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Outbound Investment Controls in a U.S. Economic Security Strategy

BY

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I. Summary of Testimony

Commissioner Miller, Commissioner Wessel, and members of the U.S.-China Economic and Security Review Commission, thank you for the opportunity to provide testimony. While I am currently employed by the Center for a New American Security (CNAS), I am providing testimony in my personal capacity.¹ The testimony draws from a large body of research that I have conducted at CNAS on economic security issues, as well as my prior experience serving the U.S. public as a proud civil servant in the U.S. Department of Commerce, the National Security Council, and the Office of the U.S. Trade Representative, including most recently serving as the Deputy Assistant U.S. Trade Representative for Investment. I have spent my career in national security roles, but always from the perspective of an economic agency. This perspective has engrained in me a deep appreciation for the strategic advantage that open markets and open capital flows provide the United States.

This testimony focuses on options for designing an effective program to address the national security risks that can arise from certain U.S. investments in China and other countries of concern. As the U.S. government considers establishing new outbound investment restrictions, it must account for a range of policy objectives, including the need to robustly protect U.S. national security, maintain U.S. economic and technological competitiveness, and ensure that any new programs can be effectively administered and enforced. Additionally, many U.S. investments in China do not present national security concerns and should be allowed to proceed so that investors can take advantage of commercial opportunities available in one of the world's most consequential markets. The analysis and recommendations of this testimony are provided with these objectives in mind.

A summary of recommendations for congressional consideration is as follows:

- Codify and provide resources for a targeted and proportionate set of outbound investment controls focused on transactions that may enable China's indigenous development of technologies critical to U.S. national security interests;
- Enhance transparency around investments made in China, including by establishing new requirements to notify the government of investment transactions involving high-risk technologies;
- Prohibit U.S. investments in Chinese entities that produce, design, test, manufacture, fabricate, or develop high-risk technologies, including military items, advanced semiconductors and related equipment and software, and frontier artificial intelligence (AI) systems;
- Consider additional prohibitions related to quantum information systems, hypersonics, and supercomputing;
- Expand the non-SDN Chinese Military-Industrial Complex (non-SDN CMIC) program to prohibit all types of investments in listed entities and to authorize the listing of Chinese entities that produce, design, test, manufacture, fabricate, or develop high-risk technologies;
- Exercise strategic restraint on the use of full blocking financial sanctions;

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- Encourage alignment of U.S. outbound investment policies with those of key international partners;
- Require independent evaluation of any new outbound investment authorities to ensure they are being implemented in a manner consistent with Congress’s national and economic security objectives; and
- Establish, or require the executive branch to establish, an economic security strategy to guide the use of all economic security tools in pursuit of a defined set of objectives related to U.S.-China strategic competition, including how outbound investment controls fit into this broader strategy.

This testimony draws from joint work conducted by the author and Sarah Bauerle Danzman, associate professor of international studies at Indiana University and resident senior fellow with the Atlantic Council, including the report *Sand in the Silicon: Designing an Outbound Investment Mechanism* published jointly by the Atlantic Council and CNAS. The testimony also draws from prior testimony provided before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, the U.S. House of Representatives Committee on Financial Services Subcommittee on National Security, Illicit Finance, and International Financial Institutions, and the U.S.-China Economic and Security Review Commission. Citations to these prior publications, and other resources that may aid the Commission’s work, are included at the end of the testimony.

II. Introduction

Certain U.S. investments in China present national security risks that are not addressed by existing U.S. authorities. U.S. firms and investors may, in some cases, be supporting the development of critical technologies in China that have important national security applications. These include investments related to chips, AI, or other technologies that can accelerate advances in Chinese military capabilities.¹ Just as U.S. law and policy have long recognized that the export of certain technologies can be counter to U.S. security interests, so too can certain overseas investments if such investments are contributing to increasing military capabilities of competitor nations. The goal of an outbound investment program is not to impose broad capital controls, but to instead address the specific transactions through which critical, non-technical industrial knowhow may transfer to China and to plug a specific gap that export controls cannot fill in the technology competition with China.

U.S. policymakers are currently debating whether and how to regulate U.S. investments in China. The administration has released an executive order, with an accompanying advanced notice of proposed rulemaking (ANPRM), outlining a targeted proposal to mandate notifications of—and in some cases, prohibit—certain U.S. investments into China’s AI, semiconductor, and quantum technology ecosystems.² Congress has considered a range of proposals, with current efforts in the Senate coalescing around a mandatory notification program.³ Debate remains ongoing in the House of Representatives, with the House Financial Services Committee advancing legislation that leans more heavily on traditional sanctions tools to address concerns with outbound investment.⁴ A proposal from House Foreign Affairs Committee Chairman Michael McCaul (R-TX) and Ranking Member Gregory W. Meeks (D-NY) advanced a sectoral approach to outbound investment restrictions.⁵ The House Select Committee on the Strategic Competition between the United States and the Chinese Communist Party, in its 2023 bipartisan report on the U.S.-China economic relationship, recommended an approach that blends both sectoral restrictions and entity-based investment restrictions.⁶

III. Need for Congressional Action

Congress has an essential role in establishing any new outbound investment authorities. While substantively the administration’s executive order generally aligns with the recommendations of this testimony, implementing these authorities under executive action is not optimal over the longer term. The International

Economic Emergency Powers Act (IEEPA) provides sufficient authority for the President to establish outbound investment restrictions. However, a legislative solution would ultimately provide a more durable policy response, as executive orders can be rescinded by subsequent administrations. Legislation also avoids the mission creep that has been associated with recent use of IEEPA for a range of China-related threats, many of which present serious national security and foreign policy concerns but may not strictly speaking constitute “emergencies” as originally envisioned in IEEPA. Brennan Center research has noted that the President’s use of IEEPA is “virtually unchecked,” calling in to question whether the extensive use of IEEPA as a routine foreign policy tool erodes the checks and balances between the executive and legislative branches.⁷

A strong congressional role would ensure that any new outbound program is designed in parallel with a consideration of the resources required for effective implementation and enforcement. Congress’s keen focus on resources during the 2018 process to modernize the Committee on Foreign Investment in the United States (CFIUS) was commendable, enabling CFIUS to effectively implement its expanded mandate. A similar resource assessment process should accompany the establishment of an outbound investment program.

Congress also has a role in determining the operational structure of a new outbound investment program. The Department of the Treasury is best situated to lead a new outbound investment program. The Treasury experience chairing CFIUS, as well as its lead role in implementing U.S. sanctions, give it unique strengths and insights when it comes to tracking international investments and global financial flows. Congress should create a new office to lead an interagency outbound investment program and place it under the leadership of the Assistant Secretary for Investment Security or the Under Secretary for Terrorism and Financial Intelligence. The outbound investment authorities should not be located within CFIUS, as this process is already under significant strain and Congress should seek to reduce rather than increase the burdens on CFIUS.⁸ The Departments of Commerce, Defense, Energy, and State should also have a role, given the need to align outbound investment restrictions with export controls. The Office of the Director of National Intelligence should be tasked to provide threat assessments in support of the outbound investment program.

IV. Principles for Outbound Investment Authorities

Addressing national security risks associated with U.S. investments in China will require a carefully calibrated approach. Overarching principles guiding the development of future outbound investment programs include that new authorities should be:

- targeted at transactions of highest national security risk;
- clearly defined and understandable to private-sector entities, who will be responsible for the first line of compliance;
- non-duplicative of and consistent with existing tools, including export controls;
- scoped proportionately to the administrative capacity available to effectively administer a new mechanism; and
- designed to enable meaningful conversations with allies about adopting similar regimes, including the need to limit extraterritorial application of U.S. authorities.⁹

Consistent with these broad principles, the United States should focus on U.S. investments that: 1) convey management expertise or other non-technical industrial knowhow along with the investment (i.e., “smart money” investments); and 2) may advance the indigenous development of China’s technology capabilities in areas critical to U.S. national security.

Focus on “smart money” investments

An outbound program should focus on regulating “smart money,” that is an investment that conveys non-technical industrial knowhow along with capital. Purely passive investment flows are unlikely to present a high-risk profile and are most easily replaced by other sources of capital. China has ample access to capital, from both domestic and foreign sources, and thus restrictions that focus on broad flows of money are unlikely to have a meaningful impact. Instead, an outbound program should focus on the unique contribution that flows from individual investment transactions, including access to leading U.S. knowhow on how to build a successful critical technology company. Outbound investment controls can be best thought of as a complement to U.S. export controls, filling a gap related to non-technical industrial expertise that export controls are ill suited to capture. Export controls address part of the national security risk associated with outbound investments, namely the risk that investments may involve the transfer of sensitive U.S. technologies. However, export controls do not cover the risks that arise from the transfer of management expertise, non-technical industrial knowhow, or other intangible benefits.

For example, one can consider the broad range of skills and expertise needed to establish and operate a semiconductor fabrication facility that can produce high-quality chips at scale and on commercially competitive terms. Technical knowledge and technology innovation will be critical to this business, and export controls can address this aspect of potential risk associated with U.S. investments in China-based facilities. But, the operators of these facilities will also need to manage complex supply chains, maintain a skilled workforce, and develop commercial strategies for succeeding in a cutthroat global marketplace. Few companies today can master these complex operational and management requirements, and it is in exactly these areas that U.S. firms excel. These types of non-technology related benefits that can flow along with an outbound investment are not, and never would be, suitable to capture under export control authorities.

Additional types of risks may arise from investments made in the start-up or venture capital space. Research from Georgetown University’s Center for Security and Emerging Technology (CSET), examining U.S. investments in China’s AI sector, describes additional types of non-technical expertise that advance indigenous technology development, noting that “earlier stage VC investments in particular can provide intangible benefits beyond capital, including mentorship and coaching, name recognition, and networking opportunities.”¹⁰ These types of intangible benefits can be critical in determining the success or failure of young technology companies, which generally have a high failure rate. The CSET report noted that, while Chinese investors remain the majority of investors in China’s AI start-ups, U.S. venture capital has been active in China’s AI start-up field.

Focus on high-risk technology areas

An outbound investment program should focus on investments in technology areas of high national security risk. This includes technologies that are subject to high levels of export controls, as well as emerging technologies that may not be mature enough to warrant export controls but are nonetheless critical to future U.S. technological and national security advantage. In both instances, the United States should take an “ecosystem” approach and implement controls based on technical parameters of how advanced particular technologies are, limiting U.S. investments into any part of the advanced technology ecosystem. While this is inherently a broader approach, it is also a necessary one in recognition of the difficulty in separating the potential for civilian and military end uses, particularly in emerging technology areas.

Investments in technologies that are subject to high levels of export controls represent a relatively more straight forward case for policymakers. The United States maintains an arms embargo for China, which includes items on the U.S. Munitions List, items in a series 600 entry under the Export Administration Regulations (EAR), and space and military items in a series 9x515 entry under the EAR. It also maintains export controls on a wide range of dual-use technologies (i.e., those technologies that have both civilian and

military applications), implemented by the Department of Commerce and listed on the Commerce Control List. Of these, multiple dual-use technologies are subject to strict (i.e., presumption or policy of denial) licensing policies for exports to China, including for national security or regional security reasons. Leveraging these lists to scope the outbound investment program can enhance coherence across policy instruments. Additionally, the U.S. government has already determined that the technologies on these lists are important for U.S. national security and foreign policy interests, and outbound investment controls can be viewed as a reinforcing measure to ensure that outbound investment does not erode the efficacy of the export control system. A key decision for Congress will be how closely to align outbound investment with the export control system, and whether it should proceed with a narrow set of technologies from these lists for an initial phase of any outbound investment program.

Emerging technologies present a more difficult case. Often, the full applications of an emerging technology area are not known, and it is therefore difficult to impose controls on the basis of an anticipated end use or end user. At the same time, these technologies, such as AI and quantum technologies, may be central to future U.S.-China competition. Given relatively lower levels of export controls in many emerging technology areas, Congress may wish to consider whether a direct link between export controls and any future outbound investment restrictions is appropriate. Noting the need for clarity and precision in applying new outbound restrictions, should Congress determine that a bespoke list of emerging technologies is required for outbound investment control purposes, it will need to develop technical descriptions of which technologies are captured and which are not—or instruct the executive branch to do so via regulation. One guide for the types of emerging technologies to consider is the Office of Science and Technology Policy's *List of Critical and Emerging Technologies*.¹¹

V. Structure of an Outbound Investment Program

Given the complexity of the investment environment in China, the United States will need a defense-in-depth approach to adequately address the national security risks associated with certain U.S. investments in China. Each of the tools described below addresses a particular area of risk, and they should be viewed as a package that can more holistically address investment risks when used in tandem.

Enhancing transparency of U.S. investments in China

The U.S. government does not have full visibility into the entire scope of investment transactions being made by U.S. investors in China. Existing data sources are often too aggregated or incomplete, providing little information on the critical technologies involved in investment transactions. It is difficult to ascertain from existing data sources what the technical capabilities are of the Chinese business receiving the investment. These data issues are exacerbated with private deal flows, including venture capital flows, which face fewer public disclosure requirements than publicly listed companies. Recent Chinese efforts to crack down on Western due diligence firms further complicate attempts to understand the investment environment. The CSET report noted above also assessed that existing data sources are insufficient to assess the full set of risks that may arise from outbound investments, a notable finding from a research institute that specializes in bringing data science to policy debates.¹²

A mandatory notification regime can fill these gaps. A notification program would need to address both the type of investment transaction covered and the type of Chinese entity that is the recipient of the transaction. It should initially include a broad scope of investment transactions, including both “smart money” and passive investments. Such a broad scope would not be necessary in perpetuity but is beneficial upfront to ensure that the government has a robust understanding of the types of investments being made. This would need to be paired with strict confidentiality requirements (e.g., exemption from Freedom of Information Act disclosures) in order to build public confidence that the confidential information collected would appropriately be protected.

Additionally, notifications should be required for covered investments made in any Chinese entity that produces, designs, tests, manufactures, fabricates, or develops any item or items that would be controlled (or, that would require a license for export to China) under U.S. export controls if originating in the United States. Notification could also be required for any covered investments made in a Chinese firm that is listed on the Department of Commerce's Entity List.

Prohibitions of investments in high-risk technologies or sectors

While notifications can help fill important gaps in U.S. government knowledge on outbound investment transactions, the government has sufficient knowledge about certain types of investments that would unarguably present national security risks. This includes:

- **Investments in arms embargoed technologies:** The United States should prohibit U.S. investments in any Chinese firm that produces, designs, tests, manufactures, fabricates, or develops any technology that meets the technical specification of a technology that is subject to the U.S. arms embargo for China. Outbound restrictions can reinforce the arms embargo, by prohibiting U.S. investments that may support the indigenous development of these types of items in China. While one would hope that U.S. investment is not flowing to these types of technologies, it would nonetheless be a commonsense step to explicitly prohibit such investments.
- **Investments in highly controlled semiconductor and related technologies:** The U.S. government has been active in protecting U.S. leadership in advanced chips technology, in recognition of the essential enabling role that chips play across the entire spectrum of U.S. military, national security, and economic capabilities. This includes CHIPS Act investments in domestic manufacturing capacity, paired with national security guardrail provisions to protect these investments. It also includes ambitious and unprecedented new export controls on advanced semiconductors, including the equipment and software required to produce leading edge chips, most notably through the export controls initially released on October 7, 2022. Investment restrictions that prohibit U.S. investments into Chinese entities that are producing advanced chips and related equipment and software would complement these existing efforts, ensuring that U.S. investment does not counter the stated policy objective of keeping the United States “as far ahead as possible” in this critical technology area.¹³
- **Investments in frontier AI systems:** Frontier AI systems (often defined as general-purpose systems at the frontier of AI research and development) are showing increasing capabilities to mimic human cognitive abilities and learn new skills through ingesting and analyzing massive amounts of data. Though these systems retain many rough edges, there are already indications of national security harms that could arise from misuse, including enabling cyberattacks, spreading disinformation, conducting weapons testing, or developing novel toxins.¹⁴ Many experts are concerned that these same capabilities could lead to catastrophic outcomes, either via accident or deliberate misuse.¹⁵ While an overall framework for governing frontier AI systems is still being debated, there is growing consensus on the need to set certain control parameters based on the computing power of the AI system. For example, the *Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence* released in 2023 includes technical parameters based on computing power for both general purpose AI systems as well as certain narrow (i.e., application specific) AI systems.¹⁶ Investment restrictions based on the computing power of the AI systems being developed can be an important element of the evolving AI governance regime. Additional analysis on considerations for setting technical controls based on computing power can be found in public comments submitted by CNAS and other researchers on the administration's outbound investment ANPRM.¹⁷

In these areas, the government has clear knowledge that U.S. investments would be contrary to U.S. national security interests. Prohibitions can act as a bright-line rule that provides clarity to the private sector and enables compliance, while minimizing the administrative burden of implementing the program. These types of prohibitions are intentionally designed to not require transaction-by-transaction screening (i.e., a “reverse CFIUS”), which would be a cumbersome and unnecessary bureaucratic process. Instead, a prohibition structure could operate in a manner more similar to how U.S. sanctions programs are administered, with the government setting clear bright line rules and then focusing government resources on providing guidance and enforcing those rules rather than adjudicating individual investment transactions.

Over time, additional prohibitions could be added to the above recommendations. Key sectors for consideration should include quantum information technologies (identified in the administration’s executive order) and hypersonics and high-performance computing (identified in the McCaul-Meeks legislative proposal). Aerospace may also be a candidate, given U.S. and European duopoly power in this sector. Clean energy technologies, including batteries, should also be considered, as U.S. investments in this sector in China raise a host of national security, energy security, and human rights concerns. Future additions could be contingent upon congressional authorization and a requirement that expansion be subject to a robust public debate and comment process that brings in a wide range of stakeholders, including workers and non-governmental organizations in addition to private sector representatives and international counterparts. Expansion should also depend on the administrative capacity to implement a larger program, as well as an assessment of whether the initial set of prohibitions is effectively meeting U.S. national and economic security objectives.

A key question for Congress will be whether to apply prohibitions on a going-forward basis only or whether such prohibitions would apply retroactively. Precedent in the CFIUS context would suggest applying new prohibitions on a going-forward basis only, as the expanded jurisdiction authorized under the Foreign Risk Review Modernization Act of 2018 (FIRRMA) applied only to transactions made after the effective date of the regulations.¹⁸ Retroactive application raises a complex set of challenges, including commercial damage to U.S. investors who were acting in compliance with U.S. law at the time the investment was made, the consideration of due process for U.S. investors, and the potential for litigation should U.S. investors dispute the U.S. government action. However, the government may wish to enhance its visibility into legacy investments, as prior investments in high-risk technology areas may present ongoing national security concerns, even if they were legal at the time of the investment. One option could be to adopt the approach to legacy investments taken by the administration’s executive order on outbound investment, which notes that the government may seek information about prior investments.¹⁹ Transparency around legacy investments can inform the design of outbound investment restrictions moving forward.

Expansion of the non-SDN CMIC program

The U.S. government should establish authorities to prohibit U.S. investments in particular Chinese entities, as a complement to sector-based notification and prohibition requirements. This allows for stronger action with respect to specific entities that the U.S. government identifies as acting against U.S. national security or foreign policy interests. The government has entity-based investment restrictions under the non-SDN CMIC program. However, this authority is limited to the purchase or sale of publicly listed securities. Congress should consider expansion of this program to include all types of investment transactions, including private investment transactions. It could also expand the scope of the program to authorize the designation of Chinese companies that are supporting Chinese indigenous development of national security technologies.²⁰

Expansion of the non-SDN CMIC program would provide a well-calibrated and proportionate response to concerns over U.S. investment transactions. Policymakers have also considered the utility of full blocking sanctions (i.e., designations of entities as specially designated nationals (SDNs)). Caution is warranted when considering the use of SDN sanctions outside the context of an active conflict. SDN designations implicate

the role that the U.S. dollar plays as an international public good, given the centrality of the U.S. dollar in the global financial system. SDN designations essentially weaponize the centrality of the U.S. dollar, ejecting the targeted entity from licitly engaging in international financial transactions.²¹ This effect extends far beyond the limited set of transactions that would be involved in U.S. investment flows to China. An SDN-based approach is also highly unlikely to be matched by U.S. partners and allies, whose alignment will be critical to ensure effectiveness of any new outbound investment policies.

Recent CNAS research on the use of sanctions in a potential conflict with China found that overall U.S. economic leverage is modest, at best.²² The strongest area of U.S. advantage is in the financial sector, given China's deep integration into the U.S. dollar-dominated financial system. Should the United States prematurely use SDN sanctions, it would erode the potency of this tool in future crisis scenarios and increase the likelihood that China will intensify efforts now to build alternative financial rails that avoid the use of the U.S. dollar. Keeping China deeply integrated into the overall financial system, while addressing discrete national security risks associated with certain U.S. investments, strikes the right strategic balance and maintains important U.S. leverage over China.

An entity-based approach based on expansion of the non-SDN CMIC program would be an important component of an overall outbound investment program, but it is insufficient on its own. Entity-based programs are inherently reactive, as they require the government to identify the problematic actor and assess whether it meets the criteria for listing. Inherently, the identification and listing process will occur after the designated entity has already engaged in behaviors contrary to U.S. national security and foreign policy interests. This presents additional challenges in the start-up space, where visibility into what companies exist and what their capabilities are is sparse.²³ Further, entity-based approaches often suffer from a “whack-a-mole” effect, in which shell companies and subsidiaries can be used to evade U.S. government restrictions.²⁴ Proactive U.S. policy that seeks to prevent national security harms, rather than just react to harms that have already occurred, must account for these limitations of entity-based programs.

VI. Assessment of Executive Order 14105: Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern

The administration released *Executive Order 14105: Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern* (the EO) in August 2023, and it reportedly intends to finalize the associated rulemaking by the end of 2024. The outbound investment controls outlined in the EO align in many ways with the recommendations of this testimony. The EO sets clear bright lines for the types of investment transactions covered, prioritizing investments in a small set of technologies that present high national security risks. However, the EO could be further strengthened by:

- **Clarifying the concept of “intangible benefits:”** The EO justifies the need for outbound investment controls by noting that “U.S. investments are often more valuable than capital alone because they can also include the transfer of intangible benefits,” such as “enhanced standing and prominence, managerial assistance, access to investment and talent networks, market access, and enhanced access to additional financing.” However, the EO does not attempt to define what activities constitute “intangible benefits” and how this concept might be used in regulation to differentiate passive investments from those investments in which the U.S. investors play a more active role.
- **Limiting extraterritorial application:** The EO should limit extraterritorial application of the U.S. outbound investment controls, asserting extraterritoriality only where necessary to prevent circumvention of the rules by U.S. investors. Risks associated with non-U.S. investors are more effectively addressed by aligning policies on outbound investment controls with key international partners that are also major exporters of capital and technology.

- Clarifying safe harbor provisions: As drafted, the EO does not specify how multi-stage investments, growth transactions, or potential pivots of the invested business would be covered, or whether such transactions would be granted safe harbor from subsequent prohibition or notification requirements if the original transaction was not subject to the requirements of the EO.
- Add an entity-based prohibition: The EO applies controls only on a technology list basis. The government should add an entity-based prohibition as well, to allow the government to list specific bad actors in which there is a national security imperative to prohibit U.S. investment. This approach would mirror that of export controls, where end use, end user, and list-based controls are used to complement and reinforce each other.
- Strengthen the controls on investments in AI companies: The EO standard for prohibiting U.S. investments in Chinese AI companies is overly narrow, as it applies only to the development of software that incorporates an AI system and is intended exclusively for use in military, government intelligence, or mass-surveillance end uses. An “exclusive use” standard in the context of a technology that is inherently dual use will likely lead to a null set of prohibited investment transactions. This standard should be modified to reflect the dual-use nature of AI systems. Additionally, the government should add a technology-based control to prohibit U.S. investments in frontier AI systems, as defined by computing power thresholds.

Additional analysis of the EO and technical recommendations are available at:

<https://www.cnas.org/publications/commentary/comments-on-provisions-pertaining-to-u-s-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern>.

VII. Additional Considerations

Investment controls in the context of a U.S. economic security strategy²⁵

Investment controls will be most effectively implemented in the context of a broader economic security strategy. The United States needs, but does not have, an economic security strategy. The Department of Defense recently released a defense industrial base strategy, the Department of Commerce is reportedly set to release its own national security strategy, and the Department of the Treasury in 2021 released a sanctions strategy.²⁶ That each agency is developing and releasing its own strategies is emblematic of the larger problem: the United States does not have a holistic vision for how to utilize all of its economic tools in tandem to achieve an articulated end state in the economic and geopolitical relationship with China.²⁷

Recent CNAS research put forth one framework for developing economic security strategies, including introduction of the concepts of economic domain ends, ways, and means:

- **“Ends** specify the desired end state between the U.S. economy, its partners’ economies, and that of its adversary, and are derived from broader ... strategic objectives....
- **Ways** are the various methods of applying economic pressure ... including a range of coercive economic statecraft measures such as financial sanctions, technology export controls, and tariffs.
- **Means** are defined in terms of the United States’ relative capacity in an area of strategic economic activity.”²⁸

While this economic domain ends, ways, and means construct was developed in the context of research on sanctioning China in the event of a conflict, the broad concepts apply equally to managing the economic security relationship today. The United States must set a clear vision for what a future economic relationship with China looks like, balancing the economic need for continued ties with the security need to de-risk certain areas of economic activity. This vision should be derived from the broader national security strategy and

focus on addressing the risks to national security that can arise from economic activities.²⁹ It then needs to develop specific, measurable strategies for how it can use all tools of economic statecraft to achieve the desired end state. Statements from administration officials have planted the seeds for what a potential strategy could look like, but none yet provide a clear view on how the United States should define the economic relationship with China to address growing national security concerns.³⁰ This is a particularly important gap, as the range of sectors that are assessed to have national security implications continues to grow and now encompasses much broader swathes of ordinary commercial activity.

The potential range of policies and programs that could be used to advance U.S. economic security objectives (i.e., economic domain ways) is broad and include tools such as tariffs and trade policy, subsidies, restrictions on the import of information technology goods and services, and government procurement requirements. How these tools are used in tandem to promote U.S. technological leadership should be a core element of an economic security strategy. Importantly, the United States cannot forgo “run faster” policies that are intended to make U.S. innovators competitive in global markets, as continued growth and technology leadership necessitates access to a broad range of customers and markets outside of the U.S. domestic market.

Semiconductors can provide a useful case study in the need for more holistic strategies. The United States has taken proactive steps to maintain U.S. advantage in advanced chips, including through precedent-setting export controls on technologies China needs to make advanced chips, as well as a large push on industrial policy to support domestic chips production and research and development. So far, so good. However, the effect of these policies is to create a structural incentive for China to double down on investments in legacy chip production, and the United States is not prepared to address a surge in imports of Chinese legacy chips.³¹ Export controls would likely be ineffective, simply because China already has the technology necessary to make such chips. Tariffs, import restrictions, government procurement policies, and outbound investment controls could all play a role in addressing the import problem, though whether they can slow China’s global growth without harming U.S. economic interests remains unclear. A more deliberative process for setting economic security strategy should anticipate these sorts of unintended consequences to enable more nimble and effective U.S. response to shifting market dynamics, including those shifts that are caused by actions of the U.S. government itself.

An effective economic security strategy will require breaking down of bureaucratic siloes and a sharp focus on prioritization of issues. It will require working across all the economic agencies in the executive branch and across multiple committees of jurisdiction in Congress. As officials proceed with developing economic security strategy, they must remain laser focused on addressing the most pronounced gaps in the U.S. toolkit. In addition to continual updating of export controls and CFIUS, passing legislation to address problematic vacuums in U.S. authorities, such as those related to outbound investment, is an important part of an effective economic security strategy. A stronger vision of a U.S. trade policy that advances U.S. economic and security interests is also essential.

Alignment with international partners

Outbound investment controls, like export controls or other economic security tools, are unlikely to be effective over the long term if implemented unilaterally. Capital and expertise can flow easily across borders and non-U.S. investors can quickly step in to backfill any space left by U.S. investors in the China market. Investment controls will work best if done with allies and partners that are also critical sources of capital and expertise. Certain allies and partners have established or are moving towards developing an outbound investment screening regime, including South Korea and Taiwan.³² The European Union recently announced further progress on its own efforts towards outbound investment security programs.³³ The United States must work closely with these and other partners to align outbound investment screening mechanisms, as well as to ensure consistency between these mechanisms and existing export control and inbound investment

screening tools. Doing so will be critical for ensuring U.S. national security, as well as preventing the further fragmentation of the global trading system.

Congress can support these efforts by fully resourcing the international engagement functions of a new outbound investment program. As it did in the FIRRMA process, it can emphasize in legislation the importance of international engagement and provide specific tools, such as the ability to share otherwise protected information, that can facilitate international coordination. These efforts in FIRRMA were a success story, as the United States was able to work effectively with a broad range of international partners as they stood up or strengthened their own inbound investment screening mechanisms.

Evaluation

Outbound investment restrictions are a novel policy approach, and they may result in unintended consequences for U.S. competitiveness if not implemented and enforced correctly. In addition to front-end efforts to design a well-scoped and proportionate set of controls, Congress should also consider requiring regular evaluation of the new outbound investment program to assess whether it is meeting Congress's national and economic security objectives. Evaluation of economic security programs has a poor track record overall. Treasury has established a sanctions evaluation office, in a welcome but lonesome step as none of the other economic security programs have similar offices. As economic security tools are being used at an unprecedented scale and for a broader range of national security and foreign policy purposes, this represents a worrisome blind spot in U.S. policymaking. Congress could avoid this problem with outbound investment by establishing an evaluation function or requirement at the start of the program. Additional analysis related to strengthening U.S. economic security programs, including in strategic planning, analytic capacity, and evaluation, is included in prior testimony provided before the U.S. Senate Committee on Banking, Housing, and Urban Affairs.³⁴

VIII. Conclusion

The United States faces a new era of strategic competition with China, one that presents challenges fundamentally different than prior eras due to China's essential role in the global economy. U.S. policy must account for objectives in tension with one another, including the need to de-risk economic ties that present pronounced national security risks while ensuring the openness and stability of the global economy. A well-designed, proportionate outbound investment program can contribute to these goals, but controls are insufficient on their own. They must instead be part of a broader U.S. strategy to affirmatively promote U.S. technological and economic leadership, advance democratic and open societies, and affirm U.S. interests and values. Only by taking the holistic view of U.S. technological competitiveness can the United States win the strategic competition with China.

IX. Additional Analysis

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