Sand in the Silicon: Designing an Outbound Investment Controls Mechanism

SEPTEMBER 2022

SARAH BAUERLE DANZMAN and EMILY KILCREASE

I. Introduction

Recent congressional efforts to establish new authorities to regulate outbound investment have revived a long-simmering debate in Washington about the economic and security risks associated with US investment in China. While the major proposals for regulating outbound investments were ultimately dropped from the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act, the conversation in Washington is far from over.

The stakes for rethinking the investment relationship between the United States and China are high. China is the world's second-largest economy and...
second-largest destination for foreign investment, after the United States. US firms have $118 billion in investments there. While foreign companies are increasingly pessimistic about the geopolitical risks associated with operating in China, the majority intend to stay in the market. Yet, policymakers have begun to question whether the benefits of free capital flows outweigh concerns that certain investments run counter to US economic and national security interests.

This working paper seeks to refine the conversation around outbound investment screening by articulating the clearest policy objectives for such a new authority, as well as offering concrete proposals for how to scope and structure a balanced approach to national-security-related outbound investment controls.

To ensure that new authorities are consistent with the United States’ commitment to open markets, support the global competitiveness of US business, and can be implemented effectively, an outbound investment mechanism must align with five overarching principles and be

1. targeted at transactions that present the highest national security risk;
2. clearly defined and understandable to private-sector participants, who will be responsible for the first line of compliance;
3. non-duplicative of existing tools that address national security risks associated with global economic activities, including inward investment screening conducted by the Committee on Foreign Investment in the United States (CFIUS), export controls, list-based export sanctions programs, and the recently passed CHIPS and Science Act of 2022;
4. scoped proportionately to the administrative capacity available to effectively administer a new mechanism; and
5. designed to enable meaningful conversations with allies about adopting similar regimes.

While a range of policy objectives have been discussed during debates on outbound investment, we recommend that policymakers focus on the flows of capital and associated expertise that can support the independent development of technology that would be controlled if it originated in the United States, or emerging technology that is likely to have national security implications. As described below, we recommend a phased approach that includes progressively more rigorous restrictions as administrative capacity is developed to support the outbound investment mechanism authorities. These recommendations could be implemented by the executive branch under existing statutory authorities, although new legislation would provide a more robust foundation. In either case, the administration must conduct a thorough stakeholder-engagement and rulemaking process to ensure that new restrictions do not inadvertently lead to negative impacts on long-term US competitiveness.

At best, outward investment controls can only slow—and not stop—Chinese indigenous technology development. Continued US technological superiority will always require “running faster”; therefore, outbound controls should be seen as complementary to, rather than a substitute for, substantial support for technological innovation.

Key policy recommendations of this working paper include the following.

- Define a clear policy mandate.
  - Focus outbound investment review authorities on slowing indigenous technology capabilities in China.
  - Limit government action to those investments that present national security risks that cannot be adequately addressed under existing authorities.
- Implement a phased approach to outbound investment.
  - Phase one:
    - Mandate notifications of a broad scope of outbound investments to better inform policymakers.

---
7 Such supports should include both proactive supportive policies, such as government research and development (R&D) funding, and enabling policies, such as trade and immigration policies that keep markets open and flexible.
and create an evidence-based case for engaging with allies.

☐ Disincentivize US investors from contributing to indigenous technology development in China by expanding the non-SDN Chinese Military-Industrial Complex (CMIC) list to target entities operating in critical sectors of concern, providing forward guidance on what limited set of critical technologies will result in a CMIC listing, and strengthen Securities and Exchange Commission (SEC) disclosure rules so that US investors must be more publicly transparent about their investments in China.

☐ Establish mirror-image investment controls for investments in Chinese companies developing
technology that meets technical specifications for items under US arms embargo.

☐ Adopt a general policy of cross-listing entities placed on the Entity List and those on the expanded CMIC.

○ Phase two:

☐ Mandate investment screening for US investments in Chinese semiconductor entities, focusing on “smart money” investments made in chip design, fabrication, electronic design-automation software, and manufacturing equipment.

○ Potential additional phases:

☐ Expand sectoral coverage, as needed, based on information gathered in first two phases and only to the extent practical based on growing administrative capacity and the ability to build a consensus among allies for outbound investment screening regimes.

■ Engage diplomatically with partners and allies to foster their development and implementation of similar, complementary mechanisms.

II. Possible Policy Objectives for Outbound Investment Screening

Policymakers have debated the suitability of an outbound investment screening mechanism to address an overlapping range of policy objectives. These include preventing US capital from supporting firms implicated in China’s systemic abuse of human rights, enhancing the resiliency of critical US supply chains, and addressing concerns arising from China’s indigenous development of technologies relevant to US national security. Of these competing objectives, the concerns related to China’s indigenous technology development are those that can be most directly addressed through an outbound investment mechanism and that represent a genuine gap in existing authorities.

Human-Rights Concerns

US policymakers are rightly concerned with China’s systemic abuse of human rights and the role that US capital or technology might play in facilitating such abuses. The United States, however, has a range of existing measures that can be utilized—and in some cases strengthened—to address these concerns.

☐ Non-SDN CMIC sanctions program: The CMIC program allows the administration to prohibit the sale or purchase of publicly traded securities of designated entities operating in the surveillance-technology sector in China, as well as those operating in the defense or related-materials sectors. Use of the CMIC program for human-rights objectives could be strengthened by amending the authorizing executive order to allow the government to require divestment of securities held in designated companies and expand the scope of prohibited transactions to include all types of investments or financial support. Additionally, the administration should continue to add entities to the CMIC list for human-rights-related reasons.

While the US government could use Specially Designated Nationals (SDN) listings under Global Magnitsky sanctioning authorities, it is advisable to reserve such actions for the most egregious human-rights violations. An SDN listing is a more severe measure than a CMIC listing, as it essentially removes the target from the US-dollar-based global financial infrastructure. Overuse of financial sanctions could create further incentives for China, Russia, and others to invest in technologies that could erode the United States’ centrality and regulatory authority over global financial markets. Expanded use of CMIC listings is a more calibrated approach designed to prevent US capital flows from supporting human-rights abusers, without creating unintended consequences.


Export controls: Existing authorities under the Export Control Reform Act of 2018 (ECRA) and the Export Administration Regulations (EAR) prohibit US persons from providing “support,” including financing, to a “foreign military intelligence service.” As Rep. Tom Malinowski (NJ) has proposed, the ECRA language could be amended to expand this prohibition to include “foreign military, security, or intelligence services.” Such a change would provide the administration with the authority to regulate financing provided by US persons to a wider range of Chinese firms, including those developing surveillance tools for Chinese government security services.

In addition to these tools, which most directly correlate to the types of investment transaction flows that could be captured under an outbound investment screening mechanism, the US government has a range of other measures directed at addressing human-rights abuses, including Entity List designations to block technology exports and the Uyghur Forced Labor Prevention Act to block imports of goods made with forced labor. Using an outbound investment screening mechanism to address human-rights concerns may not provide as much added value as further strengthening and enforcement of these existing authorities.

Supply-Chain Concerns

Recent legislative efforts on outbound investment have primarily centered on supply-chain concerns, especially the National Critical Capabilities Defense Act (NCCDA) that was considered in, and ultimately dropped from, the conference proceedings that resulted in the passage of the CHIPS and Science Act of 2022. The NCCDA would establish a “critical capabilities” framework to scope outbound investment authorities to a transaction’s implication for US supply chains for items that have national security implications.

The NCCDA has been criticized for being overly broad, but even a more narrowly tailored proposal would remain problematic due to the mismatch between policy objective and policy tool. Because so much of the US supply chain is already offshore, policies addressing supply-chain security must focus on how to move operations already in China back to the United States, or onward to partners and allies. Blocking a proposed outbound investment—as envisioned under the NCCDA—would not provide the company attempting to offshore with the capability to succeed in the United States on commercially viable terms. Nor can such screening begin to address reshoring and friend-shoring. Establishing more resilient supply chains requires an affirmative industrial policy that addresses the root economic causes of offshoring of critical capabilities long before a company enters an offshoring transaction, and that makes reshoring production commercially viable. In this regard, the incentives and other “run faster” provisions of the CHIPS and Science Act of 2022 are an excellent start. Attempts to reshape supply chains must also consider how to do so without creating additional negative supply shocks. These considerations are particularly important in the current context of high inflation, which has been largely driven by supply-side shocks.
From a broader standpoint, there may also be certain cases in which it is advantageous for US companies to have diversified supply chains—including in potential countries of concern—when those supply chains are predominantly focused on serving the country or region in which they are located, rather than for export to the United States. Indeed, prohibiting US companies from localizing certain types of supply chains in the country they are attempting to serve could put them at a significant disadvantage to competitors seeking to sell into the same market. 83 percent of U.S. firms that have invested in China have done so to serve the local market, according to the most recent survey from the U.S.-China Business Council.

**Indigenous Technology-Development Concerns**

Outbound investment that supports China’s indigenous technology development is the economic activity that presents the highest level of unaddressed national security risk. Veterans of this issue will recognize that indigenous technology development—specifically, flows of technology that could enable indigenous technology development—was at the heart of the concerns that led to the 2018 reforms of the inbound investment screening and export-control authorities, through the Foreign Investment Risk Review Modernization Act (FIRRMA) and the ECRA, respectively. During those congressional debates, lawmakers raised concerns about certain US investments, namely the establishment of joint ventures in China that could lead to the transfer of sensitive US technology. Since the concern centered on the transfer of technology, Congress struck a compromise to expand export-control authorities to reach these types of transactions, including through the establishment of new review requirements and authorities related to to-be-defined “emerging” and “foundational” technologies.

The debate today represents an expansion of the 2018 deliberations. This is an overdue recognition that investment supporting the development of technology in China can be equally harmful to US national security interests as the transfer of national security-relevant technologies. Export controls can regulate specific transfers of technology, but are not well suited to capture the full range of operational activities that relate to development of indigenous capacity and that may flow along with an investment. For example, running a successful semiconductor-fabrication plant that can produce quality chips at scale requires extensive management expertise and capital contribution. Export controls cannot constrain all of these factors, yet these are the exact types of contributions that would naturally flow into China’s domestic sector by virtue of a US investment.

Additionally, China’s indigenous growth in industrial capacity in lower-level areas of technology may present concerns if such growth crowds out more secure sources of supply, including those from US allies. This type of supply-chain concern is distinct from the broad scope of supply-chain transactions implicated in the NCCDA, which inherently involve the transfer of some capacity from the United States to China. In those instances, the US market must become more attractive to retain that capacity, including through proactive government support. In contrast, supply-chain concerns linked to China’s indigenous development may occur outside of the context of an offshoring transaction. In this context, outbound investment controls can slow the flows of capital and managerial expertise contributing to the growth of China’s industrial capacity in lower-level technologies, even if the underlying technology is already widely available on the global market and, thus, not suitable for controlling via export controls.

III. Designing an Outbound Investment Mechanism

Keeping in mind the five overarching principles outlined in the introduction, policymakers should focus on preventing the flows of capital and associated investment-related benefits such as managerial expertise that can support the indigenous development of technology that would be controlled if it originated in the United States, or that is an emerging technology with relevance to national security. We recommend a phased approach that includes progressively more rigorous restrictions as administrative capacity is developed to support the outbound investment mechanism authorities. Each of these options could be implemented by the executive branch under International Emergency Economic Powers Act (IEEPA) authorities, though a more solid basis would be to implement the new authorities via legislation.

Phase One: Building the Plane

The recommendations in phase one focus on building the government’s knowledge base and institutional capacity, while starting to implement a narrow set of restrictions in high-risk areas that can be subjected to clear black-and-white rules without necessitating a case-by-case review of particular transactions. While not discounting the need for adept implementation of such restrictions, these recommendations are intended to facilitate easier administration in the first phase of a new outbound investment program, allowing the government time to ramp up capacity to undertake more complex assessments in future phases.

Regulatory clarity (and forbearance) will also reduce the business community’s concern that overly complex regulations could severely constrain the business environment, undermining economic growth and US firms’ global competitiveness. Such uncertainty around supply chains could reduce companies’ ability to maintain and expand their operations, which could add to mounting inflationary pressures and negatively affect US labor markets. An initial focus on data gathering and taking action to address obvious, inarguable areas of risk will also best position the US government to make the case to allies about the need to establish similar authorities. With these goals in mind, we recommend the following steps during an initial phase of a new outbound investment mechanism.

1) Mandatory notifications of certain US investments in China

Mandatory notifications of certain US investments in China will provide necessary visibility into the types of transactions that may present national security risks. Specific and reliable information about the size, scope, and type of investments in China and other countries of concern remains hard to obtain. Notification requirements can inform the proper scope of an outbound investment mechanism, while also providing critically needed information to support diplomatic outreach to convince skeptical allies of the need for such tools.

The first phase of notifications is intended to be informative only; it would not independently provide the government with authority to act with respect to a notified transaction.
If the government was notified of a particularly problematic transaction, and it saw a national security imperative to block or mitigate that transaction, it could draw on IEEPA or other existing authorities on an ad hoc basis.

The scope of notifications must address both the type of investment transaction and the type of Chinese entity that is the recipient of the investment.

- **Investment transactions covered:** Notifications should be required for any transaction that involves the acquisition by a US person, including any entity owned or controlled by a US person, of an equity interest in a Chinese entity. This necessarily covers both “smart money” (i.e., investments that convey an additional benefit beyond mere capital) and purely passive investment. Such a broad scope may not be necessary in perpetuity, but is critical upfront to ensure that the government has a robust understanding of the types of investment being made. A broad notification requirement must be paired with strict rules on how the government will protect and use the information gathered, including—at a minimum—excluding such information from Freedom of Information Act (FOIA) requests and prohibiting the public release of disaggregated data that would reveal confidential business information.

- **Chinese entities covered:** 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 under US export controls if originating in the United States. In other words, if a Chinese firm makes technology that meets the technical specifications for any item or items listed on the Commerce Control List (CCL) or other export-control list, then any US investment in that firm would be subject to the mandatory-notification requirement. Notifications should also be required for US investments in any Chinese firm listed on the Department of Commerce’s Entity List.

  Additionally, noting the ongoing debate about whether existing export-control lists can adequately capture emerging and foundational technologies, notifications should also be required for any technology listed on the White House’s Critical and Emerging Technologies List. This will ensure visibility into those transactions involving technologies that may be of national security relevance that have not yet been—or may not be suited to be—listed on export control lists. Further guidance on the types of technologies covered should be issued, as the existing categories are likely too broad and generic to provide specific enough guidance for the private sector, even in the context of a notification-only program.

To be clear, these notification requirements will force companies to conduct additional diligence on the Chinese firms in which they invest, including a technical analysis of the types of technologies of the firm. This is a feature, not a bug. Heightened awareness of whether Chinese firms are making national security-related technology is an important step toward a more responsible investment posture for US firms.

2) **Prohibition on US investments in any Chinese firm that produces, designs, tests, manufactures, fabricates, or develops any technology that meets the technical specifications of technology that is subject to a US arms embargo with China**

Under existing export controls, US firms are prohibited from exporting to China any technology that is subject to an arms embargo—namely, items on the US Munitions List (USML), in a series 600 entry under the EAR, or space or military items in a series 9x515 entry under the EAR. A commonsense step is to establish an investment control that mirrors these existing export prohibitions. That is, if a US person could not export a commodity, software, or technology to China (or another arms-embargoed destination), then they should not be allowed to invest in the indigenous development or production of the same type of item in the same country, even if the person does not transfer any controlled know-how as part of the effort. This would mean that US investments of any kind, including passive investments, in Chinese firms that make such technology should be subject to a flat prohibition with few, if any, exceptions.

Implementing a mirror-image investment control to existing arms embargoes could be accomplished with relatively minor changes to the International Traffic in Arms Regulations (ITAR), which governs trade in defense articles, and the EAR, which governs dual-use items. The ITAR already prohibits

---

the provision of defense services to any arms-embargoed country, or any national thereof. The State Department could expand the scope of its “defense services” controls to include investments. The EAR already prohibits US persons from providing services—including financing—related to weapons of mass destruction or military-intelligence activities. The Commerce Department could expand the prohibitions on US persons’ activities to cover the provision of services—including financing—related to the development or production of arms embargoed items on the EAR. The Commerce Department would likely also need to consider expanding the definition of US persons to ensure that it captures foreign subsidiaries of US companies, to avoid evasion attempts.

3) Expansion of the Non-SDN CMIC list to target entities operating in sectors of concern, coupled with enhanced disclosure rules

The scope of the non-SDN CMIC sanctions program should be expanded to allow the US government to prohibit US investments in entities of concern that may be critical to China's indigenous technology development in key sectors. The goal of such a policy would be to disincentivize early-stage investment in Chinese entities involved in the development of technology with potential future national security implications, by substantially raising the risks associated with an investor's future ability to exit the investment.

A robust process of listing entities, paired with forward guidance to the private sector about the types of investments that may present concerns, can address certain difficulties associated with attempting to capture early-stage investments under a broader investment screening process applied on a transaction-by-transaction basis. Early-stage investments often do not have enough of a track record or clear use case necessary to justify a government prohibition under an investment screening regime without requiring the government to engage in highly speculative risk assessments. Additionally, government recourse in early-stage investments may be limited, as mandating divestments by US investors is likely to lead to heavy US investor losses, which may be counterproductive to longer-term competitiveness objectives. From a policy-design perspective, it is preferable to shape investor incentives to reduce interest in investing in potentially problematic businesses in the first place. An expanded CMIC list with enhanced disclosure requirements would reshape investor expectations about the long-term financial payout to, and reputational risks associated with, such early-stage investments, while providing the government with an administratively feasible way to begin expanding restrictions on US investments related to indigenous technology development.

To craft an effective entity-based process, the CMIC program should be expanded to authorize the designation of Chinese entities beyond the current scope, which limits listings to entities involved in the defense-material or surveillance-technology sectors, to instead include any Chinese entity operating in sectors important to US national security, as defined through regulation. Covered sectors should include a defined subset of critical and emerging technology subfields listed on the Critical and Emerging Technologies List (CETL). To avoid an overly expansive list—and to ensure that more assertive use of the CMIC program focuses squarely on the most important national-security-relevant technologies—the government will need to narrow the definition of targeted technologies further than the current CETL. For instance, the CETL includes the following artificial-intelligence (AI) subfields: machine learning; deep learning; reinforcement learning; sensory perception and recognition; next-generation AI; planning, reasoning, and decision-making; safe and/or secure AI. These categories are too broad to provide clear guidance to the private sector about which subfields within AI might be of most national security concern. Regulators should focus on chokepoint technologies on which other technological breakthroughs rely.

Additionally, as noted above, the scope of the CMIC prohibitions should expand beyond the current limitations to the purchase or sale of publicly traded securities. All transactions that involve the acquisition, sale, or holding of an equity interest should be included as covered transactions. This includes various types of transactions that have been raised in prior policy debates as problematic, including joint ventures and venture capital.

19 “Export Administration Regulations.”
20 Ibid.
To further increase the reputational costs of investing in sensitive sectors in China, the SEC should require general and limited partners to publicly disclose their private and early-stage investments. This may be done by revisiting the SEC’s exempt reporting advisors (ERAs) status, and perhaps only requiring enhanced disclosure for investments with a nexus in China, in countries of concern, or in commonly used tax havens.

4) **Policy of cross-listing between the Entity List and the expanded Non-SDN CMIC list**

Firms listed on the Department of Commerce’s Entity List are generally barred from receiving US-origin commodities, software, or technology, and some types of foreign-origin items subject to US jurisdiction. An Entity List designation, however, does not apply to capital flows. There is, for example, no legal prohibition on investment in Huawei, despite concerted US government efforts to hamstring Huawei’s commercial viability, including through an Entity List designation and the first use of the novel foreign direct-product rules. The administration should adopt a general policy of cross-listing entities placed on the Entity List and those on the expanded CMIC list outlined above, so long as the underlying facts and risk assessment support a listing under each legal authority.

5) **Engage in diplomatic outreach**

Outbound investment controls will fail to meaningfully slow Chinese indigenous technology development if implemented unilaterally, as investments from multinational entities could easily be routed through foreign jurisdictions in a manner that would be difficult to detect or prevent. While the United States could likely craft a mechanism with extraterritorial reach, doing so would needlessly undercut relations with key allies at a moment when the United States needs to work with allies to develop joint strategies for countering China across the economic, technological, and political domains.

Key allies in Asia either have a limited outbound process already (e.g., South Korea and Taiwan) or are willing to engage in conversations with the United States (e.g., Japan). Europe will be a tougher sell, as views on China as a systemic rival are not consistently held across the various European capitals. A core group of European, Asian, and Five Eyes partners will be critical to ensuring that outbound investment controls bite, and extensive diplomatic engagement will be required to make the case for these economies to establish such controls in partnership with the United States. Crucially, the information gathered from the notification regime proposed above would provide the basis for a fact-based discussion about the national security implications of outbound investment for US allies and partners. The United States can look to the successes of similar efforts on inbound investment screening, where deliberate, evidence-based diplomacy and technical assistance led to a proliferation of inbound investment screening regimes in allied nations.

**Phase Two: Implementing More Complex Screening Requirements**

We recommend that phase one last for twelve to eighteen months. The lessons learned from the initial phase of implementation, as well as the data gathered from the mandatory notifications, should inform the expansion of a more complex set of outbound investment restrictions beyond the black-and-white rules set forth in phase one. Phase two is additive to phase one, and we recommend that all measures started in phase one continue, with necessary amendments based on lessons learned.

1) **Mandate screening for all US investments in Chinese semiconductor firms and establish authority to block or mitigate such investments.**

The United States should screen all investments in China’s semiconductor sector, and establish the authority to prohibit or require mitigation terms for those investments that present national security risks. Investments in China’s chip sector are a priority to address in the second phase of the outbound investment program, given the importance of chips to US national security and economic interests and China’s aggressive efforts to climb the semiconductor value chain. Prioritizing chips will also have benefits for other technology areas, such as artificial intelligence or quantum computing, which rely on advanced chips as key enabling technology.

The chip-investment screening authority is intended to complement the expanded CMIC program recommended for phase one. The expanded CMIC program is intended to shrink the universe of potentially problematic transactions through changing the incentive structure for investors. A sectoral screening mechanism would serve as a necessary backstop to provide US government authority to regulate transactions that proceed despite the changed incentive structure and that present national security concerns.

Designing an effective screening mechanism requires several elements.
**Covered transactions:** Key scoping questions include whether to include all types of investments and all types of semiconductor technologies. In this phase, we recommend scoping the types of covered investment to include only “smart money” transactions. For simplicity and ease of administration, this can be defined through reference to existing definitions of “covered transactions” in the Committee on Foreign Investment in the United States (CFIUS) process, including both “covered control transactions” and “covered investments.” Covered control transactions require that the investor gain the ability to direct, decide, or determine important matters of the invested business. Covered investments involve the acquisition of an equity interest along with the right to a board seat, involvement in substantive decision-making, or access to material non-public technical information. These definitions are intended to cover a range of investment types that are not purely passive. Information gathered in phase one should inform whether this approach should be modified in the outbound investment context.

This phase should mandate screening for all covered investments across the semiconductor value chain, including design and fabrication, as well as those areas in which the United States and allies currently enjoy global dominance—namely, electronic design-automation software and semiconductor manufacturing equipment. Transactions involving lower-level technology may ultimately be cleared to proceed, but sector-wide screening provides needed visibility and legal authority for the government to address risks that may arise in this critical sector.

The new authorities should apply on a prospective basis, and should not cover transactions entered into before the effective date of the new authorities, or the effective date of any necessary follow-on regulations.

**Review outcomes, criteria, and policy:** The criteria for government action—whether mitigation or a recommendation to the president to block or unwind a transaction—should closely follow CFIUS. That is, the committee should act only after it undertakes a fact-based risk assessment that finds a credible risk to national security arising from the transaction under review. National security risk should be assessed accounting for a range of competing factors, including:

- contribution of the US investment to China’s indigenous technology development;
- relevance of the technology to US national security interests;
- availability of alternative foreign sources of capital for the proposed investment;
- capability of US investors to offshore key capabilities to circumvent US outbound investment controls; and
- willingness of key allies to implement similar controls.

After conducting its review based on these factors, the administration may clear, clear with mitigation terms, or prohibit a covered outbound investment transaction. The administration should publish guidance on how it will assess these national security risk factors. It should also establish a review policy—akin to export-control licensing policies, such as a “presumption of denial”—for certain sets of transactions that are likely to be prohibited, in order to provide bright-line tests, wherever possible, to the private sector. We recommend a “presumption of denial” policy for covered investments involving any item that would meet the technical specifications for a technology listed on the Commerce Control List for national security reasons.

**Safe harbor:** In order for the screening process to provide predictability and certainty to the private sector, the government should adopt the CFIUS “safe harbor” precedent, in which the US government provides the transacting parties safe harbor from further government action once the government concludes its review.

**Interaction with other authorities:** An outbound investment screening mechanism should be considered a measure of last resort, used only when other authorities of US law are inadequate to address identified national security risks.

---


23 The CFIUS limitation that applies covered investment jurisdiction to only a defined set of US businesses should not be retained in this context.

24 Electronic Code of Federal Regulations, Title 31, 800.701 (2020), https://www.ecfr.gov/current/title-31/subtitle-B/chapter-VIII/part-800/subpart-G/section-800.701. The government may also wish to consider applying a standard similar to the incremental-acquisition rule in CFIUS, in which parties to a covered control transaction receive safe harbor for any further transactions up to 100-percent ownership of the acquired entity (See 31 CFR 800.305). The incremental acquisition rule has been used in CFIUS to avoid situations where minor increases in ownership can trigger a new CFIUS review, even if such changes do not alter the fundamental risk profile of the investment.
arising from a transaction under review. This policy of deference mirrors a long-standing CFIUS policy, under which CFIUS is only authorized to act when other authorities are inadequate to resolve national security concerns arising from a covered transaction.²⁵ Existing authorities that are most likely to be relevant in this context include export controls and the newly enacted “guardrail” provisions in the CHIPS and Science Act.

As we argue above, outbound investment screening is necessary to cover the transfer of capital and relevant expertise that is not suitable for control under export controls. Nonetheless, an outbound investment transaction may include certain elements of technology transfer that can be addressed via export controls. In these cases, US officials should look to export controls first to address technology-transfer concerns, utilizing actions under an outbound investment mechanism only to address those aspects of a transaction that present national security concerns and that are not reachable through export controls.

Similarly, transactions involving US companies subject to restrictions on their China investments due to provisions of the CHIPS and Science Act should not be subject to duplicative requirements under this outbound investment screening process. The CHIPS and Science Act requires covered entities (i.e., entities that are receiving incentives under the CHIPS and Science Act) to enter into an agreement with the secretary of commerce prohibiting the covered entity from engaging in any significant transaction, as defined in the agreement, involving the material expansion of semiconductor manufacturing capacity in the People’s Republic of China or any other foreign country of concern. Production of “legacy semiconductors,” generally defined as technology involving twenty-eight-nanometer generation chips or older, is exempted from this prohibition.

While the CHIPS and Science Act guardrail provisions are important to ensure the responsible expenditure of federal funds, they lack a strong enforcement mechanism. If a covered entity violates its agreement with the secretary of commerce, it may be forced to return the full amount of the incentive. But the covered entity could still proceed with a problematic investment in China, if it is willing to take that financial (and political) hit. Therefore, the outbound investment screening mechanism should retain the legal right to review transactions involving covered entities to provide coverage in this type of worst-case scenario. As a general matter, however, when a covered entity is operating in good faith and in accordance with its agreement with the secretary of commerce, the outbound investment screening mechanism should act with deference to that existing agreement, and only seek to take action in exceptional circumstances.

**Future Phases: Expanding Sectoral Scope**

Phases beyond the proposed two outlined here are likely of interest to policymakers. Ultimately, a screening mechanism could be expanded to include additional sectors. Future expansion should be based on data gathered through the notification requirements and lessons learned from the first two phases. Definitional issues may become more difficult as sectors are expanded from clear-cut categories, such as semiconductors, which can be clearly defined through Harmonized Traffic Schedule (HTS) or North American Industry Classification System (NAICS) codes, to include more amorphous categories, such as artificial intelligence, that do not fall neatly into existing classification schemes.

Future expansion must also be weighed against the administrative capacity of the government to effectively implement a larger review mechanism, as well as the willingness of allied countries to implement similar regimes. An outbound investment mechanism implemented unilaterally is unlikely to slow China’s indigenous technology development if investors from other advanced nations can easily backfill in the absence of US investors. Overly expansive regulations could ultimately harm national security by eroding the United States’ locational attractiveness for businesses and entrepreneurs developing and commercializing frontier technologies.

The success of the outbound investment mechanism should be measured not by the number of transactions reviewed and blocked, but by the extent to which businesses and investors with a U.S. presence shift their critical technology activities away from China. Harder to measure but of equal importance, a successful mechanism will support rather than detract from the vibrancy of the U.S. advanced technology sector. For instance, a successful review regime will be one that does not lead to a decline in technology business formation in the United States.

---

IV. Administrative Structure

A new outbound investment mechanism should be housed within the Department of the Treasury. One option to explore is to establish a new office within the purview of the assistant secretary for investment security, who oversees the CFIUS process. We urge policymakers to keep an outbound process separate from the CFIUS process, given the existing strain on the CFIUS process and the unique characteristics of investing in the Chinese market. However, the institutional structures and knowledge resident in the CFIUS process, as well as the sanctions programs implemented by the Treasury Department, make Treasury a logical home for a new outbound investment authority. The Department of Commerce would be a workable alternative, given the emphasis on indigenous technology development and the linkages to the role of export controls. Under either scenario, an interagency process, including the intelligence community and the range of agencies represented in the CFIUS process, will be required to ensure that the outbound process benefits from the appropriate range of expertise and equities across the executive branch.

We urge the US government to resist the temptation to expand the membership of an outbound review committee beyond that of CFIUS. A key strength of the CFIUS process is its norm of operating by consensus. The larger the committee, the more challenging it is to retain a consensus-driven process. Decision-making by consensus ensures that decisions truly reflect a whole-of-government approach, rather than devolve into shifting factional battles. As CFIUS operates as a tool of last resort, an outbound review process should be fact based in its analysis and proportionate in its actions. A consensus-oriented process is best poised to prevent committee overreach.

V. Conclusion

The United States and allies have a window of opportunity to solidify their leadership in critical sectors, such as semiconductors. Outbound investment screening mechanisms can play a role in slowing China’s growth in these sectors—but only if designed smartly, implemented in tandem with allies, and laser focused on transactions of highest national security risk. Defensive policies, such as outbound investment screening, must always be complimented by proactive support of critical industries and multilateral engagement in a holistic approach to promoting US and allied technological leadership.

Implementing outbound investment controls is a dramatic shift in US investment policy and should not be taken lightly. The United States has long been an advocate for open markets and capital flows. Even in an era of strategic competition, the economic impetus for this long-standing policy holds true, and must be given due consideration as the US government simultaneously seeks to act on the genuine national security risks that may arise from a limited number of US investments overseas.

The United States must act quickly and judiciously to address these risks. It is our view that the phased approach laid out in this paper is the most expedient manner to arrive at a durable and effective outbound investment regime, taking into account the very real need to build capacity to implement such a new set of authorities, and to engage in the hard diplomatic work to build a consensus with allies on the need for such tools. One really should build the plane before flying it.
About the Authors

Emily Kilcrease is senior fellow and director of the Energy, Economics, and Security Program at the Center for a New American Security (CNAS). Her research focuses on the US-China economic relationship; alignment of national security objectives and economic policy; and the use of coercive economic statecraft. Previously, she served as the deputy assistant US trade representative for investment and held positions related to economics and national security at the National Security Council and Department of Commerce. She spent a decade working on the Committee on Foreign Investment in the United States (CFIUS).

Sarah Bauerle Danzman, Ph.D., is a non-resident senior fellow at the Atlantic Council and an associate professor of international studies at Indiana University Bloomington. In 2019-2020, she was Council on Foreign Relations International Affairs Fellow, working in the U.S. Department of State on CFIUS matters. She researches how domestic and multinational firms influence and adapt to investment regulation, the nexus of national security and investment, and how rules governing capital shape global networks of ownership and production. She is the author of *Merging Interests: When Domestic Firms Shape FDI Policy* (Cambridge University Press, 2019).

Atlantic Council intellectual independence policy: The Atlantic Council and its staff, fellows, and directors generate their own ideas and programing, consistent with the Council’s mission, their related body of work, and the independent records of the participating team members. The Council as an organization does not adopt or advocate positions on particular matters. The Council’s publications always represent the views of the author(s) rather than those of the institution.

The Atlantic Council maintains strict intellectual independence for all of its projects and publications. Council staff, fellows, and directors and those who the Council engages to work on specific projects, are responsible for generating and communicating intellectual content resulting from Council projects. The Council requires all donors to agree to the Council maintaining independent control of the content and conclusions of any products resulting from sponsored projects. The Council also discloses sources of financial support in its annual reports to ensure transparency.

CNAS intellectual independence policy: As a research and policy institution committed to the highest standards of organizational, intellectual, and personal integrity, CNAS maintains strict intellectual independence and sole editorial direction and control over its ideas, projects, publications, events, and other research activities. CNAS does not take institutional positions on policy issues, and the content of CNAS publications reflects the views of their authors alone. In keeping with its mission and values, CNAS does not engage in lobbying activity, and complies fully with all applicable federal, state, and local laws. CNAS will not engage in any representational activities or advocacy on behalf of any entities or interests and, to the extent that the center accepts funding from non-US sources, its activities will be limited to bona fide scholastic, academic, and research-related activities, consistent with applicable federal law. The center publicly acknowledges on its website annually all donors who contribute.

Acknowledgements:

The authors would like to thank Charles Lichfield, Josh Lipsky, Julia Friedlander, Maia Nikoladze, and Emily Jin for their support throughout this project. The authors are grateful to all those who participated in the working-group conversations that informed the drafting of this brief. Your insights helped shape the recommendations and our attempt to meet both national security and open-investment policy objectives. The views expressed in this report are those of the authors alone, and do not represent those of the working-group participants.
CHAIRMAN
*John F.W. Rogers

EXECUTIVE CHAIRMAN EMERITUS
*James L. Jones

PRESIDENT AND CEO
*Frederick Kempe

EXECUTIVE VICE CHAIRS
*Adrienne Arsht
*Stephen J. Hadley

VICE CHAIRS
*Robert J. Abernethy
*C. Boyden Gray
*Alexander V. Mirtchev

TREASURER
*George Lund

DIRECTORS
Stéphane Abrial
Todd Achilles
Timothy D. Adams
*Michael Andersson
David D. Aufhauser
Barbara Barrett
Colleen Bell
Stephen Biegun
Linden P. Blue
Adam Boehler
John Bonsell
Philip M. Breedlove
Myron Brilliant
*Esther Brimmer
Richard B. Burr
*Teresa Carlson
*James E. Cartwright
John E. Chapoton
Ahmed Charai
Melanie Chen
Michael Chertoff
*George Chopivsky
Wesley K. Clark
*Helima Croft
*Ankit N. Desai
Dario Deste
*Paula J. Dobriansky
Joseph F. Dunford, Jr.

Richard Edelman
Thomas J. Egan, Jr.
Stuart E. Eizenstat
Mark T. Esper
*Michael Fisch
*Alan H. Fleischmann
Jendayi E. Frazer
Meg Gentle
Thomas H. Glocer
John B. Goodman
*Sherri W. Goodman
Murathan Gündüz
Frank Haun
Michael V. Hayden
Tim Holt
*Karl V. Hopkins
Ian Ihnatowycz
Mark Isakowitz
Wolfgang F. Ischinger
Deborah Lee James
*Joia M. Johnson
*Maria Pica Karp
Andre Kelleners
Brian L. Kelly
Henry A. Kissinger
John E. Klein
*C. Jeffrey Knittel
Franklin D. Kramer
Laura Lane
Yann Le Pallec
Jan M. Lodal
Douglas Lute
Jane Holl Lute
William J. Lynn
Mark Machin
Mian M. Mansha
Marco Margheri
Michael Margolis
Chris Marlin
William Marron
Christian Marrone
Gerardo Mato
Timothy McBrine
Erin McGrain
John M. McHugh
Eric D.K. Melby
*Judith A. Miller
Dariusz Mioduski
Michael J. Morell
*Richard Morningstar
Georgette Mosbacher
Dambisa F. Moyo
Virginia A. Mulberger
Mary Claire Murphy
Edward J. Newberry
Franco Nuschese
Joseph S. Nye
Ahmet M. Ören
Sally A. Painter
Ana I. Palacio
*Kostas Pantazopoulos
Alan Pellegrini
David H. Petraeus
*Lisa Pollina
Daniel B. Poneman
*Dina H. Powell McCormick
Michael Punke
Ashraf Qazi
Thomas J. Ridge
Gary Rieschel
Lawrence Di Rita
Michael J. Rogers
Charles O. Rossotti
Harry Sachinis
C. Michael Scarparotti
Ivan A. Schlagert
Rajiv Shah
Gregg Sherrill
Ali Jehangir Siddiqui
Kris Singh
Walter Slocombe
Christopher Smith
Clifford M. Sobel
James G. Stavridis
Michael S. Steele
Richard J.A. Steele
Mary Streett
Gil Tenzer
*Frances M. Townsend
Clyde C. Tuggle
Melanne Verveer
Charles F. Wald
Michael F. Walsh
Ronald Weiser
Maciej Witucki
Neal S. Wolin
*Jenny Wood
Guang Yang
Mary C. Yates
Dov S. Zakheim

HONORARY DIRECTORS
James A. Baker, III
Ashton B. Carter
Robert M. Gates
James N. Mattis
Michael G. Mullen
Leon E. Panetta
William J. Perry
Condoleezza Rice
Horst Teltschik

*Executive Committee

Members List as of May 2, 2022