CFIUS Reform: Examining the Essential Elements
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Thank you, Senator Crapo, and members of the Committee for inviting me to testify concerning S. 2098, the Foreign Investment Risk Review Modernization Act of 2017. My remarks will also touch on the House counterpart legislation, H.R. 4311, the Foreign Investment Risk Review Modernization Act of 2017.

Two empirical facts provide the starting point for my remarks:

- Inward foreign direct investment is almost always good for the United States. Foreign firms that invest in the United States – usually by acquiring US firms -- are typically top of their class abroad. They pay higher wages than average US firms in the same industry, do more R&D and investment, and export a larger share of production.[2] These facts are just as characteristic of Chinese firms as foreign firms based in Canada, Europe or Japan.
- Outward foreign direct investment also benefits the United States. Contrary to popular mythology, investment abroad does not, as a rule, take place at the expense of investment in the United States. Instead, US firms that invest heavily abroad typically grow US R&D faster, employ more workers, and produce and export more than comparable US firms that invest little or nothing abroad.[3]

Given these facts, the burden of proof should rest on any government action that seeks to restrict either inward or outward foreign direct investment (FDI). Historically, this is how the Committee on Foreign Investment in the United States (CFIUS) has operated.[4]

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[1] This testimony is based on a blog posted on the Peterson Institute website: https://piie.com/blogs/trade-investment-policy-watch/revamping-cfius-and-going-too-far.

[2] Theodore H. Moran and Lindsay Oldenski. 2013. *Foreign Direct Investment in the United States: Benefits, Suspicions, and Risks with Special Attention to FDI from China.* Policy Analyses in International Economics 100. Washington: Peterson Institute for International Economics. Also see Moran's remarks at https://piie.com/system/files/documents/moran201702draft-c.pdf.

[3] Gary Hufbauer, Theodore Moran, and Lindsay Oldenski. 2013. *Outward Foreign Direct Investment and US Exports, Jobs, and R&D: Implications for US Policy.* Policy Analyses in International Economics. Washington: Peterson Institute for International Economics.

[4] For a detailed background, see James K. Jackson, "The Committee on Foreign Investment in the United States (CFIUS)", Congressional Research Service, October 11, 2017.

CFIUS was created in 1975 to screen foreign takeovers of US firms for threats to US national security. The focus was on *inward* investment and technology acquisition. Treasury chairs the CFIUS, ensuring that the economic benefits of inward foreign investment are given due consideration, a perspective buttressed by membership of Commerce and USTR, and observer status of OMB, CEA and the NEC. .

The CIA, NSC and Defense fully inform other Committee members of the national security dimensions of any takeover. However, an influential draft report by Brown and Singh (February 2017) calls upon Congress to vest the power to block a transaction in just three Cabinet members, if they are all in accord: Defense, Justice and Homeland Security.[5] In the past, less than five takeovers have been blocked by CFIUS, but somewhat more applications have been withdrawn prior to an adverse decision. The Brown and Singh draft report advocates more stringent screening, especially with respect to Chinese transactions.

If enacted, the blend of S. 2098 and H.R. 4311 would significantly enlarge the CFIUS mandate to cover *outward* investment and technology transactions by US firms. It would also cast a skeptical eye towards investment (inward or outward) from or to China, Russia, and a handful of other adversarial nations.

The new and broader CFIUS mandate raises three inter-related concerns:

- It could replace multilateral cooperation with unilateral restrictions on outward flows of "critical technology" to neutral or adversarial nations;
- Thereby putting US-based multinational corporations (MNCs) at a disadvantage, relative to MNCs based in Europe or Japan, when firms compete in third country markets;
- And duplicate controls on the export of merchandise and technology established under the Export Administration Act with multilateral consultation.

Using existing statutory authorities, President Trump could achieve the objectives sought by S. 2098 and H.R. 4311. If he wants to restrict US investment and technology flows to China, Russia, Iran or any other country, Trump can do so without new legislation.[6]

The lasting impact of these bills will come when a different president resides in the White House. If the CFIUS mandate is expanded as the co-sponsors contemplate, the CFIUS caseload will burst from 200 annually to thousands. Necessarily, the bureaucracy will blossom with new administrative and technical capabilities. Once the bureaucracy is created, and reviews become a thrice-daily event, it will be almost impossible to turn the clock back to today's open regime for investment and technology flows.

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[5] Michael Brown and Pavneet Singh, "China's Technology Transfer Strategy: How Chinese Investments in Emerging Technology Enable a Strategic Competitor to Access the Crown Jewels of U.S. Innovation", pre-Decisional draft, Defense Innovation Unit Experimental, February 2017.

[6] The president can restrict foreign investment and exports of goods and technology under the International Emergency Economic Powers Act (IEEPA) and other statutes.

Under S. 2098 and H.R. 4311, future decisions to block inward or outward foreign direct investment might not require the government to carry the same burden of proof as historically has been the case. Hypothetical arguments that allowing an acquisition or transferring certain technology abroad *might in the future* endanger national security will have greater weight. Proof may not be needed that the acquisition or transfer *currently* endangers national security. The cited Brown and Singh draft report, if followed, makes the change in emphasis very clear.

In fact, S. 2098 states, among other factors to be considered, "the potential effects of the covered transaction on United States international technological and industrial leadership in areas affecting national security, including whether the transaction is likely to reduce the technological and industrial advantage of the United States relative to any country of special concern."

Likewise, H.R. 4311, states, among factors to be considered, "whether the covered transaction is likely to contribute to the loss of or other adverse effects on technologies that provide a strategic national security advantage to the United States."

In plain language, both bills stipulate that any transaction that might enable a foreign country (especially an adversary) to narrow its gap with US technological leadership should be viewed skeptically. This warning covers a great deal of ground, not only with respect to transactions with adversaries, but also with respect to transactions with neutrals or allies who might in turn convey the technology to adversaries.

Chinese technology practices have generated the core motivation for S. 2098 and H.R. 3411. China has targeted several high-tech industries for massive upgrading in the next ten years. Multiple Chinese means of accessing frontier US technology in an effort to achieve this goal are spelled out in the Brown and Singh draft report. Among other means, China acquires venture capital stakes in nascent technologies and compels foreign firms to transfer technology to Chinese business partners as the "price of admission" to the vast Chinese market. President Trump has directed the US Trade Representative to launch an investigation of China's technology transfer practices, under Section 301 of the Trade Act of 1974. Once the investigation is concluded, measures to block US firms from acquiescing to Chinese demands could be Trump's response, whether or not a blend of S. 2098 and H.R. 4311 passes Congress.

Both S. 2098 and H.R. 4311 refer to China, Russia and other US adversaries as "countries of special concern" without naming them. CFIUS is directed to scrutinize inbound and outbound investment and technology transactions with these countries. At the same time, both S. 2098 and H.R. 4311 would allow CFIUS to exempt from review "covered transactions" with foreign firms based in countries that are US military allies or have close security relations.

Recommendations

Legislation enacted by Congress should be narrowed to cover the immediate problem – transfer of critical technology to adversarial countries – without a massive expansion of the CFIUS mandate to review the bulk of outward foreign direct investment by US firms.

Narrowing could be accomplished with two provisions. First, require the Committee to identify "critical technologies", drawing on the resources of the intelligence community, the National Academy of Sciences, and the National Academy of Engineering. Second, require the Committee to name "countries of special concern". With these two provisions, the workload would be narrowed while US firms that develop critical technologies would be put on notice to seek CFIUS review prior to transferring the know-how to worrisome countries.

CFIUS review of questionable transactions should take into consideration the availability of equivalent critical technology from firms not based in the United States. Obviously, if an end run through Europe or Japan has already occurred, there's less reason to block the US firm. If an end run is only a future possibility, then a decision to block the transaction should be accompanied by a forceful diplomatic *demarche* to US friends and allies to establish a multilateral basis for the denial.

Thank you for the opportunity to testify.