



Risk Mitigation Consulting Inc.

Intelligence and Analysis Division

WHITE PAPER SERIES

Chinese Investment in the U.S. and National Security: An Overview

INTENT

This white paper is designed to provide an in-depth analysis of relevant, publicly available information on threat and hazard events/trends and their potential impacts to the interests of the United States, both at home and abroad. This product is not intended to be an all-encompassing assessment of the subject, rather, it provides a brief overview to provide the reader with situational awareness regarding topics with which they may not be familiar.



Chinese Investment in the U.S. and National Security: An Overview

Introduction

Foreign direct investment (FDI) in the United States can produce positive economic effects, such as an influx of new capital for businesses, and management expertise in a particular sector. However, FDI can also raise a variety of national security concerns. In recent years, Chinese FDI (both by government-backed and private ventures) has come under close scrutiny due to ongoing geopolitical tensions between the U.S. and China. Some common investment-related national security concerns include investment assets' physical proximity to Department of Defense (DoD) installations, as well as Chinese control of DoD supply chains and other critical infrastructure.

CFIUS: Covered Transactions, Process, and Stakeholders

The Committee on Foreign Investment in the United States (CFIUS) is an interagency U.S. Government committee tasked with oversight of foreign investment transactions. CFIUS weighs the national security considerations of each proposed transaction in order to determine whether a transaction should be allowed to proceed. From its establishment in 1975, CFIUS primarily served in an advisory capacity. However, the Exon-Florio Amendment, passed by Congress in 1988, authorized the President of the United States to block “proposed or pending foreign ‘mergers, acquisitions, or takeovers’ of ‘persons engaged in interstate commerce in the United States’ that threaten to impair the national security” following a CFIUS review, as long as certain conditions are met.¹

Covered Transactions

Per the Congressional Research Service, transactions covered by CFIUS include “any merger, acquisition, or takeover which results in “foreign control of any person engaged in interstate commerce in the United States.”¹

Non-Covered Transactions

However, because CFIUS only covers transactions classified as mergers and acquisitions where foreign entities gain operational control, a number of other types of transactions are not covered by CFIUS. Non-covered transactions include investments that are too small to result in operational control, or loans that do not involve a right to profits or a transfer of management.¹

Process

The CFIUS process typically begins with a voluntary notification made by parties to the transaction, although CFIUS has the ability to evaluate transactions that are not voluntarily submitted to the Committee. When a CFIUS review is initiated, the Committee has 30 days to determine whether a potential transaction should be allowed to proceed, or whether an investigation is warranted. If the proposed transaction is investigated, the Committee has 45 days to conduct the investigation. Then, the President has 15 days to issue a decision on whether the transaction will be authorized or blocked. However, many proposed transactions are abandoned prior to a formal investigation once involved parties receive word of scrutiny from CFIUS.¹



Stakeholders

Several different stakeholders participate in the CFIUS process. CFIUS is chaired by the Secretary of the Treasury, although representatives from the departments of Defense, Homeland Security, State, and Commerce are also involved, among other agencies. Each can voice concerns that are pertinent to their own interests; for example, the Department of Defense (DoD) representative can argue that a covered transaction poses a potential risk to a nearby DoD installation.¹

Case Studies

In recent years, a number of proposed transactions involving China have either been blocked by CFIUS, or have abandoned by the investing party prior to a CFIUS review due to CFIUS concerns. A few high-profile CFIUS decisions involving China have garnered national media attention and brought the CFIUS process into the public spotlight.

Oregon Wind Farm

In 2012, President Barack Obama issued a presidential order forcing Sany Group, a Chinese company, and a Sany Group subsidiary called Ralls Corp to divest from a proposed wind farm in Oregon. The wind farm's four sites would have been located in direct vicinity of a U.S. Navy training facility, with one of the sites located in restricted airspace. Obama stated that there was "credible evidence" leading him to believe that the parties to the deal "might take action that threatens to impair the national security of the United States." The decision was the first time a president had formally blocked a transaction since 1990.²

Hotel Del Coronado

In 2016, Blackstone Group, the owner of Hotel del Coronado, called off a pending sale of the hotel to China's Anbang Insurance Group after CFIUS raised concerns over the hotel's proximity to U.S. naval bases. The historic hotel, located on Coronado Island in the San Diego Bay, is located directly in vicinity of several high-profile Navy installations such as Naval Base Coronado, Naval Base San Diego, and Naval Base Point Loma. Chinese ownership of the hotel could potentially provide a platform for intelligence collection such as the observation of ship movements.³

Lattice Semiconductor

In 2017, President Donald Trump blocked the acquisition of Lattice Semiconductor by Canyon Bridge Capital, a private equity firm with Chinese financial backing. Lattice manufactures computer components that are used by the U.S. government; one of the reasons the White House offered in support of Trump's decision. The White House contended that Chinese control of Lattice could compromise the integrity of the U.S. semiconductor market, citing Canyon Bridge's close ties to China's government. However, a Chinese government spokesman decried the decision, arguing that the security review was merely a means used to push protectionist policies. Nonetheless, high-tech companies with government or military applications are among the most scrutinized CFIUS reviews.⁴



Outlook

According to Rhodium Group, a private research firm that monitors Chinese foreign direct investment, Chinese FDI in the U.S. dropped roughly 35% from 2016 to 2017 due to two primary factors. First, the Chinese government increased regulatory pressure on outbound FDI. Second, and to a lesser extent, potential dealmakers were more hesitant to undergo the CFIUS process. Still, 2017 saw 141 transactions totaling approximately \$29 billion USD, making 2017 the second-highest year on record behind 2016.⁵

Chinese firms are likely to continue pursuing mergers, acquisitions, and takeovers of U.S. firms despite China's new regulatory measures, while CFIUS will continue to scrutinize all covered transactions. Some deals will be dropped pre-emptively prior to a formal CFIUS review, while others will undergo the full process to ensure that the transactions are compatible with U.S. interests. Transactions that are successfully approved will continue to drive the U.S. economy, while those that are blocked will ensure that the U.S. national security is not compromised. The CFIUS process, while complex, follows these basic principles based on the interest of all of its stakeholders in order to provide the United States with the best economic outcomes while protecting the country from foreign entities who may have malicious intentions.

Source List

1. Congressional Research Service. *The Committee on Foreign Investment in the United States (CFIUS)*. 06 April 2017.
2. Reuters. *Obama Blocks Chinese Wind Farms in Oregon Over Security*. 28 September 2012.
3. Bloomberg. *Blackstone Ends Plan to Sell Landmark Hotel to China's Anbang After U.S. Opposition*. 21 October 2016.
4. The New York Times. *Trump Blocks China-Backed Bid to Buy U.S. Chip Maker*. 13 September 2017.
5. Rhodium Group. *Chinese FDI in the US in 2017: A Double Policy Punch*. 17 January 2018.