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Regulation of U.S. Outbound Investment to China

Introduction

The U.S. government has generally supported an open investment environment at home and abroad to promote U.S. economic growth, sustain the U.S. position as a premier destination for foreign direct investment, and ensure U.S. competitiveness. The U.S. government's interagency Committee on Foreign Investment in the United States (CFIUS) reviews a small subset of foreign inbound investments, primarily mergers and acquisitions, that could result in foreign control of a U.S. business and raise potential national security concerns. Since 2016, some Members of Congress have focused on the potential U.S. economic and national security effects of certain U.S. *outbound* investments to the People's Republic of China (PRC or China), including the transfer of U.S. technology and know-how in sensitive or strategic sectors.

In response, the 118th Congress is considering legislation to strengthen foreign investment review authorities and restrict some U.S. investment in the PRC and other "countries of concern" that involves dual-use and critical technology. In response to congressional activity, in August 2023, President Biden issued Executive Order (E.O.) 14105 to establish a targeted outbound investment program. While the E.O.'s scope of covered activity is limited, new rules are considered a departure from traditional U.S. economic policy. Opponents argue that existing tools like sanctions and export controls can address risks. Proponents argue that new measures are needed to preserve a market-based climate and counter PRC policies that incentivize and require the transfer of U.S. technology and capabilities to PRC competitors to benefit the PRC government.

Background and Policy Debate

Since 2016, Congress has led efforts to strengthen U.S. foreign investment review and has considered regulating some outbound investment. Enactment of the Foreign Investment Risk Review Modernization Act (FIRRMA, Title XVII, Sub. A, P.L. 115-232) in 2018 enhanced CFIUS authorities to review, mitigate, or restrict *inbound* foreign investments in U.S. firms involved in critical technologies, critical infrastructure, or sensitive personal data, and certain real estate transactions. Other proposed provisions—e.g., on U.S. *outbound* investment—were diluted or eliminated during congressional and executive branch deliberations over FIRRMA, following business pressure and other policy considerations. Instead, Members reformed U.S. export controls to regulate some critical and emerging dual-use technologies and technology transfer abroad. Since then, Congress has returned to these investment issues, in part in response to high-profile PRC greenfield investments in the United States and U.S. investments in China in strategic sectors (e.g., semiconductors and biotechnology). U.S. investments in China include the creation of research and development centers, production facilities, and joint ventures (JVs) with the PRC government and PRC firms. Some Members say U.S. portfolio investments support PRC firms in strategic sectors and also should be regulated.

U.S. firms have benefitted from the ability to invest and sell in China as a top global market since the 1990s. Despite the commitments it made to join the World Trade Organization in 2001, the PRC maintains policies and practices that require firms to localize production in China and transfer technology to PRC firms in order to sell or operate in the market. Since 2014, the PRC government has issued additional industrial policies and economic security measures. The U.S. Chamber of Commerce, among other business groups, has expressed support for the Biden Administration's efforts "to develop a thoughtful regime that safeguards American national security and economic leadership without unnecessarily restricting beneficial U.S. business activity." At the same time, the Chamber advocates for an approach that is "narrowly tailored to target specific national security concerns in a transparent, efficient, and predictable manner," follows "clear, workable rules," and avoids creating a chilling effect on firm activity. The Semiconductor Industry Association warns that foreign firms could fill any loss of U.S. market share in countries of concern that might result from any new restrictions.

Congressional Activities

Congress has sought to address what some Members see as statutory, regulatory, and implementation gaps with regard to CFIUS and export controls (see **text box**).

Select Legislation in the 118th Congress

- **National Critical Capabilities Defense Act of 2023** (H.R. 3136) would create a committee to review and regulate or prohibit certain U.S. investments involving "national critical capabilities" in "countries of concern."
- **Outbound Investment Transparency Act of 2023** (S. 2678) proposed notification of certain outbound investments in certain sectors. It was part of a Senate-version of the National Defense Authorization Act for FY2024 (S. 2226) and excluded from the enacted NDAA.
- **Preventing Adversaries from Developing Critical Capabilities Act** (H.R. 6349) would prohibit or require notification for certain activities of U.S. persons involving covered sectors in countries of concern. It would codify aspects of E.O. 14105. A modified version was included in the broader bill H.R. 7476, introduced in Feb 2024.

Some legislation broadly aims to sustain and rebuild U.S. production, technology, and innovation capabilities and counter PRC trade and investment policies of concern. Proposals include notification requirements, prohibitions in key sectors, and a case-by-case review process broadly similar to CFIUS that some call a "reverse CFIUS." Some Members advocate for an entity-based sanctions approach to restricting investments (e.g., H.R. 760), rather than a sectoral approach. In early 2024, committees held hearings to debate H.R. 6349 and H.R. 760. Some experts say that sanctions could augment a sectoral approach by including portfolio investments and banning investment in PRC firms already subject to other U.S. restrictions.

Executive Branch Action

E.O. 14105 directs the Treasury Department to create a new outbound investment program. The E.O. reiterates an "open investment" posture that promotes cross-border investment, where "not inconsistent with the protection of United States national security interests." It asserts that "advancement by countries of concern in sensitive technologies and products critical for the military, intelligence, surveillance, or cyber-enabled capabilities" constitutes an "unusual and extraordinary threat" to U.S. national security. It says that such countries can exploit U.S. investment and related intangible benefits such as "enhanced standing and prominence, managerial assistance, investment and talent networks, market access, and enhanced access to additional financing." Features of the authorized program include

- A two-tiered system that (1) prohibits certain outbound investments in "countries of concern" involving sensitive technologies and products that pose an acute national security risk, and (2) requires notification for investments in technologies with a lower risk profile.
- "Covered national security technologies and products," broadly identified as those in the (1) semiconductors and microelectronics, (2) quantum information technologies, and (3) artificial intelligence (AI) sectors.
- Unlike CFIUS, no case-by-case review of transactions.
- Coverage of investments in "countries of concern" now defined as the PRC (including Hong Kong and Macau).

In October 2024, Treasury issued its final rule to establish the new Outbound Investment Security Program, which is to go into effect on January 2, 2025. Treasury said that its approach seeks to focus on U.S. investments that "present a likelihood of conveying both capital and intangible benefits." The rule describes the new regime as targeted and narrowly scoped "to avoid unintended impacts in broader sectors of the U.S. or global economies."

Covered transactions include acquisitions of equity interests in a covered foreign person; certain debt financing; the acquisition, leasing, or development of operations, land, property, or assets in a country of concern (i.e., greenfield investments); JVs; and limited partner (LP) investments in a non-U.S. pooled investment fund that the U.S. person knows "likely will invest in a person of a country of concern." The final rule elaborates on a "knowledge standard," i.e., knowledge a U.S. person must have about the facts and circumstances of each type of transaction to trigger the obligations under the rule. It defines U.S. persons as any U.S. citizen, lawful permanent resident, entity organized under U.S. laws or within U.S. jurisdiction (e.g., foreign branch), or any person in the United States.

Excepted transactions include investments in publicly-traded securities; certain LP investments in venture capital, private equity or other funds that are $2 million or less, or made with certain contractual assurances; certain intra-company transactions between U.S. parent firms and controlled foreign entities; equity-based employment compensation; and some transactions in third countries, among others. The Treasury Secretary, in consultation with others, may grant exemptions on national interest grounds.

The program also targets potential loopholes. For example, it prohibits a U.S. person from "knowingly directing" a transaction by a non-U.S. entity (e.g., foreign fund) that the U.S. person knows at the time would be prohibited if undertaken by a U.S. person. The Treasury Secretary may take actions authorized under the International Emergency Economic Powers Act (50 U.S.C. 1701 *et seq.*) to nullify, void, or require divestment of any prohibited transaction.

Multilateral Cooperation

Some bills (e.g., H.R. 6349) would direct the executive branch to coordinate with allies and partners to develop comparable regimes. Some governments (e.g., the PRC, South Korea, Taiwan) have outbound investment rules. A May 2023 G7 joint statement recognized the role of outbound investment authorities to address risks, complement existing authorities, and "protect our sensitive technologies from being used in ways that threaten international peace and security." An April 2024 U.S.-EU Trade and Technology Council (TTC) statement reiterated a common interest in addressing potential risks from certain outbound investments in a narrow set of critical technologies. The European Commission is considering new outbound measures in its economic security strategy.

Considerations for Congress

Congressional approaches to a U.S. outbound investment regime differ with regard to relevant countries, sectors, and activity to be covered. Most legislation targets China; some include Iran, North Korea, and Russia. Some bills would codify aspects of the Biden Administration's approach, while others would also expand the covered technologies and countries. Some Members favor the legislative process to set "statutory boundaries" on new rules. Some Members support more restrictions than the E.O., while others have raised concerns about the scope of new rules and whether they could discourage investment in the U.S. market or erode U.S. competitiveness. Members debated potential inclusion of outbound investment restrictions as part of an NDAA for FY2025 (H.R. 5009). As Congress considers whether and how to regulate outbound investment and oversee E.O. 14105 implementation, some questions include

- How could the U.S. government best organize a new investment regime, designate roles of national security and economic agencies, and address any potential overlap with inbound investment review authorities?
- What visibility does the U.S. government have into U.S. investment activity in China without a notification or review process? What current authorities does it have to review, mitigate, and restrict these activities?
- What is the best approach for determining which sectors or activities are subject to regulation?
- How would proposals affect U.S. competitiveness as a destination for investment, particularly compared to major economies that lack such regimes?

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