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Chairwoman Pryce, Vice Chairwoman Biggert, and Ranking Member Maloney, thank you for the opportunity to participate in this hearing on H.R. 5337, the "Reform of National Security Reviews of Foreign Direct Investments Act." H.R. 5337 would establish in statute the Committee on Foreign Investment in the United States and establish procedures "to ensure national security while promoting foreign investment." In my remarks, I want to make clear that I am speaking for myself; the Council on Foreign Relations is a non-partisan think tank that does not take positions on issues.

Among developed economies, the United States has performed uniquely well in the past decade. The key characteristic of this outstanding growth has been a post-1995 acceleration in United States productivity – that summary measure indicates the ability of an economy to produce the same goods more cheaply, generate a greater standard of living than in the past from the same people, factories, and equipment, and to use innovation to produce different and higher-quality goods than in the past. In short, productivity is the single-best summary measure of the overall long-term performance of an economy and the United States stands out in recent years.

One ingredient in this recipe for success has been openness to global trade in goods, services, and capital. There is a growing body of economic research that documents the beneficial dynamics of open trade. For example, those firms that are engaged in global markets are more productive than their domestically-oriented counterparts.

A vivid example of the dynamic benefits of open trade is in information technology hardware. As I noted, it is now widely recognized that the United States experienced a surge in productivity growth after 1995 (and perhaps again recently). A substantial factor was the increasing sophistication of IT hardware. One version of this story credits clever engineers in the selfless pursuit of Moore's law. But it is also the case that IT hardware is among the most global and competitive industries, and global markets reward entrepreneurial zeal as much as engineering skills. Moreover, policy supported these dynamics. The Declaration on Trade in Information Technology Products (ITA) from the 1996 Singapore Ministerial Conference was the foundation for reduced barriers to trade in IT hardware.

A related strength of the United States is its sophisticated, deep, and specialized financial markets. Financial markets are the central nervous system of a market economy, serving to collect and transmit important information, guide capital to its most productive use, and enhance the overall coordination of firms, households, and governments.

One particular aspect of executing these functions is financing mergers and acquisitions (M&A). These transactions generate economic value. The bids by new owners raise the overall return to existing shareholders, generating additional capital market funds. At the same time, new ownership can bid more as a result of replacing ineffective management, taking advantage of beneficial complementarities ("synergies") with their existing business model, or otherwise raising the productivity of the purchased firms' capital, technologies, and labor skills. In short, the new firm is more productive than the old – in this way, mergers and acquisitions are one manifestation of the role of competitive financial markets in efficiently allocating national capital.

As capital markets have become global in scope, so has M&A (along with "greenfield" investments by U.S. firms abroad and overseas investors in the United States). Currently, U.S. subsidiaries of companies based outside the United States have over 5 million employees and pay compensation of over $300 billion each year, or about $60,000 per employee. The vast bulk of these investments have come from countries belonging to the Organization for Economic Cooperation and Development (OECD, over 90 percent) and a small minority is undertaken by firms with government control.

In short, a strong economy is part of national security and open, global capital markets are a cornerstone of our strong economic future. Nevertheless, despite the fact that few cross-border transactions show risk of affecting security directly and few are undertaken by firms with government control, those situations do arise (and have arisen) in which strategic, safety considerations overwhelm the financial desirability of a particular transaction. Thus, to meet overall objectives, it is essential to pair policies that support well-functioning, open capital markets with specific carve-outs for transactions that pose a strategic threat.

A policy mechanism to accomplish this aim should embody several characteristics. First, the process would be a targeted mechanism to identify those transactions that generate a legitimate national security concern without excessive and wasteful scrutiny of routine transactions.

Second, the process would be predictable. That is, it would be transparent to market participants *which* transactions would merit scrutiny and review and *how* the strategic impact of the transaction would be evaluated. Ensuring that markets can anticipate which transactions will raise concerns suggests an advantage to avoiding a definition of national security that is either overly broad or indistinct. For example, the definition of "critical infrastructure" embodied on homeland security objectives could potentially include all transactions in the food supply chain. Similarly, definitions that include "economic security" are too broad and likely to generate uncertainty regarding investments.

Seeking to clarify CFIUS evaluation includes not only laying out the steps for review and investigation, but also continuing to build expertise and continuity of staff in this important area.

Third, the process would provide a high degree of confidentiality to secure proprietary business information and national security considerations.

Fourth, the process should be flexible, providing arrangements that permit means to augment security or otherwise satisfy these criteria as part of the transaction itself.

As the Congress considers revisions to the CFIUS process, it is important to recognize that the current system has served the United States very well. To date, CFIUS has to a great extent simultaneously supported national security and overall economic growth. Thus, there would appear to be little merit in a wholesale rethinking of the CFIUS process. Viewed from the perspectives of the characteristics outlined above, H.R. 5337 would have some desirable features.

Perhaps most significantly, it would clarify the "rules of the road" by making clear that if a transaction involves a foreign-government controlled firm, the transaction must be subjected to the investigation process. In addition, an investigation period may be extended by two-thirds vote of CFIUS, requires the signature of the Chair and Vice-Chair on decisions, and provides support for CFIUS by other agencies.

In addition, H.R. 5337 has the potential to build expertise by establishing tracking compliance with mitigation agreements, thereby accumulating deeper knowledge of successful and unsuccessful approaches. Also, the bill directs $10 million to CFIUS in the next few years. This may prove crucial as press reports indicate that the fraction of Treasury time and personnel devoted to the CFIUS process has risen dramatically recently.

H.R. 5337 retains desirable flexibility by permitting CFIUS to negotiate mitigation agreements flexibly with firms involved in a covered transaction.

At the same time, congressional consideration of H.R. 5337 and other such legislation raises at least the potential for concern. Over time, administrations of both political parties have helped to establish a global rules-based system for open investment and free trade. This approach has supported U.S. economic success. This success is put at risk if new procedures are unclear, viewed as overly politicized or unnecessarily discriminate against foreign investment. Procedures of this sort would in themselves worsen the favorable investment climate. An even more problematic outcome would occur if other countries chose policies that provided reciprocal discriminatory treatment against U.S. firms.

In this regard, three areas merit attention. First, it is useful to retain a targeted and clear definition of those transactions covered by CFIUS, and to focus on operational control of new technologies or sensitive locations. As noted earlier, definitions that include more vague references to "economic security" or those that include an overly-inclusive concept of "critical infrastructure" would likely be detrimental.

Second, it is useful to keep review and investigation times to the minimum necessary to determine the evidence of a genuine national security threat.

Third, it is important to avoid introducing overt political considerations into the process. Indeed, a threshold consideration is the degree to which it is desirable to legislate aspects of the policy at all. CFIUS has been successful in part because it was appropriately an administrative procedure. The greater the extent of legislated review, report, or decision-making, the greater the possibility of detrimental consequences. H.R. 5337 contains detailed reporting requirements on both specific covered transactions and CFIUS reviews in general. While in themselves not troubling, a further extension of these provisions raises concerns over politicization and confidentiality.

Conclusion

Madame Chairwoman, as CFIUS reform is considered by Congress, it is important to recognize that it is possible to provide open global markets, strong economic growth, and national security. For the most part, these go hand in hand. For example, the Congressional Budget Office projects that over the next decade and one-half, current defense plans will require spending an average of $500 billion (adjusted for inflation), a peak increase of roughly 20 percent over current levels (adjusted for inflation) and above the peak of Cold War spending. Despite this rise, these plans would result in defense spending constituting less than 2.5 percent of Gross Domestic Product, well below the postwar peak of 9.5 percent in 1968.[1] A key aspect of national security is an economy that grows strongly enough to continue to meet the resource demands in the private sector, social objectives, and our military and other national security needs.

In those narrow areas where potential tradeoffs between economic growth and national security arise, a transparent, targeted, disciplined and confidential process to augment economic transactions with security dimensions will serve the United States well.

Thank you for the opportunity to appear before the Subcommittee. I look forward to your questions.

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[1] See *The Long-Term Implications of Current Defense Plans and Alternatives: Summary Update for Fiscal Year 2006*, Congressional Budget Office, 2005.