

**Sovereign Wealth Funds, A Trojan Horse? Explaining the Role of the  
China Investment Corporation (CIC) in the United States**

**Marieke de Haan**

**Master Thesis**

# **Sovereign Wealth Funds, A Trojan Horse? Explaining the Role of the China Investment Corporation (CIC) in the United States**

**Marieke de Haan (s0419281)**

**The Hague, February 26, 2012**

**Radboud University Nijmegen**



**Nijmegen School of Management**

**Under the supervision of dr. A. Wigger**

**Master Thesis**

## **Acknowledgements**

First of all, I would like to thank my supervisor Angela Wigger for all her help during the process of writing this thesis. She encouraged me to write this very challenging thesis using a methodology I had not much experience with. Angela guided me through the process with her sharp comments, helpful food for thought and accurate questions through which I could improve my work step by step.

I also would like to thank my boyfriend Sascha Bollerman for all his love and support and for his precise corrections on my grammar and spelling. Furthermore I would like to thank my parents for their immense care and support and for keeping me motivated. Last but not least, I would like to thank my friends for their patience, since I was not much around lately, spending my weekends finishing this work.

## **Table of contents**

<b>1. Introduction</b>	<b>3</b>
<b>2. Discussion of International Relations (IR) theories</b>	<b>7</b>
2.1 Challenging neorealism	7
2.2 Challenging neoliberal institutionalism	10
2.3 Challenging constructivism	11
<b>3. Towards an alternative theoretical framework</b>	<b>14</b>
<b>4. Epistemology, methodology and operationalization</b>	<b>19</b>
4.1 From epistemology to methodology	19
4.2 Operationalization	22
<b>5. Empirical analysis</b>	<b>25</b>
5.1 Neoliberal capitalism	25
5.2 Financialization	27
5.3 The accumulation of China's foreign exchange reserves	29
5.4 US-China mutually assured destruction	32
<b>6. Conclusion</b>	<b>36</b>
References	39

## 1. Introduction

Over the past few decades the world of global powers has changed fundamentally. China's rapid economic growth has been astonishing and attracted worldwide attention. If the contemporary growth rates of the Chinese economy sustain, it might soon become the strongest economy on the globe, thereby surpassing the US as the world's longstanding largest economy (Layne 2008, p. 13). The US has had a dominant economic position in the world since the Second World War, but especially in the wake of the current global economic crisis it seems that its economy has been declining. At least, the high debt owed by households, businesses and governments have rendered the US economy more vulnerable. The Federal government had to decide on an increase in the country's borrowing limits in the summer of 2011 in order to service debts and to prevent default. As commented by the *Financial Times*: "The cost of servicing the debt could lead to a jump in interest rates, a crowding out of private investment and a fundamental diminution of US power" (*Financial Times*, July 14, 2011).

The US and China host the two most powerful economies worldwide. The economic relationship between the two is highly intertwined. China is the largest foreign holder of US Treasury securities. Chinese money has generally been welcomed to fund the US Federal government's budget deficit and keep US interest rates relatively low. Analysts have however been utterly concerned that the large holdings of US debt by Chinese monetary institutions could give the Chinese government significant leverage over the US on major bilateral political and economic issues, for example by threatening to sell off a large share of its dollar holdings. At the same time, for China, it is very important that the US economy is stable and growing, because of the large share of Chinese exports to the US, and thus its own economic growth and stability (Morrison 2010, p. 13-15). Another important aspect of the two countries' complex relationship is China's exchange rate policy while running an excess of savings over investment. China subsidizes exports via an exchange rate pegged to the dollar, which induces higher trade surpluses with yet more dollars pouring into China. The People's Bank of China buys these dollars to prevent the Chinese currency appreciating and invests them again by buying US Treasury securities. This floods the Chinese currency markets with *renminbi* which then have to be sterilized through the sale of bonds to prevent inflationary pressures. When this process continues, resisting inflation through sterilization becomes however harder and harder. Because US interest rates are very low, China's rates have to be fixed even lower to avoid incurring a running loss on its huge dollar reserves (*Financial Times* 2011, March 9). With these economic imbalances we can say that the US and China find themselves in a sort of 'deadly embrace' or 'mutually assured destruction', also referred to as 'Chimerica', a neologism by Niall Ferguson (2008) to indicate how interwoven the economies of China and the US have become. The term refers to a chimera – the mythical beast of ancient legend that was part lion, part goat, part dragon (2008, p. 340).

The Chinese economy is not only rising because of its rapid growth in terms of GDP, but also because it has become a major financial player on the global plane, mainly enabled by its large stocks

of foreign exchange reserves from major current account surpluses (Jaeger 2010). The growing importance of governments in financial markets is paramount to the rise of what is referred to as Sovereign Wealth Funds (SWFs), defined as government-owned investment funds funded by the transfer of foreign exchange assets.

SWFs have become important global players. According to the *Financial Times*, “it is now widely recognized that sovereign funds are a dominant force on international markets” (2011, February 20). From 2007 onwards, SWFs invested billions of dollars in financial institutions, especially in the US and attracted scholarly attention because these institutions were almost going bankrupt because of the subprime mortgage crisis (Overbeek 2010, p. 3). In 2007 and 2008, the Chinese SWF, the China Investment Corporation (CIC), purchased stakes in Blackstone, Morgan Stanley, and Visa (Xu 2009, p. 9). This has brought yet another dimension of Chinese investment into the spotlight. The CIC forms part of the complex US-China entanglement.

The question about the role of the CIC is relevant because in the literature we find several concerns and fears for SWFs. As Xu (2009, p. 16) explains: “The concern, and even alarm, about SWFs, is mainly because their destinations, and potential victims, are OECD countries”. Xu continues by pointing out that not the size or the rapid rise of SWFs is what makes them so controversial, but more because the debtor-creditor position between industrial countries and several developing countries is reversed, especially between the US and China (Xu 2009, pp. 2-10). Thereby it seems that investments are not just investments. Apparently it does matter who invests. It is for instance very striking that some private actors, like hedge funds and private equity companies that are generally very reckless and short-term profit oriented in their investments, tend to be tolerated much more easily than SWFs which tend to have more long-term strategies. The possibility that SWFs will play a different role in the global financial system than private market actors has raised concerns. The fact that SWFs are backed by the government is seen as problematic. According to Xu (2009, pp. 14-15) there seems to be the assumption that governments are less interested in money than in power when they manage their SWFs. It is feared that governments will behave differently than private investors, especially undemocratic and non-transparent governments. The potential risk to national security that SWFs could pose if these funds choose to purchase ownership stakes in domestic firms has been a major concern. Lyons calls this “state capitalism”, which he defines as “the use of government controlled funds to acquire strategic stakes around the world” (Lyons 2007, p. 1).

The concern on SWFs is arguably related to the underlying issue of a shifting power relationship in the global economy. China is at the centre of the debate. As a new player in the international financial system, the actions taken by the CIC may have direct impact on the financial stability of the largest economies in the world (Xu 2009, p. 13). Patterns of Chinese behavior in the recent past, such as unfair trade practices, currency manipulation, technology espionage, and the refusal to crack down on counterfeiting have also fuelled concerns about the future role of China (CBS *60 Minutes*, April 2008). For these reasons, the role of the CIC in the US financial market can be seen

as a critical theme or test case within the discipline of International Relations (IR) more generally, and of International Political Economy (IPE) in particular. The research question under investigation in this thesis is therefore: *How can we best explain the role of the CIC in the deadly embrace between the US and China?*

It is very striking that SWFs have gained a lot of attention and have become highly politicized while only a handful of political scientists has analyzed the phenomenon. In order to understand the current global economic situation, it is however very important to understand also the role played by SWFs, especially the Chinese one. In the recent past, the CIC has taken some actions that give the impression that this fund might not be an ordinary investment fund just aiming for financial gains. CIC's investments in Blackstone and Morgan Stanley, two of the flagship financial institutions in the US, have been the largest external stakes in these companies (*Financial Times*, 2007, May 18). Blackstone and Morgan Stanley are major private equity companies that have been part of one of the best-performing asset classes in the years prior to the economic crisis, attracting record investments. As Keith Bradsher puts it: "It also marks an abrupt shift in strategy for the \$200 billion fund, and underlines the extent to which the government fund appears to be under the direct control of China's leaders" (*New York Times*, 2007, December 19). The CIC decided to keep its stakes in Blackstone and Morgan Stanley despite the fact that it lost half of its investment in less than a year after it made the investment (Xu 2009, pp. 13-14). This has been one of the triggers for many commentators to believe that the Chinese government used the fund for other reasons than pure financial motives.

Moreover, in the wake of the global financial crisis, the CIC has stepped in when US financial institutions were in trouble, which has led the *Financial Times* to talk about "a match made in heaven", referring to the fact that the Chinese fund was flush with cash from trade surpluses, while capital-constrained financial players in the US seemed desperate for liquidity (2007, November 28). The role of the CIC is important because its investments concern big financial companies which are very interwoven with the entire US economy. CIC's investments, particularly in Blackstone and Morgan Stanley, have drawn scrutiny from politicians, regulators, unions, and the media (*Financial Times*, 2007, May 18). Some have argued that the CIC can be compared to a Trojan horse, invading the American economy, taking over US companies, taking away American jobs, research and development, and technology (Xu 2009, p. 13). Others have portrayed the CIC as a rescuer of the American economy. The question why China and its SWF are lending huge sums of financial players to the US, and the tensions embedded in the complex US-China relationship will be the focus of this thesis. Alternatively, one could ask the question of why China does not invest all this money in its own economy.

When analyzing this topic, this thesis will show that traditional IR theories, such as neorealism, institutional liberalism and constructivism are not able to give satisfactory explanations for what has been labeled the 'deadly embrace' between the US and China. The main problems of these theories are that they are a-historic, and generally not able to explain the rise of new powers.

Particularly the rationality principle inherent in neorealist and institutional liberalist accounts does not give adequate explanations for the US government running ever larger debts, while constructivist emphasis on rule-following and ideas runs short on explaining both US and China's government behavior. The thesis draws on an alternative framework by Arrighi that seeks to remedy these shortcomings. This framework is based on Adam Smith's dynamic process of economic development and Marx's capitalist crises and the ensuing sequence of different incumbent capitalist centers.

On the basis of insights drawn from critical realism and the method of abstraction, the structures, powers and tendencies that underlie the phenomenon at hand will be identified. It will be argued that the alternative framework is able to reveal a deeper layer of analysis than the traditional IR theories and contribute to get a better understanding of the phenomenon.

The thesis is structured as follows. The next chapter discusses how mainstream IR theories, such as neorealism, neoliberal institutionalism and constructivism would encounter the research problem and lays bare the main shortcomings in providing accurate explanations. The third chapter presents an alternative theoretical framework, based on the framework of Arrighi (2007), complemented by the work of Kotz (2008 and 2009). Chapter four discusses the virtues of critical realism and the process of retrodution and the method of abstraction. In addition, the theoretical concepts are operationalized in order to move from the theoretical towards the empirical analysis in chapter five, followed by the conclusions.



## **2. Discussion of International Relations (IR) Theories**

In this section the explanatory strength of several renowned IR theories will be discussed regarding the object of investigation. The purpose is to analyze how neorealism, neoliberal institutionalism, and constructivism would seek to make sense of the role of SWFs. It will be shown that existing mainstream theoretical approaches in the field of IR are not able to give satisfactory explanations about the role of the CIC within the complex US-China relationship.

### ***2.1 Challenging neorealism***

Within the discipline of IR, neorealism (or structural realism) has been one of the most dominant theories for the last three decades. Kenneth Waltz' *Theory of International Politics* (1979) is seen as the foundation of neorealism. According to Waltz' system theory, the international political structure will tend toward balance; states, or actually great powers who are considered the main actors in world politics, will try to balance against each other. In order to survive, states compete among themselves to gain power or to make sure that they do not lose power. States do this because of the structure of the international system, which is characterized by anarchy (Waltz, 1979). The nature of the competition is understood in (neo-)mercantilist terms within neorealism, notably as a zero-sum game (Dunne and Smith 2011, p. 93). How would neorealism explain the growing influence of the CIC in the US economy? There is not one answer to this question, since neorealists have different views on for instance a state's goals and its behavior. Most neorealists would however agree that we currently live in a unipolar system with the US as the global hegemon. China, with its huge growth rates and large population, then would be the most important upcoming and hence contender power in the world. According to neorealism, China is expected to balance the US by increasing its share of global wealth. One way to increase wealth is by making investments in the US through SWFs, because SWFs will yield higher returns than the more conservative investments that monetary authorities usually make. By definition, all structural realists would agree that China's behavior, that is becoming influential in the US financial sector through the CIC, is a result of the global system's structure. Neorealists would though disagree on how much power is needed to ensure survival. Here the difference between offensive realists like John Mearsheimer (2001) and defensive realists like Kenneth Waltz (1979) is interesting. Offensive realists argue that it is a wise strategy to pursue as much power as possible and even to pursue hegemony in order to survive. Defensive realists have a milder view on how much power is enough. The rationale is that it would be foolish to pursue as much power as possible, because at some point the system will punish states that gain too much power, because maintaining a large amount of power can be very costly (Mearsheimer 2007. pp. 72, 75-78). It is of course hard to say at this stage how much power China will pursue as an upcoming economy. But with China's high growth rates and massive population, realists would argue that China will look for opportunities to

shift the balance of power in its favor to ensure its survival (Mearsheimer 2007. pp. 82-86). From this view, the CIC would just be a means to an end, while the end is to increase China's share of global wealth. In this way, the role of China's SWF is reduced to making pure financial profits rather than having more far-reaching geopolitical motives. Why did the CIC choose to make huge investments in the US (its most important global competitor) and not in other countries or in its domestic economy? If we allow for the possibility that SWFs have not only financial but also strategic motives, the CIC's invasion in the US financial sector could be a sign of China trying to undermine the hegemonic role of the US in the world. Reasoning from this geopolitical perspective suits the neorealist theory very well. The important question arising from this is whether we should encounter SWFs in this way, or is there more to it? In other words, an important question is what aspects are left aside when sticking to the neorealist ontology?

In fact, explaining the growing influence of China's SWF in the US economy with neorealism suffers from a couple of limitations. The state-centric view and (neo-)mercantilist focus is problematic in many respects. Within neorealism, states are the central actors and in the relations among independent sovereign states there is competition over power. However, the world we live in today contradicts this state-centric and (neo-)mercantilist focus. The competition between states is not simply a zero-sum game. Because of heavily integrated financial markets, national economies have become mutually dependent and therefore need access to other economies. In a highly interdependent world, national economies cannot individually gain at the expense of others as neorealists tend to simplify the world. In other words, neorealism adopts a somewhat a-historical stance, which ignores economic and especially financial interdependence in the global realm that has evolved through the prominence of globalized financial markets in the past thirty or more years. As discussed in the introduction, this interdependence is very present in the complex relationship between the US and China. China has made huge investments in the US financial sector (of which SWF investments form a major part). The US economy has become strongly dependent on Chinese money to finance its consumption of goods and services. Some analysts even argue that the Chinese now have a 'financial nuclear option', because they have the possibility to pull out their money and heavily harm the US economy (CBS *60 Minutes*, April 2008). On the other hand, China relies strongly on exports to the US, so a collapse of the US economy also harms the Chinese. Because of its state-centric focus and the notion of competition over power as the strategy to survive, neorealism is not able to explain this mutually assured destruction that marks the strong interdependency between China and the US. Besides, because of their mutual interdependence, a conflict-prone competition between the two nations, as neorealism would predict, is very unlikely. The mutual interdependence in which the US and China are trapped might even be seen as a form of cooperation, illustrated by the concept of 'Chimerica', which was shortly mentioned in the introduction. The two countries need each other in order to grow and both perform different tasks within this relationship (for instance, the one is doing the spending, while the other is doing the saving, see Ferguson 2008, pp. 336-340). This cooperation is

obviously not very durable, but this is more due to the nature of capitalism and its imperative for continued and unlimited growth, rather than cooperation as such. Durable or not, cooperation is something that neorealism is not able to explain convincingly.

Furthermore, neorealism treats the structure of the state system as a given, which guides the behavior of states at the international level. This is a very limited view, because the international structure is much more complex than neorealism presents it. One needs to view the phenomenon of SWFs, and the deadly embrace between the US and China in which it takes place, within a broader global development, that is the stage and particular outlook of the global political economy, in order to understand the role SWFs play properly. This broader global development is the process of financialization or the increasing importance of finance in the contemporary global political economy, to which neorealists have no answer.

Another shortcoming of neorealism in explaining the research problem of this thesis is its assumption of rationality and treating states as rational egoists: “states calculate the cost and benefits of different courses of action and choose the course of action that gives them the highest net pay-off” (Martin 2007, p. 112). Cost-benefit analysis is a poor guide to actual behavior, especially in extremely complex situations. As pointed out by Martin (2007, p. 112): “Pure strategizing does not accurately characterize the process of decision-making”. The mutually assured destruction the US and China are in, has to do with such a complex economic relationship between the two countries, that the rationality assumption is way too simplified and not in place here. The US and Chinese behavior is not simply a result of a cost-benefit analysis. That the system might ‘blow up’ at a certain stage is something that state officials can be aware of, but still they do not act in ways to stop it. In other words, in this mutually assured destruction a proper cost-benefit analysis does not cover the detrimental consequences for their economies. To explain US’ and China’s behavior, an analysis of economic developments and processes over time is needed, rather than a simple cost-benefit analysis at one particular point in time. Several alternative theoretical perspectives such as constructivism have dealt with the limits of rationality as a core assumption, which will be discussed later on.

The final demerit of neorealism that will be discussed in this section is one that is not characteristic only for neorealism, but can also be applied to neoliberal institutionalism and constructivism. It concerns the inability to explain theoretically the rise of new powers. Neorealism emphasizes that the rise of a new power can form a threat to the hegemon, but is not able to answer the question why a new power rises. Why is a geographically bounded state able to become economic successful and a major economic player on the global level at some point in time? Or vice versa, why do great powers decline? In order to explain this a theoretical account of how the economic system evolved is needed. The three theories under discussion here do not emphasize historical social developments, which are however crucial for situating the role of the Chinese SWF. If the Chinese government wanted to undermine US hegemony, it could have also just started out a military attack to conquer the US, as neorealism would predict. However, this was not what the Chinese decided to do.

To summarize, neorealism gives no satisfactory explanation for the mutual interdependence between the US and China, because of its state-centric, (neo-)mercantilist focus, its neglect of the possibility of cooperation, its reliance on the rationality principle, its treatment of the structure of the state system as a given, and its inability to explain the rise of new powers. Another important IR theory which does pay attention to interdependence is neoliberal institutionalism and will be discussed in the next section.

## ***2.2 Challenging neoliberal institutionalism***

Neoliberal institutionalism emerged as a response to neorealism. It was motivated by two observations that neorealism could not explain: 1) international economic cooperation in the 1970s was stable in spite of shifts in the distribution of international economic power, and 2) organizations such as Bretton Woods and the General Agreement on Tariffs and Trade (GATT) were very prominent in the international economic environment (Martin 2007, p. 111). In *After Hegemony* (1984), Robert Keohane points on the declining US hegemony in the 1970s and that despite this decline, cooperation had not disappeared, contrary to realist theories on state hegemony. Keohane argues that this supports his theory on cooperation, building on the idea that existing regimes provide benefits that allow countries to continue to cooperate even without a hegemon (Keohane 1984, pp. 182-216). It was with these developments that IR scholars started to recognize that international organizations play an important role in the international distribution of power and wealth. Neoliberal institutionalists made theoretical progress by adding a focus on international institutions onto the neorealist assumptions (Martin 2007, p. 111). Neorealism and neoliberal institutionalism see and study different worlds. Where neorealism emphasizes relative power, security and survival, neoliberals are more concerned with economic welfare or international political economy issues. Neoliberal institutionalism pays attention to managing complex interdependence and the various processes of globalization. It is about responding to problems that threaten the economic well-being of people around the world, for instance, managing financial markets so that the gap between rich and poor does not become insurmountable (Lamy 2011, p. 123). By taking economic interdependence and processes of globalization into account, neoliberal institutionalism seems to be better able to explain the research problem in this thesis than neorealism. Neoliberal institutionalism does however draw essentially on the same assumptions as neorealism on states as agents and on cost-benefit analysis. Therefore the earlier criticism on neorealism also partly applies to liberal institutionalism. As already discussed, neoliberal institutionalism manages to explain certain aspects better, especially economic interdependence, but there are still some limitations.

Neoliberal institutionalists focus on international regimes to manage areas such as economic interdependence and processes of globalization. Krasner (1983, p. 2) defines international regimes as “sets of implicit or explicit principles, norms, rules and decision-making procedures around which

actors' expectations converge in a given area of international relations". Neoliberal institutionalists' ontological focus on international norms and institutions does however also not help explaining the role of the Chinese SWF in the mutually assured destruction situation. An institutionalized agreement between the US and China on how to deal with their mutual interdependence does not exist. Thereby principles, norms, rules and decision-making procedures play a very limited role in the process of financialization, because financial transactions have been liberalized and supervision and regulation on global financial markets are absent. Also there are no international institutions that are concerned with the role of SWFs and it is not the goal of this thesis to explain cooperation through institutions.

### ***2.3 Challenging constructivism***

Constructivism has brought new theoretical insights for the IR field with the idea that international relations is a social construction. The subjects in IR are not universally rational egoists but have different identities that are shaped by cultural, social, and political circumstances in which they are embedded (Fierke 2007, p. 171). Alexander Wendt has laid down two basic principles that characterize constructivism: "[...] the structures of human association are determined primarily by shared ideas rather than material forces, and identities and interests of purposive actors are constructed by these shared ideas rather than given by nature" (Wendt 1999, p. 1). In this respect constructivists treat the rationality principle very different than neorealists and neoliberal institutionalists do. "What is rational is a function of legitimacy, defined by shared values and norms within institutions or other social structures rather than purely individual interest" (Fierke 2007, p. 170). Constructivism is guided by a logic of appropriateness instead of a logic of consequences (ibid.). This distinction between the two logics is closely related to how both treat rationality. The logic of consequences, which applies to neorealism and neoliberal institutionalism, calculates costs and benefits to actions, taking into account that other actors are doing just the same. The logic of appropriateness emphasizes how actors are rule-following, worrying about whether their actions are legitimate (Barnett 2011, p. 155). In the previous section, it was argued that a simple cost-benefit analysis was too narrow and not helpful in explaining the role of SWFs. Constructivism, so it seems, adopts a less narrow account of the rationality principle by adding rule-following and legitimacy to the cost-benefit equation. Thus, constructivism has not rejected but only widened the rationality principle. By retaining rationality, although not limited to material interests, constructivism, or at least some branches of it, still presents states' decision making in a simplistic way, which is too narrow to analyze the mutual assured destruction between the US and China. Also it is very questionable whether taking into account rule-following and legitimacy will contribute to explaining the research question. The US and China would only assay their actions to rules if there would be a relevant international framework of norms that both countries find important enough to comply with. In the previous section, it was discussed that international norms and organizations play a very limited role in the financialization process. Also China's behavior in the

recent past is an illustration of how China is not acting according to “the rules” as some argue by pointing at unfair trade practices, currency manipulation, technology espionage, and refusal to crack down on counterfeiting (CBS *60 Minutes*, April 2008). Therefore constructivism’s treatment of the rationality principle is not contributing to explaining the role of the CIC in the US-China political economic relationship.

Since constructivism demands that we take seriously the role of ideas in world politics, it would emphasize the meaning given to the CIC. Why is there so much upheaval about the CIC in the US? SWFs usually tend to have long-term investment goals, while other private market players (private equity funds and hedge funds) tend to invest much more short-term oriented and are often also more reckless in their profit objectives. Why are the former treated with so much suspicion while the latter are less or not politicized? Constructivists would say that this irrational behavior can be explained by the meaning that is given to these SWFs as dangerous actors invading the economy. According to Bieler and Morton (2008), constructivists explain that certain ideas are constitutive of political structures but they cannot explain *why* certain ideas and norms exist or how they have become dominant on the international level. Constructivists generally ignore important questions such as: “Whose values and beliefs have constituted or embodied state identities and interests and the relevant constitutional structure of the international society of states? Which agents shape the core intersubjective beliefs of underlying social and world orders? Why does a particular set of ideas become part of the structure and not another?” (Bieler and Morton 2008, pp. 107-109). Why do the Americans give meaning to the CIC the way they do? These questions bring forth the importance of the notion of power. What configurations of power underpin such interpretations of the social world? So it seems that ideas and giving meaning processes are not able to explain the role of the CIC and is not per se the reason why the CIC is feared.

Another concern with constructivism that is problematic for the research problem is that the material dimension is underexposed. Why are ideational interests more important than material interests? As Palan (2000) puts it: constructivism is “a theory that asserts, but never proves, the primacy of norms and laws over material considerations, in domestic and international politics” (p. 575). It could be argued that in times of economic crisis, which coincided the rise of the Chinese SWF, governments will sooner or later, regardless of their interpretation of the crisis and the prominence of the Chinese SWF, be hit by material realities. As already mentioned, in the beginning of the economic crisis in 2007, when the CIC started to make huge investments in important US financial institutions, the US welcomed Chinese money and did not have many concerns on US-Chinese relations and the lack of democracy in China. Later, when US financial institutions were saved, and material interests were secured, the Americans started to question Chinese SWFs. It is thus inappropriate to emphasize ideas over material interests. The challenge ahead is therefore to theorize convincingly how the ideational and material dimension relate to each other.

To recapitulate: the shortcomings of neorealism, neoliberal institutionalism and constructivism identified above demonstrate that mainstream IR theories are not able to give satisfactory explanations for the main problem in this thesis. For neorealism, the main limitation is that it cannot explain the mutual interdependence between the US and China due to its state-centric, (neo-)mercantilist focus, its neglect of the possibility of cooperation, its reliance on the rationality principle, as well as its treatment of the structure of the state system as an unquestioned given. Neoliberal institutionalism suffers partly from the same shortcomings, but is better able to explain mutual interdependence and cooperation. Its focus on international principles, rules, and norms is however not relevant for explaining the role of SWFs within the current political situation in which the two economies find themselves. The main contribution of constructivism is in contrast that it emphasizes the role of ideas. However, constructivism, that is some of its branches, fails to explain the role of the CIC within the complex US-China relationship, because it has not abandoned the rationality principle, it cannot explain why certain ideas and norms have become dominant, and it ignores the material dimension. The inability to explain the rise of new powers and the neglect of historical social developments apply to all three IR theories. Below, an alternative framework is presented that seeks to remedy the above shortcomings in order to better explain the role of the Chinese SWF in the US-China mutually assured destruction.

### 3. Towards an alternative theoretical framework

In *Adam Smith in Beijing*, Arrighi (2007) describes and explains several major historical events by focusing on the role of finance over time. Most centrally, he claims that we cannot understand the current global political economy without understanding the history of finance. In this vein, a pure theoretical abstraction is impossible given the specific historical mechanisms that Arrighi identifies. Arrighi offers a grand narrative with considerable theoretical substance in a time where there are not many scholars who dare to argue alongside more holistic approaches. Therefore, despite several shortcomings, Arrighi deserves respect for this approach.

Arrighi seeks to explain why the East Asian region experienced a sharp economic decline in the 19<sup>th</sup> century and the first half of the 20<sup>th</sup> century and how this is connected to the present resurgence of this region (see Arrighi 2007, p. 27). Arrighi builds on different historical stages or cycles in the development of capitalism of which each ends in a crisis, leading to a new cycle. This new cycle was already born in the previous cycle and therefore the cycles are historically connected. Arrighi identified four systemic cycles of capital accumulation, some of which involved periods longer than a century. For each cycle, he identified a hegemonic city-state or state, starting from the Genovese, the Dutch, the British and our current American cycle. Focusing on long-term historical developments and seeking to develop a grand theory, Arrighi starts out by using Adam Smith's description of the dynamic process of economic development, which he subsequently links to the resulting division of labor. The Smithian dynamics, as Arrighi calls it, runs as follows: economic innovation leads to a widening and deepening division of labor and enhances productivity gains. This economic improvement raises income and effective demand after which the scope of the market increases, which enables new rounds of division of labor and economic improvement. However, this virtuous circle cannot continue forever because of the limits exposed on the extent of the market "by the spatial scale and institutional setting of the process" (p. 25). The process enters, what Smith calls, a high-level equilibrium trap. Questions arising from this are why East Asia, and especially China which is also Arrighi's focus, experienced this trap in the nineteenth century and Europe could escape it (p. 25)? Furthermore, why was China able to make such a phenomenal rise economically "so quickly after more than a century of political-economic eclipse" (p. 32)? Arrighi moves on by using the model of the Great Divergence by Kaoru Sugihara (2003). According to Sugihara, East Asia experienced 'Industrious Revolution' before its decline which was centered on the household and village community which meant that workers had to perform multiple tasks instead of specializing in a particular task, while cooperation instead of individual talent was generally encouraged. This stimulated labor-intensive technologies and was thus characterized by 'labor-intensive industrialization' (pp. 33-34). This path is what Smith had in mind when describing his dynamic process of economic development (hence the title *Adam Smith in Beijing*), also called the 'natural path'. Sugihara claims that the East Asian economic resurgence is due to a fusion of this East Asian



labor-intensive, energy-saving, home-trade-based natural path with the Western capital-intensive, energy-consuming, foreign-trade-based, unnatural path. In practice this means that in the second half of the 20<sup>th</sup> century first Japan, and later China, moved “towards the development of interlinked industries and firms with different degrees of labor and capital intensity, while retaining a strong overall bias towards the East Asian tradition of greater utilization of human than non-human resources” (p. 36). Arrighi is very confident that it is the autumn of US hegemony and that the Asian era that is emerging will be characterized by a fundamentally different kind of hegemonic power because of the fusion of the unnatural with the natural path of capitalist development. However, he is not very sure what that power will look like or how it will be exercised (Bair 2009, p. 225).

Subsequently Arrighi uses Marx’s theory of capitalist development to extend Sugihara’s thesis. In the view of Marx, capitalist crises can be seen as moments of fundamental reorganization. The fall in profits and the intensification of competition do not end in a stationary state, but lead to the destruction of the social framework in which capital accumulation (that is the wealth produced that can be used for reinvestments in the future) is embedded. A new social framework will evolve (Arrighi 2007, pp. 82-83). However, Marx points out that such capitalist crises of declining profitability and stagnation can be escaped through the international credit system. When options for expansion decrease and competition increases, there is a certain tipping point at which investment in finance is more profitable than investment in the real economy. Then, more and more money is diverted to the financial sphere. Marx starts out with the example of Venice. When Venice experienced declining profitability and stagnation it started to lend large sums of money to Holland. By the beginning of the 18<sup>th</sup> century, Holland had ceased to be the leading nation in commerce and industry and started to lend enormous amounts of capital to England. Later the same process happened between England and the US. Marx sees (as phrased by Arrighi) “the international credit system as providing capital with an escape from stagnation through migration to a larger container ... where its self-expansion could resume on a larger scale” (p. 87). However, once competition increases to an extent that there are no longer enough profitable investments, conflicts might emerge. According to Arrighi, periods of financial expansion thus tend to be periods of conflictual geopolitics.

Two tendencies that Arrighi observes on the basis of his longitudinal research are especially important in order to understand the specific European developmental path. First, accumulation of capital that goes beyond the normal channels for investment provides financial capital to become dominant. This tends to revive the fortunes of incumbent capitalist centers first, but over time existing social frameworks of accumulation are destroyed. The headquarters of the capitalist system are relocated to new centers and more encompassing social frameworks of accumulation are created under the leadership of ever more powerful states. In this respect, it is important to understand that for Arrighi, hegemony does not mean leadership within an international structure, but the power to change this international structure. Second, with the European developmental path there was an intense interstate competition for mobile capital. For Arrighi this is the key to solving the issue of the

relationship between capitalism, industrialism, and militarism (pp. 93-94). The dynamic of the European system was characterized by an intense interstate military competition and by a tendency towards the expansion of the system and its shifting centre. Also European states built overseas empires in competition with one another and engaged in an intense armament race (pp. 315-317). “The superiority of the European vis-à-vis the East Asian path depended critically on a synergy between financial and military capabilities that was hard to sustain in an increasingly integrated and competitive global economy. Once the synergy ceased to function, as it did in the closing decades of the twentieth century, Japan became the harbinger and China the bearer of the hybrid (natural and unnatural), market-based, developmental path [...]” (p. 96). However, it is not entirely clear why Arrighi is so optimistic that China’s rise is a sign “of that greater equality and mutual respect among peoples of European and non-European descent that Smith foresaw and advocated 230 years ago” (p. 379). Instead, China’s rise could also be a sign of a new Asian centered regime of accumulation in which China replaces the US as the hegemonic power. Arrighi’s optimism seems to rely on the belief that the relationship between capitalism, industrialism, and militarism, on which the European path rested, is somehow incompatible with an Eastern hegemon and that therefore China will not simply copy the strategies of the US, as the Dutch copied the Genovese, the British the Dutch, and the Americans the British. According to Bair (2009, p. 225), Arrighi’s argument rests primarily on “an assumption that the contours of China’s future course, as opposed to simply its present, will be profoundly shaped by its past”. Also Arrighi does not explain why all of a sudden the synergy between financial and military capabilities ceased to function in the closing decades of the twentieth century. He describes the process empirically, but does not theorize on that by making specific predictions about the nature or precise timing of the eventual terminal crisis that would mark the end of US hegemony (Bair 2009, p. 223). Another striking point is that Arrighi’s framework is a very structural theory, whereby the role of agents is underexposed. This theory would gain a lot if agents, for example government officials and financial market actors, were taken into account.

However, despite these important points of critique, Arrighi’s framework does still provide valuable insights on the mutually assured destruction issue and the role of SWFs within. One is that Arrighi’s approach emphasizes the economic underpinnings of political power, while treating the role of markets and capital as instruments of power in their own right, rather than focusing on the need of the conversion of economic power into military power, as neorealists do (Arrighi 2007, p. 311). Also Arrighi builds his framework around processes of economic development in order to explain China’s dependence on exports by describing how the Asian ‘natural’ path is merging with the European ‘unnatural’ path of economic development, which is very helpful in understanding US-China relationships. Another merit of Arrighi’s work is that he takes financial interdependence into account in describing the European sequence of empires. Further, Arrighi’s approach is not characterized by rationalism, because it sees state’s behavior in the light of economic developments and processes of capital expansion over time. It takes history into account, which allows, better than mainstream IR

theories, to explain the complex relationship between the US and China. Crucially, in explaining the history and development of China's current economic rise, Arrighi attributes a major role to the financialization process. The US-led financial expansion of the 1980s and 1990s can be seen as an example of financial capital becoming dominant after a moment of over-accumulation, which recurs periodically and refers to the absence of profitable investment outlets to absorb ever-increasing quantities of surplus capital at a particular historical juncture and location (Harvey 2006, Bello 2006, Hung 2008). As already discussed, the incumbent capitalist center, the US in this case, was first able to benefit from the fortunes of finances becoming dominant. Later, Arrighi argues, existing social frameworks are destroyed which gives the opportunity for new centers and new social frameworks to come into existence. This way of thinking is helpful in explaining the role of the Chinese SWF as an example or an illustration of new social frameworks, because states becoming important financial players was until recently an unknown phenomenon in the world. China could be that new capitalist center promoting new social frameworks of which the CIC is probably an important element.

Following Arrighi's line of argumentation and in explaining processes of economic development, it is unclear why China and its SWF are lending huge sums of financial resources to the US. Why does China not invest it in its own economy? It seems logic that since China is rising it still has a lot of room to invest its capital in new sectors of accumulation according to Smithian dynamics, because it has not yet by far reached its high-level equilibrium trap. On the contrary, in following Arrighi's sequence of empires, it is argued that declining profits and stagnation in the old empire is a motivation to lend huge sums of money to the new empire, as Venice did to Holland, Holland to England, and England to the US. So now it would be expected that the US would lend its excess capital to China. Of course this happens to quite a degree through US foreign direct investments in China, but it is not in line with the huge sums of money that flow from China to the US. The concept of 'Chimerica', developed by Niall Ferguson (2008), will be helpful in this puzzle and gives useful insights on the role of the Chinese SWF. With his notion of 'Chimerica' Ferguson sheds a new light on the mutually assured destruction issue. He provides a very clear understanding of why China lends huge sums of money to the US (which will further be discussed in the empirical analysis chapter), something which Arrighi is not able to explain. When following the idea of 'Chimerica' it seems that the US and China are much more intertwined than Venice and Holland or England and the US ever were, which adds important insights to Arrighi's framework. Also Kotz (2008) gives an explanation of why huge sums of money flow from China to the US. Also the US reached the Smithian high-level equilibrium trap because of stagnating wages and increasing profits, which create overproduction relative to demand. Kotz emphasizes that the US still showed impressive growth rates in the last few decades, so there must have been other forces that stimulated economic growth. These forces have been the emergence of asset bubbles, and the rapid expansion of various forms of debt (see also Schwartz 2009). These developments can promote growing investment demand and consumer demand for a time, despite the stagnation of wages (Kotz 2008, p. 175). Kotz clarifies this by saying: "A long

expansion would be possible only if an asset bubble arose of such great proportions that it would enable a large part of the population to borrow and consume beyond its means” (Kotz 2009, p. 312). This asset bubble was the housing bubble. The US thus extended its hegemony through asset bubbles and debt expansion, which has been made possible by a neoliberal institutional structure. Money was needed in order to finance the asset bubbles and debt expansion, which explains huge capital flows from China to the US.

By following Kotz’s theory, it can be said that the US hegemonic era is significantly different from previous ones, because the Venice, Holland and Britain eras were all ending when wages stagnated and profits increased. Only the US was able to extend its hegemony even after reaching the high-level equilibrium trap. Kotz adds important insights to Arrighi’s framework by providing a deeper understanding on systemic crises and by arguing that neorealism is at its end. According to Kotz, the means necessary for promoting economic growth within the neoliberal capitalist structure may soon become unavailable, because further debt expansion may not be possible. This may lead to a severe crisis of the neoliberal model itself and to conditions that can give rise to a shift to a different institutional structure (Kotz 2008, p. 176). Kotz points out that the financial and economic crisis that began in the US in 2008 indicates the start of such a systemic crisis of neoliberal capitalism and that major restructuring is likely to follow (Kotz 2009, p. 1).

To recapitulate: Arrighi’s theoretical framework builds on different historical stages or cycles in the development of capitalism of which each ends in a crisis, leading to a new cycle. These cycles were first seen in Europe (Venice, Holland and England) and the latest one is the US cycle. These cycles exist because following Smith’s dynamic process of economic development, capitalist centers will eventually reach a high-level equilibrium trap. According to Marx, when reaching this high-level equilibrium trap, a capitalist crisis occurs, which can be escaped temporarily through the international credit system. This is how the sequence of cycles in Venice, Holland, England and the US occurred. Arrighi is able to explain the rise of China, something which neorealism, neoliberal institutionalism and constructivism were not able to do, by emphasizing the fusion of the natural ‘Chinese’ path of economic development with the Western unnatural path. Arrighi admits that because of this fusion, China will not simply be the next capitalist center in the sequence of cycles in Europe and the US, but he also does not answer the question how China as the new capitalist center of the world will look like. Concerning the subject of this thesis, it is a great lack in Arrighi’s framework that it is not able to explain why large sums of money flow from China to the US. Here first Ferguson’s notion of Chimerica is very useful, in showing that the relationship between the US and China is very different from the relationship between Venice and Holland, Holland and England, and England and the US in previous centuries. Second, Kotz adds valuable insights by analyzing how the US was able to extend its growth despite stagnating wages by the emergence of bubbles and the expansion of various forms of debt. The need to finance these bubbles and debt in order for the US economy to keep growing, explains the huge flows of capital from China to the US.

#### **4. Epistemology, methodology and operationalization**

This chapter discusses epistemological questions and a range of methodological issues that guide the research. Moreover, the abstract theoretical concepts that were introduced in the previous theoretical part will be operationalized.

##### ***4.1 From epistemology to methodology***

This section discusses the main differences between positivism, postpositivism and critical theory. This discussion is important insofar as it will clarify how to move from abstract theoretical concepts to a better understanding of the research problem by uncovering the role of political agency and its underlying structures. Patomäki and Wight (2000) argue that it is time for IR scholars to move beyond the long-standing positivism/postpositivism debate and show how a critical realist philosophy can help overcome problems that positivism and postpositivism face. According to positivists, science must focus on systematic observation. The collection of sufficient data, generated through systematic observation, is expected to reveal regularities, which indicate general laws about how the social world functions. These general laws express relations between patterns in social reality. There is however nothing more going on behind the data. Positivists do not search for non-observable processes or mechanisms that could explain patterns, such as underpinning social structures. Non-observable entities are only treated in instrumental terms. Non-observables are treated sometimes as useful fictions that help explain the data, but positivist will never give them explanatory significance. Positivists emphasize the instrumental function of knowledge: “Knowledge has to be useful not truthful” (Kurki and Wight 2007, p. 21). In sum, for positivists, causal relations are discovered through the detection of regular patterns of observable behavior (Kurki and Wight 2007, p. 21).

The term postpositivism is not as clear-cut as positivism is. When discussing postpositivism it can refer to approaches that draw on a diverse range of intellectual traditions. What unites postpositivists is a commitment to reject positivism as a valid approach to the study of social processes. Some postpositivists rely on the conviction that meanings and beliefs are the most important factors in the study of social processes and that in this way the deep meaning that exist beneath the surface of observed reality can be uncovered. Also some postpositivists are skeptical of the validity of all knowledge claims and they reject the idea that science is able to produce true objective knowledge (Kurki and Wight 2007, p. 22).

Patomäki and Wight argue that both positivism and postpositivism are embedded in a discourse of philosophical anti-realism (2000, pp. 214-215). For positivists the real is defined in terms of the experienced and for many postpositivists in terms of language/discourse. Patomäki and Wight find these notions of reality problematic because existence is tied to its being experienced or being spoken. “Yet, ‘to be’ means more than ‘to be experienced’ or ‘to be spoken’” (2000, p. 217). Also

within positivism/postpositivism, discourses construct the objects to which the discourses refer. This implies that discourse can never be wrong about the existence of its objects in any methodologically interesting way. Nor can different discourses criticize one another, because the objects of a given discourse exist if the discourse says they exist. External criticism of the claims of discourses seems therefore impossible. Another point of critique on positivism/postpositivism is that they treat non-observable theoretical entities as instruments. They are no more than ‘fictions’ that might be useful but cannot be considered real (Patomäki and Wight 2000, p. 217). According to Kurki and Wight, reality should be reclaimed by acknowledging that because object domains differ in fundamental ways it is inappropriate to expect that methods deployed in one science are applicable to all sciences. Because the social world is very complex, and there are many ways to come to know the world, it is better that one does not take an a priori position on either methodology and epistemology. Science should not dogmatically rely on the certainty of its claims, but should release itself for constant critique (Kurki and Wight 2007, pp. 23-24).

Critical realism has reclaimed reality and its emergence is an important trend within IR, a trend that can also be observed in many other domains of social sciences. It has opened up new approaches for meta-theoretical and theoretical debate in IR and it has enabled the discipline to move forward from the positivism/postpositivism debate. Critical realists see material factors and ideas as both important in producing social outcomes, and both need to be integrated in the research process (Kurki and Wight 2007, p. 25). For critical realism, the world is not only composed of events, states of affairs, experiences, impressions, and discourses, but also of underlying structures, powers, and tendencies that exist even though not always known through experience or discourse. Another important aspect of critical realism is that our complex world possesses certain powers, potentials, and capacities that can act in certain ways even if those capacities are not always realized. These powers, potentials, and capacities are part of the underlying level or structures. This conception can be exemplified by nuclear weapons that have the power to bring about destruction and this power exists irrespective of being actualized. For critical realists the world consists of more than the actual course of events and accompanying experiences and/or discourses. In this view, science aims at identifying the structures, powers, and tendencies that structure the course of events instead of just detecting regular patterns. Thus, in the scientific process, some already identified phenomenon is explained by providing an account of those structures, powers, and tendencies that have facilitated the phenomenon. The logic of inference in critical realism is neither deduction nor induction, but retrodution (Patomäki and Wight 2000, pp. 223-224).

The process of retrodution begins with a conception of a phenomenon of interest and from there on moves to the development of a model of some totally different structure that is, at least in part, responsible for the given phenomenon. This structure is the deeper layer that needs to be revealed and understood in order to get a better understanding of the phenomenon of interest. As this process continues, the knowledge of the deeper layer might necessitate a revision of the conception of the

original phenomenon. This means a constant moving back and forth between the phenomenon and the model, or, in other words, between the observable and non-observable. In this way, science is seen as a constant spiral of discovery and understanding, further discovery, and revision and more understanding (Patomäki and Wight 2000, pp. 224-225). The phenomenon of interest is the starting point, which is driven by a problem and questions and not driven by methods.

In this thesis the phenomenon of interest is CIC's rising presence in US financial markets. In other words, this phenomenon was the first observation that has led to several questions of which the most important concerns the CIC's motivation to focus on the US to invest in. The goal of this research is to uncover the underlying structures, powers and tendencies that help explain or at least give a better understanding of the phenomenon concerned. In order to approach the deeper layers beneath the phenomenon, the theoretical concepts of the previous chapter are needed. With the help of theories, underlying structures can be unraveled and made sense of. The question now is how to move from theories to underlying structures that exist in the real world, in other words, from abstract concepts to concrete events. Karl Marx' 'method of abstraction' provides a useful answer. The method of abstraction contains a series of steps which go from the 'imagined concrete' (the phenomenon of interest) to evermore abstract determinations, and then back to more complex constellations, but then enriched by a more profound understanding. To clarify, the phenomenon of interest is the starting point which would be a chaotic conception of the whole. From there on the process of investigation moves analytically towards ever more simple concepts, from the 'imagined concrete' towards ever thinner abstractions. After that, the journey would have to be retraced to arrive at the 'imagined concrete' again, but this time not as the chaotic conception of a whole, but as the 'thought concrete', the view of the totality as it is at that moment, enriched with understanding of the underlying structure (Van der Pijl 2009, pp. 221-224). Which theoretical notions are important in this thesis in order to arrive at the 'thought concrete' will be discussed in the next section.

More concretely, the process of retrodution as informed by a critical realist ontology and the method of abstraction by Marx imply methodological pluralism. This means that any method that suits the topic is useful, it is ontology that matters most. There are no decisive criteria for selecting one best method of analysis and scientists should therefore employ a plurality of methods. The choice of method should be problem-dependent (Dow 1997, p. 93).

Here the analysis of events in the US-China deadly embrace is based on extensive literature study, drawing on the works of Kotz (2008/2009), Xu (2009), Krippner (2005), Zheng & Yi (2007), Cognato (2008), Overbeek (2011), and Ferguson (2008). Only few political science contributions were found, therefore the empirical analysis relies to a large extent on the work of scholars within the field of economics. To get a detailed view on the role of the CIC and its functioning within the US financial market, it would be wise to gather more detailed information on the CIC investments in Blackstone, Morgan Stanley and Visa, for instance by interviewing inside actors within these companies and the CIC. However, the scope and time constraints of this Master thesis did not allow gathering this

detailed information, but I would like to invite other scholars to do so. The resources used are mainly books, articles, news paper articles, reports from organizations, and relevant websites. It was very difficult to find official information on the Chinese situation, because there is little transparency from the part of the Chinese government, but also because of language constraints, data gathering was limited.

#### ***4.2 Operationalization***

In order to arrive at the ‘thought concrete’, an operationalization of the theoretical concepts is needed, with the goal to construct the underlying structure of reality. The most important concepts in the theoretical framework that will be referred to in the empirical chapter, have to be made explicit and concrete for analysis. In this type of research, where history has such a dominant role, it is difficult to simply move from the abstract to the concrete. Arrighi’s theoretical mechanisms for instance are very history laden, and are therefore more concrete than abstract. Also in the empirical chapter, the theoretical concepts are explained once more, because they are part of a broader history. By using the theoretical concepts in the empirical chapter, the concepts were implicitly operationalized. Of course here the concepts will also be operationalized explicitly, trying to reduce the overlap with the theoretical and empirical chapter to a minimum.

##### *High-level equilibrium trap*

Labor productivity can rise because of division of labor. Therefore products are cheaper to make which raises profit and/or wages and thus income and effective demand. This widens the extent of the market, which gives incentives to improve productivity even more through labor division. The economy improves because of these rounds of labor division. However, over time these virtuous circles have to come to an end because the extent of the market is limited by the spatial scale and institutional setting of the process. When these limits are reached, the process enters a high-level equilibrium trap (Arrighi 2007, p. 25). Overaccumulation occurs, meaning that reinvestment of capital no longer produces returns, because the potential of the market to grow is fully utilized. In this situation, wages stagnate, because new rounds of labor division are not possible and consumption decreases. Consumer demand falls causing over accumulation, or supply of goods in excess of demand for goods.

##### *Financialization and financial actors*

In making the concept of financialization more concrete, the definition by Krippner (2005) is used: “Financialization is a pattern of accumulation in which profit-making occurs increasingly through financial channels rather than through trade and commodity production” (p. 181). This definition is very useful because it makes on the hand a clear distinction between financial and non-financial



activities and on the other hand leaves room for several usages of the term. The growing importance of finance in the economy is indicated by the expansion of banks, brokerage houses and finance companies, but it is also indicated by the behavior of non-financial firms (Krippner 2005, p. 181-182). Whether financial activities have become more dominant in the economy than real production activities can be measured by the differences in profits between the financial and commodity sector, but also by the production sector engaging more in financial activities. Besides, other factors that have triggered the financialization process are deregulation, globalization and computerization, which engendered the emergence and proliferation of pension funds, mutual funds, hedge funds and private equity funds. These funds have become important financial actors in the past couple of decades and have had a major role in the process of financialization, but also in the development of neoliberal capitalism. Financial actors have developed new financial products and instruments through which asset bubbles could emerge and various forms of debt could expand. Financial actors have made it possible for the US to pile up large amounts of debt, of which the most striking examples are the subprime mortgages and securitization. Financial actors pretended these assets to bear very low risks and rating agencies rated these assets as very low risk. Also SWFs are an upcoming group of financial actors. SWFs might behave like normal financial actors, but the important difference is that they are government owned.

#### *Government officials*

Several government officials are important to mention in order to step from the theoretical framework towards the empirical analysis. Monetary policies, such as setting interest and exchanges rates, in both countries have had a major role in the mutually assured destruction between the US and China. Therefore the central bankers of both the Federal Reserve and the People's Bank of China (PBOC) are of great importance. Second, the managers of the CIC can also be seen as government officials, since they run a government-owned investment fund and are funded by the PBOC. Probably most important are the central government officials as they are responsible for the diplomatic relations between the US and China and for their economic policies. The US federal government for instance is responsible for running huge government deficits, which had to be financed with foreign money.

#### *Neoliberal capitalism*

Neoliberal capitalism is an institutional structure that has been dominant since the 1980s. This structure is characterized by limited state regulation of the economy, privatization of state enterprises and responsibilities, a heavily reduces welfare state and weak trade unions (Kotz 2008, p. 174). Because of weak trade unions, wages are not likely to increase very much in response to labor demands, therefore profits will not be diminished. The notion of social power balances, the broader power balance between capital and labor, which was in favor of capital from the 1980s onwards, is very important in analyzing neoliberal capitalism becoming dominant in the US. Weak labor, a

reduced welfare state with limited social programs and government policies aiming to raise after-tax profits of capital cause a situation of high profits and stagnant wages. This results in low consumer demand, but high production levels, leading to overproduction relative to demand. However, in a neoliberal capitalist structure, economic expansion is still possible as long as there are alternative forces that can provide growing demand despite stagnant wages. These alternative forces were the emergence of asset bubbles and the rapid expansion of various forms of debt, which for a time are able to promote growing investment demand and consumer demand. However, this neoliberal expansion brings growing imbalances, because debt cannot be piled up endlessly. These imbalances will eventually lead to a systemic crisis.

### *Asset bubble*

A bubble is a situation in which the price of an asset differs from its fundamental market value. Investors may even be aware that a bubble is occurring because the asset price is above its fundamental value but continue to hold the asset anyway. The reason for this is that investors believe that someone else will buy the asset for a higher price in the future. An asset bubble is thus caused by self-reinforcing speculative purchases aimed at gaining trading profits from an expected further rise in the price of the asset. Asset prices can deviate from their fundamental value for a long time because the bursting of the bubble cannot be predicted (Mishkin 2004, p. 164, Kotz 2008, p. 185).

A more concrete situation in which asset bubbles occur is the following. Rising profits relative to wages produces a large volume of investable funds that exceed potential productive investment opportunities. These redundant funds find their way to assets such as real estate or securities. An asset bubble and its continued growth requires a financial system that easily lends money to feed the bubble. Such a system is characterized by few regulations and a short-time-horizon thinking (Kotz 2009, p. 311).

### *Systemic crisis*

A systemic crisis occurs if the means to resolve (temporarily) the main contradiction of capital accumulation within that structure have become unavailable. The system may not survive such a crisis. A systemic crisis can only be resolved through a major restructuring of the system. If it is possible to resolve a crisis with appropriate state bailouts of financial institutions and the imposition of some new regulations on the financial system, then a systemic crisis is not the case. After these measures, the existing system would resume more-or-less normal operation (Kotz 2008, p. 186, Kotz 2009, p. 306).

The neoliberal capitalist structure gave rise to three important developments which stimulated a series of economic expansions, but which could also cause an eventual systemic crisis: 1) growing inequality between wages and profits, and between households within society as a whole, 2) a financial sector that became increasingly involved in speculative and risky investments, and 3) a series of large asset bubbles (Kotz 2009, p. 307).

## **5. Empirical analysis**

This chapter provides the empirical analysis of the role of the CIC in the mutually assured destruction situation between the US and China. In order to understand the role of CIC investments in the US, one needs to understand both the US situation marked by neoliberalism and financialization, and the Chinese situation, marked by trade surpluses and foreign exchange reserves. Thereafter, the complex relationship between the US and China will be explored, which will serve to explain the role of the CIC.

Section 1 of this chapter focuses on the development of neoliberal capitalism in the US. It analyzes how the US economy was able to grow despite stagnant wages and high profits, which created overproduction relative to demand. Section 2 addresses the process of financialization, in which financial activities became more dominant than real production activities and in which new financial instruments and new types of investment funds were developed. In section 3 the Chinese situation is analyzed, emphasizing its trade surpluses, its foreign exchange reserves piling up, and the dilemma the Chinese government faced in handling these reserves. The last section will look into more detail on the deadly embrace between the US and China. It shows how this complex relationship came into being and it will explain why it is so difficult for both countries to break the destructive pattern.

### ***5.1 Neoliberal capitalism***

In the quarter century following World War II, capitalism in the Western part of the world was highly regulated with a welfare state, strong trade unions, and in some countries a significant state-owned enterprise sector. Because welfare state programs became more generous and states began to intervene more effectively to shorten crises, workers' bargaining power remained strong and was not a reflection of unemployment rates anymore. This was one of the reasons that profit rates in the US declined after the mid-1960s. From a different but related perspective, it can be argued that the US entered the Smithian high-level equilibrium trap. New rounds of labor division, which would raise labor productivity, were not possible anymore because the limits to the extent of the market were reached. The potential of the market to grow was fully utilized. High wages and strong workers' bargaining power could not be held up, since labor productivity could not be increased. This led to the dismantling of the regulatory institutional structure and a neoliberal institutional structure becoming dominant around 1980 (Kotz 2008, p. 174). Neoliberal capitalism meant less pro-active state regulation of the economy, privatization of state enterprises, a reduced welfare state, and weaker trade unions. Social power balanced thus became more in favor of capital from the 1980s onwards, whereas in the post-war period labor had a relatively strong position. In the new capitalist structure, a contradiction appeared, namely low economic growth. With weak workers' bargaining power and the state focusing on raising the after-tax profits of capital, the economy was characterized by high profits

and stagnant wages, which create overproduction relative to demand (Bowles, Gordon, and Weisskopf 1984). The US found a way out of this situation of stagnant wages causing low demand and found an alternative force that provided growing demand. This alternative force was the emergence of asset bubbles and the rapid expansion of various forms of debt. Asset bubbles and debt were able to promote growing investment demand and consumer demand, despite the stagnation of wages (Kotz 2008, pp. 174-175). Kotz (2008) has found empirical evidence that expansion in a neoliberal capitalist structure in the US goes together with a rising rate of profit due to the weakness of labor and consumer spending that rises faster than consumer income, made possible by rising household debt. These factors have prevented overproduction for a time whereby an asset bubble was playing an important role. One of these periods of expansion was the rapid economic growth after 1995. In this period investment and consumer spending were driven by the stock market bubble and growing household debt (Kotz 2008, p. 176).

In the late summer of 2000, the stock market bubble burst, causing an economic downturn in 2001. Investment spending in the US fell by 4.2 percent in 2001 and 9.2 percent in 2002 (Kotz 2008, p. 178). Surprisingly, a severe recession failed to occur, because consumer spending grew with 2.5 percent in 2001, despite the fact that disposable income grew with only 1.9 percent (Kotz 2008, p. 178). US Households thus went deeper into debt to increase their spending. This was made possible by rapidly falling interest rates that year because of an easy monetary policy of the Fed. The result was that the expansion that would follow after the 2001 recession began with a higher rather than a lower level of household debt. This was pretty extraordinary, because after previous economic downturns in the US (1980-1982 and 1991) the level of household debt was reduced (Kotz 2008, pp. 177-181).

The following expansion period 2002-2007 was characterized by higher consumer spending caused again by low interest rates and high household debt. Household debt over disposable income rose from 91 percent in 2001 to 120 percent in 2005 (Kotz 2008, p. 184). Households have been able to borrow so much because of a bubble in the housing sector. This bubble increased the value of household assets, enabling households to borrow against their appreciating homes. Other forces that caused the major expansion in the period 2002-2007 were the following. First, investment spending rose driven by a rising profit rate, which was due to real wages growing more slowly than output per worker. Thereby investment spending also increased because of easy monetary policy and probably also by the housing bubble. Second, federal spending grew rapidly because of rising military purchases, and tax reductions, that both contributed to GDP growth, but which had to be financed by a rapid increase in the federal budget deficit (Kotz 2008, pp. 181-185). To summarize, the contradiction of growth in a neoliberal structure of stagnated wages and overproduction, were in the period 2002-2007 solved by growing household and government debt, low interest rates, and a housing bubble (Kotz 2008, pp. 181-185).

Expansion of the US economy in the neoliberal capitalist structure is thus based on increasing the level of debt by households and the federal government. International financial markets and

especially emerging countries, like China, who had major current account surpluses have facilitated the rising US debt levels. Also because the US dollar is seen as the global top currency, it has been much easier for the US government to borrow internationally by selling US Treasury bonds at very low rates. As Xu (2009, p. 12) puts it: “As the ancient Romans used to say, some live too richly for their purses and fame would allow them large debts, but everything has to be repaid in the end”. In other words, the US dollar could be seen as the global top currency, and the US is therefore easily capable of attracting large sums of foreign money. This money however has to be repaid eventually.

When the US economy was not able to grow anymore by new rounds of division of labor, or in other words, it entered a high level equilibrium trap, the US reached a tipping point at which investments in financial capital became more profitable than investments in the real economy. At this moment, the US was able to escape a crisis through the international credit system. International financial capital poured in to finance the different asset bubbles, through which the US economy was able to extend its growth and the US incumbent capitalist center could revive temporarily.

However, this neoliberal form of expansion brings growing imbalances that will in the end lead to a crash. In order to prevent overproduction, debt had to increase constantly in order to continue from one expansion to the next. At some point debt expansion may not be possible which may lead to a severe systemic crisis that can give rise to a shift to a different institutional structure (Kotz 2008, pp. 175-176). Also the housing bubble had to deflate at some point, which put a lot of households in severe financial problems. The increasingly fragile financial sector could not survive the burst of the housing bubble. The size of the housing bubble was so massive in order to make a new expansion (after several in previous decades) in the 2000s possible, that its collapse would bring the neoliberal era to a close, according to Kotz (2009, p. 315). He states: “We are witnessing a crisis of the neoliberal form of capitalism. The ability of that form of capitalism to promote expansion of output and profits appears to have reached its end” (Kotz 2009, p. 315). According to Arrighi’s theoretical framework, this crisis can be seen as a moment of fundamental reorganization which will eventually lead to the destruction of the social framework, which the US incumbent capitalist center has advocated since the 1980s.

To summarize, despite stagnant wages and high profits, the US economy was still able to grow because of the emergence of asset bubbles and the expansion of various forms of debt. However, this alternative force that made the US economy grow, was made possible through new developments on financial markets. The next section will address the process of financialization that took shape from the 1970s onwards.

## ***5.2 Financialization***

The past few decades have witnessed a rise in investment in financial intangible assets in unison with a slowdown of accumulation of real production assets. Financial capital has become more dominant

than the real economy (see for example Stockhammer 2004, Krippner 2005, Boyer 2000). The nationally organized and controlled financial system of the post-war period, which centered on commercial banking, was replaced by one that is self-regulated and globalized, and that centered on investment banking. Some economists, political scientists and also activists have argued that financial investment is gradually replacing physical investment (Stockhammer 2004, p. 719). Although this might be somewhat overstated, the dominance of financial capital cannot be denied, especially in the wake of the current global economic crises. As Tabb states: “the new regime is driven by finance” (2007, p. 2). This process is called ‘financialization’, referring “to the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies” (Epstein 2006, p. 3). Krippner (2005, p. 174) defines financialization as: “a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production”. As the first definition focuses on the dominance of financial markets, actors and institutions in the economy, the second definition emphasizes the increased importance of finances in the accumulation process. Although from different perspectives, both definitions pinpoint at the growing weight of financial activities vis-à-vis real economic production. This financialization process, which is the result of a combination of deregulation, globalization, and computerization, has transformed the financial system in fundamental ways. The emergence and proliferation of different funds – pension funds, mutual funds, hedge funds and private equity funds – engendered the changes in the financial market (Krippner 2005, p. 175).

More concrete, when studying financialization in the US, astonishing trends are shown by Krippner (2005) for the period 1950-2001. Krippner uses two indicators to describe the process of financialization. The first is the share of revenues coming from financial relative to non-financial sources of income in non-financial firms. Krippner shows that this ratio is stable in the 1950s and 1960s, but begins to increase in the 1970s. The ratio continues to rise sharply in the 1980s where the ratio is five times the level it reached in the immediate post-war decades. Manufacturing firms in particular faced serious problems in the 1970s because of increased labor militancy, intensified international competition and declining profitability (Krippner 2005, p. 182). Therefore these firms relied to a greater extent on financial sources of income. But even after something of a recovery in the manufacturing sector after its bad performance in the 1970s, the sector continues to lead the trend in the ‘portfolio income measure’ (that is the income from financial sources) through 2001. This reflects the trend that manufacturing companies increasingly depend on financial revenues to compensate for losses in profits from productive enterprise. Thus, in the financialization process, not only financial market actors had the leading role, also real production firms increasingly relied on financialization as a profitable source of income. The second indicator Krippner uses to describe the process of financialization is comparing the profits generated in financial and non-financial sectors of the economy. The ratio of profits in financial relative to non-financial firms is relatively stable in the 1950s and 1960s but rises gradually in the 1970s, followed by a sharp increase in the 1980s. At the

end of the 1990s and the beginning of the new century, the ratio is approximately three to five times the level of the 1950s and 1960s (Krippner 2005, pp. 182-188).

Overall Krippner's study has shown that the US economy is relying more and more on financial activities instead of real production activities. This was also explained and empirically shown in the theory chapter (chapter 3) and the previous section (section 5.1) where it was argued that when profits and wages stagnated, the US still showed impressive growth rates in the last few decades. These growth rates were made possible because of the emergence of asset bubbles and the rapid expansion of various forms of debt. It is important to emphasize that financialization, within the scope of neoliberal capitalism, paved the way for the growth path the US has experienced the last few decades. With the help of neoliberal capitalism and the process of financialization, the US was able to escape a systemic crisis, which would otherwise already have occurred in the 1970s and 1980s and by which it was able to revive its incumbent capitalist center and to prolong it with a couple of decades.

So far the importance of neoliberalism and financialization for growth of the US economy were analyzed. The next section will discuss the situation of China. Emerging countries, like China, who had major current account surpluses have facilitated the rising US debt levels. This is where the foundation of the complex relationship between the US and China lies.

### ***5.3 The accumulation of China's foreign exchange reserves***

In order to understand the upcoming of the CIC, it is needed to analyze the development of China's economy and especially the increase of its foreign exchange reserves. In late 1978, China launched its reform and opening-up policy. The country's economic development since then is important for explaining China's major accumulation of foreign exchange reserves. Zheng and Yi (2007) show that China has accumulated its foreign exchange reserves in five main phases since the 1978 economic reforms.

In the first phase (1978-1988), new policy incentives were taken and initial steps of economic growth were seen. The amount of foreign exchange reserves accumulated slowly but steady in this period. When the reforms began, the reserves were minimal but sufficient for a country with a small amount of imports. The reserves rose in the early 1980s because of a growth in exports, and peaked at USD 17.4 billion in 1984 (Zheng and Yi 2007, p. 16). In 1985 and 1986, the reserves decreased because of high trade deficits in those years. In 1987 reserves were pushed up again to USD 16.3 billion, caused by a surplus on trade in services and a large net capital inflow. The following two years, the reserves were held above this level (Zheng and Yi 2007, p. 16).

Between 1989-1991 (the second phase), China's foreign exchange reserves rose moderately, associated with an economic slowdown under unfavorable external circumstances. In 1989, the year of China's government's crackdown on the pro-democracy movement, the economic recession produced a sharp decrease in imports and exports even more, which produced a trade deficit of USD 6.6 billion.

In 1990 and 1991, the reserves accumulated again, caused by huge cuts in government spending, lower imports because of import bans, and rising exports. These developments pushed the current account balance back into surplus (Zheng and Yi 2007, pp. 16-17).

The third phase (1992-1996) was a period in which foreign exchange reserves accumulated rapidly, but steady. This was related to the economic takeoff in 1992, when the late Deng Xiaoping called for rapid economic reform. Imports rose faster than exports as a result of increasing economic growth, by which reserves were gradually eroded. In 1993, the current account balance was in deficit. However, major increases in foreign direct investment (FDI) flows compensated for the current account deficit and kept foreign exchange reserves increasing. For the rest of the period, the current account remained in surplus and the reserves were growing very fast (Zheng and Yi 2007, p. 17).

During the fourth phase (1997-1999) the accumulation of reserves stagnated related to economic recovery after the 1997 East Asian crisis. Trade surpluses and FDI inflows remained steady for the following three years. Therefore China's foreign exchange reserves remained at a high but static level of USD 145 billion (Zheng and Yi 2007, p. 17).

Between 2000-2005 (the fifth phase), reserves increased dramatically which was a result of high economic growth. In 2001, China joined the World Trade Organization (WTO) which on the one hand led to a rapid growth in imports, which eroded part of the trade surplus, but on the other hand to an increase in FDI, which helped push up the reserves. In the period 2002-2003, FDI inflows were over USD 50 billion a year. In 2003 and after, it was expected that the Chinese currency would be revalued, which caused huge speculative capital inflows, pushing China's reserves to a record level. In 2004 and 2005, the reserves grew with USD 200 billion a year and reached a level of USD 818.9 billion at the end of 2005 (Zheng and Yi 2007, pp. 17-18).

In February 2006, China's reserves increased to USD 853.7 billion against Japan's USD 850.1 billion (Zheng and Yi 2007, p. 15). At that moment China surpassed Japan to become the world's largest holder of foreign exchange. However, this just seemed the beginning, as China's reserves have reached USD 3,201.7 billion in September 2011 (Chinability Net 2011).

The underlying trends in China's surplus money piling up were its economic development strategies, which were very export-oriented (Zheng and Yi 2007, p. 18). In 2009 China's exports contributed over 30 percent in terms of value added to output growth, which was only 15 percent in the 1990s (Guo and N'Diaye 2009, p. 4). Exports have thus grown rapidly in the past two decades, on average 18.5 percent since the end of the 1990s (ibid.). This has led to a substantial expansion in China's global market share, which increased from only 3.5 percent of world goods exports in 1999 to 9.3 percent in 2008 (Guo and N'Diaye 2009, pp. 4-5).

China's development strategies were very export-oriented over the past few decades, but, according to Arrighi, China's economic rise was also made possible by the fusion of the Asian labor-intensive path of economic development with the Western capital-intensive, foreign-trade-based path. From the 1980s onwards, China moved towards the development of industries with different degrees



of labor and capital intensity, while holding on to its East Asian tradition of greater utilization of human than non-human resources. It was thus not only government policies that stimulated exports and economic growth, but also the development of China's capitalist structure which made these export-oriented policies work.

With the large amount of foreign exchange reserves, currency and interest risk were excessive. By the end of 2005, the People's Bank of China (PBC) warned the Chinese government that piling up such a large amount of foreign exchange reserves in US securities makes China very vulnerable to a devaluation of the US dollar (Cognato 2008, p. 13). Also, most of the reserves were held in US Treasury and Agency bonds, which were very liquid, meaning they are easy to sell off, and safe, but provide relatively low returns. So besides the currency risk, these low yield treasury bonds also have very high opportunity costs. It has been estimated that the returns that China earned on its reserves between 2003 and 2006 ranged between 2% and 4%, which was at the time of the height of the financialization process not a very efficient use of capital (Cognato 2008, p. 13). In 2006, a broad consensus among academics in China had emerged that a more proactive investment policy had to be established in order to protect the value of China's reserves (*ibid.*, p. 14). Investments in financial markets provided a much more lucrative way to receive higher returns, even though they were more risky than for example US Treasury Bonds. But at the same time, Chinese officials realized that it was also risky to be too dependent on US Treasury Bonds. The choice to go for more riskier investments has been highly politicized in China. The Chinese strategy was therefore to diversify its investments as means to have on the one hand, higher yields, and on the other hand, to spread risks. After several years of debate in Chinese think tanks and ministries, the CIC was established in September 2007 (Cognato 2008, p. 13).

After the establishment of the CIC, the National People's Congress in China authorized the Ministry of Finance to issue up to 1.55 trillion yuan (USD 200 billion) in special treasury bonds to provide the CIC with capital to purchase foreign exchange from China's central bank, the PBC. Transferring foreign exchange reserves to SWFs made it possible to move investments away from exclusively US treasury bonds to higher yield investments diversified among several currencies, which made China less dependent on the US dollar. Another welcome consequence was that some excess liquidity in China's money markets could be soaked up and inflationary pressures could be countered (Reisen 2008, p. 8 and Xu 2010, pp. 7-9, Cognato 2008, pp. 12-14).

The CIC was made directly accountable to the Chinese State Council. With prices for oil and other resources reaching new record levels and therefore were not the best option to invest in at that time, investments in financial markets were seen as the most lucrative option. Around USD 110 billion of the fund's capital was invested in the domestic financial sector in China (Cognato 2008, p. 21). The remaining USD 90 billion was channeled to international financial markets (*ibid.*). The first international investments the CIC made, were high-profile stakes in the US financial market, namely USD 3 billion (a 9,4% share) in Blackstone and \$5 billion (a 9,9% share) in Morgan Stanley (*ibid.*).

These investments were made at the very start of the US subprime crisis, in May and December 2007 respectively. Both investment came as a surprise to the market and the Morgan Stanley investment even surprised CIC's own staff (Cognato 2008, p. 21). Astonishment came also from within China, because the Blackstone investment lost nearly half of its value since 2007 (Overbeek 2011, p. 213). Another USD 3,2 billion (an 80% share) has been dedicated to the US private equity fund JC Flowers in April 2008 (Overbeek 2011, p. 213). The CIC has also taken stakes worth USD 100 million in Visa in early 2008 (Cognato 2008, p. 23). The market value of these investments, mainly of Blackstone and Morgan Stanley, fell dramatically in 2007 and 2008 which led to a lot of criticism back home (Overbeek 2011, p. 213). Senior officials in China expressed their worries over CIC's focus on the quickly weakening US financial sector and CIC's ability to pay interest to the central bank. Some Chinese thought that going overseas was a wrong investment decision and could not understand why the CIC used hard-earned foreign Chinese reserves to support US financial firms, especially at a time when China's own stock market was in near free-fall (*The Economist*, 2008, September 20). Since the establishment of the CIC, the fund was able to diversify somewhat away from US assets, but it remained significantly involved in US financial companies (Cognato 2008, pp. 14-28, Overbeek 2011, pp. 213-214).

There are two main explanations why the CIC kept investing in the US and not more in China. First, China's foreign exchange reserves are for a large part dollar reserves. A fall in the dollar would shrink China's reserves tremendously. Second, China relies heavily on exports to the US. The US is China's largest export destination with an export volume of USD 364,9 billion in 2010, which accounts for approximately 23 percent of total Chinese exports (see website US-China Business Council). For these two reasons it was of utmost importance to China to keep the US economy growing. The Chinese government found itself in a dilemma of on the one hand wanting to diversify investments away from dollar denominated assets, because of interest and exchange rates risks, and on the other hand not diversifying away too much, because of China's reliance on the US economy and the importance of the value of the dollar for its reserves. The next section will dive deeper into these issues by analyzing the mutually assured destruction between the US and China.

#### ***5.4 US-China mutually assured destruction***

In order to shed more light on the CIC's preference for the US financial market to invest in, the complex US-China relationship, referred to as 'Chimerica' by Niall Ferguson (2008), has to be elaborated further. About the mutually assured destruction between the US and China he says: "Welcome to the wonderful dual country of 'Chimerica'... For a time it seemed like a marriage made in heaven" (p. 336). Ferguson hints at the extensive economic interdependence between the two countries which to prosper need each other and both perform different tasks within this dual country. "The East Chimericans did the saving. The West Chimericans did the spending. Chinese imports kept

down US inflation. Chinese savings kept down US interest rates. Chinese labor kept down US wage costs” (p. 336).

China is the largest foreign holder of US Treasury securities. Because of the high US debt, some financial market actors and analysts have welcomed Chinese money. Like this the Federal government could fund its budget deficit and help to keep US interest rates relatively low. Others were concerned that China’s large holdings of US debt could give it significant leverage over the US on major bilateral political and economic issues. The Chinese government could for example threaten to sell off a large share of its dollar holdings, which could have a number of significant consequences for the US economy. If China decided to turn away from the dollar, the US would be forced to be more prudent in printing, borrowing and spending dollars (Overbeek 2011, p. 206). Chinese officials, in contrast, expressed concerns over the safety of their US debt holdings, because of the possibility of a big devaluation of the US dollar. As previously mentioned, the Chinese regime was confronted with a dilemma on how it could reduce China’s exposure to the US dollar without driving down the dollar by which the value of the remaining dollar reserves would decrease (Overbeek 2011, p. 207). This dilemma puts China in a “hostage situation”, according to Cognato (2008, p. 13) whereby the size of the reserves forces China to maintain the policies that cause the reserves to continue to grow. The fear of a dollar depreciation and the decrease of the value of Chinese reserves, is not the only reason for China to continue to invest in US securities. China is willing to finance US deficit spending because of its dependence on exports to the US and thus its own economic growth and stability. With the US absorbing about 20 percent of China’s total exports, it is of great importance for the Chinese that the US economy is stable and growing (Morrison 2010, p. 13-15, Xu 2009, pp. 12-13).

Another important aspect of the two countries’ complex relationship is China’s exchange rate policy while running an excess of savings over investment. China subsidizes exports via an exchange rate pegged to the dollar, which induces higher trade surpluses with yet more dollars pouring in. The People’s bank of China has to buy these dollars to prevent the Chinese currency from appreciating. (The Chinese invest these dollars by buying US Treasury securities in the world’s most liquid bond market.) This floods China with renminbi which then have to be sterilized through the sale of bonds in order to prevent inflationary pressures. In order to do this, China’s central bank, the PBC, issues short-term sterilization bonds that pay over 4% (Cognato 2008, p. 13). On the other hand, the return on new issues of US treasuries is around 3,5%. The net effect is that the PBC must run a loss to sustain China’s monetary policy. When this process continues, resisting inflation through sterilization becomes harder and harder, because of these huge losses which risk to be politically damaging for the Chinese government (Cognato 2008, pp. 12-13).

With these economic imbalances it can be said that the US and China find themselves in a deadly embrace, or mutually assured destruction in which both the US and Chinese governments have big stakes. As Overbeek (2011, p. 206) has put it: “such interdependence implies a strong *dependence* on both sides”. According to Jacques (2009, p. 360), the mutually assured destruction between the US

and China is “neither economically nor politically sustainable in the longer run”. Also Ferguson (2008, p. 338) explains that “this happy marriage will probably not last forever”. The more China was willing to lend to the US, the more the US was willing to borrow. Ferguson shows how the existence of Chimerica is related to the increase in bank lending, bond issuance and new derivatives and the explosion in the number of hedge funds after 2000 (in other words, the process of financialization which was analyzed in section 5.2). However, the rise of hedge funds was only part of the story of the, what Ferguson calls, post-1998 reorientation of global finance. He argues that the growth of SWFs was even more important, especially in the wake of the financial and economic crisis in which SWFs invested huge sums of money in Western financial companies. “For a time it seemed as if the SWFs might orchestrate a global bail-out of Western finance; the ultimate role reversal in financial history” (p. 338).

The deadly embrace between the US and China shows that these two countries are much more intertwined than Venice, Holland, England and the US ever were. China can therefore not simply be added to the sequence of historical cycles of capital accumulation. This is mainly due to US capital not escaping stagnation through migration to a larger container elsewhere in the world when it entered the high level equilibrium trap, but escaping stagnation through accumulating debt and the creation of asset bubbles. This made the world look upside down, since large sums of money were flowing from upcoming China, a potential new capitalist center, towards the US, the incumbent capitalist center, instead of the other way around as the sequence of capitalist cycles would predict. On the other hand, although China would not follow the sequence of Venice, Holland, England and the US perfectly, Arrighi’s framework is still able to uncover several interesting insights on China’s rise and the seemingly demise of the US. Arrighi is very convinced that it is now the autumn of US hegemony and we are entering the Asian era, with possibly China as the new incumbent capitalist center. The new Asian cycle of capital accumulation would be also historically connected to the previous cycle, because the Asian cycle would be born in the current American cycle, since China would not have been able to accomplish such a tremendous growth if it had not exported such a large amount to the US. Arrighi claims furthermore that China’s hegemonic power will be of a different kind than US power, because of the fusion of the Asian and the Western path of capital accumulation. It is mere speculation whether an Asian cycle will be truly different from the US cycle or whether and how the new incumbent capitalist center will change the international structure and will promote a different social framework. If it does, SWFs and governments becoming important financial players on the globe could be a first indication of such a new social framework.

To recapitulate, the phenomenon of the rise of the CIC in the US financial market was described and embedded in the broader situation of the US-China relationship. Before understanding the US-China deadly embrace, the situation of both the US, marked by neoliberalism en financialization, and China, marked by trade surpluses and foreign exchange reserves, were analyzed. As already discussed, the Chinese government found itself in a dilemma of diversifying investments

away from the dollar on the one hand, but on the other hand China's reliance on the dollar. The neoliberal capitalist structure in the US seemed to be a very convenient environment to invest in. Economic growth in the US was financed with debt, since debt could compensate for the situation of overproduction, caused by stagnated wages and high profits. In order for the US economy to keep growing, more debt was needed. China's huge amount of foreign exchange reserves provided for a major part for US debts. As long as this neoliberal capitalist structure endured, it remained profitable for the CIC to invest in US financial markets. Besides that, China had serious interests in keeping the US economy growing, because of its own export position and the value of its reserves. It could be said that in order to maintain the Chinese economy successful and growing, the US economy needed to be kept alive with Chinese money.

## 6. Conclusion

This thesis started out with the observation that in 2007 and 2008 the CIC made huge investments in the US financial market that caught a lot of attention from media, politicians, investors and analysts. The CIC, and SWFs in general, have become highly politicized because they are under the direct control of the governments, are not transparent and therefore it is not clear whether their motives are purely financial gain oriented or also political in terms of strategic geopolitical goals. Therefore this thesis aimed to find an explanation, or a broader understanding at the least, for the role of the CIC in the US financial market by answering the following research question: *How can we best explain the role of the CIC in the deadly embrace between the US and China?*

In order to arrive at an explanation for the role of the CIC, it was needed to identify the structures, powers and tendencies that underlie the phenomenon at hand. Therefore a model was developed that could reveal a deeper layer to get a better understanding of the phenomenon. This model was able to provide theoretical concepts, that helped us to return to the observed phenomenon, but this time not as the chaotic conception of a whole, but as the view of the totality, enriched with understanding of the underlying structure.

The model concerned was based on Arrighi's theoretical framework that builds on several historical cycles in the development of capitalism of which each ends in a crisis, leading to a new cycle. Arrighi is able to explain the rise of China and how China will become the new incumbent capitalist center of the world. He also emphasizes the role of financialization, with which he explains that capitalist centers that are in a crisis and in which investors have no profitable opportunities to invest in anymore, and who therefore move their investments to the future capitalist center that has a lot of potential to grow. Arrighi however is not able to explain why huge sums of capital move from China, the possible future capitalist center of the world, to the US, which is the current capitalist center facing a crisis. Additional conceptualizations were needed. First, Ferguson's notion of Chimerica was very useful in order to show that the relationship between the US and China is very different from the relationship between Venice and Holland, Holland and England, and England and the US in previous centuries. Second, Kotz adds valuable insights by analyzing how the US was able to extend its growth despite stagnating wages by the emergence of bubbles and the expansion of various forms of debt. The need to finance these bubbles and debt in order for the US economy to keep growing, explained the huge flows of capital from China to the US. With these theoretical concepts we were able to move back to the phenomenon and provide a deeper understanding of the underlying structure.

To be able to give an explanation for the US-China mutually assured destruction and the role of the CIC within, first the US situation was outlined. Already during the 1980s, the US faced stagnant wages and increasing profits due to the neoliberal capitalist structure that became dominant at that time. This situation created overproduction relative to demand and diminished economic growth. The US was however able to escape declining growth rates through the expansion of asset bubbles and

various forms of debt. This way consumption and investment levels were maintained, despite stagnant wages. An important factor that contributed to the emergence of asset bubbles and the expansion of debts in the US was the process of financialization. It was shown that in the last few decades, the US economy relies more and more on financial activities instead of production activities and in which new financial instruments and new types of investment funds were developed. We could say that within the scope of neoliberal capitalism, financialization paved the way for the growth path the US has experienced last couple of decades.

The Chinese situation was characterized by high trade surpluses and large foreign exchange reserves. The Chinese government faced a dilemma on how to handle these reserves. On the one hand the Chinese wanted to diversify investments away from dollar denominated assets, because of interest and exchange rate risks. On the other hand they did not want to diversify away too much, because of China's reliance on the US economy and the importance of the value of the dollar for its reserves. The CIC was established in order to neutralize part of the interest rate risk, by moving to assets that received higher returns, and the currency risk, by moving partly away from dollar denominated assets. With the establishment of the CIC, the Chinese were able to diversify somewhat away from US assets, but remained significantly involved in US financial companies. The deadly embrace situation between the US and China provided an explanation for this. The US and China, or Chimerica, find themselves in a complex and highly interdependent relationship. It is hard for both countries to keep Chimerica up and running. US debts keep rising and the costs for China to remain its exchange rate policies keep increasing, which can both not continue endlessly. But quitting on Chimerica seems impossible and would for both countries have dramatic consequences; it might throw both economies into a deep depression. So there is one very important reason for the Chinese not to diversify away a major part of their investments from dollar denominated assets; in order to maintain the Chinese economy successful and growing, the US economy needs to be kept alive with Chinese money.

To put it differently, the existence of Chimerica, or the post-1998 reorientation of global finance, as how Ferguson (2008, p. 338) sees it, resulted in, or is the underlying cause of, the growth of SWFs. Thereby Ferguson points on the role of SWFs as providing global bail-outs of Western finance, comparing SWFs with Western financial institutions, such as the World Bank and the IMF, who have bailed out countries in the periphery, although he does not mention them explicitly. Since China has the largest stock of foreign exchange reserves in the world, we could say that China has become the new banker of the world.

It is very hard to prove whether China will be the new capitalist center of the world and whether it will be truly different from the US, as Arrighi suggests. Will old institutional frameworks, like neoliberal capitalism, in the US be destroyed and will the new center establish new social frameworks, like more state-led economies in which SWFs are significant? It can be said that partly through the CIC, the Chinese government has become an important financial player. Haberly (2011, p. 21) sees SWF investments as an adaptive strategy for the state under contemporary conditions of

globalization and financialization. Monk (2010, p. 4) concludes in his paper that SWFs offer states an opportunity to regain sovereignty and authority over financial markets in the context of a highly financialized world.

Thus maybe China has become or will become in the near future the new banker of the world in which the Chinese government acts as a global financial player. However, Xu points out that while Chinese officials decided to partly move away from dollar denominated assets through its SWF, they will not challenge the position of the US as a top currency holder. Nor is China able or willing to become one of the top currency holders itself. As Xu (2009, p. 14) puts it: “even though the world is witnessing a significant shift of power relationships, changing the current institutional arrangement in order to give corresponding positions to those holding the credits may be too much for the top currency holder to absorb, while the creditors do not want, or know how, to take the lead”. Also the US government engaged in bilateral negotiations with Singapore and Dubai and settled on a set of principles for SWFs, which are no different from current regulations on foreign investment. This shows, however, that despite its changing position in the international economy, the US government has not changed its behavior. The US “still insists on the game being played according to its rules; it has to be in the driver’s seat in designing the future rules” (Xu 2009, p. 18). Thus, it seems that the US is not ready or willing to give up its role as the incumbent capitalist center in the world, nor is China able or willing to take up the role as a new leading center. It will be interesting to see how long these relations will continue to last.

The methodology used in this thesis was inspired by the process of retrodution, meaning starting out with an observed phenomenon, uncovering underlying structures and moving to ever more simple concepts, with which to return to the phenomenon but now with a deeper and more enriched understanding. The important question here is how deep we have to dig to find explanations for the observed phenomenon? How many structural layers have to be uncovered? How much more retrodution is necessary? By uncovering too many layers, moving too far away from the observed phenomenon might be a problem. There should always be a close connection with the phenomenon at hand in order to arrive at accurate explanations.

The aim of this thesis was to provide insights on the role of the CIC by placing it in a broader perspective and uncovering underlying structures that contributed to explanations. The theories used were very structural in nature, thereby leaving the role of agents underexposed. An attempt was made to analyze the role of agents, such as political officials, central bankers and financial agents. For the purpose of this thesis however, there was not enough detailed information available on the relevant agents and their actions. Also more work could have been done on the role of the media, especially when it concerned the CIC making huge investments in US financial institutions. If the media had not jumped on the subject, SWFs would possibly not have become so infamous. Future research should therefore focus more on political agency.



## References

- Aizenman, J. and R. Glick (2009), "Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance", *International Finance*, 12(3):351-386.
- Altbach E.G. (2008), "Understanding China's New Sovereign Wealth Fund", *NBR Analysis*, 19(1):3-8.
- Apeldoorn, B. van, N. de Graaff and H. Overbeek (2010), "Global Crisis and the Rise of Statist Capitalism", Paper for presentation at ISA Annual Conference 2010, New Orleans, Louisiana, USA, Panel FD24, 19 February 2010.
- Arrighi, G. (2007), *Adam Smith in Beijing: Lineages of the Twenty-First Century*, London: Verso.
- Bair, J. (2009), "The New Hegemon? Contingency and Agency in the Asian Age", *American Sociological Association*, 15(2):220-227.
- Baldwin, D.A. (1985), *Economic Statecraft*, Princeton: Princeton University Press.
- Barnett M. (2011), "Social Constructivism", in J. Baylis et al. (eds.), *The Globalization of World Politics: An Introduction to International Relations*, Oxford: Oxford University Press, Fifth Edition, 148-165.
- Beck R. and M. Fidora (2009), "Sovereign Wealth Funds – Before and Since the Crisis", *European Business Organization Law Review*, 10:353-367.
- Bello, W. (2006), "The Capitalist Conjuncture: Over-Accumulation, Financial Crises, and the Retreat From Globalisation", *Third World Quarterly*, 27(8):1345-1367.
- Bhushan, A., R. Culpeper, J. Foster, and P. Heidrich (2009), "Policy Response to Unfettered Finance and the Reshaping of the Global Economy", *The North-South Institute*, Working Paper, February, 1-38,  
<https://www.nsi-ins.ca/english/pdf/PRUF%20NSI%20finalcopy%20jan%2009.pdf>.
- Bieler A. and A.D. Morton (2008), "The Deficits of Discourse in IPE: Turning Base Metal into Gold?", *International Studies Quarterly*, 52(4):103-128.

- Bradsher K. (2007), "Morgan Investment Marks Shift for China Fund," *New York Times*, Dealbook web log, December 19, <http://dealbook.blogs.nytimes.com/2007/12/19/morgan-investment-marks-shift-for-china-fund/>.
- Bremmer, I. (2009), "State Capitalism and the Crisis", *McKinsey Quarterly*, July, 1-6.
- Boyer, R. (2000), "Is a Finance-led Growth Regime a Viable Alternative to Fordism: A Preliminary Analysis", *Economy and Society*, 29(1):111-145.
- Bowles, S., D. M. Gordon, and T. E. Weisskopf (1984), *Beyond the wasteland: A democratic alternative to economic decline*, Garden City, NY: Anchor/Doubleday.
- Butt, S., A. Shivdasani, C. Stendevat, A. Wyman (2008), "Sovereign Wealth Funds: A Growing Global Force in Corporate Finance", *Journal of Applied Corporate Finance*, 20(1):73-83.
- CBS (2008), "Interview with Mr. Gao Xiping, President of CIC", *60 Minutes*, April 8, <http://www.cbsnews.com/stories/2008/04/04/60minutes/main3993933.shtml>.
- Chinability Net, <http://www.chinability.com/reserves>, December 23, 2011.
- Cognato, M.H. (2008), "Understanding China's New Sovereign Wealth Fund", *NBR Analysis*, 19(1):9-36.
- Crotty J. (2006), "The Neoliberal Paradox: The Impact of Destructive Product Market Competition and 'Modern' Financial Markets on Nonfinancial Corporation Performance in the Neoliberal Area", in G.A. Epstein (ed.), *Financialization and the World Economy*, Cheltenham and Northampton: Edward Elgar, 77-110.
- Das, D.K. (2008), "Sovereign-wealth Funds: A New Role for the Emerging Market Economies in the World of Global Finance", *International Journal of Development Issues*, 7(2):80-96.
- Dockes, P. (2009), "Sovereign Wealth Funds and Emerging Imperialism", *Revue d'Économie Financière*, Special Issue, 25-35.
- Drezner, D.W. (2008), "BRIC by BRIC: The Emergent Regime for Sovereign Wealth Funds", Prepared for the Princeton summer workshop on Rising States and Rising Institutions, 1-26, <http://danieldrezner.com/research/swf1.pdf>.

- Drezner, D.W. (2009), "Bad Debts: Assessing China's Financial Influence in Great Power Politics", *International Security*, 34(2):7-45.
- Dow, S.C. (1997), "Methodological pluralism and pluralism of method", in A. Salanti and E. Screpanti (eds.) *Pluralism in Economics*, Cheltenham: Edward Elgar Publishing, 89-99.
- Dunne T. and B.C. Schmidt (2011), "Realism", in J. Baylis et al. (eds.), *The Globalization of World Politics: An Introduction to International Relations*, Oxford: Oxford University Press, Fifth Edition, 84-99.
- The Economic Observer Online* (2008), "Day of Reckoning for China's Sovereign Fund", January 31, [http://www.eeo.com.cn/ens/finance\\_investment/2008/01/31/92109\\_1.html](http://www.eeo.com.cn/ens/finance_investment/2008/01/31/92109_1.html).
- The Economist* (2008), "A Bigger World: A Special Report on Globalisation", September 20.
- Epstein, G.A. (2006), "Introduction: Financialisation and the World Economy", in G.A. Epstein (ed.), *Financialization and the World Economy*, Cheltenham and Northampton: Edward Elgar, 3-16.
- Ferguson, N. (2008), *The Ascent of Money: A Financial History of the World*, London: Penguin Books.
- Fierke K.M. (2007), "Constructivism", in T. Dunne et al. (eds.), *International Relations Theory: Discipline and Diversity*, New York: Oxford University Press, 166-184.
- Financial Times* (2007), "China to Take \$3bn Gamble on Blackstone", May 18.
- Financial Times* (2007), "Wealth to Spare", November 28.
- Financial Times* (2011), "Sovereign Wealth Funds Make Presence Felt", February 20.
- Financial Times* (2011), "Sovereign Wealth Fund Assets Rise to \$4,000bn", March 8.
- Financial Times* (2011), "The US-China Affair is Likely to Result in Mutual Pain", March 9.
- Financial Times* (2011), "US Debt Crunch: A Nation Taken to the Limit", July 14.

- Fini, M. (2010), "Hang in there, Baby: Sovereign Wealth Funds and Implications for Domestic Governance", Working Draft, 1-43.
- Glaser C.L. (2003), "The Natural and Necessary Evolution of Structural Realism", in J.A. Vasquez and C. Elman (eds.) *Realism and the Balancing of Power: A New Debate*, New Jersey: Prentice Hall, pp. 266-280.
- Guo, K. and P. N'Diaye (2009), "Is China's Export-Oriented Growth Sustainable?", *IMF Working Paper*, No. 09/172, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1478104](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1478104).
- Guttman R. (2008), "A Primer on Finance-Led Capitalism and Its Crisis", *Revue de la Régulation*, 3/4:1-19, <http://regulation.revues.org/document5843.html>.
- Haberly, D. (Forthcoming), "Strategic Sovereign Wealth Fund Investment and the New Alliance Capitalism: A Network Mapping Investigation", *Environment and Planning*, 1-30, <http://ssrn.com/abstract=1751590>.
- Harris, J. (2009), "Statist Globalization in China, Russia and the Gulf States", *Science and Society*, 73(1):6-33.
- Harvey, D. (2006), *The Limits to Capital*, London and New York: Verso.
- Helleiner, E. (2009), "The Geopolitics of Sovereign Wealth Funds: An Introduction", *Geopolitics*, 14(2):300-304.
- Hobden S. and R.W. Jones (2011), "Marxist Theories of International Relations", in J. Baylis et al. (eds.), *The Globalization of World Politics: An Introduction to International Relations*, Oxford: Oxford University Press, Fifth Edition, 130-146.
- Hung, H. (2008), "Rise of China and the Global Overaccumulation Crisis", *Review of International Political Economy*, 15(2):149-179.
- Jaeger, M. (2010), "BRIC Sovereign Wealth Funds: The External Wealth of Governments", *Deutsche Bank Research*, September 24, 1-6, [http://www.dbresearch.com/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000262808.pdf](http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000262808.pdf).

- Keohane, R.O. (1984), *After Hegemony: Cooperation and Discord in the World Political Economy*, Princeton, New York: Princeton University Press.
- Kotz, D.M. (2008), “Contradictions of Economic Growth in the Neoliberal Era: Accumulation and Crisis in the Contemporary U.S. Economy”, *Review of Radical Political Economics*, 40(2):174-188.
- Kotz D.M. (2009), “The Financial and Economic Crisis of 2008: A Systemic Crisis of Neoliberal Capitalism”, *Review of Radical Political Economics*, 41(3):305-317.
- Krasner, S.D. (1983), *International Regimes*, Ithaca, New York: Cornell University Press.
- Kratochwil, F. and Ruggie, J.R. (1986), “International Organization: A State of the Art or an Art of the State”, *International Organization*, 40(4):753-775.
- Krippner, G.R. (2005), “The Financialization of the American Economy”, *Socio-Economic Review*, 3: 173-208.
- Kuo, M.A. (2009), “The Strategic Impact of Islamic Finance: Inter-Linkages between Asia and the Middle East”, *Asia Analytica LLC*. Portions of this paper were adapted from the author’s article, “Islamic Finance in Southeast Asia: Strategic Context and Trends”, *Journal of Islamic Economics, Banking and Finance*, September-December 2009.
- Kurki M. and C. Wight (2007), “International Relations and Social Science”, in T. Dunne et al. (eds.), *International Relations Theory: Discipline and Diversity*, New York: Oxford University Press, 13-33.
- Lamy, S.L. (2011), “Contemporary Mainstream Approaches: Neorealism and Neoliberalism”, in J. Baylis et al. (eds.), *The Globalization of World Politics: An Introduction to International Relations*, Oxford: Oxford University Press, Fifth Edition, 114-129.
- Layne, C. (2008), “China’s Challenge to US Hegemony”, *Current History*, January, 13-18.
- Lyons, G. (2007), *State Capitalism: The Rise of Sovereign Wealth Funds*, Standard Chartered Bank, Global Research (available at [http://banking.senate.gov/public/\\_files/111407\\_Lyons.pdf](http://banking.senate.gov/public/_files/111407_Lyons.pdf), last accessed 25 October 2010).

- Martin L.L. (2007), "Neoliberalism", in T. Dunne et al. (eds.), *International Relations Theory: Discipline and Diversity*, New York: Oxford University Press, 109-126.
- Mearsheimer, J.J. (2001), *The Tragedy of Great Power Politics*, New York: Norton.
- Mearsheimer, J.J. (2007), "Structural Realism", in T. Dunne et al. (eds.), *International Relations Theory: Discipline and Diversity*, New York: Oxford University Press, pp. 71-88.
- Mishkin, F.S. (2004), *The Economics of Money, Banking, and Financial Markets*, Boston: Pearson, Seventh Edition.
- Monk, A.H.B. (2010), "Sovereignty in the Era of Global Capitalism: The Rise of Sovereign Wealth Funds and the Power of Finance", *SSRN Working Paper Series*, 1-42, <http://ssrn.com/abstract=1587327>.
- Morrison W.M. (2010), "China-U.S. Trade Issues", *Congressional Research Service*, Report for Congress, <http://handle.dtic.mil/100.2/ADA523596>.
- Overbeek, H. (2011), "Sovereign Wealth Funds in the Global Political Economy: The Case of China", in H. Overbeek and B. van Apeldoorn (eds.) *Neoliberalism in Crisis*, Palgrave Macmillan, pp. 191-223.
- Overbeek, H. (2010), "China's Sovereign Wealth Strategy and its Impact on Global Order", Paper presented to the panel *Bringing Historical Materialism Into Security Studies: Geopolitics and Class in a Changing World Order*, International Studies Association Annual Conference 2010, New Orleans, 17-20 February 2010.
- Palan R. (2000), "A World of Their Making: An Evaluation of the Constructivist Critique in International Relations", *Review of International Studies*, 26:575-598.
- Patomäki, H. and C. Wight (2000), "After postpositivism? The Promises of Critical Realism", *International Studies Quarterly*, 44(2):213-237.
- Reinsberg B. (2009), "Sovereign Wealth – No Fund: The Decisive Role of Domestic Veto Players", *Centre for International Political Economy, Berlin*, Working Paper No. 1/2009, 1-20, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1530222](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1530222).

- Reisen, H. (2008), *How To Spend It: Commodity and Non-Commodity Sovereign Wealth Funds*, Deutsche Bank Research, Research Note 28, 18 July 2008 (available at <http://www.dbresearch.com>, last accessed 1 November 2010).
- Robinson, W.I. and J. Harris (2000), "Towards a Global Ruling Class? Globalization and the Transnational Capitalist Class", *Science and Society*, 64(1):11-54.
- Rupert M. (2007), "Marxism and Critical Theory", in T. Dunne et al. (eds.), *International Relations Theory: Discipline and Diversity*, New York: Oxford University Press, 148-165.
- Schwartz, H.M. (2009), *Subprime Nation. American Power, Global Capital, and the Housing Bubble*, Ithaca: Cornell University Press.
- Spiegel Online* (2011), "Europe and Asia Set for Battle over Top IMF Post", May 17.
- Stockhammer, E. (2004), "Financialisation and the Slowdown of Accumulation", *Cambridge Journal of Economics*, 28(5):719-741.
- Sugihara, K (2003), "The East Asian Path of Economic Development: A Long-Term Perspective", in G. Arrighi, T. Hamashita, and M. Seldon (eds), *The Resurgence of East Asia: 500, 150, and 50 Year Perspectives*, London and New York: Routledge.
- SWF Institute, <http://www.swfinstitute.org/fund-rankings/>, February 9, 2011.
- Tabb W. (2007), "The Centrality of Finance", *Journal of World-Systems Research*, 13(1):1-11.
- US-China Business Council, <https://www.uschina.org/statistics/tradetable.html>, January 7, 2012.
- Van der Pijl, K. (2007) "Historical Materialism and Dialectics", *A Survey of Global Political Economy*, 219-224, available at <http://www.sussex.ac.uk/ir/1-4-7-1.html>.
- Waltz, Kenneth N. (1979), *Theory of International Politics*, Boston: Addison-Wesley Pub. Co.
- Wendt, A. (1999), *Social Theory of International Politics*, Cambridge: Cambridge University Press.
- Xu, Yi-chong (2009), "Who's Afraid of Sovereign Wealth Funds?", *Australian Journal of International Affairs*, 63(1):1-21.

Zheng, Yongnian and Jingtao Yi (2007), "China's Rapid Accumulation of Foreign Exchange Reserves and Its Policy Implications", *China & World Economy*, 15(1):14-25.