

# In Brief

INSTITUTE FOR  
INTERNATIONAL  
ECONOMICS

## US National Security and Foreign Direct Investment

Edward M. Graham and David M. Marchick • May 2006 • ISBN 0-88132-391-8 • \$23.95

Foreign investment in US companies and assets has long been controversial, with the recent uproar over the Dubai Ports World acquisition being only the latest example. During World War I, national security concerns arose in the United States over foreign investment, particularly from Germany. Encouraged by the US Navy, Congress moved to adopt restrictions on foreign investments in shipping, air services, and broadcasting sectors and passed the Trading with the Enemy Act, which was used to seize German- and British-owned assets. Controversy developed again in the 1980s with respect to investments from Japan. In response, Congress in 1988 passed the Exon-Florio Amendment, which gave the president broad powers to block a foreign acquisition of a US company if that transaction threatened to impair US national security.

Concern has surged over recent investment from China, beginning with the takeover of the personal computer operations of IBM by Chinese firm Lenovo. The debate intensified in 2005 with the (subsequently withdrawn) bid by the China National Offshore Oil Corporation to buy US oil firm Unocal. The furor in Congress intensified in early 2006, when Dubai Ports World bought the port operations of the UK-based Peninsular and Oriental Steam Navigation Company, which would have given Dubai Ports World control of operations at six US ports. Although this transaction easily passed a review by the Committee on Foreign Investment in the United States (CFIUS), many members of Congress deemed the transaction unacceptable. Consequently, Dubai Ports World agreed to sell its interest in the six US ports.

A number of bills (at last count about 20) have since been introduced in Congress that would modify Exon-Florio, the CFIUS process, or broader foreign investment laws. Several of these bills can only hurt the United States and therefore must be rejected. The CFIUS process can be improved, but changes should be narrowly tailored to ensure that foreign investment in the United States is not chilled. Among the changes that should be pursued are:

- **adding protection of critical infrastructure as a factor for CFIUS consideration.** CFIUS, and particularly the Department of Homeland Security, should clarify exactly how it would protect “critical infrastructure.” Currently, the link between foreign ownership of such infrastructure and national security is unclear.
- **establishing security standards for employment of nonnationals in sensitive positions.** US security agencies can have foreign nationals employed in sensitive positions screened by their own governments or by independent screening agencies operating under the laws of a particular individual’s home country. Doing so would require CFIUS to recognize the validity, through mutual recognition agreements, of background checks undertaken by friendly foreign governments.

- **enhancing disclosure of information to Congress.** CFIUS should enhance the quality and quantity of information provided to Congress on the operation of Exon-Florio. Greater information disclosure should be limited to aggregate rather than detailed, transaction-specific data. Congress should not demand, nor should CFIUS provide, confidential business data that parties to a particular transaction give to CFIUS.
- **clarifying the standard by which CFIUS determines whether there is “foreign control.”** CFIUS agencies should clarify the critical elements of the control test and consider raising the 10 percent threshold of ownership, above which control is presumed.
- **developing international standards for national security review processes.** Members of the Organization for Economic Cooperation and Development, joined by China, India, and Russia, should develop principles that govern laws for national security–related screening processes for foreign investment.

A number of other ideas will chill investment without enhancing national security. So Congress and the executive branch should reject them:

- **mandatory filings of all foreign acquisitions.** This requirement would completely overwhelm the CFIUS process, force CFIUS to focus on transactions that do not raise national security issues, and divert attention from cases that do.
- **moving the CFIUS chair.** No other US government agency is better equipped to chair the process than the Treasury Department is. At the same time, Treasury should defer to security agencies with expertise on particular transactions and should strengthen its own security expertise.
- **introducing an economic security test.** Exon-Florio is perhaps most frequently criticized for not allowing CFIUS and the president to consider economic as opposed to national security issues. Adopting an economic security test would undermine the United States’ long-standing policy of welcoming foreign investment, be extremely difficult to implement, and further politicize the CFIUS process.

The growing discomfort on Capitol Hill over the rise of China as a foreign investor and congressional reaction to the Dubai Ports World deal have cast doubt on the United States’ interest in encouraging foreign investment. Without continued and growing inflows of foreign investment, US manufacturing, employment, competitiveness, and innovation will be at risk. It will become harder to attract the massive amounts of foreign capital needed to finance the large and growing US current account deficits. Unless the United States remains open to foreign investment, it will alienate its allies and could find itself isolated in an increasingly interdependent world. Maintaining an open environment for foreign investment is in itself deeply in the national security interest of the United States.

To buy this book: [http://bookstore.iie.com/merchant.mvc?Screen=PROD&Product\\_Code=3918](http://bookstore.iie.com/merchant.mvc?Screen=PROD&Product_Code=3918).

To learn more about Edward M. Graham: [http://www.iie.com/publications/author\\_bio.cfm?author\\_id=54](http://www.iie.com/publications/author_bio.cfm?author_id=54).

To learn more about David M. Marchick: [http://www.iie.com/publications/author\\_bio.cfm?author\\_id=461](http://www.iie.com/publications/author_bio.cfm?author_id=461).