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U.S.-China Economic and Security Review Commission

Monthly Analysis of U.S.-China Trade Data **July 3, 2014**

Highlights of this month's edition

- **Bilateral trade:** U.S. exports to China stage modest recovery, driven by transportation equipment; monthly goods deficit at highest level so far this year
- **Bilateral policy issues:** State Dept official previews S&ED talking points; China disappoints at WTO ITA talks; solar dispute with China splits U.S. interest groups; 25th Tiananmen anniversary makes China business difficult for Google
- **China's economy:** Property slump adds to concerns of slowdown; anticorruption crackdown intensifies with SOE auditing campaign and indictment of top military official
- **Sector spotlight sovereign wealth funds:** China Investment Corp. under siege from Chinese auditors; adds to concerns about fund's governance and investment strategy

Bilateral Trade

The U.S. monthly trade deficit in goods with China reached $28.8 billion in May, the highest monthly deficit so far this year (see Table 1). The cumulative bilateral deficit through the first five months reached $125.2 billion, $3.9 billion higher than at the same point last year. U.S. goods exports to China staged a modest recovery, growing by 5.4 percent year-on-year, compared to only 0.9 percent in April. Exports outpaced imports by 1.7 percentage points, causing the bilateral deficit to expand at a slower rate.

Table 1: U.S. Goods Trade with China, January-May, 2014
(US$ billions)

	Jan	Feb	Mar	Apr	May
US$ billions					
Exports	10.4	9.9	10.8	9.0	9.2
Imports	38.2	30.7	31.2	36.3	38.0
Balance	(27.8)	(20.9)	(20.4)	(27.3)	(28.8)
Total	48.6	40.6	42.1	45.3	47.2
Balance YTD (US$ billions)					
2013	(27.8)	(51.4)	(69.2)	(93.4)	(121.2)
2014	(27.8)	(48.7)	(69.1)	(96.4)	(125.2)
yoy growth %					
Exports	10.4%	8.2%	13.6%	0.9%	5.4%
Imports	2.7%	-6.1%	14.4%	9.6%	3.7%

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, July 2014). http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl.

The main driver of U.S. goods exports to China in May was transportation equipment. At $2.1 billion, these shipments – comprised of mainly automotive and aviation products – led all exports, and grew by 29.1 percent year-on-year. Other top U.S. exports to China declined year-on-year (see Table 2). Computer and electronic products continued to lead all U.S. imports from China, with a 36 percent share, but declined by 3 percent year-on-year.

In contrast, electrical equipment, appliances, and components and machinery, the second- and third-largest U.S. imports from China, registered double-digit gains.

Table 2: Top U.S. Goods Exports to China in May, 2013-2014
(US$ millions)

	Value (US$ mn)		Yoy growth
	2014	2013	(%)
1 Transportation Equipment	2,102.7	1,628.4	29.1%
2 Computer and Electronic Products	1,426.4	1,496.0	-4.7%
3 Chemicals	1,145.7	1,177.3	-2.7%
4 Machinery, Except Electrical	807.9	883.2	-8.5%
5 Waste and Scrap	578.0	744.1	-22.3%
6 Food and Kindred Products	370.9	372.4	-0.4%
7 Agricultural Products	308.9	329.6	-6.3%

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, July 2014). http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl.

Bilateral Policy Issues

State Department Official Previews S&ED Talking Points

This year's Strategic and Economic Dialogue (S&ED) between the United States and China will take place in early July. At a June 25 hearing of the Senate Foreign Relations Committee, Daniel Russel, Assistant Secretary of State in the Bureau of East Asian and Pacific Affairs, previewed some of the issues likely to be addressed at the talks. Russel testified that the S&ED is an important mechanism "for building a 'new model' that disproves the thesis that the United States and China are somehow destined for strategic rivalry and confrontation." While acknowledging the longstanding imbalance in bilateral trade, he noted that China is one of the fastest growing U.S. export markets. Russel affirmed that the United States "[does] not seek to contain China; to the contrary, we welcome the emergence of a stable, peaceful, and prosperous China." He commended the "sweeping reforms" that China's leaders have announced in recent months; if realized, these reforms could give the market a greater role in China's economy. Russel maintained, however, that China should "recognize the self-benefit of upholding basic rules and norms on which the international system is built," and "exercise restraint in dealing with its neighbors […]."[1]

According to Russel, broad themes at the S&ED talks are likely to be regional and global security challenges (including the maritime disputes in the South and East China Seas), the global economic recovery, and bilateral cooperation on clean energy.[2] Specific economic issues to be discussed include:

- *Intellectual property and cybertheft.* The United States will voice its concerns over the theft of intellectual property and trade secrets, including "government-sponsored, cyber-enabled theft for the purpose of giving Chinese companies a competitive advantage."[3] This issue was brought to the fore in late May, when the grand jury of the Western District of Pennsylvania indicted five Chinese military hackers for computer hacking, economic espionage, and other offenses directed at U.S. entities. The six entities targeted spanned the nuclear power (Westinghouse), solar panel (SolarWorld), and metals industries (U.S. Steel, Allegheny Technologies Inc., U.S. Steel, and Alcoa Inc.). The indictments were made public by the U.S. Department of

Justice (DOJ).[4] China's Ministry of Foreign Affairs stated after the DOJ indictment that it would refrain from further cyber working group discussions with the United States.[5] Treasury Secretary Jacob Lew on July 2 reaffirmed that the United States will nonetheless raise cybersecurity issues with Chinese officials at the S&ED, and added that the Obama administration remains hopeful that China will seize the opportunity to re-engage on cyber policy.[6]

- *Moving China's currency toward a market-determined exchange rate.* [7] The U.S. Department of the Treasury addressed this issue in its latest semi-annual report on currency regimes, issued on April 15. The report welcomed the decision of China's central bank, the People's Bank of China (PBOC), to widen the *renminbi* (RMB) intra-day trading band to +/- 2 percent around its midpoint fixing against the dollar from the previous +/- 1 percent. In the month prior to the band widening, however, the PBOC took measures—including reported heavy intervention—to significantly weaken the RMB and push it away from the most appreciated edge of the previous band. The Treasury report states that China should "refrain from intervention within the band and should allow market forces to permit the reference rate to adjust if market pressures push the exchange rate to the edge of the band."[8]
- *U.S.-China Bilateral Investment Treaty (BIT).* A U.S.-China BIT, mulled by Washington and Beijing for several years, entered a more formal process of negotiation at last year's S&ED. Russel confirmed that negotiations will continue this year. He argued that both countries stand to benefit: while U.S. businesses have investments totaling over $50 billion in China, Chinese direct investment flows into the United States more than doubled from 2012 to 2013. [9] In March, U.S. China Business Council President John Frisbie met with U.S. multinationals in China and called on the Obama administration to prioritize the BIT talks, especially in order to reduce China's ownership restrictions on U.S. equity investors.[10]
- *Market access.* Separately from the BIT talks, the United States will press China to improve market access for U.S. companies through such measures as developing a more transparent regulatory regime, ending industrial policies that favor state-owned enterprises and national champions, and ending forced technology transfer. Although Russel made no specific reference to the Trans-Pacific Partnership (TPP) or related trade initiatives, he said that the administration will urge "Chinese integration into the rules-based international economic and trading system."[11]

China Disappoints at WTO Information Technology Talks

Efforts to conclude a revised Information Technology Agreement (ITA) in the World Trade Organization (WTO) were again stifled in June. At the latest negotiating round on June 26, China failed to table a new offer amenable to the United States and other participants. Originally slated for conclusion last year, the ITA negotiations have stalled due to China's unwillingness to include key products such as multicomponent integrated circuits (MCOs) and flat-panel displays, and its insistence on lengthy tariff phase-out periods for other products.[12]

At the Asia Pacific Economic Cooperation (APEC) meetings in May, U.S. Trade Representative (USTR) Michael Froman engaged in dialogue with Chinese officials, offering new concessions that he said had "narrowed differences" over a final ITA. The United States apparently has shown more flexibility in letting China extend tariff phase-outs for select products.[13] At the June negotiations, however, China did little to reciprocate with flexible terms of its own, calling instead on other parties to make compromises.

The ITA, first concluded in 1996 after the Uruguay Round of the WTO, is a plurilateral agreement involving 29 countries. An updated ITA is an important component of early-harvest outcomes in the WTO Doha Round. A deal on trade facilitation was concluded in Bali last December, and a plurilateral trade in services agreement (excluding China) is currently being negotiated.[i] The nominal aim is still to conclude the ITA by the November 10-11 APEC summit in Beijing. The next meeting of the ITA Committee has been scheduled for October 31. Even if talks were to restart in July, they would be interrupted by the August-September summer break in Geneva. If the November deadline is to be met, there are only two months left during which to negotiate. [14]

WTO: U.S. Criticizes China's Discriminatory Trade Practices

During China's fifth World Trade Organization (WTO) Trade Policy Review (TPR), which began on July 1, the United States described China's trade and investment practices as shrouded in a "systemic web of secrecy."[15] The United States accused China of failing to meet the transparency obligations which it agreed to upon accession into the WTO in 2001. Specifically, the Chinese government is inconsistent in notifying the WTO in advance of newly enacted policies that impact or distort trade, a requirement for WTO members. The United States described China's non-transparency policies as including "unpublished measures, internal instructions, oral directives, and confidential documents."[16] China also justifies its nontransparency by frequently citing a law that treats commercial information as state secrets—an issue that has prevented the U.S. Securities and Exchange Commission (SEC) from properly investigating possible fraudulent activity of Chinese firms listed on U.S. stock exchanges.

The United States accused China specifically of failing to notify the WTO of extensive industrial and agricultural subsidies that are called for in China's various Five-Year Plans since 2001. The United States called China's subsidization of its domestic industries "widespread and massive."[17] The WTO's TPR states that it is unclear the degree to which China subsidizes exports "since China has failed to notify any agricultural support provided after 2008."[18] The TPR also said that China retains a large number of support programs aimed at achieving its economic and social goals, but the WTO could not identify the full scope of these policies because they were often the result of "internal administrative measures."[19]

China did not respond directly to the United States' accusations, but noted that it has responded to multiple questions submitted in preparation for the TPR. China said it would work to reply to other questions as soon as possible.

Solar Dispute with China Splits U.S. Interest Groups

On June 3, the U.S. Department of Commerce announced its decision to levy countervailing duties of up to 31 percent on imports of solar products from China.[ii] Since then, intra-industry disagreement over the case has increased. On June 24, Mukesh Dulani, president of SolarWorld Americas, the plaintiff in the case, sought to shore up Congressional support for the trade remedies. Back in May, twenty-three members of Congress sent a letter to President Obama suggesting that U.S. solar producers should compromise with polysilicon producers, solar installers, and other businesses that use imported panels. Representatives Scott Peters (D-CA) and David Price (D-NC) led calls for the president to help broker an intra-industry compromise, arguing that this is a Chinese precondition for negotiating a settlement.[20]

Mr. Dulani's letter challenged these suggestions. He underscored evidence that Chinese producers continue to benefit from aggressive pricing practices and state subsidies that

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[i] For earlier analysis of the ITA talks, see the November 2013 edition of the USCC trade bulletin. For information on Trade in Services Agreement (TISA), see Iacob Koch-Weser, *Should China Join the WTO's Services Agreement?* (U.S.-China Economic and Security Review Commission, March 11, 2014). *http://origin.www.uscc.gov/sites/default/files/Research/USCC%20Economic%20Issue%20Brief_03.11.14.pdf*.

[ii] For more details, see the June 2014 edition of the USCC trade bulletin.

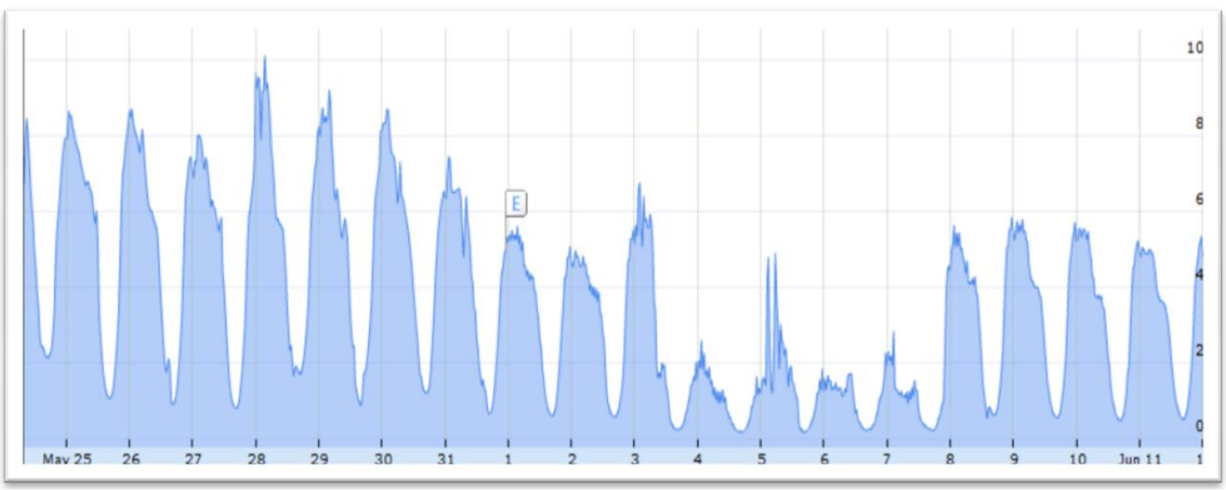
constitute unfair competition, and argued that his company's trade complaint should not be watered down to achieve a compromise with companies whose business models rely on inputs that are the products of such practices. He also cited the May 19 DOJ indictments of several Chinese People's Liberation Army officers who stand accused of hacking into the systems of SolarWorld.[21]

Tiananmen Anniversary Makes China Business Difficult for Google

June 4th marked the twenty-fifth anniversary of the Tiananmen Square massacre. Although this is a sensitive period for the Chinese government every year, this year's censorship and crackdown measures were greater in both extent and severity. According to the Human Rights Watch, the crackdown on Chinese dissidents began earlier and was harsher than ever before.[22] Amnesty International documented the crackdown measures, which ranged from verbal warnings to detention of at least 30 dissidents related to the commemorations.[23]

China disrupted access to Google products and services in the days around June 4th, increasing its Internet censorship to unprecedented levels. Said the anonymous founder of GreatFire.org, a nonprofit organization that monitors Chinese censorship, "It would be wrong to say this is a partial block. It is an attempt to fully block Google and all of its properties."[24] A review of Google's traffic data shows a significant drop in usage during the most sensitive dates of the anniversary (see Figure 1). Google sites and products remained partially accessible until May 30, when China's fraction of Google's normalized worldwide traffic dropped from a high of 8.72 percent to a high of 2.06 percent on June 4th. By comparison, during the same period a year ago, access to Google sites and products remained at roughly 7 percent.[25]

Figure 1: China's Fraction of Google's Worldwide Traffic Normalized, May 25-June 12, 2014



Source: Google, *Transparency Report Database - China,* *http://www.google.com/transparencyreport/traffic/explorer/?r=CN&l=EVERYTHING&csd=1369610708834&ced=1370983380000.*

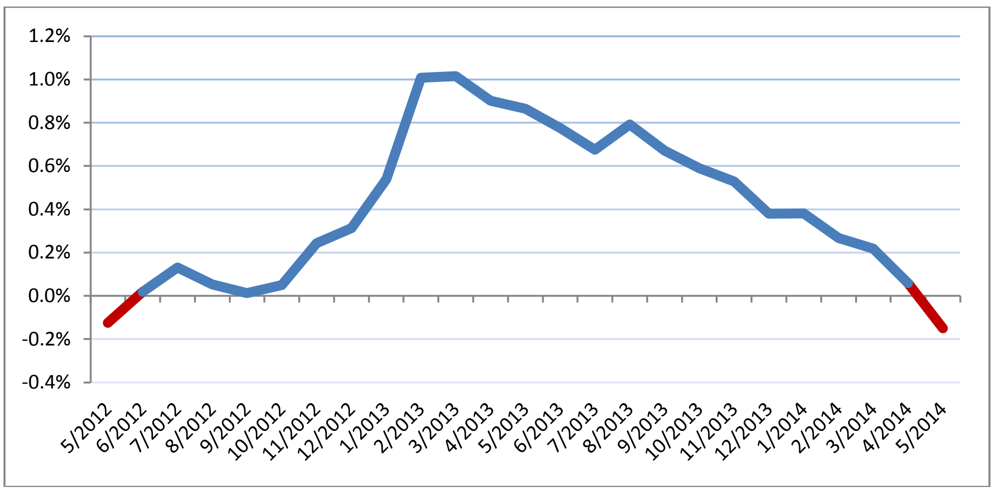
Although Google's usage rates have recovered in recent weeks, they have not returned to the same levels as before the Tiananmen anniversary. As the founder of GreatFire.org noted, "In the past we have seen aggressive crackdowns in the run-up to June 4, but this year I think we won't see a cooling off period."[26] This sustained drop could be attributable in part to China's broader crackdown on social media and the Internet under China's new President Xi, who took office last year. In March, Beijing began to block WeChat, a social messaging app.[27] In addition, the Chinese government may be targeting the China-based businesses of U.S. IT companies following the DOJ cyber indictments in late May.[28]

China’s Economy

Property Slump Adds to Concerns of Economic Slowdown

Official Chinese data released this month showed a striking drop in residential property prices. Analysts predict this could further drag down China’s slowing economy. In May, the average price of newly constructed residential properties in 70 Chinese cities declined for the first time in two years (see Figure 2). Preliminary data estimates that average new-home prices fell another 0.5 percent from May to June.[29] Although Chinese housing prices have increased over the past two years, the rate of increase has been steadily declining since March 2013. In addition, data released this month from the Survey and Research Center for China Household Finances showed that 22.4 percent of sold residential properties in Chinese urban areas remained vacant in 2013.[30]

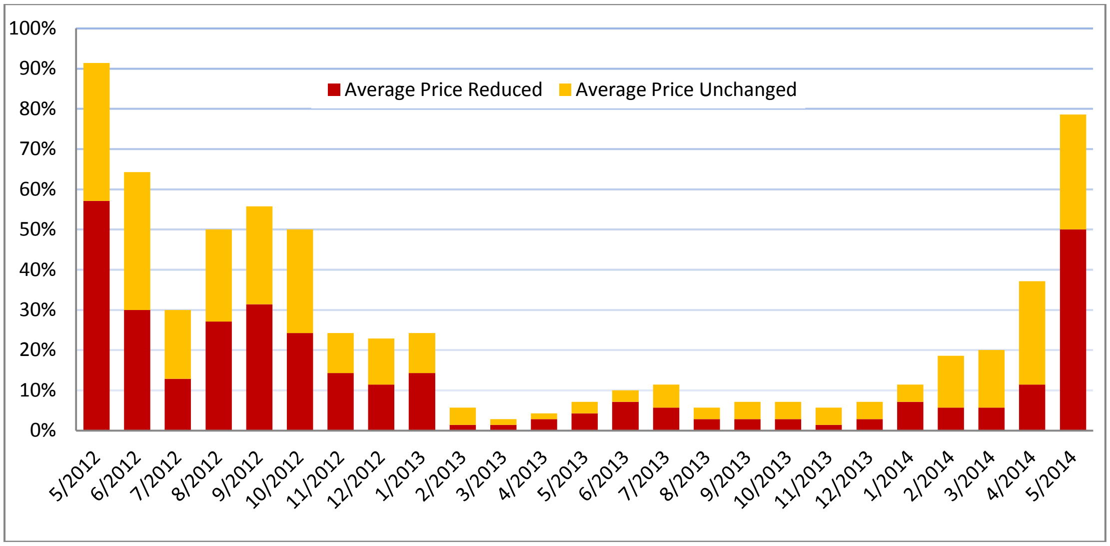
Figure 2: Change in Price of New Residential Construction
(Average of 70 Surveyed Chinese Cities)



Source: China National Bureau of Statistics, via CEIC data.

The property slump covers the vast majority of major Chinese cities. In May 2014, 50 percent of the 70 cities surveyed showed a drop in residential prices, and nearly 30 percent reported unchanged prices (see Figure 3). Between April and May, the number of surveyed cities with stagnant or falling housing prices more than doubled, rising from 26 to 55. Non-official data indicate that the property slump continued into June; home sales in 42 major Chinese cities declined by 16 percent in the first half of the month from the same period in May.[31]

Figure 3: Cities in China with Stagnant or Reduced Housing Prices
(Percentage of 70 Surveyed Cities)



Source: China National Bureau of Statistics, via CEIC data.

Economists have mixed opinions about what the property slump will mean for China's overall economy. Some argue that it is the single biggest risk through next year.[32] A key driver of growth since the 1990s, the property sector affects a multitude of related sectors such as construction and steel production, two pillars of the Chinese economy. Moody's Analytics estimates that, with construction and home renovation included, property sales account for nearly one-quarter of national gross domestic product (GDP).[33] A significant drop in property prices could cause China to miss its official 2014 growth target of 7.5 percent.[34]

Others argue that fears of a property market collapse are exaggerated, given the stability of underlying indicators and normal cyclical changes. High down payments, low household debt, and the potential for increased government intervention help to mitigate risk.[35] In addition to slashing prices, in Hangzhou and Wenzhou Provinces (China's two weakest housing markets) property developers are offering guarantees to purchase back properties above selling price in three to five years as a means of boosting demand.[36] China's property market experienced cyclical price drops of approximately 20 percent in 2009 and 2012, both of which ended in price increases once inventories declined and the market balanced out.[37]

The ultimate outcome may depend on the degree to which the Chinese government intervenes to prevent a property market collapse, and there are some signs that the government is already taking action. In May, the People's Bank of China (PBOC), China's central bank, called on the country's largest banks to accelerate mortgage approvals.[38] Banks are offering low down payment options to help potential first-time homebuyers.[39] Local governments are also providing incentives to potential home buyers, such as tax breaks[40] and local household registration (*hukou*)[iii] to residents from other Chinese provinces.[41] On the supply side, the government has reduced banks' reserve requirements to make it easier for property developers to obtain financing.[42]

[iii] The location of one's household registration in China is the basis for eligibility to receive a variety of government services such as education. Typically it is very difficult to change the location of one's household registration in China.

In the wider economy, the Chinese government is introducing so-called "mini-stimulus" policies, which include accelerating local government spending and increasing railway and infrastructure investment.[43] Substantial stimulus policies were central factors in offsetting the effects of other recent property slumps, particularly in 2009. However, some analysts estimate that the current "mini-stimulus" measures will not be enough.[44] *The People's Daily*, the mouthpiece of the Chinese Communist Party (CCP), contends that such bearish estimates intentionally exaggerate the slowdown to force the government into "heavy-handed stimulus policies." The government appears wary of expanding the stimulus, perhaps because it does not want to add to the high levels of debt among local governments and certain industries.[45] Nonetheless, if property prices continue to decline at current rates, more aggressive stimulus measures may be needed to keep growth at or near the official 7.5 percent target.

China's Anticorruption Campaign Intensifies

The Chinese leadership's anticorruption campaign, launched shortly after President Xi took office in 2013, shows no signs of abating. Recent developments include the divestment of assets by President Xi's family and relatives; the targeting of state-owned enterprises (SOEs); and the expulsion of several high-level officials from the CCP. President's Xi's relatives are reportedly reducing their assets in the wake of a 2012 investigative report by the U.S. news agency Bloomberg, which revealed that the Xi family owned some $376 million in assets.[46] The asset divestment may also be occurring at the behest of President Xi, who wants to demonstrate toughness and set an example for other CCP leaders in carrying out the anticorruption campaign.[47]

Although leadership transitions in the past have often led to anticorruption crackdowns, recent developments demonstrate that President Xi's campaign is unprecedented in breadth and scope. According to Hong Kong-based Reorient Securities, as of June the total number of officials detained or disciplined for corruption included 24 provincial officials, 23 vice-provincial officials, 204 prefecture-level officials, 3,003 county officials, and 40,579 local government bureaucrats.[48] The anticorruption campaign has also targeted powerful SOEs such as China National Petroleum Corporation, one of China's three national oil companies. In addition, China's National Audit Office (NAO) uncovered 35 cases of bribery and embezzlement earlier this year, and in June reported fraud in 11 SOEs.[49] The NAO has also leveled charges of misappropriation of more than $1 billion last year in the construction of the west-to-east electricity transmission system.[50] The government has already severely punished more than 190 people on account of anticorruption, twice last year's number.[51]

The anticorruption drive has also targeted a greater number of high-level officials than in previous campaigns. On June 30, Xu Caihou became the highest-ranking People's Liberation Army (PLA) official to be taken down in nearly three decades. He wielded significant influence as a former member of the CCP Politburo, and previously served as the PLA's second-in-command. The actions against Xu follow the targeting of Zhou Yongkang, China's former domestic security chief, and his allies. These moves suggest that President Xi's anticorruption campaign is designed at least in part to eliminate potential political threats to his leadership. President Xi is eager to build public support and consolidate power by eliminating the power bases of leaders or prominent members of different CCP factions. Christopher Johnson, Freeman Chair in China Studies at the Center for Strategic and International Studies, noted that the recent expulsion of Xu and other high-level officials demonstrates President Xi's tight control and influence over the CCP and PLA.[52] Nonetheless, continued small-scale profiteering opportunities endemic in the CCP's patronage structure, along with recent crackdowns on anticorruption activists such as the New Citizens Movement, suggest that the campaign will have limited long-term effectiveness.

Sector Spotlight: China's Sovereign Wealth Funds

Scathing Audit of CIC amid China's Anti-Corruption Campaign

On June 18, China's National Audit Office (NAO) released a scathing report on China Investment Corp. (CIC), China's flagship sovereign wealth fund (SWF). Established in 2007, CIC has $575 billion under management, making it the world's fourth-largest SWF.[53] According to the NAO report, audits carried out from 2012 to 2013 exposed a litany of poor governance practices at CIC, including lax personnel accountability; weak financial management; and non-standard selection of external managers for some overseas investments.[54] The auditors also specified cases of gross misconduct:

- From 2008 to 2013, CIC mismanaged 12 of its overseas investments. Six of the projects reported losses, four had unrealized losses, and two faced potential losses.[55]
- At the end of 2012, $10 million in payments received from private equity deals were kept out of the fund's formal accounts;[56]
- Several Chinese financial institutions owned by CIC made real estate investments in violation of government directives.[57] Central Huijin Investment Ltd., a CIC-owned asset management company, forwent $202 million in potential investment gains in 2011 by selling a stake in a local securities company at the cost price.[58]

The NAO said it had passed on suspected crimes and violations of CCP discipline at CIC to "relevant departments" for further investigation and action.[59] Promptly responding to the report, CIC acknowledged wrongdoing and vowed to rectify mismanagement. CIC has already allegedly ordered a domestic subsidiary to divest as much as $1.3 billion in property development assets.[60]

The NAO's attack on CIC is part of a broader effort by the new leadership of President Xi to root out corruption and misconduct at SOEs. The NAO performs SOE audits every year, but its findings now carry greater significance (see section on corruption above).[61] In the financial sector, CIC was not the only entity targeted: the Agricultural Development Bank of China, one of the country's three policy banks, and Bank of China, the country's fourth-largest lender by assets, were found by NAO to have issued billions of RMB in loans in violation of lending regulations.[62]

CIC's Leadership Controversy and Poor Performance

The NAO report may not result in punitive action against CIC. Still, it adds to the controversy already surrounding the fund.[iv] Over the past year, CIC has undergone an extensive overhaul of senior management. Long-serving chairman Lou Jiwei stepped down last spring to become China's new Minister of Finance, and CIC struggled to find a successor. Senior finance officials apparently turned down the job for fear that future losses at CIC could harm their careers.[63] In July 2013, Ding Xuedong, then the Deputy Secretary General of China's cabinet, took over as CIC chairman. According to the *South China Morning Post*, Ding's appointment upset CIC's then-president Gao Xiqing, a banker with Wall Street credentials and a pioneer of China's capital markets. Gao stepped down in January of this year, under the pretext that he had passed the mandatory retirement age of 60.[64] That was likely an excuse, since many top officials in China, including Lou Jiwei, are in fact over 60.[65] Notably, Gao's departure coincided with the closure of PCA Investments, an opaque, China-based hedge fund in which CIC was the only major investor.[66] Bloomberg reports that Felix Chee, the head of CIC's overseas office in Toronto, also left his post late last year.[67]

[iv] For an in-depth analysis of CIC, see Iacob Koch-Weser and Owen Haacke, "China Investment Corporation: Recent Developments in Performance, Strategy, and Governance" (Washington, DC: U.S.-China Economic and Security Review Commission, June 13, 2013).

CIC has been widely criticized in China for misallocating billions in foreign exchange reserves. There is not much solid evidence to back these assertions – the fund only discloses its annual returns in July of the following year, and its 2013 annual report contains little detailed financial information. CIC reported last July that it had registered a return of 10.6 percent on its overseas assets in 2012, reversing a loss of 4.3 percent in 2011.[68] On the sidelines of the National People's Congress meetings in March, a CIC executive hinted at a return of around 8 percent for 2013.[69] More tangible evidence of CIC's poor performance stems from the energy and commodity companies it has provided capital to, including:

- *AES Corp. (Utilities).* CIC spent $1.6 billion in 2009 to purchase a 15 percent equity stake in AES, a U.S. power-generation company based in Virginia. CIC obtained approval for the deal from the Committee on Foreign Investment in the United States, and acquired a seat on AES' board. In December 2013, however, CIC sold 66 million shares in AES at a discount, cutting its stake in the company to 8.3 percent.[70]
- *Sunshine Oilsands and Penn West (Oil).* CIC co-invested in Canada-based oil exploration company Sunshine in 2012 with Bank of China, China Life Insurance, and Chinese oil major Sinopec. This year, Sunshine revealed that its oil-sands project was 20 percent over-budget due to mismanagement, rising labor costs, and flooding.[71] The company's share price tumbled by 48 percent in 2013.[72] In a separate oil-sands exploration deal, CIC and the Canadian oil and gas producer Penn West formed a partnership in 2010, in which CIC agreed to invest $762 million for a 45 percent stake. Since then, Penn West has undergone a management shakeup to address rising costs and high debt, and has lost over half of its share value.[73]
- *SouthGobi Resources Ltd. and PT Bumi Resources (Coal).* CIC in 2010 bought a 13 percent stake in Canada-based coal miner SouthGobi for $250 million, along with $500 million worth of convertible bonds. The company has incurred major losses on its operations in Mongolia, due to a slump in the coal market. In March, the company sought additional financing to avoid defaulting on $250 million in debentures held by CIC.[74] The Indonesian coal miner PT Bumi, meanwhile, has accumulated $4.7 billion of short-term debt.[75] CIC lent $1.9 billion to the company back in 2009. At a shareholder meeting on June 30, PT Bumi received approval to issue shares in order to pay off an initial $150 million in debt to CIC.[76]
- *GCL-Poly Energy Holdings Ltd. and Longyuan Power Group (Wind and solar).* CIC in 2009 spent $710 million to acquire a 20 percent stake in domestic Chinese firm GCL-Poly Energy, the world's largest maker of solar panel parts and raw material polysilicon. Recently, the company has suffered from excess capacity and price pressures in China's solar PV industry. CIC over the past year has twice sold down its share in GCL at a discount, taking its stake from 20 percent to a mere 4.6 percent.[77] CIC has also sold stakes in the Hong Kong-listed wind farm developer Longyuan Power Group, which has struggled to turn a profit in China's alternative energy sector.[78]

CIC's Core Dilemmas

According to top officials at CIC, the fund lacks experience in managing market cycles. The slowdown in China's economy, coupled with rebalancing away from commodity-intensive sectors such as construction, has hurt CIC's commodity-related investments.[79] As the U.S. Federal Reserve begins to reduce its bond-buying program, more capital is also flowing back to advanced economies, exposing CIC's stakes in emerging markets.[80]

CIC is taking a series of steps to reallocate its capital. On June 17, CIC chairman Ding published a lengthy op-ed in London's *Financial Times*, in which he announced CIC's plans to invest in agriculture "across the entire value chain."[81] Some of CIC's most aggressive investments to date have been in real estate. In the United States, CIC has increased its stakes in General Growth Properties Inc., a big U.S. mall owner, and in Rouse Properties Inc., a U.S. real-estate investment trust.[82] To facilitate these investments, CIC is considering moving its overseas office from Toronto, where it focused on resource-related deals, to New York.[83] In the United Kingdom, CIC agreed this year to buy Chiswick Park, a West London office development, from U.S. private equity group Blackstone for about $1.25 billion.[84] CIC already holds a lucrative stake in Songbird Estates Plc, the main owner of the Canary Wharf estate.[85]

These shifts in investment strategy, however, fail to address CIC's underlying governance dilemmas. Foremost, the fund lacks a stable source of funding. It is registered in China as a state-owned enterprise, and is barred from directly withdrawing foreign exchange from the central bank. In contrast, the State Administration of Foreign Exchange, China's next-largest SWF, is a direct subsidiary of the central bank, and according to some accounts, competes directly with CIC for access to foreign exchange. By acting as the government's principal shareholder of state-owned banks, CIC has over half a trillion dollars in assets, but these do not translate into cash flow. CIC has repeatedly lobbied the central bank for enhanced funding. According to data compiled by the London-based Institutional Investor's Sovereign Wealth Center, CIC last year spent only $1.9 billion, less than SWFs that have far fewer assets under management (see Table 3). Singapore's SWFs GIC and Temasek Holdings Pte spent a combined $15.7 billion, about a third of the global total.[86]

Table 3: Sovereign Wealth Fund Rankings

Rank	Country	Fund	Assets: US$ bn	Assets: Share of total (%)	Year est.	Origin
1	Norway	Government Pension Fund - Global	$ 878.0	13.3%	1990	Commodity
2	UAE	Abu Dhabi Investment Authority	$ 773.0	11.7%	1976	Commodity
3	Saudi Arabia	SAMA Foreign Holdings	$ 737.6	11.2%	n/a	Commodity
4	China	China Investment Corp.	$ 575.2	8.7%	2007	Non-commodity
5	China	SAFE Investment Company	$ 567.9	8.6%	1997	Non-commodity
6	Kuwait	Kuwait Investment Authority	$ 410.0	6.2%	1953	Commodity
7	Hong Kong	Hong Kong Monetary Authority	$ 326.7	4.9%	1993	Non-commodity
8	Singapore	Government Investment Corp.	$ 320.0	4.8%	1981	Non-commodity
9	China	National Social Security Fund	$ 181.0	2.7%	2000	Non-commodity
10	Singapore	Temasek Holdings	$ 173.1	2.6%	1974	Non-commodity
		Rest of world	$1,666.3	25.2%		
		Commodity-based	$4,023.3	60.9%		
		Non-commodity-based funds	$2,585.5	39.1%		
		Total global sovereign wealth fund assets	**$6,608.8**			

Source: Adapted from Sovereign Wealth Fund Institute. *http://www.swfinstitute.org/fund-ranking*

CIC's managers say the fund is commercially oriented, but in practice, it lacks independence from the government. CIC's board is comprised of officials from the Ministry of Finance, the central bank, and other government agencies, as set out by the fund's founding charter. As principal shareholder in state-owned banks, CIC often engages in political actions on their behalf; for example, a senior CIC official recently urged the government to tighten regulation of internet finance in order to protect the interests of brick-and-mortar banks.[87] CIC has also done business with princelings, or children of powerful Party officials. In 2012, CIC led a consortium of investors to buy back Yahoo! Inc.'s 40 percent stake in Alibaba. That consortium included the private equity fund of Alvin Jiang, the grandson of former president Jiang Zemin, who proceeded to make a fortune off the deal.[88]

Further, CIC is supporting Beijing's foreign policy and national security objectives. For example, CIC has helped to improve ties between Moscow and Beijing. A CIC representative sits on the board of Uralkali, a Russian potash fertilizer company with close ties to the Kremlin.[89] The Russia-China Investment Fund (RCIF), a partnership of the Russian Direct Investment Fund and CIC, channels Chinese foreign investment into Russia's lackluster economy. Days after China and Russia signed a series of historic commercial deals in May, RCIF announced plans to fund a railway bridge linking China and Russia.[v90]

A recent transaction involving COFCO Corp., China's state-owned agribusiness giant, adds to concerns that CIC's motives are not purely commercial. CIC in 2009 became the second-largest shareholder in Noble Group, a global commodity trader. Earlier this year, Noble sold its entire agriculture division to COFCO for $1.5 billion. The deal appeared to be a win-win for China. By acquiring Noble's grain transport network, COFCO is now better able to circumvent the world's four big agribusinesses – Archer Daniels Midland, Bunge, Cargill, and Louis Dreyfus. Because COFCO paid Noble a premium for underperforming assets, Noble saw a jump in its share price that boosted CIC's investment returns.[91]

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