



# Electoral liabilities

LARRY E. CHRISTENSEN examines the political background behind US export control and sanctions policies, and considers the potential implications of the upcoming presidential elections.

**O**n 15<sup>th</sup> November, Americans will go to the polls to elect a new president. The two candidates naturally offer different approaches to a range of issues. But discerning their differences on matters of national security – where a wrong word could pole-axe an entire campaign – is more of an art than a science. It raises a number of questions:

- What is over the horizon for national security trade policies of the United States and why should you care?
- What is the next trend the US government may follow in its efforts to protect national security, reduce the risk of nuclear weapons proliferation and reduce the threat of terrorists using weapons of mass destruction?

- Is the answer to be found in the race for the American Presidency?

In recent years, the US government has stepped up the scrutiny of foreign direct investment and may consider steps to urge private parties to disinvest in companies, both American and foreign, that invest in Iran, Sudan and other countries it suspects of funding terrorism. But the answer to the first question is not found in the differences in the campaigns for the White House. Rather, both candidates are in agreement about the importance of nuclear non-proliferation and non-proliferation of other weapons of mass destruction, and making sure that neither ever fall into the hands of a terrorist organisation. For the most part, the export-control rules

of the United States will, therefore, remain in their current form for the foreseeable future, regardless of who wins in November.

Historically, export control and embargo policy in the US has been dominated by events around the world, as reported in the global media. Current events are a much better indicator of future US policy than the election returns in a single Presidential race.

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So far, the Presidential race has been relatively silent on the specifics of export-control licensing and embargo policy. Of course, the pundits will tell you there is a difference between the two major candidates on the definition of the future US mission and strategies in Iraq. However, it would be a mistake to conclude that means one candidate is less likely than the other to maintain tough re-export controls or rigorous enforcement policies.

Historically, national security and non-proliferation policy has been largely non-partisan with very few changes in legislation, and that will likely continue. While the United States approach to export controls has generated a good deal of debate over the years, the topic has proven both complex and the source of considerable passion in Congress.

### **The role of Congress**

The two parties in the US Congress share much common ground and common national security concerns. This broad consensus drives export control and embargo policy. These concerns are that without effective export controls:

- (a) Weapons of mass destruction will find their way into the hands of terrorists;
- (b) Items useful for the development of nuclear weapons will be diverted to Iran and other countries intent on developing nuclear weapons anew; and,
- (c) The Chinese military will become more advanced through the use of controlled western technology.

The role of Congress in the area of export controls and sanctions is important in the United States. The better view is that under the US constitution, Congress possesses the power to regulate international trade, including exports, and the power of the President to control international trade flows for the statutory delegations of power to the President from Congress.

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regulations passed under statutes. To date, Congress has granted the President broad discretion to regulate exports; however, recent Congressional oversight activity suggests that Congress will impose a somewhat tighter export control and sanctions regime over the next two years and may impose such on the President no matter who holds that office from January.

### **The threat from Iran**

The drivers of any future policy change or trend will be Iran and China. For Iran, the concern of the US and many other countries is that Iran will develop a capacity to produce weapons-grade nuclear fuel and, hence, a nuclear weapon. So far, the Iranian response has been that it has a right to enrich nuclear fuel to produce electricity and that such a purpose is authorised under the Nuclear Non-Proliferation Treaty.

The US, quite simply, does not believe this. Within the US Presidential campaigns, there is a consensus that Iran should not be permitted to develop a nuclear weapon or weapons-grade fuel. US policy makers have sought international cooperation to achieve this goal with mixed results. US foreign policy towards Iran will be dominated by the nuclear issue and will likely be the toughest foreign-policy challenge facing the next President.

### *Preventing Iran from developing nuclear weapons*

How will the US and like-minded countries persuade Iran not to develop a nuclear weapon? Public interest groups in the US and Congress are closely examining means to prevent the diversion

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of key nuclear technology to Iran. This is related to the re-export controls, discussed in earlier articles in this series. In addition, some public interest groups are seeking to prevent the growth of the Iranian economy via disinvestment in corporations trading or investing in Iran.

### *Iranian investment*

In the United States, there is support from the political left, political right, and regulators to choke-off investment in Iran. In late 2007, the US Treasury Department imposed severe restrictions on dealing with the major banks of Iran and urged European banks to refrain from accepting financial transfers from such banks. High margins in Iran for forfaiters and other trade finance business in the country reflect the effectiveness of these actions.

Some public interest groups in the US have gone a step further and encouraged investors to disinvest in individual companies that have invested in Iran. Senator Obama and the Senate's Banking



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Committee have urged Congress to pass legislation that would both facilitate such disinvestment and extend the Iranian Transaction Regulations to non-US corporations owned or controlled by US persons. The Securities and Exchange Commission (SEC) has also given an indication that it may disclose further information about corporations that invest in Iran.

The subject of Iran has seen a marked divergence of opinion between the two candidates, but the messages have also been mixed. Senator Obama favours talks, but Senator McCain has sounded more hawkish. Yet Senator McCain voted against further sanctions against Iran in 2005.

### **Public interest in disinvestment**

The Center for Security Policy is a public interest group headed by Frank Gaffney, a former Department of Defense official in the Reagan administration in the 1980s. He calls his initiative as 'Invest Terror Free'. The organisation's website publishes corporate names and urges disinvestment<sup>1</sup>.

### *Regulatory interest in disinvestment*

The SEC has determined that, in some circumstances, it will require registered companies to disclose the risks of doing

the country. Senator Barack Obama introduced such a bill prior to the Banking Committee action and, after the Banking Committee reported out its bill, Senator Obama spoke to French President Nicolas Sarkozy on the matter when he visited France in the Summer.

The Banking Committee bill recently failed as an amendment to the Senate's annual funding bill for the Pentagon. While quite unlikely this year, the disinvestment provisions may yet pass Congress if the House and Senate can reach an agreement to include such provisions in a final funding bill.

The odds that the United States will tighten its sanctions on Iran will likely increase next year. The point is that there is some support from all sides of the political spectrum to encourage investors to disinvest in companies that invest in, or deal with, Iran. If there is a new development in the US approach to national security and non-proliferation, it is likely to include some type of disinvestment strategy.

### **Scrutiny of direct investment**

The United States is stepping up its scrutiny of direct investment in the country. It may seem incongruous that the US would increase barriers to direct investment in the United States just at a time when the financial system is under enormous pressure to

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business indirectly in Iran. In addition, more than a year ago, SEC Chairman Christopher Cox issued a public statement supporting disclosure for investors, while temporarily suspending a web tool that had been designed to enable investors to easily identify a registrant's business interests in countries the US Secretary of State has determined to repeatedly support terrorism. That information continues to be available, however, through the SEC's online EDGAR database.

### *Congressional Interest in Disinvestment*

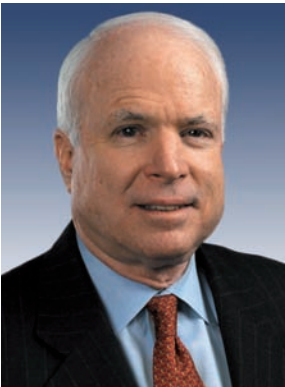
The Banking Committee of the Senate has recently passed a bill that would, if enacted into law, facilitate such disinvestment. Supporters of the bill point to the anti-apartheid precedent in the United States. At the time, many cities, states and private groups opposed apartheid in South Africa by disinvesting in companies seen to be active in

find liquidity and survive the mortgage crisis. Nonetheless, the trend seems clear and, in my judgment, is likely to continue.

### *CFIUS*

Direct investment in the United States by non-US organisations is reviewed under regulations administered by the Committee on Foreign Investment in the United States (CFIUS). This has long reviewed direct investment to ensure that such investments will not threaten the national security or critical infrastructure of the United States. Further legislation was passed last year, largely in response to the political reaction to the investments by Dubai Ports World in certain port facilities in the United States.

As a result of this legislation and rules proposed by the CFIUS, it seems clear that the US government is becoming increasingly eager to force the disclosure of the parties who ultimately control



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funds, and the decision-making processes and financial clout of so-called sovereign wealth funds, the investment funds ultimately controlled by major national governments.

### *Sovereign wealth funds and SOEs*

There are two elements in the CFIUS analysis of investments by sovereign wealth funds. First, the national security concern is that such an organisation will not make commercial decisions in its investment and management strategy, but instead will make decisions based upon its host nation's foreign policy and defence interests.

The second is a concern that certain sovereign wealth funds have become so large that withdrawal of funds or the threat of withdrawing funds from the US may cause financial instability. There are similar concerns in parts of the executive branch that state-owned enterprises (SOEs) also may not make market-based decisions and may create a risk of diversion of US-controlled technical data.

Of course, there are serious critics of such views. Chinese firms and authorities have been especially critical of the proposed CFIUS rules. Over the past few years, China has become a very important source of stable, long-term capital investments in the US private sector and the Treasury Department sale of Treasury Bonds. Chinese commentators make the point that their sovereign wealth funds invest for the long term and have been very successful financially. This is a dig at Wall Street and the emphasis on short-term results demanded by the US market. Many SOEs in China have made enormous strides towards becoming market-oriented, world-class businesses. However, if such organisations are not represented correctly before the CFIUS and the US licensing agencies, they may be viewed as somewhat tainted by government ownership and treated accordingly. This can be quite unfair and frustrating for a state-owned enterprise with benign business objectives.

### *Voluntary standards*

Many of the sovereign wealth funds have begun to respond. In early September 2008, members of the International Working Group of Sovereign Wealth Funds (IWG) met in Santiago, Chile to iron out voluntary practices regarding appropriate governance and accountability arrangements for investment practices by such funds. These generally accepted principles and practices (GAPP) of sovereign wealth funds will be presented to the International Monetary and Finance Committee on 11 October 2008.

Commentators believe that these GAPP proposals could become an international norm.

At the meeting, the GAPP proposals will be evaluated and discussed. Whether they will be acceptable to governments around the world remains to be seen. No doubt there is tension between the desire of some sovereign wealth funds to make prompt investment decisions with maximum confidentiality, versus the hope of some recipient governments for more transparency. This will be a significant debate among nations.

### **CFIUS-like reviews around the world**

The United States has no monopoly on review of direct investment. Nations such as Japan and Russia have recently used or created similar authorities and institutions to review direct investments into their countries. This raises a number of fresh questions, such as:

- Does it represent a threat to an open, global flow of investment that has done so much to improve the global economy?
- Who will be the winners and losers if direct investment slows or if direct investments are skewed by reason of well-intended controls with very little in the way of standards and large measures of discretion?

At the moment, national laws may permit actions that ultimately damage national security, and some form of increased regulation on foreign investments around the world – not just in the US – seem likely. However, at this time in history it is impossible to determine how an international patchwork of regulations by recipient countries, and the likely response of investing countries, will play out. What is certain is that the debate over such foreign-trade regulations will intensify and increasing questions will be asked over the balance between investment and national security. □

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