Testimony

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Implications of Outbound Investment Controls

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Testimony of Jason Matheny[1]
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Chairman McCaul, Ranking Member Meeks, and members of the committee: Good morning, and thank you for the opportunity to testify today. I am the president and CEO of RAND, a nonprofit and nonpartisan research organization. Before RAND, I served on the National Security Council and in the White House Office of Science and Technology Policy, as a commissioner on the National Security Commission on Artificial Intelligence, as assistant director of national intelligence, and as director of the Intelligence Advanced Research Projects Activity, which develops advanced technologies for the U.S. intelligence community. For the past 75 years, RAND researchers have conducted research in support of U.S. national security, and we currently manage four federally funded research and development centers for the federal government: one for the Department of Homeland Security and three for the Department of Defense.

RAND researchers have analyzed the strengths and weaknesses of outbound investment controls as a feature of U.S. industrial strategy.[3] That analysis is not available to the general

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[1] The opinions and conclusions expressed in this testimony are the author's alone and should not be interpreted as representing those of RAND or any of the sponsors of its research.

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[3] Bryan Frederick, Bonny Lin, Howard J. Shatz, Michael S. Chase, Christian Curriden, Mary Kate Adgie, James Dobbins, Kristen Gunness, and Soo Kim, *Extending China: U.S. Policy Options for Asymmetric Advantage*, RAND Corporation, 2021, Not available to the general public.

public, but I am happy to arrange a briefing from the research team to this committee. My testimony today is based in part on that analysis and based in part on my work on this topic for several years prior to my joining RAND.

Currently, investments by U.S. entities in foreign technology firms based in or owned by strategic competitors are essentially unlimited unless the foreign firm is sanctioned. Restricting such investments would have several costs and benefits. Among the costs of doing so are the following:

- U.S. investors often find such investments profitable. Left to their own devices, investors will attempt to make the most profitable investments. Barring them from categories of investments is likely to reduce their profits.
- In response to investment restrictions, alternative sources of capital are likely to be substituted for U.S. sources, reducing the financial impact on targeted countries.

On the other hand, restricting such investments would have several benefits:

- While funding is frequently substitutable, the intangibles that accompany funding are frequently not. A primary benefit of controls on outbound investment is a restriction on what often accompanies funding from U.S. investors: business know-how, strategic advice, business connections, and credibility that can yield additional fundraising. For some of our strategic competitors, most notably the People's Republic of China (PRC), the provision of critical management expertise is often the most valuable contribution that U.S. venture capital funds make to emerging companies. Our strategic competitors want access to this U.S. strength.
- U.S. investments could shift to U.S. firms, growing domestic strength in important industrial sectors. U.S. investments could also shift to firms in countries that are, or could be, strategic partners. These investments could improve our diplomatic relations with those countries, support their economic growth, and decrease their vulnerability to economic coercion by our competitors.

As an economist, I should offer an apology. Economists generally support free markets. But an exception is warranted when a company's activities produce *negative externalities*: effects whose costs to society are not paid by the company. Pollution is the classic example of a negative externality. To address a negative externality, some form of governmental action is usually needed, such as prevention of the activity, or a tax on the activity equal to its cost to society.

A premise of outbound investment controls is that U.S. investors are generating costs to the United States that they are not paying. As one example, consider U.S. investments in PRC high-performance computing. There are substantial security concerns about how advances in high-performance computing contribute to the PRC government's offensive cyber operations against the United States and to the design of weapon systems, such as hypersonic missiles, that threaten the United States and its allies. Both represent negative externalities of U.S. investments in PRC computing capabilities. U.S. investors do not pay back Americans for the damages caused by PRC cyber operations, and they do not pay for the consequences of PRC military modernization.

Instead, other parts of U.S. society are likely to pay these costs. Given these negative externalities, U.S. government action seems justified.

One such option is a broad investment restriction of the type described above. Another option is list-based sanctions focused on specific foreign companies that are linked to military or intelligence agencies. List-based sanctions have the disadvantage of playing "whack-a-mole" with entities whose legal names frequently change and whose relationships are intentionally obscured. Indeed, the PRC can create new companies faster than U.S. agencies can identify them. Detecting the ties between foreign companies and their governments, especially their intelligence agencies, is already an extremely challenging task. Expanding list-based sanctions would further increase the analytic burden on U.S. agencies that are already stretched thin as they attempt to track companies in countries unfriendly to the United States. Even sector-wide investment controls will need to be accompanied by additional resources for the responsible U.S. agencies, but such resources would need to be significantly greater if controls were entity-based.

The U.S. government could also consider excluding punitive actions that slow down the development of new technologies by our competitors and focus its actions exclusively on increasing investment in U.S. companies. Going faster is certainly an essential part of industrial strategy, but it can be accompanied by measures that slow down the competition. If I were in a car race, pressing down on the accelerator, I would not simultaneously syphon gas from my gas tank and give it to my competitors. Fair play does not require fueling the competition.

I thank the committee for the opportunity to testify, and I look forward to your questions.