Testimony of

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Before the Senate Committee on Banking, Housing and Urban Affairs

On the Implementation of the Exon-Florio Amendment and the Committee on Foreign Investment in the United States

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Mr. Chairman, Senator Sarbanes and Members of the Committee:

Thank you for the opportunity to testify before the Senate Committee on Banking, Housing and Urban Affairs on the subject of implementation of the Exon-Florio Amendment. It is a privilege to appear before you.[1]

I applaud your leadership, Mr. Chairman, and that of the Committee for calling these hearings. Protecting U.S. national security has to be the United States' top priority. I believe we can protect our security interests and simultaneously maintain an open investment policy, including through the effective implementation of the Exon-Florio Amendment.

You have already heard testimony from the GAO, Senator Inhofe and a distinguished panel of Executive Branch officials. I am here to offer the perspective of a private sector advisor who works closely with the twelve members of the Committee on Foreign Investment in the United States (CFIUS). I plan to speak to four particular issues:

- First, the critical importance of foreign investment to the U.S. economy. Encouraging inward investment is essential to both our economic security and our national security.

- Second, trends in the application of the Exon-Florio Amendment. Since September 11, 2001, the Bush Administration has applied greater scrutiny to foreign investments on national security grounds, imposed tougher security requirements as a condition for approving specific transactions, and enhanced enforcement of security agreements negotiated through the Exon-Florio process.

- Third, the suitability of the Exon-Florio process to address potential security issues presented by investments from China. While certain investments by Chinese firms may present unique national security considerations, experience has shown that the President and CFIUS have adequate authority and flexibility under Exon-Florio to assess and, if necessary, mitigate any national security risks such investments may pose.

- Fourth, the myriad initiatives to amend Exon-Florio. Simply put, the Exon-Florio Amendment in its present form is more than adequate to protect our national security and still preserve our economic interests. Many of the changes being discussed in Congress would risk chilling inward investment and encouraging other governments to erect new obstacles to U.S. investment abroad. At the same

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time, there can and should be greater transparency with Congress while protecting proprietary business information.

The Importance of Foreign Investment to the U.S. Economy

Few would disagree that foreign investment plays a critical role in the U.S. economy. Today more than ever, the vibrancy and vitality of the U.S. economy depends on the inflow of direct foreign investment. Foreign investment supports approximately 5.3 million jobs in the United States. These typically are highly skilled, well-paying jobs; indeed, U.S. affiliates of foreign firms on average pay wages higher than the U.S. industrial mean.[2] Foreign investors also invest heavily in manufacturing operations in the United States -- investment that is critically important given the present competitive pressures on the U.S. manufacturing base. It is precisely for these reasons that each of our 50 governors devotes a significant amount of time and resources to attract foreign investment to their states.

Perhaps most important, because the United States spends more than it produces and saves, and because of the deteriorating current account deficit ($197 billion in the second quarter of 2005, or some 6.3% of annualized GDP), our country is now *literally* dependent on inflows of direct and portfolio investment to cover the gap between what we consume and produce.

Of course, if foreign investors make investments in the United States, it is preferable that they do so in plant, equipment and other fixed assets that drive economic activity, rather than solely in the debt market. Subjecting our economy to the whims of foreign central banks -- which today hold more than one-third of the overall public U.S. debt -- creates much more risk than does foreign ownership of fixed assets in the United States.

The United States has long embraced a policy of encouraging foreign investment. Indeed, Presidents Carter, Reagan and George H.W. Bush each issued executive statements of policy on the subject and President Clinton actively promoted inward investment. In 1983, President Reagan issued the first public statement in which a U.S. President expressly welcoming foreign investment. In this statement, President Reagan said "the United States believes that foreign investors should be able to make the same kinds of investment, under the same conditions, as nationals of the host country. Exceptions should be limited to areas of legitimate national security concern or related interests."[3]

U.S. foreign investment policy has long been consistent with President Reagan's formal statement on the issue. In fact, apart from the narrow exception of a few World War I-vintage restrictions on foreign investment in aviation, shipping and the media, the U.S.

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[2] *See* Edward M. Graham and Paul R. Krugman, Foreign Direct Investment in the United States 71-72 (Institute for International Economics 1995).

[3] President Ronald Reagan, Statement on International Investment Policy, Sept. 9, 1983, *available at* http://www.reagan.utexas.edu/archives/speeches/1983/90983b.htm.

has maintained an open investment policy. Hand-in-hand with that policy, laws such as the Exon-Florio Amendment, the International Emergency Economic Powers Act, and, previously, the Trading with the Enemy Act have empowered Presidents to block foreign investment or to seize foreign owned assets (as the U.S. did in World Wars I and II) when U.S. national security is threatened by a particular foreign acquisition or involvement in the U.S. economy.

As a result, with the exception of 2003, when China briefly was the largest recipient of direct foreign investment, the U.S. has for many years attracted more foreign investment than any other country in the world. In addition to our open investment policy, the size of the U.S. market, the quality of our workforce and the ease with which foreign investors can operate here have all contributed to this remarkable record.

Moreover, the vast majority of foreign acquisitions do not implicate U.S. national security interests in any respect. It is hard to see a national security issue with a Daimler-Chrysler auto assembly plant, a Japanese investment in a film studio, or, my children's' favorite, Ben & Jerry's, which is owned by a Dutch company. For the narrow set of transactions that genuinely implicate U.S. national security interests, the Exon-Florio Amendment provides the President with ample authority to block a transaction or otherwise mitigate any concerns raised by a particular acquisition, and CFIUS agencies have demonstrated their willingness to use the full authority of the law.

Trends Toward Greater Scrutiny of Transactions in the Exon-Florio Review Process

The Exon-Florio Amendment created a statutory framework that is unique in a number of respects. First, there is no time bar on Exon-Florio reviews; CFIUS can review a transaction at any time, including after a transaction has closed. Second, unlike Hart-Scott-Rodino or other governmental reviews of mergers and acquisitions, Presidential decisions pursuant to Exon-Florio are not reviewable by U.S. courts because they involve national security, an inherently "Presidential" function. Third, the statute gives the CFIUS agencies broad discretion to interpret several key statutory criteria, including "foreign control," "credible evidence," and "national security." In my experience, particularly in the past few years, CFIUS has chosen to interpret these terms very broadly.

CFIUS has significantly broadened the scope of its "national security" reviews since September 11, 2001 -- a development that partly reflects the addition of the Department of Homeland Security to the Committee and the attendant strengthening of the security focus within CFIUS. More importantly, whereas prior to September 11 CFIUS focused primarily on (i) the protection of the U.S. defense industrial base, (ii) the integrity of Department of Justice investigations, and (iii) the export of controlled technologies, CFIUS has intensified its focus on an additional goal: the protection of critical infrastructure.

Criticism against CFIUS has focused on the fact that the President has only formally blocked one transaction of more than 1,570 reviewed by CFIUS. However, this statistic obscures the manner in which CFIUS actually operates and ignores the larger number of transactions abandoned or substantially modified by parties because of the CFIUS process. There have been more investigations and withdrawals *in just the past three years* than there were during the previous 10 years combined. In the last three years, I personally have been involved in two investigations, one proposed investment that was withdrawn when it became clear that CFIUS approval would not be forthcoming, and multiple negotiations of extremely tough security agreements with CFIUS agencies.

The tougher terms now imposed by CFIUS as a condition for approving particular transactions are another indicator of the enhanced scrutiny applied to recent transactions. For many years, the security agencies within CFIUS (DOJ/FBI, DOD and now DHS) have negotiated agreements designed to mitigate the national security impact of a particular transaction. These security agreements have traditionally been negotiated by DOD for foreign acquisitions of defense companies, by the DOJ and FBI for foreign acquisitions of telecommunications companies, and by multiple agencies for acquisitions in other sectors. Since 2003, DHS has joined DOJ, DOD and the FBI in playing a central role in the negotiation and enforcement of security agreements

By way of illustration, take the Network Security Agreements ("NSAs") negotiated to mitigate the risk of foreign investment in the telecommunications sectors. (Unlike security agreements negotiated in other sectors, NSAs in the telecommunications sector are made public via the grant of FCC licenses, which often are conditioned on the agreements.)

Before September 11, NSAs for foreign acquisitions of U.S. telecommunications companies typically focused on the ability of U.S. law enforcement to conduct electronic surveillance and wiretaps and prevent foreign governments from accessing call-related data. In the last few years, NSAs have become much tougher. Some recent NSAs have become more intrusive, limiting foreign-owned telecommunications firms' freedom of action in key areas in which American-owned telecommunications firms face no similar restrictions.

For example, to varying degrees, recent NSAs have:

- permitted only U.S. citizens to serve in sensitive network and security positions (e.g., positions permitting access to monitor and control the network);

- required third party screening of senior company officials and personnel having access to critical network functions;

- restricted or prohibited the outsourcing of functions covered by the NSA, unless such outsourcing is approved by the Department of Homeland Security;

- given U.S. government agencies the right to inspect U.S.-based facilities and to interview U.S.-based personnel on very short notice (as short as 30 minutes);

- required third party audits of compliance with the terms of the NSA;

- required the implementation of strict visitation policies regulating foreign national access (including by employees of the acquiring company) to key facilities; and

- required senior executives of the U.S. entity, and certain directors of its board, to be U.S. citizens approved by the U.S. government and responsible for supervising and implementing the NSA.

Many of these provisions reflect concepts typically utilized by the Department of Defense to mitigate security concerns associated with foreign-owned companies that have classified contracts with the Pentagon. In other words, CFIUS now imposes on foreign companies handling non-classified telecommunications work many of the same requirements that DOD has traditionally required for foreign companies handling the government's most sensitive defense-related classified contracts. These security commitments for companies not handling classified contracts can impose substantial costs. For global communications companies, for example, the limitations on outsourcing, routing of domestic calls, storage of data, and location of network infrastructure can create significant competitive burdens.

Finally, I should note that the CFIUS security agencies have increased the vigor with which they monitor and enforce these agreements. Unfortunately, in my view, some provisions required by CFIUS in these agreements can be overly intrusive and regulatory, unnecessarily limit companies' operations, and impose significant costs without commensurate security benefits. Notwithstanding this concern, it is important for the Committee to know that, in the past few years, CFIUS's scrutiny of transactions has increased, security agreements have become tougher, and enforcement and monitoring has been more rigorous.

National Security Issues Associated With Investments From China

Acquisitions of U.S. companies by Chinese firms have presented CFIUS with unique issues and concerns. Of the United States' ten largest trading partners, China is the only one not considered a strategic or political ally. China also stands out among the largest trading partners in other important respects, including the high levels of state ownership and control of its largest (and often publicly traded) companies[4] and the espionage threat assigned to China by our intelligence and law enforcement agencies.

[4] One recent study estimated that at the end of 2001, the Chinese government exerted ultimate ownership control over 81.6% of the 1,136 publicly listed Chinese companies. As of 2005, there were more than 1,300 publicly-traded companies. China has made important steps to privatize and eliminate state ownership and control of some former

For these reasons, Chinese investments have drawn, and will likely continue to draw, close scrutiny. Even with the concerns by some agencies, CFIUS is well equipped to make national security assessments of Chinese investment in the United States on a case-by-case basis.

While protection of U.S. national security should always be our highest priority, we can fulfill this objective while simultaneously integrating China into the global economy, including through Chinese investment in the United States. For close to 25 years, through Republican and Democratic Administrations, the United States has encouraged China to lower tariffs, eliminate non-tariff barriers to trade, privatize state-owned enterprises and to participate in -- and play by the rules of-- the global economy. Moreover, the United States has continually pressed China to eliminate barriers to foreign direct investment by U.S. and other foreign companies. Successive U.S. Administrations have correctly pursued these policies not only for the economic and commercial benefit of U.S. companies and workers, but also based on the belief -- correct, in my view -- that market reform will facilitate democratic reform in China. A democratic China is, of course, very much in the national security interests of the United States.

Thus, as the U.S. government utilizes the Exon-Florio process to assess carefully those investments from China that present a national security risk, the U.S. should also send a clear signal that we welcome inward investment from China. We should make clear that Chinese investments in most sectors of the U.S. economy present no national security issues at all. It is in the Untied States' interest to continue to support China's integration into the global economy. In addition, there should be a high threshold for rejecting proposed transactions, in part because of the myriad tools available to mitigate any perceived threats, including the use of security agreements. At the same time, if mitigation measures do not adequately protect U.S. national security, the President can and should block an investment.

Recent Proposals to Amend Exon-Florio

Recent proposals to amend Exon-Florio would, among other things:

- expand the definition of national security to include the economic and/or energy security;
- give Congress the power to force an investigation or block a transaction already approved by the President;
- extend the statutory time limits for CFIUS reviews; and,

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state-owned enterprises, particularly small and medium-sized companies. At the same time, however, the Chinese government has retained control over industries considered "strategic." *See* Exit the Dragon, Privatization and State Control in China (Stephen Green & Guy S. Liu eds., 2005).

- transfer chairmanship of the process from the U.S. Treasury to the Department of Defense or Department of Commerce.

In my view, these proposals not only are unnecessary to protect U.S. national security, they would have a negative impact on the U.S. economy and therefore U.S. national security. More specifically, they would chill foreign investment, slow job creation, and provide other countries with a pretext for imposing similar restrictions on U.S. investment abroad. By chilling inward foreign investment, which fuels competition and innovation, we would be harming the vitality of the U.S. economy. A strong economy is essential for U.S. national security.

Let me take each of the proposals in turn:

First, expanding Exon-Florio's criteria to include "economic security," or variations thereof, has been proposed close to a half-dozen times since 1988, including when Exon-Florio became law.[5] Indeed, the original bill offered by Senator Exon would have authorized the President to block transactions that threaten the "essential commerce" of the United States. President Reagan threatened to veto the Omnibus Trade and Competitiveness Act of 1988 because of the "essential commerce" clause in the Exon bill; proposals to expand Exon-Florio to cover "economic security" should similarly be rejected.

It would be difficult for CFIUS to implement a statutory requirement to protect "economic security." The term is extraordinarily vague. I am reminded of the late Commerce Secretary Malcolm Baldridge, who argued against a similar provision in the original Exon bill, saying "you are trying to kill a gnat with a blunderbuss."[6] Indeed, there is good reason to believe that an "economic security" test would simply become a vehicle for domestic industries seeking to block foreign competition.

Second, the proposals to allow Congress to force an investigation or to override, through a joint action by Congress, Presidential approval of a particular transaction raise serious separation of powers issues under the U.S. Constitution.[7] In addition, these proposals, if enacted, would create so much uncertainty about the prospect of Congressional involvement in the review process that a substantial number of foreign investors would simply not make investments in the United States. Congress has a legitimate and important oversight role ensuring that the Exon-Florio statute is implemented correctly. But Congress should not itself become a regulatory agency. Congress has not, and would

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[5] *See, e.g.,* H.R. 2394, "The Steel and National Security Act," 107th Cong. (2001); H.R. 2624, "The Technology Preservation Act of 1991," 102nd Cong. (1991); H.R. 2386, "The Foreign Investment and Economic Security Act of 1991," 102nd Cong. (1991); H.R. 5225, 101st Cong. (1990); H.R. 3, "The Foreign Investment, National Security and Essential Commerce Act of 1987," 100th Cong. (1987).

[6] Foreign Acquisitions of Domestic Companies: Hearing on H.R. 3 Before the Senate Committee on Commerce, Science and Transp., 100th Cong. 17 (1987).

[7] *See INS v. Chadha,* 462 U.S. 919 (1985).

not, override Hart-Scott-Rodino decisions made by the Department of Justice or the FTC. It should not assume that power here.

Third, I would recommend against extending the time limits for a CFIUS review. The existing time limits work well because they balance the need for the agencies to have sufficient time to conduct reviews with the concomitant need for parties to an acquisition to have the certainty that they will receive a decision -- up or down -- from CFIUS within a reasonable period of time. In addition, most companies that file with CFIUS -- thereby starting the statutory clock -- do so only after engaging in informal consultations with CFIUS. Through these informal consultations, CFIUS agencies have additional time to assess the national security risks and design mitigation strategies, if necessary. Indeed, it is common for security agreements to be hammered out before the parties file.

Another reason not to alter the current statutory timeframes is that the vast majority of transactions reviewed by CFIUS either do not pose a national security risk or the national security threat has been mitigated. Therefore, most transactions can appropriately be approved by CFIUS in 30 days. These investments typically come from companies located in countries that are our closest allies. There would be no good reason to prolong the timeframe for approving these transactions -- a timeframe, by the way, that currently corresponds will with the review period under Hart-Scott-Rodino. Only a small number of transactions require additional scrutiny through an "investigation." The 45 additional days allowed in the current statutory framework -- plus the informal, pre-filing consultation period -- are sufficient for CFIUS to do its job.

Fourth, just as there has been with respect to "economic security," there have been a number of proposals over the years to transfer the chairmanship of CFIUS away from Treasury toward the Department of Defense or the Department of Commerce. Indeed, the original Exon bill placed the responsibility in the Department of Commerce. Then-Secretary Baldridge stated bluntly that he did not want the authority.[8] While multiple agencies could competently lead the CFIUS process, placing the Chairmanship at Treasury sends an important positive signal to the rest of the world. Exon-Florio was intended to give the President a tool to block those rare transactions that truly threaten national security, not to change our overall open approach toward foreign investment. Under Treasury's leadership, the presumption is -- and should remain -- that foreign investment is welcome unless it threatens national security. If CFIUS were chaired by an agency with a security mission, the presumption would be reversed.

[8] Foreign Acquisitions of Domestic Companies: Hearing on H.R. 3 Before the Senate Committee on Commerce, Science and Transp., 100th Cong. 14 (1987).

Moreover, 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:

- This past summer, French politicians balked at 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."[9] Since then, the French government has announced that it will establish a list of "strategic industries" that will be shielded from foreign investment. It is hard to see how yogurt is a strategic industry.

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

- 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.

Other countries are closely watching what we do in the United States on Exon-Florio. The United States has worked for decades to reduce barriers to investment abroad. If we act now to restrict investment into the United States, we will be providing a green light for other countries to erect their own barriers to inward investment.

Conclusion

I would like to conclude my remarks by recalling the dire predictions expressed in the 1980s surrounding Japanese investment in the United States. These predictions of doom occurred at a time when Japan had huge trade surpluses with the United States, followed an export-led growth strategy, and needed a place to invest their significant foreign currency reserves -- much like China today. Congress reacted to the concerns about growing Japanese investment by adopting the Exon-Florio Amendment.

Looking back, the fears about Japan now appear misguided. Over the last twenty years, the United States economy has been the engine of growth for the world and has been strengthened by large Japanese investments in the auto, information technology and manufacturing sectors.

For decades, Republican and Democratic Administrations have pursued a policy of open investment, which has spurred the dynamism that drives our economy. For those few

[9] LCI News, July 20, 2005, available at http://np.www.lci.fr/news/economie/0,,3232812-VU5WX0lEIDUy,00.html.

investments that implicate U.S. security interests, the Exon-Florio Amendment has given the President and CFIUS ample authority to block investments or mitigate the national security impact of such investment. Exon-Florio is a flexible statute in part because it does not define "national security." And the President should not hesitate to act to block a transaction if it truly threatens U.S. national security and the threat cannot be mitigated.

Improvements in implementation can be made, including more frequent, high-level briefings of Congress by CFIUS agencies (without compromising proprietary business information supplied by the parties to a transaction). Yet for the reasons outlined above, I encourage the Committee to keep the existing statutory framework in place.

Thank you for the opportunity to appear before you today.