A National Security Study of the Shuanghui-Smithfield Case

Chanting Chen¹,a,*

¹East China University of Political Science and Law, No. 555 Longyuan Road, Songjiang District, Shanghai, China
a chenchanting@126.com
*Corresponding author

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Abstract. This article studies the Shuanghui – Smithfield Foods case from the perspective of national security review. The article firstly introduces the background of the case and the political and national security questions to the case. It then explains U.S. CFIUS review in detail. The third part of the paper analyzes that national security concerns of the deal are from the nature of meat industry, the business scale of the two parties, the nationality of the acquirer. The paper ends up with the effect of the deal to U.S. national security review mechanism, predicting that food security may become part of consideration of CFIUS review and the Department of Agriculture may take a more active part in the review.

1. Introduction

Shuanghui International Holdings Ltd. (hereinafter referred to as Shuanghui) made a joint announcement with Smithfield Foods (hereinafter referred to as Smithfield), the world’s largest producer of pork, on May 29, 2013, saying that the two companies had reached a final merger agreement. According to the agreement, Shuanghui International will spend $7.1 billion to acquire all of the shares issued by Smithfield and also bear its net debt.¹ Shuanghui agrees to remain Smithfield’s original operation system, management and staff teams, brand image and headquarter location. Shuanghui will continue to work with Smithfield’s producers, suppliers and farms in the U.S. ² For Shuanghui and Smithfield, the deal is a win-win business. It will enable Shuanghui to meet the rising demand for pork, and help Smithfield reduce debt pressure and access the huge Asian market.

Though the meat industry is not as sensitive as natural resources, the transaction still receives much criticism from politicians. Iowa Senator Chuck Grassley points out that the deal might further consolidate the agriculture industries, where many smaller market participants have lack of equal access to fair and competitive markets. He is also concerned that it will be more difficult for market participants to buy pork products with a fair price after the deal. Also, the merger brings concentration of pork market, which makes consumers fewer choices and higher costs when buying pork products.³ National Farmers Union and the Center for Rural Affairs also express the market concentration concern. Besides the market concentration brought by the deal, whether the case has a negative impact on national security and therefore should be blocked by CFIUS is an issue worthy of discussion.

2. CFIUS and National Security Review Mechanism

The Committee on Foreign Investment in the United States (CFIUS) is an intergovernmental organization established per Executive Order 11858⁴ by President Ford. The Committee was only established to evaluate the inbound investment. Its powers are significantly expanded nowadays after a series of legislation. Foreign Investment and National Security Act of 2007 (FINSA) enacted by
President George W. Bush is the current law. CFIUS’ major function now is to review the national security implications of the inflowing foreign investment.

The purpose of the national security review, as the preface of FINSA explains, is to ensure national security while enjoying the benefits of foreign investment. In accord with this legislative purpose, CFIUS members consist of pro economic interests departments and pro national security departments (see Diagram I). The formal review includes three steps, 30-day initial review, 45-day further investigation, and 15-day presidential determination. Most of the submitted cases get approval in the initial review stage when transaction parties and the Committee reach mitigation agreements. If there is any doubt on national security from any member of the Committee, the review will move on to the investigation stage. If the doubt still cannot be cleared during the 45-day investigation, CFIUS then submit the case to the President, who is the only officer with the authority to suspend or prohibit the investment.

Before the formal review proceeding, there is an informal stage of unspecified length of time. CFIUS members will reach an unofficial determination before parties formally file the notice. The informal review process has been developed for it benefits both CFIUS and the transaction parties. For CFIUS, the informal stage enables committee members to identify potential problems before the review formally starts, reducing time pressure to a certain extend. It also gives CFIUS additional negotiation time to restructure covered transactions so as to remove security concerns. For transaction parties, the informal stage provides them additional time to eliminate committee members’ national security concerns. It also helps companies to avoid negative publicity that might arise if the transaction is considered unsecured to the States. [6]

FINSA does not explain the meaning of national security. Instead, it gives ten consideration factors for CFIUS to refer when deciding whether a covered transaction is dangerous to the country’s security. These factors touch upon defense industry, military goods, critical infrastructure and technologies, the relation between acquirers and home state governments, the endeavor of home state government in the aspect of nonproliferation and anti-terrorism. The President and CFIUS are endowed to include other factors if they determine to be appropriate. [7]

3. National Security Concern over the Case

Smithfield is a top company in vertically integrated pork processing and pork producing. It produces about 20-22 million hogs per year, capturing around 26% share of U.S. domestic hog market. Smithfield business facilities include hog farms, pork processing and packing plants and pork distribution facilities, locating in more than a dozen states. [8] Some politicians concern that after the Shuanghui – Smithfield deal, there might be more purchase of U.S. poultry, dairy, or corn producers. Though purchase of Smithfield does not impair U.S. food independence, the potential following business practices may lead U.S. dependent in agriculture industry. [9]
Another issue involving national security is that Smithfield has commanded an advanced genetic technology to produce especially lean pigs. There are concerns that Shuanghui’s acquisition of this skill will put U.S. in a disadvantage position.[10] As Senator Debbie Stabenow expresses that the reason for Shuanghui to buy Smithfield is that China wants to “obtain American innovation and expertise in food production”, so as to “boost its exports and grow its agriculture economy.”[11] These innovation and food production technologies are funded in part by American taxpayers and make agriculture one of the only trade surplus areas. Members of U.S. Senate Agriculture Committee also worry that buying Smithfield may only be the beginning, and there will be more purchasing of U.S. food companies once this deal succeeds. [12]

The loss of control of such a large pork manufacturer itself is very worrying, not to mention the would-be new owner is a Chinese enterprise. From the U.S. perspective, China has a shaky history of domestic food safety, including Shuanghui. A subsidiary of Shuanghui was found to have been involved in the Clenbuterol case. Clenbuterol is an illegal additive that can cause nausea, headaches, limb tremors, and even cancer. In that case, the illegal additive was allegedly found in meat products in China. Opponents of the transaction wonder what may happen to the quality of American pork after the deal. [13]

In addition, some of states where Smithfield facilities locate forbid foreign ownership of farmland.[14] For example, Sections 442.560 to 442.591 of Missouri statute regulates that nonresident alien in Missouir is entitled to own a limited scope and amount of land. Iowa completely forbids foreign ownership of agricultural land. The rationale of the state law is due to the concern of home state people losing the ownership of their agricultural land to the foreign entities. Such concern is due to the significance of agriculture in the national economy and the people's livelihood. The Shuanghui-Smithfield deal enables the Chinese enterprise’s control of agricultural facilities in some of these states, triggering previous concerns and conflicting with relevant state legislations.

Last but not least, the national security concern is from the fact that Shuanghui was only half size of Smithfield and the latter was doing well financially on its own. Congress doubts the motive of Shuanghui and the impact of Chinese state on the business. [15] For example, the Senate Agriculture Committee expressed its concern that the deal is China’s covert attempt to control international pork price and command related U.S. intellectual property. Senator Debbie Stabenow and Senator Mike Johanns question a reciprocity issue, i.e., whether U.S. companies are able to do similar investment in China. [16]

4. The Implication of the Case to National Security Review Mechanism

The case raises a question as whether food security should be a component of the critical infrastructure or the key resources. Senator Charles Grassley has introduced S. 3161 to include the national security impact of foreign investments on agricultural assets as part of the criteria the Committee uses in deciding to recommend that the President block a foreign acquisition. [17] Though the meat industry is not as sensitive as natural resources, it is still worrying if the industry falls into someone else’s hand. The National Strategy for Critical Infrastructures and Key Assets has already identified the critical infrastructure nature of the food and agriculture sector. [18] As a consequence, CFIUS will be more scrupulous in future deals related to agricultural industries.

Another impact of the Shuanghui-Smithfield deal is the call for adding U.S. Department of Agriculture (USDA) and Food and Drug Administration (FDA) into the member staff of CFIUS. Senator Charles Grassley in his S. 3161 suggests including the Secretary of Agriculture as a permanent member of the CFIUS. [19] Senate Agriculture Committee members also have urged Treasury Secretary to include USDA and FDA experts in CFIUS review process.[20] Because Chinese food safety system is behind US,[21] expert opinions from USDA and FDA are necessary to ensure food safety during CFIUS’ assessment of foreign investment. FINSA entitles the president and the Committee to appoint heads of any other executive when they consider as appropriate. Therefore,
even though it is still uncertain whether the USDA or the FDA will be a regulatory member of CFIUS, the President or the Committee still can appoint the head of these two departments to attend transactions relating to agriculture industries.

References


