The Biden Administration's Executive Order on Outbound Investment in National Security Technologies

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At a Glance

- On August 9, President Biden issued an executive order (EO) limiting or banning US investment in core high tech sectors viewed as critical to US national security.
- The EO focuses on semiconductors, quantum computing, and artificial intelligence.
- The US Treasury is tasked with implementing the new requirements. The EO is likely to become effective in the fourth quarter of 2023 or first quarter of 2024—after a 45-day public comment period—just as the US presidential race heats up.
- This regulation, which also covers Hong Kong and Macao, marks the first limit that the US has placed on outbound investment.

Issue

The long anticipated executive order limiting or banning US investment in core high tech sectors is the first limitation that the US has placed on outbound investment. Previously, restrictions were limited to inbound investment into US firms through the CFIUS process. The US Treasury is tasked with implementing the new requirements, in consultation with other agencies, like the Commerce Department. Meanwhile, companies and associations have a 45-day public comment period to respond to the scope of the EO as well as the process.

The EO is likely to become effective in the fourth quarter of 2023 or first quarter of 2024—just as the US presidential race heats up and as being "tough on China" is galvanized as a campaign theme for both parties. While Congress pushed for a broader scope, the Biden administration is balancing the recent stabilization of the China relationship with the threat of China's growing tech capabilities.

The US government has been at pains to explain the "small yard, high fences" approach, including during Treasury Secretary Janet Yellen's most recent visit to China, but the Chinese government has been skeptical. In response, China has said it will retaliate, likely focusing on China's own outbound investment as well as on potentially limiting the sectors where foreign investment will be allowed in China.

Key takeaways from this action

- **The US Treasury will be responsible for implementation of the EO.** As with the CFIUS process, Treasury will take the lead on the EO. This is a positive sign for business, as Treasury understands the importance of the commercial relationship with China and can provide a more balanced perspective with the national security agencies. Word is that Treasury tried to delay release of the EO until after Presidents Biden and Xi meet—hopefully —at APEC in November.
- **This bureaucracy will continue to grow.** Bureaucratic institutions, once established, never disappear, and often continue to expand to justify their existence. So, expect to see the scope of the executive order expand over time. Also expect that the pre-notification system will change as more data is created to inform the approval process.
- **The scope will be narrowly defined initially.** The Biden administration is trying to narrowly define the areas banned—in keeping with the "small yard, high fences" approach—to avoid putting US firms at a competitive disadvantage with other countries who can—and will—continue to invest in the following technologies:
    - **Advanced semiconductors**, which are defined in line with previously issued October 7 export controls.
    - **Quantum computing**, which includes the production of certain computers and components, and the development of certain sensors and networking equipment.
    - **Artificial intelligence**, the sector that has been hardest to define, which will be limited to restricting technologies that directly impact US national security versus a broad ban on investment in *any* AI in China.
- **Exemptions are still to be defined.** These include types of passive and other investments that may pose a lower likelihood of conveying intangible benefits or intracompany transfers of funds from a US parent company to its subsidiary.
- **The inclusion of Hong Kong is notable.** Hong Kong is viewed as one of the most entrepreneurial and freest market economies in the world. This will hamper Hong Kong innovators as well.

What this means for business

At one level, firms are pleased that the EO has finally been issued. The lack of clarity in the interim has had a severe impact on US investment across a broad range of sectors, including biotech, over concerns of what sectors might appear in the executive order. The specter of this action, coupled with tough export controls and an equally tough bilateral political atmosphere, has contributed to a significant drop in private equity and venture capital investments in China in the first half of 2023—down 89% from last year for dollar-based funds that have at least half their capital invested in China. And new foreign investment in China is at its lowest in 25 years, as investors have been much more wary than before about investing in China—especially in high tech sectors.

The initial impact will be minimal, yet bureaucracy always grows. Companies have anticipated the ban on direct investment and altered course accordingly, and investment has also already tempered. More concerning, however, are the longer-term implications: *How will this new office at Treasury begin to define its mandate? How might the pre-notification system morph into an approval process as the government collects more data on transactions?*

China will likely respond with investment restrictions of their own. The government's initial response has been to label this action "economic coercion." As the regulations come into effect, China's restrictions are likely to include restrictions on foreign investment in certain sectors as well as on China's own outbound investment.

The future of investment in China's tech sector is unclear. This unprecedented transaction, while providing some clarity, also creates some uncertainty for institutions and investors. *Will investment banks be able to invest in China's tech sector?*