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Revamping CFIUS—and Going Too Far

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If there is one economic issue that seems to unite Republicans and Democrats in Congress with the Trump administration, it is the fear that foreign investments could jeopardize American national security, especially when the partnerships involve China, Russia, and some other countries. To address these concerns, Senator John Cornyn (R-TX) has proposed legislation to enlarge the government's mandate in these areas. However well-intentioned, the legislation as currently drafted would expand government bureaucracy, hamper the global competitiveness of US corporations, and subject the process to unwarranted political considerations.

The major problem with the Cornyn approach lies in its proposal to restrict *outward* investment and technology transactions by US firms. The vehicle for the legislative approach is to revamp the mandate of the Committee on Foreign Investment in the United States (CFIUS), which was created in 1975 to screen foreign takeovers of US firms for any threat to US national security. The focus was on *inward* investment and technology acquisition. Under the Cornyn proposal, the CFIUS mandate would be expanded to cover US *outward* investment and accompanying technology in other countries.

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

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

The Cornyn legislation, known as the Foreign Investment Risk Review Modernization Act of 2017, or H.R. 4311, has garnered support from an array of Democrats, including Senator Dianne Feinstein of California. But it is far from clear that this legislation is necessary to achieve the stated goals. Using existing statutory authorities, President Trump could achieve

the objectives sought by this Act. If he wants to restrict US investment and technology flows to China, Russia, Iran, or any other country, Trump can do so without new legislation.

The lasting impact of Cornyn's bill would come when a different president resides in the White House. If the CFIUS mandate is expanded as Cornyn and his cosponsors are contemplating, the CFIUS caseload would burst from 200 cases to thousands each year. Necessarily, the bureaucracy will blossom with new administrative and technical capabilities. Once the bureaucracy is created, and reviews become a thrice-daily event, it will be almost impossible to turn the clock back to today's open regime for investment and technology flows.

Chinese technology practices have generated the core motivation for H.R. 4311. Some concerns about China may be legitimate. China has targeted several high-tech industries for massive upgrading in the next ten years. To help accomplish this goal, China compels foreign firms to transfer technology to Chinese business partners as the "price of admission" to the vast Chinese market. But President Trump has already directed the US Trade Representative to launch an investigation of China's technology transfer practices, under Section 301 of the Trade Act of 1974. Once the investigation is concluded, measures to block US firms from acquiescing to Chinese demands could be Trump's response, whether or not the Cornyn bill passes Congress.

BACKGROUND[1]

CFIUS is a cabinet level committee, chaired by the Secretary of the Treasury, historically charged with reviewing foreign merger and acquisition (M&A) bids to acquire US companies. Established by President Gerald Ford's executive order in 1975, CFIUS was given a statutory base by Congress in the 1988 Exon-Florio Amendment to the Defense Production Act of 1950. Reviews are "voluntary," but an acquisition that has not been reviewed and approved can be subsequently revoked by the Justice Department, so in effect every significant case is subject to CFIUS review. Reviews are held in secret and essentially immune from judicial challenge. CFIUS makes recommendations to the president, who has final authority. The president can block an acquisition—but this has happened only four times in the history of CFIUS. More frequently, the CFIUS recommends "mitigation measures" that, if not accepted, could lead to withdrawal of the application.

While several departments are represented on CFIUS, the key members are the Secretary of Defense and representatives of the intelligence community. (The Secretary of State also sits on the CFIUS but is a more passive player, as former Secretary of State Hillary Rodham Clinton has maintained in the controversy over CFIUS approval of Russian acquisition of Uranium One in 2010.) The central question in a CFIUS review is whether the acquisition of an American company by a foreign player threatens national security. This approach differs from M&A screening tests in other countries (e.g., Canada and Australia), which add a national economic interest test to national security. The Cornyn bill preserves the national security test but significantly enlarges the perceived sources of national security threat.

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

In addition to joint ventures with foreign partners and transfers of critical technology, H.R. 4311 expands the scope of CFIUS review to cover foreign real estate acquisitions near US military bases or national security facilities, and foreign minority positions in sensitive US firms.

RECOMMENDATIONS

H.R. 4311 should be narrowed to cover the immediate problem—forced transfer of critical technology to adversarial countries—without a massive expansion of the CFIUS mandate to review the bulk of outward foreign direct investment by US firms.

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

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

NOTES

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

2 See Theodore H. Moran, *Three Threats: An Analytical Framework for the CFIUS Process*, Policy Analyses in International Economics 89, Peterson Institute for International Economics, August 2009.