Updated January 15, 2021

U.S.-China Investment Ties: Overview

Background

Investment is playing a growing role in U.S. commercial ties with the People's Republic of China (PRC or China). For many years, the PRC government invested much of its foreign exchange reserves in U.S. assets, particularly U.S. Treasury securities. China is the world's largest holder of foreign exchange reserves and had $3.2 trillion in reserves as of November 2020. These large reserves stem largely from China's trade surplus and investment inflows. Government actions to halt or slow the appreciation of its currency and restrict capital outflows also have boosted reserves. Since 1999, the PRC government has pushed an outward investment policy that has sought to diversify its overseas investments into hard assets by encouraging its companies—many of them state-tied firms—to invest overseas. These investments have targeted gaining access to critical raw materials and cutting-edge technology and establishing an overseas presence to expand infrastructure and create markets for Chinese goods and services.

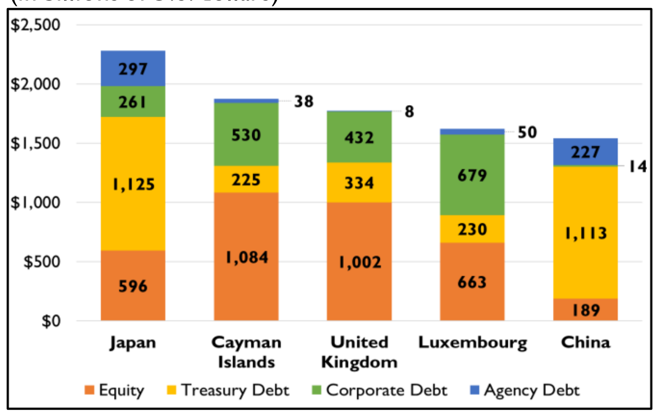
While a significant share of China's investment in the United States is in U.S. public and private securities, U.S. capital flowing into China largely has taken the form of foreign direct investment (FDI), in part due to China's restrictions on portfolio investment and investment rules that tie sales and procurement requirements or incentives to an investment or manufacturing presence. Initial U.S. investment in China focused on export-oriented manufacturing. Since the 1990s, U.S. investment has expanded into manufacturing, distribution, and services for the domestic market as well. In recent years, China has also sought to open gradually certain participation in its capital and debt markets to foreign investors.

China's Holdings of U.S. Securities

U.S. financial securities consist of securities issued by the U.S. government and private sector entities. They include Treasury securities, government agency securities, corporate securities, equities (e.g., stocks), and other debt. As of June 2019 (the most recent period for which complete data are available), China's investment in U.S. securities totaled $1.5 trillion, down $63.4 billion (4%) from June 2018 levels, making China the fifth-largest foreign holder (**Figure 1**). China's share of total foreign holdings of U.S. securities stood at 8% in 2019, down from its all-time high of 15% in 2009.

U.S. Treasury securities are the largest category of U.S. securities and one of the main vehicles through which the U.S. government finances budget deficits. As of June 2019, over 72% (or $1.11 trillion) of China's total U.S. public and private holdings were Treasury securities, which are generally considered by investors as "safe-haven" assets. PRC ownership of these securities has decreased in recent years from its peak of $1.31 trillion in 2011. In June 2019, Japan overtook China to become the largest foreign holder of Treasury securities. (Preliminary data indicates that as of October 2020, Japan and China hold $1.27 trillion and $1.05 trillion, respectively, in Treasury securities.) These figures may understate China's actual holdings because of the government's purchases of securities through offshore financial centers (e.g., Cayman Islands).

Figure 1. Foreign Holdings of U.S. Securities in 2019
(in billions of U.S. dollars)



Source: CRS with data from the U.S. Department of the Treasury.
Notes: Long and short-term U.S. securities at the end of June 2019.

Concerns about China's Holdings

Some analysts and Members of Congress have raised concerns that China's large holdings of U.S. securities give it leverage over the United States. They argue, for example, that China could seek (or threaten) to liquidate a large share of its U.S. assets or significantly cut back its purchases of new securities to influence U.S. government decision-making or signal displeasure over a policy dispute. Others contend that these holdings give China little practical leverage because such moves would likely cause the U.S. dollar to depreciate sharply against global currencies and reduce the value of China's remaining U.S. dollar holdings. Congress has focused on potential risks arising from areas in which the U.S. government may lack visibility and understanding of aggregate PRC financial holdings in the United States and U.S. holdings in China. For example, in the 116th Congress, some Members introduced legislation that would have required the Secretary of the Treasury to submit to Congress a report on the exposure of the United States to the PRC financial sector (S. 4629). In addition, the 2021 National Defense Authorization Act (P.L. 116-283) requires the Secretary of the Treasury to conduct a study about the extent to which China's increasing global trade and investment exposes the international financial system to increased risk relating to illicit finance.

Foreign Direct Investment (FDI)

China's outward FDI stock globally is estimated to have risen significantly, from $35 billion (0.5% of world total) in 2001 to $2 trillion (6% of world total) in 2019. The level of bilateral FDI stock, however, has remained low relative to the size of the overall U.S.-China commercial relationship. This has been due, in part, to a growing sense of uncertainty and risk in China's investment climate in light of rising trade tensions, PRC government restrictions, and more recently, concerns about supply chain concentration exposed during the COVID-19 pandemic. While the PRC government has made changes to its FDI policy framework, it continues to impose, both formally and informally, terms and restrictions on foreign investment. The Organization for Economic Cooperation and Development (OECD)'s 2019 FDI Regulatory Restrictiveness Index, which measures statutory restrictions on FDI in 84 economies, ranked China's FDI regime as the third most restrictive.

Since 2017, increased PRC government scrutiny of capital outflows and additional scrutiny by the U.S. government of certain PRC state-directed and financed investments in strategic sectors have contributed to a slowdown in Chinese FDI flows to the United States. Concerns over the ability of the Committee on Foreign Investment in the United States (CFIUS) to review adequately the national security aspects of FDI in the U.S. economy led to the enactment of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA, Subtitle A of Title XVII, P.L. 115-232). The Act seeks to modernize CFIUS and expand the types of investment subject to review, including certain noncontrolling investments in "critical technology."

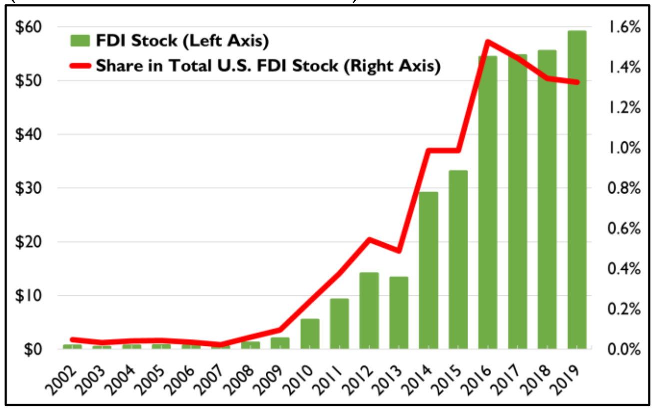
Recent surveys by U.S. and other business groups in China suggest that firms may be increasingly circumspect about China's market prospects, due in part to perceived growing protectionism and trade tensions. Nevertheless, there are areas of interest, as exemplified by several large deals, such as Tesla Inc.'s $5 billion investment in a factory near Shanghai, and Wall Street's bullish response to discrete openings to several U.S. financial firms. Moreover, in the immediate term, as China became the first major economy to return to growth during the COVID-19 pandemic, it has become an economic bright spot for many companies. With the December 2020 announcement of a preliminary European Union-China investment agreement, China has reportedly agreed to partially open up certain sectors, which could make its market more attractive to some EU investors.

Bilateral FDI Activity

According to the U.S. Bureau of Economic Analysis (BEA), net U.S. FDI flows to China in 2019 were $7.5 billion (up 20% from 2018). Net FDI flows from China into the United States were $4.3 billion (up 168% from 2018, but down from the $18.0 billion level registered in 2016). Additionally, the stock of U.S. FDI in China was $116.2 billion (up 6% from 2018), while China's FDI stock in the United States was $59.0 billion (up 6%), on an ultimate beneficiary ownership basis (UBO) (**Figure 2**). In 2019, China accounted for over 1% of total FDI stock in the United States, significantly lower than the shares of Japan and Canada—14% and 13%, respectively.

BEA also collects financial data of U.S. multinational enterprises (MNEs) investing abroad. Data for 2018 (the most recent year for which data are available) indicate that sales by foreign affiliates of U.S. firms in China totaled $580.1 billion (up 7% from 2017). China was the third-largest market for U.S.-affiliated firms overseas, after the United Kingdom ($776.2 billion) and Canada ($705.6 billion). In addition, U.S. affiliates in China employed 2.1 million workers, paid $40.1 billion in employment compensation, and spent approximately $3.8 billion on research and development (R&D).

Figure 2. China's FDI Stock (UBO) in the U.S.
(in billions of current U.S. dollars)



Source: CRS with data from the U.S. Bureau of Economic Analysis.

Table 1. FDI by Industry: 1990:Q1 through 2020:Q2
(cumulative value in billions of current U.S. dollars)

Industry	China's FDI in the U.S.	U.S. FDI in China
Real Estate & Hospitality	$41.9	$22.8
ICT	$17.2	$40.6
Transport & Infrastructure	$16.7	$7.7
Energy	$14.0	$20.7
Entertainment & Education	$13.6	$11.6
Consumer Prod & Services	$9.8	$13.7
Health (incl. Pharma & Biotech)	$8.6	$18.4
Agriculture & Food	$7.7	$19.8
Financial & Business Services	$7.5	$21.0
Other	$17.2	$81.8
Total	**$154.2**	**$258.0**

Source: CRS analysis with data from Rhodium Group (RhG).
Note: RhG tracks investments using commercial databases and media reports. Unlike BEA, RhG's figures do not account for asset divestitures.

Alternative Measurements of Bilateral FDI

Some analysts contend that U.S. and PRC government data do not accurately reflect the value of China's FDI in the United States. Rhodium Group (RhG), a private consulting firm, for example, notes that BEA "omits flows which are routed through third countries, a practice used extensively by Chinese firms due to capital controls and inadequate legal and financial infrastructure at home." According to RhG, China's gross FDI flows to the United States in 2019 totaled $4.8 billion and gross U.S. FDI flows to China stood at $13.3 billion. In addition, RhG estimates that between 1990:Q1 and 2020:Q2, cumulative Chinese FDI in the United States totaled $154.2 billion and U.S. FDI in China totaled $258 billion (**Table 1**). RG's figures, however, do not account for asset divestitures. (FDI statistics also may not always capture certain aspects of China's U.S. investment activity, including venture capital financing, private equity, R&D, technology licensing, and real estate.)

Andres B. Schwarzenberg, Analyst in International Trade and Finance
Karen M. Sutter, Specialist in Asian Trade and Finance

IF11283

Disclaimer