Pei notes that any society that has genuine confidence in its future is also robust enough to permit freedom of expression. Yet in China, speaking and thinking freely is getting harder rather than easier. Celebrations for the 60th anniversary of the People's Republic on 1 October went ahead with few hitches, but also few observers. Streets were closed off, as was Beijing's international airport – the whole event reminiscent of the brainwashed choreography of those endless Pyongyang parades in praise of North Korean leader Kim Il-sung.

And while the state cracks down on public dissent, it tacitly permits the dissemination of conspiracy theories that prey on deep-seated national fears. Despite its economic advances, China remains convinced the wider world secretly wants it to fail.

'If you are secure in yourself you don't dabble in conspiracy theories,' says Pei. 'In Tibet and Xinjiang [two areas that have seen ethnic upheaval in recent years] the Chinese think that foreigners stirred up the trouble. These are very serious, senior people who believe this, not just the man in the street.'

Throughout the global crisis, one book has sat at the top of the bestseller lists in China. Song Hongbing's novel *Currency Wars* is a bizarre ramble that blames a cabal of private banks, led by the Rothschild family and supported by the US Federal Reserve, for every disaster of the past 200 years, from the rise of Hitler to the current financial crisis. Song, a Chinese-born IT consultant who lives in Washington, advises Beijing to ignore pleas by Western leaders to open up the financial system and float China's currency, the yuan. That paranoia has infiltrated official thinking, notes Ha Jiming, chief economist at CICC investment bank in Beijing, who says such advice is seen at home as just another way of trying to loot China.

An ageing population will also begin to act as a drag on a country expected to grow old before it grows rich. In the 1960s, China boasted six workers for every dependent. Thanks largely to the one-child policy imposed on Chinese families in 1979, that demographic pattern will be fully reversed by 2040. By 2020, the country will be faced – amazing though this sounds for a nation of 1.3 billion – with a labour shortage. That will drastically cut the pool of savings, and thus the banking sector's ability to pump fresh capital into ailing state industries.

In short, China is a shiny red apple that, on closer inspection, turns out to be rotten within. The country is a chimera, more dependent on economic health elsewhere in the world than any other major economy, and lacking a coherent investment strategy or, despite the bluster of the Communist party, a working ideology. As Minxin Pei insists on asking, 'What is China; what is its raison d'être; and what does this giant emerging industrial powerhouse want to be?'

Having discussed this issue endlessly with senior party officials, Pei's own answer is illuminating. 'They don't want a future,' Pei believes. 'They want the present to remain as it is.' In other words, the party Chairman Mao built, and which has presided over an extraordinary transformation since his death 33 years ago, creating wealth and social stress in equal measures, has been left bloated and emasculated, bereft of ideas or ideology and faced with an uncertain economic future – and a panicky and restless populace.

How times change, indeed. ●

A hungry global giant

Chris Wright *observes the mighty appetite of China Investment Corporation, a sovereign wealth fund with $100 billion to spend*

Andrew Ross Sorkin's *Too Big To Fail*, the behind-the-scenes account of Wall Street's brush with oblivion, contains an interesting detail that tells us much about the power of Chinese money. In that lurching week in September 2008 after the collapse of Lehman Brothers, Morgan Stanley – by now looking perilously close to the edge – invited Gao Xiqing, president of the China Investment Corporation sovereign wealth fund, to New York to talk about increasing the 9.9 per cent stake it already held in the American bank to as much as 49 per cent. In those uncertain days, it looked like a deal that could save the whole bank.

Gao, lying on a couch in a Morgan Stanley conference room to ease his bad back, offered the ultimate low-ball offer for the increased stake: up to $5 billion and a credit line. Even in those dark days, the American firm was considered to be worth $40 billion, and it was a sufficiently hardcore negotiating stance to shock even that archetypal Wall Street ball-buster, Morgan Stanley chief John Mack. Sorkin says Mack was 'stunned', and anyone who's ever met the man knows that takes some doing.

In the end, the Japanese came to Morgan Stanley's rescue, and Gao took CIC's money home again. But the incident speaks volumes about how China's newly minted sovereign fund, established only in September 2007, has grown up and, after initial mistakes, is now nobody's fool.

The subtext to the stand-off with Mack is one of CIC's first ever investments: a $5.6 billion stake in Morgan Stanley in December 2007 which, by the time of that apocalyptic week nine months later, had halved in value. CIC had been similarly bruised by another

Enter the dragon
CIC owns a piece of Canary Wharf

investment, a $3 billion stake in private equity group Blackstone. CIC was far from being the only sovereign wealth fund to be battered by taking stakes in Western banks – others included Singapore's Temasek and GIC, and funds from Kuwait, Qatar and Korea – but many of those had wisely insisted on provisions that enabled them to reset their purchase prices if the firm subsequently raised equity at a lower level. CIC, new to these investments at the time, had not done so with Morgan Stanley – Gao's tough offer to Mack was an attempt to implement such a reset after the fact.

Consequently, one banker who deals closely with CIC says that, today, if he comes to them with a deal, 'The very first question I get asked is "Will it have downside protection?"'

'With Blackstone and Morgan Stanley they didn't, but they now consider a comfortable level of protection to be a key component of any new deal,' says the banker. 'They didn't have the sophistication back then and got taken for a ride. That's never going to happen again.'

CIC was not irredeemably put off American banks. Indeed, in June this year it bought a further $1.1 billion of Morgan Stanley stock and, after the rally of the last six months, it is in the money on its investments in the US bank. But there is no question that CIC has since changed its stance, in terms of the type of assets it acquires, the locations in which it buys them and the approach it takes in buying them.

Almost every recent deal CIC has taken on has been in the energy and resources area, and the bulk of them have come in frontier markets. An example came in October when CIC purchased $500 million of convertible debentures from South Gobi Energy Resources, a Mongolian coal mining and exploration company listed on Toronto's TSX Venture exchange. The debentures can convert into South Gobi common stock if the company goes ahead with an expected Hong Kong listing.

The same week came a potential $700 million investment in another Mongolian mining group, Iron Mining International, this time through a convertible loan. Then there's the $300 million, 45 per cent stake in Nobel Oil Group in Russia. Or the 11 per cent of Kazakh energy company JSC KazMunai Gas Exploration Production's global depositary receipts, acquired for $939 million in June. CIC has put $1.9 billion into the Indonesian mining group PT Bumi Resources and $858 million into the Singapore-listed commodity group Noble. In the developed world, CIC paid $1.5 billion for a stake in Canada's Teck Resources and most recently paid $1.6 billion for 15 per cent of Virginia-based power company AES, plus $571 million for a 35 per cent stake in AES's wind development business.

Somewhat surprisingly, CIC publishes an annual report – its first one came out in August – and from this, we know that by global standards it has done pretty well so far. In 2008, it made a 2.1 per cent loss in its global portfolio – relatively speaking, a standout among sovereign funds – and if we include CIC's Central Huijin subsidiary, which invests in domestic banks on behalf of the state to improve governance, the overall group generated a return on registered capital of 6.8 per cent. But in truth, CIC hasn't really demonstrated serious investment nous yet: it put just $4.8 billion into overseas assets in 2008 and by far the biggest driver of returns was the fact that by the end of the year, 87 per cent of its global portfolio was in cash.

CIC'S TOP TEN ACQUISITIONS ($M)

Blackstone:	**10%**
US, finance	3,000
AES Corp:	**16%**
US, energy	1,581
Teck Resources:	**17%**
Canada, mining	1,512
Morgan Stanley:	**4%**
US, finance	1,243
KazMunai:	**10%**
Kazakh, oil/gas	939
Noble Group:	**15%**
HK, commodities	856
AES (Wind):	**N/A**
US, energy	571
Goodman:	**N/A**
Aus, real estate	421
Songbird:	**15%**
UK, real estate	158
Nobel:	**45%**
Russia, oil/gas	100

Source: Dealogic

CIC declined to answer our detailed written questions, but its chairman, Lou Jiwei, occasionally speaks out at conferences to give the world a sense of where the fund might go next.

In October, for example, he told a Beijing audience that CIC had invested about half its $110 billion in available funds for offshore investment, mainly in publicly traded assets.

He went on to call returns 'not bad' and warned of a bubble in global asset prices, saying the fund's focus on investments in commodities and real estate – a stake in Aim-listed Songbird Estates, for example, gives it a significant interest in London's Canary Wharf – is partly a hedge against inflation and currency depreciation.

The point about the currency is key. CIC's existence stems from a sense that China's vast foreign exchange reserves – $2,273 billion as of September, according to China's State Administration of Foreign Exchange – could be earning better returns, and it was given a $200 billion chunk to form the foundation of its registered capital at launch in 2007. China's state agencies, CIC among them, are concerned about falls in the value of the US dollar, with a knock-on effect on the real value of China's reserves and the exchange rate.

But investing in energy is not just about currency hedging. Various arms of the Chinese state, from its behemoth listed oil groups (Petrochina, Sinopec and CNOOC), to unlisted state entities such as Petrochina's parent, China National Petroleum Corporation, have been buying up companies and oil fields from Sudan to Kurdish Iraq in a bid to improve China's energy security. Expect to see CIC buy into African energy assets before long.

This brings up a favourite subject among CIC-watchers: the degree to which it represents the state in its investment decisions. Lou knows it and said in October: 'The outside world is very suspicious of us, saying we have a national agenda. But our strategy is just one of long-term risk-adjusted returns. It is to make money.' Others say that of all sovereign funds, CIC fits most closely with broader national objectives in reflecting the interests of the sovereign. 'It's a part of the jigsaw,' says a senior banker who deals closely with them.

While this is hardly surprising, and entirely within China's rights, it does create a political sensitivity when CIC invests. It's a big issue, for example, for a Chinese state agency to go into Mongolia, where local people are adamant they won't see their natural resources swallowed up by Chinese or Russian interests. It is perhaps a result of this sensitivity that CIC had to get its South Gobi exposure by buying into a company listed in Toronto, and even then with a business structure that gives it a maximum 22 per cent stake if the firm went ahead with a Hong Kong listing.

Nevertheless, emerging markets present fewer complications for an asset-hungry state Chinese entity than developed nations, where attitudes towards CNOOC's tilt at Unocal and Chinalco's abortive $20 billion venture with Rio Tinto clearly demonstrate the unease Western politicians feel at Chinese ownership of their mines and oil rigs. With no need to explain the rationale of their decisions (or their ethics) to a democratic public, CIC's investments in 2010 and beyond will take it to some unloved parts of the world – and a long way from Wall Street. ●

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