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CFIUS reforms must be reformed*

by

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The Committee on Foreign Investment in the United States (CFIUS) screens proposed takeovers of US companies by foreign companies to assess whether such acquisitions might threaten US national security.

Principal CFIUS concerns are: 1) leakage of sensitive military or intelligence or dual-use technology to foreign companies or their home country governments; 2) provision of information technology (IT) access so that foreigners might conduct surveillance or sabotage via back-doors in IT systems; and 3) offering foreign companies or their home country governments quasi-monopoly control over goods and services that they may deny to US users.

Foreign investment in the US—including foreign investment via acquisitions—is generally very beneficial to the US. Foreign companies bring good jobs, cutting edge technology and high quality-control procedures to the US economy. The US-based employees of foreign-owned MNEs earned an average income of US$79,979 in 2013.[1] 12% of all US productivity increases over the past two decades have come from spillovers from foreign companies investing in the US domestic economy.[2]

The CFIUS process is chaired by the US Treasury, which is disposed to welcome inward FDI in all forms unless plausible threats to US national security can be clearly identified. CFIUS rejections of foreign acquisitions are quite rare—only four in the past twenty years—although companies sometimes withdraw their acquisition proposals when they are unable to mitigate CFIUS concerns.

Congress and the White House are now proposing a fundamental "reform" of CFIUS regulations, via the Foreign Investment Risk Review Modernization Act (FIRRMA). These new "reform" recommendations would change CFIUS in three problematic areas.

First, FIRRMA would replace CFIUS's traditional narrow approach to identifying potential national security threats from specific acquisitions within industries to

identifying entire sectors of the US economy where foreign acquisitions from countries such as China and Russia should be prohibited. For example, CFIUS has previously rejected Chinese acquisitions of semiconductor companies that possessed technology crucial to improving anti-missile radar systems (gallium nitride technology). Under FIRRMA, the entire semiconductor industry could be placed out of bounds for Chinese or Russian acquisitions.

Second, FIRRMA directs CFIUS to investigate "the potential effects of the covered transaction on United States international technological and industrial leadership in areas affecting United States national security, including whether the transaction *is likely to reduce the technological and industrial advantage* of the United States relative to any country of special concern" (italics added).[3]

Excluding whole sectors, industries and areas of the US economy from foreign acquisitions, even if limited to foreign investment from a handful of specific countries (China, Russia, possibly others), so as to prevent erosion of US industrial and technological superiority, would unavoidably put the US government in the business of designing a national industrial policy. This approach would require the US government to select some sectors to be protected, while designating other sectors to be open to foreign acquisitions. Such a move opens the door to a political process for which there is no logical end in sight.

Not only would the prevention of foreign acquisitions within whole industries exclude valuable technological and managerial inputs from external investors from entering broad segments of the US economy, but the change in the US approach would justify copycat sector-wide or area-wide exclusions on the part of other countries. Government authorities in Europe and Asia might well adopt mirror-image policies to avoid loss of industrial or technological leadership. Once the rationale to prevent the erosion of industrial or technological leadership becomes accepted as legitimate, could the effort be limited to foreign acquisitions involving only a few countries?

Third, FIRRMA proposes an extremely dangerous expansion of CFIUS authority to review commercial sales, joint venture arrangements and normal business licensing of intellectual property by US companies to foreigners. FIRRMA permits CFIUS to screen commercial practices even if the sales and licenses involved are not covered for national security reasons by the US export control regime.

It is important that Congressional revisions of CFIUS authority be refocused on specific national security threats that might plausibly arise from individual acquisitions rather than excluding entire industries and sectors of the US economy from foreign acquisitions, even if initially limited to China and Russia. At the same time, the objective of protecting US industrial supremacy across the entire frontier of technologies in a zero-sum manner should be rejected as the basis for US FDI policy.

Finally, CFIUS should be removed from interfering in normal sales and licensing of US intellectual property, and joint venture business relationships, when there is no national security rationale for prohibiting such.

In the end, a reformed-CFIUS should mirror the old-CFIUS, perhaps embedded in a bit of non-substantive nationalistic rhetoric.

The result would be an appropriately calibrated balance between keeping the US economy open to the benefits from foreign investment without jeopardizing US national security in the process.

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[1] Theodore H. Moran and Lindsay Oldenski, "How offshoring and global supply chains enhance the US economy," Peterson Institute for International Economics, *Policy Brief*, 16-5, April 2016, p. 2.

[2] *Ibid.* p. 5.

[3] FIRRMA, section 15.

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