TESTIMONY OF
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BEFORE THE HOUSE COMMITTEE ON HOMELAND SECURITY
ON THE CFIUS PROCESS AND FOREIGN INVESTMENT IN THE U.S.
May 24, 2006

Chairman King, Ranking Member Thompson and Members of the Committee:

Thank you for the opportunity to testify today. It is a privilege to appear before you. I applaud your leadership, Mr. Chairman, and that of Ranking Member Thompson, on the vital issues affecting our nation's homeland security. In particular, I want to thank you for your contribution to the careful, considered, prudent approach that the House of Representatives is taking towards reform of the Exon-Florio Amendment and CFIUS. This is a very heated political environment in an election year. Because of your leadership, I believe that the House is moving towards adopting tough, effective, and truly bi-partisan legislation that would restore Congress's confidence in CFIUS, enhance protection of national security, and maintain the United States' longstanding open investment policy.

Importance of Foreign Direct Investment

We live in what threatens to be a protectionist era. There is a clear and present danger that the recent Dubai Ports World controversy will be used as a platform to fundamentally change the rules governing foreign investments in the U.S., in ways that will threaten investments that are a lifeblood for a healthy economy.

We need to be clear-eyed about our vital national interests. Little direct foreign investment comes from the Middle East: 94% of foreign assets in America are owned by companies from the 25 industrialized, democratic OECD member countries, and 73% of all foreign investments in the U.S. are made by European companies. Our traditionally open investment climate has greatly benefited the American people. At a time when concerns are raised about the "outsourcing" of jobs abroad, foreign investment represents "in-sourcing," a vote of confidence by foreign firms and investors in the openness, flexibility and strength of the U.S. economy.

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In-sourcing foreign companies employ more than five million Americans, some 5% of private industry employment. At a time when U.S. manufacturing employment is hemorrhaging, almost 35% of the jobs created by foreign firms in this country are in manufacturing. Foreign direct investment often saves a struggling American company, which might otherwise be shut down or moved abroad. Foreign-owned U.S. operations account for 21% of our total exports and in 2004 plowed $45 billion in profits back into the American economy. Foreign-owned affiliates purchase 80% of their intermediate components from U.S. firms; they also spend $30 billion on R&D and over $100 billion on plant and equipment annually in the U.S.

Moreover, we also need to keep the arteries of foreign investment open to fund our record current account trade deficit, now at 7% of our GDP, and compensate for our low savings rates; foreign capital flows keep long-term interest rates lower.

Global Impact of CFIUS Reform

As Congress looks at changing the rules for foreign investment I hope you will recognize that your actions will reverberate around the world. Congressional action to tighten restrictions on foreign investment in the United States could invite similar action abroad, limiting opportunities for outward investment by American companies. This is not an idle concern:

- Last summer, French politicians reacted to mere rumors of PepsiCo's potential interest in acquiring Danone, the French yogurt and water company. French Prime Minister Dominique de Villepin made the extraordinary statement that "The Danone Group is one of the jewels of French industry and, of course, we are going to defend the interests of France." The French government has followed up by publicly opposing the purchase of the steelmaker Arcelor by Mittal Steel, and pushing for the recent merger of the water utility Suez and the national gas company GDF to pre-empt an Italian energy company from acquiring Suez. Most recently, the de Villepin's government has proposed legislation establishing a list of eleven "strategic sectors" that will be shielded from foreign investment.[2] It is hard to see how yogurt is a strategic industry.

- France is not the only European nation engaging in such protectionist machinations. Since the beginning of the year, the Spanish government has prevented a German company from taking over a Spanish energy concern; the Polish government has blocked Italians from acquiring several Polish banks, while Italy has done the same for some time; and Germany continues to insist on its "Volkswagen law,", which insulates its auto industry from foreign competition.[3]

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[2] *See* Patrick Sabatier, *Globalization a la carte*, Int'l Herald Trib., May 18, 2006.

[3] *Id.*

- In his State of the Union speech, President Putin called for a new law to protect "strategic industries" in Russia, including the oil sector. A draft of that law is expected to be put forward shortly.

- The Canadian Parliament is now considering amendments to the Investment Canada Act to permit the review of foreign investments that could compromise national security.

- China continues to restrict investment in a number of important sectors.

Permit me to give you a recent, and more tangible, example in which a foreign government's proposed restrictions on U.S. investors seems to be directly linked to security commitments imposed by CFIUS on a company from that country. Specifically, the Indian government, recently announced its intention to impose extremely broad security restrictions on foreign investments in the telecommunications sectors. These security restrictions were announced alongside a proposal to raise the ceiling on permitted foreign investment in the telecommunications sector, from 49% foreign ownership to 74% foreign ownership. In this case, it appears that the Indian government's proposed new restrictions were provoked in part by the experience of an Indian company, VSNL, which itself had a difficult time clearing CFIUS, and ultimately signed a Network Security Agreement related to one of its investments in the United States. In a letter publicly filed with Indian regulatory officials, VSNL wrote, "[we] propose that TRAI [the Indian regulatory authority] consider whether, in the interests of a level competitive playing field as well as regulatory symmetry, a similar security agreement process should exist in India for U.S. and other foreign carriers who desire a license to provide domestic or international services." VSNL further wrote, "While we certainly do not recommend that the Indian Government force foreign carriers to wait as long as VSNL has been made to wait for its license to enter the U.S. telecommunications market, we believe that the existence of these agreements in India and other countries will have a beneficial result by moderating the willingness of the U.S. government to impose burdensome conditions and requirements in their own security agreements, which of course hinder the ability of VSNL and other foreign carriers to compete fairly against U.S. carriers who are not subject to such requirements."[4]

Mr. Chairman, this letter proves the old maxim, "what goes around, comes around." We should never compromise national security, but Congress needs to realize that restrictions imposed on foreign companies in the United States will invite similar restrictions in foreign countries against U.S. companies. We need to be careful not to encourage other countries to impose restrictions that hurt American investors, nor should we chill the foreign investment that is so vital to the American economy.

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[4] Edward M. Graham and David M. Marchick, *US National Security and Foreign Direct Investment* 164 (2006).

Comments on H.R. 5337

I believe that the fundamental principle that should guide Exon-Florio reform is to ensure that CFIUS has all the tools and all of the time it needs to identify, scrutinize, and act upon the tough cases that present real national security issues, while ensuring that CFIUS has the necessary flexibility to recognize and efficiently process the majority of transactions that present no national security concerns. Ensuring that the overwhelming majority of transactions that do not raise national security issues can obtain Exon-Florio approval in 30 days is essential to avoid discriminatory treatment of foreign investors that would chill the investment our economy needs. American companies that make acquisitions need to secure antitrust approval under the Hart-Scott-Rodino Act, which also has an initial 30-day review period. Preserving two 30-day, parallel regulatory processes for both domestic and foreign acquisitions of U.S. companies ensures that foreign bids for U.S. companies are not discounted or ignored because of longer regulatory timeframes.

With a few adjustments, I believe that the CFIUS reform bill currently before the House Financial Services Committee, and that you co-sponsored, Chairman King, is the right way to reform Exon-Florio. The bill will implement structural reforms that address Congress's DP World-related concerns, restore confidence in the integrity of the CFIUS process, and reassure our global allies and partners that America is still open for business. Specifically, the bill facilitates identification of the tough cases by requiring CFIUS to consider additional factors during the review and investigation process, including whether a transaction has a security-related impact on critical infrastructure.

The House bill ensures that CFIUS will have the information it needs by giving the Committee greater investigatory authority. It defines the appropriate role of the intelligence agencies as an information resource, as opposed to a policy role. It enhances accountability for both CFIUS and the transacting parties by requiring certification of notices, reports, and decisions, and by establishing procedures for control and continued monitoring of withdrawn transactions. The bill ensures CFIUS is focused and competent to fulfill its mission by maintaining Treasury leadership of the Committee and authorizing the designation of competent agencies to take the lead on particular transactions: investments in critical infrastructure, for example, should principally be reviewed by the Department of Homeland Security. It maintains voluntary, as opposed to mandatory, notices. And it enhances transparency of the process by requiring CFIUS to collect and share more data, on an aggregate basis, through semi-annual reports to Congress, without creating unduly burdensome notice and reporting requirements that will politicize the process or risk leakage of business proprietary data. Congress needs to recognize that imposing excessive reporting requirements on CFIUS may actually complicate and distract CFIUS's focus from its principal mission of protecting U.S. national security through efficient review of foreign investments. The House bill's provisions represent important substantive and procedural improvements to the CFIUS process.

I do, however, have several concerns with specific provisions of the bill in its current form.

First, I understand the dynamics that led to the provision in the bill tightening the so-called "Byrd Amendment" for government-owned companies, particularly in the wake of the Dubai Ports Controversy. In my view, acquisitions by some government-owned companies raise unique national security issues and should receive enhanced scrutiny. U.S. companies are put at a competitive disadvantage against those government-owned companies that receive subsidized or concessional government financing. But not all government acquisitions create the same national security risk, and CFIUS should have discretion to distinguish between transactions that raise issues and those that do not. Companies affiliated with friendly governments which operate by market principles should not be arbitrarily lumped together with government-owned firms that otherwise raise substantial national security concerns. Optimally, all transactions that involve parties that operate on market principles and do not raise national security concerns should be considered by CFIUS in the same, existing 30 day review period. But if political realities are such that mandatory investigations of all foreign government-controlled transactions are necessary, I think it would be useful for Congress to clarify the intent of the legislation, perhaps in its report, that CFIUS can allow such acquisitions to go straight to the investigation stage and that CFIUS has discretion to close the investigation if no real issues exist or if any national security concerns have been mitigated.

Second, I also understand Congress's desire for additional accountability. But the requirement that the Secretaries or Deputy Secretaries of both the Treasury and Homeland Security personally approve and sign each and every review and investigation may create bureaucratic delays and impede CFIUS's ability to efficiently implement Exon-Florio. Perhaps the Congress could explore ways to require a high-level sign-off for transactions that raise real national security issues, while allowing an Undersecretary or Assistant Secretary to approve other transactions. From my own experience in public service, very important decisions are regularly made at the Undersecretary and Assistant Secretary level.

Third, CFIUS should never act if the Director of National Intelligence does not have adequate time to collect and analyze intelligence relating to a particular transaction. But again, the policy underpinning CFIUS reform should be to create a process that is tough enough for the complex cases and flexible enough for the easy cases. Some intelligence reviews might take 30, 45 or even 60 days. Reviews of companies that frequently go through the CFIUS process could simply be updated in a matter of days. But by creating a 30-day minimum for the DNI's intelligence review, and requiring that the DNI review be completed no less than 7 days before the end of the initial CFIUS review period, the bill establishes a de facto 37 day process, even for transactions that raise no national security issues. Time is money; the longer a deal takes to approve, the more it costs and the more variables can affect the underlying transaction. I am confident that a provision can be fashioned to allow the DNI to do his job well without slowing down the entire process with a requirement for extended analysis of cases that present no national security concerns.

Finally, I believe the existing review and investigation time periods are appropriate for CFIUS to do its work. But if some extension is inevitable, it is much preferable to add additional time to the end of the investigation period, as the bill does, rather than extending the process after the initial 30-day period. Thus, the Senate Banking Committee bill would extend the initial 30 day review period if only one CFIUS agency requests it. This House bill would allow an extension of the 45 day investigation period if requested by either the President or two-thirds of the agencies involved in the CFIUS process. Generally, CFIUS can determine in the initial 30 day period if a transaction is likely to cause significant concerns from a national security standpoint.

Protection of Critical Infrastructure

The final subject I would like to address is protection of "critical infrastructure." I know that this is a topic that this Committee has a particular interest and expertise in, and that "critical infrastructure" has also become a significant issue in the debate over CFIUS reform. It will continue to be an important subject as any House bill moves into conference committee work with the Senate. The focus on protection of critical infrastructure is a relatively new and evolving national security objective, and may have different implications in different regulatory contexts. CFIUS needs the flexibility to focus its scarce attention, time, and resources on those foreign direct investments that create real national security risks. Forcing CFIUS to scrutinize every foreign investment in critical infrastructure will compromise CFIUS's ability to focus on the transactions that matter from a national security perspective. Three different approaches have been proposed with respect to the protection of "critical infrastructure."

- H.R. 4881, offered by Chairman Hunter and other Members, would essentially prohibit foreign investment in critical infrastructure unless the particular investment is put in a "US Trust" run by American citizens and walled off from the foreign parent. If the Department of Homeland Security's (DHS) current list of "critical infrastructure" activities were used, close to 25 percent of the U.S. economy would be off limits to foreign investment under this proposal. This bill is the mirror image of Prime Minister Villepin's legislation shielding 11 sectors of the French economy from foreign investment, which I described earlier. I believe that the last thing we need to do with CFIUS reform is emulate the French government and move our economy closer to the French statist model.

- The Senate bill, offered by Chairman Shelby and Senator Sarbanes, requires that foreign investments in critical infrastructure go to the "investigation" stage unless CFIUS determines that "any possible impairment to national security has been mitigated by additional assurances during" the review period. This approach creates a de facto presumption that all foreign investment in critical infrastructure creates a security risk because it must go to an "investigation" unless the risk is mitigated. In my view, some investments in critical infrastructure do create real national security risks; but other investments should not even be filed with CFIUS because they create no risk whatsoever.

- The bill you co-sponsor, Mr. Chairman, requires CFIUS to consider whether a "covered transaction has a national security-related impact on critical infrastructure in the United States" as a factor in its deliberations. I think you have it right. It should be a factor CFIUS should consider. How significant a factor it should be will vary on a case-by-case basis.

One of the reasons that your approach makes sense is because the focus on protection of critical infrastructure is a relatively new and evolving security objective. In contrast to the area of foreign investments in the defense sector, an area where DOD has extensive institutional experience and protocols dealing with what aspects of foreign investments present security issues (and which do not), "critical infrastructure" remains a relatively fluid regulatory concept. Additional work needs to be done, in my view, to define what exactly is meant by critical infrastructure. For example, the Patriot Act defines "critical infrastructure" to be

> ""[S]ystems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters."[5]

This definition creates a high threshold and implies a relatively narrow list of assets that would "have a debilitating effect" on security. By contrast, the Department of Homeland Security has identified twelve extremely broad sectors that it considers to be critical infrastructure, including agriculture and food, water, public health, emergency services, the defense industry, telecommunications, energy, transportation, banking and finance, chemicals, postal services and shipping, and information technology.[6] This definition may work for physical protection of critical infrastructure; it does not work for foreign investment considerations.

But beyond specifying these sectors, the Department of Homeland Security has not publicly identified the types of companies, or even subsectors, for which acquisition by a foreign firm would be deemed a high risk to national security. Nor has anyone explained why foreign ownership of these sectors would necessarily create a national security risk. Thirty percent of value added in the U.S. chemical sector is already produced by U.S. affiliates of foreign owned firms. In the energy sector, it would seem fairly clear that foreign acquisitions of US nuclear energy companies should be reviewed by CFIUS. What about foreign acquisitions of US firms operating in other segments of the energy sector? Many foreign companies own electric distribution companies. Do these raise national security issues? What about foreign ownership of a wind farm? Similar

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[5] Section 1016(e) of the Patriot Act, codified at 42 U.S.C. 5195c.

[6] *See* National Strategy for the Physical Protection of Critical Infrastructure and Key Assets, (February 2003), *available at* www.whitehouse.gov (last visited May 20, 2006); HSPD-7 (December 2003), *available at* www.whitehouse.gov (last visited May 20, 2006).

questions certainly apply in the other sectors, including the food, transportation (including ports), and financial sectors, where foreign ownership of US firms is common.

In my view, the Administration and Congress should work together to determine how best to protect critical infrastructure, regardless of who owns a particular company. Security policies and guidance could be developed on a sector-by-sector basis. A baseline level of security requirements should be established. If there are particular national security issues associated with foreign ownership in a particular asset, CFIUS is well equipped to mitigate that risk - or block the investment.

In sum, until policies and doctrines with respect to critical infrastructure have been further developed, it is both unsound and unnecessary to do anything beyond adding "critical infrastructure" as a factor that CFIUS should consider. Creating an outright ban on foreign investment in "critical infrastructure" would both harm job creation and undermine national security, because foreign investment in these sectors has both increased research and development and spurred additional competition and innovation. Further, it would be unwise to create a presumption that foreign investment in critical infrastructure creates a national security risk. Rather, CFIUS should be given the discretion to deal with these issues on a case-by-case basis, examining both the trustworthiness of the acquirer and the sensitivity of the asset being acquired.

Conclusion

Let me close by applauding your contribution to this reform process, Mr. Chairman and Ranking Member Thompson, along with the efforts of so many of your colleagues. Doing Exon-Florio reform right is critically important. The open character and continued vibrancy that define our national economy is at stake. These are among the fundamental characteristics of our great nation, which I know this Committee is dedicated to securing. The bi-partisan bill that you are co-sponsoring is the correct approach to the problem at hand. I am grateful for the opportunity to testify and look forward to working with you as you deliberate on this important subject.