

Written Testimony of David H. McCormick Submitted to the U.S. House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party

Hearing on “Systemic Risk: The Chinese Communist Party’s Threat to U.S. Financial Stability”

September 12, 2023

Chairman Gallagher, Ranking Member Krishnamoorthi, and distinguished members of the Select Committee:

Thank you for providing me the opportunity to submit written testimony for this important hearing on the systemic risks created by the Chinese Communist Party (CCP) to the U.S. financial system.

As a combat veteran with a Ph.D. in international relations who has worked on the U.S.-China economic relationship in both government and the private sector, I have seen how adversaries like the CCP use American intellectual property, supply chain dependence, and capital to benefit their regime at the expense of American interests. We must firmly oppose the CCP’s geopolitical ambition to overtake the United States.

During the Bush Administration, I was the Commerce Department official in charge of restricting sales of U.S. technology to organizations affiliated with the Chinese military and warned of the dangers of China’s technological ambitions.¹ As under secretary of the Treasury for international affairs, I learned in my negotiations with Chinese leaders that the CCP will never hold up their end of the bargain unless compelled to by us.²

Since my time in government, my worst fears about the CCP have come true, particularly since President Xi Jinping came to power and intensified China’s efforts to overtake the United States.³ Cheap labor in China gutted American communities, including many in my home state of Pennsylvania, while U.S. capital and intellectual property helped fuel China’s economic and military rise.⁴ We cannot continue to let American innovation, money, and hard work provide the foundation for the Chinese Communist Party’s efforts to become the world’s leading superpower.

At the same time, China has not adhered to the conditions placed on its acceptance into the global economy and refused to provide reciprocal access to its market. China imposes significant restrictions on investment and capital flows into and out of the country, while the United States does not. Part of this is the virtue of our free market system. But in sectors critical to our national security, this lack of reciprocity distorts the free market and puts America at a disadvantage.⁵ Our failure to hold the CCP accountable for not playing by the rules has put our country’s future at risk.

¹ David H. McCormick and James M. Cunningham, *Superpower in Peril: A Battle Plan to Renew America*, (New York: Center Street, 2023), 196.

² *Superpower in Peril*, 202.

³ Matt Pottinger, Matthew Johnson, and David Feith, “Xi Jinping in His Own Words,” *Foreign Affairs*, November 30, 2022, <https://www.foreignaffairs.com/china/xi-jinping-his-own-words>.

⁴ *Superpower in Peril*, 200.

⁵ *Superpower in Peril*, 200-2.

I saw this firsthand during my tenure as an executive at Bridgewater Associates, one of the world's largest global macro investment firms. As CEO, I had a fiduciary responsibility to our shareholders and our clients to maximize returns in line with their needs. At the same time, I held deep reservations about Bridgewater's exposure to the moral and patriotic hazards of doing business in China and often disagreed with key colleagues over China's trajectory and the nature of the CCP.⁶ Even though our firm had only a very tiny percentage of its overall business that relied on investment in China, balancing these risks with investor demands for diversification and access to fast-growing markets like China was a recurring challenge.⁷ Since my leaving Bridgewater almost two years ago, the risks have only grown more severe, and we are now seeing them play out in the way the CCP is treating foreign businesses.⁸ It has become abundantly clear that the risks are systemic and can only be addressed through government action.

China has grown to pose an existential risk to the future prosperity of the United States. The future livelihoods of our children and grandchildren are at stake in this competition. There are four primary risks from these developments. The first risk is the geopolitical threat of China's economic and national security rise. The second risk is the threat of Chinese leadership in zero-sum technologies, which could create asymmetric advantages for the Chinese military. The third risk is U.S. dependence on Chinese supply chains. And the final risk is how U.S. investment and capital flows provide China with leverage over the U.S. economy and underwrite China's continued rise.

The U.S. economic relationship with China should not come at the expense of our national security. These risks are well documented, not just theoretical. As Congress considers how the United States should respond, it should enact tailored legislation to address these risks that provide clarity to the private sector on which investments and financial relationships in China are permitted and which are not. Private sector leaders who often lack deep understanding of the national security threat posed by the CCP and who may be conflicted by near term opportunities for growth there cannot and should not be left to navigate these choices on their own.

The Risks Posed by China

1. **Geopolitical Risk:** The aggression, abuses, and ambitions of the CCP make it the greatest external threat to the United States. In the near term, a potential Chinese invasion of Taiwan would destabilize Asia and do significant damage to the global economy.⁹ In the long term, the United States faces a marathon competition for supremacy with the CCP.¹⁰ These risks are heightened by China's "no limits partnership" with Russia that could result in

⁶ Sridhar Natarajan and Katherine Burton, "Bridgewater CEO Clashes With Dalio Over China Before Senate Race," *Bloomberg*, December 4, 2021; *Superpower in Peril*, 205-6.

⁷ *Superpower in Peril*, 206; David H. McCormick, Charles E. Luftig, James M. Cunningham, "Economic Might, National Security, and the Future of American Statecraft," *Texas National Security Review*, 3, no. 3 (2020): 50-57, <http://dx.doi.org/10.26153/tsw/10222>.

⁸ U.S. House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party, "Risky Business: Growing Peril for American Companies in China," July 13, 2023, <https://selectcommitteeontheccp.house.gov/committee-activity/hearings/hearing-notice-risky-business-growing-peril-american-companies-china>.

⁹ Agatha Kratz and Charlie Vest, "Sanctioning China in a Taiwan Crisis: Scenarios and Risks," Rhodium Group, June 22, 2023, <https://rhg.com/research/sanctioning-china-in-a-taiwan-crisis-scenarios-and-risks/>.

¹⁰ *Superpower in Peril*, 198.

coordination between our biggest adversaries across the Eurasian land mass.¹¹ China is also inserting itself into other regions with strategic importance for the United States such as the Middle East, where Beijing recently served as the broker of a normalization deal between Saudi Arabia and Iran, and Latin America.¹²

2. Leadership in Zero-sum Technologies: The CCP's stated goal is to lead the world in advanced technologies, such as artificial intelligence, bioengineering, information technology, and quantum computing. If they succeed, it will come at the expense of American interests.¹³ Through the Made in China 2025 plan and other initiatives, the Chinese government is directing significant state support into priority sectors.¹⁴ No distinction is made between military and civilian use of these technologies under China's military-civil fusion development strategy.¹⁵ China also seeks to become a world leader in data to fuel continued technological innovation and bolster its surveillance state.¹⁶
3. Supply Chain Dependence: Through its "dual-circulation" model, the CCP aims to become a world leader in advanced technology so it is less dependent on other countries while, at the same time, making global supply chains increasingly dependent on China for those products. The CCP deploys an arsenal of tactics to achieve these aims, including a combination of massive state subsidies, trade barriers, data controls, forced tech transfers, and industrial espionage.¹⁷ For example, the Chinese government is investing \$143 billion in the domestic chips sector, which could help China gain significant global market share in legacy chips.¹⁸ In the pharmaceutical industry, 80 percent of active ingredients for U.S. drugs come from overseas, including from China. Additionally, "a substantial portion of U.S. generic drug imports come either directly from China or from third countries like India that use APIs sourced from China."¹⁹ While the exact figures on China's theft of U.S.

¹¹ President of Russia, "Joint Statement of the Russian Federation and the People's Republic of China on the International Relations Entering a New Era and the Global Sustainable Development," February 4, 2022, <http://www.en.kremlin.ru/supplement/5770>.

¹² Middle East: Peter Baker, "Chinese-Brokered Deal Upends Mideast Diplomacy and Challenges U.S.," *New York Times*, March 11, 2023, <https://www.nytimes.com/2023/03/11/us/politics/saudi-arabia-iran-china-biden.html>. Latin America: Diana Roy, "China's Growing Influence in Latin America," *Council on Foreign Relations*, June 15, 2023, <https://www.cfr.org/backgrounder/china-influence-latin-america-argentina-brazil-venezuela-security-energy-bri>.

¹³ *Superpower in Peril*, 93; Special Competitive Studies Project, "Mid-Decade Challenges to National Competitiveness," September 12, 2022, <https://www.scsp.ai/wp-content/uploads/2022/09/SCSP-Mid-Decade-Challenges-to-National-Competitiveness.pdf>.

¹⁴ Lingling Wei, "Beijing Drops Contentious 'Made in China 2025' Slogan, but Policy Remains," *Wall Street Journal*, March 5, 2019, <https://www.wsj.com/articles/china-drops-a-policy-the-u-s-dislikes-at-least-in-name-11551795370>.

¹⁵ U.S. Department of Defense, "2022 Report on Military and Security Developments Involving the People's Republic of China," <https://www.defense.gov/CMPR/>.

¹⁶ *Superpower in Peril*, 182-3.

¹⁷ *Superpower in Peril*, 211.

¹⁸ Chris Miller, *Chip War: The Fight for the World's Most Critical Technology*, (New York: Scriber, 2022); Sujai Shivakumar, Charles Wessner, and Thomas Howell, "The Strategic Importance of Legacy Chips," Center for Strategic and International Studies, March 3, 2023, <https://www.csis.org/analysis/strategic-importance-legacy-chips>; Ben Noon, "Biden Needs to Broaden Semiconductor Sanctions on China," *Foreign Policy*, April 3, 2023, <https://foreignpolicy.com/2023/04/03/chips-biden-xi-china-sanctions-semiconductors/>.

¹⁹ U.S.-China Economic and Security Review Commission, "2019 Annual Report to Congress," (Washington, D.C.: Government Printing Office, 2019), 250, <https://www.uscc.gov/annual-report/2019-annual-report-congress>.

intellectual property are not known, the FBI has estimated that it could cost our economy as much as \$600 billion each year.²⁰

4. **Investment and Capital Flows:** In pursuit of returns, investors are unwittingly underwriting the development of China's technological capabilities, both civilian and military. For example, index funds offered by several major Wall Street firms include companies (or their subsidiaries) that have direct links to the People's Liberation Army and are supporting China's military buildup.²¹ And given the CCP's ongoing genocide against the Uyghurs in Xinjiang, active and portfolio investments in China can expose investors to underwriting immoral behavior. Additionally, the significant amount of U.S. investment and corporate operations in China gives the CCP influence over the behavior of many U.S. companies, at times forcing them to be more loyal to Beijing's economic influence than U.S. national interests. Companies have been rewarded for investing in China with a crackdown on foreign businesses that puts employees and their operations at significant risk of raids, adverse legal action, and even detention.²²

What Congress Should Do

The outbound investment executive order announced by the Biden Administration on August 9 was a first step towards curtailing U.S. investments in strategically important sectors of China's economy. The EO, however, was extremely narrow in scope and only banned investment in advanced semiconductors and quantum computing. As Chairman Gallagher pointed out in a recent op-ed, the EO completely ignored U.S. portfolio investments in China, which indiscriminately provide capital that helps fund everything from Chinese military aircraft to surveillance equipment used to facilitate genocide in Xinjiang.²³

American companies need near-term certainty on what kinds of economic activity in China will be legal and what will be illegal. Imposing investment restrictions through an EO makes that difficult because of the time it will take the Treasury Department to develop implementing regulations that can be changed in the future. Only Congress can provide the needed certainty through legislation that is very specific about the red lines.

Calls for a full decoupling from China are understandable—and if we do not strategically restrict active investment in China, exchanges of intellectual property, and capital flows in sectors that harm U.S. national security, those calls will grow louder. The time to act is now.

²⁰ U.S. Federal Bureau of Investigation, "China: The Risk to Corporate America," 2019, <https://www.fbi.gov/file-repository/china-risk-to-corporate-america-2019.pdf/view>.

²¹ Josh Rogin, "Americans are unwittingly funding China's military expansion," *Washington Post*, August 15, 2023, <https://www.washingtonpost.com/opinions/2023/08/15/biden-china-investment-technology-restrictions/>.

²² Chun Han Wong and Dan Strumpf, "China Spy Law Adds to Chilling Effect of Detentions," *Wall Street Journal*, April 27, 2023, https://www.wsj.com/articles/chinas-expanded-spy-law-adds-to-chilling-effect-of-detentions-ce8cea1a?mod=article_inline.

²³ Mike Gallagher, "Americans are unwittingly financing the CCP. It has to stop.," *Washington Post*, August 29, 2023, <https://www.washingtonpost.com/opinions/2023/08/29/us-investment-china-technology-companies/>.

- Outbound Investment: There are many ways that the United States already protects access to its capital markets. Given the national security threat posed by China, restricting investment into the CCP's military-civil fusion strategy is warranted.
 - Congress should pass legislation establishing an outbound investment regime for China that covers both active and portfolio investment on a sector-by-sector basis.²⁴
 - In sectors considered less sensitive for national security, such as agriculture and consumer goods, publicly traded companies and investment funds should be required to disclose their investments in China and/or fund exposure in public filings.
 - Sectors deemed important for national security or with dual-use applications, such as artificial intelligence, quantum computing, and other advanced technologies, should have restrictions on investment in China. In critical sectors, we should curtail active and passive investment. For some sectors, only notification may be required, but we must not rule out prohibitions preemptively. In other sectors, investment should be prohibited.
 - It is critical in both the legislative process and development of implementing regulations that Congress, the Treasury Department, the Securities and Exchange Commission are very specific in defining covered sectors.
 - Congress should require regulators to assess on a regular basis the threat CCP penetration of U.S. capital markets poses to national security and report on how they are responding to those risks.
 - We should delist and deindex Chinese companies that do not comply with U.S. accounting and disclosure standards or that are tied to China's security organs.²⁵ Doing otherwise gives Chinese companies preferential access to U.S. capital markets and puts investors at risk, especially those who might not realize their exposure through index funds.
- Chinese Investment in the United States: Congress should close loopholes in the Committee on Foreign Investment in the United States (CFIUS) review process. Possible areas of focus should include establishing a presumption of denial in sectors deemed critical for national security and ensuring CFIUS has the authorities it needs to guard against evolving threats from China and other adversaries, including technology transfer through limited partnerships with U.S. companies.

²⁴ *Superpower in Peril*, 204-5.

²⁵ Gallagher, "Americans are unwittingly financing the CCP. It has to stop."; Mark Maurer, "Audits of Chinese Companies Are Highly Deficient, U.S. Regulator Says," *Wall Street Journal*, May 10, 2023, <https://www.wsj.com/articles/audits-of-chinese-companies-are-highly-deficient-u-s-regulator-says-2da99766>.

- Reduce U.S. Dependence on China: There are far too many supply chains critical to U.S. national security, including for advanced technology, where we are dependent on China. Our supply chains should fit into a set of concentric circles, with different policies directed at each. At the center are the things most sensitive that should be produced at home for our own security and necessity. The next circle are vital goods that can be produced by our most trusted allies and partners, such as Australia, the United Kingdom, and Japan. Beyond that are reliable trading partners that can produce critical goods but should not be their sole source. Finally, at the outer edge, are countries like China where nonstrategic trade can take place.²⁶
 - Making this happen while driving forward innovation will require policies that incentivize private capital toward these sectors in a sustained way and working together with our allies to build new supply chains.²⁷ Areas of focus should include components of the defense industrial base, critical minerals, information technology, and pharmaceuticals.
 - An outbound investment regime is also important for addressing supply chain dependence because U.S. capital outflows should not deepen our vulnerabilities in China.

While this testimony has focused on the many ways that U.S. investment and corporate activity in China create risks, it's important to note the important role the private sector plays in our national and economic security strategy. Collaboration between the U.S. government and private sector has always been critical to our success. After all, these partnerships were a major reason why the United States won the economic and technological competition against the Soviet Union. American leadership in technology and our innovation ecosystem is a key reason why so many U.S. companies are among the world's most successful and important firms.

To win the competition with the CCP and preserve American economic competitiveness, business and government must continue to collaborate. That's why this hearing and developing a clear path forward is so important.

To be clear: the Chinese Communist Party poses a grave threat to our American way of life. If we are going to win this competition and ensure a bright future for the next generation, we must take this threat seriously and build muscle at home while at the same time ensuring that the U.S. economy and financial system are not aiding China's rise. If the Biden Administration will not take the difficult steps needed to address these risks, then it is up to Congress to enact legislation that gives American businesses the clarity they need to continue innovating, creating jobs, and growing our economy so every family can live the American Dream.

²⁶ *Superpower in Peril*, 203.

²⁷ *Superpower in Peril*, 144-7.