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Tools of Survival: Sovereign Wealth Funds in Singapore and China

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The rise of sovereign wealth funds (SWFs) as major investors in the global economy has raised worries that they serve the geopolitical ends of owner countries. However, given the paramount importance of surviving domestic political competitions, SWFs are likely also tools of domestic political survival. In examining the corporate governance and underlying political environment in which SWFs in Singapore and in China operate, this paper further examines the role of political unity in directing SWF behaviour in authoritarian regimes. The main finding is that a highly unified autocracy is more likely to direct SWFs to maximise long-term profit, while a fragmented one like China is more likely to treat its SWF as an arena for domestic political and bureaucratic infighting. SWFs operating in a fragmented regime are unlikely to make long-term profit and foreign policy objectives top priorities, and their behaviour can be highly unpredictable.

The existing discussion on sovereign wealth funds (SWFs) focuses on their potential to become geopolitical tools of owner countries. However, state leaders in a wide variety of political systems confront the problem of domestic political survival on a daily basis. Thus, to the extent that political considerations drive the behaviour of SWFs, domestic political concerns may be a stronger political driver than foreign policy concerns. Furthermore, SWFs operating in disparate domestic political environments may behave in different ways. In exploring this issue, this paper compares the China Investment Corporation (CIC) with its models, Singaporean entities Temasek Holding and Government of Singapore Investment Fund (GIC).

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Despite superficial similarities, SWFs in the two countries operate under completely different political dynamics, which profoundly affect their profit orientation. On the one hand, the powerful combination of a highly unitary and effective authoritarian political party and a relatively small city-state afford Singaporean rulers a relatively long investment horizon. On the other hand, the fragmented Chinese bureaucracy, a product of both the rampant factionalism in the ruling Chinese Communist Party (CCP) and the need to have multiple organisations to govern a large country, sees the CIC as another arena for factional and bureaucratic struggle. Thus, long-term return is expected to be far from CIC managers' mind as they operate the fund. However, this does not mean that foreign policy concerns are completely ignored. Even the devotion of a small share of these SWFs' resources on foreign policy can have a significant diplomatic impact, especially in developing countries.

THREE IMAGES OF SWFs: PROFIT, POWER, AND SURVIVAL MAXIMISERS

Even before the global financial crisis focused the world's attention on cash-rich investment funds controlled mainly by undemocratic regimes, policy makers were worried that strategic goals, in addition to profit, drove the behaviour of SWFs. In 2007, Larry Summers articulated those worries when he wondered whether SWFs solely sought profit or whether they "may want to see their national companies compete effectively, or to extract technology or to achieve influence."[1] In essence, Western policy makers seemed worried that sovereign wealth funds would be deployed as geopolitical instruments to the detriment of status quo powers in the West.

This emerging dichotomy – SWFs as profit maximisers or as geopolitical tools – harks back to the theoretical expectation of realist theories, which assume states to be unitary entities seeking to gain relative power against each other[2] Given these assumptions, it is natural to conclude that SWFs, which are founded and operated by states, would deploy its vast monetary resources to further geopolitical ends. At the very least, rising powers can use SWFs to ensure that the incumbent hegemon is being "nice" to potential challengers or to extend its autonomy vis-à-vis the hegemon.[3] This conclusion seems all the more reasonable when we consider that countries have a long history of deploying economic policies to further security ends.[4]

Beyond survival in the "anarchic" international order, however, rulers in both democracies and non-democracies must also survive domestic political competitions. In democracies, politicians are "office seekers" who structure platforms to capture a winning share of voters.[5] In dictatorships, ensuring political survival is even more challenging because of the potential of a coup launched by the ruler's closest followers.[6] In other regimes, rival factions launch political campaigns and corruption investigations to diminish each others' influence.[7] Given the constant possibility of dethronement, leaders of any government, especially ones without a clear due process for leadership transition, must place political survival on the top of their agenda and direct the instruments of state, including SWFs, toward that end. The following analysis of both the Singaporean entities and of the CIC shows that domestic political considerations play a major, if not dominant, role in the behaviour of these SWFs.

If domestic political considerations constitute a third driver of SWF behaviour besides profit and foreign policy goals, the political dynamics of different systems may influence SWF behaviour in various ways. As more information on SWF behaviour comes to light, this may be a fruitful avenue of investigation, following the liberalism tradition in IR theory which seeks to explore how domestic factors influence international outcomes.[8] For now, this paper focuses on a particular type of regimes, authoritarian regimes, to see whether the type of politics in different authoritarian regimes may have an impact on the expected behaviour of SWFs operated by these governments.

Abstracting away from regime types and cultural factors, we then focus on a key factor that may drive SWF behaviour in authoritarian regimes: regime unity. In a highly unified regime where the probability of unexpected leadership change is low, the ruler expects to reap the bulk of the tax revenue and to rule in the long-run. As such, the leadership has much higher incentive to conduct economic policies in such a way as to ensure long-term growth.[9] By the same token, a unified authoritarian regime is likely to operate SWFs in a manner that maximises profit. That is, because the dominant dictator is fairly certain of gaining control over the vast majority of the SWF's profit over a long horizon, she is much more willing to direct it to maximise profit and concurrently has less need to direct resources toward domestic political survival. Also, a unified dictatorship has stronger motivation to closely monitor agents operating the SWF in order to minimise corruption and increase long-term profit. Of course, no dictatorship is completely immune from external shocks and internal threats, so any dictatorship is expected to deploy a part of its economic resources toward political survival.[10] However, as the leadership's perceived threat decreases, the authoritarian SWF increasingly behaves like a profit maximising fund.

At the other end of the spectrum, authoritarian leaders under constant threat of a coup behave in a predatory manner in order to reap as much short-term benefits from the economy as possible.[11] Obviously, such a regime would be unable to generate the foreign exchange reserve with which to invest in a SWF in the first place. However, in the intermediate case, the authoritarian regime is sufficiently institutionalised to pursue relatively sound economic policies. At the same time, the political elite breaks down into rival factions which pose a real threat to the incumbent leader. In these cases, the political elite has sufficient unity to provide the basic public goods of regime stability and some degree of economic growth. However, on the margin, economic policies still constitute an arena in which rival factions dual for relative power.[12]

Sovereign wealth funds operating in this environment may similarly become an instrument of domestic political infighting, thus making its behaviour highly unpredictable to outsiders who do not understand the internal political game. The more elite rivalry exists, however, the less profit motive can explain SWF behaviour because the SWF, which holds an enormous sum of money, becomes a valuable political resource with which to gain the upper hand. Overall, the more the political elite is fractious, the more managers of SWF may behave in a conservative manner so that investment losses are not politicised by one's political enemy. Also, conservative investment strategy would protect SWF managers from criticism in the event of a sudden leadership change, which introduces a new set of investment preferences. Even if one had a political patron, that patron is not expected to stay in power for long. Thus, there may be a preference for short-term advantages gained through managing a SWF, whether it be quick profit or a way to pay off a politically powerful actor. In sum, a SWF operating in a fragmented authoritarian regime, like the one in China, requires much more careful analysis before one can suggest a likely behavioural pattern.

THE SINGAPORE MODEL

The performance of Singapore's SWFs is legendary, making them models for their peers around the world. In the case of Temasek, it turned humble millions from Singapore's treasury into assets worth over US$100 billion three decades later.[13] In the five years leading up to 2007, Temasek earned an average annual return of 10%, thus giving the Ministry of Finance nearly one billion dollars in dividend every year.[14] Likewise, the Government of Singapore Investment Corporation (GIC), which manages well over US$100 billion in assets, produced a real annualised return of 4.5% in the past 20 years through investing in a mix of public equities, fixed income, and alternative investment.[15] Thus, both entities succeeded tremendously in their mission to "preserve and enhance the purchasing power" of Singapore.[16]

What explains Singapore's singular success in operating its SWFs? At first glance, this seems like a clear case of East Asian developmental state where a corp of elite bureaucrats devise and implement policies with little political interference.[17] However, the reality is that the Singaporean bureaucracy has little independence from the People's Action Party (PAP)-business nexus of power. In 1981, for example, the ruling PAP removed the central bank governor and nearly a quarter of the bank's staff because the bank governor was considered too independent from the political authority.[18] The political elite and business interests are made up of the same people. Lee Kuan Yew's brother Lee Kim Yew sits on the board of the leading private companies in Singapore, while Lee's wife and son operated law firms and private investment funds. At the same time, there is a busy revolving door between business and government.[19] Clearly, Singaporean economic policies are enmeshed in the PAP's political strategy and the interest of the Singaporean business community.

The underlying reason for the profit orientation for Singapore's SWF is the relatively low threat faced by the ruling PAP and the Lee Kwan Yew Clan. This domination was achieved in large part by the ruling PAP's strong grip on state apparatus, which allowed the PAP to mobilise state resources like the court and the police to undermine opposition.[20] PAP further co-opted the business community by inviting some of them to sit on boards of economic agencies. Businessmen were socialised by their peers about the benefits of going along with the PAP agenda.[21] This domination was also helped by the relatively small size of the city-state, which decreased monitoring and enforcement costs for the ruling regime.[22]

With the ascension of Lee Hsien Loong as prime minister, the Lee family is poised to control the city-state for decades into the future. The long time horizon and unchallenged political dominance afford Singaporean rulers the luxury of focusing on long-term returns on their investment because they can expect to reap the bulk of the benefits. Indeed, the pervasive power of the Lee family is fully reflected in the country's investment vehicles. The board of GIC is chaired by Lee Kwan Yew and his son and current Prime Minister Lee Hsien Loong, while Tony Tam, a core Lee Kwan Yew loyalist, is its executive director.[23] For Temasek, CEO Ho Ching is the wife of Prime Minister Lee Hsien Loong, while Chairman Dhanabalan is a career civil servant and PAP loyalist.

With firm control over both the political system and the SWFs, the Lee family directed both Temasek and the GIC toward a mixed strategy of ensuring PAP dominance over the Singaporean economy and long-term profit. After its formation, Temasek acquired majority stakes in the key industries of Singapore – power, telecommunication, banking, real estate, and commercial airline. It further held a 100% stake in Mediacorp, which operated a virtual monopoly over the city-state's air wave.[24] The government and government linked companies (GLCs) held by SWFs account for 21% of the city-state's economy and 41% of the main stock index's capitalisation.[25] Through these commercial holdings, the ruling party and the Lee Clan gained direct control over every significant aspect of the Singaporean economy.

At the same time, however, Singaporean SWFs also kept an eye on long-term profit of the funds. Because the Lee family's dominance over the political and economic systems is so pervasive, Lee Kwan Yew felt comfortable with giving these funds some degree of autonomy so that they can seek profit. Both Temasek and GIC, which formed out of the 1981 purge of the central bank, were incorporated as independent companies.[26] The government controlled the appointment of their boards but largely left investment decisions to the companies.[27] The first head of GIC was a professional banker, and GIC retained foreign fund managers to help run the fund from its inception. Although the GIC board is composed of PAP insiders, outsiders with rich market experience hold important board positions in key GIC subsidiaries which carry out all the investment activities.[28] The Temasek board includes individuals who spent a large part of their careers outside of the Singaporean government or GLCs. They include Koh Boon Hwee, Simon Israel, and Marcus Wallenberg.[29] Their focus on profit and willingness to rely on outsiders, in addition to favourable investment environment, seem to explain the Singaporean entities' glowing performance.

The Lee family's political dominance also enabled it to undermine the positions of major economic and bureaucratic interests in order to increase the profit of the SWFs. By the late 1990s, Temasek had become a cozy club for retired PAP insiders to sit on lucrative boards of various GLCs. Then, in 2001, the Ministry of Finance issued a report criticising the passivity of Temasek in managing the GLCs.[30] Soon after, Ho Ching, Lee Kwan Yew's daughter-in-law, took over Temasek, reasserting family control over this valuable asset. She initiated a shakeup that saw the removal of over half a dozen top managers in Temasek owned GLCs and the divestment of NatSteel and SembCorp, two core state-owned enterprises.[31] Although many of those removed were senior civil servants and PAP loyalists, it was more important to protect the family fortune. Ho then initiated a substantial transformation of Temasek's strategy from mainly a holding company for GLCs to a diversified and international investment entity. Now Temasek has one third of its assets in Singapore, one third in developing countries, and one third in developed countries.[32]

Because of the unity in the Singaporean regime, its SWFs mainly devoted its resources to ensure a dominating presence in the Singaporean economy and long-term profit. Of course, this is not to say that there is no geopolitical dimension in their investment strategy. For example, Temasek's five billion dollar bid for pre-IPO shares of major Chinese state banks served to cement Singapore's ties with China while at the same time reaping a healthy profit.[33] However, Temasek would hardly have invested in Chinese companies with low expectation of profit.

THE CHINA INVESTMENT CORPORATION

China is a relative latecomer in the sovereign wealth fund game, and Singaporean SWFs have been the models for China. Senior officials of the

China Investment Corporation (CIC) repeatedly lauded the Singaporean model as something that CIC can emulate.[34] The motto of the Singaporean entities has been echoed by the top managers of CIC. As CEO Gao Xiqing put it in an April 2008 CBS interview, "We're like a typical investor: our only aim – to make money".[35] In the year since its formation, CIC has scrambled for global talent to manage the fund, recruiting 230 professionals in a year. It also held a relatively transparent bidding process to choose foreign fund managers to oversee some US$30 billion.[36] Finally, the capitalisation of CIC through bond issuance was designed to put pressure on current and future leaders of CIC to generate profit of at least 4.5%, the coupon rate of CIC bonds.

Despite these impressive accomplishments, even a cursory comparison of the institutions that govern SWFs in China and in Singapore reveals that CIC would be unable to replicate the Singaporean entities' focused pursuit of profit. The CIC is expected to behave in a much more volatile manner compared with the Singaporean entities because much more frequent and intense political and bureaucratic rivalries face Chinese policy makers. As a result, the incentives facing CIC managers are much more complex and volatile than those faced by their counterparts in Singapore.

Unlike Temasek or GIC, CIC was born into a political system rived with both elite factional contention and bureaucratic infighting. The factionalism in the Chinese Communist Party (CCP) originated from the CCP's prolonged struggle with the Kuomintang and the Japanese, which produced a series of isolated guerilla base areas. The leaders of these base areas, or "mountaintops," later became leaders of powerful factions.[37] These factions then jockeyed for power for decades after the formation of the People's Republic, which at times even threatened the power of Mao himself.[38] Although the politics of purges ended after economic reform was launched in 1978, Chinese leaders continued to use political campaigns, perceived policy failures, and anti-corruption investigations to oust opponents with little due process.[39]

Because of at times intense factional rivalry between top leaders, political leaders in China cannot afford to focus single-mindedly on long-term goals. Instead, they mobilise economic agencies controlled by loyal lieutenants to serve political ends.[40] In the past such rivalries led to grossly inefficient economic policies and policy deadlocks between competing agencies controlled by different factions. For example, until recently, former party secretary general Jiang Zemin was the patron of the National Development and Reform Commission (NDRC), which leveraged the patronage to aggressively expand its power into the jurisdiction of other agencies. This caused untold turf warfare between the NDRC and rival agencies. The NDRC's relatively strong presence in the CIC is evidence of its continual clout.[41] The Ministry of Finance, in the meantime, is known as Premier Wen Jiabao's bastion of power in the economic bureaucracy, which partially explains vice minister of finance Lou Jiwei's appointment as the head of CIC. This elite rivalry necessarily affects CIC decision-making as board members belonging to various factions consider the impact of major decisions on factional power balance.

Beyond elite politics, Chinese technocrats also must protect themselves against frequent leadership changes. Unlike in Singapore, where the Lee family has ruled for decades and is expected to rule for decades into the future, Chinese technocrats must guard themselves against new political leaders who change policy direction completely. This is especially pertinent for investment which has a maturity of over five years – the typical tenure of a premier or vice-premier. Even if a vice premier in charge of finance approves a deal, his successor may disapprove of it and blame the head of CIC, especially if a deal has gone sour.

Also, leadership volatility applies to the CIC itself because of increasingly stringent retirement rules and elite political changes. This contrasts sharply with Singapore, where Lee Kwan Yew has served as chairman of GIC since its inception in 1981. In Temasek, CEO Ho Ching, who took over in 2002, will likely continue in her current position for the next few years. In contrast, it would be surprising if Lou Jiwei, the head of CIC, serves in his position past the end of Premier Wen's tenure, which ends in early 2013. If CIC follows the norm of the typical government agency, most senior officials of CIC would only serve stints shorter than five years. Given a much shorter time horizon, officials in CIC will act with an eye to short-term political payoffs. To be sure, short-term political payoffs can include stellar profit performance, but it can come at the expense of careful due diligence and may lay the foundation for serious losses in the future. Short-term achievements also include the implementation of political tasks for factional patrons in the Politburo. Worse, ambitious CIC officials may mobilise resources at CIC's disposal to do favours for important political actors in order to obtain promotions in the future.[42] Ultimately, CIC fund managers are managing "other people's money" and have incentive to invest in such a way as to benefit their own careers. With the political leadership preoccupied by political survival, monitoring of SWF officials may be weaker than in Singapore.

Furthermore, the Chinese bureaucracy has gained in both size and complexity throughout history as it governed an increasingly vast territory. The CCP made bureaucratic structure even more complex by introducing a party bureaucracy parallel to the state bureaucracy, thus producing a complex overlap of authorities. This has produced "fragmented authoritarianism" as rival agencies and even departments within agencies competed with one another for resources and jurisdiction.[43] In the economic policy arena, rival agencies competed with one another to adopt policies that enlarged their own resources and jurisdiction. With the rise of the SWF and domestic investment funds, the key economic agencies – the People's Bank of China (PBOC), the Ministry of Finance (MOF), and the National Development and Reform Commission (NDRC) – engaged in pitch warfare to gain control over these entities. Factional competition at the top exacerbates this bureaucratic turf war because different political patrons have control over different economic agencies.

Elite disagreement often manifests as jurisdictional conflicts between top leaders with similar portfolios, which translates into bureaucratic turf fights. Every politburo standing committee member and vice premier is in charge of at least one policy area. However, their jurisdiction often overlaps, which creates arenas for elite rivalry. For example, in 2004, former Vice Premier Huang Ju was in charge of the financial sector, while Premier Wen Jiabao was in charge of the economy overall. These two disagreed over whether tight monetary policy was needed to slow the pace of investment. Because both had considerable authority over key economic agencies, decisive action was delayed, which caused inflation to spike up briefly.[44] Although currently Premier Wen Jiabao, Vice Premier Wang Qishan, and Vice Premier Li Keqiang – the three top officials with jurisdiction over CIC – are all Hu Jintao supporters, the future introduction of a vice premier from another faction may intensify deadlock over investment decisions at the CIC.

Although a new entity, the CIC was drawn into factional and bureaucratic struggle even before its formation. The January 2007 National Finance Work Meeting, a conclave of senior officials to decide the future evolution in the financial sector, decided to form a fund to manage a part of China's ballooning foreign exchange reserve separately from the central bank. Even before the decision to set up such an entity was finalised, both the Ministry of Finance (MOF) and the People's Bank of China (PBOC) made strenuous arguments in an effort to gain control over this new investment body. While MOF cited the example of Singaporean Temasek, where the Singaporean MOF continued to influence the entity, the PBOC argued that since much of the capital for the new investment body would come from the foreign exchange reserve, currently controlled by the PBOC, the PBOC should play the dominant role in the new body.

In the end, Premier Wen favoured the Ministry of Finance's argument by appointing Vice Minister of Finance Lou Jiwei as the chairman of CIC. Lou Jiwei also may have won the contest because he was cultivated by former Premier Zhu Rongji, who was also a patron of the current premier. The MOF also successfully bargained for the appointment of vice minister of finance Zhang Hongli as vice manager, as well as the appointment of two MOF officials as board members. The CEO position went to Gao Xiqing, who has the richest market experience as a Wall Street lawyer for years and as the manager of the US$75 billion National Social Security Fund. Although the PBOC and SAFE provided the capital for the fund, officials with deep PBOC background only serve as vice manager and non-executive board members (Table 1). The National Development and Reform Commission (NDRC), the offspring of the powerful State Planning Commission, obtained surprising representation with vice manager and party group member Yang Qingwei, as well as two board members.

Related, CIC corporate governance centres around the party group, which is the heart of most government organisations. Like most government agencies and state companies, the party group, rather than the board, makes most of the important decisions. As is common for state investment entities, Lou Jiwei serves concurrently as the party secretary of the CIC party group as well as its chairman. Likewise, Gao Xiqing and Hu Huaibang are

TABLE 1 CIC Management Team

Name	Positions in CIC	Background
Lou Jiwei	Chairman, Executive Director, CCP Party Secretary	Zhu cultivated technocrat with career in Commission on Systems Reform and Ministry of Finance
Gao Xiqing	CEO, Vice Chairman, Executive Director, CCP Vice Secretary	PM Zhu persuaded this Wall Street lawyer to return to China to help build the stock market, served in CSRC and National Social Security Fund
Hu Huaibang	Vice Chairman, Chair of Monitoring Committee, CCP Vice Secretary	Career academic who served short stints in the PBOC and CBRC
Zhang Hongli	Vice Manager, Executive Director, CCP Party Group Member	Career MOF official, headed the all-important Budgetary Department in the MOF during the Zhu Administration
Xie Ping	Vice Manager, CCP Party Group Member	Zhu cultivated technocrat in the PBOC, was CEO of Huijin before incorporation into CIC
Wang Jianxi (Jesse Wang)	Vice Manager	Career as an accountant in the CSRC and then Vice Chairman of Huijin, helped build the stock market, only board member who is not a CCP member
Yang Qingwei	Vice Manager, CCP Party Group Member	Career in the National Development and Reform Commission (NDRC), only manager who is serving concurrently in the NDRC
Zhang Xiaoqiang	Director	Currently Vice Chairman of NDRC, career in NDRC
Li Yong	Director	Currently Vice Minister of Finance, career in MOF
Fu Ziying	Director	Currently Vice Minister of Commerce, career in MOC
Liu Shiyu	Director	Vice Governor of PBOC, career in PBOC
Hu Xiaolian	Director	Head of SAFE and Vice Governor of PBOC, career in PBOC
Liu Zhongli	Independent Director	Former Minister of Finance, former head of the National Social Security Fund
Wang Chunzheng	Independent Director	Served as Vice Chairman of NDRC for over two decades before retiring in 2007

Source: Q. Li, '中国投资公司今日正式挂牌' [CIC formally opens for business today], *Caijing*, 2007.

also given important party positions as vice secretaries. Because the party chain of command dominates, Jesse Wang, who helped create the Chinese stock market, is subordinate to fellow vice manager Yang Qingwei, who despite being a career official in the planning commission is a member of the party group. In brief, even an examination of the formal institutions governing the CIC does not suggest that this entity would be able to seek profit autonomously of bureaucratic and elite politics.

Because CIC is such a new entity, we have little data on its performance trajectory. However, the corporate governance of the entity does not suggest that the fund will focus on long-term profit. Instead, the CIC, when internal bickering does not paralyse the entity, is prone to short-sighted and careless gambles and fulfilment of political tasks handed down by various senior political figures. First, unlike the Singaporean entities, outsiders from the private sector only play a limited role, and its management is dominated by officials from government agencies. Although CIC aspires to hire talent from the private sector, they would only be appointed to positions below the vice departmental level.[45] This is because CIC is managed like other government agencies where the top officials remain "party cadres" directly appointed by the Central Organization Department of the Chinese Communist Party (CCP). Furthermore, board positions of the CIC were highly contested by rivalling agencies seeking influence over the new entity, and none of the agencies wanted a seat to be filled by an outsider. Thus, unlike the Singaporean funds, even its "independent" board members are drawn entirely from retired government officials, including veteran planned economy stalwart Wang Chunzheng (See Table 1).

Even when jurisdictional conflict eases and the CIC is seen as taking decisive action, it is often to deliver a key outcome for political patrons at the top. The recent Huijin – a CIC subsidiary – injection of 1.2 billion RMB to uphold the share prices of the state banks is a clear example of this logic at work.[46] Intense pressure was mounting on the Premier to do something to stabilise the stock market, which saw a drop of over 60% from its high in 2007. Thus, the order was issued to buy bank shares in the market, partly because banks were a big presence in the stock index. A sudden spike of demand for bank shares lifted the entire market. In the near future, as the Chinese stock market comes under continual pressure, the CIC may act further to buy up shares of key Chinese companies, especially financial institutions. CIC's recapitalisation of China Development Bank to the tune of US$20 billion and impending injection of US$20 billion in the Agricultural Bank of China are also political missions that contribute to the improvement of the "three agriculture" problem emphasised by Premier Wen Jiabao and CCP Secretary General Hu Jintao. Although such actions may generate some profit at the end, its aim is purely political rather than commercial.

Having formed in 2007, we have only witnessed two major cases of CIC acquisitions of overseas assets, the acquisition of minority share in

Blackstone, a private equity holding company, and Morgan Stanley, an investment bank. Although the financial crisis was something that few had predicted in 2007, the hasty acquisition of Blackstone is an early manifestation of the impatience that may drive some of CIC decision-making in the future. The Blackstone deal has thus far been a spectacular failure. Soon after the CIC was approved in January 2007, former finance secretary of Hong Kong and current head of Asia for Blackstone Anthony Leung pitched this deal to new CIC leaders. In this deal, Huijin, the predecessor of CIC, would spend US$3 billion to acquire nearly 10% of Blackstone in June of 2007 at US$29.605 per share, or a 4.5% discount from Blackstone's IPO price. Upon its formation later that year, CIC would hold these shares for at least four years.

Policy makers at that time were attracted to the prospect of generating spectacular profit early in the existence of the CIC because the listing of Chinese financial institutions had generated fantastical profit for investors who held pre-IPO shares.[47] Indeed, Huijin and Temasek almost tripled their investment in the three major state banks, which listed in the Hong Kong stock exchange. Moreover, they favoured a major stake in Blackstone because Blackstone would remain a limited liability company beyond public shareholders' control.[48] The management at CIC saw it as the perfect opportunity to avoid charges of taking over the US financial sector. Technocrats who were appointed to head CIC had hoped that the guaranteed success of the first deal would afford them a relative degree of immunity from political interference going forward.[49]

By March 2008, however, the initial investment had lost over US$1.2 billion in book value. CEO Jesse Wang bravely defended the investment as potentially profitable down a five to seven years horizon.[50] Both behind the scenes and in public, however, criticism was mounting.[51] At the beginning of October 2008, Blackstone shares were trading well below $15.00, representing over 50% loss of the initial investment of US$3 billion. Although CIC managed to invest an additional US$5 billion in Morgan Stanley in December of 2007 because of high level support, the recent financial crisis in the US did not see the CIC taking major positions in any distressed financial institution.[52] Talk of buying a larger stake in Morgan Stanley stalled as Morgan Stanley struggled for more funds in September.[53]

Given that the entity is less than two years old, we can only guess how the myriad political considerations confronting the CIC leadership may direct its action in the future. Here a few possibilities are discussed. First, having learned the painful lesson of Blackstone, the CIC leadership is likely to act with great caution in the foreseeable future. Not only does this mean it won't make great commercial gamble, it means it will avoid anything that would leave CIC leadership in a vulnerable political position. This is seen in its recent inaction in the midst of the financial turmoil in the run-up to the US$700 billion bailout by the US government and coordinated action by European countries to bail out their banks. Although many potentially attractive buying options presented themselves and CIC engaged in preliminary talks in a couple of cases, it ultimately did not acquire any major stakes.[54] Instead, it may have instructed fund managers who invest on its behalf to buy small stakes in a group of financial institutions in the US and in Europe. This attracts much less attention and is politically much safer. Also, CIC may make larger acquisitions through private equity funds partially financed by CIC, like the fund managed by JC Flowers & Co. in which CIC put US$3.2 billion. More such funds may emerge in the future as CIC seeks experienced managers and also scapegoats in case an investment goes sour.

To hedge against political risks related to leadership rivalries and changing elite leadership, CIC management may decide to make alliances with large state-owned conglomerates in overseas acquisitions. Administratively, large SOEs are currently managed by Vice Premier Zhang Dejiang, while the oil sector is under the sway of oil veteran Zhou Yongkang, who currently serves as the head of China's internal security forces. Even if the CIC is controlled exclusively by Hu Jintao's faction, Hu himself, as well as CIC managers, may want to spread risks by inviting major SOEs or oil conglomerates to collaborate in any substantial acquisition overseas. In the event that the investment fails or comes under Western media scrutiny, no one faction would take all the blame, nor would the CIC alone bear the brunt of the criticism. Thus, in the future, when CIC acquires sizable natural resource or industrial assets overseas, it will likely do so in conjunction with major SOE conglomerates.

Second, the CIC will essentially behave as a major lobbying group for Chinese state banks. With CIC's US$67 billion acquisition of Huijing, which holds major stakes in three of the four large commercial state banks in China, as well as CIC's recent US$20 billion recapitalisation of China Development Bank and impending US$20 billion recapitalisation of Agricultural Bank of China, over half of CIC's US$200 billion capital will be committed to Chinese banks.[55] As such, much of the CIC's income flow would also come from dividends paid by listed Chinese banks. That being the case, the easiest way for CIC managers to fulfil the mission of generating a 4.5% return is to ensure that Chinese banks pay sufficient dividends to shareholders.[56] Thus, CIC has strong motivation to persuade the government to limit competition in the banking sector, slow down foreign entry, set interest rates to give banks a healthy spread, and bail out the banks if non-performing loan ratio rises.

Finally, because of the complicated political calculus facing CIC managers, foreign policy objectives are likely further away from their minds than domestic political considerations. Furthermore, China is well aware of the sensitivity of mobilising its vast foreign exchange reserve toward foreign policy goals. All the top executives of the CIC have repeatedly stressed that the CIC's main role would be to remain as a passive investor.[57] However, even if the CIC and China's foreign exchange reserve devote a small portion of their resources to foreign policy objectives, the result can be substantial. For example, it was recently revealed that SAFE bought US$300 million in Costa Rican bonds in exchange for the country changing its diplomatic recognition from Taiwan to China.[58] Although the sum mobilised was small relative to the foreign exchange reserve, it achieved a major diplomatic objective for China.

CONCLUSION

To be sure, SWFs have great potential of becoming geopolitical instruments because they hold such vast sums. However, leaders are typically much more concerned about domestic political survival. This holds true especially in authoritarian regimes where constitutional procedures for leadership transitions are often lacking. Authoritarian leaders in a wide variety of settings have a record of deploying economic resources to ensure that the support coalition remains loyal.

It is thus no surprise that autocrats in a unified regime tend to use SWFs as a way to maintain control over vital economic assets, as in the case of Singapore. At the same time, because the autocrat is in control, the SWF in such a country can focus more on long-term profit. In the case of a fragmented authoritarian regime, the SWFs themselves become arena for factional and bureaucratic power struggle. Decisions are made to advance the interests of factional patrons and protect and further the careers of SWF mangers rather than to increase profit or geopolitical advantages. Far from being an international menace, these SWFs may be too preoccupied with internal conflicts to do any international harm.

However, if international tension rises in the future due to rising trade protectionism, even a fragmented authoritarian regime may come to see international influence as a key aim of diplomacy. In that case, authoritarian countries which have SWFs, such as China or Russia, may be able to deploy SWF resources in a strategic way. Clearly, regimes like China and Russia have enough internal coherence in the first place to generate a foreign exchange surplus and to set up SWFs. If the elite is focused on expanding international influence, these countries are quite capable of deploying SWFs for geopolitical ends. Such interventions through the SWFs may come in subtle guises – through partial acquisitions of Western energy companies, through the accumulation of small stakes in major Western financial institutions, and through private equity acquisitions of small but strategically important firms in the West. In developing countries, where the mobilisation of a billion can make a major difference, authoritarian regimes like China can increasingly project its financial resources through mobilising a mix of sovereign wealth funds, policy banks, and major state-owned enterprises.[59] For Western policy makers, the main challenge will be to keep track of an increasing array of financial institutions linked to authoritarian states and to discern patterns of coordinated actions that may have strategic implications.

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NOTES

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