It’s time to stop state funding of China’s military build-up and human rights abuses

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By Roger W. Robinson

For more than two decades, trillions of dollars of U.S. capital – drawn from scores of millions of unwitting American investors – have been funneled into Chinese state-controlled companies – including those tied to the People's Liberation Army, or PLA. This has taken place via Beijing's unfettered exploitation of the U.S. capital markets and private equity funds – with virtually no screening, diligence or security-minded scrutiny by the U.S. government or the financial services industry.

This immense infusion of American wealth and cash into the coffers of the Chinese Communist Party, or CCP, has allowed – and funded – China's rise to become a near-peer military competitor to the U.S. It has also underwritten the evisceration of human rights in China, all while avoiding the same regulatory compliance requirements adhered to by companies of every other country in the world, including U.S. firms (i.e., courtesy of the May 2013 Memorandum of Understanding concluded between America's Public Companies Accounting Oversight Board and the Chinese Securities Regulatory Commission).

What is even more troubling is the continued use of U.S. taxpayer funds to finance the military modernization of the PLA and egregious Chinese corporate human rights violators. State public employee retirement systems have funneled taxpayer funds into China, despite having witnessed the asymmetric material risks involved in investing in adversary nations –as vividly shown by Russia's invasion of Ukraine. A recent report from Future Union found that state pension funds have made some $68 billion in new investments in China just since 2021.

In its 2021 Report to Congress, the U.S.-China Economic and Security Review Commission described the massive exposure of U.S. individual and institutional investors to Chinese equity and debt securities as worrisome. Total American holdings of Chinese equities presently exceed well over $1 trillion; debt holdings in dollars amount to nearly a trillion dollars more. Precise calculations and verifiable valuations have been made difficult to ascertain, for China uses complicated legal structures, index funds and tax havens to mask its activities involving U.S. exchanges.

Non-transparency on Chinese risk exposure

As a result, the true level of American financial exposure to CCP-controlled companies and sovereign bonds is not fully known. This, and many other abuses of our equity and debt markets, are due, in large part, to U.S. government regulatory failures on the part of the Executive Branch agencies with primary responsibility for our financial markets (i.e., the Department of the Treasury, the Securities and Exchange Commission and the White House National Economic Council), which are most often headed by conflicted Wall Street executives.

These federal agencies also lack the rigorous national security mindset and expertise to assess and defend our security interests – including the protection of human rights and U.S. retail investors – from the predatory, strategic, non-transparent and non-market practices of Chinese and other authoritarian-controlled enterprises.

Those Congressional Committees with financial services oversight responsibilities have also become excessively, if not completely, beholden to Wall Street, due, in no small part, to generous campaign contributions. This has resulted in the successful thwarting of urgently needed legislation to make illegal a number of these fiduciarily reckless avenues of U.S. investing in China (several of which are listed below).

The TSP precedent

For example, American investors remain uninformed that their pension and other stock portfolios often include a significant number of U.S.-sanctioned Chinese companies. Tragically, it is not unusual to find sanctioned Chinese PLA-linked companies and corporate human rights violators among the holdings of state retirement systems.

Worse still, states have received a clear message from the federal precedent set with regard to excluding in 2023 all mainland- and Hong Kong- based Chinese companies from the International Fund of the roughly $845 billion Federal Thrift Saving Plan, or TSP. This was a hard-fought policy battle for nearly five years against Wall Street firms (principally BlackRock), Treasury and the Federal Retirement Thrift Investment Board that administers the TSP (primarily composed of former Wall Street executives).

The reasons given for this divestment and exclusion decision had everything to do with the unacceptable levels of fiduciary, national security and human rights risks associated with such China risk exposure. One would think that the states would immediately follow suit for "investor protection" reasons alone. But that simply has not happened except in a few cases. It did, however, severely compromise the opposition arguments of state pension system administrators and those in the states siding with Wall Street and, wittingly or unwittingly, the CCP. In short, all Chinese companies were excluded from the international investment portfolios of some 7 million federal employees (via use of the MSCI All Country World ex USA ex China ex Hong Kong Investable Market Index.)

The remedy

Not surprisingly, the CCP is utterly indifferent to the serious losses that already have been sustained by American pensioners, particularly over the past three years. Prominent Wall Street asset management and other firms are, sadly, aligned with the

CCP with respect to the calloused, malfeasant and greed-driven practice of dismissing national security and human rights considerations and the associated asymmetric risks to average American investors.

Accordingly, bipartisan legislation and executive action is urgently required to declare illegal the holdings of a wide range of tainted, and even dangerous, Chinese corporate securities by U.S. investors worldwide. Moreover, state public pension administrators should be legislatively compelled to divest from: U.S.-sanctioned Chinese companies; Chinese "A-Share" companies, unregulated enterprises listed exclusively on Chinese domestic exchanges (as many as 4,000 of which are traded in the U.S. capital markets, primarily in the form of Exchange-Traded Funds, or ETFs, and other index funds); Chinese sovereign bonds, providing discretionary cash directly to the coffers of the CCP: Variable Interest Entities most often domiciled in the Cayman Islands that essentially substitute contracts with shell companies for actual shares of Chinese companies listed on the New York Stock Exchange and NASDAQ (without respecting minority shareholder rights or providing legal recourse); and Chinese companies that are equipping, and otherwise propping up, adversary regimes in Russia, Iran and North Korea.

The simplest way for states to eliminate their exposure to risky, non-transparent Chinese securities is to divest entirely from the companies of China and other adversary nations as expeditiously as possible (e.g. sell all direct Chinese holdings and move fund exposure to Ex-China Emerging Markets funds, ex-China ex-Hong Kong global index funds, etc. – virtually all of which, at this writing, are providing U.S. investors with higher returns and lower risk).

In addition, American asset managers should provide more robust and liquid investment options for state funds that seek international investment vehicles without risk exposure to adversary nations. Texas Gov. Greg Abbott, South Dakota Gov. Kristi Noem, Mississippi Gov. Tate Reeves and Iowa Gov. Kim Reynolds have publicly called for asset management companies to develop these alternatives.

Moreover, every governor and state legislature should legally require the immediate public disclosure of their state's Chinese corporate securities and sovereign bond holdings (i.e., stocks and bonds), if state pension and other fund managers continue to stonewall this essential action. This public list should include Chinese companies embedded in ETFs and other index funds. Today, in many cases, a list of state holdings in Chinese corporate and other securities are deliberately covered up from public view, as anyone seeking this information, even those working within state governments, will soon learn the hard way.

Moving forward

Our nation urgently requires an operational plan that minimizes U.S. investor losses, while transitioning out of PRC-related investments at flank speed. Just as the Reagan Administration configured a detailed plan to irreparably curtail and damage the Soviet

Union's hard currency cash flow and access to external sources of Western financing, the denial of hundreds of billions of U.S. investor dollars from various sources annually into the coffers of the Chinese government can curtail the CCP's malevolent actions globally.

It is important to remember that the U.S. utterly dominates the global financial domain. We have the bulk of the world's investable capital, capital markets roughly the size of the rest of the world's combined and the world's reserve currency. In sharp contrast, China lacks even a convertible currency and is in the throes of both a debt crisis at the local government level and a debilitating property crisis. Foreign Investor money is – at long last – fleeing China for a number of solid fiduciary reasons.

State divestment plans will also encourage more aggressive action from federal lawmakers and America's allies to adopt similar legal prohibitions and other prudent, sensible measures to protect our common security interests, fundamental values, retail investors and public pensioners. States must likewise review their business incentive programs to ensure they are not funding PRC companies within their states.

Tax credits and other economic incentive programs should not be used to attract foreign adversaries. Chinese multi-national corporations inevitably come with malign strings attached. Seen or unseen, their ties to the CCP (with CCP cells actually embedded in their senior management structures) are impossible and imprudent to ignore.

For some 25 years now, trillions of dollars of American private capital and taxpayer funds have been used to prop up and modernize the Chinese military and underwrite the country's geopolitical and economic aggression, as well as egregious human rights abuses.

State leadership is urgently needed to inspire Congress, and to silence those members and executive branch officials who have, in effect, served as subsidiaries of Wall Street to preserve this disastrous and scandalous status quo. Greed at the expense of national security and fiduciary responsibility must no longer be permitted to continue to prevail.

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