Written Testimony of

Rod Hunter
Former Special Assistant to the President and
Senior Director, National Security Council

Before the Subcommittee on Monetary Policy and Trade
of the
Committee on Financial Services
United States House of Representatives

Evaluating CFIUS: Challenges Posed by a Changing Global Economy

January 9, 2018

Mr. Chairman, Ranking Member Moore, members of the Subcommittee,

Thank you for the invitation to discuss this topic. It is a pleasure to appear with my distinguished fellow panel members.

Based on my experience in a prior administration and as a practicing attorney, I would like to offer some observations on the Committee on Foreign Investment in the United States (CFIUS), the President's authority, and the evolving context.

My government experience with CFIUS derives from my time on the staff of the National Security Council (NSC). While the Treasury Secretary chairs the interagency CFIUS, the ultimate authority under the legislation is the President's power to block or unwind a transaction. Accordingly, sensitive or difficult CFIUS reviews, at least in the administration of President George W. Bush, were managed through the NSC, especially when there was a diversity of views within the committee.

Foreign investment

An open investment regime is an important source of strength for the U.S. economy. Our stock of inbound foreign direct investment (FDI) is 35% of nominal GDP, or $6.56 trillion, and economic analysis has shown that FDI benefits the economy by contributing to output, jobs, exports, and research and development in the United States. According to a 2013 report on FDI prepared by the Council of Economic Advisers and the Commerce Department, majority-owned U.S. affiliates of foreign companies contributed 4.7 percent of total private output, 4.1 percent of private-sector employment, 20.5 percent of goods exports, 9.6 percent of private investment, and 15.9 percent of private research and development spending in the United States. The report also found that U.S. affiliate firms tend to hire highly skilled workers and to compensate them at levels significantly higher than the U.S. average over time. In 2011, compensation at such firms averaged more than $77,000 per U.S. employee as compared to average earnings of $58,000 per worker in the economy as a whole.

Chinese investment has raised concerns in the United States and across advanced markets as investors from China have sought to buy assets in sensitive and politically salient sectors ranging from semiconductors, to robotics, to food and agriculture. In many respects these investment flows reflect a normal balancing given the size of that country's economy. In 2016, some $94 billion in Chinese outbound investment went to the advanced markets of North America and Europe.

While the numbers are impressive, the Chinese outbound investment flows as a share of China's Gross Domestic Product (GDP) are in conventional ranges. Looking at 2015 OECD data, Chinese outbound investment flows represented 1.6 percent of Chinese GDP, while the United States' outbound investment represented 1.6 percent. The European Union (3.6 percent of GDP) and Japan (2.9 percent) had higher outbound investment flow percentages. Moreover, China's outbound FDI stock is relatively low at 12 percent. The US outbound stock is 34 percent of GDP, a figure more consistent with international averages.

There are many legitimate motivations for Chinese outbound investment, including diversification of assets and markets, proximity to consumers, the creation of production platforms behind tariff and other trade barriers, and the acquisition of the talent and technology necessary for enterprises to move up the value chain. Still, the role of the Chinese Communist Party and state in the Chinese economy invites concerns about the implications of Chinese investments, particularly in a time of growing strategic competition.

Chinese investment flows have prompted legislators and regulators across advanced markets to evaluate their arrangements. Germany recently expanded its investment screening regime. The U.K. is conducting a consultation process on creating its own CFIUS. The European Commission (even though it lacks a security competence) has proposed its own process. Given the significance of investment from China and other markets with strong state intervention, it is appropriate to assess the functioning of the U.S. foreign investment screening system, which is typically referred to by the acronym of the inter-agency committee assisting the President, CFIUS.

U.S. legal framework

The Exon-Florio Amendment of 1988 to the Defense Production Act of 1950 and the Foreign Investment and National Security Act of 2007 (FINSA) were designed to manage national security risks arising from foreign control of U.S. businesses. The legislation created a targeted instrument that works in tandem with other tools, such as our export controls regime that was designed to manage risks associated with the transfer of sensitive technologies.

The investment regime managed by CFIUS was designed to be minimally disruptive of the economy, while providing the President broad authority to address national security threats. This combination of policy goals was achieved through three features:

- **National security focus —** CFIUS's mandate is limited to "national security," but the President and derivatively CFIUS were granted broad discretion in determining what constitutes a threat to national security.

- **Voluntary filings —** Filings with CFIUS are normally voluntary, but private parties are motivated to file in order to secure legal certainty as the President may unwind any transaction that has not been previously approved by CFIUS.
- **Tight timelines —** The legislation sets tight timelines (30 days for "reviews," and an additional 45 days where "investigations" are necessary), but CFIUS always has the ability to recommend that the President block a transaction if the Committee believes there are "unresolved" national security concerns.

In my experience, CFIUS staff are thorough and highly professional. When conducting their analyses, CFIUS members normally examine (1) whether the U.S. business receiving the investment presents a national security vulnerability, and (2) whether the foreign person making the investment represents a potential threat. The intelligence community plays a crucial role in framing the analysis for the CFIUS policy agencies.

National security concerns are never given short shrift or traded off against other equities. True, there are sometimes disagreements or diverging assessments. However, CFIUS operates by consensus, with any agency able to force an escalation ultimately up to the President. Deliberation on individual cases can be extensive and time-consuming, and sensitive cases can reach the President's desk for guidance.

Key questions

As the Subcommittee considers the changing investment context and the operation of CFIUS, there are several key questions that the Subcommittee may want to consider.

- **Jurisdiction: Does CFIUS have the authority to reach all relevant foreign investments?**

CFIUS has jurisdiction over any foreign investment that could result in a foreign person's "control" of a "U.S. business." CFIUS looks through corporate structures to ultimate ownership and control relationships. Moreover, "control" is a low bar: the mere potential to influence business, management or personnel matters is enough "control" for CFIUS to assert jurisdiction. Thus, any transaction that could result in foreign "control" of a U.S. business — a joint venture, bankruptcy, etc. — is subject to CFIUS jurisdiction.

A gap exists where a foreign investor seeks to acquire a sensitive asset that is not a "U.S. business" — for example, fallow land next to a military base. It may make sense to revise the scope to clarify CFIUS's jurisdiction over investments in U.S. real assets even if there is no current associated commercial activity.

- **Knowledge: Does CFIUS have the ability to identify all relevant foreign investments?**

While CFIUS's reviews are normally voluntary, the Committee can require a filing on its own initiative. CFIUS monitors the business press and other sources, and is aware of publicly announced transactions. Government procurement rules typically require contractors to inform contracting officers of changes in control, so CFIUS agencies should be aware of relevant foreign investments in government contractors.

There are other transactions, often involving smaller enterprises and start-ups, that may go unobserved. Some have suggested “light notifications” or “declarations” for transactions involving certain technologies. In principle, that could make sense. The risk would be, given the risk aversion of government committees, that the declaration process would become in time an increasingly burdensome prior approval process. One would want to design any such information mechanism to make it as non-burdensome as possible, while providing CFIUS the ability to identify investments of interest.

- **Timelines and resources: Is CFIUS following its statutory timelines? Is CFIUS adequately resourced?**

The volume of cases is up — from 138 in 2007 when FINSA was passed to nearly 250 in 2017. CFIUS’s analysis has grown more searching. CFIUS officials say that cases have become more complex, in part because of an increasing focus on emerging technologies.

A visible consequence has been an impact on timelines. First, an increasing number of cases go into the second (investigation) phase — four percent of cases went to investigation in 2007, while 46 percent of cases went to investigation in 2016. Second, a series of current cases have been withdrawn and refiled multiple times, a process that affords CFIUS more time to deliberate. Third, we have witnessed an extension of the pre-filing phase for notices. Previously, it took a couple of days for CFIUS to assess whether filings were adequate to commence reviews. Now, the pre-vetting typically takes a couple of weeks, and we have seen one simple case take several months. The statutory schedule has become more of a guideline than an obligation, creating uncertainty for private parties of all nationalities. Based on professional experience in transactions, the delays and uncertainty are beginning to impact decisions of investors, with the risk of the United States being viewed as an unpredictable place to seek to invest.

From legislative and appropriations perspectives, it may be opportune to enquire into the causes for protracted review processes. While the transition may have had a transient impact, it seems clear that a lack of resources is a significant component of the protraction. It is my understanding that resources have been largely constant during a period in which the case load has doubled. As able and energetic as the case handlers are, it should not be surprising to see an impact on performance. So, even if it is appropriate to review the statutory timelines, CFIUS has an acute need for additional resources.

- **Mitigation agreements: Does CFIUS systematically and effectively monitor and enforce mitigation agreements?**

CFIUS uses mitigation agreements negotiated with the parties as a condition of approval as a tool for resolving national security concerns. While some agreements are simple, others are complex instruments requiring significant management resources for the parties and the government. As the years pass, monitoring obligations for the government cumulate. From the legislative and appropriations perspectives, one may want to assess systemically the performance of mitigation agreements over time. What has been the compliance record? What have been the costs for the government and the private sector? Should some mitigation agreements be revised, tightened, or phased out? Is the administration organized and resourced appropriately to fulfill the ongoing obligations entailed in mitigation agreements?

- **Technology control: Should CFIUS's mandate be expanded to reach technology transfers, even those abroad?**

The control of emerging technologies has rightly been identified as an urgent policy issue. Some have suggested that CFIUS's jurisdiction should be expanded to encompass technology control, and should include reviewing transfers by U.S. firms of intellectual property to foreign persons. This could mean CFIUS reviews for multitudinous licensing, joint development, hiring, and even sales transactions with foreigners. The suggestion is that U.S. export controls do not adequately regulate transfers of emerging technologies. While export controls merit review, CFIUS is the wrong vehicle for a new technology control regime.

The United States has maintained for decades export controls designed specifically for regulating the transfer of technology. That regime is capable of regulating any transfer of designated technology, even if a transfer occurs abroad. The U.S. government has imposed targeted controls addressing specific national security threats. An example is the "China catch-all" rule that imposed licensing requirements on exports of specified items not normally requiring licenses for China when such items are destined for military end-use in China.

As flexible and well-conceived as the export control regime is, there is a need for Congressional attention. First, the export control regulations are presently grounded on the International Emergency Economic Powers Act, the export control legislation having expired. Second, there is a legitimate question of whether the Administration runs an effective policy process for identifying emerging technologies meriting control under export control laws.

In any event, CFIUS would be an ineffective substitute technology control vehicle. CFIUS, being a committee, has limited bandwidth — it has difficulty managing its 250 or so cases per year, and expansion of its jurisdiction to technology transfer control could balloon its docket to thousands. Imposing such a regime on U.S. technology businesses would be burdensome and could undermine U.S. innovation. Uncertainty around CFIUS determinations could encourage investment in research and development to move offshore, beyond the scope of the bureaucratic review process. This in turn could undermine the U.S. innovation and technological development so essential for our defense industrial base and economy more broadly.

- **Cooperation with other countries**

The recent flow of Chinese investment —$46 billion into Europe and $48 billion into North America in 2016 — has spurred concerns across advanced markets. The United States is not the only advanced market generating cutting edge technologies. While the United States need not wait for others to reform its own regulatory regime, unilateral U.S. action is less likely to be effective over time. From a policy perspective, the United States should seek to coordinate with other countries in the design of their regulatory frameworks, working bilaterally with individual countries and collectively through, say, the G7 and/or the OECD. With respect to individual cases, the Administration should be able to share information and coordinate with other governments, much as it already does in antitrust cases. Congress may want to assess whether the confidentially rules need to be modified to facilitate that case-specific coordination, while otherwise preserving the commercial confidentiality.