THE GEO-POLITICS OF SOVEREIGN WEALTH FUNDS IN CHINA, 2007-2017

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TAHERA DAUD

Chinese Division

Centre for East Asian Studies

School of International Studies

JAWAHARLAL NEHRU UNIVERISTY

New Delhi 110067

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जवाहरलाल नेहरू विश्वविद्यालय
CENTRE FOR EAST ASIAN STUDIES
SCHOOL OF INTERNATIONAL STUDIES
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI-110067 (INDIA)

Phone : 91-11-2670 4346

Date: 23/July/2018

DECLARATION

I declare that the dissertation entitled "**THE GEO-POLITICS OF SOVEREIGN WEALTH FUNDS IN CHINA, 2007-2017**" submitted by me for the award of the degree of **MASTER OF PHILOSOPHY** of Jawaharlal Nehru University is my own work. The dissertation has not been submitted for any other degree of this University or any other university.

Tahera Daud

CERTIFICATE

We recommend that this dissertation be placed before the examiners for evaluation.

Prof. Srikanth Kondapalli
(CHAIRPERSON,CEAS)

Chairperson
Centre For East Asian Studies
School of International Studies
Jawaharlal Nehru University
New Delhi- 110067

Prof. Alka Acharya
(SUPERVISOR)

Supervisor
Centre For East Asian Studies
School of International Studies
Jawaharlal Nehru University
New Delhi- 110067

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ABBREVIATIONS

ABC	Agricultural Bank of China
ADIA	Abu Dhabi Investment Authority
AMC	Asset Management Commission
APFC	Alaska Permanent Fund Corporation
HSTF	Alberta Heritage Savings Trust Fund
BOC	Bank of China
CCOB	China Construction Bank
CCP	Chinese Communist Party
CDB	China Development Bank
CDC	Caisse des Depôts et Consignations
CIC	China Investment Corporation
CICC	China Investment Capital Corporation
CISF	China Insurance Security Fund Co. Ltd CLGRSS
CTGC	China Three Gorges Corporation
EIBC	Export-Import Bank of China
FOREX	Foreign Exchange market
FYP	Five Year Plan
GAPP	Generally Accepted Principles and Practices
GLF	Great Leap Forward
ICBC	Industrial and Commercial Bank of China
IMF	International Monetary Fund
KIA	Kuwait Investment Authority
LAFICO	Libyan Foreign Investment Company
MOF	Ministry of Finance
NDRC	National Development and Reform Commission
NPL	Non Performing Loan
GPF-G	Norwegian Government Pension Fund-Global
PBOC	People's Bank of China

PRC	People's Republic of China
RCC	Rural Credit Cooperative
RERF	Reserve Equalization of Reserve Fund
RMB	Ren Min Bi
SIC	Singapore Investment Corporation
SAFE	State Administration of Foreign Exchange
SASAC	State-Owned Assets Supervision and Administration Commission
SDBs	State Development Banks
SEC US	Securities and Exchange Commission
SEZ	Special Economic Zone
SGD	Singapore Dollar
SIC	State Administration of Foreign Exchange Investment Company
SOEs	State-owned Enterprises
SRR	Statutory Reserve Requirement Ratio
SWF	Sovereign Wealth Fund
SGRF	State General Reserve fund of Oman
UCC	Urban Credit Cooperative
US	United States of America
WTO	World Trade Organisation

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Chapter 1. Introduction

1.1 Background

1.1.1 History and Origin of Sovereign Wealth Fund (SWF)

‘The origins of SWF can be traced back to 1816 when France created the *Caisse des Dépôts et Consignations* (CDC) to manage government and overseas tax-exempt funds collected by French savings banks and post offices. Today, CDC invests its deposits to finance public housing, universities and other sustainable development projects. A more recent category of SWF was created in 1953, when, 8 years before its independence in 1961, the Gulf state of Kuwait established the Kuwait Investment Authority (KIA) to manage the country’s oil surpluses’, (Xu, 2010:1).

It was followed by the Revenue Equalisation Reserve Fund (RERF) of the pacific island republic of Kiribati in 1956 which was created to manage and collect the earnings from the export of phosphate mining. It was not until 1970’s and 80’s the new SWF would be added in the list (Stitsart, 2014:14).

1976 saw the establishment of the Abu Dhabi Investment Authority (ADIA) of UAE, Future Generations Fund of Kuwait, the Alaska Permanent Fund Corporation (APFC) of the US and Alberta Heritage Savings Trust Fund (HSTF) of Canada all of which were from oil revenues. Singapore also established two funds one in 1974 Temasek Holdings and in 1981 Singapore Investment Corporation (SIC), both of which were non-commodity. It was followed by 1980 the State General reserve fund of Oman (SGRF) and Libyan Foreign Investment Company (LAFICO) in 1981 which were based on natural gas. From 1950s to 1990s 16 SWF were established, most of which were based on oil and natural gas resources. One of the major funds formed during 1990 was the Norwegian Government Pension Fund-Global (GPF-G), which is the largest sovereign wealth fund in the world at present (Stitsart, 2014: 15-17). It was established while it was adopting measures to avoid the so called ‘natural resource curse’- (The term was first used in 1993 by Richard Auty to describe the way countries with abundant natural resources were unable to actually augment and promote their economies; rather it led to slower economic growth) in the form of the

Dutch Disease'[1]. The phenomenon specifically gained dominance in the decade of 90s (Xu, 2010:6).

SWF established during 1998 to 2004 were 15 in number and were for the most part, commodity based. But the number of SWF suddenly rose in the intervening period of four years from 2004 to 2008 from just 34 to 53; this was one of the most crucial time periods in the history of the SWF.

The year 2005 saw the coining of the term SWF. Andrew Rozanov working with State Street[2] came up with a compelling article titled, "Who holds the wealth of nations?," highlighting readers attention to a certain type of public sector players whom he named as sovereign wealth managers or sovereign wealth fund (SWF) (Rozanov, Andrew 2005). Thus, the term "sovereign wealth fund" (SWF), came to describe the government-owned investment vehicles, which in 2005 were growing on a large scale not only in terms of number but in terms of assets also.

The year 2008 not only saw the emergence of maximum number of SWF but the investment strategies for the same also changed. In the first phase, from 1950-1990, SWF were pure financial investments with low-risk securities, as mentioned by Curzio and Miceli. The second phase, 1990-2004, saw economies trying to self-insure themselves against the backdrop of future financial crises, as had been seen in the past decades. The third phase of 2005-2008 witnessed the emergence of game-changing mechanisms in the financial world. This was the period when the changing contours of economic history were recognized, as investments began moving from eastern to western countries (Murphy, 2012: 14-15). Pana Stitsart quotes Hassan (2009) to the effect that 'this phenomenon [w]as a significant indicator showing gradual shift of geo-political and economic power from West to East' (Stitsart, 2014: 21). It also saw

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[1] The term 'Dutch Disease' originated in the Netherlands during the 1960s when revenues generated by natural gas discovery led to an appreciation of the national currency and to a sharp decline in the competitiveness of the non-booming tradable sector. The revenue windfall served to increase imports to the determent of national production, provoking a sharp decline in economic growth. The resources boom attracts scarce inputs to production such as labour and capital away from other sectors, thus creating a 'triple whammy' impact on the national economy. This economic paradox has since been recognised as a situation in which a large inflow of foreign currency – whether it originates from a sharp surge in natural resource prices, or from foreign assistance or foreign investment – adversely affects the performance of the non-booming sectors of an economy, and in particular, the non-booming tradable sector (De Silva 1994).

[2] State Street Corporation is a financial services and bank holding company headquartered at 'One Lincoln Street' in Boston with operations worldwide.

the entry of countries like China, Russia into the financial forums of SWF, changing the dynamics of world politics. Not only did the world's perception in 2005 change with regard to the SWF, but by the second quarter of 2008, at the height of the sub-prime crisis, SWF were seen almost as 'lenders of the last resort' (Curzio and Miceli, 2010:13).

Following the role and significance of SWF in the Global Financial Crisis (GFC) of 2008, where the eastern countries were bailing out the western from the financial blackouts, an International Working Group on Sovereign Wealth Funds was set up in 2008, comprising the IMF and 26 concerned states to discuss the economic and financial risk and return-related considerations regarding SWF. Thus, the 24 Generally Accepted Principles and Practices (GAPP) for SWF or "Santiago Principles" finally materialised in October 2008. The Principles are designed to encourage transparency, accountability, good governance and discreet investment practices while promoting more open dialogue and deeper understanding of SWF. The GAPP, therefore, is underpinned by the following guiding objectives for SWF:

i. To help maintain a stable global financial system and free flow of capital and investment;

ii. To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;

iii. To invest on the basis of economic and financial risk and return-related considerations; and

iv. To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability. (IWG 2008: 4)

The Sovereign Wealth Fund Institute (SWFI) a private firm and a global organization was also established in 2007. It was designed to study SWF in the areas of investing, asset allocation, risk, governance, economics, policy, trade and other relevant issues (SWFI, 2018a, accessed July 2018).

Largest Sovereign Wealth Funds by Assets Under Management

Country	Sovereign Wealth Fund Name	Assets-USD Bill	Inception	Origin
Norway	Government Pension Fund-Global	998.3	1990	Oil
China	China Investment Corporation	900	2007	Non-Commodity
UAE-Abu Dhabi	Abu Dhabi Investment Authority	82	1976	Oil
Kuwait	Kuwait Investment Authority	524	1953	Oil
Saudi Arabia	SAMA Foreign Holdings	514	1952	Oil
China-Hong Kong	Hong Kong Monetary Authority Investment Portfolio	456.6	1993	Non-Commodity
China	Safe Investment Company	441	1997	Non-Commodity
Singapore	Government of Singapore Investment Corporation	359	1981	Non-Commodity
Qatar	Qatar Investment Authority	320	2005	Oil & Gas
China	National Social Security Fund	295	2000	Non-Commodity
Saudi Arabia	Public Investment Fund	223.9	2008	Oil
UAE-Dubai	Investement Corporation of Dubai	209.5	2006	Non-Commodity
Singapore	Temask Holdings	197	1974	Non-Commodity
UAE-Abu Dhabi	Mubadala Investment Company	125	2002	Oil
South Korea	Korea Investment Corporation	122.3	2005	Non-Commodity
UAE-Abu Dhabi	Abu Dhabi Investment Council	110	2007	Oil
Australia	Australia Future Fund	105.4	2006	Non-

				Commodity
Iran	National Development Fund of Iran	91	2011	Oil & Gas
Russia	National Welfare Fund	72.2	2008	Oil
Libya	Libyan Investment Authority	66	2006	Oil
…	…	…	…	…
	Total Oil & Gas related	4,293.56		
	Total Other	3,224.70		
	Total	7,518.26		

Table 1.: *The 20 largest SWF*

*Source: Based on Sovereign Wealth Fund Institute (Dec. 2017), https://www.swfinstitute.org/sovereign-wealth-fund-rankings/

1.1.2 Classification of SWF

In the academic literature, SWF have been classified not only according to the source of funding, but also based on purposes for which these funds were set up. With regard to the source of funding, it has been divided into commodity and non-commodity SWF. Commodity sovereign wealth funds are financed by primarily exporting commodities like oil and natural gas, but also minerals and diamonds. Non-commodity funds are typically financed by an excess of foreign currency reserves from current account surpluses (SWFI, 2018b, accessed July 2018).

SWF are usually distinguished by their "stated policy objectives and consequent asset allocation. Though there are many SWF with multiple objectives, based on the IMF specifications and/or the Generally Accepted Principles and Practices (GAPP, 2008), popularly referred to as the "Santiago Principles", five types of SWF can be distinguished: (IMF Working Paper, 2013: 4).

• *Stabilization funds* are set up to insulate the budget and economy from commodity price volatility and external shocks, as for instance, the Economic and Social Stabilization Fund in Chile and the Oil Stabilizatio1n Fund in Timor-Leste, Iran, and Russia. Their investment horizons and liquidity objectives resemble central banks reserve managers, in view of their role in counter-cyclical fiscal policies to smoothen boom/bust cycles. They tend to invest largely in highly liquid portfolio of assets (and sometimes in instruments that are negatively correlated with the source of risk being addressed with the fund) by allocating over 80 percent of their assets to fixed income securities, with government securities consisting around 70 percent of total assets.

• *Savings funds* intend to share wealth across generations by transforming non-renewable assets into diversified financial assets (Abu Dhabi Investment Authority, Libya, Russia (National Wealth Fund)). Their investment mandate emphasizes high risk-return profile, thus, allocating high portfolio shares to equities and other investments (over 70 percent).

• *Development funds* are established to allocate resources to priority socio-economic projects, usually infrastructure (e.g., UAE (Mubadala) and Iran (National Development Fund)).

• *Pension reserve funds* are set up to meet identified outflows in the future with respect to pension-related contingent-type liabilities on the government's balance sheet (e.g., Australia, Ireland, and New Zealand). They held high shares in equities and other investments to offset rising pension costs.

• *Reserve investment corporations* intend to reduce the negative carry costs of holding reserves or to earn higher return on ample reserves, while the assets in the funds are still counted as reserves (e.g., China, South Korea, and Singapore). To achieve this objective, they pursue higher returns by high allocations in equities and alternative investments— with up to 50 percent in South Korea and 75 percent in Singapore‘s Government Investment Corporation (IMF Working Paper, 2013: 5-6).

On the other hand Bortolotti et al. (2014) also highlight another way of classification of SWF, which focuses on the regime-type - democratic or non-democratic – prevailing in a country. Their findings indicate that most of the SWF were sponsored

by non-democratic regimes like China, Russia, UAE rather than what they describe as "full democracy" like Norway, New Zealand and Australia.

As stated in the SWFI, China has four listed funds presently – the China Investment Corporation (CIC), the National Social Security Fund (NSSF), the State Administration of Foreign Exchange (SAFE) Investment Company (SIC) and the China-Africa Development Fund (CAD). The CIC established in 2007 has been the main contender till now. It is headquartered in Beijing as an entirely state owned company under the Company Law of the People's Republic of China.

1.1.3 Definitions of Sovereign Wealth Fund

SWF are owned or directly controlled by governments investing in any kind of financial asset, both domestically and abroad. In practice, they are mainly configured to take into account the surplus wealth in foreign reserves accumulated due to net export of goods as in the case of China, or other natural resources like oil. Various organizations have come up with varied definitions of SWF.

According to the IMF, (2008) "SWF is a special investment fund created and owned by a government to hold assets for long-term purposes. SWF is typically funded from reserves or other foreign currency sources, including export revenues" (IMF Committee 2007: 6).

The 'Santiago Principles' define SWF as "…special-purpose investment funds or arrangements that are owned by the government. Created by the general government for economic purposes, SWF hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets" (IWG, 2008: 3).

Since the last quarter of the twentieth century, international relations have been characterised and shaped by the forces of economic globalization[3]. However, complex

[3] Economic globalization refers to the increasing interdependence of world economies as a result of the growing scale of cross-border trade of commodities and services, flow of international capital and wide and rapid spread of technologies. It reflects the continuing expansion and mutual integration of market frontiers, and is an irreversible trend for the economic development in the whole world at the turn of the millennium (Shangquan 2000, UN.ORG)

transformations have taken place in the last decade in the global economy. The GFC,[4] which shook the world in 2008, engulfed not only the developed economies but also unsettled the developing countries. It was during this period that China first created its SWF.

Over more than three decades of economic reforms since 1978, the share of China's GDP in the world economy increased from 1.7% to 9.5% (1978-2010), when valued at market exchange rates (Li et al., 2012:1). Besides, the Chinese foreign exchange reserves have also grown at an average annual rate of 23% (Stefano Lugo, 2012:13). The Chinese economic policy was able to achieve this impressive success through a strategy of export-led and driven growth and high investment and saving rates. China also attracted huge amounts of foreign investment through its export-oriented policy, which eventually led to its huge surplus of foreign exchange reserves.

China's high saving rates do not come only from the domestic household structures; the state-owned corporations also contribute in no small measure. The household saving rates can be attributed to two major reasons: Asian societies tend to save more; secondly lack of an adequate social security system (pension scheme, healthcare system, unemployment benefits) is also a significant contributory factor (Csoma, 2015:279) (Chamon and Prasad, 2008: 15-19).

> *'Corporations – especially those under state ownership – are major net savers, because they do not pay out dividends to shareholders. The high savings rate and consequently, the decline in the ratio of private consumption and disposable income to GDP, thus can be largely attributed to two factors: China's banking policy and the lack of an adequate social security system. Since China restricts households' capital exports, they deposit a substantial part of their savings in Chinese banks. The government sets deposit rates, and occasionally they are lower than the inflation rate. In practice, this implies an income transfer from households to the corporate sector, as corporations take advantage of the alignment of the lending rates to low deposit rates'.* (Csoma, 2015:279).

[4] The financial crisis of 2007–2008 which started in US is known as the global financial crisis. It began as the subprime mortgage market crisis in the United States and with the collapse of the investment bank Lehman Brothers on September 15, 2008; the international banking crisis prevailed across the globe, swamping huge many economies under the garb of it. It has been considered the worst financial crisis since the Great Depression of 1930s by many economists.

The Chinese government's economic policies have not only led to China's economic growth and its consequent rise in the global economic rankings, but have also buttressed its stature as a rising global power. Among other steps in the management of this excess foreign exchange, the Chinese authorities decided to set up its SWF in 2007.

"*Guo jin min tui* (国进民退), the state advances, the private sector retreats", was the phenomenon that gained precedence in the Chinese economy during the 2008 Global Financial Crisis (GFC), the time when China had set up its first SWF (Chovanec 2010). China announced a stimulus package worth four trillion yuan ($586 billion), helping out the SOEs (Congressional Research Service 2009). Chinese analysts and watchers all over the world noted that the fundamentals of Chinese State power were moving towards a powerful state backed economy.

As stated in the SWFI, China has four listed funds presently – the China Investment Corporation (CIC), the National Social Security Fund (NSSF), the State Administration of Foreign Exchange (SAFE) Investment Company (SIC) and the China-Africa Development Fund (CAD). The CIC established in 2007 has been the main contender till now. It is headquartered in Beijing as an entirely state owned company under Company Law of the People's Republic of China.

1.2 The Rationale and Scope of the Study

SWF are symbolic of two major trends in the recent global political economy:

> "(a) Redistribution of wealth and economic and financial power from the United States, Europe and other mature industrial economies, to countries perceived to be less firmly grounded in similar, economic, financial and political mores,
>
> (b) Increasing role of governments in managing wealth and economic power." (Xu, 2010: 7).

These trends have propagated distrust and apprehensions in the OECD countries particularly, as the flow of wealth from the non-OECD countries owning SWF is perceived as a threat to the recipient countries where these are investing. The rise of

SWF in the non-OECD countries had led to a number of accusations by the recipient countries. The major ones are:

“(i) the rapid increase in the number of SWF (ii) the growing size (iii) the government ownership of the funds; (iv) their lack of transparency (Xu, 2010: 7)”.

The headway in establishing SWF in China was mainly because of the two conditions. First, China had been running a trade surplus and steadily accumulating foreign exchange reserves since 1994. Secondly, the non-performing loans (NPLs) accumulated during the time were huge in size and SOEs were unable to restructure them. Therefore, to accommodate the same, the state needed another company. Thus, a shell company called Central Huijin Investment Corporation was created to recapitalize and restructure the banks, seen as a de facto SWF. ‘Huijin might have remained the only core SWF option in China if foreign exchange reserves were used solely to recapitalize domestic banks, but the massive accumulation of foreign exchange reserves had closed this option as well’, (Liew and He 2010: 33).

Establishment of China Investment Corporation

The Chinese government finally decided to use foreign exchange to invest in foreign assets other than foreign government and agency debt. Hence, the China Investment Corporation (CIC) as a SWF was set up by the Chinese State Council as a Ministerial level organization on 29 September 2007, with a registered capital of US$200 billion (about 15% of China’s foreign exchange reserve at the time). There was also bureaucratic competition for the control of foreign reserves and CIC. Hence, CIC’s top management team was drawn from officials of China’s most important financial organizations: the Ministry of Finance (MOF), the Bank of China (PBC, which is China’s Central bank), SAFE, (which is under the PBC), and the Ministry of Commerce. Presently, the SWFI has ranked CIC, with around $900 billion, as the world's second largest SWF by assets under management (SWFI, 2018c, accessed Dec 2017).

When CIC was created, China as a large emerging industrial economy was more or less keen on investing foreign reserves into long term supplies of key natural resources and thereby giving leeway to one of the most vital aspects of national security. In the first of its terms in 2007-08, CIC concentrated on acquiring stakes in

US financial institutions such as Blackstone, the private equity fund, and Morgan Stanley. Owing to the GFC China faced losses on those and eventually adjusted its strategy to concentrate on energy, metals, mining and the other hard commodities needed to fuel China's surging industrial rise.

Subsequently after 2012, CIC shifted its strategy toward long-term investments, particularly direct investments, using funds to renew infrastructure development in Europe after the financial crisis, to invest in African industry, and now to build up infrastructure along the Silk Road. China's SWF is shifting its focus to invest in agriculture and global food supplies in a significant strategic move that reflects the priorities of the country's new leadership.

The proposed study of SWF of China will take into cognizance China's attempt to maximize, through the use of SWF, its national economic as well as geopolitical goals. The period under study commences from 2007 - when the SWF was officially formed – and covers the developments up to the present.

1.3 Review of the Literature

The first decade of the twentieth century has proven to be a game changer in China's rising stature around the world. This research would begin by examining some of the general works on the SWF and how they are shaping the emerging trends in global, markets, investment strategies and governance. Some of the leading writers here are Bernstein, Lerner et. al (2013), Castelli and Fabio (2012), Truman (2010), Bremmer (2009), and Gilson and Milhaupt (2008). Their insights would be drawn upon in shaping the conceptual underpinnings of this dissertation.

The Chinese SWF have now been operational for ten years and while there are no major books specifically on this subject, it has been the focus of several articles and institutional papers which have examined various aspects, viz, the growth of the Chinese economy, the new economics shaped by the SWF, China's exchange rate mechanism and China and international financial reform. While the bulk of the writings are from the vantage point of China's rise in the world economy, most of the literature on the topic has tried to deconstruct China's SWF primarily in geopolitical terms. Three broad themes can be identified within this literature:

- Investment plans of Chinese SWF

- SWF and Currency Manipulation
- State Capitalism

1.3.1 Investment plans of Chinese SWF

The CIC's website states: 'The mission of CIC is to make long-term investments that maximize risk-adjusted financial returns for the benefit of its shareholder'. It adds that it 'maintains a strict commercial orientation and is driven by purely economic and financial interests'. Furthermore, it asserts that the CIC 'makes its investment decisions based on its assessment of economic and financial objectives' (CIC, 2018a, accessed July 2018).

With respect to the investment plans and its discourse in terms of Chinese SWF, an important work is by Cieślik, 'Investment Strategy of Sovereign Wealth Funds from Emerging Markets: the Case of China' (2012). The author has examined the investment patterns and performance of two large Chinese SWF: the SAFE IC and the CIC and analyzed the most important investments made by both between 2007 and mid-2013. Her finding is that there is a significant linkage between China's long-term development and investment plans and foreign policy. The investment strategies of Chinese SWF clearly represent the state's 'Go Global' strategy and the politics of maintaining raw materials and energy security. The article also provides an insight into the major external agencies contributing towards these goals such as, ANZ Banking, Munich Re, Veolia Water, Blackstone, Morgan Stanley, Kaz Munai Gas, South Gobi Energy, Penn West Energy, General Growth Properties, GDF Suez, AES and POSCO, Russian Direct Investment Fund, Song Bird Estates, Thames Water etc.

Blanchard in his article, 'China Investment Corporation: Power, Wealth or Something Else?' (2014), has argued that there are different ways through which government can actually put through the huge financial investments and leverage them as a political weapon through CIC, but it is not doing that. Rather, CIC chiefly is used by Beijing in advancing its domestic objectives. He also discusses the long-term investments in the resource companies where CIC has been investing and building international partnerships. Although he concedes that China might have not used economic statecraft till now, he argues that where China's interests are concerned, the lines are somewhat blurred. And he quotes Gao Xiqing, CIC ex-president at a CIC summit in

2011 to the effect that, ‘when China makes overseas investments, it aims to make profits and build influence’. (Blanchard, 2014:165)

Sun et. al., in the article, ‘China's Sovereign Wealth Fund Investments in Overseas Energy: The Energy Security Perspective’ (2014), focus on the role of CIC as a SWF in the context of China’s Twelfth Five-Year Plan which pledges to “…accelerate mutually beneficial co-operation of exploring, developing and processing energy resources in the worldwide”. They also tried to explain the concept through the idea of ‘Social Capitalism’ expounded by Clark and Li in 2004, which is conceptualised as a hybrid or combination of private market mechanisms, characterised by the ownership of common industries for the good of all citizens (Sun et. al., 2014: 657).

The studies of SWF have primarily focused on the CIC and its investments plans and strategies. Most of the literature sidesteps the other SWF of China, be it SAFE IC, NSSF and the CAD. Although, some authors have taken a look at SAFE IC, but that also has been minimal in contrast to CIC’s investment. The NSSF and CAD have mostly been untouched. Secondly, in the long-term investment plans, the studies have not examined in a detailed manner the infrastructure, agriculture and technological investments, which can prove to be a crunch point in the investments of SWF.

1.3.2 *SWF and Currency Manipulation*

While it has been widely acknowledged that Chinese SWF were based on excess of foreign exchange reserves stemming from its massive exports, critics from the western world, specifically the US have been consistently accusing China of currency manipulation leading to the pool of foreign exchange reserves of China. These critics, examined below, have asserted that Chinese currency is undervalued, which makes Chinese exports in US cheaper and increases the price of American exports to China. This debate has acquired much traction in the literature on this subject and many writings appear to uphold the rationale of undervalued Chinese currency as the main factor behind its export surplus and hence leading to the formation of SWF in China. This dissertation will be looking at the veracity of this assessment in a detailed manner.

Debating China’s Exchange Rate Policy edited by Goldstein and Lardy (2008), brings together a number of articles, which examine China’s exchange rate regime and the

factors shaping it. Prasad's contribution, 'Monetary Policy Independence, the Currency Regime, and the Capital Account in China' (2007), argues that China cannot achieve well-balanced growth, (especially if it wants to bring about the much-needed increase in consumption levels), if it continues to resist the implementation of a flexible exchange rate and keep the Chinese monetary policy free from high capital investments. The other contributors to the book like Michael Mussa are highly critical of IMF's shortsightedness in failing to address the issue of undervaluation of Chinese RMB, according to Article (IV) of the Fund. The contributors are also of the view that because of these imbalances and improper financial architecture and monetary policies, glaring rural-urban inequality has surfaced in China.

However, Mercurio and Leung, in their article, 'Is China a 'Currency Manipulator'?: The Legitimacy of China's Exchange Regime Under the Current International Legal Framework' (2009), maintain that in general a country pegs its currency against one or a basket of currencies, and under the international law, they have the full freedom to choose the exchange rate regime and policies. Therefore, China's exchange regime pattern is quite consistent with the present IMF Articles and WTO Agreements and the PRC cannot be coerced to take any particular step, till the organizations themselves change or amend their regulations.

At another level, Liu and Deng (2012), refute the charges of currency manipulation and posit that the westernized international system where the US 'Dollar' is the world standard for currency rates, it is the US which manipulates the system. In their article, 'Who is the Exchange Rate Manipulator: China or America?' (2012), they attempt to make a convincing case for the contrarian point of view by pointing out that while the developed countries opt to go in for intervention or joint intervention to deal with the tidal economic effects, the developing countries do the same by pegging their currencies against the US dollar. The authors are of the view that during the sub-prime mortgage crisis, China's floating exchange rate system was able to alleviate the effects of the depreciation of the US dollar on the Chinese economy and consequently was not affected by the crisis to a significant degree. They contend that in a system characterised by the hegemony of the US dollar that manipulates the exchange rate regime and currencies in other countries, China's managed floating exchange rate system effectively mitigated the impact of the depreciatory flood of US dollars on the Chinese economy and financial system, thereby successfully preventing America's

attempt to foist the crisis onto China. At the same time they also advocate that the Chinese RMB needs to be stabilized for China's economic growth.

In 'The Roles of Saving, Investment and the Renminbi in Rebalancing the Chinese Economy' (2013), Ma et. al., maintain that the real effective exchange rate is helping the rebalancing of the Chinese economy in terms of more domestic consumption-led growth, while not depending so much on the external environment and also leading to the competitiveness of the economy. The authors specify that since savings would be displaying a downward trend in the foreseeable future, the rebalancing of the economy would be effected through the exchange rate regime and currency derivatives.

Prima facie, there is not much serious empirical research to justify the contention that the Chinese *Renminbi* is trying to take over the US Dollar and establish its hegemony and that China is trying to transform the extant financial architecture in the world economy. This dissertation would take on board the available literature and make an assessment of this debate.

1.3.3 *State Capitalism*

One of the major concerns among scholars and observers of the international political economy has been that the Chinese SWF are being used as a geo-political tool leading to a new form of 'State Capitalism' in the geo-politics of the world. In 'State Capitalism Comes of Age: The End of the Free Market?' (2009), Bremmer hypothesizes that free market capitalism is receding, giving way to a new system - 'State Capitalism' - where the State itself uses the drivers and nuts and bolts of its economic resources for its political gain. He emphasizes that this new competition is seen not only on the political ideology front, but it is morphing into a global competition between the economic model of the western world and the newly arrived emerging economies. He points out that it was the use of oil as a geo-political tool in 1973 during the Yom Kippur war that kick-started the way to 'State Capitalism'. Among the four major instruments of 'State Capitalism' he cites the SWF and goes on to argue China and the US are at the forefront of this rivalry. He is however extremely skeptical about the prospects of 'State Capitalism' taking over the world, if it does not provide sustainable economic growth. (Foreign Affairs, 2009: 54)

Subacchi in her article, 'New Power Centres and New Power Brokers: Are They Shaping a New Economic Order?' (2008), talks about the relation between centre and periphery in an asymmetric power relationship, where the 'centre' is constituted by the countries 'with open capital markets and market-determined exchange rates such as the United States and the Eurozone, while all countries with relatively closed capital markets and managed exchange rates such as China, developing Asia and oil-exporting countries comprise the 'periphery'. She points out that the 'centre' and 'periphery' relations have however been undergoing a shift since the manufacturing capacity of the world shifted to emerging economies since the last few decades, particularly countries like China and new power-broker tools like SWF. Subacchi also refers to the increasing linkages between the markets and states and points out that market autonomy is linked to the politics of state. She concludes that this new multipolar world order is a system in a 'stable disequilibrium' and highly diffused, wherein economic power is distributed among a variety of global actors, including both state and non-state actors, but it remains to be seen whether this new world order be sustainable?

In the article, 'Statist Globalization in China, Russia and the Gulf States' (2009), Harris examines the role of 'statist globalizers' as part of the 'Transnational Capitalist Class' (TCC), who are integrated at levels of production and finance. Consequently, we are witnessing a deepening of globalization. It is in this context, where SWF become one aspect of statist investment activity. The concerns are with regard to how the TCC would change geo-politics through this engagement with financial investments; a case in point being the $3bn investment in Blackstone from China's SWF. Harris is persuaded that this TCC, through various geo-political tools like SWF, will in the future be able to change the milieu of the market capitalism to state capitalism. However, he does not make a detailed analysis of the role of SWF in the market dynamics of state vs. market capitalism and also does not explore the issue of the sustainability of 'state capitalism' and 'state capitalists' in the long run. The proposed study will try to fill in the gaps that have been identified in the literature review within the specified themes.

As the literature review revealed, China's SWF are assessed as a threat by the other countries, especially developed economies like US. The SWF of China entered the world market in 2007 and since then it has invested in financial services, energy and

resources sector, farmland and food supplies. Most recently, in January 2017, Ding Xuedong, Chairman of China's SWF-CIC has shown keen interest in investing in infrastructure in US, which has led to much speculation about China's intentions. The apprehension stems from the fact that China's SWF – and in particular the SWF-CIC - ultimately report to the State Council of the PRC, i.e., they are state-owned funds. The proposed dissertation would deconstruct the geopolitical implications of China's SWF within the context of China's economic and foreign policy. The period of the proposed study (2007-2017) would try to critically interrogate the contention that China economic success led to a more assertive foreign policy, enabling China to expand its geopolitical significance. In other words, the proposed study would attempt to explore – through the mechanism of the SWF – the economic underpinnings of China's geopolitical rise.

Framework of Analysis

1.4 Research Problem/Question

1. What were the factors that led to the setting up of the SWF in China?
2. What is the structure, nature and characteristics of the SWF in China?
3. What is the location of the SWF in China's domestic and international economic decision-making structures?
4. What are the kind of agencies involved and their inter-linkages?
5. What are the mechanisms and processes whereby the relevant agencies and bodies formulate the policies and decisions with regard to the SWF?
6. What are the long-term investment plans with regard to all the four SWF in China?
7. Which are the priorities for Chinese investments through its SWF – and what are the factors that have shaped those priorities?
8. What is the veracity of the US official accusation that the PRC engages in currency-manipulation?
9. Are Chinese leaders and establishment economists looking at SWF as a geopolitical tool, which might help their ascendancy to super-power status?
10. State capitalism is emerging as a strong force in the world politics. It has led to the emergence of debate around already established market capitalism versus

evolving state capitalism. The study will also look at the aspects of the debate surrounding the two.

1.5 Hypothesis

- The major disquiet and apprehension with the Chinese SWF is not with the SWF *per se*, but with respect to the lack of transparency regarding the same.

1.6 Research Methodology

Since the objective, among others, is to explore – through the mechanism of the SWF – the economic underpinnings of China's geopolitical rise, the proposed dissertation will utilize the empirical approach to gather data regarding the sectors and amount of investments made by the PRC through the SWF to leverage its position on the geopolitical front. That data will also be used to establish trends to further analyse the degree to which China is able to secure its economic goals. Furthermore, qualitative methods will also be employed in examining the theoretical approaches in the study of SWF and its implications for the global political economy. The SWF of China would be the independent variable, strategic assets of the recipient countries are treated as dependent variable. The intervening variables are sectors in which SWF investments are channelised, in this case, energy, infrastructure (including the proposed Belt and Road Initiative) and agriculture.

The primary resources used in this research would be the policy documents and official statistics and papers with regard to the SWF available on the website of the relevant institutions such as the State Council of the PRC, People's Bank of China (PBC), Ministry of Finance of the People's Republic of China, Ministry of Commerce and the Sovereign Wealth Fund Institute (SWFI) Speeches and official statements of the Chinese leaders and other official/government statements from other countries will also be included.

The secondary sources will take into account the various works available on the subject by various authors in China and West. It is necessary to emphasize here that there are extremely few book length studies on this topic so far. Secondary sources will therefore incorporate reports and research papers and other related studies released by agencies such as the Congressional Research Services (CSR), Chinese Academy of Social Sciences (CASS), Institutional papers from organizations like

IMF, Goldman Sachs, Morgan and Stanley etc., articles from various scholarly journals and periodicals like *China and World Economy* (UK), *Harvard International Review*, *The Economist, The Journal of Economic Perspectives, Chinese Journal of International Politics, Review of International Political Economy, Foreign Affairs, Journal of World Investment & Trade, Bulletin of Geography: Socio-economic Series, International Affairs (Royal Institute of International Affairs 1944-), The Economic Journal, International Security, Financial Analysts Journal, Stanford Law Review, Science & Society, Geopolitics, Economic and Political Weekly (EPW), Tsinghua China Law Review, Asian Journal of International Law, World Review of Political Economy, Review of International Economics, The International Lawyer, International Affairs, Nomura Journal of Capital Markets, The Journal of East Asian Affairs, Journal of Contemporary China, Energy Policy, Australian Journal of International Affairs, and reports and articles from newspapers like China Daily, China Economic News, Global Times, Xinhua News Agency* etc.

1.7 Structure/Chapterization

The dissertation is divided into five chapters, (including the Introduction)

Chapter 1: Introduction. This chapter will include the etymology, definition and historical development of Sovereign Wealth Funds (SWF) in general and of the SWF in China in particular. It will look into the various characteristics of SWF, which will promote an understanding of their political and economic role.

Chapter 2: The Chess Board of SWF. With a brief introduction and historical background of the research subject, the chapter will introduce the structures and processes involved in dealing with the SWF as also the loci of decision-making of the Chinese SWF. It will also take up the issue of 'transparency' in the functioning of the SWF in a comparative context so as to understand the points of convergences and divergences between the Chinese system with those of the Organisation for Economic Co-operation and Development (OECD) and other non-OECD countries.

Chapter 3: Chinese SWF Investments: Destinations and Sectors. The chapter will deal with the investments taken up by the SWF in different parts of the world. It will cover all the four Chinese SWF, namely, CIC, SAFEIC, NSSF and CAD. It will

examine the long-term investment plans of China in various sectors around the world and try to understand how the PRC leverages its foreign policy goals simultaneously.

Chapter 4: Analyzing the debate on Currency and Manipulation. This Chapter will lay an emphasis on the controversies regarding currency manipulation by China; especially the accusations leveled against the PRC by the US and other OECD countries. It would also seek to understand the ongoing debate regarding the exchange rate regimes and the politico-economic factors that affect the composition of the SWF through the exchange rate phenomenon.

Chapter 5: Conclusion - SWF: The new face of China's rise. This Chapter will take into cognizance how SWF is seen as a geopolitical tool in the process of China's ascendancy as a global economic power. It would make some exploratory inquiries into the new form of 'State Capitalism' paving its way into world politics through the supremacy of Chinese State. Finally, this chapter would try to assess whether the SWF of China is able to engineer a favourable position for itself and expand its influence and power in the countries where it invests through the SWF.

Chapter 2.The Chess Board of SWF

2.1 Introduction

The chapter takes a detailed look at the different kinds of the Chinese SWF and seeks to provide an understanding of their historical background, their organization, modus operandi and the issue of 'transparency'. With the establishment of the PRC in 1949, China went through an entire gamut of changes to recreate and develop its financial and monetary system. Prior to 1949, the Chinese economy was estimated to be one of the poorest economies in the world, about USD50/year per capita (Thomas and Chen 2011: 468). The economic losses faced by China were the consequence of the 'unequal treaties' forced by the Western imperialist powers following China's defeat in the Opium wars of 1839-1842 and 1856-1860. China also had to pay war indemnities to Japan in 1895, which the Chinese Imperial Government managed by taking out huge foreign loans (the unequal treaties of 1842 and 1860 barred the Chinese government from levying taxes which could have generated enough government revenue. During 1895, one of the prime sources of revenue for governments all over the world was foreign trade tariffs) (Thomas and Chen 2011: 469).

These foreign loans also became a burden for the Chinese economy as they also had to pay huge loans reparation because of the unequal treaties. Therefore, the Chinese government had to impose taxes on the 'Chinese people, on agriculture and on Chinese-owned enterprises, which also had to compete with foreign enterprises operating in China free of Chinese business taxes' (Thomas and Chen 2011: 469). Between 1911-1949, the Chinese Government was in debt to foreign and domestic stakeholders, resulting in meager exchange reserves.

2.2 Establishment of the PRC and Foreign Exchange Reserve

The newly established PRC in 1949 adopted a series of measures for the economic development and trade policies of China. One of the major moves of the administration was to improve transportation and communication. The period 1949-1978 however did not see any drastic changes in foreign reserves, as the country adopted the central planning system under the Communist Party-led government, and

the emphasis on foreign trade was minimal. The development model was predominantly based upon state ownership. The foreign trade that did take place, was mostly about international balance of payments and was under the supervision of deputed state enterprises. The plan also regulated the foreign exchange rate for China's currency. Moreover, China adopted the import substitution strategy which other developing countries were also following at the time, but this also became a reason for the shortage of foreign exchange. It was in 1964 that all the Chinese debt was cleared off. Thus, under this period of 'central planning' China's foreign trade contributed very little because of the stagnant trade, overvalued domestic currency, famine, political skirmishes and out dated economic policy (Hall 2004: 436-438 ;Lardy 1992: 17-19;Riskin 1987: 77, 207).[5]

Post 1978-1993

With the consolidation of the post-Mao leadership under Deng Xiaoping in 1978, China embarked on market reforms and opened the door to foreign investment, which ushered major changes in economic structures and policies. The Chinese leadership moved from the position of a centralized, planned economic system during the Mao-period, to its own version of market reforms (Brandt and Rawski 2008;[6] Naughton 2007[7] ;Lin 2011)[8]. Chinese leadership also was also influenced by the economic development and foreign trade policies of the four East Asian tigers, which it adapted to a great extent, viz, export-led development. Thus, from the late 1980s, China's foreign exchange reserves started to accumulate.

[5] Riskin, C. (1987), *China's Political Economy: The Quest for development since 1949*, Newyork: Oxford University Press.
[6] Brandt and Rawski (2008), *China's Great Economic Transformation*, Cambridge: Cambridge University Press.
[7] Naughton, B. (2007), *The Chinese Economy: Transitions and Growth,* Massachusetts: MIT.
[8] Lin, J.Y. (2012), *Demystifying the Chinese Economy*, Cambridge: Cambridge University Press.

Foreign Exchange Reserves, 1950-2005

Foreign Exchange Reserves, 1950-2005 (in billions of US dollars)					
End of Year	Forex Reserves	End of Year	Forex Reserves	End of Year	ForexReserves
1950	0.157	1969	0.483	1988	3.372
1951	0.045	1970	0.088	1989	5.550
1952	0.108	1971	0.037	1990	11.093
1953	0.090	1972	0.236	1991	21.712
1954	0.088	1973	-0.081	1992	19.443
1955	0.180	1974	0.000	1993	21.199
1956	0.117	1975	0.183	1994	51.620
1957	0.123	1976	0.581	1995	73.597
1958	0.070	1977	0.952	1996	105.049
1959	0.105	1978	0.167	1997	139.890
1960	0.046	1979	0.840	1998	144.959
1961	0.089	1980	-1.296	1999	154.675
1962	0.081	1981	2.708	2000	165.574
1963	0.119	1982	6.986	2001	212.165
1964	0.166	1983	8.901	2002	286.407
1965	0.105	1984	8.220	2003	403.251
1966	0.211	1985	2.644	2004	609.932
1967	0.215	1986	2.072	2005	818.872
1968	0.246	1987	2.923		

Table 2.: Foreign Exchange Reserves

* **Source:** SAFE.
URL: http://www.safe.gov.cn/wps/portal/english/Data/Forex/ForeignExchangeReserves
Accessed 12 July 2018

The main initiatives which laid the foundations of this build-up of the foreign exchange reserves were:

- Setting up of Special Economic Zones (SEZs) in 1980s to attract FDIs and procuring new technology in coastal areas.
- Setting up of Rural Credit Cooperatives (RCCs) and Urban Credit Cooperatives (UCCs) for local businesses and enterprises in the rural and urban sectors (Franklin et al. 2009:5).
- Establishment of the People's Bank of China (PBC) in 1979, as China's central bank, a move towards a two-tier banking system in China. (This aspect is discussed below)

- Inception of Shanghai Stock Exchange (SHSE) and Shenzhen Stock Exchange (SZSE) in 1990.

2.3 People's Bank of China (PBOC) and Foreign Exchange Reserves

From 1950 to 1978, China's financial system comprised only one bank, the People's Bank of China (PBOC), a central government owned and controlled bank under the Ministry of Finance (MOF), serving both as a commercial and central bank. It was in 1979 that PBOC became a distinct organization from the Ministry of Finance while the Bank of China (BOC), the People's Construction Bank of China (PCBC) and the Agriculture Bank of China (ABC) were set up to handle commercial businesses.

Another major reform was the formation of State Administration of Foreign Exchange (SAFE) (Guojia Waihui Guanli Ju) in 1979. This was done keeping in mind, the regulation and administration of foreign exchange by shifting from central planning to the regulatory administration. Foreign exchange from all sectors and individuals had first to be sold in exchange for China's domestic currency. State economic planners determined the exchange rate.

Another crucial step taken in 1985 was the formation of dual exchange rate system in China, wherein the foreign-invested enterprises and the domestic enterprises were able to trade the currency in two different markets. The Foreign Exchange Adjustment Centers were established for Chinese enterprises and Swap markets for Foreign Invested Enterprises (FIEs). Eventually the dual currency exchange rate emerged, whereby one was the official rate of the currency and the other 'Swap' market rate. This system worked till 1993, the official rate maintained the purchasing power parity and while the swap market rate was used for non-trade transactions[9] (Hall 2004: 442). The Chinese government managed to devalue its currency adequately for trade transactions because of the dual exchange rate system. In the long run, this depreciation of the Chinese Renminbi (RMB) became one of the primary reasons for trade surpluses, ultimately leading to the accumulation of massive foreign reserves. Between 1986 and 1993 China's foreign exchange reserves grew more than ten-fold (Hall 2004: 443).

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[9] The Chinese maintained a strict distinction between foreign trade transactions and non-trade transactions and used different exchange rates for both the transactions. Non-trade transactions included the expenses to diplomats, students going abroad and other exchange personnel (Gang Zhao 1974).

By the end of 1993, the dual exchange rate system became a hindrance to further economic development and growth of China. It was seen as a non-tariff trade barrier by most of its partners and was also becoming an obstacle in China's accession to World Trade Organization (WTO). Thus, a unified currency exchange rate was established on January 01, 1994 that pegged the Yuan at 8.734 per US dollar (USD), which was the official rate. With this amendment, the swap market was abolished and was replaced with the 'Bank of Foreign Exchange Settlement System' leading to purchase of foreign currency from the FOREX banks and well as conversion of all the earnings and entities into RMB. By April 1994, China Foreign Exchange Trading Center (CFETC) was opened in Shanghai, guaranteeing sufficient liquidity for FIEs. In December 1996, Beijing declared that the current account transaction was in conformity with the Article VIII of the International Monetary Fund (IMF) and fully convertible. China's pronouncement of the conversion of the current account convertibility was delayed[10] because of the East Asian Financial Crisis of 1997, and was reinstated only in 2000. During the ensuing period of 1998-1999, China became very strict in terms of capital flight as opposed to the period before the East Asian Financial Crisis. Thus, SAFE and PBOC passed a stricter set of amendments and set of regulations to minimize the effect of capital flight, which led to China's long-term goal of full currency convertibility (Hall 2004: 451-450; Guijun, L. and Schramm, R. M. 2003: 246-280). The reforms during this period were able to create a better platform for international trade, encouraging the influx of Foreign Direct Investment (FDI). During these nine years, from 1993 to 2002, China saw its foreign reserves increase from USD21 billion to USD212 billion, or almost tenfold (SAFE 2011a).

In 2001, China finally joined WTO, which led to the opening up of the Chinese economy and further changes in China's foreign trade legislation, resulting in an increased rate of expansion of China's foreign exchange reserves. Another major reason was China's currency speculation till July 2005, when finally the pegged-exchange rate against the USD changed into the 'managed floating' exchange regime. In 2005, under US pressure, China began to appreciate the value of the RMB against the US$. In July 2005, The RMB was delinked from the USD, tied to a basket of

[10] China was not directly affected by the East Asian Financial Crisis, but secondary damage to China did occur. The currency devaluation and economic recession in Southeast Asia greatly reduced China's investments. As a result, SAFE instituted a series of measures in 1998 and 1999 clamping down on certain types of forex transactions and perceived abuses of the forex rules, delaying the process of full currency convertibility of China..

foreign currencies and permitted to vary in a greater range. The RMB then started to appreciate, beginning with an immediate 2.1% gain against the USD, and vast amounts of 'hot money' and short-term speculative funds looking for returns based on RMB appreciation, began to flow into China (Thomas and Chen 2011: 471;CRS 2013: 2-3).

The portfolio capital flows averaged $8 billion a month from late 2003 until mid-2005. From 2001 to 2007, the scale of foreign exchange reserves increased 6.2 times (Zhang and He: 2009:102). The end of 2006 marked the crossing of USD1 trillion mark and 2007 saw the arrival of the 'hot money' at a faster rate, increasing and expanding the foreign exchange reserves monthly by about 4%. Thus, by 2008 China's foreign exchange reserves reached USD1.5 trillion making China's official foreign exchange reserves the largest in the world history (Thomas and Chen 2011: 472).

It was the East Asian Financial Crisis of 1997–2000 when China decided to maintain a fair share of foreign exchange reserves so as not to fall into a similar crisis. The Chinese government ensured that when the need arose, China would have a foreign exchange reserve that would be proof against any currency attack and maintain liquidity in turn against the potential capital flight on China's weak capital markets. It provided a safe accord for 'exchange rate stability' (Zhou et al. 1999) (Wang 1999). China wanted to make sure that its foreign currency reserve was enough to pay back China's foreign loans in the times of an international crisis.

Therefore, the Chinese Government adopted a series of pro-active policies.

> "It actively participated in the IMF-organized aid projects for some Asian countries. In the wake of the financial crisis in 1997, the Chinese Government provided Thailand and other Asian countries with over 4 billion US dollars in aid, within the framework of IMF or through bilateral channels. It offered Indonesia and other countries export credit and emergency medicine given gratis.

> The Chinese Government, with a high sense of responsibility, decided not to devaluate its Renminbi in the overall interest of maintaining stability and development in the region. It did so under huge pressure and at a big price. But it contributed considerably to the financial and economic stability and to the development in Asia in particular and the world at large.
>
> While sticking to its non-devaluation policy, the Chinese Government adopted the policy of boosting domestic demand and stimulating economic growth. This policy played an important role in ensuring a healthy and stable economic growth at home, easing the pressure on the Asian economy and leading it into recovery" (MOFA 2016).

Although, an ample amount of foreign exchange reserve is required for international trade and finance, possessing vast amounts of reserves can also create problems and challenges for the economy, specifically for central bankers and monetary authorities. The opportunity cost of holding foreign exchange reserves is the low returns on the same. There has been a gap in FDI and Chinese foreign exchange investment, where FDI return in China was high while on the foreign exchange front, it was low. This is because China's investment of foreign exchange reserves is in US Treasury and Agency bonds which were low on returns, while the average annual return on foreign direct investment reached 22 percent by 2005 (Xinhua Agency 2006).

One of the major risks involved was the exchange rate risk; fluctuation of currency can lead to a huge loss in the international purchasing power of China's foreign exchange reserve. By the end of March 2008, Chinese foreign exchange reserves had reached USD1.68tn (SAFE 2008). As explained by Zhang and He, if the nominal exchange rate of US$ to RMB were to depreciate by 10 percent, the domestic value of Chinese foreign exchange reserves would suffer a loss of US$ 168 bn, which would be equivalent to 5 percent of the 2007 GDP of China. The reform of the exchange rate policy in 2005 had already led to the RMB slowly appreciating against the US dollar and with the financial crisis in 2007, it might have further appreciated, leading to huge losses for China. The exchange rate instability could also be a potential risk for inflation and economic bubbles.

One of the other risks involved was with regard to PBOC, China's Central bank, as the foreign exchange reserves led to excess liquidity in China's financial market. To come clean on that, i.e. to offset the effect of foreign exchange intervention purchasing of the financial assets, the bank had to issue central bank bills for

sterilization of the same. Therefore, the central bank had to see losses as the interest rate it had to pay was increasing.

China has to come up with a solution to all these risks and costs involved with regard to accumulated excess foreign exchange reserves. It made ample sense for China to invest its reserve in other resources. Finally, the State Council decided on the idea of setting up its own (SWF), which had already made a foray in the international financial world. China had already seen the successful examples of other SWF, such as the Government Investment Corporation (GIC) and Temasek in Singapore.

In June 2007, the State Council therefore decided to invest about 20% of its then USD1.3 trillion of foreign exchange reserves in both domestic and foreign alternative investments, with the alternative investment being SWF. Accordingly, USD270 billion was directed to China's two newly established outward foreign investment companies: USD200 billion to the China Investment Corporation (CIC), and about USD70 billion to the SAFE Investment Company (SIC).

2.4 Historical Background of the SWF

2.4.1 China Investment Corporation (CIC)

Introduction

In September 2017, within a decade since its establishment, the CIC has emerged as the second largest SWF in the world over (Shicong 2017). Setting up the CIC was one of the most intricate alignments in the political and financial arena of China. From the formation of Huijin Investment Company to the creation of CIC, the contention between the key economic policy-making organisations – PBOC and MOF - was regarding the ownership, management and best possible utilization of China’s excess foreign reserves, in order to obtain higher returns through the state’s investments, so as to look for resource security, specifically in the energy quadrant (Xu: 2010 41).

Establishment

The CIC was officially established on September 29th 2007, after a two year period of intensive work by Chinese authorities (Zhang and He 2009: 1-2). The CIC was marked as a professional investment agency and was funded and supported by the Chinese government. It has been placed directly under the Chinese State Council and

the PBOC or the MOF do not have any ownership rights in CIC. Thus, the CIC has a ministerial ranking but comes after the PBOC and the MOF, although the high ranking officials in CIC are mainly from the PBOC and the MOF.

The CIC received USD200 billion in reserves purchased from the PBOC, which was swapped with 1.55 trillion worth of government bonds issued by the MOF. Therefore, the foreign exchange was incorporated in the form of a loan in CIC, which meant that CIC had to pay the dividend at the end. One-third of the USD200 billion, i.e. USD67 billion, was used to purchase Huijin from PBOC - making Huijin the subsidiary of CIC. Another one third was supposed to reshuffle and reorganize two of the other major banks - the China Development Bank (CDB) and the Agricultural Bank of China (ABC) leaving USD66 billion to invest overseas. This amount was further revised and the amount dispensed for the restructuring was reduced and added in the amount accorded for the overseas investment. The assets since then have equivocally increased, resulting from the income of the investment and its infusion in the asset (Martin 2008: 8-9).

Administration

As required by the Company Law, CIC has been working on its internal institutional setting and governance structure. It has established a Board of Directors, Supervisory Board, and management team. Responsibilities and accountabilities within the CIC, across departments and desks, are clearly defined.

CIC governance structure is in accordance with the China's Company Law. It has a three way governance structure which includes:

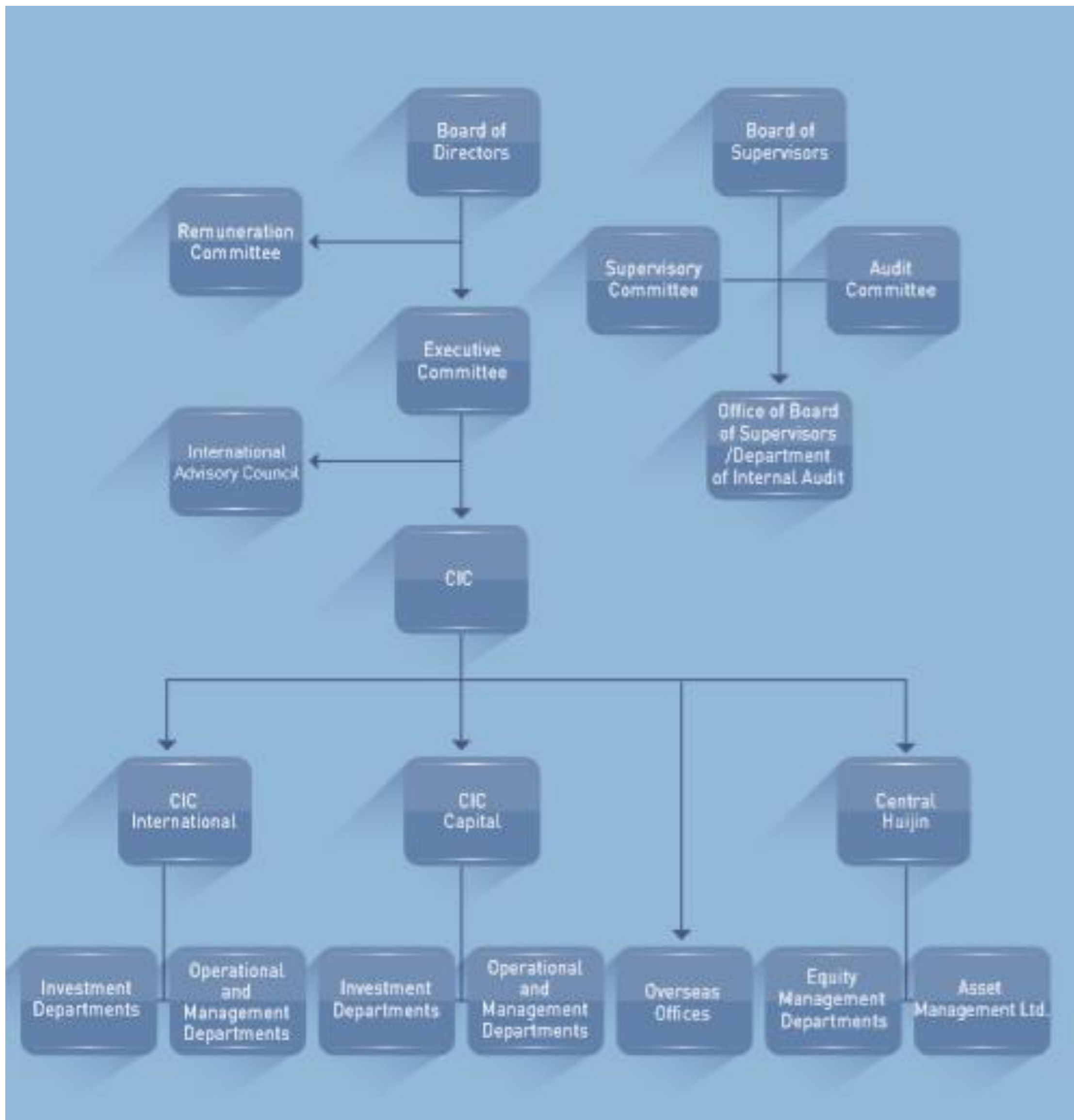
1) Board of Directors,

2) Board of Supervisors, and

3) The Executive Committee

The appointment and dismissal of the Board directors is approved by the State Council. The chairman and vice chairman of the Board are also appointed by the State Council. The framework for investments transaction and the development strategies are all guided by the Board of Directors. The broad governance structure of CIC has been given below:

Table 3: Organizational Structure of CIC



*** Source:** CIC. URL: http://www.china-inv.cn
Accessed 13 July 2018

CIC has three subsidiaries, CIC International Co., Ltd. (CIC International), CIC Capital Corporation (CIC Capital), and Central Huijin Investment Ltd. (Central Huijin). It was in September 2011 that CIC International was established, with a decree for the management and investment of overseas assets. Since then, the overseas investment and management are under the supervision of CIC International. In January 2015, CIC Capital was formed. Therefore the overall international

investments are now complied under CIC International and CIC Capital (CIC About 2018a).

Sources of Assets

> CIC investments are run on a commercial basis. According to the China Investment Corporation website, "The Company was established as a vehicle to diversify China's foreign exchange holdings and seek maximum returns for its shareholder within acceptable risk tolerance". It further says that it 'maintains a strict commercial orientation and is driven by purely economic and financial interests' (CIC About 2018b).

CIC International conducts public market equity and bond investments, hedge fund, multi-asset and real estate investments, private equity (including private credit) fund investments, co-investments, and minority investments as a financial investor.

> 'CIC Capital was incorporated in January 2015 with a mandate to specialize in making direct investments to refine CIC's overall portfolio management and enhance investment on long-term assets. Central Huijin makes equity investments in key state-owned financial institutions in China' (CIC About 2018c).

Investments

CIC's Investments have been distinguished between international and domestic investments. The disposition of the capital investments by these two portfolios has varied governance systems. In case of Huijin, executive managers are assigned directly by the Chinese Central Government. The two capital portfolios also differ in terms of profit-generated accounting rules, in pursuance of investment strategies. In the revenue accounting rule book, the global output is calculated on a market base while the domestic output is calculated on a cash base (i.e. calculated as dividends over the equity book value). The difference in investment strategies lies in the fact that the in the global scenario, the investments started with minority stakes where the CIC has time and again confirmed that it has no plans to own a foreign firm, albeit in case of Huijin investments the stakes gives the leeway to own a number of State Owned Enterprises (SOEs) (Stefano 2012: 15).

The overseas investments by CIC were in the financial sector. In the beginning, the firms were Blackstone, Morgan Stanley, J.C. Flowers Fund, Canadian Teck Resources, Tesco etc. To begin with, even the domestic investments were in the top

domestic financial institutions, like the Agricultural Bank of China, China Development Bank, China Silver River Holding, China Galaxy securities, China Construction Bank etc. Huijin Investments in a joint venture with Morgan Stanley owned the China International Capital Corporation (CICC), the largest investment bank in mainland China. The bank was engaged with most of the outward investments of the topmost firms: Chinalco, Shenhua, China National Offshore Oil Corporation (CNOOC), PetroChina, and Sinopec (Li 2011:15).

Issues in Governance

Objectives and Purposes

The main purpose of establishing CIC has always been to secure its foreign exchange reserves, as also to seek investment opportunities in different sectors so as to support future financing domestic industry policy and to minimize the international pressure on the yuan's appreciation (Xu 2010: 41).

Legal Architecture

As is the case with the SWF in different countries, since there is no legally accountable apparatus, it makes things a little difficult for the CIC. The CIC is under the State Council, but is very transparent in terms of the public participation, which lets it open on the domestic and international front for its real purposes and economic objectives.

'Hence, a lack of a legal accountability mechanism is a double- edged sword: it allows the CIC to enjoy more flexibility in the decision-making process while at the same time confining and criticizing its legitimacy and efficiency'.

All this leaves the CIC in a vulnerable situation for upholding a politics-proof, commercial and professional deal (Li: 2009a 1506).

Disclosure and Transparency

Since the inception of CIC, the officials and other important related economic personnel in China have attempted to convince western countries about the transparency of the CIC's operations and management, but at the same time, their

caveats in this regard tend to send mixed signals. For instance, speaking at a dinner hosted by the Lord Mayor of London at Mansion House in December 2007, Lou Jiwei, chairman of CIC said,

> "We will increase transparency without harming the commercial interests of CIC. That is to say it will be a gradual process. Transparency is really a tough issue. *If we are transparent on everything, the wolves will eat us up,*" he said (*Financial Times* [UK] 2007. Emphasis added).

2.4.2 State Administration for Foreign Exchange (SAFE)

Introduction

State Administration of Foreign Exchange (SAFE) is responsible for managing China's foreign exchange reserves. It is an administrative agency also responsible for drafting rules and regulations for conducting foreign exchange market activities. SAFE has a subsidiary in Hong Kong, which was established in 1997 and is known as SAFE Investment Company (SAFE IC). SAFE IC has invested heavily in foreign equities, becoming one of the second largest SWF of China.

Establishment

Since the founding of the PRC, there was no formal state institution/authority for the management of foreign exchange. For the most part, it was BOC that was in charge of this matter, as a specialized foreign exchange bank. It was in 1979, that the central government established SAFE for regulating and administering foreign exchange.

SAFE, unlike CIC, is at the deputy-ministerial-level in the state administration. Other than the Communist Party Committee, the SAFE Head Office includes other eight functional departments:

- General Affairs Department (Policy and Regulation Department),
- Balance of Payments Department,
- Current Account Management Department,
- Capital Account Management Department,
- Supervision and Inspection Department,
- Reserves Management Department,

- Human Resources Department (Internal Auditing Department) and
- Science and Technology Department

The institutions affiliated with SAFE are:

- Central Foreign Exchange Business Center,
- Information Center,
- General Services Center and
- Editorial Office of the Foreign Exchange of China journal

SAFE also has multiple subsidiaries inside and outside China. Inside China, it has come up with branches, central sub-branches, sub-branches and administrative offices in different provinces, autonomous regions and municipalities.

These subsidiaries are either directly under the Central Government or with a vice-provincial status. It has 36 administrative branches and 298 central sub-branches. Outside of China, SAFE had branches in Hong Kong, Singapore, London, New York and Frankfurt, which help in carrying out international investments (SAFE About 2018a).

The Hong Kong branch SAFE IC is the first and most significant subsidiary. It is based in Central Hong Kong and was established on June 02, 1997 with a capital of US $ 20 billion. The SAFE officials are on the Board of SAFE IC, although it functions as a private firm (SWFI 2018a).

It was opened a month before Hong Kong was handed to China from Great Britain, to 'support and promote the development of Hong Kong's financial market' (Anderlini 2008a). It proved to be extremely helpful in securing and promoting the development of the Hong Kong's financial market.

Sources of Assets

SAFE IC primarily makes its investments into securities, currencies and commodities markets.[11] According to some analysts, SAFE IC may diversify from its mandate of low-risk liquid securities to a relatively small and carefully concealed scale. According to Arthur Kroeber, managing director of Dragonomics, an independent

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[11] "Company Overview of SAFE Investment Company Limited", [Online: web] , Accessed July 10 2018, URL: https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=130906210

research firm, this is due to Chinese bureaucratic rivalry. He further adds that, ‘It might be that, having been forced to surrender control of Huijin to CIC, SAFE and the central bank is now lobbying for authority to make alternative investments on their own account’(Anderlini 2008a).

The investments of SAFE IC are only supposed to be known by Head of SAFE and Central Bank Governor (Anderlini 2009). SAFE is a very secretive organization unlike CIC, it does not publicly share information regarding its investments. Moreover, it has not even accepted the existence of its offshore subsidiaries, but dismissed the fact repeatedly. It was only in 2008, when the *Financial Times* (UK) confronted it with irrefutable evidence, that it was acknowledged (Anderlini 2008b).

Investments

As early as 1997, even before the formation of CIC, SAFE had started to invest in global equity markets, by secretly buying small stakes in large-cap listed western companies (Li 2009b: 1501). After the formation of CIC, SAFE started acquiring smallholdings in some of the world’s largest companies. Some of the companies where SAFE came up with small stakes, are BP and Total, as well as at least three Australian banks. SAFE had also used the Hong Kong subsidiary SAFE IC to secretly “build stakes of less than 1 per cent in numerous companies listed in the UK, including BHP Billiton, Rio Tinto, Unilever, T1esco, British Gas, Cadbury, Royal Bank of Scotland and Barclays Bank, as well as in other markets”. Although, some of the western politicians and analysts have been worried about transparency issues, as also the strategic and political intentions of CIC, SAFE’s equity positions have been steadily increasing (Setser 2009a).

Issues in Governance

Objective and Purpose

The major objective of the formation of SAFE in 1979 was basically for the proper administration and regulation of foreign exchange through a formal institution. This helped the government to shift from the direct management of foreign exchange by central planning, to indirect management by regulatory dispensation.

Legal Architecture

SAFE is in charge of studying and proposing policy suggestions on the reform of the foreign exchange administration system, to participate in the drafting of relevant laws, regulations, and departmental rules on foreign exchange administration and releasing standard documents related to the carrying out of responsibilities along with international financial activities (SAFE 2018b). Besides the central branch, the responsibilities are divided between the provincial - and local-level offices, located throughout the country. It was in 2016 that SAFE revised the Regulations of the PRC on Foreign Exchange Administration with relevant departments, even abolishing 50 laws in 2015 (SAFE Rules and Regulations 2016).

Disclosure and Transparency

The ventures and projects of SAFE and its subsidiaries have always been very secretive. The investment strategy of SAFE was never made public, nor does it publish any reports on its investments. As in the case of SAFE IC, it's most successful business venture, it does not even publish reports on its investments, financial statements or any kind of annual reports. Given this lack of transparency and in the absence of any information, it becomes extremely difficult to surmise anything about SAFE IC. Westerners are thus very cautious of China's real intentions (Cieślik 2013: 32).

2.4.3 National Social Security Fund (NSSF)

Introduction

During the 1990s, China faced a major crisis of sustaining the future of China's senior citizens. The demographic change at the provincial level of the aging population was due to the one-child policy enacted by the Chinese government since the late 1970s and the improvement in life expectancy, led to rise in numbers of the senior citizens. The Chinese government was very well aware of the imminent difficulties in ensuring pensions for this section of the population. Throughout the 1990s therefore, the Chinese government tried to devise policies for building a sustainable pension system.

Establishment

On August 1, 2000, the Central Committee of the CPC and State Council, established the NSSF under the administration and management of National Council for Social

Security Fund (NCSSF). The Fund was created as a 'strategic reserve fund' to sustain the future social security expenditure at the national level to bail out potential pension defaults at the provincial level. Therefore, it is expected that NSSF for the next 20 years at least would not be utilized; meanwhile the amount would build itself up during this period, in order to prevent future shortages.

Administration

The NCSSF, which is a ministerial level organization that directly reports to the State Council, was simultaneously created to operate the Fund-SSF. The NSSF council acts as a Board of Trustees for the management of funds. It is the main decision-making body, and is made up of representatives from the government, business and academia. In case of government most of its members have served in MOF, PBOC, National Development and Reform Commission (NDRC) etc. All of its members are appointed by the State Council. The NCSSF comprises 17 executive board members; it is led by a chairman and three vice chairmen. Under the Council of the NSSF, there is a Secretariat, which is responsible for the day-to-day administration of the Council. It consists of eleven permanent departments, the most important of which are:

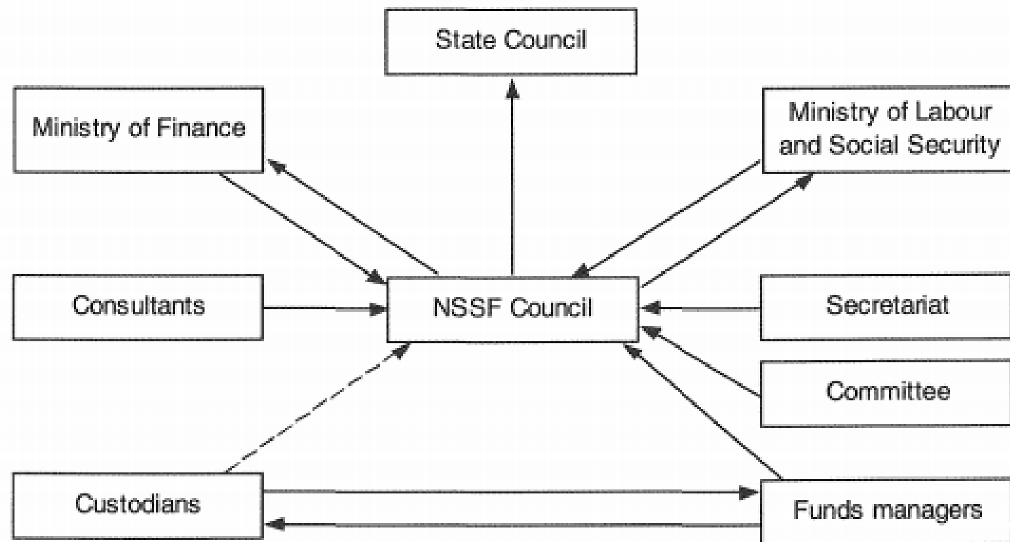
- Administrative Affairs Section,
- Finance and Accounting Section,
- Investment Management Section,
- Stock Management Section and
- Legal and Supervision Section

There are also a number of committees directly under the control of the Council of the NSSF. The committees are:

- Investment Committee,
- Risk Management Committee and
- Specialist Evaluation Committee

The Council of the NSSF also has consultants to assist the council, to train and advise them in the areas of asset allocation and risk management. NSSF's consultants are involved in training of the staff, particularly in fund management postulates and techniques as well as risk management procedures.

Table 4.: **Reporting structure of the National Social Security Fund**



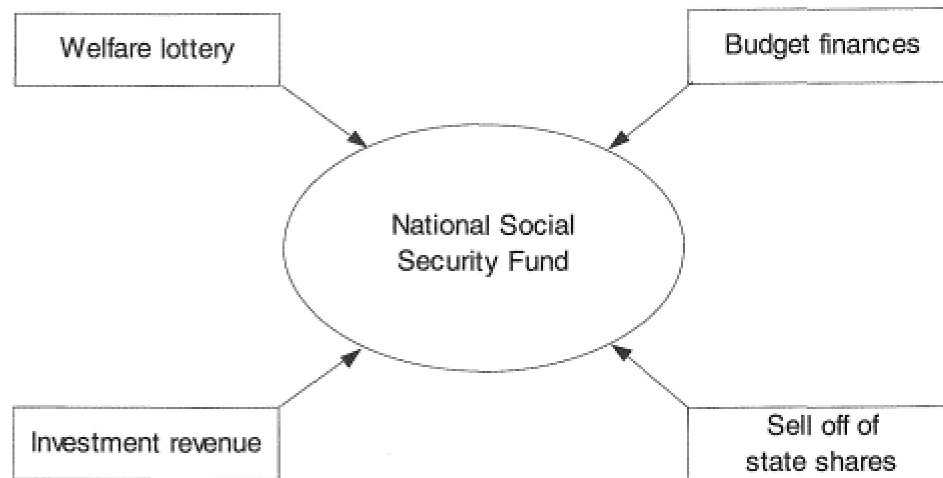
*** Source:** Tim Murton 2012: 359. URL: http://www.jstor.org/stable/j.ctt24h9qh.27 Accessed 13 July 2018

Sources of Assets

The funds for the NSSF come from the following sources:

- Funds allocated from the central government's budget
- Capital and equity assets derived from state-owned enterprise share sales
- Other means approved by the State Council (in practice, this refers to state lottery proceeds, as well as funds obtained through a securities repo programme)
- Investment Income

Table 5.: **Funding of the National Social Security Fund**



* **Source:** Tim Murton 2012: 361. URL: http://www.jstor.org/stable/j.ctt24h9qh.27
Accessed 13 July 2018,

Investments

According to SSF's website,

> '[t]he safety and maintenance of NSSF's investments are the core value of its business. It pursues an investment philosophy of "Valuable Investment, Long-term Investment and Responsible Investment" while sticking to prudent investment, scientific and refined management and the pursuit of increasing investment returns' (NSSF 2018a).

An external manager selected by SSF, manages the assets of NSSF; there are eighteen (18) domestic investment managers and thirty six (36) overseas\investment managers. NSSF adopts an investment method which is a combination of direct investment and mandated investment. The NSSF's assets that are managed by external managers are in the custody of the custodians selected by SSF. Currently there are eighteen (18) domestic investment managers and thirty-six (36) overseas investment managers of SSF. NSSF investment pursuits are guided by two set of rules:

1) 'The Preliminary Rules on the Administration of the Investments of the NSSF' (The Preliminary Rules) issued jointly by Ministry of Labour and Social Security (MoLSS) and MoF in December 2001.

2)'The Preliminary Rules on the Management of Overseas Investments of the NSSF' (The Preliminary Rules on Overseas Investments) issued jointly by MoLSS, MoF and SAFE in March 2006 (Stuart and Ning 2007: 91).

The modus operandi of investment adopted by NSSF includes a merger of direct and mandated investment. Therefore, in accordance with the methodology and the above given principles, the NSSF investments include domestic investments,

> 'which come from bank deposits, inter-bank negotiable certificates of deposits, bonds, trust investments, asset-backed securitized products, stocks, securities investment funds, equity investments and equity investment funds, etc' (NSSF Introduction 2018b).

NSSF regularly lobbied for overseas investments and it was in 2006 that the government finally permitted this. NSSF was able to gather huge amounts of foreign capital from the Chinese SOEs, but instead of converting that amount into RMB, it invested in foreign currencies to get higher returns on the same.

> Thus the Overseas Investments are from money market products such as,'bank deposits, bank bills and large transferrable deposits, bonds, stocks, securities investment funds and financial derivatives such as swaps and forwards for the purposes of risk management' (NSSF Introduction 2018c).

Issues in Governance

Objective and Purpose

The basic mandate of the NSSF, as stated on its website, is to constitute a solution for the problem of its aging population and thus it serves as a strategic reserve fund for future (NSSF Introduction 2018d). But, it does not specify which aspect/s of social security (pensions, medical insurance, unemployment insurance, workers' compensation, maternity benefits and poverty alleviation) will it cover or whether it will only constitute 'pension funds'. Secondly, the word 'reserve' comes with its own connotations, so as will it be used in the case of emergency, only to bail out provincial level pension system. Therefore, given the absence of clearly defined objectives, this can lead to the misusing of the funds.

Legal Architecture

NSSF is not established under any trust, which can hamper its long-term security. One of the major reasons for this could also be that the Trust Law only came into effect in 2001. Therefore, NSSF does not have any defined boundaries for the fund nor does it have clear guidelines for the distribution of benefits. A possible option, suggested by

some experts, could be the substitution of the NSSF with an alternative 'trust structure', where the State Council can pass the regulations and the NSSF could operate in the same manner.

Consequently, on March 28, 2016, "the State Council issued its Decree NO. 667 to promulgate the Regulation on National Social Security Fund, taking effect from 1 May, 2016, which spells out the nature, funding, usage, management, operation, supervision and legal responsibilities of the Fund" (NSSF 2018d).

Transparency and Disclosure

With regard to the issue of transparency, the NSSF needs improvement and more opening up. The annual report by NCSSF is only published once a year on operations and investment. In 2014, the National Audit office of China also reported that the fund had lost more than 17.5 billion yuan between 2010 and 2014 due to management deficiencies and loopholes (Sun 2014).

It eventually said that 'The NSSF should establish an open, public and transparent selection process for trust loan projects, improve post-investing management ability … and gradually turn to an entrusted indexing investment practice'. It seems fairly evident that the NSSF needs to address these issues within its own governance structure proactively, so as not to create any complications in its long-term strategic goals and priorities.

2.4.4 China Africa Development Fund (CADF)

Introduction

The CADF is a Chinese private equity fund, completely funded by China Development Bank (CDB), one of the three Chinese government policy banks. The CADF is one of the major parts of Chinese government plans for the execution of its objectives for the African continent. The fund aims to activate investments in Africa through Chinese companies in different sectors like infrastructure, agriculture, manufacturing etc (CADF Introduction 2018a).

Establishment

The fund officially began operating on June 26, 2007 and is the first equity investment fund established by China whose complete focus is on African investments. The year 2006 marked the 50th anniversary of the diplomatic relations between Africa and PRC. Therefore, both the sides jointly conducted FOCAC (Forum on China-Africa Cooperation) Summit and the Third Ministerial Conference together. It was held in Beijing on November 05 2006 and the CADF was established during that time. President Hu Jintao also announced "Eight Measures" for Sino-African cooperation and formation of CADF was one of them (FOCAC 2012a; CDB 2018a).

It was established with an initial capital of USD 1 billion in June 2007 by China Development Bank and an initial scale of expansion of USD 5 billion. CADF was established to support economy and trade between Africa and China. In 2010, CADF began with the second phase of fund raising, and it raised another $ 2 billion in three years. Then in the 2015 FOCAC Summmit, President Xi Jinping promised an additional investment of $ 5 billion to the CADF (Yan *China Daily* 2015).

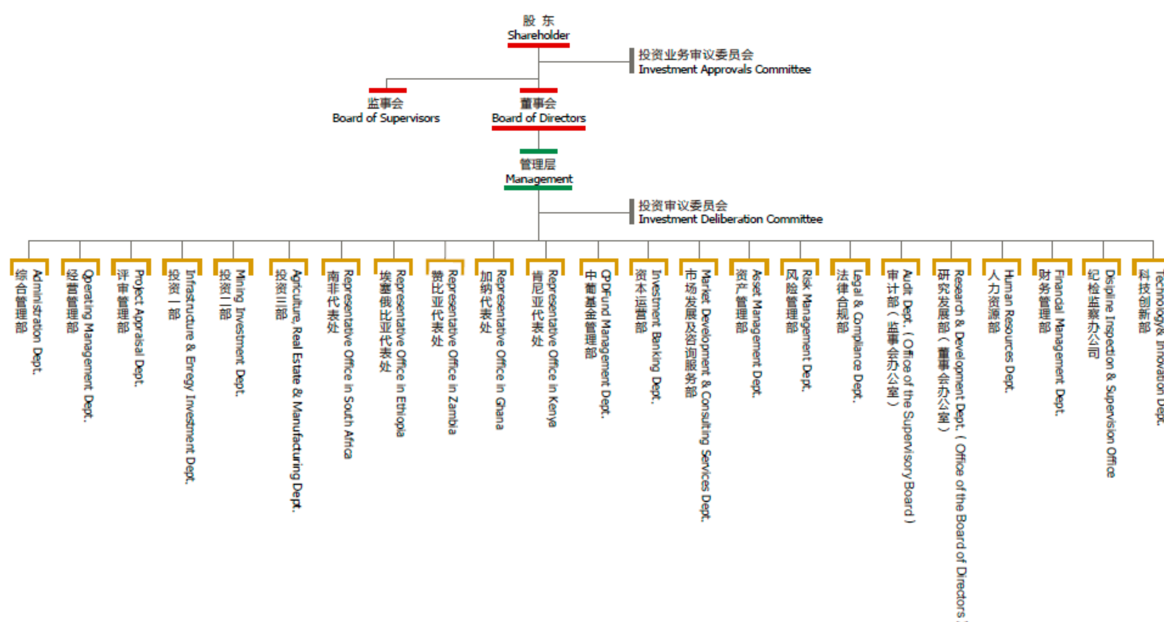
Administration

'The Fund has been operating since 2007 and is a subsidiary of China Development Bank (CDB). This "stockholder" - by now a commercially operating bank – is first in the chain of command'.

> In 2012, the Fund went through an organizational re-structuring; the investment function went from geographic-based to sector-based departments. The four investment departments mostly are related to infrastructure, mineral resources, agriculture and manufacturing respectively (Schickerling and Grimm 2013).

The Supervisory Board of CADF consists of representatives from each of the following Chinese organizations: the Ministry of Commerce (MOC), the Ministry of Foreign Affairs (MOFA), National Development and Reform Commission (NDRC), the Ministry of Finance (MOF), People" Bank of China (PBC), China Banking Regulatory Commission (CBRC), China Security Regulatory Commission (CSRC), State Administration of Foreign Exchange (SAFE) and China Development Bank (CDB). The two representatives from the MOC and MOFA and co-chaired the Supervisory Board. The Office of the Supervisory Committee falls under the Department of Western Asian and African Affairs which is located within the Ministry of Commerce. The Supervisory Committee convenes once or twice a year, to provide CADF with guidance from the policy level (Schickerling 2012: 48).

Table 6.: **Organisational Structure of the Fund**



* **Source:** E. J. Schickerling.
URL: http://www.cadfund.com/en/Article_List.aspx?columnID=85
Accessed 12 July 2018

Sources of Assets

The CADF mostly is organized by CDB and it converts foreign reserves into funding sources through a market-based vehicle. The fund normally comes from the domestic companies where the fund does not hold any controlling stakes.

Investments

The Chinese-African investments particularize through equity investments and investment consulting services. Chinese companies invest in African enterprises and projects through China-Africa development projects, advising on matters of consultancy, finance and management etc. Majority of the investments are conducted through:

(i) Equity investment: direct investment in enterprises and projects by acquiring common shares;

(ii) Quasi-equity investment: preferred shares, convertible bonds, hybrid capital instruments, etc;

(iii) Fund investment: as a fund of funds, China-Africa Development Fund invests in other funds in conformity with the state's diplomatic and trade cooperation policies for African countries; (CDB 2018b).

(iv) Knowledge Investment: Management, consulting and financial advisory given to the Chinese enterprises by CADF is in the form of knowledge investment (Schickerling and Grimm 2013).

Issues in Governance

Legal Apparatus

The Chinese and the various African governments have also collaborated in legal dimensions. In the Action Plan of the 2006 Beijing-Africa Summit, China proposed more research on African Legal systems and to make a connection between the legal institutions of China and Africa. African countries need unified laws specifically trade and Business laws. A strong rule of law is paramount in safeguarding trade and investments.

Objective

The mandate of CADF has always been to promote trade and economics between China and Africa; it has been directed towards economic capacity building and industrialization of African countries. The CADF has been doing it through investments and it relies on the market principles for the same.

Disclosure and Transparency

In terms of transparency CADF is one of the most forthright SWF in terms of its clearly laid objectives and mandates, which was primarily to promote the development of Sino-African commercial and economic ties The SWF helps keep a check on risks and also makes a gainful impact through its policy measures in Africa, thus, sustaining and promoting the new strategic partnership between China and Africa.

2.5 Conclusion

Transparency

In general, the politically driven investments by authoritarian states make the recipient countries suspicious of the aims of the investor countries and thus the opacity of the Chinese SWF has been a cause of apprehension for western analysts, A major source of confusion and also conflict, is the rise of state capitalism, where the non-OECD countries are at the fore front. The transparency of any SWF is based on its mandates, the projects and the funds released. The more a fund discloses information, the more trust can be built in between the recipient and owner countries.

Going by the history and background of the Chinese SWF, as well as the *Linaburg-Maduell* Transparency Index released by SWFI, it can be said that among the Chinese SWF, CIC is the most transparent fund, followed by SAFE IC, CADF and then NSSF. The ratings accorded to the various funds by *Linaburg-Maduell* are:

NSSF	CADF	SAFE IC	CIC
3	4	5	8

Loci of the decision-making

The other major issue is with regard to the decision-makers of the SWF and the rationale behind the decisions. This also opens a window on to the Chinese internal politics and the power structures of the CPC as also the factors driving the diversification of the Chinese SWF behaviour. Pascale Massot (basing his analysis on Lieberthal and Oksenberg's 1998 work), points out that the Chinese political system is not a unified, top-down institutional system; rather it reflects "fragmented authoritarianism" (Massot 2009: 16-17). He also utilizes the findings of Victor Shih and Cheng Li in highlighting the role of factional politics within the Communist Party political elite.

Massot observes that there are two major factors working at the policy-planning level. He says that at the top decision-making levels, there are multiple opinions and perspectives along with composition of power politics being played at the domestic and the international level. He further adds that the economic and political clout

changes the equation of the decision making body of SWF, the bureaucratic tensions between and within key political/bureaucratic organizations. Secondly, he cites Cheng Li[12] and Victor Shih[13] to assert that factional politics is present in the internal dynamics of Chinese politics and it plays a major role in the same. He also argues that the decision-making body is a 'time-specific' alignment of the policy coalitions, which becomes a major factor in shaping the objectives and mandates of the SWF and their subsequent behaviour. The 'time specific' coalitions as Massot explains, are basically a core group of people, including top party leaders, bureaucrats, economists and business community members, who voice their opinions in the framework of the decision-making processes, having different policy priorities, perspectives and their own vested interests. The coalitions are time-bound in terms of the institutional and political orientations of the creation of a SFW and its impact (Massot 2009: 4-14) (Oksenberg et al.,[14] 1988; Lieberthal 2004).[15]

Hence, the loci of the decision making body is a diverse platform, guided by people who differ not only in terms of policy perspectives but in the overall outcome of these policies. Therefore, it leads to different Chinese SWF moving and eyeing different goals and sectors and eventually to a multitude of potential mandates and targets around the length and breadth of the globe. Hence in the words of Massot, China's desire to be a strong state through the use of the SWF and the emergence of the same, was a consequence of these fragmented decision-making structures and the emerging hybrid policy coalitions.

By way of conclusion the following table formulates the nature and focus of the Chinese Sovereign Wealth Fund:

Table 7.: *Formulating Chinese SWF*

[12] Li C. (2007), "China's Inner-Party Democracy: Toward a System of "One Party, Two Factions?", *China Brief* 6(24).

[13] V.C. Shih, (2008), *Factions and Finance in China: Elite Conflict and Inflation*, New York: Cambridge University Press.

[14] M. Oksenberg and Kenneth Lieberthal. (1988), *Policy Making in China: Leaders, Structures, and Processes*, Princeton University Press.

[15] Kenneth Lieberthal et. al. (1992), *Bureaucracy, Politics, and Decision Making in Post-Mao China*, Berkeley, University of California Press.

Objectives	Statist Interests			
	Wealth Enhancement			
	Geopolitical interest		Geoeconomic interest	
	Political and industrial strategic positioning	Projection of domestic industrial policy, regionally focused	Moderate returns on investment, domestic financial policy	Gain leverage in the international financial system, reserves diversification
Chinese SWFs	SAFE	CADF	NSSF	CIC

This formulation by Massot is inspired by Friedrich List's work on national economics and the literature on the developmental state in East Asia (Friedrich List (1841) The National System of Political Economy as cited by Massot 2009: 22) Mark Leonard has labeled it as "Yellow river capitalism", with others describing it as the Beijing Consensus as well. (Mark Leonard (2008) *What Does China Think?* as cited in Massot 2009: 22)

Chapter 3: Chinese SWF Investments - Destinations and Sectors

3.1 Introduction

SWF have gained a prominent position in the global economy as important investors in the world over and more, since the decade of 2000. Their growth was very rapid in the past decade and the global financial crisis during 2007-2009 has brought them at the vanguard of not only the capital markets but at the forefront of the global economy.

This chapter discusses the investments made by the Chinese SWF - CIC, SAFEIC, NSSF and CADF - in different parts of the world. It will try to uncover the long-term investment plans of China in varied sectors surrounding the world. It will also try to decipher how the PRC's foreign policy goals are sought to be achieved through these SWF investments.

3.2 Investments by Chinese Sovereign Wealth Funds

3.2.1 China Investment Corporation (CIC)

China Investment Corporation (CIC), investment activities are guided by an 11-member board of directors. The investments by CIC have been distinguished on the following bases:

- Domestic and International; (the portfolios of the SWF differ because of the different governance systems.
- Different sectors and countries

The major purpose of CIC has always been to obtain higher returns from the investments. But since it reports to the State Council, its political motivations have always been under international scrutiny in the international forum.

During the initial phase, 2007-2008, the investments by CIC predominantly went to the US financial sector. It included minority stakes (under 10%) in U.S. firms of Morgan Stanley and Blackstone i.e. USD 3.0 billion and USD 5.6 billion respectively and another USD 120 million in various small investments. CIC earned a nominal 0.2% return on the global portfolio in 2007. It also led to CIC entering the year 2008

with its portfolio in cash and cash products (*CIC Annual Report* 2008a: 11 - 33). The initial investments in the domestic arena were also done in the top financial institutions like that of Agricultural Bank of China (ABC), China Development Bank (CDB), China Silver River Holding, China Galaxy securities, China Construction Bank, Industrial and Commercial Bank of China (ICBC) and Bank of China (BOC) etc. Again in 2008, China aggressively carried out investments in United States in financial institutions and private equities such as Visa, JC Flowers, and Reserve Primary Fund *(CIC Annual Report* 2008b: 38 - 39).

CIC suffered huge losses because of the financial global crisis of 2008, leading to hefty domestic political retaliation and eventually leading to a change of strategy in terms of investments. Therefore, starting in 2009, the new strategy included the diversified investments throughout the sectors and in different geographical areas. Hence, the investments moved into energy, natural resources and real estate along with the financial sector. Since 2009, the global portfolio in terms of geographical distribution shifted from a concentration of investments in US with diversified equity investments made in North America, Asia Pacific, Europe, Latin America, and Africa.

On the other hand, in terms of sectoral distribution, the major investments during 2009 and 2010 were in energy and natural resources. The portfolio also included real estate and financial institutions. According to Wu et al. 2012 "Transformation of China's Sovereign Wealth Fund Since the 2008–2009 Global Crisis" (as cited in Eaton & Zhang, 2010: 498) the "CIC's investments in individual entities were much smaller, between USD600 million and USD700 million on average, suggesting moderation in risk taking as well".

In case of CIC's global investment portfolio, direct investments platform were actively encouraged. The 2009 annual report of CIC points out that CIC work[ed] on producing a "win-win" outcome, by taking into account the specific needs of individual investments and investee company in varied securities structures like private equity, public equity, structured and hybrid instruments and other vehicles. The direct investments done in 2009 were predominantly in the areas of natural resources, green fuels, infrastructure and the financial services sector.

The assortment of CIC's investments into energy and natural resources was seen as a strategic move, since China was a booming economy and was dependent on exports

for those resources. Therefore, it required vast quantities of energy supply and natural resources to support its economy. Hence, in 2009 and 2010, energy and natural resources were the areas where CIC invested the most. As the Chairman of the CIC stated, “[c]ommodities have been the focus of the fund’s investing strategy and asset location” (Wu et. al. 2012: 351). Notwithstanding this, China equally looked towards the financial markets and invested in them, since they provided market intelligence for the global investments not only in the financial sector but also in the energy and real estate sector.

The investments done during 2009, were in Morgan Stanley (United States), Black rock Inc. (United States), Apax Partners (United Kingdom), BTG Pactual (Brazil). However, the amount of investment was far less as compared to the financial investments in the beginning.

There were other minor investments in American corporations which were valued at USD31 million or less, viz, in American International Group Inc., Bank of America, Citigroup Inc., and Wells Fargo and Co.

Table 8: **Direct Investments in Energy and Natural Resources (2009 & 2010)**

Company	Contract Month	Amount of Investment (Million USD)	Type of Investment	Sector	Approximate Initial Ownership %
Teck Resources Limited (Canada)	July 2009	1,500	Class B subordinate voting shares	Mining and mineral development	17.2%
JSC KazMunaiGas Exploration Production (Kazakhstan)	July 2009	940	Global depositary receipt	Oil and gas	10.6%
Nobel Oil	September	270	Equity	Oil and gas	45.0%

Group LTD (Russia)	2009		Acquisition		
PT Bumi Resources Tbk (Indonesia)	September 2009	1,900	Private Debt	Thermal Coal Production	Not applicable
Noble Group Limited (Singapore)	September 2009	858	Common Shares	Resources	14.9% of outstanding shares on an undiluted basis
SouthGobi Energy Resources Limited (Canada)	November 2009	-500	30-year secured convertible debenture	Coal mining and exploration company	Not applicable
AES Corporation (United States)	November	1,581	Common shares	Power generation	15.0%
GCL-Poly Energy Holdings Limited (Hong Kong)	November 2009	717	Common shares	Renewable energy	20.1% on a fully-diluted basis
Penn West Energy Trust (Canada)	May 2010 Energy	416	Equity	Energy	5.0%
Peace River Oil Partnership (Canada)	June 2010	329	Joint Venture	Oil and gas	45.0%

Chesapeake Energy (United States)	June 2010	200	Convertible Preferred Shares	Oil and gas	NA
Buma (Indonesia)	December 2010	73	Equity	Mining services	8%

***Source**: CIC Annual Report (2009) Accessed June 22 2018
URL: http://www.china-inv.cn/china-invTheme/themes/html/ztnb/2009e.html
CIC Annual Report (2010) Accessed June 22 2018
URL: http://www.china-inv.cn/china-invTheme/themes/html/ztnb/2010e.html

CIC's strategic investments can be seen ranging from iron from Australia to sugar from Brazil, to investments in commodity infrastructure such as terminals, processing facilities and supply chain parts. It also invested in agricultural commodities in 2008 in Noble, when the price of rice, wheat and soybeans were hiked.

Wu et. al. have pointed out that experts had believed that property prices might soon "bottom out" in the developed economies (Wu et al. 2012: 353). Therefore, CIC started with major investments in real estate in 2009, making investments in Australia's Goodman Group, Songbird Estates Limited (United Kingdom) and also bought a stake in London's Canary Wharf. In 2010, CIC also invested in Brazil BTG Pactual Finance.

In February 2010, CIC filled its first regulatory Form 13F with the US Securities and Exchange Commission (SEC), which was indicative of increasing diversification of investments within the US economy. By end of 2009, CIC held USD9.6 billion in stocks of 84 US listed companies, out of which 63% were in financial and energy sectors, and 15% in well-known American brands such as Johnson & Johnson, Coca-Cola, Apple, and companies in the Dow Jones Industrial Average (Wu et al. 2012: 351).

Following this, in November 2010, CIC obtained a 7.6% stake in General Growth Properties Inc. (United States) through a fund manager. CIC also opened its first subsidiary branch in Hong Kong in November 2010, CIC International (Hong Kong),

which functions as an independent legal entity and was basically opened to diversify and improve CIC's cross border investments. Furthermore, the CIC representative office in Toronto also opened in January 2011.The backdrop to this was the national campaign launched by the Chinese government in 2006 - "Go Global" - in order to persuade Chinese firms as a part of strategy to extend China's competitiveness and to rebalance China's export-oriented growth model. Furthermore, the 12th Five-Year Plan (FYP) which was adopted by the Chinese government in March 2011, accorded top priority to energy and climate change. CIC dedicated itself to improving its global portfolio in energy investments and therefore saw this as the perfect opportunity to become part of both, China's 'Go Global' strategy and the 12th Five-Year Plan (FYP) (Cieślik 2014: 36-37).

In 2011, the investment base of CIC was further diversified. CIC's investments in 2011 include Global Diamond S (USA) in July 2011, AES-VCM Mong Duong Power (Vietnam) in September 2011, Horizon Roads (Australia) in October 2011. CIC also made its foray into Africa in 2011; it obtained a 25.8% shareholding in Shanduka Group for US $247 million. It also invested in GDF Suez Exploration & Production International SA (France) and Atlantic LNG Company of Trinidad and Tobago. In early 2011, CIC also collaborated with AREA Financial Corp. of New York so as to purchase an unspecified preferred equity stake in the building that houses the headquarters of Polo Ralph Lauren (Wu et al. 2012: 354). The investments of 2012 saw an increase in infrastructure investments across the western periphery, as the CIC Chairman himself conveyed in 2012 that the company was interested in investing in European and US infrastructure (BBC 2012). CIC in 2012 built-up its post-investment management of long-term assets. The major investment in 2012 was CIC's investment in UK; the first investment was in Thames Water in January 2012 which was the UK's largest water and sewerage company. Then it went on to invest in EP Energy (United States), Polyus Gold (Russia), Eutelsat Communications SA (France). Finally, in November 2012 CIC also invested in Heathrow Airport Holdings Ltd. in UK, which was seen as a long-term investment because of the environment being business friendly, with a proper legal framework. In December 2012 it invested in Moscow Exchange (Russia). CIC also set up the Russia-China Investment Fund (RCIF) with Russia Direct Investment Fund in 2012. In 2013, this fund also invested in Russia Forest Products, which is one of the largest forestry companies in Russia.

CIC signed and approved 44 deals in private equity fund investments, co-investments and direct investments in 2014 and launched the China-Mexico Investment Fund (*CIC Annual Report 2015a: 8).*

In 2015, the CIC established a specialized investment platform known as CIC Capital Corporation (CIC Capital). Following which it also closed its office in Toronto and set up a new one in New York. In collaboration with other investors, CIC Capital joined a consortium of institutional investors to invest in Tank & Rast, Germany's largest owner and concessionaire of motorway service areas; together with China Merchants Holdings (International) Company Limited and COSCO Pacific Limited, it also invested in Kumport, the third largest container port in Turkey. It invested in the convertible bonds of Paladin Energy in Australia. CIC Capital and COFCO Corporation together opened up a joint venture, COFCO International Holdings to furtherance an international trade platform for agricultural products. CIC Capital in 2015 also ventured into new a number of new investments in technology, media, telecommunications and manufacturing. CIC Capital also contributed to the bilateral, multilateral and platform funds by contributing 15% of its funds to the Silk Road Fund in 2015. It also was engaged in consultations on European Union-China Cooperation Fund and the China-France Fund regarding joint cooperation with Third Parties (*CIC Annual Report 2015b: 34).*

In 2016, CIC Capital entered into long-term strategic collaborations with international institutions and further conducted joint projects with several Chinese companies. It increased the investments in infrastructure and specifically in high-quality core infrastructures and came out with projects in ports, railways and pipeline tele-communications in Europe, Oceania and Latin America. The projects constituted UK National Grid's gas distribution network, Nova Transportadora do Sudeste S.A. (NTS, a system of natural gas transmission assets in the southeast of Brazil), Port of Melbourne in Australia and the Australian rail and port operator Asciano. It also invested in internet and financial services. In 2016, there were 16 direct investment deals, which were worth about $5 billion *(CIC Annual Report 2016a: 43).*

In 2016, Central Huijin's holding companies achieved a stable and organic growth in serving the real economy and supporting the adjustment of domestic economic structure and in accordance with the State Council stipulation, it makes equity

investments in major state-owned financial enterprises (*CIC Annual Report 2016b: 46).*

By the end of December 2017, Central Huijin held stakes in the institutions listed below: China Development Bank, Industrial and Commercial Bank of China Limited, Agricultural Bank of China Limited, Bank of China Limited, China Construction Bank Corporation, China Everbright Group Limited, China Everbright Bank Corporation Limited, China Export & Credit Insurance Corporation, China Reinsurance (Group) Corporation, New China Life Insurance Company Co., Ltd., China Jianyin Investment Limited, China Galaxy Financial Holding Company Limited, Shenwan Hongyuan Group Co., Ltd., China International Capital Corporation Limited, China Securities Co., Ltd., Jiantou Zhongxin Asset Management Co., Ltd., Guotai Junan Investment Management Co., Ltd. *(Central Huijin Investment Ltd. 2018: Investments).*

In 2017, the CIC announced that the fund would promote huge investments in the Belt and Road Initiative of President Xi Jinping and therefore expand its investments in infrastructure. On June 6, 2017 "CIC Forum 2017—Belt and Road and Cross-Border Investment CEO Summit" was held in Beijing. The President of CIC said that "the forum aims to build a platform for cross-border investment, promote the participation of capital providers in the development of the "Belt and Road" Initiative, and bridge cooperation to facilitate Chinese enterprises "going out" and overseas capital "coming in". With the emphasis on collaborations through the Belt and Road Initiative, the Chinese can advance the cause of going-out of Chinese enterprises and make better use of foreign capital, the prospect of opportunities to make joint investments in third party markets increases at a larger level, therefore improve the investment environment globally (EDT 2017).

In November 2017, the CIC signed a Memorandum of Understanding with Goldman Sachs Group to establish China-US Industrial Cooperation Partnership, L.P. (Cooperation Fund). The Cooperation Fund will target $5 billion in commitments with a broad mandate to invest in American companies in the manufacturing, industrial, consumer and healthcare industries or business, to build trade relationship *(CIC 2017).*

CIC's real estate acquisition streak has continued in force in 2017 as well. In June 2017, the CIC announced that it had completed the acquisition of Blackstone's European logistics, Logicor for €12.25 billion ($13.82 billion), which has been one of the biggest real estate deals in history. It became the largest-ever European real estate deal in terms of transaction value, and the fourth-largest in terms of Chinese foreign acquisition to date (Shuiyu 2017).

Logicor has been identified among Europe's major economies and countries along the "Belt and Road" initiative. In July 2017, CIC joined a consortium led by TIAA Private Investments and Antarctica Capital LLC to buy InterPark LLC, the largest owner-operator of parking infrastructure in the United States from Alinda Capital Partners LLC. The deal was estimated to be around $1 billion (Miller 2017).

Long-term Investment Plans

By the close of 2017, CIC's long-term objectives were to make further international investments and work closely with partners to seek opportunities under the Belt and Road Initiative (BRI). In terms of BRI, China Investment Corp President Tu Guangshao has signaled the CIC's intent for regional cooperation and cross-border investments, to promote China's economic growth and structural adjustment.

Looking at its long term agenda, CIC is setting up its overseas branches in a strategic move to expand global outreach, deepen partnership and improve investment capabilities. In pursuance of its goal to make direct investments in US Economy, the CIC thus opened its representative office in New York.

Ding Xuedong, chairman of CIC also said that CIC in future would pay more attention to alternative investments asset categories, other than stocks, bonds and cash, and set up a sustainable development mechanism to prevent risks as compared to CIC's investments in equities and fixed incomes previously (Xiao 2017). CIC Capital, the fund's direct investment subsidiary, is also planning to expand into sectors like technology, media, telecoms, health care, consumer goods and advanced manufacturing. CIC has also invested in the energy sector which is seen as a long term investment ensuring long term returns and also fulfilling China's energy needs.

Foreign Policy Objective

CIC's main agenda has always been profit making through investment returns, so it can support the domestic economy. But the western government has always been fearful of Chinese government using it as a tool of economic statecraft. The outbound investments are seen to act as bargaining chips in case of a foreign policy objective, as in bringing about China-friendly policies on matters like Taiwan and Tibet and the resources of CIC can be helpful in building China's soft power. However, CIC's investments in strategic sectors like technology and industry can be potentially dangerous in case they get a control over or steal the technological know-how and collect information regarding the host country (Shih-Ping 2010: 88).

3.2.2 Administration of Foreign Exchange Investment Company (SAFE IC)

During the establishment of SAFE IC in 1997, the fund assets constituted around $ 13 million. As pointed out by the author Ewa Cieslik, "the fund focuses its investments generally on the developed countries and mainly in four sectors: financial, energy, real estate, and to a lesser extent agriculture" (Cieślik 2014: 32). However, in 2007, the SAFE IC mostly focused its investments on low-yielding securities, mainly bonds and most of its reserves were invested in US treasury securities.

The investments done around 2008 were more or less in the energy and finance sector. In January 2008, it purchased and invested in minority stakes of around $ 800 million in the Australian banking sector: ANZ Bank, Commonwealth Bank of Australia and National Australia Bank. It also invested in Texas Pacific Group (TPG) purchasing 20 percent stake for more than $ 2.5 billion in US financial sector.

It also invested in the French oil major Total, purchasing 1.6% of its shares in 2008 and in British BP Petrochemical Corporation by procuring the acquisition of less than 1% of its shares in 2008. The other energy sectors in UK where SAFE IC has invested in are, Royal Dutch Shell, Rio Tinto, BG Group, and BHP Billiton. Then in 2011, SAFE IC invested in more than 3% shares of Munich Re in Germany (Financial Sector). It was in mid-2011 that SAFE IC's focus moved more into financial and real estate sectors as well.

The fund reached nearly $ 570 billion in 2012. In late 2009 SAFE IC registered its fund, Gingko Tree Investment Ltd in the UK, but it was not before 2012 that it started making investments. The biggest four investments in real estate deals in Britain were done through Gingko Tree fund-UPP Group Holdings Ltd. providing university accommodation - Gingko Tree bought 40% stake in it in January 2013. It also invested in the Manchester office building, One Angel Square in December 2012 for about $110 million. In May 2012, it invested in Drapers Gardens, a New York based research firm and a 16 story office building in London. Gingko Tree also acquired a 10% stake in Affinity Water Ltd. (Veolia Water Central), a water utility in 2012. These investments were acquired in cooperation with another group of investors.

Ewa Ciselik quotes Pignal and McCrum (2013), that SAFE IC was speculated to have shares brought back from the largest US asset management companies from the General Motors pension fund.

In 2014, SAFE released a new law simplifying the administration of foreign exchange matters concerning cross-border equity transactions and investment/financing activities superseding an earlier version of 2005 of the same. The circular explicitly talked about China's "going-out" strategy in order to use both the domestic and international resources, as well as markets so as to improve the convertibility of cross-border capitals (Norton Rose Fullbright 2014).

SAFE is also one of the stakeholders of Silk Road Fund dedicating 65% of its shares and fund to Xi Jinping's "One Belt, One Road" initiative (Huang 2016a). To that end, it established Buttonwood in December 2014, which invested $6.5 billion in China's Silk Road Fund. Then in 2015, SAFE IC also invested in the Buttonwood or Wutongshu Investment Platform Co Ltd (which is a platform wholly-owned by the SAFE), along with two subsidiaries, invested in the shares of 11 listed companies in Q4 2015. SAFE injected a total of 27 billion yuan ($4.2 billion) into mainland stocks and it became the first time that China invested in domestic shares (Huang 2016b). Wutongshu invested $48 billion in China Development Bank, which provides medium-and long-term financing to major national projects, and another $45 billion in Export-Import Bank of China, a policy bank focusing on export and import loans, according to a statement by the People's Bank of China in August 2015.

SAFE also invested in A-share markets to promote the development of the domestic capital market according to the experts (Xiao 2018). Eswar Prasad, a former China head for the IMF however believes that SAFE's use of foreign exchange reserves in A-share market basically is for stabilizing the stock market as well as the exchange rate (WSJ 2016).

The investments in 2016 consisted of Chinese companies securing foreign acquisitions. SAFE IC again invested in the BRI initiative through ChemChina. ChemChina agreed to buy the Italian premium tyre maker Pirelli & C. SpA for roughly $7.7 billion. It secured a 25% stake from the Silk Road Fund Co. — an investment vehicle controlled by China's SAFE and other state-owned entities in order to set up subsidiary to acquire Pirelli's shares. In May 2017, while addressing the "Belt and Road Forum for International Cooperation", President Xi Jinping pledged to boost the Silk Road Fund with an investment of $14.5 billion. The fund will eventually finance infrastructure projects in Asia and upgrade trade and transportation networks between China, Central Asia and Europe.

In November 2017, the Silk Road Fund, under the auspices of SAFE, established a joint energy infrastructure investment platform, along with General Electric (GE). The two sides will make joint investment in infrastructure projects in the fields of power grid, new energy, and oil and gas, in countries and regions along the Belt and Road, declared SAFE (Xinhua 2018).

Long-term Investment Plans

SAFE oversees the management of foreign exchange; it has also purchased the most US Treasury bills but for higher returns SAFE diversified its pool. It invested in commodities like private equity, the investment managers at SAFE had a long term view of the equities but with the GFC, they started looking for sustainable long term investments. Of late, it has been investing in real estate and infrastructure, joining the BRI initiative of long-term infrastructural investments in 2017. SAFE in 2016 invested in Chinese equities (A-share market) to play a stabilization role (China.org.cn 2016).

Foreign Policy Objective

The actions of SAFE have always been secretive, even though every year it comes out with an Annual Report; it does not give the information regarding SAFE IC investments. The obscurity of SAFE raises suspicions over the political purpose of the fund, whereby it can be very easily used by China to fulfill its foreign policy objective (SWFI 2018).

3.2.3 National Social Security Fund (NSSF)

The NSSF is invested in a variety of financial products both at home and abroad, which includes fixed-income assets as well as stocks (Xinhua 2016). The NSSF fund invests according to the regulatory framework for investments, therefore the fund can invest directly or it can take up licensed investment managers. And if NSSF directly prefers to invest in the assets, it can only invest in bank deposits or government bonds, while in all other cases, the NSSF needs to designate fund-managers as approved by the MoHRSS.

In between 2001-2003, the majority of the NSSF funds were self-managed and retained in the form of cash and government bonds, except in case of a one-time purchase of about RMB1.3bn (USD153mn) of Sinopec IPO shares in 2001. However, the situation took a turn in 2003, when finally the NSSF elected 6 domestic fund managers for domestic equity and bond mandates. These were Boshi (now re-named Bosera), Changsheng, Huaxia (also known as “China AMC”), Harvest, Penghua and Southern. The Annual Report of 2003 specifies that around RMB32bn (US$4bn) assets were mandated to these mangers. Following that in 2004, more domestic mangers were appointed – CICC, China Merchants, E-fund and Guotai (Impavido 2009a: 23).

The NSSF has long been trying to convince the government bodies to let them allow investing abroad. Since the domestic equity market was not generating much returns, the NSSF hoped that the high amount of foreign capital with China, if invested abroad, would lead to higher returns as well as diversification of the fund. In the words of Xiang Huaicheng, the ex-chairman of the NSSF “Overseas investment is very important for the social security fund to broaden its investment channels, diversify its investment risks and preserve and increase the value of the fund”

(Reuters Staff 2007a). It was in October 2003, that the chairman of the NSSF submitted the proposal for overseas investment to MoF, MoLSS, SAFE, and CSRC as well as the PBoC. It was in March 2006, that NSSF got the green light and it announced that by the end of 2006 it will invest in the overseas market between USD500mn – USD800mn.

In January 2007 NSSF awarded its first mandates to 10 foreign fund managers to plough more than $1 billion into overseas stocks and bonds. It also notified that it selected Citibank and Northern Trust as global custodians for its overseas investments (Leckie and Ning 2007: 89).

The NSSF awarded a mandate to invest in Hong Kong shares to Allianz Asset Management Co. (ALVG.DE) AZ.N, Invesco Investment Management Co. Ltd. AVZ.L and UBS Global Asset Management Co. UBSN.VX. UBS teamed up with domestic investment bank China International Capital Corp. (CICC), nearly 35 percent owned by Wall Street investment bank Morgan Stanley (MS.N). The NSSF mandated AllianceBernstein Co. Ltd. (AB.N), Axa Rosenberg Investment Management Asia Pacific Co. Ltd. (AXAF.PA) and State Street Global Advisors Investment Management Co. Ltd. (STT.N) to invest in non-U.S. equities. Janus Intech Asset Management Co. Ltd. JNS.N and T. Rowe Price Asset Management Co. (TROW.O) won the business to invest in U.S. stocks. The chairman of the NSSF also announced that the cash going into equities would be split in equal amounts among the three mandates. AllianceBernstein, BlackRock (BLK.N) and PIMCO won the mandates for global bonds and BlackRock additionally will manage the NSSF's foreign-currency cash position (Reuters Staff 2007b).

The NSSF had assets worth 516 billion yuan ($73.7 billion) by the end of 2007, including $1.66 billion in overseas investments. (Zhu and Lin 2008).In 2008, the NSSF was also allowed to invest in venture capital and private equity funds which were registered with the National Development and Reform Commission (NDRC) and even that up to 10 percent of its total asset (Impavido 2009: 18). In 2008, the assets under management also reached $ 80 billion (Reuters Staff 2009). Subsequently, in late 2009, the NSSF Chairman announced that the fund obtained permission to invest as much as 20 percent of its assets in overseas stocks and funds, 13 percent higher than the share until then, which gave NSSF capacity to invest in a

variety of assets in the overseas market, the investment approximately increased from $30billion to $40billion. It was then in April 2010, that the Chairman of NSSF estimated that $300 billion would more than double in size (billions) by 2015. And by the end of 2011, the NSSF had over 868.82 billion yuan ($137.9 billion) worth of assets. The fund's asset portfolio at this time was 50.66 percent as fixed-income revenues, 32.39 percent as stocks, 16.31 percent as industrial investment and 0.64 percent as cash and equivalents, according to the report (Xinhua 2012a).

Thereafter in July 2012, NSSF signed 12 agreements with global investment managers including JP Morgan, Lombard Odier, Nueberger Berman, Schroders, Standish, Stone Harbor Investment Partners, AGF Management Limited, Investec, RBC Global Asset Management, AEW Capital Management, AMP Capital and European Investors. According to the NCSSF, of the total, direct investment assets totaled 504.2 billion yuan, or 58.03 percent, while entrusted investment assets stood at 364.7 billion yuan, or 41.97 percent. In a breakdown by investment sector, the proportion of assets with fixed income was 50.66 percent, while that of stock assets was 32.39 percent. Industrial investment accounted for 16.31 percent of the total, with the remaining 0.64 percent in cash and cash equivalents (Xinhua 2012b).

In 2013, the NSSF recorded a 6.2% return on investment, according to the annual reports released by NSSF. The $200bn (€146bn) fund earned CNY68.6bn (€8.1bn) from its investments in 2013 (Ang 2014). China's National Council for Social Security Fund (SSF) announced a return of 11.69% for its funds in 2014 on the back of a strong equity market rally in the Mainland. The assets of the SSF's funds totaled 1.5 trillion RMB as of the end of 2014. Direct investment assets accounted for 50.26%, whereas the remaining 49.74% were allocated through mandates, up from 46.05% in 2013 and 41.17% in 2012. The SSF reported that 8.50% of total assets were used for overseas investments, which amounted to around 131 billion RMB (Au 2015).

The investment return for 2015 was 15.1 percent, which went up from 11.4 percent in 2014. The NSSF earned 228.7 billion yuan ($35.1 billion) in 2015, by the end of 2015 the assets of the NSSF totaled up 1.9 trillion yuan (Xinhua 2016). The fraction of the assets which were invested via entrusted bodies was about 54 percent, while 6 percent were invested overseas. It was in 2015, that the Chinese government allowed the

NSSF fund to buy more local government debt, investment trusts and shares in state-owned companies (Hui 2015).

In January 2015, the Chinese government came out with new pension reforms which came into force in October 2016. These new pension reforms were carried out to comply with the provincial and local pension funds. The NSSF also appointed 21 new fund managers for the same, out of which 14 were domestic fund managers. They are - Bosera, China AMC, China Universal, China Southern, E Fund, Fullgoal, Harvest, HFT, Yinhua, China Merchants, DaCheng, Penghua, ICBC-Credit Suisse, and GF Fund. Six out of the 21 are insurance asset and EA (enterprise annuity) managers, comprising: Taikang Asset Management, PICC Asset Management, China Life Pension, Changjiang Pension Insurance, Ping An Pension and Huatai Asset Management; while CITIC Securities is the only securities house to be awarded the pension mandate. The new scheme in August 2015, allowed local pension funds to invest up to 30% of its total assets in domestic equities, equity funds and mixed funds. The predicament of the NSSF was that the fund was able to invest up to 120 billion RMB in pension fund in the A-share market originally. In November 2016, the commission named the Bank of China, China Merchants Bank, Bank of Communications and Industrial and Commercial Bank of China as the custodian banks. In 2012 and 2015, NSSF received 100 billion RMB worth pension emoluments from Guangdong and Shandong provincial governments respectively (AAM 2016). NSSF possessed total assets of 2.04 trillion yuan by the end of 2016, with a 1.7 percent of investment return (Xinhua 2017).

At the start of 2017, the NSSF with its trillion-yuan (USD317 billion) was looking for more overseas investment opportunities and therefore the fund is now looking towards joining and investing more in the Silk Road Fund. The vice-chairman even confirmed that a bag of investment deals are in the pipeline, although still the fund would take a go-slow and low-key approach. The NSSF most probably might mandate part of its assets to private equity funds so as to seek investment returns (Ren 2017a).

Long-term Investment Plans

As a strategic reserve fund, NSSF is looking towards future long term investments only. By the end of 2016, the overseas investment had reached 136 billion yuan, which was 6/7 percent of its total investible assets. Chairman Lou Jiwei said that there were substantial risks in investing such large sums in the domestic market, therefore ‘ to achieve a high risk-adjusted, long-term return and ensure the appreciation of the social security fund, the NSSF would look for more investments overseas but only if returns proved promising. He also added that the fund was keen to invest more in alternative markets, but was short of staff with the relevant experience. The fund also decided to be a part of BRI initiative where it would like to invest in the globally known private equity fund so that it can create strong investment returns and a stable cash flow for future (Ren 2017b; Tang 2017).

Foreign Policy Objective

The agenda of the NSSF is to sustain the public pension funds as a means to support future social security; as of now it has not been a supportive factor in the PRC’s foreign policy. It can invest 20 percent of its fund assets in China (Koch-Weser and Haacke 2013).

3.2.4 China Africa Development Fund (CADF)

The CADF is China's largest private equity (PE) fund focused on African investment. And as an equity fund, its objective is to support Chinese enterprises in expanding their investments in African countries (Élodie 2009). The fund started functioning in the year 2000. Between June 2007 and June 2008, the CADF granted investment to six projects, which involved more than $90 million. The CADF investments are predominantly invested in agriculture, manufacturing, infrastructure, natural resources, natural resources exploration and industrial parks. The fund focused on initiating strategic relations with more than 10 major enterprises in China, promoting business cooperation with African countries. The companies provide them with low interest bearing loans and on-site facilitation services.

By January 2009, CADF invested USD400 million in over 20 projects in Africa. It invested in the following projects:

- Malawi - cotton project; also implemented in Mozambique, Zambia and Zimbabwe;
- Ghana – the Sunon-Ansogi Power Plant, with a production capacity of 560 000 kW power station;
- Ethiopia - glass factory: it holds 40 percent shares (other projects in the following sectors are under investigation: agriculture, manufacturing and construction); (Xinhua 2008)
- Egypt - Suez Trade Park;
- Liberia - projects under discussion include agriculture and construction;
- Nigeria - Lachish Trade zone;
- Zimbabwe - chromite project;
- Star Africa Digital Project

On 16 March 2009, the CADF opened its first African representative office in the city of Johannesburg. The opening ceremony also included the signing of an MOU between CADF and the South African Department of Trade and Industry (DTI). The investment of the fund in 2009 reached $140 million (Yan 2010a). By 2010 the fund had already invested in 30 projects in Africa, costing around US $800 million. One of the major investments that took place during this year was the Jidong Development Group investment. The cement producer Jidong Development Group along with Johannesburg-based South African partner Women Investment Portfolio Holdings (WIPH) and South African limestone mining company Continental Cement teamed up with CADF to set up a more than $ 200 million cement plant in South Africa's Limpopo province (Yan 2010b).

The fund opened another representative office in November 2011, which was in West Africa in Accra, Ghana; making it the fourth office of CADF in Africa. The other three offices of CADF are based in South Africa, Ethiopia and Zambia (GNA 2011). By 2012, the CADF had ultimately financed and backed 60 projects across 30 African countries (Hanauer and Morris 2014: 42). In May 2014, the assets of the CADF crossed $ 5 billion mark. The China Development Bank gradually hit its target of $5 billion of the equity investment held in Africa by the close of 2015. By this time the fund had invested in more than 80 projects across 35 African countries from infrastructure to agriculture to energy resources and it granted almost $3.2 billion in

CADF (Xinhuanet 2015). Moreover, at the Johannesburg Summit of the Forum on China-Africa Cooperation also held in December 2015, Chinese President Xi Jinping announced an extra allocation of USD 5 billion for CADF, with the total amount reaching USD 10 billion. CADF came up with one more representative office in September 2016 in Nairobi, Kenya, which became the second office in Eastern Africa and the first regional office in East African Community (EAC). It also became the fifth representative overseas office including the ones in South Africa, Ethiopia, Zambia and Ghana. And by the end of November 2016, the Chinese Vice President said that the projects have attracted an additional amount of US $ 17 billion in enterprise investments and bank loans across Africa (African Review 2016).

In an interview to *Xinhua* in December 2017, the chairman of the CADF Zhao Jianping, provided a glimpse of the comprehensive nature of the fund and its activities. He said that the fund consisted of $4.5 billion, which it plans to invest in 91 projects around 36, and that the amount that had already been invested, was $3.2 billion which would be further augmented since the fund was planning to make more investments and direct more capital into Africa through the 'Belt and Road Initiative'. He further announced that the fund had reached an agreement with the Bill & Melinda Gates Foundation on investment in the agricultural and pharmaceutical sectors, and had signed memorandum of understanding on investment and exports with the UK Department for International Cooperation. He also conveyed the information that the fund was exploring cooperation with other international organizations, including that of World Bank, the United Nations Industrial Development Organization and the African Development Bank (Xinhua 2017).

Long-term Investment Plans

CADF investments have always been focused on the long-term results. The head of the fund, Chi Jianxin has also said that the fund looked towards its African investments in the medium to long term perspective,as different African countries are at different stages of development, industrialization and urbanization.

As a long-term investment plan, the fund is planning to invest in sectors like agriculture, manufacturing, resources and industrial zone development. Expanding its ambit, the CADF will invest in greener projects like solar, wind and hydro and in developing high-yield agriculture within a sustainable development paradigm

(MOFCOM 2013). The CADF is also collaborating with the BRI to make African economies more competitive and is trying to narrow the gaps between landlocked countries and coastal regions (Nan and Xiaojin 2017).

Foreign Policy Objective

After the financial crisis of 2008, China's exports were going down and it needed to break into new markets. The economic conditions of China led it to look for new markets and engage with its excess industrial capacity as a part of its 'going global' strategy (Albert 2017a). The fund also is part of the BRI initiative through its development framework, therefore promoting cooperation and interconnectivity from Eurasia to Africa.

Michael Levi and Elizabeth C. Economy have argued in their book, '*By All Means Necessary*', that China in pursuit of the resources has been engaged in so called 'commercial diplomacy', "Beijing pitches vast trade, assistance, and investment deals on frequent trips to resource-rich countries, and retains an almost unparalleled ability to provide low-cost financing and cheap labor for infrastructure projects" (Albert 2017b).

3.3 Conclusion

As SWF, specifically in case of China, are not only state-funded but also under the auspices of the Chinese State, they have thrived, amplified and expanded at large. Although at times they have slumped and faced significant losses specifically during the time of the global financial crisis of 2008 and during other major financial shocks like that of 2015, nonetheless, the diversification of their investments has led them to grow and they have proliferated and benefitted.

As the PRC's growth story and export earnings unfolded, Beijing basically invested this huge amount of foreign exchange reserve in SWFs for the development and growth of China's economy. The crucial criteria have always been in terms of more capital, investments and sustainable growth.

In the western capitalist countries, (specifically the US where China has invested the most), there is a degree of wariness regarding China's intentions, as these are not private corporates or individual-funded institutions. It is this controlling aspect of the

Chinese State and its role which raises doubts and apprehensions as to a possible strategic and political usage of SWFs. These in turn generate national security consideration and consequently stoke greater fears about the rise of China. The academic discourse in the western countries is woven around the notion of 'State Capitalism' and its geo-political consequences, wherein, it is surmised that the major support of the capitalist economy of the state will become the major pillar for the political monopoly of the CCP, which again is seen threatening the powerful lobbies of the western governance system.

The CCP in the last decades has been very successful in governing Chinese economy and giving political stability to China. This in turn has given legitimacy to the party and the state in terms of its continuation. The SWF is bringing huge investments back into China and facilitating China's rise as an economic power which would surely foreground the party's strong standing. Not only will it generate a nationalistic fervor in favour of the ruling regime inside China albeit China's success will also be given a green light in other countries, demonstrating keenness and acceptance for China's governance system, communism.

The governance system of China is characterized by a ruling communist party engaging with the western system of market capitalism at large. While the debate on whether it constitutes a threat goes on, with its massive resources, the PRC does poses a challenge to the global financial/economic architecture, which has been shaped and controlled ruled by the 'Westphalia System' since last half a century.

As Ian Bremmer rightly points out, "[S]tate capitalism will not disappear anytime soon. Throwing up walls meant to deny access to U.S. markets will not change that. Instead, profiting from commercial relations with state capitalist countries is in the United States' near-term economic interests. For the sake of the United States' and the world economy's long-term prospects, defending the free market remains an indispensable policy. And there is no substitute for leading by example in promoting free trade, foreign investment, transparency, and open markets, in order to ensure that the free market remains the most powerful and durable alternative to state capitalism.

Chapter 4. Currency Manipulation

In the third edition of *Alchemy of Finance*, George Soros wrote:

> "Exchange Rate misalignments have become a major source of disruption for the world economy. They make it unsafe to make long-term investments, they endanger the value of investments already made, and they are at the root of protectionist sentiment in the United States. The market mechanism fails to bring currencies back into alignment. On the contrary, speculation tends to exaggerate currency moves. As we have seen, the system of freely floating currencies is cumulatively destabilizing".

4.1 Introduction

This chapter discusses the allegations of currency manipulation generally leveled against China by the US and other OECD countries. It would mainly focus on the major debates with regard to the exchange rate regime controversy and eventually its politico-economic effect on the configuration of the SWF. The Chinese SWF are based on excessive holdings of foreign exchange reserves and is one of the most crucial aspects of China's exchange rate policy with regard to its involvement in the foreign exchange market. Hence, China has been accused of currency manipulation in order to boost exports, in order to amass secure huge amount of foreign reserves.[16]

4.2 Origins of the *Renminbi* (People's Currency)

The Chinese monetary system in the beginning of the 20th century was the part of the prevailing international monetary systems. It was in 1948 that the Chinese Communist Party's People's Bank of China issued a unified currency throughout the PRC, with the denomination of yuan 元, though, at that time the currency was also identified by different names, such as, 'People's Bank of China banknotes, People's Bank of China notes, New Currency, People's Notes. It was in June 1949 that the term *Renminbi* 人民币 (RMB), (literally, 'People's Currency') was used for the Chinese currency (Mulvey 2010 BBC News).

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[16] For some representative works in this regard see, D. Palmer, (2008), "Obama says China must stop manipulating currency", *Reuters*, 29 October 2008, Accessed 21 July 2018, URL:https://www.reute4rs.com/article/us-usa-china-obama-currency-idUSTRE49S7FQ20081029
C Herrmann, C. (2010), "Don Yuan: China's 'Selfish' Exchange Rate Policy and International Economic Law", in Christoph Herrmann and Jörg Philipp Terhechte (eds.) *European Yearbook of International Economic Law*, Springer Science & Business Media; R.W. Staiger. and A.O. Sykes (2010), "Currency 'Manipulation' and World Trade", *World Trade Review* 9: 583-627.

4.2.1 The Pre-reform period (Before 1978)

From 1949-1978, Chinese currency followed the fixed exchange-rate system. Throughout 1951-1971, the value of the RMB was held quite high against the USD: RMB 2.46 to one USD. From 1971-1978 it was RMB 1.68 against one USD. During this period, China followed an import substitution model of industrialization and therefore to keep the exports limited, the exchange rate was kept high. Before the reforms initiated by Deng Xiaoping in 1978, China's foreign trade was part of the centrally planned economic system and therefore the foreign exchange rate had little role to play in the foreign trade plan. As mentioned above, the RMB was deliberately kept overvalued; it was inconvertible and subject to extensive exchange controls. Secondly, the domestic currency cost of earning one dollar in export sales substantially exceeded the exchange rate throughout the 1950s-70s and so foreign trade companies on average lost money on their export sales (Lardy 1992: 24-27).

One of the most vital steps for moving towards a more flexible market exchange rate, was a control on trades and other account transactions. On 22 December 1978, the 3rd Plenary Session of the 11th Central Committee of the Communist Party of China announced major reforms; chief among which was the reform of the RMB exchange rate regime by demolishing the earlier system of government-dictated reforms and shifting to a market-determined regulatory framework. Thus, in 1979, the State Council endorsed a system where the exporters and the provincial and local governments were allowed to keep a share of their foreign exchange earnings as foreign exchange quotas. Secondly, the government also permitted the retention of foreign exchange earnings emanating from non-trade sources as overseas remittances, port fees being paid by foreign vessels and the tourism sector. Cumulatively, these changes led to the foreign exchange retention system from exports and other sources. These market led reforms of the 1980s were one of the major causes of the huge foreign exchange reserves in the later period (*People's Daily Online* updated 2008)[17].

4.3 The Evolution of the Exchange Rate Regime

[17] "Third Plenary Session of 11th Central Committee of CPC held in 1978", [Online: web] Accessed 15 July 2018, URL: http://en.people.cn/90002/95589/6512371.html

Wen Si citing Mehran et al. (1996), described the Chinese exchange rate regime and its evolution, as a process of gradualism.[18] This process incorporated four phases:

- Phase 1: (1978-1984), characterized by a centrally planned administrative mechanism.
- Phase 2: (1985-1993), dual-track exchange rate system – the official fixed exchange rate coexisted with market-determined rate in the foreign exchange adjustment centers (swap rate).
- Phase 3: (1994-June 2005), Managed floating exchange rate regime, based on market supply and demand with reference to a single currency (*de facto* pegged to the USD).
- Phase 4: (July 2005 to date), Managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies.

4.3.1 The Reform Phase I (1978-1984)

The monetary policy reforms of the 1980s played a huge role in China's growth, although they were slow and cautious. The overall period was characterized by the 'Bird and Cage' approach, (the bird being the economy and the cage being the Plan) propounded by the then Party leader, Chen Yun, who was a staunch advocate of economic planning. As he put it, "[T]he bird should be allowed to fly, but only in the cage. If there is no cage, the bird will escape." This gradualist approach to economic reforms, keeping the focus on economic growth, marked the first phase.

The foreign exchange retention system became the paramount incentive for exports and other sources of foreign exchange. It was the first attempt by the Chinese authorities to allow the market to play a substantial role in regulating the exchange rate (Wu 1998: 83). Wen Si states that in early October 1980, the exporting companies having excess of foreign exchange reserves (more than the import needs) were permitted to sell it to SAFE. Goldstein and Lardy go on to say that by the mid-1980s, forty percent of the foreign exchange earnings went to the provinces and export producers, while the remainder went to the central government (Lardy 1992, 51–57 as cited in Goldstein and Lardy 2009: 5) Swap Centers were also set up in

[18] "Gradualism" is the principle applied in the reform of the RMB *exchange rate regime* rather than in the *adjustment of its exchange rate*.

many cities by this time. The other major policy reform by the Chinese government with regard to the movement of the currency towards a market-determined rate, was devaluation (adjusting the foreign exchange rate according to the structure of domestic prices). It started off in January 1981 with the introduction of the official exchange rate and of 'internal settlement rate' (ISR) by the State Council. The rate at which ISR was fixed was RMB 2.8 per USD and was used for trade related foreign exchange transactions. On the other hand the official exchange rate was fixed at RMB 1.5 per USD, adjustable against a basket of currencies and it included transactions like overseas Chinese remittances, tourism etc. Notably, this official exchange rate was a devaluation of nearly 100 percent. The period from 1981 to 1984 saw the rise of domestic prices rise in China, leading to the devaluation of the official exchange rate to the IRS. In order to increase the export performance, fiscal subsidies given to exports had to be increased, although it was evident that continuation of the export subsidies would be detrimental to the national economy in the longer run. Hence, by the end of 1984 the ISR was devalued at RMB 2.80 per USD, which was the official exchange rate. In early 1985, the ISR was abolished, thus settling the international transactions at the official exchange rate. However, the authorities continued to conduct the internal swap market for foreign exchange (Goldstein and Lardy 2009: 4-5; Si 2014: 3).

4.3.2 The Reform Phase II (1985-1993)

In the 1980s, four Special Economic Zones (SEZs)[19] were opened in China to attract foreign investment. By April 1984, 14 more SEZs and coastal cities were opened along the east coast and in the same year, the authorities also opened up dual-track exchange rate centers and swap centers at these places. By March 1988, all the provinces were allowed to have Swap centres. At the outset, it was only Foreign Funded Enterprises (FFEs) that had access to the market, but since October 1988, all the enterprises with foreign exchange retention quotas (Si 2014: 4-5). By December 1991, the domestic residents were also allowed to sell off their foreign exchange at the swap rate branches. Since then, foreign exchange transactions increased at the

[19] China's special economic zones (SEZs) have been conceptualized as part of the free-trade zone system, which ranges from customs-bonded warehouses/ factories and export processing zones to free ports or comprehensive free trade zones (Wong and Chu, 1984). Some of the significant studies done on the same are by the Chinese University of Hong Kong Scholars, David Chu, Sang Feng, and Leung C.K.

adjustment centers and the swap rate was used in 80% of these transactions after 1991 (Lin and Schramm 2003: 19). Therefore around the end of 1993, a total of 108 local foreign exchange adjustment centers were opened in China. The authorities regulated the swap market again by tightening the regulations on the official exchange rate. Even after the government abolished the ISR, it continued to devalue the currency. By mid-1986 it was RMB 3.2 per USD and on 05 July 1986, an additional 15 percent brought it up to RMB 3.7. In December 1989, it was further devalued to RMB 4.7 (Lardy 2002: 49). By the end of 1993, the devalued currency had reached RMB 5.8 per USD. This widening gap between the official and the swap rate and the volatility of the markets paved the way for the new reforms to be undertaken (Goldstein and Lardy 2014: 5-6).

4.3.3 The Reform Phase III (1994 – June 2005)

After the path-breaking reforms of 1979, it was in 1994, that most comprehensive and inclusive reforms were undertaken.

At the beginning of 1994, China adopted its most comprehensive reform package covering major aspects of the economy including taxation, banking, foreign exchange, foreign trade, investment and state-owned enterprises. They covered all the major sectors of economy including taxation, banking, foreign exchange, foreign trade, investment and state owned enterprises. The reforms paved the way for China to recover its status in the General Agreements on Tariffs and Trade (GATT), leading to its eventual accession to world organizations like IMF and WTO (Testuji 2003, as cited in Goldstein and Lardy, 2014: 6; Guijun and Schramm 2003: 21). Hence, the shift from a planned economy towards a new socialist market economy became essential.

Some of the major measures that were taken during this reform period were:

- The official and swap market rates of the RMB were finally unified on 01 January 1994.
- The foreign exchange retention system was also abolished for domestic firms; instead thirteen new commercial banks called “Foreign Exchange banks” were set up for the foreign exchange settlements.

- The practice of dual-track exchange system, i.e, the swap markets were totally abolished and a new system of managed floating exchange rate regime based on the supply and demand of market was established, which was pegged only against the USD.
- The circulation of foreign currencies and pricing of foreign currency in the domestic market was completely abolished, and the circulation of foreign exchange certificates (FECs) that had been started way back in 1980, was also discontinued.
- China Foreign Exchange Trading System (CFETS), an inter-bank market was also established.

Towards an Exchange Rate Equilibrium

In 1994, many commentators were of the view that the unification of the two rates led to the devaluation of the RMB, leaving the currency undervalued (Makin 1997 as cited in Goldstein and Lardy 2009: 6).This soon proved to be an error. Therefore before the unification of the official and the swap market rate the gap became so wide that at China's foreign exchange retention system that while four-fifths of all foreign exchange transactions were through the swap market rate at RMB 8.7 (IMF 1995: 13 as cited in Goldstein and Lardy 2009: 6), left one-fifth were through the official rate, which was at RMB 5.8. Goldstein and Lardy (2009), therefore concured with (Fernald, Edison, and Loungani 1998) when they emphasize that the depreciation value was only 7 percent rather than the 35 percent, which is the one often cited.

The second most important phenomenon was that the price of the foreign exchange in the swap market was being determined without the government intervention at the time of the unification of the two rates. It had stopped around 1988. Therefore the swap rates in the market in the mid-1990s, were not encumbered by government intervention, as it was in the mid-1980s. The unification of the swap and the official exchange rate was RMB 8.1; therefore the rate was slightly undervalued during the unification. The primary reason that the RMB was undervalued in January 1994, was because the importers, who came to know of the government plans about the unification, stimulated the transactions to dodge from paying more for the foreign exchange. The exporters, on the other hand, deferred their trade till the unification of the swap and official exchange rate in order to gain leverage (People's Bank of China

1995: 44; IMF 1995, 6 as cited in Goldstein and Lardy 2009:7). Consequently, China's trade balance that was positive in 1990-92, underwent a deficit and returned to a moderate surplus only in 1994. Within 18 months of the rate unification, the nominal exchange rate of RMB against the USD appreciated to RMB 8.30. China went through one of the highest rates of inflation during 1994, where prices increased by 24% and again in 1995, when prices shot up by 17%. These developments led to the equilibrium of the exchange rate in China. The IMF calculated that after the unification of the swap market and official exchange rate, the real effective exchange rate of the RMB appreciated by 13% in 1994 and an additional 5% in 1995 (IMF 1996: 50 as cited in Goldstein and Lardy 2009: 7).

China's current account position was not far from equilibrium during the period of 1994-96. The current account deficit of 1993, which was 2.0% of gross domestic product, gave way to surpluses of 1.4% in 1994, 0.2% in 1995 and 0.9% in 1996 (Goldstein and Lardy 2009: 7).

Finally, the unification of swap and official exchange rates in 1994, led to reduction in exchange controls on current account transactions, although, it was followed for less than two years, culminating in an official move to full convertibility on all current account transactions.

In April 1994, the state established the China Foreign Exchange Trade System (CFETS) based in Shanghai. It unified interbank market for foreign exchange transactions replacing the old foreign exchange market. In the first place, beginning in March 1995, the USD and the Hong Kong dollar were the only currencies that were being traded in the interbank market, but the Japanese Yen was also allowed for trading. Besides, in the former adjustment, non-financial institutions mostly dominated market transactions, while in the case of interbank transactions, the institutions were the central bank, foreign exchange banks, foreign funded banks and institutions approved by the SAFE. Nonetheless, due to limitations of the market, the interbank was unable to provide a proper price forming mechanism and the RMB was allowed to float within a very narrow band of ± 0.15% and ± 0.3 %, with the reference rate published by the People's Bank of China (PBC) for daily retail and interbank transactions respectively (Si 2014: 6-7).

Before the exchange rate unification in 1993, China had a trade deficit of $12.2 billion. While after the unification of official and swap exchange rate, the trade balance was increased to $5.4 billion, eventually the net foreign capital that entered at the same time accumulated around $32.6 billion. This surplus both on the trade and capital accounts, led to an overall surplus balance of payments of USD 30.5 billion (Guijijn and Schraam 2003: 24).

Hence, the foreign exchange market saw an excessive supply of foreign currency resulting in high inflation rates and RMB appreciated rapidly after late April 1994. The RMB exchange rate fell from RMB 8.7 per USD to RMB 8.44 per USD. PBC interceded in the foreign exchange market to forestall further appreciation of the exchange rate, which eventually resulted in steadily building up of the country's foreign exchange reserves. Therefore, the official exchange reserves from January 1994 to January 1996 rose from $26.4 billion to $77.9 billion (tripling the amount). It was in May 1995, that the RMB exchange rate started to gradually stabilize around RMB 8.3 per USD, leading to RMB 8.28 per USD by the end of 1996 (Guijijn and Schraam 2003: 25).

In 1996, foreign exchange gained momentum calling for new reforms in the system to replace the interim regulations issued in 1980. These were:

First, the Foreign-Funded Enterprises (FFEs) were permitted to sell their foreign exchange for current account transactions in the nominated foreign exchange banks On the other hand the foreign-funded banks were also appropriated for the foreign exchange banks, which could directly engage in buying and selling of foreign exchange with the FFEs.

Second, foreign-funded banks in the four trial areas were granted the status of designated foreign exchange banks and could engage in buying and selling of foreign exchange with FFEs.

Thirdly, it was required for FFEs to open two foreign exchange accounts; one was the settlement account for current account transactions and other for capital account transactions. SAFE also fixed a ceiling on the amount of foreign exchange being held in the settlement account (Guijijn and Schraam 2003: 26).

Eventually on 29 January 1996 the State Council went ahead with the new rules and regulations in case of foreign exchange administration. The agenda of these new regulations was in line with the official policy to augment control on capital account transactions and RMB current count convertibility.

On 27 November 1996, the then PBC governor Mr. Dai Xianglong wrote a letter to the IMF, accepting the obligations of Article VIII of the IMF Articles of Agreement. According to Article VIII, Sec. 2, China was unable to impose any kind of restrictions on the making of payments and transfers for current international transactions without the approval of the IMF. On the other hand, China eventually attained the goal of current account convertibility, ahead of the given schedule of three years (Si 2014: 7; Guijijn and Schraam 2003: 27).

In 1997, a financial crisis hit the shores of Thailand, soon spreading to other East Asian economies too. The crisis also impacted China, although most of that was secondary damage, since China was spared from the direct effects of the crisis. During the crisis, many Asian currencies plummeted vis-à-vis the USD (Si 2014: 8). Since the RMB was pegged to the USD, when the USD appreciated on the trade-weighted basis, the RMB also appreciated. When around mid-1995 to early 2002 the USD reached a peak, the RMB also appreciated by 24 percent on the real trade weighted value. China's export growth began to slow down in the second half of 1997 and China had to maintain tight controls on its capital account, which went against the full account liberalization that China had been aiming for. China's account surplus was a bit elevated during 1997 and 1998 reflecting the slowdown in China (Goldstein and Lardy 2009: 9). China was also able to keep the Yuan stable during the crisis, despite the pressure to devalue it, because of the central bank intervention. Later in 2000, China also authorized the yuan to close marginally above its 30-basis-point band, which eventually widened by 10 points to 8.2760-8.2800 against the USD (*Reuters* 2012a). It was in 2001 that its normal rate of growth was resumed and the current account surplus fell to 1.3% (Goldstein and Lardy 2009: 10).

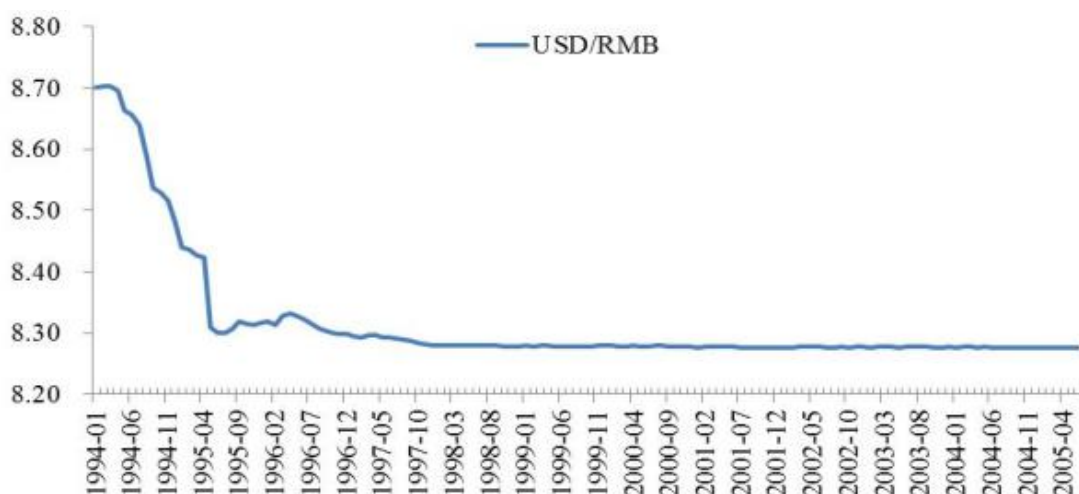
Eventually on 11 December 2001 China became the 143rd member of the World Trade Organization (WTO). According to the accession agreement, China conceded that it would open its financial markets over a period of five years, to foreign competitors (Si 2014: 8). China's nominal effective exchange rate remained fixed vis-

à-vis the USD while the USD's appreciation during 1994 to the early 2000s, kept China's current account position in equilibrium. With regard to the actual/real effective exchange rate, it kept in string the real equilibrium exchange rate from the mid-1990s to the very early part of the next decade. On the other hand, China's policy of maintaining a fixed nominal exchange rate *vis-à-vis* the USD after 2001, brought about new results. In February 2002, after being at a peak, it started to depreciate, leading to depreciation in the value of the RMB as well (Goldstein and Lardy 2009: 9-10).

It was in 2003, that China's huge trade surplus scaled up with the US and all over the world, which led to the international pressure on China to let the yuan rise to balance global trade (*Reuters* 2012b).

Around mid-2005, the value of the RMB on a real-trade weighted basis had fallen by 10 percent and according to the productivity growth in China's export sector, it was undervalued by about 20 percent. Thus, from June 1994 to June 2005, the RMB exchange rate fluctuated in a range of RMB 8.7 to RMB 8.28 per USD; internal and external imbalances were also generated due to the *de facto* fixed exchange rate regime (Reuters 2012c).

Table 9.: **USD/RMB Exchange Rate (1994 to June 2005)**



***Source:** Wen Si 2014
URL: https://papers.ssrn.com/sol3/Delivery.cfm?abstractid=2543400
Accessed 15 July 2018

4.3.5 The Reform Phase IV (July 2005 to date): From Fixed to Floating

It was on 21 July 2005 that PBC announced that China had moved into a floating exchange rate regime, based on the market of supply and demand with reference to a basket of currencies. Governor Zhou Xiaochuan of the PBC said that, 'according to the general goals of the reform of the exchange rate regime set at the Third Plenary Session of the Sixteenth CPC National Congress in 2003, China [would] seek to establish and improve the managed floating exchange rate regime based on market supply and demand to keep the RMB exchange rate basically stable at an adaptive and equilibrium level' (People's Bank of China 2005a).

He elaborated further that the reform of the RMB exchange rate regime was a basic requirement for the establishment of the socialist market economic system in China and for strengthening the same. It was needed for macro economic adjustment and to deepen the economic system reform and to maintain the RMB exchange rate stable at an adaptive and equilibrium level. He concluded that therefore the RMB exchange rate regime would also have to proceed in a proactive, controllable and gradual way.

> *“"Proactive" implied the reform mode; its content and timing based on the needs arising in the process of China's domestic reform and development. The impact of the exchange rate regime reform on macroeconomic stability, economic growth and employment must be taken into account. "Controllable "implies that China should be able to control the changes brought by the reform of the RMB exchange rate regime at the macro level so that the reform momentum could progress steadily to avoid large fluctuations of the financial markets and the economy. "Gradual" means the reform of the exchange rate regime must be carried forward in a gradual manner to ensure sufficient resilience of all the parties involved” (People's Bank of China 2005b).*

The reform also led to the RMB no longer being pegged to the USD; rather the new RMB exchange rate was determined on the basis of a basket of currencies that included four major currencies: the USD, the Euro, the Japanese yen, and the Korean won, as well as seven other currencies, viz., the Singapore dollar, the British pound, the Malaysian ringgit, the Russian ruble, the Australian dollar, the Thai baht, and the Canadian dollar. The currencies in the basket were assigned according to the weightage of each currency along with the real situation of China's external economic development. Therefore the currencies reflected the geographical distribution of trade, services, or capital flows and thus the new RMB exchange rate was in line with China's global economic profile. The reference to a basket of currencies indicates that

the exchange rate changes between the foreign currencies, and not necessarily pegs the RMB to the basket currencies equally The managed floating exchange rate regime is also based on another major factor, ie., the situation of market supply and demand (People's Bank of China 2005c).

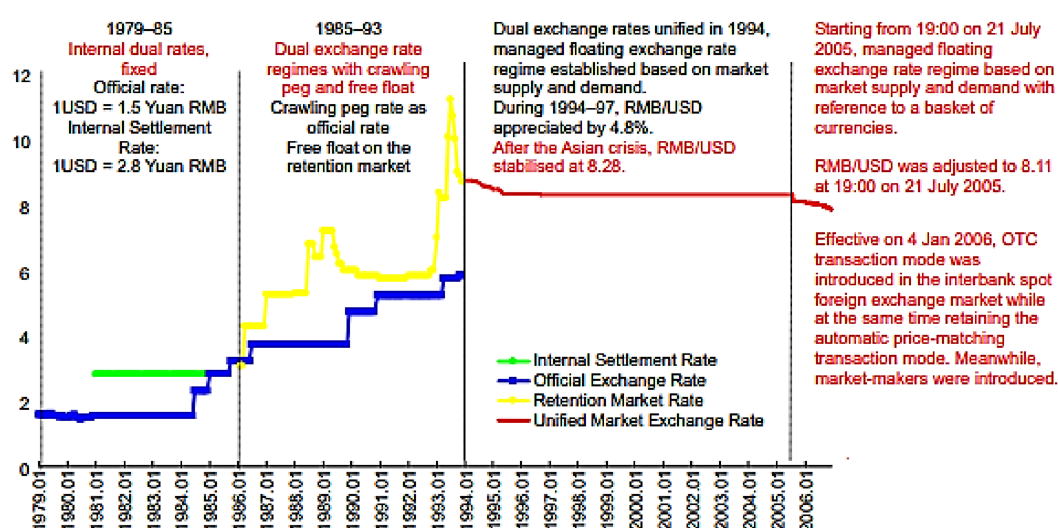
The PBC also revalued the yuan by 2 percent from RMB 8.28 to RMB 8.11 per USD. The daily trading price of the USD against the RMB in the inter-bank foreign exchange market, was allowed to float within a band of ±0.3 percent around the central parity published by the People's Bank of China, while the trading prices of the non-USD currencies against the RMB would be allowed to move within a certain band announced by the People's Bank of China (People's Bank of China 2005).

The band widened from ±1.5% to 3% in September 2005, then in 2006 the rate of the RMB, relative to the USD, was almost uniform. It was in May 2007, that the band was enlarged from 0.3% to 0.5%, while for the RMB against the non-USD currency (Si 2014: 9). In July 2008, China's central bank pegged the yuan against the USD at 6.83 reflecting a cumulative nominal appreciation against the USD of 21 percent compared with that in July 20, 2005. The move basically was to prevent the yuan from falling back and to help China to negotiate the worst phases of the global financial crisis (Morrison and Labonte 2013: 3).

The official exchange reserves have also taken an upturn with the change in the new foreign exchange regime. The foreign exchange reserves rose from $230 billion in June 2005 to $240 billion in June 2006. Although, the new regime officially went by the statement that the supply and demand in the market would determine the rate of RMB, but in fact government intervention increased rather sharply. In the next 12 months, from June 2007 to June 2008, the foreign exchange reserves rose by $391 billion to $476 billion. By the end of 2008, it had reached to $1,946 billion. The exchange market intervention in the last quarter of 2008 fell apparently. Morris Goldstein and Nicholas Lardy endorse Stephen Green's (2009) finding that this fall may be due to reasons like a combination of large short-term capital flows, disruptions in trade financing and possibly other transitory factors, implying that the accumulation of reserves in 2009 might be because of the low levels seen in 2008 (Goldstein and Lardy 2009: 21-22).

It was in the 1950's that the Chinese authorities had adopted the highly overvalued exchange rate and rigid exchange controls and in early 1979, the decentralized trading system was introduced. Between 1980 and 1995, the authorities were able to devalue the currency by about 70 percent in real effective terms (Lardy 2002: 49) and it was by mid-1990s that all exchange controls were abolished on trade transactions by domestic firms. These developments led to equilibrium in the exchange rate regime. Therefore, in 1998 China accepted the requirements of Article VIII of the IMF on current account convertibility, abolishing all prevailing controls on foreign exchange for current account transactions on foreign invested enterprises. The fixed exchange rate regime that was present in the mid-1990s, gave the system stability. While the RMB remained pegged to the USD from 1994-2001, it gradually appreciated on a real effective basis. The result of the appreciation was felt in the export sector, where the differential productivity growth was offset, leading to a modest surplus in China's average current account. In a nutshell, China's currency after 2001 underwent devaluation at a rapid pace, enabling its trade and current account surpluses to rise higher. In mid-July 2005, the approximate degree of under-valuation of the RMB was 23 percent, which rose to 26 percent by November 2007. As China's trade and current account surpluses amplified, the foreign exchange reserves increased at an unparalleled rate (Goldstein and Lardy 2009: 26).

Table 10: The Evolution of China's Exchange Rate Regime (1979-2007)



Source: People's Bank of China (2014), "China: The Evolution of Foreign Exchange Controls and Consequences of Capital Flows."

URL: https://www.bis.org/publ/bppdf/bispap44h.pdf
Accessed 15 July 2018

This huge current account surplus of China and its international reserves became the source for China to invest in Sovereign Wealth Funds, which continued to grow in 2008. This investment became a source of suspicion in the Western capitalist world towards China and the US Treasury's December 2008 Report took a critical view of China's constantly undervalued RMB exchange rate and major interventions in the foreign exchange market.

Around mid-July 2008, China again put an end to the appreciation of its currency because of the diminishing demand for Chinese products, resulting from the global financial crisis. In 2009, Chinese exports fell again by 15.9% against the previous year. All this led to the closure of many export industries and over 20 million migrant workers losing their jobs. Therefore, to avoid any further appreciation of the yuan against the dollar, Chinese government held constant the yuan per dollar exchange rate (stable exchange rate), which was 6.83 in mid-June 2010. Thus between July 2008 and June 2010, the regime adopted a fixed peg with little escalation being allowed around the peg.

In June 2010, the People's Bank of China on the basis of the prevailing economic conditions, once again announced an appreciation of the RMB and proceeded with the reform in the RMB exchange rate regime through RMB exchange rate flexibility. This continued from June 2010 to May 2012. Citing other observers of the yuan's movement, Morrison and Labonte argued that since the yuan depreciates after a period of appreciation, it is not at all certain whether the Central Bank of China would permit it to appreciate over a period of time. Thus, they contended that the appreciation of yuan will happen over a longer period of time. They further add that in an effort to limit the RMB speculation and the flow of 'hot money' can lead to de-stabilization of the economy.

During the period from May 2012 to March 2015, the PBC announced greater flexibility in the exchange rate regime, and the band of RMB-USD exchange rate increased from ±0.5% to ±1.0%. It also allowed, and at times encouraged, bi-directional changes in the RMB exchange rate. Citing Wei 2014, Moosa and Li make the point that 'China took a major step in its endeavour to make "yuan a freer

currency by further loosening its daily trading limits, [which] indicates the leadership's belief that the country's economic growth, though slowing, is strong enough for exchange-rate reforms to move forward". Wei Li also argued that since this was the yuan/dollar rate, the variation of a 2% margin was allowed on either side of the parity rate, to be determined by the Central bank on a day to day basis. Therefore, it can be clearly seen that the exchange rate system was of limited flexibility, governed by a band that determined the maximum variation on either side of the parity, a fixed exchange rate and flexible within a band (Moosa and Li 2016: 354).

Another major reason that China went on to adopt a flexible exchange rate system, was in order to make the yuan a part of the Special Drawing Rights (SDR) and was a key step towards making RMB a future international currency.

According to a research by the Peterson Institute for International Economics, China was not manipulating its currency from 2015 to 2017. On 11 August 2015, China amended its policies to allow greater market volatility to the yuan. It announced that the yuan's "reference rate" would be equal to the previous evening's closing value on the foreign exchange markets. The rate of the yuan per dollar fell immediately by 1.9 percent. In the coming days, capital flight caused substantial depreciation and volatility in the RMB exchange rate. The yuan continued to fall in 2016; on 11 January it was 6.58055 yuan against the USD. Then on 01 October 2016, it reached a six-year low of 6.7008 and continued falling, reaching 6.9582 on 18 December 2016. Although it strengthened somewhat in 2017, reaching 6.8432 on 18 January, it fell again in the spring and started to strengthen from 6.89 on 24 May to 6.794 by 11 June 2017. The yuan has strengthened more than nine percent against the dollar since December 2017. Since then, China has kept the yuan nearly constant against a broad trade-weighted currency basket. It is expected that the yuan-dollar exchange rate will stabilize and stay above 6.8 in 2018 (Hunter, G.S. 2016 WSJ; Amadeo, K. 2018 The Balance).

4.4 Currency Manipulation

Currency manipulation occurs when a country artificially inflates or deflates its exchange rate. Thus, according to the Peterson Institute for International Economics (IIE), currency manipulation is observed “when a government buys or sells foreign currency to push the exchange rate of its currency away from its equilibrium value or to prevent the exchange rate from moving toward its equilibrium value.”

According to Bergsten and Gagnon (2017), a country must meet all of the following criteria to be considered a currency manipulator in a given calendar year:

- The current account surplus exceeds 3 percent of GDP;
- Net acquisitions of official foreign-currency assets (net official flows) exceed 2 percent of GDP;
- Foreign exchange reserves and other official foreign assets exceed three months of imports;
- Foreign exchange reserves and other official foreign assets exceed 100 percent of short-term external debt, public and private;
- Net official flows exceed 65 percent of oil exports minus production cost;
- Classification by the World Bank as a high-income or upper-middle-income country.

Countries also manipulate their currency for a number of reasons:

- To boost current account surpluses,
- For political gain,
- To avoid inflation,
- To make exports more competitive, and/or
- To reduce the inflow of capital into their country (Gagnon and Morrison 2015 PIIE)

The most commonly held assumption regarding currency manipulation is its effect on trade. When a country’s currency depreciates, relative to other currencies, the exports of the country become cheaper to importing countries, at least for the short term. Therefore, the imports become relatively more expensive for that country, leading to the domestic manufacturing undergoing losses.

4.4.1 History of Currency Manipulation

The first perils of currency manipulation were seen during the tumultuous times of the 1920s and 1930s. During the Great Depression of the 1930s, it played a crucial role as the currency wars increased in the face of a weak global economy. Countries started devaluing their currencies in the backdrop of a general nationalistic wave. This in turn led to the markets being ruined at the global level. This competitive devaluation among the various economies resulted in rampant inflation, which proved to be fatal. This propelled the Federal Trade Commission (FTC) to look for the possible solutions towards exchange rate manipulation, but it did not come out with any particular solution; rather it said that, 'dumping has been repeatedly recognized as unfair competition in national legislation and in international conferences and agreements, although it is sometimes very difficult to draw the line between what is fair and what is unfair in foreign-trade development (As cited in Howard 2013: 1218).

Soon after the end of World War II, at the Bretton Woods Conference, the major powers finalised the blueprint for the International Monetary Fund (IMF) and the World Bank. It was in 1947 that the General Agreement of Tariffs and Trade (GATT) was signed between countries to shift from *laissez faire* economics to a regulatory regime, administering inter-state monetary affairs. The IMF was assigned to oversee the affairs of the international monetary system. The IMF "ensures[s] exchange rate stability and encourage[s] its member countries to eliminate exchange restrictions that hinder trade." In the beginning, the IMF-pegged exchange rates were to be measured by standard par-value based on the value of gold. This system again collapsed in late 1960s, as the exchange rate was not stable. Therefore, in 1971 the Board of Governors of the IMF agreed on an amendment to the Articles of Agreement, that the gold system would not serve as the set standard, hence stable exchange rates were no longer the rule. But, when currencies are not pegged to a certain standard, problems might set in.

As mentioned at the outset, currently, China has been described by the OECD countries as being a Currency Manipulator (Howard 2013: 1219).The articulation of this charge of 'Currency Manipulation' on the part of China began in 2003, when a series of US Congressional Bills labeled the RMB as a 'manipulated' or 'fundamentally misaligned' currency, calling for retaliatory measures unless

considerable appreciation occurs. During different periods of times, Chinese currency went through different exchange rate policy regimes: it has been pegged to the dollar, allowed to float and devalued by Chinese government.

Before 1994, China adopted a dual exchange system, consisting of an official and a market rate system. By 1994, the system was abolished and the RMB was pegged to the dollar at 8.70 RMB, which by 1997 was 8.28 RMB and remained that way till 2005. Since 2005, it changed from a fixed to a basket peg, while from 2006 to 2008, it gradually appreciated under a policy of a crawling peg. Between 2008-2010, it stabilized relative to the dollar. From 2010, it was again a crawl-like management. In 2015, the Chinese government came out with an exchange rate index of 13 currencies, so as to shift markets away from interpreting the RMB exchange rate movements as being driven only by its connection to the USD. It was in 2016, that the IMF changed China's classification from flexibility against USD to a basket of currencies. Since December 2017, the RMB has been nearly constant against a broad trade-weighted currency basket (Clark 2017: 1-2).

China's swift economic rise in the last four decades has brought about significant levels of integration between China and the economies of many countries. It has a trade surplus with US since 1985, leading to the current account deficit. From 2000 to 2010 it accumulated currency account surpluses of $1.8 trillion, while the United States accumulated global trade deficits of $7.6 trillion (Howard 2013: 1221). The European Union's trade deficit with China reached €180 billion in 2015 during the time period of 2002 and 2006. China's hold over huge amounts of trade deficits thus led to concern over China's exchange rate policy,[20] and consequently led to the charge of being a 'currency manipulator'.

The RMB's value, relative to the dollar and euro in the United States and European Union is one of the contentious issues in the political arena. While the US is at the forefront of this issue, the Euro being the second most powerful currency also plays an important role. Most of the analysts have implicated China in the matter of interfering in the currency markets so as to give its currency a competitive advantage.

[20] "Is the Renminbi undervalued or overvalued?", *China Power Project*, Accessed 15 July 15, URL: https://chinapower.csis.org/renminbi-undervalued/

According to them, China's policy is to limit the appreciation of its currency, so that the RMB gains unfair trade advantages over its trading partners.

4.4.2 Debates on Currency Manipulation

The kinds of debates that have emerged recently in the context of currency manipulation are:

- Among the most significant of the debates is whether the RMB is or has been, artificially low[21], undervalued[22], misaligned[23] or manipulated[24] and what the extent of the manipulation is. The latter question emerged in the context of the US' trade imbalance with China and the ensuing debt. It centers on China's rising current account surplus (and the United States' rising current account deficit) and the Yuan's contribution to this situation. The other major argument is with regard to the American business losses, as their exports have higher value in China and the job losses that Americans have faced in the manufacturing sector.
- Another major debate that came up was in relation to the role of RMB in future international (financial sector) reforms.
- Finally, there is the question of the potential threat from China and its currency regime owing to Beijing's impressive foreign reserves, which are mostly in USD. This massive build up of foreign reserves was invested overseas by China through the vehicle of Sovereign Wealth Funds. This investment is the potential threat, which many analysts believe was prompted by the devaluation of Yuan i.e. currency regime of China. This has become has one of the major debates in OECD countries; the fear of SWF and its strategic and political leverage by China adds to the levels of mistrust about the rise of China.

Since the RMB was pegged against dollar in 1994, China's foreign reserves have steadily risen. From USD 52.9 billion, its foreign reserves crossed more than $ 1trillion by October 2006 and by the end of December 2009, it had gone up to USD

[21] The currency boosting its exports and trade surplus at the expense of trading partners.
[22] A currency with an exchange rate lower than it ought to be.
[23] Whenever a country runs persistent, significant overall trade surpluses or deficits, its currency in misaligned.
[24] Currency manipulation is the act of changing its value against other currencies instead of leaving it free to fluctuate based on market dynamics.

2.4 trillion. The value of Chinese foreign exchange reserves peaked at just over $4 trillion in June 2014, but since declined to $3.19 trillion in August 2016 (Neely 2017: 1). In March 2018, China's foreign exchange reserves stood at $3.1428 trillion (*Xinhua* 2018). This has been the source of much speculation and discussion among the OECD countries and specially the US, generating concerns about the leverage that it imparts to China in the world economy as also politically and strategically.

4.5 China's Exchange Rate Policy and the International Legal Framework

In general, international law acknowledges a state's right and freedom to issue a currency and also to ordain its value. It also recognizes the currency regulation as a part of the state's internal matter. Hence, China, as other countries, is free to determine the value of its currency and its exchange rate policy. Mercurio and Leung (2009) examine this problem of determining the exchange rate in the case of two nations, in their article, 'Is China a 'Currency Manipulator?' They point out that "the impossibility for both nations to achieve their respective desirable exchange rate may imply either that the countries at issue do not exchange currency or that both countries compromise to agree on an exchange rate". They believe that these compulsions are not important enough to take away from the state, its fundamental right of determining its own currency. Therefore, it is their contention that China has the inherent sovereign right to regulate its currency; China's exchange rate policy is not circumscribed by any international law. China can adopt any exchange rate policy that it deems to be in its best interest. However, there are economists like Michael Mussa, who differ with this view, arguing that the exchange rate is the value of one currency against another; therefore states cannot determine the same as their sovereign right. Other than that, China has been a signatory to a plethora of international agreements. Therefore the legitimacy of its exchange rate policy can be rated under such agreements. In the sections below, they would be rated on the basis of the provisions governing the IMF and the WTO.

4.5.1 International Monetary Fund (IMF)

In 1977, the IMF took a decision to maintain surveillance over exchange rate policies, which were made on the basis of the collapse of the Bretton Woods system of par

values[25]. But, it was mostly about the maintenance of undervalued or overvalued exchange rate pegs for domestic reasons. It was in 2007 that the decision to implement bilateral surveillance under Article IV of the IMF's Articles of Agreement was incorporated. The new amendment in Article IV took into account the shift from achieving a stable exchange rate into achieving a stable exchange rate system.

The explanation of the term ‘fundamental misalignment’ by IMF is: “[W]hen the underlying current account is not in equilibrium (which may be due to exchange rate policies but also to unsustainable domestic policies or to market imperfections), the exchange rate is “fundamentally misaligned.” In other words, fundamental exchange rate misalignment, an important indicator of external instability under the 2007 decision, is a deviation of the real effective exchange rate from its equilibrium level– that is, the level consistent with a current account (stripped of cyclical and other temporary factors) in line with economic fundamentals.”

Furthermore, the IMF also stated:

“The IMF’s Articles of Agreement provide that member countries shall ‘avoid manipulating exchange rates . . . to prevent effective balance of payments adjustments or to gain an unfair competitive advantage over other member.’ But the Fund had provided little guidance on what constitutes such exchange rate manipulation. The 2007 Decision on Bilateral Surveillance that the IMF’s Executive Board approved on June 15 provides guidance to the IMF’s 185 member countries on the type of behavior that is at issue”.

The decision of 2007 decision states that a member would be “acting inconsistently with Article IV, Section 1 (iii)’, if the Fund determined it was both engaging in policies that are targeted at – and actually affect – the level of exchange rate, which could mean either causing the exchange rate to move or preventing it from moving; and doing so ‘for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate’ in order ‘to increase net exports” (Yu 2013: 585-586).

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[25] Apparent worth or the nominal value shown on the principal ('face' or 'head') side of a bill of exchange, currency, security (stock/share, bond), or other type of financial instrument.

The bilateral surveillance however is unlikely to change much, in the context of the exchange rate policies of China. According to the literal interpretation of Article IV, manipulation is only counted when the member engages in policies specifically 'for the purpose' of prompting a fundamental misalignment to assure increase in net exports. This violation is difficult to prove, as China can easily defend its policies by rationalizing them as a means of bringing economic stability and its advancement of domestic economic growth through exports.

Secondly, the decision of the board mostly stresses 'dialogue and persuasion' as the way of effective surveillance, if a country is found to be in violation of Article IV. So it is not a counter measure against a powerful country, rather just a judicious move stressing persuasion and consensus by IMF.

Overall, IMF has little sway over a country like China. Theoretically, the members who violate the stipulations of the IMF have to be punished through reduction in access to the Fund's resources and in extreme cases, suspension or expulsion from the membership. Nonetheless, the decision of the board of 2007 does not imply directly that any such sanctions would be deployed against the violators of Article IV.

The IMF in practice can recommend cutting off IMF borrowings, but that is not the case with China. The only restraint is the 'firm surveillance' of conflicting activities resulting in fundamental misalignment or currency manipulation. But IMF has no power to ask a country to change its exchange rate; it can only try to persuade countries by offering economic advice and convincing states that it might be in their best interests to comply. *To date, the IMF has never found China to be in breach of the provision against currency manipulation.* For that matter, even the U.S. Treasury has conceded that it cannot find any conclusive evidence of China's intent concerning its exchange rate regime (Yu 2013: 587; Howard 2013: 1225-1226).

4.5.2 World Trade Organization

The World Trade Organization was commissioned in 1995 and its major aim was to "provide a forum for negotiating agreements aimed at reducing obstacles to international trade and to ensure a level playing field for all, thus contributing to economic growth development." The WTO takes measures to enforce its policies, if a country violates its rules and regulations. A country may file a complaint against the

other if it considers the other country has violated WTO rules and put up their case before a dispute settlement panel., [I]f the losing party does not comply with the ruling within a reasonable period of time, the WTO may . . . authorize it to impose retaliatory measures . . . against the offending country or to take other appropriate retaliatory measures against that country's trade'. Therefore, as a member of WTO, all of China's laws most comply with WTO's rules and regulations. There are two major laws that can be used against China's currency policy, a complaint based on GATT Article XV and SCM Agreement constituting of an impermissible export subsidy (Yu 2013: 588).

Impermissible Export Subsidy

The Agreement on Subsidies and Countervailing Measures (SCMs) stipulates that 'subsidy' exists if 'there is a financial contribution by a government involving a direct transfer of funds, tax credits, or assistance in goods or services other than general infrastructure.' Additionally, export subsidy is 'contingent upon export performance' and must be 'specific to an enterprise or industry' and not be applicable to all producers. The WTO regulations proscribes countries from procuring subsidies to promote their national exports, but whether that apply to a country's currency policy or not, can be questioned. The authors elaborate their argument with the example of the countervailing duty petition filed by US producers of flexible magnets, alleging that when China devalues the RMB, the Chinese importers get the profit, making the US imports expensive and therefore fewer consumers for the same. But, if looked at carefully, this is not the work of Chinese exporters and nor are they directly benefitting from the same. Hence, the argument against China is not a compelling one (Yu 2013: 589).

4.5.3 GATT

The WTO members are required to accede to the already established rules and regulations by GATT. Article XV of the GATT, titled "Exchange Arrangements" can be a ground for a probable WTO complaint. The article recognizes the link between trade and exchange rate policies. Article XV, paragraph IV provides that members shall not (1) "frustrate" the intent of the provisions of the GATT by an "exchange action"; or (2) "frustrate" the intent of the IMF Articles by 'trade action'. One of the major subjects of concern when drafting the Article was the meaning of the

“frustrating the intent of provisions.” This led to an explanatory note being added. The note says ‘that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article, if, in practice, there is no appreciable departure from the intent of the Article.’ Many commentators believe that it is ‘highly unlikely,’ not impossible, to enforce rights and obligations under Article XV (IV) (Mercurio and Leung 2009: 1285-1287; Howard 2013:1227-1229).

Mercurio and Leung further try to explain the same with the findings from other analysts. They quote Subramanian and Mattoo to the effect that Article XV (IV) provides ‘too vague an obligation to provide a basis for effective enforcement,’ and questions that with such a case whether a panel without any previous jurisprudence on the issue can make a ruling against an undervalued exchange rate or not. They also quote Hufbauer, Wong, and Sheth (who they say also agree with Subramanian and Mattoo), and eventually conclude that the appendix to the interpretation of Article XV (IV) which says that “specific GATT article needs to be frustrated in an important way before the structures of Article XV (IV) can be invoked” (Mercurio and Leung 2009: 1288).

The Article has been applied only once since its establishment in 1947. The Article XV (IV) has been differentiated based on the exchange and the trade action where the exchange action generally talks about currency and capital and pertains to the matters of currency convertibility or capital movement. On the other hand, trade action is engaged with the domestic and cross-border flows of goods and services (Yu 2013: 590).

A sub-group looked into this differentiation in 1954 during a review session and they concluded that ‘in many instances, it was difficult or impossible to define clearly whether a government measure is financial or trade in character and frequently it is both.’ It further stated that the differentiation is based on the technical nature of government measures, rather than on the effect of these measures on international trade and finance. Although, at times both actions work similarly, in case of balance of payments and foreign reserves, but in terms of aims and objectives, are distinct from each other (Yu: 2013: 590).

In case of China, the pertinent category for China's exchange regime seems to be an exchange action. China's exchange regime includes a currency peg, which includes policies determining currency convertibility and managing capital movements. Now, the major question that comes in is if China's exchange rate policy "frustrates the intent of the provisions" of GATT. But then again, there is nothing in GATT which specifically talks about the kind of regulations that would 'frustrate its intent', and the issue is also a matter of contention among analysts.

Furthermore, in case of Article XV (IV), WTO has never interpreted it and no case laws specifically exist on the same. In the case of adjudicating a claim under Article XV, the course differs from that of IMF on a number of issues. On top of that, it also states in Article XV (2) that in cases with regard to the concerns of monetary reserves, balance of payments or foreign exchange arrangements, GATT must take IMF into cognizance.

GATT members must consult with the IMF and 'shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange . . . and shall accept the determination of the Fund as to whether action by a contracting party . . . is in accordance with the Articles of Agreement of the International Monetary Fund'. Therefore, a violation of GATT Article XV (IV) corresponds with the infringement of Article IV of the IMF agreement. China's exchange rate regime exchange regime does not frustrate the intent of either the GATT or the IMF Article, and is therefore consistent with Article XV (IV) (Yu 2013: 590-591; Mercurio and Leung 2009: 1273-1278).

China definitely does not infringe Article XV (4) since the exchange regime cannot be an exchange action that frustrates the intent of the GATT. Even if the exchange regime is equated with and amounts to a trade action, China's regime does not frustrate the intent of the Article of the IMF. China thus cannot be questioned on determining its exchange rate regime.

Therefore, when it comes to institutions like IMF and WTO (along with US Treasury) that have jurisdiction over the currency manipulation, it has already been concluded that according to its measures, the charge of 'currency manipulation' is not applicable on China. A country pegs its currency against one or a basket of currencies and under the present international laws they have full leeway to chose their exchange rate

regime and currency policies. Hence, China's exchange regime is well-aligned with the present IMF Articles and WTO Agreements. In respect to the present laws and regulations China cannot be constrained to make any changes until and unless the organizations rectify themselves.

On the other hand, Chinese officials have always insisted that their currency policy is not about favouring exports over imports; rather it is for the purpose of economic stability through currency stability. They have further explained that it is the goal of the government to use exports as a way of regulating jobs for Chinese workers, to attract FDI and for contracting technology know-how. On that basis they also emphasize that the currency reform is a long-term goal of the government, which is in gradual process. Hence, Chinese officials have always strongly protested against the international pressure on China to appreciate their currency, which is an infringement of China's sovereign rights to further its goal of strengthening its domestic policies (Morrsion and Labonte 2013: 35-37).

Consequently, it also clears the assumption that Chinese RMB is challenging the domination of USD and establishing its hegemony in order to transform the existing financial architecture in the world economy.

Conclusion

The growth of China's economy was a result of the major economic reforms that took place after 1978. Michael Nelson Berger says that in the post-Mao world, China wanted to be a major player in the global market and its leaders soon realized that while their agricultural exports were satisfactory, the industrial sector lagged behind in terms of manufactured products. They also realized that were losing money, since their primary exports were subsidized and this was draining their economy. This was the time when China decided to go on a dual rate exchange system in the early 1980's and then went on for the unification of the currency in the 1990's to boost their economic growth. As a result of these reforms of the 1980s and 1990s, China's economic growth leaped forward. It was complemented by the annual increases in exports, which led to accumulation of huge amount of foreign exchange reserves in

China. These massive foreign exchange reserves were then used by Chinese government for further investments in Sovereign Wealth Funds (SWF).

In terms of international economics, when exports of a country increase, it ultimately leads to the appreciation of the currency. The appreciation of the currency also leads to a rise in the real interest rates, which may damage the domestic economy, resulting in ‘Dutch Disease’ as explained in Chapter 1. So in order to avoid all those circumstances, out of necessity, China invested in assets outside the country. According to the Chinese officials, currency policy is a long-term goal and should be seen through the lens of economic stability of the domestic economy rather than merely as a tactic favouring exports over imports.

Therefore, Chinese currency policy was not specifically a case of manipulation and investments in the foreign countries to confront the supremacy of the western powers; it appears more likely that it was essentially a move towards stabilizing its own domestic economy.

Chapter 5: Conclusion - SWF: The new face of China's rise

By way of conclusion, we shall look at the implications of the SWF for China's rise and its growing leverage in the world economy and hence its geopolitical implications. China's SWF are being increasingly seen as a geopolitical tool in the hands of Chinese State, and a range of apprehensions predominantly from the western capitalist world (as also from other regions as well) have emerged about this enormous economic asset as China steadily moves towards super power status. As was mentioned at the outset, the hypothesis on which this study is based is that the major disquiet and apprehension with the Chinese SWF is not with the SWF *per se*, but with respect to the lack of transparency regarding the same. This brief summing up will discuss the phenomenon of 'State Capitalism' and the manner in which it has permeated into the political realms of the world, providing an extra edge to China's capacity and rise

This dissertation has sought to examine the emergence and development of the Chinese SWF in the context of three main themes:

- Investment plans of Chinese SWF
- SWF and Currency Manipulation
- State Capitalism

The time-period of 2007-2017 has been taken into consideration, since the first SWF, the CIC was established in 2007. Since then, China has gone on to establish three more SWF and charted out a strategy for pursuing its investment plans throughout the world, starting with US. The second chapter 'The Chessboard of SWF, as the title suggests, focused on the history, bureaucracy and organization of the SWF. It looked into their operations as well as the politics underlying their functioning. With this understanding, the study went on to examine the decision-making bodies, detailing the sectoral investments and the degree to which they adhered to the global norms and rules in this regard. Finally, the study discussed the critical issue of the 'transparency' with which the four Chinese SWF operate and critically analysed the extent to which the concerns of 'capitalist market economies were justified.

Of all the SWFs in China, the most transparent is CIC, which is also the second largest fund by assets under management in the world. SAFE, on the hand is seen as

the discreet one, but SAFE IC investments are not known in the public forum. However, the transparency index shows that NSSF – the pension fund of China is the most non-transparent one and above that is the CADF - the SWF solely dedicated to investments in Africa. By examining the available and relevant literature and information, it emerged that there is very little empirical evidence to sustain the contention that the *modus operandi* of the Chinese SWF is very different from the SWFs of other countries. As such, the charge of non-transparency cannot be proven in any serious or rigorous fashion. The CIC, which has certainly been attracting the most attention due to the strategic nature of the sectors where it is investing, and which is believed to reflect its geo-strategic and geo-political goals, is highly transparent. Undoubtedly, the NSSF - the pension fund - which is domestically located and is geared to strengthening domestic stability, is the one that is shrouded in mystery. But in this case, China is investing in SWF for its own economic agenda of domestic growth and stability.

The other important point which emerges from this study and which is relevant in our conclusions is with regard to the decision-making bodies. All the four SWF have people on their boards who come from different agencies, ministries and organisations – they therefore have different perspectives, interests and policy priorities. The critique that the China's SWF are essentially targeted towards the geo-political domination of the world would imply that all members from diverse backgrounds in charge in the different SWFs are eyeing one particular goal, which would not be logical. Clearly it is important to nuance this aspect and look at the different SWF within their context and objectives.

The need to carefully examine the experiences of the Chinese SWF as they undertake investments in different geographical regions and sectors of the world was underscored in the third chapter. It was observed that while CIC and SAFE have been investing in the financial instruments, when they suffered losses during the 2008 GFC, they moved towards investing in energy, infrastructure and real estate respectively. We also see that CIC and SAFE have mostly been in investing in developed world, specifically SAFE whose major investments are in Europe while CIC's were more concentrated in US. In the case of NSSF, we find that its major investments have so far been limited to the domestic sector and in financial instruments, but it is likely to soon move to the international sector. Finally, the

investments through CADF have been in various sectors and industries of Africa where the major focus is natural resources, infrastructure and connectivity.

Insofar as the accusations against China by US and other OECD countries of manipulating the Chinese currency so as to increase its foreign exchange reserves is concerned, this study has taken a close look at the different stages of Chinese exchange rate reform to understand the factors and circumstances that led to the appreciation of the Chinese currency. In the third chapter it was found that given the priority accorded to economic reform by the Chinese leadership, most of the policy changes and financial sector reforms were geared to facilitating the macroeconomic reform agenda and removing the obstacles in its export-led growth strategy and keeping China open to FDI. Thus challenging the western hegemony of the world financial architecture or deploying the SWF as a tool of foreign policy appears to be somewhat far-fetched since China was beginning to reap the benefits from the structures and processes of economic globalization. Beginning with the reforms of 1978, China went through different generations of reforms and by the time it entered the 21st century, it had acquired huge amount of foreign reserves. There does not seem to be any evidence to suggest that China went in for the currency manipulation as a deliberate strategy, or that they were explicitly using the SWF as a geo-political tool – indeed they do not have the capacity to do that at present. However, given the heavy hand of the state in China, a degree of political engineering to promote its economic growth cannot be entirely ruled out. On the whole, it would be more plausible to argue that the priority concern in launching the SWF was to favour China's own domestic growth and stability.

State Capitalism – the trend of the future?

Divergent trends characterize international political economy today. On the one hand, Western Liberal Capitalism has been shaken up by crises of various sorts and on the other hand, it has given way to a potential alternative of state capitalism in emerging markets (*The Economist* 2012). Some of the prominent countries that are part of the 'State Capitalist' group are: China, Russia and Venezuela. The major argument among the critics and analysts of State Capitalism is the use of the SWF by the host countries in the recipient countries challenging their economy and impacting their foreign policy.

Ian Bemmer in his article, 'State Capitalism Comes of Age: The End of the Free Market?' (2009), points out that,

> 'the free-market tide has receded and its place has come state capitalism, a system in which the state functions as the leading economic actor and uses markets primarily for political gain. This trend has stoked a new global competition, not between rival political ideologies but between competing economic models. And with the injection of politics into economic decision-making, an entirely different set of winners and losers is emerging….State capitalism has four primary actors: national oil corporations, state-owned enterprises, privately owned national champions, and sovereign wealth funds (SWFs)'.

The economic meltdown of 2008 made it easier for China to actively participate in the international financial architecture. It gave China a tremendous opportunity to bail out the dying corporations of the western world. It was supposed to be the third wave of State Capitalism, the first appearing during the oil shocks and the subsequent oil crisis of the 1970's. The second emerged during the 1980's with the rise of the developing countries - which were predominantly state-centric - and continued till after the collapse of the socialist bloc and the centrally planned economies, giving way to a more liberalised and free trade economy.

The financial crisis of 2008 led to the slump-down of top-notch banks like that of Lehman Brothers, which went bankrupt. Other big names such as Merrill Lynch, AIG, Freddie Mac, Fannie Mae, HBOS, Royal Bank of Scotland, Bradford & Bingley, Fortis, Hypo and Alliance & Leicester[26] in the US ran into financial difficulties as well, when China intervened to bail them out with the help of its SWF. China also came out to aid other western financial institutions as the crisis deepened in the fall of 2008 and winter of 2009. Notwithstanding this bailout of major western financial institutions, the western nations are still very wary of China's SWF as an investor and the motivation of Chinese SWF is seen more as political rather than economic.

AS we have seen, the SWF have been around for nearly half a century, but we are now witnessing a turn in the movement of finance from west to east, which is making the western countries more suspicious of these emerging nations and of their SWF. The number of countries possessing SWF in the non-Western world has risen in the

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[26] Mathiason, N. (2008), "Three weeks that changed the world", The Guardian, 28 December 2008, [Online: web] Accessed July 22 2018 URL: https://www.theguardian.com/business/2008/dec/28/markets-credit-crunch-banking-2008

last few years, but little is known with regard to their decision-making power, even as they are supposed to be 'government investment vehicles'. Therefore, as discussed in the previous chapters, the OECD countries tend to perceive these SWF as Trojan horses arriving from the non-democratic countries and invading the western financial systems, their economies and threatening their sovereignty and national security. Finally, the amount of finance they hold is bringing about a historic change in the economic and financial landscape of the global economy and hence in the long run can change the power dynamics on the global front.

However the SWF of various states, specifically China, have always asserted their authority in global finance not as regulators but instead as major investors. As discussed in the preceding pages, the PRC government officials in various pronouncements have stressed the need for China to continue to generating economic growth and prosperity – it is critical in ensuring regime legitimacy and well as a prerequisite to realize the China Dream. However, Chinese SWF investment portfolios, quite markedly diverse – from financial institutions to strategic sectors - which has intensified the concerns within the OECD countries as to whether the PRC's motivations are purely commercial or geo-politically oriented. Mistrust of China also arises from issues of transparency. The fact that there is a Communist Party dominated state in China and there are strong connections between the SWF and the communist regime – makes the functioning and the decision-making somewhat opaque. So, from a western liberal perspective, this also gives rise to concerns regarding China's political intentions of politicising the market to pursue its geo-political goals. High profile financial investments by China in Morgan Stanley and Blackstone group have only intensified these concerns, with implications for national security. This has also contributed to the adoption of protectionist measures by the western nations against China to guard against the impact on the financial markets.

As Chinese SWF are perceived to be politically motivated by the west, many countries are holding down on China's regulation and it faces more barriers in playing on a level financial field with a particular country. Therefore to create a better financial investment environment and clear the air of suspicion, a global and regulatory approach in terms of SWF should be taken up with the seriously it demands in the world forums. Arguably, the most secretive of the Chinese SWF is SAFE, which does not even produce any annual report on the investments and its

returns. SAFE thus symbolizes the strongest and most dominant form of state ownership of capital and can theoretically be used the state to follow the state's strategic objectives of gaining access to energy resources, high technology and geopolitical influences. The use of SAFE as 'a conduit for diplomatic influence is highlighted by the Chinese government's decision to use that institution – and not the CIC – to invest discreetly in Costa Rican government bonds as part of a 2007 China-Costa Rican agreement which led to the latter cutting off its diplomatic ties with Taiwan and extending recognition to the PRC (Hellenier 2009: 300-304).

As stated on its official website, the CIC's objective is wealth maximization, but since it is the one which is purely state-owned and working under the auspices of the State Council, it is perceived that it will maximize its political capital in addition to the commercial one. With regards to its investments that are strategically steered under the guidance of the State Council, the most pertinent investments look into the acquisition of skills, brands and technology, the concerns are that they could be directed against the national security interests of the recipient countries. The threat perception is rooted in the possibility of the Chinese state acquiring sensitive technologies through the Chinese SWF, or increasing unjustified international influence.

Another major concern about the Chinese SWF is the issue of transparency. As some have argued, most of the above-mentioned concerns would be ameliorated to some extent if the SWF were more transparent and relied on the private corporate governance, rather than being a political and state controlled asset. The opacity of SWF has always been a key factor for western analysts and critics who are extremely skeptical of the politically-driven investment decisions. The major contention here is between the state capitalism and market capitalism, where, in the case of the former, the government is involved in the market forces and decision-making processes. In a system of market capitalism on the other hand, the market is largely unrestricted by government intervention - it essentially plays the role of a regulator. While in market capitalism, the markets are for the most part free to regulate market prices, in state capitalism, the state not only intervenes in the market but also decides the rules and regulations of the market, in addition to also intervening in the matter of prices. Therefore the market forces do not have a free hand to pursue profit and wealth maximization. The lack of transparency of SWF is leading to protectionist

measurements by the western countries, which hamper the cross border capital flows. The major trouble which stems from this paucity of transparency is the issue of a clash between the host and recipient country taking a toll on the global financial markets. Consequentially, an increase in the protectionist backlash against strategic investments could be damaging for global trade.

Contrary to the fears and concerns about the Chinese SWF prevalent in the west – or in other parts of the world - the Chinese themselves appear to be in a more sanguine and optimistic frame – as has been assessed by a leading western tabloid:

> "[W]ith the West in a funk and emerging markets flourishing, the Chinese no longer see state-directed firms as a way-station on the road to liberal capitalism; rather, they see it as a sustainable model. They think they have redesigned capitalism to make it work better, and a growing number of emerging-world leaders agree with them" (The Economist 2012).

From the outset, the Chinese have stressed that their SWF is yoked to their goals of growth rather than being designed to further their political and strategic concerns. The Chinese government is trying to maximise the returns on its SWF by harnessing it in the present period to President Xi Jinping's signature Belt and Road strategic initiative. The government appears to focused on its own sustainable economic growth rather than attempting to curb western capitalist economies and posing national security threat to other countries.

In the last decade (2007-2017), SWF have seen ups and downs in investment returns but that has not stopped China from continuing to use the SWF in further investments, motivated by the desire to look towards long term investment growth. It is even trying to expand its portfolio in the pursuit of positive returns.

Furthermore, there has never been any direct or conclusive evidence of the Chinese SWF using their ownership stakes in a manner that is threatening to the national security of the recipient country. However, one of the significant steps that can be taken is the openness of the capital market, which can curb or ameliorate the implications of the SWF gaining an upper hand in the realms of the political arena. But as a Chinese analyst point out,

> ["A]lternatively, the west has years of experience in holding down of investments which might threaten its stability and security. 'The Committee on Foreign Investment in the United States (CFIUS) is capable of reviewing SWF investment for national security concerns. CFIUS, together with a whole host of anti-trust, banking, securities and other regulations, provides a secure safety net to assure that SWF are likely to act pursuant to commercial interests" (Bu 2010: 849-877).

The huge amounts of foreign exchange holdings, the favorable balance of trade and the financial crisis presented China with an opportunity to make major investments in developed states in the hopes of further investments returns and economic growth enhancement. It could be plausibly argued that the Chinese clearly took advantage of the financial and economic situation that had emerged in the wake of the global financial crisis, rather than engaged in a deliberate act of creating an investment situation with the objective of acquiring political clout or disrupt the global financial architecture by bringing down the USD and promote its own currency, the RMB. On the contrary, China has also been highly receptive to the suggestions from IMF, WTO and GATT when it was charged with currency manipulation. Eventually, the organizations have themselves concluded that the 'currency manipulation' cannot be held against China, until and unless the organization themselves amend their own laws and regulations.

Conversely, again Chinese have been insisting that their currency policy is not directed at challenging the western financial architecture or increasing their exports over imports; rather, it is fundamentally about pursuing economic stability through currency policy. Above all, as discussed in the previous chapters, there is little evidence to support that charge that the Chinese are operating the SWF with the strategic objective of shaking up the western financial architecture or replacing the USD with the RMB

Chinese SWF, specifically CIC, has seen a significant growth in the last decade and acquired the position of second largest fund in 2017. The growth of Chinese SWF in the next 10 years will be geared to ushering in China's rise to the ranks of the developed countries. Hence, China's SWF will definitely be huge boon in the economic growth and development of a new China. For the present, they do not appear to constitute a challenge to the well-established western institutions or to the national security of other countries. But in the long term that could well be an inevitable consequence of China's rise as world power. The current debates have

obscured the nature and objectives of the SWF – and instead of generating a serious rethink on fashioning the norms and rules with regards to the SWF, it has got entangled with the fears and uncertainties regarding the rise of China. China is certainly looking forward to its emergence as a major player in the world, but at the time of writing this dissertation, there is no case to be made for these SWF as holding or exercising the kind of power that could shake up the global financial architecture.

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