

FROM TIMBER TO TUNGSTEN: HOW THE EXPLOITATION OF NATURAL RESOURCES FUNDS ROGUE ORGANIZATIONS AND REGIMES

Before the House Committee on Financial Services, Subcommittee on National Security, International Development and Monetary Policy on November 4, 2021

WRITTEN TESTIMONY

BY ROBBY STEPHANY SMITH, NATIONAL SECURITY ADVISOR | SUBMITTED November 10, 2021

Coalition for a Prosperous America (CPA) thanks the Subcommittee on National Security, International Development, and Monetary Policy for holding this hearing, which explores the capital available to rogue regimes and international malign actors via their exploitation of the globe's vast natural resources, including minerals, timber, and other naturally occurring assets, and looks at solutions to the problems this exploitation poses. CPA is a nonprofit, bipartisan organization representing the interests of 4.1 million households across the country who are engaged in domestic production through our agricultural, manufacturing and labor members.

Natural Resource Exploitation: A Tool for Financing Rogue Regimes and Organizations, a Financial Trap for Unwitting American Investors

We understand that many of the world's terrorist organizations, violent extremist groups, rogue actors, pariah states, and malign actors all harness and harvest natural resources to gain capital, create industry that they can control, gain access to global marketplaces, enrich themselves, and more. Politically-connected businesses tend to exploit natural resources with little care for the local community or the environment. These businesses often violate international law along the way, enriching themselves and their regimes while destroying livelihoods and leaving communities unable to responsibly benefit from their own natural resources. Examples of these activities include cobalt mining in the Democratic Republic of the Congo (DRC), illegal, unregulated, and unreported (IUU) fishing off the coast of Ecuador, timber smuggling and illegal logging in Nepal, coal mining in Myanmar, and more.

This is a global phenomenon. The United States and its allies should institute policies to halt and punish these illicit activities. The world's financial centers and sectors must better understand the root causes of these lucrative operations and levy consequences on those implementing and benefiting from these practices – from businesses to corrupt bureaucrats and rogue regime militants. The real risks to the United States, however, come not just in the form of negative environmental impacts or the rogue behavior of international bad actors and nefarious regimes that are direct results of these sources of ill-gotten financial means, **but in the actual risks to American investors posed by non-vetted – and often Chinese - companies' exploitation of our free and open capital markets.**

The average American investor often is propping up the very companies that are facilitating the internationally condemned activities that are exploiting our natural resources for the benefit of

the rogue actors and regimes that we are trying to stop. Upon a simple scan, dozens of known Chinese natural resources companies, as well as others complicit in transnational criminal activity and environmental exploitation are currently raising capital from US investors in our capital markets as publicly traded companies, in electronically traded funds (ETFs) and indexes, as well as in other passive investment vehicles, and in relationships between parent and subsidiary corporations.

The risks to investors are great, as are the risks to the global environment. In order to better grapple with rogue actors' natural resources exploitation as a means of financial underwriting, the financial services industry must take on the tough task of working with the U.S. and foreign governments (including border protection and customs officials), international organizations (including international law enforcement and security agencies), firms, and more. But stopping bad behavior is not good enough. *While we want to stop the nefarious activities of these rogue regimes and organizations, as well as to stop the environmental damage being done at their behest or by their natural resource exploitation, we also must protect American investors from unwittingly financing these activities.* Mitigating rogue regime and organization financing via ill-gotten natural resources is important, but the U.S. government has an even greater responsibility to use its powers to protect its citizens from harm – and this includes acting to protect American investors from supporting bad actor companies complicit in financing destructive operations that harm our planet, limit our future livelihoods, finance our adversaries, and benefit those who comb the globe for riches with impunity while destabilizing our society.

While Chinese companies are not the only ones complicit in financing this bad behavior or directly raising capital for their suspect operations via the U.S. capital markets, they are a predominate offender, and through their Belt and Road Initiative (BRI) have a global footprint of impact and a trail of evidence of their questionable and destructive operations. While this document specifically addresses Chinese bad actor companies in our assessment of risks to investors in U.S. capital markets and in its appendices listing Chinese companies complicit in environmental damages, other countries, regimes, and companies ought to be researched and included in a robust analysis of offenders. However, for the purposes of this statement, the focus is on Chinese companies, their offensive behavior, and the myriad ways in which they pose risks to U.S. investors in our capital markets. More research is needed on these Chinese companies as well as their linkages to the BRI, international development, and U.S. financing.

Below is an outline of the various ways Chinese companies – in all industries – exploit U.S. capital markets and pose risk to investors, as well as policy solutions to close loopholes. Following is an explicit listing of Chinese mining and extraction companies that are publicly traded, as well as examples of publicly traded Chinese companies complicit in environmental damages.

Risks to Investors Posed by China's Manipulative Behavior, Fundraising Schemes, Lack of Disclosure and Accountability, and Gaps in U.S. Law

Variable Interest Entities (VIEs)

Unlike in the United States, the government of the People's Republic of China (PRC) restricts foreign ownership in Chinese companies in a wide array of what it deems to be "strategic"

sectors. These sectors notably include many of China's most profitable technology firms and internet companies. In order to list overseas and access foreign capital, Chinese firms often use the Variable Interest Entity (VIE) structure to subvert Beijing's foreign ownership limits. While there is dissent in China regarding whether or not U.S. dollars or the Chinese renminbi are better for these sensitive industries, as of now, the dollar prevails as the currency of choice.

To raise capital, Chinese parent companies set up a shell company outside of China (often incorporated in the Cayman Islands), which mirror the value of the parent via a contract, and list on an American exchange. Unbeknownst to the vast majority of American investors, rather than owning shares of a Chinese company (Alibaba Group, for instance), they are in fact invested in a Cayman-based company with no assets or operations. Further, the legal validity of a VIE contract has not been explicitly confirmed by the Chinese government. This leaves American investors entirely devoid of legal recourse to recuperate their losses in the event of delisting or fraud and no minority shareholder rights. These shell companies in the Caymans, and other offshore locations, enjoy foreign issuer status and yet are not subject to the U.S. securities laws that would provide material risk information and protection to American investors.

Recently, Securities and Exchange (SEC) Chairman Gary Gensler discussed this issue and outlined steps the SEC is taking to protect American investors. These steps include pausing IPO approvals for Chinese companies; asking SEC staff to enforce higher disclosure standards for listed Chinese companies (only) to make information more readily available to American investors, including political and regulatory risk posed by the CCP and warnings on what the government of China could do to significantly change the rules in the middle of the game.

Americans must not be complicit in funding Chinese companies engaged in industries or activities that undermine American values, economic, and national security interests. Congress should take action to protect American investors from the risks associated with scandalously deceptive VIEs and their questionable legal status, beginning with informing American investors of whether their money is, in fact, invested in Chinese shell corporations domiciled in the Cayman Islands with no real equity ownership rights or investor protections whatsoever. This dubious financial structure should be terminated, as it is "unreformable".

A-shares, Indices, and ETFs

Over the last nearly two decades, basic investor protection measures required by law in the U.S. for inspecting the audits of public companies have been evaded by U.S.-listed and traded Chinese companies. The Chinese government is the only foreign government which does not comply with the required third-party financial audits of companies listed in the United States and has sought special waivers for non-compliance with U.S. law.

Last year, the *Holding Foreign Companies Accountable Act* (HFCAA) was signed into law, and the SEC is now working with the Public Company Accounting Oversight Board (PCAOB) to implement the law to bring Chinese companies into compliance with U.S. securities laws. This is welcome progress, but the new law only covers Chinese companies listed on a U.S. exchange, or N-shares.

The HFCAA neglects to address A-shares (securities listed on mainland Chinese exchanges and only accessible to American and foreign investors via inclusion in indices and associated index funds) and H-shares (Hong-Kong listed shares). For example, there are over 4,200 such A-share companies in American passive investment products that have basically never seen the regulatory light of day and little, if any, diligence. The vast majority of American investors are unaware that their Exchange-Traded Funds or mutual fund portfolios includes exposure to China A-share companies that are not compliant with U.S. securities laws and, in some cases, have been sanctioned by the U.S. for egregious human rights and national security abuses.

The scope of the HFCAA is limited to approximately 260 U.S. -listed N-shares, and approximately 900 securities traded on the over the counter (OTC) market but neglects to include the A-shares present in indices and Exchange-Traded Funds (ETFs) tracking them, which, as mentioned earlier, leaves over 4,200 Chinese companies not covered by the same laws that protect American investors and are required of U.S. companies. Put another way, HFCAA only covers about 22 percent of the problem, if we consider the problem to be Chinese companies not covered by American securities law, leaving 78 percent of the problem yet unresolved. Exposure to these indices through ETFs amounts to hundreds of billions of dollars or more in U.S. investment.

Congress must therefore pass a similar act like HFCAA to address the glaring problem facing U.S. investors.

Risks to Investors Posed by Lack of Disclosure and Accountability of Chinese Companies

Disclosures

Many criteria are considered to be required material information to investors, but often this information neglects to include important and financially significant information on key risk factors such as political or national security risk posed by the location or type of investment being made. In order to protect American investors from unknowingly investing in Chinese corporate bad actors – including enablers of genocide and other gross human rights violations, the Chinese Communist Party (CCP), Chinese military companies, the Chinese civilian-military fusion operations, the Chinese surveillance technology regime, and the list goes on.

The Committee should work closely with the SEC to promulgate rules that require greater disclosures of national security, human rights and political information that is material to investor protection, as well as reassess the definitional standard of a foreign issuer to ensure that the highest degree of scrutiny and protection is brought to bear against companies that pose a heightened risk to American investors.

ESG Standards

As the SEC pursues implementation of new rules and definitions regarding environmental, social, and governance (ESG) standards, it is paramount that an approach be taken to include national security, human rights and political factors into the analysis of both social and governance factors when providing information to American investors and investment managers.

This would include such information as a company's status as being a sanctioned entity by the U.S., ties or connectivity to forced labor, linkages to state-owned enterprises and dubious foreign governments, genocide or other gross human rights violations, support for foreign militaries or the military industrial / civilian-military fusion operation of a foreign government (notably those considered to be an adversary of or non-allied with the U.S.), and connection to surveillance technology companies and those in the technology sector that have linkages to international espionage or the construction of a "surveillance state".

Chinese solar companies are an excellent example whereby a company could have a false positive rating under ESG for its efforts on renewables. But the company in question has direct links to forced labor and using dirty-coal fire power plants to manufacture its product. This real-world example should serve as a template for how companies should receive a negative rating in ESG. ESG must be inclusive of forced labor, and related U.S. government sanctionable activities.

It is highly troubling that of the at least 440 Chinese companies on the Commerce Department's Entity List, only 4 of them –less than 1% - are on the Treasury Department's Office of Foreign Assets Control (OFAC) list of sanctioned companies, thereby imposing an investment ban via capital markets sanctions per Executive Order 14032 and the establishment of the Non-SDN Chinese Military-Industrial Complex Companies List (NS-CMIC List). This means that companies that are sanctioned by our government and denied access to U.S. technology, components, equipment, and other services are still allowed to raise large sums of capital from unsuspecting American retail investors and enjoy all of the global prestige of being listed or traded on the world's deepest and most voluminous markets. This is a scandalous double-standard that must be reconciled immediately. Simple improvements to ESG standards and sharing information with investors such as U.S. sanctions status would greatly enhance investor protection and improve the efficacy and quality of what is ESG.

Risks to Investors Posed by the Gaps and Inconsistencies in Imposition of U.S. Sanctions

The Global Magnitsky Human Rights Accountability Act

The U.S. has a robust sanctions arsenal, including the individual and targeted sanctions of the *Global Magnitsky Human Rights Accountability Act* that freeze assets or block property, eliminate access to visas, and imposes other punitive measures for criminal activity. However, this law has untapped potential when it comes to punishing bad actor companies and protecting American investors. While companies affiliated with sanctioned individuals have been listed in previous executive orders implementing the *Global Magnitsky Human Rights Accountability Act* sanctions (the first in 2017), companies are not formally targeted by this law. And until the capital markets sanctions imposed by Executive Orders 13959, 13974, and now 14032, U.S. sanctions did not focus on purely financial and capital markets activities of bad actor corporations – instead, they primarily targeted the individual. While targeting individuals is meritorious, there is room for greater Congressional and Executive action to enhance the *Global Magnitsky Human Rights Accountability Act*, or establish new laws covering corporate bad actors and capital markets activities. Congress must clarify its intentions, or pass new laws, that create a requirement that the State Department, in consultation with Treasury, report semi-annually on the presence of PRC-incorporated companies in U.S. capital markets (including in

passive investment funds and products), and their ties to activities that violates internationally recognized human rights or represent a national security risk to the U.S. The resulting list of companies must then be placed on the capital markets sanctions NS-CMIC List. Chinese corporate human rights abusers, for example, or companies engaged in militarizing illegal man-made islands in the South China Sea, should not be permitted to attract funds, often in the billions of dollars, from unwitting American retail investors. It is that simple.

Appendix A:

Most Active Publicly-Traded Chinese Mining Companies, per IntelTrak Project Count by Owner

1. Zijin Mining Group (2899.HK / MSCI ACWI, MSCI EM, FTSE EM)
2. China Nonferrous Mining Corp. (CNMC) (1258.HK)
3. Ganfeng Lithium Co. Ltd. (002460.SZ / MSCI ACWI, MSCI EM, FTSE EM)
4. Sinosteel Engineering & Tech (000928.SZ)
5. China Molybdenum Co. Ltd. (000831.SZ)
6. China Nonferrous Metal Industry's Foreign Engineering and Construction Company (000758.SZ)
7. Hesteel Group (HBIS) (000709.SZ / MSCI ACWI, MSCI EM, FTSE EM)
8. Baosteel Group Corporation (600019.SS)
9. China Metallurgical Group Corporation (601618.SS)

Natural Resource Extraction

China Nonferrous Metal Mining (Group) Company (CNMC)

- Damage to Ecosystem and Wildlife/Imposition on Preserved Lands
 - China Nonferrous Metal Mining (CNMC)'s Tagaung Taung Nickel Mine project in Thabeikying, Myanmar ignited an ongoing dispute between CNMC and villagers, who claim that their land and water resources have been contaminated by the project, endangering local marine life.
 - Thabeikying, Myanmar
 - <https://www.rfa.org/english/news/myanmar/mine-runoff-adds-to-controversy-08302019135617.html>
- Pollution
 - Some CNMC projects have allegedly caused local land and water resources to become contaminated.

Appendix B:

These companies are publicly-traded, posing risk to U.S. investors if their corporate bad actor status is not known via disclosure or investment in them is not prohibited via sanctions.

Publicly-traded but not natural resource-specific companies:

China Gezhouba Group Company (CGGC) 中国葛洲坝集团股份有限公司 (600068.SS)

- Pollution
 - China Gezhouba Group Corporation's \$1.06 billion coal-fired power unit project in Tuzla faced major pushback with regard to environmental concerns. The project uses cooling water from the major drinking water source in the area, leading to concerns about pollution.
 - Tulza, Bosnia
 - <https://www.reuters.com/world/china/bosnias-11-blnd-deal-china-backed-coal-fired-plant-under-threat-2021-07-15/>

China Grand Pharmaceutical and Healthcare Holdings (China Grand Pharmaceuticals) (0512.HK)

- Environmental Damage
 - The Norges Bank Investment Management (NBIM), which oversees Norway Government Pension Fund Global, decided to exclude China Grand Pharmaceutical and Healthcare Holdings from its fund due to "unacceptable risk that the company contributes to serious environmental damage."
 - Norway
 - <https://www.swfinstitute.org/news/88643/norway-swfbans-some-chinese-medicine-companies-over-environmental-impacts>

China North Industries Corporation (NORINCO) (中国北方工业集团有限公司 / 中国兵器工业集团公司) (00065.SZ)

- Displaced populations
 - Because the environmental impact assessment claimed fewer than 30 people would be affected by this event, environmentalists challenged the validity of the assessment as it was clear there was no public engagement, particularly from local indigenous peoples who the project would directly impact.
 - Thailand
 - <https://www.voanews.com/a/thai-water-project-clears-major-hurdle-after-china-shows-interest/6283331.html>

China Railway Construction Corporation (CRCC) (中国铁建股份有限公司) (0390.HK)

- Environmental Damage

- In June 2021, CRCC's road construction project was accused of causing a serious environmental disaster resulting in landslides and damaging houses in Sindhupalchok, Nepal. Locals have protested against CRCC and demanded payment for damages.
- Sindhupalchok, Nepal
- <https://www.timesnownews.com/international/article/protests-in-nepals-sindhupalchok-against-chinese-road-construction-firm-after-landslides-damage-to-houses/774062>

[Dongfang Electric Corporation \(DEC\) \(1072.HK\)](#)

- Disrupted or Deprived Local Populations of Livelihoods
 - In 2015, the 1,870 MW Ethiopian Gibe III hydroelectric dam project was operationalized following its completion by Dongfang Electric Corporation. Since the project's inception, environmental activists have campaigned against the dam, concerned that it can cause environmental damage to the already fragile local environment. In May 2011, food resources were so scarce in the drought-ridden border region between Kenya and Ethiopia that two of the main ethnic groups were in conflict for more land and water. This led to 70 ethnic Turkana people from Kenya being killed when they attempted to buy food across the border in Ethiopia. The project is also primarily financed by the state-owned Industrial and Commercial Bank of China.
 - Sodo, Ethiopia
 - <https://theconversation.com/fears-over-ethiopian-dams-costly-impact-on-environment-people-80757>

[MMG Limited \(1208.HK\)](#)

- Disrupted or Deprived Local Populations of Livelihoods
 - In 2017, reports emerged that local subsistence farmers in Peru had been displaced and lost their livelihoods to MMG Limited's Las Bambas copper mining project. The mining operations, which were awarded to MMG in 2014, resulted in widespread local protests due to their negative environmental implications. Locals were allegedly not properly compensated for their displacement, despite initial assurances.
 - Apurímac, Peru
 - <https://www.reuters.com/article/us-mmg-peru-insight/displaced-by-mining-peru-villagers-spurn-shiny-new-town-idUSKBN1E10JG>

[PetroChina Company Ltd. \(PTR: NYSE\)](#)

- Displacement of Local Populations

- In 2011, the Norwegian Council on Ethics recommended the Norwegian government divest US\$90 million held in the Norwegian Government Pension Fund Global (GPF) from the Chinese oil giant PetroChina due to human rights abuses connected to controversial oil and gas pipelines under construction in Myanmar. The pipeline allegedly forcibly-displaced locals in the area.
- Myanmar
- https://earthrights.org/media_release/chinese-oil-company-linked-to-human-rights-abuses-in-burma-myanmar/

Power Construction Corporation of China (PowerChina) 中国电力建设集团有限公司

(601669.SS)

- Environmental Damage
 - On October 26, 2016, Power Construction Corporation of China (PowerChina) and PT Intraco Penta began building the Bengkulu power station, a 200-megawatt (MW) coal-fired station in South Sumatra Province, Indonesia. In May 2018, a number of farmers in Bengkulu city expressed opposition to the plant because its construction was damming a stream and causing their land to flood. Locals also reported that sea life washed up dead on their beaches, allegedly due to the chemicals from the plant's waste treatment center. On November 15, 2019, the plant was connected to the power grid.
 - Palembang, Indonesia
 - <https://www.thejakartapost.com/news/2019/12/06/10-dead-turtles-over-2-months-in-bengkulu-some-found-near-power-plant.html> ; <https://ejatlas.org/conflict/bengkulu-coal-fired-power-plant-bengkulu-province-indonesia>
- Pollution
 - In July 2017, Power Construction Corporation of China (PowerChina) entered a joint venture arrangement with Iso Tech Group and Taylor Power Environmental Company to build, own, and operate the Barguna 350-megawatt (MW) supercritical coal-fired power plant in Barisal, Bangladesh. The joint venture signed a power purchase agreement with the Bangladesh Power Development Board. The project has faced pushback from locals and environmental activities who allege that it will contaminate local water resources and damage arable lands.
 - Barishal, Bangladesh
 - <http://www.newagebd.net/article/47813/coal-fired-power-plant-in-barguna-despite-environmental-concerns>

[Rio Tinto Group \(RIO:NYSE\)](#)

- Pollution
 - On July 15, 2021, PAKT and the Coalition against Corruption in the Environment filed a claim against Rio Tinto's subsidiary, Rio Sava Exploration, with the Basic Public Prosecutor's Office in Loznica for causing environmental pollution in the Jadar River valley area. Leaks of hazardous substances by the facilities for monitoring groundwater levels used by Rio Sava caused significant material damage to the local owners of land plots. The NGOs allege that Rio Sava has been causing environmental damage since 2015.
 - Loznica, Serbia
 - <https://balkaninsight.com/2021/07/14/serbia-green-ngos-file-charges-against-lithium-mining-giant/>

[Shanghai Electric Power Co., Ltd. \(上海电力股份有限公司\) \(2727.HK\)](#)

- Pollution
 - On October 24, 2009, Shanghai Electric won a \$1.38 billion contract to build the 1,244-megawatt coal-fired Vinh Tan 2 thermal power plant in Vietnam's Binh Thuan province. Vinh Tan 2 is one of three power plants in Binh Thuan's Vinh Tan power complex and will supply electricity to Vietnam's southern region. The plant has been the focus of significant complaints and protests by local residents due to dust pollution and health issues. Additionally, there have been claims made that the plant has degraded water quality in the area. As of 2016, cinders and fumes from the plant were still blowing into residential areas, affecting thousands of civilians, and some residents have reported their children contracting pneumonia.
 - Pan Thiet, Vietnam
 - <https://old.business-humanrights.org/en/vietnam-govt-orders-vinh-tan-2-coal-power-plant-to-reduce-pollution-amid-protests>
- Damage to Ecosystem and Wildlife/Imposition on Preserved Lands
 - In February 2018, a construction contract for the Hunutlu Thermal Power Plant was signed by Shanghai Electric Power Co., AVIC International, and Emba Elektrik Üretim. The contract is valued at \$1.7 billion and outlines the construction of a 1,320-megawatt (MW) power plant near Sugozy Village, Turkey. A lawsuit alleging future environmental harm was filed in 2018, and local environmentalists allege the area is internationally protected under the Bern Convention on Conservation of European Wildlife and Natural Habitats.
 - Sugozy Village, Turkey
 - https://www.banktrack.org/project/emba_hunutlu_coal_power_plant