hong Kong accounting firm to have its registration revoked by the PCAOB,* highlighting the difficulties auditing firms face when tasked with securing audit work reports from Chinese companies prohibited from sharing sensitive financial information with foreign regulators.[181] Instead of increasing its cooperation with foreign auditors, the Chinese government has insisted the United States offer regulatory equivalency to China, accepting the work of Chinese regulators and auditors as though it was done by a U.S. company.[182] The EU already accepted regulatory equivalency with respect to audits of Chinese companies, but U.S. regulators have instead pushed for joint inspections of Chinese accounting firms together with local regulators.[183]

Chinese Firms Disadvantage Investors on U.S. Exchanges

Since cracking down on Chinese reverse mergers, U.S. regulators have struggled to deter sophisticated efforts by some Chinese companies to defraud U.S. investors. According to Peter Halesworth, founder of Heng Ren Investments, most Chinese companies listed in the United States are "ethical and law abiding."[184] However, legal barriers hindering audits and reviews of U.S.-listed Chinese firms have left bad actors shielded from prosecution for crimes committed against U.S. investors.[185] In a report released by Heng Ren in April 2016, Mr. Halesworth detailed instances of U.S.-listed Chinese issuers forcing sales below their U.S. market value, effectively lowballing U.S. investors.[186] The report found that from the start of 2015 to April 2016, 38 U.S.-listed Chinese companies announced buyout offers. Of those 38 buyouts, the premiums paid to U.S. shareholders averaged just 20.6 percent, compared to the 28.4 percent average premium typically paid to shareholders in buyouts of U.S.-listed companies. Ten of these buyouts offered shareholders premiums of 10 percent or less.[187] Because FPIs are not under U.S. jurisdiction, U.S. investors are left without legal recourse to challenge the unjustifiably low buyout price.[188] The average total assets of these 38 companies rose from $122 million pre-IPO to $994 million at the buyout announcement, with these firms leaving the United States financially strengthened after low-balling investors.[189] Several prominent Chinese companies have utilized this practice to disadvantage U.S. investors, including China Mobile Games & Entertainment Group and Focus Media Holdings Ltd.[190]

Another report by GeoInvesting, a financial information website focused on small-cap stocks, found China-based companies have perpetrated dozens of frauds on U.S. exchanges totaling at least

*In January 2016 the PCAOB deregistered the Hong Kong affiliate of the auditing firm PKF International for not cooperating with a probe into its work for a Chinese company. Jennifer Hughes and Alice Woodhouse, "Hong Kong Auditors Trapped by U.S.-China Dispute," *Financial Times*, July 26, 2017.

$5 billion in losses.[191] In many of these schemes, the executives of U.S.-listed Chinese companies sold their firm's assets and then raised money from U.S. investors.[192] One notable case was Puda Coal, a Chinese mining company that was listed on the NYSE until 2012, when it was revealed that the company's management had sold its assets to a Chinese competitor before raising money from U.S. investors. After the scheme was revealed, Puda's market capitalization on the NYSE dropped by nearly $342 million.[193] The firm's shares were delisted (the company is no longer in business) and a $250 million fine was issued to Puda's chairman and former chief executive.[194] The SEC never collected on the fine, however, and Puda's U.S. investors lost hundreds of millions of dollars.[195]

Role of U.S. Regulators

The job of protecting U.S. investors and mitigating the risks of stock market fraud falls primarily to two U.S. regulatory agencies, the SEC and the PCAOB, along with the stock exchanges themselves. The regulators' authority is based on the assumption that a firm's financial disclosures will accurately reflect its market value. However, China's strict limits on the activities of foreign auditors undermine the authority of these U.S. institutions, putting U.S. investors at risk.

SEC Regulations

The SEC is tasked with protecting U.S. investors, ensuring fairness in cross-border securities transactions, and maintaining efficient and transparent markets. This includes detection and prosecution of fraudulent activities perpetrated on U.S. stock exchanges by overseas issuers.[196] To this end, the SEC has worked to address concerns over foreign disclosure requirements and cross-border regulatory cooperation. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, for example, requires reciprocal inspections for audit regulators outside the United States, and mandates confidential exchanges of information with regulators in foreign countries.[197]

The SEC has sought multilateral and bilateral cross-border regulatory cooperation agreements with foreign governments to enhance oversight protocol.[198] The SEC is party to more than 75 formal cooperative arrangements with over 50 foreign regulators and law enforcement agencies, including a formal information sharing agreement with China signed in April 1994.[199] The SEC and the China Securities Regulatory Commission are also signatories to the International Organization of Securities Commissions (IOSCO) Multilateral Memorandum of Understanding (MOU) on enforcement cooperation, an agreement with 109 signatories seeking to enhance cross-border cooperation on issues such as enforcement cooperation, supervisory oversight, and exchanges for information regarding issuers.[200]

Even with these cooperation agreements in place, the SEC's ability to secure Chinese companies' audit work reports and prosecute fraudulent companies remains limited.[201] That responsibility has fallen largely to the SEC Cross-Border Working Group, which targets U.S.-listed foreign companies suspected of fraudulent activity.

The working group was established in 2011 in part due to the rise of Chinese reverse mergers in the United States and filed cases against more than 65 foreign issuers or executives and deregistered the securities of more than 50 companies by June 2013.[202] However, SEC criminal prosecutions have only been successful in cases involving individuals located in the United States, with Chinese securities regulators choosing not to prosecute firms or individuals for crimes committed by Chinese companies listed overseas.[203] Lewis Ferguson, a member of the PCAOB, estimates fraud by Chinese companies listed on U.S. stock exchanges has resulted in the loss of billions of dollars for U.S. investors.[204]

PCAOB Negotiations

For the past decade, the PCAOB,* an independent regulator that audits U.S.-listed firms, has been negotiating with the China Securities Regulatory Commission and Ministry of Finance to permit joint inspections of accounting firms located in China.[205] Under the Sarbanes-Oxley Act of 2002, the PCAOB is required to conduct regular inspections of all registered U.S. and non-U.S. public accounting firms that audit firms listed on U.S. stock exchanges.[206] These inspections seek to protect investors in U.S. capital markets by ensuring that all public accounting firms are adhering to U.S. auditing standards and making such firms subject to the jurisdiction of U.S. courts.[207]

However, the Chinese government views inspections by foreign regulators in China as a violation of national sovereignty under its state security laws.[208] Despite SEC regulations mandating that every accounting firm registered with the PCAOB be inspected every three years, Chinese regulators have blocked the PCAOB from inspecting certified public accounting firms in China and Hong Kong.[209]

On May 24, 2013, the PCAOB and Chinese regulators announced an MOU providing for information sharing on matters relating to investigations of audits of U.S.-listed Chinese companies. Under the MOU, the PCAOB is permitted to access audit documents from Chinese accounting firms for use in investigations.[210] Shaswat Das, a senior attorney at Hunton & Williams, was the lead negotiator in the PCAOB's discussions with China until 2015, and saw the negotiations break down, in part over China's insistence that PCAOB inspection programs not include any SOEs or certain Internet-based firms.[211] Instead, Mr. Das noted in his testimony before the Commission, U.S.-listed Chinese companies continue to operate with little oversight under China's opaque accounting and auditing system, leaving U.S. investors exposed to exploitative and fraudulent activities.[212]

U.S. Stock Exchange Regulations

When FPIs list in the United States, they are subject to rules set by the exchanges themselves. Rather than enforcing vigorous listing requirements, however, many U.S. exchanges compete to attract list-

*The Sarbanes-Oxley Act of 2002 created the PCAOB to oversee all accounting firms that audit public companies listed on U.S. stock exchanges. The PCAOB is a private-sector, nonprofit corporation, but the SEC is charged with approving PCAOB budgets and rules, appointing board members, and approving rules. Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 STAT. 745 (July 30, 2002), codified at 15 U.S.C. § 7201 (2002).

ings from Chinese companies.[213] Compared to other international exchanges like the Hong Kong Exchange (HKEX) and London Stock Exchange (LSE), U.S. exchanges have lower barriers to entry for foreign firms. For instance, the NYSE and NASDAQ require emerging growth companies* to provide only two years of audited financial statements that can be up to nine months old. Meanwhile, the LSE and HKEX both require all firms to submit three years of audited accounts that are no more than six months old.[214]

The NYSE and NASDAQ also have more lenient ownership requirements than the LSE and HKEX.[215] This was the primary sticking point in Alibaba's 2014 IPO, when Alibaba decided to list on the NYSE after it was rejected by the HKEX for failing to meet the exchange's listing requirements.[216] Alibaba's pre-IPO structure allowed 28 partners (mainly founders and senior executives) to maintain control of the board despite owning around 10 percent of the company.[217] While the HKEX refused to permit this structure on its market, both the NYSE and NASDAQ have no rules preventing this kind of corporate arrangement and competed for Alibaba's listing.[218]

Chinese Bid for the Chicago Stock Exchange

In February 2016, the Chicago Stock Exchange (CHX), which makes up 0.5 percent of all U.S. stock transactions, announced it would be acquired by Chongqing Casin Enterprise Group for $27 million—the first sale of a U.S. exchange to China.[219] Casin is a private Chinese investment holding company, but the deal attracted the attention of U.S. lawmakers over Casin's alleged connections to the Chinese government. Casin's ownership is difficult to confirm, but John Kerin, CEO of CHX, admitted the Chinese government may be a minority stakeholder in the firm.[220] Additionally, Casin's chairman, Shengju Lu, maintains ties to the Chinese government through a seat on a local industry committee overseen by the mayor of the Chongqing municipality.[221]

In February 2016, 46 Members of Congress wrote to CFIUS requesting the sale be closely investigated for any connections between Casin and the Chinese government.[222] Five lawmakers also wrote to the SEC in December 2016 to ask for an extended public comment period for review of Casin's bid.[223] According to Congressman Robert Pittenger (R-PA), the deal could provide the Chinese government with influence over U.S. financial markets, making them vulnerable to manipulation that could benefit Chinese firms or the Chinese economy.[224] The deal was approved by CFIUS in December 2016, with the panel finding "no unresolved national security concerns" in the deal.[225] Subsequently, the deal was submitted to the SEC and is still awaiting approval.[226] In July 2017, 11 Members of Congress wrote to the SEC asking it to stop the sale of CHX to Casin.[227] In August 2017, SEC commissioners ruled to delay a decision, overriding a staff recommendation that the deal be approved. SEC commissioners are set to review and vote on the deal on an unknown date.[228]

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*An emerging growth company is an issuer with the most recent year's total revenues below $1 billion. U.S. Securities and Exchange Commission, *Jumpstart Our Business Startups Act Frequently Asked Questions*, December 21, 2015.

Implications for the United States

The United States has long benefited from an open investment environment, encouraging FDI in all but a few sectors, mostly those with direct ties to U.S. national security. As Chinese FDI to the United States has increased, however, it has become clear that Beijing is not always motivated by the same commercial considerations that guide economic policy in Washington. Instead, the CCP has at times sought to utilize the U.S. investment environment to advantage Chinese firms and industries at the expense of their U.S. competitors. This reality necessitates a careful review of U.S. investment policies to preserve vital economic and national security interests.

As Chinese investment flows to the United States reach record levels, three important trends have emerged. First, most Chinese FDI in the United States (outside of real estate investments) is targeting industries deemed strategic by the Chinese government. Investments in U.S. ICT, for instance, may further the CCP's goals of advancing and controlling China's technology infrastructure, disseminating and controlling information, and protecting national security. Moreover, investments in U.S. agriculture and biotechnology ensure the stability of Chinese food imports, increase the efficiency of China's agricultural production, and give Chinese agribusinesses a competitive advantage over other global firms. Taken as a whole, these investments in strategic industries lead to the transfer of valuable U.S. assets, IP, and technology to China—particularly in sectors where the Chinese government does not offer reciprocal access to U.S. investments—presenting potential risks to critical U.S. economic and national security interests.

Second, some private Chinese companies operating in strategic sectors are private only in name. Instead, the state extends its influence through an array of measures, including financial support and other incentives, to influence business decisions and achieve state goals. This puts U.S. companies in these sectors at a distinct disadvantage, with their Chinese counterparts making business decisions based not on commercial considerations, but on political interests and with the financial backing of the state.

Third, some Chinese firms are utilizing increasingly sophisticated methods to acquire strategic U.S. entities. Chinese companies employ a myriad of methods to circumvent U.S. investment laws and regulations, including obscuring government-influenced investments through shell companies, conducting cyber espionage campaigns to financially weaken and then acquire U.S. firms, and claiming immunity from U.S. lawsuits under FSIA. These methods not only injure U.S. businesses, but also hinder the work of U.S. regulators; CFIUS reviews, for instance, are becoming more numerous and complex as investigators must navigate China's opaque and complex corporate structures.

Chinese activities on U.S. capital markets also present challenges for U.S. financial regulators, though many of these challenges are not unique to China but are true of all FPIs—particularly those based in tax havens. Specifically, offshore issuers are obligated to abide by the laws of their home country, allowing them to operate with relative anonymity and circumvent U.S. regulations. As a result, U.S. investors in offshore securities are not only vulnerable to fraud schemes, but also lack the legal means to seek restitution for their losses.

China-based issuers often pose additional challenges because China's state secrecy laws limit foreign access to Chinese firms' audit reports, preventing the PCAOB from inspecting certified public accounting firms in China and Hong Kong. This leaves U.S. investors exposed to potentially exploitative and fraudulent activities by Chinese firms listed in the United States. Meanwhile, the complex listing structures of Chinese issuers, coupled with Chinese authorities' general unwillingness to actively regulate and protect U.S. investors, leave U.S. shareholders with no legal recourse to dispute fraud cases. The SEC and PCAOB—the regulatory bodies tasked with managing U.S. capital markets—have also been unable to reach an agreement with Chinese regulators to address the inadequacies of China's disclosure practices. After a decade of negotiations with Chinese regulators, it is apparent that, absent a dramatic policy shift, Beijing is unlikely to cooperate with efforts to make Chinese firms more accountable to their U.S. investors.

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