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'Small Yard and High Fence': US National Security Restrictions Will Further Impact US-China Trade and Investment Activity in 2024

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Key Points

- The Treasury Department is expected to initiate restrictions in 2024 on U.S. investments in Chinese companies pursuing key technologies deemed to have national security implications.
- The Commerce Department's export controls on advanced semiconductors and computers, and related manufacturing equipment and technologies, are likely to be expanded in the new year.
- Commerce has new funding to step up enforcement of its information and communications technology and services (ICTS) supply chain restrictions.
- There are proposals in Congress to extend the responsibilities of CFIUS to include the review of Chinese investments in agricultural businesses and farmland.

The economic relationship between China and the U.S. remains one of the most significant in the world, and U.S. and Chinese government leaders have repeatedly signaled their intent to maintain stable trade and commercial relations.

Simultaneously, both governments have enacted laws and regulations in the interest of national security that restrict trade and investment between the two countries. U.S. National Security Advisor Jake Sullivan has used the phrase "a small yard and high fence" to describe the Biden administration's intent to allow most trade and economic relations with China to continue, outside a core area of heavily restricted products, technologies and business activities.

In 2024, we anticipate continued additions to the "fence" in the form of targeted changes to three areas of U.S. national security regulation — investment review, export controls and supply chain restrictions — and the potential expansion of both the "fence" and the "yard" in legislative initiatives in the U.S. Congress relating to China. We highlight likely developments in each area below.

Investment Review

Inbound foreign direct investment (FDI) from China to the U.S. decreased significantly in 2022 and 2023, largely as a result of a more aggressive approach to reviewing investments from China by the Committee on Foreign Investment in the United States (CFIUS). Additional U.S. legal and regulatory developments in 2024 will likely result in further meaningful changes to FDI transactions in both directions.

Outbound Investment Restrictions in Key Technologies

In 2024, we expect that the U.S. Treasury Department will issue regulations imposing new restrictions on U.S. investments in companies based in China. In rulemaking materials issued in August 2023, Treasury signaled its intent to take a targeted approach to these restrictions, with reporting or (in more narrow circumstances) prohibitions, where the Chinese companies targeted for investment are developing sensitive products in artificial intelligence, quantum computing, or semiconductors and microelectronics.

Although some have referred to these restrictions as "reverse CFIUS," we expect that the new restrictions will more closely resemble a version of targeted economic sanctions — with prohibitions and reporting obligations to be imposed on U.S. companies and U.S. persons working overseas based on the nature of the investment target — rather than a CFIUS-like case-by-case U.S. government review of specific investment transactions. (For more on this topic, see our August 10, 2023, client alert "US Moves To Narrowly Limit Investment in China.")

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Many issues must be resolved before Treasury can finalize outbound investment regulations, such as how the restrictions will apply to continuing investments in assets or joint ventures that predate the restrictions, limited partner liability and the scope of potential exceptions for trading in public securities. The bipartisan leadership of the House of Representatives' Select Committee on the Chinese Communist Party has urged Treasury to broaden some aspects of its proposed approach.

We also expect further developments on outbound investments from the European Union and the U.K. in 2024, as both have signaled an intent to impose similar restrictions.

Potential Restrictions on Investments in US Farmland

In 2023, the U.S. Congress proposed several bills that would increase restrictions on non-U.S. investments in U.S. agricultural companies and agricultural land. In particular, the Promoting Agriculture Safeguards and Security Act (PASS Act) — which the Senate added to its version of the annual National Defense Authorization Act (NDAA) — would expand CFIUS' scope to review transactions involving U.S. agriculture. It would effectively require the committee to prohibit certain investments in U.S. agricultural businesses or land by persons from China, Iran, North Korea and Russia.

The PASS Act (which could become law if it is included in the version of the NDAA enacted by the full Congress) and similar measures under consideration in Congress follow initiatives by numerous U.S. states to enact or expand CFIUS-like restrictions on foreign investment in U.S. agriculture.

Export Controls

In 2024, the U.S. will almost certainly continue to refine and potentially expand restrictions on exports of advanced semiconductors and computers, and related manufacturing equipment and technologies to China.

The U.S. Commerce Department released an initial package of export controls covering these items in October 2022 and expanded the controls in October 2023; Commerce officials have indicated that they expect to review and update these controls on an annual basis. (See our October 25, 2023, client alert "BIS Updates October 2022 Semiconductor Export Control Rules.")

We also anticipate efforts by the U.S. government to seek further coordination on these controls with international partners and allies, similar to the outreach Commerce conducted with counterparts in the Netherlands and Japan on semiconductor controls over the last two years.

Commerce has also made clear that it will consider imposing controls for the first time on the provision of cloud computing services (also known as "infrastructure as a service," or "IaaS") to China-based companies. Commerce has historically taken the position that merely providing these cloud computing services, without more, does not amount to an "export" subject to export controls. But in October 2023, it indicated that it was "concerned regarding the potential for China to use IaaS solutions to undermine the effectiveness" of the semiconductor export controls.

Commerce stated that it "continues to evaluate how it may approach this through a regulatory response." The agency will most likely focus any new cloud computing controls on IaaS that provides access to advanced computers and semiconductors.

Supply Chain Restrictions

Finally, we anticipate that the Biden administration will take steps in 2024 to add "teeth" to the information and communications technology and services (ICTS) supply chain restrictions initially set forth in a 2019 executive order.

The executive order provides the Commerce Department with expansive authorities to protect the ICTS supply chain by reviewing and prohibiting the use within the United States of telecommunications equipment, technology or services from China and other named "foreign adversary" countries upon a finding of an undue or unacceptable risk to U.S. national security.

To date, Commerce has done little publicly to enforce the ICTS restrictions, but the agency received significant additional resources in 2022 and 2023 to expand its implementation of the ICTS restrictions. We therefore expect additional guidance and related activity from Commerce in the new year.