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**BEFORE THE**  
**U.S. SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND**  
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Good afternoon Chairwoman Stabenow, Ranking Member Cochran and members of the Committee. I thank you for inviting me to participate in today's historically significant hearing on "Smithfield and Beyond: Examining Foreign Purchases of American Food Companies". I am pleased to testify. I have researched Chinese business and global strategy for almost 15 years, have several books and peer-reviewed articles on the subject and I testify in that capacity. Much of the research that I refer to today is from my 2013 book Subsidies to Chinese Industry: State Capitalism, Business Strategy and Trade Policy (Oxford University Press) and from independent research on Shuanghui, Smithfield and the global food industry.

**Summary of Position**

Shuanghui International, the largest Chinese food processor, has made a successful bid for Smithfield Foods, the world's largest pork producer, by paying a 31% premium. Smithfield owns an array of well-known brands, including Armour, Farmland and Healthy Ones, and gets the vast majority of its sales in the United States, with about 25% of its exports going to China. Smithfield and four other companies also control 73% of the U.S. pork-processing industry. Shuanghui is a heavily subsidized and opaquely managed private company with strong links to China's provincial and central governments: the company holds a majority stake in Henan Shuanghui Investment & Development Co., which is China's largest meat-processing enterprise.

This takeover provides long-term benefits to China, the province of Henan and to Shuanghui as well as short-term benefits to Smithfield's managers, shareholders and pension funds. However, the medium and long-term benefits to U.S. consumers, industry and society are highly questionable and the risks outweigh the benefits.

China's pork output, the world's largest, is predicted at 53.8 million tons, compared with U.S. output of 10.7 million tons. China imported more than 1.3 million tons of pork and its by-products last year, including more than 500,000 tons from the United States. Buying Smithfield would give Shuanghui access to more advanced production technology as well as to 460 farms that raise about 15.8 million hogs a year. Smithfield also promises brand reassurance after numerous Chinese food-safety scandals including the deaths of at least six babies in 2008 because of melamine-tainted milk and the discovery of more than 16,000 dead pigs in Shanghai's Huangpu River in March. Shuanghui apologized in March 2011 over illegal additives found in its meat and halted output after a CCTV report that farmers in Henan province fed the additive to their pigs and then sold them to a Shuanghui slaughterhouse. The company subsequently pledged to step up quality control.

If completed, this deal, the largest takeover of a U.S. company by a Chinese company, will double the number of U.S. jobs tied to direct investment by China. After the acquisition, Smithfield will cease to be publicly traded and information on operations will come through Chinese reports. The magnitude of this deal in a strategically important global industry will almost certainly affect food safety, how we do business in the United States, U.S. companies' and regulatory agencies' modes of participation, U.S. competitive environments (including company evaluations, pricing mechanisms and other food producers' competitive positions), efficiencies, intellectual property (IP) protection, and compatibility with U.S. industrial, economic and cultural policies. There is little doubt that this Chinese foray will be the first of many in the U.S. food and agricultural sectors. Consequently, the deal merits a thorough examination by the Committee on Foreign Investment in the United States (CFIUS) and broader participation by the Department of Agriculture and other affected parties.

### **Comparative Advantage, Subsidies & Trade with China**

In China, political considerations trump economic ones. No free market exists for food products in China and so economic arguments of efficiencies accruing from global logistics have little explanatory power: when subsidies and negative externalities (such as pollution<sup>1</sup>) exist as they do in this strategic Chinese food sector and in others we studied, the markets can no longer set prices and market failure occurs with detrimental effects on other countries' economies.

For the past five years, we have examined how China swiftly moved from being a global bit player and net importer to the world's largest manufacturer and exporter in capital-intensive industries where it had no labor-cost or comparative advantage just a few years prior. We witnessed industrialized countries become exporters of commodities and scrap to China. In 2000, labor-intensive products constituted 37% of all Chinese exports; by 2010, this fell to 14%. In parallel, from 2004 to 2011, U.S. imports of technologically-advanced products from China grew by 16.5% annually, while similar U.S. exports increased by only 11%. In 2011, the U.S. imported 560% more technologically-advanced products from China than it exported to that country. Meanwhile, the annual U.S. trade surplus with China in scrap and waste grew from \$715 million in 2000 to \$8.4 billion in 2010. The U.S. trade deficit with China, which has ballooned to account for more than half of the total U.S. trade deficit with the world, has had welfare implications, including lost U.S. jobs. Researchers have disputed the exact number of U.S. jobs lost to China trade but not that jobs have been lost.

Half of the world's pigs, about 476 million, reside in China. Yet, China has no comparative advantage in pig farming. U.S. pig farming is a consolidated, modern industry with economies of scale. Eighty-seven percent of the pork sold in the United States comes from big pig farms with more than 2,000 hogs. Such farms are climate-controlled and self-contained to minimize the spread of disease. By contrast, the Chinese pork industry is fragmented, small-scale, and low-tech. Seventy percent of the pork in China comes from pig farms with 500 hogs or less. Farmers

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<sup>1</sup> About 576 gallons of water and four pounds of grain go into manufacturing one pound of pork. Pound-for-pound, factory-farmed pigs also produce four times the waste volume that people do. According to the FAO, the global livestock industry is the largest sectoral source of water pollution. China with the world's largest livestock population has significant water pollution, soil degradation, rising rates of obesity and chronic disease, risks to food security and food safety, pressure on small farmers, and declining farm-animal welfare. A 2013 report by the Chinese Academy of Social Sciences' Institute of Rural Development concluded that in 2012, large-scale livestock and poultry pollution had become the biggest source of agricultural pollution in China.

with annual production of less than 50 hogs contribute 35% of the nation's output, while producers with less than 500 contribute 65% (Soozhu.com). Hygienic conditions are often primitive; yet, bureaucratic hurdles make consolidation of pig farms in China impossible. In the United States, by contrast, 53% of farms produce 5,000 or more pigs a year, according to the National Pork Producers Council. Shuanghui also imports all its slaughtering and processing equipment from the United States.

Yet, as I discuss later, despite no comparative advantage, pork is a strategically important industry for China. The same patterns that occurred in other strategically important industries will repeat in this sector and the United States will lose its competitive edge in food becoming dependent on China.

Extrapolating from what has occurred in steel, paper, glass, auto parts and solar, the United States will become an exporter of the commodity of pork to China, and an importer of higher-value-added processed foods from China, with attendant negative externalities including pollution, and detrimental effects on competitors, consumers and national security. Although U.S. exports to China of pork will rise, U.S. imports of processed foods from China will rise even faster contributing to the trade deficit and loss of manufacturing capacity.

In the Chinese industries we studied — solar, steel, glass, paper, and auto parts — labor was between 2% and 7% of production costs, and imported raw materials and energy accounted for most costs. Chinese production mostly came from small companies that possessed no scale economies or technological edge. Yet, in 5 years, China had moved from being net importer to largest manufacturer and exporter. The products in these strategically important industries for China (and often for the rest of the world) routinely sold for 25% to 30% less than those from the United States or European Union. This is similar to the food-processing industry in which Shuanghui and Smithfield operate, where labor costs are about 5% to 7%, most costs come from purchases and scale economies matter.

We found that Chinese companies could expand in this fashion only because of subsidies they received from China's central and provincial governments. Subsidies in strategically important Chinese manufacturing industries appear in dollar terms to exceed over 30% of industrial

output. The subsidies took the form of free or low-cost loans; artificially cheap raw materials, components, energy, and land; and support for R&D and technology acquisitions.

Since 2001, when China joined the World Trade Organization (WTO), subsidies have annually financed over 20% of industrial expansion for both large private firms (such as Shuanghui) and State Owned Enterprises (SOEs). The state has willingly paid the price of economic inefficiency to accomplish political, social, economic, and diplomatic goals. Huge Chinese subsidies have led to massive excess global capacity, increased exports, depressed worldwide prices, and hollowed out other countries' industrial bases.

As a non-market state-capitalist economy, China favors employment and domestic growth over its enterprises' profitability with implications for the entire U.S. pork sector and associated industries that feed in and out. Shuanghui has not released its profitability figures, but most of the companies we studied would have been bankrupt without subsidies. U.S. companies would be unable to compete domestically and in exports against a Shuanghui-Smithfield that does not pursue profits but is heavily subsidized and aims for industry domination. U.S. competitors would be forced to reduce their profit margins to compete, and in this consolidated industry, cost-cutting and bankruptcies would ensue in a very short time, perhaps in as little as two or three years (as with the solar industry).

Take paper and forestry. Since 2000, China tripled its paper production. In 2008, China overtook the United States to become the world's largest producer of paper and paper products. But, China has no comparative advantage in paper. The companies in China's paper industry are mostly small, with limited economies of scale or scope and no technological advantage. The industry is geographically fragmented as well, operating in 30 provinces. China also has among the smallest forest bases in the world per capita. Consequently, it is the largest importer in the world of major industrial inputs, including pulp and recycled paper. Labor makes up about 4% of the costs in this industry; in contrast, imported recycled paper and pulp comprise over 35% of the costs. Yet Chinese paper sells at a substantial discount compared to U.S. or European paper. China's rapid rise in the global paper industry was fueled by over \$33.1 billion in government subsidies. Governmental policies have systematically aimed to reduce China's dependence on imported raw materials and to subsidize the paper industry's restructuring. The

Chinese industry is opaque and we measured just the tip of the iceberg. The subsidies we measured from 2002 to 2009 included those for electricity (\$778 million), coal (\$3 billion), subsidy income reported by companies (\$442 million), and loan-interest subsidies (\$2 billion); from 2004 to 2009 they include those for pulp (\$25 billion); and from 2004 to 2008, they include subsidies for recycled paper (\$1.7 billion). Missing data prevented calculation of pulp or recycled-paper subsidies in 2002, 2003, and 2009.

Subsidies to Chinese private-sector companies such as Shuanghui, not just to SOEs, are widespread. China's local governments are the source of nearly all subsidies to private companies. Many subsidies come in the form of cash or tax rebates from city and provincial governments, given to support companies' employment, R&D spending, and similar activities that aid the local economy. Subsidies to private companies are growing fast, and once companies start getting large subsidies, they tend to continue, contributing to supply-chain inefficiencies and other logistical problems. In line with subsidies to this sector, Shuanghui's wholly owned subsidiary almost certainly gets a great many "unconditional" subsidies from the provincial Henan government, probably in line with subsidies that others receive in this industry, such as Yurun Pork Products that revealed subsidies to net profit of 36% (Fathom China). Relationships with officials help to attract subsidies. Local governments usually grant subsidies for promoting employment, drawing additional investment and stimulating economic growth.

### **Policies Molding China's Pork-Processing Sector**

Shuanghui traces its origins to the province of Henan and its wholly-owned pork-producing subsidiary, Henan Shuanghui Investment & Development Co, the province's largest employer. The food industry is one of Henan's pillar industries; through assiduous state support, Henan has evolved from becoming the nation's granary into the nation's kitchen. Through state subsidies, Henan upgraded its industry, agriculture, forestry and high-tech industries and helped all industries expand production scale, achieve broad integration, extend supply chains and expand markets at home and abroad.

The food-processing industry has also benefitted from Beijing's trade policy of indigenous innovation that focuses on domestic production and includes networks of regulation that advance

the goals of state capitalism, not of market efficiencies. Technology transfer, such as with Smithfield's animal-gene technologies, becomes the prerequisite for foreign companies to access China's markets and to move China into higher-value-added and innovative manufacturing. In 2006, the Chinese Communist Party's Central Committee and the State Council issued a *Decision on Implementing the Science and Technology Plan and Strengthening the Indigenous Innovation* (the "*Innovation Decision*") to carry out the landmark *National Mid and Long-term Science and Technology Development Plan (2006-2020)* issued a year earlier. This plan to strengthen indigenous innovation lists eleven general fields of applied research for emphasis including those that affect pork processing: Water and mineral resources; Environment; Agriculture; Population control and health; and, Public safety.

Implementing the *Innovation Decision* calls for establishing a series of supporting policies and measures to encourage indigenous innovation, including: Government grants; Preferential lending; IP protection; Construction of public forums; Tax incentives; Government procurement; Incentives to attract and retain talent; and International cooperation.

As patent filings become part of performance evaluations, local governments give subsidies for filings that often exceed budgeted costs. Shuanghui, for example has over 500 patents in China. According to the European Chamber, China's indigenous-innovation policies and official procurement catalogs wall off 17% of China's \$5.9 trillion economy from foreign participation. If other strategic industries are an indicator, it is unlikely that other U.S. competitors will be allowed into the pork-processing industry in China, or even be able to export pork to China at competitive prices.

The *12th Five Year Plan* emphasizes the development of seven strategic emerging industries (SEIs) that should account for 8% of Chinese gross domestic product at the end of the period, including Biology (biomedicines, biomedical engineering products, and biological agriculture). Article 27 of China's new *Enterprise Income Tax* law provides that income generated from agriculture, forestry, husbandry, or fisheries may be exempted from tax. The State Council issued the *National Strategic Emerging Industries 12th Five Year Development Plan* in July 2012. The plan designates the biology industry as one of the seven SEIs. The plan also calls for

further development of the biopharmaceutical, biomedical engineering, bio-agriculture, and bio-manufacturing industries through supporting policies for SEIs, including establishing an SEI special development fund, improving and implementing tax incentives, and encouraging financial institutions to increase lending. Various Chinese governmental agencies disburse indigenous-innovation subsidies. China's Ministry of Science and Technology funds science parks, research labs, and megaprojects. The state-owned China Development Bank provides soft loans for projects and may help finance the Smithfield takeover. The Export-Import Bank of China creates special accounts for innovative enterprises to lower their costs and to increase their exports.

These Chinese subsidies could lead to a bifurcation in food processing, with Smithfield becoming the lowest rung of the commodity supply chain to China's higher-value-added food processing. Essentially, higher-value manufacturing would move to China, while lower-value, lower-technology manufacturing would remain in the United States. One danger here is that Shuanghui could mix its plentiful supply of local hogs into this supply chain and re-export the higher-value-added processed food back to the United States and its export markets under the Smithfield brand.

A large proportion of Chinese household income goes into food, with pork as the staple protein source. Consequently, the price of pigs is linked to China's social and political stability: When pork prices rise, Beijing assumes that discontent will follow. To defuse protests that may threaten state power, Beijing has from 2007 managed a strategic pork reserve to control pork prices and to signal the need for shifts in policy<sup>2</sup>. The only reserve of its kind in the world, China's strategic pork reserve consists of two different parts: a live-hog reserve of a few million pigs rotated every four months between 200 to 300 commercial farms; and a frozen-pork reserve of about 200,000 tonnes, rotated every four months to ensure freshness and administered through domestic packing plants with pig facilities such as Shuanghui. The specifics of how the strategic pork

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<sup>2</sup> The Chinese government considers a hog-to-corn price ratio of six as a break-even level for pig farmers. The ratio also provides a gauge to check stability in Chinese pork supply and to guess at farmer's income. If the ratio rises over nine the government may release more pork into the market, and if it falls below six it may purchase pork to support prices.



reserve operates are classified as state secrets. The state-owned China National Cereals, Oils and Foodstuffs Corporation (COFCO) has a monopoly on both the live-hog and frozen-pork reserves.

In 2007, COFCO signed a deal with Smithfield Foods for 60 million pounds of pork for the frozen reserve. Smithfield scaled up production and added 250 workers at their Sioux City, Iowa plant, expecting that this deal signaled the opening of a promising market for pork exports. In 2009, however, Chinese authorities decided that only domestically produced pork would be used for the reserve in the future.

Pork processing is one of the most polluting industries in the world and China's central government has started seeing this as a potential threat to social stability. At this year's National People's Congress, pollution became a major focus. Chen Jiping, a retired Chinese Communist Party official, said that pollution had replaced land disputes as the main cause of social unrest in China. He blamed a reaction against pollution for the majority of the country's 30,000-50,000 "mass incidents" each year.

### **Governance & Evaluation of Shuanghui**

The bid for Smithfield included Goldman Sachs, CDH Investments, Singapore's sovereign wealth fund Temasek, and New Horizon Capital, a Chinese private-equity firm co-founded by Winston Wen (a.k.a. Wen Yunsong), the former Chinese prime minister Wen Jiabao's son. The group controls Shuanghui International, which was acquired about seven years ago by helping privatize a state-owned meat processor. The company's extremely complicated ownership structure, deliberately built over a period of years to signal no political attachments, leads people outside China to believe that it is not state-owned and therefore not state controlled. However, like most large private companies in China, especially those in strategically important industries, the government exercises considerable influence on Shuanghui; managers enjoy no independence from the state as Americans understand the term.

China is a high-context culture, where the annual reports and formal reporting relationships never tell the full story and may even distort. Shuanghui has excellent connections not just to the local government but also to the central government, which enabled its wholly-owned subsidiary to get a listing on the Shenzhen stock exchange.

Shuanghui's management retains the majority stake in the company at around 36% of shares, but has more voting rights than other shareholders. CDH has the next biggest stake at about 34%. Goldman and New Horizon each have about 5% and Temasek holds about 3%. When Winston Wen ran Beijing-based New Horizon, the firm invested about \$20 million into Shuanghui from 2006 through two avenues, according to a 2012 research report from China Investment Capital Corp. Winston Wen left New Horizon in 2010 after some in the industry criticized his company's aggressive deal-making. Beijing later appointed him chairman of the China Satellite Communications Corporation, a State Owned Enterprise. New Horizon is run by some of Wen's former college classmates, but how much stake he or his relatives have remains unclear. Regardless, Winston Wen continues to take an interest in operations, remains involved in New Horizon and derives income from its investments. In 2012, about a year after Shuanghui was hit by a food-safety scandal involving the illegal additive clenbuterol, Winston Wen's father, Prime Minister Wen Jiabao, visited the company's factories and headquarters. Prime Minister Wen encouraged Shuanghui's workers to put food safety first, stating that if the company made "unremitting efforts" it would shine brightly. Such public pronouncements and visits signal official patronage in China.

Based in the city of Luohe in the central Henan province, Shuanghui was set up by the local government in 1958. Current Chairman Wan Long was appointed head in 1984 and steered Shuanghui through a restructuring and a successful initial public offering in 1998. After the local government sold its stake in 2006, Shuanghui transformed itself into its current labyrinthine corporate structure, with a view to foreign acquisitions.

Smithfield too has previous ties to the Chinese government, knows the value of these ties in China and the suspicion they arouse elsewhere. Smithfield began exporting to China in 2007. In 2008, the state-owned COFCO, China's largest food importer/exporter, bought a 5% share in Smithfield. Shuanghui and Smithfield first discussed the potential acquisition in 2009, with on-and-off negotiations for 4 years. In 2012, Smithfield repurchased COFCO's shares. In 2013, Shuanghui made the bid for Smithfield.

Like many of China's top business leaders, Shuanghui's Chairman Wan Long has cultivated political connections in Beijing. For the past 15 years he has been a member of China's National

People's Congress, a national-level legislature that meets once a year to formalize measures proposed by leaders of the Chinese Communist Party. The backing of princeling stakeholder Winston Wen gives the company direct access to power brokers and key decision makers in Beijing.

In 2010, the investors explored the possibility of listing Shuanghui by having its Shenzhen-listed subsidiary, Henan Shuanghui Investment & Development Co., buy the parent company's assets. They abandoned the plan because local media reports on the proposed parent company's state affiliations sparked investors' concerns.

In 2011, CCTV revealed that Shuanghui's buyers had pressured farmers to spike pig feed with the chemical clenbuterol, banned in both the United States and China, to stop pigs from accumulating fat to produce lean meat. Local government officials and inspectors had given a green light to this problematic food chain, disregarding food-safety guidelines. When Shuanghui was exposed, local officials protested that the company had been unfairly targeted as farmers all over China regularly used clenbuterol. But Shuanghui buyers had ordered hog farmers to supply unnaturally trim 70% lean pigs. An average pig can produce meat that is only 40% lean. Regardless, provincial officials insisted that the largest employer in central and southern Henan could not fail.

Accounting data in China are particularly opaque and provide scant information on these interrelationships between business and government. Despite Beijing's avowed goal of adopting international accounting standards, certain activities, such as "related-party transactions", are not consistent with international standards, so officials and managers fudge. Under international accounting norms, managers should clearly disclose deals between companies with overlapping ownership. But, because overlapping ownership permeates China, detailing individual transactions would overwhelm financial reports. Consequently, "pure state-controlled enterprises" have no disclosure requirements. For the research in our book, Subsidies to Chinese Industry, we found that many of the companies' annual reports did not reveal standard accounting data such as "Bad Debts" and did not define terms such as "Payables to The Government". Cash Inflows from some companies' operations exceeded the Sales reported on the Income statements with no clarification.

Unclear governance and incomplete, even misleading, information from Shuanghui and Smithfield would impact the U.S. stock market, company evaluations, pricing mechanisms and other food producers' competitive positions.

### **Food-Safety Issues**

Shuanghui's and China's food-industry culture exudes outrageous food-safety violations and a history of food adulteration. As discussed prior, the company finally shut down a plant after numerous reports surfaced (including from CCTV) that it fed pigs with banned chemical clenbuteral. Chinese food calamities include glowing, bacteria-infused pork, cadmium-laced rice, rat meat sold as mutton, and toxic milk formula that killed six infants.

Smithfield's CEO Larry Pope recently said "People have this belief that everything is made in China. Open your refrigerator door, look inside. Nothing in there is made in China because American agriculture is the most competitive and efficient in the world" (Bloomberg Businessweek, May 29, 2013). Respectfully, Mr. Pope is wrong.

Americans have long been eating foods imported from China, the world's largest agricultural economy and one of the biggest exporters of agricultural products. China shipped 4.1 billion pounds of food to the United States last year, according to the Agriculture Department, including almost half of the apple juice, 80% of the tilapia and more than 10% of the frozen spinach, as well as fresh mushrooms, canned tuna, mandarin oranges, and artificial vanilla. The United States currently does not import meat products from China. The United States has cracked down on milk products imported from China, including baby formula and pet food containing the toxic protein-additive melamine. The United States has also banned at various times honey, shrimp, catfish and eel from China.

Oversight of China's food producers has lagged behind Chinese food imports. A 2009 study by the Agriculture Department concluded that while Chinese officials were working to improve food safety and the regulation of food production (requiring the small number of Chinese food exporters to gain certification) imports from China remained problematic. Monitoring the wide range of products and hazards that can arise at various points in supply chains posed a challenge for Chinese and U.S. officials. The Food and Drug Administration (FDA) inspects less than 2%

of imported produce, processed food and seafood. Despite a Memorandum of Understanding between the FDA and China's Certification and Accreditation Administration signed in 2010, the FDA only inspected ten food facilities in China in 2012.

Imported foods sold in groceries and other food stores must be labeled with their country of origin; but, many imports end up in restaurant and food-service meals, where consumers have no information of source. Additionally, once imported foods are processed in any fashion, government regulations no longer require such labeling.

Consequently, frozen imported peas and carrots would require a label if packaged separately, but mixed together and sold in a single package, they do not need labeling. Fish fillets must carry labeling, but imported fish sticks or crab patties do not. China is also a big source of ingredients used in food, like xylitol (a candy sweetener), artificial vanilla, soy sauce and folic acid. China cannot, however, export fresh pork or beef to the United States because the country still has outbreaks of hoof-and-mouth disease. Processed-pork products like smoked hams, sausages and bacon could conceivably be imported from China, if they meet the World Organization for Animal Health's recommendations, which require cooking at high heats for a specific amount of time. Disturbingly, this would not catch wrong doings such as Shuanghui's selling pork laced with clenbuterol or other banned additives with widespread use in China.

China is not yet approved to ship meat and poultry products to the United States but is being certified as equivalent to U.S. meat-inspection standards. Simultaneously, the Department of Agriculture has weakened oversight by moving from conducting annual on-site audits to relying on a Self-Reporting Tool augmented by audits every three years. This increases the risks of exporting potentially unsafe pork products from China to the United States and the safety risks for U.S. consumers and society.

### **Quality Control & IP Protection**

Shuanghui, which controls Shenzhen-listed Henan Shuanghui Investment & Development Co, China's largest meat processor, is one of China's few integrated meat producers, with farm-to-fork operations -- but it only raises 400,000 of its own hogs a year, a fraction of the 11 million it needs. This means the company, which has more than 61,000 employees, relies heavily on private breeders in a country where overcrowding on farms is commonplace, raising the risk of

spreading disease back to the United States. Overcrowding on farms around Shanghai led to some 16,000 rotting pig carcasses floating down the Huangpu River earlier this year, according to official documents. More alarmingly for Shanghai's residents, the Huangpu supplies 20% to 30% of the city's tap water.

Quality control does not seem a strong suit for Shuanghui. A recent report on the U.S. Meat Export Federation website about training seminars at large Chinese meat processors, including Shuanghui, noted some participants were unfamiliar with the proper use and handling of frozen raw materials. "In some instances, we found that while the processing equipment was very modern, there was room for improvement in terms of maintenance and sanitation," it said.

The United States Trade Representative has listed China as one of ten countries on its Priority Watch List of worst violators of intellectual property rights. Shuanghui will acquire and possibly license Smithfield's animal-gene technology, with corresponding competitive losses for U.S. industry and Smithfield's competitors.

One offshoot of the acquisition will be counterfeit meat products that China consumes and exports, leading to brand dilution and loss of export markets (other than China) for the United States. For example, New Zealand exports 20 milk-powder brands to China made by six companies. Yet, more than 200 Chinese brands claim to be from New Zealand. The New Zealand Herald (June 25, 2013) reported that 90% of so-called NZ dairy products in Chinese supermarkets were counterfeit. This situation will probably occur with Smithfield's patents and brands exacerbating loss of domestic and export markets for U.S. companies and brand dilution for U.S. food processors generally.

### **Reciprocity**

Shuanghui did not acquire Smithfield for its hogs alone. In 2012, the number of hogs slaughtered by Smithfield, which has about a quarter of the U.S. slaughter capacity, would account for only 3% of China's slaughtered hogs. However, Shuanghui's purchase of Smithfield is a harbinger of things to come as China prepares to buy more in this U.S. and other agricultural sectors.

As the Chinese government views pork-processing as a strategically important industry, the country is unlikely to open this market to U.S. companies. Conversely, protecting the U.S. local food industry will probably not stop Chinese processed-pork imports. A 2011 World Bank study noted that from 2001-2009, China has loomed especially large in the most-protected sectors of major trading partners' markets. In 2009 in these most-protected sectors, China's share of imports greatly exceeded overall imports and dwarfed that of any other country. For example, China's share of the most-protected sectors in Japan was over 70%, in Korea over 60%, in Brazil about 55%, and in the United States, Canada, and the EU about 50% each. Even in these protected sectors, China's share increased dramatically over the course of the Doha Round. In many of the importing countries (e.g., Brazil, the EU, and the United States), China's share more than doubled. Indeed, China gained market share even in countries such as Canada, Mexico, and Turkey that have free-trade agreements with close and large neighbors. Thus, liberalization under the Doha agenda, especially in the politically-charged, high-tariff sectors, resulted in other countries opening their markets to Chinese exports. For example, in the United States, China had by far the highest share of imports in eight out of the ten most-protected sectors, ranging from 22% in man-made fibers to 76% in footwear. But, the Chinese market, despite China's far-reaching WTO-accession commitments, remained protected across several products while the Chinese government simultaneously subsidized its manufacturers for increased exports.

Indeed, the Smithfield acquisition will be the first in a long line of Chinese acquisitions in U.S. agriculture and we should prepare for this as a matter of national interest.

Chinese acquisitions of U.S. companies have soared to \$8.7 billion so far this year from \$56 million in 2003, according to data compiled by Bloomberg. The deal volume through May 31 was already close to 2012's record \$9.2 billion and more than double the \$3.9 billion in 2011. The size of China's purchases have grown as well. Three of the four biggest Chinese deals in the United States have been announced since the start of 2012, including the Smithfield acquisition.

Closely-held companies undertook about half of the Chinese transactions in the United States by dollar value over the past 15 months. But, as previously argued, these large private acquisitions (and many small ones in strategically important industries) have their Chinese provincial and central governments' close backing and support; in return the companies have an obligation to

respond to governmental demands. The Chinese government, through its investment arms, also has investments in major private Chinese firms engaged in strategic businesses include food production, aside from companies fully owned or controlled by the Central Committee's key members. The People's Liberation Army has its own investments in companies engaged in profitable areas of business which provide funds for the improvement and development of military personnel and hardware.

Through record subsidies and loans that never have to be repaid for the life of the loan, the Chinese government is encouraging a going-out strategy in agriculture to acquire foreign food assets and farms. The government has blessed a \$32.7 billion foreign investment splurge in the last five years after just \$4.2 billion in the previous five. China's announced purchases in agriculture, including pastoral land, farm chemicals, processors and food companies, have already reached about \$7.8 billion this year, compared with the record \$8.1 billion in all of 2010.

Shuanghui's bid for Smithfield, which owns 460 farms and has contracts with 2,100 others across twelve U.S. states, would be the largest Chinese acquisition of a U.S. company and follows a string of global food and agricultural-related purchases in Southeast Asia, Brazil and Australia.

China's acquisitions are being driven by the desire to secure volumes of safe produce for import and eventually access to the transfer of technology. Vice Agriculture Minister Chen Xiaohua said in March that China is "willing to encourage" investment by capable Chinese companies in foreign farm sectors. Similarly, Chen Xiwen, deputy head of the Central Rural Work Leading Group under the State Council said in May 2012 that the nation's agricultural businesses should invest in global grain trading and supply-chain logistics to help China to secure supplies.

Holdings in industry-leading farmers and food processors around the world give Chinese companies access to the intellectual property that drives it all, propelling a steeper increase in China's domestic pork-processing productivity. The United Nations estimates that with 20% of the world's population and just 8% of its farmland, China needs to spend \$861 billion on its farm sector through 2050 to produce crops and livestock to feed its people. Food security has become critically important to the Chinese government eliciting genuine demand to invest in large-scale



assets especially food-processing plants and various technologies associated with food production. Shuanghui is not venturing into the Smithfield acquisition alone.

### **Conclusions**

Countries undertake activities with negative externalities such as pork production with the promise of societal benefits. For China, the Smithfield acquisition provides the benefits of American land, water, brands and technology. For U.S. consumers, competitors, and society the risks are clearer than any long-term benefits. Unanswered questions include who owns the farm land in the United States and who manages its oversight as well as who sees that what we eat is not toxic. Our present regulations do not protect us adequately in this brave new world.

Medium and long-term benefits to Smithfield's shareholders are debatable as well. Continental Grain, which together with several related parties recently owned roughly 6% of Smithfield, has said the board should consider separating the company into three businesses: hog production; fresh pork and packaged-meats production; and international pork operations. Smithfield's chairman said he disagreed with Continental's recommendations.

In a conference call with analysts (May 29, 2013), Shuanghui's Managing Director Yang Zhijun, said "Continuity is very important to" Shuanghui, and it "will not change the people, the places, the products, [or] the leaders" at Smithfield. "We want the business to stay the same, but [be] better." He did not elaborate on how Smithfield would become better as no transfers of technology or knowhow were forthcoming from Shuanghui. He also did not elaborate on better for whom, which is the question that CFIUS and this committee should be asking on behalf of the American people.

Thank you and I look forward to your questions.

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