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

---

[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.