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China Investment Corporation: A Perspective on Accountability

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Abstract

The incorporation and investment of the China Investment Corporation have been viewed under a spotlight as a significant event in the international financial community since the fall of 2007. With the assumption of a dual-tier accountability model, and using a comparative study with selective sovereign wealth funds, this article argues that the dual role the China Investment Corporation plays as a quasi-administrative agency at home, and a quasi-commercial entity abroad is the crucial factor responsible for its opaqueness and multi-billion dollar loss in value. It proposes that the administrative function should be separated from commercial operations, and that a firewall should be erected between the Corporation and relevant administrations to depoliticize its investments. Furthermore, the CIC-like governmental investment should be treated on an indiscriminate and unbiased basis and be included in the redefinition and negotiation of international investment regimes.

I. Introduction

This article explores selective problems, from a legal viewpoint, of the China Investment Corporation (CIC), the fifth largest sovereign wealth fund (SWF),[1] regarding its formation and the development of its investment policy, and in view of considerable con-

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1. The first documented use of the term is attributed to Andrew Rozanov. *See* Andrew Rozanov, *Who Holds the Wealth of Nations*, 15 CENT. BANKING J., n. 4 (2005). There is no universally accepted definition of SWF. *See* INT'L MONETARY FUND, SOVEREIGN WEALTH FOUNDS–A WORK AGENDA, Annex II, at 37 (2008) *available at* http://www.imf.org/external/np/pp/eng/2008/022908.pdf [hereinafter IMF WORK AGENDA]. Here it uses this term as the investment vehicle owned by governments and formed out of reserves for investments in debt and equity markets of other countries.

cerns expressed by various public officials, politicians, and scholars in the United States and Western European countries.[2]

The SWF issue, which has gained new prominence since the fall of 2007, deals with the typical controversy regarding foreign exchange reserve management. Such public attention is the result of three factors: first, the level of the foreign exchange reserve (forex) has increased dramatically over the last decade to a record high; second, more central banks of both developing and developed countries prefer diversifying their reserve management and investing the foreign exchange into financial markets with higher rates of return than U.S. Treasury bonds;[3] and third, SWFs have a large size and a high growth rate, and are opaque in their operation.[4] Officials and analysts have raised concerns that include the possibility that SWFs could be used to further political purposes and target strategic acquisitions,[5] that the risk of equity price bubbles due to the sheer size of their investments are high,[6] that the risk of an increase in volatility of financial markets is large,[7] that SWFs might have a detrimental effect on corporate governance of firms that have invested from political motives or lack of sophistication,[8] and that new forms of financial protectionism may emerge as reaction to SWFs.[9]

Thus, SWFs have been driven into the spotlight and depicted mainly in a negative light as "barbarians in the gate,"[10] political monsters, or presumed offenders. For example, a February 2008 poll showed that Americans are overwhelmingly opposed to SWF invest-

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2. *See, e.g.*, Lawrence Summers, *Sovereign Wealth Funds Shake the Logic of Capitalism*, FIN. TIMES, July 30, 2007; Steven R. Weisman, *Concern about Sovereign Wealth Funds Spreads to Washington*, INT'L HERALD TRIB., Aug. 20, 2007; Jeffrey Garten, *We Need Rules for Sovereign Funds*, FIN. TIMES, Aug. 8, 2007; Edwin M. Truman, *Sovereign Wealth Funds: The Need for Greater Transparency and Accountability*, PETERSON INST. FOR INT'L ECON., No. PB07-6 (2007); Bertrand Benoit, *Germany Drafts Plans for Own CFIUS Deal Watchdog*, FIN. TIMES, Sept. 7, 2007; Larry Elliott, *Chancellor Backs G7 Move to Get Tough on Sovereign Wealth Funds*, THE GUARDIAN, Oct. 20, 2007; Gerard Lyons, *State Capitalism: The Rise of Sovereign Wealth Funds*, STANDARD CHARTERED BANK, Oct. 15, 2007, https://research.standardchartered.com/researchdocuments/Pages/ResearchArticle.aspx?&R=50729.

3. Lawrence Summers, *Opportunities in an Era of Large and Growing Official Wealth*, *in* SOVEREIGN WEALTH MANAGEMENT 28 (Jennifer Johnson-Calari & Malan Rietveld eds., Central Banking Publications 2007).

4. Current market estimates of SWFs' assets range from $1.9 to 3.2 trillion. INT'L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: FINANCIAL MARKET TURBULENCE CAUSES, CONSEQUENCES, AND POLICIES 45 (Oct. 2007), *available at* http://www.imf.org/External/Pubs/FT/GFSR/2007/02/pdf/text.pdf.; Stephen Jen, Sovereign Wealth Funds and Official FX Reserves, Morgan Stanley Research Global (Sept. 15, 2006), http://www.morganstanley.com/views/gef/archive/2006/20060915-Fri.html; Steffen Kern, *Sovereign Wealth Funds-State Investments on the Rise*, DEUTSCHE BANK RESEARCH, Sept. 10, 2007, *available at* http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000215270.pdf. The SWFs' assets are believed to reach up to $12 trillion by 2015. For underlying assumptions and detailed calculations. *See* Stephen Jen, *How Big Could Sovereign Wealth Funds be by 2015?*, MORGAN STANLEY RESEARCH GLOBAL, May 3, 2007, http://www.morganstanley.com/views/gef/archive/2007/20070504-Fri.html.

5. Summers, *supra* note 2; Weisman, *supra* note 2.

6. Satoshi Kambayashi, *The World's Most Expensive Club*, THE ECONOMIST, May 24, 2007.

7. Krishna Guha, *Warning over Sovereign Wealth Funds*, FIN. TIMES, June 22, 2007.

8. Weisman, *supra* note 2.

9. Michael R. Sesit, *Sovereign Wealth Funds are Starting to Dominate Global Finance*, INT'L HERALD TRIB., June 18, 2007; David J. Lynch, *U.S.: Secretive Global Funds May Hurt Treasuries Market*, USA TODAY, June 21, 2007.

10. MONITOR GROUP, WEATHERING THE STORM: SOVEREIGN WEALTH FUNDS IN THE GLOBAL ECONOMIC CRISIS OF 2008 (2009), *available at* http://www.monitor.com/Portals/0/MonitorContent/documents/Monitor-FEEM_SWF_Weathering_the_Storm_04_2009.pdf.

ments.[11] Many politicians have responded to this public distrust through hearings, statements, and regulations hostile to sovereign investments.[12] Some countries have made and implemented adverse economic policies.[13] Given this climate, the issue was put on the agenda of the Group of Eight, the IMF, and the OECD and, as a result, the voluntary code Santiago principles were created last October.[14] Some commentators pointed out that the worst scenario could have happened if SWFs, combined with so-called authoritarian governments, finally emerged as a viable challenger, like Trojan horses, to the liberal democratic path taken by the advanced industrialized states.[15] On this basis, opposition was particularly focused on investments by SWFs headquartered in the Middle East or East Asia.[16] But today, SWFs are no longer seen as something to be dreaded, and their investments no longer consistently make headlines; sometimes they are even called "a source of stability" in times of financial turbulence.[17]

The CIC has never been an exception to this change, even before its formal incorporation. Its sudden peril may well be related to China's increasing economic or geopolitical power because both China's forex reserve management as well as its regulator, i.e., the State Administration for Foreign Exchange (SAFE) has invested its reserve in financial markets through its secretive subsidiary for a decade.[18] Since the deal with Blackstone in May 2007, any investment of the CIC has faced the dangers of over-interpretation as a likely elaborated move with a non-commercial goal.

Even against this background, many other countries have considered the possibility and desirability of establishing their own SWFs to invest national savings or revenue in international assets. While the origin of their consideration usually lies in the better return of forex reserves, the desirability to make a special agency, and the possibility of reaching the end has been contested. For example, on February 19, 2008, it was reported that the Indian government planned a Temasek-like multi-billion-dollar SWF to invest in overseas energy assets.[19] While this plan was proposed and supported by the Planning Commission of India to maintain future economic growth and better return of forex reserves, both the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) had previously expressed their reluctance at using foreign exchange reserves to set up an

11. According to Public Strategies Inc, "A majority of American voters think investment by foreign governments in U.S. companies harms U.S. national security interests, and nearly half believe such investments harm the American economy, according to a new survey of the attitudes of U.S. voters toward sovereign-wealth funds." Public Strategies Inc, Survey Reveals Voters Wary of Foreign Government Investment (Feb. 21, 2008), http://www.pstrategies.com/PR_20080221_PSI_SWF_Poll.php.

12. *See* Monitor Group, *supra* note 10.

13. *See* Garten, *supra* note 2.

14. Security & Exchange Board of India, *Sovereign Wealth Funds—A Study*, 7 SEBI n.4, April 2009, *available at* http://www.sebi.gov.in/bulletin/bull-april09.pdf.

15. Daniel W. Drezner, *White Whale or Red Herring?–Assessing Sovereign Wealth Funds*, GLASSHOUSE FORUM, June 4, 2008, *available at* http://www.glasshouseforum.org/pdf/GF_drezner_SWF.pdf.

16. *Id.* at 8.

17. Miller Center of Public Affairs: *Panel Summaries of The New Financial Architecture: A Global Summit* 22, Sept. 8–9, 2008, *available at* http://web1.millercenter.org/conferences/papers/conf_2008_0908_caplin.pdf [hereinafter Miller Center] (bringing together former finance ministers from around ten countries across the world to deliberate on the critical financial questions and was managed by former United States Treasury Secretary John W. Snow).

18. *See* Garten, *supra* note 2.

19. *Gov't Debating Sovereign Wealth Fund*, REUTERS, Feb. 19, 2008, http://in.reuters.com/article/idINIndia-32031920080219?pageNumber=1&virtualBrandChannel=0.

investment fund.[20] Several important factors have held back the final decision of the Indian government: its fiscal and current account deficits, the trade-offs among safety, liquidity, and profitability in reserve accumulation, the uncertain return of SWFs, its limited investment capacity, the uncertainty and turmoil of financial markets, and its domestic economic and political challenges.[21] Therefore, the necessity of resorting to such a governmental agency will depend in large part on the particular circumstances—the politics, the economy, and the legal system of a given country.

This article borrows the definition of accountability from Grant and Keohane,[22] and proposes a dual-tier accountability model to analyze the reasons and solutions for the main concerns mentioned. This model is then used to analyze legal and market accountability arrangement of the CIC. Finally, this article discusses the involvement of sovereign investment in the international investment legal framework as discussed in the concluding remarks.

II. A Dual-Tier Accountability Model for SWFs

"Accountability is a protean concept."[23] Here, the term is used to mean that some actors have the right to hold other actors to a set of standards, to judge whether they have fulfilled their responsibilities in light of these standards, and to impose sanctions if they determine that these responsibilities have not been met.[24] I propose that two types of separate accountability mechanisms are allocated among three actors: the funds, home states as sponsors, as well as the final controllers of the funds, and the investors both at home and abroad. Highly linked with mechanisms affecting the efficiency and effectiveness of SWFs' operation is the legal regime between the home states and the funds, and the market regime between the funds and the investors. "The legal accountability refers to the requirement that agents abide by formal rules and be prepared to justify their actions in those terms, in courts or quasi-judicial arenas."[25] The market accountability model suggests that market competition provides rewards and sanctions through the aggregation of individual investor or consumer choices.[26]

All of the concerns and controversies about SWFs, then, are centered on how to allocate the mechanisms or how to draw a boundary between state and market. From this angle, the red-hot debate around SWFs is just an alternate version of the traditional proposition on the role of government and its relationship with the market.

20. Security & Exchange Board of India, *supra* note 14.

21. *Id.* at 290. Y.V. Reddy, Governor, Reserve Bank of India, Government-owned Investment Vehicles and Capital Flows: Indian Perspective, Address at the session on *The Role of Government-owned Investment Vehicles in Global Capital Flows*, at the International Capital Markets and Emerging Markets Roundtable (April 14, 2008), *in* BANK OF INT'L SETTLEMENTS REV. 44/2008, *available at* http://www.bis.org/review/r080416d.pdf.

22. Ruth W. Grant & Robert O. Keohane, *Accountability and Abuses of Power in World Politics*, 99 AM. POLITICAL SCI. REV. nn.11, 29, 30 (2005).

23. *See also* Jerry L. Mashaw, *Accountability and Institutional Design: Some Thoughts on the Grammar of Governance*, *in* PUBLIC ACCOUNTABILITY: DESIGNS, DILEMMAS AND EXPERIENCES 115 (M. W. Dowdle ed., Cambridge University Press, 2006).

24. *Id.* at 29.

25. *Id.* at 36.

26. *Id.* at 37.

The legal accountability mechanism emphasizes the role of enforceable and explicit rules, which are preset and rule-based rather than the discretionary and sometimes unpredictable or arbitrary power held by political elites.[27] "In most western countries, legal accountability is of increasing importance to public institutions as a result of the growing formalization of social relations."[28] The salient features are its integrity, predictability, and explicitness, ensuring transactional security.

But, these merits cost flexibility and efficiency in the decision-making process. Hence, there is a tradeoff to be reached. In the context of the emergence and expansion of SWFs, legal accountability is linked closely with their motivation and transparency. Some countries have detailed rules encompassing the varying scope from the fund's capital resource to investment portfolio; some others rely only on decisions of a few political elites such as China, and Middle Eastern countries. Given westerners' prevailing understanding of law and democracy, it is not unusual that the latter is usually viewed as being politically motivated entities without the necessary checks and balances. Further, the opaqueness in decision-making will intensify the concerns about its non-commercial objectives and potential harm to recipient countries' national interests or "strategic sectors." In this way, the rule-based structure will be considerably helpful to present the black box of political decision-making in a clear light, to set a high barrier to any political interference, and to address those concerns resulting from imperfect and asymmetric information. But it seems difficult to have an effective institution in managing SWFs for the national variations in legal traditions and mentalities on one hand and the adaptability to reflect market changes on the other.

At the second layer, the market accountability displays its importance to both the funds and investors in investment decision-making. Here, the term is utilized to highlight information disclosure, competition, and caveat emptor principle, etc. To a certain extent, one could roughly equate it with market discipline. The investments of SWFs, which are viewed as governmental investors[29] or a sign of state capitalism[30] are changing, more or less, the landscape of global finance.[31] But it is noteworthy that when involving commercial activities as an exception to sovereign immunities, the state agencies or their subsidiaries will not enjoy sovereign status in transactions and possible dispute resolution in accordance with relevant prescriptions and practices.[32] Once SWFs invest in another country, their home countries impliedly acknowledge that the funds may be considered ordinary commercial entities without any privilege or special treatment.[33] Simply put, the funds must comply with commercial principles and discharge responsibilities, such as the ethnical and environmental conditions of host countries, like any other actors. But today, the same problem confronts SWFs as that of hedge funds and private equities one or two

27. Mark Bovens, *Analysing and Assessing Public Accountability: A Conceptual Framework*, *in* EUROPEAN GOVERNANCE PAPERS, No. C-06-01, Jan. 16, 2006, *available at* http://www.connex-network.org/eurogov/pdf/egp-connex-C-06-01.pdf.

28. *Id.*

29. Ernesto Zedillo, *Governments as Global Investors*, FORBES, May 19, 2008, at 25.

30. Lyons, *supra* note 2.

31. Miller Center, *supra* note 17, at 35.

32. KATHRYN GOLDWIN & APRIL TASH, FOREIGN GOVERNMENT-CONTROLLED INVESTORS AND RECIPIENT COUNTRY INVESTMENT POLICIES: A SCOPING PAPER (2009), *available at* http://www.oecd.org/dataoecd/1/21/42022469.pdf.

33. *Id.*

years ago: because of their systematic significance in the market, they have been pressured to become more transparent and accountable.

III. CIC's Incorporation and Legal Framework

A. Background and Facts

On September 29, 2007, the CIC, as a professional investment agency was sponsored and controlled by the Chinese government for several reasons.[34] First, in August 2007, China's forex reserve hit an unprecedented level of $1.4 trillion after rapid accumulation since 2000.[35] It is believed that the amount is substantially in excess of China's medium-term needs estimated in any measure.[36] Empirical research also shows that over the long horizon, the return on reserves invested, according to standard central banks approaches in local terms, is close to zero or even negative.[37] Second, other costs which are increasingly unacceptable are those associated with holding excessive reserves, including sterilization costs, opportunity costs, and balance sheet risks.[38] Third, rapid reserve accumulation may create a false sense of security, and reduce the incentive to tackle difficult reforms, such as currency policy.[39] Even worse, because over two thirds of the reserve is invested in low-yield U.S. Treasury bonds,[40] the concentration in portfolio left China vulnerable to losses led by either a strengthening of the Yuan or a rise in American interest rates.

On the other hand, the compulsory settlement of the foreign exchange system made this situation more unsustainable than ever.[41] All citizens and firms should preserve foreign currency, within a limited number, and must sell the excess to the People's Bank of

34. The US-China Business Council, http://www.uschina.org/public/china/govstructure/govstructure_part6/cic.html (last visited Sept. 12, 2009).

35. By June 2009, the reserve has hit $2.1 trillion. *See* SAFE, Monthly Foreign Exchange Reserves, http://www.safe.gov.cn/model_safe_en/tjsj_en/tjsj_list_en.jsp?ID=30303000000000000&id=4 (last visited on August 20, 2008).

36. According to recent literature, several basic benchmarks for emerging market economies are suggested: reserves equal to short-time external debt (1.0), reserves equal to roughly five to twenty percent of M2 (0.05-0.22), and reserves equal to three or four months of imports (3.00). China's ratios are 11.58, 0.22, and 15.72, respectively. *See* J. Onno De Beaufort Wijnholds & Arend Kapteyn, *Reserve Adequacy in Emerging Market Economies*, (IMF, Working Paper No. 01/143, 2001); Russell Green & Tom Torgerson, *Are High Foreign Exchange Reserves in Emerging Markets a Blessing or a Burden?*, U.S. Dep't. of the Treasury, Mar. 2007, *available at* http://www.treas.gov/offices/international-affairs/occasional-paper-series/docs/reserves.pdf.

37. Summers, *supra* note 3, at 21.

38. M.S. Mohanty & Phillip Turner, *Foreign Exchange Reserve Accumulation in Emerging Markets: What are the Domestic Implications?*, BIS Quarterly Rev., 40 (2006).

39. *Id.* at 43. And some researchers point out that from 2005 to 2007, the total amount of hot money entering to China is as much as over $820 billion, accounting for half of the reserves. *See* Zhang Ming & Xu Yisheng, *How to Estimate the Scale of Hot Money in China at Present*, in J. of Contemporary Asia-Pac. Studies (2008).

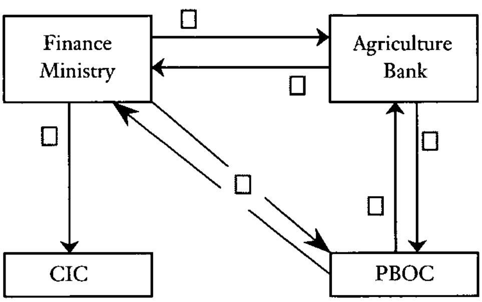
40. SAFE, China's International Investment Position, http://www.safe.gov.cn/model_safe_en/tjsj_en/tjsj_detail_en.jsp?ID=30307000000000000,1&id=4 (last visited on August 20, 2008).

41. In August 2008, SAFE has revised the basic rule governing the management of foreign exchange, i.e. Regulations of the People's Republic of China on Foreign Exchange Administration, including lifting the compulsory settlement for the first time in eleven years. The new regulations allow qualified entity deposit foreign exchange aboard etc. The changes are designed to cope with rapid growth in the country's foreign reserves and increasingly heavy cross-border capital flows. *See China Revises Foreign Exchange Rules*, Xinhua News Agency, Aug. 8, 2007, http://www.chinadaily.com.cn/bizchina/2008-08/07/content_6913287.htm.

China (PBOC).[42] This suggests that the PBOC is the largest, as well as the terminal, buyer of foreign exchange at the expense of the issuance of the same amount of fundamental currency. Unfortunately, it is not without risk to purchase high-graded treasury or other institutional bonds. The latest example is the bond issued by Fannie Mae and Freddie Mac, which hit record lows.[43]

These factors make diversifying reserve management necessary, reasonable, and desirable for China. Actually, as early as 1997, SAFE secretively set up a commercial entity, China SAFE Investment Co.,[44] in Hong Kong and began investing stock and equities. Yet so far, little information about its operation has been made available, and the spotlight has never shined as much as it did when the CIC recently released the annual report of 2008 on its website.[45]

According to the action plan approved by the 28th meeting of the Standing Committee of the National People's Congress (NPC) to have a commercial agency invest surplus reserves in a diversified way, the Finance Ministry will issue $1.55 trillion Yuan worth of special treasury bonds to the public in three batches, with outstanding terms of more than ten years. This will allow the public to buy into the $200 billion reserve from PBOC as the registered capital of the CIC.[46] Last year, the Ministry issued two batches, totaling $1.2 trillion Yuan, and injected it into the CIC.[47] The specific process can be divided into six steps as described in the below chart:



The Six Steps of the Capitalization:

□ Issuing special treasury bonds;
□ applying for loan pledged by the bonds;
□ approving the application and lending;
□ transferring the loan as payment;
□ buying into $200 bn foreign reserve;
□ injecting it into CIC as registered capital.

Since its formation, the CIC has constantly encountered criticism and comment for its financial performance. The huge losses in the last two years especially attracted public bombardment on its investment policy, expertise, and accountability. When Lou Jiwei, the chairman of CIC, announced that the "CIC has booked small losses in its external

42. The basic regulation is Regulations on the Foreign Exchange System of the People's Republic of China made by State Council. Regulations on the Foreign Exchange System of the People's Republic of China (promulgated by the State Council of the Nat'l People's Rep. of China, Jan. 29, 1996, effective April 4, 1996) (P.R.C.).

43. Krishna Guha, et al., *US Takes Control of Fannie and Freddie*, FIN. TIMES, Sept. 7, 2008, http://us.ft.com/ftgateway/superpage.ft?news_id=fto090720081555129034.

44. SAFE, Investment Company, the Sovereign Wealth Fund Institute (Apr. 4, 2009), http://www.swfinstitute.org/fund/safe.php.

45. CHINA INVESTMENT CORP., 2008 ANNUAL REPORT (2009), *available at* http://www.china-inv.cn/cicen/resources/resources.html.

46. Lin Li, *China's Legislature Approves 1.55 Trillion Yuan of Treasure Bonds to Buy Forex*, XINHUA NEWS AGENCY, June 29, 2007, http://news.xinhuanet.com/english/2007-06/29/content_6309265.htm.

47. *Id.*

investments in 2008 . . . [and its] financial performance is far better than other sovereign wealth funds in the world,"[48] several economists and observers pointed out that Lou's explanation hid the fact that all of the overseas investments of the CIC exposed more than $10 billion in total losses, and the position was balanced by stock price appreciation of state-controlled financial institutions at the Shanghai and Hong Kong Stock Exchanges. They also concluded that the marked feature of CIC's investment was "being strong at civil war and fragile at overseas competition."[49]

B. Legal Status of CIC

While several significant differences from IMF's working definition of SWF[50] exist in terms of capital resources, CIC has been generally seen as a typical SWF. For the following reasons, however, CIC should be legally classified as a special State-Owned Enterprise (SOE) rather than an SWF.

First, the registered capital of the CIC is from fiscal revenues rather than foreign exchange reserves. While, as the chart above illustrates, the final result is that the CIC receives $200 billion from the PBOC through the Finance Ministry, this deliberately designed pass-through structure, as a matter of legal fact, has profound implications beyond what appears at first sight. On the one hand, the structure successfully enables the central bank to avoid violating Article 29 of the Act of the People's Bank of China (PBOCA), which explicitly prohibits the central bank from over-drafting for any level of government and subscribing bonds issued by domestic governmental agencies, such as treasury bonds.[51] To legitimize transferring the $200 billion reserve to a commercial entity, such as the Agriculture Bank of China, certain measures must be taken. Although producing the same factual effect, this sale on the payment balance sheet of the central bank is still one of the legitimate and proper methods to manage the reserve in line with the PBOCA.[52] On the other hand, this way of capitalization does not affect the total amount of basic currency, lest inflation be exacerbated at the cost of substantial growth of the Finance Ministry's debt. The adoption of the pass-through structure changes the nature of the money; in terms of registered capital resource, there is no difference between the CIC and the other SOEs of China.

Second, there is no dynamic linkage, either institutional or practical, between the PBOC and the CIC, suggesting that the CIC will operate on the basis of the $200 billion registered capital separately with no forex reserve administration. Because issuance of a special bond must be approved by the NPC or its Standing Committee, if the surplus

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48. Zhou Xin, *China CIC Made Small Overseas Loss in '08*, Reuters, Mar. 30, 2009, http://www.reuters.com/article/privateEquityFinancialServicesAndRealEstate/idUSPEK178233200903 31.

49. *See, e.g.*, Liu Yonggang, ZhongTou: Jingnei Dakui Jingwai Dazhuan [CIC: Overseas Investments Lost Big Money while Domestic Made More], Zhongguo Jingji Zhoukan [China Economic Weekly], Aug. 16, 2009. Also, up to 26,500 web pages can be found at google.com for (CIC and "waster of state asset" in Chinese) as keywords.

50. One of the essential requirements of IMF's definition is that capital resource is foreign exchange assets. *See* IMF Work Agenda, *supra* note 1, at 5.

51. Act of the People's Bank of China (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 18, 1995, effective Mar. 18, 1995), art. 29, *available at* http://www.pbc.gov.cn/english//detail.asp?col=6800&ID=5.

52. *Id.* art. 4-(7).

reserve grows, PBOC cannot transfer them to the CIC by itself; rather, any plan would involve at least three additional parties: the NPC or its Standing Committee as an approval agency, the Finance Ministry as an issuer, and one or more commercial banks as subscribers or underwriters in line with the Budget Act.[53] There is no alternative for transferring surplus forex reserve to the CIC without the involvement of the legislature, the Finance Ministry, and a third private party.

Third, the CIC is viewed as a full ministerial enterprise. As a well-known practice, and part of the command and control economy's legacy, almost all of the state or collectively owned enterprises and their leaders are categorized into different administrative levels, like civil servants.[54] They have been periodically scaled and estimated by the State Assets Supervision and Administration Commission (SASAC), and Organization Department of Communist Party of China (CPC) in terms of administrative ranking, such as full ministerial, deputy-ministerial, and so on, according to the strategic importance and performance of the enterprises in their charge.[55] And the leaders' promotion and remuneration are, in large part, determined by the evaluation of these agencies.

It is not uncommon for outstanding SOEs' leaders to appointed as first hands of provinces, ministries, or other key positions, and this kind of exchange is viewed as a special and significant way to make cadres with a deep understanding of economic principles and practical management.[56] As a consequence, the leaders consider themselves more as administrators or cadres than as professional managers and are probably promoted, demoted, or transferred to other positions by the commands of relevant authorities. It is believed that the CIC is a full ministerial-level enterprise, ranking higher than common SOEs under the supervision of the central government SASAC. This is because Mr. Lou is the former vice Secretary-General of the State Council, a full ministerial-level position, and all of the other directors are deputy-ministerial cadres.[57] Therefore, in terms of administrative ranks, the CIC is a rare enterprise controlled directly by the State Council, and enjoys similar (if not the same) political status as the PBOC, SASAC, Finance Ministry, or Commercial Ministry. This special arrangement preserves its independence and protects its operation from government interference on the one hand, and shadows the CIC with non-commercial motivation as well as low risk awareness and market sensitivity on the other hand.

Although whether or not the bureaucratic competition between the PBOC and the Finance Ministry has been serious remains unclear, it will be difficult for the CIC to stay

53. According to Article 39 of the Budget Act of China, issuance of any kind of special Treasury bond must be approved by NPC or its standing committee. Budget Act art.39 (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 22, 1994, effective Jan. 1, 1995), *available at* http://www.lehmanlaw.com/resource-centre/laws-and-regulations/banking/budget-law-of-the-peoples-republic-of-china-1994.html.

54. *Id.*

55. Barry Naughton, *Top-Down Control: SASAC and the Persistence of State Ownership in China*, Paper Presented at the Conference on China and the World Economy at the University of Nottingham (June 23, 2006), *available at* http://www.nottingham.ac.uk/shared/shared_levevents/conferences/2006_June_China_Naughton.doc.

56. For example, Wei Liucheng, the CEO of China National Offshore Oil Corporation (CNOOC) was appointed the Governor of Hainan in February 2004 and then has been the CPC Committee Secretary of Hainan since 2006; Miao Wei was the president of Dongfeng Motor Corp before 2004 and now is the deputy minister of industry and information technology.

57. National Bureau of Asian Research, *Understanding China's New Sovereign Wealth Fund*, 19 NBR. ANALYSIS, 1, 20 (2008).

independent and unaffected in operation. Based on the PBOCA and related rules, SAFE should be the sole agency in charge of regulation, management, and operation of reserves subject to the principles of safety, liquidity, and profitability in turn. Also, the Professional Commercial Corporation has been established for almost a decade.[58] From this viewpoint, it does not seem necessary to have another outside manager under the control of the State Council. Nonetheless, the battle between CIC and SAFE Corporation is becoming evident, if not intense, which will then pose a potential impact on their operations and increase the difficulty in forecasting the future of China's overseas governmental investments.[59] There is no direct hierarchical relationship between them, and the impact of this phenomenon will be detailed later in Part III.

The CIC, however, cannot be equated with common SOEs in China, but instead must be equated with a special one. The CIC is a legal person exclusively funded by the state's fiscal reserve and is not sponsored by either the Finance Ministry or SASAC. It is approved by and under the direct authority of the State Council, making the CIC an exception. Besides, after its merger with Central Huijin Corporation, the CIC has become one of the biggest shareholders of all of the main financial institutions in China, including several of the biggest banks and securities firms, and the sole re-insurance company. Therefore, there are some concerns about whether the CIC should be viewed as a financial holding company subject to the supervision and regulation of the financial regulators.

C. A Comparative Analysis with Selected SWFs

Compared with some other high-profile SWFs, there remains room for the CIC before having an effective legal accountability arrangement. Among all of the SWFs, Singaporean funds such as Temasek and GIC are probably the most aggressive and profitable in recent years.[60] Actually, both of them have specific and clear institutional orientations in domestic laws and even in the Constitution.[61] Under the Constitution, each of them has been designated as a "Fifth Schedule Company" and is regulated accordingly.[62] For example, the appointment and removal of their Directors and Group Managing Director require the assent of Singapore's President.[63] Also, they shall be periodically audited by the national auditor-general, and the boards are accountable to the President to ensure that every disposal of investment is transacted at a fair market value.[64] Moreover, neither the President nor the Government is involved in directing investment, divestment, or other business decisions. Such legal arrangements erect a firewall between government companies and relevant agencies under strict supervisory legislation in personnel, reporting and disclosure, and asset transfer, and lay a firm foundation for purely commercial operation of both companies.

58. *Id.*

59. Logan Wright, *CIC and SAFE: Coordination or Bureaucratic Conflict?* CHINA STAKES, June 24, 2008, http://www.chinastakes.com/2008/6/cic-and-safe-coordination-or-bureaucratic-conflict.html.

60. According to Temasek's announcement on its website, the total shareholder return since its inception thirty-four years ago is more than eighteen percent compounded annually. In last financial year, its profits hit a record S$18.2 billion. Temasek Holdings, http://www.temasekholdings.com.sg (last visited Sept. 2, 2009).

61. CONSTITUTION OF THE REPUBLIC OF SINGAPORE arts. 22A & 22C.

62. *Id.* sched. 5.

63. *Id.*

64. *Id.*

The difference in capital resource between Temasek and GIC, however, should not be overlooked and probably leads to a clearer understanding of CIC. Temasek is the owner of the assets under its management, yet GIC merely plays a trustee role, like a professional asset manager. As for GIC, the clients set the investment objectives and monitor its overall performance. Then GIC receives fees to finance its operating expenditure. Actually, the gold model of SWFs, the Norwegian Pension Fund-Global falls into this category as well. This is the very reason why Temasek is reluctant to be described as an SWF[65] and declines to accept the nine principles reached by the U.S. Treasury, the governments of Singapore and Abu Dhabi, the Abu Dhabi Investment Authority, and GIC.[66] It is not difficult to find that the CIC and Temasek share the same type of capital resource, that is, fiscal revenue rather than foreign exchange reserve; neither of them are the channel or conduit to invest reserves on behalf of their Government, but instead legally own those assets under their management.

The SWFs of some other countries such as Russia, South Korea, and Norway also have clear-cut legislation to regulate the funds' corporate governance, portfolio decision-making procedure, asset transfer, and the qualification and appointment of directors and senior managers.[67] These arrangements explicitly define the relationship among SWFs and relevant administrative agencies in the respective countries and then, in some degree, address the distrust of SWFs' mere commercial motivation partly resulting from ideologies,

65. Ho Ching said in 2008 that "Thus, Temasek was formed in 1974-a unique experiment to take over a mixed bag of new investments and start-up companies. . ..It was more like a 'sovereign poverty fund'. Singapore had no oil money, no natural resources. Temasek was not managing the country's foreign reserves, the little there was." Ho Ching, *Story of a "Sovereign Poverty Fund,"* BUS. TIMES, June 27, 2008, http://app.mfa.gov.sg/pr/read_content.asp?View,10478. Besides, its chairman S. Dhanabalan said thatTemasek is an atypical SWF rather than a conventional SWF in his speech on the "Role of Sovereign Funds in Today's Globalization" at the Indus Entrepreneurs event on August 21, 2008 at Singapore. S. Dhanabalan, Temasek remarks at the Indus Entrepreneurs Event Holdings: the Role of Sovereign Funds in Today's Globalization, (Aug. 21, 2008), *available at* http://www.temasekholdings.com.sg/media_centre_news_speeches_210808.htm.

66. U.S. Treasury, *Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment with Singapore and Abu Dhabi*, http://www.treas.gov/press/releases/hp881.htm (last visited Sept. 2, 2009).

67. Relevant legal bases for these SWFs are: Biudzhetnyi Kodeks [BK] [Budget Code]; (2) Korea Investment Corporation Act, Act No. 7393 (Mar. 24, 2005), http://www.kic.go.kr/program/kicboard/list.jsp?id=ekn 050000; Enforcement Decree of Korea Investment Corporation Act, Decree No. 18883 (June 30, 2005), www.kic.go.kr/program/kicboard/proc.jsp?id=ekn050000; Korea Investment Corporation Act, art. 6 Articles of Incorporation (Mar. 24 2005), www.kic.go.kr/program/kicboard/proc.jsp?id=ekn050000; Management Mandate, Act 36 (June 22, 1990), http://www.norges-bank.no/templates/report____47782.aspx; Regulation on the Management of the Government Petroleum Fund (Oct. 3, 1997), http://www.regjeringen.no/en/archive/Jaglands-Government/fin/236309/236964/new_regulations_for_the_government.html?id=237650; Implications for the Management of the Government Petroleum Fund if Special Environmental Considerations are Used as a Basis for the Choice of Investment Strategy, Norges Bank (Mar. 16, 1999), http://www.norges-bank.no/templates/article____14077.aspx; Guidelines for the Investment of the Foreign Exchange Reserves, Norges Bank (Dec. 12, 2007), http://www.norges-bank.no/upload/import/english/reserves/foreign_exchange/guidelines%20reserves.pdf; Ethical Guidelines for the Government Pension Fund, Ministry of Finance (Dec. 22, 2005), http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund/Ethical-Guidelines-for-the-Government-Pension-Fund—-Global-/the-ethical-guidelines.html?id=434894.

the massive concentration of economic power, and a political "black box" in the course of decision-making.[68]

D. Negative Effects of CIC's Legal Arrangement

Apart from the misunderstanding of its capital resource, the lack of a legal accountability arrangement seems to be a more pressing problem to be solved for the CIC. Most decisions by, and about the CIC seem insulated from public participation and an effective accountability mechanism in spite of the fact that the $200 billion fiscal debt was generated overnight. Although it is more transparent than SAFE Corporation, this problem has still brought about much criticism and many doubts. Concretely, it is causing many after-effects both at home and abroad.

First, the CIC will be directly exposed to considerable domestic public opinion. Being short of the firewall with the government attracts more publicity at home for citizens worried about its return in the context of growing taxpayer awareness and the concern over possible corruption in the course of running this huge asset. Although in politics, the CIC is directly supervised by the State Council, the latter is still traditionally viewed as a more responsible, people-caring government entity than local and other subordinating departments and agencies. Another catalyst is the completely realized press freedom in the finance area. So the CIC is exposed to both pre-trial and post-trial publicity by mass media and the internet for any practical and potential tiny loss. Because of the lack of legal and express mandates, as well as the investment policies in place, any defense and explanation is viewed as an excuse for the CIC's wrong decision, and then the CIC's limited expertise and even its loyalty would be questioned. Therefore, the CIC's management and decision-making will be broadly influenced, its independent and professional status will not be sustained, and all of this will be politicized at home. In taking account of the political-cadre commitment of the leaders and high-level managers, the CIC probably has to stress external feedback from different social classes more than with their investment and performance. Here, 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. In this circumstance, it seems a difficult undertaking to maintain a politics-proof, commercial, and professional operation.

Second, the CIC confronts additional negative publicity from host countries for no proper or predictable legal accountability. Combined with conventional ideological biases, the transfer of the CIC's colossal-scale assets with little supervision and regulation will cause citizens of recipient countries concern and fear that its real purposes are not economic objectives. Because no formal institution about the CIC has taken place, for security and in their own interest, the public and legislatures of the recipients have become more inclined and active to make or search for rules to regulate the CIC and foreign government investments. Declaring that it will play as a long-term passive actor, CIC loses hard evidence to argue for its own commercial-based orientation and to justify its corresponding transactions, which sharply contrast its initial intention.

68. *See* Budget Code, *supra* note 69; Korea Investment Corporation Act, *supra* note 69; Enforcement Decree of Korea Investment Corporation Act, *supra* note 69; Regulation on the Management of the Government Petroleum Fund, *supra* note 69.

All of these factors make a negative difference on the accountability and independence of the CIC in decision-making, which weakens the function of market accountability in the course of investment and offers excuses for trade protectionism. Also, the reality in the past year shows that home regulators should play a more important role in their development, and should be afforded top priority for their lack of expertise and experience in international investment.

But the history of China's reform probably can be understood as the history of marketization. The CIC's incorporation and investment can be considered a key step in deepening and expanding the market-oriented economy along the path of reform and opening up since 1978.[69] In comparison with peer SWFs in other countries, neither its legal accountability nor market accountability are adequate.[70] Historically, the central government held the financial industry as a significant sector and hesitantly let foreign and private investors into the market. It seems that the excessive reserve and financial globalization make the "state first policy" unsustainable and obsolete. The CIC's investment suggests that the Chinese government began to outsource state-held financial assets mainly to foreign asset managers to earn rational return over the long-run. The CIC's investment return, good or bad, is a step forward to a more market-oriented economy; although, as a matter of degree, there are some drawbacks to the growing pains that arise in the institutional and market efficiencies around the corporation.

An immediate conclusion can be drawn that the essential element of the controversies around SWFs is the distance or length between SWFs and their host governments. Whether or not an SWF has a credible and effective legal arrangement when it is stepping into a market is the key to commercial running of the fund. The consideration of the arrangement, not the opaqueness of its operation, should be given special notice given that the latter is not unique or fresh but instead a common and tricky problem to be tackled.

IV. CIC's Investment Policy and Market Accountability

If lack of legal accountability could be corrected in some proper way, the CIC as well as other SWFs can be equated with other institutional investors in the global financial market, such as hedge funds, private equities, or pension funds. In other words, on the condition that the noncommercial motivation is separated from the operation of SWFs by an effective legal accountability mechanism, SWFs share several similarities with other institutional investors, especially in decision-making and risk management. Because the final objective is a sustainable return rather than geopolitical influence, SWFs should play as reasonable and rational investors subject to the common principles of wealth management with all the exposure to risks and competition. No other market-driven accountability mechanism exists for public funds that is different from private investors in this highly globalized financial market. This has three implications: first, SWFs should be treated the same as other investors by host countries' regulators in line with their rules, especially for market entrance requirements. Second, in practice, SWFs should not restrain the proper functioning of market principles by themselves, such as by giving up their shareholder rights in response to fears about their excessive influence. Third, the transparency prob-

69. Sebastian F. Buck, *China Risks Caution Overkill After Bear Prudence*, ASIA TIMES, Mar. 26, 2008.
70. Naughton, *supra* note 55.

lem of SWFs should not be exaggerated, and can hardly be solved before the other heavyweight investors. This is especially true of hedge funds and private equities.

A. CIC's Investment Practice

It seems that there is no coherent and concrete investment policy, as some commentators have suggested.[71] In the following part, the investment of the CIC both at home and abroad will be examined respectively, and then based on a comparative study with selected SWFs. Additionally, the implications of its market accountability mechanism will be discussed.

1. *Overseas Investments*

Despite criticisms of lack of transparency, the basic outline of the CIC's initial investment strategy is relatively clear. "Roughly $110 billion of the fund's capital has been dedicated to the domestic financial sector."[72] "The remaining $90 billion, slated for international markets, has drawn the most interest from international observers."[73] Table 1 presents the investments that the CIC has made to date.

Table 1: CIC Overseas Investments[74]

2008	Amount	2009	Amount
Morgan Stanley	$5.6 bln	Australian Goodman Group	$158.9 mln
Blackstone	$3 bln	Morgan Stanley	$1.2 bln
J.C. Flowers fund	$3 bln	Canadian Teck Resources	$1.5 bln
Visa	$100 mln	Diageo	$365mln
China Railway	$100 mln	Tesco	n/a
		CITIC Capital	$258mln

The first $8 billion of international investments went to high-profile stakes in Blackstone and Morgan Stanley.[75] The Blackstone deal was a direct, pre-IPO stake that has lost nearly half of its value, provoking considerable criticism from the public in China.[76] The CIC's stake in Morgan Stanley, however, was structured to limit its potential downside: the CIC held convertible bonds with a nine percent return, convertible to stock after a tie-

71. *See, e.g.*, Does the China Investment Corporation (CIC) Have a Coherent Investment Strategy?, http://www.rgemonitor.com/setser-monitor/234551/does_the_china_investment_corporation_cic_have_a_coherent_investment_strategy (Dec. 30, 2007).

72. KDI Private Equity, PEI for Global Sovereign Wealth Funds, http://kdiprivateequity.wikidot.com/group-3-afternoon (last visited Sept. 15, 2009).

73. Initial plans were to dedicate only $67 billion to international investments. *Id.* In late April, however, Gao Xiqing announced that less cash than expected was needed at home, and the fund's international spending would increase commensurately. Jamil Anderlini, *CIC Raises Global Spending Power*, FIN. TIMES, Apr. 24, 2008, http://www.rgemonitor.com/setser-monitor/234551/does_the_china_investment_corporation_cic_have_a_coherent_investment_strategy.

74. Jenny Strasburg, *China Ready to Place Bets on Hedge Fund*, WALL ST. J., June 19, 2009.

75. *Id.*

76. *Id.*

up period.[77] Still, the fund's leadership had grown wary of the U.S. financial sector as a result of its recent losses.[78] It is believed that both deals at least appeared to have been helped along by personal connections. The chairman of Blackstone's Greater China operations, Antony Leung, is a former finance secretary of Hong Kong and is known to be on very good terms with the mainland's financial authorities.[79]

CIC officials have gone out of their way to describe these two stakes as anomalous, insisting that most investments would be made in international stock markets through third-party managers. Chairman Lou has stressed that the CIC would be "focusing on financial portfolios."[80] President Gao Xiqing has specified that the fund would concentrate on "the cash market, fixed income, equity[,] and hedge funds," as well as private equity.[81]

In addition to plans that the CIC has already confirmed, rumors abound of potential tie-ups with Chinese SOEs looking to expand abroad. Not long before the official establishment of the CIC in September 2007, Li Rongrong, head of SASAC, publicly lobbied for the new institution's recourse to be used to assist Chinese state-owned firms to grow into more "influential" multinational firms.[82] Unnamed sources in December claimed that the CIC would shift its attention to natural resources, and specifically work to assist Chinese SOEs in their outward investment plans. Some unconfirmed news showing that the CIC would assist China Petrochemical Corporation in acquiring overseas assets seemed to buttress these reports.[83] Also, the fund was engaged in discussions with Hainan Province about a potential investment in a commercial crude oil reserve.[84] Following this, the CIC also discussed assisting Shenhua Energy to purchase 15.85% of Fortescue.[85]

2. *Domestic Investments*

Though receiving less attention from outside of China, the CIC's role in the domestic economy may ultimately prove to be much more crucial than that in global market. By absorbing Huijin, the CIC has assumed controlling ownership of almost all of the heavyweight domestic financial institutions. Table 2 presents its subsidiaries, including affiliated companies and the amount of the CIC's investment.

77. *Id.*

78. *China Investment Corp Suspends Investments in Overseas Financial Cos—Report*, XFN-ASIA, Mar. 7, 2008, http://www.hemscott.com/news/static/tfn/item.do?newsId=61518964236066.

79. Kevin Hamlin, *Stepping-Stone Interpreting the First Deal by China's State Investment Co.*, INST. INV., June 2007, http://www.iimagazine.com/article.aspx?articleID=1369725.

80. Bob Davis, *China Investment-Fund Head Says Focus Is on Portfolios*, WALL ST. J., Feb. 1, 2008, at A13.

81. *Wealth Fund Hiring Foreign Money Managers*, CHINA DAILY (BEIJING), Feb. 29, 2008, http://www.chinadaily.com.cn/bizchina/2008-02/29/content_6496106.htm.

82. Li Yanzheng, *Li Rongrong: Zhongtou Gongsi jiang Bangzhu Yangqi Jiada Haiwai Touzi Lidu [Li Rongrong: China Investment Corporation Will Help Central SOEs to Increase Overseas Investment]*, SHANGHAI ZHENGQUAN BAO [SHANGHAI SEC. J.], Sept. 13, 2007, *available at* http://news.xinhuanet.com/newscenter/2007-09/13/content_6713982.htm.

83. Tan Wei, *China's CIC Likely to Diversify Away from Further U.S. Banking Sector Investments, Source Says*, FIN. TIMES, Dec. 30, 2007, http://www.ft.com/cms/s/2/d0852a46-b69a-11dc-aa38-0000779fd2ac,dwp_uuid=e8477cc4-c820-11db-b0dc-000b5df10621.html.

84. *China's Hainan Kicks off Oil Storage Project*, PLATTS OILGRAM NEWS, Dec. 14, 2007, at 3.

85. Leonora Walet, *China Shenhua, CIC to Make Biggest Investment yet in Reported Fortescue Bid*, AFX NEWS LTD., Feb. 4, 2008, http://www.forbes.com/feeds/afx/2008/02/04/afx4608890.html.

Table 2: CIC's Subsidiary and Affiliated Companies

Investment	Amount(bln)	Details
Agricultural Bank of China	$20	One of the "big four" state owned banks
China Development Bank	$20	policy bank
China Reinsurance	RMB 30	Biggest reinsurance firm in Asia; 85.5% stake
China Everbright Bank	RMB 20	71% stake
China Silver River Holding	RMB 5.5	1st financial holding company officially approved
Guotai Junan Securities	RMB 2.5	1 billion to purchase its stake and 1.5 billion as a special loan
Shenyin & Wanguo Securities	RMB 4	2.5 billion to purchase its stake and 1.5 billion as a special loan; 2nd biggest securities firm
China Galaxy Securities	RMB 10	Biggest securities firm in total turnover value
Industrial & Commercial Bank of China	$15	1st Biggest bank both in China and the world
Bank of Communication	RMB 3	4th biggest bank in China and 10th in the world
China Jianyin Investment	$ 2.5	3rd biggest securities firm in total turnover value
China Construction Bank	$ 20	2nd biggest bank of both in China and the world
Bank of China	$ 22.5	3rd biggest bank of both in China and the world

Through a joint venture with Morgan Stanley, Huijin also owns the China International Capital Corporation (CICC), the biggest investment bank in the mainland. CICC has been involved in all recent high-profile outward investments: Chinalco, Shenhua, CNOOC, PetroChina, and Sinopec. CICC is also looking to expand its role in China's financial markets by developing into a full-service financial outfit offering private equity, asset management, and wealth management services.[86]

B. Some Implications

The CIC has announced that the asset under management would be roughly subdivided into three equal parts: one-third to take over Central Huijin Investment, one-third for overseas investments, and the rest to bail out unreformed state banks.[87] Because of its role in these institutions and its special political background described above, the CIC practi-

86. *CICC Broadens Range of Services*, Asiamoney-China Supplement, Sept. 2007, at 28.

87. As the amount of injection to Agriculture Bank of China has been reduced to $20 billion, CIC has $ 90 billion rather than the initial $66 billion for investment offshore. Jamil Anderlini, *CIC Raises Overseas Budget to Dollars 90bn*, Fin. Times, Apr. 24, 2008, at 11.

cally exerts its influence and discharges the functions of SASAC in finance to improve the quality and competitiveness of the whole financial sector. It makes the CIC like Temasek as well as de facto SASAC. Therefore, the CIC is not only a heavyweight business entity, or even a quasi-monopolist, but also a quasi-governmental agency performing multiple functions. At least it hardly manages the stakes in domestic financial firms like a private and purely commercial investor. This is true as long as China relies on the state banks and state-controlled securities market to support economic policy objectives, including exchange rate management. Ironically, though, the CIC's non-commercial strategic stakes in the domestic financial sector have been the most profitable of all of its investments until now.[88] The CIC also has a mandate to advance the governance of its affiliated Chinese enterprises and support their global development.[89] Therefore, it is easy to observe that the CIC serves strategic purposes beyond commercial functions.[90]

As the CIC is fiscal debt-based, the cost of treasury debt and the expected appreciation of RMB become the "hurdle rate" that the CIC must beat in order to be economically viable over the long term. As most observers expect inflationary pressures to rise, and RMB to appreciate much faster, the actual hurdle rate is likely to be significantly higher. So if the CIC is run as a long-term passive investor, it will be hard to reach success.[91]

This mixture of public and private functions, however, is similar to the Gulf countries' royal wealth funds, and is blurring the boundary between public agencies and commercial entities. This will compromise its announcement to comply with commercial principles. The conflicts of objectives then will lead to unnecessary ambiguities and some worries about investment principles, strategies, policies, and other resultant difficulties in transparency.

Worthy of special note is the impact of the CIC as a controlling actor of China's financial industry on the possibility of interest transfer and market monopoly, especially in the context of the adoption of the Antimonopoly Law in August 2008.[92] Under the definition and standard of the "dominant market position" based on market share,[93] the CIC will be presumed dominant at least in banking and reinsurance sectors. Besides, although there is not an explicit rule directly concerning financial holding companies in China, this behe-

88. Compared to the sharp decline in value of their overseas investments, Chinese banks are benefiting from little exposure to US sub-prime loans and the booming domestic economy. And Industrial & Commercial Bank of China even has become the most profitable as well as biggest bank in the world since 2008. *China Bank Sees Top 2008 Profits*, BBC, Aug. 21, 2008.

89. Yanzheng, *supra* note 82. Mr. Li Rongrong is the chairman of SASAC.

90. The evidence is that the list of 2008 top 500 Chinese enterprises released by the China Enterprise Confederation does not include CIC. *See China's Top 500 Enterprises Catching Up with Global Giants*, GOV.CN, Aug. 30, 2008, http://english.gov.cn/2008-08/30/content_1083456.htm.

91. For example, if one assumes, very conservatively, that the annual cost of local debt is four percent and the expected annual appreciation of the RMB is five percent, CIC will need to make at least nine percent annually just to break even. ANDREW ROZANOV, THE SOVEREIGN WEALTH FUNDS DEBATE (2008), *available at* http://www.ssga.com/library/esps/The_SWF_Debate_Andrew_Rozanof_1.8.08CCRI1200431495.pdf. But CIC's expected rate of return is around five percent in short term, said Mr. Wang Jianxi, Vice-President and Chief Risk Officer of CIC in a speech at the Credit Suisse Asia Investment Conference on April 2, 2008 at Hong Kong. Karen Cho & Amy Lam, *Wealth Fund Aim Modest*, CHINA DAILY (BEIJING), Apr. 3, 2008, http://www.chinadaily.com.cn/bizchina/2008-04/03/content_6590172.htm.

92. *China Adopts Anti-Monopoly Law*, CHINA DAILY (BEIJING), Aug. 30, 2007.

93. Anti-Monopoly Law arts. 17 & 19 (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), http://www.china.org.cn (last visited Aug. 30, 2009) (P.R.C.).

moth, with both economic and political significance, will certainly impinge on the effectiveness of the financial regulation.[94] Therefore, there is a practical need to define the relationship between the CIC and the financial regulators in both China and the rest of the world.

In sum, apart from lack of effective and explicit legal mechanisms, the market accountability of the CIC has been fragmented and incoherent. At home, the CIC plays the role of a quasi-administration for state-owned financial assets, while it has restrained itself from involvement in the management of the affiliated companies and has been very careful to keep a lower profile than other private investors (a quasi-commercial actor). These two masks of the CIC cause the problem of opaqueness in market.

V. Concluding Remarks

The question of how to draw the boundary between government and market is a tricky one, particularly in this transitional and emerging country, for more than thirty years (beginning with the implementation of open door and reform policies in the late 1970s). Historically speaking, in contrast with the suspicion that the CIC may be a tool for geopolitical ends, the corporation can be considered the latest effort for building a market-oriented economy and rule of law state, and a transitional or intermediate form in de-politicizing the finance industry.[95] The near future will witness more CIC-like, state-controlled conglomerates or national champions emerging in certain businesses vital to national interest and people's well-being for ongoing reform of state-owned firms and implementation of "go global" policy.[96] From this viewpoint, the CIC is just a microcosm of the transfer of global wealth and economic power now underway, the origins of which lay in China's market-oriented reform during the recent three decades.

As a matter of reality, however, it is the opaqueness of the internal structure without a firewall between state and market that is stirring controversies among the public and policymakers on the drive and method of the CIC's investment. Therefore, it is imperative for governments to substitute the political mechanism with a legal and market mecha-

94. In particular, the mode of "One Central Bank and Three Commissions" per se is lacking potent coordination and adequate independence and accountability, which has caused much regulatory overlapping and a vacuum. Whether or not CIC should be treated as a financial holding company and operates subject to existing financial rules remains to be seen.

95. A distinctive state system has taken shape from the interaction between the old state system and the new marketization of the past thirty years of Chinese reform. It is both the principal actor in the economic "miracle" of the past thirty years and the main source of the current social crisis. This state organization could become a rigidified system, but it could also be something still "in transition." *See* Philip C.C. Huang, *The State System of Reform China: The Root of Both the Economic "Miracle" and the Social Crisis*, KAIFANG SHIDAI (OPEN TIMES), Apr. 2009.

96. Li Rongrong, the chairman of SASAC, said at a press conference that after the Olympics, the government would intervene in the consolidation of centrally-administered SOEs instead of letting them regroup on a voluntary basis for its moving slowly and the target is reducing the total number of centrally-administered SOEs to 80 or 100 by 2010 from 147 at the end of 2007. *China Plans More Post-Olympics Reforms for SOEs*, CHINA DAILY (BEIJING), Aug. 11, 2008. Besides, apart from CIC and PBOC and their subsidiaries, the state-controlled investment vehicles include the investment companies under the SASAC of both central and local governments and National Social Security Fund (NSSF), the total assets of which are over $300 billion. In this way, CIC accounts for only about ten percent of the total asset of all state-controlled investment arms. Against this background, lack of accountability and transparency seems a universal and self-styled problem to all Chinese SOEs and other state investment vehicles rather than a unique one to CIC.

nism. This means that home countries should take the first step to mitigate the concerns, which are not all irrational or unreasonable. As for China, the State Council or NPC should clarify the legal status of the CIC in special legislation, and adhere to arms-length principles in dealing with the relationship among the professional investment institution and administrative agencies. All of these active measures are expected to produce a comparatively clear boundary between government and market, and will be conducive to eliminating concerns and controversies in the foreseeable future. As for market accountability, special efforts should be taken to establish an incentive-compatible remuneration scheme, which should be different from a valuation system for either civil servants or CPC cadres, to attract experts and skillful staff. To further abate worries about its motivation and objectives, the CIC should periodically take the ex post disclosure principle in transparency: the annual report reveals the rough fiscal information and then in the next year it discloses in a more transparent way the concrete portfolio and transactional details to avoid losing its competitive edge in market. In these aspects, the best benchmark of policy development will be the Santiago principles.

The second step is to abandon all biased laws and regulations regarding SWFs. While host countries have a need to build effective mechanisms to prevent SWFs from distorting the market and threatening the strategic sector, they also should assume it is their own responsibility to advance the free flow of capital at the global level. The essential point may well be keeping recipient countries subject to regulatory neutrality: singling out SWFs per se would be a dangerous path, and there should be the same rules for all investors from beyond a nation's border without any discrimination resulting from their ownership.

The final step is to involve SWFs and other sovereign or governmental investments in the ongoing negotiation of global investment legal architecture,[97] while the most feasible measure is redefining investment in Bilateral Investment Agreements. Then there will be no need to create national or international regulatory agencies or to formulate biased regulations.

97. *See generally* Bart De Meester, *International Legal Aspects of Sovereign Wealth Funds: Reconciling International Economic Law and the Law of State Immunities with a New Role of the State* (Leuven Ctr. for Global Governance Studies, Working Paper No. 20, 2009).