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SYSTEMIC RISK: THE CHINESE COMMUNIST PARTY'S

THREAT TO U.S. FINANCIAL STABILITY

Tuesday, September 13, 2023

House of Representatives,

Select Committee on the Strategic Competition Between

the United States and the Chinese Communist Party,

Washington, D.C.

The committee met, pursuant to call, at 8:30 a.m., at the Council on Foreign Relations, 58 E 68th Street, New York, New York 10065, Hon. Mike Gallagher [chairman of the committee] presiding.

Mr. Gallagher. The select committee will come to order. And the clerk shall play the video. Preferably with audio.

[Video shown.]

Mr. Gallagher. Thank you. We can play it again, but I think we got the message.

For years national security leaders by Admiral Davidson have been screaming from the rooftops that the People's Republic of China and specifically the Chinese Communist Party poses the greatest threat to our country. President. Biden's Director of National Intelligence, Avril Haines, recently testified that, quote, the CCP represents both the leading and most consequential threat to U.S. national security.

Just yesterday, the Secretary of the Air Force Frank Kendall said that the intelligence couldn't be clearer; China is preparing for war with the United States. It should be a sobering message to all of us.

Yet, here in New York, it seems sometimes that Wall Street does not act like PRC is a threat at all. A few months back, the head of a major asset management firm came to my office and told me that the chance of China invading Taiwan in the next 5 years was, and I quote, near -- zero -- not near zero -- zero. Another told me that the U.S. would never impose real sanctions on China even if it were to invade Taiwan.

It seems like Washington and Wall Street are two different countries speaking completely different languages. And it is ironic because these banks and asset managers have incredibly complex value at risk model too look at volatility and correlation. But, when it comes to the systemic risk emanating from a genocidal Communist regime, they tend to put on their golden blindfolds and chase a yield that never comes.

Ranking Member Krishnamoorthi and I recently launched an investigation into Wall Street firms that are funneling American retirement money into companies that help build aircraft carriers for the PLA, next-generation stealth fighter jets for their Air Force, and artillery shelves for the PLA. Mind you, these companies are all blacklisted by the U.S. Government and often have strong prohibitions on selling them advanced technology, according it our export controls, yet Wall Street sees no problem in shoveling money to them.

So imagine if the disastrous scenario that Admiral Davidson fears is all too plausible and actually comes to pass. China's military could be raining missiles on our friends in Taiwan and very likely American servicemembers with weapons that Americans funded. They may be using AI targeting systems that Silicon Valley VCs helped them build. In short, we are at risk of financing our own destruction.

The Biden administration's executive order is a first step to address the problem, but it must not be the last. It is up to Congress to ensure American money isn't financing the CCP's top tech ambitions including AI, quantum computing, and semi-automatic, but also biotechnologies, directed energy, hypersonics, advanced manufacturing, space technologies, anything associated with the PRC's military-industrial complex.

Here's the thing: Every day that we keep funding the CCP'S military ambitions, every day that we delay vital military aid to Taiwan, we make conflict in the Indo-Pacific more likely.

Last night we hosted a variety of Wall Street executives at a tabletop exercise that focused not on missiles and torpedoes, but rather on sanctions on shipping routes, the SWIFT system, supply chains, and other areas of economic warfare. We saw that if China were to initiate preparations to invade Taiwan, the losses across our financial system would dwarf the writedowns taken at the outset of the Russia-Ukraine war. The entire U.S. economy and banking system would be imperiled. Equity markets would drop precipitously as global shipping lanes close. Shipping insurance premium would skyrockets. Supply chains would break down. And the specter of global conflict would grow, causing further chaos in the global financial system.

Americans would likely see their pensions shrink and their bank accounts hemorrhage cash.

So the question is, what are we doing and what is Wall Street doing to guard against that outcome? Are banks and asset managers moving to protect American investors, or are they just betting on another bailout? The risks, in my opinion, go well beyond the kinetic conflict in the Taiwan Strait. American investors in China are like the proverbial frog slowly boiling in a pot of water. The CCP is criminalizing routine business practices, often once necessary for if you fulfilling fiduciary obligations to investors and shareholders, like due diligence, data gathering, and independent corporate governance.

Given those risks -- the risks are myriad -- you would think that, if American pension money were going into Chinese firms, we would have a much higher accounting and regulatory standard for those firms, especially when they list on our exchanges. But, in fact, the very opposite is true.

A recent deal struck between SEC, PCAOB, and the Chinese Government effectively circumvents the Holding Foreign Companies Accountable Act and allows China to audit its own firms, throwing American investors to the wolves and disadvantaging American companies.

The CCP has nothing but contempt for our democratic capitalist system. Why should they enjoy the unfettered benefits of our capital markets? If nothing else, you would think Wall Street would think twice about financing companies that facilitate the

CCP's Uyghur genocide, engage in forced genetic testing of oppressed populations, or use forced labor up and down their supply chains. To quote written testimony submitted by David McCormick, the former CEO of Bridgewater Associates, will these firms ever stop underwriting immoral behavior?

The truth is American pensions, endowments, and retirement savings are not being protected; they are being swindled. Fraud, fake accounting, and outright lies are endemic in the Communist system. Taking on a genocidal Communist regime as a business partner is not a recipe for success; it is a recipe for systemic risk.

And, with that, I recognize the ranking member, Raja Krishnamoorthi, for his opening statement.

[The statement of Mr. Gallagher follows:]

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Mr. Krishnamoorthi. Thank you, Mr. Chair.

Good morning to all of our attendees, and thank you to our witnesses.

Mr. Chair, just a couple of weeks ago, we were in Stoughton, Wisconsin. Just a few weeks before that, we were in Dysart, Iowa. Today, we're here in New York City.

Over the past 6 weeks that we've traveled the country, we've seen a dominant theme emerge. The CCP has taken aggressive steps to advance its economic interests at the expense of American ones. Doing nothing in response to these risks posed by the CCP's economic aggression is not an option. These risks harm people in the smallest towns and the biggest cities. They threaten industries from the corn and soy fields of Iowa to the factories of Wisconsin to the training floors of Wall Street. They are risk realized through intellectual property theft and forced technology transfer by unfair trade and industrial policy and by a military-civil fusion system that takes American dollars and uses them to fuel military aggression and human rights abuses.

When we were in Iowa, we asked what we could do to better protect our farmers and the intellectual property that helps defeat the world. When we were in Wisconsin, we asked what we could do to better protect our job creators who help to create paths into the middle class. And now, here in New York, the world's financial capital, it's important that we ask what we can do to better protect Americans' money and the global financial system.

Let's use the Federal Government's Thrift Savings Plan as an example. As reported by Newsweek earlier this summer, more than 115 mutual funds in the Thrift Savings Plan, or otherwise known as the TSP, contain more than 20 sanctioned or watchlisted PRC companies or their subsidiaries. These companies make, among other things, fighter aircrafts and ship engines for the People's Liberation Army and pose a direct national security risk. They also use Uyghur forced labor to produce textile, clothing, household electronics goods, and medicines. By investing in these companies we risk supporting the CCP's military aggression and their human rights abuses.

But that's not the only risk facing American investors from the CCP. As of January 2023, there were more than 250 Chinese companies listed on U.S. stock exchanges, with a total market cap of over $1 trillion. These are stocks that Americans are investing in every day, but they don't come with what most Americans consider to be standard investor protections. Their complicated corporate structures carry massive risk, all the way the CCP is cracking down on the very act of disclosing risks. The CCP is doing this by cracking down on due diligence to the point where the U.S. Chamber of Commerce has said that, quote, risk can't be properly assessed.

The CCP is so afraid of bad news getting out that they've stopped publishing their skyrocketing youth unemployment numbers and instructed investment banks to avoid publishing politically sensitive data that could make the Chinese economy look bad. It's no wonder that, just a couple weeks ago Secretary Gina Raimondo said that, according to some business leaders, quote, China is uninvestable because it's become too risky.

It's our job on this select committee to make sure that our constituents face less risk and more certainty. It's our job to make sure that, in the same way your food supply and your jobs are protected from harmful CCP policies, that your money is protected too. It's why we've acted in the committee to launch a bipartisan investigation into American VC firms supporting Chinese AI semiconductor and quantum computing companies, as well asset managers and index providers helping to direct capital to red flag companies that violate human rights and strengthen the Chinese military.

It's also why I believe the Biden administration has taken critical and positive steps to address these problematic outbound investments, steps that deserve our support and legislative action to strengthen them.

The stakes for our families from Iowa to Wisconsin to New York are simply too high to ignore. And they are too high for us to settle on a path of inaction.

I look forward today from hearing from our witnesses about what we can do to address these risks and protect the interests of American people. Thank you, and I yield back the balance of my time.

[The statement of Mr. Krishnamoorthi follows:]

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Mr. <u>Gallagher.</u> Thank you.

If any other member wishes to submit a statement for the record, without objection, those statements will be added to the record.

We are privileged today to have a great line up of witnesses, each of whom brings a unique set of insights into the threat the Chinese Communist Party poses to U.S. financial stability. Unfortunately, one of our witnesses, Mr. Jim Chanos, could not make it here due to bad weather. My understanding is he was over Pennsylvania when his plane was forced to turn around, and he could not find any other flights due to air traffic control in New York. I will not make a sort of jab at LaGuardia or JFK. I appreciate the hospitality we've been shown in New York City.

But I just really want to quote -- his testimony is exceptional. I encourage you all to read it. One thing that stood out to me was this quote: I've often said that China is the only country in the developed world that knows its GDP on January 1st of that year. However, as GDP grows, so does the required amount of additional investment needed in grow in the future, much of which is debt funded. We call this China's treadmill to hell.

So he didn't pull any punches in the testimony.

Our first witness is The Honorable -- and a great Wisconsonite and Packers fan. Our first witness is The Honorable Jay Clayton, who will help us understand the breadth and severity of the systemic risk which the PRC's penetration or our capital markets creates. Mr. Clayton served as the Chairman of the Securities and Exchange Commission from May 2017 to December 2020 and is now of counsel to Sullivan & Cromwell.

Next to him, we have Ms. Anne Stevenson-Yang, the founder of J Capital Research. Having lived in and studied in China and studied the PRC market for decades, Ms.

Stevenson-Yang brings a unique credibility in unraveling the truth behind the data on the PRC economy.

Thank you to both of you for being here this morning.

If you please rise and raise your right hand, I'll now swear you in. Do you swear or affirm under penalty of perjury that the testimony you are about to give is true and correct to the best of your knowledge, information, and belief so help you God?

[Witnesses sworn.]

Mr. Gallagher. You may be seated.

Let the record show that the witnesses have answered in the affirmative. Thank you all.

Mr. Clayton, you're recognized for 5 minutes for your opening remarks.

TESTIMONY OF THE HONORABLE JAY CLAYTON, FORMER CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION; AND ANNE STEVENSON-YANG, FOUNDER, J CAPITAL RESEARCH.

TESTIMONY OF THE HONORABLE JAY CLAYTON

Mr. Clayton. Thank you Thank you, Chairman Gallagher, Ranking Member Krishnamoorthi. It's nice to be here today. I submitted detailed written testimony. What I think I'll do is respond a bit to your opening remarks and make four points.

First, I want to recognize Speaker McCarthy, Leader Jeffries, and the members of the committee for taking on this traffic. It is a complex, difficult, and, I would say, novel task. I don't know that, in our globally integrated economy, we have ever had two what I would say -- well, the two largest economies be deeply conjoined but also what I would say is deeply at odds in certain areas. It is a difficult task. It is one that spans not just financial regulation but, as you both mentioned national security, trade policy, human rights, and dare I say foreign policy because it's not a bilateral issue; it's a multilateral issue. So congratulations and thank you.

Next thing is the touchstones of financial regulation. Touchstones of financial regulation at the individual firm level, why we make investments, why we pull back investments, go down to transparency and accountability. I think we should remember those as we look to craft policy going forward and the policies that we have. Given good information, which you need accountability to have good information, investors generally make good decisions. The other one is stability, financial stability. The commitment of the U.S. and other countries to financial stability, to responsible capital rules, to liquidity rules. It gives us the confidence in order to have a globally integrated and globally integrative financial system. If you're confident that other countries have a commitment to stability, it's much easier to trade with them and have cross-border investments.

The next thing, and it's a bit of a sobering pill, is the limits of financial regulation. Financial regulation can be incredibly powerful. Capital flows are incredibly powerful. They finance the future. They do things. And, as I said, investors are very good at responding to good information. Investors are very good at responding to financial metrics and prudential requirements, financial institutions are.

Investors are not good at, they don't have the information to be good at, human rights, national security, trade policy. Those are matters for the government. And I want to emphasize that.

But what I will say and my last point is that, given clear and coherent direction from governments, the power of the market to respond to policy is remarkable. If -- a recent example provides this: The Russian sanctions around financial instruments and financial markets were incredibly powerful. They were comprehensive. They were bilateral. And immediately people pulled back. Now that I think has caused a number of people on Wall Street and investment community to look at what would have happened in a similar scenario with China. And I have seen in initial indicia of people looking at what would happen going over those scenarios and starting to think: Okay, how can I derisk such a situation?

One of the recommendations I make, and I will close with this, is that the U.S. Government through the FSOC or other body could do that kind of scenario planning and help us better understand what the risks are and how to derisk any type of abrupt shift in investment in capital flows.

And, with that, I thank you.

[The statement of Mr. Clayton follows:]

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Mr. Gallagher. Thank you very much.

Ms. Stevenson-Yang, you are recognized for 5 minutes for your opening statement.

TESTIMONY OF ANNE STEVENSON-YANG

Ms. Stevenson-Yang. All right. So thank you, Mr. Chairman and ranking member and the other members in attendance.

And I agree with Mr. Clayton that the key here is investor information. How to get investors information is a bit of a different issue. We're in a bit of a bind with China with China because we a have a deep and broad economic relationship with China, and we can't simply decouple. And, yet, we face some fundamental disjunctions between the U.S. systems and Chinese systems.

Countries expect one another to be honest and to follow norms, like telling -- giving clear and true information about the economy, not deputizing members of society to steal intellectual property, not committing human rights violations and so on and so forth. And China does none of these things. So what do we do?

I think the first step is to stop letting the wolf warrior class in China intimidate Americans and keep us from, for example, meeting with Taiwanese leaders, putting bans on products made in Xinjiang, talking about human rights and so forth, by raising the threshold of threat so very high as they do.

The next step is targeted sanctions. I think that the strengthening of CFIUS during the last administration was very effective. I think that the October 2022 targeted export restrictions on semiconductors were very effective and the August 2023 executive order on investment looks to be very effective, and we need do more of that.

What else do I have to say? I think that, in the end, there are some measures that we can take to limit the damage of the sort of juxtaposition of this square peg in the round hole of the U.S. economy. But, ultimately, we need better investor information, and we need to, as a country, invest in our own infrastructure, our own education, and our own strengths as a country as opposed to China.

So I will yield there.

[The statement of Ms. Stevenson-Yang follows:]

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Mr. Gallagher. Thank you.

Whatever that was in our ears, it wasn't because of anything you said; I assure you.

Mr. Krishnamoorthi. CCP.

Mr. Gallagher. That's right.

We'll now move to member questions. I'll begin.

Mr. Clayton, I guess I was struck by two things yesterday and then in reading your statement and listening to your statement. One, we had a variety of conversations with asset managers and bankers yesterday, who I think it's fair to say have a slightly more dovish view of China than I do. I won't speak for the other members of the committee.

But one thing I left with is that, as long as they had predictability and an appropriate transition period to live with new rules let's say on outbound capital investments, I think that we could reach an agreement. What Wall Street hates more than anything else is uncertainty and this prospect of swinging wildly back and forth between this executive order, this -- that executive order, this administration, that administration. So, to me, it sort of emphasized a basic point where it said Congress should step up and legislate a lasting solution. And, when you mentioned clear and coherent direction, I was reminded of that. I would just be curious to get your reaction to that.

Mr. Clayton. Well, I would agree. And I would say, you're right, Wall Street -- but markets hate it.

Mr. Gallagher. Yeah.

Mr. Clayton. Markets hate surprises. The bigger the surprise, the worse of market reaction. The more retrenchment, the worse it is for investors. And I completely agree with you that let's just posit -- and I think it's pretty easy -- that we are uncomfortable with the level of integration, particularly in certain areas. We are uncomfortable with the investment flows to certain places. A coherent strategy to deal with those two issues I believe, as I said in my testimony, investors will respond.

Mr. Gallagher. Yeah.

Mr. Clayton. Investors respond to return for level of risk. And, if it's demonstrated to investors that the level of risk has increased, they will pull back. If the level of risk has decreased, they will invest.

Mr. Gallagher. And, on the latter issue of capital outflows to China, would that in your opinion include both passive and active investment or private and public investment? Because the executive order only tackles private equity and venture capital.

Mr. Clayton. Well --

Mr. Gallagher. Which is 17 percent of the --

Mr. Clayton. I agree with Anne, that the executive order and what it tries to capture, which is inflows into areas where investors can't make these judgements but governments can.

Mr. Gallagher. Yeah.

Mr. Clayton. A government can say: This is not an area we want to fund.

It has to be coherent, cohesive. That means not just one channel of investment but all of the channels of investments that you look at. So I agree that the order is, you know, well-structured, clear, provides direction, but you have to make sure that it's coherent across all investment channels and not just from the United States.

Mr. Gallagher. And then you talked about the need for -- you referenced a proposal that's in your written testimony about the need for scenario planning. I mean, we went through a scenario yesterday. And, at one point, maybe I made the comment that I would assume somebody at Treasury or Commerce or the Fed is doing this every single day, giving the complexities. Like, we should be wargaming a financial and economic escalation with China over Taiwan, but I doubt that that's happening. Based on your experience in government, have you seen such a robust contingency planning? And what would your proposed solution look like?

Mr. Clayton. So I'm sorry for a bit of a long answer.

Mr. Gallagher. Yeah.

Mr. Clayton. Companies do contingency planning at the company level.

Mr. Gallagher. Yeah.

Mr. Clayton. They are pretty good at it. They know their markets. They know what will happen.

At the macro level, macro flows, that's where we do rely on our prudential financial regulators and others. I believe that -- you know, let's put it this way, scenario planning, tabletop exercises, they are not just academic. By going through them, you reduce risk because people adjust to the results of those. So I completely agree that those types of exercises should be taking place with the considered input not just of Treasury, the SEC, but also commerce and national security issues. This is new, and it's worth doing that work.

Mr. Gallagher. Yeah.

And, Ms. Stevenson-Yang, in the minute I have left, I think your comments about the need for better information are very well taken and important.

What basic steps can Congress take to ensure that we have full transparency and to the extent of -- recipients of U.S. investment in China and to address the risks that you've outlined for us?

Ms. Stevenson-Yang. Well, as Mr. Clayton said, the role of government is to look at these macro flows and to identify where the risks are there. I think a lot more information needs to be gathered on which companies, for example, are active in Xinjiang, which companies use forced labor.

Mr. Gallagher. Yeah.

Ms. Stevenson-Yang. Which companies are actively engaged in taking U.S. technologies and in transferring technologies to the military, which companies are connected to the military, because I think that, as investors and consumers get this information, they tend to back off. Yeah.

Mr. Gallagher. Thank you. My time has expired.

I now recognize the ranking member for 5 minutes.

Mr. Krishnamoorthi. Good morning. Thank you again.

The risks associated with the PRC's entanglement with U.S. capital markets aren't just a concern for Washington or Wall Street. It is turns out it's something that should matter to ordinary Americans investing in the market. For example, here's a graphic that shows Alibaba isn't just the PRC's most famous tech company; it was the largest IPO in American history. I think Mr. Clayton actually worked on that IPO at one point. But it turns out, Alibaba is just one of member. Always of January, there were 250 companies listed in the U.S. with a market cap of more than $1 trillion. But, in most cases, Americans don't actually own these companies. They own something called a variable interest entity, a VIE for short. To quote Mr. Chanos' statement submitted for the record and his writings, it's, quote, a piece of piper with no legal ownership rights in the underlying assets in the PRC; just a contract that says they'll share profits.

Ms. Stevenson-Yang, in a 2021 Forbes article, you said that this VIE structure is, quote, clearly illegal under Chinese law. Right?

Ms. Stevenson-Yang. Yeah, that's correct.

Mr. Krishnamoorthi. And you also mentioned, quote, Beijing has made threats against the VIE structure. And in this statement that you submitted to us, you said, quote, would likely ban, close quote, these VIE listings. Doing so would tremendously impair the value of all the investors' assets. Right?

Ms. Stevenson-Yang. It would. But I think that one thing we've learned about the Communist Party in China is that they will be willing to sacrifice economic growth for their own strength and dominance.

Mr. Krishnamoorthi. Sure. But it would hurt our investors.

Ms. Stevenson-Yang. And it would hurt -- it would hurt our investors for sure, but I think that, in the end, that's probably inevitability. They have done it before, and I think they will do it again.

Mr. Krishnamoorthi. Ms. Stevenson-Yang, one of the VC firms in our investigation also invested in Megvii. And I want to throw up a graphic of a chilling picture of a Uyghur concentration camp. Megvii is now sanctioned for, quote, actively supporting the biometric surveillance of Uyghurs. Americans shouldn't be able to invest in companies that support this. Right?

Ms. Stevenson-Yang. That's right. It's not a happy tool to use investment, but it's the only one that we have.

Mr. Krishnamoorthi. Some of the companies we are investigating also helped direct capital to ZTE, which is banned from U.S. networks due to espionage concerns. Ms. Stevenson-Yang, if a router is too risky to use in America, we shouldn't be routing money to its manufacturer. Right?

Ms. Stevenson-Yang. That's right. ZTE is directly under the Ministry of Aeronautics and is clearly part of the Chinese military system.

Mr. <u>Krishnamoorthi.</u> Let me turn to another issue we are very familiar with, and that is the Federal Thrift Savings Plan, also known as TSP: 6.8 million Federal employees are invested in the TSP, including many Active Duty military members, including many Members of Congress, including me. And what I learned talking to my staff in researching this issue is very unsettling. TSP funds companies involved in building this, this graphic. The PLA's fifth-generation fighter jet, also known as the J-20, which would be critical for China possibly invading Taiwan. It's manufactured by a company call AVIC, A-V-I-C. TSP offers index funds which invests in subsidiaries of AVIC, which is under U.S. sanctions today.

Again, Ms. Stevenson-Yang, most Federal employees probably have no idea that their money is potentially invested in these companies. Right?

Ms. <u>Stevenson-Yang.</u> That's correct.

Mr. <u>Krishnamoorthi.</u> It turns out multiple TSP index funds also invests in something called Huafu Fashion Company, which is sanctioned for using forced labor. But what I don't get is that the TSP board seems fine this. In 2019, its chair said, quote, the TSP board doesn't believe it's appropriate to prohibit TSP participants from making a choice that could be, quote, in their best interest.

Now, Ms. Stevenson-Yang, you don't think it's in the best interest of Federal employees to be invested in stuff like this. Right?

Ms. <u>Stevenson-Yang.</u> I do not.

Mr. <u>Krishnamoorthi.</u> I find it unacceptable that we maintain lists of sanctioned Chinese Companies but allow investment in them. I think it's wrong. Now some of our critics of this committee have written op-eds claiming that even investigating these kinds of issues is, quote-unquote, overstepping the committee's purview and, quote, egregious overreach. But, frankly, the only thing that's egregious is Wall Street's continued investment in companies that the U.S. government has literally sanctioned for CCP's human rights violations and espionage.

I yield back.

Mr. Gallagher. Hear hear.

I now recognize the gentleman from Illinois -- the other gentleman from Illinois, Mr. LaHood.

Mr. LaHood. Thank you, Mr. Chairman. And thank you for having this hearing in New York. I think it's very important.

I want to thank our two witness for your valuable testimony here today.

I'd like to focus my questions today on the conversation around outbound investment, and both of you touched on that, and where the line should be drawn for U.S. investment in China. Over the past few years, we've seen U.S. outbound investment into the PRC continually decline. According to research conducted by the Rhodium Group, direct U.S. investment dropped to $8.2 billion last year, which was a 20-year low. However, despite the slowdown in investment, more restrictions are being called for, especially on certain targeted sectors.

Earlier this year, we had former U.S. Trade Ambassador Bob Lighthizer, who testified before this committee. And, in his written remarks, he stated that, quote, Congress should take steps to severely curtail outbound American investment in China, particularly investment flowing in strategically important or dual-use sectors.

And, last month, as everyone knows, President Biden issued an executive order directing the Treasury Department to develop a system by which the government is notified of outbound investment in Chinese companies in select industries.

Additionally, the executive order grants Treasury, in consultation with the Department of Commerce, the authority to restrict certain investments in national security technologies.

Mr. Clayton, I'll start with you. As we look at this, do you agree -- first of all, do you agree with Mr. Lighthizer's assessment that we should severely curtail outbound investment? And then, as we look at how do you restrict those outbound investments in China, where do we draw that line?

Mr. Clayton. So Bob is an expert more than I am in trade and where we should draw those lines. If we chose to draw those lines, if we chose to make that decision that we are going to restrict investment into certain companies, how do you do it? That's more in the area of what I know. And, like I said previously, the executive order is one piece of that, but also direct investment through whether its indexation, other offerings, those types of things; you need to look at that.

I believe that, for example, entities on the OFAC list, Wall Street responds very quickly if an entity is on there and it's a prohibited investment to stop that type of investment. So it is doable. As the chairman noted, it should done in a way that allows for, I would say, a non-abrupt withdraw. But it is certainly a tool that's at your disposal and one that I think Wall Street will respond to.

Mr. LaHood. Maybe let me ask it another way. In terms of the behavior of the CCP and what we've heard here this morning, whether it's the genocidal behavior in Xinjiang, whether it's the theft of IP from the United States, whether it's their actions supporting Russia. I mean, the justification for curtailing outbound investment, do you have an opinion on where we should be going with that?

Mr. Clayton. Look, I do. Now my own personal opinion is I believe that there should be restrictions in place. Where those lines get drawn, that is a collective view of the government, and that's where the Federal Government should be stepping in. Let me say it another way, asking the private sector to make those shades-of-gray distinctions is a very difficult thing to do. Private sector folks are not good at making those types of national security, human rights -- we're all bothered by it, but where do we draw the lines? And I think, let me just say this, you may hear a little bit of pushback from some. I think the vast majority of people in the financial community, the vast majority of citizens, if Congress draws those lines, they are going to follow. And I would, you know, I say that with all of my experience. If the United States Government says, "We don't want to fund this," people are going to follow that -- that rule. We are a compliant society in terms of our capital flows.

Mr. LaHood. Thank you.

Ms. Stevenson-Yang, you mentioned in your opening statement that we need to stop the wolf warrior mentality by China. But I didn't hear necessarily hear you say how you stop that wolf warrior diplomacy and how we do that. What are your suggestions on that?

Ms. Stevenson-Yang. So what I meant was stop reacting to it. So, if we're going to, for example -- if, you know, a U.S. textiles company is going to say, "Well, we won't source cotton from Xinjiang," and then China angrily issues a lot of statements about how that company is banned and, you know, Xinjiang is absolutely fine and cotton is absolutely fine from there and our patriotic companies should all buy cotton from there; we should just be unperturbed by that, not apologize to the China Government, not go back on what we've said, but just -- and we've spent a long time in corporate America sort of being timid and afraid of these statements from China.

Mr. LaHood. Thank you both.

Mr. Gallagher. Mr. Moulton is recognized for 5 minutes.

Mr. Moulton. Thank you very much, Mr. Chairman.

I think, Mr. Clayton, what you were speaking about just now how we strike that balance and where the Federal Government draws the line is a tricky question that we're really trying to grapple with as a committee and specifically here with this visit to New York. So I'd like to ask about how do you strike that balance. I mean, if I were an investment advisor, I'd have two primary concerns about investing in China that you've explained. One, that we're funding genocide, the buildup of the PLA and then eventual invasion of Taiwan, weapons that could be used against our kids. And then, of course, the second reason is just the simple risk of those investments given China's complete obfuscation of what's actually happening with their economy.

Now, with regards to the first part, making sure that we're not supporting genocide, that's an absolute place where of course the U.S. Government should be involved. On the risk side of things, I tend to -- I think that's a harder thing to figure out where the government should be involved versus where we should trust the market. I mean, there are probably a lot of Members of Congress who in the early 20th century thought that horseless carriages were a risky investment and it wouldn't have been a good idea for Congress to respond to that by saying we should restrict investment in Ford. So, trying to strike that balance with various different entities, you know, and you say we cannot totally decouple. At the same time, if we were to totally decouple, we'd lose a lot of the potential economic leverage that we could have long term to perhaps be valuable in deterrence. So there are other reasons why it's not such a bad thing for our economies to be intertwined. When you think about making these restrictions, do you think that they should be company specific or sector specific? How would you approach this? Maybe start with you, Jay.

Mr. Clayton. It's a terrific question. Let me give you a micro example and a macro example around your transparency question, which is, at the micro level, do we really know that the information we're getting is correct. Okay. If we do, people will make good decisions. If you look at U.S. companies through disclosing their level of integration in China, investors are telling them: That is too much. I need you to derisk. If you want more of my capital, you should derisk your supply chain.

But, if what we getting from Chinese companies or other companies around the globe is not candor as to those types of issues, it's difficult for investors to make those choices. That's where you go to the macro issue.

If the government, our government, sees that across companies, I think it's incumbent upon the government to say: We're looking across these companies, and we don't think that information adds up. We think that you should discount the value of some of that information. That was the motivation behind the Holding Foreign Companies Accountable Act. And I think it is something that our regulators should be looking at.

And then, to your specific question, you know, where do you draw the line? I think it's a mix. Right? I think there are certain industries if you look at the EO where it's pretty easy to go industry specific if that's the choice, and then there are other more nuanced questions for companies that may be multifaceted or the like.

Mr. Moulton. Ms. Stevenson-Yang, I would love to hear your perspective on this and also then talk about how we think about VIEs. Should we just completely restrict VIEs and, you know, wipe them off the face of the planet so that is not a legitimate investment vehicle? Or, if we do that, will they just find another way around it and so we've got to be more thoughtful about what the second and third order of consequences might be?

Ms. Stevenson-Yang. Well, as to the first question, I would say, first, we need to strengthen the regulators. So I think that the -- for example, the PCAOB needs to stop giving China a pass on -- they've already made tremendous progress in being able to audit in Hong Kong this year or last year, I guess, but it needs to go a little farther. The audit failure rate was extremely high. We need to -- the IMF has given China a pass on giving detail around its foreign -- what do you call those -- foreign reserves for a long time. So those things need to stop. We need to apply the same regulations to China that are applied to every other country.

After that, I think we look at the export restrictions, and we follow those. We have a very competent team at BIS so we follow them and look at what they are doing. I think the import restrictions and tariffs tend to be less effective. The export restrictions tend to be more effective. So we look at what technologies those are focusing on and perhaps focus on investment in those.

Mr. Moulton. If you could, for the record, just take this question more specifically to VIEs, I'd appreciate it.

Ms. Stevenson-Yang. Oh, VIEs. I forgot, yeah.

Mr. Gallagher. We'll probably have time for a second round.

Mr. Moulton. Okay.

Mr. Chairman, I yield back.

Mr. Gallagher. Ms. Hinson.

Mrs. Hinson. Thank you, Mr. Chairman. And I thank you to both of you for joining us today. It is absolutely critical we continue to shine this light on what the CCP is doing to continue to undermine and aggressively and systemically undermine our economic success here in the United States using our U.S. investments as we've already discussed to fund companies that aid the PLA and assist in those egregious human rights abuses that I think we all need to be more cognizant of as consumers as well. I think our small businesses, also working families, should be able to trust that their investments are not being funneled to these malign practices in China.

And, while they continue -- the PRC and CCP continue to kind of worm their way into a lot of international trade agreements, they are not following the rules. They are simultaneously sidelining deals and promises that they've made. That really undermines obviously our agricultural and manufacturing success and stability here in the United States, whether it's digging in a cornfield in the State of Iowa to try to get those seeds out and reverse engineer them and steal that IP, trying to harvest American's information, personal and financial data. They are undermining our tech sectors' ability to innovate. It could not be clearer to me how blatant the attack really the PRC has unleashed on our country to try to destroy our financial security here in the United States and undermine our critical industry.

So I have a couple of questions. I am going to direct them to both of you so feel free to give your perspective. But what would you say is the most concerning avenue that you've seen the Chinese use to really exploit our U.S. capital markets and companies?

Ms. Stevenson-Yang. Please go ahead.

Mr. Clayton. I'll go back to the things that I say are fundamental: Transparency and accountability, to the extent that you flout transparency and accountability that undermines our capital markets and allows you not to make good investment choices. And stability, global financial stability, it's essential to investment flows and trade. To the extent that the Chinese Communist Party would take actions, it would jeopardize global financial stability. That is something of great concern.

Mrs. Hinson. But do you think -- obviously, it's a signal when they stop reporting information because it's so bad. Correct? I mean, that's a signal to investors: Hey, you probably need to pull back here because we are not getting that transparent and reliable data from the Chinese.

Mr. Clayton. Look, information is the lifeblood of markets. Transparent information is the lifeblood of markets. And I think that you are seeing I would say the investment community writ large respond to a view that the information they are getting is not as reliable as it maybe has been in the past or not as reliable as it was expected to be, so that's for sure.

Mrs. Hinson. Ms. Stevenson-Yang.

Ms. Stevenson-Yang. Yeah, I would agree with all of those comments. In China, the idea of the U.S. IPO has been you struck gold; you know, you won your lottery ticket. You managed to collect a whole lot of money and whatever means you use to get to market have been sanctioned in China. And there's no regulator within China who watches out for that sort of activity. So what we need is clearer analysis and more critical analysis of companies that are trying to IPO in the United States and stronger standards about forcing them to delist if they have misrepresented their data.

Mrs. Hinson. Turning that around a little bit on the companies that are trying to do business in China, obviously, they are trying to work within the regulatory framework, but we've seen some of these kind of frequent offenders in China kind of pushing the envelope with American companies trying to do business there. What do you think we can be doing to support these companies and industries as they continue to make those investments but face those uphill challenges from the PRC?

Ms. Stevenson-Yang. I'm not sure that there's a ton that we can do except through the WTO. There are a number of WTO agreements that China has not abided by over these 20 years. So I think maybe we go to that forum and push a little bit harder. But, in the end, China has this magic wand, which is the approval rights over companies. So, even though they've agreed to allow U.S. foreign participation in banking and telecom, for example, if they don't approve the companies, then you can't participate.

Mrs. Hinson. Well, it's certainly a red flag for American investors when their capital and their risk that they are taking could be immediately upended by the whims of the Chinese Communist Party.

Thank you. I yield back.

Mr. Gallagher. Ms. Stevens is recognized for 5 minutes.

Ms. Stevens. Thank you. I'm interested in indirect capital flows hailing from the industrial Midwest where we see major components of our automotive supply chain invested in China. This certainly began at the beginning of this century in an accelerated way where we were chasing low labor costs and exposure to markets. COVID woke us up to incredible supply chain vulnerabilities. But, if you are a tier 1, tier 2, tier 3 supplier looking to expand and grow your business and you look up expanding my business to China and you get a sense of opportunity and risk, there is very little articulation about the capital risk. And so, when we look at dollar flows, and certainly here in the United States where we're very well aware of the capital crunches. Venture capitalists are sitting on enormous sums of money. Capital investments are down 70 percent from '22 to 2021. And I am concerned about what this means for our supply chain, particularly is this going to motivate further pushes outside of the United States? What are the continued risks? Our ranking member just presented a very great case about our pension funds and our Thrift Savings Plan. But what does this mean for the everyday manufacturer? What does this mean for our suppliers? And what steps should our manufacturers take when assessing expanding into markets today like China?

Ms. Stevenson-Yang. That's a great but very complex question. And I would say that that sort of offshoring really began in 1980s and in a way became such a behemoth that the U.S. Government could no longer control the companies that were investing overseas.

And the Midwest industrial heartland is not so much investing in China for the Chinese market as offshoring and outsourcing. And that clearly -- I would say the biggest risk there is the currency because, as these companies make more money and want to bring it back to the United States, they run into currency controls, and they may not be able to get dollars out.

I think that what you're seeing now with companies is what we need to do, which is spread risk, so push some of their contracts to Vietnam or to Malaysia or to other countries so that they have other places to go. But, if China really does close up, will it be a big shock to the U.S. supply chain? Absolutely.

Mrs. Stevens. Well -- and Mr. Clayton, you talked about in your testimony getting an understanding of these risks for public and large companies, particularly from the investment side. And you've had a great career, and it's a treat to have both you of here today. But, as best as you're able to, could you talk about export controls and exposed risk? Particularly with what Ms. Stevenson-Yang just mentioned, if China closes off, do we have any protection for our small manufacturers, who are maybe overleveraged or overinvested? You know, we've obviously run these different scenarios in this committee on the economic ramifications. But I know from firsthand experience, there are way too small companies that have had to expand over to China. They have a presence there. They were hurt by COVID absolutely. But now we're looking at this new environment. Do we have the protections in place for these companies?

Mr. Clayton. You make a terrific point. We talked about abrupt dislocations in markets and the ramifications, whether it's pulling back on investment, pulling back on consumption, and the kinds of stresses that that puts on companies. That does not happen uniformly. Any time you have you that kind of dislocation and stress, it is typically the smaller and medium-size companies that suffer most because they are unable to assess capital. They are unable to pivot to the same extent that large companies can. And it is a consideration when you think about decoupling and the like.

The other I'll make that you also raise -- and you both raise this: This is multilateral. If there's a derisking, decoupling with China, it doesn't mean every activity comes back to the United States. We see Mexico right now having the greatest inbound investment that we've seen in a long time. I think that is largely related to the derisking of the supply chain, as you mentioned. So I wanted to make sure I made that point.

Ms. Stevens. I yield back.

Mr. Gallagher. I will now entertain a second round of questions. I will recognize myself for 5 minutes.

First a comment: I think when I sort of began this journey on the committee, particularly on the financial and economic aspect of competition, I just assumed that a lot of the pushback we got from Wall Street was because of the returns that were to be made in China. Right. Put differently, the reason people continued to pour capital into China, even during the pandemic, was basically the same reason John Dillinger robbed banks, because that's where the money is. Right? But, in digging into this and particularly if you read Mr. Chanos' testimony, it's not clear to me that this is even a good investment at this point. And I quote Chanos here in saying it's no surprise that Chinese stocks have significantly underperformed relative to U.S. stocks. Since 2010, the S&P 500 total return index has outperformed the China stock ETF by a factor of 8x on a relative basis. On an absolute basis, the China ETF has nearly been cut in half versus the S&P 500 total return increasing over 5x. So, even if you put aside the moral concerns that I think the ranking member brilliantly laid out or the geopolitical concerns, just as like an investment proposition, the risks are mounting up where the returns aren't there. You can comment on that when I ask a question.

The other thing I have to bring up that I've been struck by on this trip, and we've had great discussions and great tabletop, and this has been very illuminating. But almost everyone we met with, with a few exceptions, has asked that we keep their identity secret. If you think about it, these are the same people that have no problem going to Hong Kong and Beijing and, you know, dancing with Lio Ha (ph) at various conferences. And yet, when they meet with Members of Congress, it's like we're in some witness protection program, and we have to shuttle them around, which I kind of think gets to the -- maybe it's related to the wolf warrior point. We're so sensitive to the reaction. In fact, we had people tell us explicitly that their Chinese LPs would object if they knew they were meeting with us. That kind of crystallizes I think the dilemma we're facing and how difficult it is to mobilize action in light of those concerns.

Mr. Clayton, to get a better handle on this problem -- you talk about this in your written testimony, but I want you to orally -- should Congress mandate that publicly traded companies disclose their exposure to the PRC?

Mr. Clayton. Okay. Let me say that I am generally not in favor of issue-specific mandatory disclosure for public companies. I think we often use the securities laws to accomplish other objectives. In this area, I believe that large public companies that have significant exposure to China, for the reasons you just articulated, I would say a greater understanding of the geopolitical risks, the company risks that we've come to learn from COVID, this is an area where I would at least consider a pilot program for very large companies disclosing the China-specific risks and what type of scenario planning they have done in the event of abrupt decoupling. And, look, this is not about liability. It's not about gotcha. It's just about, in the boardroom, if you have a substantial exposure to China, how have you thought about the type of risks that you're talking about if they come to fruition and provide that information to investors? I think those questions are already being asked, but I think that this is an area where you can to show leadership. And I would say, you know, look, again, I'm not a big fan of excess liability. I think we have too much of it, but you can show leadership in the type of disclosure, the type of dialogue a company should be having. I will just make my last point there.

During COVID, this is exactly what we did: We asked public companies to come forward and say, given all the challenges of a lockdown, given all the challenges that -- give us your best estimate, give us your planning as to what you're going to do in response. U.S. public companies did a fabulous job. They told the public: Here are our challenges. Here are our human capital challenges. Here are our supply chain challenges. Here is what we're going to go do about it.

And it instilled great confidence in the marketplace.

RPTR BRYANT

EDTR ZAMORA

[9:36 a.m.]

Chairman Gallagher. So what exactly in your paradigm would they disclose in a pilot program? Would it be revenue generated in China? Would it be -- you mentioned the contingency plans they have.

Mr. Clayton. Yeah. My view is if they have a certain level of exposure to China that they should say, here are our contingency plans in the event that --

Chairman Gallagher. Got it.

Mr. Clayton. -- we were to have an abrupt decoupling. This is what we've thought about, and these are the risks. I think investors know they exist, but that dialogue is a good dialogue to have.

Chairman Gallagher. Yeah.

And then, Ms. Stevenson-Yang -- it's unfair -- in the remaining 23 seconds I have, to go back to the VIE issue, just in simplest terms, what does one own when one owns the VIE and what shareholder protections does one have?

Ms. Stevenson-Yang. One owns a stream of revenue, not profit, because profit is explicitly not permitted under Chinese law. And -- and what -- what protections does one have? Companies arrange that the owners of the VIE sign documents that allow them to, you know -- that allow investors to kick them out, if need be. But it's a fairly thin reed to hang on.

Chairman Gallagher. Yeah. Thank you. My time is expired.

Mr. Krishnamoorthi.

Mr. Krishnamoorthi. Thank you again.

We all know that the CCP bans books, but now it's also cooking the books. Take real estate. According to government figures, new home prices have slipped just 2.4 percent. That's according to the CCP. But data from private sources tell a different story. Existing home prices have fell by at least 15 percent in areas like Shanghai and Shenzhen, and the city of Hangzhou saw a price drop of about 25 percent.

Ms. Stevenson-Yang, one very humorous part of your past statements include the following. You said, quote, When you go around and meet state-owned industry people, everybody laughs at the national statistics. So I don't know why foreigners believe them.

Ms. Stevenson-Yang, when it comes to official PRC Government statistics, you noted in your testimony that numbers are often distorted in order to reach goals. They are goal-driven. That combination of factors right now, a serious real estate crisis involving vast amounts of debt and a government that misleads the world about basic economic facts poses a serious threat to the global economy.

Isn't that what you think?

Ms. Stevenson-Yang. I think that's correct, yes.

Mr. Krishnamoorthi. Now, Mr. Clayton, I wanted to bring your attention to some -- a very interesting headline that we saw in the Wall Street Journal.

Can you put that graphic up?

It says: China's economy isn't ailing -- it's evolving: IPO lawyers told to watch their language.

This is by the Chinese Communist Party.

It's not just the CCP's official government data that's made up. They're requiring companies to tell tales to their own investors. The Chinese Securities Regulatory Commission, their version of the SEC which you led formerly, recently convened a group of Chinese law firms and ordered them to not disclose risks to investors that paint the

CCP in a negative light.

Mr. Clayton, you know, as you see from this headline in The Wall Street Journal, law firms aren't allowed -- these are Chinese law firms -- aren't allowed to describe the Chinese economy as ailing, even though it is, or highlight other problems in the PRC.

Don't you think that these types of risks put retail investors in jeopardy here?

Mr. Clayton. In a word, I think they put investors at jeopardy, yes.

Mr. Krishnamoorthi. And at this point, the CCP simply doesn't play by the rules American investors take for granted. We disclose risks, while the CCP creates them and conceals them. We value human rights, while the CCP violates them, and then expects us to fund those very companies facilitating those violations which I pointed out before.

Now, Ms. Stevenson-Yang, the implications of CCP financial censorship don't end with what we just discussed. It appears that the CCP is even creating a, quote/unquote, digital RMB, a state-backed cryptocurrency that will allow Beijing to track every transaction and block any transaction the CCP doesn't like. It's almost like they're able to censor transactions in addition to censoring bad information.

So, Ms. Stevenson-Yang, you've said, quote, the digital RMB profiled -- I'm sorry, The digital RMB profiles will be shared with security agencies and they will inform so-called social credit scores.

First of all, what is a social credit score? Tell us all what that means.

Ms. Stevenson-Yang. It's basically the same as a -- as a credit score in the U.S., except it includes a much broader set of criteria about political reliability and, you know, past mistakes and things like that.

Mr. Krishnamoorthi. It's like an Orwellian kind of assessment by the CCP of your worth in China. It's like your social credit score.

And so the digital RMB is going to help to, quote/unquote, inform your social credit score in China. And so I think it poses a real threat to privacy and human rights in the PRC. What do you think?

Ms. Stevenson-Yang. I mean, I think all of the digital economy poses a significant threat to privacy, both of U.S. citizens and Chinese citizens.

Mr. Krishnamoorthi. I think one area, Mr. Chair, that we should also look at in outbound restrictions -- and we talked about this yesterday -- was not just artificial intelligence and semiconductors and quantum computing, but we should also look at fintech.

Chairman Gallagher. Yeah.

Mr. Krishnamoorthi. And to the extent that fintech is going to be used in this way, in informing social credit scores and the like, I think that's deeply troubling.

Chairman Gallagher. That's a great point.

Mr. Krishnamoorthi. I yield back.

Chairman Gallagher. Mr. LaHood.

Mr. LaHood. Thank you, Mr. Chairman.

As our committee has done its work over the last 9 months, one area that we've obviously been focused on is the U.S. business relationship with China and the fact that we have the two largest economies in the world and that we're intertwined economically at almost every level and every sector in our economy. But we've also tried to drill down a little bit on, you know -- you know, that relationship. And I think one inflection point that we focused on is when we allowed China into the World Trade Organization roughly 20 years ago and the expectations of what we thought would happen there.

And as we look at many U.S. multinational corporations and many private equity groups, we look at and we hear about, has China progressed or regressed, and what have they been able to do in terms of that business climate, and trying to evaluate that on whether they've gone forward or backwards on that.

And we also hear a lot about, well, that's the price of doing business in China, of being in bed with the CCP over the last 20, 30, 40 years, and that many of these corporations and companies, they look the other way when it comes to human rights, IP theft, the fact that China's a surveillance state and has doubled down on that, you know, and the lack of a free press. And there's lots of other things.

But I guess, Mr. Clayton, as you look at the last 20 years and when you think about how China has or has not liberalized their economy, modernized, put in more transparency, and can you evaluate the pros and cons on whether -- the status and the narrative of how China has gotten better or worse?

Mr. Clayton. It's a great question, because we shouldn't forget how we got here, right? Deeply interconnected, large amounts of cross-border investment and the like, and a level of interconnection that, for all the reasons we discussed, makes us uncomfortable.

Twenty years ago, we believed that, with investment, with economic integration would come those principles that we discussed, of transparency, accountability, rule of law, financial stability, that that type of economic regulation overlay in the Chinese economy would come to China.

It has happened in the past. Other countries that have emerged and have grown have adopted that approach to international financial integration.

That bet didn't pay off. That's the simple way to say it, is that that level of transparency, accountability, commitment to financial stability did not emerge. And now here we are.

And, you know, there is a question, will we eventually get there or do we need to take a pause? I think that's where we are right now. I think that's why this committee, the work of this committee is so important, because we made a judgment about the future that turned out not to be correct.

Mr. LaHood. And with that opinion, are you -- do you have any confidence that the Chinese will wake up to that fact and change their ways?

Mr. Clayton. Look, we, the U.S., and China did have great benefit from this integration, right? The trade benefits to both countries were substantial. You had incredible economic growth in China. We had lower cost of manufacturing, providing better goods for the consumer at, you know, cheaper prices. That was all good.

If that's going to decouple, you would think that people would wake up to the fact of how do we keep that from happening. But that's what's playing out right now, as I see it.

Mr. LaHood. Ms. Stevenson-Yang, do you have a comment on that?

Ms. Stevenson-Yang. I would agree with all of that. I think, though, to some extent what we're looking at represents a technology gap, that in the 1990s emerged a lot of online communication technologies, and we simply were able to unstring value chains in a way that wasn't possible before and move a lot of portions of those value chains to China and didn't really have the regulatory structure to capture that.

I think also that 1989 and the Tiananmen rebellion is underestimated as a force in Chinese politics. I think after that, the Chinese Communist Party decided we've got to pull back on this experiment.

Mr. LaHood. Thank you. Those are all my questions.

Chairman Gallagher. Mr. Moulton.

Mr. Moulton. Thank you, Mr. Chairman.

I'd like to continue on my earlier line of questioning about how we figure out where to draw this line and strike this balance between telling investors what to do for good reason and trying to distort the markets when we're not in a great position to do so.

So, Ms. Stevenson-Yang, could you pick up that question with respect to VIEs? Should we banish VIEs? If we did do that, what would be the result? Would companies and investors just find a new way around the loophole or loopholes through the existing system? What would happen, and what do you think our policy prescription should be?

Ms. Stevenson-Yang. We have to take a gradualist approach, and I think we're doing that through the HCF -- what's it called? -- the Holding Foreign Companies Accountable Act.

Because if we were to ban VIEs at once, then a lot of very, very large companies would have to delist, and that would be very harmful to American investors. So I think bit by bit we do that.

Mr. Moulton. Mr. Clayton, do you have anything to add to that?

Mr. Clayton. No, I -- yes, I do. I think, to pick up on the Holding Foreign Companies Accountable Act, I think it was a very responsible piece of legislation, because it gave a timeframe for when delisting would take place in the event of a finding of noncompliance.

The PCAOB found compliance. There's a new timeframe. But, you know, I think that that type of lead time gives the market time to adjust. I think the market was adjusting. The indications were that delisting was a real possibility. That was having market effects. When the PCAOB found sufficient compliance, that was a bit of a shift.

But I would say that any type of legislation, any type of restriction that deals with already-in-place investing should have that kind of forecasted timeline to allow markets time to adjust.

Mr. Moulton. So picking up on this point about delisting, I mean, you ran the most comprehensive investment oversight and, you know, enforcement program really in the world at the SEC. Do you think that you have the tools to enforce things like proper transparency if companies are going to be in the market? And should we be looking at delisting a lot of Chinese companies because they're not following these standards?

Mr. Clayton. Wow, there's a lot in there. Let me say -- let me start by saying that the most effective securities enforcement regime by far in the world is the U.S. Securities and Exchange Commission. The women and men there do an unbelievable job. And when you look at number of actions, successful actions around the world, more than a majority, substantial more than a majority are brought by them.

That said, the ability to bring an SEC action outside the United States, not a -- you know, not a U.S. actor bringing securities to the United States, but actually to have an effect outside the United States is very limited.

Mr. Moulton. And do you think it should be limited or is that a place where legislation should allow the SEC more rein to do this, to take these kinds of actions?

Mr. Clayton. The longstanding view of international comity was that local securities regulators and local law enforcement officials took care of local problems.

Mr. Moulton. But, obviously, that can't apply to the PRC. I mean, we learned earlier in this committee that the PRC has established police authorities in New York City.

Mr. Clayton. Let me be very clear. I've said this publicly many times. U.S. investors should understand that if they are the victim of an offshore fraud, it is very, very difficult to get their money back.

Mr. Moulton. So, in other words, your basic answer is that it should come back to managing risk and it's not a place where the SEC should be given expanded powers.

Mr. Clayton. Yes. You do not have, in effect -- you may have the -- you may have the same rights in words, but you do not have the same rights in effect when you're dealing with a U.S. company versus any company outside the United States.

Mr. Moulton. Ms. Stevenson-Yang, do you have anything to add to this?

Ms. Stevenson-Yang. I don't really. I mean, there's a reason why Chinese companies like to list in the United States. It's the deepest and -- and most liquid market, and, you know, you'd have to be really a sad little company to go to Singapore or another exchange. But even the SEC has limited range for -- for regulation.

Mr. Moulton. Do you think that a lot of companies will simply change domiciles if that's what it takes to get around any sort of increased regulations that come out of Congress or this committee?

Ms. Stevenson-Yang. They already have, to Hong Kong and to Shanghai.

Mr. Moulton. Thank you, Mr. Chairman.

Chairman Gallagher. Just quick clarification, 10 seconds. PCAOB found compliance -- sufficient compliance, right? But my understanding is that it's based on Chinese audits, and we don't know how many of these audits are actually failures. Can you explain that? Maybe I'm confused. Or take it for the record? Yeah.

Mr. Clayton. No, I'll take it for the record. I would encourage more dialogue between this committee, as an oversight committee, and that PCAOB process.

The Chairman. Okay. We'll leave it cryptically there.

Mrs. Hinson.

Mrs. Hinson. Thank you, Mr. Chairman.

Obviously, this committee's goal is strategic competition with the Chinese Communist Party. And one of the ways where I think we can be strategically competitive, other than making investments in our people here in the United States, is really making investments in trade. That said, we are seeing China be very aggressive in developing relationships when it comes to trade, expanding BRICS, for example.

So there was just an article -- I think it's Bloomberg yesterday -- that highlighted that Brazil has become the biggest exporter now of not only corn and soybeans, but cotton could be next. So, obviously, we're seeing these raw materials increase in supplies coming from these countries. China, India looking to be the dominant supplier of manufactured goods.

So when we look at the aggressive action that China is taking in expanding BRICS, what do you think that risk poses to the United States economy?

Ms. Stevenson-Yang. Well, I'd say on the specific case of Brazil and corn and soybeans and to some extent iron ore and met coal, the shift came as a result of tariffs that were -- that were poorly thought out in the previous administration, and that shift may not shift back.

As for what we should -- what we should do now -- I'm sorry, I forgot -- I forgot your --

Mrs. Hinson. I think, obviously, we're just seeing China be so aggressive here --

Ms. Stevenson-Yang. Oh, right. Yeah.

Mrs. Hinson. -- in terms of expanding that. So I think -- I mean, we face some serious risk to our economy with these numbers just coming in.

Ms. Stevenson-Yang. It's being -- it's being aggressive in expanding what -- what you might term the global south, a sort of reconstruction of Nehru's sort of nonaligned movement. And I think that's because it doesn't have a lot of choice. I think if China were as welcome in the United States and Europe, if the exports were as strong to those countries as they used to be, then you wouldn't see this same BRICS expansion.

Mrs. Hinson. What do you think -- obviously, China is not living up to its end of trade deals that we've made with them. And, obviously, when you look at the commitments that they've made to purchase U.S. goods, they're now purchasing those from other nations.

How can we -- how can we counter that, other than continuing to expand our trade relations with other countries as well?

Ms. Stevenson-Yang. Spread the risk. Focus on multilateralism. I think this is going to be a significant problem for Iowa and for some other -- a couple of other States in the middle of the United States as the Chinese economy starts to deflate and demand fewer soybeans, corn, pork and so forth. And I'm not sure there's much we can do about that.

Mrs. Hinson. Yeah. So we spent a lot of our time yesterday talking about what economic levers we can be pulling right now, because we do still have leverage. That could change down the road as they continue to make these investments and develop these alliances.

So you talked about technology gap earlier and some of the places where we might need to make some investments. China has figured out how to game the system, and they are getting -- for instance, Huawei is receiving an exponentially greater number of patents, for example, here in the United States than many of our companies.

What do you think we can be doing to counter that kind of aggression, because that obviously takes advantage of our system, to support our companies here at home?

Ms. Stevenson-Yang. Well, I think that the export controls have been extremely effective. And notably, the controls on U.S. citizens working for Chinese fabs and Chinese semi companies that were -- that were issued in October 2022, those were very effective and really -- really kind of shook a lot of Chinese companies.

Mrs. Hinson. All right. Mr. Clayton, anything to add?

Mr. Clayton. Well, my -- my expertise is in markets and flows and that type of regulation. What I would say is that your questions illuminate a fact that we have to deal with, which is, countries do what's best for the country. That's their job. Their elected officials, their regulators do what's best for the country. And you have to think about what other countries will do in response to any policy measures we take, including, like you said, strengthening trade alliances and the like that didn't previously exist.

Mrs. Hinson. Thank you. I yield back.

Chairman Gallagher. Ms. Stevens.

Ms. Stevens. Ms. Stevenson-Yang, your career fascinates me. Now, you lived in China for over 20 years. Is that right?

Ms. Stevenson-Yang. Yeah, that's right, 25 years.

Ms. Stevens. When did you move there?

Ms. Stevenson-Yang. Moved there the first time in 1985, came -- married there, came back in '89, and then -- and then moved back there in '94 and stayed until 2014 --

Ms. Stevens. You met your husband in China?

Ms. Stevenson-Yang. -- when our youngest graduated. Sorry?

Ms. Stevens. You met your husband in China?

Ms. Stevenson-Yang. Met my husband in China, correct.

Ms. Stevens. Okay. And what moved you there in the eighties?

Ms. Stevenson-Yang. Just, you know, I worked -- you know how much I earned for being a journalist? $25 a story. So I thought, well, maybe I'll go someplace and learn a language and learn a culture and, you know, get some experience, and then I'll be more valuable as a journalist when I come back.

So I went to China Books and Periodicals on Fifth Avenue and I bought all the magazines. And I wrote to them and said, would you like to hire me? And one did.

Ms. Stevens. Yeah. Well, and you've obviously continued to write quite prolifically. And just last year, during some of the uprisings pushing back on the CCP governance structure, you wrote that -- that China is witnessing its biggest governance upheaval since the Tiananmen Square.

And I thought that article -- I think it was published in Forbes -- was really quite fascinating. It exposed, you know, people jumping out of their buildings in Shanghai; people going hungry; and certainly during the beginning of the COVID-19 pandemic, seeing how China was responding and also seeing how local journalists were attacked.

Have you received any retaliation from the CCP since writing so demonstrably about what is happening over in China?

Ms. Stevenson-Yang. Well, the last time I gave testimony to a congressional commission, there was retaliation against people close to me in China.

Ms. Stevens. Are you concerned about being able to go back?

Ms. Stevenson-Yang. Yes. I will not go back at this point, which is sad. I have lots of in-laws and friends there.

Ms. Stevens. Yeah. And so from your time there in the eighties on and off to now, has that surprised you that -- that turn and that closing off? And what do you think are some of the motivations for the CCP in becoming so closed off as compared to where they were maybe 20 years before the turn of the century?

Ms. Stevenson-Yang. Maintaining their power. They saw in 1990 the fall of the Soviet Union and the breakup of the Soviet Socialist Republics, and they quaked in their boots. And they issued a lot of -- they commissioned a lot of reports out of the Chinese Academy of Social Sciences to try to figure out how not to fall prey to that. They spent a lot on technology to improve the responsiveness of government to the party.

Ms. Stevens. In your new enterprise, J Capital, are you advising companies? Is that what you're doing in your current enterprise?

Ms. Stevenson-Yang. We -- we do a couple of things. One of -- the primary thing is we're a short activist. So we look at fraudulent companies. We study them. We write a report on them, and then we expose them.

Ms. Stevens. Okay. And so you're -- you're getting in front of some of the IP considerations as well?

Ms. Stevenson-Yang. Yes.

Ms. Stevens. Okay, great.

Well, thank you so much, Mr. Chair, and I yield back.

Chairman Gallagher. Thank you.

Would the ranking member like to offer any closing comments?

Mr. Krishnamoorthi. Sure. Thank you.

Thank you to our witnesses. Thank you to our audience, both here and virtually, for paying attention to these issues that we've brought up here.

Today we talk about basically the risks posed by investing in PRC companies and entities. And it turns out there are many risks. There is the risk associated with a lack of information about those investments. There is a risk associated with doing business in China. And we've heard about how hard it is to do business in China, including exit bans being placed on employees, raids happening on American companies, the counterespionage laws or counterintelligence laws preventing our companies and businesses from doing due diligence.

But in addition to that, I just respectfully submit the following principles associated with our investments going forward in China: We should not be investing in PLA military modernization. We should not be investing in companies that assist with espionage or that hurt our national security. And we should not be investing in companies that facilitate human rights abuses and, worse yet, facilitating a genocide.

Now, we in Congress have a duty. We must legislate to create clarity and predictability surrounding these restrictions. The Biden administration and the executive branch must also strengthen rules and regulations and bring consistency to the various lists that contain sanctioned companies and watch list red-flagged entities.

However, in the meantime, I respectfully submit the following to Wall Street firms who may be paying attention to this hearing: Please divest from these companies if you haven't done so already. Don't be a part of the problem. Don't be invested in PLA military modernization. Don't facilitate espionage or activities that could endanger our national security and, for heaven's sakes, don't invest in companies that facilitate human rights abuses.

You have the right to do these things currently in many cases, but it's not the right thing to do.

I yield back.

Chairman Gallagher. I thank the ranking member.

Someone said something yesterday to the effect of, well, you know, Jay Clayton, Anne Stevenson-Yang -- obviously, we don't agree on everything, but we sort of I think are thinking in the same direction. Why not have one of the asset managers, the bankers testify before the committee, to which I said, that would be great.

They're not eager to testify before the committee, though they have an open invitation. But it's been very helpful, even notwithstanding the secrecy issues I mentioned before, to get pushback, I think. That's how we improve our policy recommendations, our ideas. And what we're after are solutions that last and endure beyond whatever which way the political winds are blowing, left or right, at a particular moment.

And so I really thank our witnesses for challenging our thinking with your testimony, your thoughtful responses to our questions and your time.

I want to thank the Council on Foreign Relations for your hospitality. You've been incredibly generous with this facility. We were parked out here all day yesterday. And despite the fact that I failed to buy snacks for the members, then we were struggling at the end of the day, we got through it.

I want to thank our members. It's not easy to get everyone in one place outside Washington, D.C. It's a significant investment of time for the members. But I certainly learned a lot from this experience in New York.

And finally, I'd just say, you know, we started our day yesterday by going down to Ground Zero and participating in the ceremony to recognize 22 years since 9/11. And the memorial itself is incredibly moving and powerful. The event was powerful and moving. And I was reminded of what was said by the 9/11 Commission after that tragic event, which was -- they described it, the intelligence failure leading up to it as a failure of imagination.

And what we're trying to do by engaging in tough conversations with Wall Street, by doing tabletop exercise, is to imagine some of the worst case scenarios so that we can avoid them, so that we can prevent them, because an ounce of prevention, an ounce of deterrence is worth a pound, if not more, of warfare.

I mean, the consequences of getting this wrong are so massive that we have to devote as much time and energy to getting it right now while we still have a window to defuse a war over Taiwan or something like that.

So thank you to members for your commitment and for helping us think through all the imagined possibilities in a bipartisan fashion.

With that, questions for the record are due 1 week from today, on September 19th. And, without objection, the committee hearing is adjourned.

[Whereupon, at 10:04 a.m., the committee was adjourned.]