

**TESTIMONY OF THE HONORABLE HEATH P. TARBERT**  
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**Before the U.S.-China Economic & Security Review Commission**  
**“China, the United States, and Next Generation Connectivity”**  
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Chairman Cleveland, Vice Chairman Bartholomew, and distinguished Members of the Commission, thank you for the opportunity to submit written testimony on the potential effects of next-generation connected devices and networks on U.S. economic and national security interests. We appreciate the Commission’s recognition of emerging technologies—including fifth-generation wireless (5G) and Internet-of-Things (IoT)—as a key driver of America’s economic future and your thoughtful consideration of the potential national security implications of a broader shift toward these new technologies. In addition, we are grateful for the Commission’s longstanding support of the Committee on Foreign Investment in the United States (CFIUS), and specifically for your recommendations on how to strengthen and modernize CFIUS. A number of your recommendations are reflected in the Foreign Investment Risk Review Modernization Act (FIRRMA), S. 2098, 115th Cong. (2017), which the Administration has endorsed.

**Economic and National Security Implications of 5G and IoT**

We believe the rollout of 5G and IoT technologies will involve a growing convergence of know-how and platforms across companies, industries, and countries. These innovations also promise to push us toward enhanced connectivity at the global, national, and individual levels. The potential for enhanced interconnection across users, greater interoperability across platforms, and deeper convergence of 5G and IoT know-how with other breakthrough technologies—such as block chain, robotics, and artificial intelligence—will stretch beyond the traditional realm of what we think of today as communications infrastructure, likely touching almost every aspect of our economy. There are both economic and national security dimensions—opportunities as well as challenges—inherent in these new developments.

The potential significance and breadth of 5G and IoT technologies are generating questions about the best role for government to play not just to address general privacy interests, but also to address vital national security interests. Given the promise that these new breakthroughs offer to our economy and quality of life, it is in our interest to allow these businesses the freedom to seek market opportunities and sources of growth. However, given the potential national security interests at stake, it is important for us to be able to mitigate potential vulnerabilities that could emerge in this new environment.

A key element of U.S. success will be the modernization of our national security-related trade and investment tools to ensure U.S. agility in embracing opportunities while addressing potential risks. As you know from my recent testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, my top priority as Assistant Secretary of the Treasury is ensuring that CFIUS has the tools and resources it needs to

perform the critical national security functions that Congress intended it to.<sup>1</sup> FIRRMA—a bill introduced with broad, bipartisan support—is designed to provide CFIUS with the tools it needs to meet the challenges of today and those likely to arise in the future, including in emerging technologies—the topic before the Commission today. Passage of FIRRMA would enable CFIUS to protect our national security and strengthen America’s longstanding open investment policy that fosters innovation and economic growth.

On behalf of the Treasury Department, I want to express our appreciation to the Commission for its early and active support of legislative proposals to update the CFIUS statute to address current and evolving security risks. We share the Commission’s view on the importance of expanding CFIUS’s ability to review investments in certain U.S.-based start-ups, joint ventures, and other similar arrangements. These types of corporate structures are frequently used in emerging technology sectors—including sectors related to 5G and IoT, such as semiconductors, sensors, and software—and can involve the transfer of sensitive U.S. assets, know-how, and capabilities to foreign actors that merit close scrutiny by CFIUS to mitigate potential U.S. national security risks. We also appreciate the Commission’s emphasis on the importance of critical technologies and infrastructure to U.S. national security. Emerging technologies and know-how, including those associated with 5G and IoT, contribute to a broader innovation ecosystem and communications architecture with wide-ranging applications, the ramifications of which often stretch beyond one particular company or technology.

### **Importance of Foreign Investment in the United States**

From the early days of our Republic, the United States has been a leading destination for investors, entrepreneurs, and innovators. In his famous *Report on the Subject of Manufactures*, Alexander Hamilton argued that foreign capital was not something to be feared or viewed as a rival to domestic investment, but was instead a “precious acquisition” in fostering our economic growth.<sup>2</sup> Throughout the nineteenth and twentieth centuries, capital from abroad funded the construction of America from our railways to our city skylines, while at the same time helping make such innovations as the automobile a reality.<sup>3</sup>

Today, the United States is an international leader in emerging technologies and a magnet for global research and development, including foreign capital to support these efforts. Foreign investment plays an important role in U.S. innovation and in developing specific emerging technologies in the United States, just as it has contributed to other important U.S. sectors historically. From Main Street to Wall Street to Silicon Valley, foreign investment has also brought significant benefits to American workers and their families in the form of economic growth and well-paid jobs. As Secretary Mnuchin—echoing his

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<sup>1</sup> See *Nomination Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 115th Cong. (May 16, 2017) (testimony of Dr. Heath P. Tarbert).

<sup>2</sup> Alexander Hamilton, *Report on the Subject of Manufactures* (Dec. 5, 1791), available at <https://founders.archives.gov/documents/Hamilton/01-10-02-0001-0007>.

<sup>3</sup> See Mira Wilkins, *The History of Foreign Investment in the United States to 1914* (Harvard Univ. Press 1999).

predecessor, Secretary Hamilton—has observed, “we recognize the profound economic benefits of foreign investment” today and place the utmost value on having “industrious and entrepreneurial foreign investors” continue to invest, grow, and innovate in the United States.<sup>4</sup>

### **Evolution of CFIUS**

Despite its many benefits, we are equally cognizant that foreign investment is not always benign. At several junctures in our history we have moved to address specific national security risks generated by the foreign policy context of the time, while aiming to maintain an overall open investment posture.

On the eve of America’s entry into World War I, concerned by German acquisitions in our chemical sector and other war-related industries,<sup>5</sup> Congress passed the Trading with the Enemy Act, giving the President broad power to block investments during times of war and national emergency.<sup>6</sup>

Later, in the 1970s, the oil shock that made OPEC countries wealthy led to concern that petrodollars might be used to purchase key U.S. assets. In 1975, President Ford issued an Executive Order creating CFIUS to monitor and report on foreign investments, but with no power to stop those posing national security threats.<sup>7</sup>

Then in the 1980s, a growing number of Japanese acquisitions motivated Congress to pass the Exon-Florio Amendment in 1988.<sup>8</sup> For the first time, the President could block the foreign acquisition of a U.S. company or order divestment where the transaction posed a threat to national security without first declaring an emergency. That law added a new Section 721 to the Defense Production Act of 1950, which remains the statutory cornerstone of CFIUS today.

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<sup>4</sup> Steven T. Mnuchin, Secretary, Dep’t of the Treasury, SelectUSA Investment Summit Welcome Address (June 20, 2017).

<sup>5</sup> Edward M. Graham & David M. Marchick, Institute for Int’l Economics, *U.S. Nat’l Security & Foreign Direct Investment* 4-8 (2006). Prior to America’s entry into World War I, it was revealed that the German government made a number of concealed investments into the United States, including establishment of the Bridgeport Projectile Company which “was in business merely to keep America’s leading munitions producers too busy to fill genuine orders for the weapons the French and British so desperately needed.” Ernest Wittenberg, *The Thrifty Spy on the Sixth Avenue El*, *American Heritage* (Dec. 1965), available at <http://www.americanheritage.com/content/thrifty-spy-sixth-avenue-el>. The company placed an order for five million pounds of gunpowder and two million shell cases “with the intention of simply storing them.” *Id.* The plot was revealed when a German spy inadvertently left his briefcase containing the incriminating documents on a New York City train, with the documents being returned to the custody of the Treasury Department. *Id.*

<sup>6</sup> 50 U.S.C. § 4305. TWEA, originally passed in 1917, empowered the President to “investigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest.” *Id.* § 4305(b)(1)(B).

<sup>7</sup> Exec. Order 11,858, 40 F.R. 20,263 (May 7, 1975).

<sup>8</sup> Pub. L. 100-418, Title V, § 5021, 102 Stat. 1107 (1988).

Subsequently, in 1992, Congress passed the Byrd Amendment, which requires CFIUS to undertake an investigation whenever two criteria are met: (1) the acquirer is controlled by or acting on behalf of a foreign government; and (2) the acquisition results in control of a person engaged in interstate commerce in the United States that could threaten our national security.<sup>9</sup> In the years that followed, it became evident that CFIUS and Congress did not share the same view on when a 45-day investigation period was discretionary rather than mandatory, a rift that was more clearly exposed in the wake of the Dubai Ports World controversy. In order to instill greater procedural rigor and accountability into CFIUS's process, Congress enacted the Foreign Investment and National Security Act of 2007 (FINSA), which formally established CFIUS by statute and codified its current structure and processes.<sup>10</sup>

Now, more than a decade after FINSA and three decades after Exon-Florio, we find ourselves at another historic inflection point. New developments in the current geopolitical climate—including the significant uptick in strategic investments by some foreign governments and the growing role of technology in the economy and in national defense—call again for an updating of CFIUS to allow for closer scrutiny of the potential national security risks associated with foreign investment in U.S. emerging technologies. The national security landscape as it relates to foreign investment has been shifting over the past several years in ways that have eclipsed the magnitude of any other shift in CFIUS's 40-year history. Nowhere is that shift more evident than in the caseload CFIUS now faces.

The new challenges that CFIUS is confronting arise from a number of different factors. First, the ways some foreign governments are using investments—particularly those in emerging technologies—to meet strategic objectives, are generating concerns about the potential U.S. national security ramifications of acquisitions, including in sectors that might not have been considered sensitive in the past. Second, increasingly complex transaction structures—in some cases designed to dilute the appearance of government involvement or even to skirt CFIUS authorities—have become more common. Third, growing U.S. reliance on globalized supply chains in which there are newly forming concentrations of control, poses particular risks. Fourth, with the growing role of technology in national defense, CFIUS faces new national security risks posed by technologies that have current and potential future defense applications; military capabilities are rapidly building on top of commercial innovations. And fifth, the digital, data-driven economy—a trend likely to accelerate and intensify with the introduction of 5G and IoT technologies—has created national security vulnerabilities never before seen. Today, the acquisition of a Silicon Valley start-up may raise just as serious concerns from a national security perspective as the acquisition of a defense or aerospace company, CFIUS's traditional area of focus.

CFIUS's exposure to such complex and challenging cases has allowed it to play a critical role in protecting against threats to national security. At the same time, however, this has highlighted gaps in our jurisdictional authorities—particularly in sectors such as

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<sup>9</sup> Pub. L. 102-484, 106 Stat. 2315 (1992).

<sup>10</sup> Pub. L. 110-49, 121 Stat. 246 (2007).

emerging technologies. We continue to be made aware of transactions we lack the jurisdiction to review but which pose similar national security concerns to those already before CFIUS. These gaps are widening as threat actors see such transaction forms as an effective means to acquire leading edge capabilities rapidly without being subject to national security-based regulatory restrictions. The problem lies in part in the fact that CFIUS's jurisdictional grant is now 30 years old, originating with the Exon-Florio Amendment and maintained in FINSAs. Under current law, CFIUS has authority to review only those mergers, acquisitions, and takeovers that result in foreign "control" of a "U.S. business." That made sense in the 1980s and even in the first decade of this century. But in recent years, the foreign investment landscape has changed significantly, with non-controlling investments and joint ventures becoming ever more popular.

Consequently, certain transactions—such as investments that are not passive, but simultaneously do not convey "control" in a U.S. business—that CFIUS has identified as presenting a national security risk nonetheless remain outside our purview. These types of venture capital deals are particularly widespread within the emerging technology sector. Similarly, CFIUS is also aware that some parties may be deliberately structuring their transactions to come just below the control threshold to avoid CFIUS review, while others are moving critical technology and associated expertise from a U.S. business to offshore joint ventures. We see joint ventures and licensing arrangements of concern, for example, in emerging technologies, including subsectors that support 5G, IoT, artificial intelligence, medical technologies, microelectronics, robotics, and semiconductors, to name a few. While we recognize there can and should be space for creative deal-making, purposeful attempts to evade CFIUS review put our country's national security at risk. Finally, we regularly contend with gaps that likely never should have existed at all, such as the statutory loophole that allows purchases of businesses located in close proximity to sensitive military sites to be reviewed by CFIUS, but not purchases of vacant land. These gaps can lead to disparate outcomes in transactions presenting identical national security threats.

### **Support for FIRRMA**

The Administration endorses FIRRMA because it embraces four pillars critical for CFIUS modernization. First, FIRRMA expands the scope of transactions potentially reviewable by CFIUS, including certain non-passive, non-controlling investments, transfer of sensitive capabilities of U.S. businesses through arrangements such as joint ventures, real estate purchases near sensitive military sites, and transactions structured to evade CFIUS review. The reasons for these changes are twofold: (1) they will close gaps in CFIUS's authorities by expanding the types of transactions subject to CFIUS review; and (2) they will give CFIUS greater ability to prevent parties from restructuring their transactions to avoid or evade CFIUS review when the aspects of the transaction that pose critical national security concerns remain.

Second, FIRRMA empowers CFIUS to refine its procedures to ensure the process is tailored, efficient, and effective. Under FIRRMA, CFIUS is authorized to exclude certain non-controlling transactions that would otherwise be covered by the expanded authority.

Such exclusions could be based on whether the foreign investors are from a country that meets specified criteria, such as having a national security review process for foreign investment.

FIRRMA also allows CFIUS to identify specific types of contributions by technology, sector, subsector, transaction type, or other transaction characteristics that warrant review—effectively excluding those that do not. Additionally, CFIUS can define circumstances in which certain transactions can be excluded because other provisions of law—like export controls—are determined to be adequate to address any national security concerns. Only where existing authorities cannot resolve the risk will CFIUS step in to act. Emerging technologies is likely to be one of those areas where there are gaps and CFIUS will continue to have an important role as the last line of defense.

Third, FIRRMA recognizes that our own national security is linked to the security of our closest allies, who face similar threats. In light of increasingly globalized supply chains, it is essential to our national security that our allies maintain robust and effective national security review processes to vet foreign investments into their countries. As noted above, FIRRMA gives CFIUS the discretion to exempt certain transactions from review involving parties from certain countries based on such factors as the nature of the U.S. strategic relationship with the country and the nature of the other country's process to review the national security implications of foreign investment. FIRRMA will also enhance collaboration with our allies and partners by allowing information-sharing, subject to appropriate controls, for national security purposes with domestic or foreign governments.

Fourth, FIRRMA requires an assessment of the resources necessary for CFIUS to fulfill its critical mission. FIRRMA would establish for the first time a “CFIUS Fund,” which would be authorized to receive appropriations. Under FIRRMA, these monies are intended to cover work on reviews, investigations, and other CFIUS activities. FIRRMA also authorizes CFIUS to assess and collect fees, which we would anticipate would be set by regulation at a level that does not affect the economics of any given transaction. Finally, FIRRMA grants the Secretary of the Treasury, as CFIUS chairperson, the authority to transfer funding from the CFIUS Fund to any member agencies to address evolving needs in executing requirements of the bill. This approach would enhance the ability of agencies to work together on national security issues.

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In sum, I appreciate the Commission's support for modernizing and strengthening CFIUS to address current and future national security risks. In that regard, I am hopeful that FIRRMA will continue to move forward on a bipartisan, bicameral basis. It is our aim that, with these enhanced authorities, the United States will be best positioned to embrace the promise of emerging technologies, including those associated with 5G and IoT. Thank you.