

**CFIUS REFORM: H.R. 5337, THE
REFORM OF NATIONAL SECURITY
REVIEWS OF FOREIGN DIRECT
INVESTMENT ACT**

HEARING
BEFORE THE
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION
OF THE
COMMITTEE ON ENERGY AND
COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS
SECOND SESSION

JULY 11, 2006

Serial No. 109-110

Printed for the use of the Committee on Energy and Commerce



Available via the World Wide Web: <http://www.access.gpo.gov/congress/house>

U.S. GOVERNMENT PRINTING OFFICE

30-216PDF

WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

COMMITTEE ON ENERGY AND COMMERCE

JOE BARTON, Texas, *Chairman*

RALPH M. HALL, Texas
MICHAEL BILIRAKIS, Florida
Vice Chairman
FRED UPTON, Michigan
CLIFF STEARNS, Florida
PAUL E. GILLMOR, Ohio
NATHAN DEAL, Georgia
ED WHITFIELD, Kentucky
CHARLIE NORWOOD, Georgia
BARBARA CUBIN, Wyoming
JOHN SHIMKUS, Illinois
HEATHER WILSON, New Mexico
JOHN B. SHADEGG, Arizona
CHARLES W. "CHIP" PICKERING, Mississippi
Vice Chairman
VITO FOSSELLA, New York
ROY BLUNT, Missouri
STEVE BUYER, Indiana
GEORGE RADANOVICH, California
CHARLES F. BASS, New Hampshire
JOSEPH R. PITTS, Pennsylvania
MARY BONO, California
GREG WALDEN, Oregon
LEE TERRY, Nebraska
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
C.L. "BUTCH" OTTER, Idaho
SUE MYRICK, North Carolina
JOHN SULLIVAN, Oklahoma
TIM MURPHY, Pennsylvania
MICHAEL C. BURGESS, Texas
MARSHA BLACKBURN, Tennessee

JOHN D. DINGELL, Michigan
Ranking Member
HENRY A. WAXMAN, California
EDWARD J. MARKEY, Massachusetts
RICK BOUCHER, Virginia
EDOLPHUS TOWNS, New York
FRANK PALLONE, JR., New Jersey
SHERROD BROWN, Ohio
BART GORDON, Tennessee
BOBBY L. RUSH, Illinois
ANNA G. ESHOO, California
BART STUPAK, Michigan
ELIOT L. ENGEL, New York
ALBERT R. WYNN, Maryland
GENE GREEN, Texas
TED STRICKLAND, Ohio
DIANA DEGETTE, Colorado
LOIS CAPPS, California
MIKE DOYLE, Pennsylvania
TOM ALLEN, Maine
JIM DAVIS, Florida
JAN SCHAKOWSKY, Illinois
HILDA L. SOLIS, California
CHARLES A. GONZALEZ, Texas
JAY INSLEE, Washington
TAMMY BALDWIN, Wisconsin
MIKE ROSS, Arkansas

BUD ALBRIGHT, *Staff Director*

DAVID CAVICKE, *General Counsel*

REID P. F. STUNTZ, *Minority Staff Director and Chief Counsel*

SUBCOMMITTEE ON COMMERCE, TRADE, AND CONSUMER PROTECTION

CLIFF STEARNS, Florida, *Chairman*

FRED UPTON, Michigan
NATHAN DEAL, Georgia
BARBARA CUBIN, Wyoming
GEORGE RADANOVICH, California
CHARLES F. BASS, New Hampshire
JOSEPH R. PITTS, Pennsylvania
MARY BONO, California
LEE TERRY, Nebraska
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
C.L. "BUTCH" OTTER, Idaho
SUE MYRICK, North Carolina
TIM MURPHY, Pennsylvania
MARSHA BLACKBURN, Tennessee
JOE BARTON, Texas
(EX OFFICIO)

JAN SCHAKOWSKY, Illinois
Ranking Member
MIKE ROSS, Arkansas
EDWARD J. MARKEY, Massachusetts
EDOLPHUS TOWNS, New York
SHERROD BROWN, Ohio
BOBBY L. RUSH, Illinois
GENE GREEN, Texas
TED STRICKLAND, Ohio
DIANA DEGETTE, Colorado
JIM DAVIS, Florida
CHARLES A. GONZALEZ, Texas
TAMMY BALDWIN, Wisconsin
JOHN D. DINGELL, Michigan
(EX OFFICIO)

CONTENTS

	Page
Testimony of:	
Castellani, John, President, Business Roundtable	13
Cohen, Calman J., President, Emergency Committee on American Trade.....	19
Holtz-Eakin, Douglas, Director, Maurice R. Greenberg Center for Geoeconomic Studies, Council on Foreign Relations.....	26
Mulloy, Hon. Patrick A., Commissioner, United States-China Economic and Security Review Commission	33

CFIUS REFORM: H.R. 5337, THE REFORM OF NATIONAL SECURITY REVIEWS OF FOREIGN DIRECT INVESTMENT ACT

TUESDAY, JULY 11, 2006

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION,

Washington, DC.

The subcommittee met, pursuant to call, at 2:10 p.m., in Room 2123 of the Rayburn House Office Building, Hon Cliff Stearns [Chairman] presiding.

Members present: Representatives Stearns, Terry, Rogers, Murphy, Blackburn, Barton [ex officio], Schakowsky, and Brown.

Staff Present: David Cavicke, General Counsel; Chris Leahy, Policy Coordinator; Will Carty, Professional Staff Member; Brian McCullough, Professional Staff Member; William Harvard, Legislative Clerk; Jonathan Cordone, Minority Counsel; Chris Treanor, Minority Staff Assistant, and Jonathan Brater, Minority Staff Assistant.

MR. STEARNS. Good afternoon. Our consideration of H.R. 5737, the Reform of National Security Reviews of Foreign Direct Investment Act, is an opportunity for the committee to exercise its jurisdiction over a bill that has far reaching implications for the economic health and vitality of the United States' commerce, both domestic and international. Foreign direct investment in the United States economy is an essential ingredient in the fuel that powers America's economic engine. Such open investment policy has made the United States a favorite destination for foreign direct investment with over \$115 billion dollars invested in 2004 supporting over 5 million American jobs found in every State of the Union. Car manufacturing plants in Ohio, pharmaceutical research and development in New Jersey, or aircraft components production in my home State of Florida.

The United States is and will hopefully remain the benchmark for open, transparent investment policy that results in better products for consumers, more technological innovation, and a strong and vibrant job market. Moreover, the byproducts of this free and open domestic treatment of foreign investment is that it has tremendous reciprocal benefits in the foreign markets that American companies invest, produce,

and sell in. This openness and transparency have enabled American companies to export those principles to the rest of the world, increase prosperity abroad, and in turn, encourage better acceptance and understanding of the American way of life.

The Committee on Foreign Investment in the United States or CFIUS, as it is commonly known, has operated for over 30 years as an interagency mechanism designed to flag foreign investment transactions in the United States that could affect our national security. The possibility of a CFIUS review is always a consideration with a foreign investment transaction and companies generally apply for a review as a matter of good due intelligence. Preserving a balanced and transparent process is vital to enjoying this open cooperation in companies wishing to invest in the United States. In practice, CFIUS has operated relatively well, not only empowering the committee to scrutinize foreign investments that could have security implications, but also by allowing it to be in a position to counsel companies on how to improve the structure of their transactions to better address national security concerns.

I do, however, believe that the balance that has been struck under the current process is capable of being fine-tuned. So accordingly I would like to better understand why the bill designates a permanent chair and vice chair, and how that new statutory element will help maintain a balanced and collaborative review process. Codifying a leadership structure that includes Homeland Security as vice chair clearly creates a broad security component rather than providing a general organizational leadership structure. That has worked well over the years. In addition, a leadership structure with an extremely broad security portfolio like the Department of Homeland Security could have the unintended effect of intimidating legitimate investors from investing their capital in the United States economy, thereby harming our prosperity in the long run.

I would also like to see the chairmanship function become more transparent and responsive, a proven and responsive way to generate substantive, collaborative input from all the departments and agencies that are involved. With this in mind, I would like to hear the panel's thoughts about the ideas of periodically rotating or changing the leadership structure to better reflect the commercial nature of the transactions that are subject to scrutiny and review, as well as to, better balance those issues with the national security focus of the analysis. I think there may be a better way to keep the interagency process balanced and as a result, further improve the functioning of the body as envisioned by the bill.

In closing, I think H.R. 5337 is a good bill that would benefit from some relatively minor improvements. I am a cosponsor. I support the bill to facilitate better Congressional oversight over the committee while

preserving a balanced and transparent review process that would prohibit politicizing these important issues, principles which have served the United States economy and our world-class financial markets extremely well over the years.

And with that, I yield to the Ranking Member, Ms. Schakowsky.

[Prepared statement of Hon. Cliff Stearns follows:]

PREPARED STATEMENT OF THE HON. CLIFF STEARNS, CHAIRMAN, SUBCOMMITTEE ON
COMMERCE, TRADE, AND CONSUMER PROTECTION

Good afternoon. Our consideration today of HR 5337, the “Reform of National Security Reviews of Foreign Direct Investment Act” is an opportunity for the Committee to exercise its jurisdiction over a bill that has far reaching implications for the economic health and vitality of United States commerce, both domestic and international. Foreign direct investment in the U.S. economy is an essential ingredient in the fuel that powers America’s economic engine. Such open investment policy has made the United States a favored destination for foreign direct investment with over \$115 billion invested in 2004, supporting over 5 million American jobs found in every state of the union - car manufacturing plants in Ohio, pharmaceutical R&D in New Jersey, or aircraft component production in my home state of Florida. The United States is and hopefully will remain the world’s benchmark for open, transparent investment policy that results in better products for consumers, more technological innovation, and a strong and vibrant job market. Moreover, the byproduct of this free and open domestic treatment of foreign investment is that it has tremendous reciprocal benefits in the foreign markets that American companies invest, produce, and sell in. This openness and transparency has enabled American companies to export those principles to the rest of the world, increase prosperity abroad, and in turn, encourage better acceptance and understanding of the American way of life.

The Committee on Foreign Investment in the United States or “CFIUS”, as it is more commonly known, has operated for over thirty years as an interagency mechanism designed to flag foreign investment transactions in the United States that could affect our national security. The possibility of a CFIUS review is always a consideration with a foreign investment transaction, and companies generally apply for a review as a matter of good due diligence. Preserving a balanced and transparent CFIUS process is vital to enjoying this open cooperation from companies wishing to invest in the U.S. economy. In practice, CFIUS has operated relatively well, not only empowering the CFIUS committee to scrutinize foreign investment that could have security implications, but also by allowing it to be in a position to counsel companies on how to improve the structure of their transactions to better address national security concerns.

I do, however, believe that the balance that has been struck under the current CFIUS process is capable of being fine tuned. Accordingly, I would like to better understand why the bill designates a permanent CFIUS chair and vice chair and how that new statutory element will help maintain a balanced and collaborative review process. Codifying a leadership structure that includes Homeland Security as Vice Chair clearly creates a very strong and broad security component, rather providing a general organizational leadership structure – a structure that has worked well over the years. In addition, a leadership structure with an extremely broad security portfolio like the Department of Homeland Security COULD have the unintended effect of intimidating legitimate investors from investing their capital in the United States economy; thereby harming our prosperity in the long run. I’d also like to see the chairmanship function become more transparent and responsive – a proven and effective way to generate substantive collaborative input from all the departments and agencies involved. With this

in mind, I'd like to hear panel's thoughts about the idea of periodically rotating or changing the leadership structure to better reflect the commercial nature of the transactions subject to CFIUS scrutiny and review, as well as to better balance those issues with the national security focus of the analysis. I think there may be a better way to keep the interagency process balanced, and as a result, further improve the functioning of CFIUS as envisioned by the bill.

In closing, I think HR 5337 is a good bill that would benefit from some relatively minor improvements. As a cosponsor, I support the bill's general approach to facilitate better congressional oversight of the CFIUS process while preserving a balance and transparent review process that avoid politicizing these important issues -- principles that have served the U.S. economy and our world class financial markets extremely well over the years.

Thank you.

MS. SCHAKOWSKY. Thank you, Chairman Stearns, for holding today's hearing on the Committee on Foreign Investment in the United States, CFIUS, and H.R. 5337, the reform of national security, the bill that we will be marking up tomorrow in the full committee. I hope we can reach a bipartisan agreement on the bill. I know that we both agree that it is time to reform the Exon-Florio process, which determines what can be bought in the United States by foreign entities.

Because this has direct implications for our national and economic securities, I believe it is one of the most important issues that fall under the jurisdiction of the subcommittee. For years, CFIUS, the interagency committee that was formed to protect the United States' economic well being and national security, has been making decisions about what foreign companies can buy up in the United States under a shroud of secrecy. Under the guise of protecting the confidentiality of the potential investors, CFIUS has decided to keep Congress, including us, the committees with jurisdiction over it, in the dark about its decisions whether to investigate, approve, deny foreign entities including foreign governments purchasing within the United States. I think we need to shift the focus of CFIUS back to the protection of America as it is related to foreign investment.

Under current law, CFIUS is only obliged to report to Congress every 4 years on the very narrow issue of whether any foreign government has a coordinated strategy to acquire U.S. companies that do research, development, or production of critical technologies, but it has been shirking even that limited responsibility since its first and only report in 1994.

Only because the press broke the story that CFIUS and the President approved the purchase of operations at six major U.S. ports by Dubai Ports World, owned by the United Arab Emirates, did the foreign investment approval process and problems with its reporting and transparency come to the forefront and center of our attention.

Although the Dubai Ports World deal was effectively ended on March 9th when the company said it would transfer its operation of American ports to its U.S. entity, I believe it is a telling example of why we need to insist upon a more open and informed process of approving foreign investment in the United States.

My opposition to this deal is not about the idea of an Arab country controlling American port operation. My opposition is that President Bush would outsource the safety of American ports to any foreign country. I believe that Americas' security is America's business. The security of our ports is an inherent function of the United States government. It is unacceptable, in my view anyway, that 5 years after 9/11, only 6 percent of cargo coming in to Americans ports is inspected and that we would further put our ports at risk by outsourcing their offices or that of any other critical infrastructure for that matter.

So I thank you again, Chairman Stearns, for holding this hearing, and I look forward to hearing from our witnesses.

MR. STEARNS. The gentelady from Tennessee, Mrs. Blackburn.

MRS. BLACKBURN. Thank you, Mr. Chairman. I thank our witnesses and I thank the Chairman for the hearing today, and I am looking forward to this and to examining the legislation to reform the committee.

You know, I think that many of our constituents are very concerned about CFIUS and how it operates and many did not know that the committee existed until the Dubai Ports deal. And then once they learned that the committee existed, they really didn't appreciate that many of the decisions, and much of the committee's work, is done without the consent or participation of Congress.

So the bill before us does take significant steps and takes those steps towards transparency, accountability, and oversight of foreign investments that may impact our national security by codifying CFIUS into law, mandating investigative semiannual reports to Congress. H.R. 5337 will keep Congress as an informed participant in the process, and we are looking forward to that, and I am looking forward to hearing from each of you today.

I thank you for your time, for your participation. Mr. Chairman, I yield back.

MR. STEARNS. Thank the gentelady. The gentleman from Ohio.

MR. BROWN. Thank you for inviting Commissioner Mulloy to testify. I want to thank him especially for his work of the U.S.-China Security and Economic Review Commission and his work in shaping CFIUS reform. Thank you for that.

If the objective of CFIUS reform is national security, this bill as introduced falls well short of the mark. First, the bill maintains the

Treasury Secretary as the CFIUS Chairman, a job that so many of us as critics of the current CFIUS process believe should be filled by the Secretary of Commerce. Foreign investment can provide good jobs for American workers and the Treasury Department's traditional role as cheerleader for foreign investment is entirely reasonable. But that role, in this case, creates an unavoidable conflict of interest. The Commerce Secretary has no such inherent conflict. His role as coordinator of imports, exports, industrial security, and manufacturing gives the Commerce Secretary a better vantage point from which to evaluate the economic security issues raised by foreign acquisitions.

A related problem with the bill is its additions to the CFIUS roster. Let us start with the U.S. Trade Rep and the National Economic Council Director. Comparing those guys as security watch dogs for international transaction to the fox guarding the hen house is a sleight to the fox. They have no place as CFIUS members. Neither does the OMB Director. In practice, his role would simply be to give the White House a stronger hand in CFIUS deliberations. Even worse is the bill's authorization for the President to add practically anyone who works in the West Wing to CFIUS.

IF the President wants these decisions made by a political insider, he should scrap CFIUS and make them himself. If not, he and we should let this agency work without the internal Administration politics.

Mr. Chairman, in deference to my friend from Michigan and the time, I will just enter the rest of my statement in the record. Thank you for doing the hearing today.

[Prepared statement of Hon. Sherrod Brown follows:]

PREPARED STATEMENT OF THE HON. SHERROD BROWN, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF OHIO

Thank you, Mr. Chairman, for scheduling this important hearing on reforming the Committee on Foreign Investment in the United States. And thanks, as well, for inviting Commissioner Pat Mulloy to testify.

To call Commissioner Mulloy a CFIUS expert is to sell him short. Not only has he worked as a member of the United States-China Economic and Security Review Commission to shape the Commission's CFIUS reform recommendations. But he also served as General Counsel to the Senate Banking Committee during the 1980s and participated in the negotiations resulting in the enactment of the 1988 Exon-Florio amendment that charged CFIUS with its current mission.

Commissioner Mulloy, your unique perspective on CFIUS' past and your keen insights into its future challenges make you an exceptional witness. I am pleased to welcome you to today's hearing.

Mr. Chairman, I wish I could offer such an enthusiastic endorsement of HR 5337 – which is the subject of our hearing. But if the objective of CFIUS reform is national security, HR 5337 as introduced falls well short of the mark.

First, the bill maintains the Treasury Secretary as CFIUS Chairman – a job that I and other critics of the current CFIUS process believe should be filled by the Secretary of Commerce.

Foreign investment can provide good jobs for American workers – and the Treasury Department’s traditional role as cheerleader for foreign investment is entirely reasonable. But that role creates an unavoidable conflict of interest.

The Commerce Secretary has no such conflict. And his role as coordinator of import, export, industrial security, and manufacturing give the Commerce Secretary a better vantage point from which to evaluate the economic security issues raised by foreign acquisitions.

A related problem with the bill is its additions to the CFIUS roster. Let’s start with the U.S. Trade Representative and the National Economic Council Director. Comparing those guys as security watchdogs for international transactions to the fox guarding the henhouse is a sleight to the fox. They have no place as CFIUS members.

Neither does the OMB Director. In practice, his role would simply be to give the White House a stronger hand in CFIUS deliberations. Even worse is the bill’s authorization for the President to add practically anyone who works in the West Wing to CFIUS.

If the President wants these decisions made by political insiders, he should just scrap CFIUS and make them himself. If not, he – and we – should let the agencies work without the internal Administration politics.

The bill also maintains current law’s faith-based approach to covered transaction notifications. Under the bill, CFIUS reviews, National Intelligence Director analyses, and reports to Congress are all in large part contingent on the parties to covered transactions notifying CFIUS that those transactions are happening. But nowhere does the bill require those parties to make those notifications.

Sure, it allows for CFIUS reviews after the fact. But as anyone who’s ever tried to put a genie back in the bottle can tell you, it’s much easier not to let him out in the first place. We ought to require that companies party to covered transactions notify CFIUS before the deal is done.

And finally, the bill fails to expand the scope of CFIUS reviews to take into account changes in the economic world since 1988. The 1994 North American Free Trade Agreement and the trade deals that followed changed not only our economic policy, but also our security policy.

These and similar trade deals have subjected our domestic laws – including homeland security laws – to arbitration by international tribunals whose mission is trade promotion, not security enhancement.

China and the EU have already expressed concern about the effects of US homeland security policies on trade. And the trade agreements we’ve signed give our trading partners – and even foreign companies – the right to sue us if homeland security rules cut into their bottom line.

So unless we create a process for systematic security reviews of trade agreements – in addition to individual transactions – we may only be picking at the tip of the iceberg. This bill offers an opportunity to create such a process, and I hope you will work with me to do so.

I appreciate this beginning to a long-overdue effort to reform CFIUS. And I look forward to working with you as the legislation advances.

MR. STEARNS. I thank you. Mr. Rogers.

MR. ROGERS. Very quickly. To me it is very--

MR. STEARNS. We have 10 minutes.

MR. ROGERS. I understand. I am looking forward to the testimony. It is incredibly important in that we respect the free and fair trade of goods and services. It is good for Americans, it is good for consumers, it is good for our economy, and we in Congress need to carefully balance the need for proper security actions and legitimate need for foreign investment in the United States. What shocked me most about the most recent uproar was not asking the right questions or stopping, asking questions at the wrong time.

And I hope that we can get to the bottom of that. I look forward to the testimony today, because this is incredibly important as we move forward. The world has changed. We need CFIUS to change with it, and I don't think it is quite there yet, but I think hopefully as a result of this hearing and this testimony, we can establish a dialogue to get where we need to get to when it comes to protecting Americans and protecting a world-wide investment, both from America to other countries and from other countries to here as well.

Thank you, Mr. Chairman. I yield back.

MR. STEARNS. Thank you, gentlemen.

We have votes scheduled, and it turns out this vote's coming to the end, and then we have a 10-minute debate and we have some more votes. So I suspect it will be about 30 minutes that we will temporarily adjourn the subcommittee, and then reconvene probably about 30 minutes. So we will all return with that. So with that, if you will be patient we will be back in about 30 minutes.

[Recess.]

MR. STEARNS. The committee will come to order. We welcome on the witness list John Castellani, President of the Business Roundtable; Mr. Calman J. Cohen, President, Emergency Committee on American Trade; Mr. Douglas Holtz-Eakin, Director, Maurice R. Greenberg Center for Geoeconomic Studies, Council on Foreign Relations; and the Honorable Patrick Mulloy, Commissioner, United States-China Economic and Security Review Commission.

And so I welcome all of you. Joined with us is the Chairman of the full committee.

CHAIRMAN BARTON. Is it still in order to give an opening statement?

MR. STEARNS. You are in order. Yes, sir.

CHAIRMAN BARTON. I appreciate the courtesy of the other members. I was, as they say, unavoidably detained on the floor in the conversation dealing with some committee issues tomorrow.

I want to welcome our panelists here. The Committee on Foreign Investment in the United States, which we know as CFIUS, was operated largely out of the public eye until very recently. It is an interagency committee established to review transactions of foreign investment or

purchases of an American company and determine if the proposed transaction has any effect on national security. CFIUS used to be nearly anonymous, but the work performed by this group has attracted great attention in the past year, primarily because of the proposed transaction involving CNOOC, and more recently, involving the Dubai Ports World acquisition of numerous American ports. These two different transactions raised concerns in the public regarding both the review process and the relevant disclosure of CFIUS decisions.

I want there to be more foreign investment in the United States, not less, but I do not want the kind that would threaten our national security. CFIUS exists to make that distinction, and we need to know and the American people need to know that it is doing the job it was intended to do.

We should not automatically fear foreign investment in the United States. Many of our most promising companies are able to pursue beneficial R&D precisely, because our country welcomes foreign investment. Our high tech industries would not be world leaders if we had barred investment from overseas. The venture capital industry that funds many start-up companies all over the United States could not thrive without a vibrant global economy where our goods and services are sold. The money that is provided to the United States creates jobs in the United States, creates growth and opportunity in the United States. And we should want more of it and not less. Again, if it doesn't affect national security, we want to be sure that proposed investments will not harm our Nation. If the highly publicized proposed transaction of CNOOC and the Dubai Ports demonstrated anything, it was that the process by which our Government has been sorting through these types of investments from bad to murky, is to say the least, in itself, bad and murky. Congress and this committee need to be aware of the criteria used to evaluate the transactions. We need to know which transaction should be subject to a more rigorous review. I understand that there are differences in the interpretation to CFIUS review process as it applies to foreign government-controlled transactions. In this regard, I think legislation is warranted to clarify any ambiguity under the current review process. We need to ensure that some consistent criteria with appropriate discretion will improve the process without impairing our ability to attract significant and needed foreign investment.

H.R. 5337 would codify the creation and membership of CFIUS as well as address the criteria for transaction reviews. Whether it strikes the appropriate balance for mandatory review is an issue that we should discuss in this hearing.

The United States has long standing ties to traditional allies and trading partners. We also have new and evolving relationships with

other countries. It would seem logical to me that not every foreign government-controlled transaction threatens national security, and not every one requires the same level of scrutiny.

While the bill establishes some new reporting requirements to Congress that I applaud, I am very troubled by the appointment of the Secretary of Homeland Security as the permanent vice chair of CFIUS. It is not clear to me why the newest member of the CFIUS process is better suited to evaluate the nature of these transactions than another agency, such as Commerce that has been involved since the beginning of the process.

There may be an amendment on this issue in the markup that is currently scheduled to begin tomorrow.

As we move to mark up the bill in committee, I look forward to a discussion of these issues with the witnesses and with members on both sides of the aisle.

With that, Mr. Chairman, thank you for allowing me to give this opening statement. I yield back the balance of my time.

[Prepared statement of Hon. Joe Barton follows:]

PREPARED STATEMENT OF THE HON. JOE BARTON, CHAIRMAN, COMMITTEE ON ENERGY
AND COMMERCE

The Committee on Foreign Investment in the United States, better known as CFIUS (see-fee-us), has operated largely unknown to the American public until recently. It is an inter-agency committee established to review transactions of foreign investment or purchases of American companies, and determine if the proposed transaction will affect national security.

CFIUS used to be nearly anonymous, but the work performed by this once-obscure group has attracted great attention in the past year. First, the proposed transaction involving CNOOC and more recently the proposed Dubai Ports World acquisition of numerous American ports has raised concerns regarding both the review process and the relevant disclosure of CFIUS decisions.

I want more foreign investment in America, not less, but I do not want the kind that threatens our security. CFIUS exists to make the distinction, and we need to know that it's doing a good job.

We don't automatically fear foreign investors here in America. Many of our most promising companies are able to pursue beneficial research and development precisely because our country welcomes foreign investment. Our high tech industries would not be world leaders if we had barred investment from abroad. The venture capital industry that funds many start-up companies all over the United States could not thrive without a vibrant global marketplace where our goods and services are sold. The money provided by foreign investors creates jobs, growth and opportunity here at home, and I want more of it, not less.

I also want to be sure that proposed investments will not harm our nation. If the highly publicized proposed transactions of CNOOC and Dubai Ports demonstrated anything, it was that the process by which our government sorts out good investment from bad is murky, to say the least. Congress and this Committee need to be aware of the criteria used to evaluate the transactions and which transactions should be subject to more rigorous review.

I understand that there are differences in the interpretation of the CFIUS review process as it applies to foreign government controlled transactions. In this regard, I think legislation is warranted to clarify any ambiguities under the current review process. We need to ensure that some consistent criteria with appropriate discretion will improve the process without impairing our ability to attract significant and needed foreign investment.

H.R. 5337 codifies the creation and membership of CFIUS, as well as addresses the criteria for transaction reviews. Whether it strikes the appropriate balance for mandatory reviews is an issue I look forward to discussing further.

The United States has longstanding ties to traditional allies and trading partners, and we also have new and evolving relationships with other countries. It seems logical to me that not every foreign government controlled transaction threatens our national security, and not every one requires the same level of scrutiny.

While the bill also establishes some new reporting requirements to Congress that I applaud, I am troubled by the appointment of the Secretary of Homeland Security as the permanent Vice-Chair of CFIUS. It is not clear to me why the newest member of the CFIUS process is better suited to evaluate the nature of these transactions than an agency, such as Commerce, that has been involved since the beginning.

As we move to mark up the bill in Committee, I look forward to a discussion of these issues with the witnesses, and any suggestions they may have to improve the bill.

Thank you, and I yield back.

MR. STEARNS. I thank the distinguished Chairman.

Mr. Terry? No opening statement? Mr. Murphy.

MR. MURPHY. I will waive, too. Thank you.

MR. STEARNS. Thank you. With that, we have introduced you and Mr. Castellani, you are welcome to begin.

STATEMENTS OF JOHN CASTELLANI, PRESIDENT, BUSINESS ROUNDTABLE; CALMAN J. COHEN, PRESIDENT, EMERGENCY COMMITTEE ON AMERICAN TRADE; DOUGLAS HOLTZ-EAKIN, DIRECTOR, MAURICE R. GREENBERG CENTER FOR GEOECONOMIC STUDIES, COUNCIL ON FOREIGN RELATIONS; AND THE HON. PATRICK MULLOY, COMMISSIONER, UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

MR. CASTELLANI. Thank you, Mr. Chairman. Thank you for giving me the opportunity to testify before you today to discuss the Committee on Foreign Investment in the United States, CFIUS, and express our support for H.R. 5337, the National Security Foreign Investment Reform and Strength and Transparency Act of 2006.

With your permission, I would like my written statement to be included in the record.

MR. STEARNS. By unanimous consent so ordered.

MR. CASTELLANI. As chief security officers of major U.S. companies, Business Roundtable members recognize the need to protect

national security; in fact, protection of national security is paramount. But we also know firsthand the critical importance of foreign investment. As your committee considers the CFIUS legislation, we encourage you to recognize these are not incompatible goals, and the proposal to reform the process needs to be balanced and constructive so that they do not place unnecessary damaging and counterproductive restrictions on foreign investment.

I would like to focus my remarks today on three topics. First, how important foreign investment is to the U.S. economy; second, the three central principles we believe should guide your thinking about the CFIUS process and the reform; and third, why we support this legislation.

Foreign investment in the U.S. is essential to continued viability of the American economy. In 2004, investors invested more than \$115 billion in the United States, providing U.S. companies and workers with important capital for expansion of U.S. production facilities, increased research and development spending, and other investments to help grow the U.S. economy. This data demonstrates that if foreign companies were to spend less in America as a result of perceptions that the U.S. no longer welcomes foreign investment, reduced investment would harm U.S. economic growth, choke innovation, and undermine our overall economic competitiveness in today's global economy, just as significantly losing foreign investment to our overseas competition would cost American workers good jobs.

Foreign companies with operations in the United States support 5.3 million American jobs spread out over all 50 States. Just like the foreign competitors, U.S. companies make significant investments in other countries in order to expand their markets and establish worldwide production and distribution networks in the ongoing struggle to maintain their international competitiveness.

U.S.-owned foreign assets total about \$9 trillion, and while 90 percent of U.S. companies' investments on an annual basis are made in the United States, the fact is we invest considerably more in foreign companies than they do in ours.

It is, therefore, important to recognize that burdensome or discriminatory barriers to foreign investors in the United States will jeopardize U.S. investment overseas by inviting retaliatory treatment against American investors. Given the importance of the foreign investment to the U.S. economy, we believe the legislative process to reform CFIUS should be guided by three central principles. First, national security should continue to be the principal focus of the foreign investment review process. Second, the review process should continue to be objective, fair, and nonpolitical. It should not create obstacles to

investments that put a damper on legitimate business activities; and third, maintaining an open, fair, and nondiscriminatory environment for legitimate foreign investment is important for national interests.

Looking ahead after 18 years of operations, we understand why Congress sees a need to fine tune the CFIUS review process to restore the confidence of Congress and the American public. While we know the CFIUS process to be rigorous, there is room for improvement and that is why Business Roundtable supports the general consensus in Congress that the CFIUS process should be refined through measures that increase transparency, establish greater accountability, and above all, enhance national security, but do not stifle legitimate foreign investment in economic growth.

The CFIUS process in the House has proceeded in a deliberate bipartisan manner that strikes an appropriate balance between safeguarding our national security and protecting job creating foreign investment. We believe, along with many in the business community, that H.R. 5337 is generally consistent with the three principles that I have highlighted.

It keeps national security as a principal focus of the foreign investment review process and strengthens the national security tools used in that process, all without putting a damper on foreign investment that is critical to our economic growth and job creation.

H.R. 5337 also reforms the CFIUS process in an objective, fair-minded, nonpolitical matter without adding nonregulatory matters or delays that would curtail foreign investment that is critical to the U.S. economy.

Mr. Chairman, let me close by reiterating the real threats to the U.S. national security must be tackled with purpose and resolve.

No business deal is worth jeopardizing the safety of the American people. But at the same time, challenges to U.S. economic success must be met with a similar commitment to global leadership in engaging in open markets that have contributed to increasing national and global prosperity.

Thank you for the opportunity to appear before the committee, and I look forward to your questions.

MR. STEARNS. Thank you.

[The prepared statement of John Castellani follows:]

PREPARED STATEMENT OF JOHN CASTELLANI, PRESIDENT, BUSINESS ROUNDTABLE

Thank you for giving me the opportunity to appear before you today to discuss with you the Committee on Foreign Investment in the United States (CFIUS) and express our support for HR 5337, the "National Security Foreign Investment Reform and Strengthened Transparency Act of 2006." I am here as President of the Business Roundtable, an association of chief executive officers of approximately 160 leading U.S.

companies with over \$4.5 trillion in annual revenues and more than 10 million employees.

As CEOs of major U.S. companies, Business Roundtable members know firsthand the critical importance of foreign investment, in particular foreign investment in the United States, which supports over 5 million American jobs. The Business Roundtable also recognizes that protecting national security is paramount. If an acquisition of a U.S. company would impair national security, the President should not hesitate to exercise his authority to block any such deal or insist on conditions that will adequately and effectively protect our national security.

As your Committee considers the CFIUS legislation, we urge you to recognize that protecting national security and foreign investment are not incompatible goals, and that proposals to reform the CFIUS process need to be balanced and constructive so that they do not place unnecessary, damaging and counterproductive restrictions on foreign investment.

I would like to focus my remarks today on three topics: First, how important foreign investment is to the U.S. economy; second, the three central principles we believe should guide your thinking about the CFIUS process and its reform; and, third, why the Business Roundtable supports H.R. 5337.

FOREIGN INVESTMENT IN THE U.S. ECONOMY

First, foreign investment in the United States is essential to the continued vitality of the American economy. In 2004, foreign investors invested more than \$115 billion in the United States, providing U.S. companies and workers with important capital for expansion of U.S. production facilities, increased R&D spending, and other investments to help grow the U.S. economy. U.S. subsidiaries of foreign companies spent about \$30 billion in R&D and accounted for 21 percent of total U.S. exports in 2003. Nearly 20 percent of U.S. manufacturing GDP is attributable to subsidiaries of foreign firms. Indeed, the very presence of such companies in the United States sets into motion a multiplier effect that parcels out benefits—including tax revenue—throughout local and national economies felt by all Americans, including small businesses.

This data demonstrates that if foreign companies were to spend less in America as a result of perceptions that the United States no longer welcomes foreign investment, reduced investment would harm U.S. economic growth, choke innovation, and undermine our overall economic competitiveness in today's global economy.

Just as significantly, losing foreign investment to our overseas competition would cost American workers good jobs. Foreign companies with operations in the United States support nearly 5.3 million American jobs spread throughout all 50 states. Put differently, almost 5 percent of Americans working in the private sector are employed by foreign companies. These U.S. workers receive compensation totaling \$318 billion annually, with an average annual compensation of over \$60,000 (which is over 34 percent higher than compensation at all U.S. companies), and their ranks are growing rapidly. Over 90 percent of these investments come from friendly countries belonging to the Organization for Economic Cooperation and Development and only 2 percent involve firms that own assets that are owned or controlled by foreign governments.

Besides putting good-paying American jobs at risk, restricting foreign investment in the United States would harm U.S. investors' stock portfolio. For example, cell phone manufacturer Nokia may be headquartered in Helsinki, but 40 percent of its shares are owned in America. Broad restrictions on ownership of U.S. assets would harm U.S. pensions, mutual funds, and investors through falling stock prices and lower investment returns.

Foreign investment is also vital to the success of our capital markets, which provide the "seed corn" essential to the creation of new businesses, innovations, and ideas. Our growing economy and robust capital markets attract more foreign investment than any

other single country: from \$185 billion in 1985 to more than \$1.5 trillion today. Shut off that spigot and our mighty economic engine will sputter.

Just like foreign companies, numerous U.S. firms make significant foreign investments in other countries in order to expand their markets and establish worldwide production and distribution networks in the ongoing struggle to maintain their international competitiveness. U.S.-owned foreign assets total about \$9 trillion. While nearly 90 percent of U.S. company investments on an annual basis are made in the United States, the fact is we invest considerably more in foreign countries than they do in ours. Given the U.S. business community's global reach and increasing dependence on foreign markets and foreign earnings, U.S. companies rightly fear the prospect of confronting an anti-investment, anti-U.S. business backlash in important markets outside the United States.

It is therefore important to recognize that burdensome or discriminatory barriers to foreign investment in the United States will jeopardize U.S. investments overseas by inviting retaliatory treatment against American investors. Already, some of our trading partners are now considering legislation to place new limits on foreign investment. For example, Mexico is contemplating restrictions on foreign investment related to infrastructure projects. Other countries, including China, France, and India, have taken similar types of steps to restrict investment in a number of important sectors, and are prepared to use any restrictive U.S. legislation as a ready excuse to implement protectionist measures.

In addition to causing harm to U.S. businesses and workers, as well as the overall American economy, any retaliatory measures to curtail U.S. ownership of "critical infrastructure" overseas would undermine U.S. national security by limiting our access to energy and critical mineral resources. For example, the United States imports about 58 percent of its oil today (compared to 33 percent in 1973). By 2020, that figure could jump to 70 percent. Yet, U.S. proposals to restrict foreign ownership of "critical infrastructure" unrelated to national security provide a pretext for countries with strategic natural resources to impose their own restrictions on U.S. companies investing overseas.

PRINCIPLES FOR CFIUS REFORM

Given the importance of foreign investment to the U.S. economy, we believe the legislative process to reform CFIUS should be guided by three central principles:

- National security should continue to be the principal focus of the foreign investment review process.
- The CFIUS process should continue to be objective and fair, and non-political; it should not create obstacles to investment that put a damper on legitimate business activities.
- Maintaining an open, fair, and non-discriminatory investment environment for legitimate foreign investment is important to the U.S. national interest.

I will briefly talk about each of these main principles and then conclude by discussing why HR 5337 is a tough, effective bill that is consistent with these ideas.

First, national security should continue to be the principal focus of the foreign investment review process.

At the outset, it is important to recognize there is no inconsistency between our national security and investment in the United States by overseas companies. Foreign investment is an important contributor to a strong U.S. economy, which is vital to our security. Our nation cannot be secure unless our economy continues to be strong and vibrant. In many instances, foreign investment helps modernize U.S. infrastructure needed to improve the international competitiveness of U.S.-based companies and their workers and to protect our national and homeland security.

The existing national security factors in the CFIUS process are sufficiently broad enough to cover threats to American security that have evolved in recent years, and to continue to do so as technology and global politics change. One of the strengths of the current law is its flexibility to adjust with the times: The Internet was barely known in 1988 when the law was written, but CFIUS now reviews most cross-border telecom transactions because the Internet backbone is part of critical communications infrastructure.

Attempts to redefine national security by, for example, identifying specific sectors or including economic factors would only have the unintended adverse consequence of discouraging legitimate foreign investment. Such efforts are often misguided attempts at protectionism masquerading as national security policy.

Moreover, proposals that introduce political or economic considerations unrelated to national security into the CFIUS process would divert scarce government resources away from keeping America safe, the principal focus of the CFIUS process. Such measures would also provide competitors opportunities to interfere with transactions for reasons that have nothing to do with national security.

Second, the review process should continue to be objective and fair, and non-political; it should not create obstacles to investment that put a damper on legitimate business activities.

We understand that an improved relationship with the Executive Branch is needed to ensure that the Congress can effectively fulfill its responsibility to oversee the operation of the CFIUS process.

We also believe that the CFIUS process should be rigorous, thorough, and comprehensive in order to fully and properly protect national security. However, if it is allowed to become unduly political or burdensome, the CFIUS process will deter foreign investors from making legitimate investments that are vital to the U.S. economy. For example, establishing unprecedented Congressional reporting requirements on a case-by-case basis would be especially counterproductive because it invites politicization of the CFIUS process. Such measures would introduce regulatory uncertainty that would chill foreign investment in the United States, diminish the value of U.S. assets, and adversely effect U.S. economic growth.

At the same time, reform measures ought not to threaten the confidentiality of sensitive business proprietary information. Submission of all relevant information by companies to CFIUS allows it to conduct complete and timely reviews and investigations of transactions. A system that does not guarantee confidential treatment of business proprietary information will undermine the entire process and risks the unintended consequence of discouraging companies from making investments in the United States.

Third, maintaining an open, fair and non-discriminatory environment for legitimate foreign investment is important to the U.S. national interest.

As discussed above, foreign investors provide U.S. companies and workers with millions of quality jobs at high wages, important capital for expansion of U.S. production facilities, increased R&D spending, and other investments to help grow the U.S. economy. If the Congress were to adopt excessive changes to the CFIUS process, there is a significant risk that such changes would discourage legitimate foreign investment in the United States and encourage other countries to discriminate against U.S. companies investing overseas.

H.R. 5337, “NATIONAL SECURITY FOREIGN INVESTMENT REFORM AND STRENGTHENED TRANSPARENCY ACT OF 2006”

Looking ahead, after eighteen years of operation, we understand why Congress sees a need to fine-tune the CFIUS review process to restore the confidence of Congress and

the American public. While we know the CFIUS process to be extremely rigorous, there is room for improvement. That is why the Business Roundtable supports the general consensus in Congress that the CFIUS process should be refined through measures that increase transparency, establish greater accountability, and above all enhance national security, but do not stifle legitimate foreign investment and U.S. economic growth.

The CFIUS reform process in the House has to date proceeded in a deliberative and bipartisan manner that strikes an appropriate balance between safeguarding our national security and protecting job-creating foreign investment.

H.R. 5337 is generally consistent with the three general principles I have discussed today. It keeps national security as the principal focus of the foreign investment review process without putting a damper on foreign investment that is critical to U.S. economic growth and job creation. H.R. 5337 also reforms the CFIUS process in an objective, fair-minded, and non-political manner without adding unnecessary regulatory burdens that will curtail foreign investment that is critical to the U.S. economy.

The bill takes a number of important steps to protect against foreign acquisitions that could threaten national security:

- It ensures that foreign government owned investors will be required to go through an investigation.
- It provides CFIUS with the ability to extend the investigation period if security issues are not resolved, while at the same time authorizing greater investigative authority.
- It strengthens transparency and achieves greater accountability by requiring CFIUS to collect and share more data, on an aggregate basis, through reports to the Congress, without creating burdensome notice and reporting requirements that would risk politicization of the process or leakage of business proprietary data.
- It retains needed flexibility by permitting CFIUS to negotiate mitigation agreements, but also requires improved monitoring of those agreements, and authorizes CFIUS to reconsider previously approved transactions if security agreements are materially breached.
- It creates a clear statutory role for the Director of National Intelligence to review proposed acquisitions and furnish relevant information and analysis.

These measures represent significant substantive and procedural enhancements to the existing national security review process.

Mr. Chairman, as the Committee participates in CFIUS reform, let me close by reiterating that real threats to U.S. national security must be tackled with purpose and resolve—no business deal is worth jeopardizing the safety of the American people. But at the same time, challenges to U.S. economic success must be met with a similar commitment to global leadership and engagement in opening markets that has contributed to increasing national and global prosperity.

National security and open economic policies that promote growth go hand-in-hand. Indeed, an important aspect of protecting national security is open economic policies, including investment policies, which can help generate wealth, ideas, and innovations to meet our national security requirements. We look forward to continuing our work with Congress to reform the CFIUS process in ways that both strengthen national security and promote foreign investment.

Thank you for the opportunity to appear before the Committee. I look forward to your questions.

MR. STEARNS. Mr. Cohen.

MR. COHEN. Thank you, Mr. Chairman. I welcome the opportunity to appear before you today to express support for H.R. 5337 on behalf of

the Emergency Committee for American Trade, ECAT. ECAT is an association of chief executives of major American companies with global operations who represent all principal sectors of the U.S. economy.

All too often, the recent debate over the effort to reform CFIUS foreign investment review process poses a false choice, the choice between preserving national security and welcoming foreign investment. In fact, the United States national security is strengthened, as the Chairman has pointed out, by promoting a vibrant economy, and economic growth here at home and abroad, which, in turn, is fostered by foreign investment into the United States as well as U.S. investment abroad.

Foreign investment inflows into the United States are a major source of U.S. economic growth as is U.S. investment abroad. Continued foreign investment in the United States and its corollary U.S. investment abroad require policies that support and protect foreign investment. CFIUS plays an important role in ensuring that the United States continues to welcome investment and its reform makes sense to ensure a credible objective and strong process focused on national security.

ECAT and several other major business associations have laid out a number of key principles that we believe need to be achieved through the CFIUS reform process, ensuring that the security review process is objective, focused on national security issues promoting the full use of sensitive and classified information while protecting confidentiality, operating on a case-by-case basis and remaining sufficiently flexible to cover new national security issues, operating in a timely manner and not serving as a substitute for other more targeted and effective tools to protect national security.

I would now like to turn to H.R. 5337. Overall, it would establish a strong, firm framework for CFIUS to review, make decisions, and notify Congress on the national security implications of foreign investments in a way that emphasizes an objective, timely, and fact-based process that promotes national security objectives while promoting continuing support for investment here in the United States.

It would enhance the credibility of the review process by codifying and strengthening CFIUS, including intelligence reviews. It would improve attracting insurance agreements and withdrawn agreements. It would enhance the Congressional notification process and it would maintain an objective and time-limited process, and it would ensure the confidentiality of proprietary information.

Improvements are possible in any piece of legislation, and ECAT very much welcomes the work by the Committee on Financial Services to improve several aspects of this legislation. At the same time, it is

critical to avoid proposals that would undermine rather than enhance the national security review process.

In particular, efforts should continue to avoid proposals that would overwhelm the process by expanding its scope beyond national security, effectively downgrade the use of sensitive, classified, and business confidential information to per se judgments on mandatory tests, politicize the process, or chill foreign investment.

Congressman Stearns, Mr. Chairman, you had asked one question about the possibility of rotation of the chairmanship of CFIUS, and I did want to respond to that in my opening statement in the time remaining.

And it is to point out as we look at it, the chair of the CFIUS process serves basically a secretariat function. And it is designed to allow each of the agencies that serves on the CFIUS committee to make individual contributions to the review process. Indeed, one of the areas where perhaps we can go to what you were emphasizing, that is the role of particular agencies, is with assurance agreements and mitigation agreements, which are often entered into by the chair or the vice chair. However, it is structured and can point to a particular member of the committee to follow a particular transaction making particular use of the expertise of that agency in the sense that that agency may best be able to follow a particular transaction.

We are basically agnostic with regards to the chairmanship. We think the chairmanship with Treasury has worked just fine. But again, I point out as we read it, it is basically a secretariat function as opposed to a function that actually decides the outcome of the review process.

With that comment, let me conclude my opening comments and say that I very much appreciate the opportunity to appear before the committee, and I look forward to your questions. Thank you.

MR. STEARNS. Thank you.

[The prepared statement of Calman J. Cohen follows:]

PREPARED STATEMENT OF CALMAN J. COHEN, PRESIDENT, EMERGENCY COMMITTEE O
AMERICAN TRADE

- The United States' national security is strengthened by promoting a vibrant economy and economic growth here at home and abroad, which in turn are fostered by foreign investment into the United States, as well as U.S. investment abroad. Foreign investment inflows into the United States are a major source of U.S. economic growth, as is U.S. investment abroad. Continued foreign investment in the United States and its corollary, U.S. investment abroad, require policies that support and protect foreign investment.
- CFIUS plays an important role in ensuring that the United States continues to welcome investment and its reform makes sense to ensure a credible, objective and strong process focused on national security. ECAT and several other major business associations have laid out a number of key principles that need to be achieved through the CFIUS reform process.

- In particular, reform must ensure that limited CFIUS resources are directed at potential transactions that raise national security issues, rather than diverting resources to mandatory investigations, regardless of any national security nexus. It must also consider potential changes to the U.S. national security review process in light of how such an altered process would impact U.S. investors abroad if similar changes were adopted by foreign governments.
- Overall, H.R. 5337 would establish a strong framework for CFIUS to review, make decisions and notify Congress on the national security implications of foreign investments in a way that emphasizes an objective, timely and fact-based process that promotes national security objectives, while promoting continued support for investment here in the United States.
- Improvements are possible in a few areas, but efforts must be made to avoid proposals that would overwhelm the CFIUS process; effectively downgrade the use of sensitive, classified and business confidential through per se judgments, politicize the process or chill foreign investment.

Mr. Chairman, Congresswoman Schakowsky, Members of the Committee, I welcome the opportunity to appear before you today to express support for H.R. 5337, the Reform of National Security Reviews of Foreign Direct Investments Act, of 2006, on behalf of the Emergency Committee for American Trade (ECAT). ECAT is an association of the chief executives of major American companies with global operations who represent all principal sectors of the U.S. economy. ECAT was founded more than three decades ago to promote economic growth through expansionary trade and investment policies. Today, the annual sales of ECAT companies total nearly \$2.4 trillion, and the companies employ approximately five and a half million persons.

Global Investment and U.S. National Security

All too often, the recent debate over the effort to reform the foreign investment review process of the Committee on Foreign Investment in the United States (CFIUS) poses a false choice – the choice between preserving national security and welcoming foreign investment. In fact, the United States’ national security is strengthened by promoting a vibrant economy and economic growth here at home and abroad, which in turn are fostered by foreign investment into the United States, as well as U.S. investment abroad.

Foreign investment inflows into the United States are a major source of U.S. economic growth. Foreign investment in the United States promotes U.S. exports, economic and employment opportunities and productivity. Based on the most recent data from the Bureau of Economic Analysis, majority-owned U.S. affiliates of foreign companies with operations in the United States employed 5.4 million U.S. workers, accounting for nearly five percent of total U.S. employment in private industries.

U.S. foreign investment outflows are also critically important to supporting growth in the U.S. and global economies. Over the past 20 years, U.S. companies that invest abroad have:

- exported more (accounting for one-half to three-quarters of all U.S. exports)
- expended more on U.S. research and development and physical capital investments, and
- paid their U.S. workers more

than companies not engaged globally. Foreign affiliate sales of U.S. companies invested abroad amount to approximately \$2 trillion, which help to support jobs and business activities in the United States. More than 70 percent of the profits earned by such affiliates are returned to the United States. Moreover, U.S. investment abroad is essential to supporting access to natural resources, as well as the economic growth in foreign

countries that is very important, albeit not sufficient, to support stability overseas. In short, U.S. foreign investment is critical for supporting U.S. economic growth and a higher standard of living here in the United States and abroad.

Continued foreign investment in the United States and its corollary, U.S. investment abroad, require policies that support and protect foreign investment.

Importance of a Strong, Credible, Objective and National-Security-Focused Review Process

CFIUS plays an important role in ensuring that the United States continues to welcome investment, and its reform makes sense to ensure a credible, objective and strong process focused on national security. As enunciated by ECAT and several other leading business organizations in March 2006, there are a number of key principles to maintain in reforming and improving the CFIUS process, including ensuring that the national security review process is:

- Objective, fact-based and analytically rigorous.
- Focused on national security issues.
- Promoting the full use of sensitive and classified information, while protecting the confidential information of the parties from public disclosure.
- Operating on a case-by-case basis and remaining sufficiently flexible to cover new national security issues as they arise.
- Operating in a timely manner.
- Not a substitute for other more targeted and effective tools to protect U.S. national security.

I would like to highlight two key issues. The first is the need to ensure that limited CFIUS resources are directed at potential transactions that raise national security issues. To do otherwise, could overwhelm the CFIUS process, diverting resources from the transactions that require the most attention. Requiring mandatory investigations of certain types of transactions, regardless of any potential national security issues raised, simply does not guarantee greater protection for national security; in fact it may lead to the opposite result.

The second is to consider potential changes to the U.S. national security review process in light of how such an altered process would impact U.S. investors abroad if similar changes were adopted by foreign governments. Indeed, foreign governments are very closely monitoring Congressional action on CFIUS. Changes that would politicize the process or move beyond a national-security-focused review may encourage other countries to adopt similar provisions and deny U.S. companies access to key investment areas that are important for our economy, from resources to infrastructure to key service sectors.

The full set of principles is appended to my testimony.

H.R. 5337 Makes Important Reforms to Improve the CFIUS Process

ECAT believes that H.R. 5337 makes important improvements to the CFIUS process in ways that reflect the principles described above. In particular, H.R. 5337 would:

- Strengthen the CFIUS process and enhance its credibility by providing greater clarity to its role and operation.
- Improve the integrity of the process by ensuring intelligence and other information is fully considered.
- Enhance the role of the Director of National Intelligence and the ability of CFIUS to review intelligence reports.
- Improve CFIUS' oversight by requiring reviews and monitoring of mitigation and assurance agreements, as well as of transactions for which notice has been

withdrawn, and reconsideration of transactions where there has been a breach of the mitigation agreement.

- Ensure time-limited, fact-based and objective reviews of notified transactions.
- Improve the protection of confidential and proprietary information.
- Enhance the Congressional notification system.

Overall, H.R. 5337 would establish a strong framework for CFIUS to review, make decisions and notify Congress on the national security implications of foreign investments. ECAT welcomes the work of all of the bill's sponsors in carefully crafting this legislation in a way that emphasizes an objective, timely and fact-based process that promotes national security objectives, while promoting continued support for investment here in the United States. In so doing, H.R. 5337 would support the open investment climate that the United States has long fostered and set a positive example for foreign governments that have or may institute their own investment reviews, which is important for U.S. companies that invest abroad to the benefit of the United States.

Improvements are always possible in any piece of legislation. To that end, ECAT welcomes the work done by the Committee on Financial Services to improve several aspects of this legislation and looks forward to working with you and your colleagues in the House and the Senate in support of the strongest possible legislation. Areas where additional work could be beneficial include:

- Enhancing the case-by-case analysis, rather than requiring mandatory investigations for certain types of acquisitions. Alternatively, where investigations are mandated, it should be clarified that the investigation should begin immediately and not wait for a distinct review process.
- Avoiding transaction-by-transaction notifications that could lead to the potential politicization and undermining of the process.

As Congress' review continues, ECAT is concerned by a variety of other CFIUS reform proposals that would set back, rather than advance, the reform effort represented by H.R. 5337. Therefore, ECAT urges that potential modifications to this legislation maintain the key improvements incorporated by the bill's sponsors and avoid proposals that would:

- *Overwhelm the CFIUS process.* In particular, proposals that would drastically alter or expand the scope of mandatory CFIUS investigations, regardless of a national security nexus, should be avoided. Subjecting significant numbers of transactions to review and investigation would not only waste valuable government resources, it would take away the valuable time of government agencies to focus on the actual transactions that have potential national security implications.
- *Effectively downgrade the use of sensitive, classified and business confidential information* in the review process through *per se* judgments based, for example, on nationality or the views of persons without sufficient access or ability to review such information.
- *Politicize the process*, which potentially would subject U.S. investors overseas to subjective, politicized investment review processes, resulting in the denial of U.S. investments that promote stability, economic growth and access to critical resources and infrastructure - harming thereby U.S. national security.
- *Chill foreign investment* in the United States and deny, as a result, significant economic opportunities to Americans who benefit substantially from foreign investment in the United States.

Conclusion

I welcome the opportunity to present the views of ECAT today with regard to the national security investment review process and, in particular, the reforms made by H.R. 5337. I look forward to your questions.

BUSINESS ROUNDTABLE
COALITION OF SERVICE INDUSTRIES
EMERGENCY COMMITTEE FOR AMERICAN TRADE
NATIONAL ASSOCIATION OF MANUFACTURERS
NATIONAL FOREIGN TRADE COUNCIL
ORGANIZATION FOR INTERNATIONAL INVESTMENT
U.S. CHAMBER OF COMMERCE
UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

PRINCIPLES TO GUIDE NATIONAL SECURITY REVIEWS
OF FOREIGN INVESTMENT

March 13, 2006

Presidential authority to review foreign acquisitions in the United States, authorized by section 721 of the Defense Production Act (the so-called Exon-Florio amendment), represents an extremely important tool to protect U.S. national security. It provides wide authority to the President to investigate foreign acquisitions, authority delegated to the Committee on Foreign Investment in the United States (CFIUS), and to suspend or prohibit foreign acquisitions of U.S. companies where the foreign entity might take action that threatens U.S. national security.

Numerous proposals have been made to modify the U.S. national security investment review process. We recognize the desire of many in Congress to improve the process. It is critical, however, that the strengths of the current process and other U.S. national security priorities not be undermined through hasty and ill-conceived reform efforts. As the Administration and Congress consider proposals to reform the Exon-Florio structure, we urge that the following principles be used as a guidepost to evaluate all proposals.

Principle 1: It is appropriate for foreign investment in the United States that might affect U.S. national security to be subject to special review by the President and Executive Branch government agencies that are designated. The current Executive Branch national security review process, chaired by Treasury, represents an appropriate mix of security, diplomatic, trade and investment agencies, which is critical to ensure that governmental officials with needed expertise can examine the potential implications of proposed acquisitions and require appropriate special conditions as needed.

Principle 2: The national security investment review process must be objective, fact-based and analytically rigorous. These attributes are critical to ensure that national security interests are fully and properly protected – the ultimate purpose of the review process. The review process must include advice of government agency experts in the relevant fields. Confidence in the national security investment review process will not be strengthened by proposals that undermine the objectivity of the current process. Furthermore, altering the basic objective process will encourage other countries to impose unjustified and unreasonable barriers to U.S. investments abroad – investments that support economic growth and access to resources and, in turn, U.S. national security. Such a result would harm U.S. economic and job growth and national security interests.

Principle 3: The national security investment review process must be focused on national security issues. “National security” is a broad and flexible term that places no

limits on the examination of relevant transactions. It may be counterproductive to redefine the scope of the investment review process, which actually could limit the issues that the U.S. government can review. It may also encourage other countries to adopt similar provisions and deny U.S. companies access to key investment areas that are important for our economy, from resources to infrastructure to key service sectors.

Principle 4: The national security investment review process must promote the full use of sensitive and classified information, including protecting the confidential information of the parties from public disclosure. The ability of the U.S. government to review fully and make accurate assessments of the national security implications of foreign acquisitions requires in many, if not all, cases, reliance on sensitive, classified and confidential business information. The ability of the U.S. government to continue to make the most effective use of such information must not be undermined by requiring public disclosure of sensitive, classified or confidential business information.

Principle 5: The national security investment review process must operate on a case-by-case basis and be sufficiently flexible to cover new national security issues as they arise. Given the complexity and changing nature of national security issues, it would be counterproductive to establish a process to promote uniform outcomes in all investigations and reviews. Analyses should be focused on the facts of a particular transaction and not be focused on fitting transactions in a particular box with a pre-determined outcome. In the same way, it is also important for the President to maintain sufficient flexibility to deal with changing national security concerns.

Principle 6: The national security investment review process must operate in a timely manner. The United States is a major destination for foreign investment that is vital to promoting productivity, employment and growth in the United States. Given that most foreign investments do not affect in any way U.S. national security interests, it is very strongly in the U.S. interest to continue to maintain a time-limited process whereby initial decisions can be made with further review available where warranted.

Principle 7: The national security investment review process must not become a substitute for other more targeted and effective tools to protect U.S. national security. While an important tool, the national security investment review process is by no means the only, or even primary, tool of the U.S. government in ensuring national security. For example, the Department of Defense administers an extensive industrial security program designed specifically to protect assets critical to the U.S. defense infrastructure. There are also specific programs already in place to protect the security of our ports. The Coast Guard, U.S. Customs and Border Protection and other units of the U.S. Department of Homeland Security run security at our nation's ports and already require all companies, domestic or foreign, to abide by security and other regulations. The U.S. Government should use the most effective tool to address specific national security concerns.

MR. STEARNS. Mr. Holtz-Eakin.

MR. HOLTZ-EAKIN. Thank you, Mr. Chairman, Ranking Member. I appreciate the chance to be here to talk about the CFIUS process and reform in H.R. 5337. In doing so, I do have a written statement I would like to submit for the record.

MR. STEARNS. So ordered.

MR. HOLTZ-EAKIN. I want to make clear these views are my own. The Council does not take a position on pending legislation. I really want to make just a couple of main points about H.R. 5337, which is a good bill, and certainly the best under consideration in Congress, in my view.

The first is to emphasize that the bill is consistent with the notion that national security and economic progress go hand in hand and are not at odds with one another. Certainly business transactions require a secure environment in order to take place, and there are vivid examples of the contrary around the globe. And also, it is essential to have well functioning capital markets to do the kinds of investment risk sharing and otherwise promote economic growth that the United States has experienced.

The U.S. stands out among developed countries for its prowess in choosing economic investments that is the route to our superior productivity growth that as the result is a foundation of our ability to meet all of the national security needs in the future, the large military demands on our economy, as well as the private-sector and peacetime demands. So those go hand in hand.

As a result, the second main point is that there are pitfalls in reforming the CFIUS process. Among them would be an overly broad scope using definitions which were imprecise; economic security stands out, and automatic homeland security definition which includes critical infrastructure which are wasteful or overly intrusive. These would have both brought security consequences. There would be time spent on reviews that were unnecessary. And the possibility would increase that a genuine security chance would be missed, and it would appear to the other countries that the United States had invoked a procedure of investment screening, something that we have a long history of opposing in international transactions and that would open the door to retaliation by other countries with direct impacts on U.S. interests and damage to our overall economic performance.

Another pitfall that stands out would be politicalization of the reviews. Keeping politics out, doing it in an open and fact-based fashion, focused on national security, I think, is imperative.

Those two points, notwithstanding, we do need something like CFIUS, and reform of CFIUS is necessary.

There will be those transactions, which, while financially advantageous, are not desirable from a security point of view. It is important to have a process that identifies and carves those out in a targeted fashion and certainly the track record of CFIUS, while it might be superb on the substance, fails miserably on transparency on communication with the Congress, and as a result, the ability of Congress to properly exercise its oversight responsibilities.

I think it is also desirable to improve the continuity in the CFIUS process, in particular the expertise in tracking of mitigation agreements which might have been agreed to in the past. So there is certainly an

opening here for improvements on the part of the Congress in the CFIUS process.

I think this committee is to be commended for taking up the issue. And I think the bill, as it stands, has much improved reporting and monitoring of the security agreements. It has a clear designation of CFIUS, which I understand is an area of concern, but which does, in fact, make this more transparent to investors around the globe, which I think is desirable. I think it also retains some desirable aspects to the process. The voluntary nature of filings is important in keeping the workload appropriately balanced, and also the timelines remain tight and will not interfere with commercial transactions.

I also want to close in responding to the specific questions that were raised about the chairmanship and Homeland Security as the vice chair. I would concur with Mr. Cohen in being relatively agnostic about the importance of the chairman designation, given that it is largely convening power in the way it actually functions, with the single caveat that the bill itself now requires sign-off by the chair and vice chair and that elevates the importance of who is the chair, and I think that is important to recognize.

Regarding Homeland Security, I think the bill has it right when it talks about Homeland Security and critical infrastructure when it emphasizes the national security implications of any transactions involving those. National security should be the focus, not Homeland Security per se, and in designation of Homeland Security as the vice chair changes the focus, then I think that would be an undesirable move. And I want to close with that.

Thank you for the opportunity for being here today.

[The prepared statement of Douglas Holtz-Eakin follows:]

PREPARED STATEMENT OF DOUGLAS HOLTZ-EAKIN, DIRECTOR, MAURICE R. GREENBERG
CENTER FOR GEOECONOMIC STUDIES, COUNCIL ON FOREIGN RELATIONS

Chairman Sterns, Ranking Member Schakowsky, thank you for the opportunity to participate in this hearing on H.R. 5337, the "Reform of National Security Reviews of Foreign Direct Investments Act." H.R. 5337 would establish in statute the Committee on Foreign Investment in the United States and establish procedures "to ensure national security while promoting foreign investment." In my remarks, I want to make clear that I am speaking for myself; the Council on Foreign Relations is a non-partisan think tank that does not take positions on issues.

The Economic and Global Power of the United States

Among developed economies, the United States has performed uniquely well in the past decade. The key characteristic of this outstanding growth has been a post-1995 acceleration in U.S. productivity – that summary measure indicates the ability of an economy to produce the same goods more cheaply, generate a greater standard of living than in the past from the same people, factories, and equipment, and to use innovation to produce different and higher-quality goods than in the past. In short, productivity is the

single-best summary measure of the overall long-term performance of an economy and the United States stands out in recent years.

One ingredient in this recipe for success has been openness to global trade in goods, services, and capital. There is a growing body of economic research that documents the beneficial dynamics of open trade. For example, those firms that are engaged in global markets are more productive than their domestically-oriented counterparts.

An example of the dynamic benefits of open trade is in information technology hardware. As noted, the United States experienced a surge in productivity growth after 1995 (and perhaps again recently). A substantial factor was the increasing sophistication of IT hardware. One version of this story credits clever engineers in the selfless pursuit of Moore's law. But it is also the case that IT hardware is among the most global and competitive industries, and global markets reward entrepreneurial zeal as much as engineering skills. Moreover, policy supported these dynamics. The Declaration on Trade in Information Technology Products (ITA) from the 1996 Singapore Ministerial Conference was the foundation for reduced barriers to trade in IT hardware.

A related strength of the United States is its sophisticated, deep, and specialized financial markets. Financial markets are the central nervous system of a market economy, serving to collect and transmit important information, guide capital to its most productive use, and enhance the overall coordination of firms, households, and governments.

One particular aspect of executing these functions is financing mergers and acquisitions (M&A). These transactions generate economic value. The bids by new owners raise the overall return to existing shareholders, generating additional capital market funds. At the same time, new ownership can bid more as a result of replacing ineffective management, taking advantage of beneficial complementarities ("synergies") with their existing business model, or otherwise raising the productivity of the purchased firms' capital, technologies, and labor skills. In short, the new firm is more productive than the old – in this way, mergers and acquisitions are one manifestation of the role of competitive financial markets in efficiently allocating national capital.

As capital markets have become global in scope, so has M&A (along with "greenfield" investments by U.S. firms abroad and overseas investors in the United States). Currently, U.S. subsidiaries of companies based outside the United States have over 5 million employees and pay compensation of over \$300 billion each year, or about \$60,000 per employee. The vast bulk of these investments have come from countries belonging to the Organization for Economic Cooperation and Development (OECD, over 90 percent) and a small minority is undertaken by firms with government control (2 percent).

In short, a strong economy is part of national security and open, global capital markets are a cornerstone of our strong economic future. Nevertheless, despite the fact that few cross-border transactions show risk of affecting security directly and few are undertaken by firms with government control, those situations do arise (and have arisen) in which security considerations overwhelm the financial desirability of a particular transaction. Thus, to meet overall objectives, it is essential to pair policies that support well-functioning, open capital markets with specific carve-outs for transactions that pose a security threat.

Reform of CFIUS

The topic of today's hearing is reform of the Committee on Foreign Investment in the United States (CFIUS) and the process by which it accomplishes these needed carve-outs. As the Congress considers revisions to the CFIUS process, it is important to recognize that the current system has served the United States very well. To date, CFIUS has to a great extent simultaneously supported national security and economic growth. Thus, there would appear to be little merit in a wholesale rethinking of the CFIUS

process. Nevertheless, some improvements are possible; by what criteria should proposed changes be judged?

A Targeted Process. First, CFIUS should be a targeted process to identify those transactions that generate a legitimate national security concern without excessive and wasteful scrutiny of routine transactions.

An important aspect of achieving this objective is preserving the voluntary nature of CFIUS filings. At present, participants to transactions have excellent incentives to seek CFIUS clearance: a safe harbor from future security scrutiny, mitigation or divestiture. This system avoids wasteful reviews of routine transactions and targets CFIUS efforts on achieving satisfactory reviews and investigations of problematic transactions. H.R. 5337 preserves this system.

Predictability. Second, the CFIUS process should be predictable. That is, it would be transparent to market participants which transactions would merit scrutiny and review and how the security impact of the transaction would be evaluated.

H.R. 5337 makes some improvements to the CFIUS process in this regard. It clarifies the “rules of the road” by making clear that if a transaction involves a foreign-government controlled firm, the transaction must be subjected to the investigation process. In addition, an investigation period may be extended by two-thirds vote of CFIUS, requires the signature of the Chair and Vice-Chair on decisions, and provides support for CFIUS by other agencies.

The transparency of the process is improved by designating in statute CFIUS member agencies and improving the nature and regularity of reporting to Congress. One issue that arises in this regard is the organization of CFIUS in H.R. 5337, particularly the designation of Treasury as the Chair and Homeland Security as the Vice-Chair.

With regard to the former, the contention is sometimes made that a “security” agency should lead CFIUS; a reciprocal concern being that with Treasury as the Chair the process may have a commercial bias at the expense of national security. This concern strikes me as misplaced. Treasury is a member of the National Security Council, takes a lead role in the battle against terrorism, and otherwise has functions that mirror those of traditional security agencies. Moreover, in practice the role of the CFIUS Chair has largely been organizational and not operational. To the extent that Congress chose not to designate Treasury as Chair, it may be desirable to rotate the convening power among selected agencies. This strikes me as having a small cost in transparency, but one that Congress may deem to be acceptable.

H.R. 5337 also designates Homeland Security to be the Vice-Chair of CFIUS, which raises the larger issue of the role of homeland security in national security reviews. A danger is setting a standard for national security that is either overly broad or indistinct. For example, drawing into the standard “critical infrastructure” as embodied in homeland security objectives could potentially include all transactions in the food supply chain. Similarly, definitions that include “economic security” are too broad and likely to generate uncertainty regarding investments. H.R. 5337 requires CFIUS to consider whether a transaction has a security-related impact on critical infrastructure, a specification that retains the correct focus – *a security-related impact*, not critical infrastructure *per se*.

Put differently, I believe that homeland security should be seen as an integral part of the traditional focus on national security and not as a separate, new, or elevated consideration. From this perspective, the Department of Homeland Security has operational roles that contribute to national security. The Congress may wish to consider whether those roles are sufficiently broad and important to designate Homeland Security as the standing Vice-Chair of CFIUS.

Confidentiality. A third criterion is that process would provide a high degree of confidentiality to secure proprietary business information and national security considerations. H.R. 5337 seeks an appropriate balance between the duty for

congressional oversight and the importance of confidentiality and streamlined transactions.

Flexibility. Fourth, the process should be flexible, providing arrangements that permit means to augment security or otherwise satisfy these criteria as part of the transaction itself. H.R. 5337 retains such flexibility by permitting CFIUS to negotiate mitigation agreements flexibly with firms involved in a covered transaction. The bill also makes improvements that may serve to build expertise and continuity of staff in this important area, by establishing tracking compliance with mitigation agreements that will accumulate knowledge of successful and unsuccessful approaches and by directing \$10 million to CFIUS in the next few years. This may prove crucial as press reports indicate that the fraction of Treasury time and personnel devoted to the CFIUS process has risen dramatically recently.

Timeliness. The final criterion is that the CFIUS process should be as timely as possible. Many observers have expressed support for the current timetables, particularly the ability to coordinate with (Hart-Scott-Rodino) anti-trust reviews. H.R. 5337 retains the 30-day review period, but also properly draws into the CFIUS process information from the Director of National Intelligence. It also mandates a 45-day investigation for all foreign-government controlled transactions, regardless of whether a genuine security risk is present. These features may require more time, but it is desirable to keep mandated extensions to the existing timetables a limited as possible.

Larger Issues

Looking past narrow evaluation of H.R. 5337, the topic of CFIUS reform legislation raises the potential for concern. Over time, administrations of both political parties have helped to establish a global rules-based system for open investment and free trade. This approach has supported U.S. economic success. This success is put at risk if new procedures are unclear, viewed as overly politicized or unnecessarily discriminate against foreign investment. Procedures of this sort would in themselves worsen the favorable investment climate. An even more problematic outcome would occur if other countries chose policies that provided reciprocal discriminatory treatment against U.S. firms.

In this regard, three areas merit attention. First, it is useful to retain a targeted and clear definition of those transactions covered by CFIUS, and to focus on operational control of new technologies or sensitive locations. As noted earlier, definitions that include more vague references to “economic security” or those that include an overly-inclusive concept of “critical infrastructure” would likely be detrimental.

Second, it is useful to keep review and investigation times to the minimum necessary to determine the evidence of a genuine national security threat.

Third, it is important to avoid introducing overt political considerations into the process. Indeed, a threshold consideration is the degree to which it is desirable to legislate aspects of the policy at all. CFIUS has been successful in part because it was appropriately an administrative procedure. The greater the extent of legislated review, report, or decision-making, the greater the possibility of detrimental consequences. H.R. 5337 contains detailed reporting requirements on both specific covered transactions and CFIUS reviews in general. While not troubling, a further extension of these provisions raises concerns over politicization and confidentiality.

Any lingering perception of politically-driven reviews raises the danger that other countries will use recent events in the United States as pretext for protectionist rules draped in the guise of national security. For example, press reports indicate that China will tighten screening of deals and impose new curbs on foreign acquisitions – setting up a ministry-level committee to review controlling stakes in strategic industries including steel and the manufacturing of equipment for shipbuilding and power generation. Any broader, global trend of this type would directly hurt U.S. investments abroad.

Conclusion

Mr. Chairman, as CFIUS reform is considered by Congress, it is important to recognize that it is possible to provide open global markets, strong economic growth, and national security. For the most part, these go hand in hand. For example, the Congressional Budget Office projects that over the next decade and one-half, current defense plans will require spending an average of \$500 billion (adjusted for inflation), a peak increase of roughly 20 percent over current levels (adjusted for inflation) and above the peak of Cold War spending. Despite this rise, these plans would result in defense spending constituting less than 2.5 percent of Gross Domestic Product, well below the postwar peak of 9.5 percent in 1968.¹ A key aspect of national security is an economy that grows strongly enough to continue to meet the resource demands in the private sector, social objectives, and our military and other national security needs.

In those narrow areas where potential tradeoffs between economic growth and national security arise, a transparent, targeted, disciplined, and confidential process to augment economic transactions with security dimensions will serve the United States well.

Thank you for the opportunity to appear before the Subcommittee. I look forward to your questions.

MR. STEARNS. Mr. Mulloy. Welcome.

MR. MULLOY. Mr. Chairman--

MR. STEARNS. You just need to turn your mic on.

MR. MULLOY. Chairman Stearns, Ranking Member Schakowsky, I appreciate being invited here to testify.

My name is Patrick Mulloy, and I am a member of the U.S.-China Economic and Security Review Commission, and have been since the Commission was created by the Congress in the year 2000.

I also teach international trade law and public international law as an adjunct professor at George Mason Law School and at Catholic University Law School, and I also serve as the Washington representative of the Alfred P. Sloan Foundation.

During the period of 1987 and 1988, when the Congress was considering the Exon-Florio law, I served as General Counsel of the Senate Banking Committee that was involved in every step of the process in which we put that provision into the law. I also was very much involved in crafting the 1992 changes that were put into the law in 1992 requiring mandatory investigations when there is a government-owned foreign corporation, making the purchase and also putting the intelligence requirement that you have to have these intelligence studies done as to who is buying what and what patterns of acquisitions are being made in this country by foreign governments.

I want to note, Mr. Chairman, that while a member of the U.S.-China Economic and Security Review Commission, I am not testifying on behalf of the Commission. I have put into my testimony

¹ See *The Long-Term Implications of Current Defense Plans and Alternatives: Summary Update for Fiscal Year 2006*, Congressional Budget Office, 2005.

recommendations that the Commission has made unanimously in its 2004 report, and by a vote of 11-1, in its 2005 report about how we should reform the CFIUS.

Let me make some general points right off the bat.

The Founding Fathers, in Article 1, section 8 of the Constitution, gave the Congress the power to regulate foreign commerce and foreign investment. Not the executive branch. In Exon-Florio, the Congress gave the executive branch some of its authority and then wanted to be able to do oversight of how that authority was being carried out. The Treasury Department, in my view, and the way it has chaired the CFIUS, has not provided any criteria as to how this grant of authority from the Congress is being used.

Secondly, foreign acquisitions are the other side of your current account deficit. When we are running massive trade deficits, and this year our trade deficit current account will be about \$900 billion, when you have that happening, foreigners have a lot of dollars. They can buy your goods which you are not doing or they can buy our assets. They are coming and they are buying our assets. That is some part of the foreign investment issue. Warren Buffett has said we are like the rich family living on the hill selling off parts of our estate to support a lifestyle we are no longer earning.

That is part of the foreign investment. We are selling off assets to support a lifestyle we are no longer earning.

Now, the issue is what do you favor in foreign investment. I don't think that is the real issue. The real issue is everything in the country is up for sale. I think Congress, when it passed Exon-Florio, said no, everything in the country is not up for sale, and they established a process by which you could review who is buying what in this country. What we have to understand, too, is that other governments, particularly Asian governments, the Chinese government, the Japanese government, Korean governments, they are much more involved with their companies in directing as to what are important technologies for their companies to build for their future prosperity. Dr. Allan Bromley, President Bush's first Science Adviser, warned policymakers in 1991, quote, "Our technology base can be nibbled from us through a coherent plan of purchasing entrepreneurial countries." In 1992, we in the Banking Committee, under Senators Sarbanes and Connie Mack of Florida, did some hearings to oversee how Treasury was handling the Exon-Florio responsibilities. The head of SemiTech, which was the joint government industry consortium, made sure that we had some leadership ability in semiconductors because they are so important to the national security.

Mr. Peter Mills of SemiTech, said "Foreign interests have targeted key U.S. technologies and the present CFIUS process or its

implementation is ineffective in preventing such transaction.” Mr. Mills also said you have to be aware of the “cumulative effect of multiple foreign purchases of U.S. companies.” That is exactly why we put into the law in 1992 the idea that the intelligence communities should be getting information to understand patterns of acquisitions in this country.

The Treasury Department did one such report and despite mandating the law to do these every 4 years, they were never done it again, leaving you and leaving policymakers blind as to these patterns of acquisitions.

In my testimony, I explain how the Treasury Department has mismanaged the CFIUS process. First, Treasury opposed the enactment of Exon-Florio in 1988. They were going to veto the whole trade bill over it, and we worked out a compromise. They did not want the Commerce Department chairing the CFIUS as this committee originally reported it. You guys and the Senate Commerce Committee both had commerce chairing the CFIUS process. The Treasury Department opposed that and got the Congress to be neutral in the law it passed. And then they got the executive order putting the chairmanship in the Treasury Department.

They have also ignored specific statutory mandates that the Congress put into law in 1992. And they were caught clear in the Dubai Ports deal. That should have been--it was a government-owned corporation. It should have been reviewed and it wasn't. And that revealed, and I think Chairman Barton spoke about the CNOOC. This committee, I think, passed legislation to prevent CNOOC from taking over Unocal. I think that suggested that you guys had no confidence in how the executive branch was carrying out its CFIUS responsibilities.

Now, very specific recommendations on H.R. 5337, but if I could just take the time now, Mr. Chairman, to make one point. I point out that CFIUS reviews are effectively completed before the parties to the transaction even file for the review. This is, let me quote, there has been a practice that has developed whereby in the words of one knowledgeable private-sector lawyer, and this was in a George Mason University Law School publication, this lawyer had laid out how this process really works. She said “in the vast majority of cases, the parties reach an agreement with the interested agency before notice is filed with the CFIUS committee. Before you even start the 30-day clock, they have already worked this out, and that is just a cover.” So what that means is that the Congress doesn't get any reporting on the criteria and the judgments that are being made as to how our national security is being protected.

I want to note, Mr. Chairman, that I have no claims on any of this. I am speaking only from my experience, and as a matter of public interest,

and I think this needs a thorough scrubbing. I have made very specific recommendations in my full testimony. I ask that be included.

MR. STEARNS. By unanimous consent. So ordered.

[The prepared statement of Hon. Patrick A. Mulloy follows:]

PREPARED STATEMENT OF THE HON. PATRICK A. MULLOY, COMMISSIONER, UNITED STATES-CHINA ECONOMICS AND SECURITY REVIEW COMMISSION

Introduction

Mr. Chairman, Ranking Member Schakowsky, and Members of the Committee, thank you for providing me with this opportunity to speak before you today on this crucial issue.

My name is Patrick Mulloy and I have been a member of the twelve member bipartisan, bicameral United States-China Economic and Security Review Commission since it was established by the Congress in the year 2000. The Commission's charge from the Congress is, among other things, to examine the "national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China". I also teach International Trade Law and Public International Law as an Adjunct Professor at the Law Schools of Catholic University and George Mason University and serve as the Washington representative of the Alfred P. Sloan Foundation.

During the period of 1987-1988, when the Exon-Florio Provision was being considered by the Congress, I served as the Senate Banking Committee's General Counsel and was directly involved in the negotiations which led to its enactment.

I should note that, while a member of the U.S. China Economic and Security Review Commission, I am not testifying on its behalf and the views I present will be my own. I will, however, set forth the two recommendations the Commission adopted unanimously in its 2004 Report on the Exon-Florio/CFIUS matter which is the subject of today's hearing, and the four recommendations it adopted in its 2005 report by a vote of eleven to one.

CFIUS Established in 1975

The Committee on Foreign Investment in the United States (CFIUS) was not established by the Exon-Florio Provision in the Omnibus Trade Bill of 1988. The CFIUS, rather, was established some years earlier on May, 1975 by President Ford in Executive Order 11858. That order, which created CFIUS and made the Secretary of the Treasury its Chairman, charged the Committee to "have the primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy in such investment."

While the Treasury Secretary was given the Chairmanship of CFIUS, the Executive Order also gave the Department of Commerce a key role, charging it, among other things, to submit "appropriate reports, analyses, data and recommendations relating to foreign investment in the United States, including recommendations as to how information on foreign investment can be kept current."

In 1975, there were concerns about the fact that, because of the establishment of OPEC and the spike in oil prices in the 1972-1975 period, many oil producing countries suddenly had substantial amounts of money to buy assets in this country and CFIUS was established to help monitor such acquisitions. I had occasion, when I served as an attorney in the Antitrust Division of the Justice Department, to attend some meetings of CFIUS in the 1981-1982 period. One matter in particular I remember is when the Kuwait Petroleum Company wanted to buy the Santa Fe International Company. This raised

concerns within the Executive Branch because apparently Santa Fe had some technologies that U.S. authorities did not want transferred in such a merger. Since the President then lacked the authority given to him by the Exon-Florio Provision in 1988, the Antitrust Division was asked to hold up the merger on antitrust grounds. This was done and I believe an acceptable solution was negotiated by which the Santa Fe Company sold off to a third party some technologies which our government did not want transferred to the Kuwait Petroleum Company.

Enactment of the Exon-Florio Provision

In 1987 the leadership of the Congress, troubled by our nation's rising trade deficit, decided to craft an Omnibus Trade Bill and charged each relevant Committee in the House and Senate to craft different portions of such a bill. Senator Proxmire, then Chairman of the Banking Committee, asked the International Finance Subcommittee, led by Senators Sarbanes and Heinz, to develop the Banking Committee portions of such a bill. Chairman Proxmire asked me as his General Counsel to work closely on the process and to keep him informed of developments. I thus worked closely with Senator Sarbanes and was personally involved in the development of all facets of the Banking Committee's contributions to the Omnibus Bill.

The Banking Committee on May 19, 1987 marked up and ordered to be reported S.1409, the United States Trade Enhancement Act of 1987, which dealt with export controls, trade promotion, exchange rates, third world debt, the Foreign Corrupt Practices Act and better access for U.S. financial institutions to foreign markets. The Committee Report stated:

“The cumulative trade deficits of over \$500 billion, built up by the U.S. since 1982, have made this country the world's largest debtor nation and underscore the need of our economy to compete internationally.”

The bill reported by the Banking Committee did not have any provision giving the President the authority to block certain takeovers of U.S. companies by foreign purchasers. The so-called Exon-Florio provision, which contained that authority, appeared in the bills reported by the Commerce Committee in the Senate, on which Senator Exon served, and the Energy and Commerce Committee in the House, where Congressman Florio served. After the Senate Commerce Committee reported the provision, the Banking Committee appealed to the Parliamentarian that the investment matters covered by its provisions were properly within Banking Committee jurisdiction. The Parliamentarian ruled in favor of the Banking Committee and thus the Banking Committee took the lead on the provision. It worked very closely with Senator Exon and his staff in doing so.

The various portions of the Omnibus Trade Bill, reported by each Senate Committee, were merged into one bill, each Title of which was considered sequentially on the Senate floor during the summer of 1987. The House followed a similar procedure and in fact passed its bill, H.R. 3, first. This was because the trade bill was considered a revenue measure on which the House had to act first. The Senate at the conclusion of its work took up H.R. 3, substituted the text of the Senate bill, and asked for a conference with the House. Senate conferees, appointed to deal with the Exon-Florio Provision were Senators Sarbanes, Dixon and Heinz of the Banking Committee, along with Senators Exon and Danforth of the Commerce Committee.

Section 905 of the House bill provided that the Secretary of Commerce should “determine the effects on national security, essential commerce, and economic welfare of mergers, acquisitions, joint ventures, licensing and takeovers by or with foreign companies which involve U.S. companies engaged in interstate commerce.” It also charged the Secretary of Commerce (not the Treasury Secretary) to determine whether

such takeovers would “threaten to impair national security and essential commerce.” If such a determination were made by the Secretary of Commerce the President would block the transaction unless the President determined there was no threat to “national security and essential Commerce.” The Senate provision was quite similar and said the criterion to block a takeover was “national security or essential commerce that relates to national security”.

The Department of the Treasury, then headed by Secretary Baker, led the Executive Branch opposition to enactment of the Exon-Florio merger review authority. Some contend that both protection of its jurisdiction over investment policy and championing an open investment policy led to Treasury’s opposition. Regardless of the reason, the Administration put the item on its “veto list” and threatened to veto the whole Omnibus Trade bill if the provision stayed in the bill. At that point I was directly involved in negotiations with Treasury officials with the objective of making the provision acceptable to the Administration. I advised the Senators for whom I worked what I had seen regarding the Kuwait Petroleum Company/Santa Fe merger and said it was my belief that the President needed the authority given to him by the Exon-Florio Provision. Our Senators charged us in our staff negotiations to keep the provision but to try to get an agreement acceptable to the Administration.

The Treasury was adamant that the term “essential commerce” had to come out of the bill because it was not clear what that entailed. Conferees agreed to delete those words but added language to the statute and the Conference Report stating that the term “national security” was not to be narrowly interpreted. To make this absolutely clear the statute itself was revised to read:

“The President or the President’s designee may, taking into account the requirements of national security, consider among other factors

- (1) domestic production needed for projected national defense requirements;
- (2) 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; and
- (3) the control of domestic industries and commercial activities by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security”

A decision also was made to put the provision into law under Title VII of the Defense Production Act. This was done to indicate that the Exon-Florio Provision should be interpreted as dealing with the broad industrial base issues addressed by that statute rather than the narrower national security controls associated with export control matters. The Conference Report on the provision states:

“The standard of review in the section is “national security”. The Conferees recognize that the term “national security” is not a defined term in the Defense Production Act. The term “national security” is intended to be interpreted broadly without limitation to particular industries.”

On August 23, 1988 the Exon-Florio Provision, as modified in the Conference, became law as Title VII of the Defense Production Act.

Treasury Charged to Lead New Merger-Review Authority

On December 27, 1988 President Reagan issued Executive Order 12661. That order amended Executive Order 11858 which established the Committee on Foreign Investment in the United States and effectively put the President’s new authority to review and block mergers for national security reasons into the hands of the Treasury-

chaired CFIUS. So the Executive Department that most strongly opposed the blocking authority ended up chairing the Committee charged to implement its provisions. I think that has led to the concerns in Congress and elsewhere about the provision not being implemented as Congress intended.

Because it now had the lead for implementing the statute, the Treasury Department also took the lead in the notice and comment rule-making that developed the regulations under which it would be administered. It took the Treasury Department almost three years until November 21, 1991 to promulgate the final regulations. (56 F.R. 58774-01 (1991)). Those regulations, not the Exon-Florio Provision, established the voluntary system of merger and acquisition notification that has been criticized as inadequate by many.

1992 Oversight Hearing by Banking Committee

On June 4, 1992 the Senate Banking Committee's Subcommittee on International Finance and Monetary Policy, under the leadership of its Chairman, Senator Sarbanes, and Ranking Member Mack, held an oversight hearing on the implementation of the Exon-Florio Provision. In opening that hearing Senator Sarbanes stated:

“Of particular interest this morning are the criteria for review of Exon-Florio cases that have been developed by the Interagency Committee on Foreign Investment in the United States, which has been charged by the President with responsibility for implementing the statutory provision.”

In his opening statement Senator Mack, who also served on the Armed Services Committee, stated:

“My interest this morning is to better understand how the Administration determines the U.S. national security interest through the CFIUS process”.

He then referred to a matter that was then of public concern: the acquisition of the Missile Division of the LTV Aerospace and Defense Company by Thomson-CSF, a French firm controlled by the French Government. Senator Mack said, “We don't want any foreign government to own major U.S. defense contractors.”

In his opening statement, Senator Riegle, the Chairman of the full Banking Committee, in his opening statement said:

“The Administration examines takeovers on an isolated basis and is missing the cumulative impact such takeovers are having on our technology base. The President's science advisor, Dr. Alan Bromley, has voiced concerns about this matter. He warned policymakers that ‘our technology base can be nibbled from under us through a coherent plan of purchasing entrepreneurial companies’.”

Mr. Peter Mills, the first Chief Administrative Officer of SEMATECH, also testified at that June 1992 hearing. SEMATECH was a joint DOD/Industry consortium that was established in the 1980's to ensure our nation maintained the ability to make advanced semiconductor products deemed essential to our national defense needs. In that hearing Mr. Mills voiced his concerns and frustration about the failure of CFIUS to prevent foreign interests from buying U.S. semiconductor equipment and materials suppliers. He told the Committee:

“...foreign interests have targeted key U.S. technologies and the present CFIUS law *or* its implementation is ineffective in preventing these transactions”. [Emphasis added]

He also voiced concerns that CFIUS was not considering the cumulative effect of multiple foreign purchases of U.S. companies and urged that the Chairmanship of CFIUS be moved from the Treasury Department to the Commerce Department.

1992 Amendments to Exon-Florio

Subsequent to that hearing the Congress in 1992 enacted two key changes to Section 721 of the Defense Production Act. First, it put into the law a new provision **requiring** CFIUS to move beyond the basic 30-day review period and conduct a 45-day investigation in any instance in which an entity controlled by or acting on behalf of a foreign government is seeking to acquire of a U.S. entity. It also inserted a provision **requiring** the President and such agencies as the President designates to report to Congress in 1993 and each four years thereafter whether any foreign government has a coordinated strategy to acquire U.S. companies involved in research development or production of critical technologies. Congress also to the statute added additional criteria that it for consideration during reviews of foreign takeovers.

The Treasury Department Has Failed To Implement Congressional Mandates

In 1994 the Administration submitted to the Congress its first report under the required quadrennial report statutory provision of the DPA. It has never submitted another. The 1994 Report stated on page 13:

“Despite examples of government involvement, the working groups did not find credible evidence demonstrating a coordinated strategy on the part of foreign governments to acquire U.S. companies with critical technologies. **The absence of credible evidence demonstrating a coordinated strategy, nevertheless, should not be viewed as conclusive proof that a coordinated strategy does not exist.**”

The Report then went on to say:

“In some cases, however, foreign governments give indirect assistance and guidance to domestic firms acquiring U.S. companies. The main methods of government involvement include:

- extending tax credits to promote foreign M & A activity
- exercising controlling government interest in major firms to influence foreign M & A activity, and
- identifying technologies that are critical to national economic development, and thus prime targets for acquisition through M & A’s.”

After submitting this one report, the Treasury Department, which is charged by Executive Order to implement the requirements of Section 721 of the DPA in which the quadrennial report mandate is placed, has ignored this requirement of law, and no more reports on this most important matter have been submitted to the Congress as required by law. This means neither the CFIUS nor the Congress has the background information Congress wanted both of them to have concerning patterns in takeovers and their cumulative effect.

The Government Accountability Office (GAO) in its September 2005 report on the implementation of Exon-Florio, notes that the statutorily-required 45-day investigation of foreign government purchases of U.S. firms has been stymied by the Treasury’s insistence that any such investigations can be conducted only if, during the 30-day initial review, there is “credible evidence” that the foreign controlling interest may take action to threaten our national security (page 3). This means the Treasury has effectively read the 45-day mandated investigation of foreign government acquisitions of U.S. companies right out of the statute. This is exactly the point on which the Treasury’s ineffective

implementation of Exon-Florio was made so absolutely clear earlier this year in the Dubai Ports transaction.

In addition, GAO on page 3 of its September 2005 Report to this Committee points out that the Treasury Department as Chair of CFIUS has “narrowly defined what constitutes a threat to national security.” The GAO tells us Treasury has “limited the definition to export controlled technologies or items, classified contracts, or specific derogatory intelligence on the foreign company.” This does not reflect the statutory criteria Congress mandated. On page 13 of its report, GAO told us that the Treasury insists that Defense Department concerns about foreign acquisitions of integrated circuits essential to national defense is an industrial policy concern and not a “national security” concern. This flies in the face of the statute and legislative history of the Exon-Florio provision of law that was deliberately placed in the Defense Production Act to indicate Congress *did* want defense industrial base issues considered in Exon-Florio reviews.

The CFIUS Process Needs to be Reformed

I believe a review of the record demonstrates that the Treasury Department opposed the enactment of the Exon-Florio Provision and has sought to stymie its effectiveness ever since it was enacted. It is in a position to do this as it chairs and staffs the Interagency Committee that the President charged to implement the statute. The agency is so wedded to its open investment policy that it leans over backwards to protect that interest over legitimate national security concerns. Awareness of this fact is one reason many Members of Congress had no confidence that the Executive Branch would adequately review the 2005 proposed purchase of Unocal the Chinese National Overseas Oil Company (CNOOC). The Dubai Ports fiasco made the need for reform of the CFIUS process even clearer to all informed observers.

The China Commission, on which I serve, in its 2004 Report to Congress unanimously recommended:

- (1) that Congress explicitly provide in statute that the term “national security” in the Exon-Florio provision includes “national economic security”
- (2) that the chairmanship of CFIUS be transferred from the Treasury Department to the Commerce Department.

In its 2005 Report the Commission by an eleven to one vote recommended:

- (1) the Exon-Florio provision be amended to require CFIUS to provide Congress notice of each proposed transaction CFIUS is requested to approve. In addition, CFIUS should be required to report to Congress on the disposition of each case it considered.
- (2) the Exon-Florio provision should be amended to specifically require CFIUS to consider economic security as well as national security in making decisions.
- (3) Congress urge the President to transfer the chairmanship of CFIUS from the Treasury department to another of its member agencies.
- (4) Congress should amend the Exon-Florio provision to require post-transaction reviews of CFIUS filings that have received full investigations, and that the results of these reviews be provided to Congress.

Under the Constitution, the Congress has the authority to regulate Interstate and Foreign Commerce. Our nation is facing new challenges as we find ourselves in a globalized economy where other countries have clear national strategies on how to compete and raise the standard of living of their people and their national power. We must take such matters into account when administering our open investment policy and ensure we not sacrifice technologies and industries important to our national defense by

taking an ideological approach on open investment. China over the last ten years has run massive and ever increasing trade surpluses with this country. This year alone our bilateral deficit with China will be well over \$200 billion. Its Government has acquired almost one trillion dollars by forcing companies earning dollars to turn them in for yuan. Since China does not buy very many U.S. made goods in comparison with what we buy from China, it can use these dollars earned through trade surpluses to buy important U. S. assets and it is now starting to do so.

Part of the reason we have run these massive trade deficits with China is because that country has for a number of years been engaged in currency manipulation to keep the yuan undervalued against the dollar. This subsidizes Chinese exports here, makes our goods more expensive there, and gives our companies incentives to move operations to China. The 1988 trade bill gave the Treasury Secretary major responsibilities in the exchange rate area. The Treasury is charged to identify currency manipulators and to persuade them, by bilateral negotiations and efforts in the IMF, to halt such practices that are deleterious to the international trading system and unfair to American companies and workers. As this Committee is well aware the Treasury has failed to carry out its responsibilities in that area as well. Its failure there has contributed to Chinese trade surpluses and has helped China accumulate vast amounts of U.S. dollars. We will thus soon see a lot more proposed takeovers of American companies by Chinese companies. We need a serious, functioning, CFIUS process that takes account of our national security interests.

My Views on H.R. 5337

Let me now offer some specific comments on H.R. 5337, the bill to reform the CFIUS/Exon-Florio process that was unanimously reported out of the Financial Services Committee on June 22, 2006. The bill, while it does not remove the Treasury from chairing the CFIUS process as I and the China Commission had previously recommended, does make major improvements in the present law and process. I will not focus my testimony on all the good things this bill does to ensure greater transparency and Congressional oversight to the process, but rather will focus on some matters where I believe improvements to the bill can be made.

First – While H.R. 5337 in its definition of “covered transactions” does apply its provisions to all foreign purchases of U.S. companies, it does not require that the Government receive notice of all such purchases. I believe the Government should have some means of gathering information on every purchase by a foreign person of a U.S. company even if that transaction is not filed for review by CFIUS. I make this point to ensure that our intelligence agencies get information on all purchases of U.S. companies so they can analyze the cumulative impact of various acquisitions of key technologies and examine patterns of foreign acquisitions. Having such analyses from the intelligence agencies can help ensure that our technology base will not, as Dr. Alan Bromley, the first President Bush’s science advisor, warned, “be nibbled from under us through a coherent plan of purchasing entrepreneurial companies.” Section 4(b) of H.R. 5337, which is entitled “Analysis by Director of National Intelligence,” assumes that information on every transaction is available to the intelligence communities. That provision charges the Director to “expeditiously carry out a thorough analysis of any covered transaction” – not just transactions that are filed for review. The Director of National Intelligence cannot carry out this mandate unless information on all foreign purchases of U.S. companies is made available to the intelligence agencies.

Second – I believe the test for moving from a 30-day investigation to 45-day national security investigation is too strict. The bill provides that CFIUS should move from a 30-day review to a 45-day investigation if the review “results in a determination that the transaction threatens to impair the national security and that threat has not been mitigated during or prior to the review of a covered transaction.” I believe the provision

should be modified by substituting “could threaten” for “threatens.” Otherwise the test for commencing an investigation the same test for blocking a transaction after the conclusion of an investigation.

Third – I am concerned that many times CFIUS reviews are effectively completed before the parties to a transaction even start the CFIUS process by filing a written notice of the transaction to the Chairperson of the CFIUS Committee. This is because a practice has developed whereby, in the words of one knowledgeable private sector lawyer, “in the vast majority of cases the parties reach an agreement with the interested agencies before notice is filed with the CFIUS Committee.”¹ This has the effect of making the statutory time frame almost meaningless. It also makes the CFIUS process totally non-transparent and makes it very difficult for Congress to conduct effective oversight of the process. Substantive discussions between the CFIUS agencies and the parties to a proposed transaction should not take place until after the written notice is filed that formally initiates the review process.

Fourth – I support the idea of putting the membership of CFIUS into law. I would not however, as H.R. 5337, section 3, does, include the “Chairman of the Council of Economic Advisors,” the “Director of the Office of Management and Budget,” or “any other designee of the President” in the CFIUS membership. I do not believe the Council or OMB bring much national security expertise to the process. They do bring, in my experience, an ideological commitment to not interfering with market transactions. I also think you do not need the open-ended “any other designee” as that could pave the way for political operatives rather than professional appointees to gain a role in making judgments on important national security matters.

Conclusion

Thank you very much for inviting me to this hearing. I have no clients other than the public interest on this issue and have never been paid by any company or any other party to advise it on CFIUS matters. I am happy to answer any questions.

MR. STEARNS. I will start the questions of my colleagues. Mr. Mulloy, would you say CFIUS, the bill we have now, will improve over existing law?

MR. MULLOY. Yes. In my testimony, I noted that while the bill does not remove Treasury from chairing the process, I do think it makes many improvements in existing law.

MR. STEARNS. And you still would want the Department of Commerce to chair it rather than Treasury?

MR. MULLOY. I think it should be in Congress.

MR. STEARNS. Okay. As you pointed out that the history of this, basically I guess under Gerald Ford, by Executive order, was done in 1975, and then in 1988, or you said 1989 the Senator Exon and Florio passed this. But what I hear from you is that Congress has acceded its responsibility to the executive branch, and that is not good. And so this bill would be a step forward of us going back and under the Constitution doing our responsibility.

¹ Committee on Foreign Investment: The Critical Infrastructure Protection Program. Published by the George Mason University Law School on February 2006. See page 26.

MR. MULLOY. I agree. I think this is a vast improvement over present law. There are four changes in the present law that I have recommended in my testimony, Mr. Chairman.

MR. STEARNS. Mr. Cohen, I think a lot of us who believe in free trade also have some concern about foreign companies owning not just sectors in the aerospace industry or semiconductor industry, but in areas that systematically could undermine our national security.

Do you think the way foreign companies apply today under the CFIUS review, isn't it voluntary?

MR. COHEN. It is indeed.

MR. STEARNS. So what happens if they don't apply? Does the deal automatically not go through or can it go through even if they don't apply.

MR. COHEN. It is a very important question that you ask. It could go through.

MR. STEARNS. Without even them volunteering to?

MR. COHEN. But the important point to make is that the Government has the power to overturn a transaction.

MR. STEARNS. And who is that government?

MR. COHEN. The United States Government,

MR. STEARNS. The executive branch catches it.

MR. COHEN. Indeed. And again it also applies to a transaction that is reviewed and is not blocked by the Government and then the Government subsequently learns that information that was provided was false. In a material way, it can overturn --

MR. STEARNS. Okay.

MR. COHEN. --a transaction.

MR. STEARNS. Do you think when you go to review a consideration of a foreign investment, that it is true that we should take into account Mr. Mallory's comment about this, it is an economic issue that could affect national security rather than just national security issues? In other words, is there some tie-in that we could lose our economic advantage and they could take over? It is not just national security we are talking about here. We are talking about economic advantage. Is that a component or not?

MR. COHEN. I would have to say national security is the broadest concept that we possibly could use as the test for review of investment in the United States. It includes virtually every argument and economic security, homeland security, energy security, and I think there is a real danger if the legislation moves in the direction away from the pure focus on national security. Because every time we emphasize one particular area, we send the message that other areas are not equally important.

And I believe that restricts rather than expands the scope of CFIUS. And therefore, I would say that there is no need to begin to specify subsets of areas of national security that need attention. I believe all is included. The other thing I would say with regard to this broader issue of economic security, we are beginning, in part, from different approaches. I would say that my friend, Mr. Mulloy, that we believe that economic security is, in part, promoted by foreign investment in the United States and foreign investment abroad. Nothing should be approved in the United States that is a threat to U.S. national security. However, we are a stronger country with a stronger economy, better able to defend ourselves and of the resources to defend ourselves because we have such a strong economy, which is, in part, generated by foreign investment in the United States.

MR. STEARNS. Mr. Mulloy, have you ever had an incident related to national security involving a foreign-owned company operating in the U.S. since this was passed under Gerald Ford and then when it passed under the Florio-Exon, was there ever an incident related to national security involving a foreign-owned company operating in the U.S.? Yes or no.

MR. MULLOY. Yes.

MR. STEARNS. Yes, there was.

MR. MULLOY. Let me just tell you how many of us knew that all of these foreign governments were owning Dubai-type port facilities in the United States before the Dubai transaction.

MR. STEARNS. No one knew.

MR. MULLOY. No one knew, right. And these were government-owned corporations. No one knew. I think if people had known at the time the transactions were going through we might have said hold it, is this a good idea?

MR. STEARNS. In fact, after Dubai came out, we found out Dubai was already in the United States, right?

MR. MULLOY. May I make one more point, Chairman Stearns? Section 4(b) of the bill before you charges the Director of National Intelligence to, quote, "expeditiously carry out a thorough analysis of any covered transaction." The bill defines covered transaction as "any purchase of an American company by a foreign company." But the problem is, you only find out about it if it is noticed. There are probably 6,000 transactions that have taken place since Exon-Florio had passed. You have notice of about 1,800, so there are about 4,200 you have no idea who purchased what. There has been no reporting on it.

MR. STEARNS. Do you think some national security has been breached because of those 4,200? You personally.

MR. MULLOY. I personally think, Mr. Chairman, in these days with global economic competition directed by foreign governments we ought to have information whether--

MR. STEARNS. You can't substantively say today because these 4,200 were never scrutinized that we have a problem. Do you personally think we have a problem?

MR. MULLOY. I personally think that some of these port deals which were never reviewed--

MR. STEARNS. You think they affect our national security?

MR. MULLOY. I have concerns, yes, Mr. Chairman.

MR. STEARNS. Do you think this bill would correct this?

MR. MULLOY. I think this bill goes a long way to correcting some of the points, but I have some clear recommendations in my testimony for improving the bill.

MR. STEARNS. Okay. We will do a second round here, but my time has expired.

Ms. Schakowsky.

MS. SCHAKOWSKY. Thank you, Mr. Chairman. I would like to continue with you, Mr. Mulloy, and I appreciate your knowledge and your history with this issue, which I think is very enlightening in our discussion right now. In your testimony that you made to the Senate Banking Committee, and you state your agreement with Senator Shelby, who said that not everything in America is for sale, and Senator Sarbanes, who said that the foreign investment screening, quote, "process was broken, leaving the country vulnerable to foreign threats," unquote.

You have certainly talked about the ports, but can you give us examples of what you think should not be put on the auction block, other things that you think should not be for sale?

MR. MULLOY. Well, let me just pause at one, for example. Say that the technology to make Google or that Google has, what if some foreign company, foreign country saw the technology like that when it was being developed by guys that didn't have a lot of money and decided that would be a good one for someone to come in here and buy. Would that be good or bad, do you think, for our own long-term economic strength and national security?

I think that is the kind of thing that is going on in this country. I think key technologies that are important to our industrial strength are being picked off by foreign governments. That 1994 study that was done, the one that was supposed to be done every 4 years and was only done once, that pointed out that the other governments do have strategies to buy up key technologies in this country and that the governments help their companies target what technologies they want to buy. I didn't say that. That is in the 1994 report.

So this is not just a market game that is being played out there by private companies. A lot of these other governments are much more involved in this process than our Government is.

MS. SCHAKOWSKY. Now, I would like to give you an opportunity. You mentioned actually two I think through the Q&A. You mentioned the issue of covered transactions, I think, and then the other recommendation that you met, the idea that these reviews are effectively completed before the parties. Did you want to put on the record? You had four, so there were two others.

MR. MULLOY. I have in my prepared testimony--

MS. SCHAKOWSKY. Do you want to say what those are briefly?

MR. MULLOY. I would be happy to do that if you want at this point.

MS. SCHAKOWSKY. You only had four in particular, right?

MR. MULLOY. I only had four in particular. I don't think Treasury should be chairing this process. That is a key one. H.R. 5337, in its definition of covered transaction, does apply its provision to all foreign purchases.

MS. SCHAKOWSKY. I think you kind of went over that one.

MR. MULLOY. Yeah. So you don't know what you don't know.

Second, the bill provides that in order to move from the 30-day to the 45-day national security investigation, that you have to have a determination that the transaction to be investigated threatens to impair the national security. That is the test that you use at the end of the 45-day investigation to decide whether to block it. It seems to me that should be "could threaten" rather than "threatens," otherwise you have to prove your point before you even begin the investigation.

The third, I say that the CFIUS reviews are all being done through this process before they even file, and that you ought to find a way to correct that.

MS. SCHAKOWSKY. Right. You mentioned that one.

MR. MULLOY. Finally, the members of the CFIUS, I point out that I didn't think--and I have been in these when I was an Assistant Secretary, International Trade in the Commerce Department during the last 3 years of the Clinton Administration. I have been in these interagency meetings. My judgment is the Council of Economic Advisors and the Office of Management and Budget don't necessarily bring a lot of national security expertise. They do bring kind of an ideological commitment to let markets work and that isn't--there are other people in the process who can make those points. Otherwise you load up too many people in the White House.

Secondly, in the bill it provides that the President can name any other designee that he wants. I am not so sure that that is a good idea. I am

not so sure you need political people from the White House in either party.

MS. SCHAKOWSKY. The point that Mr. Brown made in his opening remarks.

MR. MULLOY. Yes. I think that is a good point. You shouldn't allow that to happen. You ought to list the people you want involved. This is your authority. You should list it and tell the executive branch how you want it conducted.

MS. SCHAKOWSKY. Thank you.

MR. MULLOY. Thank you.

MR. STEARNS. Mr. Terry.

MR. TERRY. Thank you, Mr. Chairman. I am almost embarrassed to ask some of my questions because they are going to be fairly simplistic. To start off with, I am having a hard time grasping the term used here, the term "national security." And I think just a discussion between Mr. Mulloy or the answers by Mr. Mulloy and Mr. Cohen demonstrate that it seems to be a term of art, in essence, and maybe it has special meanings or meaning to CFIUS, but to me it is so broad that it can encompass anything.

Is there a specific definition of "national security" that already exists and/or does this Blunt bill in any way change or alter that definition of "national security"? And I will throw that out to anybody.

MR. COHEN. Mr. Terry, I will take the first stab at it. I don't, as I argued before, think you would want to see, I would argue, a definition of "national security." That is the strength of the term. It is all encompassing. It gives government the ability in this particular legislation to block an investment that they believe needs to be blocked. And if you start defining it, I think it makes the concept and your ability to take action more limited, and therefore, it is not in our best interest, and many pieces of legislation, many international agreements provide governments with what is called a "national security exception," and it is used in statecraft and I think it is appropriate that it remain in this bill, and I think it is a good idea to keep it.

MR. TERRY. Mr. Mulloy, would you agree that the definition needs to be flexible and broad?

MR. MULLOY. I agree with that, but I do think you should know that the Congress, when it passed Exon-Florio and it amended it in 1992, put down some criteria for the executive branch to use in judgment of what national security is. And the law states, domestic production needed for projected national defense requirement, the capability and capacity of domestic industry to meet national defense requirements, the control of domestic industries and commercial activities by foreign citizens that affects the capacity of the United States to meet its national defense

requirements, and then it talked about the potential effects on international technological leadership of the United States.

So the Congress put these criteria into the law. And in the report that Congress put it into the law in 1988, here is what the Congress said in the conference report. The standard of the review in this section is national security. The conferees recognize that the term “national security” is not a defined term in the Defense Production Act, where this law resides. The term “national security” is intended to be interpreted broadly without limitation to particular industries. This was the guidance that Congress gave to the executive branch.

Now, you read what the GAO says, and you will see the GAO criticizes the executive branch for narrowing the definition to almost things that you would put export controls on. In other words, if there were some high-tech item that you want to put an export control on, that is the way the executive branch is interpreting these charges by the Congress, and I think they are misreading the law and not carrying out the duties that the Congress gave to them. And then they go through all these processes of working out the whole deal before it is even filed. Now, why did they do that? Because once it goes under the national security review, the 45-day investigation, they do all these in the first 30 days. There is no reporting them to the Congress. Once you get into the 45-day investigation, then they have to report what they are doing and how they decided it. So they don't want to do that. So they work out all these deals in the first part, in the 30-day review. That is what is going on here.

MR. TERRY. Well, I want to follow up on that question, and Mr. Castellani?

MR. CASTELLANI. Castellani.

MR. TERRY. Appreciate that. If we continue to broaden this definition of “national security,” especially under what Mr. Mulloy is suggesting, it seems like we can incorporate just about everything that may be owned by a Middle Eastern country or China or—I mean, name off any country. Can we broaden this to the point where it becomes counterproductive to encourage foreign investment in this country?

MR. CASTELLANI. Indeed we can. I do not believe, and I may be mistaken, I do not believe H.R. 5337 changes the definition in the criteria of national security that currently applies. I think you have to think of it from two perspectives. One is having enough flexibility, as Mr. Cohen said, to be able to broadly apply it to protect the national interest but, secondly, to have it remain broad so as to be able to be flexible for new technologies.

For example, 30 years ago, one would not have said that Internet technologies were critical to national security. Now they are absolutely

critical to national security. They did not exist. Now they do exist. On the other extreme, we have to be careful that we don't waste both the national focus, national assets as well as de-erode an environment for investment that we are requiring national security reviews of the acquisitions of Ben & Jerry's ice cream because it happened to have been acquired by a foreign-owned country or company.

MR. TERRY. But they could still poison the ice cream. I am serious. If a country is inherently dangerous, I think anything they purchase could risk our national security.

MR. CASTELLANI. Well, I think the flexibility of the definition allows the members of CFIUS to make that determination and that is what that process is intended for, and the process will serve we believe under this law, will serve the country and the national security well.

MR. TERRY. Your discussion there in my clip I think goes to part of my confusion about the term "national security" here. Does it evolve around a particular country and their history or does it focus on the business that is being purchased?

MR. CASTELLANI. Well, I think the answer is yes.

MR. TERRY. Okay.

MR. CASTELLANI. It involves around all of the circumstances that may affect the inherent safety of the American people and to the inherent national security. Whether it is the technology or interest that is being acquired, whether it is the nature of the domicile of the inquirer or whether it is any aspect this could provide the flexibility for the committee to be able to take into account all aspects to determine whether or not national security--

MR. TERRY. Okay, Mr. Cohen. And Mr. Holtz-Eakin after that.

MR. COHEN. I just wanted to add that I think your question points out the importance of the reviews being done on a case-by-case basis rather than trying to make a decision on a particular transaction by fitting it into some kind of category, a particular nation, for example, or a particular concern with a particular sector. For example, some are suggesting we want a provision that specifically applies to energy security. Well, if we are going to do that, we are going to be giving some of our trading partners a roadmap to preventing the very investments we were making in energy facilities overseas, energy resources overseas that are important for our national security.

So I would not argue that we would want to see these types of specific references, such as to energy security, in legislation because we are basically going to see something then applied to us overseas that is not going to be in our interest.

MR. TERRY. Mr. Holtz.

MR. HOLTZ-EAKIN. I guess we would all agree you do not want to enhance the ability of our enemies to harm us, nor hinder our ability to harm our enemies, and that is the heart of looking at these things. It is not ownership per se, and your example is a sufficiently motivating evil foreign entity could poison Ben & Jerry's ice cream now. The question is how is the transaction--

MR. TERRY. This side isn't particularly worried about the outcome of that.

MR. HOLTZ-EAKIN. The question is how does a transaction change that and that is why I think a case-by-case review of the transactions is so important. How does the transaction change the exposure that we face. That is the key issue, not ownership or by whom, but what happens with the transaction. And it is not black and white. There is often a discussion of these as if it is all or nothing. In fact, the transactions are reviewed and often involve a mitigation agreement, a security agreement that says, yeah, this is fine except--and we make sure that, for example, wiretaps are handled by American citizens and we put in place additional safeguards to make sure that the economic transaction can proceed without impairing the national security. It is not an either/or.

MR. STEARNS. I thank the gentleman. Mr. Murphy.

MR. MURPHY. Thank you, Mr. Chairman. I thank the panel. An issue that most Americans had no idea existed, the CFIUS, until the things came about with the Dubai ports deal which certainly brings some important issues to light. Many of you have talked about the issue of foreign investments being a vital part of our economy. I know in the Pittsburgh economy we have a number of companies that wouldn't be there without foreign investments. Links, it's a German chemical company; Nova Chemical, Canadian company; Bayer, German company; Sony Corporation makes flat screen TVs, not the ones in this room unfortunately but makes them; and GlaxoSmithKline, a British company, and Westinghouse Electric recently was purchased by Toshiba. And things like the purchase of Westinghouse were ones under review. But I want to ask this in terms of--we do not want to upset those investments which help create a lot of jobs in America, but this is all part of this balance that when we have the conditions that exist in this country and other countries, their businesses feel they can invest in our Nation. I understand the balance that we all must take, that we are not going to somehow turn off these foreign investments and then in turn hurt a lot of American jobs and a lot of those great investments, but it comes down to this then, what lesson have we learned from the Dubai ports deal that is going to help us to protect that national security in the first place. Then I feel compelled to follow up on Mr. Terry's questions because I looked through this, I am still not sure how we define "national security" in this

whole process where CFIUS or any other organization can look carefully at this, or is this under the category I don't know what this is but I know it when I see it? Whoever wants to answer that.

MR. CASTELLANI. Let me take a stab at it. In fact, the definition of "national security" is implicit in how CFIUS is constructed, because it does include those elements of Defense, of Commerce, of Treasury, of all of the elements of Homeland Security, all of the elements and the jurisdictions that are brought to bear. Those are the pods, if you will, of concern, that are brought to bear on the specific transaction, and whether or not with the perspective of all of those expertise, all of that perspective the transaction violates national security and the definition of "national security" by any of those perspectives. And so by constructing the committee in and of itself you are indeed in part defining "national security."

Second aspect and the second part of the question you asked is have we learned anything, and the answer is clearly yes. One of the things we have learned, if nothing else, from the Dubai Ports World potential acquisition is that the appropriate amount of transparency and notification is absolutely essential to these processes because I would say that the surprise in and of itself was as damaging to this process as the underlying facts because we took a long time to get back to the facts about who actually is responsible for security at our ports. But I think the biggest lesson we learned is transparency and operating in a process and proper notification, which this bill does bring forward.

MR. MULLOY. Congressman Murphy.

MR. MURPHY. Yes, Mr. Mulloy.

MR. MULLOY. In the bill passed by Congress itself, Congress tells the President some of the factors that they want taken into account. In other words, this wasn't just nebulous. They said, and they list them, and they are listed in the factors under (f) of the current law, which is not changed by the bill. So these factors remain in the law. And why do you put those factors in? Because if the Congress is going to be able to do effective oversight, it has to understand the charge it gave to the executive branch, and then it has to get reporting from the executive branch how these duties are being carried out, and one of the key problems that was revealed by the Dubai ports was the executive branch was not following the law. Secondly, there was not the reporting that is needed for the Congress to be able to do effective oversight. I think the current bill that is before the committee makes some good improvements in the reporting by the executive branch.

MR. COHEN. On the factors, if I could just add, Congressman Murphy, if you look at the factors that were included, I think one of the most important factors is what is called the "A" factor, which is such

other factors as the President or the President's designee may determine to be appropriate generally or in connection with a specific review of investigation. And that is what I think all of us or many of us were trying to refer to, that you don't want a limited list that cannot cover, as Mr. Castellani has pointed out, new developments that were not included as factors from one through seven and as a matter of fact, if you take a look at this bill, the committee has expanded the number of factors from current law.

MR. MURPHY. Given that, was that what was in there before--let me see whose testimony this was. This was in Mr. Holtz's testimony with regard to the current 30-day review period and the 45-day investigation period, is that sufficient time then? I am interested in the panel's thoughts in that. You seem to think that H.R. 5337 retains those periods. Do we need to expand that if we are really fulfilling the communication, the security issues we have?

MR. COHEN. I think one of the things the bill successfully does, Congressman, is ensures that early on information is provided by the Intelligence Community, and that is one of the emphases of this particular bill that the information be provided to the entire membership of CFIUS with regard to a potential transaction, and they have up to 30 days to provide that information. I would say that a right balance is struck. You have the 30-day review period because that is where most of the cases will go before that is reviewed, and you really don't want to have a chilling effect on foreign investment in the United States. The only ones that should be moved to the investigatory stage are ones where there is a threat to U.S. national security. So we think the right balance is struck with the 30 and the 45 days with a potential for an expansion of the investigatory period if more information needs to be put together.

MR. MURPHY. Mr. Holtz, do you agree with that?

MR. HOLTZ-EAKIN. It has an additional advantage in that it coincides pretty closely with the timelines for the antitrust investigations so that coordination I think that is an advantage on the whole.

I think the other comment which the whole Dubai Ports episode brought out was the general lack of transparency in reporting. What has to be recognized is this is not a one-shot operation but, by having better reporting and better transparency, Congress can see in action what constitutes national security, see in action those things which progress from review to investigation and, by doing its oversight, tailor the process going forward. So the bill makes great improvements in the ability of the process to be fine-tuned by the Congress going forward.

MR. MURPHY. I think that is the key word here, that we get the information here when we need it.

MR. HOLTZ-EAKIN. You couldn't possibly have guessed before. So I think that is pretty important. And then to close this issue of the timelines, I disagree with Mr. Mulloy in what is going on in the 30-day. I think the fact that there is a heads up about potential transactions that companies--and remember, either party to the transaction can notify CFIUS, so if the company being acquired feels that they are doing something that has a genuine national security component, they can alert the committee, giving an early heads up, and taking more time than the statutory 30 days can't be a bad thing, and so I would disagree with the way that is playing out.

MR. MURPHY. Mr. Mulloy, do you want to close the comment?

MR. MULLOY. I do want to point out that the bill crafted by Chairman Shelby does extend the initial period from 30, I think, to say 60 days or it combines it all into a larger 75-day period because of the fact that they found out that so many of these transactions are being resolved before you even start the 30-day clock. So the deals are all being done before they even file.

Mr. Kimmitt testified before the Senate Banking Committee last March and he said this, this is after the Dubai Ports deals. He says, "in some cases CFIUS members negotiate security agreements before the filing is made." In other words, they even do the security agreement and then there is no reporting to you guys what is being done and I think that is wrong. I think they could give the heads up that we are coming in with a transaction, get clarifications about the dates and what information is needed, but you start the time clock when you file and then you start your subsequent negotiations so that there is a clear record of the decisions being made that can be reported to the Congress and the criteria that were used.

MR. MURPHY. Thank you, Mr. Mulloy. Mr. Chairman, I would hope these are issues that we can get in our committee report of this to find out not only how the timing works but to make sure of the transparency in what information we do get so we can conduct the proper reviews for national security.

MR. STEARNS. I thank my colleague. I think we will go another round if the gentlemen want to stay. I am going to have a couple of questions. After listening to you folks, I just realize, obviously under the Constitution, Congress has a responsibility for oversight, but whether Congress will do that or not I don't know, and whether we have an interest and whether we have the ability to do it, I don't know. So my question is to Mr. Holtz-Eakin. Shouldn't we take all of these countries and try to bring some quantitative measure to this, have somebody separate from Congress or the executive branch, rate all of these companies in terms of the threat to the United States' national security?

So once we quantify it, then CFIUS would have the ability to use some quantitative information to rank these and to scrutinize these deals involving these governments and these companies because I hear Members of Congress ask, "What is this definition of national security?" I mean if we are asking this question, it just seems like we need to somehow bring some measure of mathematics here, and that is my question for you.

MR. HOLTZ-EAKIN. Well, I guess I have three responses. Response number one is that artificial precision by putting things in a numerical scale doesn't buy you anything. In the end, what you need is to evaluate whether the transaction enhances or impairs.

MR. STEARNS. So if a country like China, a communist country, is going to own the port in Long Beach and we rank it as possible high security risk, that wouldn't mean anything because we have maybe a port in Shanghai or something like that; is that what you are saying?

MR. HOLTZ-EAKIN. No. Giving it a five versus a three versus a two when we know what China is I think brings nothing to the process.

MR. STEARNS. No relevancy.

MR. HOLTZ-EAKIN. Publishing it, making it public and codifying it I think would be a bad idea. The information belongs in the process certainly.

MR. STEARNS. Why would publicizing it be a bad idea?

MR. HOLTZ-EAKIN. It would be an invitation for retaliation. The United States is an open democracy with reliance on private markets that is not uniformly admired so we could have people say, well, that is bad stuff, we will just close off our markets to American companies. That is the kind of thing that I think--

MR. STEARNS. So you want to keep those actions under wraps?

MR. HOLTZ-EAKIN. Certainly.

MR. STEARNS. So that there is no retaliation by other countries.

MR. HOLTZ-EAKIN. I think the focus should be on the security implications to the transactions. And again it is not ownership per se. It is not the piece of the geography on the globe from which their economic sources flowed. It is how does this merger and acquisition affect our safety.

MR. STEARNS. You said there were three points. Did you get all three in?

MR. HOLTZ-EAKIN. I think so.

MR. STEARNS. Mr. Castellani, how many ports in Hong Kong does the United States operate? Do you know?

MR. CASTELLANI. I don't believe it operates any.

MR. STEARNS. Okay. And as I understand it here in the United States my staff has told me one-third of the ports are operated by foreign countries. Is that true?

MR. CASTELLANI. Oh, I would say if that is the number, it is probably a number on the basis of the number of ports but not on the total tonnage. If it was total tonnage, it would be a higher percentage.

MR. STEARNS. So one-third of the ports in the United States are already owned by foreign companies. In your opinion, is that good or bad? Does it matter whether that is 50 percent or whether it is 100 percent? Let's say that I said to you, is there anything wrong with foreign governments operating our ports?

MR. CASTELLANI. I think from our perspective the answer is there is nothing inherently wrong with foreign companies owning anything in the United States unless it is a threat to national security. And this is one--

MR. STEARNS. You wouldn't even make the argument, as some people on the panel said, sometimes they work it incrementally so they can harbor economic advantage by doing it systemically and things like that?

MR. CASTELLANI. Well, I think there are two issues with that. One is there is an implication that we wouldn't recognize that as a threat to national security, and in fact part of this process is to evaluate that. The second is an implication that from U.S. industries' perspective, U.S. businesses' perspective, we are just helpless victims in a world where the rest of the world is buying our assets. We purchase more of the world's assets than the world purchases of our assets. And in fact, we are as U.S. businesses, U.S. concerns, we are out around the world buying technologies, buying capabilities, buying services that enhance our economic strength and our economic competitiveness and we want to continue to do that.

MR. STEARNS. So in your mind you are thinking it is really not relevant who owns what port, who operates in what port, if it is a foreign country or not?

MR. CASTELLANI. Provided national security is protected.

MR. STEARNS. And that is the prime reason in your estimation?

MR. CASTELLANI. Absolutely.

MR. STEARNS. Okay. My time has expired.

MS. SCHAKOWSKY. Mr. Mulloy, you wanted to respond?

MR. MULLOY. I just wanted to say this to the Chairman. I agree with the point you are at. The Senate bill does say that you should make some distinctions between the countries who are coming to make the purchases. Particularly when they are government-owned corporations that are doing the purchasing. And let me make the point. Remember last year this committee got very concerned about CNOOC buying

Unocal, and I think you passed legislation to prevent that, and you were criticized and everybody was saying this was just a normal commercial transaction.

There was an article in the Washington Post last July 20. Listen to this. William Blair & Company was the largest American investor in CNOOC, and they announced in this article July 20, 2005, they said they were selling their CNOOC stock. They said CNOOC had made decisions in the best interest of shareholders in the past, but the effort to buy Unocal appeared to be based on government policy, not business reasons.

You have to understand that other governments are much more intertwined with their business community. There are certain critical technologies that people understand are important for your economic strength going forward, and everybody wants to have the leadership in those technologies. And we ought to know, our intelligence communities ought to be able to help identify those and then identify the cumulative effect of patterns of acquisitions of those activities by foreign--particularly if they are foreign government-controlled corporations. I think that is very much needed in this whole process.

MR. COHEN. Mr. Chairman, may I just comment, or Congresswoman? I apologize.

MS. SCHAKOWSKY. Yes.

MR. COHEN. I would say there is a real danger in trying to do too many investigations and then missing the objective that the legislation has, and that is if we start expanding the investigatory period of the review, the review process and the investigatory process, we are not going to focus on those transactions that are a real threat to U.S. national security, and my fear is that if we have--

MS. SCHAKOWSKY. Not be some screen through which everything has to go?

MR. COHEN. I would argue the other way, Congresswoman, that the best way to have a successful CFIUS process is to do the reviews on a case-by-case basis and get the information from the intelligence community, get the information from the State Department that goes to the issue of a threat to the United States and have that taken into account with a transaction. My fear otherwise is you are going to be using resources that should be focused on the few transactions, and hopefully they are a few, that are a real threat, and moving away from that, trying to do too much.

MS. SCHAKOWSKY. Mr. Castellani, you said in your statement that the United States may experience a backlash if we limit foreign investment in critical infrastructure unrelated to national security. So

what critical infrastructure is okay to put up for sale or, to put it the other way, what would not be? Is there anything that would not be?

MR. CASTELLANI. As I said before, the things that this process is designed to define are those things that should not be.

MS. SCHAKOWSKY. It sounded from what you said before that the Dubai Ports deal would not have necessarily met your criteria.

MR. CASTELLANI. And in fact I want to make sure I didn't mis-answer the Chairman's question because you said owned the ports.

MR. STEARNS. Yeah. I meant operated.

MR. CASTELLANI. Ports are in fact actually owned by U.S. entities such as port authorities or our cities. Again the issue from our perspective isn't where the ownership lies. The issue is whether or not national security is jeopardized by that ownership, by that particular company, its origin, its operations, its history, that asset. It is the only blanket statement I can make.

MS. SCHAKOWSKY. What about Dubai? There certainly are those that have argued articulately that the Dubai deal should have been fine.

MR. CASTELLANI. The thing that bothered me just personally about the Dubai Ports deal, which was mishandled by just about--

MS. SCHAKOWSKY. Aside from the mishandling.

MR. CASTELLANI. Okay. Other than the mishandling is we lost focus on who is actually responsible for security at our ports? And the people who are responsible for security at our ports are customs officials, the Coast Guard and the border security, and that is the issue, the paramount issue in terms of port security, which is very important to the members of the Business Roundtable as opposed to who operates those ports and who owns those operating companies. And so I think many Members of Congress, including yourself in your opening statement, focused on the fact that the real issue is how secure are our ports, not who owns, the people who operate--

MS. SCHAKOWSKY. Right. I am concerned that in light of the fact that only 6 percent of the cargo right now is inspected that in fact who operates the port could be of great concern to the United States.

Let me ask you another thing. You stated that the CFIUS process should include a Congressional--you do not think that it should include a Congressional reporting requirement on a case-to-case basis, but you support the sharing of aggregated information that is not associated with any one investment. But what it seems to me is that what you are saying is that you support sharing with Congress only information that is not particularly useful or helpful to us to determine if a foreign investment is in the best interest of our country.

MR. CASTELLANI. Again, I respectfully disagree. Our position is that you should share enough information to ensure for Congress to be

able to ensure that the process is working as Congress had intended in enacting the law, but not so much so as to discourage the kind of investment that our economy benefits from. And this is proprietary information related to a specific deal, a specific circumstance that may, in fact, give an advantage or may cause something desirable not to occur, give an advantage to a competitor or another suitor, or cause something not to occur should it be released.

MS. SCHAKOWSKY. How can we do oversight if it is only on an aggregated basis?

MR. CASTELLANI. Well, I think the data--

MS. SCHAKOWSKY. We have just figured out whether you agree with our conclusions or not on the whole Dubai issue.

MR. CASTELLANI. We think the data, the way the bill has laid it out, would provide that, information that would be sufficient.

MS. SCHAKOWSKY. Thank you.

MR. STEARNS. I thank my colleague and also I want to thank the panel for waiting while we went to vote. We are concluding the hearing. I think I hear from all of you, you support for the bill, and as you all know, we are going to mark up this bill in the full committee tomorrow, and we will take some of your comments to heart here. And I would feel that after the discussion we have had, the Congress has responsibility and we must exercise it and hopefully we will do that tomorrow in the markup of this bill.

So with that, the subcommittee is adjourned.

[Whereupon, at 4:40 p.m., the subcommittee was adjourned.]

