







Q

Home ▶ All Journals ▶ Politics & International Relations ▶ Review of International Political Economy ▶ List of Issues ▶ Volume 17, Issue 3 ▶ A principal-agent analysis of China's so ....

### Review of International Political Economy >

Volume 17, 2010 - Issue 3

1,132 15
Views CrossRef citations to date Altmetric
The Politics of Trade, Aid and Standards

# A principal-agent analysis of China's sovereign wealth system: Byzantine by design

#### Sarah Eaton & Zhang Ming

Pages 481-506 | Published online: 17 Aug 2010



Reprints & Permissions

Read this article

Share

## **ABSTRACT**

Full Article

The paper provides an explanation for a puzzling aspect of China's nascent sovereign wealth system, namely the ever-more obvious competition between China's officially designated sovereign wealth fund (SWF), the China Investment Corporation (CIC), and the foreign exchange reserve management agency, the State Administration of Foreign Exchange (SAFE). We outline an analytical framework which illuminates the various pathways by which state leaders seek to address a principal-agent problem common to all sovereign wealth funds. We suggest that state leaders select corporate governance regimes that mesh with what we call the state's 'governance endowments'. We then substantiate the claim that China's particular governance endowments have led China's leaders to embrace a corporate governance model premised on competition among the state's sovereign wealth investors. We trace the intense bureaucratic conflicts that

shaped the creation of CIC and then show how SAFE was subsequently drawn into competition with CIC in the area of high risk, high yield investment. Although China's SWF tournament emerged as a quite unintended consequence of bureaucratic politics, China's leadership has since tacitly endorsed this rivalry because it has supplied the government with valuable carrot and stick mechanisms with which to discipline fund managers.

#### **KEYWORDS:**

principal-agent problem corporate governance	China Investment Corporation State Administration		Foreign Exchange	sovereign wealth funds
	principal-agent problem cor	porate governance		

## **ACKNOWLEDGEMENTS**

The authors are grateful to two anonymous RIPE reviewers for incisive comments on an earlier draft of this paper. The authors also wish to thank Sandra Heep, Scott Kennedy, Genia Kostka, Alanna Krolikowski, Mark Kruger, Miguel Otero, Louis Pauly, Victor Shih, David Steinberg and Joseph Wong for helpful feedback at various stages of the paper.

# Notes

- 1 Kaufmann et al.'s (2008) governance measures cover 212 countries and aggregate data from 33 separate sources. The 'voice and accountability' score 'measure[s] perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media' (Kaufmann et al., 2008: 7)
- 2 This point is made well in a <u>Wall Street Journal (2007)</u> editorial which argues that CIC would have a hard time replicating Temasek's successes. The author argues that the insular Singaporean model would not take root in China: '[It'] may work ok in Singapore, where the civil service has a reputation for clean management. But China's bureaucracy has proved to be riddled with corruption. Party leaders are probably attracted to the Temasek model because their power rests on keeping a tight grip on

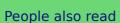
information and capital. How profitably, and properly, will an opaque Chinese agency reporting to the State Council manage billions of dollars without public supervision.'

3 Our measures of Abu Dhabi transparency/accountability are not as strong as the others. In all the data sources we consulted, data sources for Abu Dhabi specifically (i.e. as separate from United Arab Emirates) were not available so we have used the UAE measures. We think this is reasonable especially considering that Abu Dhabi is the most powerful emirate in the UAE. Unfortunately, the Institutional Profiles Database data, the only data source we found that includes direct measures of government transparency, did not collect data from UAE.

4 The EIU Democracy Index is based on five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. The index categorizes countries in terms of four types: full democracies; flawed democracies; hybrid regimes; and authoritarian regimes. The CHECKS variable counts "the number of veto players in a political system, adjusting for whether these veto players are independent of each other, as determined by the level of electoral competitiveness in a system, their respective party affiliations, and the electoral rules" (Beck et al., 2001: 170). Since countries that do not hold competitive legislative elections are assigned the minimal score of one, the CHECKS variable does not capture contestation in authoritarian systems. For political systems with competitive elections, the CHECKS variable increases by the number of veto players in the system and adjusts for differences between presidential and parliamentary systems.

5 Conceived during the turmoil of the Asian financial crisis in 1997, these special meetings of the State Council are held every five years and are occasions for setting the framework of broad financial policy reforms.

6 Bank recapitalization, it is worth noting, was yet another source of discord between the MoF and PBoC. Due to concern about loss of influence to PBoC (via Huijin), the MoF which had been sole shareholder in the Big Four commercial banks prior to the creation of Huijin, is reported to have successfully lobbied for much smaller Huijin capital injections into the Industrial and Commercial Bank of China (ICBC) and Agricultural Bank of China (ABC) (Green, 2007). (The tab for Huijin's recapitalization of ICBC came to only US \$15 billion and left MoF and Huijin each with 50 per cent of the bank's equity prior to listing.)



Information for Open access

Authors Overview

R&D professionals Open journals

Editors Open Select

Librarians Dove Medical Press

Societies F1000Research

Opportunities Help and information

Reprints and e-prints

Help and contact

Advertising solutions Newsroom

Accelerated publication All journals

Corporate access solutions Books

#### Keep up to date

Register to receive personalised research and resources by email



Sign me u





Accessibility

Copyright © 2025 Informa UK Limited Privacy policy Cookies Terms & conditions

Taylor and Francis Group

Registered in England & Wales No. 01072954 5 Howick Place | London | SW1P 1WG