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## The Need for CFIUS Reform to Address Homeland Security Concerns

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Today, the United States is the world's dominant economy. Because of the promise of America's economic potential and the openness of its markets, the U.S. is a major destination for foreign investment. According to the Commerce Department's Bureau of Economic Analysis, net inflows of foreign direct investment (FDI) increased by almost 50 percent between 1996 and 2005, growing from \$86 billion to \$128 billion. Between 2004 and 2005 alone, the level of FDI in the U.S. increased by \$21.8 billion, or 20 percent.<sup>1</sup>

Foreign investment introduces new technologies and skills to America's economy, helping to promote U.S. competitiveness abroad. About 20 percent of all U.S. exports originate from U.S. affiliates of foreign-owned companies.<sup>2</sup>

FDI supports about 5.3 million U.S. jobs from California to New York, and from Texas to Ohio.<sup>3</sup> U.S. subsidiaries support an annual payroll of \$317.9 billion with average compensation per employee worth almost \$60,000—over one-third more than the average American salary.

Moreover, the benefits of FDI extend into the American economy as a whole. Increased investment and competition generate higher productivity and more efficient resource use. Ultimately, this culminates in greater economic growth, job creation, and higher living standards for all.

Any new rules that restrict, delay, or politicize foreign investment will result in the loss of FDI as greater

### Talking Points

- The Bush Administration's National Security Strategy correctly identifies "free markets" as a necessary component of our national security strategy.
- Erecting barriers to foreign investment would stifle innovation, reduce productivity, undermine economic growth, and cost jobs without making America any safer. Improving the transparency of the CFIUS process is appropriate; provoking a wave of anti-trade, anti-investment policy is not.
- Reform should address the heart of the CFIUS problem—appropriate reporting and consideration of investment by government-owned firms—without risking the economic and political consequences of politicizing foreign investment in the U.S.
- Protectionism would endanger U.S. prosperity, strain relationships with important allies in the war on terrorism, and make it more difficult to use open markets to spread American values and bolster U.S. interests around the world.

This paper, in its entirety, can be found at:  
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uncertainty and delays in investment transactions add to the cost of foreign firms' doing business in the U.S. Consequently, America will pay for higher investment barriers with lower growth and fewer jobs. FDI restrictions would undermine America's chances of remaining an economic superpower in an increasingly competitive global economy.

Moreover, there may be secondary consequences of enacting new foreign investment barriers. America could face less market access and opportunity abroad as countries enact retaliatory policies that result in ever higher barriers to global investment. With over \$2 trillion of direct investment abroad, the U.S. is the world's biggest investor: Foreign retaliation in reaction to new U.S. investment restrictions would be costly for many Americans.<sup>4</sup>

### The CFIUS Process Today

The United States generally welcomes foreign investors and provides them equitable and nondiscriminatory access to investment opportunities. While the bulk of foreign investment in America generates no threat to national security, the Exon-Florio provision was implemented in 1988 to ensure that FDI remains benign.<sup>5</sup> The intent of Exon-Florio is to provide an objective, nonpartisan mechanism to review and, if the President finds necessary, to restrict or prohibit foreign investment that may threaten America's security.

The Exon-Florio provision is implemented by the Committee on Foreign Investment in the United States (CFIUS), an interagency committee chaired by the Secretary of the Treasury. The Departments of Defense, Justice, Commerce, and Homeland Security are four of the 12 agencies that participate in CFIUS. The committee's task is "to suspend or prohibit any foreign acquisition, merger

or takeover of a U.S. corporation that is determined to threaten the national security of the United States." In 1992, Congress amended the statute through section 837(a) of the National Defense Authorization Act for Fiscal Year 1993, requiring CFIUS also to review transactions where the acquirer is controlled by or acting on behalf of a foreign government.

Once notified of a potential transaction, the CFIUS process begins with a 30-day review of the planned foreign acquisition, followed by an additional 45-day review for exceptional cases. At the end of an extended review, a report is provided to the President, who then has up to 15 days to announce whether the investment is approved. In total, the process cannot exceed 90 days.

The amending legislation, set in 1992, requires the President to report every four years to Congress on whether there is credible evidence of foreign efforts to acquire critical U.S. technologies or commercial secrets. Additionally, a report is to be made to Congress regarding any transaction that required presidential action.

Through the Exon-Florio provision, CFIUS is directed to consider the following factors in evaluating the security risk of a foreign acquisition or merger:

- Domestic production needed for projected national defense requirements;
- The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
- The control of domestic industries and commercial activity by foreign citizens as it affects

1. See Bureau of Economic Analysis, "U.S. International Transactions," at [www.bea.gov/bea/newsrel/transnewsrelease.htm](http://www.bea.gov/bea/newsrel/transnewsrelease.htm) (May 21, 2006).
2. William J. Zeile, "U.S. Affiliates of Foreign Companies: Operations in 2003," Bureau of Economic Analysis, at [www.bea.gov/beatARTICLES/2005/08August/0805\\_Foreign\\_WEB.pdf](http://www.bea.gov/beatARTICLES/2005/08August/0805_Foreign_WEB.pdf) (May 21, 2006).
3. Organization for International Investment, Insourcing Statistics, at [www.ofii.org/insourcing-stats.htm](http://www.ofii.org/insourcing-stats.htm) (May 21, 2006).
4. Bureau of Economic Analysis, Balance of Payments and Direct Investment Position Data, at [www.bea.gov/bea/international](http://www.bea.gov/bea/international) (May 21, 2006).
5. 50 U.S.C. app 2170.

the capability and capacity of the United States to meet the requirements of national security;

- The potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country that supports terrorism or proliferates missile technology or chemical and biological weapons; and
- The potential effects of the proposed or pending transaction on United States international technological leadership in areas affecting United States national security.<sup>6</sup>

A transaction may be voluntarily notified to CFIUS by the companies involved in the acquisition or by CFIUS member agencies. The incentive for firms to notify the CFIUS process voluntarily is strong; firms that should, but do not, notify CFIUS of an acquisition remain subject indefinitely to divestment or other negative actions by the President. In order to protect proprietary commercial data, notifications to CFIUS are confidential.

### Balancing Act

With a few exceptions, the current CFIUS process minimizes the cost of such legislation on the U.S. economy while preserving the intent—protecting America from those that would cause the country harm. Favorably, the process:

- Is designed to be nonpartisan and nonpolitical because these decisions should not be based on political considerations, but solely on the merits of the transaction and appropriate security concerns consistent with U.S. policies.

Congress does not receive comprehensive notification in any other administrative procedure. Congress sets the law, establishes procedures to implement and enforce the law, and oversees the successful fulfillment of those procedures. Congress plays no collaborative role in anti-trust decisions, patent and trademark awards, or International Trade Commission reviews. Likewise, a successful CFIUS process

depends on Congress playing its oversight role without becoming a part of the procedure.

- Reduces the risk and economic cost of delayed foreign investment by concluding its reviews in as timely a manner as possible.
- Subjects investment transactions involving foreign government-owned companies to additional investigation only if merited rather than as a rule. Transactions involving companies where the foreign government is a minority shareholder should not necessarily be evaluated with the same scrutiny as those transactions involving companies that are wholly owned and operated by foreign governments.

Likewise, the potential threat to U.S. national security interests by foreign governments is not the same around the world. CFIUS is, and should remain, flexible enough to differentiate the level of investigation needed for each case. The foreign government-owned company headquartered in an ally country that competes fairly and according to market-based rules should not automatically face a more stringent investment approval process.

- Relies on a traditional and narrow definition of what constitutes a threat to national security. Left undefined in the Exon–Florio provision, member agencies have generally associated risky transactions with those involving (1) a U.S. company that possesses export-controlled technologies or items, (2) a company that has classified contracts and critical technologies, or (3) specific derogatory intelligence on the foreign companies.<sup>7</sup> This narrow definition of what constitutes a threat reduces the likelihood that barriers will be erected, inappropriately protecting domestic industries from foreign competition. Investigations should remain focused on evaluating security concerns.

While today's CFIUS process is generally effective in balancing an open investment climate with national security, it could be improved. The recent

6. *Ibid.*

7. U.S. Government Accountability Office, *Defense Trade: Implementation of Exon–Florio*, GAO–06–135T, October 6, 2005.

Dubai ports controversy is the latest example demonstrating that the investment approval process needs to be better defined and more transparent.

- Amendments to Exon–Florio set in 1992 require the President to provide quadrennial reports to Congress of credible evidence of foreign efforts to acquire critical U.S. technologies or commercial secrets. In 1994, the first and last four-year report was provided to Congress.<sup>8</sup> Successful congressional oversight of the CFIUS process relies in part on having reliable information describing the extent of foreign espionage and attempts to circumvent sensitive technology controls. The Administration should immediately resume the practice of providing this report.
- Any CFIUS investigations that result in presidential action are also subject to reporting to Congress; however, few reports are actually submitted.<sup>9</sup> As a result, Congress has little insight into the CFIUS process and deliberations that occur during investigations. Few reports are made to Congress because firms are allowed to withdraw a notification that would result in an extended investigation. Companies may then refile the notification of acquisition after previously identified security concerns are addressed.

Refiling restarts the clock on the duration of the investigation and reduces the chance that the transaction will fall under presidential review. While this allows greater flexibility in the process and promotes investment, it has resulted in less information reaching Congress about CFIUS operations. To fill this gap, Congress should receive regular, general reports of committee investigations in addition to the required reports on any extended investigations. The content of these reports should

focus on CFIUS proceedings without compromising confidential information.

- While the option to withdraw and refile provides additional time for companies to resolve national security concerns pertaining to an acquisition, withdrawal may increase national security risks if the transaction is completed during the withdrawal period. In this scenario, a foreign firm may inappropriately gain control of a U.S. asset until it refiles a notification with CFIUS. To mitigate this risk, provisions should be incorporated into the process that (1) establish interim protections in cases where security issues have been raised, (2) specify clear and reasonable timetables to limit the duration between withdrawal and refiling, and (3) establish penalties for noncompliance.<sup>10</sup>
- The current definition of what foreign investment may constitute a threat to national security should be formally incorporated into the CFIUS process. Leaving “threat” undefined in the legislation keeps the door open for misusing the process to erect protectionist barriers to foreign investment. The CFIUS process is solely concerned with identifying the national security risks of foreign investment. CFIUS should not be used as a vehicle for conducting industrial policy.

## Conclusion

A strong economy, bolstered by free trade and investment, is a pillar of national defense. The Bush Administration’s National Security Strategy correctly identifies “free markets” as the key to a secure America and a necessary component of our national security strategy.

The notion that merely precluding foreign ownership of U.S. assets offers a measure of security or saves American jobs is flawed.<sup>11</sup> Erecting barriers to

8. *Ibid.*, p. 9.

9. *Ibid.*

10. *Ibid.*, p. 8.

11. James J. Carafano, Ph.D., Tim Kane, Ph.D., Daniel J. Mitchell, Ph.D., and Ha Nguyen, “Protectionism Compromises America’s Homeland Security,” Heritage Foundation *Backgrounder* No. 1777, July 9, 2004, at [www.heritage.org/Research/HomelandDefense/bgl1777.cfm](http://www.heritage.org/Research/HomelandDefense/bgl1777.cfm).

foreign investment would stifle innovation, reduce productivity, undermine economic growth, and cost jobs—without making America any safer. The government's role is not to decide how the marketplace operates, but to perform due diligence to ensure that vital national interests are looked after.

Thus, improving the transparency of the CFIUS process is appropriate; provoking a wave of anti-trade, anti-investment policy is not. Reform should address the heart of the CFIUS problem—appropriate reporting and consideration of investment by government-owned firms—without opening the door to protectionism and without chancing the economic and political consequences of politicizing foreign investment in the U.S.

Protectionism would endanger U.S. prosperity—the very cornerstone of security—as well as strain relationships with important allies in the war on terrorism and make it more difficult to use open markets to spread American values and bolster U.S. interests around the world. A successful strategy for improving national security must include an ongoing commitment to free trade and investment policies.

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