EVALUATING CFIUS: CHALLENGES POSED BY A CHANGING GLOBAL ECONOMY

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TUESDAY, JANUARY 9, 2018

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ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

EVALUATING CFIUS: CHALLENGES POSED BY A CHANGING GLOBAL ECONOMY

Tuesday, January 9, 2018

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONETARY POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Andy Barr [chairman of the subcommittee] presiding.

Present: Representatives Barr, Williams, Lucas, Huizenga, Pittenger, Love, Hill, Emmer, Mooney, Davidson, Tenney, Hollingsworth, Hensarling, Moore, Sherman, Green, Heck, Kildee, Vargas, and Crist.

Also present: Representative Posey.

Chairman BARR. The committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time, and all members will have 5 legislative days within which to submit extraneous materials to the Chair for inclusion in the record.

This hearing is entitled, "Evaluating CFIUS: Challenges Posed by a Changing Global Economy."

Without objection, the gentleman from Florida, Mr. Posey, is permitted to participate in today's subcommittee hearing. Mr. Posey is a Member of the Financial Services Committee, and we appreciate his interest in this important topic.

I now recognize myself for 5 minutes to give an opening statement.

Napoleon famously said that an army marches on its stomach, meaning if it ran out of provisions, an army would quickly cease to be useful. To paraphrase that line, an economy marches on investment. And for that reason, the American economy always has welcomed foreign as well as domestic investment.

But with increasing globalization has come an increased velocity of international investment and developing economies with geysers of money to invest, and, in turn, that has brought some caution to our welcoming posture. In 1975, concerned that barrels of petrodollars would distort the economy, President Ford created a multiagency panel to monitor foreign investment. In 1988, concerned that Japanese yen were flooding the United States, President Reagan signed legislation that gave him the authority, working through that panel, to actually block a foreign investment that threatened national security. Ten years ago, in the aftermath of the

first big wave of terrorism, Congress upgraded the panel's enabling legislation again.

Now, a new tide of money has hit the U.S. shores, but it comes from China, which many fear is not merely a business competitor that plays hard ball harder than most but, is actually, a threat to national security.

To that end, our colleague Robert Pittenger and Senator John Cornyn have undertaken a yearlong study of that multiagency panel, the Committee on Foreign Investment in the United States, known by its acronym as CFIUS, and proposed some changes.

To evaluate the challenges posed by this new global economic environment, the committee today is holding its second hearing on CFIUS in less than a month—part of an effort that I believe will consume much of the committee's hearing in the first half of this year.

We are fortunate to have, as we did at our first hearing, top-flight witnesses to discuss CFIUS operations and the challenges it faces. We have a former Deputy Secretary of Commerce, the former Director of National Intelligence, a former Senior Staffer from the National Security Committee, and two top economists from a pair of the elite think tanks in this country.

One theme we will discuss today is perhaps at the center of how we should consider any changes: Can we precisely define the technologies or ideas or techniques we need to protect, and can we find ways to protect them without unnecessarily affecting other flows of capital or creating an investment scrutiny regime so onerous that good money just decides to go somewhere else? Could we inadvertently make the U.S. investment climate so difficult that even U.S. companies move their research and development efforts—the labs that create the innovations that have kept our economy strong and vital for so many decades—to other countries, even to China? With the best intentions, could we do CFIUS reform that fails to improve U.S. national security or, worse, enact reforms that will make the American people less safe than when we started?

I believe Congress can achieve the opposite. I believe we can modernize the CFIUS review process so that it better addresses security threats while avoiding undue harm to U.S. business at home or to its efforts to compete abroad. And I believe that with enough effort we can do that relatively quickly, even in what is likely to be a hard-fought election year, because protecting national security and protecting U.S. economic interests are bipartisan goals we always have been able to work together on productively.

As evidenced by the first CFIUS hearing this committee held less than a month ago, members are engaged on the issue, educated about the process, and already working on solutions. And I am hopeful, confident even, that we will be successful in crafting an approach that will get to the President's desk before the August work period. That is going to take a lot of work here and in the U.S. Senate, and it is going to require a lot of input from outside voices interested in a successful outcome, but I believe it is achievable and that it must be achieved. And I am anxious to get to work.

Again, I would like to recognize the work of our colleague Mr. Pittenger and for his leadership on this issue.

With that, I yield back the remainder of my time and yield to the Ranking Member for an opening statement.

Ms. MOORE. Thank you so much, Mr. Chairman, and thanks to our distinguished panel for appearing here today. I wish everyone a happy new year.

I just want to start out by agreeing with the chairman that this is definitely a bipartisan issue. While on one hand we want to make sure that we become the destination of choice for foreign investment, we want to make sure that we don't allow our open borders with regard to investment to make us prey to technological attacks and other attacks on our country.

And we look forward to hearing from our distinguished panel here today about how we can achieve those reforms to CFIUS that wisely balance the need to protect our national security and other interests without needlessly cutting off the benefits that can be gained from foreign direct investment. And undergirding this debate are a variety of national security concerns, including countries attempting to use foreign direct investments in our country to access sensitive technologies.

It has been over a decade since Congress last acted in response to concerns about the CFIUS process. I am most familiar with the DP World debacle, but the world has changed considerably even in the last decade. The last time we addressed this issue, it was through strong bipartisan legislation that came out of this committee, and I hope that this is the route we are going to take. It is going to really require that. And we have seen that that is what is occurring so far.

As we consider what new authorities may be needed to address the modern-day threats, I do want to point out that this subcommittee's previous hearing, the one we just had, the witnesses agreed that the greatest challenge facing CFIUS today is, Mr. Chairman, the lack of resources available to the Federal agencies to do thorough and extensive investigations and reviews.

So, when we start thinking about standing up our national security efforts, we can't always do it through a defense authorization bill. Financial crimes are a peril to our national security, and we need to fight for the resources to protect these agencies. And I really look forward to a good discussion on the key issues that we need to keep in mind as we look to reform CFIUS.

At this point, I want to yield the balance of my time to our Vice Chair of the full committee, Mr. Kildee.

Mr. KILDEE. Thank you to the Ranking Member and to the chairman and to the witnesses for being here today, our second hearing in as many months aimed at evaluating the operations and challenges that CFIUS faces.

CFIUS plays an extremely important function in the area of national security. Congress has an important responsibility to ensure that CFIUS is balancing the benefits of our traditionally open investment climate with the requirement to protect U.S. national security.

Given that we have not formally reviewed the CFIUS process in over a decade, in the evolving threat environment with respect to certain kinds of foreign investment, I appreciate the chairman's intention to hold this series of hearings in the coming weeks so that

members can assess not only the challenges that CFIUS faces but also determine an appropriate set of policy responses.

A primary concern that we face, that I am particularly challenged on, is the area of China's aggressive industrial policy and their efforts to invest in early stage cutting-edge U.S. technologies with potential military applications, including artificial intelligence, robotics as well, in part to advance China's military modernization and to diminish America's technological advantage.

If China represents the biggest threat to U.S. security with respect to foreign investment, I would argue that the second-greatest threat is an underfunded and understaffed U.S. Government. A serious problem facing CFIUS today is the lack of resources. Even without expansion of authority, CFIUS already has significant staffing and resource problems. As the volume of cases and the complexity of transactions continue to increase, along with the need for an aggressive use of intelligence resources, any expansion of CFIUS authority, absent additional resources, would not only jeopardize the existing mission but would also undermine U.S. national security.

And I know there are members working on legislation—Mr. Heck, to my left, which is not something I often say, is working on legislation—sorry, Denny—which would not only address authority but would also provide a mechanism for additional resources. So that is important legislation. It is something that we need to seriously consider.

And I appreciate the panel's willingness to contribute—

Mr. HECK. Time.

Mr. KILDEE. —And I yield back.

Chairman BARR. The gentleman yields back.

The gentlelady yields back. The gentlelady's time has expired.

Today we welcome the testimony of several distinguished witnesses, and we thank them for their participation in this hearing.

And we look forward to your insights.

Dr. Derek Scissors is a Resident Scholar at the American Enterprise Institute, where he focuses on the Chinese and Indian economies and on U.S. economic relations with Asia. He is concurrently Chief Economist of the China Beige Book. Dr. Scissors is the author of the China Global Investment Tracker, which shows China's investments throughout the world. Before joining AEI, Dr. Scissors was a Senior Research Fellow in the Asian Studies Center at the Heritage Foundation and an Adjunct Professor of Economics at George Washington University. He has worked for London-based Intelligence Research Ltd., taught economics at Lingnan University in Hong Kong, and served as an action officer in international economics and energy for the U.S. Department of Defense.

Dr. Scott Kennedy is Deputy Director of the Freeman Chair in China Studies and Director of the Project on Chinese Business and Political Economy at CSIS, a leading authority on China's economic policy and its global economic relations. Specific areas of focus include industrial policy, technology innovation, business lobbying, multinational business challenges in China, global governance, and philanthropy. For over 14 years, Dr. Kennedy was a Professor at Indiana University. From 2007 to 2014, he was the Director of the Research Center for Chinese Politics and Business. And he was the

founding academic director of IU's China office. From 1993 to 1997, he worked at the Brookings Institution.

Admiral Dennis Blair is Co-chair of the Commission on the Theft of American Intellectual Property. He serves as a member of the Energy Security Leadership Council and on the board of the National Committee on U.S.-China Relations. From January 2009 to May 2010, he served as Director of National Intelligence. During his distinguished 34-year Navy career, he has served as Director of the Joint Staff and held budget and policy positions on the National Security Council and has been Commander in Chief of the U.S. Pacific Command. He has been awarded four Defense Distinguished Service Medals and three National Intelligence Distinguished Service Medals.

The Honorable Ted Kassinger is a partner in the Washington office of O'Melveny & Myers, LLP. Ted joined O'Melveny in late 2005 after serving from 2001 to 2005 first as the General Counsel and then as Deputy Secretary of the U.S. Department of Commerce. Ted is a member of the Council on Foreign Relations and of the U.S. Department of State's Advisory Committee on International Economic Policy, which he formerly chaired.

Mr. Rod Hunter is a partner based in the Washington, DC office of Baker McKenzie. He previously served as Senior Director for International Economics at the National Security Council, the White House office that coordinates international trade policy and supervises national security reviews conducted by the Committee on Foreign Investment in the United States, CFIUS. In that role, he managed CFIUS cases, including negotiating resolution of the most sensitive cases, coordinating the Administration's legislative communications and diplomatic outreach in particular cases, and developing the Government's procedures for incorporating intelligence agencies' assessments. He also served as Senior Counsel at the U.S. Trade Representative's Office, where he litigated cases before the World Trade Organization.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. Without objection, each of your written statements will be made part of the record.

Dr. Scissors, you are now recognized for 5 minutes.

STATEMENT OF DEREK M. SCISSORS

Mr. SCISSORS. Thank you, Mr. Chairman.

As you mentioned, I am the creator of the China Global Investment Tracker. I think that my contribution here is primarily going to be to provide facts about Chinese investment in the U.S. and around the world.

The tracker is every Chinese construction and investment transaction globally, including the United States, worth $100 million or more since 2005. There are more than 2,700 of such transactions. And our main contribution is you get to see all of them. We don't tell you what the totals are and it comes out of nowhere. You can see everything that we include, all of our numbers. They are tagged by year. They are tagged by sector. They are tagged by name of the company, so you can see if it is a state company or a private company. So I urge you to utilize that resource in the process of your work on CFIUS and other issues involving China.

Some facts: Chinese investment in the U.S. fell about 50 percent in 2017. In 2016, it was in the $50 billion range; 2017, in the $25 billion range.

However, this hearing is focused on the globe. Globally, Chinese investment rose mildly from a record-breaking 2016 to about $185 billion globally last year. And the reason was that private Chinese firms investing in the U.S. were stopped by the Chinese government, but their investment was replaced by large Chinese state-owned enterprises investing primarily in Europe.

I can go into detail, but that is the main event of 2017: Less private Chinese investment in the U.S.; more state investment in Europe. We can easily imagine security questions that arise out of that change.

By sector, in the U.S., aviation led due to one large purchase. Real estate was second. There was almost no successful Chinese technology investment in the U.S. in 2017. However, there were multiple Chinese purchases of U.S. healthcare firms, which raises an issue that I think we are going to talk about more: Personal data.

Again, there is a lot more information along those lines. I do want to make some nonfactual points, but I urge you, if you or your staff would have questions, we would be happy to help answer them.

Point one I want to hammer home: State-owned enterprises and private Chinese firms are different with regard to economics. State-owned enterprises are heavily subsidized; Chinese private firms usually are not. However, in my opinion, with regard to national security and the rule of law, there is no effective difference between Chinese state-owned enterprises and private firms.

The reason is a private Chinese firm has no more recourse, it has no more protection against the Communist Party than a state-owned enterprise. So if a private Chinese firm has technology or personal data of Americans that the party wants, the party will get it. The private Chinese firm cannot protect that data even if its intent is to do so. Not all data, not all technology is important. But I don't think anyone should think, in this room or outside, that private Chinese firms can protect anything they acquire in the United States from the Communist Party. They cannot.

That is a factual statement, I think. Now we are getting into opinion, for sure.

There is an obvious split over what to do about CFIUS between the economic community/business community on one side and the national security community on the other side. I am from the econ side. I like foreign investment. It increases competition in the United States. It creates or supports jobs. I don't think all infrastructure is critical and needs to be protected from foreign competition, but I have watched Chinese investment since 2005, and the sophistication of both the firms and the government is still growing now. They will be better this year than they were last year or the year before in acquiring, coercing, stealing, and using technology, whether American, European, or otherwise.

There has long been a risk, as Admiral Blair knows extremely well, to our intellectual property (IP). There is now a risk to per-

sonal data, as Chinese companies try to buy U.S. firms which hold Americans' personal data.

What can we do about this, in my last minute? We need to be transparent. In my opinion, for the foreseeable future, China is the threat. I don't like the language in some bills that talk about "critical countries" or "countries of special concern." We are talking about China here. Don't put other countries in the crossfire.

It has already been mentioned repeatedly, and I agree wholeheartedly, that we need to devote resources to this problem. Loss of technology could come back to harm the U.S. in national security terms in a huge way. It is a small investment to try to limit that now.

I want action to be taken yesterday, if I were in charge. Our current rules have not been sufficient to stop the Chinese from acquiring or coercing American technology. We cannot look forward to "well, we could do this better in the future" or "this could happen." We need to take substantive action immediately, in my opinion.

Finally, there is a global element to this, and I encourage U.S. global cooperation, but first we need to get our own house in order. So let's do that first and then reach out to our partners.

Thank you.

[The prepared statement of Mr. Scissors can be found on page 63 of the appendix.]

Chairman BARR. Dr. Kennedy, you are recognized for 5 minutes.

STATEMENT OF SCOTT KENNEDY

Mr. KENNEDY. Thank you, Chairman Barr, distinguished members of the committee. I appreciate the invitation to appear before you.

I have been asked to share my views about Chinese industrial policy, trends in technology flows, and the implications for American policy to limit diffusion of advanced technologies to China that could harm U.S. national security, including the role of CFIUS.

Today I want to make three analytical points and then offer several policy recommendations. There are more details in my written statement.

First, although highly wasteful and inefficient, Chinese industrial policy has been relatively effective at facilitating both the domestic development of technology in China as well as the acquisition of foreign technology from the United States and elsewhere.

Chinese technology policy, I think, could long be defined as engaging in techno-nationalism, but under Xi Jinping in the last few years Chinese industrial policy is much more centralized than ever before, and steps have been taken to make industrial policy serve China's economic and national security goals. Just recently, China formed a national commission on civil-military integration. Xi Jinping personally chairs that commission, and its goal is to find ways to take commercial technologies and use them to help Chinese national security.

China has set specific targets for technology acquisition and growing market share across a vast range of technologies, including electric cars, renewable energy and storage, robotics, commercial aircraft, biologics and pharmaceuticals, and many other areas relevant for the U.S. economy and national security. If you just look

today at the Consumer Electronic Show, CES, which is opening in Las Vegas, fully one-third of all of the exhibitors, 1,500 of them, are from China.

Relatedly, China is using globalization to pursue all of these goals through international trade, sending students to study abroad, hiring foreign employees, foreign investment in and out of China, opening R&D centers in Silicon Valley and other technology hubs.

As Dr. Scissors said, there was a slight downward tick in overall investment out of China in the United States in 2017, but a growing share of Chinese investment is in high-tech overall. There are some investment deals which are in high-tech that aren't covered by his database that are important even though at a dollar level they are relatively small. Some of these deals are acquisitions of mature companies, as well as minority stakes and also venture investment in startups.

Second, the U.S.-China economic relationship brings both benefits and problems to the American economy. Industrial policy is inherently discriminatory, and, given China's size, Chinese tech policy could harm global supply chains and business models. But, on balance, the United States, our companies, workers, consumers, still benefit in many ways from our commercial ties with China.

At the same time, the U.S. and China have conflicting strategic interests in the Asia-Pacific. As a result, while the U.S. has to balance issues of fairness and opportunity in the economic realm, the security challenge should lead us to be more conservative and withhold more technology than would otherwise be the case.

Third, American technology reaches China through a variety of channels, including investment, trade, employment, R&D centers, education, as well as cybertheft, industrial espionage. And constrained diffusion of technology in one area doesn't necessarily stop diffusion of technology in other areas. In fact, it may be more like a balloon, where you plug one place and you will see expanding technology diffusion in another way. So an American response needs to be comprehensive; it can't just focus on one avenue of technology diffusion.

Let me just make a couple policy recommendations and then look forward to the discussion.

In terms of the technology CFIUS covers, I can see it makes sense to expand the definition of critical technologies and infrastructure to include critical materials, data, and potentially IP, because of how acquisitions of technology, even in their early stages, can be misused against American interests. At the same time, in addition, I could see the benefits of expanding CFIUS's mandate to cover nonpassive investments, not just majority acquisitions, where the foreign party doesn't gain a controlling interest because Chinese, even as minority shareholders, can still get access to that technology, whether they are private or state-owned.

I would suggest several limitations, including limiting some of these expansions to areas of countries of special concern. I actually like that terminology and can explain why in more detail. One area I would also limit is, I would try to explicitly be sure the legislation doesn't cover American outward investment because it would be too broad and difficult for the Committee to manage.

[The prepared statement of Mr. Kennedy can be found on page 55 of the appendix.]

Chairman BARR. Thank you.

The Honorable Admiral Blair, you are recognized for 5 minutes.

STATEMENT OF ADMIRAL DENNIS C. BLAIR

Admiral BLAIR. Chairman Barr, Ranking Member Moore, and members of the committee, it's really heartening for those of us who have been involved in these issues for a while to see that Congress is tackling the task of governing the control of foreign investment into this country. And I am delighted to be able to participate in the process through testifying about the updating of the CFIUS statute, because it is dealing with a very major and growing threat to our national security.

The changes that have been proposed under one potential statute, what is called the Foreign Investment Risk Review Modernization Act, or FIRRMA, I consider to be well-considered, very important. Widening the category of covered transactions, expanding the specific factors that are to be considered by the Committee, as well as the improved Congressional notification will go a long way toward plugging the loopholes in the application of the current statute. And I certainly urge adoption by this committee of those provisions of H.R. 4311.

But I also think we need to think more widely about the risks of investment in this country by foreign companies. And I would urge the incorporation of an additional fairly simple principle into the CFIUS statute: If a foreign company has stolen American intellectual property or has taken actions against American security policies or interests, it should not be allowed to invest in this country.

This committee needs no education on the damage to our precious technological edge that has been caused by the theft by foreign companies and governments of our intellectual property. As we on the Commission on the Theft of American Intellectual Property stated in our reports, it has robbed this country of up to $600 billion a year, more than our trade deficit with all of Asia. It erodes the competitiveness of our companies and the combat capability of our Armed Forces.

And FIRRMA would go a long way toward protecting our militarily relevant technology, but I recommend going further to prevent the investment in this country by any company that has stolen American IP—big, international Chinese companies like Sinovel, like Trina Solar, like Jiangsu Shinri Machinery Company.

We should prevent investment in this country by companies that have harmed American security interests in other ways. The China Communications Construction Company, or CCCC, was the company that built the wall of sand in the South China Sea. It acquired a Houston-based American design firm, Friede Goldman United, in 2010. CNOOC then sent its oil rig, the HD–981, off the coast of Vietnam to assert China's territorial claims.

We should force foreign companies to make a choice. They either steal our intellectual property and otherwise undercut this country's interests, or they invest in the United States. They can't have it both ways.

Finally, I would like to add my voice to those highlighting the resource consequences of expanding the scope of the CFIUS statute. Policy without capacity is frivolous. Right now, the CFIUS work in the Executive Branch is done by a group of the part-time and the willing. The application-fee funding mechanism, the special hiring authorities that are currently in H.R. 4311 will put the right people in greater numbers on the job to protect our national security interests.

My business friends do not object to government regulation. They object to slow, incompetent government regulation. We owe them speedy, savvy decisions, and we owe the country the protection of its national security.

Thank you.

[The prepared statement of Admiral Blair can be found on page 38 of the appendix.]

Chairman BARR. Mr. Kassinger, you are recognized for 5 minutes.

STATEMENT OF THE HON. THEODORE W. KASSINGER

Mr. KASSINGER. Thank you, Mr. Chairman, Ranking Member Moore, members of the subcommittee. I very much appreciate the invitation to appear before you today. It is an honor to join my distinguished fellow panel members in contributing to your work assessing the operations and activities of CFIUS.

I wish to emphasize that I appear today solely in my personal capacity, and the views that I express are my own.

I concur in the sentiments expressed by several members that, 10 years after Congress last amended section 721 of the Defense Production Act, it is time to take stock of how the purposes and processes that Congress put in to place in 2007 have worked, how they withstood the test brought by dramatically changing economic and geopolitical circumstances.

Section 721 established the legal foundation for what is a critically important but nonlegal task of the Government, and that is to determine on a case-by-case basis whether specific foreign direct investment transactions present a threat to the national security and, if they do, what are the appropriate means, if any, to resolve those issues.

Unlike some of my fellow panel members, I think that section 721 has and continues to provide the fundamentally correct approach to balancing national security and economic interests of the United States and that the process administered by CFIUS works reasonably well.

There are clear signs of stress in that process however, and there are serious questions to examine regarding whether CFIUS is optimally empowered and resourced to address current challenges.

I think in any assessment of changes to the current process it is important to look back at what Congress created in 2007 and then what the Administration, through CFIUS, promulgated in its rules in 2008. These were thoughtful processes on all counts, and they leave us, I think, with certain principles that should be kept in mind as we look again at CFIUS in new circumstances.

The first, to which many have alluded here, of course, is the longstanding U.S. commitment to welcoming foreign investment.

Second is that, in the competition for global capital, the United States is well-served by regulatory processes that are transparent, predictable, and efficient. Foreign investors and U.S. business partners understand that the United States must be able to step in where business transaction presents a threat to national security. Nevertheless, before committing to transactions involving perhaps billions of dollars, they want to manage the business risks appropriately, including by structuring transactions to address potential national securities ahead of time, if possible. That is a natural business process.

These two fundamental principles lead to a third overarching proposition. Any statutory or regulatory amendments to section 721 should seek to replicate the principles that I think were achieved through the 2007 act and regulations. Those were models of deliberative consideration. They produced an unusually well-crafted set of Federal rules. The rules carefully define concepts and terms, provide numerous examples to indicate how the rules might apply to specific factual circumstances.

That rulemaking process took about a year after the 2007 law was enacted. It was well worth it, not because the rules answer every question that arises, but because, as a whole, they faithfully implemented the balance struck by section 721 while providing useful guidance to private enterprises and entrepreneurs, who are the primary sources of investment capital.

CFIUS does face, as the country faces, many current challenges that were not present in 2007. The rise of China as an increasingly assertive strategic adversary and global economic power lie at the heart of most of those concerns. You have heard from experts, in the December hearing and here today, who can provide you far more insights on those concerns, which I fully share.

I wish principally to observe that the complexity of the U.S.-China economic relationship itself provides reason not to lose sight of the basic principles of consistency, fairness, efficiency in a process that is adopted. Over the last 20 years, commerce between China and the United States has become evermore interdependent, and the rules going forward should address not only the threat from China but also the continuing value of foreign investment in the United States.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Kassinger can be found on page 49 of the appendix.]

Chairman BARR. Thank you.

Mr. Hunter, you are recognized for 5 minutes.

STATEMENT OF ROD HUNTER

Mr. HUNTER. Thank you, Mr. Chairman, Ranking Member Moore, and members of the subcommittee. I appreciate the invitation to speak, and I would like to offer a couple of observations based on my experience in a prior Administration and as a practicing attorney.

The highest priority for public officials is, of course, ensuring the national security. Our national security depends, however, on the innovation and the productivity of our economy. And the open investment environment and open investment regime enables us to

draw the capital and ideas and talent from around the world to make America more productivity, innovative, and prosperous.

As my fellow panelists have pointed out, recent increases in Chinese investment has created concerns here in the United States but also across advanced markets. Now, there are legitimate reasons for Chinese investment in the United States: Diversification, proximity to customers/consumers, a number of others. Still, the deep involvement of the Chinese Communist Party and the state in the Chinese economy gives reasons for concern and particularly in this increasingly tense strategic competition with the United States and China.

The CFIUS law was designed to secure the benefits of open investment while ensuring that the President had broad authority to block or unwind foreign investments in order to protect national security. The President is assisted by CFIUS, made up by economic and security agencies and, importantly, by the Intelligence Committee, which forms in many ways a key component of the analysis that guides the CFIUS work.

In my personal experience, national security was never given short shrift in those debates, though there were, as all the people who participated in CFIUS know, long and extensive, vigorous debates within CFIUS about the proper analysis of risk and balancing.

In practice, any agency can force the escalation of an issue of a case up to the President for guidance—something which, in my experience, happened with some frequency. As the subcommittee considers CFIUS going forward, I would highlight four questions:

First, does CFIUS have adequate legal authority to reach foreign investments of concern? CFIUS can reach any investment in the United States in a U.S. business enabling a foreign person to acquire control. The "control" definition in the legislation and as it is applied is actually quite low so that CFIUS's jurisdiction is quite encompassing.

There is one gap in particular, around real assets where there is no commercial activity and, hence, no business. This can be a problem when someone acquires land next to a sensitive government site, something that Congress may want to consider.

A second question is whether CFIUS is adequately resourced, and Ranking Member Moore highlighted this at the very beginning. The caseload has doubled in recent years. Resources have remained essentially constant. The most visible indication of the stretching of the resources has been the lengthening of timelines as applied to individual transactions. Indeed, the uncertainties around timelines, as much as outcomes, are going to have an impact on investment decisions of people from diverse nationalities. And no doubt the protraction is caused in part by policy debates within the Committee but also, I would believe strongly, because of the resource constraints.

A third question is, should CFIUS's mandate be expanded to technology control? Technology transfer, as many have highlighted, is the right issue; CFIUS emphatically is the wrong tool. CFIUS was designed to manage risks arising from foreign ownership or control of U.S. businesses. It is a reactive instrument. It is labor-intensive, time-consuming, and, frankly, is straining under its cur-

rent workload of 240 cases or so. Imposing a committee process vetting the international licensing, joint development projects, even hiring by U.S. technology companies could, in fact, drive the R&D that is so essential to our economy and defense industrial base offshore.

The export control regime, however, was crafted for just this purpose. And while there may be important issues to look at in terms of a legal basis for the export control regime and whether it is adapting to policy—and those are, in fact, issues worthy of Congressional attention.

With that, I would stop and thank the committee.

[The prepared statement of Mr. Hunter can be found on page 43 of the appendix.]

Chairman BARR. Thank you all for your testimony.

And the Chair will now recognize himself for 5 minutes for questioning. Let me start with Mr. Kassinger.

Are Chinese and U.S. companies routinely structuring deals to avoid CFIUS jurisdiction presently?

Mr. KASSINGER. Not in my experience, Mr. Chairman. I think there is a narrative that all minority investments are somehow designed to avoid CFIUS jurisdiction. I just don't think that is true. I have never seen that. Investments are structured for business reasons. The rules themselves, until recently, provided certain safe harbors for sizes of investments, and people often, actually, to the benefit of U.S. national security, have pushed Chinese and other investors to maintain minority positions.

So I think CFIUS has jurisdiction currently to cover virtually any transaction that it seeks to cover. I don't think circumvention is an issue.

Chairman BARR. Admiral Blair, do you believe that CFIUS jurisdiction should be more defined or perhaps even expanded in order to capture all the transactions that you believe CFIUS should be scrutinizing?

On a related note, do you believe that there could be a risk of giving CFIUS too many different things to do so that it could not do any of them well?

Admiral BLAIR. I would say that the definition should be expanded and then the application of that expanded definition should be worked out in practice and that it should be governed by the size of the competent staff that can be assembled under the new procedures. So I think it is a balance of the staffing of it.

But I don't think we should simply limit the CFIUS-controlled transactions definition to what we see today and just narrowly tailor it. I think we need to leave some room to be able to adapt without coming back and getting a new piece of legislation, a new review process, so that smart people can interpret a fairly broad set of guidelines to protect the interests of the United States.

Chairman BARR. So, in your judgment, should the Committee make ad hoc decisions regardless of the structure of the deal in terms of whether or not to assert its jurisdiction?

Admiral BLAIR. Yes.

Chairman BARR. OK.

Mr. Hunter, given your experience coordinating CFIUS, what is your sense of the Committee's ability to handle a broader caseload?

There has been a lot of discussion about resourcing, but including these nonpublic transactions, contributions of intellectual property to foreign persons through licensing, joint ventures, and the like?

Mr. HUNTER. Thank you, Mr. Chairman.

I think that it would overwhelm the Committee. The Committee is stretched by resources, but it is, on top of that, a committee, and, as we all know, committees often require considerable deliberation to reach consensus. And going to the President for every significant, challenging decision would be, itself, not feasible.

So I think the ultimate consequence of a dramatic expansion of jurisdiction would actually be a poorer performance by the Committee in dealing with those transactions that matter.

Chairman BARR. Thank you.

Dr. Scissors, most, if not all, of our major developed-world trading partners do not have a CFIUS-like process, or, if they do, it is much different than ours. Can a stricter CFIUS process be effective if it merely incentivizes investment and innovation to flow to less-regulated countries?

Mr. SCISSORS. I think there are two answers. Yes, it can be more effective than we have now. We can debate about how to do that. The U.S. is still the primary source for dual-use in military technology. We are the leader in semiconductors, where the main Chinese research effort is devoted. So our actions, by themselves, are going to help.

But, in terms of protecting our national security, of course it would be good to coordinate with our allies. Our allies, as you mentioned, don't seem to have this process in place at all. In fact, I know and I am sure other panelists know from personal experience they look to us for an example. So the first step in coordinating with our allies is deciding what we want to do and then telling them why.

I agree with your point, but I do think we have to handle ourselves first.

Chairman BARR. Fair point.

Dr. Kennedy, final question in my remaining time. Your fifth point in your written testimony was, I think, a good one. You state that "although it is important to protect the United States from unwise transfer of technologies, the United States also gains tremendous strength from having an economy open to flows of goods, services, people, and ideas."

What specific recommendations would you have to update the CFIUS process without unduly burdening foreign direct investment?

Mr. KENNEDY. Mr. Chairman, I think clarifying the definitions of what CFIUS covers, the type of transactions related to the types of technologies and the type of investment inward to the United States, I think would help; also increasing funding for the Committee but not overburdening it by adding cases that could be better handled through export controls or other types of things that are better prepared to handle that increased burden.

But the American economy benefits tremendously from being open. Even though it looks like China is catching up fast and passing, China's economy also has lots of burdens as a result of its industrial policy. So we want to protect what is best about our econ-

omy while also making sure that our national security is protected as well.

Chairman BARR. Thank you.

My time has expired, and the Chair now recognizes the distinguished gentlelady from Wisconsin, the Ranking Member of the subcommittee, Ms. Moore.

Ms. MOORE. Thank you so much, Mr. Chairman.

I have 1,001 questions, but just let me start out very quickly with Dr. Scissors.

I noticed how cute your thing was, said, "Don't listen to my colleagues on this topic, only me." I am wondering about the difficulty of differentiating between legitimate economic motivations that China might have and strategic motivations that may be a threat.

And I want to congratulate you on putting together the metric. I am sure I will be studying this for a long time.

Could you give us some advice about what we ought to be looking for specifically, a metric for what are legitimate investments and what are not?

Mr. SCISSORS. Thank you for the compliments. It has become an enormous amount of work. When I started, it was small and easy, and I think I may have made a mistake.

Obviously, the first thing to do is to look at sectors. There are some sectors where it is very difficult to see any strategic rationale. The Chinese like to buy soccer clubs in Europe. If they want to buy the Redskins—please don't take this as a political comment about the Redskins—I don't think we see a strategic threat there.

So I think the first thing to look at is that there should be some sectors that are open to China because they will benefit the American economy and they have no strategic element to them whatsoever.

I will, however, then say, to provide a caution, as I try to drive home in my statement, you can't use ownership of a Chinese firm to say it is strategic or it is not strategic. A private Chinese firm can be a strategic tool for the Communist Party just like a state-owned firm can be a strategic tool. And if it isn't now, if it is a well-intentioned Chinese firm now just looking to operate on commercial principles, which is likely, 5 years from now it may not be.

So I would use sector; I would not use ownership.

Ms. MOORE. OK. Thank you so much.

Let me ask Admiral Blair, given your extensive experience, if the President decides to not follow the recommendations of CFIUS, is this something that is made public? How will this committee—is there any mechanism for our supporting the Committee's recommendations if the President decides not to act?

Admiral BLAIR. It has been my experience that Congress has had no trouble in influencing CFIUS decisions that are of high consequence and category. Process is one thing, but once something gets into the press, once something becomes a big issue, it really gets higher than the CFIUS process.

Ms. MOORE. So it would be public?

Admiral BLAIR. Yes, it would be.

Ms. MOORE. OK. Good.

I want to yield the balance of my time to the distinguished member, Mr. Heck on this committee, who has a lot of background in this area.

Mr. HECK. I thank the Ranking Member.

I would like to start with you, Admiral Blair, and begin by thanking you for your lifetime of service to this country in uniform and in so many ways. Your co-chairmanship of the IP Commission is something that I have specifically cited, and the data coming out of it, on numerous occasions here in this committee.

My perspective is that we are here today, frankly, because there has been a problem that has been growing as a consequence of a lot of the trends and behaviors on the part of other actors, most specifically China, and so it brings us to the point of revisiting a 10-year old-statute and its adequacy for the current challenges. But it is also my perception that this body doesn't act unless we are at critical mass or threshold of perception of a problem that is going to get worse and going to be compelling.

So I want to ask you the "what if" question. What if we don't do anything? What if we don't act? What if we don't reform CFIUS? What if we don't increase its resources? What if we don't change it? Based on your considerable experience, look forward and describe as best you can what you think occurs if we fail to act.

Admiral BLAIR. I think if we don't make these changes our military technological edge erodes in key areas. Our choices are either accepting the consequences of a narrowing gap or else spending more money on defense. I think our economic competitive, similarly, erodes as those high-technology, high-innovation sectors, in which the United States really has a competitive advantage, are undercut by other competitors.

So I think it contributes to negative trends in this country. It doesn't mean we can't overcome them by the inherent entrepreneurial nature of the country, by the dynamism of our people, and so on, but why make it harder, I guess is my—

Mr. HECK. Well, they have been catching up. Are you suggesting that the velocity at which they continue to catch up increases?

Admiral BLAIR. Yes, I think it has in recent years. And we should protect our own interest in order to slow it.

Mr. HECK. Thank you, sir.

Chairman BARR. The gentlelady yields back.

The Chair now recognizes the Vice Chairman of the subcommittee, the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

The preservation of our national security I think is every Member of Congress's constitutional responsibility, and I and this committee remain committed to finding policy solutions which promote U.S. interests and keep bad actors away.

I want to thank Chairman Barr and Ranking Member Moore for holding today's hearing. I am also glad to see this subcommittee making CFIUS a priority. I look forward to learning more about this important interagency committee and the best ways that Congress can potentially improve it while at the same time still promoting foreign investment to the U.S.

I thank the witnesses for their time, and I thank many of them for their service to this Nation and their prior involvement with CFIUS. Our Nation is indebted to your dedication.

Mr. Hunter, I want to start with you. Thank you for being here today. And I, too, share your concerns about the gap existing where a foreign investor seeks to acquire an asset that is not a U.S. business. The example in your testimony of fallow land near a military base was particularly concerning to me because I represent a large portion of Fort Hood, the largest military base we have.

So does a change need to be made to codify the inclusion of sensitive assets by CFIUS? And can you explain what a provision could look like to achieve that goal?

Mr. HUNTER. Thank you.

I think the solution is really quite simple. It is just to say specifically that real estate can be covered. At present, you need to have a covered transaction involving a U.S. business being acquired by a foreign person. The limitation of a U.S. business is an asset plus a commercial activity. Fallow land, land that is not being used, doesn't have a commercial activity.

So you just define specifically land. Easily done.

Mr. WILLIAMS. OK.

Another question. I agree with your assessment that foreign direct investment in the United States is positive for the economy. When companies invest in America, they bring jobs, they bring facilities and further development. But it is concerning to me that CFIUS delays could create uncertainty that drives away investment.

So how can we modernize CFIUS in such a way that makes the U.S. more attractive to development but at the same time does not compromise our national security?

Mr. HUNTER. Thank you. That is a great question.

The timelines, as I have mentioned in my written testimony, have gotten longer in practice. The intelligence community does a fantastic job of producing their analysis very quickly, but it is a committee and so it requires a lot of debate internally within CFIUS. The resources that Ranking Member Moore highlighted at the outset I think are a key component of that.

The second thing is, I would be very cautious about what additional responsibilities one gives to CFIUS. The export control issues are very important issues, in fact, maybe the most sensitive issues. But the CFIUS process would come to a grinding halt if one were to put all of that inside of CFIUS instead of doing it through a reform of the export control procedures.

Mr. WILLIAMS. OK. Thank you.

Dr. Scissors, I am concerned with patterns of targeted investment by Chinese state-owned enterprise into this critical U.S. infrastructure—for example, the investments that Chinese groups have already made into the U.S. rail manufacturing.

Do you believe that involvement of Chinese state-owned enterprise in U.S. critical infrastructure has or could potentially jeopardize our Nation's ability to effectively respond to national security threats?

That would be my first question.

Mr. SCISSORS. The way I would put it is, again, I don't think it matters that it is a state-owned enterprise, except that they have access to more Chinese government funding. So the size is what matters there, not the ownership.

I think what we should consider, with regard to China, is not what is happening now. Right now, China is trying to expand its rail industry all around the world, not just in the U.S., not principally in the U.S., mostly in Southeast Asia, sub-Saharan Africa. But if it is owned by a Chinese entity, it is a future national security risk. I don't know any other way to put it.

So I think what you look at is the size of the transaction, the extent of Chinese involvement, and the future risk, not the current risk. At present, I would say the Chinese have no interest in disrupting U.S. national security preparations, but a Chinese entity is controlled by the party, and if the party changes its mind, so does the Chinese entity.

Mr. WILLIAMS. Real quick, is there more that you think we can do to modernize our investment review laws to address the challenge we are talking about?

Mr. SCISSORS. Yes. This is where my colleague and I disagree. We have heard people talk about not overburdening CFIUS. The way I would not overburden CFIUS is make it clear that there is one primary national security risk to the United States and it comes from China. Everything else is much smaller in comparison.

So, when we give CFIUS additional tasks, whether they are a little bit of an additional task or a lot of additional tasks, we can focus on the primary country of concern, which is the Chinese side. We are not worried about the Iranians buying up U.S. rail assets. They don't have the money.

Mr. WILLIAMS. OK. Thank you for your testimony.

And I will yield my time back.

Chairman BARR. The gentleman yields back.

The Chair recognizes the gentleman from Washington, Mr. Heck.

Mr. HECK. Thank you, Mr. Chairman.

Back to you, Admiral Blair, if I may. So I asked you to look forward before. Now, I do, in fact, want to ask you to look back a little, and characterize for us, if you would, the advances in technology and equipment made by the Chinese Armed Forces in, let's say, the last decade, and indicate whether or not you think that those advances were materially advanced by IP theft by the Chinese and technology transfers. Was there a role there?

Admiral BLAIR. The Chinese Armed Forces have done a remarkable job in transforming from the mid–1990's when they were basically a pretty immobile, light-infantry-based defensive force to a much more advanced force capable of projecting in the near areas around China, with ambitions to go further. And they have, in fact, leapt several generations of technology that other countries have gone through over many decades.

And I would say that a combination of strict theft, breaking into companies like Lockheed Martin and Northrop Grumman and pulling out information, which they accomplished, and taking advantage of the examples of other armed forces, chiefly the United States, they have used in a pretty savvy way.

And when I was Commander in Chief for the Pacific Command, we could handle contingencies like Taiwan without scratching the paint on our ships and our airplanes. Now, it is going to be a tough confrontation if we get into it over an issue like Taiwan. And part of that has been Chinese ability to jump to the latest technology by acquiring it by fair means and foul, and the foul means have been a major part of that.

Mr. HECK. So I realize there is an underlying disagreement here about how to deal with the outbound stuff. But, before we get to the solution to that, I want to size the bread box and have you maybe describe what role you think joint ventures, Chinese performance requirements, and the outbound stuff, has played in their absorption, if not theft, and acquisition of technology that has enabled this more rapid advance and the implication to our national security.

Mr. BLAIR. The Chinese weapons designers and engineers are competent people. And when they are devising a new surface-to-air system, for example, they look around at what the most advanced systems are. A large part are American.

They then issue orders to their intelligence service to go out and get as much of the specific data on wavelengths, design of components, sources, as they can. The Chinese actors, human intelligence and so on, know the companies and the—

Mr. HECK. Excuse me for interrupting, Admiral, but do our outbound investments play a role in that?

Mr. BLAIR. Oh, our outbound investments?

Mr. HECK. Right. That is what I am getting at. Is it the fact that we enter into these joint ventures with them and they have performance requirements which—

Mr. BLAIR. No. From the military point of view, the primary theft that has benefited China has been their penetration of our domestic defense industries and the cooperation with allies, the U.K., Japan, and all. There have been some losses through our allies, but most of the benefit has come from stealing from American companies in the United States that are building defense equipment.

Mr. HECK. Not American companies that are operating in China?

Mr. BLAIR. Correct, in the past, mostly through coming here. There are certain filters. American businesses are smart. They are not going to take their best stuff. They are going to be careful in China. So why go for the second rate stuff there when you can go into the United States and get it at its source? And that is what Chinese intelligence units have been tasked to do, and they have been somewhat successful in doing it.

Mr. HECK. Dr. Scissors, would you agree with that?

Mr. SCISSORS. Yes. I think there has been a progression in the way China has approached stealing IP. I work on the econ side, not the security side, so I can't answer your national security question. But I agree with the admiral's point that the Chinese are now skipping over whatever they think is secondary technology and moving to where they think the best technology is. I used to tell clients, if you don't want China to steal your IP, don't go to China. That doesn't work anymore.

Mr. HECK. Thank you. My time is up. I yield back, Mr. Chairman.

Chairman BARR. The gentleman yields back.

The chairman now recognizes the author of the Foreign Investment Risk Review Modernization Act, the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Chairman Barr. I sure appreciate your support and leadership on this important bill.

And certainly I appreciate Senator Cornyn and the leadership and partnership he has been on this bill, and Secretary Mnuchin, who played a major role in writing the bill.

And thank each of you for being with us today.

I would like to say that the bill now has the full support of not only Secretary Mnuchin, but Secretary Mattis and Attorney General Sessions. Many others have commented about the bill and the need for reforms in CFIUS.

Mr. Kassinger, I heard your remarks in terms of joint ventures. I would say to you respectfully that the Director of the CIA and Secretary of Treasury both would have disagreed with that, that they believe that they are an important, critical part of how the Chinese and others would pursue acquisitions. Mike Pompeo said CFIUS deals mostly with changing control of transactions and analysis. There are many other ways one could invest in an entity in the United States and exert significant control over that entity, and I think we need to look into that. So I would respectfully disagree.

I would say that I would like to hear from Mr. Scissors regarding your perspective of the export control regime and its ability to adequately address our national security risk related to foreign transactions. In your opinion, do you believe that the control regime has adequately addressed national security risk, particularly Chinese investments?

Mr. SCISSORS. I will give a disclaimer. I am not an export control lawyer. But on the Chinese side I do have a lot of information, and I would say our current export control regime has not been sufficient to prevent illegal Chinese acquisition of technology. It is not supposed to do all the work. But we can say for sure it is not doing the job.

So we can argue about where we want the changes, whether to be in CFIUS, or in export controls, or elsewhere, some combination. But I would disagree with anyone who says, oh, export controls are handling this problem, we are fine. That is evidently not the case with China.

Mr. PITTENGER. So you would then concur that the need to expand, reform, modernize CFIUS would be important to address the concerns in the future?

Mr. SCISSORS. Yes. Again, how we do that and whether that is sufficient, whether we should locate all reform in CFIUS, I think those are big questions, and I don't want to use up all the time. But I think modernization and improvement of CFIUS is indispensable.

Mr. PITTENGER. I think underscoring our concern lies in a comment that Secretary Mattis made. He stated that rapid technology change is one of the several concurrent forces acting on the Defense Department. And as well he said that new commercial technologies will change society and ultimately will change the character of war.

So I think looking ahead in the future, our objective is to have a structure that will address the needs and concerns as we proceed ahead.

Admiral Blair, you have obviously worked a great deal on intellectual property and matters relative to national security. Can you please help us understand what we need to do to further tighten CFIUS regulations and the rules and procedures to protect the intellectual property of national security?

Mr. BLAIR. We have talked a great deal about tightening CFIUS in order to protect militarily relevant technology. But I think CFIUS need not be simply limited to that. As the chairman said in the beginning, it was used in the 1970's because of concern about petrodollar recycling. It was done in the 1980's because of concern about Japan. These were not military secrets that we were worried about there. It was the economic competitiveness.

And as the commission that I had the honor of co-chairing testified, this is a hemorrhage of profits and competitiveness of this country. And I think it is fully appropriate that CFIUS go beyond simple narrow military calculations and be used to punish, and therefore deter, companies that are stealing American-owned intellectual property, whether it is applied to military devices or whether it is putting companies out of business in many parts of this country. So I say go further with CFIUS.

Now, put the statute on the books and then all the questions of implementing it in smart ways, getting the right people, those can be solved. But if you have the goal there, then you can build the capacity to do it and face these companies with a challenge: They either use the United States, they use our stock market, invest in our company, export to this country, and play it by the rules, or else they don't. I think we ought to freeze them out if they don't.

Mr. PITTENGER. Thank you. I yield back.

Chairman BARR. The gentleman yields back.

The Chair recognizes the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. I thank the Ranking Member as well. And I thank the witnesses for appearing.

I am concerned about energy. I am a Representative from the State of Texas, so it seems that would be something that would be of concern to me and of course to the country as well.

My concern emanates from technology that the Russians don't have. They seem to have the ability to drill but not nearly as much ability and technology as is needed to drill in the Black Sea where it is exceedingly cold.

In 2012, Secretary Tillerson signed a deal with Rosneft, the Russian-owned oil company, and that deal would allow drilling in the Black Sea by way of the Russian-owned company and our very own Exxon.

The deal was thwarted, but the question still remains: How will our associating ourselves with a Russian-owned oil company that doesn't have the technology necessary to drill in these cold waters, how will that possibly impact us long term?

Who would like to take the first shot at my question?

Mr. BLAIR. That is a very complicated question, Representative Green. And there is a tension there, because the increase of the world oil supply is a good thing for the economy of the United

States and for all other countries. It gives the United States a flexibility in its security policies which we don't have when the price is high and it is only countries in the Middle East that can quickly increase their production that will keep the price under control.

So I don't think any of us who watch this issue are against helping other oil companies provide more into the world market. Where we do have concerns is how that power is used for geopolitical purposes. And Russia has clearly demonstrated, particularly in the use of its gas lines, that it is perfectly willing to use that for political pressure. It has not been so successful in oil because of the fungibility of oil shipments around the world.

So, in general, I think cooperative oil measures are OK, and ought to be entered into by U.S. companies. They are pretty savvy at not giving away the family jewels when they work with another company. They have been doing it for a long time. And then we watch the use to which these oil shipments are put, by countries like Russia or Saudi Arabia or Iran or other producing countries.

Mr. GREEN. Would someone—yes, sir, if you would, please.

Mr. KASSINGER. Just two quick points, Congressman Green.

First, of course right now the Ukraine sanctions, both promulgated by Executive Order and by this Congress, preclude transfers of unconventional oil and gas technologies from U.S. persons, U.S. companies, to Russia. So at least for the time being that is not an issue.

Second, I think in considering this issue I align with Admiral Blair but for another reason. And that is, U.S. companies don't have a monopoly on offshore drilling technology. The question is, would we rather have U.S. companies there participating or cede that market, and the presence that goes with it, to others?

Mr. GREEN. Just quickly, this point. It is my understanding from the intelligence that has been accorded me that, within that deal there is also an opportunity for Rosneft to do some drilling in the United States. Any response to this contingent?

[Inaudible responses.]

Mr. GREEN. Well, thank you very much. Madam Ranking Member, I greatly appreciate the time. Mr. Chairman, thank you.

Chairman BARR. Thank you. The gentleman yields back.

The Chair recognizes the gentleman from West Virginia, Mr. Mooney.

Mr. MOONEY. Thank you, Mr. Chairman.

So one issue was brought to my attention about a year ago where the Chinese—although any country could do it—but the Chinese tried to buy a company based out of Europe somewhere, use it as a third party, then have that company purchase an American semiconductor company. Lattice was the one that was brought to my attention.

But I was just wondering—I guess anybody could answer this—but how do we detect when a company is being bought out by a foreign entity and then that company is also trying to buy American technology, a company that has access to sensitive American valuable technology.

Dr. Scissors, but anybody else can jump in.

Mr. SCISSORS. Well, we do it, so I assume the U.S. Government can do it. If you decide to focus on certain companies, like large

Chinese entities who have funding from the state, you know what they have done in the past. So the biggest example, quantitatively, is not the failed Canyon Bridge-Lattice Semiconductor deal. It is the successful HNA—which is a Chinese private firm with very strange ownership—purchase of CIT Leasing in the U.S.

HNA did that through its Irish subsidiary, Avolon, wholly owned Irish subsidiary. All the money came, supposedly, from Ireland. But if you know what HNA has done in the past, you know that is a Chinese entity.

And I believe the U.S. is perfectly capable of tracking back companies of concern or of special interest and knowing who actually owns what. I don't know that we do that, necessarily, on a consistent basis.

And the evidence I would give is my number, our number at AEI, other numbers, not just ours, for Chinese investment in the U.S. are larger than the U.S. Government number, in particular because the U.S. Government treats that investment as being from Ireland. It is not. It is from China. We can determine that, but we may not be doing so on a regular basis.

Mr. MOONEY. Sure.

Mr. HUNTER. Thank you.

So, first off, the legal structures, from CFIUS' perspective, the legal structures don't matter. CFIUS looks all the way up the chain to ultimate owners and control. So in terms of legal authority, that is there. What I think your question is getting to is the information, whether CFIUS is aware.

Now, CFIUS does track transactions. They can see the public transactions that are reported and they do a pretty good job at that. When there are government contractors involved, there are rules under the government contracting rules that require notification. So there is visibility there.

I think the bill that we were talking about a moment ago, FIRRMA, seeks to deal with what is perhaps one of the gaps that may be there, which is particularly smaller businesses, businesses which may not be publicly held companies, where there may not be visibility in terms of the transaction. And that may be most relevant to what I think has been the constant theme in this discussion today, is the concern about technology. So I think that is—and I think that was your focus in the legislation.

Mr. MOONEY. Sure. And I guess also, to follow up on that, how do you determine if—normally a company is owned by somebody if they have 51 percent of the stock or more. They are a majority shareholder. But if a Chinese company or some other company in the world buys a third of the company, or 5 percent, or even 1 percent of the stock, are they then considered eligible to be reviewed by the CFIUS process because they have access to sensitive information? Or do they have to have a certain amount of stock? Like, how do you determine that, is my question.

Mr. HUNTER. One of the virtues as a Government official, one of the virtues of CFIUS is its flexibility, both in its national security definition, but also the definition of control. Control is basically the ability to influence business decisions and financial decisions and personnel decisions. It doesn't really matter what the threshold in terms of ownership is.

Mr. MOONEY. And then another follow up, and you can answer both of these if you want. I only have a minute left. But I read an article about a port, or a trucking company, an exchange company, that would have access to the information for a short period of time. They don't own the chip-making company, but they own the truck or the boat that is going to transport it, and there were some concerns about that. Is that also something that you look at?

Go ahead, Dr. Scissors.

Mr. SCISSORS. This is a very important point because you have to decide what constitutes control. And I agree that it requires flexibility and we are not always going to do a perfect job of this.

My solution is, it is where firms respond to money. If the Chinese are putting money in a firm, directly or indirectly, I don't care if they formally own it or whether they have seats on the board. So if you look at dependence on Chinese financing, that is when you know the Chinese have influence. That is when you know data could be compromised.

Mr. MOONEY. I guess my last 20 seconds, Mr. Chairman, I would just suggest that if they control the port or the truck or the airplane and they have total control of that product for a few days, they can look in the product and get everything they want out of it, and then go ahead and ship it. So that could be something of concern that we need to watch more closely.

Thank you, Mr. Chairman.

Chairman BARR. The gentleman yields back.

The Chair recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you.

I have asked the prior panelists the same question. CFIUS does not currently contain an explicit provision stopping state sponsors of terror or companies based in countries that are state sponsors of terror or other nations that support terror but are not formally designated from acquiring U.S. assets.

Do you believe that we should put into the statute a requirement that we explicitly take into consideration whether the company seeking to invest in the United States is located and based in a country that supports terror? Does everyone agree with that? Let me know if anyone disagrees.

Mr. BLAIR. If you use the phrase take into consideration, I don't think any of us would disagree. Of course you should take into consideration. And Dr. Scissors has been quite eloquent about the control that authoritarian countries can have over the company.

But I think you have to look at the company itself as well. Has it, in fact, connived in or supplied the materials for terrorism? Has it done it? And then you make a call. But take it into consideration, absolutely.

Mr. SHERMAN. Yes.

Mr. KASSINGER. Mr. Sherman, I would just add two things.

One is most, if not all, of the countries designated as state sponsors of terrorism are, of course, a subject of U.S. sanctions, which would preclude investments in the U.S. in most cases anyway.

Second, I don't think there is any question that CFIUS would take into account, in its threat analysis, the status of the country.

Mr. SHERMAN. I would point out that with our current trade relationship with China, they export goods here, they don't allow us to export goods there. When they do, they require a co-production agreement. We have a huge trade imbalance.

And we can try to have government stand in the way of this tidal wave, but those dollars do come back to the United States either as loans or investments in U.S. Government bonds or as direct controlling investments in our companies, and that the real solution to this is to impose such tariffs as are necessary to assure a balanced trade agreement.

I am concerned with the CFIUS process that allowed China to control the AMC movie screens. Do we have sufficient provisions in CFIUS designed to prevent them from controlling what movies are made in the United States? Because I will tell you now, if you have another movie about Tibet and it can't be shown on one quarter of the movie screens in the United States, they aren't going to make the movie.

Does anybody have a comment on that?

Dr. Kennedy.

Mr. KENNEDY. I agree that Chinese investment in Hollywood and influence over movies and China's effort to influence popular opinion positively toward China is an issue that the U.S. needs to be aware of.

Mr. SHERMAN. And I would also point out they also control, because we have accepted it, have not imposed massive tariffs in response to their limitation—first of all, the theft of our intellectual property. But, second, they limit us to 35 to 40 movies. So every studio is turning somersaults trying to make their movies favorable to China so that they can get in.

Mr. KENNEDY. So I would agree that these are problems in the commercial relationship and things that Washington ought to be worried about. I just don't think that the CFIUS process is the appropriate place to manage that, just because we have already talked about potentially adding all companies where we have all different kinds of IP problems or where it is not necessarily a deal in the United States.

But I guess the question is, from a practical perspective, what is the best approach? And I am not sure that CFIUS would be the best approach.

Mr. SHERMAN. If you buy one studio, you control one studio. If you control the entire Chinese movie market and a quarter of the screens or a fifth of the screens in the United States, then you control all the studios in the United States because not one of them will dare to make that next Tibet movie.

I will try to squeeze in one more question and that is, does CFIUS adequately take into consideration, not only the technology that is being acquired in the target company, but the technology that company has the capacity to develop? Does someone have an answer to that?

Mr. SCISSORS. I will say that, I consider that almost impossible. The great thing about the American economy is how innovative it is. And today's company that is leading, is tomorrow's loser because it has been surpassed.

I think it is a legitimate concern that China would, or another country, potentially buys a lot of U.S. startups because some of them may pay off. But I think CFIUS has a difficult task in evaluating that security threat.

Mr. SHERMAN. Is the solution there to have CFIUS have the right to force a divestiture?

Mr. SCISSORS. I think the solution is for CFIUS to have a re-review right, yes. If the Chinese buy a company that we don't consider a national security threat and it becomes one later, CFIUS should be able to re-review.

Chairman BARR. The gentleman's time has expired.

The Chair recognizes the gentleman from Ohio, Mr. Davidson.

Mr. DAVIDSON. Thank you, Mr. Chairman.

Witnesses, I thank you all for your expertise on this subject matter and your willingness to come share it with us. So it is nice to spend some time talking about this very important topic for all of U.S. national security.

Frankly, I spent my first years as an adult wearing our uniform in the United States Army. And I thought at the time I would probably never—well, back then, the cold war was going on. We were thinking about the Soviets and the threat. And then we think about China, and I thought I would probably never go there without a rucksack full of ammo, some body armor, night vision goggles, and all the kit.

But I was fortunate to go there and do a fair bit of trade. So I have seen a lot from 2005 until the end of 2015 when I decided to run for this office. Now that I am here, I see things that we are doing from a policy thing in a different way.

But I will highlight one of the concerns I had while I was at West Point was the technology transfer. Hughes transferred the ability to launch multiple satellites in this case—could be warheads—from one launch vehicle to China. In fact, that was one of the first things President Clinton did, was shift release authority for sensitive technology from Defense to Commerce. Unfortunately, shortly thereafter Secretary of Commerce Brown died in a plane crash. So we still aren't able to ascertain some of his opinions about that transfer.

But I am curious to know where the gaps are between technology transfer. Because if you think about a company like—let's just take Apple. They don't generally buy everything that they need. They license lots of things. So they don't necessarily control it, but they have access to exactly how it works.

So could you highlight that interplay between CFIUS, which deals with control, and export control, which nearly uniformly the panel seems to say, keep this separation between the two? But I think there is a pretty important gap to understand there.

Mr. BLAIR. I will start, but there are practitioners here who have worked in this.

The shortcomings right now in the Export Control Act, ITAR, and so on, are that it requires a more defined definition of the technology and it is generally at a more advanced stage and a license has to be granted and so on.

The concern now in the fast-moving world of military technology and other technology are the potential, which has not formed itself

into the technology to build a device but pretty applicable, whether it is artificial intelligence or high-speed computers or any of the others.

Right now the Export Control Act does not reach far enough into those things which experts can figure out are pretty much a threat. So we need to fill in that gap between CFIUS and the export control pushing from one direction or another. You all are considering CFIUS. I vote for having CFIUS take up some of the burden of trying to protect that earlier-stage technology that will have military application soon.

Mr. DAVIDSON. Thank you.

Mr. Hunter, you highlighted some concerns. Could you please address them?

Mr. HUNTER. Thank you.

Well, first off, export control issues come up in CFIUS. And CFIUS does deal with those. Export control officials participate in CFIUS. So there is overlap.

Second, while we have a pretty robust, well-thought-out export control regime, one, the legislation on which it is based has lapsed. It is being supported now through IEEPA, so the temporary authority. That is worth looking at.

Second, the policy process, which Admiral Blair was highlighting, for designating which technologies need to be protected is not keeping pace with the evolution of the technology. That you might look at as something of a software problem, something that, again, Congress may want to look at, as well as the Administration.

But the tools exist. And they are highly adaptable. They can deal with evolving technologies. They can deal with transfers outside the United States of U.S. technology.

Mr. DAVIDSON. Thank you, sir.

Mr. Kennedy, maybe, any concerns there, that you want to address?

Mr. KENNEDY. I would agree. I am particularly worried about Chinese investment in Silicon Valley and elsewhere with investment funds that then go around scooping up garage-size companies that end up providing technology which has commercial and military applications, which I think needs to be covered. Whether that is through expanding CFIUS or through export controls, I think whatever is most practical makes the most sense.

Mr. DAVIDSON. Thank you.

And I would highlight, some of the things we look at that seem nefarious, it is good that you highlighted that CFIUS does have the capability to address. So if you think an investment through Ireland as a vehicle, for example, where beneficial control is Chinese, perhaps it is because of the tax haven. So, hopefully, we have done some good with our own tax laws. Thank you.

Mr. Chairman, I yield.

Chairman BARR. The gentleman yields back.

The Chair recognizes the gentlelady from Utah, Mrs. Love.

Mrs. LOVE. Thank you. Thank you very much for being here.

Mr. Hunter, you mentioned in your written statement that the recent flow of Chinese investment, $46 billion into Europe and $48 billion into North America in 2016, has spurred concerns across advanced markets. Since the United States is not the only advanced

market generating cutting edge technologies, unilateral U.S. action is less likely to be effective over time.

I would like to ask you, and maybe some of the other witnesses, if they have any comments to add on this, how the United States could best coordinate with other countries, either bilaterally or through forums such as G7 or OECD, to evaluate the implications of these transactions. And what should that coordination look like? For instance, should we coordinate on specific cases or do you think we should be more general in our coordination?

Mr. HUNTER. Thank you, Representative Love.

The substantial increase of Chinese investment, as we have discussed and Derek Scissors has highlighted, is having a political effect across advanced markets. You have seen legislative changes, regulatory changes in Germany. The United Kingdom is considering its own CFIUS process. The EU has proposed a framework as well. And then there are a number of very sensitive cases that have come up in a number of countries, like Australia.

I think that the opportunities for coordination are two, as you highlighted. One is on the policy. I think it would be a wise thing for this Administration and Congress to engage with counterparts in other advanced markets to ensure that their legal systems, their regulatory systems, are adequate to the challenges, that are both transparent, predictable, but also address the national security issues that may be there.

Second, on individual cases, the CFIUS legislation imposes strict constraints on confidentiality and the handling of information relating to transactions. That is entirely appropriate. However, those confidentiality rules could have an unintended consequence in restricting the ability of our national security officials to communicate with their counterparts.

And it would make sense, it would seem to me, that just as our competition officials can communicate with their counterparts in other countries, that our national security officials can communicate with their counterparts about particular individual transactions. So I think both dimensions are possible.

Mrs. LOVE. So you think it should be, as far as you are concerned, all of the of the above, just on general policy and also on specific transactions?

Mr. HUNTER. Correct.

Mrs. LOVE. OK.

Does anybody else have anything?

OK. Yes.

Mr. SCISSORS. So we have an example of CFIUS working with a country that does not have an investment review process already, which is the U.S. coordinated with Germany to block a Chinese purchase of a German chip firm in 2016. We can do that on an ad hoc basis. What I think would be more useful is if the Congress, the Administration, laid out principles for how they would like to guide the regime.

I spent a lot of last year in Australia, in Germany, talking to governments. They do see this as a concern, as Mr. Hunter just said. But they are behind us. We are considering more advanced questions than they are. And I think the number one thing the U.S. can do to its allies is tell them what we think is most important, as

practical as saying not semiconductor investment right now, that is what we want you to close off.

Mrs. LOVE. Are we not doing that currently?

Mr. SCISSORS. Talking to Europe about their political process is very confusing, at least for me. But they don't perceive that we are doing that. And one of the reasons is we are having an extensive and valuable debate here.

My point is, at the conclusion of this debate, if we adopt some clear principles about what we want to do, that is the first step, and countries are waiting for that.

Mrs. LOVE. OK. So the general consensus is to make sure we have at least our ducks in a row and then communicate that and let everyone know which standards that are OK.

Would our European trading partners have any reservations about coordinating with the United States as far as you are concerned? Do you see any circumstances where they would have some trouble or reservations about coordinating with the United States?

Mr. SCISSORS. Well, having just been there and had this discussion, they are not going to adopt the same tactics and strategies that we are. They are actually probably more concerned about personal data. But they are also not going to get into a war over Taiwan with technology that was taken from European firms because they don't have the same military concerns.

So I see the European side as more interested in economics than we are, less interested in national security. It is not that they will hesitate to cooperate, but they have their own priorities.

Mrs. LOVE. OK. Thank you.

Chairman BARR. The gentlelady's time has expired.

The Chair recognizes the gentleman from Arkansas, Mr. Hill.

Mr. HILL. I thank the chairman and the Ranking Member for this second and a good hearing on discussing how we can improve our CFIUS process. And I certainly think it needs to have the flexibility that keeps up with the times, both in terms of style of investing in companies or technology, keep up with the changing times in how technologies develop. I thank the chairman for his work, and I certainly thank my friend from North Carolina for his work in bringing this to us.

But we also need to keep in mind, we need a permanent reauthorization of our export control systematic process as well. These two work hand-in-hand. One doesn't work without the other. Both need improvement. That is something that I think Congress should and must do.

Also, listening to the testimony today in our first panel, this is something we have gotten right since World War II. We know how to do this over the years. We have led the world in trade liberalization during that period, but we have also protected what we thought was important here in our country, not just national security, but media ownership, control of the media was an equally important issue, telecommunications, utilities, and power generation in this country.

All of these things are important. So I don't want us to lose sight that we can do more than just the military application of technology in this work, and that is not inconsistent with standing as the world's leader in trade liberalization.

Admiral Blair, I have a question for you. In listening to your testimony and reading it, very interesting in terms of your re-review recommendation that came from your panel, review acquisitions that have been previously approved when new evidence comes to light of damaging actions by foreign companies. I found that interesting.

Are you suggesting that the U.S., through the CFIUS process, have a no-buy list, that we actually essentially put companies on a no-buy list for just general purposes because of their—maybe what country they are—this is a nonsanctioned country, let's presume. What is your response to that?

Mr. BLAIR. If I were DNI again, I would establish an organization somewhat like our National Counterterrorism Center where you have a fairly sizable, several dozen people, some of them full-time staff, some of them detail personnel coming from other agencies, Commerce. They would have a different character from the combination of intelligence analysts and legally trained people that we primarily use now.

And you would really have a group that knows about what is going on in this world of foreign companies dealing in the United States, dealing with technology. And you would have built up databases so that instead of having a research project for each new transaction that came along, you would have a sense of where these companies were, and who ought to be ruled out right from the start, and who requires more research.

So in that sense, yes, it would develop a de facto, this company is dirty, we are not going to approve anything that they do.

Mr. HILL. Yes. So we wouldn't even entertain a transaction?

Mr. BLAIR. No. And I think that would be a very powerful tool for the United States to develop.

Right now, I would defy you to find that—Dr. Scissors has been very kind. But the people who work on export control within the intelligence community are part-timers who have other jobs. It is not that full time, intense, really understand the world.

A lot of this information is done by private research firms. But we can tap that. We can bring them in. And then we know what is going on, and then we can make smart decisions.

Mr. HILL. I thank you for your contributions to the debate and your leadership for our country.

And I would like to yield, Mr. Chairman, what time I have remaining to my friend from North Carolina.

Mr. PITTENGER. Thank you, my good friend, Mr. Hill.

Again, thanks to each of you all.

I would like to clarify that I am from North Carolina. We have, in my district, the largest hog processing plant in the world in Bladen County, and it is owned by the Chinese, a Smithfield processing plant. So I have a great respect for Chinese investments. Notwithstanding that, I do have a concern for their focus today.

Admiral Rogers, Director of the NSA, stated that: "I think we need to step back and reassess the CFIUS process and make sure it is optimized for the world of today and tomorrow, because I am watching nation-states generate insight and knowledge about our process. They understand our CFIUS structure. They understand the criteria broadly that we use to make harder, broader policy de-

cisions, and it is an investment acceptable from a national security perspective."

So I would just say to each of you, as we move forward with this deliberation, your perspective is welcome and appreciated because this is a very important area for us to address.

Thank you very much. I yield back.

Chairman BARR. The gentleman yields back.

The Chair now recognizes the gentleman from Florida, Mr. Posey.

Mr. POSEY. Thank you very much, Mr. Chairman, for having this hearing and for allowing me to participate in the discussion on the Committee on Foreign Investment in the United States, or CFIUS, as it is known.

Is there anyone on the panel who would disagree with the statement that national security is a mission of the Committee on Foreign Investment in the United States?

OK. We all agree on that.

Out of curiosity, have any of you ever read the book "One Second After"? It was a New York Times bestseller by William Forstchen who talked about an absolutely incredible threat to this country. It is a novel, but it is based on confidential and some public Congressional resources. Has anyone ever heard of that or read that book?

Many are concerned about the entry of a Middle Eastern company as an investor and service provider in container operations at one of Florida's seaports. Since 9/11, the Nation has been focused on the potential threats posed by containers as a vehicle for delivering terrorist activities to our shores. TSA is spending millions on screening of these containers.

I am thinking that the entry of a firm like this with uncertain relationships to terrorist organizations should be reviewed by the Committee on Foreign Investment in the United States. And I am just wondering if you are aware of any current authorities that would require CFIUS to be involved in this.

OK. Seeing none.

Recently, my office attempted to contact the Committee on Foreign Investment in the United States, or CFIUS, at the Treasury Department to discuss this inbound foreign investment transaction and were told that one Federal staff liaison was managing 90 percent of the inquiries related to CFIUS filings. My understanding is that CFIUS does not have a dedicated staff at the U.S. Department of Treasury.

Two questions. Given the information, do the current resources allocated to CFIUS seem adequate? I could take a quick yes or no from each of you.

Secondarily, what types of mitigation requirements or agreements might be appropriate in a case between one of our Nation's busiest ports—containing a nuclear sub base, by the way, and adjacent to Cape Kennedy, physically adjacent to Cape Kennedy—and a Middle Eastern cargo terminal operations company?

Mr. BLAIR. So the scenario is, Mr. Posey, that the Middle East company that operates part of a cargo facility would actively allow a terrorist organization to use that access to introduce a device into the United States? I haven't read the book so I am not quite sure of the—

Mr. POSEY. Well, actually, the book is background material. In this particular case, we have a Middle Eastern company, a container company involved in a lease with a port, I think a very, very critical location of a port.

And I don't know even if it is even remotely true, but there have been posts and there have been statements to the effect that some of the principals in this cargo company might be terrorist sympathetic in one way or another.

And it has amazed me that we have not been able to be find any Federal agency that vets people who lease property at our ports like this for our national security, for the interest of our national security. The agencies we have contacted have passed the buck, one to the other, and by definition it seems like that might fit in here. That is why I appreciate the kindness of the chairman to let me sit in on this and seek your information or input for this.

Mr. BLAIR. Right. Well, I think you ought to keep on it until you get a good explanation. It sounds like something that should be—I am not sure if it is CFIUS, export control, antiterrorist legislation, or what the right legal thing is. But I think you are absolutely right to get a good investigation of this so you are satisfied whether this is a clean operation or not.

Mr. KASSINGER. Mr. Posey, I would say there certainly are permanent employees of the Treasury assigned to CFIUS matters, including the CFIUS staff chairman, and you might well go directly there.

Also, the Department of Homeland Security has comprehensive regulatory authority over port security matters, and I would think they would have resources here.

Mr. SCISSORS. A comment has been made, starting with the Ranking Member, and I think everyone agrees, that resources are crucial. And CFIUS is not resourced properly, in my own view, because of a surge of Chinese investment in 2016 that we didn't respond to in terms of resources.

But I will add one other thing. You should be able to get an answer. One of the things that has been raised by other people, and I entirely agree with is, there are some ways in which this process can be more transparent. An answer like, "Yes, we reviewed this company and we did not find any embedded foreign intelligence assets", privately made to a Member of Congress, seems to be appropriate.

Mr. POSEY. Thank you.

Thank you, Mr. Chairman.

Chairman BARR. The gentleman's time has expired.

And there is a request for a brief second round of questioning, and I will start with myself for an additional 5 minutes and then recognize a couple of other members.

I want to revisit this issue of the interplay between the export control regime and CFIUS. It appears to me that there is a diversity of opinion about what CFIUS reform should look like in that regard and whether or not the CFIUS process should become a one-stop shop.

Admiral Blair, I take it that is your view, that the CFIUS process should be a one-stop shop and that there should be greater in-

tegration between CFIUS and export controls, and maybe Mr. Hunter disagrees with that.

Could you all amplify that discussion a little bit and help us examine what is the right policy direction?

Mr. BLAIR. Well, Mr. Hunter has worked on the other end of the organization. But I would say in this area that having both belts and suspenders is not a bad idea and that if there is some overlap in terms of the point in technological development at which you make a regulatory—a go/no-go, decision, is going to be moving.

So if have you a company in which you have some of the top AI people in the world that are working on something that has a military application, and there is a minority Chinese interest in it that brings Chinese workers in to learn—and by technology, how to approach this, the human potential—that is something you ought to look at, at the early stage of the CFIUS level.

Once this is turned into a device which can build a piece of equipment with a military application, then, of course, ITAR and export controls have to be considered.

But there are a whole range of threats that exist ahead of time that I think can be handled better by CFIUS consideration at the beginning of the covered transaction rather than waiting until you know exactly what piece of militarily relevant equipment is there. And I think I would attack it from the CFIUS end as well as from the other end.

Chairman BARR. Mr. Hunter, do you disagree with that assessment, and why?

Mr. HUNTER. I think there is a consensus, probably across the table here, about the importance of the technology control. And I think to the extent that there are divergences, it is about the best tool to deal with the emerging technologies.

My concern about CFIUS is that it is, as I mentioned earlier, reactive. It only deals with cases that are presented to it. It is very time consuming. And the beauty of the export control regime, when it is operating properly, is that it can be much more systematic. It can set rules that apply across the economy.

Now, what has been missing, and I think this is where Admiral Blair is highlighting, and others, is the policy development, the identification of the technologies that need to be controlled. But certainly the tools exist. Indeed, Secretary Kassinger supervised the operation of those tools in his time as deputy secretary, so he could probably speak to it as well.

But this is not a disagreement about the fundamental policy. I think it is about the tools.

Chairman BARR. I am sensitive to the concern about the time-consuming nature of the CFIUS process. I think the admiral painted out that we should be able to be identify—I think Dr. Scissors as well—there are some obvious cases of actors that are engaged in nefarious activities attempting to obtain technology transfer.

I know, I think, in the last time the CFIUS process was updated, 2007 timeframe, that there were some deadlines and timelines that were codified in that process. Could we do a better job in putting some better timelines in place that would allow the process to work so that the transaction would be approved or disapproved in a timely manner? Anybody want to comment on that?

Dr. Scissors.

Mr. SCISSORS. I am just going to take a couple of examples, and this is probably dangerous to generalize from. But I think the short timelines are now hurting us. What we have is CFIUS not responding within its allocated time, and companies, a lot of companies, refiling, refile, refile, refile.

That is not the system we want to create. We want to think about what is an adequate amount of time, in the current environment, not 10 years ago, in the current environment, for CFIUS to respond to a company, and then tell them that, and they get a final decision. They don't get a constant resubmission.

So I am not sure short time is the solution. Sticking to the deadline, whatever it is, is a better approach.

Chairman BARR. Mr. Kassinger.

Mr. KASSINGER. Just quickly on that. I think timelines are misleading in the sense that CFIUS doesn't even initiate a case until it has spent a lot of time with companies beforehand.

But, second, I do think that the existent timeline should be extended. I think Mr. Pittenger's suggestion in his bill of extending the initial review period is a good one. I think we need it in the current environment.

Chairman BARR. My time has expired. And I will now recognize the gentleman from Washington, Mr. Heck, for an additional round.

Mr. HECK. Thank you, Mr. Chairman.

Dr. Scissors, back to you. You have written and I think asserted here again today that you think the basis for CFIUS evaluation ought to be restricted to national security considerations. I agree with you. Not everybody does. There are some people who advocate broadening this mission.

So I think this is a very basic issue for our considerations. I know why I believe the way I do. But, as succinctly as possible, will you share with us why you think it is important to restrict CFIUS evaluations to national security considerations?

Mr. SCISSORS. Two reasons, a U.S. reason and a China reason.

The U.S. reason is, I really like foreign investment. It creates jobs. It improves competition. It gives better products to Americans. I want the default to be, we let in foreign investment unless we have a really good reason not to.

The China-specific reason is that because of the rise of China, because of the rise of their investment around the world as seen in the last 12–13 years, it is a big job for CFIUS just to do national security. We have heard people who disagree on other issues all agree on that. I think we absolutely have to get the national security mission right before we think about anything else.

Mr. HECK. So second and last, I was fascinated by your comment in your opening remarks about understanding, however, that national security may be more broadly defined than we have traditionally. It is not just software related to rocketry, for example, but it could include access to personal data that can then be weaponized in an effort against us.

I assume that you are aware that section 15 of our proposed bill, which delineates factors to be considered, includes the following language in subsection 14, and I quote: "The extent to which the

covered transaction is likely to expose, either directly or indirectly, personally identifiable information, genetic information, or other sensitive data of United States citizens to access by a foreign government or foreign person that may exploit that information in a manner that threatens national security," end quote.

So my question is what your reaction is to that. Is that adequate? Would you have any recommended changes to it? Or do you think this gets at the nubbins of what I thought you so appropriately raised at the top of this hearing?

Mr. SCISSORS. I think it gets at it. I think there is a legitimate issue of when personal data actually threatens the national security. But I don't think there is any question that as Chinese firms become more interested in U.S. firms which hold personal data, there is a potential national security risk there.

This is one of the changes that has occurred and I think the bill responds appropriately to it, with the caveat that this is going to be hard. Not everything involving personal data is a threat to national security, but it should be one of the considerations for CFIUS.

Mr. HECK. You are satisfied with this information? Remember, I am a cosponsor of this bill before you respond.

Mr. KASSINGER. And the first thing I would say is your definition captures exactly current CFIUS practice. So I think it would codify it and that is a good thing.

Second, I want to echo Derek's comments about personal data being a very difficult issue. I thought his original comment was, any consumer-facing company would have to be off limits because they all collect personal data. That would include the Washington Redskins. Think how much personal data is collected by a sports team with its ticket buyers.

So it is a very difficult issue. I don't think there are any bright line tests that can be made. But ensuring that CFIUS takes into account appropriately how to deal with personal data issues is an important task of the committee.

Mr. HECK. Thank you, sir.

And with that, not only I do yield back, I want to reiterate my gratitude to the Chair for holding this second hearing on a very important topic.

Chairman BARR. I thank the gentleman.

And for the final word today I will return to the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman.

Again, thanks to each of you all sincerely.

I would like to clarify for those who may be watching this hearing that this is a bill, H.R. 4311, that is directly laser focused on national security application. And it is not by design or intent or purpose to have a broader construct than that. As well as this effort will be led by Treasury, with some 16 agencies having involvement.

So I think the purview of Treasury, in the total engagement by the broad spectrum of our government, is very critical going forward as we consider the direct interest by our adversaries in acquiring our technology companies, we have the right people who are positioned to review future interest.

So, again, thank you so much for being with us. I know that we have much more to discuss. I think as we all look ahead, we know that this is a critical area of concern for our national security.

Thank you very much. I yield back.

Chairman BARR. The gentleman yields back. Thank you.

And I would like to thank our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 12:05 p.m., the subcommittee was adjourned.]

A P P E N D I X

January 9, 2018

THE
IP COMMISSION
THE COMMISSION ON THE THEFT OF
AMERICAN INTELLECTUAL PROPERTY

Testimony before the House Committee on Financial Services

Subcommittee on Monetary Policy and Trade

United States House of Representatives

Hearing:

"Evaluating CFIUS: Challenges Posed by a Changing Global Economy"

Testimony by:

Dennis C. Blair

Co-chair

The Commission on the Theft of American Intellectual Property

January 9, 2018

2128 Rayburn House Office Building

I. Introduction

Chairman Barr, Ranking Member Moore, and members of the Committee, thank you for the opportunity to testify on this important matter.

My recommendations in the testimony are based on my work as co-chair of the Commission on the Theft of American Intellectual Property (IP Commission), and on my observations of the behavior of this country's economic and security competitors since the end of the Cold War. While this hearing is primarily concerned with how the Committee on Foreign Investment in the United States (CFIUS) process might usefully be reformed, I encourage members and committee staff to review the findings of both the original IP Commission report and the 2017 update for additional details on the scale and scope of the IP theft problem. We have brought copies of those reports today.

II. CFIUS Reform

The bill to reform CFIUS currently under consideration by this committee is welcome. In the ten years since CFIUS was last updated, there have been many developments. We have learned a great deal about how other countries and their companies are able to take advantage of the American economy while working actively against American interests in other areas.

The Foreign Investment Risk Review Modernization Act (FIRRMA) is a welcome and necessary update to the current CFIUS statute. It recognizes that majority ownership of a U.S. company is not the only way that foreign countries gain access to cutting edge U.S. technology with potential military applications. It widens the categories of "covered transactions" to include deals short of full ownership that would enable the loss of militarily relevant technology of a U.S. company. One of its most important features is the updating and expanding of the specific factors that CFIUS may consider when analyzing a transaction's national security implications. For example, it adds the following as a specific factor: "Whether the transaction involves a country of special concern that has a demonstrated or declared the strategic goal of acquiring a type of critical technology that a U.S. business that is a party to the transaction possesses."

Chinese investors are now involved in up to 10% of all American venture deals, and especially in startups in areas such as AI, autonomous vehicles, augmented/virtual reality, robotics, and blockchain technology, all important to American military effectiveness in the future. The CFIUS process needs to cover these transactions and these areas to ensure that we preserve the American edge.

Beyond the important considerations of preserving our advantage in military technology, I recommend that the CFIUS process be expanded to punish foreign companies for actions that have already damaged our economic and national security. By punishing past damaging behavior, we can prevent future harm by those companies and deter damaging behavior by other companies. I would add to the CFIUS process the following principle: If a foreign company has stolen American intellectual property, or has taken actions against American security policies or

interests, it should not be allowed to invest in this country – it should not be allowed to purchase ownership of American companies.

This principle would widen the current military security focus of the CFIUS process. Over the decades CFIUS has addressed many different risks of foreign investment in this country, from petrodollar investment from countries in the Middle East to Japanese investment in American companies and real estate in the 1980s. These investments did not pose immediate military risks to the United States, but they had the potential to pose economic risks. In the long term, our national security depends on our economic vibrancy and growth. CFIUS should be the means by which the United States controls foreign investment that causes risks to the country, whether they are financial, commercial or military.

III. Foreign Investment Risks

Foreign companies, predominately Chinese companies, with the encouragement of official Chinese policy and often the active participation of government personnel, have been pillaging the intellectual property of American companies. This is a significantly new environment from the one that existed when CFIUS was last reformed ten years ago. In an updated report last year by the IP Commission, which Ambassador Jon Huntsman and I originally co-chaired, and which I now co-chair with Craig Barrett, we found that all together, IP theft costs the United States up to $600 billion a year, which is more than the total U.S. trade deficit with Asia. China accounts for most of that loss.

Deficiencies in China's IP rights regime have gone uncorrected, with cyber theft and forced data transfers being particularly harmful. China singles out high-tech sectors in its five-year plans, increasing pressure on Chinese firms to procure the technologies necessary to reach or surpass global competitors, in some cases using Chinese government-controlled entities to illegally acquire the intellectual property. Affected sectors include electronics, telecommunications, robotics, data services, pharmaceuticals, mobile phone services, satellite communications and imagery, and business application software.

The United States urgently needs a comprehensive program to deal with this hemorrhage of its competitive advantage, and our Commission report lists the many elements of such a program. However, at a minimum, Chinese and other foreign companies that have stolen American intellectual property should not be allowed to invest in this country. We need to face these companies with a choice – either follow American intellectual property rights law or do no business in the United States. The CFIUS process should be a part of imposing this choice.

Chinese companies like Sinovel, one of the world's largest producers of wind turbines, should be stopped from investing in U.S. companies, based on Sionovel's theft of intellectual property from American Superconductor (AMSC). Chinese companies that manufacture solar panels like Trina Solar and JA Solar, two of the top builders and installers of solar panels in the world, with subsidiaries in the United States, and both of which have used IP stolen from the American

company SolarWorld, should not be allowed to invest in this country. Companies like the huge Jiangsu Shinri Machinery Company, which stole intellectual property from its joint venture partner Fellowes, should not be allowed to invest in the United States.

There are many ways beyond IP theft that foreign companies, sometimes acting on their own, sometimes compelled or induced by their own governments, have harmed American security interests. They have undercut American sanctions against authoritarian regimes that oppress their own people, supported terrorist groups or contributed to the development of nuclear weapons. Most of these foreign companies do not invest in the United States where they would be subject to CFIUS review, and there are other ways under American law of dealing with them, especially denial of their access to the American banking system. However, it is not clear to me, for example, whether we have kept a list of the Dutch, German and French companies that supplied the AQ Kahn-led Pakistani nuclear development program, and whether we use that information in the CFIUS process. I would guess not. We should develop a list of companies like this, their current structures, related parent and partner companies, and ensure they are not able to invest here.

Major international companies that have harmed American security interests have been able to purchase American companies. For example, the primary Chinese company that built up seven features in the South China Sea into potential military bases is a subsidiary of the China Communications Construction Company, known by its initials CCCC. In August 2010, another subsidiary of CCCC purchased an American company that is the world's leading designer of offshore drilling rigs, the Houston-based company Friede Goldman United, or F&G. We should face CCCC, one of the top international construction companies in the world, with a choice: either cooperate with the Chinese government against American interests or invest in the United States. You can't have it both ways.

To give another Chinese example. It was China Oilfield Services Limited (COSL), a subsidiary of the Chinese energy giant China National Offshore Oil Corporation, or CNOOC, that deployed drilling rig HD 981 into disputed waters in the South China Sea in May 2014 and provoked a confrontation with Vietnam. CNOOC is no stranger to the CFIUS process, having been denied permission to purchase UNOCAL in 2005. CNOOC should not be allowed to purchase American companies or raise funds in the United States so long as it serves as a partner with the Chinese government in aggressive actions against American interests.

IV. CFIUS Capacity

Those in the U.S. government who work every day on CFIUS reviews in my observation are knowledgeable, dedicated, and effective. However even under the current statute, they are straining to meet the tight deadlines of a CFIUS application review with in-depth research. If the Congress expands the CFIUS standard in the direction I recommend, it will take more government officials to do the work. It will take additional staff with different skills. Lawyers

and part-time military analysts currently do most of the work within the government to staff CFIUS decisions. We need to add officials with business backgrounds, especially in finance and M&A. We need to take advantage of private, independent business analysts who follow specific industries in microscopic details. We need to exchange information with organizations in Europe and Japan that have unique insights into their foreign competitors. We need to build up fresh databases tracking the activities of foreign companies so that we can quickly identify those that have engaged in harmful activity in the past. Those databases need to include the very complicated ownership structures of foreign companies, in many cases specifically designed to hide subsidiaries that are harming American interests. If we are serious about this national security threat, we would establish an organization like the National Counterterrorism Center, or NCTC, with a combination of full-time staff and personnel detailed from other government departments and agencies – a true center of expertise on the activities and structure of foreign companies taking actions and posing risks hostile to American interests.

V. Summary of Recommendations

Let me summarize the three major areas in which I believe the CFIUS legislation can be strengthened:

1. Approve the provisions of FIRRMA to update the CFIUS statute to deal with the new threats to our military technology from foreign investments.

2. Broaden the criteria for review to include whether acquiring companies have damaged or threatened U.S. national security or the national security of U.S. treaty allies through the illegal acquisition of American intellectual property, or other activities against American security polices and interests.

3. Review acquisitions that have been previously approved when new evidence comes to light of damaging actions by the foreign companies.

4. Increase staffing to support CFIUS decisions, and expand the exchange of information with the private sector and with our allies.

VI. Conclusion

The scale and scope of the theft of American intellectual property and of other actions by foreign companies against our interests demand robust policy responses that fundamentally change the cost-benefit calculus of foreign companies. Reforming the CFIUS process to include an IP protections evaluation—both before and after acquisition of American firms—and then staffing the CFIUS interagency team with sufficient resources to conduct this more thorough review are important next steps. I look forward to your questions.

Written Testimony of

Rod Hunter
Former Special Assistant to the President and
Senior Director, National Security Council

Before the Subcommittee on Monetary Policy and Trade
of the
Committee on Financial Services
United States House of Representatives

Evaluating CFIUS: Challenges Posed by a Changing Global Economy

January 9, 2018

Mr. Chairman, Ranking Member Moore, members of the Subcommittee,

Thank you for the invitation to discuss this topic. It is a pleasure to appear with my distinguished fellow panel members.

Based on my experience in a prior administration and as a practicing attorney, I would like to offer some observations on the Committee on Foreign Investment in the United States (CFIUS), the President's authority, and the evolving context.

My government experience with CFIUS derives from my time on the staff of the National Security Council (NSC). While the Treasury Secretary chairs the interagency CFIUS, the ultimate authority under the legislation is the President's power to block or unwind a transaction. Accordingly, sensitive or difficult CFIUS reviews, at least in the administration of President George W. Bush, were managed through the NSC, especially when there was a diversity of views within the committee.

Foreign investment

An open investment regime is an important source of strength for the U.S. economy. Our stock of inbound foreign direct investment (FDI) is 35% of nominal GDP, or $6.56 trillion, and economic analysis has shown that FDI benefits the economy by contributing to output, jobs, exports, and research and development in the United States. According to a 2013 report on FDI prepared by the Council of Economic Advisers and the Commerce Department, majority-owned U.S. affiliates of foreign companies contributed 4.7 percent of total private output, 4.1 percent of private-sector employment, 20.5 percent of goods exports, 9.6 percent of private investment, and 15.9 percent of private research and development spending in the United States. The report also found that U.S. affiliate firms tend to hire highly skilled workers and to compensate them at levels significantly higher than the U.S. average over time. In 2011, compensation at such firms averaged more than $77,000 per U.S. employee as compared to average earnings of $58,000 per worker in the economy as a whole.

Chinese investment has raised concerns in the United States and across advanced markets as investors from China have sought to buy assets in sensitive and politically salient sectors ranging from semiconductors, to robotics, to food and agriculture. In many respects these investment flows reflect a normal balancing given the size of that country's economy. In 2016, some $94 billion in Chinese outbound investment went to the advanced markets of North America and Europe.

While the numbers are impressive, the Chinese outbound investment flows as a share of China's Gross Domestic Product (GDP) are in conventional ranges. Looking at 2015 OECD data, Chinese outbound investment flows represented 1.6 percent of Chinese GDP, while the United States' outbound investment represented 1.6 percent. The European Union (3.6 percent of GDP) and Japan (2.9 percent) had higher outbound investment flow percentages. Moreover, China's outbound FDI stock is relatively low at 12 percent. The US outbound stock is 34 percent of GDP, a figure more consistent with international averages.

There are many legitimate motivations for Chinese outbound investment, including diversification of assets and markets, proximity to consumers, the creation of production platforms behind tariff and other trade barriers, and the acquisition of the talent and technology necessary for enterprises to move up the value chain. Still, the role of the Chinese Communist Party and state in the Chinese economy invites concerns about the implications of Chinese investments, particularly in a time of growing strategic competition.

Chinese investment flows have prompted legislators and regulators across advanced markets to evaluate their arrangements. Germany recently expanded its investment screening regime. The U.K. is conducting a consultation process on creating its own CFIUS. The European Commission (even though it lacks a security competence) has proposed its own process. Given the significance of investment from China and other markets with strong state intervention, it is appropriate to assess the functioning of the U.S. foreign investment screening system, which is typically referred to by the acronym of the inter-agency committee assisting the President, CFIUS.

U.S. legal framework

The Exon-Florio Amendment of 1988 to the Defense Production Act of 1950 and the Foreign Investment and National Security Act of 2007 (FINSA) were designed to manage national security risks arising from foreign control of U.S. businesses. The legislation created a targeted instrument that works in tandem with other tools, such as our export controls regime that was designed to manage risks associated with the transfer of sensitive technologies.

The investment regime managed by CFIUS was designed to be minimally disruptive of the economy, while providing the President broad authority to address national security threats. This combination of policy goals was achieved through three features:

- **National security focus** — CFIUS's mandate is limited to "national security," but the President and derivatively CFIUS were granted broad discretion in determining what constitutes a threat to national security.

- **Voluntary filings** — Filings with CFIUS are normally voluntary, but private parties are motivated to file in order to secure legal certainty as the President may unwind any transaction that has not been previously approved by CFIUS.
- **Tight timelines** — The legislation sets tight timelines (30 days for "reviews," and an additional 45 days where "investigations" are necessary), but CFIUS always has the ability to recommend that the President block a transaction if the Committee believes there are "unresolved" national security concerns.

In my experience, CFIUS staff are thorough and highly professional. When conducting their analyses, CFIUS members normally examine (1) whether the U.S. business receiving the investment presents a national security vulnerability, and (2) whether the foreign person making the investment represents a potential threat. The intelligence community plays a crucial role in framing the analysis for the CFIUS policy agencies.

National security concerns are never given short shrift or traded off against other equities. True, there are sometimes disagreements or diverging assessments. However, CFIUS operates by consensus, with any agency able to force an escalation ultimately up to the President. Deliberation on individual cases can be extensive and time-consuming, and sensitive cases can reach the President's desk for guidance.

Key questions

As the Subcommittee considers the changing investment context and the operation of CFIUS, there are several key questions that the Subcommittee may want to consider.

- **Jurisdiction: Does CFIUS have the authority to reach all relevant foreign investments?**

CFIUS has jurisdiction over any foreign investment that could result in a foreign person's "control" of a "U.S. business." CFIUS looks through corporate structures to ultimate ownership and control relationships. Moreover, "control" is a low bar: the mere potential to influence business, management or personnel matters is enough "control" for CFIUS to assert jurisdiction. Thus, any transaction that could result in foreign "control" of a U.S. business — a joint venture, bankruptcy, etc. — is subject to CFIUS jurisdiction.

A gap exists where a foreign investor seeks to acquire a sensitive asset that is not a "U.S. business" — for example, fallow land next to a military base. It may make sense to revise the scope to clarify CFIUS's jurisdiction over investments in U.S. real assets even if there is no current associated commercial activity.

- **Knowledge: Does CFIUS have the ability to identify all relevant foreign investments?**

While CFIUS's reviews are normally voluntary, the Committee can require a filing on its own initiative. CFIUS monitors the business press and other sources, and is aware of publicly announced transactions. Government procurement rules typically require contractors to inform contracting officers of changes in control, so CFIUS agencies should be aware of relevant foreign investments in government contractors.

There are other transactions, often involving smaller enterprises and start-ups, that may go unobserved. Some have suggested "light notifications" or "declarations" for transactions involving certain technologies. In principle, that could make sense. The risk would be, given the risk aversion of government committees, that the declaration process would become in time an increasingly burdensome prior approval process. One would want to design any such information mechanism to make it as non-burdensome as possible, while providing CFIUS the ability to identify investments of interest.

- **Timelines and resources: Is CFIUS following its statutory timelines? Is CFIUS adequately resourced?**

The volume of cases is up — from 138 in 2007 when FINSA was passed to nearly 250 in 2017. CFIUS's analysis has grown more searching. CFIUS officials say that cases have become more complex, in part because of an increasing focus on emerging technologies.

A visible consequence has been an impact on timelines. First, an increasing number of cases go into the second (investigation) phase — four percent of cases went to investigation in 2007, while 46 percent of cases went to investigation in 2016. Second, a series of current cases have been withdrawn and refiled multiple times, a process that affords CFIUS more time to deliberate. Third, we have witnessed an extension of the pre-filing phase for notices. Previously, it took a couple of days for CFIUS to assess whether filings were adequate to commence reviews. Now, the pre-vetting typically takes a couple of weeks, and we have seen one simple case take several months. The statutory schedule has become more of a guideline than an obligation, creating uncertainty for private parties of all nationalities. Based on professional experience in transactions, the delays and uncertainty are beginning to impact decisions of investors, with the risk of the United States being viewed as an unpredictable place to seek to invest.

From legislative and appropriations perspectives, it may be opportune to enquire into the causes for protracted review processes. While the transition may have had a transient impact, it seems clear that a lack of resources is a significant component of the protraction. It is my understanding that resources have been largely constant during a period in which the case load has doubled. As able and energetic as the case handlers are, it should not be surprising to see an impact on performance. So, even if it is appropriate to review the statutory timelines, CFIUS has an acute need for additional resources.

- **Mitigation agreements: Does CFIUS systematically and effectively monitor and enforce mitigation agreements?**

CFIUS uses mitigation agreements negotiated with the parties as a condition of approval as a tool for resolving national security concerns. While some agreements are simple, others are complex instruments requiring significant management resources for the parties and the government. As the years pass, monitoring obligations for the government cumulate. From the legislative and appropriations perspectives, one may want to assess systemically the performance of mitigation agreements over time. What has been the compliance record? What have been the costs for the government and the private sector? Should some mitigation agreements be revised,

tightened, or phased out? Is the administration organized and resourced appropriately to fulfill the ongoing obligations entailed in mitigation agreements?

- **Technology control: Should CFIUS's mandate be expanded to reach technology transfers, even those abroad?**

The control of emerging technologies has rightly been identified as an urgent policy issue. Some have suggested that CFIUS's jurisdiction should be expanded to encompass technology control, and should include reviewing transfers by U.S. firms of intellectual property to foreign persons. This could mean CFIUS reviews for multitudinous licensing, joint development, hiring, and even sales transactions with foreigners. The suggestion is that U.S. export controls do not adequately regulate transfers of emerging technologies. While export controls merit review, CFIUS is the wrong vehicle for a new technology control regime.

The United States has maintained for decades export controls designed specifically for regulating the transfer of technology. That regime is capable of regulating any transfer of designated technology, even if a transfer occurs abroad. The U.S. government has imposed targeted controls addressing specific national security threats. An example is the "China catch-all" rule that imposed licensing requirements on exports of specified items not normally requiring licenses for China when such items are destined for military end-use in China.

As flexible and well-conceived as the export control regime is, there is a need for Congressional attention. First, the export control regulations are presently grounded on the International Emergency Economic Powers Act, the export control legislation having expired. Second, there is a legitimate question of whether the Administration runs an effective policy process for identifying emerging technologies meriting control under export control laws.

In any event, CFIUS would be an ineffective substitute technology control vehicle. CFIUS, being a committee, has limited bandwidth — it has difficulty managing its 250 or so cases per year, and expansion of its jurisdiction to technology transfer control could balloon its docket to thousands. Imposing such a regime on U.S. technology businesses would be burdensome and could undermine U.S. innovation. Uncertainty around CFIUS determinations could encourage investment in research and development to move offshore, beyond the scope of the bureaucratic review process. This in turn could undermine the U.S. innovation and technological development so essential for our defense industrial base and economy more broadly.

- **Cooperation with other countries**

The recent flow of Chinese investment —$46 billion into Europe and $48 billion into North America in 2016 — has spurred concerns across advanced markets. The United States is not the only advanced market generating cutting edge technologies. While the United States need not wait for others to reform its own regulatory regime, unilateral U.S. action is less likely to be effective over time. From a policy perspective, the United States should seek to coordinate with other countries in the design of their regulatory frameworks, working bilaterally with individual countries and collectively through, say, the G7 and/or the OECD. With respect to individual cases, the Administration should be able to share information and coordinate with other

governments, much as it already does in antitrust cases. Congress may want to assess whether the confidentially rules need to be modified to facilitate that case-specific coordination, while otherwise preserving the commercial confidentiality.

Written Testimony of

Theodore W. Kassinger

Before the Subcommittee on Monetary Policy and Trade of the

Committee on Financial Services

United States House of Representatives

Evaluating CFIUS: Challenges Posed by a Changing Global Economy

January 9, 2018

Mr. Chairman, Ranking Member Moore, Members of the Subcommittee:

Thank you for your invitation to appear before you today. It is an honor to join my fellow panel members in contributing to your work assessing the operations and activities of the Committee on Foreign Investment in the United States ("CFIUS").

The perspectives I offer on this subject stem from my nearly 40 years of law practice in the field of international investment and trade, including extensive experience with CFIUS matters. Although I have spent much of my career in private practice, I have been fortunate also to work in both the executive and legislative branches of government. Most recently, I served as General Counsel and Deputy Secretary of the U.S. Department of Commerce from 2001 – 2005. I wish to emphasize that I appear today solely in my personal capacity, and the views I express are my own.

Thirty years after Congress enacted Section 721 of the Defense Production Act – and a decade since Congress substantially amended Section 721 to provide the current statutory underpinnings of CFIUS – it is indeed timely for this Subcommittee to take stock of how the purposes and process that Congress envisioned are withstanding the tests brought by dramatically changing economic and geopolitical circumstances. Section 721 established the legal foundation for what is a critically important, but non-legal task of the government: To determine, on a case-by-case basis, whether specific foreign direct investment transactions present a threat to U.S. national security; and if so, what are the appropriate means, if any, to resolve the issues giving rise to the threat.

In my view, Section 721 has and continues to provide the fundamentally correct approach to balancing national security and economic interests of the United States, and the process administered by CFIUS works reasonably well. There are clear signs of stress in that process, however, and serious questions to examine regarding whether CFIUS is optimally empowered and resourced to address current challenges.

Adherence to Basic Principles

When assessing the current effectiveness of CFIUS and any proposed changes to Section 721, it is essential to maintain as guideposts certain basic principles that shaped the law and current CFIUS regulations.

First, foreign investments should be welcomed and subject to regulation only to protect vital national interests. Since the founding of our nation, foreign investment has been an important source of capital that supports U.S. innovation, economic growth, employment, and global competitiveness.[1] The early adoption of a policy of welcoming foreign investment contributed substantially to the country's economic development.

Federal regulatory controls on in-bound investment have been remarkably limited. For 200 years, until the enactment of Section 721, there was no general authority for the federal government to block inbound investment transactions. Section 721 appropriately addresses a paramount national interest. That authority should adapt to the times, but with the same cautious consideration that this Subcommittee and others gave to the subject previously.

Second, in the competition for global capital, the United States is well served by regulatory processes that are transparent, predictable, and efficient. Foreign investors and U.S. business partners understand that the United States must be able to step in where a business transaction presents a threat to national security. Nevertheless, before committing to transactions involving perhaps billions of dollars, they want to manage the business risks appropriately, including by structuring transactions to address potential national security issues ahead of time if possible.

In the CFIUS context, by "transparency" and "predictable" I do not mean either full disclosures of the Committee's bases for national security determinations or an analytical approach that is anything other than fact-specific. Rather, I believe it is important that the decision-making process itself be rules-based and that experiences drawn from national security assessments be more freely and specifically identified.

These two fundamental guideposts lead to a third over-arching proposition: Any statutory or regulatory amendments to Section 721 should replicate the rigorous path set by the legislative and rule-making processes followed in 2007 and 2008. Those were models of deliberative consideration and produced an unusually well-crafted set of

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[1] In his 1791 *Report on the Subject of Manufactures,* Alexander Hamilton made the point that the United States competed with other countries for investment capital, and that the young nation already was positioned to succeed ("'Tis certain, that various objects in this country hold out advantages, which are with difficulty to be equalled elsewhere....") Secretary Hamilton further noted that foreign capital –

> "ought to be Considered as a most valuable auxiliary; conducing to put in Motion a greater Quantity of productive labour, and a greater portion of useful enterprise than could exist without it. It is at least evident, that in a Country situated like the United States, with an infinite fund of resources yet to be unfolded, every farthing of foreign capital, which is laid out in internal ameliorations, and in industrious establishments of a permanent nature, is a precious acquisition."

regulations. The rules (published at 31 CFR Part 800) carefully define concepts and terms, and provide numerous examples to indicate how the rules might apply to specific factual circumstances. The rule-making process took about one year following the 2007 law. It was well worth it – not because the rules answer every question that arises, but because as a whole, they faithfully implemented the balance struck by Section 721 while providing useful guidance to private enterprises and entrepreneurs who are the primary sources of investment capital.

Current CFIUS Challenges

The rise of China both as an increasingly assertive strategic adversary and global economic power lie at the heart of most discussion about CFIUS reform, and rightfully so.

Our panel fortunately includes experts who will provide you with further insight into those concerns, which I share fully. I wish only to observe that the complexity of the U.S.-China economic relationship provides reason not to lose sight of the guidepost principles noted above when assessing the role of CFIUS.

That relationship is broad, deep, increasingly fractious – and of bedrock importance to global, as well as bilateral, security and stability. According to U.S. Census Bureau data, U.S.-China trade in goods and services exceeded $648 billion in 2016, with China the third largest destination for U.S. exports of goods ($116 billion) and the largest source of goods imported into the United States ($463 billion – resulting in a U.S. goods trade deficit of $347 billion). U.S. exports of services to China reached about $54 billion in 2016, with sales of services in China by majority-owned affiliates of U.S. companies of roughly the same magnitude ($55 billion in 2014). The U.S. direct investment position in China reached $92.5 billion in 2016, while Chinese direct investment in the United States measured about $27.5 billion.

Over the past 20 years, commerce among the two countries has become ever more interdependent, manifested in multi-faceted, cross-border design/manufacturing, supply chain, R&D, and a multitude of other relationships.

China unfortunately has taken a sharp turn toward reframing the terms of its global economic engagement. "Made in China 2025" and numerous other industrial policies aim to recast China's economy both as self-sufficient and globally dominant across a broad spectrum of advanced technologies. The Chinese government backs these goals with massive funding, tight control over in-bound investments, demands for disclosures of intellectual property, barriers to entry into social media businesses, and strategic direction of state-owned enterprises.

China's techo-nationalism presents profound economic and national security challenges. It would be incorrect, however, to view every Chinese investment in the United States, and every U.S. company investment in China, as another advance of misguided Chinese policy. Investors and investments from China are widely varied; many Chinese investments have contributed to the U.S. economy and positive U.S.-

China ties. It would likewise provide false comfort to cast CFIUS as a central player in the U.S. policy response. And, it is important to keep in mind that investment-related national security threats do not only arise from China.

In their important report in January 2017 on the state of the U.S. semiconductor industry, the President's Council of Advisors on Science and Technology noted the role of export control and investment regulation as tools to address aspects of Chinese policy, while making the broader point that such tools are inherently limited and short term. Rather,

> "Our core finding is this: the United States will only succeed in mitigating the dangers posed by Chinese industrial policy if it innovates faster. Policy can, in principle, slow the diffusion of technology, but it cannot stop the spread. And, as U.S. innovators face technological headwinds, other countries' quest to catch up will only become easier. The only way to retain leadership is to outpace the competition."[2]

CFIUS Operational Issues

Against this background – and especially the aspiration to achieve transparency, predictability, and efficiency – I offer the following observations about certain aspects of current CFIUS operations and possible ways to improve the Committee's effectiveness.

1. Scope of Jurisdiction – Questions have arisen whether CFIUS lacks needed jurisdiction to cover important forms of commercial activity beyond direct investments.

   There is no question that CFIUS possesses – and exercises – jurisdiction over acquisitions of control of U.S. businesses in the context of joint ventures, bankruptcy proceedings, real estate, and other forms of transactions, including asset transactions. The form of transaction is not relevant: What matters is the substance. In practice, CFIUS has increasingly lowered the bar to finding that a "U.S. business" exists for its jurisdictional purposes, to the point where there is no material limitation on its jurisdiction on this ground.

   Of more consequence is the question whether Congress should authorize CFIUS to assert jurisdiction over transactions involving licenses of technology by U.S. companies to foreign joint ventures to which they are a party, or otherwise to foreign entities. Such transactions, of course, do not involve foreign investments in the United States. Empowering CFIUS to review outbound licensing transactions would thrust CFIUS, which by design is not an agile regulatory authority, into vast and cumbersome oversight of commercial activity that is critical to U.S. innovation and market success. An expansion of CFIUS

[2] *Ensuring Long-Term U.S. Leadership in Semiconductors*, Report to the President by the President's Council of Advisors on Science and Technology (PCAST), January 2017, p. 2.

jurisdiction in this way could incentivize U.S. companies to hold intellectual property offshore, a reaction exactly contrary to U.S. interests.

Fortunately, U.S. export control regulations provide a sound existing framework for regulating transfers of technology. If additional oversight is warranted, then I recommend focusing on possible enhancements to those regulations.

2. Resources – The CFIUS docket has increased substantially over the past two years. It is fair to say that substantively, the complexity of cases also has mushroomed, with the rapid increase of investment notifications involving advanced technology companies, investors from China, and new areas of potential security vulnerabilities to consider. In addition, the number of mitigation agreements grows every year.

   Real consequences of these developments include prolonged delays in initiating cases, a steady rise in the number of investigations, and frequent withdrawal and refilings of notices because CFIUS cannot complete the work within the statutory time frames. Indefatigable work by CFIUS staff has succeeded in making delays shorter than they might otherwise be, but at great wear and tear that is not sustainable.

   Several actions could help. Congress could consider:

   a. Increasing the current 30-day initial review period to 45 days.

   b. Authorizing senior officials below the Deputy Secretary level to approve decisions in circumstances where the statute currently requires at least that level of approval.

   c. Authorizing and funding more resources. One possible source of additional funds would be filing fees. I note, however, that only four years ago, the CFIUS new case tally was less than 100. There is every reason to expect the case load to vary widely in coming years. It may be risky to base resource decisions on expected levels of fee support.

   d. Creating a short-form notice process for a defined set of transactions that are not likely to present serious national security concerns.

   Administratively, CFIUS could consider:

   a. Confining information requests to what is reasonably necessary to assess the national security risks of a transaction. CFIUS should not be used as a discovery tool to satisfy other government interests in information that the parties may possess.

b. Reestablishing meaningful standards for what constitutes "control" in small minority and limited partner investment transactions, and for a passive investment safe harbor. CFIUS practice has effectively nullified the carefully crafted 2008 rules addressing these subjects.

c. Incorporating a "reasonableness" standard into risk assessments, consistent with industry risk management practices. In addition, CFIUS should seriously incorporate into its risk assessments the potential benefits to U.S. national security that could result from a mitigation agreement.

d. Sunsetting mitigation agreements more systematically.

Conclusion

Thank you again for inviting me to appear today. I will be pleased to respond to any questions that you may have.

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Statement Before the
House Committee on Financial Services,
Subcommittee on Monetary Policy and Trade

"Evaluating CFIUS: Challenges Posed by a Changing Global Economy"

A Testimony by:

Scott Kennedy

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Director, Project on Chinese Business and Political Economy
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January 9, 2018

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Introduction and Main Points

Thank you for the invitation to appear before the committee. I have been asked to share my views about Chinese industrial policy, trends in technology flows, and the implications for American policy to limit diffusion of advanced technologies to China that could harm U.S. national security, including the role of CFIUS.

I. Summary

I want to make four points today.

First, although highly wasteful and inefficient, Chinese industrial policy has been relatively effective at facilitating both the domestic development of technology in China as well as the acquisition of foreign technology from the United States and elsewhere. All signs point to China further strengthening its industrial policy apparatus and not engaging in substantial marketization and liberalization in the coming years.

Second, although the US-China relationship has many problematic elements, economic ties on balance have and continue to benefit the American economy, including companies, workers, and consumers. At the same time, the US and China have conflicting security interests in the Asia-Pacific, creating the difficult situation in which the economic and security components of the relationship are to some extent contradictory. I expect this tension will also persist well in to the future.

Third, American technology reaches China through a wide variety of channels, including investment, trade, employment, and education. Constraining technology diffusion in one area does not stop its diffusion via other means.

And fourth, American policies taking these three factors into account would require the US to: 1) Focus on technology that could harm American national security that China does not already have and would have difficulty developing domestically; 2) Take into account that technology diffusion occurs via multiple routes, and that some routes are easier to regulate than others; 3) To be successful, the United States needs to expand coordination of its technology control policies with those of its allies; and 4) Adopt policies that are highly targeted so that they do not hurt the vibrancy of the American economy.

My written and oral testimony seek to elaborate on these four points.

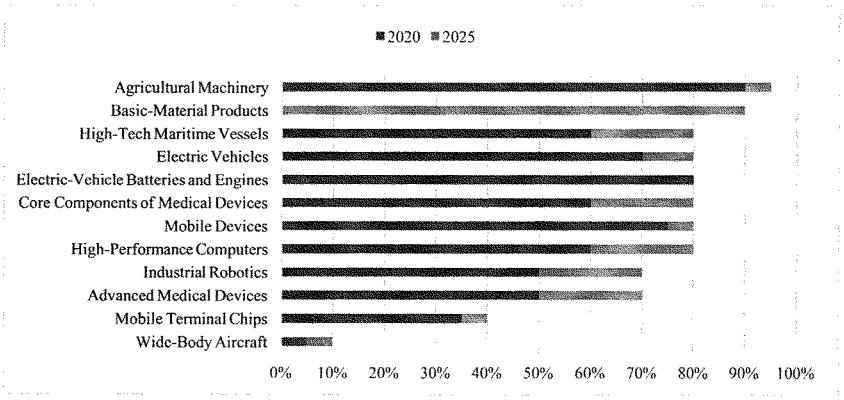
I. The State of Chinese Industrial Policy

2018 marks the 40th anniversary of China's launching of the Era of Reform and Opening Up. Compared to the autarkic state socialist system in which the country found itself at the end of the Cultural Revolution, four decades later China's economy is far more marketized and open. Private firms account for the large majority of the country's employment, profitability, and economic growth. The vast majority of prices for final goods and services are set by the market, and the financial system is large and diverse. China's average tariffs have fallen from 14.1% in

2001 to 4.2% in 2016, the country is the largest recipient of foreign direct investment (with over 520,000 foreign-invested firms in China), and China is the fastest growing source of outward direct and portfolio investment.

That said, the Chinese state is far from a neutral referee of a competitive marketplace. Rather, its consistent goal has been to use state authority to not only further the overall growth of the economy but to promote specific companies, sectors, and regions. Although China's leadership in the late 1990s and early 2000s made a genuine effort to marketize the economy and sought WTO entry to pursue that goal, their successors have not maintained the same commitment. Under the leadership of Hu Jintao and Wen Jiabao (2002-2012), China reinvigorated the industrial policy apparatus and ramped up state-directed investment in priority sectors and projects. Under their watch China set forth the goal of "indigenous innovation," which still holds today, of making industrial policy's chief aim the development and acquisition of more advanced technology by domestic actors in order to raise productivity and make China more competitive internationally.

Figure 1: Selected Domestic Market Share Targets of *Made in China 2025*



Source: China Ministry of Industry and Information Technology.
Note: The government set targets for 2020 and 2025 for most technologies, but not all. Hence, some denote only a single target.

Since Xi Jinping assumed power in late 2012, several trends have emerged. First, China has only intensified its industrial policy efforts. China's goals are far more ambitious than in the past, as it aims to have Chinese firms become dominant in just about every area of advanced technology imaginable. The 13th Five-Year Plan calls for a rapid growth in R&D spending, the number of patents, and the contribution of science & technology to the economy, and identifies over 200 technologies deserving support. *Made in China 2025*, a strategy document issued in 2015 and a high-priority component of the 13th Five-Year Plan, sets forth high targets for the local firms'

market share in China of technologies and supply chains by 2025, such as 80% for electric vehicles, 70% for industrial robotics, and 70% for advanced medical devices (see Figure 1).[1]

Second, the scale of Chinese initiatives and investment has grown enormously, with spending on research and development (R&D) in 2016 reaching over $232 billion. Direct government funding is growing, but more important is how the state increasingly utilizes policy levers to induce banks, other financial institutions, companies and research institutes to target their own spending in priority sectors established by policymakers.[2]

Third, industrial policy is far more strategically coordinated than ever before. Local experimentation has declined in favor of centralization. The top leadership is more than ever utilizing "leading small groups" overseen by the Party and State Council (China's cabinet) leadership to reduce inter-bureaucratic conflicts and raise the likelihood that investments address the country's technology gaps. Relatedly, under Xi there is greater emphasis on coordinating the development of dual-use technologies, so that products and services created in a commercial environment are available for adoption by China's military, domestic security, and intelligence organizations.[3] During the implementation process, the various tools of industrial policy are increasingly coordinated with each other. Priority sectors and companies are supported through fiscal stimulus, tax reductions and holidays, access to low-cost or free land, low-interest credit, easier access to securities markets, patent approvals, discriminatory technical standards, antitrust policy directed against disfavored competitors, privileged government procurement, limits on market access, and other preferential policies.

And fourth, China has expanded efforts to have globalization serve the country's industrial policy goals. In addition to sending millions of students abroad over the last few decades to obtain advanced degrees in engineering and science, Chinese financial institutions and companies have ramped up outward investment and acquisition of overseas companies. According to the Rhodium Group, Chinese investment in the United States was at least $46 billion in 2016 and $26.4 billion in the first three quarters of 2017. The leading sectors of Chinese US investment in Q3 were in health and biotech, financial and business services, basic materials, and other high-tech. Looking globally in 2017, the overall level of outward investment declined somewhat as a result of China's fears about capital flight and corruption, but among deals being made recently, a higher proportion involve Chinese state-owned companies and

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[1] Jost Wubbeke et al., *Made in China 2025: The Making of a High-Tech Superpower and Consequences for Industrial Countries* (Berlin: Mercator Institute for China Studies, December 2016); *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces* (Beijing: European Union Chamber of Commerce in China, March 2017); and *Made in China 2025: Global Ambitions Built on Local Protections* (Washington, DC: U.S. Chamber of Commerce, September 2016).

[2] Scott Kennedy, *The Fat Tech Dragon: Benchmarking China's Innovation Drive* (Washington, DC: Center for Strategic and International Studies, August 2017): 19.

[3] Xi Jinping personally heads the Central Commission on Civilian-Military Integration Development. Christopher K. Johnson, Scott Kennedy and Mingda Qiu, "Xi's Signature Governance Innovation: The Rise of Leading Small Groups," CSIS Commentary, October 17, 2017, https://www.csis.org/analysis/xis-signature-governance-innovation-rise-leading-small-groups.

financial institutions and are in materials and high-tech sectors (telecom, media, computing).[4] Finally, as part of this effort, Chinese companies have opened up R&D centers in Silicon Valley and other high-tech hubs, and are hiring talent from other companies and straight out of universities to help them strengthen their own innovation capacity.

Looking ahead, there is every indication that China plans to continue along the current path in which industrial policy is intensively used to serve economic and strategic goals. And that is because despite all the waste that is created through extensive government intervention, the broader record, at least from the leadership's point of view, is "good-enough" success. The economy has grown faster longer than any other economy in history, and Chinese companies are gradually moving up the value-added chain and claiming more market share in China and abroad. And although there is concern about protectionism by the United States, Europe and their advanced industrialized neighbors, China believes it can continue to use its large market as leverage to obtain technology and knowhow from others for the foreseeable future.

II. The Benefits and Challenges in the US-China Economic Relationship

The economic relationship with China has created both benefits and problems for the American economy. Industrial policy certainly puts American companies at a disadvantage in China and in third markets. And given China's size, to the extent that Chinese successes are the product of subsidies and other distortions, this could challenge the health of not only individual competitors, but supply chains and business models that operate in a competitive environment where the participants face hard budget constraints. That said, to date, the American economy has on balance benefited from our relationship with China. Trade in goods and services is over $600 billion per year and two-way investment has risen substantially, all of which not only creates profits for companies, but employment for millions of workers, and less expensive goods for consumers. The relationship would be more beneficial if China would reduce its discriminatory policies, but the best way to deal with this problem is to find ways to constrain Chinese industrial policy, not shutdown the economic relationship.

The operating logic of American security policy is different, which is to safeguard the United States as much as possible. Fairness and balance are not typical principles of this effort. Whereas there may be technology transfers that are entirely reasonable when seen through a commercial lens, they may be entirely unreasonable when viewed in the context of national security. The United States faces a conundrum because the US-China economic relationship is so large and China is moving up the value-added chain so quickly in ways that may be reasonable, even if not welcome from a market competition perspective, but far more worrisome from a national security perspective. Chinese efforts in semiconductors, quantum computing, artificial

[4] See the Rhodium Group's "China Investment Monitor," http://rhg.com/interactive/china-investment-monitor; Daniel H. Rosen and Thilo Hanemann, "Trump Heads to China – Is Chinese Investment Still Headed Here?" Rhodium Group, November 3, 2017, http://rhg.com/notes/trump-heads-to-china-is-chinese-investment-still-headed-here; and Thilo Hanemann, Adam Lysenko and Cassie Gao, "Tectonic Shifts: Chinese Outbound M&A in 1H 2017," Rhodium Group, June 27, 2017, http://rhg.com/notes/tectonic-shifts-chinese-outbound-ma-in-1h-2017.

intelligence, advanced materials, biologics, energy storage, aeronautics and space, and other areas may be headaches for American companies, but they are much greater concern for those responsible for ensuring America's national security.

III. Technology Diffusion to China

Another important element of China's technology engagement with the world is that it occurs via many different avenues. The various pathways include:

1. Attracting foreign investment in China.
2. Chinese investment abroad, both greenfield and M&As, including minority stakes.
3. Imports.
4. Hiring foreigners to work in Chinese companies and research institutes.
5. Sending Chinese students abroad to study (which totaled 4.6 million between 1978 and 2016).[5]
6. Theft of foreign technology through cyber and other means.

Two consequences emerge from this fact. First, Chinese companies that desire acquiring technology have many routes to success. If the investment route is blocked, they can look to imports, poaching employees, hiring students, or other means. Similarly, if a technology exists in multiple countries but not in China, they can also benefit from differences in regulatory environments and levels of vigilance between jurisdictions.

And second, governmental authorities may benefit from deals and interactions that are entirely commercial or private. Not all of the elements of international technology acquisition are all part of a single, unified industrial policy. Much trade and investment is entirely private and does not involve approval by China's industrial policy apparatus or national security bureaucracy. This is particularly true for R&D centers – in both directions – as well as overseas students. That said, it is certainly possible that originally entirely private activity could be identified and utilized by China's authorities to serve China's domestic and national security goals.

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[5] This data is from China's Ministry of Education, https://mp.weixin.qq.com/s/5764saZiSyFlnH6um46Jtg. According to the US-based Institute of International Education, in 2016, there were 328,500 Chinese students studying in the United States, of which 140,300 were in science and engineering programs: https://www.iie.org/Research-and-Insights/Open-Doors/Data/International-Students/Places-of-Origin, and https://www.iie.org/Research-and-Insights/Open-Doors/Data/International-Students/Fields-of-Study/Fields-of-Study-by-Place-of-Origin/2015-16.

IV. Implications for American Policy

The above discussion about trends in Chinese industrial policy, the contradictions between promoting the US-China economic relationship and American national security, and the multiple paths by which China acquires technology are directly relevant to the current discussion in the United States about whether to reform its system to ensure that foreign investment does not harm American national security. It certainly makes sense for the U.S. Congress to consider reforming the operations of the Committee on Foreign Investment in the United States (CFIUS), but given the above discussion, I suggest that policymakers keep several points in mind that emerge from this analysis.

First, the United States should focus on limiting transfer of technologies that could harm American national security that China does not already possess and is not likely to develop internally. CFIUS's current focus on military-related technologies and critical infrastructure seems to be working relatively well. It may make sense to expand the scope of CFIUS to include certain kinds of data, but this determination should be made based on guidance from American national security professionals.

Second, to the extent CFIUS's mandate is expanded to other forms of investment, it may be most appropriate to consider having CFIUS review even investments where foreign parties obtain only a minority stake, particularly in cases of high-priority technologies. Obtaining majority stakes may not be necessary for Chinese and other foreign parties to obtain access to technologies which affect American national security. Some have suggested that this change would lead to a "slippery slope" that would induce misuse or retaliation by other countries against American investment and weaken the global economy. I am less concerned about this outcome as long the United States is careful and transparent about the need for this shift. On the other hand, I would not support expanding CFIUS's ambit to include outward American investment. Although certainly an avenue for important technology transfer, one that may increase in the years ahead, taking this step would likely be impractical. CFIUS currently reviews 100-150 cases per year; moreover, these cases all occur within a common jurisdiction well known to American regulators (their own). Expanding its coverage to outward US investment could raise that number to several thousand per year, certainly far more than could be effectively managed by the committee even if its resources were significantly expanded. And trying to gain understanding about each deal across many different regulatory environments would be beyond daunting.

Third, given that CFIUS needs should be reformed and not revolutionized, the United States should consider other policy and legislative options to address other potential weaknesses in oversight of American technology transfer to China and elsewhere. Particular focus should be placed on updating American export control rules, not only for physical technologies and intellectual property but for American employees who are then recruited by foreign industry.

Fourth, American efforts to constrain inappropriate technology diffusion to strategic rivals requires it to expand coordination with its allies in Europe and Asia. Differences in American policy and regulation differs from its allies can and have been exploited by jurisdictions subject

to technology controls. Globalization of manufacturing and innovation is likely only to expand in the future, and so policy coordination must increase simultaneously.

And fifth, although it is important to protect the United States from the unwise transfer of technologies to countries that pose a security challenge to America, the United States also gains tremendous strength from having an economy open to flows of goods, services, people, and ideas. This is not just a nice-sound goal, but central to maintaining America's hard and soft power. Hence, policymakers should be careful that any steps taken to adjust technology investment have a net positive effect on the American economy and its potential future for high-productivity growth.

Statement before the House Committee on Financial Services
Subcommittee on Monetary Policy and Trade

Hearing on "Evaluating CFIUS: Challenges Posed by a Global Economy"

Chinese Investment Still Rising Globally; Tough Choices for the US

Derek Scissors
Resident Scholar, AEI
January 9, 2018

Translation: don't listen to my colleagues on this topic. Only me.

China's investment around the world in 2017 was dominated by talk of restrictions applied by the central government and host governments such as the United States. The obvious implication, supported by misleading official statistics, was that China's global spending had plunged. This is wrong. On the best available evidence, Chinese investment overseas climbed modestly in 2017, after a path-breaking 2016.

The China Global Investment Tracker (CGIT) from the American Enterprise Institute is the only fully public record of China's outbound investment and construction.[i] Rather than merely asserted totals, *all 2700 transaction are listed*. The CGIT shows investment rising almost 9 percent in 2017. This was heavily dependent on the $43-billion acquisition of Swiss agro-tech giant Syngenta, without which investment would have dropped more than 16 percent. For perspective, the 2017 total without Syngenta would still be the second-highest on record.

It's true that the top line is more bullish than what's below it. The number of transactions fell, as did investment volume in many countries and sectors. But the numbers make clear that the overarching story is not decline but change, to very large transactions by state-owned enterprises and new sectors of emphasis, such as logistics. Such purchases lead to a banner 2017 for Britain and Singapore, as examples.

The People's Republic of China's (PRC) investment is often conflated with its overseas construction of rail lines, ports, and so forth. While construction activity is valuable, it does not bring ownership as investment does. Construction contracts are smaller on average, but there are more $100 million construction contracts since 2005 than $100 million investments. Last year alone, China signed construction deals worth $100 million or more with almost 60 countries. This is the core of the much-discussed Belt and Road Initiative (BRI).[ii] By sector, most the most activity occurred in transportation.

Construction under the BRI should be similar in 2018. The main questions for this year are whether Beijing will allow private firms to invest more aggressively and how far Washington will go in blocking Chinese acquisitions. By the end of 2017, private Chinese investment began to pick up again. It will not be allowed to return to the 2016 frenzy but will probably grow this year, helping offset any decline in state spending.

Downside risk for Chinese spending is found in the Committee on Foreign Investment in the United States (CFIUS). CFIUS has refused to approve a number of Chinese transactions in a timely manner. Along with PRC restrictions, this undermined 2017 Chinese spending in the US, which fell by half to below $25 billion. A bipartisan bill to extend CFIUS' authority is being watched globally. Just as important, CFIUS has stalled Chinese acquisitions involving customer data. This embodies a difficult trade-off: the evident benefits of foreign investment versus lack of rule of law in the PRC. Chinese spending here is positive for our economy. But Chinese firms cannot be trusted to obey American laws.

CGIT v. MOFCOM

The CGIT includes all verified investment and construction transactions worth $100 million or more from 2005 through 2017. This features more than 1300 investments worth more than $1

trillion in total. Although the construction data set is incomplete, it includes almost 1400 projects totaling over $700 billion. The CGIT also lists well over 200 troubled transactions worth a combined $350 billion in which investment or construction was impaired after commercial agreements were struck. Not tracked are loans, bonds, and other uses of foreign exchange that do not involve ownership or services in the host country. (The CGIT is reviewed and updated every six months.)

Through 2015, CGIT figures were a good match for those published by the Chinese Ministry of Commerce (MOFCOM), with the annual gap capped at 10 percent for more than a decade (see table 1). For 2016, MOFCOM initially announced a figure of $170.1 billion. It then made an unannounced revision up to 181.2 billion.[iii] This revision was on top of the standard appearance of "financial investment" in annual totals many months after year's end and the inclusion of a fixed, monthly figure for reinvestment which has no apparent basis.

Table 1: Two Views of Chinese Outward Investment ($ Billion)

	CGIT	Ministry of Commerce
2005	10.2	12.3
2006	19.8	21.2
2007	29.9	26.5
2008	54.7	55.9
2009	57.6	56.5
2010	65.5	68.8
2011	68.8	74.7
2012	80.3	87.8
2013	83.8	92.7
2014	104.3	107.2
2015	113.2	121.4
2016	170.4	181.2
2017*	185.4	130.5
Total	1044	1037

* The CGIT is subject to revision each update. The 2017 MOFCOM figure is extrapolated from the first 11 months and includes only a minor amount for Syngenta. Numbers may not add due to rounding.
Sources: American Enterprise Institute, China Global Investment Tracker, January 2018 update, http://www.aei.org/china-global-investment-tracker; National Bureau of Statistics of the People's Republic of China, State Administration of Foreign Exchange, 2016 Statistical Bulletin of China's Outward Foreign Direct Investment, China Statistics Press, September 2017; and Xinhua, "China Jan.-Nov. outbound investment falls 33.5 pct to 107.55 bln USD," December 14, 2017, http://www.xinhuanet.com/english/2017-12/14/c_136825421.htm

For 2017, MOFCOM is advertising a steep investment drop, fitting its incessant claims that "irrational" spending has been controlled. [iv] The ministry does not disclose individual transactions as CGIT does. But monthly figures and direct communication indicate the bulk of the value of the Syngenta deal was never counted, on grounds it was financed outside the PRC.

This is unlikely and, in any case, leaves Chinese statistics in the dubious position of excluding the country's biggest (by far) foreign acquisition. It's always possible to argue for some deals to be placed a year earlier or later but MOFCOM's 2017 total is unreasonably small. If true Chinese investment fell this year, it was not a steep decline.

There are also problems beyond MOFCOM's control. It is national policy, not chosen by the ministry, to treat Hong Kong as an external customs port. Hong Kong is then assigned more than half of Chinese outward investment. Funds flow through on their way to their final destination but the ministry is required to stop following them in Hong Kong. Its bilateral figures, e.g. China-Germany, are often much too low. The CGIT follows money to the true recipient, generating correct bilateral numbers.

Also affecting country totals is intense pressure to show the BRI is a success. PRC construction activity in BRI countries is heavy but finding high investment interest requires imagination. Using a government list of 70 BRI partners, the combined investment they received from China 2014-2017 was only slightly ahead of what the US received and trails the US plus Australia by a good margin.[v] Finally, MOFCOM has always used odd sectors. "Leasing and business services" is the top in drawing funds, which appears to be a way to deny the importance of energy investment. CGIT sector labels evolve with patterns of spending and building.

China's Global Footprint

The CGIT's far more accurate bilateral figures make clear that neither the BRI nor Hong Kong draws the bulk of Chinese money. The top 10 recipients feature wealthy economies, plus Brazil and Russia, which are middle-income but rich in resources (see table 2). While the US easily leads in terms of total investment attracted, the American figure is not impressive as compared to, say, Australia after adjusting for population or economic size. Once a darling for PRC companies, Canada has been largely ignored since 2013 and has been pushed down the list.

Table 2: Top Recipients of Chinese Investment 2005-17 ($ Billion)

Country	Investment Volume
United States	170.4
Australia	91.0
Britain	72.4
Switzerland	60.0
Brazil	54.6
Canada	49.4
Russian Federation	38.2
Singapore	30.8
Germany	25.5
Italy	21.5
Subtotal for top 10	613.8
Total for all countries	1044

Source: American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker.

In 2017 alone, Switzerland was the top recipient of Chinese funds and now appears in the top five overall. This is misleading because it is an exaggeration to locate the entire value of the Syngenta acquisition there. Unfortunately, it is not feasible to assign discrete values to assets in each country where large multinationals operate. Another example is the $14-billion acquisition of London-based Logicor by one of the PRC's sovereign funds, which helped Britain see the second-most Chinese investment last year though some Logicor assets are in continental Europe. The US was third in 2017 at over $24 billion, a 54% drop. Given its tiny population, Singapore had an exceptional year, at $13 billion.

Investment involves ownership, partial or full. Yet China may own little in the way of local assets while signing contracts worth billions. These are construction projects, for coal plants, schools, and more. While investment is more valuable dollar for dollar, construction can provide substantial benefits and is a vital part of the PRC's economic relations with many nations. Even closing on $750 billion, the value of construction contracts captured by the CGIT is too low. Early years were underreported and new projects trickle in slowly, leaving the 2017 list as yet incomplete. The number of $1+ billion projects does fit over time with official Chinese reports.

The PRC's construction activity looks nothing like its investment. There are no rich countries in the top 10 construction list (see table 3) while seven are BRI members (vs. 2 in the investment top 10). Casual observers talk of BRI investment, for example the ever-rising figure boasted for the China-Pakistan economic corridor.[vi] They should say construction and engineering. The PRC is not looking to own $60 billion worth of Pakistan, it is building there. In 2017 alone, Argentina saw the most Chinese construction activity, followed by a bunched pack that included Australia due to Chinese acquisition of local mainstay John Holland.

Table 3: Top Areas of Chinese Construction Activity 2005-17 ($ Billion)

Country	Investment Volume
Pakistan	39.8
Nigeria	37.1
Indonesia	26.0
Saudi Arabia	25.3
Malaysia	24.9
Algeria	22.9
Ethiopia	22.7
Bangladesh	22.4
Angola	20.1
Iran	18.8
Subtotal for top 10	260.0
Total for all countries	736.5

Source: American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker.

There is another important difference between investment and construction: the role of private Chinese companies in investment has become considerable over time while construction remains utterly dominated by state-owned enterprises (SOEs) such as Power Construction Corp. These have a proven engineering record in difficult settings and they are massively aided by concessionary financing from state-controlled banks. It should not be any surprise if many Chinese projects are money-losers; if they are perceived to support the PRC's foreign policy goals, they are initiated on that basis.

That energy is the most popular sector for PRC investment and construction over the past 13 years will surprise no one. Among energy subsectors, oil draws the most investment, by itself on par with metals investment, which has been languid for years. In construction, coal and hydro plants lead energy but here transportation is a fast-moving second. In 2017 alone, transport and energy accounted for four-fifths of construction value. Technology receives a great deal of attention but accounted for only five percent of completed investment since 2005 and only two percent last year. Two large 2017 logistics acquisitions elevated the status of that sector.

Table 4: Sector Patterns, 2005-17 ($ Billion)

Sector	Investment	Construction	Troubled
Energy and power	354.8	310.6	117.6
Transport	95.1	230.1	44.4
Metals	123.9	32.4	74.9
Real estate	97.7	70.0	19.1
Agriculture	79.5	16.7	10.9
Finance	75.2	-	36.5
Technology	51.1	15.6	27.7
Tourism	36.3	6.6	7.4
Entertainment	38.8	2.0	1.6
Logistics	33.0	4.5	1.0
Chemicals	11.7	14.3	1.9
Other*	47.8	33.7	5.0
Total	1044	736.5	347.9

* In other investment the leading sector is health care; in other construction it is utilities. Numbers may not add due to rounding.
Source: American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker.

Beijing May Green-light More Spending

The January 2017 CGIT update incorrectly forecasted retrenchment last year, and many observers still cite official statistics to say it happened. There were important areas of retrenchment but total investment was bolstered by multiple large SOE acquisitions such as Ping An's stake in HSBC. This enabled China to maintain its global visibility while rolling back spending by private companies in sectors like entertainment.[vii] For 2018, Beijing probably

believes it has made its point and now-chastened private investors will feel less pressure. This should support investment in the 2016-7 range, to be reported by Beijing as an increase. It's hard to see annual volumes rising further but $1 trillion over the next six years is feasible.

The main reason Beijing will be more relaxed lies in the same indicator that caused it to belatedly crack down: foreign exchange reserves. The quasi-crisis of early 2016 has been stabilized by formal capital controls and informal but unsubtle events like the disappearance of globally visible CEO's.[viii] Net foreign exchange outflows all but vanished over the course of last year.[ix] The threat is certainly still present, but has been blunted for now.

This does not mean a return to the 2016 free-for-fall. Chinese authorities have become reluctant to allow capital outflow in the form of large-scale property purchases, particularly hotels. This and other sector-based curbs will be retained. The central government's emphasis on BRI will serve to effectively limit Chinese investment, as BRI country markets are not as appealing and incentives to push investment there will bear little fruit.

A key variable is the spending signal to private Chinese firms. The demise of private investment last year was exaggerated but its 2016 trajectory was sharply altered, from a rising share of a rising total to an enforced pullback. This year, a moderate pick-up is most likely. Given the hostility of some foreign partners to SOE's, private companies can be better able to acquire desirable foreign assets and it would therefore harm the PRC's economic progress to sideline them for long. The $80 billion in private investment in 2016 remains a bit excessive but $70 billion is achievable.

Table 5: The Private Share of Investment Since 2010 (Percent)

Year	Share
2010	9.4
2011	11.8
2012	14.1
2013	29.9
2014	27.7
2015	31.6
2016	46.4
2017	36.2

Note: The private share was tiny before 2010. Numbers may not add up due to rounding.
Source: American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker.

For construction, another $100-$110 billion in PRC projects is likely in 2018. This remains notable but a major upswing did not appear to occur last year, despite BRI, and there's little economic reason for one this year. A shrinking labor force means China no longer needs to send workers overseas. Foreign exchange may no longer be tightly constrained but Beijing still cannot afford to be profligate, especially since large construction projects in developing economies (e.g. hydroelectric plants) generally do not offer good prospects for profit. It will still be possible to talk up large figures for BRI simply by expanding the number of participant countries.

There is a new data problem on the construction side – SOE engineering majors have become more opaque recently after years of improvement. Reporting failure in a BRI partner may no longer be politically acceptable even while setbacks are inevitable in building new infrastructure in difficult environments. Of course long rail lines risk extended delays and grand urban plans can fall short of sales pitches. When non-commercial factors impair a commercial agreement, this qualifies as a "troubled" transaction. PRC construction companies typically face $6-7 billion worth in impairment annually, for example a long-delayed elevated expressway in Bangladesh.

Because it involves ownership, investment gets into a lot more trouble than construction, to the tune of $20 billion in lost opportunities annually despite the commercial partners wanting to proceed. Beijing has belatedly unraveled deals it does not like and local or international security confrontations have undermined transactions. Multi-year operating losses also qualify.

The main source of trouble, though, is host governments either inhibiting or outright blocking transactions. A basic issue affecting many PRC partners is reciprocity, or rather its lack. At the most dramatic level, Beijing would never allow a Chinese company of Syngenta's size to be bought, much less one in a field like agro-tech. Dozens of small Chinese acquisitions can have the same effect as one huge bid, occurring as they do while multinationals increasingly complain the PRC is not open to foreign competition.[x]

The long-standing perception that China likes competition only in other markets is reinforced by the ebbing of greenfield investment in favor of acquisitions. The PRC averaged $175 billion in spending in 2016-7 yet greenfield spending is starkly unimpressive, at barely $20 billion annually.[xi] The turn to large SOE acquisitions also caused the raw number of greenfield transactions to fall in 2017. Acquisitions carry fear of loss of competitiveness and technology and possible relocation of jobs back to China. Greenfield investment avoids all these problems, but the PRC is engaged in less of it.

A second concern of host governments was spotlighted in 2017: a Chinese presence, including investment or construction spending, bringing undue social and political influence. Developing countries have fretted over this for years, even while pining for Chinese funds. The scope of the challenge has expanded with accusations of graft in Australia, which has had a large PRC presence but also a seemingly strong civil society.[xii] As with reciprocity, this does not impede specific deals, rather it creates an environment of greater suspicion.

Another objection does focus on specific transactions: loss of advanced technology. A new development is European concern (the US is discussed in the next section). The EU does not worry about use of dual-use technology in the South China Sea, it worries that the PRC will use acquisitions to climb the manufacturing ladder at the expense of European firms and workers. This has melded with standing reciprocity complaints and new questions about China's intent in courting east Europe.[xiii] Brussels and the member capitals have of course not made any decisions but they are now interested in a joint international position on this particular Chinese challenge.

For the moment, the top two recipients of the PRC's investment by volume remain by far the top two in terms of trouble. The US is actively inhibiting Chinese companies while Australia is more trying to avoid being drowned by them. Other countries seeing $10+ billion in impaired

transactions are present due to older events. It can take time for a transaction to sputter, so there will eventually be more of them for 2017 and perhaps earlier, adding to the tally.

Table 6: Most Troublesome Countries 2005-17 ($ Billion)

Country	Troubled Transactions
United States	65.4
Australia	59.1
Iran	25.2
Germany	15.4
Libya	12.7
Nigeria	11.5
Subtotal for top 6	189.3
Total for all countries	347.9

Source: American Enterprise Institute and Heritage Foundation, China Global Investment Tracker, https://www.aei.org/china-global-investment-tracker.

Washington's Stop Sign Is Bright Red

In July, this section was titled "decision time in the US." The decision appears to have been made. The plunge in PRC spending in the US in 2017 was due primarily to Beijing's curbing of Chinese private firms' mad rush in 2016 (which was replaced by SOE's heading for Europe). But what Beijing took away last year, it could conceivably give back this year. It is now Washington making clear there will be no new surge, through (in)action by CFIUS and potential reform of that body, where both could have wide-ranging effects.

Deciding how to handle Chinese firms requires identifying them correctly. The biggest PRC acquisition in the US last year was routed through Ireland. It's still Chinese. Perhaps the most controversial deal saw Lattice Semiconductor briefly try to pretend it was being bought by an US company. Also Chinese.[xiv] The best way for CFIUS and American policy-makers to determine control of a firm is to trace the money being used. Layers of subsidiaries and shell companies mean any other method of determining control can be gamed. Ultimately Chinese money guarantees influence, no matter the company's name or location of its headquarters.

For 2018, US policy choices must sort old and new risks. An old risk misunderstood by some is from SOEs versus private firms. While SOE's account for most of China's global investment, their US share is below 40 percent. More important, *there is no difference in the control the Communist Party can exercise over private firms and SOEs.* There is no rule of law in the PRC, no court or media through which private Chinese firms can resist Party orders to ignore US law or steal technology.[xv] Private Chinese companies receive less in the way of subsidies but are as beholden to the Party for their survival as SOEs are.[xvi] There is no justification to treat them differently with regard to national security.

Another old issue is reciprocity. It has of course long been true that the Chinese market is less

open than the American, but calls for applying reciprocity in investment offer little. The US does not want to close off the same sectors the PRC does, nor would it have any value for Beijing to promise to open already massively overcrowded industries such as steel. Further, if the PRC's response to demands for reciprocity was positive, the Trump administration has little interest in making it easier for American companies to invest in China.

New issues pertain more directly to investment review. Legislation was introduced last year that effectively sidesteps CFIUS for the sake of screening for net economic benefits.[xvii] This would be a mistake. Foreign investment, including Chinese, benefits Americans economically through job preservation or creation among other positive impacts. Pretending otherwise looks mostly like a way to slow and politicize the investment process, in order to reduce competition, Legislation of this kind should be rejected.

Another bill deserves serious consideration. Originally conceived in Senator Cornyn's office, it is now bipartisan and bicameral.[xviii] It expands CFIUS' responsibilities substantially, perhaps excessively, but is properly focused on national security. What China does should not be allowed to inhibit investment from dozens of good partner countries. Nonetheless, the PRC's singular effort to acquire advanced technology is increasingly global, increasingly sophisticated, and increasingly intense. America's best response can be extensively debated[xix] but a strong response is necessary, supported by greater resources. Moreover, action is already overdue, so pledges of future improvements are inadequate.

The challenge of confronting the threat from China without harming the national security review process has obscured a separate but pressing matter. It is difficult to find Chinese acquisitions that CFIUS should have halted but did not. It is all too easy to find PRC entities simply breaking American law with no apparent consequences. The obvious example is theft of intellectual property (IP), where loss estimates can run in the hundreds of billions of dollars yet not a single Chinese firm has been sanctioned[xx] (this may change in 2018 under Section 301). Chinese companies shown to have received stolen IP should not be allowed to invest or trade here.

Data theft has joined IP theft as a China risk. A number of Chinese companies are now legitimately interested in acquiring US counterparts which hold personal data for thousands of Americans or more. The danger comes if the Party later wants these data. In that case, it does not matter if Chinese firms wish to cooperate with the Party, they have no option. This logic lies behind CFIUS' refusal to approve a high-profile bid by an Alibaba unit for MoneyGram.[xxi] While the outcome was right, the process was not. The US needs a clear and durable policy stance to protect personal data, not stalling by CFIUS until the companies "figure it out."

Because the rule of law does not apply in China, Chinese firms cannot be trusted with personal data. PRC entities should be sanctioned for involvement with IP theft. As before, American dual-use and military technology must be protected, against a sharpening threat. At the same time, a large amount of Chinese investment is not itself objectionable and benefits the US economically. The last point has been, properly, the core of American policy toward foreign investment. The US now must find a way to incorporate China-specific restrictions without harming ourselves or long-time investment partners. Because the PRC is a global economic player, global cooperation is a logical next step. But first the US has to be wise in our own choices.

[i] American Enterprise Institute and Heritage Foundation, "China Global Investment Tracker," https://www.aei.org/china-global-investment-tracker/.

[ii] Jessica Meyers, "China's Belt and Road Forum lays groundwork for a new global order," *Los Angeles Times*, May 15, 2017, http://www.latimes.com/world/asia/la-fg-china-belt-road-20170515-story.html.

[iii] Xinhua, "China's ODI up 44.1% in 2016," January 16, 2017, http://english.gov.cn/archive/statistics/2017/01/16/content_281475543375328.htm. The revision is in the outward investment yearbook, published eight months later.

[iv] Xinhua, "Economic Watch: China guards against overseas investment mania", March 31, 2017, http://www.china-ceec.org/eng/zjzdo_1/t1450476.htm.

[v] This of course can be addressed by simply adding Australia to the BRI. For now at least a reasonable government list can be found at Belt and Road Portal https://eng.yidaiyilu.gov.cn/info/iList.jsp?cat_id=10076, accessed January 7th, 2018.

[vi] Ben Blanchard, "China, Pakistan to look at including Afghanistan in $57 billion economic corridor," Reuters, December 26, 2017, https://www.reuters.com/article/us-china-pakistan-afghanistan/china-pakistan-to-look-at-including-afghanistan-in-57-billion-economic-corridor-idUSKBN1EK0ES.

[vii] Bloomberg, "China's Outbound Investment Plunges as Irrational Deals Curbed," November 16, 2017, https://www.bloomberg.com/news/articles/2017-11-16/china-s-outbound-investment-plunges-as-irrational-deals-curbed.

[viii] Lisa Murray, "China's strict capital controls are working," Financial Review, August 8, 2017, http://www.afr.com/news/world/chinas-strict-capital-controls-are-working-20170808-gxrtxi, and Matthew Miller and Koh Gui Qing, "China's Anbang says chairman steps aside, after report of his arrest," Reuters, June 13, 2017, https://www.reuters.com/article/us-anbang-group-chairman-idUSKBN19500D.

[ix] Xinhua, "China's yuan funds for foreign exchange rises for 3rd straight month in November" December 14, 2017, http://news.xinhuanet.com/english/2017-12/14/c_136826308.htm.

[x] Reuters, "Foreign Firms in China Say They Are Less Welcome Than in the Past," in Fortune, January 18, 2017, http://fortune.com/2017/01/18/china-foreign-businesses-xi-jinping-open-markets-business-optimism-pessimism-american-chamber-of-commerce-china-poll/.

[xi] There is a technical problem in classifying many investments in developing countries. The deal will be represented as a Chinese participant joining an existing project but the project will turn out to be very little on the ground. The CGIT methodology is to be cautious and decline to label these as greenfield. A more liberal approach could change the greenfield totals but would not change the trend of sharply declining importance in 2016-7.

[xii] African Development Bank, "The Expansion of Chinese Influence in Africa - Opportunities and Risks," August 14, 2012, https://www.afdb.org/en/blogs/afdb-championing-inclusive-growth-across-africa/post/the-expansion-of-chinese-influence-in-africa-opportunities-and-risks-9612/ and Nick McKenzie and James Massola "Andrew Robb's secret China contract: money for nothing," *The Sidney Morning Herald*, December 6, 2017, http://www.smh.com.au/federal-politics/political-news/andrew-robbs-secret-china-contract-money-for-nothing-20171205-gzzaq5.html.

[xiii] Anders Fogh Rasmussen , "China's investment in Europe offers opportunities — and threats", Financial Times, November 20, 2017, https://www.ft.com/content/9e7428cc-c963-11e7-8536-d321d0d897a3 and Christopher Cermak, "Eastern Europe cozies up to China," Handelsblatt Global, November 30, 2017, https://global.handelsblatt.com/politics/eastern-europe-cozies-up-to-china-859869.

[xiv] Avolon, "Avolon Completes US$10.38 Billion Acquisition of Cit Aircraft Leasing Business," April 4 2017, http://avolon.aero/wp/wp-content/uploads/2017/04/Avolon-Final-Closing-4-April-2017.pdf; and Business Wire, "Lattice Semiconductor to be Acquired by Canyon Bridge Capital Partners, Inc. for $1.3 Billion," November 03, 2016, https://www.businesswire.com/news/home/20161103005762/en/Lattice-Semiconductor-Acquired-Canyon-Bridge-Capital-Partners.

[xv] If Chinese firms can be ordered to violate American anti-trust law, they can certainly be ordered to steal valuable technology. See Alison Frankel, "DOJ bucks China, urges SCOTUS to hear case against vitamin cartel," Reuters, November 17, 2017, https://www.reuters.com/article/legal-us-otc-chinese/doj-bucks-china-urges-scotus-to-hear-case-against-vitamin-cartel-idUSKBN1DH2HA.

[xvi] Michael Forsythe, "Fosun Group's Chairman Is Said to Be Missing in China," *New York Times*, December 10, 2015, http://www.nytimes.com/2015/12/11/business/chairman-of-fosun-group-of-china-is-said-to-be-missing.html.

[xvii] Sylvan Lane, "Bipartisan bill would force Commerce Dept. to judge economic risks of foreign investments" *The Hill,* October 18th, 2017, http://thehill.com/policy/finance/356107-bipartisan-bill-would-force-commerce-department-to-judge-economic-risks-of.

[xviii] Robert Pittenger Office, "Pittenger: China targeting our tech, we must react," December 18, 2017, https://pittenger.house.gov/media-center/press-releases/pittenger-china-targeting-our-tech-we-must-react.
[xix] Derek Scissors, "CFIUS, Chinese Investment, and How to Improve Both," AEI, September 18, 2017, http://www.aei.org/publication/cfius-chinese-investment-and-how-to-improve-both/.
[xx] National Bureau of Asian Research, "Update to the IP Commission Report," February 2017, http://www.ipcommission.org/report/IP_Commission_Report_Update_2017.pdf.
[xxi] PRNewswire, "MoneyGram And Ant Financial Announce Termination Of Amended Merger Agreement," January 2, 2018, https://www.prnewswire.com/news-releases/moneygram-and-ant-financial-announce-termination-of-amended-merger-agreement-300576618.html.

Evaluating CFIUS: Challenges Posed by a Changing Global Economy
Responses to CFIUS QFR – Admiral Dennis Blair
March 19, 2018

Representative Bill Posey

Question #1

Series 1) Many of us are aware of the entry of a Middle-Eastern company as an investor and service provider in container operations at one of our Florida ports. Ever since 9/11, the nation has been focused on the potential threats posed by containers as a vehicle for delivering terrorist activities to our shores. TSA is spending millions of dollars on screening containers.

- Shouldn't the entry of a firm based in an unstable region of the world be reviewed by CFIUS?
- Isn't it incumbent upon us to examine inbound foreign investment transactions from countries that may have political and business relationships with rogue actors?
- Are the current statutory authorities adequate to require such a review?
- What types of mitigation requirements or agreements might be appropriate in a case like this one?
- What is the difference between an acquisition and a long-term lease agreement?
- Why is a CFIUS review not warranted under current law or regulation in regard to a long-term lease agreement between a U.S. entity and a foreign investor?

Response:

I do not believe that all investments in the United States by firms based in unstable regions of the world should be reviewed by CFIUS. Beyond the difficulty of defining an "unstable region," I believe that CFIUS review should be triggered by the threat posed by the nature of the company and the nature of the investment it seeks to make.

So far, violent extremist Muslim organizations have not demonstrated the capability to take control of a large business in the Middle East, hide the fact of their control, then use the company to invest in the United States to gain access to American infrastructure to conduct terrorist attacks. This threat does not rank high in my priorities for CFIUS. TSA needs to spend resources to ensure the safety of container cargoes no matter what company operates American and overseas ports.

CFIUS is the primary statute under which the United States reviews foreign investments to ensure they do not threaten national security. As I have testified previously, I believe it should have a broad charter. It should have the authority to review investments into American critical infrastructure, whether it be telecommunications or container ports. I believe the CFIUS statute should be broadened to ensure this broad charter is explicit.

The CFIUS mitigation process works well, and I believe it could be adapted to investments into companies that operate port facilities. Measures would include vetting of employees and surprise inspections of operations.

If long-term lease agreements provide the same rights to an investor as ownership, then they should be covered by CFIUS.

Question #2

Series 2) Several panelists express the view that expanding CFIUS review to technology export risks incentivizing U.S. companies to hold intellectual property offshore. They argue that instead of employing CFIUS to enhance our national security oversight of outbound technology transfer, we should focus on enhancing U.S. export control regulations.

- Could you elaborate on how enhancements of export control regulations might work?
- Why would there be a difference in the *incentives to off-shore intellectual property* under an enhanced CFIUS review as opposed to enhanced export control regulations;
- Wouldn't the incentive effects of the two alternatives be similar?
- Please describe conceptually how an expanded CFIUS process or approach might work compared to enhanced export control regulations.
- Who would make the decisions in each case and what are the pros and cons of the two alternatives?
- Is one method clearly more cost-beneficial than the other?

Response:

I believe amending CFIUS to account for risks inherent in foreign investment in the United States *and* reforming our export control laws are both necessary to safeguard our national security. Investment reviews under CFIUS and export controls work together to prevent the loss of national security technologies to foreign countries. Here are several points that show the inter-connectedness of investment control reform and export control reform:

First, export controls primarily regulate commercial products and product features involving late-stage technologies, not early-stage technologies or investment activity. Even if amended to better regulate exports of early-stage technologies, export control regulations do not effectively differentiate between dual military and commercial uses of technologies. In contrast, CFIUS specifically operates with national security interests in mind, having an inherent purpose to identify dual civilian and military technological uses in making decisions about problematic investments.

Second, compliance with export control regulations is primarily a company's responsibility, and many startup companies have neither the incentives nor the capacity to understand the national security implications of foreign investment. The CFIUS process ensures that experienced government personnel review both the nature of a foreign company making investments, and the dual-use risks of the technologies being developed by a company.

I do not understand the concern that strengthened CFIUS review will lead to "intellectual offshoring." Today, although some of our IP losses have been from China's cooperation with our allies, China has benefited most from stealing from American companies building defense

equipment *in the United States*. We must stop the theft already occurring within our borders to preserve not only the further erosion of our defense industries, but American national security. If American companies react to strengthened CFIUS review by moving their early-stage technology development, then we should make further adjustments to the statute.

Fundamentally, export controls and CFIUS review are designed to be complementary. So as I noted in my testimony, to maximize our coordination across relevant agencies and to ensure that accurate and timely information is available for both the CFIUS and the export control processes, I recommend the establishment of a new National Counter IP Theft Center, based on the model of the National Counterterrorism Center in the intelligence community, to collate and publicize the corporate structures, funding, and activities of foreign firms that pose the greatest threats to American intellectual property. This new Center would serve as an umbrella entity that coordinates across relevant agencies, including the Department of Treasury and the Department of Commerce. Having this database would inform sensible decisions about the laws and regulations appropriate for application.

Question #3

Series 3) I assume that with either export controls or with an expanded role for CFIUS in outbound technology transfer, U.S. defense technology firms have a strong incentive to acquire intellectual property [sic; read: *patents*] in the United States.

- Is that true?
- Does U.S. intellectual property (a patent) have a clear and powerful advantage over a foreign patent when it comes to defense technology?
- Please describe how the patent application process provides or can provide opportunities to protect our defense sensitive technologies?
- Is it part of the screening process to identify the sensitive technologies we need to protect in outbound transfers?

Response:

U.S. firms, not only defense technology firms, always have a strong incentive to acquire patents for hard-earned technological innovation. However, neither U.S. nor foreign patents will protect a U.S. firm from foreign theft without cooperation from the acquiring State, which in the case of China and national security technologies is unlikely. Additionally, because patents are territorial, a U.S. patent will not necessarily have a clear and powerful advantage over a foreign patent. While building in additional mechanisms in the patent application process could be an option, the Patent and Trademark Office awards patents to incentivize innovation and grant temporary monopolies on inventions, not to preserve national security.

CFIUS was formally established through the Foreign Investment and National Security Act of 2007 whose purpose was "[t]o ensure national security while promoting foreign investment" and "to reform the process by which such investments are examined for any effect they may have on

national security."[1] CFIUS has a clear mandate to examine the effects on national security of foreign acquisition or investment. An enhanced version of CFIUS is the appropriate vehicle to make decisions to block technology transfers if necessary for American national security and prevent early-stage intellectual property theft.

Question #4

Series 4) Section 721 of the Defense Production Act of 1950, as amended, provides authority for the President to unwind or block inbound foreign investment transactions. As a result, the principal way that CFIUS operates is by using the threat of presidential action as a means of securing agreements from the parties to take steps to mitigate the perceived national security threat.

- Can you please describe the President's role or powers in export controls related to national defense and how they may differ from his role under Section 721 – in ways other than that CFIUS is inbound control rather than outbound control?
- Are the President's powers roughly the same in terms of his role in blocking or unwinding under the two authorities?

Response:

The president's powers to manage CFIUS review and export controls differ in purpose and in available implementation tools. CFIUS primarily serves to clear foreign investments in U.S. businesses; thus the failure of a proposed foreign transaction to pass CFIUS review means that the president in consideration of national security concerns may suspend, block, place conditions, or unwind the proposed investment into the United States. Generally, if a transaction passes CFIUS review with all the proper documentation submitted, the president is unlikely, except in extreme circumstances calling for a national security emergency under the International Emergency Economic Powers Act (IEEPA), to roll back the transaction. But if false or incomplete documents were submitted or the transaction was not previously cleared by the CFIUS process, the president may unwind the transaction.

On the other hand, U.S. export controls primarily serve to restrict actors with a U.S. nexus from exporting certain material or technology, or from exporting to a foreign country under economic sanctions; thus, noncompliance with export control and related sanctions regulations is a violation of U.S. law and may lead to severe civil penalties and criminal prosecution in the United States. The president also has authority under IEEPA to block or nullify, among other actions, any export that violates the regulations.

Question #5

Series 5) Admiral Blair you make a clear recommendation: "...at a minimum, Chinese and other foreign companies that have stolen American intellectual property should not be allowed to

[1] Foreign Investment and National Security Act of 2007, PL 110-49, July 26, 2007, 121 Stat. 246.

invest in this country. We need to face these companies with a choice – either follow American intellectual property rights law or do no business in the United States. The CFIUS process should be a part of imposing this choice."

- Don't we need to apply the same principle to investments by U.S. firms making technology transfers to such rogue nations?
- Should we apply sanctions by amending the export control regulations to limit export of technology to nations that violate U.S. intellectual property rights or should we consider expanding the CFIUS review to ensure we prevent technology export to such nations?

Response:

We need to be careful about definitions, but if we define a "rogue nation" as an authoritarian country with fundamental national security policies hostile to the United States, then I agree that companies from rogue nations should not be permitted to invest in the United States. Right now I would include only North Korea and Iran in the category of rogue nations. I do not believe that companies from either of these countries currently attempts to invest in the United States, but the principle of such legislation would be valid.

Currently, beyond CFIUS and export controls, the United States uses sanctions to prohibit commercial dealings with rogue nations, and I believe this approach is appropriate.

Representative Gwen Moore

Question #1:

Section 3(a)(5)(B) of the proposed legislation would treat as a covered transaction any transaction involving the contribution by a US critical technology company of intellectual property and associated support. The legislation defines a US critical technology company as any company that produces, trades in, designs, tests, manufactures, services or develops critical technologies. The definition in the proposed legislation of "critical technologies" is very broad and leaves room for further expansion through regulations.

The proposed legislation covers contributions of IP by critical technology companies, but as written, the IP could relate to any kind of IP that the company possesses.

- Shouldn't we focus specifically on the contribution of IP related to critical technologies, and not other kinds of technology that a US critical technology company happens to possess?

Response:

I would be very suspicious of a foreign investment in a critical technology company that claimed that it was interested only in its non-defense technology. However if there is an exceptional

circumstance, then it could be handled by mitigation agreements.

Question #2:

The current CFIUS regulations already define "critical technologies" with specific reference to export control regulations. CFIUS has said on page 37 of its most recent annual report that export control regulations "were determined to be the most reliable and accurate means of identifying critical technologies."[2]

- If that's the case, then there is no apparent reason to change that definition, and it would seem that the best way to deal with the transfer of critical technologies is through the export control regulations, not CFIUS.
- Don't you agree?

Response:

I respectfully disagree. The important question before Congress is not whether CFIUS regulations or export control regulations provide more security. They are both necessary and both need updating and reform.

Even my fellow witnesses at the hearing testified that the current export control legislation has lapses and needs updating. Right now, the export control regulations "critical technologies" definition includes only late-stage technologies—"[d]efense articles or defense services," "items specified on the Commerce Control List," "[s]pecially designed and prepared nuclear materials and technology," and "select agents and toxins."[3] This list fails to include early stage technologies with potential to evolve into a national security threat.

[2] *See Committee on Foreign Investment in the United States: Annual Report to Congress, Report Period: CY 2015*, 1, 37, https://www.treasury.gov/resource-center/international/foreign-investment/Documents/Unclassified%20CFIUS%20Annual%20Report%20-%20(report%20period%20CY%202015).pdf. ("The Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons (the 'CFIUS regulations'), published in the Federal Register on November 21, 2008, and codified at 31 C.F.R part 800, defines 'critical technologies' with reference to U.S. export control regulations, as they were determined to be the most reliable and accurate means of identifying critical technologies.").
[3] 31 C.F.R. § 800.209.

Responses to
Questions for the Record of Rep. Gwen Moore
Subcommittee on Monetary Policy and Trade Hearing
Evaluating CFIUS:Challenges Posed by a Changing Global Economy

Responses of
Rod Hunter
Partner, Baker McKenzie
former National Security Council Senior Director and
former Special Assistant to the President for National Security Affairs

- **Question: "Shouldn't the legislation focus specifically on the contribution of IP related to critical technologies, and not other kinds of technology that a US critical technology company happens to posses?"**
    - Response: Foreign investment review legislation should focus on risks arising from foreign investments in U.S. businesses, including where those investments permit transfer of technology with security implications. It is not the transfer of the intellectual property, per se, that is the issue, but access the technology itself.

- **"[I]t would seem that the best way to deal with the transfer of critical technologies is through the export control regulation, not CFIUS. Do you agree?"**
    - Response: Yes. The proponents of the initial FIRRMA bill have a point that export control regulation has not kept pace, but the solution, as Representative Moore suggests, is to be found in updating export control regulation, not allocating to CFIUS the role of supervising technology transfers.

Questions for Record
Of
Representative Gwen Moore
Subcommittee on Monetary Policy and Trade
Hearing
Evaluating CFIUS: Challenges Posed by a Changing Global Economy

Responses of Hon. Theodore W. Kassinger

Questions

Section 3(a)(5)(B) of the proposed legislation would treat as a covered transaction any transaction involving the contribution by a US critical technology company of intellectual property and associated support. The legislation defines a US critical technology company as any company that produces, trades in, designs, tests, manufactures, services or develops critical technologies. The definition in the proposed legislation of "critical technologies" is very broad and leaves room for further expansion through regulations.

Can each of the witness please answer the following questions:

> The proposed legislation covers contributions of IP by critical technology companies, but as written, the IP could relate to any kind of IP that the company possesses. Shouldn't we focus specifically on the contribution of IP related to critical technologies, and not other kinds of technology that a US critical technology company happens to possess?
>
> The current CFIUS regulations already define "critical technologies" with specific reference to export controlled regulations. CFIUS has said on page 37 of its most recent annual report that export control regulations "were determined to be the most reliable and accurate means of identifying critical technologies." If that's the case, then there is no apparent reason to change that definition, and it would seem that the best way to deal with the transfer of critical technologies is through the export control regulations, not CFIUS. Don't you agree?

Responses

I agree that the legislation should focus on critical technologies, and not whether a company is deemed to be a critical technology company. Companies may have some proprietary technology that is "critical technology," while predominantly possessing other technologies that are proprietary but not sensitive. Such companies should have the flexibility to structure transactions with foreign partners in a manner that differentiates critical technologies from technologies that do not rise to that level of national security sensitivity.

I also agree that the export control regulatory scheme is the better path for protection of U.S. national security interests while reducing regulatory risk and burdens on the private sector. Identifying controlled technologies through an expert process conducted outside of the pressures of a CFIUS case would lead to much better informed and defined classifications, and guide

businesses toward transactions that will not be scuttled after agreement, through an after-the-fact CFIUS review. I am confident that an enhanced process for identifying emerging and critical technologies is feasible and will be effective in addressing potential national security risks arising from innovation that may outpace appropriate controls on exports of technology.

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FREEMAN CHAIR
IN CHINA STUDIES

September 21, 2018

Francesco Castella
Legislative Assistant
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Castella:

Thank you for your note of September 18, 2018, seeking my answers to the questions from Representative Moore that emerged out of the January 2018 hearing held by your committee. My sincere apologies for my late reply, as I was unaware that my providing answers to these questions was mandatory and needed for the hearing report to be completed. In any case, my brief answers are below.

Q#1: The proposed legislation covers contributions of IP by critical technology companies, but as written, the IP could relate to any kind of IP that the company possesses. Shouldn't we focus specifically on the contribution of IP related to critical technologies, and not other kinds of technology that a US critical technology company happens to possess?

> A#1: The definition of "critical technology" is necessarily general and needs to be open to including new kinds of specific technologies over time. I also think it makes sense to have a relatively flexible definition for which intellectual property (IP) is covered by this part of the legislation. The Executive Branch needs to have flexibility in how they implement CFIUS with respect to which technologies and their underlying IP are covered. If interpreted too narrowly, the Executive Branch may not be able to fully limit diffusion of technology that should be kept out of foreign hands. This does open the possibility that the Executive Branch could overreach and place limits on technologies and IP that go beyond "critical technologies," but I'd argue in giving the Executive Branch a broader mandate and then work closely with American industry to implement the rules in an effective manner that finds the right balance between protecting national security and promoting international commerce. Congress then should carefully monitor implementation to determine if the rules have been properly implemented to meet these goals.

Q#2: The current CFIUS regulations already define "critical technologies" with specific reference to export controlled regulations. CFIUS has said on page 37 of its most recent annual report that export control regulations "were determined to be the most reliable and accurate means of identifying critical technologies." If that's the case, then there is no apparent reason to change that definition, and it would seem that the best way to deal with the transfer of critical technologies is through the export control regulations, not CFIUS. Don't you agree?

A#2: I believe the US needs to both update its rules and regulations regarding foreign investment and those related to export controls and that we should actively use both mechanisms to protect American national security while also facilitating international commerce. Expanding both kinds of regulatory tools could potentially lead to over-regulation and inhibit reasonable investment and commerce, but I would advise that we err on the side of protecting national security in terms of how the regulations are written. The Executive Branch, with Congressional oversight, will then need to take great care in determining which specific technologies and underlying IP are covered to ensure balanced implementation of both sets of rules.

If you require anything else, please let me know.

Best Wishes,

Scott Kennedy

Scott Kennedy
Deputy Director, Freeman Chair in China Studies
Director, Project on Chinese Business and Political Economy
Center for Strategic and International Studies

Response to Representative Moore:

I think the ideal focus is on how critical technologies could be compromised. In other words, it's not necessarily the transaction itself but rather whether the transaction would place US control of critical technology at risk. There are three categories:

1) The company doesn't have any critical technology – no need for review.
2) The company is directly selling critical technology through an acquisition or otherwise – this should be rejected.
3) There is a transaction involving a company which holds critical technology which is not a sale but which could otherwise compromise the technology. Doesn't call for rejection but should be reviewed and, possibly, mitigated.

I agree with the point that critical technology can be defined too broadly and also consider export control regulations a good way to make that definition concrete. However, it does not follow that export controls are the best means of preventing technology transfer. As a semantic matter, CFIUS reviews investment and export controls pertain to trade. Where is the threat coming from?

More telling, export controls are not doing the job of preventing unwanted technology transfer to China. Perhaps they could if they were improved but there is no suggestion on the table for their improvement. FIRMMA is definitely not perfect but it is incumbent upon those touting export controls as the superior method to show how export controls will be upgraded to prevent Chinese technology acquisition. Until then, they are not offering anything to address a current, serious problem.

Response to Representative Posey on Series 2.

I am not a strong advocate of export controls over CFIUS. From my perspective as a China expert, it is clear that our system of technology control isn't working properly with respect to the PRC; it is not stopping acquisition and theft of technology.

FIRMMA is certainly not perfect and I would be pleased to see a bill to upgrade our export control regime which could be compared to FIRMMA to see how they complement each other or even to pick one as superior. Until such a bill is produced, however, I find the export control arguments either demonstrate an incomplete understanding of the extent of the problem or, in the case of a few interested parties, are simply disingenuous.