

Protecting Our Prosperity

*Ensuring Both National Security and the
Benefits of Foreign Investment in the United States*

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Executive Summary

- A danger exists that Congress will use the recent Dubai Ports World controversy to change fundamentally the rules governing foreign investment in the United States. These changes would reverberate across the nation and around the world, and could both damage U.S. prosperity and diminish U.S. security.
- Recent cases involving government-controlled entities attempting to acquire operations in the United States raise a fundamental question: how can U.S. authorities simultaneously protect U.S. security interests and maintain an open investment climate?
- Attention has focused on the interagency Committee on Foreign Investment in the U.S. (CFIUS), which is charged with examining the national security implications of foreign acquisitions of U.S. companies. A flurry of reforms have been proposed to improve the CFIUS system. Many, however, risk harming the U.S. economy without enhancing national security.
- Although the aftershocks of the Dubai Ports World episode have already improved the CFIUS process even in the absence of legislative action, a better consultation mechanism is needed with the Congress. The Administration owes legislators greater accountability, but a variety of changes could be initiated by the Executive Branch rather than mandated by Congress.
- CFIUS has been successful in part because it has remained a rather technocratic administrative process. Onerous and time-consuming micro-management by Congress, which was never intended to be a regulatory agency, could threaten confidentiality and America's traditionally open investment climate, and risk politicization at home and retaliatory actions by foreign parliaments against U.S. investments abroad.
- Any effort to reform CFIUS should:
 - avoid politicization;
 - avoid nebulous criteria such as "economic security";
 - define "critical infrastructure" reviews more clearly and narrowly;
 - avoid actions that would discriminate between foreign and domestic investors;
 - avoid impairing the substantial economic benefits that the U.S. derives from foreign investment; and
 - be mindful that restrictions on foreign investors in the U.S. are likely to hit U.S. investors abroad.

The Importance of Investment Flows to the U.S. Economy

- Lost in the debate about a rising tide of foreign ownership of the U.S. economy are a few simple facts. The focus has been on government-controlled companies from the Middle East or China. But 98 percent of foreign direct investment in the U.S. is from private sector firms. 94 percent of foreign assets in the United States are owned by companies from the 25 developed democratic member countries of the OECD, and 73 percent of all foreign investments in the U.S. are made by companies from our closest European allies.
- U.S. investment outflows and inflows in the first decade of this century are on pace to surpass easily the record-setting totals of the 1990s. U.S. foreign direct investment outflows totaled \$749 billion and inflows totaled close to \$815 billion over the 2000-2005 period.
- Notwithstanding the recent angst over foreign purchases of U.S. assets, the foreign direct investment balance favors the U.S.; corporate America owns more assets overseas than foreign firms own in the United States. The stock of U.S. overseas investment exceeded \$2 trillion (on a historic cost basis) in 2004; inward foreign direct investment stock in the United States totaled \$1.5 trillion
- The United States remains the world's largest source and recipient of foreign investment in the world. Despite the popular conception that China is the most favored destination of global multinationals, such companies invested \$814 billion in the United States versus just \$320 billion in China in the first six years of this decade.
- The fact that U.S. investment inflows were more than two-and-a-half times larger than China's is surprising to most people who assume—incorrectly—that low wages are the principal driver and determinant of foreign direct investment inflows and thus low-wage China must be more attractive than high-wage America.
- While companies from America's closest democratic allies remain the dominant sources of foreign direct investment in the U.S., companies from the developing nations are poised to play a bigger role in the future. Companies from developing nations spent roughly \$13 billion on U.S. acquisitions in 2005, more than double the annual average of \$6.6 billion over the first half of this decade. Leading the way have been companies from Israel, Mexico and Brazil—the top three investors from the developing nations to the U.S. over the 1997-2005 period.

Foreign Direct Investment: The National Impact

- Notwithstanding periodic headlines that America is being bought on the cheap and that sizable proportions of the U.S. economy are in danger of falling under foreign control, the reality is quite different.
- Foreign participation in the U.S. economy is rather modest if foreign direct investment is measured as a percentage of U.S. GDP—12.6 percent in 2004, well below the global average (21.7 percent), the average for developed nations (20.5 percent) and the average for developing nations (26.4 percent).
- Nonetheless, in terms of output, employment and trade, foreign companies are important contributors to the U.S. economy.
- In 2004 majority-owned U.S. affiliates of foreign companies employed 5.2 million U.S. workers in 2004—which represents 4.7 percent of total U.S. private sector employment -- and paid compensation totaling \$318 billion annually.
- The average salary for those workers is a healthy \$60,000—34 percent more than compensation at all U.S. firms. Roughly 40 percent of these jobs are in manufacturing, four times the national average.
- Capital expenditures in 2004 by foreign affiliates totaled \$108 billion and their sales totaled \$2,302 billion.
- Foreign investments are important to the U.S. trade economy, given that a good deal of U.S. trade is generated by cross-border investment linkages. Foreign-owned U.S. operations accounted for 21 percent of total U.S. exports (\$150.8 billion) in 2003.
- Foreign-owned companies reinvested \$45 billion in profits back into the U.S. economy in 2004. Foreign-owned affiliates purchase 80 percent of their intermediate components from U.S. firms; spend \$30 billion on research and development; and invest over \$100 billion on plant and equipment annually in the United States.
- Moreover, foreign investment is also an important channel funding the record U.S. current account deficit (6% of GDP), compensating for low U.S. savings rates, and keeping long-term interest rates lower. Actions that threaten to halt or slow such inflows are likely to damage the U.S. economy.
- In short, in the U.S. economy foreign investors are important contributors but not dominant owners. Companies owned by foreign governments account for only 2 percent of foreign direct investment in

the United States. The gross output of foreign-owned affiliates in the U.S. totaled nearly \$500 billion in 2003, less than 6 percent of total U.S. output in 2003.

Sectoral Impact

- In certain sectors, however, the foreign affiliate share of employment is much higher than the national average: 28.3 percent in chemicals, 24.8 percent in motor vehicles, 23.6 percent in nonmetallic mineral products, 19.5 percent in mining, and 19.4 percent in electrical equipment, appliances and components.
- Roughly 40 percent of foreign affiliate jobs are in manufacturing, four times the national average.
- The financial services sector is a major beneficiary of foreign direct investment, receiving approximately 15 percent of all such investment in 2004. German and British interests account for most investment in that sector.

Regional and State Impact

- Foreign direct investment can also be critical for particular regions. For instance, foreign affiliates employed over 1.3 million workers in the American Southeast in 2003. Due to rising foreign investment from the world's leading automakers the Southeast has become a dynamic player in the world auto industry.
- At the state level, the role of foreign affiliates is even more telling. For instance, the 2003 affiliate share of manufacturing employment was 24.3 percent in Delaware, 23.3 percent in South Carolina, 22.6 percent in New Hampshire, 18 percent in Kentucky, and 16.3 percent in Tennessee.

The Importance of a Sound Regulatory Environment

- Creating an outright ban on foreign investment in critical infrastructure would both harm job creation and undermine national security, because foreign investment in these sectors has both increased research and development and spurred additional competition and innovation.
- A liberal regulatory environment has been a key variable driving U.S. foreign direct investment inflows, although the recent rise in investment protectionism in the United States threatens to become a deterrent to investment inflows over the near-term. Commentators and executives have pointed out the requirements under Sarbanes-Oxley and the increased choices available to investors have resulted in a higher proportion of Initial Public Offerings (IPOs) taking place outside the United States.

- If the U.S. develops a reputation as a less welcoming place for investment, money will flow to other nations that otherwise may have fueled the U.S. economy. The result could be higher interest rates, higher mortgage rates, higher inflation, less innovation, lower wages, and lower stock prices.

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Part I

The Role of Foreign Direct Investment in the United States

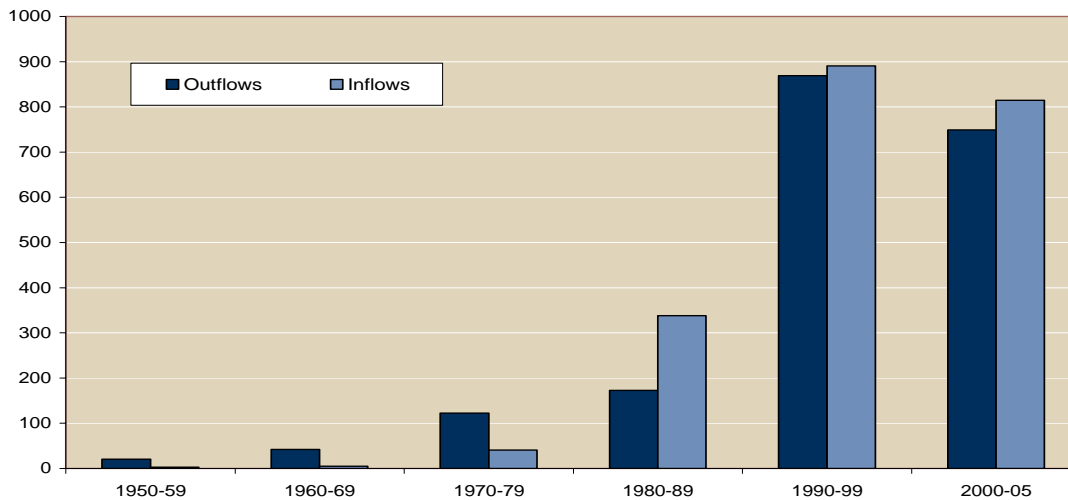
U.S. Foreign Direct Investment: The Long View

Today, the United States is one of the world's largest sources and recipients of foreign direct investment. In the quarter century following World War II, however, U.S. foreign direct investment flows were primarily one-way: outbound.

This investment imbalance was due in large part to the global economic conditions of the time. Spared the destruction of war, U.S. firms had the advantage of a healthy home market and the financial wherewithal to expand their overseas operations in the decades following World War II. By contrast, the early 1950s was a period of rebuilding and reconstruction for Europe and Japan. Before expanding overseas, many European and Japanese firms first had to resurrect their own plants at home and reestablish their domestic market positions. It was only later in the decade, following the formation of the European Economic Community, that European companies began venturing overseas. Japanese firms would not begin to build an overseas presence until the mid-1970s, with strict capital controls keeping a lid on foreign direct investment outflows over most of the 1960s.

Among the Triad—the United States, Europe and Japan—the U.S. was the largest provider of foreign direct investment in the two decades following the war. U.S. investment outflows greatly exceeded inflows. Indeed, by 1969 the stock of U.S. outward foreign direct investment (\$68 billion) was nearly six times larger than the stock of U.S. inward investment (\$11.8 billion). During the ensuing decade, however, the tide began to turn.

U.S. foreign direct investment inflows surged over the 1970s, due in large part to rising investment outlays from Europe. Following a decade of economic recovery in the 1960s, Europe's industrial leaders were back on their feet in the 1970s. After watching American firms move aggressively into their home markets, they were ready and willing to engage more deeply in the U.S. market. Strong U.S. economic growth, together with a weak U.S. dollar, which lowered the cost of U.S. assets to foreign buyers, and a desire among European firms to counteract America's growing presence in Europe, drove European inflows into the United States to record highs over the 1970s. By 1978 the United States had surpassed Canada as the largest recipient of foreign investment in the world, a position the U.S. still maintains today.

Figure 1. U.S. FDI Flows: The Long View*

*Cumulative totals in nominal dollars. Source: U.S. Department of Commerce

While the investment gap was unequivocally in favor of the United States at the beginning of the 1980s, it evaporated over the subsequent decade. By the end of the 1980s, the level of foreign direct investment in the U.S. was roughly equal to U.S. overseas investment. What brought U.S. foreign direct investment into balance by the end of the 1980s?

Part of the reason lies with U.S. outflows, which slowed sharply in the first half of the decade. Weak economic growth in Europe and Canada, coupled with the Latin American debt crisis, dulled corporate America's enthusiasm for overseas expansion. Similarly, the global recession of the early 1980s further curbed U.S. investment inflows. Over the second half of the decade, however, inflows rose sharply, thanks to a rebound in European investment and a surge in new capital investment from Japan.

Japanese firms were late entering the U.S. market relative to their European counterparts. Investment inflows from Japan were negligible in the 1950s and 1960s on account of capital controls. On a global basis, Japan was not a significant source of foreign direct investment in the first quarter century following World War II, and what overseas investment Japan did undertake was designed primarily to secure natural resources—a strategy not unlike the one presently being pursued by China.

Japan's investment orientation, however, shifted towards the United States in the mid-1970s, a strategic redirection triggered by a number of factors. Like other nations, Japan was attracted to the size and wealth of the U.S. market. Another variable was Japan's rising dependence on the U.S. market (by 1975, the U.S. accounted for one-fifth of Japan's total exports) juxtaposed against the revaluation of the yen. The stronger yen relative to the US dollar—with the yen appreciating by more than 40 percent between 1970 and 1978—made it increasingly difficult to effectively serve the U.S. market via trade. This, along with rising protectionism in the United States due to Japan's soaring trade surplus with the U.S., prompted many Japanese firms to increase their investment presence in the United States in the late 1970s and during the 1980s. By the end of the decade, Japan's share of total U.S. foreign direct investment had climbed to 27 percent, compared with less than 6.5 percent in 1979.

By the late 1980s, it was not Japan's trade surplus that produced the most angst among legislators in Washington. Rather, it was the growing perception that Japan was on the verge of gaining unprecedented control over the U.S. economy. The upshot was a xenophobic backlash against Japanese investment in the United States over the second half of the 1980s, and a deepening ambivalence in the United States about the role of foreign direct investment. This same ambivalence towards foreign investment has resurfaced again in the past few years, with China the center of attention.

The Roaring 90s

Since the early 1990s, the United States has remained one of the largest sources and recipients of foreign direct investment. Not unexpectedly, U.S. foreign direct investment outflows and inflows dipped on account of the global economic slowdown in the early 1990s. Subsequently, however, U.S. inflows and outflows soared. Indeed, American companies invested more capital overseas in the 1990s—nearly \$870 billion—than in the prior four decades combined. The surge in U.S. foreign investment, however, did not flow to developing nations; rather, the majority of U.S. foreign direct investment in the 1990s, and the first half of this decade, was directed at Europe.¹

By country, the bulk of U.S. overseas investment in the 1990s was concentrated in the market most similar to the United States—the United Kingdom. The UK accounted for nearly 22 percent of total U.S. foreign direct investment (FDI) outflows (on a cumulative basis) in the 1990s. To put that number into perspective, the amount of U.S. investment in the United Kingdom in the 1990-99 period (\$175 billion) was nearly 50 percent larger than the total invested in the entire Asia-Pacific region.

Additionally, despite all the talk about U.S. investment flows to Mexico courtesy of the North American Free Trade Agreement (NAFTA), U.S. firms ploughed nearly twice as much capital in the Netherlands in the 1990s as they sank in Mexico. Five of the top ten destinations of U.S. investments in the 1990s were

in Europe—the United Kingdom (ranked No. 1), the Netherlands (3), Switzerland (6), Germany (7) and France (8). Rounding out the top ten were Canada (2), Brazil (4), Mexico (5), Australia (9) and Japan (10).

In the first half of this decade (2000-04), six countries in Europe were among the top ten destinations of U.S. foreign investment. The United Kingdom ranked first again, followed by Canada (2), the Netherlands (3), Switzerland (4), Mexico (5), Ireland (6), Germany (7), Singapore (8), Japan (9) and Italy (10). U.S. investment stakes in Europe have expanded sharply this decade, with Europe attracting nearly 56 percent of total U.S. foreign direct investment in the first half of the decade. The bias towards Europe runs counter to the hype and angst associated with U.S. outsourcing to such low-cost locales like China and India, and the common belief that it is the low-cost destinations of East Asia that have attracted the bulk of U.S. investment.

Similarly, the U.S. received more foreign investment over the 1990s (\$891 billion) than the cumulative total of the prior four decades. Leading the way into the U.S. markets were European firms.

Despite Western Europe's investment push into central Europe over the 1990s, the amount of capital sunk in such places as Hungary, Poland and others pales in comparison to the amount of capital sent across the Atlantic over the same period. After averaging \$22.2 billion over the first half of the 1990s, foreign direct investment inflows to the U.S. from Europe soared to an annual average of nearly \$110 billion in the second half of the decade, marking one of the most explosive periods of inward foreign investment in U.S. history. For the entire decade, European firms sank nearly \$660 billion into the United States, accounting for roughly three-quarters of total U.S. investment inflows over the 1990s. European investors accounted for a similar percentage again in the first half of this decade, with the United Kingdom, Switzerland and France ranked as the top three foreign investors in the U.S. over the 2000-04 period.

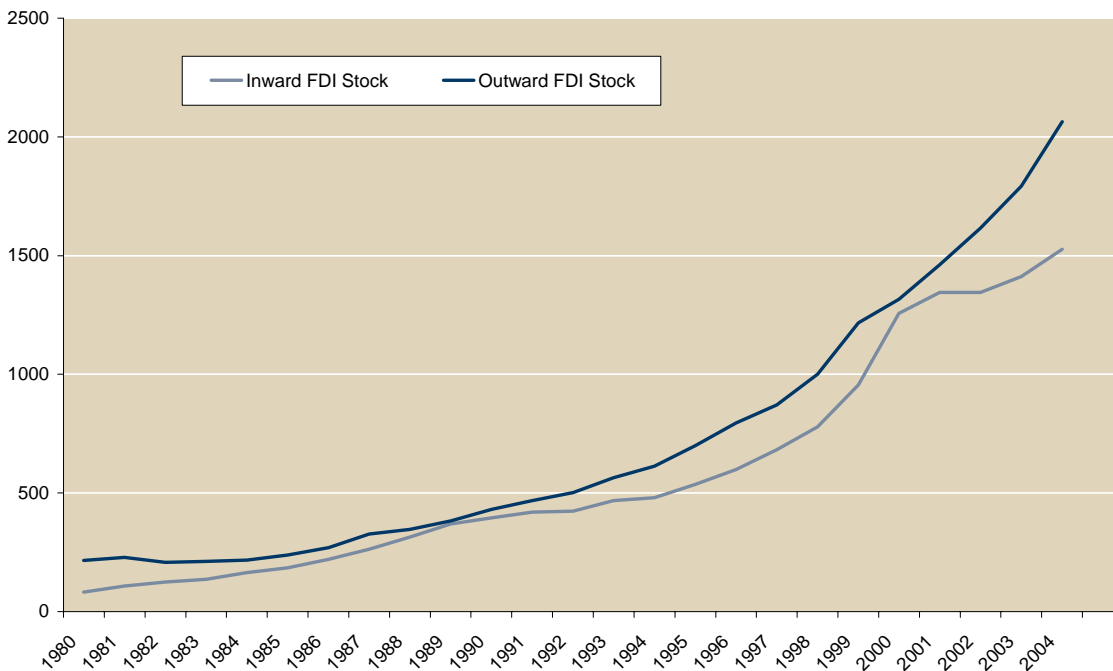
Many variables lie behind the large and expanding European investment stake in the United States. As the largest and wealthiest market in the world, the U.S. is considered too important to neglect. As Krish Prabhu, chief operating officer of Alcatel at the time, put it to the *Financial Times*, "So much of company strategy is driven out of the United States today. No serious player can afford not to have a presence there." In addition to market access, many European firms have entered the U.S. to obtain U.S. technological capabilities, or so-called "created assets." Other firms have crossed the Atlantic to gain greater market access in U.S. services sectors like utilities, financial services and telecommunications. Indeed, greater service linkages between the United States and Europe have been at the heart of greater transatlantic deepening.

Currently, U.S. investment outflows and inflows in the first decade of this century are on pace to surpass easily the record-setting totals of the 1990s. U.S. foreign direct investment outflows totaled \$749 billion over the 2000-2005 period, while inflows were just shy of \$815 billion over the same period.

The stock of U.S. overseas investment exceeded \$2 trillion (on a historic cost basis) in 2004, the last year of available data. Meanwhile, inward foreign direct investment stock in the United States totaled \$1.5 trillion, three-fourths the level of U.S. outward investment stock. In other words, notwithstanding all the recent angst over foreign purchases of U.S. assets, the foreign direct investment balance favors the U.S., with corporate America owning more assets overseas than foreign firms own in the United States.

Figure 2. America's Global Investment Advantage

U.S. direct investment stock at year-end on a historical-cost basis, annually, \$ billions



Source: Bureau of Economic Analysis; Investment Strategies Group at Bank of America
Data through December 31, 2004

That said, the level of foreign direct investment in the United States is second to none. No other country in the world has as large a foreign presence in their domestic economy than the U.S. Neither do most regions of the world. Indeed, the total foreign direct investment stock in the United States exceeded the total of the entire Asia/Pacific region, in addition to being greater than the total investment stock in Africa

and Latin America in 2004. In short, no other country has benefited more from globalization than the United States.

Global Foreign Direct Investment Flows: The Trend Remains Toward the Developed Nations and the United States

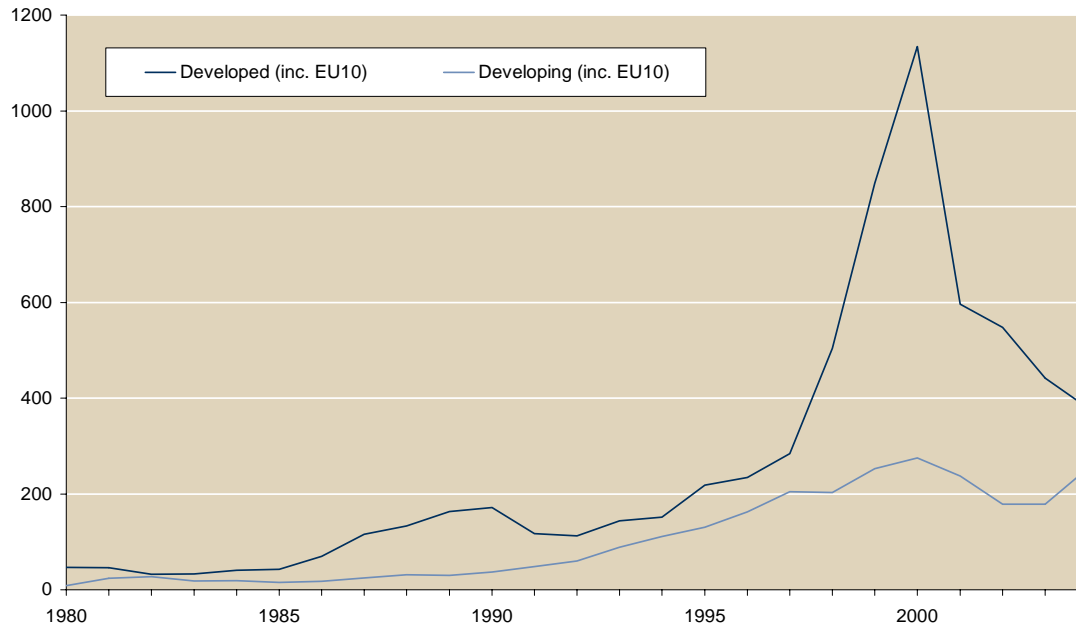
When the economic history of the late 20th century is written, the globalization of economic activity will undoubtedly stand out as one of the defining precepts of the time. The last decade and a half has been a time of buoyant global trade and robust global capital flows, helped in large part by the inclusion of various nations and regions long on the fringes of the global economy.

Globalization's return heralded the opening of new and untapped markets in central Europe, Latin America, and the Indian subcontinent. Free market reforms have been the mantra of Poland, Hungary, Brazil, India and a host of emerging markets for over a decade. At the heart of these reforms are initiatives to promote external trade and investment linkages and thereby integrate more companies, more workers and more consumers into the global economy. Falling telecommunication and transportation costs have helped drive this process, giving global firms greater access to new consumers, new resources and new opportunities to grow sales and revenues.

Yet despite all the hype associated with globalization—or the growing economic interdependence of nations through the increasing volume and variety of cross-border transactions in goods and services—global foreign direct investment flows have changed remarkably little over the past few decades.

The developed nations remain the main sources and destinations of global foreign direct investment. In other words, global investment flows are thickest between developed economies and thinnest between developed and developing economies. Numerous economic similarities—in education, per capita incomes, demographics, infrastructure development, technology usage—along with converging macro and micro economic policies in the United States, Europe and to a lesser extent, Japan, have driven global foreign investment flows towards the developed nations, or so-called “Triad” powers. The latter is where the major markets are; it is where the competitive threat comes from; and it is where new technologies are likely to originate. In addition, firms in the developed nations, as opposed to companies from the developing nations, are apt to have the resources (capital, technology) and managerial experience that enable them to invest overseas.

Figure 3. FDI Inflows: Developed Nations vs. Developing Nations, 1980-2004, Annual, \$Billions



Source: *Investment Strategies Group at Bank of America; UCTAD*

Against this backdrop, global foreign direct investment inflows have long been biased towards the developed nations, notably the United States and Europe. Over the 1990s, for instance, over 60 percent of total foreign investment inflows were directed at the developed nations in general, with the United States and the European Union, in particular, accounting for 22.1 percent and 37.2 percent, respectively, of the global total.

Meanwhile, the developing nations attracted roughly one-third of global foreign direct investment on average over the 1990-99 period. When China is excluded from the figures, the developing nations' share of global investment inflows drops to just one-quarter of the total.

Over the first half of this decade (2000-04), the share of foreign direct investment inflows to the developing nations continued to decline, falling to less than 29 percent of the total. Excluding China, the developing nations' share of global investment inflows fell to roughly 21 percent, a much smaller share of global investment flows than is commonly assumed.

Multinationals have increased their productive capacity in the developing nations over the past decade, notably to China, Mexico and a handful of other nations. On the on the whole, however, there remain numerous impediments to investing in the developing nations, chief among them being underdeveloped infrastructure—i.e., poor roads, inadequate power supplies, the lack of clean water, telecommunication shortfalls.

Another impediment lies with the sheer number of people living in developing nations who are unable to work for multinational companies due to their extreme poverty and education level. Some 1.3 billion people, according to the United Nations, still live on less than a dollar a day. At the micro level, the absence of intellectual property rights, restrictive distribution rights, the lack of transparency, diverging industry standards—all of these variables have impaired and inhibited foreign direct investment flows to the developing nations.

In contrast, most developed nations enjoy good infrastructure, adhere to strong property rights, advocate relatively open trade regimes, possess innovative technological capabilities, encourage high levels of general education, thrive on efficient capital markets, and operate within legal frameworks that is equitable and transparent. Many of these fundamental building blocks are either missing or incomplete in many developing nations, helping to skew foreign direct investment towards the developed nations.

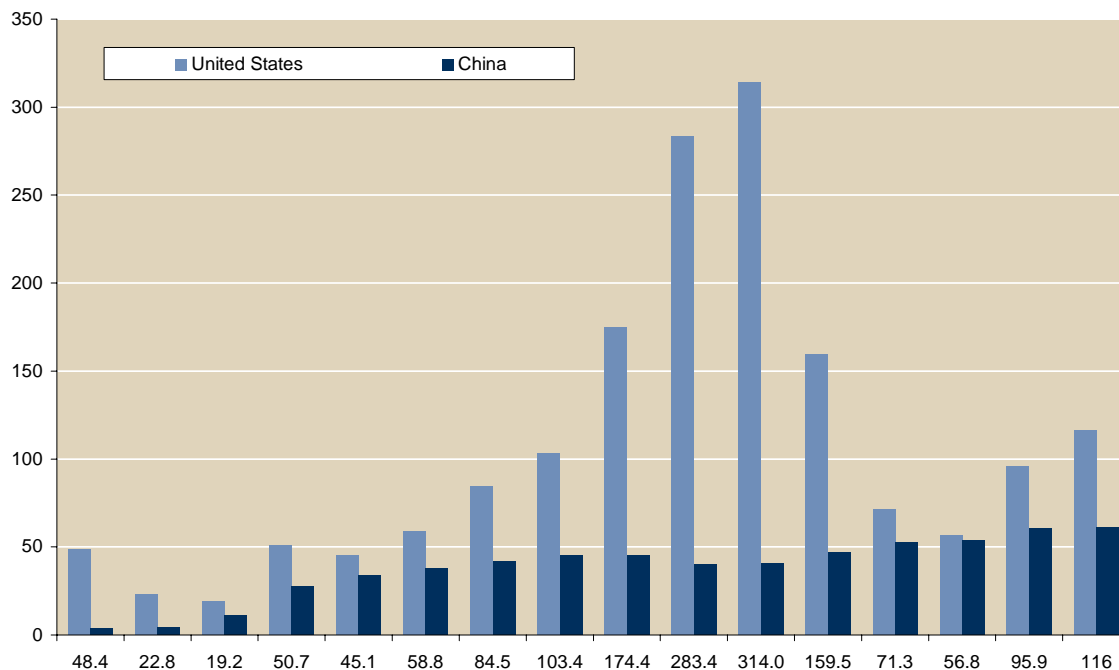
In short, despite many headline fears, the United States remains the most attractive market in the world for foreign multinationals.

Why the United States? The Attractiveness of the U.S. to Foreign Multinationals

China is often considered the most favored destination of global multinationals, yet neither popular wisdom nor media anecdotes square with reality. While international investors have sunk billions of dollars into China over the past decade, their overriding preference lies with the United States. Over the 2000-05 period, for instance, foreign multinationals invested \$814 billion into the United States versus just \$320 billion into China over the same period. The fact that U.S. investment inflows were more than two-and-a-half times larger than China's is surprising to most people who assume—incorrectly—that that low wages are the principal driver and determinant of foreign direct investment inflows and thus low-wage China must be more attractive than high-wage America.

Figure 4. U.S. Outranks China in Capital Attraction

Total inward foreign direct investment (FDI) flows, annual, \$ billions



*Source: Bloomberg; Bureau of Economic Analysis; United Nations Conference on Trade and Development; Investment Strategies Group (ISG) at Bank of America; * ISG estimates*

The motivations of foreign multinationals are quite diverse and complex, but rarely are low wages a primary motivation behind foreign direct investment outflows. Other variables—the size and wealth of the local market, the availability of skilled labor, prevailing technological capabilities of the host nation, tax incentives, a liberal regulatory environment, productivity levels, access to innovation and new knowledge—are far more important to foreign multinationals when determining where to expand their global production/service networks.

A particularly important development over the past few decades has been the explosive growth in “asset-augmenting” investments, primarily between the United States and other developed economies. This type of foreign direct investment is driven by the emergence of intellectual capital as the key wealth-creating asset in most industrial economies. Global competition is not only based on such tangible assets as energy, cheap labor and natural resources, but increasingly on such intangible assets such as financial and intellectual capital – knowledge and information of all kinds. The knowledge component of the output of manufacturing goods is estimated to have risen from 20 percent in the 1950s to more than 75 per cent today.²

The growing importance of intangible assets, especially knowledge-building skills, in the wealth-creating process, requires companies to harness these assets from a variety of locations. Assets such as technical knowledge, learning experiences, innovative production networks or distribution chains, management expertise and organizational competence tend to be concentrated in the advanced industrialized countries. And as asset-augmenting investment has become more important, the location needs of corporations have shifted from those having to do with access to tangible resources to those having to do with access to knowledge-intensive assets and learning experiences. The growing importance of created assets is a critical shift determining the location of foreign direct investment in the globalizing economy.³ The growth of strategic asset-augmenting investment has been an important factor powering the tidal wave of mutual investment flowing across the Atlantic, and particularly into the United States

Asset-augmenting strategies of multinationals are reinforcing another phenomenon, and that is what some have termed “coopetition” or “alliance capitalism.” A particularly important development since the end of the Cold War has been the rise of strategic alliances or partnerships, which have become nearly as prominent, if not more so in some industries, as global mergers and acquisitions. Since the intellectual capital needed to augment assets is complex and rarely the property of only one firm, to deploy such knowledge a firm may have to enhance its capabilities by forging cooperative arrangements with other firms. The growth of “knowledge capitalism” has led to a proliferation of business networks and “coopetitive” alliances between U.S. and other companies who may be competitors one day and partners the next. Data on mergers and acquisitions and collaborative non-equity coalitions suggest that, whether by foreign direct investment or by cross-border licensing, franchising and other agreements, alliances have been most pronounced, and increased the most, in knowledge-intensive sectors, and have been predominantly concluded between companies in advanced industrial economies, primarily between Europe and the United States.⁴

The global forces driving the proliferation of strategic alliances are similar to the ones behind the surge in cross-border mergers and acquisitions: market liberalization, intensifying competition, and above else, soaring costs of research and development, juxtaposed against shortened product life cycles and rapid technological obsolescence in a number of advanced industries. Many companies have concluded that going solo is just too expensive and time-consuming. It is more advantageous perhaps to find a partner or partners to spread the costs and risks of developing new products, entering new markets, gaining access to critical technologies and leveraging existing distribution channels.⁵

The competitive need for “asset-augmenting strategies” and strategic alliances in the global knowledge economy underscores the importance of strategic positioning within the Triad. Executives realize that a strong strategic position requires a foothold in the U.S., in Europe and, increasingly, in Asia. The drive to develop new business models capturing the value of new information and communication technologies accentuates this strategic positioning: International companies not only want the link to each other’s

business, consumer and financial markets, they need to stay abreast of each other's adaptation to new technologies.

All of these metrics lead many international companies to make the United States a strategic investment priority. U.S. consumers are among the wealthiest in the world, with monthly average retail sales in the United States four and a half times greater than monthly retail sales in China (\$328 billion in the U.S. vs. \$72 billion in China in April 2006). The U.S. marketplace is not only one of the largest in the world, but also one of the most dynamic, with the U.S. economy easily outperforming Europe and Japan over the past fifteen years. Meanwhile, America's physical infrastructure (ports, roads, power and telecommunications) is world-class; so too are U.S. universities, among the top-ranked in the world, producing a steady stream of graduates attractive to multinationals.

A highly skilled labor pool, together with a business culture and entrepreneurial class that encourages risk taking, further buttress the attractiveness of the U.S. The availability of risk capital and a deep, liquid and sophisticated capital market adds to the desire among foreign companies to set up locally in the United States.

A liberal regulatory environment has been another key variable driving U.S. foreign direct investment inflows, although the recent rise in investment protectionism in the United States threatens to become a deterrent to investment inflows over the near-term. Commentators and executives have pointed out the requirements under Sarbanes-Oxley and the increased choices available to investors have resulted in a higher proportion of Initial Public Offerings (IPOs) taking place outside the United States.⁶

U.S. Investment Inflows: Traditional Verses non-Traditional Sources

Aggregate investment inflows to the United States have rebounded from the cyclical lows set earlier this decade. The bursting of the U.S. technology bubble, the U.S. recession of 2001, and stricter rules and regulations in the wake of Sarbanes-Oxley legislation—all three variables converged in the early part of this decade to dramatically slow foreign direct investment flows into the United States. In fact, from peak to trough, direct investment flows into the United States fell from an annual total of \$314 billion in 2000—the height of the tech and telecom mergers and acquisition boom—to just \$57 billion in 2003. Investment inflows rebounded to \$96 billion in 2004 and climbed to \$117 billion last year, a level more in line with the pre-bubble U.S. inflows of the late 1990s.

Foreign direct investment flows to the United States remain concentrated among just a few nations. Indeed, at the end of 2004, five nations—the United Kingdom, Japan, the Netherlands, Germany, and

France, in that order—accounted for nearly 60 percent of total U.S. investment inflows based on a historic cost basis. The top ten investors in the United States accounted for a staggering 87.5 percent of total U.S. investment in 2004; 94 percent of foreign assets in the United States are owned by companies from the 25 developed democratic member countries of the OECD.⁷

By region, Europe is the overwhelming top foreign investor in the United States—a dynamic that has changed very little over the past half century. On a historic cost basis, Europe accounted for nearly 71 percent of total U.S. inward investment stock in 2004; on a capital flow basis, the share was even higher: European firms accounted for roughly 75 percent of total foreign direct investment inflows over the first half of this decade; in 2005, the European share was 67 percent, with British, German, French, Dutch and Swiss investors leading the way.

Figure 5. FDI Positions in U.S., Top Ten Investors, 2004
(% share in historic cost basis)

Rank	Country	% Share
1	United Kingdom	16.5
2	Japan	11.6
3	Netherlands	11.0
4	Germany	10.7
5	France	9.7
6	Canada	8.7
7	Switzerland	8.1
8	Belgium/Luxembourg	7.8
9	Australia	1.8
10	Sweden	1.6
	Total	87.5

Source: Bureau of Economic Analysis

Outside of Europe, Japan and Canada are significant investors in the U.S. economy, with the two nations accounting for nearly 18 percent of total U.S. investment inflows over the first half of this decade. Canadian natural resource companies have been notably active in the U.S. market over the past few years, while the investment push from Japan has been lead by the nation's leading automobile manufacturers.

While America's traditional sources of foreign direct investment have not changed all that much over the past few decades, a new dynamic is emerging as it relates to U.S. foreign direct investment inflows. Non-traditional players—namely companies from the developing nations—are poised to play a bigger role in U.S. inflows in the future. Reflecting this trend, the developing nations spent roughly \$13 billion on U.S. acquisitions last year, more than double the annual average of \$6.6 billion over the first half of this decade.

Leading the way have been companies from Israel, Mexico and Brazil—the top three investors from the developing nations to the U.S. over the 1997-2005 period. Israeli firms have been notably aggressive in the U.S. pharmaceutical industry, and accounted for roughly 25 percent of total U.S. acquisitions (based on the value of the deals) from the developing nations over the 2000-05 time frame. Mexican firms ranked second (18.7 percent of the total), followed by Brazil (16.7 percent).

Figure 6. Foreign Direct Investment in the United States: Selected Items, by Industry of Affiliate, 2001–2004 [Millions of dollars]

	Direct investment position on a historical-cost basis				
	2000	2001	2002	2003	2004
All countries, all industries	1,256,867	1,343,987	1,344,697	1,410,672	1,526,306
By industry of US affiliate					
Manufacturing	480,561	476,474	469,802	491,963	519,410
<i>Of which:</i>					
Food	18,073	18,577	19,817	19,517	21,108
Chemicals	120,413	128,630	123,341	136,466	147,952
Primary and fabricated metals	24,184	19,998	18,545	17,702	18,897
Machinery	32,283	43,317	47,777	48,093	49,541
Computers and electronic products	92,782	54,729	42,443	44,026	41,883
Electrical equipment, appliances, and components	43,109	53,559	45,832	12,573	13,593
Transportation equipment	55,750	62,349	61,463	66,455	70,022
Wholesale trade	173,991	184,743	197,568	180,802	201,101
Retail trade	26,703	22,647	20,871	23,656	26,122
Information	146,856	146,913	116,056	124,734	117,190
Depository institutions (banking)	64,236	67,207	75,483	87,512	123,304
Finance (except depository institutions) and insurance	167,007	173,801	169,172	190,152	206,533
Real estate and rental and leasing	49,985	44,280	47,333	44,450	47,577
Professional, scientific, and technical services	30,492	31,477	26,964	34,507	38,778
Other industries	117,037	196,446	221,448	232,896	246,290

Source: *Bureau of Economic Analysis*

China ranked among the top ten foreign investors from the developing nations, although Chinese acquisitions of U.S. firms totaled less than \$2 billion between 2000 and 2005. That figure, however, is likely to grow in the years ahead. Many Chinese firms, like their counterparts in the developed nations, increasingly believe that an in-country presence in the United States is essential if they are to be successful in one of the world's most dynamic and wealthiest markets. In this respect, China's major corporate giants are no different than other foreign multinationals. And despite China's recent setbacks in trying to buy two well-known U.S. companies—Unocal and Maytag—China's appetite for U.S. acquisitions remains undiminished. Some Chinese firms continue to grow organically in the United States. Chinese refrigerator manufacturer Haier, for instance, is building its presence in the U.S., with plans to add a second plant to its initial operations in Camden, South Carolina.

Part II

Foreign Direct Investment in the U.S.: The National, Sectoral, Regional and State Impact

Rising levels of foreign investment in the United States have led to a greater role for foreign-owned firms in the U.S. economy. Indeed, the level of foreign participation in the U.S. economy has never been greater, meaning that what is familiar to most Americans—having a cup of Lipton tea or a Ben & Jerry's ice cream cone, shopping at Giant Foods, or buying a Mack truck -- is also foreign. Lipton tea and Ben & Jerry's, for instance, belong to Unilever, a giant Dutch retailer. Giant Foods is owned by another Dutch company—Ahold. Mack Trucks, Inc. belongs to Volvo, the Swedish automaker. Most Americans know that BMW is a German automaker and Honda is a Japanese automobile manufacturer. Many Americans do not realize, however, that the BMW they purchased may have been manufactured in South Carolina, that their new Honda minivan was assembled in a plant in Ohio, or their company's Mack truck was built in Pennsylvania or Virginia.

These examples reflect the extent to which numerous foreign companies have become embedded in the United States. Capital expenditures in 2004 by foreign affiliates totaled \$108 billion and their sales totaled \$2,302 billion. Foreign affiliates employed over 5.2 million American workers in 2004 -- which represents 4.7 percent of total U.S. private sector employment -- and paid compensation totaling \$318 billion annually.⁸

The average salary for those workers is a healthy \$60,000 – 34 percent more than compensation at all U.S. firms. Roughly 40 percent of these jobs are in manufacturing, four times the national average.⁹

Foreign-owned companies reinvested \$45 billion in profits back into the U.S. economy in 2004. Foreign-owned affiliates purchase 80 percent of their intermediate components from U.S. firms; spend \$30 billion on research and development; and invest over \$100 billion on plant and equipment annually in the United States.¹⁰

Moreover, foreign investment is also an important channel funding the record U.S. current account deficit (6% of GDP), compensating for low U.S. savings rates, and keeping long-term interest rates lower. Actions that threaten to halt or slow such inflows are likely to damage the U.S. economy.

In short, in the U.S. national economy foreign investors are important contributors but not dominant owners. For instance, the gross output of foreign-owned affiliates in the U.S. totaled nearly \$500 billion in 2003, the last year of available data. That's more output than either Belgium or Ireland produces in a year. Yet relative to the U.S. economy, the output of foreign affiliates represented less than 6 percent of total U.S. output in 2003.

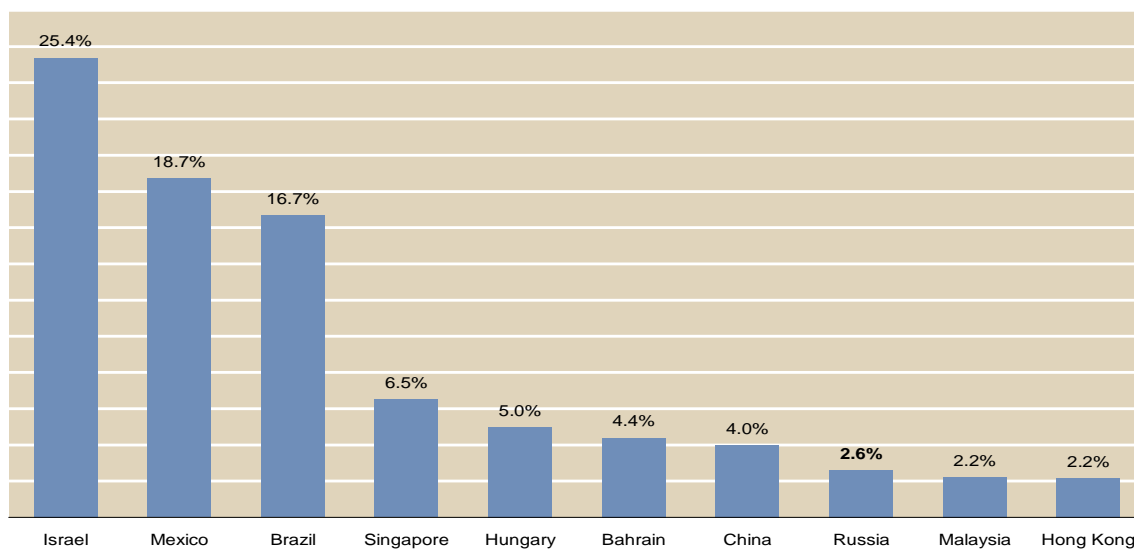
Sectoral Impact

In certain sectors the role of affiliates in terms of employment is much higher than the national average. For instance, according to the Bureau of Economic Analysis (BEA), the foreign affiliate share of U.S. employment in the mining sector was 19.5 percent in 2003. Foreign affiliates accounted for 11.5 percent of total manufacturing employment, although the share of employment was much higher in such sectors as chemicals (28.3 percent), motor vehicles (24.8 percent), nonmetallic mineral products (23.6%), and electrical equipment, appliances and components (19.4 percent).

Roughly 40 percent of foreign affiliate jobs are in manufacturing, four times the national average.¹¹ One third of foreign direct investment in the United States (on a historic cost basis) is in manufacturing, with the rest in various service activities. Chemicals and transportation equipment are the two manufacturing sectors with the largest amount of foreign direct investment. Foreign investment stock in chemicals totaled \$148 billion in 2004, while investment in transportation equipment topped \$70 billion.

In services, wholesale trade and finance are the two sectors with the largest participation of foreign direct investors. The financial services sector received approximately 15 percent of all foreign direct investment in 2004. German and British interests account for most investment in the sector, with Dutch, British, French and Canadian investments account for over half.¹²

Figure 7. Top ten developing countries, as a share of total developing acquisitions of U.S. firms Jan. 1, 2000 through May 17, 2006 period, pending or completed deals*



*Includes deals valued at \$100 million or greater. Source: Bloomberg; Investment Strategies Group

Moreover, foreign investments are important to the U.S. trade economy. A good deal of U.S. exports is due to foreign investors creating world-class products in the United States and then exporting them to other countries. Foreign affiliate exports totaled \$150.8 billion in 2003, accounting for roughly 21 percent of total U.S. exports.

Japanese-owned affiliates, according to the BEA data, accounted for the largest share of affiliate exports (27 percent), with Japanese wholesale trade affiliates playing a prominent role in driving exports. Meanwhile, the affiliate share of imports was even higher—tallying \$357 billion in 2003, or 28 percent of the total U.S. imports. Again, Japanese-owned affiliates accounted for the largest share of affiliate imports, reflecting wholesale trade of affiliates specializing in motor vehicles.

Cross-border investment flows in some economic sectors, particularly across the Atlantic, are charting new ground. If the New York Stock Exchange (NYSE) and Euronext proceed with their planned merger, for example, they would create a powerful and groundbreaking transatlantic bourse that would further deepen the financial ties between the United States and Europe. A NYSE-Euronext deal would create the first transatlantic link of stock and derivatives markets, valued at more than \$21 billion. The value of the listed companies on the combined institution amounts to about \$26.7 trillion. The new entity would be the world's most liquid marketplace, with average daily trading volume of about \$80-100 billion.¹³ The merger would lead to the creation of a host of transatlantic products for institutional and retail investors alike, and facilitate even greater transatlantic financial flows. In addition, the deal is also likely to be the first of many transatlantic deals. Nasdaq, for example, already owns more than 25 percent of the London Stock Exchange. These and other exchanges are likely to seek additional transatlantic integration opportunities as the marketplace becomes even more competitive. Ultimately, the NYSE-Euronext marriage could turn out to be the first step towards the creation of a single transatlantic stock market.

The NYSE Euronext merger is a particularly dramatic example of our contention, which we and other analysts outline in some detail in a recent book,¹⁴ that despite the understandable attention being paid to Asia's dramatic rise it is in fact deep integration between the highly developed U.S. and European markets that in many respects is charting the new landscape of globalization.

Regional Impact

While foreign direct investment may play a relatively minor role in the overall U.S. economy, it can be critical for particular regions. In the global knowledge economy a region's extra competitive edge may come as easily from across the ocean as from across town or across the nation. Foreign-sourced knowledge and the competitive networks and jobs it creates may be as significant for any region as domestically-sourced investments.

At the regional level, the investment of foreign multinationals is helping to reshape the industrial landscape of the U.S. economy. For instance, owing to rising foreign investment from the world's leading automotive groups, the southeastern part of the United States has become a dynamic player in the world automobile industry. While the region has lost textile jobs to Mexico and China over the past decade, one counterbalancing factor has been a rise in transportation employment as more and more auto firms, and their suppliers, set up shop across the region.

Figure 8. Direct Foreign Investment* in the U.S. by geographic region, 2003

Region	U.S. \$ Billions	% of Total Foreign Investment
Southeast	223.5	21.3
Great Lakes	158.8	15.1
Mid-Atlantic	147.6	14.1
West	133.1	12.7
Southwest	107.7	10.3
New England	48.8	4.6
Rocky Mountains	40.9	3.9
Plains	41.3	3.9
Other (Unspecified)	147.9	14.1

*Gross Property, Plant and Equipment of Affiliates Source: Bureau of Economic Analysis

One consequence is that the U.S. automobile industry is gradually shifting from Michigan and the Midwest to the southeastern part of the United States. Foreign affiliates employed nearly 500,000 manufacturing workers in the Southeast in 2003, the last year of available data, accounting for 13.6 percent of total manufacturing employment for the region. Including service jobs, foreign affiliates employed over 1.3 million U.S. workers in the Southeast in 2003. In the Great Lakes region, meanwhile, foreign affiliates employed 402,000 manufactured workers in 2003, representing 11.9 percent of total manufacturing employment.

State Impact

At the state level, the role of foreign affiliates is even more telling.¹⁵ For instance, the affiliate share of manufacturing employment in Delaware, South Carolina and New Hampshire was 24.3 percent, 23.3 percent, and 22.6 percent, respectively, in 2003. These figures are well above the national average (11.5 percent) and underscore the importance of foreign affiliates in providing manufactured jobs to U.S.

workers. In Kentucky, foreign affiliates accounted for over 18 percent of all manufactured jobs in the state in 2003. In North Carolina, the affiliate share of manufacturing employment was 13.8 percent; in Tennessee, it was 16.3 percent, 12 percent in Alabama, and 14.1 percent in Georgia. In Michigan, manufacturing employment of foreign affiliate affiliates has consolidated over the past few years, although affiliates still accounted for 12.5 percent of total manufacturing employment in the state in 2003. American governors understand the importance of foreign investment in their states, and devote significant time and energy seeking to attract new investors from abroad.

Beyond the Southeast and Great Lakes area, the presence of foreign affiliates is quite noticeable in other region and states. Swiss investment, for instance, is rather prominent in New Jersey and New York. This reflects the large capital position of Swiss pharmaceutical firms in New Jersey and the extensive presence of Swiss financial service firms in New York.

Texas and California are the two most attractive states for foreign investors and are independent of or outside the regional favorites – almost regions on their own. Texas is host to a number of foreign firms in such sectors as defense, oil exploration, automobiles and technology. Foreign participation in California's economy runs the gamut, from financial services to retailing to transportation.

In the end, in many regions and states of the United States, American affiliates of foreign firms have become embedded into the mainstream of the U.S. economy and in the daily lives of American consumers. Thousands of foreign affiliates have become so “local” that consumers and legislators cannot tell or do not care whether the local gas station, bank or automobile dealer is American or foreign.

Consumers and lawmakers, though, do care about access to competitively priced goods and services, job creation, and the overall health of the economy. And on all three counts, foreign affiliates have made and continue to make significant contributions to all regions and states of the United States. The bottom line impact cuts across many different activities, with foreign affiliates a key source of investment in research and development, new capital investment and exports. In short, foreign affiliates are key agents of change and growth, and a significant catalyst to U.S. growth and U.S. global competitiveness.

Figure 9. Manufacturing Jobs Supported by Foreign Affiliates, 2003

State	Manufacturing Employment by Foreign Affiliates	Percent of all Manufacturing Jobs
Delaware	8,700	24.3%
South Carolina	64,900	23.3%
New Hampshire	18,300	22.6%
Kentucky	49,900	18.6%
District of Columbia	500	18.4%
West Virginia	11,700	18.0%
Alaska	2,000	16.9%
New Jersey	57,400	16.3%
Tennessee	67,400	16.3%
North Dakota	3,700	15.5%
Connecticut	28,600	14.3%
Indiana	81,900	14.2%
Georgia	64,300	14.1%
North Carolina	83,900	13.8%
Maine	8,300	12.9%
Missouri	39,800	12.7%
Massachusetts	41,300	12.6%
Michigan	90,400	12.5%
Alabama	35,600	12.0%
Ohio	100,600	11.8%
Virginia	35,700	11.6%
Pennsylvania	83,300	11.5%
Illinois	81,600	11.3%
Colorado	17,400	11.1%
Texas	97,300	10.7%
Maryland	15,800	10.6%
Wyoming	900	10.0%
Kansas	17,100	9.9%
New York	60,900	9.8%
Louisiana	15,400	9.8%
Wisconsin	48,300	9.5%
South Dakota	3,600	9.4%
Iowa	20,600	9.3%
Arkansas	19,400	9.3%
Florida	35,600	9.1%
Nebraska	9,300	9.0%
Nevada	4,000	9.0%
Oklahoma	12,900	8.9%
California	134,800	8.7%
Utah	9,400	8.3%
Arizona	13,700	7.7%
Washington	20,500	7.6%
Minnesota	24,000	6.9%
Hawaii	1,000	6.5%
Montana	1,200	6.0%
Oregon	11,500	5.9%
Rhode Island	3,400	5.8%
Mississippi	9,600	5.3%
Idaho	3,200	5.1%
Vermont	1,900	5.0%
New Mexico	1,800	5.0%
U.S. Total	1,685,400	11.5%

Source: BEA; U.S. Affiliates of Foreign Companies: Operations in 2003, William Zeile, SCB, August 2005

Figure 9a. All Jobs Supported by Foreign Affiliates, 2003

State	Total Employment by Foreign Affiliates	Percent of all Jobs
South Carolina	127,500	8.4%
Hawaii	36,100	7.8%
New Hampshire	41,900	7.7%
Connecticut	104,900	7.3%
Delaware	26,500	7.3%
Massachusetts	189,000	6.5%
New Jersey	223,200	6.5%
North Carolina	204,600	6.3%
Rhode Island	25,900	6.1%
Maine	30,100	5.9%
Kentucky	87,000	5.8%
Georgia	182,800	5.5%
Tennessee	127,400	5.5%
New York	382,600	5.4%
Michigan	205,000	5.4%
Indiana	134,200	5.3%
Alaska	11,700	5.2%
Maryland	104,100	5.0%
Illinois	254,900	5.0%
Virginia	138,600	4.8%
Alabama	72,800	4.6%
Wyoming	8,800	4.6%
Pennsylvania	227,700	4.5%
California	561,000	4.5%
Ohio	208,600	4.4%
Texas	339,300	4.3%
Vermont	10,400	4.1%
Wisconsin	97,600	4.0%
Colorado	73,500	4.0%
Florida	248,900	3.9%
West Virginia	22,200	3.9%
Missouri	87,200	3.8%
Washington	82,800	3.7%
District of Columbia	16,500	3.6%
Minnesota	84,600	3.6%
Oregon	48,400	3.6%
Utah	32,200	3.5%
Arkansas	33,700	3.4%
Kansas	35,600	3.2%
Iowa	38,100	3.1%
North Dakota	7,900	3.0%
Louisiana	48,000	3.0%
Arizona	59,800	3.0%
Oklahoma	32,500	2.8%
Nevada	27,200	2.8%
Nebraska	18,900	2.5%
Mississippi	22,800	2.5%
Idaho	11,200	2.3%
South Dakota	7,000	2.2%
New Mexico	12,500	2.1%
Montana	6,600	2.0%
U.S. Total	5,253,000	4.7%

Source: BEA; *U.S. Affiliates of Foreign Companies: Operations in 2003*, William Zeile, SCB, August 2005

Part III
***CFIUS: Ensuring National Security in our Open Investment
Economy***

Although foreign investment is critical to the U.S. economy, from time to time it has become the subject of public and congressional anxieties. As we discussed earlier, in the 1980s some high profile Japanese purchases and a slowdown in the U.S. economy raised concerns about growing Japanese investments in the United States. In recent years concerns have turned to investments from China, notably the China National Offshore Oil Corporation's attempt to buy U.S. energy firm Unocal in 2005. This debate intensified in early 2006 when Dubai Ports World bought the global port operations of the UK-based Peninsular and Oriental Steam Navigation Company, which would have given Dubai Ports World control of operations at six U.S. ports. The ensuing congressional firestorm led the company to abandon the U.S. aspects of the global deal, announcing in March 2006 that it would transfer its operations of American ports to a "U.S. entity."

These episodes raise a fundamental question: how can U.S. authorities simultaneously protect U.S. security interests and maintain an open investment climate?

Attention has turned to the interagency Committee on Foreign Investment in the U.S. (CFIUS), which is charged with examining the national security implications of foreign acquisitions of U.S. companies.

CFIUS was created originally in 1975 by Executive Order of the President to monitor the economic effect of foreign investment in the United States. Chaired by the Treasury Department, its main responsibility at that time was "monitoring the impact of foreign investment in the United States and coordinating the implementation of United States policy on such investment."¹⁶ It analyzed foreign investment trends in the U.S. and offered guidance to the President on significant transactions. However, it had no authority to take action with regard to specific foreign investments.

In 1988, at the height of American concerns over Japanese investments, Congress passed Section 5021 of the Omnibus Trade and Competitiveness Act of 1988 (known as the Exon-Florio Amendment), which amended Section 721 of the Defense Production Act to authorize the President to block proposed foreign acquisitions that threatened national security.

Under this authority President Reagan issued Executive Order 12661, which designated CFIUS to receive notices of foreign acquisitions of U.S. companies, to determine whether a particular acquisition has national security issues sufficient to warrant an investigation, and to undertake an investigation, if necessary, under the Exon-Florio provisions. As a result of a CFIUS investigation, the President can block a proposed sale if:

- a) there is credible evidence that the foreign entity exercising control might take action that threatens national security; and

- b) the provisions of law, other than the International Emergency Economic Powers Act and the Exon-Florio amendment itself, do not provide adequate and appropriate authority to protect the nation’s security.

The President may direct the Attorney General to seek appropriate judicial relief to enforce Exon-Florio, including divestment. The President’s findings are not subject to judicial review.

CFIUS is staffed by mid-level officials and chaired by the U.S. Treasury. It includes 12 federal agencies with defense, security, and economic interests. Representatives from FBI and the intelligence community are also involved in an advisory capacity. The President made the Department of Homeland Security a member of CFIUS in April of 2003. (See Figure 10.)

Figure 10. Committee on Foreign Investment in the United States (CFIUS) Member Agencies

Department of Treasury (chair)	Office of Management and Budget
Department of Commerce	Council of Economic Advisers
Department of Defense	United States Trade Representative
Department of Homeland Security	Office of Science and Technology Policy
Department of Justice	National Security Council
Department of State	National Economic Council

Other agencies, such as the Department of Energy and Transportation and the Nuclear Regulatory Commission, are regularly invited to participate in a review when they have relevant expertise on a particular case.

In addition, the U.S. intelligence community contributes to all CFIUS reviews. The Intelligence Community Acquisition Risk Center (CARC), under the Director of National Intelligence, provides threat assessments on foreign acquirers

The Formal CFIUS Process

Although companies are not required to file with CFIUS, the U.S. can force a foreign acquirer to divest itself of its investment if CFIUS objects to the purchase. Many companies decide it is safer to file formally with CFIUS than to risk having their transaction unscrambled after the fact. Once a company has formally filed, CFIUS has 30 days to decide whether there may be national security concerns that may warrant further investigation. If CFIUS chooses not to investigate, the acquisition may proceed. If CFIUS decides that further investigation is in fact needed, it then has 45 days to draft and submit a report and

recommendation to the President. The President then has 15 days to decide upon an appropriate action. All told, the entire formal process could last 90 days.

Since 1988, CFIUS has reviewed over 1,600 investments, and the overwhelming majority has been approved. Between 1988 and late spring 2006 only 26 extended reviews had been conducted; 12 reached the President's desk. Only one case went through the entire process and was formally blocked: in 1990 President George H.W. Bush forced China National Aero Tech to divest itself of MAMCO, a U.S. aircraft parts manufacturer in Washington state.¹⁷

The Consultative Process and Security “Mitigation Arrangements”

Some criticism has focused on the apparent laxity of the formal process. But the statistics obscure some important ways in which the CFIUS process actually operates. Before the formal CFIUS review period begins, an informal review often takes place. Parties to a transaction may contact CFIUS before a filing in order to identify potential issues and seek guidance on information the parties to the transaction could provide to assist CFIUS review. This type of informal consultation enables both parties to address potential issues earlier in the review process.

The formal statistics ignore the larger number of transactions abandoned or substantially modified by parties because of this pre-filing consultation process. In many cases, for example, agencies involved in CFIUS raise their concerns and work with individual companies to devise security measures that preclude the need for a full investigation. As a result of these consultations, parties have either voluntarily restructured a transaction to address national security concerns, agreed to different types of so-called “mitigation” agreements that implement specific security measures before a formal filing is made and thus preclude the need for a full formal investigation, or have withdrawn from the transaction altogether because they have concluded that the transaction will not pass CFIUS review.¹⁸

To understand how both the formal and consultative CFIUS processes work, it is useful to understand three broad areas of concern that drive most CFIUS investigations.

The first area of concern involves issues that might affect the defense industrial base, particularly cases of technology transfer in which a foreign investor might gain access to sensitive technology by acquiring the U.S. producer of that technology. In such cases the Department of Defense (DOD) routinely suggests that the acquiring company consult with DOD staff before filing formally with CFIUS. Firms that do not informally consult with DOD run the risk of having DOD announce that the 30 days allowed by law were not enough to review the transaction. Some firms have had to temporarily withdraw their CFIUS petitions

in order to give DOD more time – often to propose and work out arrangements with the acquiring party that place restrictions on their acquisition to resolve national security concerns.¹⁹

The second area of concern involves telecommunications security and cooperation with law enforcement, where a foreign purchaser of a U.S. telecommunications company would gain access to private communications or would be less willing to cooperate with U.S. law enforcement agencies in investigations.²⁰ The telecommunications sector has been a key agent and beneficiary of globalization, due to privatization, new services, plummeting prices, rapid innovation, and the removal of most barriers to foreign ownership and wide participation by foreign communications operations in key global markets, including the United States.²¹

Some of the higher profile cases in this area in recent years have included efforts by European and Asian firms to acquire telecommunications service providers such as VoiceStream or Global Crossing. In such cases the Department of Justice (DOJ) and the FBI have routinely sought advance consultations with the acquiring firm to ensure that their concerns are addressed. These concerns usually focus on the ability of U.S. law enforcement to conduct electronic surveillance and wiretaps and prevent foreign governments from accessing call-related data. This is usually done with a letter or memorandum between the concerned agency and the company (Examples of such arrangements are in Figure 11). The most common is a Network Security Agreement, under which a foreign purchaser agrees to abide by certain limitations. Since September 11 these agreements have become more restrictive, and some limit foreign-owned telecommunications firms' activities in areas in which US-owned telecommunications firms face no similar restrictions. Essentially, through CFIUS U.S. law enforcement agencies are imposing on foreign companies handling non-classified telecommunications work many of the same requirements that the Pentagon has traditionally imposed on foreign companies handling defense-related classified contracts.²²

The third area of concern, and one which has assumed a much higher profile since September 11, involves foreign acquisition of critical infrastructure. CFIUS reviews whether foreign ownership of critical infrastructure could give a potential opponent the opportunity to disrupt important services or use insider knowledge to plan attacks.²³ In cases involving critical infrastructure, the Department of Homeland Security (DHS) is the lead agency. Similar to the DOD or DOJ efforts in related areas, DHS also seeks to engage foreign acquirers in a consultative process might lead a foreign purchaser in some cases to agree to conditions that could mitigate risk, such as requiring that key functions be performed only by U.S. citizens. The area of critical infrastructure is the least well defined area of CFIUS concern, and the one most in need of further clarification, as will be discussed later.

Security “mitigation” arrangements designed to address agency concerns and facilitate the formal CFIUS process have taken a variety of shapes and forms. Some examples are included in Figure 11.

Figure 11. Examples of Security “Mitigation” Arrangements Agreed to by Foreign Investors

In cases raising security concerns among U.S. agencies involved in CFIUS, foreign investors have on occasion agreed in advance of the formal CFIUS review procedure to special security arrangements, sometimes referred to as “mitigation agreements,” addressing specific security measures. These arrangements vary in nature and type. Examples include:

Special Security Agreements providing security protection for classified or other sensitive contracts;

Board Resolutions requiring a U.S. company to certify that the foreign investor will not have access to particular information or influence over particular contracts;

Proxy Agreements isolating the foreign acquirer from any control or influence over the U.S. company;

Network Security Agreements, which are used in telecommunications cases and often are imposed in the context of the Federal Communication Commission’s licensing process.

Foreign Government Controlled Companies

In each of these instances, CFIUS is guided not only by the nature of the acquisition but the nature of the acquiring firm. Investigations may be more complicated if the foreign purchaser is owned or controlled by a foreign government. In 1993, Congress amended Exon-Florio to require foreign companies to obtain CFIUS approval before acquiring U.S. companies if the foreign purchaser is “controlled by or acting on behalf of a foreign government” and the acquisition “could result in control of a person engaged in interstate commerce in the U.S. that could affect the national security of the United States.” This amendment reflects the judgment that government-owned or controlled companies pose a greater risk to security than purely commercial entities and should always be reviewed. It is certainly true that acquisitions by some government-owned companies may raise unique national security issues and should receive scrutiny. Moreover, U.S. companies may be put at a competitive disadvantage against government-owned companies that receive subsidized or concessional government financing. But it is important to keep this issue in perspective: companies owned by foreign governments account for only 2 percent of foreign direct investment in the United States. Any particular transaction involving a government-controlled entity, of course, could raise potential national security issues. As we discuss later, however, not all government acquisitions create the same risks, and the challenge for CFIUS is to distinguish between transactions that raise issues and those that do not.²⁴

How the U.S. Can Ensure National Security and the Benefits Gained by Foreign Investment

Proponents claim that the CFIUS process works well and has found a path that addresses national security concerns while maintaining an open investment climate. They argue that in recent years CFIUS scrutiny of transactions has increased, security agreements have tightened and enforcement and monitoring has become more rigorous. They point to the fact that there have been more extended reviews and withdrawals in the past three years than in the previous ten years combined.²⁵

Critics, however, argue that the Committee has been negligent. Popular and congressional confidence in the CFIUS process was shaken by the Dubai Ports World case. Some critics focus on what they believe to be lax implementation by the Bush Administration of what otherwise is a workable process. Others charge that CFIUS is inadequate to the challenge, and that radical reforms are needed. Some believe such criticism is validated by internal reviews conducted by the U.S. Government itself. In September 2005, for example, the Government Accountability Office (GAO) argued that CFIUS rarely blocks agreements, operates in secret, and fails to involve Congress in its decisions.

In the wake of the Dubai Ports World episode, there is a broad consensus that CFIUS must be reformed in some way. A key question is whether this is done more effectively through new legislation passed by Congress or via internal changes instituted by the Executive Branch on its own.

Before considering what changes may be needed, it is perhaps useful to note that the aftershocks of the Dubai Ports World episode have already had a real impact on the CFIUS process even in the absence of Congressional action. Deals that would never have been notified are now being notified because companies are concerned that their acquisitions could be overturned after the fact. Some transactions that ordinarily would have just gone through the 30-day review process are being bumped to the 45-day investigation phase. Senior officials of key departments spend more time reviewing specific acquisitions.

Moreover, the role of the Office of the Director of National Intelligence (DNI) has been formalized. DNI does not and should not vote on CFIUS matters, since its role is to offer intelligence support rather than to make policy judgments. But it participates in CFIUS meetings, examines every transaction notified to the Committee, and provides broad and comprehensive threat assessments. The DNI has assigned an all-threat assessment responsibility to the National Intelligence Council to ensure that all relevant intelligence community agencies and activities participate in the development of final intelligence assessments provided to CFIUS.²⁶

Despite such changes, there appears to be broad agreement on the need for a better consultation mechanism between CFIUS and the Congress. There is little question that the CFIUS review process has

been lax in this regard. No quadrennial report on possible foreign efforts to acquire critical U.S. technologies or to conduct economic espionage in the United States has been prepared since 1994. Stung by external criticism, the Bush Administration is scrambling to prepare a 2006 report. Treasury is now notifying Congress of every review upon its completion and has offered quarterly congressional briefings on CFIUS issues.

Some have been critical of the confidential nature of the process. This criticism is misplaced since CFIUS deals with issues involving national security, intelligence and proprietary business information. The Exon-Florio amendment requires that information furnished to any CFIUS agency by the parties to a transaction shall be held confidential and not made public, except in the case of an administrative or judicial action or proceeding. The issue is less the confidentiality of the issues than the Executive Branch's failure to inform Congress routinely of pending transactions in ways that would enable lawmakers to express potential concerns. Exon-Florio's confidentiality provision does not prohibit CFIUS from sharing information with Congress. Upon request of congressional committees or subcommittees with jurisdiction over Exon-Florio matters CFIUS agencies can arrange, and in fact have arranged, congressional briefings on transactions reviewed by CFIUS. These briefings are conducted in closed sessions and are classified if necessary. There are numerous processes and procedures in place in which confidential, business proprietary information is protected in monetary policy, trade policy and anti-trust reviews, or in which classified information is secured in intelligence and national security briefings to relevant congressional committees.²⁷

In short, the Administration owes the Congress greater accountability, but a variety of changes could be initiated by the Executive Branch rather than mandated and micro-managed by Congress. In addition to some of the changes already discussed, the Administration could offer to certify notices, reports and decisions, and establish notification procedures for control and continued monitoring of withdrawn transactions, without Congress having to mandate such procedures in legislation. Rather than face yet another congressional mandate for semi-annual reports, the Administration could establish regular reports to Congress as a routine administrative procedure. None of these reforms should be beyond the wit of the Executive Branch.

On balance, then, our preference and recommendation would be to seek administrative changes by the Administration rather than mandated changes by the Congress. CFIUS has been successful in part because it has remained a rather technocratic administrative process. Onerous and time-consuming micro-management by Congress of CFIUS, which was never intended to be a regulatory agency, could threaten confidentiality and America's traditionally open investment climate, and risk politicization at home and retaliatory actions by foreign parliaments against U.S. investments abroad.

Nonetheless, the political firestorm unleashed by the Dubai Ports World episode may still lead to more substantial reforms. Any effort to reform CFIUS, however, whether initiated by the Executive or imposed by the Congress, should bear in mind four key factors:

First, do not widen Exon-Florio criteria to encompass such nebulous terms as “economic security,” as some are advocating. CFIUS will work best if it doesn’t take its eye off the ball, focusing on transactions that by virtue of the nature of the acquirer or the acquisition itself threaten national security. Not only would it be extraordinarily difficult to implement any statutory requirement that extended government reviews to protect “economic security,” such a requirement could easily become a vehicle for protectionism, with negative results for U.S. consumers and the U.S. economy as a whole.²⁸

Second, be clearer about what areas of “critical infrastructure” fall under CFIUS purview. As mentioned above, the area of critical infrastructure is the least well defined area of CFIUS concern, and the one most in need of further clarification. Regulations and security protocols have yet to be established in this area, unlike foreign investments in the defense sector, in which the Department of Defense has well-established policies and doctrines.

The difficulties begin with the very definition of “critical infrastructure.” David Marchick, a partner at Covington & Burling, makes this point cogently by comparing the Patriot Act definition with that of the Department of Homeland Security:

“...the Patriot Act defines “critical infrastructure” to be

“[S]ystems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of these matters.”²⁹

This definition creates a high threshold and a relatively narrow list of assets that would “have a debilitating effect” on security. By contrast, the Department of Homeland Security has identified 12 extremely broad sectors that it considers to be critical infrastructure, including agriculture and food, water, public health, emergency services, the defense industry, telecommunications, energy, transportation, banking and finance, chemicals, postal services and shipping, and information technology.³⁰ This definition may work for *physical* protection of critical infrastructure; it does not work for foreign investment considerations.

But beyond identifying these sectors, the Department of Homeland Security has not identified the types of companies, or even subsectors, for which acquisition by a foreign firm would be deemed a high risk to national security. Nor has anyone explained why foreign ownership of these sectors would de facto create a national security risk. Thirty percent of value added in the U.S. chemical sector is already produced by U.S. affiliates

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of foreign owned firms. In the energy sector, it would seem fairly clear that foreign acquisitions of US nuclear energy companies should be reviewed by CFIUS. What about

foreign acquisitions of US firms operating in other segments of the energy sector? Many foreign companies own electric distribution companies. Do these raise national security

issues? What about foreign ownership of a wind farm? Similar questions certainly apply in the other sectors, including the food, transportation (including ports), and financial sectors, where foreign ownership of US firms is common."³¹

As Marchick notes, creating an outright ban on foreign investment in critical infrastructure would both harm job creation and undermine national security, because foreign investment in these sectors has both increased research and development and spurred additional competition and innovation. Furthermore, it would be unwise to create a presumption that foreign investment *per se* in critical infrastructure creates a national security risk.³² Adopting the DHS definition of critical infrastructure as a framework for national security evaluations of foreign investment could lead the U.S. Government towards new heights of ludicrous behavior. Stuart Eizenstat and Michael Maibach point out that under such expansive definitions, Unilever's acquisition of Ben & Jerry's Ice Cream is likely to have required investigation as a national security threat.³³ The Administration and Congress need to work together to determine how best to protect critical infrastructure in the United States, regardless of who owns a particular company.

Third, do not politicize CFIUS. Some proposals would require the government to notify pending acquisitions in a particular state that are under CFIUS review to state delegations of Congress and the respective Governor of that state. This opens the door to all sorts of potential mischief, including the opportunity for domestic firms to use the CFIUS process to lobby local politicians to block competitors' deals in order to achieve politically what they couldn't achieve economically. Even the hint of this would chill foreign investment in the United States.

Fourth, do not discriminate between foreign and domestic investors. The common 30-day timeline for both CFIUS investment reviews and Hart-Scott-Rodino antitrust reviews has been essential to avoiding such discrimination. Altering this common timeline would discourage foreign investment, deny U.S. asset owners the opportunity to get the best price for their assets, and do little to enhance security. Certainly officials need adequate time to vet carefully any potential security risks associated with a particular transaction. But the vast majority of CFIUS filings can be processed within the initial 30-day review period. The small number of acquisitions that might still raise security concerns can be further vetted in the 45-day investigation period.³⁴

Fifth, don't shoot yourself in the foot. Political uncertainties and potential delays for foreign investors would have a huge chilling effect on their proclivity to buy American assets. The United States needs to attract almost \$1 trillion of foreign financing a year to fund its huge and growing trade and current account deficits. The current account deficit has reached 6 percent of GDP, underscoring the wide gap that has

developed between what Americans buy and what they sell to foreigners. This deficit has not harmed the U.S. economy because U.S. remains one of the best places in the world to invest. As a result, dollars that Americans send abroad when they buy imports are recycled back as capital investments. Americans are quite dependent on foreign investment inflows to cover the gap between what they produce and what they consume. At the end of 2004 (the most recent figures) foreigners owned about \$12 trillion in US assets: \$6 trillion in stocks and bonds; \$3 trillion in debt to banks and other lenders and \$3 trillion in hard assets such as factories. As we discussed earlier, these investments employ Americans, boost their salaries and keep interest rates down. If, however, the U.S. develops a reputation as a less welcoming place for investment, money will flow to other nations that otherwise may have fueled the U.S. economy. The result could be higher interest rates, higher mortgage rates, higher inflation, less innovation, lower wages, and lower stock prices.³⁵

Sixth, what goes around comes around. Restrictions on foreign investors in the U.S. are likely to hit U.S. investors abroad.³⁶ Many nations are currently considering changes to their own investment rules, and are looking closely at the U.S. debate as a point of orientation. The European Union, for instance, is embroiled in its own foreign investment debate as France, Poland and Spain seek to check intra-European investments by their own EU fellow-members. French Prime Minister Dominique de Villepin is working to restrict foreign investment in eleven “strategic” sectors, including yogurt and casinos. Spain is taking action to prevent a German company from acquiring a Spanish energy company. Poland is taking action to block a number of Italian acquisitions of Polish companies. Canada is considering similar legislation to that of the United States. China continues to restrict investment in a number of important sectors, and Russia is considering additional restrictions, particularly in so-called “strategic” areas such as energy. In 2005 Indian telecom company Videsh Sanchar Nigam Ltd. agreed to a range of U.S. government-imposed management and shareholder restrictions when it acquired Tyco International Ltd’s fiber-optic cable unit. VSNL then pushed the Indian government to apply similar restrictions on U.S. and other investors entering the Indian telecom market.³⁷ In short, efforts to target foreign firms here may wind up hitting American firms abroad.

Congressional Activity

The controversy over the Dubai Ports World case generated a flurry of congressional hearings and bills to amend Exon-Florio. At this writing two bills have taken center stage.³⁸

The key Senate bill, sponsored by Senators Richard Shelby (R-AL) and Paul Sarbanes (D-MD), passed through the Senate Banking Committee by a 20-0 vote, and is awaiting Senate floor action. It poses particular problems. First, originally the bill created a *de facto* presumption that all foreign investment in

critical infrastructure represented a potential security risk and bumped any such transactions into the 45-day “investigation” phase.³⁹ However, an amendment by Senator Chuck Hagel (R-NE) limits this far-reaching provision by restricting such an investigation to take place only if CFIUS first demonstrates there is a national security concern with a deal involving critical infrastructure. A second amendment by Senator Hagel allows a second 30-day review only if a member of CFIUS demonstrates a national security concern exists. The bill originally allowed any member of CFIUS to trigger a second 30-day review of essentially any deal for any reason.⁴⁰

Second, transactions involving government-owned or government-controlled companies would bump to the 45-day period, even if such companies operate by market principles and are owned by allied governments. Third, the 45-day requirement places the transaction timeline for many foreign acquisitions out of sync with the 30-day Hart-Scott-Rodino antitrust review timeline, and thus is likely to discriminate between foreign and domestic companies. Fourth, the bill uses the more narrow definition of critical infrastructure from the Patriot Act, as opposed to the broader Department of Homeland Security definition. Fifth, the bill requires that, as part of the review process, countries be ranked according to their adherence to nonproliferation efforts and other foreign policy factors. Finally, the bill provides for extensive notice provisions to members of Congress and the governor of the state in which the transaction takes place, which is certain to lead to leaks of proprietary information and encourage domestic companies to seek political redress. This last part may be the most troubling aspect of the bill.

The second bill (H.R. 5337) is sponsored by House majority whip Roy Blunt (R-MO) and a bipartisan group of House members, including Mike Oxley (R-OH), chairman of the House Financial Services Committee, Deborah Pryce (R-OH), chairwoman of that committee’s subcommittee on Domestic and International Monetary Policy, ranking subcommittee member Carolyn Maloney (D-NY) and subcommittee member Joseph Crowley (D-NY). This bill proposes more modest changes to the existing CFIUS process than the Shelby-Sarbanes bill. Importantly, it retains the 30-day review and 45-day investigation period. Regarding critical infrastructure, it requires CFIUS to focus only on the question of whether a “covered transaction has a national security-related impact.” It gives CFIUS greater investigative authority; ensures that the intelligence community’s role is that of information resource rather than a policymaker; maintains voluntary rather than mandatory notices; establishes tracking compliance with mitigation agreements that could lead to a body of “good practice” in this area; and provides additional funding of \$10 million to CFIUS in recognition of its greater caseload.

Although supported by the business community, the House bill, however, still contains provisions that some investors may find troublesome. First, it also stipulates various notice and reporting requirements, although such notices would be provided to state political leaders after the transaction had been approved, which should address the issue of politicization. Second, the bill also creates the presumption

that any transaction involving a foreign-government controlled firm would go through the 45-day investigative review process, even if such firm operated according to market principles or was from an allied nation. Third, the bill apparently creates an additional 7-day timeline for intelligence reviews, which also puts the CFIUS review out of sync with the Hart-Scott-Rodino 30-day antitrust review timeline.⁴¹

Given the congressional calendar and the differences between the two key House and Senate bills the chances are less than even that any CFIUS legislation will emerge from the Dubai Ports World controversy. As we have suggested earlier, some reforms of the CFIUS process appear warranted, but we believe that effective changes to the CFIUS process could be implemented by the Executive branch rather than mandated by the Congress.

In addition, we recommend that the Administration couple any effort to tighten the CFIUS process with a clear message that the United States welcomes foreign direct investment. With this in mind, Senators Jeff Bingaman (D-NM) and Richard Lugar (R-IN) have introduced “The United States Direct Investment Act of 2006 (S.3171), which seeks to encourage additional foreign direct investment in the United States. The bill would create a U.S. Direct Investment Administration within the Department of Commerce to track foreign investment data; work with business and state and local governments to advance investment opportunities in the U.S.; and offer tax breaks to foreign companies that decide to locate and hire in designated “renewal communities.” Lugar and Bingaman note that many other countries have a federal agency designated to recruit companies to invest and expand, and argue that the U.S. must compete on an equal footing. The bill was introduced on the Senate floor and referred to the Finance committee on May 25, 2006. The bill will not affect the implementation or application of CFIUS or any successor committee.

Part IV

Conclusion: Revisiting “Who Is Us?”

In 1990 Robert Reich made the case that “corporations that invest in the United States, that build the value of the American work force, are more critical to our future standard of living than are American-owned corporations investing abroad.”⁴² Reich argued that in a rapid globalizing economy, the lines defining “us” and “them” were becoming increasingly blurred. Indeed, since Reich’s seminal piece the boundaries and borders of the global economy have become harder to discern and disaggregate, notably in the United States.

No nation in the world has attracted as much foreign direct investment as the United States over the past fifteen years. Yet, as the recent backlash against a number of proposed foreign acquisitions illustrates, many legislators and policy makers have yet to come to grips with the question “Who is Us?” Lost in all the debate about a rising tide of foreign ownership of U.S. assets are a few simple facts. First, if one considers foreign direct investment inflows as a percentage of U.S. GDP, foreign participation in the U.S. economy is rather modest. In 2004, for instance, foreign investment as a percent of U.S. GDP was just 12.6 percent, well below the global average (21.7 percent), the average for developed nations (20.5 percent) and the average for developing nations (26.4 percent). Notwithstanding recent headlines that America is being bought on the cheap and that sizable proportions of the U.S. economy are in danger of falling under foreign control, reality is quite different.

Figure 12: Foreign Direct Investment Inflows as Percentage of GDP, 2004, percent of total

World	21.7
Developed Nations	20.5
EU	31.7
France	26.5
Germany	12.9
UK	36.3
US	12.6
Japan	2.4
Developing Nations	26.4
South America	30.1
Brazil	25.2
Chile	58.2
Mexico	27.0
East Asia	28.4
China	14.9
India	5.9

Source: UNCTAD

Second, opposing foreign investment in the U.S. may be good populist politics, but it is bad economics. In terms of output, employment and trade, foreign companies are important contributors to the U.S. economy. A significant number of American jobs are dependent on foreign investment in such economic sectors as chemicals, motor vehicles, mining, electrical equipment and financial services. American exports are increasingly reliant on the intra-firm production networks forged globally by foreign investment in the United States. At the state and local levels, participation by foreign investors can be quite important, as underscored by the reindustrialization of the southeastern United States.

Third, policies that threaten to halt or slow foreign direct investment inflows are likely to inflict serious economic consequences on the U.S. economy. Turning away foreign investors makes America's job of financing its massive current account deficit (running at annual rate of 6% of GDP) that much more difficult.

Fourth, fears about foreign ownership of U.S. assets overlook the simple fact that U.S. firms own and control more assets overseas than foreign firms do here in the United States. A xenophobic backlash against foreign investors here in the United States risks similar policies against U.S. corporate interests around the world. Given corporate America's extraordinary global reach (which is second to none) and growing dependence on foreign markets and foreign earnings, the last thing U.S. chief executives want to confront are anti-investment policies in key markets outside the United States.

Finally, the 2006 Dubai Ports World case and the 2005 CNOOC case pose very real challenges to U.S. efforts to ensure national security while maintaining an open investment climate. There is good reason to examine particular foreign acquisitions for their potential impact on the nation's security. A useful spotlight has been cast on the government's procedures for reviewing such transactions. However, practical adjustments have been proposed that would best be initiated and implemented by the Executive Branch rather than imposed or micro-managed by the Congress.

Endnotes

¹The authors would like to thank Carrie Schenkel for excellent research assistance. For more details on transatlantic investment flows, see Daniel S. Hamilton and Joseph P. Quinlan, eds., *Deep Integration: How Transatlantic Markets are Leading Globalization* (Washington, DC: Center for Transatlantic Relations, 2005).

² Thomas A. Stewart, *Intellectual Capital* (New York: Doubleday/Currency Publishers, 1997), authors' own estimates.

³For fuller development of this theme, see Joseph P. Quinlan, *Global Engagement: How American Companies Really Compete in the Global Economy* (New York: McGraw Hill, 2000); John Dunning, *Regions, Globalization, and the Knowledge-Based Economy* (Oxford: Oxford University Press, 2002); John Dunning, "Location and the Multinational Enterprise: A Neglected Factor?" in *Journal of International Business*, 29, 1 (1998).

⁴ See Dunning, *Regions*, p. 10-19, and Quinlan, *Global Engagement*, *op. cit.*

⁵ Dunning, *Regions*, *op. cit.*, Quinlan, *op. cit.*

⁶ "Going Private," Review and Outlook, *The Wall Street Journal*, June 3, 2006. The *Wall Street Journal* recently editorialized, "Sarbanes-Oxley has been the last straw for some, with its auditing and reporting requirements imposing major new costs, especially on smaller companies. This has already played a part in the remarkable slowdown in U.S. initial public offerings. Today's largest IPOs are taking place mainly on foreign markets, away from the reach of U.S. regulators."

⁷ Bureau of Economic Analysis; Testimony of Todd Malan before the House Financial Services Committee, Subcommittee on Domestic and International Policy, Trade, and Technology, March 1, 2006.

⁸ Donald L. Evans, Testimony before the House Financial Services Committee, Subcommittee on Domestic and International Policy, Trade, and Technology, April 27, 2006.

⁹ Testimony of U.S. Treasury Assistant Secretary for International Affairs Clay Lowery before the House Financial Services Subcommittee on Domestic and International Monetary Policy, Trade and Technology on Reform of CFIUS, May 17, 2006; Malan, *op.cit.*

¹⁰ *Ibid.*

¹¹ *Ibid.*

¹² Evans, *op. cit.*

¹³ For further details, see “NYSE, Euronext Set Plan to Form a Markets Giant,” *Wall Street Journal*, June 2, 2006; “NYSE and Euronext to merge,” *Financial Times*, June 2, 2006.

¹⁴ See Daniel S. Hamilton and Joseph P. Quinlan, eds., *Deep Integration: How Transatlantic Markets are Leading Globalization* (Washington, DC: Center for Transatlantic Relations, 2005).

¹⁵ For a state-by-state breakdown of European-sourced jobs, trade and investment, see Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2005* (Washington, DC: Center for Transatlantic Relations, 2006).

¹⁶ For official documents and statements reviewing the history and nature of the CFIUS process, see the testimony by Robert M. Kimmitt, Deputy Secretary, U.S. Department of the Treasury, before the House Financial Services Subcommittee on Domestic and International Monetary Policy, Trade and Technology, March 1, 2006; and U.S. Department of the Treasury, “Committee on Foreign Investment in the United States,” <http://www.treas.gov/offices/international-affairs/exon-florio/>.

¹⁷ *Ibid.*

¹⁸ At least 13 companies are known to have withdrawn. One indicator of enhanced concern is the fact that there have been more investigations and withdrawals in the past three years than during the previous 10 years combined. For more details, see U.S. Department of Treasury, *Ibid.*; Testimony of David Marchick before the House Financial Services Committee, “On Foreign Investment, Jobs and National Security: The CFIUS Process,” March 1, 2006; Evans, *op. cit.*

¹⁹ For further details see the Testimony of the Department of Defense before the House Financial Services Committee regarding the Dubai Ports World CFIUS Case.

²⁰ For more details on CFIUS activities in this area, see James A. Lewis, “New Objectives for CFIUS: Foreign Ownership, Critical Infrastructure, and Communications Interception,” *Federal Communications Law Journal*, Vol. 57, No. 3, pp. 457-478.

²¹ For further details, see Michael Tyler and Matthew Dixon, "Transatlantic Telecommunications: Markets, Policies, Issues," in Daniel S. Hamilton and Joseph P. Quinlan, eds., *Deep Integration: How Transatlantic Markets are Leading Globalization* (Washington, DC: Center for Transatlantic Relations, 2005).

²² See Lewis, *op. cit.*; Marchick, *op. cit.*

²³ For more detail, see the Testimony of Deputy Secretary of Homeland Security Michael Jackson before the U.S. House of Representatives Committee on Financial Services, Subcommittee on Domestic and International Monetary Policy, Trade and Technology, March 1, 2006; Lewis, *op. cit.*, Marchick, *op. cit.*

²⁴ See David Marchick, Testimony to the U.S. House of Representatives Committee on Financial Services, Subcommittee on Domestic and International Monetary Policy, Trade and Technology, May 17, 2006.

²⁵ According to the Department of Treasury, in 2005 CFIUS received 65 filings and in 2006 is on pace to receive about 90 filings. See Lowery, *op. cit.*; Stuart E. Eizenstat and Michael C. Maibach, "Protect Our Heritage," *Wall Street Journal*, March 30, 2006.

²⁶ For a brief review, see Lowery, *op. cit.*

²⁷ For differing views, see C. Fred Bergsten, "Avoiding Another Dubai," *Washington Post*, February 28, 2006; Testimony of Todd M. Malan before the House Financial Services Committee Subcommittee on Domestic and International Monetary Policy, Trade and Technology, March 1, 2006.

²⁸ See Malan, *ibid.*; Marchick, March 1 testimony, *op. cit.*

²⁹ Section 1016(e) of the Patriot Act, codified at 42 U.S.C. 5195c. See Marchick, May 17 testimony, *op. cit.*

³⁰ See *National Strategy for the Physical Protection of Critical Infrastructure and Key Assets* (February 2003), available at www.whitehouse.gov.

³¹ Marchick, May 17 testimony, *op. cit.*

³² *Ibid.*

³³ Eizenstat and Maibach, *op. cit.*

³⁴ The GAO study of September 2005 suggested that CFIUS process may need more time for its reviews. But in the addendum to the GAO study all CFIUS members argued that timeframes for review and investigation are adequate. See Malan, *op. cit.*; Marchick, March 1 testimony, *op. cit.*; John K. Veroneau, testimony before the House Financial Services Committee, available at www.businessroundtable.org

³⁵ See James K. Glassman, Testimony to the House Financial Services Committee, March 1, 2006.

³⁶ For elaboration see Marchick March 1 testimony, *op. cit.*

³⁷ *Wall Street Journal*, April 10, 2006., p. A4.

³⁸ A third bill, HR 4881, offered by Duncan Hunter (R-CA) and others, would essentially prohibit foreign investment in critical infrastructure unless the particular investment was put in a “US trust” run by U.S. citizens and fenced off from the foreign parent company. If the DHS list of “critical infrastructure” was used, about 25 percent of the U.S. economy would be off limits to foreign investors. See Eizenstat and Maibach, *op. cit.*

³⁹ “CFIUS Reform: National security and International Investment,” American Enterprise Institute, April 2006.

⁴⁰ The amended version of the bill states: “Upon written request by the Secretary, Deputy Secretary, or Under Secretary of one or more of the agencies that make up CFIUS (including any agency described in subsection (c)(4)(I)) for additional time to review a case, the 30-day period described in subparagraph (A) shall be extended by not longer than an additional 30 days, if the Secretary, Deputy Secretary, or Under Secretary concludes that there is credible evidence to believe that if permitted to proceed with the transaction, the foreign acquiring entity may take action that threatens to impair the national security.” The amended bill also states “CFIUS shall undertake an investigation to determine the effects on national security of any merger, acquisition, or takeover described in subsection (a)(1) proposed or pending on or after the date of enactment of this section . . . (A) which would . . . (ii) result in control of any critical infrastructure of or within the United States by, with, or on behalf of any foreign person if CFIUS determines that any possible impairment to national security has not been mitigated by additional assurances . . .”

⁴¹ See the May 17, 2006 testimonies by Douglas Holtz-Eakin and David Marchick to the House Financial Services Committee, Subcommittee on Domestic and International Monetary Policy, Trade and Technology.

⁴² Robert B. Reich, “Who Is Us?” *Harvard Business Review*, January 1990, p. 64.

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