

# Research on the Countermeasures for the High-Quality Development of Government Investment Funds in China

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## Abstract

It is pointed out in the report of the 20th CPC National Congress that it is necessary to build a high-level socialist market economic system, give full play to the decisive role of market in the allocation of resources, and give better play to the role of government to promote state-owned capital and state-owned enterprises to become stronger, better and bigger. Government investment funds play a key role in supporting innovation and entrepreneurship, the development of small and medium-sized enterprises, industrial transformation, upgrading and development, infrastructure and public services. This paper analyzes the development of government investment funds in China from three aspects: connotation and objectives, operation and management, supervision and performance evaluation. In combination with the plight in fund-raising, investment and management with investment and management practice, the paper puts forward some suggestions for the development of diversified sources of social capital, marketization of operation management, flexibility of system and mechanism and differentiation of supervision management on this basis.

## Keywords

China, Government Investment Fund, Fund Operation Management, Development Strategy

## 1. Introduction

Entering the new era, China's economy has shifted from the stage of high-speed growth to high-quality development, and economic growth has stepped on the slow downward channel in the medium-long term. Under the influence of slow-

ing economic growth and tight fiscal balance, the Chinese government has continuously increased investment through counter-cyclical regulation, which has significantly stabilized the economic growth. The government investment fund, as a policy tool, plays a guiding and magnifying role in social capital through government guidance and market-oriented operation. It also actively promotes the development of strategic emerging industries and pillar industries, boosting supply-side structural reform, and innovating the way of resource allocation, which is conducive to giving better play to the guiding role of the government and introducing more market mechanisms and market-oriented means to realize the innovation-driven development strategy. After more than a decade of rapid growth, Chinese government investment funds have shifted from high-speed development to high-quality development stage. According to Qingke Research Center, China now has more than 2000 government investment funds, worth more than 10 trillion yuan. In the new stage, it is of great significance for China's economic and social development to clarify the problems existing in the development process of government investment funds and to study how to give full play to the positive role of government investment funds.

## **2. Status Quo of the Development of Government Investment Funds in China**

### **2.1. Connotation and Objectives of Government Investment Funds**

The government investment fund has existed in China for only ten years since its birth, but it has been put into practice in the west and other developed countries for long, scholars at home and abroad have different emphases on the connotation and function of government investment fund. Foreign countries are more inclined to study the auxiliary and supporting role of the government in the development of the whole venture capital industry. In China, before the promulgation of the Interim Measures for the Administration of Government Investment Funds in 2015, the definition and connotation of government investment funds were discussed more. [Aernoudt \(1999\)](#) believes that the government should try its utmost to remove administrative, tax and regulatory restrictions that may hinder the development of venture capital industry. He believes that government support is decisive in the development of venture capital industry, economic growth and employment. According to the study of [McGlue \(2002\)](#), government investment funds can improve the market failure caused by information asymmetry to some extent. [Li \(2005\)](#) points out that the so-called government investment fund refers to the parent fund set up by the government as the sponsor or shareholder to invest in the commercial venture capital sub-fund. [Yang & Chu \(2006\)](#) believes that the sponsors of government investment funds also include state-owned holding companies and wholly state-owned enterprises.

The governments of developed countries in Europe and America help the development of their venture capital industry and the innovation and upgrading of enterprises in related industries through a new way of investment and financ-

ing-private equity funds. According to the investment attributes of private equity funds, they can be divided into government-funded private equity funds and market-oriented private equity funds. The domestic government also refers to the practice of foreign developed countries, through government financial funds to set up private investment funds to pry more social capital to participate in venture capital so as to solve the capital, market and technology problems in key industrial areas and weak links, and further facilitate regional economic development and the upgrading transformation of traditional industries. In 2015, the Ministry of Finance issued the Interim Measures for the Administration of Government Investment Funds, which is the first departmental administrative regulation on the management of government investment funds, and it is also the most authoritative and comprehensive management system for the management of government investment funds so far. According to this method, governments at all levels shall guide all kinds of social capital to invest in key areas and weak links of economic and social development through budgetary arrangements, setting up alone or jointly with social capital, and adopting market-oriented methods such as equity investment to support the fund development of related industries and fields as government investment funds. The measures define the connotation of government investment fund from five aspects: investor, capital contribution mode, operation mode, establishment purpose and investment field. In July 2023, the State Council promulgated the Regulation on the Supervision and Administration of Private Investment Funds. Private investment funds, including government investment funds, have entered a new stage of standardized and sound development.

## 2.2. Mode of Operation of Government Investment Fund

As a kind of private equity fund, the complete operation process of government investment fund includes four stages: “raising, investment, management withdrawal”. At present, no standardized or unified regulations are set up on the operation mode of government investment funds in China. Li (2013) believes that the government should set up a parent fund, guide the fund and social capital to cooperate in a certain proportion to form a sub-fund and entrust the sub-fund to a qualified management organization. Within the set scope, it shall independently select investment enterprises to carry out investment and value-added services, and realize the government’s industrial policy intention through the operation of “fund-raising and setting up sub-fund-investment-management-withdrawal”. From the point of view of the source of funds, Cao (2011) divides it into the joint establishment model of local government and national development bank, the direct establishment model of local government and the joint establishment model of national and local governments.

In practice, our government investment fund generally adopts the structure of mother-child fund. In legal form, most of our government investment funds adopt limited partnership to avoid the problem of repeated collection of indi-

vidual income tax and corporate income tax, and make full use of its simple governance structure, flexible management, easy to implement investment incentive mechanism and other advantages. Generally, the government contributes to the government investment fund as a limited partner (LP) and entrusts the local platform company or the fund management company under the state-owned enterprise to carry out daily operation and management as the general partner (GP) of the fund. The major matters related to the fund need to be decided or final decisions made by the relevant government departments in charge to achieve the purpose of risk control. In terms of management, it is mainly divided into independent management and entrusted management: under the independent management mode, the operation and management of government investment funds is usually carried out by fund management institutions with a government background designated by government departments. At present, the operation and management of most government investment funds in China are carried out by state-owned investment companies or units in the financial system. The entrusted management is to entrust the fund to external professional investment institutions for operation and management after the establishment, while the government generally is not or rarely involved in investment decisions. Due to the abundant experience in the operation and management of funds by the teams of external professional investment institutions, the efficiency and marketization level of fund operation and management are also improved accordingly, but it will increase certain management costs compared with independent management. In recent years, government investment funds in some developed areas of China have adopted this approach. For example, Shenzhen makes full use of the policy and location advantages, with Shenzhen Venture Capital, Songhe Capital and many other head equity investment institutions as the fund managers, set up angel mother fund to carry out extensive investment business.

### **2.3. Supervision and Performance Evaluation of Government Investment Funds**

To study whether the government investment fund really plays an effective guiding role, many scholars begin to pay attention to the performance evaluation management. [Bartzokas & Mani \(2004\)](#) evaluate the success rate of investment, the volume of funds, the role of guidance, the number of withdrawal and other indicators of the Israeli government entrepreneurship guiding fund. [Gumming \(2005\)](#) analyzes the operation results of Australian innovation investment fund program from the aspects of risk-taking tendency of investment start-ups and high-tech enterprises, management of invested enterprises, tendency of post-investment value-add and withdrawal success rate.

In terms of performance evaluation of domestic government investment funds, Dr. [Yu \(2007\)](#) put forward the issue of performance evaluation for the first time, thinking that the supervision of funds cannot be separated from performance evaluation. [Li & Chen \(2023\)](#) took the performance evaluation cycle,

constructed the performance evaluation indicators of government investment funds from four aspects of decision-making, process, output and benefit, and analyzed the key points of index weight allocation. On the practical level, because the government investment fund is characteristic of strong government leadership, deep participation of state-owned enterprises, weakening of profit-seeking and outstanding policy, its performance evaluation differs from market-oriented evaluation, mainly reflected in the government industry orientation and direction of support, risk prevention, capital value maintenance and appreciation, leverage effect and social benefits and so on.

In 2015, the Ministry of Finance issued the Interim Measures for the Administration of Government Investment Funds, requiring financial departments at all levels to establish a performance evaluation system of government investment funds, evaluate the realization degree of fund policy objectives, investment and operation situation, and apply the performance evaluation results. In 2018, the National Development and Reform Commission issued the Notice on The Performance Evaluation of Government-funded Industrial Investment Funds, which clarified the objective and fair performance evaluation of government investment funds and fund managers in terms of the realization degree of policy objectives, investment management ability, comprehensive credit level, and economic benefits. In 2020, the Ministry of Finance issued the Notice on Strengthening the Management of Government Investment Funds and Improving the Efficiency of Financial Investment, which proposed to implement the performance management of the whole process of government investment funds. In practice, the central and local governments also have different priorities on the performance evaluation of government investment funds. The central government pays more attention to the realization of policy goals, while local governments have different concerns, including fund compliance, economic benefits and operational efficiency.

### **3. Plight Faced by the Development of Government Investment Funds in China**

Although the government investment fund has developed rapidly and played a positive role in promoting economic development, industrial upgrading and innovative use of fiscal expenditure in China, many are still challenging the fields of fund operation, institutional arrangement and potential financial risk prevention. With the strengthening of local government debt management and the implementation of new regulations on asset management, the problems existing in the investment and management practice of government investment funds are also gradually exposed, such as uncertain investment, dare not invest, low efficiency and other difficulties need to be tackled.

#### **3.1. The Fund-Raising Dilemma**

The problem of implicit guarantee in the early stage is left over, and the social

capital is absent after the new rules of asset management. No matter through the joint direct investment project model or the equity sub-fund model, in order to attract social capital, the government meets the risk-return needs of banks, insurance and other financial institutions through direct profit concessions and priority repurchase. This kind of direct local government endorsement and a joint and several guarantee to the source of fund share repurchase in the future increase the local hidden debt. In 2018, the Guidelines on Regulating the Asset Management Business of Financial Institutions were implemented, under the influence of policies such as restraining channel business, eliminating regulatory arbitrage, breaking rigid payment, and reducing leverage ratio, bank funds withdrew from the ranks of investors, and funds such as trusts, insurance and securities were restricted. During the economic downturn, the cash flow of listed companies and private business owners is tight, which makes it more difficult for government investment funds to raise funds from the society. In the sub-funds set up by China Public-private partnership Financing Support Fund in different provinces in China, As a result of the introduction of the new asset management regulations, the local commercial banks, as one of the investors, cannot continue to contribute to the new investment projects, and the investment in the only investment projects is also constrained.

### **3.2. The Investment Dilemma**

With the strict investment restrictions, actual implementation becomes a mere formality. When the government investment fund is set up, there are relatively strict restrictions on investment areas and investment fields. More investment projects are optional for the eastern coastal areas and first-and second-tier cities with a large economic volume and active market bodies. The number of investment projects available for the central and western regions and third-and fourth-tier cities is limited. At the same time, it is easy for brand enterprises and high-quality projects to raise funds through wider channels in the market, but government investment funds with more restrictions and stricter requirements are not their first choice. On the other hand, for start-ups with greater demands for funds and projects with a long investment return period, due to the weak credit enhancement ability of private capital and uncertain project prospects, the government invests little for the sake of maintaining and increasing the value of state-owned assets.

### **3.3. The Dilemma of Performance Evaluation**

Managers dare not invest boldly, the problem of inactive capital is prominent, deviation from policy objectives, and the natural contradiction between the high risk of equity investment and the goal of maintaining and increasing the value of state-owned assets is difficult to solve. Although the government investment fund is not for profit, it cannot tolerate large losses. State-owned investment institutions are bound by various mechanisms and dare not to invest due to the

lack of fault-tolerant mechanism and the lifelong responsibility. To maintain and increase the value of state-owned capital, they are absent in the enterprise angel period, seed period and other stages. Therefore, most governments guide funds to invest in the late-stage projects such as maturity, or directly buy financial products, or even idle funds, which fails to achieve the policy goal of promoting innovative and entrepreneurial enterprises and guiding the upgrading of industrial structure.

### **3.4. The Dilemma of Supervision**

The rights of fund investors are confused with the duties of supervisors. On the one hand, the financial department is the investor of government investment fund, which performs the civil contribution obligation and enjoys the corresponding rights according to the agreement. On the other hand, it is also the supervision department of financial fund, and the behavior of performing supervision duty belongs to the administrative act, which is mandatory. Discrepancies exist between investment obligations and regulatory duties in the pursuit of value, the nature of rights, the role of status and the ways of relief. How to co-ordinate and balance the two roles of financial department has also become an important issue restricting the high-quality development of government investment funds.

### **3.5. The Management Dilemma**

The operation efficiency of non-market-oriented management fund is low. Under the independent management mode, the operation and management of the fund is often administrative tinted, and the government generally is directly involved in investment decision-making. The decision-making procedures of local platform companies or state-owned enterprises are complex, and they need to be examined and approved by functional regulatory departments before investment. The procedures are complicated and tedious, and the timeliness is poor, coupled with the professional ability of the personnel of institutional units, a certain impact is imposed on the operation and management efficiency of government investment funds.

## **4. Countermeasures and Suggestions**

At present, China's economy is in an important development stage of economic restructuring and upgrading of traditional industries. As an important tool to promote the rapid development of "new economy" and change the mode of financial investment in this historical period, government investment funds play an important boosting role. Clarify the problems in the operation and management of government investment funds and put forward improvement measures will help to give full play to the effectiveness of government investment funds in promoting industrial upgrading and transformation as soon as possible.

The first is to realize the diversified development of social capital sources. The

fund-raising objects of the fund can be guided to turn to investors who have better risk-bearing ability and better match the investment projects, such as PE/VC investment institutions, sovereign wealth funds, high net worth individuals and so on. At the same time, the requirements for fund raising should be appropriately relaxed: first, to appropriately lower the requirement for the enlargement of financial funds, and implement profit concession measures to attract social capital, so as to avoid the funds being unable to play its role because it is difficult to raise social capital; the second is to support the fund teams to cooperate with city and county governments or leading enterprises and social capital to set up sub-funds to give full play to their respective advantages and achieve joint development. Third, the fund through joint investment to drive financial capital can be seen as raising funds. To encourage the fund teams to cooperate with banks and other financial institutions so that the fund provides long-term capital for investment projects, banks can provide short-term credit funds in the form of joint investment support.

The second is to appropriately relax many restrictions, such as the proportion of return investment and the restrictions on the place of registration, gradually delegate power to the market. Practice has proved that the various restrictions set by the government on guiding funds are difficult to achieve the original intention of promoting industrial development in this region. On the contrary, they are unable to attract excellent fund managers, distort the investment actions of managers, and the efficiency of fund operation is low. The executive should publicly select, carry out market-oriented recruitment, provide market-oriented compensation, market-oriented assessment of the board of directors and sign a letter of responsibility for business strategies and objectives. The board of supervisors shall supervise the executive in a market-oriented way, establish and improve the system mechanism, establish a modern corporate governance system, and introduce modern enterprise incentive mechanisms such as management investment and capital management plan.

The third is to implement the due diligence fault-tolerant mechanism and give full play to the subjective initiative of fund managers. On the one hand, the trustee shall not be held responsible for the investment losses caused by force majeure, policy changes and other factors that have been dutifully performed. On the other hand, comprehensive performance evaluation shall be carried out according to the law of guiding fund investment and the principle of marketization, the whole process of performance management be implemented, and the degree of realization of policy objectives, standardization of fund operation, management efficiency, investment performance and so on be quantitatively evaluated. The application of the results of performance evaluation shall be strengthened; the evaluated fund can increase the counting and drawing proportion of management fees, the actual contribution sped up, more profits distributed, profit concession increased and so on.

Fourth, accurate definition, differential supervision. To explore the authorized



decentralization operation mechanism of the government investment fund, and determine whether the fund belongs to the government investment fund by the contribution level. The policy-oriented government investment funds directly contributed by finance department and held by state-owned enterprises or state-owned financial capital shall be directly supervised by the financial department in accordance with the law, and adopt different regulatory policies from the private equity funds set up by their own funds. For industrial guidance fund established by the development and reform department, the financial department shall perform the duties of investor, and the development and reform department shall perform the duties of competent department. The other sub-funds and investment projects that are not under the direct supervision of financial departments shall be authorized or delegated to the competent authorities and funds for “penetrating supervision” in an inventory way.

In general, the government investment fund, as a policy tool to innovate the way of financial fund support, plays a positive role in broadening the financing channels of enterprises, improving the efficiency of financial fund allocation and supporting the development of the real economy. Due to the economic downturn cycle and COVID-19 and other factors, the Chinese government’s fiscal budget is tight. Although the government investment funds are large, the establishment and practice in China are relatively short, and the problems of raising funds, investment, assessment, management and supervision continue to exist. In order to further improve the operation efficiency of government investment funds, give full play to its regulating role of economy and industry, Chinese government should promote the diversification of social capital sources, raising link measures to improve the marketization level of more, establish and improve the fund management mechanism, the different types of government investment funds differentiation regulatory measures, to ensure the high quality development of government investment funds.

### Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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