

Senator Kit Bond  
Keynote prior to Panel Discussion  
“Evaluating the National Security Risk of Chinese Investment”  
Heritage Foundation  
Monday, October 15, 2007  
Washington, D.C.

20 minutes

Thank you, Walter. It is a pleasure to be here for this important discussion.

I think your topic “Evaluating the National Security Risk of Chinese Investment” flies under the radar of most Americans, but the implications – militarily and economically - are enormous.

The decision by Bain Capital to include China’s Huawei Technologies - a company with close ties to the Chinese military - in a buyout of 3Com Corporation, has for obvious reasons, raised a number of questions and security concerns.

After all, this deal comes in the wake of a litany of troubling events:

- A cyber attack on the Pentagon earlier this year, purportedly by some entity in China.
- The surfacing of a Chinese submarine miles within the USS Kitty Hawk Aircraft Carrier.
- The successful test of an anti-satellite weapon that destroyed a civilian Chinese satellite, leaving a trail of space debris in its wake.

So, your question as to whether or not these investments pose a threat to America’s security is a legitimate one, and a timely one.

The US Department of Defense is among 3Com's clients for technology designed to prevent such cyber-attacks. Does Chinese investment increase the security risk?

As the global economy grows larger and more interdependent, we are increasingly facing such difficult policy questions about how to handle foreign investment. How to balance the need for economic growth and job growth...with our paramount national security needs.

Let me start off by sharing with you an example of one way in which we should NOT handle this situation...

Many of you may recall the publicity and media frenzy last year surrounding the proposed sale of a number of U.S. port operations to Dubai Port World.

The frenzy was exacerbated by many of my congressional colleagues whom, had they been armed with the facts and set aside politics and phobias, would have concluded that the sale in no way jeopardized our national security.

Rather, it would have enhanced our security and would have been a great benefit to our economy.

But in a post 9-11 world, it is understandable that so many citizens were sensitive to the deal. That fact alone warranted additional prudence. However, the outright opposition to the Dubai Port sale by Members of Congress, who should know better, was shortsighted and frankly, dumb.

This was a bad example of a hockey hat trick...

- 1.)It was contrary to our free-market and open and fair trade policies.

- 2.) It was also a snub to an ally. We desperately need moderate allies in the War on Terror, especially in the Arab world which is too often populated by extremists.
- 3.) For those worried about outsourcing jobs... need to understand that capital investment creates jobs. Demanding that the U.S. buy back the port facilities means that \$8B will be outsourced, along with jobs it will create overseas rather than in the U.S.

But instead of waiting to learn the ins and outs of the deal, many members of Congress leaped before they looked. .

Businesses do not invest \$8 billion in something to let it be blown up.

The agreement would have allowed one of our most forward-thinking friends in the Middle East to invest in and have a stake in our homeland security.

Disapproving the sale sent a message contrary to our efforts to win the “hearts and minds” of moderate, pro-Western Arab allies in Global War on Terrorism.

The UAE had been and continues to be a tremendous ally in the war on terror:

- The UAE has afforded unprecedented access to U.S. troops.
- The UAE has a world class carrier port and we have more US Navy ships in UAE ports than in any other port outside the U.S.
- They service and supply our ships while they are in port which ensures that our ability to project power in support of our national security interests will not be compromised.

- And last year alone, the United States docked over 500 war ships in Dubai and operated countless numbers of air exercises from air strips in Dubai.

Put simply, those who rejected the deal – and with it billions of dollars in foreign investment and job security for thousands of longshoremen and stevedores – did so based on nothing more than good old-fashioned protectionism and xenophobia.

I belabor this example of the Dubai Ports situation from last year as an example of how we must NOT handle ANY foreign investment deals....whether they involve outside investors from the Middle East, Europe, South America, Australia....even China.

Parenthetically, speaking of inappropriate Congressional meddling in foreign affairs, I would cite the House Foreign Affairs Committee's passage of condemning genocide.

What impact will this have? Disastrous on Turkey and bad for our efforts in Iraq.

Last Friday, Prime Minister Ergodan of Turkey stated:

"Democracts are harming the future of the United States and are encouraging anti-American sentiments."

However, I need to make it very clear that I am not suggesting that China be treated exactly like Dubai. Far from it.

As the Pentagon's 2007 report to Congress on "Military Power of the People's Republic of China" notes:

"The outside world has limited knowledge of the motivations, decision-making, and key capabilities supporting China's military

modernization. China's leaders have yet to explain adequately the purposes or desired endstates of the PLA's expanding military capabilities." *(taken from the report's executive summary)*

The Pentagon report also notes that "China continues a systematic effort to obtain from abroad through legal and illegal commercial transactions dual-use and military technologies," and that obtaining these foreign "dual-use" technologies, such as software and electronics, is vital for the modernization of the Chinese military. The Pentagon report also cites several high profile legal cases that highlight China's efforts to obtain illegally sensitive U.S. technologies by targeting well-placed scientists and businessmen. "U.S. Immigration and Customs Enforcement (ICE) officials have rated China's aggressive and wide-ranging espionage as the leading threat to U.S. technology. Since 2000, ICE has initiated more than 400 investigations involving the illicit export of U.S. arms and technologies to China." *(taken from page 29 of the report)*

More specifically, it has been noted that China's Huawei Technologies grew out of the People's Liberation Army (PLA) General Staff Department's Information Engineering Academy in 1988 and has been the PLA's political patron, customer and R&D partner .

The sale to China of high performance computers and other advanced technology with potential military uses is a vital national security issue.

Despite official U.S. monitoring of the export of sensitive electronic equipment to China during the late 90's and early 2000's, the communist regime in Beijing managed to acquire lots of dual use American technology to modernize its armed forces.

Back in 2002, Gene Poteat, President of the Association of Former Intelligence Officers and a retired CIA scientific intelligence officer and expert on China's threat capability stated:

“Nobody believed in terrorism and what would happen. We're sort of doing it to ourselves again by subsidizing these technology sales through our commercial purchases [from China]," he said.

China spends hard currency it earns through the sale of consumer goods to the West on the latest in modern weapons from Russia, including destroyers that have SSN-22 cruise missiles, which if properly armed could sink an aircraft carrier.

The answer to the question of how China is getting this technology is this: in every way, possible both legal and illegal.

Just last Thursday, the Justice Department along with several partner agencies, launched a national initiative to combat the growing national security threat posed by illegal exports of restricted U.S. military and dual-use technology.

The Justice Department release stated:

“China and Iran pose particular U.S. export control concerns. The majority of U.S. criminal export prosecutions in recent years have involved restricted U.S. technology bound for these nations as opposed to others. Recent prosecutions have highlighted illegal exports of stealth missile technology, military aircraft components, Naval warship data, night vision equipment, and other restricted technology destined for China or Iran.”

As troubling as all this is, it does not mean that we should slam the door on any and all investment from China.

For instance, if Huawei really had designs to steal Us technology, then couldn't they perhaps find a better way of doing it than by acquiring a 16.5% equity stake in a U.S. company?

While this could very well be the case, we need an objective and sophisticated process, like CIFIUS, to sort through all the available information on a company like Huawei and determine whether a particular investment poses an unacceptable risk.

I understand some members of the House have already decided that they know better and have introduced a resolution, HR 730, calling on CFIUS to block the acquisition by Huawei.

Again, while I share many of their concerns, they are basing their conclusions on what they refer to in the resolution as a “preponderance of publicly available evidence” that clearly suggests that the proposed transaction threatens U.S. national security.

The Dubai Ports World deal serves as an excellent example of Congress’s increasingly isolationist, protectionist and sadly even in some cases, xenophobic, attitudes towards free trade and foreign investment. Again, however, China is in no way on the same level as the United Arab Emirates in terms of military cooperation and in fact, are apples and oranges.

But most of all, the Dubai Port deal underscores why politics and politicians should play only a limited, oversight role and let the Congressionally-approved Committee on Foreign Investment in the United States, conduct its work, regardless if we are dealing China, a middle east ally, or wherever.

My corollary to Newton’s 2<sup>nd</sup> Law of Physics; for every action, Washington tends to pursue an unequal and negative over-reaction.

The litany of legislative proposals in the wake of the Dubai Ports deal to reform the Committee on Foreign Investment Inside the U.S. or CFIUS, were by in large an overreaction that could have stifled foreign

investment, stunted U.S. economic growth and in some cases, weakened our national security by pushing allies away

Miraculously though, Congress managed to pass a sensible law on CFIUS that was signed by the President on July 24.

It reaffirms that Treasury should chair an interagency committee in which all the agencies are equal in the CFIUS process. For instance, on something of importance to the Department of Defense, then the DOD would have the lead role in assessing vulnerabilities, as I would assume would be the case for the Huawei deal.

MOST fortunately, Congress did not give itself a detailed role in the process.

The risk that decisions would become political footballs by members protecting an industry, a state business or just looking for political issues, would be too great, as we discovered during debate over the Dubai ports deal.

So Congress does not have a role in the process beyond conducting oversight and making sure the government agencies are doing their jobs correctly.

The law does address the concerns of Congress:

- It gives the DNI a permanent role, even though they were conducting intelligence assessments prior to passage of this law.
- It ensures that security agencies will have an equal voice in the process and in cases like Huawei, that DOD will have a lead role in the process.
- It ensures senior level oversight in the agencies by requiring that all final decisions be made by senior officials, and in the case of a

government-controlled company, the Secretary or Deputy Secretary themselves have to make the final decisions.

- It ensures that CFIUS reports to Congress on its decisions, any mitigation measures, and reasons for arriving at those decisions.

Many critics have asserted, just as they did during the Dubai debate, that CFIUS has only blocked one deal and that CFIUS would be reluctant to disapprove the Huawei deal.

But while it is true CFIUS has only blocked one deal, it does not account for those deals in the past that were dropped because it was clear they were not going to be approved.

And it does not account for those deals that went through after companies divested part of their assets or were put under strict conditions by the government.

The new law provides for level-headed consideration of foreign investment deals.

The Huawei Technologies deal might well yield different conclusions based on the increased potential threat posed by China versus that of a staunch ally like the UAE.

Embracing protectionism and isolationism, however, will protect us from nothing and will surely isolate us from the economic and security benefits that trading and engaging nations abroad yields....especially a continually emerging economic powerhouse like China.

Goldman Sachs projects that by 2030, China will have surpassed the United States in terms of GDP as the world's largest economy.

In terms of purchase power parity, some statistics have China's economy as large as ours in 2008 or 2009.

A quarter of Chinese industry is foreign-owned and we depend on Chinese industry for cheap consumer goods.

We can ill afford to isolate ourselves from what will be the largest economy in the world with the largest consumer market in the world as well.

But at the same time, we must be mindful of any security concerns, recognizing China's military growth commensurate with its economic growth.

We must also be mindful that China that:

“The leadership of the 50 largest central state-owned enterprises—enterprises that invest around the world—is directly appointed by the Politburo.” (Essay by Carsten A Holz, April 2007, The Far Eastern Economic Review)

Foreign direct investment –when determined not to be a threat to national security – is good for the American economy – whether from China, Europe, Southeast Asia or anywhere.

**Foreign Direct Investment (FDI) Creates New Jobs.** 5.3 million Americans work for the U.S. affiliates of foreign companies.

**Foreign Investment Boosts Wages:** U.S. affiliates of foreign companies tend to pay higher wages than U.S. companies.

- **Foreign Investment Strengthens U.S. Manufacturing:** 41 percent of the jobs related to U.S. affiliates of foreign companies are in the manufacturing sector. (Source: BEA)
- **Foreign Investment Brings in New Research, Technology, and Skills:** Affiliates of foreign companies spent \$30 billion on research and development in 2003 and \$109 billion on plants and equipment. (Source: BEA). These advances are often adopted by locally-owned companies.
- **Foreign Investment Contributes to Rising U.S. Productivity:** The increased investment and competition from FDI leads to higher productivity growth, a key ingredient that increases U.S. competitiveness abroad and raises living standards at home. (Source: Bureau of Economic and Business Affairs (EB), U.S. Department of State)
- **Foreign Investment Contributes to U.S. Tax Revenues:** In 2002, foreign affiliates paid \$17.8 billion in taxes, which represented 12 percent of U.S. corporate tax revenues. (Source: Internal Revenue Service)
- **Foreign Investment Can Help U.S. Companies Penetrate Foreign Markets, and Increase U.S. Exports:** U.S. companies can use multinationals' distribution networks and knowledge about foreign tastes to export into new markets. Approximately 21 percent of all U.S. exports come from U.S. subsidiaries of foreign companies. (Source: BEA)
- **Foreign Investment Helps Keep U.S. Interest Rates Low:** The inflow of foreign capital also decreases the cost of borrowing money for domestic entrepreneurs, especially in the small- to medium-sized enterprise sector. (Source: EB)

Just ask our Nation's farmers – who produce more than enough food and fiber to feed our nation – who wish to sell their products abroad.

China, with its remarkable growth and population of over 1.3 billion people, has the potential to increase the global economy more than any other nation in history.

China's emergence on the world stage as an economic power and increasingly advanced military power, is one of the great foreign policy opportunities AND challenges before our nation and the world.

In particular, the prospect of a cyber attack on major private sector entities such as banks, power companies, stock markets, et al., could have an impact on our economy more devastating than 9-11.

Because of the potential devastation, preventing cyber-attacks on BOTH government and major private sector entities involves employing all of our preventative tools necessary...including the denial of a potentially dangerous foreign investment.

When evaluating the positives and negatives of foreign investment, particularly with China, our nation's security concerns must be paramount.

So let's allow our national security leaders and experts involved in the CFIUS process to do their jobs and address the need for balancing our nation's security with our economic opportunities.

Thank you very much.