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Introduction

Over the past few decades, the global economy has witnessed successive paradigm shifts: the Soviet Union collapsed; the United States ushered in the Internet economy; Brazil, Russia, India, and China, among other rapidly growing emerging-market economies, were integrated into the global supply chain; the China–U.S. economic alliance blossomed but then hit "choppy-waters"; and finance, with all its associated agents and institutions, came to overshadow, and eventually derail, the real economy. Overall, the market became an incontrovertible force for change in the world, rewriting the geography of the global economy and revolutionizing the interplay between various public and private actors and institutions. From liberal democracies to authoritarian and even communist regimes, capitalist systems of economic coordination have become pervasive.

The decisions by nation-states to deepen economic integration and facilitate globalization are premised on the idea that, when sovereign nations cede some portion of their domestic autonomy to a global system of coordination, they are compensated through efficiency gains, such as the discounted costs of consumption and a more productive supply chain. Without this benefit, countries would universally reject trade agreements and treaties. Instead, politicians have embraced, albeit begrudgingly in some cases, these new economic realities underpinned by global competition for capital, industry, jobs, goods, and services (among other things). States have willingly adopted postures motivated by a market-based logic, legitimated by vaguely specified notions like "competitiveness" (Monk 2008a). As Gertler and Wolfe (2004, 45) note, "communities and regions, like companies, need to innovate and adapt to remain competitive."

However, the interplay of two competing counterparties in this new economic paradigm—capital's global search for higher returns and jurisdictions' global search for capital—has led the global economy into a murky institutional world without easily identifiable boundaries. Indeed, the prospect of political localities being motivated by the same market incentives as the firms located within these jurisdictions augurs a degradation of the boundaries that previously separated states from markets. Significantly, a growing number of states have become reliant on markets, and in particular financial markets, for the economic and social well-being of their citizens. The rapid rise of prefunded pensions in the twentieth century has been the most obvious example of this transformation (Clark 2000). While the power of financial markets promises a great deal for managing difficult public problems, it also leaves these governments, and their constituencies, vulnerable to the volatility of financial markets.

The recent global financial crisis is a telling reminder of capitalism's dark side and the precarious position that governments may find themselves in when they rely on markets for national well-being. Take the current global economic environment as an example: highly imbalanced and with a penchant for extreme volatility and unpredictability, the global economy's future trajectory is increasingly difficult to predict. How then do governments make plans in an era with a flattened distribution of outcomes? The "rare" and "unexpected" events are much less rare and, as a consequence, much less unexpected than they used to be. Volatility, tumult, and crisis are seemingly routine, which makes generalizations (and thus predictions) about economic variables almost impossible. Indeed, the quantitative models upon which so many analytical frameworks rely have lost their luster. It seems that the world has fallen under the spell of a financial capitalism, leaving nation-states powerless in the face of global economic forces.

But this is where the story turns against those who would claim the world is converging toward a single model of economic coordination based on free-market capitalism. In the face of new and persistent global financial volatility, governments have managed to implement new mechanisms and tools that mute some of this global chaos at the local level. Indeed, policymakers are creating new institutions that seek a measure of certainty to domestic planning (Weiss 2005). Recurring crises have served to "jolt" governments into action, sending them in search of new ways to claw back (or simply retain) their decision-making authority. Technocrats are cast as institutional entrepreneurs, searching for coping mechanisms that can help their states manage their precarious position in a rapidly globalizing world.

One such coping mechanism has been the accumulation and sequestration of government reserves in the form of financial assets. The inspiration for reserve accumulation almost certainly goes back to the 1997 Asian financial crisis and, in particular, the resilience of certain reserve-rich economies therein. For example, Singapore demonstrated at the time that having financial assets on hand (and in large quantities) was extremely helpful in times of economic uncertainty (see chapter 6). Years before, the country's politicians had recognized the value of having a dedicated fund that stood ready to mobilize financial resources should that become necessary for the stabilization of the economy.[1] Other countries around the world took note, deciding that what worked for an island nation could equally work for a country of more than a billion. By 2010, global government reserves had quadrupled from their 2001 levels.

Nonetheless, while reserves had come to represent a new and powerful form of self-insurance and stabilization, holding these reserves proved costly. The difference between what the reserves earn (if they are invested in financial markets) and what the country pays on the domestic debt that is used to sterilize the foreign assets can be significant. Coupled with increasingly low yields on traditional reserve assets, such as U.S. Treasuries, a new investment vehicle was thus needed to facilitate the diversification of accumulated reserves into higher-yielding assets. This is the purpose of SWFs. In SWFs states found an institution that could transform sovereign wealth into financial assets for the purpose of investment, either directly or indirectly, in domestic and international financial markets. The idea was that by investing sovereign wealth in riskier assets, and generating higher returns, government sponsors could contain the costs of holding such reserves. And while the assets in an SWF are typically "excess" reserves, not needed for prudential purposes, these reserves could still be mobilized quickly to defend, engage, or simply stabilize domestic policies or institutions.

Take as an example Russia, which used its commodity-based SWF to stabilize its spending during the most recent financial crisis; or Singapore, which also tapped its reserve investment corporation for the first time; or Kuwait, which used its commodity fund to bolster domestic markets through direct investments. Even in the United States, Chairman of the Federal Reserve Ben Bernanke (2010) extolled the virtues of SWFs to state governors, suggesting that SWFs could be helpful for a rainy day in the future. In short, policymakers of all stripes, from democracies to autocracies, have all come to see SWFs—be they in the form of a pension reserve fund, commodity fund, or a reserve investment corporation—as important buffers against global market forces that threaten domestic institutions and policies.

The Rise of Sovereign Wealth Funds

If we consider SWFs to be special-purpose vehicles that provide governments with the ability to tap into the power of global financial markets, why do governments want this power? Put simply, global financial markets offer a ready storehouse for accumulated reserves and, equally, promise a mechanism for efficient diversification. The bigger question, however, is why governments need to accumulate reserves or diversify their assets in the first place. Here we proffer a more complicated explanation: in a world seemingly at the mercy of globalization, SWFs offer states an opportunity to reassert their sovereignty and authority over the hegemonic forces of global capitalism. Through self-insurance and financial stabilization, SWFs mute global forces at the local level. In effect, the rise of these funds is emblematic of a widespread realization that accumulating wealth in the form of financial assets is a reasonable precautionary policy, whether it is to deal with looming pension obligations or to manage the inevitable problems associated with a country's integration into the global capitalist system. It is also about gaining access to the leading edge of globalization: global financial markets.

While some funds resembling SWFs have been around for years, economic historians will inevitably mark the first decade of this millennium as the beginning of the SWF era. During this period tens of new SWFs were created, accounting for a large proportion of all SWFs in existence today. Governments around the world decided—seemingly en masse and independent of their level of development or the form of government—that these special purpose investment vehicles were crucial to achieving their policy objectives. What is more, the economic and financial turmoil of the past several years has reinforced this trend; in the period 2009–11 eleven new SWFs were established and several more were at some stage of creation or implementation (see figure 1.1). In addition, SWFs' assets under management increased collectively from less than US$1 trillion in 2000 to US$6 trillion by 2012, as

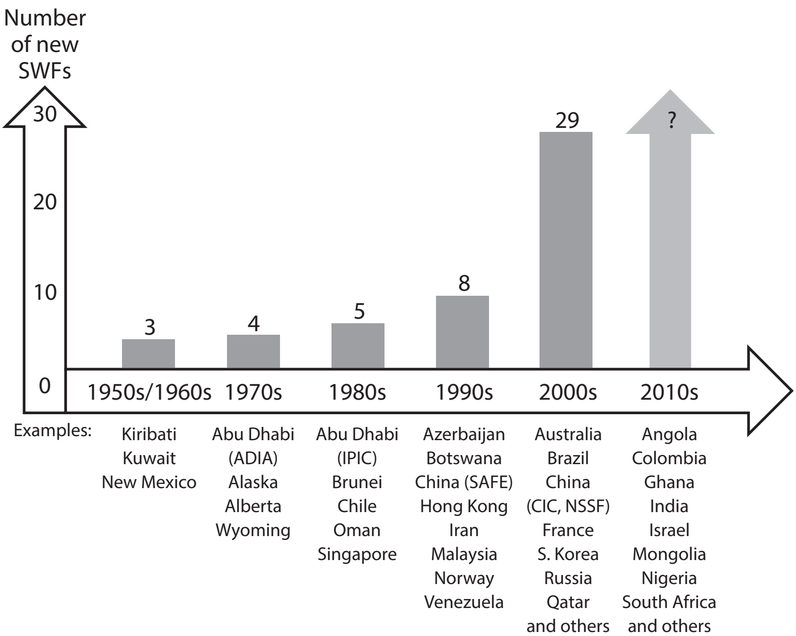

Figure 1.1. The rise of sovereign wealth funds. *Source*: Authors' calculations

more governments funneled increasing amounts of their sovereign wealth into these funds.

In effect, SWFs have become a core element in global financial markets and a constituent part of the related financial services industry. Many expect this relationship to become increasingly important in the future, as renewed commitments made by many sovereign entities to their SWFs as well as the growing number of newly established SWFs suggest that the institution has not been as compromised by the turmoil in global markets as have other types of financial institutions. If anything, it seems that their significance has been strengthened. On the one hand, governments are increasingly committed to SWFs as a policy instrument while, on the other hand, the global financial services industry has grown dependent on their assets and commitment to portfolio investment. If otherwise risk-averse in relation to the possible political costs (borne directly or indirectly) of high-profile failures of investment strategy, the long-term nature of SWFs gives these instruments the power and position to drive the frontiers of global investment management. Indeed, SWFs are intimately related to finance-led capitalism, with its form and functions based on the hegemony of Anglo-American finance over the late twentieth and early twenty-first centuries (see chapter 9).

While some might have welcomed the addition of SWFs to the tumultuous economic environment of the past several years, given that these funds exist to facilitate macroeconomic stability *and* invest a country's assets over the long term, many in the West initially saw the rapid rise of these funds with concern and suspicion. To a certain extent, this was due to the fact that these funds represented a permanent redirection in investment flows and a shift in the dominant sources of financial capital. After all, financial markets were hitherto dominated by Anglo-American financial institutions (Clark 2000). The apparent loss of hegemony left some, particularly in the United States and Europe, uncomfortable. By blurring the line between finance and politics, there was a fear that SWFs would not only redirect financial flows but also change the very nature of global markets. Indeed, there was a sense that foreign governments were resorting to SWFs to (mis)use financial markets to advance political, as opposed to commercial, agendas (Schumer 2008). Some came to view SWFs as the source of a new "state financial capitalism" (Lyons 2007), or as instruments for hiding attempts by foreign governments to obtain technology and expertise to benefit national strategic interests (European Commission 2008). Others wondered what the introduction of public investors into private markets would do for market efficiency (Gieve 2008). In all cases, SWFs were a new source of political intrigue and concern. Yet, concerns about emerging-market investors are not new (see Moorsteen 1975), and it has been over two decades since Benjamin J. Cohen argued that, "high finance can no longer be kept separate from high politics" (1986, 3). Still, it seemed that SWFs were an affront to many Western policymakers, and these funds came quickly to face a global crisis of legitimacy.

Legitimacy and Governance

Because distrust toward the activities of SWFs could lead to increasing protectionist sentiments (see Levi and Stoker 2000), which could in turn result in restricted access to key financial markets (see Tucker and Hendrickson 2004), there has been a premium placed on trust. One initiative that has sought to build trust is the voluntary Generally Accepted Principles and Practices (GAPP), known as the Santiago Principles, which were developed by the International Working Group of SWFs with the support of the International Monetary Fund (IMF). According to Hamad al Suwaidi of the Abu Dhabi Investment Authority and Co-Chair of the International Working Group, the Santiago Principles were designed to establish "trust" between SWFs and recipient countries.[2] Investment-receiving countries shared this commitment. For example, according to Joaquin Almunia, the European Commissioner for Economic and Monetary Affairs, "The principles and practices of the GAPP amount to a global public good that can help foster trust and confidence between SWFs, their originating countries, and the recipient countries. This is what we need in these turbulent times: a strong commitment to enhance mutual trust."[3] Similarly, Kathryn Gordon of the OECD notes that their project on SWFs and the International Working Group's project are "flip sides of the coin in the trust-building process."[4]

Evidently, "trust" is an important stepping-stone for SWFs' integration into the global financial system, and distrust is a problem that requires the attention of SWFs and policymakers alike. But is trust the primary issue? Trust reflects someone's belief that an institution is *performing* in accordance with his or her normative expectations (Kaina 2008). Hence, embedded in this notion of trust is a *performance*; for SWFs, a performance could be a specific investment or asset allocation decision. These performances either conform to a normative expectation and create trust or contradict a normative expectation and create distrust. Subsequently, the question arises whether SWFs inspire concern among policymakers due to undesirable past performances (i.e., investments). The answer is no. Past SWF investments are not the issue. There are few, if any, examples of SWF investments that clearly demonstrate a breach of trust due to politically motivated investing. This would suggest that concerns over SWFs are largely unjustified if SWFs are evaluated according to their track records.

Rather, much of the concern about SWFs is about codes of conduct and the appropriateness of funds' investment strategies. Indeed, the current debate revolves around SWF *principles* and *practices*, which refer to the established norms and methods for operations and behavior, rather than *performance* per se. In short, SWFs inspire fear within certain policy circles, because some SWF principles and practices do not conform to their expectations. Therefore, the issue is less about trust and more about legitimacy.[5] While this may seem to be simply a semantic argument, it has important implications for geopolitics. Yet the issue of legitimacy also goes beyond geopolitical concerns. As several of our case studies show, legitimacy is equally a matter of domestic politics and the domestic political claims on SWFs.

Legitimacy can be described as the acceptance of an organization by its "environment," and as the belief that an organization is authorized (legally and morally) to operate in a certain place and time. In this sense, legitimacy is a constraint (Dowling and Pfeffer 1975; Suchman 1995; Kostova and Zaheer 1999).[6] According to Zimmerman and Zeitz (2002, 416), "legitimacy is a relationship between the practices and utterances of the organization and those that are contained within, approved of, and enforced by the social system in which the organization exists." Being legitimate means that organizational procedures, structures, and principles align with the values, norms, and expectations of the society or the environment in which the organization seeks legitimacy, at home or abroad. It is a subjective quality that is defined by a certain actor's perception of an institution's practices and principles. Being illegitimate limits freedom of action, which may undermine organizational effectiveness. As Massey (2001, 157) notes, "[A]n illegitimate status demands that the organization respond, or else organizational failure could result."

One method for evaluating issues of SWF legitimacy, domestic and international—which we adopt as a primary mode of inquiry throughout the book—is to analyze SWF governance (see Appendix), as governance and legitimacy are intertwined (Stoker 1998). Legitimation is a process necessitating an evaluation of an organization's governance: the techniques, procedures, categories, and structures through which organizational decisions are made (Perrow 1970; Suchman 1995). We define governance in financial institutions as the procedures, policies, structures, and decision-making norms underpinning operations and investments (see Appendix).[7] Governance is an important resource for financial institutions, as it provides, for example, the tools to protect against outside influence, stem fraud and corruption, maintain accountability and transparency, manage new and existing financial risks, and supervise new and existing stakeholders (Clark and Urwin 2008a). In effect, governance ensures that an organization is operating in accordance with the values and norms of society relevant to that institution (Monk 2009b). A well-governed financial institution inspires confidence among stakeholders.

Institutional Form and Function

Conceptually, the design of any organization and its governance architecture will affect its ability to meet its institutional objective(s) (see Davis and Steil 2001). Research has shown that there is a premium on properly designing investment institutions such that their structures and practices sustain performance, both in terms of financial returns and other objectives (Clark and

Urwin 2008a). These are the characteristics that will dictate how internal authority is utilized and financial capital is distributed and mobilized. Ultimately, for any organization to be successful, its form must be consistent with its functional imperatives. In the case of SWFs, the functional imperative is to operate effectively in global financial markets.

To achieve this objective, sponsoring governments have to consider two factors in designing SWFs. First, SWFs are required to generate the financial returns desired by the sponsor. Significantly, the Western model of corporate governance offered SWFs a form that was specifically designed to maximize efficiency and profits. Second, SWFs are required to maintain access to global financial markets, lest they cease having a reason to exist. As such, SWFs adopted the Western model of corporate governance, with its "recognized" management practices, logics governing investment, and principles of best practice (Clark and Urwin 2008a, 2008b). SWFs thus match, mimic, and approximate the management structure and governance practices of pension funds, endowments, and foundations, all of which also rely upon global financial markets for investment opportunities (Morrison and Wilhelm 2007).

However, in thinking about the future of SWFs, one of the challenges facing these financial institutions is whether they will continue to rely on Western markets. Should they adapt their current form to create new pathways for the investment of sovereign wealth? After all, when considered over the past fifteen years or so, it is arguable that Western financial markets have hardly returned anything more than the global real rate of economic growth (taking account of volatility, inflation, and the costs of investment management). Moreover, the commercial orientation of today's SWFs may not match up with the long-term interests of the states that sponsor SWFs. Indeed, the formation of every SWF represents, inevitably, a political moment in the life of a nation-state, which means these institutions carry with them the interests of the sponsoring entity. In this context, it is not obvious that a traditional financial institution is the best form to realize SWFs' functions.

The current SWF form seems to be the source of looming institutional contradictions. On the face of it, these funds swear off national, or strategic, investment strategies in deference to Western sensibilities. Nevertheless, they ultimately exist to serve the sovereign sponsor. Gelpern (2010) articulates this dilemma in the following way: "Reading between the lines of SWF definitions and commentary reveals a jumble of contradictions: public money that pledges to act private, vast pools of capital that promise not to move markets, non-controlling investors that manage centrally controlled economies; and public fiduciaries that balk at corporate governance of their investment targets." While SWFs claim to pursue financial profit alone, there nonetheless remains the long-term interest of the nation-state in using its sovereign wealth to advance the status and fortunes of the sponsoring nation as a whole.

It should be noted, moreover, that SWFs enjoy a unique position among investors that makes them suited to this type of strategic investing: SWFs are not constrained by liabilities, as is the case with defined benefit (DB) pension plans; they are not managed in relation to participants' account balances, as is the case with defined contribution pension funds; and, they are not subject to increasing solvency requirements, as is the case with insurance companies and banks. Accordingly, SWFs have greater discretion over tactical and strategic asset allocation (Campbell and Viceira 2002). Put simply, SWFs are unconstrained investors, which affects (or should affect) the nature of the risks that they are willing to bear, the time horizon of investment, the benchmarks (if any) used to evaluate performance, the demand for innovation in investment management, as well as the nature of "products" offered to SWFs by investment companies.

Hence, it is entirely possible that SWFs will evolve, transforming into long-term investors whose holdings are selected on the basis of their strategic interests rather than on the basis of modern portfolio theory. If so, the future of SWFs sponsored, for example, by Eastern countries will be more like that feared by their critics than the ideal form upholding a symbiotic relationship with the West. And while this evolution will unquestionably raise concern in certain quarters, Western policymakers will have to confront the issue as to whether it really matters if the motivation of a Chinese SWF, which owns 10 percent of a certain company, is commercial or political. If it does matter, will Western governments be able to respond?

The Geography of Finance

The great irony embedded in SWFs is that while these funds exist to reap returns in global financial markets, their objective is to mute capitalism's transformative forces, such as global finance, at the national level. In a manner of speaking, SWFs are chasing their own tail. That SWFs are the chosen means of protecting national sovereignty from the hegemonic forces of globalization is thus illustrative of the inherent contradictions embedded in capitalism. Moreover, these funds are at odds with the argument that the world is, and remains, a mosaic of different countries sustained by path dependence and tradition—the logic underpinning the political scientists' commitment to varieties of capitalism and economic geographers' commitment to path dependence. The growing importance of these funds would seem to give credence to the argument that all the world is subject to a financial capitalism. After all, these funds are emerging around the world from Canada, China, and Chile to Norway, Nigeria, and New Zealand. Independent of their variety of capitalism, countries have come to see the value of being in, and managing the forces associated with, financial markets. The rising importance of these funds thus underscores the difficulty of conceptualizing the global economic environment.

Long before the SWF phenomenon was on the front pages of newspapers, a conceptual debate was raging in the social sciences over the resilience of local institutions to global market forces (for details, see Rodríguez-Pose 1999; Gertler 2001; Hess 2004; Peck and Theodore 2007; Clark and Wójcik 2007). Two questions were core to this debate: (1) How do local, regional, and national geographies (i.e., laws, cultures, norms, and histories) respond to global capitalist forces (e.g., finance)? (2) Will filtering these forces through these same geographies result in convergent or path-specific developments at the institutional and firm level?

Originally, the pendulum swung out to the right with claims that the technological and financial revolution would result in an "end of geography" or "end of history" for which the result would be a total convergence toward a set of institutional best practices (see Fukuyama 1992; Ohmae 1990; O'Brien 1992). However, before this view could make significant inroads (except within the management-focused publications that spawned it), the pendulum had swung back to the left with a conceptual riposte: path dependence and the varieties of capitalism (see Hall and Soskice 2001), which held that, by virtue of history and geography, the local would always hold sway over the global.

Neither set of concepts, however, offers analysts reliable insights into some of the more troubling (empirical) problems facing the global economy (Clark and Wójcik 2007; Monk 2009a; Dixon and Monk 2009; Dixon 2011, 2012). Neither offers an adequate explanation for a world inhabited by SWFs. The vagaries of finance-led capitalism are too complex to reify in this manner. On the one hand, the hyper-globalization theses appear overly simplistic. Globalization may have forces driving convergence, but the idea that countries will adopt best practices that do not reflect local characteristics is mistaken (Gertler 2001). On the other, the supporters of path dependence come across as overly reductionist. Attempting to examine the global economy as if it were bimodal (i.e., coordinated market economies versus liberal market economies) cannot adequately reflect the variety inherent in the global economy. Instead, we see the world as a hybrid of these (and other) conceptualizations. It is not converging toward a singular model or "best-practice" system of economic coordination. And yet, numerous practices, principles, and institutions are undoubtedly subject to market-based expectations and global pricing (see Christopherson 2002).

While much of the research to date has focused on the hegemony of finance at the individual level (Langley 2008; Strauss 2009), as well as the effects of financial markets on national and regional systems of corporate governance (Clark and Wójcik 2007), there is overwhelming evidence that nation-states are at risk to the incontrovertible world of high finance (see Helleiner 2009). It is for this reason that theories of institutional change built on convergence and path dependence are of little use to our analysis of SWFs. In short, as states increasingly turn to SWFs, they find themselves better able to maintain their own path-specific patterns of development. As a result, political economies have been shown to be capable of responding to global forces in ways that preserve local differentiation, autonomy, and, indeed, sovereignty. However, through their financial investments in global markets, SWFs have ushered global finance—which is the quintessence of contemporary economic globalization—into the state apparatus in countries of all political inclinations the world over (Monk 2009a).

We rehearse these arguments and conceptualizations here because this pluralist approach forms the basis of our ontological perspective in this book. As economic geographers, we implicitly recognize the inherent variety and idiosyncrasy of economic life. In fact, our generic interest is in "mapping" the changing spaces and places that make up the ever-changing global economic geography, highlighting the factors that inspire, constrain, or redirect economic agents and institutions. This includes the actual physical characteristics of the environment, but, equally, encompasses organizational and even psychological variations. In our view, these different geographic configurations can and do filter global forces at the local level. Moreover, we recognize the role of agency in this process, whereby local agents are cast in terms of institutional entrepreneurs that are constrained but also empowered by their local environment to effectuate change (or maintain the status quo) (Crouch 2005). We are also cognizant of the difficult balancing act governments are facing between the policies that will encourage economic growth and efficiency in the global economy and the policies that will match up with their promises and commitments to local constituents.

The significance of this fact of life for many social scientists was largely ignored until the global financial crisis in the first decade of the twenty-first century brought into the open the pervasive and indeed hegemonic influence that finance is having on individuals, corporations, and even governments. We should not act surprised by this, however, as the size of the financial economy was already estimated to be nearly three times larger than the real economy in 2007 (Lee et al. 2009). Moreover, the significance of institutional investors in global financial markets is well documented (see Davis and Steil 2001; Hawley and Williams 2005). Perhaps it is appropriate, then, that twenty-first-century capitalism is often portrayed as the era of financial capitalism (Clark 2009), which is another way of saying that production and trade, often described as the core attributes of the real economy, are no longer the dominant forces in the global economy.

This is not to say that the real economy has lost its importance for understanding the global economy, but its relevance has fallen in favor of finance. As Dore (2007) puts it, the global economy has moved away from industrial relations toward investor relations. While inherited systems are resilient in certain places and industries, the financial concept of "shareholder value" still seems to permeate decision-making among elites (Bauer, Braun, and Clark 2008). Former Chief Economist of the IMF Simon Johnson (2009) offers a very useful illustration of this phenomenon,

> [F]or the past 25 years or so, finance has boomed, becoming ever more powerful. . . . From 1973 to 1985, the financial sector never earned more than 16 percent of domestic corporate profits. In 1986, that figure reached 19 percent. In the 1990s, it oscillated between 21 percent and 30 percent, higher than it had ever been in the postwar period. This decade [the 2000s], it reached 41 percent.

In our view, SWFs are a core element of this new geography of finance. They represent the high-water mark of financialization and the next installment of capitalist development following Clark's (2000) pension fund capitalism.