ARTICLE IN PRESS

Energy Policy ∎ (∎∎∎∎) ∎∎∎–∎∎∎

Contents lists available at ScienceDirect

Energy Policy

journal homepage: www.elsevier.com/locate/enpol

Sovereign Wealth Fund investments in Europe as an instrument of Chinese energy policy

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HIGHLIGHTS

- The energy sector account for almost half of Chinese's SWF investments in the EU.
- SWFs should be treated differently on the energy market than private investors.
- SWFs' representatives on company boards may create a conflict of interests.

ARTICLE INFO

Article history:
Received 28 January 2016
Received in revised form
11 September 2016
Accepted 14 September 2016

Keywords:
Sovereign Wealth Funds
Chinese investments
Chinese energy policy

ABSTRACT

Chinese Sovereign Wealth Funds (SWFs) are new instruments of Chinese 'Go Global' strategy and the politics of maintaining raw materials and energy security. Europe has lured 60% of the total USD 27.3 billion invested by Chinese SWFs in the energy sector globally, which provokes the question as to how important SWF investments are in the political sense and what security concerns they bring. This paper is the first that presents a comprehensive picture of Chinese SWF investments in the European energy market and one of the very few papers about SWFs based on multiannual, comprehensive empirical data. The author argues that Chinese SWFs are different players on the energy market than private investors, could be potentially harmful for some European interests. By installing representatives on the company boards, China gains access to sensitive information that could be then transferred to Chinese competitors. Moreover, through its SWFs China could take control over energy companies or critical infrastructure and increase its political influence in European countries, making them more vulnerable to political pressure. Therefore, the European policy-makers should consider taking special steps to monitor and maybe limit Chinese SWFs expansion in the energy sector.

1. Introduction

Keeping an iron grip on energy and raw materials is a *sine qua non* for continued economic growth, which is the cornerstone of China's social stability and survival of the Chinese Communist Party. A predominant view among China watchers is that since the mid-90s, China's diplomatic purpose is to 'maintain the international conditions that will make it feasible for China to focus on the domestic development' (Goldstein, 2001). In other words, 'China's diplomacy is geared totally towards China's own development' (Schambaugh, 2012).

Securing access to foreign natural resources is necessary for both continued economic growth and the survival of the Communist Party, since growth is the cornerstone of China's social and political stability (Zweig and Jianbai, 2005). Energy resources are particularly important, because China is the world's biggest energy user and oil importer. China's reliance on energy imports poses a challenge for the state and its future development. Therefore, energy, particularly oil and gas, has become a strategic component of China's foreign and security policy in recent times. Paul (2010) called this strategy of Chinese elites 'the scramble for energy'.

Chinese companies are often used as tools to implement Beijing's policy. The scope and scale of Chinese commercial activities abroad often depend on the financial resources provided by the state in the form of subsidies and credits to companies. Securing access to energy, for example oil and gas, is high on the agenda for the government and therefore state-owned companies such as Petrol China, Sinopec, and China National Offshore Oil Corporation (CNOOC) are rapidly investing overseas in order to acquire foreign assets that can help China to continue fueling this economic growth (Klinck, 2011; Norris, 2016).

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http://dx.doi.org/10.1016/j.enpol.2016.09.033
0301-4215/

Please cite this article as: Kamiński, T., Sovereign Wealth Fund investments in Europe as an instrument of Chinese energy policy. Energy Policy (2016), http://dx.doi.org/10.1016/j.enpol.2016.09.033

Obviously, not only enterprises could be used as tools to implement foreign policy – Sovereign Wealth Funds (SWFs) are equally good in this regard, if not better. Due to the different objectives, management structures, sources of capital and investment policies, it is difficult to generalize them. There is no widely accepted definition of SWFs (Rozanov, 2005, IMF, 2008, Clark et al., 2013), however, without any doubt one can say that they are 'government-owned or controlled funds operated as the government's investment tools, in order to achieve a series of economic and political objectives' (Sun et al., 2014). Reflecting on SWFs from the perspective of political science they can be perceived as state-controlled entities that could be instruments of economic statecraft. This term, conceptualized by Baldwin (1985), basically means pursuing foreign policy goals by economic means. Thus, theoretically, as state sponsored actors, SWFs can be used by their mandators for politically driven purposes (Truman, 2010; Weiner 2011; Csurgai, 2011). The Chinese case is particularly interesting because of the enormous value of assets at the disposal of the institutions controlled by the state as well as the ever growing political ambitions of China in international relations (Norris, 2016).

The main aim of this paper is to analyze Chinese SWF investments in the energy sector of the European Union (EU) in the context of their potential use as an instrument of Chinese foreign policy. What are the political consequences of Chinese SWF investments in the European energy sector? What security concerns do they pose to Europe? On the basis of statistical data, the paper confirms claims (Cieślik, 2014; Sun et al., 2014) that the characteristics of investment patterns and performance of the Chinese SWFs indicate that they are tools of the state's 'Go Global' strategy and the politics of maintaining raw materials and energy security. Chinese SWFs on the wider scale than other state investors, such as state-owned enterprises, are engaged in investments aiming at securing the strategic energy interests. Their acquisition in the energy sector might be commercially motivated but the literature suggests that SWF behaviors often include political motives. Due to this fact, the paper argues that the EU member states should consider treating Chinese SWFs as different players on the energy market than private investors. Examples of SWFs installing their representatives on company boards, which gives impact on a company's management and access to its secrets, shows a clear conflict of interest as well as being possibly harmful for European interests. Moreover, through its SWFs China could take control over energy companies or critical infrastructure and increase its political influence in European countries, making them more vulnerable to political pressure. This paper is the first that presents a comprehensive picture of Chinese SWF investments on the European energy market and one of the very few papers about SWFs based on multiannual, comprehensive statistical data. Given the lack of publicly available data on SWF asset allocations, the majority of the research has been done on the theoretical side, supported by case studies or statistical research based on a small number of transactions (Sun and Hesse, 2009; Norris, 2016).

The paper is divided into six sections. Section 2 discusses the methodology used, in particular the source of the statistical data and some limitations resulting from the non-transparent information policy of SWFs. In Section 3 Chinese SWFs are briefly presented and conceptualized as an instrument in the Chinese foreign energy policy toolbox on the basis of existing literature. In Section 4 the characteristics of SWF investments in energy related sectors in the EU have been made. Their investments are analyzed in terms of their value and sectoral distribution. Next, in Section 5 the author discusses the concerns related to the Chinese SWF activities in the European energy market. This study concludes in Section 6 with an assessment of the phenomenon of the Chinese 'renationalization' of the energy sector in Europe and presentation of questions for policy-makers that it provokes.

2. Methodology

This research study is based on an in-depth literature review and statistical data gleaned from the Sovereign Wealth Fund Institute Transaction Database – probably the most comprehensive and authoritative resource tracking SWF investment behavior globally. Chinese SWF transactions indexed by the SWF Institute were extracted out of the database, in which till mid-2014 11,633 SWF transactions were cataloged. Then, the list was combined with a few additional transactions found in the Sovereign Wealth Center database. Finally, there is a list of 229 Chinese SWFs transactions dated from 2007 to 2014. Out of these, 34 transactions were related to the energy and natural resources sector in the EU.[1]

Certainly, SWFs are widely perceived as relatively opaque. They often operate through special purpose vehicles (SPVs), which complicate the identification of their beneficial ownership, or accurate and timely portfolio compositions. Particularly, the Chinese SWFs are notorious for inferior standards of transparency measured via the Linaburg-Maduell Transparency Index.[2] Sufficed to say that in 2013, China Investment Company (CIC) scored 7 and the State Administration for Foreign Exchange (SAFE) only 4 out of a maximum of 10 points (SWF Institute).[3] Due to this fact, their investment activity is commensurately obscure and although the list of transactions, used in this research, is based on the most comprehensive data that is available, some omissions are possible. However, considering the aforementioned constraints, it can be claimed that this statistical research is sufficiently representative to enable the postulation of conclusions and recommendations.

3. Chinese SWFs as foreign policy instruments

The People's Republic of China has several public investment vehicles that invest overseas but among them two major SWFs can be singled out. The first is CIC, formally established in September 2007 to manage and diversify Chinese foreign exchange reserves beyond its traditional investments in dollar-denominated bonds. This is a flagship fund, officially acknowledged as an SWF, subordinate directly to the State Council and supervised by representatives from agencies such as the People's Bank of China (PBoC) and the Chinese Ministry of Finance (Martin, 2010; Blanchard, 2014). This fund provides annual reports, has official representative offices overseas, eleven-member boards of directors and even an ethical Code of Conduct. CIC's website states: 'The mission of CIC is to make long-term investments that maximize risk adjusted financial returns for the benefit of its shareholder.' All of this makes CIC similar to a typical financial corporation. However, Gao Xiqing, former CIC president, bluntly stated that Chinese overseas investments aim to make profits but in the same time build influence (Blanchard, 2014).

The second is the SAFE Investment Company (SIC), a Hong Kong based subsidiary of SAFE, an institution primarily responsible for the management of Chinese foreign exchange (Thomas and Chen, 2011). On the contrary to the CIC, this fund is much more obscure, and China had repeatedly refused to acknowledge its existence until it was confronted with incontrovertible evidence collected

[1] Energy-related transactions in the SWF Institute's database are classified in a few different categories' Energy or 'Materials' sometimes 'Utilities'. Therefore, I decided to analyze all entries from those categories and classify transactions on my own.

[2] The Linaburg-Maduell transparency Index is a method of rating the transparency of SWFs. The index is based on ten essential principles and each of them add one point to the transparency rating.

[3] In the 1Q 2016 CIC scored 8 and SAFE only 5 points.

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