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HEADLINE: Bill boosting oversight of foreign investment draws concern

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WASHINGTON (MarketWatch) –– A Senate bill unveiled in the wake of the fumbled Dubai ports deal could soon make its way to the Senate floor for speedy passage –– and its potential influence on foreign investment in the United States has some people worried.

The bill, sponsored by Sens. Richard Shelby, R–Ala., and Paul Sarbanes, D–Md., is designed to strengthen government review and oversight of foreign investment in the U.S.

But a study released this week by two scholars at the Paul H. Nitze School of Advanced International Studies at Johns Hopkins University, and commissioned by the ***National Foundation for American Policy***, said the legislation may cause more problems than it solves.

"The Dubai Ports World controversy raised national security concerns, but it also caused some people to forget the enormous benefits Americans gain from foreign investment in the United States," said Stuart Anderson, executive director of American Policy, a nonpartisan group that researches free trade policies.

According to the study, U.S. affiliates of foreign companies employed more than 5.2 million U.S. workers in 2004, representing almost 5% of the total U.S. private sector workforce.

The legislation revolves around reforming the Committee on Foreign Investment in the United States (commonly known as CFIUS), a little known policy group before being thrust into the spotlight after it green lighted the Dubai Ports deal. Shelby's bill would force CFIUS to give more scrutiny to deals involving foreign investment in areas which may be critical to national security.

Based in Washington, the foreign investment committee includes officials from 12 federal agencies with defense, security and economic interests. Representatives from the FBI and the intelligence community are also involved in an advisory capacity. It is chaired by the Treasury Department.

CFIUS's role is to determine whether acquisition of an American company by a foreign investor raises national security concerns. The committee has 30 days to decide whether further investigation is needed before the deal goes forward. If CFIUS decides more investigation is warranted, it then has 45 days to draft and submit a report and recommendation to the President. The White House has 15 days to make a final decision.

Criticism of the current system

What caught lawmakers' eyes in the wake of the Dubai Ports deal was that only one case had been formally blocked since 1988. The concern was on top of an earlier critical report in September of 2005, when a Government Accountability Office report argued that CFIUS rarely blocked agreements, operated in secret and failed to involve Congress in its decisions.

Early this year, Dubai Ports World, a state−owned company based in the United Arab Emirates, was set to take over a number of major U.S. ports that were managed by a British firm. Lawmakers from both sides of the aisle, including Senate Majority Leader Bill Frist, R−Tenn., immediately threatened legislation to block the deal, citing national security and a lack of oversight.

Some critics even tried to make direct links between the United Arab Emirates and terrorism.

Sen. Susan Collins, a Maine Republican and chairwoman of the Homeland Security and Government Affairs Committee, said that "although the UAE is an ally in the war on terrorism, the country has historically been used as a base of terrorist operations and financing." The Dubai company eventually backed out of the deal.

In late March, when the Shelby−Sarbanes bill was considered in the Senate Banking Committee, Shelby −− chairman of the committee −− said the Dubai Ports deal, "demonstrates that the system CFIUS is woefully short of transparency and has no recognizable requirements for accountability. Additionally, the deal brought into question the basic application of the standards that are supposed to govern review of foreign acquisitions."

Daniel Ikenson, Associate Director of the Center for Trade Policy Studies at the Cato Institute, said that the wave of political criticism was not necessarily warranted.

"The critics of CFIUS say look, this is a rubber stamp, because they always give it the nod," Ikenson said, "but the fact is that there have been several cases where the potential investor backed out because they weren't going to make it."

What is a threat?

The rush to improve CFIUS has caused confusion as to what constitutes a national security threat. CFIUS is supposed to look hard at foreign investment when it is going into what is deemed "critical infrastructure" in the U.S. −− but the definition of that phrase is difficult to nail down.

Under the original Shelby−Sarbanes legislation, critical infrastructure had a broad and open definition. According to the Senate Banking Committee, the requirements for critical infrastructure have since been tightened. Some of the areas mentioned in the bill include "major energy assets," "critical technologies" and "domestic production needed for projected national defense requirements."

American Policy's Anderson said that although the definition is now clearer, there is still a question of how CFIUS will proceed. "It's still open to interpretation...you still really don't know and some of it can be very much subject to political winds," he said.

The determination of critical infrastructure is important in figuring how long a foreign acquisition may be delayed. Under the legislation, if CFIUS demonstrates there is a national security concern with a deal involving critical infrastructure, it will automatically enter the 45−day investigation period.

It is also possible that the initial 30−day review may be extended another month if a member of CFIUS argues a national security threat exists, even if the concern is not related to critical infrastructure.

Aside from the delays that may slow private foreign investment, companies owned or controlled by foreign governments would automatically go to the 45−day investigation period, even if such companies operate by market principles and are owned by allied governments.

Disincentive to invest in the U.S.?

Daniel Hamilton, director of the Center for Transatlantic Relations at Johns Hopkins and one of the two scholars who did the study, said such delays could cause huge problems for foreign investors.

"If you know about investment decisions you know you can win or lose investments in a matter of minutes, not just a few days, and that will open up a real deterrent to investment," he said at the release of the study.

There is also concern that the slowdowns may act as a form of discrimination against foreign investors. The common 30−day timeline was meant to match up with existing Hart−Scott−Rodino antitrust reviews, which apply to both foreign and domestic investors.

Other forms of discrimination are also of concern. Last year, the China National Offshore Oil Corporation, a giant state−owned Chinese oil company, tried to acquire Unocal, a U.S. oil company. Despite the fact that the Chinese firm on its own asked CFIUS to review the deal, a political firestorm erupted in Washington and the company withdrew its $18.5 billion cash bid. Unocal was soon bought by the American company Chevron for $17.9 billion.

"This political environment has made it very difficult for us to accurately assess our chance of success," the Chinese company said in a statement, "creating a level of uncertainty that presents an unacceptable risk to our ability to secure this transaction."

Ikenson said that the canceled oil company deal highlights the problems with politics and protectionism. If a government creates a system where only domestic buyers can buy a company, fair market value won't be achieved.

Situations like the oil takeover deal may become more likely with the legislation. The bill provides Congress and the governors of affected states with extensive notice provisions on foreign acquisitions.

The Senate Banking committee said the idea is not to politicize the CFIUS process, but to keep Congress informed.

Ikenson, however, said advance knowledge of foreign acquisitions might cause domestic companies and politicians to pressure CFIUS to block deals.

Potential fallout from canceled foreign deals could result in retaliation against American companies seeking to invest abroad, Ikenson said.

Recently confirmed Treasury Secretary Henry Paulson, who will chair CFIUS, spoke about this Tuesday at a Senate Finance Committee meeting.

"A reduction in foreign investment would cost American workers good jobs, reduce innovation, and lower the growth of the U.S. economy," he said, "Moving away from an open investment policy could lead other countries to impose restrictions on U.S. investors."

Foreign investors backing out of deals also could have an impact on the U.S. economy.

According to the Johns Hopkins study, the U.S. needs to attract almost $1 trillion of foreign financing a year to help offset its huge and growing trade and account deficits.

"If we are to make it more difficult for foreigners to invest here then ultimately there's going to be less money coming in to the economy, the Fed is going to have to raise interest rates...and that could slow the economy," Ikenson said.