

ISSUE BRIEF

No. 3844 | JANUARY 28, 2013

A Better Committee on Foreign Investment in the United States

Derek Scissors, PhD

According to The Heritage Foundation's China Global Investment Tracker, Chinese non-bond investment in the U.S. set a record in 2012.¹ China has \$3.3 trillion in foreign reserves and, like other fast-growing economies, wants to invest more here. Foreign investment and other commerce benefits America, but there are understandable concerns about the loss of advanced technology and possible threats to national defense.

Evaluating these concerns is the job for the Committee on Foreign Investment in the United States (CFIUS). CFIUS is an inter-agency group chaired by the Secretary of the Treasury and including the Secretaries of Defense, State, and Commerce; the Attorney General; the United State Trade Representative; and others. The U.S. does not have to choose between security and the many benefits

brought by foreign business. CFIUS can screen transactions so that nearly all proceed immediately while a remaining very few are investigated and possibly blocked.

CFIUS is responsible for all countries investing in the U.S., not just China. The surge in Chinese investment, however, indicates the prudence of enhancing the American review process. The initial presumption should remain that all transactions go forward. Beyond that, the CFIUS mandate should be extended while transparency and responsiveness are improved in several ways.

Threats to Security. The major controversy involving CFIUS in 2012 involved a Chinese firm, Ralls. CFIUS rejected Ralls's acquisition of wind farm assets in Oregon on the grounds they were too close to a U.S. Navy facility, and Ralls sued. Perhaps the most telling feature of the case is that, if Ralls had simply started its own project nearby as a "greenfield" investment, CFIUS would not have had the legal mandate to investigate and block the deal.

Whatever one thinks of the Ralls outcome, this makes no sense. The nature of the transaction is not what is important; the national security risk is. The CFIUS mandate should be expanded so that the committee

is able to legally and easily investigate any domestic transaction involving a foreign entity. It should, for example, be able to investigate certain equipment contracts, with telecom equipment the principal focus in light of cybersecurity issues. This expansion is long overdue.

A more difficult question is whether outside actors should have standing to prompt CFIUS. The obvious candidates are Members of Congress, who frequently express concerns about investments while referring to national security. The present, informal contribution of Congress to the CFIUS review may allow security concerns to be adequately raised, but it does so in highly politicized fashion. Politicization can be reduced. As a result, transactions with little security risk are effectively blocked by protectionism masked as invocations of national security. This undermines the legitimacy of the national security review and breeds retaliation against American companies.

There is a danger of a cure being worse than the disease, and any new mechanism for congressional communication with CFIUS should be carefully considered. Still, the rise of Chinese investment, especially, makes clear that the current system

This paper, in its entirety, can be found at <http://report.heritage.org/ib3844>

Produced by the Asian Studies Center

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

can be harmful to American prosperity. Chinese manufacturers have seen one investment ignored while another becomes a political football, with no warning or apparent logic. Overseas, the U.S. seeks clear and quick review processes when its companies pursue foreign investments, but one is not yet available here and will not be until the congressional role is better defined.

Threats to Prosperity. The additional CFIUS investigations that could be triggered by such reforms breed the opposite concern: CFIUS will either bar or effectively discourage foreign companies from American business. Unjustified prohibitions are unlikely; the presumption is still and should remain that investments proceed and that the standards to judge security risk are unchanged. As Congress considers reforms, it needs to be aware that merely extending the flaws of the CFIUS mechanism could make matters worse. The solution, however, is not to limit the scope of a flawed process. How many transactions CFIUS reviews is far less important than how it reviews them.

For investors, two vital attributes of government reviews are transparency and speed. In light of an expanded mandate, CFIUS should set new maximum times to determine whether a transaction should be altered or blocked. More important, most inquiries should be concluded in less time. Notification deadlines are necessary but not sufficient to ensure that foreign investors are well-treated. Some sort of performance metric is necessary to respond properly to complaints about CFIUS performance, starting with how quickly it acts.

Responsiveness is another criterion. Some CFIUS personnel need to be shielded from outside influence, but the suppression of personnel names, other than inaccessible Cabinet secretaries, can confound communication for foreign firms and inhibit accountability. There should be a liaison between foreign business and CFIUS decision makers, shielding the former but assisting the latter. This role is currently played essentially by private-sector actors who may have skewed incentives. This will require additional personnel assigned to CFIUS and more intense inter-agency cooperation. The alternatives—let foreign firms run free or block foreign investment and contravene long-standing American principles—are far less pleasant.

Most important, the review itself should be transparent. Notifications to the parties should come as early as possible, and frequent updates should be provided even if they merely confirm that the investigation is ongoing. The American government denies charges of low transparency, but there is inadequate information available even to evaluate foreign complaints. The U.S. market is more open than almost any other—and far more open than some—but U.S. multinationals would complain loudly if some CFIUS features were replicated elsewhere.

The last and potentially most important change goes beyond CFIUS. Nations increasingly use national security provisions to circumvent World Trade Organization rules. The U.S. can make its own process more transparent and set a global standard by more explicitly defining national security for the purposes of investment review.

CFIUS Reform: A Continuous Process. CFIUS was modified in 2007. If needed changes are made in 2013, CFIUS could still need more reform by the end of the decade. The global economy evolves, and the American investment review process should evolve in response.

For now, the following changes would improve the investment environment here, benefiting the economy and also offering more comprehensive protection of national security. It is important that CFIUS's mandate not be expanded without the presumption that transactions should proceed as well as improvements in speed and transparency.

- The CFIUS mandate should be extended to all types of transactions involving foreign entities.
- As part of this expansion, it should be extremely easy for investors to contact specific CFIUS personnel to ask questions and, if necessary, provide information.
- CFIUS should keep salient foreign firms apprised on a regular basis and whenever there is a material development.
- CFIUS should regularly provide to Congress classified and declassified lists of transactions it is currently reviewing and has recently reviewed. In turn, initial congressional communication with CFIUS should be kept confidential, since these are matters of national security.
- With its expanded mandate, CFIUS should retain a maximum time by which any action should

1. See Derek Scissors, "China's Global Investment Rises: The U.S. Should Focus on Competition," Heritage Foundation *Background* No. 2757, January 9, 2013, <http://www.heritage.org/research/reports/2013/01/chinas-global-investment-rises-the-us-should-focus-on-competition>.

be taken. There should be public performance metrics for CFIUS, including average time to complete a review.

- The U.S. should formulate a more precise definition of “national security” for use by CFIUS, thus offering a solution to a major global issue.

Balancing Security and Transparency. Caution and secrecy are often needed in national security, but foreign investment is first and foremost an economic activity. As such, transparency and timeliness are ideal and secrecy a drawback. Operational freedom for CFIUS is important, but the U.S. should also work to improve the environment for

foreign investors. Further, the current informality of the congressional role breeds random political interference and is self-defeating. The U.S. can do better.

—*Derek Scissors, PhD, is Senior Research Fellow in Asia Economic Policy in the Asian Studies Center at The Heritage Foundation.*