NATIONAL SECURITY AND FOREIGN OWNERSHIP

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In a globalizing world, in which America benefits economically and strategically from openness and trade and cross-border investment, what national security rules and guidelines should govern our interaction with other countries? The concern is particularly acute, not for close allies like Britain, not for clear adversaries like North Korea, but for more complex cases such as China and a number of states where al Qaeda has had a strong presence in the past.

A number of specific questions have arisen in recent years, in response to China's interest in obtaining the Unocal energy company, China's ongoing economic assertiveness in places such as Panama, Iran, and Sudan, and the United Arab Emirates' interest in managing operations at six U.S. ports. At what point, if any, are such developments dangerous for the United States? How do we figure that out in advance—so that we have appropriate legal frameworks for regulating such sales, and so that we avoid diplomatic brouhahas that harm relations with countries with which we are trying to construct cooperative partnerships?

There are a number of possible reasons for concern about changes in control of strategically significant industries. The most acute involve possible transfers (licit or illicit) of our highest technology, or developments that would open up our country to possible attack by compromising sensitive security procedures and allowing would-be enemies to learn about our nation's greatest vulnerabilities. Secondary, but still potentially real, concerns involve the possibility that we would develop major dependencies for strategically important goods or commodities on countries that ultimately might not prove to be dependable suppliers.

Using this framework, I would conclude unsurprisingly that our greatest economic/strategic vulnerability today comes from our dependence on foreign oil (with the issue of who drills, refines, and transports that oil secondary to the issue of where it is originally found). This is the dependency for which we have the least effective policy responses in place. Other concerns, which I develop further below in regard to the two recent cases of Unocal and Dubai Ports World, are of potential worry. But in general, our controls over transfer of high technology goods and our monitoring of foreign ownership of American strategic assets have been improving in regard to the recent developments discussed below. That said, more progress is essential, and Congress's interest in providing greater vigilance and oversight is welcome.

THE BIG STORY OF 2005: CHINA AND UNOCAL

A Chinese company's interest in buying Unocal in 2005 raised a big question for the US: how much of our country do we want to sell to a potential adversary? Put more diplomatically, given that the US and China are not allies, and that China is the world's fastest growing economy: what rules should govern how we invest and trade with it?

Whatever the merits of the Unocal deal, it was a useful wake-up call. During the cold war, we developed criteria for determining when to worry if a key global resource or technology was found primarily behind the Iron Curtain. We have not had similar principles to guide relations with China. The proposed Unocal sale to CNOOC has pushed us to begin this debate.

In 2005, Brookings' vice president Lael Brainard and I proposed four benchmarks to assess how much economic dependence on China is too much.[1] The first concerns critical technologies. If China became the world leader in a major strategic technology, we would have to try to limit this trend. Crucial areas include high-energy lasers, advanced optics, submarine quieting equipment, stealth technologies and, perhaps of greatest concern in China's case, high-performance computers. While not trying to disrupt China's own legitimate advances, we should oppose transfers of advanced strategic western technologies to its ownership.

The second benchmark relates specifically to computer technology. Even if China does not become a leader in supercomputer development soon, it could easily become the dominant world producer of chips, computers or software. It is already the leading exporter of computers, with some 20 per cent of the global market already a couple years ago, although China's expertise is primarily in inexpensive production of lower-end machines. The world needs several suppliers of computer capabilities so that others can increase production if China cuts the US off in a future crisis; thankfully, we still have them. However, should the Chinese share of global computer trade increase by 50 to 100 per cent, more assertive policy measures could be required.

Meanwhile, preserving US leadership in the critical technology field demands more proactive domestic policies encouraging research and development, science and engineering education, and workforce training.

The third point relates to important natural resources. This is where oil and Unocal come in. The situation with essential energy sources can be more nettlesome than for a product such as computers, where others could increase production quickly if China ever threatened to cut its own off during a security crisis. China's share of global oil production is modest and well below what it needs for its own consumption—a useful benchmark for assessing potentially troublesome dominance. Unocal accounts for much less than 1 per cent of global oil production

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[1] This is based in large part on Lael Brainard and Michael O'Hanlon, "A Test of American Independence," *Financial Times*, July 26, 2005.

(China's total assets account for well under 10 per cent). Rather than seeking domination of world oil markets, Chinese leaders probably wanted assurances over their energy supplies given their economy's extreme dependence on the resource. Moreover, given the amount of dollars we are putting in China's pockets through our enormous appetite for imports, we should not be surprised that Beijing would seek higher yielding investments than Treasury bonds. This deal did not happen, but it probably would have been just fine if it had.

The final benchmark is the question of overall economic dependence. Leaving aside the specifics about what trade the US carries out with China, it is not prudent to allow a huge share of the US economy to depend on favorable future political relations with one of the world's last great autocratic states. Although overall imports from China account for just 2 per cent of US gross domestic product, the nation depends heavily on China to finance its deficit. China's recent loosening of the renminbi did not change the situation dramatically. China would be exposed to hefty capital losses if it offloaded its dollar assets impetuously, but the degree of our dependence is still concerning, especially in the context of a possible future crisis over Taiwan.

The best way to address this problem is through fiscal policy and further exchange rate realignment, not trade or investment policy. As for owning US companies, China is a long way from buying up America. Its direct investment in the US in 2005 was less than $1bn (about $2bn counting investments from Hong Kong), compared with US investment in China of over $15bn ($60bn including Hong Kong)—and a very small fraction of the $1,500 billion of total foreign investment in the US. One should remember that when Japan went on a US buying spree two decades ago, a sharp fall in the dollar and real estate valuations turned it into a bonanza for American sellers.

THE BIG ISSUE OF 2006: THE UAE AND DUBAI PORTS WORLD

Many U.S. observers were critical of the supposedly populist political reaction against the proposal by Dubai Ports World to take operational control of six American ports.[2] But real issues were raised by the idea of a company owned and operated by the United Arab Emirates gaining such direct access to a critical node of America’s transportation underbelly. The opposition to the deal of former 9/11 commissioner Thomas H. Kean, a former governor of New Jersey, and at least one former official of the Department of Homeland Security also constituted a serious basis for taking the objections seriously on their substance, not just their politics.

Homeland security adviser Frances Townsend said to critics of the proposed deal on national television that there would be no notable difference between a British firm running the port operations in question and a UAE firm doing so. This statement was meant to suggest that only xenophobia could explain the actions of those who opposed the deal.

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[2] This is based in part on Michael O’Hanlon, “Port Deal Raises Serious Concerns,” *Baltimore Sun*, March 2, 2006.

That is too simple. Leave aside what we clearly remember about the UAE's behavior in the not-too-distant past: that it recognized the Taliban government of Afghanistan, that it was the country of origin for two 9/11 hijackers and a nexus for much of the funding needed to organize that plot, and that the proliferation network of Pakistani scientist Abdul Qadeer Khan used UAE territory as a transshipment point for sensitive technologies. Admittedly, these concerns were at least partially counterbalanced by the facts that the UAE has become a responsible player in port security on its own territory and that it has helped the United States substantially with intelligence cooperation and military bases in the war on terror.

However, existing policy draws a sharp distinction between close allies—allies such as Britain—and most of the world's other countries when it comes to vigilance against possible terrorism. Most relevant is the visa waiver program. Citizens from European states and a few other close allies need not have visas when coming to the United States; everyone else must. This suggests that we recognize that our close democratic partners, whatever their own foibles, have better procedures for monitoring the proper behavior of their citizens than most other countries and a better means of fixing problems that become apparent.

The policy also underscores the point that, however reputable UAE officials are, however trustworthy the DPW management team may be, however nonviolent most UAE citizens undoubtedly are, there are nonetheless far more al-Qaida members living in the Middle East than in most other parts of the world. Recognizing this does not make anyone racist. It is simply a fact. That means there is a serious case for drawing a distinction between ownership of port operations by a British, a Korean or even a Singaporean firm and one run by a company in the UAE. (Whether Chinese firms should run U.S. ports is another matter, but a largely separate one.)

The argument that DPW would not have responsibility for security operations at U.S. ports, which would remain in the hands of the Coast Guard and DHS, was partly right but incomplete. Any firm managing cargo at such ports would necessarily know a great deal about the port, its shipping practices and its potential vulnerabilities. And even if DPW's current management was, as I suspect, entirely dependable in not wishing to misuse any such information, what assurance would we have had that future employees hired into its management team would be as trustworthy?

I would that foreign ownership of key strategic assets allowing the potential for exploitation of key vulnerabilities needs to have different rules for countries like UAE than countries like the UK. And the visa waiver program is important here. Countries that we do not believe we can trust yet to monitor their own citizens need to create special, monitored procedures for vetting their citizens who would have access to sensitive information in any such future cases.

CONCLUSION

Clearly a great deal has improved since 2005 and even 2006 in how the federal government thinks comprehensively about strategic vulnerabilites, trade, and investment. It is a privilege to be part of the conversation before this committee. And I will conclude by emphasizing a point made earlier: that our ongoing dependence on foreign oil, while not necessarily the main focus of this committee, strikes me as the chief unaddressed strategic economic vulnerability of the United States today.