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Chair Cleveland, Chair Glas, and members of the Commission, thank you for inviting me to testify before the Commission. I appreciate the opportunity to appear before you today to testify about the distinctive features of China's sovereign funds and their evolution in financing the global ambitions of the Communist Party of China (CPC) since President Xi came to power.

Sovereign funds globally today collectively manage over $11.5 trillion in assets under management. These funds are predominantly based in commodity-exporting economies and capitalized by revenues from the monetization of natural resources, notably oil and gas. The world's first sovereign fund was the Kuwait Investment Authority, established in 1953 from oil revenues. However, the largest of them in terms of assets under management is China Investment Corporation (CIC), based in China, the world's leading commodity-importing country. [1] In 2022, CIC surpassed the Government Pension Fund of Norway and became the largest sovereign fund in the world, having more than $1.35 trillion assets under management – exceeding the GDP of Mexico, the world's 15th largest economy.

The evolution of China's sovereign funds has unfolded against the backdrop of China's domestic financial reform and the globalization of Chinese capital. Once a backward country, China has caught up with Western powers on gross

[1] China surpassed the United States as the world's largest crude oil importer in 2017. More details, see U.S. Energy Information Administration, https://www.eia.gov/todayinenergy/detail.php?id=37821. China overtook Japan as the world's top LNG importing country in 2021 due to rising demand from the power generation and industrial sectors. However, in 2022, Covid-19 lockdowns and high prices curbed demand for LNG in China. That year, Japan the world's top LNG importer, although both Japan and China imported less LNG in 2022 when compared to 2021. For detail, see "Japan was the world's largest LNG importer in 2022, followed by China," *LGPrime,* January 19, 2023, https://lngprime.com/asia/japan-was-the-worlds-largest-lng-importer-in-2022-followed-by-china/71299/

economic terms by relying upon its ability to mobilize capital. No other country in history has so rapidly transformed its economy from being among the world's poorest and most isolated to one of the world's largest economies, at the heart of the global supply chain, and a leading source of international investment capital. For the last two decades, China's sovereign funds have played a significant role in China's economy, mitigating financial crises and tempering exogenous shocks. They have supported China's industrial policies by financing the state's procurement of strategic overseas assets, bankrolling Chinese enterprises' mergers and acquisitions abroad, and sponsoring the development of indigenous Chinese technology startups. As China's state-owned capital has gone global, the scope of China's geoeconomic influence has duly expanded.

Let me explain how China's sovereign funds fit into the state's political economic system, why these funds are "leveraged" funds rather than "wealth" funds, and how they relate to China's approach to managing its massive foreign exchange reserves. Unlike traditional commodity-based SWFs, China's way of leveraging foreign exchange reserves to create sovereign funds does not rely upon natural resource revenues. China's experience with sovereign funds demonstrates that a state without significant natural resource revenues can take on explicit or implicit leverage to source the seed capital for the founding of what I call sovereign leveraged funds (SLFs). China's sovereign funds differ from commodity-based SWFs and constitute a distinct class. An inherent trait of SLFs is their funding scheme, which relies upon a series of complicated transactions, including debt issuances and other forms of implicit financial leverage. SLFs are a political-economic innovation because they are the product of the state leveraging its financial and political resources to make it possible to capitalize a fund without relying upon a high-profit revenue stream like the export of commodities.

The way through which China created its sovereign funds is by using both explicit leverage and implicit leverage foreign exchange reserves. Explicit leverage means the issuance of debt and using the debt proceeds to capitalize SLFs. How the debts are structured and raised, who provide the debt proceeds, and who would control the newly established funds are not only financial issues but political issues. In other words, the decisions about how the newly issued debt will be underwritten and who will ultimately control the resultant SLF are the product of intensive political negotiation and aggressive bureaucratic competition. The establishment of CIC is an example of using explicit leverage.[2] An alternative approach for the state to obtain investment capital is the use of implicit leverage to convert existing pools of low-risk capital, or state-owned assets like foreign exchange reserves, into high-risk-bearing capital that is subsequently transferred to the management of the SLF. How this process constitutes an increase in the state's financial leverage can be understood by considering the typical investment made by a SLF. In general, the fund uses its capital to make an equity investment in a target company that is itself internally leveraged—that is, carrying debt on its own balance sheet. The sovereign fund's equity interest is subordinate to the debt of the target company. The state is implicitly leveraged because the debt of the company stays off the balance sheet of the state, but the state still bears the risk of losing its entire equity stake if the company's debt cannot be repaid. In other words, the leverage is external to the state's balance sheet. In this way, the state itself does not issue any new debt or expand its balance sheet, but it still increases its financial leverage.

China's experiment with implicitly leveraging its reserves started with the transfer to Central Huijin of $66.4 billion in foreign exchange reserves in 2003 to recapitalize China's failing banks and reform China's nonbanking financial institutions. At that time Central Huijin was not created with the intention to be a sovereign fund but instead a special purpose vehicle for the sole purpose of restructuring China's failing state-owned commercial banks. The success of Central Huijin's restructuring of the banks ultimately led Central Huijin to outlive its original mission and take on new tasks of reforming China's nonbanking financial institutions, such as the brokerage firms and capitalizing major Chinese policy-oriented financial institutions. While Central Huijin was China's first attempt at leveraging foreign exchange reserves to solve an urgent domestic crisis, its proven track record has made it an indispensable part of the

[2] For more details about CIC, see Liu, Z. Z. (2023) *Sovereign Funds: How the Communist Party of China Finances Its Global Ambitions*. 1st ed. Cambridge: Harvard University Press.

government's crisis response toolbox. In May this year, the Ministry of Finance (MOF) reportedly proposed to restructure the state's biggest bad-debt managers, or the so-called asset management companies, by moving MOF's stakes in three asset management companies to Central Huijin.[3] This proposal is in line with the government's commitment to separate the government's role as a regulator and shareholder, strengthening the role of Central Huijin as the "shareholder in chief" on behalf of the party-state while having the state's regulators, including the newly-established National Administration of Financial Regulation, focus on financial risk prevention and mitigation.

The creation of CIC can illustrate the explicit use of leverage over China's foreign exchange reserves. The Ministry of Finance issued RMB1.55 trillion special purpose bonds and used the bond proceeds to purchase $200 billion foreign exchange reserves from the People's Bank of China (PBoC), the central bank, and then capitalize CIC. The effect of these transactions was the transfer of $200 billion to CIC from the PBoC, but MOF remained as the sole shareholder of CIC. On September 29, 2007, CIC was officially incorporated as a wholly state-owned company under China's Company Law. The key takeaway is that this process does not take any sophisticated financial engineering, but it does require a tremendous amount of political engineering and multi-agency political levering in order to move the foreign exchange reserves out of the PBoC for investment purposes without having to revise the PBoC Law, which prohibits the central bank from directly purchasing government bonds and financing fiscal expenditure.

Economically, the use of either explicit (internal) or implicit (external) leverage over foreign exchange reserves decreases the stock of foreign exchange assets that can be counted towards foreign exchange reserves as defined by the International Monetary Fund (IMF). A most important distinction between the two approaches is the accounting treatment and awareness among the general public of its existence. Regardless of which type of leverage the state chooses when raising capital, the political outcome is the same: it will inevitably precipitate a political conflict among those that aspire to control the resultant capital. Implicit leverage is usually the more politically expedient choice because the associated liabilities are usually not recorded in official accounts. Both Central Huijin and investment companies affiliated with the State Adiministration of Foreign Exchange (SAFE) serve as examples of how the state takes on implicit leverage and then political conflict ensues.

Since 2007, CIC and SAFE-owned investment funds have become more sophisticated in overseas investment activities. They have become significant market participants in terms of assets under management and prestige. Each has developed its own distinct culture and approach to investing. CIC has taken pains to present itself to the global financial community as a traditional institutional investor by being relatively transparent and pledging to be impartial to politics. Soon after its founding, CIC signed on to the Santiago Principles, a set of guidelines on transparency and governance designed by the IMF and meant explicitly for government-owned investment funds. In CIC's early days, Chairman Lou Jiwei made great efforts to present CIC as a market-oriented, stabilizing force in global markets. Not everyone shared this view of CIC, and Chairman Lou publicly expressed frustration that some Western countries used "national security" as an excuse to block CIC's investments. After Lou left CIC and was succeeded as chairman by Ding Xuedong in 2013, CIC began to align its investment strategy much closer to China's national economic strategy while still maintaining its previous transparency.

Compared to CIC, SAFE remains an opaque institution that has largely been able to avoid public scrutiny. Neither SAFE nor its affiliated investment funds disclose their portfolio holdings or gains and losses. At times, this penchant for secrecy has protected SAFE from criticism. For example, CIC received heavy public criticism when its first investments made during the 2008 financial crisis turned out to be loss-making. By contrast, SAFE's public reputation was unaffected even though its investment losses in 2008 were likely much greater than CIC's. The *Financial Times*

[3] The three asset management companies include China Cinda Asset Management Company, China Great Wall Asset Management Company, and China Orient Asset Management Company. "China Considers Moving Stakes in Bad Banks to Sovereign Wealth Fund," *Bloomberg News*, May 18, 2023. Available at https://www.bloomberg.com/news/articles/2023-05-19/china-mulls-moving-stakes-in-bad-banks-to-sovereign-wealth-fund?sref=51J26SiN

reported that while CIC was savaged domestically for losing more than $4 billion in its misjudged investment in Blackstone and Morgan Stanley, the secretive SAFE hardly faced any criticism even though its losses were greater than those of CIC by an estimated twenty-fold.[4] CIC may have learned a political lesson from SAFE that transparency is not always worthwhile. One long-time observer of CIC said the fund "has turned to stealth mode; it is doing transactions and is looking at lots of resource-related deals all over the world, but it is trying to hide its involvement."[5] Undoubtedly, there is some truth to these comments. CIC may be motivated by a desire to avoid potential domestic criticism of its actions and to head off reactionary protectionism in the countries in which it invests.

Let me now turn to explain the Chinese government's strategic use of foreign exchange reserves under President Xi. The bottom line is that the ascendance of Xi Jinping to China's top leadership position in 2012 and the rollout of the Belt and Road Initiative (BRI) has motivated the party to leverage China's foreign exchange reserves as strategic financial power to advance China's overseas interests. According to Li Hongyan (李红燕), director of SAFE's Central Foreign Exchange Business Center, since 2013, the party has used foreign exchange reserves to replenish China's policy banks and establish several new sovereign funds. These new funds include the Silk Road Fund, China-Latin America Production Capacity Cooperation Investment Fund (CLAC Fund), China-Africa Industrial Capacity Cooperation Fund, and Guoxin International Investment Corporation Limited (commonly known as CNIC Corporation). Li Hongyan identified three areas where the diversified use of foreign exchange reserves serves China's national strategies. First, she argued that creating policy banks and sovereign funds provides a sustainable mechanism to put China's foreign exchange reserves to work in service of China's national strategies. Such diversified reserve usage has informed the formation of a Chinese investment system featuring equity and debt in adherence to commercial principles that can provide stable financial support for the Belt and Road Initiative and other national strategies. Second, she stated that using China's foreign exchange reserves for international investment and cooperation can advance China's participation in global governance and create a favorable international environment for the Belt and Road Initiative. Third, she asserted that strengthening the party's leadership and corporate governance can discipline equity investment institutions and drive convergence towards professional management standards that will ultimately serve China's national strategies.[6]

Under President Xi, the party-state has gradually expanded the SLFs model, applying it to reform state-owned enterprises (SOEs) to update the state's industrial policy. China's SOEs are supervised by the State-Owned Assets Supervision and Administration Commission (SASAC), formed in 2003 to consolidate many industry-specific bureaucracies. SASAC's purview does not include the financial sector overseen by Central Huijin, itself sometimes called the "Financial SASAC." Unlike in the financial sector, SOEs in the other sectors haven't benefited from a SLF like Central Huijin, which sits atop the whole industry and directs capital flow down to individual SOEs.[7] However, this began to change in November 2013 after President Xi laid out his vision for China's economy for the first time at the Third Plenary Session of the Eighteenth CPC Central Committee. Xi led the working group that called for

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[4] "China Forex Funds Find Security in Secrecy," *Financial Times*, March 15, 2009.

[5] Ibid.

[6] "Li Hongyan: Foreign Exchange Reserve Management Serves National Strategies and Prioritizes Risk Management" (李红燕: 外汇储备管理服务国家战略 风险防范放在首位). *China Finance* (中国金融杂志), January 17, 2019. Accessed at https://www.sohu.com/a/289648623_481887 ; "Yi Gang: the marginal cost of additional FX reserves accumulation outweighs the benefit," (易纲: 继续积累外储边际成本大于收益), *Caixin*, November 21, 2013.

[7] China's state-owned assets include two primary categories: financial assets and industrial and commercial assets. Central government controlled financial assets include centrally-owned financial enterprises and institutions, which are managed by the Ministry of Finance. Central Huijin also invests in some of these enterprises and enjoys shareholder rights. At the central level, industrial and commercial assets include three types of state-owned industrial and commercial enterprises: 1) more than 100 large enterprise groups under the jurisdiction of the Sate-owned Assets Supervision and Administration Commission; 2) China Post Group, China Railway Corporation, China National Tobacco Corporation, and approximately 104 state-owned cultural enterprises under the jurisdiction of the Ministry of Finance; 3) enterprises directly managed by about 75 central government departments or administrative units, of which there were about 5,200 first-level legal person enterprises. The data is from reformdata.org (中国改革信息库)。

creating "state-owned capital investment companies" to invest in "key industries and fields that are vital to national security and are the lifeline of the national economy."[8] In effect, Xi's proposed state-owned capital investment companies are SLFs mandated to focus on financing development in state-prioritized strategic industries like civil aviation, energy and mineral resources, nuclear power, and global shipping and logistics. Since July 2014, SASAC has begun reforming nineteen centrally administered SOEs in these strategic sectors and critical for the party's military-civil fusion strategy to state-owned capital investment companies.[9] Finance Minister Lou Jiwei (楼继伟), the founding chairman of CIC and its former CEO, was the person in charge of fleshing out the details of Xi's vision. As the primary author of the State Council's policy document "Opinions on Reforming and Improving the State-Owned Assets Management System," Lou clearly drew upon his familiarity with the organizational models of CIC and Central Huijin while describing how a group of state-owned capital investment companies could exercise their shareholder's rights in portfolio companies to "form a 'separation zone' between the government and the market."[10]

Such a change in the mode of interactions between the state and the market does not represent the complete retreat of the state from the market but a retrenchment. The ongoing transformation of SASAC speaks to the continued centrality of the state in the market. In May 2017, the State Council approved SASAC's plan to change its mandate from the administration of SOEs to the management of capital with the stated goals of pursuing long-term interests by channeling state capital into essential industries, critical infrastructure, and forward-looking strategic sectors of national security interest.[11]

Xi's prioritization of capital management in China's economic reform—and his use of SLFs as a tool to accomplish this—is not a complete departure from the path of his predecessors. Instead, it reflects the enduring influence on China's economic policymaking of the dual successes of Central Huijin in stabilizing China's financial system and CIC's expansion into global financial markets. Like SLFs, the state-owned investment companies of SASAC allow the party-state to exercise control by leveraging capital instead of resorting to administrative directives. For Xi's generation of CPC leadership, the SLFs model provides a ready playbook for expanding the influence of the party-state both at home and abroad.

In recent years, Chinese sovereign leveraged funds have rarely been reported as involved in crass geoeconomic powerplays after SAFE was exposed for using its foreign exchange reserves to buy Costa Rica switching diplomatic

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[8] Full text in English of the "Decision Of The Central Committee Of The Communist Party Of China On Some Major Issues Concerning Comprehensively Deepening The Reform" is available on the website of USC US-China Institute at https://china.usc.edu/decision-central-committee-communist-party-china-some-major-issues-concerning-comprehensively. The original Chinese text (十八届三中全会《决定》、公报、说明全文) is available at http://www.ce.cn/xwzx/gnsz/szyw/201311/18/t20131118_1767104.shtml

[9] As of June 2022, the State Council and SASAC declared that five centrally administered SOEs completed the reform into state-owned capital investment companies. These five SOEs include: China Baowu Group, State Development & Investment Corporation, China Merchants Group, China Resources, and China National Building Material. The Chinese government also identified twelve centrally administered SOEs to deepen the restructure process, these include: Aviation Industry Corporation of China, China COSCO Shipping Corporation, China Energy, State Power, China Minmetals, China National Machinery Industry Corporation, Aluminum Corporation of China, China National Cereals, Oils and Foodstuffs Corporation (or COFCO Group), China General Technology Group, China Communications Construction, China Poly Group, and China General Nuclear Power Group. Details see SASAC official website, "SASAC deepens the reform of state-owned capital investment companies" (国资委深入推进国有资本投资公司改革), June 20, 2022, available at http://www.sasac.gov.cn/n2588030/n2588924/c25197635/content.html. Also, "Five centrally adiministered SOEs officially transformed into state-owned capital investment companies" (5 家央企正式转为国有资本投资公司), Chinareform.org (中国改革论坛), June 20, 2022, accessed at http://www.chinareform.org.cn/2022/0622/36202.shtml.

[10] "Lou Jiwei: State asset supervision has problems of overreach, absence, and misplacement" (楼继伟：国有资产监管存在越位、缺位、错位现象), people.com (人民网), November 4, 2015. Accessed at http://finance.people.com.cn/n/2015/1104/c1004-27777431.html

[11] "State-owned Assets Supervision and Administration Commission of the State Council Plan to Transform Functions towards Focusing on Capital Management" (国务院国资委以管资本为主推进职能转变方案), Office of the State Council (国务院办公厅), April 27, 2017. Accessed at http://www.gov.cn/zhengce/content/2017-05/10/content_5192390.htm

relations to Beijing instead of Taipei in 2008.[12] This is indicative of the considered steps taken to structure and obfuscate the funds' activities in such a way that provides plausible deniability of their role in advancing the party-state's strategic interests. Cultivating a sense of being detached from China's geopolitical interests helps Chinese sovereign funds reduce market access barriers and transaction costs when they invest in Western markets, where China's state-led investment bids have frequently been red-flagged as having geopolitical motives. As foreign animosity toward Chinese state-backed investments has risen, CIC has increasingly turned to joint ventures with influential institutional investors in host countries to shelter its assets from undue scrutiny by foreign governments or to sidestep administrative blocks on investing. CIC has seen some success with this method, as evidenced by the China-U.S. Industrial Cooperation Partnership, a private equity fund jointly launched by CIC and Goldman Sachs. The Partnership has bought several U.S. firms despite escalating U.S.-China trade tensions and intense scrutiny from Washington. The effectiveness of the joint venture strategy is most vividly illustrated by Goldman Sachs's successful advocacy in front of the Committee on Foreign Investment in the United States (CFIUS) that the joint venture's plan to buy Boyd Corp., a manufacturer of rubber gaskets and seals, be allowed to proceed.

With the evolution of China's sovereign funds in mind, I would like to discuss the specific case of the Silk Road Fund (SRF) to illustrate how the party-state under President Xi has strategically used China's foreign exchange reserves and sovereign funds. SRF is unique among China's sovereign funds that leverage foreign exchange reserves for overseas investment and strategic asset acquisitions. President Xi Jinping created the SRF to finance his BRI global campaign. The fund has closely followed the priorities of the BRI, focusing on infrastructure, connectivity, resource development, and industrial capacity cooperation. SAFE is the majority shareholder of this signature BRI financing vehicle, owning a 65 percent interest in the fund. Former PBoC Governor Zhou Xiaochuan described the SRF as a "private equity investor with a longer investment return."[13] He compared SRF to the World Bank's International Finance Corp, the African Development Bank's Mutual Development Fund, and the China-Africa Development Fund.

Apart from the initial $10 billion invested into SRF discussed earlier, President Xi committed an additional RMB100 billion in capital to SRF at the opening ceremony of the Belt and Road Forum for International Cooperation in May 2017.[14] Notably, this capital injection was in China's currency, the renminbi, not in foreign exchange. Deputy Governor of the PBoC Yi Gang (易纲) endorsed the plan the day after President Xi's announcement, calling it "quite necessary and timely to expand SRF's capital." Yi explained that abundant capital would help SRF mobilize additional resources in BRI countries and crowd-in investment from other financial institutions.[15] With ample capital, SRF proceeded to finance projects under the BRI umbrella. Bloomberg data show that during SRF's first three years of operating, it invested $10.5 billion in Europe,[16] more than one-quarter of the $40 billion that President Xi promised when he announced the fund's establishment. SRF Chairman Xie Duo (谢多) disclosed that SRF had signed forty-seven projects and committed more than $17.8 billion in investment as of October 2020.[17] SRF's investment track

[12] In September 2008, SAFE purchased $300 million of US-denominated Costa Rican government bonds and offered a grant of $130 million to incentivize and reward Costa Rica to cut diplomatic ties with Taiwan and establish relationship with Beijing. For more details, see "Beijing uses forex reserves to target Taiwan," *Financial Times*, September 12, 2008. https://www.ft.com/content/22fe798e-802c-11dd-99a9-000077b07658. After taking office, President Xi visited Costa Rica in 2013, when the two countries signed nine cooperation agreements totaling $1.5 billion on infrastructure development cooperation such as building roads and public transit fleets in Costa Rica, purchasing solar panels from China, and the building of a new police school. See "China Buys Costa Rica for $1.5 Billion," *The Costa Rican Times*, June 3, 2013. Accessed at https://www.costaricantimes.com/china-buys-costa-rica-for-1-5-billion/16500

[13] "The Silk Road Fund Begins Operations: An Interview with Zhou Xiaochuan," February 16, 2015. Full text available on the official website of the Silk Road Fund at http://www.silkroadfund.com.cn/enweb/23809/23812/26884/index.html

[14] Xi Jinping Opening Remarks at the Belt and Road Forum for International Cooperation(习近平在"一带一路"国际合作高峰论坛开幕式上的演讲), *People's Daily*, May 15, 2017. Full text available at http://cpc.people.com.cn/n1/2017/0515/c64094-29274601.html

[15] "Deputy Governor of the Central Bank Yi Gang: It is very necessary to expand the size of the SRF now." (央行副行长易纲: 现阶段扩大丝路基金规模非常必要). *Sinanews*, May 15, 2017.

[16] "How China Is Buying Its Way Into Europe," *Bloomberg*, April 23, 2018.

[17] "丝路基金成立六年，承诺投资金额 178 亿美元," *Seetao*, October 26, 2020.

record suggests that it indeed has an investment horizon similar to that of a medium-to-long-term private equity fund, just as Governor Zhou said it would at the fund's inception. The fund's average investment period is seven to ten years, with some investments projected to be fifteen years or longer. Chairwoman Jin Qi disclosed that more than 70 percent of SRF's committed investments are in the form of equity, with the rest being debt investment and project financing.[18]

The infusion of an additional RMB100 billion in cash into SRF was motivated by more than just ensuring the fund had adequate capital; it also served to advance cross-border payment and settlement using renminbi within the framework of the BRI. In a *People's Daily* article commemorating the fifth anniversary of the BRI and reviewing the achievements of SRF, Chairwoman Jin Qi said that the renminbi capital injection meant that SRF could "provide financial support to Belt and Road projects in multiple currencies." She added this would allow SRF to "satisfy different needs of Belt and Road countries for cross-border payment and settlement." According to her, SRF was "exploring and promoting effective ways of investment in renminbi" and was aiming to take advantage of more "renminbi-denominated investment."[19]

Using SRF as a vehicle to promote the use of the renminbi in international finance has clear benefits for China. First, it decreases currency risks for Chinese investors. Second, the renminbi's internationalization is essential if China ever develops a financial network independent of the U.S. dollar. Using the BRI to promote renminbi internationalization gives the CPC more control over the process. This allows the party to decide how and at what pace renminbi internationalization will proceed, providing confidence that financial instability can be avoided.

SRF has supported leading Chinese SOEs in their overseas project financing. SRF's debut was its commitment to cooperate with China Three Gorges Corporation (CTG) and to finance the Karot Hydropower Project. The Karot Hydropower Project is a high-profile piece of the China-Pakistan Economic Corridor proposed by Premier Li Keqiang in May 2013. During President Xi's visit to Islamabad in April 2015, SRF, CTG, and Pakistan Private Power and Infrastructure Board signed a memorandum of understanding to develop Pakistan's hydropower project. According to SRF's official statement, the total planned investment for the project is $1.65 billion. SRF's financial support for this project took the form of both equity investment and debt participation. SRF bought an equity stake in CTG's investment and operation platform for clean energy projects in South Asia, CTG South Asia Investment. SRF also agreed to participate in a consortium led by the Export-Import Bank of China to provide loans to the project.[20] Besides the project in Pakistan, SRF also agreed to buy a 9.9 percent stake in Russia's Yamal LNG project – of which China National Petroleum Corporation owns a 20 percent equity stake – and provide a fifteen-year loan of around €730 million (about $790 million).[21] It also joined a consortium of four Chinese and international banks to invest $2.43 billion in the Hassyan Clean Coal Power Plant in Dubai, a project that China Harbin Electric International serves as the general contractor.[22]

Besides providing project financing using equity investment and loan provisions, SRF has financed major asset acquisitions by Chinese SOEs. In 2015, SRF provided financing to China National Chemical Corporation (ChemChina), China's largest chemical company, to buy the Italian company Pirelli, the world's fifth-largest tire

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[18] Qi, J. (2018). Building a Golden Bridge and Pursuing Mutual Benefit. *People's Daily*, March 27, 2018.
[19] Ibid.
[20] "Q&A about the Silk Road Fund's First Project Investment" Silk Road Fund press release, April 20, 2015. Accessed at http://www.silkroadfund.com.cn/enweb/23809/23812/23942/index.html
[21] Sun Kai, Ma Yanhong. China-Russia Arctic Energy Cooperation in the Context of the "Polar Silk Road"—A Case Study of Yamal LNG Project. *Journal of Ocean University of China* (Social Sciences), 2018, (6): 1-6. "Opportunities created by Sino-Russian cooperation on Yamal LNG project with investment by the Silk Road Fund" (丝路基金入股的中俄合作亚马尔 LNG 项目造就了哪些机会), *Sohu Finance* (搜狐财经), October 26, 2015. Accessed at http://business.sohu.com/20151026/n424177115.shtml
[22] "How banks and enterprises can join forces to go out: lessons from the Dubai Hassyan project" (从迪拜哈翔项目看银企如何"抱团出海"), Bank of China official website, March 20, 2017. Accessed at https://www.boc.cn/aboutboc/ab8/201703/t20170320_9126429.html

maker, for $7.7 billion. The deal was structured in multiple steps, including a voluntary tender offer, mandatory tender offer, sell-out procedure, and squeeze-out procedure.[23] To finance the purchase, SRF signed an equity investment agreement with ChemChina in June 2015, agreeing to purchase a 25 percent stake in CNRC International Holding (HK) Limited, a special purpose vehicle used to acquire the Pirelli ordinary shares owned by Camfin, an Italian holding company. ChemChina took out a syndicated loan from CDB, China Construction Bank, and the Export-Import Bank of China, all of which previously received cash injections from CIC at different times.[24] The deal was completed in 2017, resulting in a combined entity with a 10 percent global market share in tire manufacturing. The Pirelli acquisition gave ChemChina access to technology to make premium tires that sold at higher margins and gave the Italian manufacturer preferential access to China, the world's largest automotive market.

At the time of ChemChina's Pirelli acquisition, Italian Prime Minister Matteo Renzi was uncharacteristically silent about the deal. The Italian government made no protectionist noise against ChemChina's acquisition.[25] The deal led some Italian business leaders, including Pirelli's CEO Marco Tronchetti Provera, to lobby the Italian government and steer Italian foreign policy towards a pro-China direction.[26] The lobbying may have influenced Italian Prime Minister Giuseppe Conte to sign a preliminary accord for Italy to join the BRI during a visit by President Xi in March 2019. Italy was the first, and so far only, G7 country to sign on to support the BRI. Alongside this signing, Italy and China made about thirty deals that were cumulatively worth an initial €2.5 billion ($2.8 billion) but a potential total value of €20 billion.[27] One of these deals was a memorandum of understanding to cooperate on international investments in China and BRI countries signed by SRF, Italian investment bank Cassa Depositi e Prestiti SpA (83 percent owned by the Italian Ministry of Economy and Finance), and Snam, Italy's leading natural gas company. Recently, as the Italian government has become more wary about undesired Chinese influence, Prime Minister Giorgia Meloni's administration has taken actions to block ChemChina from taking control over Pirelli and has been reviewing its options to exit BRI.[28]

In recent years, SRF has acquired strategic infrastructure assets like pipelines and ports in the countries along the BRI. SRF participated in a consortium that bought a 49 percent equity stake in Aramco Oil Pipelines for $12.4 billion in June 2021, one of the highest-value energy infrastructure transactions globally. Aramco Oil Pipelines is a new subsidiary of Saudi Aramco, Saudi Arabia's national oil company and the world's single largest oil producer. Aramco Oil Pipelines has the right to collect tariff payments for oil transported through Aramco's crude oil pipeline network for twenty-five years. The consortium included Mubadala Investment Corporation (Abu Dhabi's sovereign wealth fund), Samsung Asset Management, and Hassana Investment Company, a financial institution controlled by the Saudi government.[29] SRF's participation in such a large infrastructure deal shows that less than five years after its inception, it has already ascended to the ranks of the world's largest and most respected sovereign funds and private institutional investors.

SRF partnered with COSCO Shipping Ports (CSP), one of the world's largest port terminal operators, to acquire port assets and advance China's maritime strategies as part of the 21st Century Maritime Silk Road. In July 2019, SRF and CSP launched Navigator Investco in Hong Kong as an investment platform for equity investment in port assets and

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[23] "ChemChina to buy into Italian tire maker Pirelli in $7.7 billion deal," *Reuters*, March 23, 2015.
[24] "Silk Road Fund Joins ChemChina in Industrial Investment in Pirelli," SinoChem corporation news, June 5, 2015. Accessed at SinoChem website http://www.china-bluestar.com/en/xwymt/jtxw/webinfo/2015/06/1433463198162102.htm
[25] "ChemChina to buy into Italian tire maker Pirelli in $7.7 billion deal," *Reuters*, March 23, 2015.
[26] Interview with an Italian scholar in European University Institute, September 2017.
[27] "Italy signs deals worth 2.5 billion euros with China," *Reuters*, March 23, 2019.
[28] "Pirelli: Italy blocks Chinese control of tyre giant," *BBC*, June 19, 2023. Accessed at https://www.bbc.com/news/business-65947050. "Italy to hold talks with China about exiting Belt and Road Initiative," *Financial Times*, May 11, 2023. Accessed at https://www.ft.com/content/5666fcde-2a5d-4af0-927c-ab971517554d
[29] "EIG-led consortium closes $12.4 bln Aramco pipelines deal," *Reuters*, June 18, 2021.

related businesses upstream and downstream.[30] SRF owns 49 percent of Navigator Investco through its wholly-owned subsidiary TRD Investco, and CSP holds the remaining 51 percent shares.[31] In October 2021, Navigator Investco agreed to acquire 100 percent of the shares of COSCO Shipping Ports (Rotterdam) Limited (Rotterdam Company), a wholly-owned subsidiary of CSP that owns a 35 percent stake in the Netherlands' Euromax Terminal. Navigator's acquisition of CSP's subsidiary Rotterdam Company has two direct effects. First, upon completing this transaction, Navigator—and SRF, by extension—will become an indirect shareholder of Euromax Terminal through its full ownership of Rotterdam Company. Holding a minority share in Euromax Terminal firmly fits SRF's mission to support the BRI and contributes to SRF's portfolio diversification. Second, CSP will replenish its capital base by selling its subsidiary to Navigator and receiving cash. In effect, SRF is providing a capital injection to CSP via Navigator. The essence of SRF's partnership with CSP and their joint investment platform Navigator is to leverage SRF's access to China's foreign exchange reserves and support CSP's endeavor to establish a global terminal network and advance China's maritime strategic interests.

Besides working alongside Chinese corporations and directly supporting their overseas investment, SRF has entered into many cooperation agreements and memoranda of understanding to establish partnerships with foreign sovereign funds, state-owned asset management firms, and leading private institutional investors.[32] A few of these agreements have already materialized into joint investment funds or cooperation funds. For example, SRF is the sole sponsor of the $2 billion China-Kazakhstan Production Capacity Cooperation Fund,[33] with the Kazakhstan government agreeing to provide tax exemptions to the fund's investments.[34] This is the first such cooperation fund where SRF has participated as the sole sponsor structure. For its first investment, the fund bought common shares of stocks on the Astana International Exchange. Another example is the China-EU Co-Investment Fund, first proposed in June 2017 and launched in July 2018. The fund made its first investment in Cathay Midcap II, and it is committed to fostering synergies and advancing collaboration among businesses and enterprises in China and Europe. CIC has also adopted joint investment funds as a strategy to more expeditiously invest abroad amid heightened scrutiny of Chinese foreign direct investment (FDI) in foreign countries. For CIC, the primary purpose of investing through joint funds is to mitigate the risk that a foreign government will block an overseas investment. While this is certainly applicable for SRF, SRF's cooperation funds also have China's broader strategic agenda in mind concerning acquiring assets overseas and developing China's long-term geoeconomic capacity in the long run.

The economic difficulties triggered by the COVID-19 pandemic have driven policymakers in many countries to strengthen FDI reviews in order to head off opportunistic acquisitions by geopolitically-motivated investors. The supply chain disruptions stemming from the pandemic have brought home to many in government the dependence of the domestic economy on international suppliers. As multinationals reconfigure their global industrial supply chains, it is imperative that the United States and its allies strengthen and coordinate their FDI screening measures to ensure that hostile foreign governments are not allowed to gain control over companies that are critical to the global supply chain. In this context, I would like to conclude with three recommendations for legislative action.

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[30] "Silk Road Fund Acquires Minority Stakes in Europmax Terminal (Netherlands)," Silk Road Fund Press Release, Octover 26, 2021. Accessed at http://www.silkroadfund.com.cn/enweb/23809/23812/42316/index.html. "COSCO Shipping Ports and Silk Road Fund agreed to establish cooperative strategic relationship," COSCO SHIPPING Port press release, October 20, 2021. Full text of the press release in English is accessible at https://doc.irasia.com/listco/hk/coscoship/press/p211020.pdf

[31] "COSCO Shipping Ports and Silk Road Fund agreed to establish cooperative strategic relationship," COSCO SHIPPING Port press release, October 20, 2021. Full text of the press release in English is accessible at https://doc.irasia.com/listco/hk/coscoship/press/p211020.pdf

[32] For details, see "Table 4.3 Silk Road Fund Cooperation with foreign institutional investors" in Liu, Z. Z. (2023) *Sovereign Funds: How the Communist Party of China Finances Its Global Ambitions*. 1st ed. Cambridge: Harvard University Press, pp 167-169.

[33] http://www.silkroadfund.com.cn/enweb/23809/23812/34267/index.html

[34] "China and Kazakhstan Sign the Agreement on Tax Exemption with Regard to Certain Types of Income of China-Kazakhstan Production Capacity Cooperation Fund Making Direct Investment in Kazakhstan," Silk Road Fund press release, June 9, 2017. Accessed at http://www.silkroadfund.com.cn/enweb/23809/23812/35432/index.html

First, the U.S. government should take the initiative to consider working with the EU and lead a concerted effort to protect companies in critical sectors from undesired foreign takeovers that may hurt the national interests of FDI recipient countries. The launch of the EU-U.S. Trade and Technology Council in June 2021 is a step towards an integrated transatlantic approach to foreign investment. While high-level consultations are necessary, well-designed procedures for implementation are critical. An important first step is to identify hidden sources of state-owned or state-sponsored investors by enforcing the rule of "follow the money" in a multi-jurisdictional FDI reviewing process. China's SLFs often operate through an offshore subsidy or joint investment fund, partnering with reputable Western investment brands to mask the source of capital for their investments and ultimately obscuring their connections to the Chinese state. This hidden state-owned capital requires that regulators conduct a forensic audit during the FDI review process. U.S. authorities have enforced the rule of "follow the money in the financial services sector and should consider integrating the practice into its FDI review process. There ought to be more formal cooperation between CFIUS and authorities from other countries going forward. Since the passage of the Foreign Investment Risk Review Modernization Act (FIRRMA) in 2018, the U.S. Treasury has engaged with dozens of countries on FDI screening. FIRRMA provisions make sharing information with national counterparts easier.

Secondly, besides "follow the money," an integrated transatlantic approach to FDI calls for creating a shared Entity List that identifies which foreign investors are unwelcome and a list of exempted foreign entities that are pre-approved, a so-called "white list." This effort should include commonly adopted and enforced ground rules for determining which industries and segments of companies' supply chains are off-limits to FDI. Implementing the shared Entity List will require not just support from government officials but also input from legal professionals specializing in cross-border mergers and acquisitions. The governments of the West are bound by the rule of law, and foreign state-led investors have increasingly spared no expense in hiring top-flight legal representation to help navigate FDI screenings and bring to close their cross-border mergers and acquisitions. Thus, western governments must work with legal service professionals to develop and enforce industry-wide best practices to successfully fend off foreign investment from undesired foreign entities.

The goal of an internationally coordinated FDI screening regime should not be to implement protectionist policies but to strengthen U.S. leadership in shaping the global FDI investment environment. Ultimately, the United States and its allies should aim to create a level playfield that can protect the national interests of FDI recipient countries while maintaining a fair and open global investment system. When appropriate, domestic capital markets or government support should meet the capital needs of strategically important companies.

Finally, the experience of China's SLFs shows that there is an effective role to be played by the state as a direct participant in the market so as to maximize the embeddedness of national interests in market operations. The advent of China's SLFs speaks to the broader issue of the rise of state-led investment and finance globally. Western policymakers tend to discredit the idea of state-led investment institutions. This thinking requires some change. With proper design and supervision, Western liberal market economies can establish their own SLFs to work as white knights to fend off undesired foreign takeovers in defense of their strategic industries and national interests. In fact, France and Germany have been making progress along this line. Like China, Western countries can establish and use their SLFs to strengthen the international competitiveness of specific critical companies, defend those companies from foreign takeover, and support the development of strategic industries.