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Financial Ideas, Political Constraints:
The IPE of Sovereign Wealth Funds

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Declaration

This dissertation is entirely my own work. It has not been submitted for a degree at another university.

Chapters Three and Eight draw from ‘Financial Ideas, Political Constraints: Sovereign Wealth Funds and Domestic Governance’, an article forthcoming in *Competition and Change* (Fall 2011).

Chapters Four and Five include some material from ‘Enacting the Rules of Global Finance: Sovereign Wealth Funds and the Promotion of Corporate Governance Reform’, an article to be resubmitted with revisions to *Economy and Society* in December 2010. This article was co-authored with Dr. Lena Rethel. The material noted above, however, is exclusively my own research.

Summary

Rather than ponder sovereign wealth funds' (SWFs') significance for global capital markets, this thesis takes a step back and asks the following: why do SWFs exist in such numbers across the global political economy? The SWF literature, dominated by financial economists and neoliberal commentators, has yet to adequately address this puzzle. This is significant given the funds embed systematically significant amounts of national wealth throughout speculative capital markets, thereby increasing their state's vulnerability to recurrent asset bubbles and crises. The thesis consequently examines the interest-based politics behind SWFs' domestic origins. It begins its analysis with the argument that SWFs are first and foremost domestic strategies of governance created to achieve specific short and medium term goals of the administrative state. This is despite their international and long-term investment orientations. In short, the funds serve to immediately stabilize state actors' governance function by reconceptualising problems of uncertainty in the quantitative and manageable terms of financial risk. This account of SWFs' origins thus contests that currently dominating mainstream commentary, which portrays the funds as evolutionary features of modern finance capitalism. The domestic political interests SWFs were initially created to serve consequently remain critically unexamined.

Drawing from the constructivist institutionalism literature, the thesis also seeks to demonstrate that SWFs are the institutional embodiment of a specific array of prescriptive financial ideas. It will be shown this framework of financial 'knowledge' problematically constrains political actors to defer their interests to the demands of the speculative financial realm. In the face of recurrent crises, such constraint highlights how SWFs' immediate impact on domestic socioeconomic spheres outweighs their imagined financial benefits. The funds' rapid expansion since 2000 therefore poses significant implications for the nature and exercise of sovereign authority in SWF-states. These theoretical arguments are developed in Part I of the thesis, and then tested against three case studies in Part II: Norway's Government Pension Fund-Global; Alberta's Heritage Savings Trust Fund; and Ireland's National Pension Reserve Fund.

List of Abbreviations

- AHF – Alberta Heritage Savings Trust Fund
- AIB – Allied Irish Bank
- AID – Alberta Investment Division
- AIM – Alberta Investment Management
- AIMCo – Alberta Investment Management Corporation
- ASF – Alberta Sustainability Fund
- BoI – Bank of Ireland
- BSTAG – Budget Strategy for Ageing Group (Ireland)
- CDNID – Canadian Investment Division (Alberta)
- CPD – Capital Projects Division (Alberta)
- CPSP – Commission on Public Service Pensions (Ireland)
- EMH – Efficient Market Hypothesis
- ERP – Equity Risk Premium
- FLAM – Fundamental Law of Active Management
- FRA – Fiscal Responsibility Act (Alberta)
- FX – Foreign Exchange
- GDP – Gross Domestic Product
- GNP – Gross National Product
- GPFG – Government Pension Fund-Global (Norway)
- GRF – General Revenue Fund (Alberta)
- IMD – Investment Management Division (Alberta)
- IMF – International Monetary Fund

INPRFMIPA – Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act (Ireland)

IPE – International Political Economy

IFSWF – International Forum on Sovereign Wealth Funds

IWG – International Working Group on Sovereign Wealth Funds

MLA – Member of the Legislative Assembly (Alberta)

MPT – Modern Portfolio Theory

NESC – National Economic and Social Council (Ireland)

NBIM – Norges Bank Investment Management – (Norway)

NPPI – National Pensions Policy Initiative (Ireland)

NPRF – National Pension Reserve Fund (Ireland)

NTMA – National Treasury Management Agency (Ireland)

OECD – Organization for Economic Co-operation and Development

PAYGO – Pay-as-you-go

PC – Progressive Conservatives (Alberta)

RIH – Rational Investor Hypothesis

SWF – Sovereign Wealth Fund

Introduction

Background to Research

While a longstanding presence in global capital markets, sovereign wealth funds (SWFs) remain an understudied class of speculative investor.¹ In January of 2008, for example, *The Economist* led with a story conspicuously titled: ‘Invasion of the Sovereign-Wealth Funds’. The cover image depicted a number of military helicopters – noticeably branded with the flags of Kuwait, Singapore and South Korea – headed on the same bearing, stacks of gold bars in tow. The image was a tongue-in-cheek reference to the stern protectionist sentiments aired by US Treasury officials the previous week. The source of their alarm was the investments recently made by the SWFs of these three states: \$21 billion in much needed liquidity to support two failing US banking giants, Citigroup and Merrill Lynch.² The irony that these governments, traditionally held to the periphery of modern finance, had ‘flown to the rescue of capitalism’s finest’ was thus not lost on *The Economist* (2008). By 2009, a range of such peripheral governments would in fact invest over \$70 billion in western financial institutions still reeling from the liquidity crisis.³ Yet like so much of the commentary from media, policymakers, and think tanks that soon followed, *The Economist* article offered no definitive conclusions as to what SWFs really were, how they were structured, or why they existed. The last of these questions has gone particularly unaddressed by this growing body of literature.

¹ It suffices to say for now that the term ‘sovereign wealth fund’ refers to a state-linked fiscal vehicle that invests public capital in speculative financial assets, primarily public equities. They are thus demarcated from other fiscal institutions of the state such as central banks, commodity stabilization funds, and public pension funds by the degree of financial risk assumed in their portfolios. A more thorough definition of what constitutes an SWF and what does not is developed in Chapter’s One and Two.

² Unless otherwise noted, monetary figures are expressed in US dollars.

³ For a review of these investments, see Couturier et al, 2009: Sections 4-5.

In one of international political economy (IPE) scholarship's first offering to the SWF literature, Helleiner and Lundblad (2008: 68) ambiguously conclude that 'the transformation of these states into this kind of market actor is important'. Clearly this is so. Yet surprisingly little analysis has been conducted on the transformation process itself, or what significance it poses for these states' understanding of, and approach to, 'good' domestic governance. This dissertation consequently focuses its attentions on the question of why SWFs exist and in such numbers across the variegated global political economy (see Appendix 1). It does so by examining the motivations behind the funds' domestic political origins, as well as the relationship SWFs share with the domestic citizenry to whom they are ultimately accountable.

To be sure, the SWF literature has yet to provide either a theoretically convincing or empirically rich account of the funds' domestic origins and socioeconomic significance. Discussion has instead remained rooted in financial regulatory debates that ask whether SWFs should be allowed to aggressively speculate with public capital, in what asset-classes, and in what markets. This is given the funds' political linkages confuse the orthodox view held by financial economists that capital markets are self-regulating and generally efficient. State originated investment would only upset this delicate balance, so what category of investor are they? Do they follow a 'political' or 'financial' logic? To whom are they accountable? Are they 'white knights' coming to the rescue of the global financial system (Couturier et al, 2009), or are they 'Trojan horses', enabling foreign government to insidiously take over strategic industries (Truman, 2007)? The formative role played by domestic politics in SWFs' creation and development through time, and thus the funds' significant implications for state sovereignty, consequently remain unexamined in the IPE literature.

The Research Puzzle and Objectives

In *Gatekeepers of Growth: The IPE of Central Banking in Developing Countries*, Maxfield (1997: 12) asked why 30 states across five continents increased the independence of their central banks between 1990 and 1995. Specifically, why would government politicians, who are generally assumed in International Relations to be motivated by self-interest, cede discretion over monetary policy to an independent central bank? Why would they limit their authority in this manner given the widespread economic – and therefore political – effects this decision would undoubtedly expose them to? The recent and rapid rise of SWFs represents a similar puzzle to that of central bank independence. While several funds have existed for decades, over half were created post-2000, spanning a diverse range of states characterized by unique socio and politico-economic backgrounds (cf. Miracky et al, 2008: 13-15; Appendix 1). Also similar to central bank independence, SWFs limit a government's capacity to manage key areas of economic and fiscal policy. This is due to the fact that SWF capital is placed at one remove of government auspices for fear of political tampering, thereby limiting their capacity to set short and medium-term expenditure frameworks for this wealth (Davis et al, 2001). Hence if it can be assumed government actors are strategic and motivated to action by their individually formulated policy preferences (cf. Hay, 2001), how to explain the global diffusion of the SWF policy path witnessed over the past two decades?⁴

⁴ The term 'diffusion' here refers to the process whereby institutional principles or practices are spread 'with little modification through a population of actors' (Campbell, 2007: 77). Miracky et al (2009: 14-20) detail the various waves of SWFs' emergence. Although the Kuwait Investment Authority was established in 1950, the first two waves did not occur until the 1970s and 1980s. This followed from the increased price for energy assets, primarily oil, as well as the rise of the 'Asian Tiger' economies. Over half of today's SWFs were then formed after 2000 due primarily to an increase in the price of oil as well as the expansion in global foreign exchange reserve levels.

To be sure, SWFs are not one-off fiscal institutions created, but then left critically unobserved, by political authorities. Rather, the funds are the institutional embodiment of politically constituted and highly contested fiscal *policies*, whose legitimacy must be actively maintained by governments through time. Many domestic commentators have been quick to argue SWFs expose their national wealth to excessive amounts of financial risk. This wealth could instead be directed to achieve more fruitful socioeconomic goals.⁵ SWFs global emergence is thus puzzling given they limit these governments' access to a systematically significant amount of public capital, as well as expose them to unpredictable financial volatility and crises. Why would these actors wish to limit their realizable policy preferences by foregoing their access to SWF capital, instead opting to invest this wealth throughout speculative financial markets? What impact, moreover, does this fiscal management strategy have on these states' approach to domestic governance, and thus state sovereignty in general?

These questions are indeed necessary to examine from the perspective of critical IPE scholarship given the significant financial risks to which SWFs – and by extension, their government overseers and domestic beneficiaries – are ultimately exposed. In 2008, for example, SWFs' total assets under management were reduced by approximately 25 percent – or \$700 billion – in the wake of the financial crisis that began in August 2007 (Financial Times, 2008). The crisis also prompted a majority of SWF-states to redirect their investment focuses inwards so as to stabilize their own fragile economies reeling from volatile property and financial markets (Couturier et al, 2009: Section 4). SWFs' public capital was thus directed towards stabilizing the fragile financial system while non-financial actors and sectors were left reeling. This

⁵ The Chinese Investment Corporation, for example, has been subject to much heated criticism following the poor performance of several of its investments in western financial institutions (Cheng, 2008).

is to say that while these bailouts were made in the name of protecting the greater good – i.e. the ‘too big to fail’ mantra – they nonetheless reflect what Connolly (1995: 85) refers to as ‘forms of discipline, regulation, and surveillance...[that] control or neutralize those populations excluded from [their] benefits’. To be sure, global equity markets recovered much of their losses in 2009. But again, this recovery was predicated on the interventionist hand of governments, many of whom had substantial amounts of national wealth invested in the very system they were bailing out.

This experience of domestic crisis and SWF-directed intervention in 2007 and 2008 held for each of this dissertation’s three case studies: the SWFs of Norway, Ireland, and Alberta, Canada. Being so heavily invested throughout the speculative financial realm in the midst of this crisis also took a political toll on these three governments. Each of the political parties that had held a parliamentary majority prior to the crisis lost a significant share of their political support, due in large part to their SWFs’ poor performances. It is thus surprising that each of these governments’ resounding and unequivocal response to the crisis was not to critically examine whether the SWF policy path was in their best interests. Instead, these governments opted to more aggressively support and promote their funds’ speculative financial identities throughout domestic society. Why did these governments decide to not only maintain the SWF policy path in the face of the crisis’s globally reverberating ramifications, but also more aggressively promote its legitimacy? This question speaks to a second piece of the SWF puzzle examined in this dissertation.

To this end, this dissertation’s research objectives are two-fold. The first is to provide an alternative explanation for the global diffusion of the SWF policy path than that currently offered in the SWF literature. These analyses begin with the assumption that SWFs were created to enable states to capitalise on ‘rationally

desirable' investment opportunities afforded by modern finance capitalism. The funds are thus portrayed as fundamentally necessary macroeconomic tools of the state. SWFs' highly contested domestic political origins, as well as how they came to be perceived as meeting the interests of state actors whose authority over this capital would be severely limited, consequently remain unaddressed. The reasons why financial speculation was specifically pursued by these governments over alternative and competing fiscal management strategies remains theoretically unquestioned and empirically unsubstantiated.

The dissertation's second research objective is to investigate the impact that SWFs have on the realizable policy preferences of the government actors to whom they are ultimately accountable. This is to emphasize that SWFs' primary significance for states – as well as domestic society – is not what they are formally mandated or informally intended to achieve. Indeed, the funds speculative financial futures are entirely unknowable. Rather, SWFs domestic significance lies in how they prevent governments from using this public capital to pursue any short-term goals other than financial maximization through speculative investment. How does this impact these governments' political agency through time, and to what ends? This dissertation consequently adopts an 'inside-out' versus 'outside-in' understanding of SWFs (cf. Deeg and O'Sullivan, 2009). This is to emphasize the funds are not the product of external constraints imposed on them by global financial market realities or finance capital itself as suggested in mainstream analyses. Rather, the funds have been voluntarily established by governments who view the speculative investment of national wealth into the long-term as benefiting their immediate political interests. This dissertation therefore seeks to identify what has driven this inside-out

phenomenon, and thus from where the SWF policy path derives its legitimacy for such a diverse range of state actors.

The Argument

How to explain the global diffusion of the SWF policy path witnessed over the past two decades? In regards to this first research objective, it is hypothesized that SWFs are best understood as strategies of governance first created, and then maintained, to meet the interests of government actors in the *short-term*. This is opposed to commonly held assumptions in the SWF literature, which portray the funds' global emergence as an evolutionary development of modern finance capitalism. These analyses argue the funds' lack of short-term financial liabilities and thus atypically long-term investment horizons provide states with a means to harvest speculative investment opportunities into the indefinite future. Thus rather than be limited to the thankless task of financial market regulator, governments can become powerful market participants to the benefit of future generations of domestic society. Under such assumptions, the interests and policy preferences of SWF-state actors are incorrectly assumed to be both uniform and fixed through time.

The argument that political agency is a prerequisite for SWFs' global emergence is not, however, a bold claim in itself. Indeed, SWFs' public source of funding leads to the logical conclusion the funds were created to meet one interest of government or another. What this dissertation finds worthy of note, however, is the specific process through which the SWF policy path is first championed and then sustained through time over alternative fiscal management strategies. Indeed, the institutional legitimacy of SWFs largely stems from their possessing a long-term investment outlook. This supposedly enables them to ride the volatile ups and downs

of capital markets in the short-term, but on the expectation these markets will eventually ‘float all boats’ in the unspecified future. What cannot be accounted for under such analyses is why so many government actors of diverse and often competing policy preferences, spanning a variegated array of socio and politico-economic landscapes, have perceived this long-term policy path as benefiting their short-term interests.

This dissertation contends that a government will create an SWF only when faced with a specific problem of uncertainty they believe they must address. These problems of uncertainty may be strictly fiscal in nature, such as how to manage the unexpected accrument of windfall petroleum revenues, as was the case in Norway. However, SWFs have also been created to solve a budgetary crisis as in Alberta, as well as to ensure the sustainability of a state pension system as in Ireland.⁶ It is moreover argued that SWFs appeal as strategies of governance as they enable states to reconceptualise such problems of uncertainty in the quantitative and thus manageable terms of financial risk. Undefined and highly uncertain socioeconomic futures can instead be defined in terms of their SWFs’ expected financial return. This consequently defers a government’s responsibility to actually solve these problems of uncertainty to their political successors, thereby stabilizing their governance function and supporting their political legitimacy in the short-term.

It will be demonstrated, moreover, that SWFs possess this stabilizing capacity due to their being founded upon an identifiable epistemology of speculative finance.

⁶ In more authoritarian political systems such as Abu Dhabi, for example, the problem of uncertainty was how to govern a nation with vast reserves of petroleum wealth owned by an elite ruling family. Indeed, the Abu Dhabi Investment Authority was established in 1976 by Sheikh Zayed bin Sultan Al Nahyan. The SWF policy path thus represented a compromise between three factors: the state’s uncertainty of how to develop their emerging market economy with this petroleum wealth, their desire to maintain this wealth’s purchasing power parity into the future, and their desire to do so in a centralized and easy to monitor fashion. To this end, this dissertation seeks to explain why the SWF policy path, and the speculative financial risks assumed therein, was specifically pursued over alternative competing fiscal management strategies.

This authoritative knowledge framework both *informs* and *legitimizes* the forward-looking financial expectations promoted by SWFs to state managers and ‘everyday’ citizens. As such, a key task of this dissertation is to deconstruct the specific ideas and key assumptions from which this speculative financial epistemology derives its authority to be believed by state actors. Only then can it be demonstrated why SWFs should be understood as the institutional embodiment of this speculative epistemology, and thus why the funds serve government interests in the short-term.

Yet how to gauge the impact SWFs have on the governments who create and maintain them? Deconstructing the financial epistemology from which SWFs derive their legitimacy also serves to support this second research objective. It is argued that SWFs constrain state agency not just by placing government actors at one remove of their systematically significant public capital bases. Rather, SWF-state actors are also constrained to act within the expectations of what constitutes legitimate versus illegitimate action prescribed by modern financial epistemology. This argument is premised on the assumption that the financial realm in which SWF capital is embedded is not just a structurally bounded system of competing rules and regulations as held in much orthodox IPE scholarship (cf. Helleiner, 1994; Germain, 1997: 13-14, 24; Langley, 2008: 6-7; Froud et al, 2006; Cohen, 1997). Such characterizations obscure the political struggle and ideational contestation that occur on a daily basis to substantiate what is commonly considered ‘normal’ finance. The financial market realm is instead conceptualised here as a ‘discursive domain made possible through performative practices, which have to be articulated and rearticulated on a daily basis’ (de Goede, 2005: 7). Hence ‘knowledge’ about what speculative finance is and how one should engage with it is a crucial but nonetheless elusive variable the IPE literature on global finance must continuously deconstruct. Financial

knowledge is the primary mechanism through which speculative investment practices materialize on a daily basis, and not just how they are informed (ibid. 7).⁷ This dissertation contends that creating an SWF represents the moment state actors are committing themselves to adhere to this prescriptive knowledge framework that makes financial speculation possible.

This dissertation views such SWF constraint in a critical light. Indeed it has tangible effects on the trajectory of socioeconomic development within a polity. These governments are prevented from investing substantial pots of national wealth in domestic diversification or socioeconomic development projects. While such projects may raise the quality of life for current and future generations of society – whether through improving infrastructure or stimulating economic growth outside of the resource sector – they do not represent legitimate investment opportunities as prescribed by the epistemology of speculative finance. Such investments would be deemed too interventionist and threatening to financial market equilibrium, as well as detrimental to the long-term interests of domestic constituents. It is moreover contended this constraint becomes problematic in the face of recurrent and globally reverberating financial crises. Indeed, the ramifications of recent crises, such as the Asian Financial Crisis, the Dot Com Crisis, and the so-called Credit Crunch, have come to increasingly transcend the borders of the financial economy to the detriment of global socioeconomic stability. In short, this dissertation maintains that SWFs theoretical long-term financial benefits do not outweigh the short-term socioeconomic costs they impose on the domestic citizens whom they are ultimately meant to serve.

⁷ For example, government actors and the SWFs they monitor must imagine speculative profit before it can be realized. That is, believing that an SWF will profit through financial speculation performatively constitutes real financial outcomes when government actors' direct public capital to pursue these imagined profits (cf. de Goede, 2005: 7-8).

The Approach

In its analysis of sovereign wealth funds, this dissertation seeks to demonstrate how an authoritative form of modern financial knowledge – or epistemology – has at once both informed and constrained the policy preferences of a wide variety of government actors. It therefore employs a constructivist approach that sees ideas as important explanatory variables of institutional change (cf. Blyth, 2002; Cameron and Palan, 2004; Hay, 2007; Seabrooke, 2006; Schmidt, 2009). To be sure, the puzzle presented by the diffusion of the SWF policy path across a diverse range of socio and politico-economic backdrops is, at base, a matter of institutional change and global convergence. Only a critical IPE approach grounded in an ideational approach can sufficiently explain – as well as problematize – the financial epistemology underpinning SWFs’ global emergence. Indeed other attempts to challenge dominant financial orthodoxies, such as those conducted by behavioural economists, remain anchored in positivist explanations of markets and finance (cf. Shiller, 2001; Shefrin, 2005). These approaches consequently suffer from the same ontological fallacies they seek to problematize and ultimately correct (cf. Maki, 2001). While critical of the view that markets are efficient and composed of utility-maximising individuals, for example, behavioural economists continue to portray investors as constrained to act within a bounded rationality driven primarily by self-interest. This dissertation’s constructivist approach will be expanded upon in Chapter One.

To substantiate these theoretical arguments, the dissertation examines three SWFs in particular: Norway’s Government Pension Fund-Global (established in 1990), Alberta’s Heritage Savings Trust Fund (established in 1976), and Ireland’s

National Pension Reserve Fund (established in 2001).⁸ These funds were selected for three reasons. First, they come from three countries of unique political, economic, and cultural heritages. This enables us to investigate the problems of uncertainty that instigated each government to create an SWF. Why their political successors opted to maintain support of this constraining policy path can also be examined. Second, each fund was created by a democratic and open government whose members are accountable to the popular opinions of domestic society. This allows us to examine how SWFs and their speculative investment of public capital have been legitimated not only to government, but also the citizens whom they were created to serve. Third, there is an abundance of available information concerning the political origins and government reasoning behind each of these funds' creation. This is opposed to some of the more opaque SWFs that have yet to disclose much information to outsiders, such as the Abu Dhabi Investment Authority, the China Investment Corporation, and the Government Investment Corporation of Singapore.

The empirical resources used throughout this dissertation therefore include: official and unofficial memos sent between government branches, such as between the Legislature and Ministry of Finance; Hansard transcripts of legislative debates and specialist committee hearings; research interviews with SWF managers, government representatives, and externally-hired financial consultants; press releases; annual reports; opposition party and externally-conducted consultancy reports; and finally newspaper articles and online forums.

⁸ This comparative approach is therefore grounded in Mill's 'method of agreement' (2002), where comparing similar cases helps us to identify the factors that gave rise to those similarities.

Thesis Structure

The dissertation is divided into two Parts and includes a total of eight Chapters. Part I comprises three chapters that construct an alternative theory for SWFs global emergence than that currently offered in the SWF literature. First, Chapter One elaborates upon why the global diffusion of the SWF policy path represents a noteworthy puzzle for IPE scholarship. It does so by clarifying several key definitions and concepts that substantiate this puzzle, such as what is referred to by the term ‘state’, what is ‘governance’, and what is ‘speculative finance’. It then outlines the constructivist approach used to investigate this puzzle by reviewing the IPE literature on ideas and institutional change.

Chapter Two then demonstrates how the current literature on SWFs – dominated primarily by financial economists – has yet to provide either a theoretically convincing or empirically rich explanation of the SWF puzzle detailed in Chapter One. It does so by drawing attention to three features that distinguish SWFs from other government-linked fiscal institutions such as central banks, public pension funds, and commodity stabilization funds. It shows how mainstream analyses have yet to adequately account for the central role played by government agency and domestic politics when explaining why each of SWFs’ three distinguishing features exists. Indeed, such analyses portray the government interests served by SWFs as globally uniform and fixed through time.

Finally, Chapter Three constructs an alternative explanation for the global diffusion of the SWF policy path than that offered in existing analyses. It argues that each of SWFs’ three distinguishing features collectively represent a strategy of governance that benefits government interests in the short-term. It will be shown that this is due to the stabilizing effects engendered by the modern financial epistemology

that both informs and legitimates SWFs speculative financial identities. SWFs' grounding in this epistemology enables states to render uncertain socioeconomic futures into the calculable and manageable terms of financial risk. To illustrate this, this framework of financial knowledge is deconstructed into three simple, but nonetheless authoritative, ideas. First is that financial speculation is inherently *profitable*; second, that financial speculation is *calculable*; and third, that financial speculation requires a specific form of *financial expertise* to be successfully engaged with. Chapter Three concludes by theorizing how SWFs' grounding in this financial epistemology can constrain government agency. This is by its prescribing what governments can consider legitimate versus illegitimate action in regards to SWF capital once institutionalised into the state apparatus. It is argued such constraint is highly problematic, especially in the context of recurrent and globally reverberating financial crises witnessed since 'Black Monday' in October 1987. Indeed as their SWFs continue to grow in size and financial breadth, government actors and their political successors have been increasingly pressured to defer their policy preferences to the contradictions and crisis tendencies of the speculative financial realm.

Part II of the dissertation comprises five empirical Chapters against which the theoretical arguments developed in Part I are tested. Chapters Four and Five examine the case of Norway's Government Pension Fund-Global since 1990, Chapters Six and Seven that of Alberta's Heritage Savings Trust Fund since 1976, and Chapter Eight Ireland's National Pension Reserve Fund since 2001. The case studies demonstrate how these three sets of government actors internalized the SWF policy path only after it came to be framed as benefiting their short-term interests. That is, only after each of these governments was faced with a problem of great uncertainty they were led to believe the SWF policy path could solve. The case studies moreover draw attention to

specific instances – such as recurrent financial crises – where the SWF policy path constrained the agency of these governments. This constraint is not, however, solely attributable to the fact that authority for these SWFs' management was placed at one remove of government auspices. Rather, it was also constrained due to the authority exerted by modern financial epistemology to prescribe what these actors' policy preferences should be in the face of political opposition and financial crisis.

Chapter One

Clarifying the Sovereign Wealth Fund 'Puzzle'

A number of IPE scholars have recently drawn attention to sovereign wealth funds as an important yet critically unexamined field of study (cf. Helleiner, 2009; Datz, 2009; Monk, 2009). The funds also remain black-boxes in the literatures of financial economics (cf. Couturier et al, 2009; Bortolotti et al, 2009; Fernandes, 2009), international law (cf. de Meester, 2008; Keller, 2008; Rose, 2008), and financial policymaking (cf. Truman, 2007; Mason, 2008). This is surprising considering their recent rise is only the ‘intensification’ of a pre-existing phenomenon that dates back to the 1950’s (Helleiner and Lundblad, 2008: 73).⁹ Such a lack of engagement may be because SWFs’ political ties and public sources of funding confuse the state-versus-market paradigm preferred by orthodox IPE scholarship (cf. Zysman, 1983; Shonfield, 1965; Katzenstein, 1978; Weiss, 1998). Indeed, SWFs render such simplistic binary distinctions empirically untenable. As Helleiner and Lundblad aptly describe: ‘The state is neither regulating capital mobility nor responding to its externally imposed imperatives’. Instead, it has ‘become part of the very structure of capital mobility from which it was analytically distinguished in earlier analyses’ (2008: 68).

The recent, rapid and truly global emergence of SWFs therefore poses a significant challenge to traditional approaches to IPE scholarship. The funds epitomize the argument that ‘neither states nor global markets are “ontologically distinct”’; rather each exists and evolves in various forms, and is entwined within and around the other’ (Helleiner and Lundblad, 2008: 68, quoting Wendt, 1987: 360). As

⁹ The first SWF – the Kuwait Investment Authority – was established in 1953. It did not start investing in equities until 1961. Over half of the funds that exist in 2009 were since established post-2000 (Miracky et al, 2007; see Appendix 1 for a complete list of SWFs).

such, analyses of SWFs cannot be situated on one side of a linear divide that narrowly pits public politics against private market actors, spheres, or systems. For Helleiner and Lundblad, these classic state-market debates merely ‘foster a theoretical oscillation between classical liberal, neoliberal and “embedded liberal” *epistemes* that governed ages past’ (2009: 74). To analyze SWFs and their significance for IPE scholarship thus requires us to step outside the bounds of this binary state-market debate. In order to do so, this dissertation deconstructs the specific ideas upon which SWFs’ institutional legitimacy is strategically constructed by financial and political actors alike.

The literature on sovereign wealth funds is moreover incomplete in that the vast majority of analyses exclusively focus on the funds’ significance for financial markets and financial market participants. This singularity in focus is especially pronounced in the financial economics and international law disciplines, which see the state and politics as threatening the general efficiency of the market mechanism. They are therefore preoccupied with trumpeting the potentially dislocating effects SWFs and their political ties pose for more or less efficient capital markets. This literature nonetheless remains incomplete as the data required to perform these analyzes is not readily available, if at all. As Caner and Grennes indicate in their econometric study of Norway’s Government Pension Fund-Global, such mainstream SWF analyses remain ‘inconclusive and full of conjecture’ (Caner and Grennes, 2010: 2). Indeed, few SWFs publish readily available financial statements or annual reports, a fact that has received much critical attention throughout OECD policymaking circles in recent years (Gordon, 2008; Bernstein et al, 2009; Carson and Litmann, 2009).

To fill one gap in the IPE and financial economic literatures, this dissertation examines SWFs' domestic political origins. It seeks to explain why so many variegated state actors, influenced by diverse and often competing policy preferences, have all endeavoured to establish sovereign wealth funds. In so doing, it also seeks to account for how the funds impact these state actors' capacity to govern once established. Indeed, SWFs universally embed public capital throughout the speculative financial realm, thereby limiting government's capacity to determine how this wealth can support socioeconomic development and growth. How to explain why so many state managers have been willing to forego their access to such systematically significant amounts of public wealth in the short to medium-terms? What significance does this development pose for these states considering the high-risk and volatile nature of SWFs' speculative financial portfolios?

As witnessed by the scale of government bailouts necessitated by the latest global financial crisis, the authority of the nation state is being increasingly constrained by the expectations and demands of speculative finance capitalism. Within this context, the rapid emergence and continued growth of SWFs represents a global movement that could see governments' embed tens of trillions of dollars throughout the crisis prone financial realm over the following decades (cf. Bortolotti et al, 2010). While this dissertation's first task is to deconstruct SWFs' political origins, it also seeks to problematize this global movement. Through their SWFs, state actors are not just generating and enforcing formal financial regulations to which market participants must adhere. They are also voluntarily ceding much of their sovereign authority over public capital management to short-termist financial experts. The global diffusion of the SWF policy path thus represents a process whereby state sovereignty is being voluntarily transformed from the 'inside out' in key areas of

economic policymaking.¹⁰ It represents a changing perception of what the relationship between the state, citizen, and global finance can and *should* be. And while the ‘fiction’ of the nation state as ultimate authority over this development is maintained by SWF and non SWF-states alike, this authority is ultimately situated within a set of traditionally ‘non-political’ financial boundaries (cf. Cameron and Palan, 2004: 8). To understand why SWFs have been created – i.e. from where this policy path derives its *domestic* appeal and legitimacy – is thus a critical puzzle to examine if we are to gauge the significance this global movement poses for the future development of the nation state. This puzzle is also necessary to deconstruct if equally legitimate alternative public capital management strategies are to be developed.

To this end, the dissertation also traces the ways through which SWFs constrain the realizable policy preferences of governments in their approach to public capital management. It seeks to demonstrate this constraint is not just by SWF management being placed at one remove of government auspices, as would be understood in traditional approaches to ‘depoliticization’ (Burnham, 2001: 128). Thus whether authority for SWF management is delegated to a specialized division within an independent central bank as in Norway, an independent crown corporation as in Alberta, or externally hired professional investors as in Ireland is but one source of constraint on political agency. Rather, this dissertation emphasizes that constraint also emerges from an authoritative epistemology of speculative finance that informs these financial experts. It is the authority exerted by this specific understanding of what

¹⁰ Campbell describes diffusion as the process whereby institutional principles or practices are spread ‘with little modification through a population of actors’ (2004: 77). The institutional convergence of SWFs and their three distinguishing features on a global scale represent such a process of diffusion. Yet how these outside or new principles are internalised and put to use across politico-economic contexts must also be identified. To this end, new institutional principles or ideas are first internalized by specific actors within the state, translated into local practices, and then enacted as concrete policy outputs such as SWFs (Campbell, 2004: 77-80). Chapters Four through Eight identify these processes and how they materialized in three SWF-states, whereas Chapter Three identifies the specific ideas that were ultimately translated, acted and diffused by these governments.

speculative finance is and how to engage it that dictates what constitutes legitimate and desirable action in regards to SWF management. The dissertation will also demonstrate it is these ideas upon which SWFs' domestic legitimacy is strategically built and maintained through time by SWF managers and government actors alike.

In order to develop this understanding of SWFs as governance strategies and their significance for the global political economy, the dissertation employs a constructivist institutionalist approach. Here, ideas and self-perceptions of identity compliment material or structural factors as explanatory variables of agency and institutional change (cf. Palan, 2000: ch. 14). To be sure, SWF's global emergence is at base a matter of institutional change and diffusion. Why have so many state actors with variegated and competing interests all endeavoured to institutionalize the SWF policy path into the state apparatus? Structural factors alone – such as high levels of foreign exchange reserves, the prevalence of developed capital markets, or the increased mobility of transnational finance capital – cannot account for why this fiscal management strategy was specifically pursued over traditional or alternative wealth management strategies. Before this SWF puzzle can be more thoroughly addressed, however, a clarification of terms is in order. This will help contextualise how the puzzle presented by SWFs' global emergence fits – or perhaps does not fit – into orthodox IPE scholarship. The Chapter then outlines the constructivist approach through which this puzzle will be analyzed by examining the IPE literature on ideas and institutional change.

1.1 Key Definitions and Concepts: The SWF Puzzle

First, the term 'sovereign wealth fund' refers to the government-linked investment vehicles that purchase speculative financial assets with public capital.

They are demarcated from other types of government linked or private institutional funds – such as commodity stabilization, public pension and mutual funds – by their lack of short-term liabilities. As such, SWFs are believed to have long-term investment horizons. They can thus theoretically withstand higher degrees of financial volatility in the short-term than other government-linked fiscal entities, such as central banks. It is this unique time horizon that is believed to enable SWFs to adopt high degrees of financial risk, and hence potentially more profitable forms of speculative assets. SWFs are also distinguishable by the authority relationship they share with their overseers in government. A more in-depth analysis of what constitutes an SWF, what does not, and the nature of the funds' relationship with their state owners is presented in Chapter Two.

Second, the term 'state' reflects that used in the constructivist institutionalism literature (Hay, Lister, and Marsh, 2006; Schmidt, 2009; 2010). This understanding of the state and how it changes through time is in contrast to historical and rational institutionalist accounts. While the former tends to reduce the state and its development to path-dependent rules and regularities, the latter sees the state as singularly guided by incentive structures that constrain political actors' so-called 'rational' choice-sets (Schmidt, 2009: 516).¹¹ For constructivist understandings such as that offered by Hay, Lister, and Marsh (2006: 4), however, the state is not a material object but a 'conceptual abstraction' whose utility must be demonstrated. This is achieved through state actors' proactive engagement with policy reforms that are framed as seeking to improve socioeconomic well-being and development. A state's power does not therefore derive solely from its vaunted position of authority in an objective sense of power. This is because 'ideas and values infuse the exercise of

¹¹ For a review of rational and historical institutional approaches, see Schmidt, 2009; Seabrook, 2006: ch. 2. For examples of historical institutionalist approaches in particular, see Hall, 1993; Finnemore, 1996; March and Olsen, 1989; DiMaggio and Powell, 1991.

power and (subjective) perceptions of position' (Lukes, 2004 referenced in Schmidt, 2009: 519). Indeed state actors' power also derives from their capacity to wield 'purpose', or in other words, how capable they are in ensuring their policy preferences are regarded as legitimate by domestic society through narrative construction. This is to emphasize the fact that state authority is based on 'consent rather than domination' (Overbeek, 2000: 171), but also that this consent can be influenced by narratives 'constructed historically in a way that generates *plausibility*' (emphasis in original, Cameron and Palan, 2004: 4).

To understand the state and its role as governor must therefore account for the crucial role played by domestic society, who provides input and feedback that ultimately shapes state manager's policy preferences (Seabrooke, 2006: 28). This is not to discount the significant role of external influences or broader structural factors that can constrain or enable state agency. For example, numerous IPE scholars have demonstrated the structuring influence of the neoliberal policy paradigm on predominantly OECD-state development since the 1980s (cf. Harvey, 2005; Hay, 2007: 96-102; Cerny, 1993; Roy, Denzau, and Willet, 2007). This dissertation nonetheless maintains the state is a distinct form of authority 'independent of those who give effect to its power' (Hay, Lister, and Marsh: 2006: 7), but that the specific ways in which this power is exercised is largely contingent on domestic social inputs. Indeed Seabrooke has demonstrated that the way in which states align themselves with international financial orders – such as the neoliberal policy regime – can be greatly influenced by the role of non-elite social groups (2006: 173). This is through the capacity of these 'everyday' actors to confer legitimacy onto government's regulation of credit issuance, property ownership, and taxation, thereby 'deepening

the domestic pool of capital, which then bolsters the state's influence in the international financial order' (ibid. 173).

Hence the modern state is conceptualised here as 'an institutional complex claiming sovereignty for itself as the supreme political authority within a defined territory for whose governance it is responsible' (Hay, Lister, and Marsh: 2006: 5). At the same time, these political institutions only have 'legitimacy' to the extent to which the members of society regard those institutions as reflecting, embodying, or promoting their shared beliefs (Friedman, 1990: 58). In this sense, state authority is both a bottom up as well as top down process. Those in power can claim their actions are just and legal, but still require the conferral of legitimacy through expressed consent upon such actions from those who are subordinate to them in the power relationship (Seabrooke, 2006: 12; Finnemore and Sikkink, 1998). Conceptualising the state and political authority in this way thus leads to the question: how have sovereign wealth funds come to be regarded as legitimate fiscal institutions from the top down perspective of state actors, *as well as* the bottom up side of domestic constituents? In short, from where do they derive their legitimacy as strategies of governance in a domestic socio-political context? Before these questions can be answered, however, it is necessary to outline what this term 'governance' refers to.

Governance as it is understood here refers to 'the pursuit of collective interests and the steering and coordination of society' – or the process of social coordination with a public purpose (Pierre and Peters, 2006: 209). Given states must be mindful of whether their actions are perceived as legitimate by domestic constituents, state actors are strategic in pursuing their role as governors but are not necessarily dominant in this pursuit. Overbeek contends that state actors play 'a facilitating rather than a leading role' in governing social and economic life (2000: 171). They are susceptible

to a variety of influences – whether formal organizations and rules or informal values, norms and ideas – that both guide and constrain the substance of their policy preferences, as well as how these preferences are presented to the discerning public. Indeed for Kjaer, state governance is about managing the ‘rules of the game’ in a way that enhances the legitimacy of the public realm (2004: 15). State governance thus primarily manifests itself as a coordinative mechanism, through its ‘setting the rules of overall coordination among a plurality of organizational forms’ (ibid. 132). As argued throughout this dissertation, sovereign wealth funds represent one such coordinative strategy of governance through which state actors can demonstrate their utility, thereby preserving or even enhancing their domestic political legitimacy. But again, from where does speculative investment of public capital derive this legitimacy? Given SWFs’ long-term investment horizons, moreover, how is this legitimacy maintained through time?

The fourth term to be contextualized within IPE literature is that of ‘speculative finance’. This refers to the system through which money is created, bought and sold, and which determines how this capital is used by both firms and other speculators (Langley, 2002: 8). However, the speculative financial realm is not just composed of value-neutral capital ‘flows’ as understood in orthodox economics (cf. Obstfeld and Rogoff, 1995; Rodseth, 2000; Ugur, 2001). Nor is it a ‘coherent, powerful and clearly bounded system (or agent)’ that undermines the national sovereignty and domestic policy autonomy of states (de Goede, 2006: 3). These orthodox approaches to IPE scholarship – such as those speaking of the ‘global financial architecture (cf. Eichengreen, 1999; Cerny, 2005; Soederberg, Menz, and Cerny, 2005; Langley, 2004) – are based on too stark a divide separating the state and market realms. They generally assume the form and function of capital markets to be

susceptible to, and contained by, changes in formal and informal regulations, guarantees, and contracts. Such analyses subsequently obscure the political struggle and ideational contestation that ultimately shape the day-to-day practices of financial speculators.

In contrast, speculative finance is conceptualized here as a ‘discursive and ideological constitution’ only made possible by practices that have to be iteratively performed on a daily basis (de Goede, 2005: 3). That is, the financial realm derives its structure from a ‘complex architecture’ of socially embedded and constituted performances, or ‘transactions’ (Sassen, 2005: 19). These performances are in turn based on specific ideas that seek to explain how speculative finance works, and thus how investors should orient themselves strategically towards it. Thus financial ‘knowledge’ and the ideas that substantiate it is a crucial means through which speculative capital markets materialize, and not just how they are informed (de Goede, 2005: 7). Yet despite their importance, the way these ideas about finance have been formalized into regulatory and institutional frameworks by states remains empirically unaddressed in much orthodox IPE scholarship. This is with some exception to an emerging group of scholars – such as Watson (2007), Langley (2008), de Goede (2005), and Preda (2007) – who have begun to critically examine the highly contested origins of what we ‘know’ about modern finance, how we know it, and whose interests this knowledge serves. This dissertation seeks to add to these studies by examining how a particularly dominant form of modern financial knowledge has become a blueprint for action by a diverse range of states. To this end, SWFs provide a number of case studies that demonstrate how a broad array of governments have internalized this dominant understanding of what financial speculation is, and how it can be strategically used, in their approach to domestic governance.

It is also necessary to note that the modern speculative financial realm can be demarcated from previous conjunctural orders primarily by its excess (Langley, 2002: 11). This is to draw attention to the gap that separates the theory of speculative finance and its contemporary realities, as well as the ever-growing divide between synchronic and diachronic forms of investment (cf. Sinclair, 2005: 58-59).¹² Indeed, speculative financial markets are argued by economists to be the most efficient means of allocating footloose capital to the most deserving firms (cf. World Bank, 2002; Demirgüç-Kunt and Levine, 2001; Allen and Gale, 2000). This dissertation instead asserts that speculative investment has problematically become an end in itself, with global financial markets more closely embodying the bubble-inducing synchronic investment form. This is evidenced in the global trade in speculative assets far exceeding the funding needs of the so-called ‘real’ economy. Since 1980, for example, the stock of financial assets has increased three times faster than the aggregate GDP of OECD member states, and the volume in trade of financial assets – including stocks, bonds and currencies – has increased five times faster. By 1998, the value of cross-border bond and equity transactions as a percentage of GDP had reached 230 per cent in the US, 334 per cent in Germany, and 415 per cent in France (Bank for International Settlements, 2000 quoted in Sassen, 2005: 19-20). As Langley indicates, such an expansion in credit has propelled speculative accumulation to become a dominating structural feature of modern finance capitalism (2002: 30). As the empirical Chapters more closely examine, SWF-states’ dependence on such speculative accumulation is inherently problematic. It exposes systematically

¹² Noted by Sinclair (2005: 59), the synchronic form of investment is oriented on the short-term realization of profits that can be accumulated through financial speculation. Synchronic investment is typically associated with the so-called ‘financial’ economy. The diachronic investment form, on the other hand, links financial practices ‘directly to investment in productive assets that improve the social stock of material capabilities’. The diachronic investment form is thus commonly associated with the so-called ‘real’ economy.

significant amounts of public capital to recurrent – and increasingly destabilizing – asset bubbles and financial crises that demand government intervention to correct (cf. Wright, 2010; Shiller, 2001; Kindleberger, 2005). It problematically subjects a portion of sovereign state authority to the uncontrollable and unpredictable demands of the ‘supraterritorial’ financial market realm (Scholte, 2000).

The preceding discussion sought to contextualize the terms sovereign wealth fund, the state, governance, and speculative finance in the constructivist institutionalism literature. This endeavour has, however, produced more questions than it has answered. Taken cumulatively, these questions represent the SWF puzzle to be examined in this dissertation. First, state actors must be strategic in formulating their policy preferences so as to maintain domestic political legitimacy. How, then, to account for the global diffusion of the SWF policy path in states as politically and socioeconomically diverse as Norway, Canada, and Ireland? Second, from where does this fiscal management strategy derive its legitimacy? Legitimacy in this regard is important for government actors who are ultimately prevented from accessing SWF capital. However, it is also important for current and future generations of domestic constituents given the great financial risks this wealth is exposed to. Finally, how has the adoption of the SWF policy path affected state actors’ ability to formulate alternative policy preferences in regards to public capital management? In other words, how have SWFs affected the nature of state authority, and thus the power relationship that exists between government, the citizenry, and the speculative financial market realm? This is given the fact that SWFs appear to prevent governments from using this wealth to pursue any goal other than profit maximization. The following section now outlines the constructivist approach through which these questions will be analyzed.

1.2 Approach: Institutional Change, Ideas, and Constraint

The constructivist approach used to investigate the puzzle presented by sovereign wealth funds' global emergence begins with the concept of uncertainty.¹³ That is, when presented with problems of governance that entail uncertain or unknowable futures, state actors are unaware of their interests let alone how to realize them (cf. Blyth, 2002; 2007: 71; see also Schmidt, 2009; Knight, 1921). Examples of such problems of uncertainty could be how to address a mounting future liability in the present such as expected public pension expenditures, or how to best manage windfall government revenues. State actors must first interpret the specific context of uncertainty in which they find themselves so as to orient themselves strategically towards it. When analyzing institutional change, then, accounting for the presence of uncertainty opens a gap between structure and agency through which ideas can be seen to inform actors of what 'rational' actions they should pursue and which 'irrational' actions to avoid (cf. Hay, 2001: 209-11).

This is to address an undeveloped issue in the historical institutionalist literature on 'punctuated equilibrium', which would argue that periods of heightened uncertainty represent necessary moments for SWFs' institutional development (cf. Greenwood and Hinings, 1996; Campbell, 2004: 34-36; Streeck and Thelen, 2005: 1). That is, unexpected structural factors such as financial crises or political assassinations are crucial for instigating large-scale institutional change. Thus for SWFs, only when in crisis could the ideas, principles and values supporting pre-existing approaches to sovereign wealth management be undermined and overtaken by the alternative ideas pushed by 'policy entrepreneurs'. At the same time, however,

¹³ Uncertainty here is defined as 'the character of situations in which agents cannot anticipate outcomes of a decision and cannot assign probabilities to the outcome' (Beckert, 1996: 804).

ideas are necessary ‘constructions that allow agents to define a crisis *as a crisis*’ (emphasis in original, Blyth, 2002: 10; see also Blyth, 2007: 71; Konings, 2009: 78). As Hay posits, ‘the mobilization of perceptions of crisis....involves the formation and triumph of a simplifying ideology which must find and construct points of resonance with a multitude of individuated experiences’ (Hay, 1999: 321). Thus the ideas that constitute such catalytic ‘simplifying ideologies’ do not just reflect the world that precedes them else little institutional change would occur. Strategically drawing from various authoritative ideas subsequently enables actors ‘to order and intervene in the world by bringing their beliefs, desires, and goals into alignment.’ It is only once this consensus is reached that they can ‘diagnose, and thus collectively act upon, the “crisis” [of uncertainty] they are facing’ (Denzau and North, 1994: 12, 22-23).

This role played by ideas to first mobilize and then inform agency is especially important for state managers in democratic states. A primary objective for these actors when faced with problems of great uncertainty is to maintain political legitimacy in the eyes of the domestic electorate. This is to ensure they remain a functioning member of the administrative state (cf. Seabrooke, 2006: 3-4; Burnham, 2001: 127-8; Kjaer, 2004). State actors must thus construct and pursue governance strategies they believe will address these problems, thereby reducing uncertainty and stabilizing socioeconomic expectations in the immediate term. This is achieved by their strategically drawing from various ideas to construct authoritative interpretations of socioeconomic reality that dictate how they should act within it. Which ideas are turned to and which are not subsequently legitimates certain policy preferences and institutional development strategies over competing alternatives. Ideas subsequently provide an important explanatory device linking the realization of interests with institutions in periods of uncertainty. For Blyth, ideas can consequently be understood

as the ‘predicates of institutional construction, while institutions...are the products that promote long-term stability by coordinating agents’ expectations’ (2002: 37).

At the same time, the ideas that government actors draw from to inform themselves of what policy preferences are ‘rational’ or ‘legitimate’ are neither value-neutral nor objective reflections of socioeconomic reality. These ideas are instead constantly interpreted and ‘framed’ by a diverse range of political and non-political actors competing for control of the understanding of the ‘real’ world, and how they should act within it (Abolafia, 2005: 208). For SWF-state actors in particular, ideas about what the speculative financial realm is and how to operate within it are consequently constructed rather than revealed – that is, ‘made up with an interest in mind, rather than discovered...latent in reality’ (Peet, 2007: 53). The guiding role of ideas and how they are framed to direct the trajectory of institutional change is thus a fundamentally political act. For Denzau, North, and Roy (2007: 16), framing involves drawing from a distinct set of ideas to interpret an uncertain environment in which actors may find themselves, thereby highlighting certain features of this environment while ignoring others. For state managers, using ideas in such a manner is a strategic means through which they can ‘enframe the world in such a way as to make intervention within it meaningful’; for the more people that accept these ideas, the more ‘true’ they become (Blyth, 2007: 76).

Emphasizing the role of ideas as explanatory variables for institutional change and convergence is useful here as pursuing the SWF policy path is a forward-looking condition replete with uncertainty. As further examined in Chapters Two and Three, this is despite the vociferous assertions made by actors attempting to legitimate their SWFs’ risk-laden identities over more conservative fiscal management strategies. Indeed, the outcomes the SWF policy path will produce in the short, medium and

long-terms remain entirely unknowable. Ideas about what finance is, how investors should operate within it, and what they should expect from doing so therefore represent powerful communicative tools that render such uncertain futures into seemingly calculable and predictable forms. Actors can only rely on the ‘certainty of the convention’ – in the case of SWFs, that future profits will meet state actors’ expectations (Pixley, 2004: 41). Ideas about finance subsequently enable SWF-government actors to make ‘reverse projections of the present into the future’ (Barbalet, 2001: 96 quoted in Pixley, 2004: 34), thereby reducing the uncertainty posed by various socioeconomic problems these actors may face.

Financial ideas do not therefore objectively reflect the world that precedes them, but actively construct or ‘perform’ financial reality (cf. Mackenzie, 2004; Callon 1998). Ideas about finance construct expected futures in the present, thus enabling state actors to ‘plan and politic’ their way forward in the presence of uncertainty (Blyth, 2002: 10; cf. Abolafia, 1997: 36)). This notion of the facilitative role of ideas to guide agency compliments similar advances made in the neurosciences. Several studies in this field have demonstrated the human brain is unable to imagine any future or choose to act decisively without the physical (read: chemical) stimulation provided by anticipatory emotions derived from the cognitive realm of ideas (cf. Damasio, 1994). In summary, there is nothing that can guarantee certainty of future events, especially in the speculative financial realm. Instead, actors must rely on their ideas of what finance is, and how they should engage with it, to inform them why, when, and how to act in the present.

Despite their capacity to inform action in the face of uncertainty, however, ideas about finance can also be significant agential constraints. Kirshner posits such constraint emerges when ideas contribute to ‘normative understandings about

“appropriate behaviour” (2003: 15; cf. Sinclair and Thomas, 2001: 103; Scholte, 2000: 93; McNamara, 1999). SWFs’ institutionalization of a specific array of value-laden financial ideas can thus be demonstrated to constrain state actors’ policy preferences to remain within the expectations of ‘legitimate’ action promoted therein. Such ideational constraint is in contrast to global material constraints imposed by regional financial orders on states’ domestic behaviour – such as those encapsulated within the capital mobility hypothesis (Andrews, 1994; cf. Gilpin, 2001: ch. 10; Eichengreen and Leblang, 2003; Eatwell and Taylor, 2000: 111).¹⁴ The literature on global material constraints has also sought to explain why some states are more bank versus capital-market oriented, as well as why globalization has brought about institutional divergence rather than convergence in many elements of economic policymaking (cf. Hall and Soskice, 2001; Underhill, 1997). What this literature cannot explain, however, is how or why state actors’ policy preferences change or remain fixed through time, as they have a ‘thin conception of how economic relations are socially constructed’ (Seabrooke, 2006: 6). To this end, identifying which financial ideas both substantiate and legitimate SWF-state actors’ policy preferences – as well as how they do so – can help fill this gap that pervades the IPE literature on institutional change, ideas, and constraint.

That being said, this dissertation’s focus on ideas is not to discount the significant role played by material or structural influences to guide and constrain institutional change. Indeed, SWFs’ speculative financial practices would most likely not be possible if it weren’t for the deregulation of financial borders engendered by global material constraints – such as international agreements and organizations – since the 1980s (cf. Cerny, 1993; Helleiner, 1994; Weiss, 2003: 8). As such, it is

¹⁴ The capital mobility hypothesis posits that ‘when capital is highly mobile across international borders, the sustainable macroeconomic policy options available to states are systematically circumscribed’ (Andrews, 1994: 193).

necessary to be mindful of the unique politico-economic contexts through which transformative ideas gain the ‘difference’ that defines them in relation to prevailing ideas and institutions. It is only by being mindful of these politico-economic contexts that the way in which the authoritative financial ideas substantiating SWFs are mediated through state actors’ pre-existing interests. Any analysis of SWFs must therefore be mindful of the mediating and guiding role played by domestic politics, which is currently lacking in existing analyses.

Considering the ‘newness’ – or perhaps abnormality – of SWFs, however, structural factors alone cannot account for why SWFs were created over competing alternative policy preferences. Indeed, the global emergence of SWFs redefines IPE scholarship’s understanding of the relationship binding the administrative state with their governance of domestic society *as well as* the financial realm. Simply put, both structural as well as ideational factors must be taken into account to explain why so many variegated state actors all interpreted high-risk speculative investment as a desirable strategy of governance. This is a significant puzzle to be examined given (i) the growth SWFs’ are projected to experience as global foreign exchange reserve levels continue to expand, and (ii) the constraining nature of the financial ideas that inform government actors of how to act in regards to SWF management. Chapter Two now examines the explanation of SWFs’ global emergence purported by financial economists, who have left both financial ideas and domestic political contexts unexamined variables. Chapter Three then offers an alternative explanation for SWFs’ global emergence to that offered by such mainstream analyses. It does so by identifying and deconstructing the specific array of authoritative financial ideas that substantiate and legitimate the SWF policy path to \state actors – as well as domestic society.

Chapter Two: *The Sovereign Wealth Fund Literature (Thus Far)*

If state actors are strategic and motivated to action by dynamic and diffuse policy preferences (cf. Hay, 2001: 131), how to explain the global diffusion of sovereign wealth funds witnessed over the past two decades? How to account for the global popularity of this policy preference given it places systematically significant amounts of public capital at one remove of government auspices? What impact, moreover, has this global movement had on the nature of SWF-state authority? The existing SWF literature has been largely contained within financial economics, and has yet to provide an adequate account of SWFs' contested political origins when examining these questions. Its focus on quantitative evaluations of the funds' impact on financial markets remains 'almost exclusively descriptive and anecdotal' (Caner and Grennes, 2009: 1). Financial economists assume the desirability of SWFs to be implicit, instead focusing their attentions on transnational regulatory debates where the funds' political origins are framed as anomalous and threatening (cf. Truman, 2007). As such, the roles of the state and political agency in the SWF literature have thus far been reduced to latent and unimportant variables. The necessary domestic political and social sources of support upon which SWFs' institutional legitimacy is based have therefore been left unexamined. This gap in the SWF literature is significant considering the funds are pools of public capital ultimately accountable to domestic social versus international financial interests. Yet before such analysis of the fund's domestic political origins can occur, it is first necessary to distinguish SWFs as a unique albeit institutionally cohesive group of like-minded financial entities. The following Chapter consequently draws attention to three features that distinguish

SWFs from other seemingly similar financial institutions of the state, such as central banks, commodity stabilization funds, and public pension funds. These common features allow us to classify the funds as a distinct albeit diverse class of state-sponsored financial speculator that can be treated as a collective whole.

The Chapter then highlights the deficiencies inherent to existing analyses of the puzzle presented by SWFs' global emergence. Focus is placed on financial economic and neoliberal policymakers' analyses in particular. Such accounts can be considered 'mainstream' as they have dominated the academic and policymaking debate in regards to SWF governance and best practice since 2007. To be sure, the funds came to the fore of intellectual debate in November of that year following a string of SWF capital injections into failing western investment banks reeling from the so-called credit-crunch (Couturier, 2007).¹⁵ The following discussion examines each of SWFs' three distinguishing features from the perspective of these mainstream analyses. This is intended to highlight how such analyzes prevent a critical reading of the funds to be had by taking their desirability as fiscal management strategies as implicit.¹⁶ The state and political agency are consequently rendered latent and unimportant variables in explaining SWFs institutional diffusion on a global scale. In so doing, existing analyses merely explain why so many political actors of variegated backgrounds and interests *should* establish SWFs under dominant financial economic *epistemes*. That is, they base their analyses on several ontological presuppositions that substantiate their pre-existing and financially-oriented worldview. As such, they do

¹⁵ For an introduction to SWFs' investment patterns between 1975 and 2008, see Miracky et al, 2008: 35-49.

¹⁶ Both Johnson-Calari and Rietveld (2008) and Rietveld (2008) provide a broad cross-section of 'mainstream' SWF analyses – i.e. those offered by financial economists and neoliberal policymakers. These analyzes and the questions they leave unanswered are more closely examined in Sections 2.1-2.3.

not adequately account for how or why state actors overcame competing and equally plausible policy preferences in regards to sovereign wealth management.

2.0 Sovereign Wealth Funds' Three Distinguishing Features

Given their 'newness', or perhaps abnormality, financial economists and neoliberal policymakers have yet to provide a universally agreed upon definition of what constitutes a sovereign wealth fund and what does not. Some commentators have argued SWFs are any pool of government owned or controlled financial capital. This would include public pension funds – such as the California Public Employees' Retirement System – and even investment arms of central banks (Truman, 2007: 2).¹⁷ Others have adopted more technical approaches by arguing SWFs are distinguished by their unique 'liability profiles', which enable them to take abnormally long-term investment horizons (Rozanov, 2008: 13-18; Rietveld and Pringle, 2008: 5). In any case, how one defines an SWF depends on the normative goals that commentator wishes to promote in their analysis.

Financial regulators in OECD states, for example, have paid considerable attention to the way in which SWFs skirt the lines of dominant (neoliberal) financial proprieties due to the unique fiduciary relationship they share with their state overseers (cf. Truman, 2007: 2; Summers, 2008; Carson and Litmann, 2009). These commentators have subsequently emphasized it is the funds' government-linked identity that is their most important, albeit threatening, characteristic. Financial economists, on the other hand, have attempted to quantify the extent to which SWF

¹⁷ This understanding of SWFs has, however, been largely discredited for two reasons. First, SWFs have no fiduciary responsibilities to trustees or short-term payment liabilities in the same manner as do public pension funds. Secondly, such an expansive definition would inflate the global value of 'sovereign wealth' from approximately \$3 trillion to \$15 trillion (see, for example, United Nations, 2008: Annex table A.I.11). For a review of several similar definitions of SWFs, see: Miracky et al. 2008: 13-21; Monk, 2009: 451-455.

investments impact the day-to-day functioning of the broader financial realm. Such analyses have subsequently emphasized it is their long-term investment horizons and systematically significant capital bases that define SWFs as a distinctive investor class. They argue that due to these unique properties, SWFs are capable of imposing their interests onto their portfolio companies either directly through voting or indirectly through the exertion of ‘soft-power’ on company management (cf. Farrell, Lund, and Sadan, 2008: 7; Derwenter, Han and Malatesta, 2009; Bortolotti et al, 2009: 10-15; Kvam, 2008). The following definition identifies three distinguishing features in particular that demarcate SWFs as a unique and cohesive class of like-minded financial institution. As this dissertation is focused on examining the domestic sources of SWFs’ social and political legitimacy, each of these features draws attention to the nature of the relationship binding SWFs with their state owners.

2.1 The First Distinguishing Feature: *Speculation in ‘risky’ assets*

The first of three distinguishing features is that SWFs are pools of sovereign – read: public – capital managed with the intent of generating a return above what is commonly known as the ‘risk-free rate’ (cf. Balding, 2009).¹⁸ They thus invest in riskier asset classes and markets, including 40-70 percent equities and some combination of government-guaranteed and corporate bonds, real estate, private equity, commodities, and foreign currency (Fernandez and Eschweiler, 2008: 12-13; IMF, 2008: 14).¹⁹ The exclusive pursuit of financial returns and increased appetite for

¹⁸ The risk free-rate of return is defined as the interest an investor would expect from an absolutely risk-free investment over a specified period of time. As no such ‘riskless’ investment exists in reality, the interest rate on a three-month US Treasury bill is usually taken as the risk free rate.

¹⁹ The IMF has calculated the average SWF portfolio to be invested in approximately 40-70% equity, 4-10% of private equity funds, 13-40% fixed income, 2-5% infrastructure, 2-5% commodities, and 8-

financial risk are commonly believed to enable states to circumvent various problems associated with traditional approaches to sovereign wealth management.²⁰ Financial economists in particular argue that adopting high amounts of financial risk enable states to capitalize on ‘rationally desirable’ investment opportunities proffered by the broader financial realm (cf. Jen, 2007; Miracky et al, 2008: 11-12; Rozanov, 2008: 13-18; Kern, 2008).

Like central banks, SWFs’ capital bases are derived from the foreign exchange (FX) reserves that constitute a state’s sovereign wealth. Unlike central banks, however, SWF’s are generally assumed to consist of ‘surplus’ sovereign wealth, which typically derives from one or a combination of three sources (Santiso, 2008: 183-185):

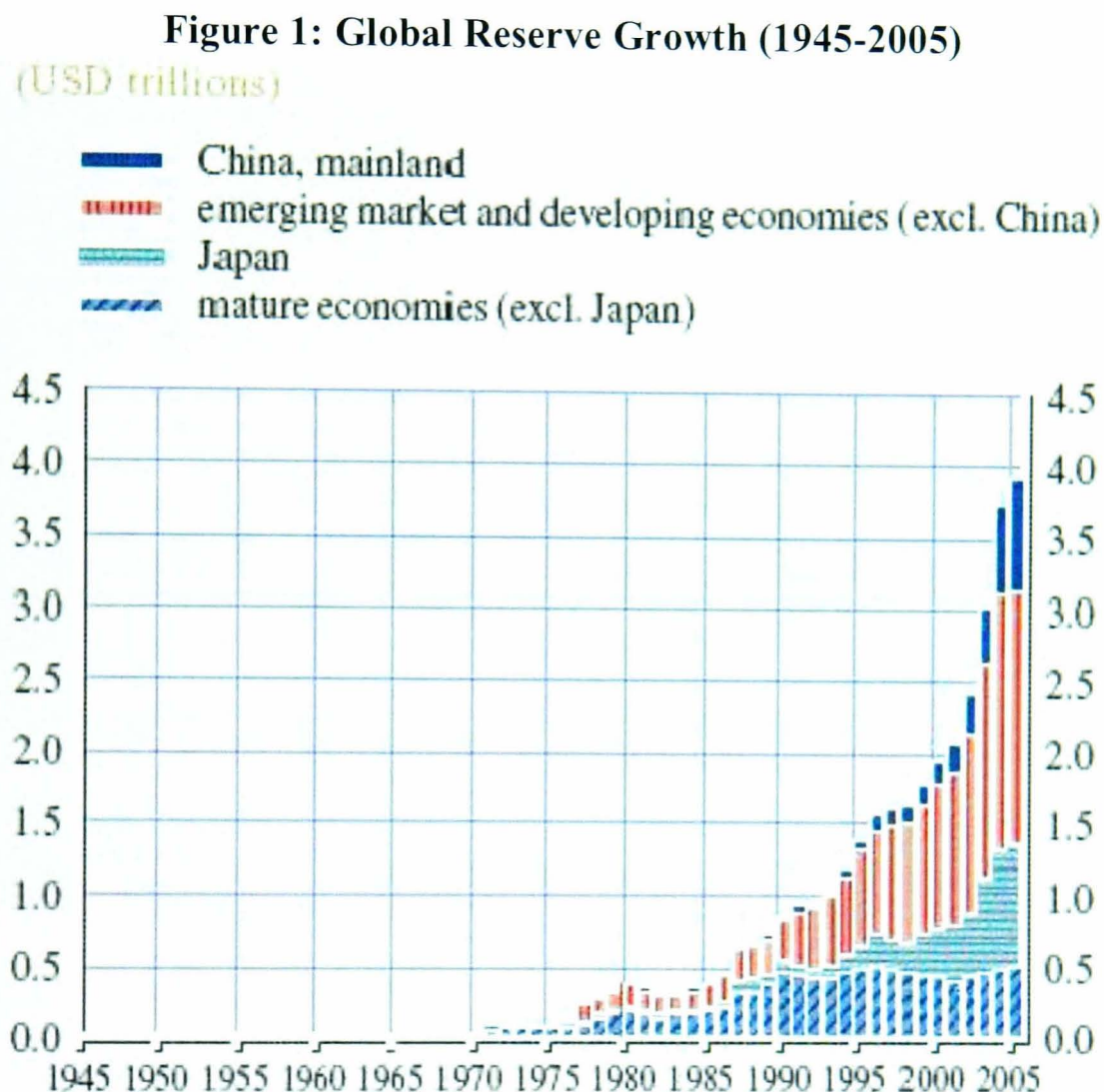
- (1) *Export of state resources*, with revenues generated either directly from state owned companies – such as in Botswana, Chile, Abu Dhabi and Kuwait – or export taxation – such as in Russia or Alaska
- (2) *Fiscal revenues* arising from either budget surpluses – as in Korea or New Zealand – or privatization receipts – as in Malaysia or Australia
- (3) *Pure FX* sources generated by central bank activities such as the sale of government debt – as in China, Singapore, and Ireland.

The problem, argue mainstream analyses, is that conservative central banks are ill-equipped to manage the sovereign credit bubble that has expanded so rapidly since the 1980s. To be sure, central bank reserves have risen 11 percent annually throughout the past two decades, 15 percent over the past ten years, and 22 percent over the past five years. This has been particularly pronounced in the so-called developing world, wherein FX reserves rose 27 percent between 2006 and 2007, largely driven by reserves in Asia (31 percent), the Middle East (35 percent) and Latin America (47

10% real estate (IMF, 2008). Moreover, 90 percent of all listed SWF investments are international in focus, and more than 75 percent are in OECD companies (Bortolotti et al, 2009: 5).

²⁰ Traditional strategies to manage surplus foreign exchange reserves – particularly those generated from commodities – have been extensively covered by the World Bank and IMF in particular (see Devlin and Lewin, 2005; Fasano, 2000; Soderling, 2002; Ramirez and Tan, 2004).

percent). This is opposed to the OECD whose revenues grew only eight percent (Kern, 2008: 5; see Figure 1).²¹



Sources: IMF, International Financial statistics, in European Central Bank (2006) 'The Accumulation of Foreign Reserves', *Occasional Paper Series*, no. 43

Mainstream SWF analyses assume that numerous states experiencing such reserve growth had little choice but to invest into a diverse array of international financial assets so as to sterilize foreign currency inflows, smooth long term

²¹ This expansion in global reserve levels is largely attributable to US monetary policy since the abandonment of the gold standard in 1971. The US's historical propensity to expand its M1 money supply – and thus the global supply of credit – through the Federal Reserve has propelled the US current account deficit to equal the current account surpluses of the rest of the world (cf. Clarida, 2007; Block, 1977; Hildebrand, 2008: 33). It also attributable to a number of governments' actively building their reserves as a buffer against global economic volatility. Between 1997 and 2007, for example, Korea increased their reserves by \$250 billion. Their capacity to re-inflate their fledgling economy in the current crisis was then partly dependent on the greater freedom these reserves gave them to manage speculative outflows.

consumption and investment patterns, avoid experiencing economic boom-bust cycles, and other such expected maladies associated with reserve growth (Rietveld and Pringle, 2008: 1-2; Hildebrand, 2008).²² For Noreng, the problem posed by this wealth is that it must be able to ‘secure a level and pattern of economic activity that maintains social and political stability, without dislocations and undesirable structural changes that can be caused by rapidly rising [household] incomes’ (1981: 28). Diversified investment strategies are moreover thought to enable states to capitalize on rationally desirable opportunities afforded by speculative capital markets (cf. Summers, 2008: 21-24; Johnson-Calari, 2008: 47-70). Given a lack of domestic investment opportunities, limited capital absorption capabilities, and inefficient or non-existent financial services within these states, such diversification was then forced to take an outward-looking international focus (cf. Balding, 2008: 3; Johnson-Calari, 2008: 47; Rietveld 2008, 8). SWFs are consequently assumed by such analyses to be inevitable by-products of modern finance capitalism, rather than politically and strategically established institutions of the state.

Financial economists in particular argue FX reserve growth will inevitably lead state actors to model reserve management around riskier types of investment behaviour. This is due to the fact that there is no expectation this money will be called upon in the short term (Sweeney Barnes, 2008; Rozanov, 2008: 18; Summers, 2008: 18). They then also assume there are no alternative beneficial uses for this capital

²² A number of SWF commentaries have demonstrated that the funds are structured around several liability ‘tranches’, each of which carries a unique set of goals and functions (Rozanov, 2008: 17; Sweeney-Barnes, 2008). For example, almost all SWFs have a stabilization and currency sterilization function in order to address what are known as contingent liabilities. These liabilities include unforeseen commodity-price shocks, domestic overheating, or rapid currency appreciation. Additional investment tranches are then determined according to whether the SWF must meet *fixed liabilities* (such as the Chinese Investment Corporation having to meet annual interest payments on its debt-based source of funding), *mixed liabilities* (have limited long-term liabilities with an obligation to make regular budgetary payments to government, such as Norway’s Government Pension Fund-Global or Russia’s National Reserve Fund), or *open-ended liabilities* (no identifiable or contractually defined obligations such as the Kuwaiti and Qatari Investment Authorities).

and, if there are, governments should not make them anyway lest they destabilize the general efficiency of the private market mechanism. Instead, stagnant reserves can be transformed into a diversified portfolio of financial assets, thereby minimizing the ‘implicit cost of capital’ associated with traditional central bank-style management (Rietveld and Pringle, 2008: 6). They cite that central bankers are constrained to invest primarily in sovereign debt assets – such as highly liquid US Treasury Bills – so as to maintain an undisputed reputation in international debt markets.

Indeed for central bankers, a loss of profitability is synonymous with a loss of credibility. As Leyshon and Thrift describe (1997: 19), ‘state credit money’ is distinguished from ‘bank credit money’ not because of the private-public nature of central banks themselves, but the private-public nature of the debt they manage (cf. Maxfield, 1997: 24). Hence increased levels of financial risk could undermine a central bank’s capacity to conduct monetary policy in times of global or regional crisis, specifically by reducing the attractiveness of their sovereign debt to international bond markets (Hildebrand, 2008: 40; Bakker and van Herpt, 2008: 284; De Beaufort, Berelaar and Petre, 2008: 132).²³ The existing SWF literature has consequently argued the funds were created to enable state actors to invest in riskier and more volatile financial assets, which are assumed to be profitable in the long-term. This is given central banks are constrained to give precedence to domestic monetary and fiscal responsibilities such as wealth preservation and liquidity, maintenance of healthy exchange rates, price stability, and the orchestration of private sector bailouts in the case of crisis (Sweeney-Barnes, 2008; Nugee, 2008; Dumenil

²³ Some exceptions to this rule – which remain unresolved anomalies in mainstream SWF analyses – are witnessed in those central banks pursuing a higher rate of return such as the Swiss National Bank (cf. Hildebrand, 2008) or the Bank of Mexico (cf. Ortiz, 2008).

and Levy, 2000: 69).²⁴ Simply put, central banks are constrained to preserve the structural conditions believed necessary to make speculative credit practices efficient, and thus profitable for private market investors.²⁵ Some commentators have even argued governments who can afford to lose state money credit to volatile equity markets in the short-term, but who only invest in government-guaranteed liquid securities, are ‘guilty of financial malpractice’ (Summers, 2008: 22). Sovereign wealth funds’ focus on financial maximization is thus portrayed in the existing literature as correctly filling the gaps left by central banks’ management of FX reserves. This is rather than begin their analysis by noting SWFs are strategically constructed, debated and contested institutions created and sustained through time by domestic political actors.

For mainstream analyses, SWFs’ first distinguishing feature is thus attributed to the authoritative influence of mobile finance capital itself. State actors’ hands were effectively tied by the pull of financial opportunity on the one hand, and the fear-induced push of domestic economic failure from fiscal mismanagement on the other. How this policy path won out over alternative strategies of sovereign wealth management – such as infrastructural investments, domestic diversification, or more risk-averse investment strategies – is left unexamined. Their understanding of SWFs are instead couched in the assumption that financial maximization through diversification is always a normatively good and rationally-desirable end in itself. As

²⁴ Central banks have short-term liquidity requirements and therefore must invest in highly liquid but safe financial assets, typically government bonds such as US Treasury Bills. These assets do not, however, generate profitable yields such that inflation renders annual central bank returns, especially those in emerging markets, close to 0% (Summers, 2008: 21).

²⁵ Additional perceived deficiencies of central banks by mainstream SWF analyses include: (i) lack of experience in dealing with riskier investments; (ii) lack of incentives to pursue more aggressive strategies due to high levels of accountability to both the state as well as international capital markets; and (iii) low compensation relative to the private sphere which leads to the hiring of managers of sub-optimal talent and financial acumen (Rietveld and Pringle, 2008: 6).

such, little attention is paid to either the politico-economic contexts or alternative short-term government interests SWFs were ultimately created to serve.

2.2 The Second Distinguishing Feature: *Risk management through diversification*

Diversification in the sense of investing in riskier assets as a strategy to maximize financial returns can also be pursued in an attempt to control for increased financial risk. This is achieved by diversifying investments *within* and *between* equities, corporate bonds, real estate, private equity etc. The second distinguishing feature of SWFs can thus be summarized as the process whereby a states' sovereign wealth is continuously embedded throughout the financial realm in both a 'functional' as well as 'spatial' sense of capital mobility (cf. Watson, 2007).²⁶ This ultimately limits state actors' access to this capital and, by extension, their immediately realizable policy preferences. To be sure, the diffusion and geographic reach of SWF investments steadily increased from 1990 onwards alongside the expansion in global reserve levels (cf. Chang, Covrig, and Ng, 2005; Bortolotti et al, 2009; Miracky et al, 2008: 47-48). Mainstream SWF analyses argue this distinguishing feature is the

²⁶ What distinguishes functional from spatial capital mobility will be more closely examined in this Section as well as in Chapter Three, Section 3.2. It can nonetheless be indicated here that understanding finance capital as mobile in these two senses is necessary when analyzing the global embedment of sovereign wealth engendered by SWFs' second distinguishing feature. Indeed, more traditional accounts of finance capital as diffuse yet fungible in a purely spatial sense (see: Obstfeld and Rogoff, 1996; Rodseth, 2000; Ugur, 2001; Watson, 2007: 5; Hay, 2007: 127-32) cannot account for why at particular historical moments investors will 'rebalance their investments so as to reduce their exposure to trading dynamics on one asset market but to increase exposure to trading dynamics on another' (Watson, 2007: 11). In short, traditional characterizations of financial capital mobility do not adequately account for the social or political underpinnings of modern financial relations and practices. They instead explain real-world phenomena through a systemic view of how financial markets *should* operate under assumptions of pareto-optimal equilibrium and rationality. They do not account for the way in which attitudes towards and ideas of finance performatively constitute financial market reality (cf. Mackenzie, 2006; de Goede, 2007; Langley, 2008). Thus the political and social relations that actively constitute and transform speculative capital markets and the legitimated choice-sets – or strategies – available to SWFs embedded therein go unnoticed and inadequately theorized in mainstream analyses.

natural by-product of two factors. First, and as just mentioned, is the perceived ability of diversification within and between riskier assets to minimize the overall risk of an investment portfolio. The second is the increased mobility of transnational finance capital witnessed since the 1980s.

To this effect, the reigning paradigm for financial economists when determining investment strategy is still the ‘mean-variance efficient frontier’ approach introduced by Harry Markowitz in 1956 (Weinberger and Golub, 2008: 75; Poitras, 2005; IMF, 2008: 14). Providing the basis for today’s lauded ‘modern portfolio theory’, Markowitz made the normative claim that rational investors should – and thus would – further diversify their investments within and throughout apparently uncorrelated asset classes and markets. This represented a means to reduce the amount of ‘unsystematic risk’ of a portfolio – or variability in stock prices produced by company or asset class-specific developments – while at the same time allowing for other types of potentially more profitable risk to be assumed.²⁷ Because unsystematic risk cannot be predicted but only controlled for under the assumptions of the random-walk hypothesis (Malkiel, 1999), SWF portfolios are constructed around how much of the latter categories of potentially more profitable risk states are willing to assume – the so-called risk-reward trade-off.²⁸ Given SWFs’ seemingly long-term investment horizons and burgeoning capital bases, mainstream analyses argue SWFs can diversify their investment risk on a more universal and thus effective

²⁷ Examples of such profitable forms of risk include: systemic risk, credit risk (the likelihood of repayment on debt-based instruments such as bonds), and liquidity risk (the ease to which assets can be converted into cash).

²⁸ The random walk hypothesis states that the price of speculative financial assets evolve according to a ‘random walk’ and cannot therefore be predicted (cf. Malkiel, 1999).

manner than other synchronically-minded investors such as mutual funds or hedge funds (Johnson-Calari, 2008: 68-69; Weinberger and Golub, 2008: 82-85).²⁹

Indeed for the existing literature, financial volatility and the possibility of crisis are necessary and expected ills SWFs are assumed capable of weathering. The funds are theoretically capable of withstanding high degrees of short and medium term price volatility, such as equity assets' 14-16% annual volatility swings versus government bond's 1-2% (de Beaufort, Berkelaar and Petre, 2008: 134). Financial economists in particular thus characterise SWFs as a stylised version of the long-term oriented 'value' (or 'buy-and-hold') investor as presented in the Capital Asset Pricing Model. So when investments are diversified in accordance with the assumptions of modern portfolio theory, mainstream SWF analyses posit that riskier investment strategies will actually raise the likelihood of preserving sovereign wealth than would conservative central bank investment strategies (Summers, 2008: 25). This is despite the high degree of short-term risks this strategy entails. Hence if financial risk is not only inherently profitable but also quantifiable and manageable, SWF-states were incentivised to universally embed sovereign wealth throughout the financial realm.

Such mainstream analyses then also argue the increased functional and spatial mobility of finance capital witnessed since the 1980s has made this incentive to globally diversify a logical inevitability. First, the *functional* mobility of capital refers to the degree to which investors are able to transfer wealth between various categories of financial instrument (Watson, 2007: 9). If market sentiment in a certain market or asset-class was perceived as turning 'bearish', for example, the proceeds from an equity sale could be used to purchase corporate bonds. For financial economists, sovereign wealth can consequently remain invested and continuously 'put to work' in

²⁹ For a review of the constraints imposed by a synchronic approach to investment on mutual funds' investment activities and their significance to IPE scholarship, see Harmes, 1998. For hedge funds, see Robbotti, 2003.

accordance with SWFs' long-term investment horizons. This is rather than remain 'stagnant' in cash or sovereign debt (Gieve, 2008: 17, 22; De Beaufort, Berelaar and Petre, 2008: 132-138).³⁰ The *spatial* mobility of capital, on the other hand, is reflected in most all accounts of financial globalization. It refers to the ability of investors to switch their wealth's national orientations but remain invested in the same type of instrument, such as the sale of one country's debt instruments for another's (Watson, 2007: 9). Finance capital's increasing spatial mobility is synonymous with the deregulation of financial borders for transnational investment, the OECD's commitment to which was reiterated in the updated Washington Consensus (cf. Rodrik, 2006). The increasing functional and spatial mobility of finance capital, assume mainstream analyses, has naturally enabled SWFs to extensively diversify sovereign wealth in attempts to mitigate the risks inherent to their equity-exposed portfolios. Indeed as Truman summarizes, SWFs' first and second distinguishing features are portrayed as co-dependant in mainstream analyses:

'The rapid accumulation of FX reserves coupled with a swelling appetite for returns...increased global integration, substantial elimination of restrictions on international capital flows, technological innovation...recognition that diversification contributes to increased investment returns, and loosening of "home bias" in investment decisions has led to a dramatic increase in the rate of SWF investments' – Truman, 2007

Yet by assuming such diversification and financial embedment of public capital to be inherently desirable, mainstream analyses do not make explicit the reasons *why* they should be considered desirable. SWFs' need to control for increased financial risk through diversification is instead rendered axiomatic; it becomes an

³⁰ Various IPE scholars have attributed the increasing functional mobility of finance capital to a number of factors, such as: (a) the rapid expansion of financial innovation in the 1980s and 1990s, motivated by the need to hedge risk in the context of increasingly volatile equity markets (Watson, 2007: 15); (b) opportunities afforded by technological innovation – such as telecommunications and computer-based algorithmic trading (Sassen, 2005); and (c) the popular rise of rational choice theory throughout academia and practitioner spheres to substantiate the claim that markets are inherently efficient and self-sustaining if investors are left to their own devices (Hay, 2007: 98-101).

unremarkable and self-evident feature of modern financial thought and practice. Yet SWFs' diversified investment strategies are worthy of more rigorous examination as they prevent this systematically significant amount of capital from being used for any other purpose than financial maximization (cf. Davis et al, 2001). The illiquid nature of the riskier asset-classes in which public capital is invested effectively limits the realizable policy preferences of state actors and, ultimately, its relationship with domestic society.³¹ The global financial embedment of SWF capital thus appears to be in tension with the short-term interests of the interest-maximizing politicians that establish and maintain SWFs through time. To this end, the existing literature does not adequately account for the reasons why state actors would want to limit their realizable policy preferences by pursuing the SWF policy path. The assumed capacity of spatial and functional diversification to control for increased financial risk does not adequately explain the desirability of this second distinguishing feature of SWFs.

2.3 The Third Distinguishing Feature *The Government-SWF authority relationship*

The extensive diversification of public capital throughout the financial realm by sovereign wealth funds appears to have propelled a number of governments to become systematically significant financial market participants. To this end, SWFs' third distinguishing feature is that the funds are ultimately accountable to government

³¹ Despite the increased mobility of finance capital witnessed since the 1980s, each financial transaction requires both buyers and sellers, the matching of which is not as seamless or instantaneous when dealing with large block trades as SWFs are. SWFs are thus constrained in their capacity to sell poorly performing assets as readily as other investors due to the large size of these investments, as well as the spatial and functional embedment of their diversified portfolios. Hirschman refers to this feature of investment as 'exit' capacity (1970). Sovereign wealth funds' exit capacity is often further constrained by their underlying legislation – whether it be a parliamentary Act, or constitutive, fiscal or company law passed by government (cf. IMF, 2008: 5-7). Such legislation limits SWF capital to the strictly commercial pursuit of financial maximization, often times dictating what percentage of assets should be allocated to specific asset classes.

actors but managed by an operationally independent – though still government-linked – group of financial actors. Simply put, SWF management is placed at one remove of the political arena in a similar fashion to independent central banks (cf. Maxfield, 1997). Hence given their public source of funding, the funds do not readily fit into predominantly binary public-private framework dominating the SWF literature. This simplified and altogether polemic approach narrowly pits irrational states against efficient markets. This third feature of SWFs also remains anomalous for much of the IPE literature on finance. Here, a number of scholars have increasingly focused their attentions on the practices through which ‘everyday people’ are drawn into the market (cf. Langley, 2008; Seabrooke and Hobson, 2007), as well as ‘pointing out the implausibility of the agential assumptions underlying the logic of market stability’ (Watson, 2007: 2; cf. Blyth, 2007; Frankfurter and McGoun, 1999). The presence of SWFs is therefore anomalous for both literatures given the administrative state must maintain relations with their funds, but at the same time cannot be treated as just another everyday citizen or market participant. So what is the nature of the state-SWF relationship?

To this end, SWF managers are deliberately placed at one remove of regulatory entities such as finance ministries or central banks traditionally tasked with the management of sovereign capital.³² These managers can be developed internally as in Norway and Alberta or hired externally as in Ireland, although all SWFs are invariably managed by a combination of both types. According to financial economists, the delegation of operational authority to SWF managers necessarily fills

³² The terms ‘SWF manager’ and ‘state manager’ will be used to demarcate between two different sets of actors. SWF managers are those actors who make the day-to-day investment decisions and are not currently employed as politicians. This can include both ‘in-house’ and externally hired managers. State managers, on the other hand, refers to those actors that are either represented on their SWF’s board of directors or other oversight committee while at the same time holding some other official post in government bureaucracy.

a gap left by political actors' lack of financial expertise (Balding, 2008: 14; cf. Section 2.1). As this belief is taken as axiomatic, what financial expertise actually is, why it is necessary, and thus why state managers should limit their authority over sovereign wealth management in favour of SWF managers goes critically unexamined. The knowledge that financial expertise is necessary for successful speculation is instead taken as implicit, and relegated to Polanyi's 'tacit dimension' (1967: 4). The ideationally constructed and politically contested nature of financial expertise subsequently goes unobserved. The specific financial and political interests this feature of SWFs serves are also left unidentified.

Financial market regulators in particular have emphasized SWFs' unique organizational structure are fundamentally necessary if financial market equilibrium is to be maintained. This is due to the potential for SWFs' strictly financial identities to be compromised by the meddling and ultimately destabilizing influence of self-interested government actors.³³ To be sure, SWFs have fiduciary responsibilities to the state similar to those of policy-minded central banks as both are entrusted with the management of public funds (Hildebrand, 2008: 43). The problem for these primarily OECD-policymakers, then, is that it is unclear what mechanisms of authority SWF managers possess over state managers. This is opposed to central banks that can theoretically impose fiscal discipline on the state by financing government budget overdrafts through purchasing government securities, making unsecured loans on its reserves, or printing money (Maxfield, 1997: 7, 20). SWF managers, on the other hand, lack the same degree of discretion over their funds' short, medium or long-term goals. Their authority is limited to determining which financial tools and strategies should be used to achieve the goals set by the state. The potential for political

³³ For a review of the international regulatory debate that occurred after a number of SWFs invested in various Western financial institutions in the fall of 2007, see Carson and Litmann, 2009.

authorities to interfere in SWF managers' investment activities is thus framed as posing a threat to financial market equilibrium. This third distinguishing feature also creates the potential for states to abuse their position of authority by directing SWF managers to take stakes in so-called strategic industries, such as aerospace and defence (Truman, 2007; Cox, 2007; Weisman, 2007).

The origins of this international regulatory debate arose following a number of very large SWF investments into several failing western financial institutions in the fall of 2007 (IWG, 2008: 11-13; Connon, 2008). SWFs and their supporters in the IMF, OECD and various financial lobbyists were subsequently pressured to ease these fears by actively supporting the funds' legitimacy throughout international policymaking circles (Gordon, 2008; Monk, 2009: 457-460).³⁴ Legitimacy in this sense thus refers to 'the belief that an organization or firm is authorized (legally and morally) to operate in a certain place' (Monk, 2009: 458; cf. Tucker and Hendrickson, 2004). To be sure, promoting SWFs legitimacy through forums such as the International Working Group on Sovereign Wealth Funds (IWG) became synonymous with 'gaining access to operate and invest in a given country or market' (Monk, 2009: 459). The transnational regulatory debate did not therefore trigger a regulatory backlash against SWFs. Instead, it instigated a promotional movement that sought to legitimate SWF directed investment in general (cf. IWG, 2008: 11).

The IWG emphasized the following characterization of the state-SWF relationship in particular. On the one hand, state managers were argued to derive authority from their *design* capacity (cf. Vipond, 1993: 1987) – i.e. the ability to

³⁴ The IWG – renamed the International Forum of Sovereign Wealth Funds (IFSWF) in 2009 – is a voluntary group of 23 of the world's largest SWFs that meet, exchange views on issues of common interest, and facilitate an understanding of SWFs activities throughout the international financial community. Of particular importance were the 'Santiago Principles' passed in October 2008 which detail a number of 'Generally Agreed Practices and Principles' member states are expected to meet. The Group's primary function is to promote these principles in a way that ensures financial borders for SWF investment remain open (IWG, 2008: 11-13).

structure the laws and regulations through which SWFs' financial activities are implemented (IWG, 2008: GAPP #7, 8, 18). At the same time, SWF managers retain their *operational* capacity as an entirely separate, technocratically managed institutional body that determines which specific industries and companies capital under its management will be invested and how. SWF managers are thus responsible for the operational execution of investment decisions in compliance with the financial risk preferences approved by their state overseers (IWG, 2008: GAPP #9, 11; cf. Das et al, 2008: 75). State managers are therefore expected to rely on SWF managers' expert financial knowledge when it comes to operationalizing a fund's speculative financial mandate. It is SWF managers that actually invest in markets: they have licenses to trade, formal and informal financial networks to help them do so, and the expertise to justify their investment preferences. State managers, on the other hand, do not invest but still retain the capacity to either determine or approve their SWF's investment universe (cf. IWG, 2008).³⁵

According to this understanding of the SWF-state relationship as promoted by SWF lobbyists and support organizations, authority is portrayed as existing in two senses. First, an actor or firm can be *in* authority such that they are entitled to decide how others behave (Friedman, 1990: 57, 80-81). Conversely, actors and firms can be *an* authority in that their views are entitled to be believed by others. This distinction between *an* versus *in* authority derives from the presupposition of inequality: that one actor (e.g. state managers) lacks the knowledge or insight they assume another (e.g. SWF managers) to possess. This effectively abdicates state managers from judgement. Friedman refers to this second form as 'epistemological' authority (1990:

³⁵ This governing role of the state has manifested itself in various ways that differ between individual SWFs and are both formal (i.e. degree of bureaucratisation, legislation, and political representation) and informal (i.e. informational feedback loops) in nature. For a summary of the different reporting mechanisms employed by states in their oversight of SWFs, see: IMF, 2008: 5-9; IWG, 2008: 38-56.

83), a term that will be more thoroughly introduced in Chapter Three. It suffices to indicate here that SWF proponents in the IWG and elsewhere argued the funds could be considered legitimate investors as political authorities were placed at one remove of SWF management. Indeed, the more vaunted position of being *an* authority was rightly retained by SWFs in their role as operational managers of sovereign capital. SWFs' third distinguishing feature is thus commonly attributed to the need for state managers to act in strict accordance with the recommendations provided by epistemologically authoritative financial experts.

Despite these convictions, however, why state actors would be willing to defer their authority for SWF capital to professional financial speculators has not been adequately addressed. Examining the authority relationship that exists between state and SWF managers remains an empirical exercise yet to be engaged with by SWF scholarship. This is given the fact that the financial data used in these typically econometric analyses – such as actual versus benchmark asset allocation and performance history – is limited. In any case, moreover, what financial data is available cannot be used to quantify state versus SWF authority – which is not a material thing but an intransitive act that must be iteratively performed to become 'real'. Indeed, mainstream SWF analyses have yet to convincingly demonstrate financial expertise exists as a measurable concept, what it is composed of, and thus why state managers should defer their authority to it. Simply put, the SWF literature has yet to critically examine the ideational building blocks upon which modern financial knowledge is constructed, and through which SWF discourse is filtered. As will now be explored in Chapter Three, it is only by identifying these ideas and their capacity to inform state actors of legitimate action that these gaps in the SWF literature can be filled.

Conclusion

The growing clout of sovereign wealth funds throughout global capital markets since 2000 represents a shift in many states' attitudes towards speculative investment. Rather than be relegated to play a game of regulatory catch-up, SWF-states have propelled themselves to the frontlines of the global financial arena. With support from financial economists, professional investors, and international organizations such as the IWG, speculative investment of sovereign wealth has become increasingly synonymous with good governance. The preceding Chapter drew attention to three features in particular that distinguish SWFs from other government-linked fiscal institutions. First, SWFs are pools of public capital managed with the intent of generating returns above the risk-free rate into the long-term. They thus speculatively invest in a broad range of traditionally riskier asset classes and markets, primarily public equity. Second, SWFs continuously embed this public capital throughout the financial realm in both a functional and spatial sense of capital mobility. Such global diversification is pursued in attempts to control for the higher degree of risk their investments entail. It is moreover facilitated by the funds' systematically significant capital bases and lack of short-term liabilities. Finally, SWFs are managed by an operationally independent, though still government-linked, array of SWF managers placed at one remove of the political arena. It was emphasized that each of these features prevents state managers from using SWF capital for anything but financial maximization in the short and medium-terms.

Despite these features, the SWF literature has left the state and domestic politics unexamined variables in explaining the funds' global emergence. They instead take the desirability the SWF policy path as implicit, building their analyses on preconceived notions of the inherent benefits afforded by speculative investment.

Discussion has consequently been limited to asking whether financial regulators should allow the funds to invest, and in what amounts, asset classes and markets. Mainstream analyses moreover argue that governments cannot be trusted to profitably invest SWF capital due to the meddling influence of self-interested politicians. Yet they then contradictorily maintain these same state actors will altruistically create an SWF so as to benefit future generations and preserve domestic economic stability. Why so many state actors, supposedly motivated by competing and self-serving policy preferences, all chose to create and maintain their SWFs through time thus remains critically unexamined. How did the SWF policy path appeal to the short-term interests of state managers – as well as the domestic populations to whom SWFs are ultimately accountable – given their long-term and internationally focused financial orientations? How was each of SWFs' three distinguishing features legitimated over alternative fiscal management strategies considered by these states?

The existing SWF literature has provided a rough sketch of why the funds are categorically distinct financial entities. They are nonetheless lacking in their analysis of the relationships that bind SWFs with financial markets *as well as* states and domestic political interests. These commentaries understand the administrative state and its public interests ultimately define SWFs' unique financial identities, but go no further than acknowledge this unique public-private identity exists. The nature of the SWF-state relationship, why it should be considered a legitimate partnership, and its significance for domestic society as well as political authority are consequently left unexamined. The following Chapter provides an alternative explanation for the global emergence of SWFs than that currently offered in either the IPE or financial economic literatures. It does so by first identifying and then deconstructing the ideational

building blocks – or forms of modern financial knowledge – upon which SWFs’ institutional legitimacy is based.

Chapter Three

Politicizing the Sovereign Wealth Fund Puzzle

The preceding Chapter argued that sovereign wealth funds are distinguishable from other government linked financial vehicles such as central banks, commodity stabilization funds, and public pension funds. This is due to their: (i) investment of public capital in speculative financial assets, (ii) universally diversified orientation, and (iii) unique authority relationship shared with the state. The following Chapter seeks to expand on this understanding of SWFs, and where they can be situated in the IPE literature on global finance. It argues the funds are best conceptualised as domestic strategies of governance, first and foremost created to support the short-term interests of state managers. This is to fill in a gap left in the SWF literature currently dominated by financial economists. That is, if state managers are strategically selective when devising their often-competing policy preferences, how to explain the global diffusion of the SWF policy path witnessed over the past two decades? Taking the desirability of SWFs as implicit, existing analyses are exclusively focused on examining the funds' significance for financial market participants. In their rush to either condemn or celebrate SWFs' legitimacy as private market participants, these analyses speciously paint the funds as evolutionary by-products of modern finance capitalism. They assume extra-budgetary sovereign wealth derived from commodity exports, trade surpluses, or the privatization of state owned enterprises must indeed be 'put to work' through speculative investment so as to avoid incurring unnecessary 'opportunity costs' (cf. Nugee, 2008; Summers, 2008; Johnson-Calari, 2008; Rietveld, 2008). In so doing, these assumptions rigorously abstract political agency,

and the domestic political struggles that underpin SWF creation and development are left unexamined.

The following offers an alternative explanation to the puzzle presented by the global diffusion of the SWF policy path. It posits the funds' speculative financial identities represent a means for state actors to immediately address various problems of uncertainty they are expected to address as governors of domestic society. If left unaddressed, these problems may undermine a government's political legitimacy (cf. Seabrooke, 2006: 3-4). SWFs effectively enable states to reconceptualise these problems of uncertainty in the quantitative terms of financial risk management. State actors can thus construct forward-looking financial projections that command the authority to be believed, thereby managing short-term expectations of these actors' capacity to govern. In short, establishing an SWF serves much more inward-looking and short-term political interests than currently assumed in the SWF literature. For example, the expectation that Ireland's vaunted state pension system was unsustainable represented a great problem of uncertainty for the Fianna Fail majority government in the late 1990s (cf. Chapter Eight). Establishing the National Pension Reserve Fund – mandated to maximize financial returns through financial speculation – thus immediately created forward-looking expectations of Fianna Fail's capacity to generate investment income and lessen the cost-savings gap. The SWF policy path was thus only pursued once Fianna Fail saw a great need to pacify emerging fears of their pension system's seemingly imminent demise. It was not pursued due to any innate properties of speculative finance or rationally desirable opportunities afforded therein. Yet from where did the financial expectations promoted by Fianna Fail derive their authority to be believed?

As a first step to addressing this question, the following Chapter identifies the authoritative financial ideas upon which each of SWFs' distinguishing features is based. It is these ideas that render SWFs more desirable strategies of governance over competing policy preferences for state managers faced with problems of great uncertainty. These ideas have been categorized under three headings: *financial profitability*, *financial calculability*, and *financial expertise*. The Chapter draws attention to the specific ontological presuppositions that lend these ideas the authority to inform belief-driven action. For example, both the rational investor and efficient market hypotheses substantiate the notion that riskier assets such as equities will always pay a premium over more conservative assets. These theories about the nature of speculative finance subsequently lead to the idea that speculative investment is profitable, a powerful tool used by state actors to legitimate the creation of an SWF. The Chapter argues it is these specific ideas that represent the 'weapons' of institutional change state actors use to legitimate the SWF policy path over competing fiscal management strategies (Blyth, 2002: 38). Chapters Four through Eight then examine three specific politico-economic contexts – Norway, Ireland, and Alberta – within which these financial ideas were internalized over competing policy preferences to guide state agency (Campbell, 2004: 77).

At the same time, however, these financial ideas also serve to constrain states in their approach to the socioeconomic problems their SWFs were created to solve. Indeed for Nobel Prize winning economist James Buchanan, these ideas about the nature of speculative finance have become 'absolute absolutes', and thus the 'constraints and constitutions' within which modern financial discourse is conducted (1991: 13-14). Once institutionalized into an SWF, these ideas limit what can be considered acceptable uses for this public capital lest they be accused of fiscal

unaccountability or malfeasance. In short, successive governments must ensure their policy preferences remain within the bounds of acceptable action enforced by these ideas no matter how volatile the markets or recurrent the financial crises. As such, SWF-states are constrained to actively normalize the contemporary financial relations, thoughts, and practices upon which their funds' speculative financial identities are based. As the case studies demonstrate, this constraint is problematic, as SWFs do not necessarily solve the long-term problems of uncertainty they were created to address. Instead, they primarily serve to replace socioeconomic uncertainty with a seemingly more measurable and manageable form of financial uncertainty. This ultimately increases these states' vulnerability to the inherent contradictions and destabilizing crisis tendencies of the speculative financial realm.

Chapter Three is structured as follows. Sections 3.1, 3.2 and 3.3 present the theoretical arguments for why SWFs appeal as strategies of governance that meet the short-term political interests of state actors. Each Section examines the authoritative financial ideas underlying each of SWFs' three distinguishing features, and are thus divided into three associated headings: *financial profitability*, *financial calculability*, and *financial expertise*. Section 3.4 then concludes by arguing these ideas also constrain state actors to defer their policy preferences to the financial interests of their SWFs, and the speculative financial realm in general. To reiterate, then, the purpose of this Chapter is to construct an alternative explanation for why SWFs represent desirable strategies of governance than that currently offered in the SWF literature. This theoretical argument will then be applied to each of the dissertation's three case studies to test its plausibility.

3.0 SWFs as Strategies of Governance

Sections 3.1-3.3 identify the authoritative financial ideas that legitimate SWFs' speculative financial identities to state actors and domestic constituents. In short, it is these financial ideas and their authority to be believed that ultimately lead individuals to perceive the SWF policy path as a legitimate and desirable strategy of governance. SWF-state actors are particularly dependent on the work of financial economists to reinterpret speculative investment practices from matters of unpredictable uncertainty to manageable financial risk. Without this distinction, SWFs would be cast as irrational gambles that subject public capital to unnecessarily high degrees of global financial volatility. This is to highlight that financial economists do not merely debate the finer points of investment strategy, occasionally providing a theory that transcends the academic-practitioner divide – e.g. modern portfolio or options pricing theory (cf. Jovanovic, 2007; MacKenzie, 2006). Rather, these intellectuals also dogmatically maintain the ideational building blocks of modern financial knowledge through which SWF discourse has thus far been filtered. Indeed, financial economists seek to present knowledge of speculative finance in a normatively objective and methodologically-positivist light. Yet modern financial knowledge is in no way value-neutral, but is 'imbued with certain beliefs and cast in a certain language that make it out to be what its believers want it to be and not the way things in any sense 'are'' (Frankfurter and McGoun, 1999: 161). As Maki has argued, to be considered a legitimate participant in either the financial economics or investment professions requires the world be viewed through the same 'shared ontological windows' (2001: 5). These ontological windows – or ideas – then gain strength as an *ideology* of speculative finance through their iterative communication and performance across territorial borders. This modern financial ideology provides

an authoritative interpretation of the speculative financial realm while simultaneously prescribing how to act within it (cf. Denzau and North, 1994: 4; Roy, Denzau and Willet, 2007: 6). Sections 3.1 to 3.3 thus look critically *at* – and not merely *through* – the ontological windows upon which the domestic institutional legitimacy of SWFs is based (Maki, 2001: 6).³⁶

3.1 SWFs as Strategies of Governance: *The Idea of Financial Profitability*

Sovereign wealth funds are pools of public capital managed with the intent of generating returns above the risk-free rate into the long-term. According to financial economists, the primary means through which this can be achieved is by investing in a variety of traditionally riskier asset classes and markets. Simply put, then, this feature of the SWF policy path is legitimated by the idea that diversified finance – and the accompanying levels of increased financial risk assumed therein – is profitable into the long-term. This idea of financial profitability derives from the notion of the ‘equity-risk premium’ (ERP): that investment into riskier assets such as equity will always pay out a premium due to the natural risk aversion of investors.³⁷ The

³⁶ Several genealogical analyses of modern finance have been conducted elsewhere in both the sociology and history of finance literatures (see for example Poitras, 2005; McGoun, 2007; Preda, 2007). While these genealogical accounts provide a detailed history of modern finance, they have yet to identify the specific assumptions that substantiate the ‘science’ of modern financial speculation. They have instead primarily focused on the ‘gendered constructions of danger and security’ that have led to the widespread commercialization of speculative investment (de Goede, 2004: 197), as well as to the cultural practices that rendered financial speculation as distinct from gambling (Preda, 2007). As this dissertation’s case studies reveal, however, states place great emphasis on the ‘scientistic’ properties of financial speculation and their authority to be believed when debating the merits and demerits of the SWF policy path. It is a critical reading of these scientistic properties that is this Chapter’s focus.

³⁷ Based on historical data of the past twenty years, financial economists have calculated the equity-risk premium to be six percent annually. However, economists assume the more likely long-term equity-risk premium to be three to four percent due to the uncertain future of this ‘favourable environment’ and impending ‘demographic change’ in the world’s developed and emerging markets (Summers, 2008: 22). In any case, the ERP is extremely difficult to measure even in a historical sense, and its calculation into the future is an entirely theoretical exercise.

following Section identifies the ontological presuppositions that underpin the notion of the ERP. This is a necessary task as the ERP is the primary idea from which SWFs' first distinguishing feature derives its legitimacy as a governance strategy for state actors. This is to demonstrate it is the simplified assumptions about the nature of financial market reality – and not any innate properties of speculative finance itself – that lead state actors to perceive the SWF policy path as benefiting their short-term interests over competing fiscal management strategies.

While formally defined as the 'difference between the return on common stock and the return on government securities' (Cornell, 1999: 19), the ERP represents the single most important concept that makes speculative investment possible. Poitras asserts that investing in riskier assets in the belief their returns will be greater than those on safer assets is the 'procedure underlying the mantra of modern finance' (2005: 46, 23). For Maki (2001: 5), the ERP is finance's 'ultimate and unquestioned presupposition' to which all of its relative suppositions are justified. Indeed, the ERP represents a 'unified theory' through which uncertain financial futures can be reduced to the axiomatic assumption of financial risk's inherent profitability (cf. Constantinides, 2002: 1567). Without the ERP, SWFs would lack institutional legitimacy as there would be no incentive to establish and maintain their risk-laden portfolios. There would be little point for governments – let alone any other investor – to invest sovereign wealth in equities as they could not expect to be paid a premium for any extra risk assumed.

Yet despite its significance to modern financial thought and practice, the ERP remains a theoretical and empirically unsubstantiated proposition. Its value can only be approximated *ex post* where data over particular time periods can be collected and analyzed (Cornell, 1999: 19). Such historical measurements have in any case been

accused of suffering from ‘survivorship bias’ – as only continuously profitable stocks are accounted for – and a lack of sufficient data (Goetzmann and Ibbotson, 2005: 8). Attempts to quantify, measure and prove the ERP’s existence are in fact a relatively recent phenomenon; the belief it existed long predated any attempts to measure it or prove *why* it existed.³⁸ It was not until so-called ‘modern finance’ gained a position of intellectual superiority over that of ‘old finance’ – who were preoccupied with analyzing firm-specific risk and individual stock selection – that economists would attempt to do so (Poitras, 2005: 125).

To this effect, the idea of the ERP is substantiated by the presuppositions of investor rationality and market efficiency that only gained prominence in economics in the 1960s. Financial economists have since internalized these presuppositions as the ‘central abstractions upon which theoretical knowledge about security pricing can be obtained’ (Poitras, 2005: 130; cf. Kindleberger, 2005: 29; Haugen, 1999). Prior to this intellectual revolution, economists lacked a methodologically inductive, quantitatively testable, and universally accepted narrative to legitimate speculative financial practices. The forefathers of old finance such as Withers (1916) and Graham and Dodd (1934) subsequently lacked the ability to project how stock markets *should* behave in the future with any degree of mathematical certainty. They lacked the theoretical abstractions and quantitative models that a new network of academics emerging out of the Chicago School of Economics and elsewhere in the 1950s began to develop (Fourcade, 2009). To be sure, the assumptions that investors were rational utility maximizers and markets were efficient were ‘intellectually enforced’ by this new brand of academics who wished to cast off the epistemological straightjacket of

³⁸ The first real attempt at introducing the presence of the ERP from a theoretical perspective was by Edgar Lawrence Smith’s *Common Stocks as Long Term Investments* (1928). It would be another six decades before Mehra and Prescott (1985) first attempted to compare the theory of the ERP – as based on the assumption of static investor preferences – with empirical measures of historical returns.

old finance (Haugen, 1999; Poitras, 2005: ch. 2). Those who questioned the rational investor and efficient market mantras were quickly ‘dismissed as *gauche*...ridiculed...their methods, of course, naïve’ (Haugen, 1999: 7; cf. Frankfurter and McGoun, 1999).

In regards to the presupposition of investor rationality, financial economists assume people prefer more wealth to less, and the pleasure – or utility – derived from an extra unit of wealth decreases as their total wealth rises (Cornell, 1999: 126-27).

As summarized by Petit:

‘Every agent has a utility function that identifies a certain degree of utility, a certain intensity of preference, for every way the world may be...and a probability function that determines, for each option and for each prospect, the probability that the choice of that option would lead to the realization of that prospect’ – Petit, 2001

If investors are rational, concluded the new generation of mathematically-trained financial economists in the 1960s, they would avoid purchasing riskier assets unless adequately compensated for doing so. As such, rational investors always make calculated bets on assets that carry a higher potential reward for the added risk of losses such investments entail. The rational investor hypothesis (RIH) thus helped explain why the ERP should exist in the ‘real’ world. The efficient market hypothesis (EMH), on the other hand, helped explain why the ERP should be considered a measurable constant. The EMH argues that investors will not take the risk of purchasing equities if they lack the information necessary to accurately assess the true value of the premium they should be paid on these assets (Frankfurter and McGoun, 1999: 170). It claims that investors will analyze all relevant past and present market data – i.e. ‘price signals that are presumed to provide “information” about future events’ – when forming rational expectations as a basis for making utility-maximizing decisions (Davidson, 2007: 221). Hence the EMH substantiated the argument that the

market is capable of forming a consolidated opinion of what value the ERP should be and, as such, why it should be considered an accurate quantification of investor rationality.

Given the idea of financial profitability as substantiated by the notions of the ERP, EMH, and RIH, financial economists are quick to argue riskier assets such as public equities represent optimal investments for the likes of long-term oriented SWFs. To be sure, the profitability of diversified finance has been high over the past four decades, with investors averaging a noteworthy six percent above the risk-free rate each year since 1971 (Summers, 2008: 22). It has been so high, in fact, a hotly contested debate surrounding this ‘ERP Puzzle’ continues to thrive in financial economic scholarship since first introduced by Mehra and Prescott in 1985. The ERP puzzle simply states that in order to explain the abnormally high return of US equities versus government bonds since the 1970s, either the ERP as a theoretical concept does not exist or investors must have implausibly higher risk aversions than financial economists assume. The majority of financial economists nonetheless maintain that despite this unresolved puzzle, the idea of the ERP has proven an ‘accurate forecast’ for investors since the 1970s despite its not being empirically proven to exist (Goetzmann and Ibbotson, 2005: 13).

A major contribution of critical IPE scholarship, however, has been to fill in the gaps left by financial economists by providing an alternative explanation for the ERP puzzle. These scholars have highlighted the active role played by states – particularly those of the OECD – to provide an abundant supply of transnational finance capital while at the same time institutionalizing rules and policies that have facilitated this capital’s spatial and functional mobility. Indeed, political economists have shown the modern financial era to be demarcated by the more multilateral and

deeply embedded ‘patterns of institutionalization’ through which speculative finance is made possible (Watson, 2007; cf. Langley, 2003: 11; Harvey, 2005; Helleiner, 1994; Dumenil and Levy, 2004; Germain, 1997; Moran, 1991; Underhill, 1997).³⁹ These patterns are evidenced in existing regulatory institutions designed to foster high capital mobility, large private capital flows, market-conforming tools of macroeconomic management, and the role of central banks to maintain the primacy of price-stability over social welfare and full employment (Blyth, 2002: 6; Peet, 2007: 117; Rodrik, 2006).

As documented by much of the literature on ‘financialization’, the end result of these policies has been the rapid expansion in both volume and profitability of speculative financial practices over the past four decades (cf. Epstein, 2006; Froud, 2006; Dore, 2000).⁴⁰ Critical IPE scholarship has subsequently demonstrated that the profitability of diversified finance since the 1970s is not just a natural by-product of rational utility-maximizing actors operating within efficient markets. Nor has it been the result of the global growth of developed and developing economies alike as financial capital far exceeds the day-to-day needs of this so-called real economy. Rather, it has been the product of state-sponsored and orchestrated interventions into the structural conditions that aid and abet transnational and increasingly integrated

³⁹ Hay distinguishes between two periods in which the formal institutionalization of neoliberal ideals took place (2007: 98-100). The first period of ‘normative’ neoliberalization of the 1970s and 1980s provided a theoretical critique of the former Keynesian financial order, presenting a ‘science of political failure’ that attempted to subvert actors’ belief in Keynesian models’ ‘science of market failure’ (Buchanan, 1988: 3). The political and bureaucratic overload theses in particular provided a ‘powerful, public and highly politicized dramatization of the “crisis” afflicting the advanced liberal democracies’ of the time (ibid. 98). This ‘normative’ period was followed by a ‘normalized’ period of ‘diffusion and consolidation’ from the mid-to-late 1980s onwards wherein rational expectations microeconomics, new public management theory, and open macroeconomics were ‘used to derive stylized models which demonstrate[d] the necessity of the neoliberal economic paradigm’ (ibid. 100). This period essentially allowed the ideas underpinning neoliberalization formed in the normative phase to be decentralized across a number of previously peripheral territories. This ideas subsequently provided an ‘interpretive framework’ upon which a scientific and normative critique of how economies work and how they should be constructed was based (Blyth, 2002: 10).

⁴⁰ In the United States alone, for example, equity markets grew from \$136 billion or 13 percent of GDP in 1970, to \$14.2 trillion or 144.9 percent of GDP in 2000 (Crotty, 2006; Dumenil and Levy, 2004: chs. 13-15).

financial market systems and practices. This is in addition to the fact that states have regularly provided much needed emergency capital to reassert investor rationality and market equilibrium distorted by recurrent financial bubbles and crises (cf. Kindleberger, 2005: chs 10-13; Wright, 2010). This interventionist role played by states to facilitate and maintain financial market equilibrium consequently demonstrates the fallacy of presenting the ERP as a naturally occurring feature of speculative finance.

The simplified idea that speculative finance is inherently profitable has nonetheless found and constructed numerous ‘points of resonance’ with a variety of state actors throughout the global political economy (Hay, 1999: 321). Chapter Two demonstrated how financial economists are quick to assume these state managers consequently saw the profitable opportunities to be reaped through the diversified investment of sovereign capital. It is argued here, however, that political actors view their SWFs’ long-term and riskier approach to investment in a slightly different light. Indeed when institutionalized into an SWF, the idea of financial profitability suspends a government’s need to develop alternative policy and expenditure frameworks to address various problems of uncertainty that may arise. If faced with the rapid accrument of petroleum-derived FX reserves as in Norway, for example, belief in the ERP renders investing in risky financial assets an optimal means of saving this wealth. Speculative investment into the long-term would prevent them from having to set conservative extraction limits on much prized petroleum revenues. It would also help the Norwegian government avoid instigating the reoccurrence of a deep recession exacerbated by government overspending as that experienced in the 1980s.

Thus if socioeconomic stability is a prerequisite of political stability (cf. Burnham, 2001: 127-8; Seabrooke, 2006: 21), the ERP’s ability to manage short-term

financial expectations is an invaluable benefit provided by SWFs. That is, belief in the ERP comes to manage and coordinate future expectations of the long-term profitability of their diversified portfolios such that these expectations converge to become ‘self stabilizing over time’ (Blyth, 2002: 41). The idea of financial profitability is an authoritative ‘imaginary’ that suspends states’ governance function in time vis-à-vis the problem of uncertainty their SWFs were tasked to address (cf. Langenohl, 2008: 8). When these problems are situated within SWFs’ long-term investment horizons, what matters for a scrutinizing public is not the past or present but the distant future. SWFs’ intent to harvest the ERP over time is thus an abstraction because it resists being specified in concrete situations, or into any clear temporal perspective. Yet while the idea of the ERP is a social imaginary never to be fully realized, to pursue it requires the continuous investment and reinvestment of sovereign wealth into the indefinite future. Hence no matter how negative the returns or volatile financial markets become, the legitimacy of speculation as a strategy of governance is preserved.⁴¹ States are consequently enabled to recast their governance function as a matter of promoting their SWFs’ expected vs. actual financial performance.

Yet the financial crisis that began in August 2007 and those that preceded it have demonstrated the fallacious nature of this long-term financial logic. It demands

⁴¹ As demonstrated throughout the case study Chapters, financial crises are in fact necessary moments through which the legitimacy of the SWF policy path is reproduced. If such crises and heightened periods of volatility did not occur, it would be an indication that SWF managers were not assuming any extra risk in their diversified approach to investment. They should thus not expect to be paid a premium as a result. Simply put, belief in the long-term profitability of diversified finance is not grounded in the smooth functioning of markets but ‘on their constant crisis and criticisms’. Indeed each period of ‘irrationality’ – such as bubbles, herding, and noise trading – give rise to ‘moments of openness’ that can be used to strengthen the imaginary of long-term market efficiency and growth (Langenohl, 2008: 7; Edkins, 1999: 8). For Langley (2002: 12), crises are subsequently ‘cast as resulting not from inherent features of world finance, but from misguided domestic economic policy choices and institutional arrangements’ that fall outside the realm of ‘rational’ financial practice. As the experiences of Norway, Alberta and Ireland show, criticisms of SWFs in the midst of financial crises can in fact be appropriated and turned into a resource of legitimacy by the state.

the state place faith in the inherent rationality of investors and efficiency of markets. At the same time, however, state actors must be willing to stabilize market equilibrium and investors expectations in the face of recurrent financial bubbles and crises with the same public capital that compose SWFs. Hence SWFs do not necessarily solve the underlying problem of uncertainty they have been tasked to address, but merely replace this uncertainty with the expectation of financial profitability. The following section now identifies the means through which financial economists have rendered financial uncertainty into a more quantitatively measurable and manageable form of financial 'risk'.

3.2 SWFs as Strategies of Governance: *The Idea of Financial Calculability*

SWFs' second distinguishing feature regards the way in which sovereign capital is continuously embedded throughout the financial realm in both a functional and spatial sense of capital mobility. For financial economists, the desirability of this feature for state managers is attributable to two factors. First is the notion that diversification within and between riskier asset-classes can control for the high degrees of risk adopted in an SWF's portfolio. Second is that the increased mobility of transnational finance capital witnessed over the past four decades has greatly increased the ease through which capital can be diversified. Thus if states wish to maximize their SWFs' speculative financial returns, the global diversification of sovereign wealth is a rationally desirable investment strategy these actors logically pursued. However, such an explanation of SWFs' second distinguishing feature takes little regard of the state or political agency. It does not adequately explain what short-term incentives this feature presents for states if it means limiting their access to a

systematically significant amount of public capital. Why would state actors voluntarily and continuously embed national wealth throughout the financial realm if it limits their ability to devise and pursue alternative policy preferences?

To this effect, the second distinguishing feature of SWFs can also be understood as a strategy of governance that benefits states' short-term political interests. The following seeks to demonstrate that such diversification strategies enable state managers to reconceptualise complex problems of uncertainty they face as issues of short-term financial risk management. This follows from the idea that finance is calculable, which is in turn premised on the assumption that financial risk is a calculable and manageable form of uncertainty. For Beckert, uncertainty is 'the character of situations in which agents cannot anticipate outcomes of a decision and cannot assign probabilities to the outcome' (1996: 804). It is therefore fundamentally different from risk in that 'the distribution of the outcome in a group of instances is known [i.e. probabilities can be assigned to possible outcomes]...while in the case of uncertainty...it is impossible to form a group of instances because the situation dealt with is in a high degree unique' (Knight, 1921 quoted in Beckert, 1996: 229). So while contemporary understandings of risk provide a readily communicable guide for action, it is nonetheless a contestable simplification of financial market reality. As with the ERP, the distinction between risk and uncertainty is a theoretical abstraction whose ontological presuppositions have yet to be critically engaged by either financial economists or SWF-states. Critically engaging with these assumptions that render risk distinct from uncertainty is thus necessary given the extent to which they have come to substantiate SWFs' institutional legitimacy from a domestic perspective.

To this end, the distinction between risk and uncertainty was a highly contested issue in economics until intellectual consensus was reached by financial

economists in the 1950s. Prior to some theoretical leaps made in the preceding decade, there was little agreement as to how financial risk should be defined let alone whether it should be considered distinct from uncertainty (McGoun, 2007: 199). Financial risk, economists of the early 20th century argued, was just immeasurable uncertainty by another name. The ‘reference-class’ problem proved a particularly problematic obstacle in this debate.⁴² For Knight, whose work is still referenced but not taken seriously by modern economists, the reference-class problem can be summarized as follows:

‘Business decisions...deal with situations which are far too unique, generally speaking, for any sort of statistical tabulation to have any value for guidance. The conception of an objectively measurable probability or chance [derived from historical data] is simply inapplicable’ -- 1921: 231

Thus prior to the 1940s, risk was synonymous with uncertainty as a ‘lack of knowledge’ that could in no way guide short-term investment behaviour (Fisher, 1930; Hardy, 1923: 46; McGoun, 2007). Under such an understanding of the financial realm, investment decisions can only be affected by actors’ subjective expectations and ‘not the future as it will turn out but the future as it appears to us beforehand through the veil of the unknown’ (Fisher, 1930: 222). Scholars of so-called ‘old finance’ were therefore limited to make individual stock selections in the short-term based on the identification of a firm’s ‘fundamentals’. According to McGoun (2007: 199), there were just too many theoretical problems to be ignored to make the ‘foolish simplification’ that an optimal investment strategy could be determined through the probabilistic measurement of uncertainty-as-risk.

Throughout the 1940s, however, a new generation of Austrian and German mathematicians turned the ontological roots of old finance on its head by portraying

⁴² McGoun alternatively defines the reference-class problem as follows: ‘There is no simple way to determine which historical conditions, *if any*, are sufficiently similar to current conditions in order to use the relative frequencies of an event under *those* conditions then as an appropriate measure of rational probability with which to expect the event to occur under *these* conditions now’ (2007: 193).

risk as a calculable expression of economic activity. Led by the likes of Marschak, Tintner, Rosenstein-Rodan, and Lange, probabilistic-based measurements of risk began to creep back into mainstream scholarly debate. What remain unclear are the reasons behind this ideological transformation. Indeed, none of the theoretical problems that had prevented the likes of Knight and Fisher from approaching risk in the same way had been dealt with. Rather than attempt to address these problems head on, these economists began to ‘cavalierly dismiss them’ (McGoun, 2007: 203). Snooks (1993) accounts for this transformation in approach to a decline in concern for the reality content of econometric models. Both Weintraub (2001) and Davidson (2007) have similarly argued that what amounted to ‘truth’ in economic analysis began to rapidly change. Thus rather than be constrained to the philosophical musings of economic theorists such as Knight, this new generation of mathematicians-turned-economists could increasingly rely on axiomatization and mathematical abstraction as ‘the path to discovery of new scientific truths’ (Davidson, 2007: 216).

Dominant among these assumptions introduced in the 1940s was the ergodic axiom, which held all investors analyze past and present market data to form ‘rational expectations as a basis for making utility-maximizing decisions’ (Davidson, 2007: 221).⁴³ The ergodic axiom substantiated the notion that ‘relative frequency probability’ – or the chance an event will occur given a history of recorded events – provided a basis from which financial risk could be distinguished from uncertainty (McGoun, 2007: 192-3, 207). Without the assumption of a relative frequency theory

⁴³ In contemporary parlance, the ergodic axiom is referred to as the ‘prudent person rule’, wherein the term ‘prudent’ is synonymous with those of the rational and self-interested investor. The prudent investor is thus an ideal-type who only makes investment decisions they expect will maximize their utility, and who will only attempt to do so when in possession of all available and relevant information. While financial academia and practitioners alike would concede that investors may possess differing degrees of prudence, they nonetheless maintain that markets remain in a state of relative equilibrium largely because investors possess a base level of rationality. If this were not the case, there would be little difference between investing and gambling (cf. de Goede, 2005).

of probability, economists lacked the means to quantify rational degrees of belief. With the ergodic axiom, however, financial economists could estimate the likelihood of reoccurring events such as market booms and busts from the use of historical data. This intellectual revolution subsequently propelled economists to collect statistical information in the form of past and current stock prices to develop ‘conditional probability functions’ as a basis for measuring risk (Davidson, 2007: 221). From these conditional probability functions, financial economists argued that investors could modify their behaviour and models according to the ‘peculiarities’ of the current situation (cf. Fellner, 1948: 196). With the seminal works of Arrow and Debreu (1954), the ergodic axiom and its ability to help economists distinguish between risk and uncertainty became the ‘the definitive mother-structure from which all further work in economics would start’ (Weintraub, 2001: 122).

To be sure, it was the work based on assumptions of the ergodic axiom that led to the notion of the ERP. More specifically, it substantiates why the rational investor and efficient market hypotheses should be taken as an accurate reading of financial market reality. The path-breaking works of Markowitz (1956), Modigliani and Miller (1958), and Sharpe (1964) among others built upon these assumptions and succeeded in what their predecessors had sought to do: render the financial realm a calculable system guided by identifiable rules of mathematical probability. Despite their vaunted position, however, these theories have yet to empirically prove their validity as accurate depictions of financial market reality. The notion of risk’s measurability – and thus the benefits to be derived from diversification as a risk management strategy – is and always has been an idea based on an idealized market realm. It is a theoretical proposition that has exhibited a ‘dismal empirical record’ in terms of preventing or avoiding the recurrence of financial crises and the destabilizing

effects that result (McGoun, 2007: 194). Perceiving financial uncertainty as risk is an act of faith, and ‘the heroic strategies that are invoked to immunize [these] cherished theories are acts of faith as well’ (ibid. 209).

Thus as opposed to the assumptions of financial economists, the idea that speculative finance is calculable is not a naturally occurring phenomenon discovered latent in reality. Rather, it is a contestable assumption strategically constructed and reinforced to meet the needs of economists whose work seeks to render financial reality into simplified and more calculable forms. As such, the need for states to globally embed public capital throughout the financial realm should not be unquestionably taken as a natural feature of speculative investment. Nor can the funds’ preference for diversification be framed as a natural by-product of the increased spatial and functional mobility of finance capital. Such analyses assume the state and political agency to be latent and unimportant variables. They consequently fail to provide an adequate account for specifically why state actors should wish to actively embed public capital throughout the financial realm. Clearly the ideas that finance is profitable in the long-term and calculable in the short are attractive explanations for the SWF puzzle. But ignoring individual state interests cannot explain why these beliefs were internalized and legitimated over competing policy preferences. This requires us to provide an alternative account of SWF’s appeal as strategies of governance.

To this effect, SWF-states’ use of financial risk management techniques also represents ‘a way – or rather, a set of different ways – of ordering reality, of rendering it into a calculable form’ so that it may ‘be made governable in particular ways, with particular techniques and for particular goals’ (Dean, 1995: 177; cf. Beunza and Stark, 2005: 90; Thevenot, 2001). Indeed, the notion that financial speculation is calculable

as based on a distinction between risk and uncertainty allows states to construct, manage, and promote financial expectations in precise mathematical ways (cf. Watson, 2007: 17). This idea and the investment strategies it legitimates thus enable state managers to reconceptualise complex problems of uncertainty as solvable through the quantitative terms of financial risk management. It moreover provides a readily communicable means through which SWFs' exposure to high degrees of financial risk can be presented as manageable and thus legitimate to the domestic electorate.

For example, the Canadian Province of Alberta has had a Progressive Conservative (PC) majority government since the mid 1970s. By the 1990s, however, the PCs faced a problem they nor their predecessors had yet encountered: a CDN\$32 billion budgetary crisis fuelled by petroleum-funded spending and decreased tax revenue. The PCs traditional approach to petroleum wealth management subsequently lost favour in both parliament and the public. This was due to the ambiguous and open-ended mandate upon which it was based. Indeed this mandate merely stipulated extra-budgetary petroleum wealth be used to 'strengthen and diversify' the provincial economy, which enabled politicians to invest in a wide variety of capital-intensive provincial projects. The PCs thus faced a problem of great uncertainty: how to reduce the budgetary deficit and assuage criticisms directed towards them, but while simultaneously ensuring they remain the ultimate managing authority over Alberta's prized petroleum wealth? As examined in Chapter Seven, the Albertan government opted to create an SWF to address this problem, thereby increasing their dependence on speculative risk technologies. They believed a wealth management strategy based on modern principles of risk management would limit them to invest in a way that would minimise financial risk and increase expected return. This strategy would

simultaneously provide elected officials with a quantitative and readily communicable means to show exactly how petroleum wealth was being invested and for what reasons to a critical Albertan public.

The following Section now examines why SWFs' unique fiduciary relationship with the state should not be understood as an evolutionary development of modern finance capitalism. Rather, this financial depoliticization of public capital represents a strategy of domestic governance pursued only after it is perceived as benefiting the states' short-term interests.

3.3 SWFs as Strategies of Governance: *The Idea of Financial Expertise*

The existing SWF literature assumes diversification of sovereign wealth within and between riskier asset classes and markets to be a rationally desirable fiscal strategy. It enables these state actors to harvest the ERP into the future while simultaneously controlling for the high degrees of financial risk assumed therein. The problem for these analyses is that SWFs' government overseers lack the financial rationality – or utility function – assumed to be the cornerstone of this strategy's success. State actors are deemed incapable of successfully operationalizing their SWF's diversified investment strategies due to their being motivated by political versus purely commercial objectives. The third distinguishing feature of SWFs arises out of such an understanding of state identity. That is, SWF management is placed at one remove of government and its policymaking bodies by delegating operational authority to professional investors, whether internally developed or externally hired. This feature of SWFs is attributable to the idea that a specific form of financial expertise, which state actors lack, is required to harness speculative finance's inherent

profitability. The following deconstructs what ontological presuppositions this idea is based on, and why state actors would perceive it as benefiting their short-term interests.

To this effect, dominant understandings of why state actors should limit their authority over their SWFs begins with the so-called ‘collective action problem’. This idea holds that states as public institutions are obligated to distribute national resources in such a way as to project and reinforce a sense of the collective good throughout domestic society. This is meant to circumvent the inherent self-interested rationality of a society composed of utility maximizing individuals (Hay, 2007: 2; cf. Hirschman, 1977: 35-6). At the same time, however, governments are thought to suffer from a ‘deficit bias’, which is the tendency to distribute all available resources to the present so as to meet the self-interested demands of society. This school of thought derives from public choice theory, which posits governments are also comprised of individual value-maximizers. Hence if state actors can be expected to act in a self-interested manner, they will also be unable to ensure the delivery of collective goods to future generations. This is unless they limit as much as possible their influence over SWF managers and SWF capital (cf. Dunleavy, 1991; Hay, 2007: 95-99; Hindamoor, 2006). SWF-states’ delegation of operational authority to financial experts charged with strictly financial objectives is therefore thought to address the collective action problem, mitigate the deficit bias, and circumvent the self-interested rationality of politicians. SWFs’ third distinguishing feature is thus thought a means to ensure national wealth is fairly distributed to both current and future generations, given the belief that states are obligated but incapable of doing so themselves.⁴⁴

⁴⁴ A prominent example of a government succumbing to these problems is witnessed through the experience of Alaska between 1969 and 1975. In this time, the state legislature managed to spend \$900 million accrued from the sale of state-owned land for the purposes of petroleum drilling two years before any revenues were actually accrued. The Alaskan government was then forced to request an

Yet the collective action problem, deficit bias, and public choice theory only help explain why states should wish to place themselves at one remove of SWF management. The idea of financial expertise, on the other hand, helps explain why professional investors are deemed more capable for overseeing this task. This idea of financial expertise dictates that state actors' capacity to make financial decisions is inferior to those of private market actors. As Harvey (2005: 21) summarizes, 'the information available to the state could not rival that contained in market signals'. The existing SWF literature attributes this to the fact that private market actors and institutions are rational utility-maximizers. Any informational advantages they may have will consequently be revealed in their investment decisions due to high levels of competition – hence the efficient market hypothesis (Fama, 1965; Malkiel, 1999). The delegation of operational authority to SWFs has therefore allowed states to participate in international equity markets while circumventing the informational disadvantages supposedly inherent to their public identities.

While these presuppositions of investor rationality and market efficiency are theoretical abstractions, they are nonetheless grounded in two practical developments through which financial market reality is constructed and reproduced. First is that financial markets are influenced by a vast array of financial and non-financial actors, spaces and events that continuously reproduce information. Second is that the way this information is absorbed determines the actions (read: investment strategies) taken by financial actors and institutions. These actions then alter the pre-existing market environment from which the market signals originated. Knorr Cetina refers to this process as the 'doubly-reflexive character' of financial markets, wherein the constant flow of information 'continually project[s] financial reality as it emerges' just as

interest-free loan from these oil companies in order to balance the 1976 budget, resulting in much embarrassment for the state congress. This experience directly led to the establishment of the Alaska Permanent Reserve Fund in 1977 (Cowper, 2008: 223-228).

investors' immediate reaction to this reality alters this projection (2005: 42). Modern financial epistemology posits that because financial markets are continuously (re)projected in the form of shifting prices and trading strategies, professional investors must be embedded within financial information networks so as to develop an instinct, or 'feeling', for market movements.⁴⁵ For Knorr Cetina, financial experts are those actors best capable of dealing with the 'ontological liquidity' engendered by the financial realm's 'reality in flux' (2005, 52-54). In short, they are those actors who are not only less susceptible to being influenced by non-commercial interests, but are faster than others to anticipate future market developments. Expert SWF managers thus derive their epistemological authority from the fact they are 'seen as holding, producing, and verifying relevant forms of knowledge' within an uncertain and forward-looking financial environment (Langley, 2004: 126; cf. Sinclair, 1994: 447).

The idea of financial expertise is thus based on the ontological presuppositions of investor rationality and market efficiency, which enable financial economists to render financial speculation into a highly technical albeit profitable exercise. This is despite it being a forward-looking task whose outcomes are highly uncertain. As such, the primary function served by this idea of financial expertise is to provide state actors with an authoritative guide to action when approaching speculative finance.⁴⁶

⁴⁵ The term 'embeddedness' here reflects that used in economic sociology (cf. Granovetter, 1985; 1992). The concept of embeddedness 'suggests that economic decisions and behaviour occur within concrete networks of relations' whereby 'information accrued within existing relationships is considered the most reliable guide to action' for financial actors (Granovetter, 1985: 487-493).

⁴⁶ The idea of financial expertise loses its value as a realistic guide to action when compared to the notion of investment 'skill'. This is to say there continue to be no reliable techniques for separating skilled from unskilled experts. Declaring an investor to be skilled is 'a value judgement' akin to declaring a stock to be attractively priced (Jaeger, 2008: 54). So while an SWF manager may possess financial expertise in that they are versed in the language of risk and return, as well as embedded in financial information networks, there is no way to ensure they possess investment skill. Investment skill subsequently remains an abstract concept for financial economists and professional investors who strive to prove its existence. In the face of the EMH, academics and practitioners can add nothing more to this debate than reiterate their convictions that investment skill exists. That is, investment skill cannot exist if market prices already reflect all available information. Under such an assumption, the optimal strategy for all investors would be to 'buy the market' and passively wait for global economic growth to 'float all boats'. In his article entitled 'The Elusiveness of Investment Skill', Jaeger (2008:

Indeed, the delegation of operational authority to semi or fully independent financial experts is understood to be a prerequisite for SWFs' financial success (Nugee, 2008; Sweeney-Barnes, 2008; Mohohlo, 2008). State managers must limit themselves to the task of *ex post* oversight, and defer to the authority of specialist SWF managers divorced from the political arena and versed in the language of risk and return. So how does delegating operational authority for SWF management to financial experts appeal to the short-term interests of state managers? If it is only future governments that will be reaping their SWFs' financial rewards, how does limiting their access to a systematically significant amount of sovereign wealth represent a desirable policy preference?

To this effect, SWFs' third distinguishing feature represents a desirable strategy of governance as it depoliticizes states' governance function vis-à-vis the problem of uncertainty their funds were created to address. In short, delegation of operational authority to SWF managers displaces the state's responsibilities from the government to quasi-public authorities who are more capable of circumventing the collective action problem than are states. The diversified investment of sovereign wealth by these managers offloads formal political responsibility for solving these problems to the seemingly more manageable ebb and flow of the financial realm. If the aim of government is to achieve in the eyes of the public a certain level of governing competence 'and not make anything worse in economic management', then such depoliticization of sovereign wealth management would appeal to the state's short-term interests (Burnham, 2001: 127-8). It serves to suspend both their governance function and political legitimacy in time.

58) ambiguously concludes: '*Skill is elusive, but it's not illusory. Indeed, it is real precisely because it is elusive. If your conception of investment skill is unrealistically simple, then the insights of the [EMH] will force you to conclude that skill does not exist. What makes skill real is the fact that it's more complicated than you might think*'.

The depoliticizing impact of SWFs thus appears to fall within traditional approaches to depoliticization in IPE scholarship (cf. Burnham, 1999; 2001: 128; Hay, 2007: 82; Flinders and Buller, 2006). That is, SWFs appear to benefit the state by making policymaking seem more credible, reducing the state's political overload, and insulating the state from failure. Thus rather than directly solve the problems to which their SWFs have been tasked to address through continuous engagement and policymaking, SWF-states can instead preoccupy themselves with persuading the domestic electorate 'that they can no longer be reasonably held responsible for [this] issue, policy field or specific decision' (Flinders and Buller, 2006: 296-298). Contentious issues and potential ramifications surrounding the expenditure of SWF capital in the immediate-term are passed as technical financial matters, thus shifting the locus of accountability to SWF managers.

Yet while SWFs may insulate the state from political criticism by depoliticizing the management of a specific problem of uncertainty, it does not lessen public scrutiny over their funds' financial performance. This is to say that the institutionalization of the SWF policy path ultimately pressures states to ensure their funds are financially profitable in the short to medium-terms. As examined in the case studies, the Norwegian, Albertan, and Irish governments' political legitimacy was immediately implicated with the financial performance of their SWFs. The funds essentially quantified that which was traditionally a qualitative judgement – i.e. political legitimacy – by providing a scrutable barometer of government's financial successes and failures. Indeed if SWFs are not profitable in the short-term, the domestic electorate is apt to see better uses for this sovereign wealth than inflate the already bloated profits of international bankers and professional investors. SWFs subsequently limited these states' realizable policy preferences, pressuring them to

promote diversified investment of sovereign wealth as a desirable, long-term strategy of governance rather than consider alternative fiscal management strategies. The discussion now continues in this vein by examining the way in which SWFs constrain state agency through time.

3.4 Concluding Remarks: *A Constraining Strategy of Governance*

How to explain why so many previously unrelated states came to view the creation and maintenance of a sovereign wealth fund as befitting their otherwise divergent and competing interests? The preceding Chapter argued the global diffusion of the SWF policy path should not be solely attributed to the existence of rationally desirable investment opportunities afforded by finance capitalism. Such an assumption rigorously abstracts political agency, and reduces the state and its interests to latent variables. Instead, SWFs are best conceptualised as domestic strategies of governance whose desirability stems from their perceived capacity to benefit state interests in the short-term. Indeed, a primary interest of state actors is to maintain socioeconomic stability, a prerequisite for political legitimacy (cf. Burnham, 2001: 127-8; Seabrooke, 2006: 21). This stability can, however, be threatened by unexpected problems state actors are expected to address. These problems can range from how to ensure the sustainability of public pension systems (as which occurred in Ireland), how to manage the rapid and unexpected accumulation of sovereign wealth from energy revenues (as in Norway), or even how to avert politico-economic crisis by re-legitimizing budgetary politics (as in Alberta). The preceding Chapter thus argued the financial ideas that substantiate modern financial epistemology provide an authoritative guide to action for state actors when faced with such problems of

uncertainty. It was also demonstrated, however, these financial ideas collectively represent an authoritative financial epistemology that does not accurately reflect how investors or markets operate. Rather, it legitimates the increasingly risky speculative practices through which this reality is performatively constituted on a daily basis.

It was subsequently proposed SWFs are the institutional embodiment of this speculative financial epistemology. As such, the funds enable states to create and manage forward-looking projections as to how problems of governance will be solved by their SWFs into the future. This serves to stabilize the domestic electorate's short-term socioeconomic expectations by rendering uncertainty into a seemingly calculable and more manageable financial form. Section 3.1 argued the idea of financial profitability dictates that high amounts of financial risk are inherently profitable into the long term given the assumption of the equity-risk premium. Tasking SWFs to maximize financial returns into the long-term thus suspends and stabilizes state actors' governance function in time. The expectation of financial returns reduces uncertainty as to how successive governments will be able to fund socioeconomic growth and development, and thus how future generations will benefit from this wealth. Section 3.2 then argued the idea of financial calculability posits SWFs' exposure to financial risk can be controlled for through extensive diversification within and between these asset classes and markets. This effectively reconceptualises problems of uncertainty as problems of financial risk management, reducing their solvability to a quantitative and technical – albeit manageable – exercise. Finally, Section 3.3 argued the idea of financial expertise dictates that such an exercise can only be legitimately executed by professional investors who are divorced from the political arena and versed in the language of risk and return. This appears to depoliticize the states responsibility to address the socioeconomic problems their

SWFs were created to support, thereby reducing political overload and insulating the state from criticism of fiscal mismanagement or incompetence.

At the same time, however, the SWF policy path is a constraint on state agency. It limits successive government's capacity to devise and pursue alternative policy preferences in regards to the problems of governance their SWFs were created to address. The term 'financial depoliticization' is used here to capture this constraining feature of SWFs. Existing understandings of depoliticization are limited in their primarily *functional* description of authority. They only account for the transfer of authority between institutions, either through 'placing at one remove the political character of decision making' or the promotion or relegation of certain issues from one arena to another (Burnham 2001: 128; Hay 2007: 78). In such accounts, only the fact that SWFs are government-linked entities appears to impact state actor's realizable policy preferences. Financial depoliticization, on the other hand, entails an *ideational* – or *epistemological* – reading of authority. This is to emphasize that expert SWF managers are *an* versus *in* authority, and thus command the expectation to not only be followed but also believed by their state overseers (Friedman, 1990: 81-83; cf. Sinclair, 2001: 103). The SWF policy path thus constrains political agency as state actors must come to view the world through the same epistemological framework that inform the actions of SWF managers. This is despite their being barred from accessing this same knowledge through learning or experience due to their political and thus non-commercial identities (cf. Friedman, 1990: 83). Common sense is effectively fixed by this interpretive framework, which provides an authoritative and 'scientific' critique of what constitutes proper versus improper action in regards to SWF management (Langley, 2002: 2; cf. Blyth, 2002: 10).

This dissertation maintains this constraint is inherently problematic as SWFs prioritize the pursuit of financial returns above any other socioeconomic objective. In the event of crisis, for example, negative returns must be recouped. As witnessed between 2007 and 2009, this was pursued through the continued financial diversification of sovereign wealth. These SWF-state actors were also constrained to intervene in their own domestic capital markets to ensure their continued functioning and mitigate emerging recessionary pressures (Couturier et al, 2009: Section 4). Modern financial epistemology thus contradictorily demands government actors distance themselves as much as possible from SWF management, but at the same time continuously support the financial markets throughout which their public capital is embedded. As SWFs' portfolios continue to expand in size and global breadth throughout crises prone speculative markets, such constraint poses significant challenges to the future character of sovereign authority. The preceding discussion has, however, been largely theoretical in nature. It is therefore necessary to test these arguments against three case studies: Norway's Government Pension Fund – Global, Alberta's Heritage Savings Trust Fund, and Ireland's National Pension Reserve Fund.

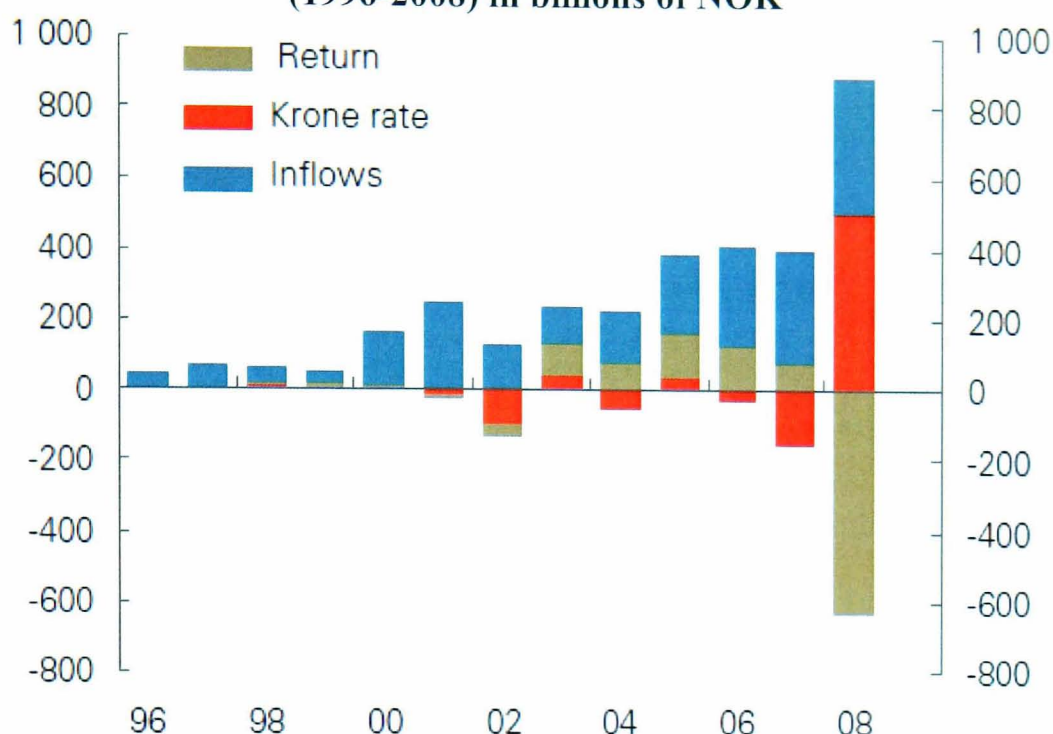
Chapter Four: *Norway's Government Pension Fund–Global* (1990-1997)

Through a comprehensive system of direct and indirect taxes, resource revenues have accounted for a significant portion of Norway's GDP since petroleum was first discovered in the North Sea in 1969. This wealth has, however, represented a burden as much as boon for the Nordic state as evidenced by the dislocating socioeconomic effects it provoked between 1976 and 1990 (Eide, 1997; Storvik, 1998).⁴⁷ Since 1997, however, these resources have been managed by a government-linked sovereign wealth fund through which all of the state's petroleum wealth is channelled. Established in 1990 as a conservatively managed stabilization-savings vehicle – and first known as the 'Petroleum Fund' – this fund was reconceptualised as an SWF in 1997. It was then renamed the Government Pension Fund–Global (GPF, or the 'Fund') in 2005.⁴⁸ At \$350 billion in 2009 and projected to grow to \$900 billion by 2020, the GPF is one of the largest SWFs in the world (Qvigstad, 2009*a*; see Appendix 1; Figure 2).

⁴⁷ In 2010, the petroleum sector accounted for approximately half of Norway's exports and over 30 percent of annual government revenue. This is compared to 1997 figures where the petroleum sector represented 18 percent of GDP and 16 percent of central government revenues (CIA, 2009).

⁴⁸ For the purposes of continuity, all references to Norway's SWF will be to the 'Government Pension Fund – Global', the 'GPF', or the 'Fund'.

Figure 2: Annual Changes in GPFG Market Value (1996-2008) in billions of NOK



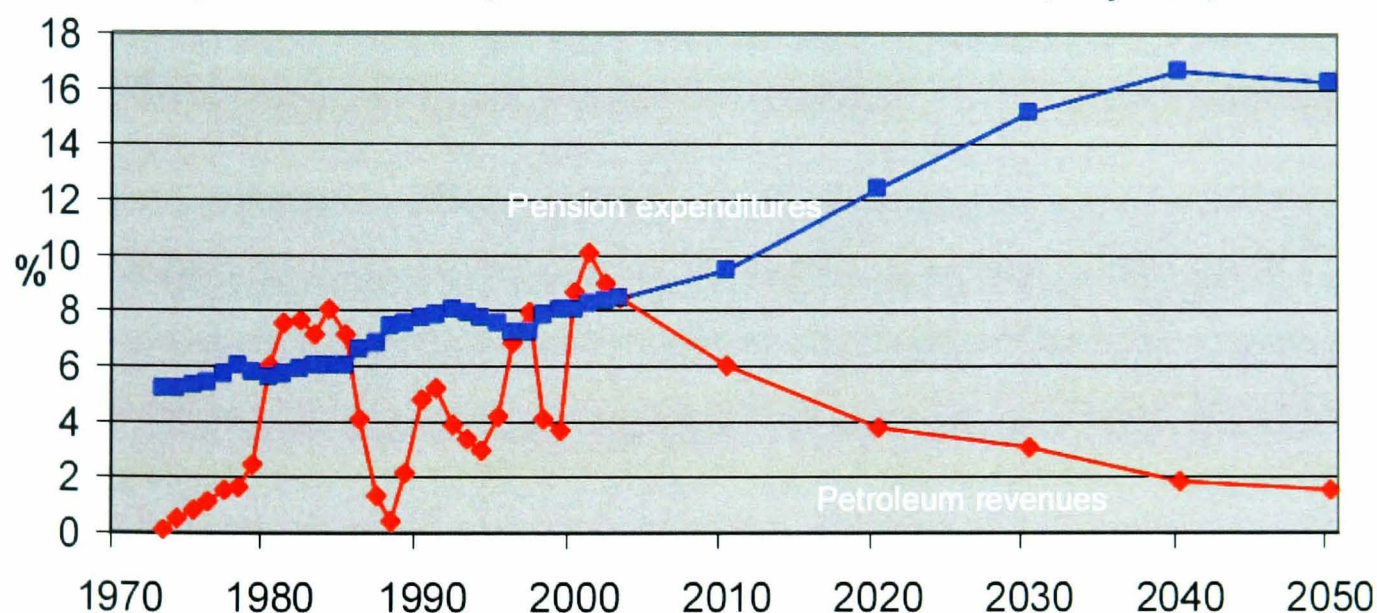
Source: NBIM, Annual Report, 2008: 22

By 2009, the GPFG's universally diversified and risk-exposed portfolio was invested approximately 60 percent in equity and owned a full one percent of total shares in global capital markets (Annual Report, 2009: 22). The embedment of public capital on such a global scale represented a massive feat considering the Fund only began investing in equities in 1998 (Annual Report, 2008: 2). More impressive is the fact this financial expansion was entirely orchestrated by Norges Bank Investment Management (NBIM) – a specialized investment arm of the central bank also established in 1998 to act as the Fund's autonomous operational manager. This meant GPFG management was placed at one remove of its owners and governors in the democratically elected Storting (Parliament) and the Ministry of Finance. Thus despite its origins as a highly liquid and conservatively managed stabilization and savings fund in 1990, by 2009 the GPFG had come to exhibit the three distinguishing features of the SWF policy path. The following Chapter seeks to account for why this policy path was adopted and maintained as a desirable strategy of governance in

Norway between 1990 and 2009, and its significance for the politico-economic landscape of this welfare state.

According to central government ministers in the wake of the global crisis of 2007-2009, the widespread embedment of petroleum wealth throughout the financial realm was legitimated by a pragmatic approach to a daunting socioeconomic problem. Indeed, the welfare state's public pension expenditures were projected to rise from seven percent of GDP in 2000 to fifteen percent by 2030, just as petroleum revenues were expected to drop from sixteen to four percent of GDP (see Figure 3; cf. Gjedrem 2000, 3; Kjaer, 2006). Converting current and future petroleum wealth into a diversified portfolio of financial assets was therefore portrayed as a means through which an aging Norwegian population could be supported by the state into the future.

Figure 3: The 'Pension Issue'
Expected Pension Expenditures vs. Petroleum Revenues (% of GDP)



Source: Ministry of Finance, 1998

Yet neither the GPFG's investment strategy, relationship with the Norwegian state, or even fundamental purpose have remained fixed since the Fund's inception in 1990. To be sure, the pension issue was only made a formal element of the GPFG's mandate a full eight years after the Storting opted to speculatively invest public capital throughout a broad range of riskier financial assets, markets, and management

strategies. If not originally for the pension issue, why was the SWF policy path and its high levels of financial risk pursued in 1997 by the Norwegian state? Given the Fund's long-term and outward-looking orientation, how was this strategy internalized as befitting the state's short-term interests over alternative approaches to sovereign wealth management? Financial economists, OECD financial regulators, and numerous Norwegian policymakers have argued that even in the absence of the pension issue, reconceptualising the GPFG as an SWF represented a rationally desirable policy preference. It effectively transforms stagnant foreign exchange reserves into influential positions in an array of global companies and markets. It also makes the role of petroleum wealth in the budgetary process 'highly visible', enabling the central government 'to stand firm against populist appeals for spending rather than saving' (Kjaer, 2008: 194; cf. Skjørestad, 1998; Bergo, 2003; Caner and Grennes, 2010). Yet these desired outcomes do not by themselves explain why SWF's three distinguishing features were institutionalized by the central government in 1997 over alternative strategies.

The following offers an alternative explanation to this puzzle than those currently offered in the SWF literature. It argues the SWF policy path represented a quick-fix means for the Storting to address an unexpected but not unprecedented problem of great uncertainty that faced them in 1996 (cf. Eide, 1997). At this time, petroleum revenues were suddenly projected to grow by 1,500 percent from previously held expectations in just three years. Investing this systematically significant pool of expected capital for speculative financial gain would stabilize socioeconomic expectations as to how Norway's highly politicized petroleum resources would be managed into the indefinite future. To be sure, these revenues were seen as threatening socioeconomic stability given the central government's

previous approach to petroleum wealth management had exacerbated a prolonged domestic recession between 1976 and 1990. Investing its vast petroleum wealth reserves in a diverse array of speculative financial assets thus represented a strategy to stabilize the states governance function in the face of this uncertainty. Yet from where did this strategy derive its legitimacy given the distance it would place between government and this capital, as well as the risks it entailed? What were the political channels through which this strategy was internalized?

Structural conditions alone – such as the prevalence of developed financial markets and unprecedented resource revenues – cannot explain why the SWF policy path was pursued over competing alternatives. The most noteworthy of these presented in the Storting and media included implementing counter-cyclical monetary, fiscal and commodity extraction policies that would stymie the inflow of so-called ‘surplus’ resource revenues (Tranøy, 2009: 372; Storvik, 1997). By assuming speculative investment to be inherently desirable as a fiscal strategy, the politics of the GPFG’s origins have remained unexamined. Indeed, the Storting had to be proactively convinced of the SWF policy path’s legitimacy over more conservative and thus safer alternatives. This was given the extent to which it would expose the state’s prized petroleum wealth to the fluctuations and crisis tendencies of the financial realm. Losses arising from the global liquidity crisis of 2007-2009 in fact amounted to a 23.3 percent decline in the Fund’s value, reducing it ‘right back where it started’ thirteen years earlier. This subsequently exposed the Norwegian central bank – ‘Norges Bank’ – and Storting officials to widespread domestic criticisms, and initiated a widespread review of the GPFG’s investment strategy and relationship with the central government (Gjedrem, 2009; cf. Qvigstad, 2009*a*).

The following Chapter thus argues that despite its risks and long-term orientation, the SWF policy path was adopted as a strategy of governance intended to benefit the Storting's interests in the short-term. It draws attention to the authoritative financial ideas that informed Norwegian state actors of what their interests should be – as well as how to achieve them – when faced with the task of managing windfall petroleum revenues. These ideas ultimately created forward-looking expectations of the benefits to be derived from speculative investment that commanded the authority to be believed over competing alternatives presented to the Storting. They are evidenced in the numerous policy documents, internal memos, recommendations, and external reports produced and commissioned between 1990 and 2008 by Norges Bank and the central government. Identifying these authoritative ideas is important for IPE scholarship as they allow us to critically examine the contested and ultimately fallacious ontological foundations upon which SWF legitimacy is based.

To be sure, the GPFG's significant losses in 2008 were eventually recouped in 2009. This sudden change in fortune was championed by the Fund's supporters in the Storting, as well as its managers in Norges Bank. The globally reverberating crisis and its rapid recovery in 2009 were thus strategically appropriated as a resource of legitimacy that 'proved' the validity of the GPFG's long-term and risk-exposed investment strategy. Yet such a rapid turn from loss to profit in 2009 was the product of large-scale and ad hoc government interventions into global capital markets. Governments around the world were called upon to reassert investor confidence by providing much needed liquidity the markets were unwilling to put at risk (cf. Altman, 2009). The need for these emergency capital injections undermines the financial logic of market efficiency and investor rationality that legitimated the SWF policy path to the Norwegian government, Norges Bank, and – most importantly

considering the public nature of the GPFG's wealth – the domestic electorate between 1997 and 2009. The following Chapters therefore seek to problematize the relationship that exists between SWFs, their state owners, the financial markets in which they are invested, and the domestic societies to which they are ultimately accountable. This is to provide a necessary first step towards the development of alternative and potentially more beneficial means of managing a state's foreign exchange reserves.

Chapter Four examines why and how the SWF policy path was institutionalized in Norway in 1997, and then charts the Fund's institutional development to 2005.⁴⁹ It demonstrates how reconceptualising the GPFG as long-term oriented SWF was pursued as a desirable strategy of governance, but whose legitimacy had to be actively constructed by officials in Norges Bank. This is to highlight that the Norwegian central government did not immediately view speculative investment as an inherently desirable pursuit as assumed by mainstream SWF analyses. Section 4.1 introduces the GPFG's origins by examining the history of Norway's experience with petroleum wealth management from 1970 onwards. Sections 4.2 and 4.3 then examine how the ideas of financial profitability and financial expertise were drawn from by Norges Bank to provide an authoritative guide to action for the state when faced with a problem of great uncertainty. Indeed, uncertainty as to how to manage the state's petroleum wealth surged in 1996 following the expectation these revenues would swell by 1,500 percent in just three years. The Sections consequently reveal the extent to which a discernable epistemology of speculative finance was strategically drawn from by Norges Bank officials to legitimate the SWF policy path over competing alternatives within the

⁴⁹ It was not until 2006 with the passing of the Government Pension Fund Act that the SWF policy path was officially made a substantive feature of Norway's politico-economic landscape.

central government, and in a way that appealed to these state actor's immediate interests.

Sections 4.3 and 4.4 then examine the constraining impact these ideas had on the central government's policy preferences when institutionalized into the GPFG in 1997. They examine how throughout this period, Norges Bank's authority over the central government grew in congruence with the GPFG's expansionary capital base and universally invested portfolio. This was based on the capacity of these ideas to dictate of what constituted legitimate and desirable action, and what did not. As a consequence, the central government became increasingly dependant on the epistemological authority of Norges Bank officials to inform them of their policy preferences in regards to petroleum wealth management from 1997 onwards. Chapter Four therefore seeks to fill a gap in the IPE literature on depoliticization. Accounts of depoliticization such as those offered by Burnham (1999; 2001: 128), Hay (2007: 82), and Flinders and Buller (2006) cannot account for how SWFs directly influence the way in which government's formulate their policy preferences through time, but can only gauge the effects of these preferences once acted upon. Indeed, the influence of sovereign wealth funds on a state's approach to fiscal governance is not just by their having placed the political character of decision making at one remove of government. They also limit what government actors consider to be an optimal means of engaging with sovereign wealth management.

Chapter Five then expands upon these arguments by drawing attention to the key role played by the central government to construct and maintain the GPFG's domestic legitimacy between 1997 and 2009. This supportive role provided by state actors was crucial in the face of ideational competition posed by minority parties in the Storting, as well as the dislocating socioeconomic impacts engendered by two

financial crises experienced in this time. Chapter Five thus seeks to further fill in the gaps pervading mainstream analyzes by drawing attention to the politics behind the SWF policy path's institutional legitimacy. More specifically, it sheds light on the GPFG's impact on the fiscal governance strategies pursued by the Norwegian state between 1997 and 2009.

4.1 The GPFG as a Stabilization-Savings Fund (1990-1996)

With the discovery of North Sea oil in 1969, the Norwegian government faced a number of important questions. How to manage the unexpected revenues accrued from oil production that fell outside short-term budgetary needs? What role should it play in supporting the future development of the Norwegian state? What of the everyday lives of current citizens? The Storting initially endeavoured to spend the majority of this wealth on a variety of welfare programs, targeting industrial development and public pension provision in particular. While made with good intentions, these investments coincided with a wider structural downturn in the global economy following the Petroleum Crises of 1973 and 1979. Thus between 1970 and 1990, public welfare programs were expanded just as non-petroleum sector industries were contracting; manufacturers became dependant on state support; domestic consumption demand grew with the injection of Kroner into the economy; and a credit bubble developed which subsequently burst in 1986 at the same time as a significant drop in the international price of oil. The government's petroleum spending consequently exacerbated a deep recession characterized by highly volatile inflation from which Norway would not fully recover until the 1990s (Eriksen, 2006: 6-8; cf. Gjedrem, 2000: 1; Gjedrem, 2005; Tranøy, 2009: 367-70).

These experiences with petroleum wealth spending left a lasting impression on both the Norwegian electorate and Storting. They resulted in the social-democratic Labour government of the early 1990s to internalize the notion that petroleum wealth must be preserved and in such a way that Norway would not be negatively – let alone positively – affected (Norges Bank, 1990: Section 3.2; Eriksen, 2006: 7; Odelsting, 1974; Skånland, 1988). To be sure, the ‘problems’ posed by Norway’s surplus sovereign wealth were framed in a number of ways and to varying degrees of significance in the years preceding the creation of a conservatively-managed GPF in 1990. Primary of these concerns were:

- (i) *Budgetary concerns* – how to distinguish between petroleum and non-petroleum savings on government balance sheets?
- (ii) *Monetary policy concerns* – how to counteract the appreciation of the Norwegian Krone from the excess currency income generated from petroleum?
- (iii) *‘Sector balance’ concerns* – an appreciation of the Krone would shift resources to non-competitive sectors as well as potentially instil ‘Dutch disease’
- (iv) *Savings concerns* – how can future generations of Norwegians benefit from today’s petroleum wealth?

These unresolved issues posed very real problems of uncertainty for the Storting’s approach to domestic governance once the economy stabilized in the early 1990s. It was within this historical context that the notion of a twin stabilization-savings fund was born in the Conservative-led government in 1987, but which was eventually acted upon by left-leaning Labour in 1990. Such an extra-budgetary and highly liquid fiscal vehicle managed by Norges Bank would provide a readily visible means of separating petroleum from non-petroleum revenues on government balance sheets. Transfer of accumulated revenues to the Fund would then also prevent the Krone from

appreciating while being left free of large-scale governmental budgetary tampering – a real fear given Norway’s volatile economic history (Kjaer, 2000: 13; Eide, 1997).

Passing the Petroleum Fund Act in 1990 and its establishing the GPFG was thus a direct reflection of Norway’s fiscally conservative values at the time. The Act institutionalized the objectives of liquidity, safekeeping and preservation as top priorities in the state’s approach to petroleum wealth management. This original version of the GPFG thus embodied the Storting’s fears of reliving the experiences of the 1970s and 80s, and their new desire to ensure ‘intergenerational justice and economic policy considerations’ above all other objectives (Storvik, 1998; cf. Norges Bank, 1990). This would in turn complement the Storting’s policy tradition of prioritizing the energy export sector and its competitiveness as a driving feature of socioeconomic development (Tranøy, 2009: 361).

For Norwegian politicians, however, the Petroleum Fund Act was more significant in its acting as a symbol of fiscal conservatism. The Act ambiguously stipulated for ‘the deployment and investment of a fund intended to safeguard long-term interests through the use of petroleum revenues’. This was to be achieved through the foreign investment of resource revenues in ‘the same manner as the central government’s other assets’, such as government-guaranteed bonds and other short-term liquid assets (Petroleum Fund Act, 1990: Sections 1, 4). The GPFG and its conservative approach to investment thus represented a quick-fix and easily operational means to manage extra-budgetary petroleum wealth once the domestic economy stabilized in the 1990s. Indeed, the 1990 Act represented a symbolic means to stabilize domestic expectations in regards to petroleum wealth management considering all accrued and expected petroleum revenues had already been ‘spent’ up

to 1995 (Gjedrem, 2005: 2).⁵⁰ It provided the newly elected Labour-led government with a domestically desirable means of immediately alleviating the burden to manage petroleum wealth. It would at the same time limit their exposure to criticism for mismanagement endured by the Storting throughout the 1980s (cf. Tranøy, 2009: 372-3).

Yet just one year into operationalizing the Fund's conservative management strategy in 1997, the passive savings mandate was replaced with one of aggressive profit maximization. From then on, the Fund would be tasked to maximize financial returns through risk-based speculation rather than ensure the government's short-term liquidity requirements were met (Revised National Budget, 1997: Section 3.5.2).⁵¹ In little over a decade, the GPFG would come to hold some 7,900 equity and bond positions, represent approximately \$100,000 per Norwegian citizen, and own a full one percent of world financial markets (Qvigstad, 2009*a*; Annual Report, 2009: 22). Why did government actors in the Ministry of Finance and Storting choose to forego the GPFG's objective of thrift and stability in favour of excess financial risk and reward given Norway's volatile economic history? Why was the uncertainty posed by

⁵⁰ This is to note that the first allocation of state petroleum revenues to the GPFG did not occur until 1996 despite the Petroleum Act being passed six years earlier. The first two oil billions were transferred to the GPFG in May 1996, and were invested in the same way as Norges Bank's foreign exchange reserves – i.e. in foreign denominated government guaranteed fixed-income assets. This investment strategy was also applied to the NOK48 billion transferred at the end of that same year (Kjaer, 2006: 2).

⁵¹ This amendment made three immediate changes to the GPFG's managerial structure. First, the fund was to be placed under the management of a newly established division within the central bank – Norges Bank Investment Management (NBIM) – tasked to 'achieve the highest possible return on the separate portfolio within the limits set out in the regulation' (Petroleum Fund Amendment Act, 1997: Section 2). Second, a benchmark portfolio was to be established by NBIM and regularly adjusted according to market conditions (ibid. Section 4). This meant that the GPFG would be judged in much the same way as any other large institutional investor rather than an entity of the state restrained by domestic policy commitments, such as a central bank (Norges Bank, 1997*b*: Section 3). Third, the Fund's investment universe was expanded so as to include international equities which, 'with a high degree of probability', would provide a higher return than the original GPFG's investments (Norges Bank, 1999*a*: 2; Petroleum Fund Amendment Act, 1997: Sections 5, 6). At year-end 1998, the GPFG was invested in over 2,000 different companies across 9,000 total equity holdings, and owned 500 different bonds, in addition to warrants, various types of money market instruments, futures contracts and pure foreign exchange positions (Norges Bank, 1999*b*).

speculative investment deemed more manageable and less threatening to socioeconomic stability than that posed by passive savings or domestic development initiatives? In short, what led state actors to reevaluate their interests in regards to petroleum wealth management in a way that favoured their direct exposure to global financial volatility? Sections 4.2 and 4.3 address these questions. They examine how Norges Bank officials drew from the ideas of financial profitability and financial expertise to inform the central government of their policy preferences in a context of heightened uncertainty they unexpectedly found themselves facing in 1996. Norwegian state actors did not therefore naturally internalize the SWF policy path as the optimal strategy for managing their petroleum wealth, but had to be proactively convinced of this strategy's desirability by Norges Bank officials.

4.2 The GPFG as an SWF (1996-1997): *The Idea of Financial Profitability*

The uncertainty originally associated with windfall petroleum revenues in 1970 suddenly re-emerged in 1996 following a triennially released government white paper. The report revised the government's future allocations to the Government Pension Fund-Global upwards to NOK300 billion in 2000 and NOK400 billion in 2001 – more than a 1,500 percent increase from earlier projections (Norges Bank, 1997*a*; National Budget, 1996: Section 3.5; Kjaer, 2006: 2).⁵² The Storting and its ever-shifting string of coalition governments thus faced a situation they believed could once again instigate a domestic recession. Norges Bank officials were quick to

⁵² This report was the Long Term Programme of 1998-2001 (National Budget, 1996: Section 3.5): a government white paper that approximates the future development of various aspects of the Norwegian economy. The Long-Term Programme of 1998-2001 also judged that the Fund's resources would not be drawn from until 2020 given the new projections of the GPFG's expected growth (Norges Bank, 1997*a*).

provide an actionable plan within this context of uncertainty. They argued the GPFG's conservative investment strategies no longer fit with its 'considerably longer time horizon'. As such, the Storting was empowered to adopt a riskier approach to investment by making 'some adjustments' to the Fund's mandate and managerial structure (Norges Bank, 1997a: 2). These recommendations emerged out of the 'Investment Management Project': a specialized commission created on Norges Bank's initiative in 1996 to devise alternative wealth management strategies. Yet the adjustments these central bank officials recommended amounted to the total overhaul of Norway's approach to petroleum wealth management. At the same time, however, the ideas they drew from to legitimate such institutional change would effectively suspend the Storting's need to devise alternative strategies to deal with this problem of great uncertainty they faced. The following investigates this development. It demonstrates the SWF policy path did not emerge in Norway as a natural by-product of contemporary finance capitalism, nor was it proactively sought out by the state as an inherently desirable means of managing petroleum wealth. Norges Bank officials had to first delegitimize the GPFG's conservative investment strategy, while simultaneously promoting the SWF policy path's desirability as a more favourable strategy of governance.

Norges Bank officials first sought to frame the SWF policy path as benefiting the central government's short-term interests. They did so by arguing the GPFG must be considered a long-term investor with no short-term liabilities in the face of the revised revenue projections (cf. Norges Bank, 1997a: Section 1; Skjørestad, 1998; Norges Bank, 1999b; Skancke, 2003: 318; Norges Bank, 2003: 6-7; National Budget, 2004: Section 3.5.1.3; Ministry of Finance, 2007: 41). The GPFG's short-term performance was thus argued to be of little importance, placating politicians'

uncertainty concerning the benefits to be derived from petroleum wealth with the expectation of the Fund's profitability (Norges Bank, 1997*b*: Section 4). Indeed, Norges Bank officials went so far as to argue the GPF's unspecified time-horizon meant the Storting should ignore short-term performance altogether and 'instead focus more on the expected return' (Norges Bank, 1997*a*: 5). The central bank aggressively promoted the notion that it was impossible to predict 'any period during which markets or market segments [would] seem, in retrospect, "cheap" or "expensive"'. Norges Bank subsequently framed the heightened revenue projections as presenting the Storting with an ambitious opportunity to stabilize their petroleum wealth management strategy in a forward-looking and sustainable manner (Ministry of Finance, 2007; Eide, 1997: Section B).

A small number of officials in the Ministry of Finance and even Norges Bank were nonetheless wary of these claims made by the Investment Management Project. This doubt arose in the context of the highly profitable equity markets of the late 1990s. They worried a concomitant cyclical downturn would soon follow this period of rapid financial growth. Supporters of the financial maximization mandate in Norges Bank were nonetheless capable of reducing this fear by again emphasizing the GPF's new long-term investment horizon. They successfully argued that what happened in the short-term was of little consequence for the state (National Budget, 1998: Section 3.5.1, referenced in Ministry of Finance, 2007: Section 3.2.1; cf. Norges Bank, 2001). By vociferously promoting expectations of the Fund's long-term profitability, the SWF policy path represented a means to stabilize the state's petroleum wealth management strategy into the indefinite future. This was an appealing prospect that readily gained prominence in the Ministry of Finance given the recessionary fears brought on by the increased revenue projections (Revised

National Budget, 1997: Section 3.5.1; Storvik, 1998). Indeed, the prevalence of the ‘New Labour light’ political grouping that has assumed the majority of ministerial posts from the mid-1990’s to 2008 readily internalized these ideas given their ‘solid belief in free markets and [refusal] to see the financial sector as anything else than just another sector’ (Tranøy, 2009: 370). Norges Bank, those in the Investment Management Project specifically, drew from the basic qualitative assumptions of modern financial epistemology to lend authority to their recommendations.

The notion of the equity-risk premium (ERP) was given particular emphasis. It was reiterated throughout committee meetings and informal communications that equities are only ever purchased on the expectation they provide a higher rate of return than safer investments. If this were not the case, there would be no incentive to speculate on riskier assets given a lack of compensation and thus demand (Vik, 2008; Norges Bank, 1997*b*; Annual Report, 1997: 32-34; Eide, 1997; Revised National Budget, 1997: Section 3; Norges Bank, 1999*b*: 4; Gjedrem, 2001). In a ‘normal’ situation based on ‘generally accepted assumptions about rational investor behaviour’, Norges Bank argued, equities would have a higher long-term return than fixed-income assets. This was, in turn, supported by ‘undisputed empirical results’ (Norges Bank, 1999*b*: 4). Norges Bank subsequently argued it is ‘normal’ to assume investors who take risks should expect to earn higher returns by their capacity to ‘harvest’ the risk premium over time (National Budget, 2004: Section 3.5.1; Revised National Budget, 1997: Section 3.5.1).⁵³

⁵³ Two quantitative studies in particular were referenced as providing the undisputed quantitative evidence substantiating Norges Bank’s belief in the ERP. First, a G-10 study commissioned in 1995 analyzed the relationship between saving, investment, and real interest rates from a historical perspective (G-10, 1995). This study provided quantitative evidence for the argument that the Storting should expect to realize an ERP of at least four percent if it elected to adopt equities into its portfolio. The second study, Siegel’s *Stocks for the Long Run* (1994), was based on similar US stock market data to that used in the G-10 study. It argued that equity has paid out an average seven percent premium over the fixed income assets the GPFG was invested in between 1996 and 1998 (Siegel, 1994). The study confirmed the idea that equity does in fact experience more volatility in the short term than fixed

The expectation of increased revenue projections, the GPF's unspecified long-term investment horizon, and thus its perceived capacity to earn speculative financial returns enabled Norges Bank officials to promote an authoritative guide to action the Storting should pursue (Eide, 1997). This was over alternative strategies being considered, such as maintaining the Fund's conservative status quo, investing in infrastructure, or attempting to diversify the domestic economy away from petroleum dependence (cf. Gjedrem, 2009). The Jagland administration – in power between 1996 and 1997 only – was particularly influenced by the argument that long-term international investors were invested 30-70 percent in equities (Revised National Budget 1997: Section 3.5.1). The government would thus not be going it alone in its management of petroleum wealth as it did previously, but would be participating in a wider financial realm of discernable rules and established precedents.

Yet what Norges Bank officials did not do in 1997 was make a serious attempt to explain *why* equity should pay out a premium over fixed income into the future. This was no matter the evidence offered by the historical studies cited in their recommendations, which even they cited as being incapable of providing a complete depiction of historic let alone future trends (Norges Bank, 1997*b*; Annual Report, 1998: 34). The qualitative assumptions that substantiated Norges Bank's quantitative historical data would not in fact be questioned by the Storting until 2003, and then only by an externally hired consultancy firm (cf. Mercer, 2003: Section 2.6-2.17). Norges Bank could not explain away the 'survivorship bias' these studies' underlying data was eventually accused of harbouring (Qvigstad, 2009*a*). That is, the tendency to

income assets, but also that higher returns are virtually guaranteed upon adoption of a time horizon of 30 or more years (Siegel, 1994: 5-7). Both of these studies are referenced throughout Norges Bank's first proposal to focus on financial maximization as a means for the government to maintain socioeconomic stability following the increased petroleum revenue projections of 1996 (Norges Bank, 1997*a*: 2; Norges Bank, 1997*b*: Section 1; cf. Norges Bank, 1999*b*). A third unpublished study conducted by Jorion and Goetzemann (1999) was then also cited a year later in the 1998 Annual Report (pp. 34) as further supporting the existence of the ERP if a long enough time horizon was adopted.

analyze those markets and time periods for which data is most readily available, and which have not experienced crises that reduce equity values to nil such as in China, Russia, and Poland. This would mean that '[e]ven though the probability of a lower return is reduced when the [time] horizon is extended', the size of these lower returns will increase when accounting for extreme losses arising from recurrent crises (Norges Bank, 2001; cf. Annual Report, 1998: 33; Mercer, 2003: 5; Ministry of Finance, 2007: 49). This is in addition to the costs to government who have historically been expected to support failing markets with the same public capital that compose SWFs.

It nonetheless suffices to indicate now that including the survivorship bias clause in Norges Banks' recommendations would have dampened their authority to inform the Storting of what their policy preferences should be. These quantitative studies of the ERP did not therefore provide the Storting with a rationally desirable guide to action in themselves, but their underlying assumptions were strategically drawn from to advocate Norges Bank's recommendations over competing alternatives. And to reiterate, these recommendations were not entirely motivated by the self-interested desire of Norges Bank officials to increase their own authority over public capital management. Rather, they were made once these officials were convinced new ideas to inform them of how to best manage the GPFG had to be turned to given the significant growth the Fund was projected to experience between 1997 and 2001. It was the uncertainty presented by these projections and modern financial epistemology's capacity to manage this uncertainty in the present that led to the GPFG's reconceptualisation as long-term financial maximizer. These ideas then had to be framed by Norges Bank as complimenting the Storting's short-term interests. Specifically, their desire to avoid setting conservative extraction limits on

much prized petroleum fields, and in a way that would prevent them from inducing a similar period of socioeconomic turbulence as that experienced in the 1980s. Despite the authority – or perhaps believability – of these recommendations, however, what remained uncertain in 1997 was who exactly would manage the Fund’s new financial mandate given Norges Bank’s lack of experience overseeing such riskier investment practices.

4.3 The GPFG as an SWF (1996-1997): *The Idea of Financial Expertise*

The Government Pension Fund–Global’s reconceptualisation as a financial speculator in 1997 led to major changes in its managerial structure, as well as its relationship with the central government. The following Section examines why the central government approved these changes given the fact they would limit the Storting’s authority to manage Norway’s prized petroleum wealth. Particular attention will once again be paid to the role played by ideas – modern financial epistemology’s notion of financial expertise, specifically – to guide the development of the government-GPFG relationship.

While the roles performed by Norges Bank, the Ministry of Finance, and the Storting would remain formally unchanged from the 1990 Petroleum Fund Act, the central bank would now be responsible for overseeing the purchase of global equities with which they had little to no experience. While there were other organizations considered for the role, the Storting held that Norges Bank should retain its position as operational manager of the Fund. This was given the bank’s two years of experience with GPFG management, and their already being subject to governmental oversight (Eriksen, 2006: 13; Revised National Budget, 1997: Annex 1). Operational

management by Norges Bank would therefore contribute to the ‘national confidence’ required for the GPF’s success if it were to be domestically scrutinized to the extent the central government suspected. This was considering the state’s historical experience with a hands-on approach to public capital management, as well as the degrees of financial risk to which the GPF would be exposed from 1997 onwards (Storvik, 1998: 1-3).

To be sure, the desire to retain Norges Bank as operational manager was primarily influenced by the Storting’s previous experience with petroleum wealth management. Since the 1970s, Norway had established a tradition for both relatively weak minority governments and correspondingly ‘spend happy’ parliaments (Tranøy, 2009: 269). To reiterate, then, the substantial increase in resource revenue projections from 1997 onwards therefore presented a problem of great uncertainty for the Storting. However, this was not just in terms of *how* to manage these resources, but also *who* was to manage them. They believed they could be neither hands-on with the GPF’s now risky financial mandate, nor could they leave it unmonitored lest the domestic electorate accuse them of unaccountability. Empowering the central bank as a ‘force of prudent demand management’ – despite the inclusion of equities – was therefore deemed an optimal compromise that would satisfy the GPF’s financial as well as the central government’s domestic political obligations (Tranøy, 2009: 269; Storvik, 1998; Kjaer, 2000).

Thus in a functional sense of depoliticization – i.e. placing the political character of decision-making at one remove of government (cf. Burnham, 2001: 128; Hay, 2007: 82) – Norwegian state managers believed they were fortifying socioeconomic stability by limiting their managerial influence over current and future petroleum revenues. Thus resonating with the arguments of public choice theory, the

Storting internalized the notion they could not be trusted to manage this wealth into the long-term. This was given their short-term political orientations, as well as the fragmented and unstable nature of the Storting's historically short-lived coalition governments. Whether such views were an accurate depiction of what would unfold was unimportant in the context of uncertainty both Norges Bank and the government found themselves facing in 1996. More important was their pre-existing belief that elected officials remained ill suited to adopt a hands-on approach to GPFM management no matter the form of its mandate.

In debates leading up to and following the GPFM's 1997 transformation, officials in both the Ministry of Finance and Storting cast themselves in an openly pessimistic light when speaking of their relationship with petroleum wealth management (Eide, 1997; Storvik, 1997; Skjørestad, 1998; Revised National Budget, 1997: Section 3.5). Acting on these beliefs would in turn limit their responsibility for this task and the potential domestic criticisms it exposed them to. Government actors in the then majority Centre-Left coalition proclaimed that not only were they incapable of managing the GPFM in any fashion, but they were also unable to internalize the lessons-learned between 1976 and 1990. This was in regards to populist appeals to spend petroleum revenues for short-term socioeconomic gain. They would instead once again succumb to their inherently self-interested desires in approaching GPFM management to the detriment of medium to long-term socioeconomic stability and growth. By informing themselves of how to act based on these pre-existing beliefs, the government proactively delegitimized their capacity to manage the GPFM's new SWF identity to the rest of the Storting and Norwegian public in general. Their responsibility would instead be to ensure these political and everyday actors viewed Norges Bank as more legitimate managers despite the bank's lack of

experience with speculative finance. This was to be achieved by communicating this message through the Fund's annual and quarterly reports, as well as the Ministry of Finance's annual reports to the Storting (Qvigstad, 2009*b*).

However, depoliticization of GPFM management to Norges Bank also occurred in an ideational sense of authority. That is, the notion that the Storting would be open to 'disciplining from empowered technocrats in the central bank' was a major reason Norges Bank was delegated managerial authority for the GPFM's new financial mandate (Tranøy, 2009: 269). Thus in addition to being largely detached from government auspices and political pressures, Norges Bank's capacity to direct the GPFM's institutional development would also stem from the epistemological authority commanded by their expert knowledge of speculative finance. As just mentioned, however, Norges Bank had yet to develop its financial expertise to the extent it could be deemed such an authority over the Norwegian SWF. These newly empowered technocrats traditionally tasked with overseeing monetary and fiscal policy would first need to develop their organization in a way they believed would accommodate the GPFM's new financial maximization objective. Norges Bank's development would in turn serve a non-financial function for the state. That is, it would satisfy the interests of a sceptical Norwegian public who preferred their prized petroleum wealth be managed independent of politicians, but with Norwegian interests in mind (Revised National Budget, 1997: Annex 1; cf. Tranøy, 2009: 371). The development of Norges Bank's financial expertise was therefore in the interests of the state not just for its perceived capacity to enhance GPFM returns and preserve the Fund's international purchasing power. It also served to shift the locus of accountability for petroleum wealth management even further from central government auspices. Indeed, the expectation that Norges Bank would be developing

its financial expertise from 1997 onwards was understood as capable of insulating election-wary politicians from the negative reputational impacts that would arise from a poorly performing GPFG (Annual Report, 2007: 74-75; Skancke, 2003).

Yet Norges Bank as it stood in 1997 only satisfied one requirement of what modern financial epistemology considers ‘financial expertise’. That is, they were free of political interference and would thus make decisions based on strictly commercial interests. They therefore could be considered ‘rational’ investors, and could thus reap the equity-risk premium into the long-term without fear of succumbing to ulterior motives, political or otherwise (Revised National Budget, 1997: Annex 1; Annual Report, 2007: 75). What they lacked, however, was an intimacy with the language of risk and return required to determine exactly how they should act in the short-term to ensure the GPFG generated these returns. As a first move to fill this gap, a new ‘Management Agreement’ between Norges Bank and the central government was drafted in 1998. The Agreement stipulated the Bank could hire external managers, but it also established Norges Bank Investment Management (NBIM) as an operationally autonomous investment arm within the central bank to take over all responsibility for GPFG management (Norges Bank, 1998: Section 2.2; Norges Bank, 2000a).⁵⁴

The way NBIM would develop as a semi-independent investment firm between 1997 and 2009 thus started with the notion that the government’s short-term political outlook would only hinder the GPFG’s new long-term financial maximization mandate. Norges Bank officials instead framed an autonomous NBIM as more capable of developing the unique brand of financial expertise necessary to ensure the GPFG’s speculative financial (Revised National Budget, 1997: Annex 1; Norges Bank, 1997b: Section 2; Kjaer, 2001). The 1998 Management Agreement was

⁵⁴ As a point of clarification, Norges Bank’s Executive board decided to establish NBIM following recommendations proposed to them by the Investment Management Project. This group was led by Knut Kjaer, who would eventually become NBIM’s first Chief Executive Officer (Kjaer, 2001: 4).

thus significant due to its symbolism. It signified to the Norwegian public that NBIM officials would be drawing from a range of strictly financial ideas and commercial interests to inform them how to act and develop as a financial management institution. This is to highlight the Agreement did not affect the formal degree of authority separating the central bank from the central government. It would nonetheless increase the Storting's dependence on professional investors in NBIM to support their governance function and domestic legitimacy. Indeed, NBIM immediately became the primary advisor to the Ministry of Finance as well as Storting in all matters of investment strategy as befitting 'the Bank's general obligation to provide professional advice to the political authorities' (Storvik, 1998: 1).⁵⁵

The following Section now examines how the authority exerted by the ideas of what constitutes financial expertise under modern financial epistemology continued to inform both NBIM and central government officials of how they should approach GPFG management between 1998 and 2005. This constrained the central government to increase the independence and specialization of tasks for the GPFG's new managers in NBIM. These ideas about what the speculative finance realm was and how to successfully participate within it were repeatedly turned to so as to inform both groups as to how NBIM should develop as speculative financial manager. Both sets of state actors faced similar problems of uncertainty – i.e. how to monitor versus operationalize speculative investment of petroleum wealth – that this prescriptive knowledge framework helped them 'plan and politic' their way through (cf. Blyth, 2002: 10). Identifying these particular ideas and how they were internalized to inform the Norwegian state's policy preferences from 1998 onwards helps explain how the unique relationship between the GPFG, NBIM, and the central government emerged.

⁵⁵ The Norwegian central bank was not made fully independent of the central government until 2001.

This is a necessary task as it was those ideas and their authority to inform legitimate action in the face of uncertainty that would ultimately expand NBIM's authority over the central government in all matters of petroleum wealth management. Section 4.4 therefore seeks to fill in a gap left in existing SWF commentaries that take the necessity of politically divorced financial experts as implicit. Such an assumption prevents these analyzes from critically examining how this feature of the SWF policy path constrains government agency. This is through its limiting political actors' capacity to implement policy preferences that fall outside the bounds of legitimate action prescribed by modern financial epistemology. Whether SWFs are in a domestic population's short, medium, or even long-term socioeconomic interests therefore remain unquestioned. The following Section identifies the ideational form of this constraint and how it emerged in Norway between 1998 and 2005.

4.4 The GPFG-Central Government Relationship (1998-2005): *The Development of NBIM's Financial Expertise*

Between 1998 and 2005, the central government approved a number of recommendations made by NBIM to increase the Government Pension Fund-Global's risk exposure. These included expanding the Fund's equity portfolio by 20 percent, as well as increasing the use of short-term active – or 'alpha' – management strategies.⁵⁶

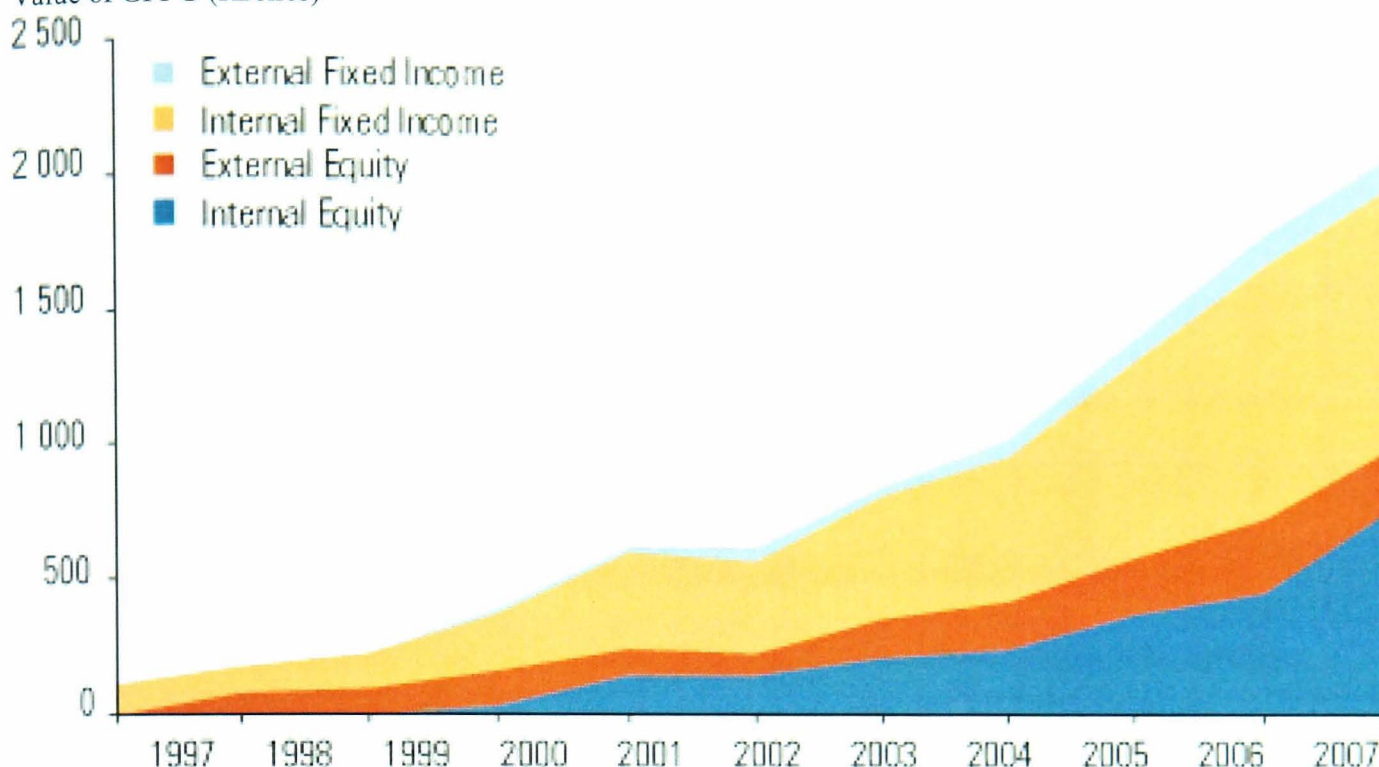
⁵⁶ The most noteworthy of NBIM's recommendations adopted by the Ministry of Finance were: (i) inclusion of 40 percent equities in the GPFG's investment universe in 1997, then 60 percent in 2006 (Norges Bank, 1997*b*; Olsen, 1997; Norges Bank, 2001); (ii) inclusion of more markets, and then emerging markets, in the investment universe (Norges Bank, 1999*c*; 2002; 2003*b*); (iii) higher allowable ownership concentrations, from one to three percent, then three to five percent, then five to ten percent (Norges Bank, 2000*b*; 2008); (iv) inclusion of non-government-guaranteed bonds (Norges Bank, 2002*a*); (v) inclusion of private equity, inflation-linked bonds, and real estate (Norges Bank, 2002*b*; 2007); (vi) inclusion of pre-IPO investments (Norges Bank, 2008*b*). This is not to say that all NBIM's recommendations were adopted without consideration or debate. In 2008, for example, NBIM's CEO – Yngve Slyngstad – requested the GPFG increase its ownership concentrations to fifteen percent, but was granted only ten. There is also a prolonged lag-period between investment advice being offered and approved by the government (Vik, 2008; Kvam, 2008). In any case, NBIM has been the sole driver behind the expansion of the GPFG's investment universe due to their being

Why would the central government want to expose Norway's petroleum wealth to such increased financial risk rather than maintain their already risky investment strategy? To be sure, the Storting was well aware that increasing the GPFG's exposure to equities was no assured means of increasing its short-term returns (Revised National Budget, 2007: Section 3). If government actors are motivated by political self-interest as posited by mainstream SWF analyzes, what would the Storting gain from increasing their susceptibility to short-term financial volatility? Explanations offered by NBIM and financial economists have thus far been unsatisfactory. They simply maintain the GPFG's expansionary investment universe and more risk-exposed portfolio were necessitated by the demands of the Fund's financial maximization mandate (cf. Annual Report, 2007: 83-87; Vik, 2008; Nugee, 2008). These accounts do not adequately explain how or why the central government's interests became increasingly synonymous with those of the GPFG's financial interests. The following attempts to fill in this gap by demonstrating how NBIM aggressively began developing what they understood to be their financial expertise from 1998 onwards. It was these efforts that increased NBIM's epistemological authority over GPFG management, and which ultimately constrained government actors to approve their recommendations. Indeed, development of their financial expertise led to an increased proportion of the GPFG that was managed internally by NBIM, as well as their capacity to dictate how the Fund's investment strategy should develop into the future (see Figure 4).

informed by modern financial epistemology such extensive diversification is in the interests of the Fund's speculative financial mandate.

Figure 4: The proportion of GPFG being managed internally by NBIM (1997-2007)

Value of GPFG (Krones)



Source: Annual Report, 2007: Feature Article

From 1997 onwards, the central government wished to be transparent and accountable in regards to all matters of GPFG management and governmental decision-making given Norway's volatile economic history. Yet this transparency campaign only revealed the extent to which central government actors depended on what Tranøy (2009: 363) refers to as 'a highly technocratic form of authority'. This had the effect of shielding NBIM – and GPFG management in general – from public and democratic scrutiny due to 'the sheer complexity of its tasks' (ibid. 363). Indeed, NBIM internally developed financial risk management techniques between 1997 and 2005 that everyday Norwegians and most members of government had 'scant chance of understanding' (ibid. 363). This is to highlight that once the SWF policy path was adopted in Norway, modern financial epistemology's understanding of legitimate versus illegitimate actions rapidly came to constrain central government agency in regards to petroleum wealth management.

To this effect, the Storting's creation of the GPF in 1990 was pursued as a means to avoid incurring a similar period of socioeconomic instability as that experienced throughout the 1980s. As an extra-budgetary stabilization-savings account, it would prevent current and future government administration's from once again spending petroleum wealth, which could potentially destabilize the country's tenuous fiscal position. Norges Bank was thus delegated operational autonomy for the management of the Fund, which was to be invested 'in the same manner as the central government's other assets'. This was without giving consideration for generating excess returns (Petroleum Fund Act, 1990: Section 4). This governance structure was intended to provide enough buffer room for the central government to maintain it was not involved with the management of the Fund, but at the same time ensure it kept within the regulatory bounds they set through the Ministry of Finance (Kjaer, 2006: 2). To be sure, the vast majority of governing authority between 1990 and 1997 resided with the Ministry of Finance, as the GPF's conservative investment strategy was operationalized entirely 'in house' under the auspices of existing central bank arrangements.⁵⁷

This level of authority over GPF's management would, however, be subject to contestation and change in NBIM's favour from 1998 onwards. Indeed the central government would come to increasingly rely on the epistemological authority of financial experts in NBIM to provide policy advice as petroleum revenues swelled even more than projected into the 2000s (cf. Annual Report, 2004: 2). This is to indicate that the continued expansion of the GPF's investment universe and

⁵⁷ Norges Bank's Executive Board was initially charged with being 'responsible for making sure that asset management is practised in accordance with the framework defined by the Ministry of Finance' (Norges Bank Act, 1985: Section 5). This governing role would primarily be served every two years through the Executive Board's setting of strategy plans which determined the framework of operations for NBIM (Annual Report, 2007: Feature Article). At the same time, a 'Supervisory Council' composed of 15 members elected by the Storting would supervise Norges Bank's activities and ensure that the rules set by its Executive Board were observed (Norges Bank Act, 1985: Section 5).

exposure to financial risk is not attributable to any inherently rational desires held by state managers as currently assumed in the SWF literature (cf. Caner and Grennes, 2010). Nor was NBIM's increasing authority and desire to expose GPFGE capital to higher amounts of risk uncontested by either the Storting or Norwegian public. Instead, NBIM's capacity to direct the GPFGE's institutional development had to be proactively constructed and iteratively promoted to both the Storting and public throughout this period. A primary means of achieving this was through NBIM's 'strategy plans', released every two years (cf. Annual Report, 2007: 51, 89). These reports strategically drew from the same authoritative – but ultimately fallacious – ideas that convinced the central government of the SWF policy path's legitimacy as petroleum wealth management strategy in 1997.

To this effect, the 1998 Management Agreement – which determined NBIM's relationship with both the GPFGE and central government – placed the Ministry of Finance in a position 'to control all the main aspects of management'. That is, in formulating the overall guidelines of how GPFGE's capital was to be invested (Kjaer 2001: 4-5; Norges Bank, 2000*a*). Yet given the central government's desire to limit their interference with the fund, it would ultimately be NBIM that decided 'how to use its latitude to achieve the highest possible return' (Gjedrem, 2000: 4). Thus not only was NBIM expected to operationalize the GPFGE's financial mandate, but it also had great influence in determining what its risk limits should be (Norges Bank, 2000*a*; Revised National Budget, 1997: Annex 1). NBIM was consequently enabled throughout the ensuing years to propose significant changes to what assets the GPFGE could be invested, as well as how they were to operationalize this investment

strategy.⁵⁸ Yet in 1998, NBIM only satisfied one of the criteria of what constituted financial expertise – i.e. it was shielded from the self-interested interference of Norwegian politicians. It was the authority of these financial ideas that enabled Norges Bank officials to construct a believable and desirable guide to action in regards to how petroleum wealth should be managed. The SWF policy path cannot therefore be said to have emerged in Norway due to the evolutionary tendencies of speculative finance. Instead, several qualitative assumptions concerning the speculative financial realm had to be strategically drawn from to authoritatively prescribe how NBIM should develop as an organization. The informative role of these ideas proved especially important as Norway's petroleum revenues continued to swell into the 2000s.

To this effect, the Fundamental Law of Active Management (FLAM) was cited in particular throughout NBIM's biennial strategy reports as providing 'extremely important guidance' on how NBIM should be managed and organized (Annual Report, 2007: 86).⁵⁹ FLAM posited that 'the risk-adjusted return...increases proportionally with skill (information coefficient) and with the square root of the number of positions'. As such, it was believed NBIM would be more successful as operational manager if it made 'many more decisions each accounting for less of the

⁵⁸ For example, acting on NBIM's advice in March 2002, the Ministry of Finance lifted the restrictions on non-government-guaranteed bonds (Norges Bank, 2002: 5). Prior to this change in regulation, the GPFG was allowed to invest only a maximum of five percent of the fixed income portfolio in non-government-guaranteed bonds with a credit rating of BBB, and ten percent in those bonds with a higher rating. These types of assets were not, however, included in the GPFG's benchmark portfolio. This meant that taking positions in such riskier bonds forced the GPFG to assume more risk than that allowably prescribed by the Ministry of Finance. After 2002, however, NBIM would 'in fact be taking active risk if it *fails* to invest in non-government-guaranteed bonds' (emphasis added, Norges Bank, 2002: 1). Hence from March 2002 onwards, NBIM went from being limited in their ability to assume extra financial risk in the fixed income portfolio to being limited in their ability *not* to do so. As will be further examined in Chapter Five, this would prove highly significant for the Centre-Left's political legitimacy as the active bond portfolio decimated GPFG returns in 2007 and 2008 in the wake of the 2008 global liquidity crisis.

⁵⁹ FLAM was first introduced into the financial economics literature by Girnold and Kahn (1995). Its newness to the literature despite its long-standing use in practice is due to the continued debate as to whether active management strategies are capable of enhancing annual returns over and above more traditional strategies of passive investment.

overall risk limit....and in such a way that these positions are as independent of one another as possible' (Annual Report, 2006: Feature Article 1; cf. Kjaer, 2003; Annual Report, 2008: Section 3.1.2). The internalization of FLAM to provide a blueprint for action thus brought about real institutional change in the Norwegian state. It was expectations of legitimate action it authoritatively enforced that directly altered the power relationship between the Fund, NBIM, and the central government in Norges Bank's favour from 1998 onwards. Four ideas in particular were internalized by NBIM in their approach to developing their financial expertise and, by extension, their epistemological authority over the GPFG.

First, NBIM believed they needed to develop 'the strategy, capacity and control systems' necessary to manage a portfolio the size of the GPFG's. Indeed between 1998 and 2005, NBIM consistently cited investment strategies and organizational principles as being 'two sides of the same coin' (Annual Report, 2007: Feature Article; cf. Norges Bank, 1999*a*). These organizational capacities developed unexpectedly fast, however, as NBIM oversaw a total of 17,258 equity transactions carried out in 21 countries between January and June of 1998 (Norges Bank, 1999*b*). The investment arm of the central bank therefore began arguing in 1999 that the 'extensive infrastructure' that had been developed to manage the GPFG in its first two years provided 'sound system platform[s] and trading routines' that would benefit internal management'. This was in addition to the argument that the GPFG's size ensured 'ease of access to important sources of information' that would give them an advantage compared to other investors (Norges Bank, 1999*a*).

In a similar vein, the second requirement of financial expertise NBIM believed necessary was to have a clear 'information advantage' based on better access to relevant information, and better generation of investment ideas based on this

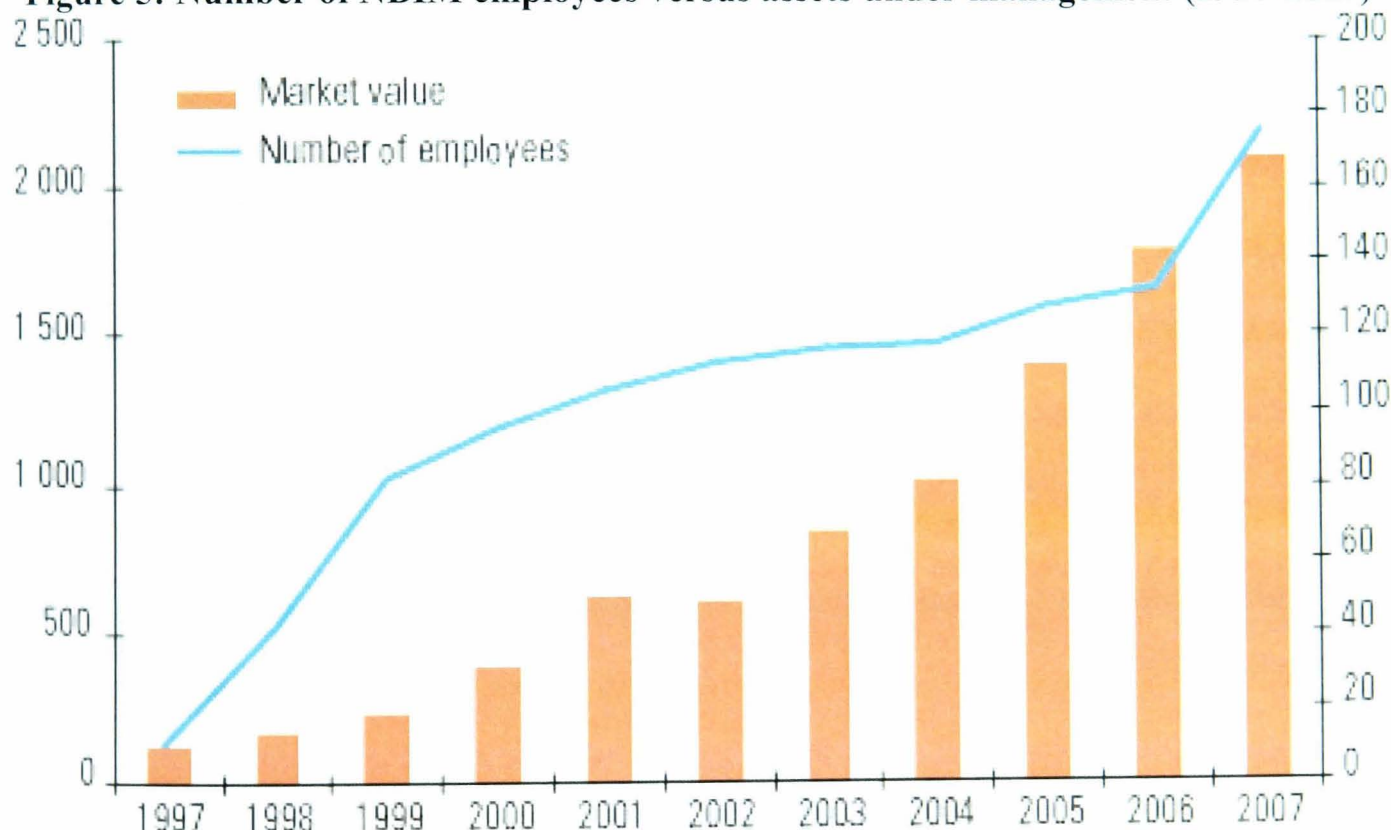
information (Norges Bank, 1999a: 2). This meant ‘processing information better than the average participant’ rather than ‘possessing special information on the individual market’ (Norges Bank, 2000a). Thus in 2001, NBIM began using ‘RiskManager’, a system that ‘provide[d] an updated overview of holdings of cash and equities in all the internal portfolios’ (Norges Bank, 2002b: 2).⁶⁰ At the same time, they also installed ‘market information systems’ such as Bloomberg Terminals that would enable them to ‘obtain knowledge of events [in financial markets] at an early stage’. Such systems were argued as necessary in their provision of ‘continuous price info and other news, and...access to historical data’. This was in addition to the data that was developed in-house ‘as an aid in constructing portfolios, analytical work and reporting’ (Norges Bank, 2002b: 2). These information systems were thus deemed capable of enabling NBIM to better deal with global financial market’s ‘reality in flux’ (Knorr Cetina, 2005: 52-54).

Third, NBIM believed GPFM managers had to have ‘skill...in constructing their portfolios resulting from their information advantage’ (Norges Bank, 1999a: 2). To be sure, NBIM gave academic backgrounds and skills a greater priority than other Norwegian and international investment firms. ‘Technical expertise’ – or an affiliation with the intricacies of modern financial risk management techniques – was in fact put on equal footing with managerial competence (Annual Report, 2007: Feature Article). NBIM subsequently went on a global headhunting spree in order to lure professional investors in possession of what they determined to be investment skill. Between 1999 and 2005, NBIM as an organization grew by 44 percent – from 71 full time employees in 1998 to 128 in 2005 – with approximately 25 percent of this growth consisting of ‘skilled investors’ according to NBIM (Annual Report, 2007: 88;

⁶⁰ Perhaps not so incidentally, Knut Kjaer – NBIM’s former CEO – became president of RiskMetrics in 2009.

see Figure 5). Such growth was achieved by offering unconventional – at least from a Norwegian public services standpoint – remuneration packages that were structured so as to more closely resemble wages offered in the private sector.⁶¹ It was believed that such wages would instil ‘a professional and vigilant business culture within the central bank’ believed necessary if the GPFG were to maximize its investment returns (Bergo, 2007; cf. Annual Report, 2003: Section 6). At the same time, these performance-linked wages would serve to further distinguish NBIM’s distinct commercial mentality from that of the politically minded central government. NBIM managers could therefore be considered ‘rational’ investors capable of reaping the ERP into the future. Governmental involvement would only complicate this pursuit.

Figure 5: Number of NBIM employees versus assets under management (1997-2007)



Source: Annual Report, 2007: Feature Article

⁶¹ In 1997, for example, total management fees amounted to NOK66.8 million. By 2008, they were NOK2.165 billion to attract top financial talent from across the world. This was despite the Fund generating net losses of NOK129 billion in 2008, and NOK80 billion just a year earlier in 2007 (Annual Report, 2008: 70).

Finally, specialization of tasks within NBIM – i.e. more individual autonomy of decision-making – was also understood to be a necessary prerequisite for the development of financial expertise (Norges Bank, 1997*a*). For NBIM's first CEO, Knut Kjaer, this could be derived from 'spreading active management over a large number of independent decisions' as well as 'combining external and internal management and specialising internal management in areas where there is a good possibility of predicting price movements better than the average market participant' (2001: 6). NBIM thus argued increased *individual* autonomy, and not just organizational autonomy, was necessary. This was because 'investment decisions across sectors must to a greater degree be based on the managers' views concerning developments in macroeconomic conditions, structural developments and the rate of change of various sectors' (Norges Bank, 2002*b*).

In sum, turning to these four ideas promoted by FLAM to develop NBIM's financial expertise lent them greater authority over the GPF's institutional development with each passing year (cf. Annual Report, 2007: 87). This aggressive development of NBIM's financial expertise was, however, surprising. Norges Bank had in fact stressed in their 1997 recommendations that it was unlikely they would assume the majority of responsibility for the Fund's equity portfolio (Norges Bank, 1997*a*: 16; Norges Bank, 2000*a*). Indeed, there was initially a strong resistance from several Norges Bank and Ministry of Finance officials – as well as the 1996 Investment Management Project itself – to increase the proportion of the GPF managed by NBIM vs. external managers (Annual Report, 2007: 86; cf. Johnsen, 2010*a*; Gjedrem, 2009*a*). Yet based on the guidance provided by FLAM, NBIM argued that by 2005 they had gained 'considerable expertise as far as equity management is concerned, together with experience in the handling of fluctuating

portfolio performance from one year to the next' (Ministry of Finance, 2007: 46). As evidenced by the adoption of a new Management Agreement in 2005 that only served to increase NBIM's independence to determine investment strategy, the majority of Storting officials were fully supportive of the investment arm of the central bank at this time (cf. Ministry of Finance, 2005).

The development of NBIM's financial expertise consequently demonstrates how Norway's approach to sovereign wealth management was depoliticized in both a functional as well as ideational sense of authority. Throughout this period, good governance in regards to petroleum wealth management was increasingly framed throughout policymaking circles as a purely technical matter that could only be managed by professional investors in NBIM (Norges Bank, 1997*b*: 5-9; Norges Bank, 1999*b*; Norges Bank, 2000*a*). NBIM in fact cited in 2007 that it should not just be considered as an investment arm of the central bank, but a 'modern knowledge company'. This was given that its management function was derived more from a 'natural' or knowledge-based reading of authority, rather than a 'formal' hierarchical view of authority (Annual Report, 2007: 87). It was depoliticization in the first sense of authority that ultimately came to constrain the central government's capacity to determine the form and function of the GPF, as well as its relationship with Norwegian society.⁶² These state managers came to place more and more faith in NBIM's financial expertise to help them traverse the volatile ebb and flow of the speculative financial realm. To reiterate, this constraint is witnessed in the government's approving the continued expansion of the GPF's investment universe based on NBIM's advice between 1998 and 2005. This was despite the fact that such

⁶² What's more, NBIM managers were themselves constrained by the prescriptions of modern financial epistemology. Indeed in the face of uncertainty arising from their lack of experience with speculative finance, NBIM could only act in a way they believed optimal based on the dominant financial ideas of the time. This dissertation nonetheless emphasizes the constraint these ideas put on governmental agency when formulating policy preferences.

increased exposure to risk would not necessarily benefit government managers in the short-term, but would expose public capital as well as their domestic legitimacy to a much higher degree of financial volatility.

Conclusion

The preceding Chapter demonstrated that the Government Pension Fund-Global was not naturally or logically reconceptualised as a sovereign wealth fund by the central government between 1996 and 1997. As a fund composed of public capital, the government had to be proactively convinced by Norges Bank officials that investing for speculative financial gain was a legitimate means of managing windfall petroleum revenues. They also had to be convinced that adopting such increased levels of financial risk would not expose them to criticisms for fiscal recklessness or unaccountability in the short-term. Norges Bank officials thus strategically drew from several qualitative assumptions espoused by modern financial epistemology to placate any uncertainties, and to lend authority to their recommendations. This fills in a gap pervading the literature on sovereign wealth funds. These commentaries have yet to empirically examine the politics behind SWFs' institutional development, instead assuming SWF-states' policy preferences to remain fixed through time. They consequently ignore the authoritative role played by ideas to inform action in the face of uncertainty over competing alternatives. These commentaries also have yet to critically engage with the fact that these ideas do not account for the financial realm's contradictions and crisis tendencies. Indeed, Chapter Three demonstrated that SWFs' underpinning financial logic is rooted in a number of simplified presuppositions that primarily serve to legitimate modern financial practices rather than provide an accurate or objective guide to action.

NBIM and the Storting nonetheless heavily relied on several of these basic assumptions of modern financial theory to inform them of their policy preferences when faced with the problem posed by unexpected windfall petroleum revenues. These ideas then also acted as important mechanisms through which the SWF policy path's legitimacy could be communicated to the Norwegian public. NBIM first placed particular emphasis on the notion that speculative investors are rewarded with an equity risk premium. This belief primarily derived from the assumptions that markets were efficient and investors were rational. For the Storting, then, belief in the ERP effectively stabilized expectations of how profitable the GPFG's financial maximization mandate would be. The notion of financial expertise – specifically that the GPFG must be managed by professional investors divorced from the clouding influence of politics – was then called upon to legitimate NBIM as the manager best suited to operationalize this mandate. The SWF policy path thus benefited the central government's short-term interests as it immediately stabilized their governance function in regards to the highly scrutinized issue of petroleum wealth management. Indeed, the SWF policy path effectively managed short-term socioeconomic expectations as to how the state's petroleum wealth would be managed by reconceptualising them as more calculable and predictable *financial* expectations.

The Chapter then also demonstrated how these ideas continued to dictate to the central government how the GPFG should develop as a systematically significant strategy of governance between 1997 and 2005. This was firstly in terms of dictating the GPFG should continue to diversify its portfolio into more speculative asset classes and markets as a means to better manage financial risk. Anything less than continued diversification was argued to be irrational and even threatening to the long-term interests of the Norwegian state. These financial ideas then also served to enhance

NBIM's authority in making these recommendations to expand the Fund's investment universe. Indeed, the idea of what constitutes financial expertise under modern financial epistemology informed these officials how they should develop as an organization given their lack of experience with speculative investment. These ideas then increasingly came to constrain central government agency between 1998 and 2005. Indeed, it enhanced NBIM's epistemological authority and thus their capacity to guide the GPF's institutional trajectory. This is to highlight that it was not just NBIM being placed at one remove of government in matters of petroleum wealth management that lent them their authority over the GPF. It was more importantly their command of a particular form of financial knowledge that enabled them to couch their recommendations in an authoritative 'science' of speculative investment.

The authority NBIM derived from their unique position as government-linked financial experts was eventually issued as a point of concern by the Ministry of Finance in 2006. The Ministry questioned their diminishing capacity to monitor the GPF given their increasing dependency on financial experts to provide advice. How could they be considered accountable regulators of the risk-exposed Norwegian SWF given their reliance on NBIM? The Ministry argued that the rules defining the central government's relationship with NBIM 'are brief and general...[and] need to be defined more clearly' (Revised National Budget, 2006: Section 1.5.3). Simply put, the central government recognized the high degree of autonomy NBIM had gained for itself between 1997 and 2005. Yet the creation of an additional government-appointed supervisory layer – the 'Advisory Council' – in 2006 would not increase the government's authority over GPF management.⁶³ Indeed, while it placed the

⁶³ The Advisory Council was meant to provide an additional check on NBIM in 'their work on investment management'. It would consist of four 'internationally recognised experts with extensive experience from large investment management institutions' and would meet with NBIM's Executive Board bi-annually (Annual Report, 2006: Section 5.1).

democratically-elected Storting closer to GPFG oversight in a functional sense of authority, they were still heavily reliant on the epistemological authority of financial experts in NBIM.

The following Chapter takes a closer examination of this constraint imposed by NBIM's epistemological authority on the central government's political agency between 2005 and 2009. It also highlights how the central government was increasingly constrained to actively construct and promote the GPFG's domestic legitimacy throughout this time. The following Chapter thus examines how Norges Bank as well as central government officials legitimated the SWF policy path to the Norwegian public. This is opposed to the task of the preceding Chapter, which limited its analysis to how the SWF policy path came to be internalized as a legitimate strategy of governance by the central government. Chapter Five thus demonstrates how the SWF policy path's legitimacy had to be proactively constructed and maintained by central government actors in much the same way that Norges Bank convinced these actors of its desirability in 1997. Chapter Five therefore also adds to the discussion on how SWFs as strategies of governance constrain government agency. This by their rendering state actor's policy preferences synonymous with the demands of the funds' long-term and outward-looking financial interests. Specific evidence will be drawn from the Norwegian government's reaction to the financial crisis of 2007-2009 to elaborate on this constraining and altogether problematic feature of sovereign wealth funds.

Chapter Five

Norway's Government Pension Fund-Global (1997-2009)

In efforts to maintain domestic accountability, both the Norwegian central government and Norges Bank Investment Management sought to be transparent in all aspects of decision making in regards to the Government Pension Fund-Global (Qvigstad, 2009b). A variety of consultancy papers, detailed annual and quarterly reports, committee hearings, and letters between the Storting, Ministry of Finance and Norges Bank were consequently made available and promoted throughout the press and government websites between 1997 and 2009. An unexpected product of this transparency campaign, however, was that it revealed to both the Storting and public the unresolved inconsistencies pervading the GPFG's long-term financial logic and actual investment practices. Their concern was predominantly with NBIM's increasing use of short-term oriented 'active' management strategies. The Fund's expansionary and increasingly risk-exposed investment universe was also increasingly scrutinized throughout this period. This was as the GPFG's capital base began to rapidly expand on the back of increased petroleum revenues in the early 2000s. Such concerns were problematic for the Norwegian central government as they threatened to undermine the GPFG's domestic institutional legitimacy. The following Chapter consequently examines the efforts pursued by central government and NBIM officials to appease these concerns by actively constructing the GPFG's legitimacy between 1997 and 2009. It argues these efforts – which spanned from writing new legislation to 'educating' the public of financial theory's base assumptions – ultimately constrained the Norwegian state in their approach to management of petroleum revenues. Chapter Five seeks to demonstrate this constraint is problematic.

It does so by examining how the GPFG influenced the government to increase their vulnerability to global financial volatility following the global crisis that began in August 2007.

To this effect, recall that Norges Bank originally emphasized in 1996 that the influx of windfall petroleum revenues granted the GPFG a long-term time-horizon. Its lack of short-term liabilities thus meant it could invest in riskier assets that were believed to have historically paid a premium over more conservative assets. Storting officials could therefore adopt an equally long-term perspective in their management of highly scrutinized petroleum wealth. They could and should have little regard for short-term fluctuations in the Fund's performance. Yet shortly after these recommendations gained the Storting's approval in 1997, the Fund's managers in the newly formed NBIM began to increase their use of a short-term oriented and riskier investment strategy known as 'active' management. This is a noteworthy development as active management strategies are premised on the notion that markets are capable of producing inefficiencies that can be exploited for short-term gain. Indeed, its basic ontological assumptions on the general efficiency, rationality, and thus profitability of speculative capital markets stood in stark contrast to NBIM's initial arguments for why the SWF policy path should be pursued. The increased reliance on active management strategies would then prove costly in the wake of the financial crisis that began in August 2007. Indeed, such riskier strategies ultimately exposed the GPFG to higher degrees of financial risk than other institutional investors, which greatly contributed to the GPFG's 23.3 percent losses – approximately NOK500 billion – in 2008 (Caner and Grennes, 2009).⁶⁴ According to the Governor of Norges Bank, the GPFG's dependence on active management prior to

⁶⁴ The return generated by NBIM in 2008 was 3.4 percent lower than the benchmark portfolio against which they are measured (Gjedrem, 2009b).

the crisis relegated the Fund 'right back where it started' thirteen years earlier (Gjedrem, 2009a).

The crisis, the losses accrued therein, and the socioeconomic instability that followed exposed central government officials to much domestic criticism – especially those in the majority Centre-Left coalition that had overseen the GPF's rapid expansion (Esmerk, 2009; Qvigstad, 2009a; Halvorsen, 2009a; Johnsen, 2010a). Surprisingly, however, the majority of Norwegians continued to see the SWF policy path as benefiting their long-term interests. Criticisms were instead directed more towards the use of the Fund's capital to support the Norwegian banking system, which was experiencing a liquidity crisis of its own (Londt, 2008; Johnsen, 2010b). Given the crisis's destabilizing effects, why did the Norwegian public remain so committed to the GPF as not just a savings fund, but as an aggressive financial speculator? How to explain this unfaltering policy preference given the complex and highly technical nature of the GPF's financial activities, the likes of which everyday Norwegians would 'have scant chance of understanding' (Tranøy, 2009: 363; Qvigstad, 2009b; Hegge, 2009)? In short, how was the GPF's legitimacy communicated to the general public, and in such a way that it became embedded in the national psyche as the optimal strategy for petroleum wealth management?

To address these questions, the following Chapter builds off the arguments developed in Chapter Four. That Chapter demonstrated the SWF policy path appealed to the Storting as it provided them with an immediate means to stabilize their governance function. This was in the face of unexpectedly high petroleum revenue projections expected to be accrued between 1997 and 2000. Yet neither the central government nor Norges Bank officials were aware at this time of how rapidly the Fund would grow as a universal investor in the ensuing years (Annual Report, 2007:

75). As commented by the governor of Norges Bank in 2009: 'I have every reason to believe that the people that prepared the proposal [for the GPFPG] did not think at the time that the savings in the Fund would prove to be of any significance' (Gjedrem, 2009b). Thus from 1997 onwards, the GPFPG's increasingly diversified and risk exposed portfolio had to be actively promoted to the Norwegian public so as to construct its domestic legitimacy. This was achieved through various means, four of which are examined in this Chapter.

Chapter Five also seeks to problematize this support provided by the central government. It effectively limited government's policy preferences in regards to vast petroleum wealth reserves to remain within the bounds of legitimate action prescribed by modern financial epistemology. This prevented the Storting from engaging with alternative and less risky sovereign wealth management strategies in this period. It constrained them to normalize the GPFPG's speculative financial identity rather than critically examine if this strategy was in fact the optimal means to manage the state's petroleum wealth. Such critical engagement should have been more aggressively undertaken given the novelty of this fiscal strategy and the risks it exposed this wealth to. Indeed, the SWF policy path greatly influenced the government's understanding of, and approach to, broader socioeconomic issues of governance throughout this period to the detriment of non-financial and non-petroleum sectors.

Section 5.1 examines how the central government re-tasked the Fund in 2006 to pursue the long-term goal of supporting the state pension system. This was in an attempt to bestow a greater sense of ownership over the GPFPG's SWF identity throughout Norwegian society. Section 5.2 then examines how the government also sought to aggressively normalize the financial ideas from which NBIM drew to guide the GPFPG's institutional development between 1997 and 2009. Section 5.3

deconstructs the central government's efforts to reconcile the contradictions pervading NBIM's use of short-term 'active' versus long-term 'passive' investment management strategies. This followed their being criticized by minority opposition parties for allowing Norway's petroleum wealth to be exposed to an unreasonable degree of financial risk. Finally, Section 5.4 examines how modern financial epistemology dictated what 'lessons' the government should learn from the global financial crisis that began in August 2007. This constraint led the central government to in fact increase the GPF's dependence on the modern risk technologies that fed the crisis in the first place. It therefore increased the Norwegian state's vulnerability to future financial crises. Hence despite this crisis revealing the fallacious nature of the GPF's long-term financial logic, the government nonetheless held fast to the stabilizing narrative espoused by modern financial epistemology. Specifically, both NBIM and Ministry of Finance officials were quick to argue the crisis represented an expected feature of speculative finance despite its magnitude and global breadth. Norway should therefore remain committed to the SWF policy path in the belief markets would correct themselves eventually. This argument was then maintained even as the crisis necessitated state-directed interventions be made into ailing financial institutions and systems to stabilize global capital markets.

The following Chapter thus examines how the SWF policy path gained legitimacy throughout Norwegian society only through the promotional support provided by the central government. This is to fill a gap in the SWF literature, which leaves the state and the domestic politics of SWF legitimacy latent and unexamined variables. Indeed, the GPF's new financial identity had to be constructed and iteratively promoted by the Storting and NBIM as it expanded between 1997 and 2009. This was achieved by drawing from several qualitative assumptions that

appeared to render financial reality into a quantitative and manageable form. This further suggests that the GPFG should not be considered a naturally or immediately desirable fiscal tool of the state due to any innate properties of finance. Chapter Five thus critically examines how modern financial epistemology constrained the government to increasingly expose Norway's expansive petroleum wealth reserves to the contradictions and crisis tendencies of the speculative financial realm. This is to demonstrate that the short-term socioeconomic costs of investing for speculative gain in the crisis prone capital markets between 1997 and 2009 outweighed the expected financial benefits the GPFG's SWF identity was intended to provide.

5.0 Constructing the GPFG's Domestic Legitimacy (1997-2009)

From 1997 onwards, the Ministry of Finance believed that building 'trust and support' in the Government Pension Fund-Global's speculative financial identity was a 'fundamental and continuous process' they should proactively engage with (Qvigstad, 2009*b*). A lack of public confidence in the GPFG's expansion into equities and other riskier securities was perceived as threatening the long-term interests of the Norwegian state as a whole (cf. Gjedrem, 2001; Bergo, 2002; Annual Report, 2009: 66-69; Halvorsen, 2009*a*; Johnsen, 2010*a*). As the Fund began to grow unexpectedly fast from 2000 onwards, however, the central government had to actively 'sell' the SWF policy path to an emerging group of dissenters in the Storting and domestic electorate. This group was spearheaded by the politically isolated but still primary opposition – the 'Progress Party' (cf. Tranøy 2009: 9, 14-15).

In order to sell the GPFG's SWF identity to the public, Ministry of Finance and Norges Bank officials drew from the same ideas that had convinced them – through Norges Bank's recommendations – of the long-term benefits to be gained

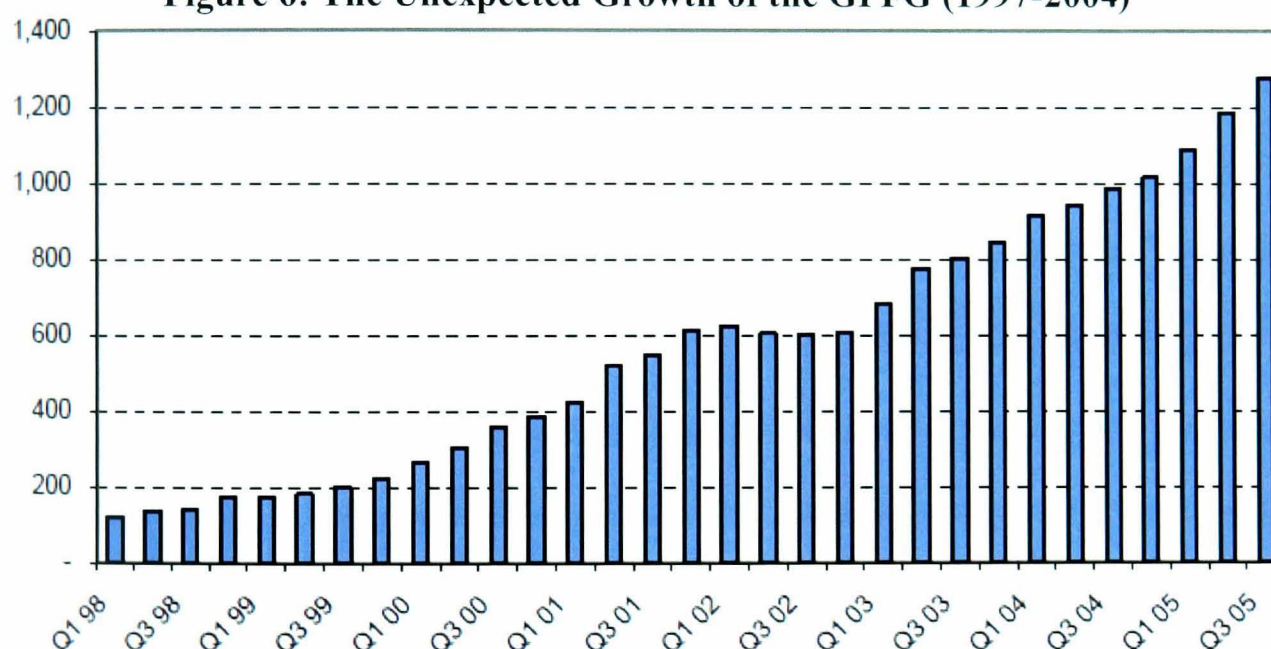
from speculative investment. In so doing, however, these same officials became aware of several inconsistencies in the GPFG's underlying financial logic that were not remarked upon in the 1996 deliberations. Yet if the government were to retain the psychologically stabilizing effects brought by the GPFG's long-term investment horizon, these basic inconsistencies could not remain unaddressed as they are in financial economics (Maki, 2001: 5; cf. Poitras, 2005; McGoun, 2005). Indeed a GPFG that lacked domestic legitimacy would be highly damaging to both the Storting and central bank's reputation given the substantial risks it exposed Norway's prized petroleum wealth to. Existing commentaries have yet to account for this crucial supportive role played by state actors to maintain their SWF's legitimacy through time. Nor do these analyses critically engage with the contestable financial presuppositions state actors draw from to construct this legitimacy. Sections 5.1 to 5.4 examine four instances where the GPFG's domestic legitimacy had to be supported by the government. This is to highlight four times in which the SWF policy path came to constrain government actors when formulating their policy preferences between 1997 and 2009.

5.1 Constructing the GPFG's Legitimacy (1997-2005): *The Government Pension Fund Act*

Norway's petroleum wealth began producing another unexpected problem for the Centre-Left coalition government by the early 2000s. This was the extent to which the GPFG's growth propelled the SWF policy path to become a highly scrutinized feature of the central government's politico-economic landscape. Indeed between 1997 and 2004, the Government Pension Fund-Global grew much faster than either the Storting or Norges Bank had originally envisioned (Annual Report, 2004: 5, 8;

2007: 75). This was firstly in terms of its underlying capital base, which by 2004 had increased by NOK902 billion on the back of swelling petroleum revenues (GPFG Annual Report, 2004: 2). This far exceeded the expectations put forth in the Long-Term Programme of 1998-2001 that ultimately led to the GPFG's reconceptualisation as a speculative investor in 1997 (see Figure 6). The Fund also expanded in terms of its investment universe, and thus risk exposure, based on several recommendations made by NBIM. Indeed, it quickly came to include a higher concentration of equities, riskier types of bond assets, and more emerging market assets (cf. Chapter 4: Section 4.4).

Figure 6: The Unexpected Growth of the GPFG (1997-2004)



Source: Quarterly Report, 2005: 2

With this rapid growth, uncertainty as to how to best manage Norway's petroleum wealth once again resurfaced within the central government. Both the right wing Progress Party and left wing Liberal Party were vocal critics of the GPFG's expansionary portfolio given the financial volatility it exposed Norway to. Criticisms became especially pronounced following the Asian Financial Crisis in 1997 and 1998 and then again following the Dot-Com bubble burst between 2001 and 2003. Global economic volatility was, after all, what had ultimately instigated the prolonged

recession between 1976 and 1990 from which the Nordic state had only recently recovered. These opponents also argued the Fund's SWF identity had yet to be fully approved by society – or at least made transparent to them – as its significance for fiscal policy increased. In short, critics in the Storting argued the GPF's primary role as budgetary stabilizer did not provide ample justification for its increasingly risky and long-term oriented approach to petroleum wealth management (Ministry of Finance, 2007: 49; Tranøy: 2009: 369).

To be sure, the GPF's official mission statement remained rooted in open-ended and ambiguous terms despite its growth in size and global financial embedment. Its primary guiding principal was simply to 'safeguard long-term interests through the use of petroleum revenues' (Petroleum Fund Act, 1990: Section 1). The Fund's institutional legitimacy in the short-term thus derived from its making petroleum revenues in the budget 'more easily visible', as well as distancing this wealth from a 'spend happy' Storting (Tranøy, 2009: 269; Annual Report, 1998: 1; Eide, 1997; Kjaer, 2000: 13; Skancke, 2003: 334-35; Gjedrem, 2005: 1).⁶⁵ This ambiguity in long-term purpose meant that financial maximization through speculative investment immediately became a primary end goal in itself. Various members of the Storting and media from both the right and left questioned this

⁶⁵ This purpose of the GPF as stabilizer of budgetary politics was solidified in 2001 with the introduction of the 'Fiscal Rule'. This rule was intended to ensure the use of petroleum revenues over the annual budget be phased into the domestic economy in pace with an estimated four percent annual real return the Fund was expected to generate (Ministry of Finance, 2001: 7; Revised National Budget, 1997: Section 3.5.1). Four percent as an average was selected as it was believed to be 'fairly close to the return achieved by the business sector as a whole over a long period' (Gjedrem, 2000: 5). From a technocratic standpoint, the 2001 fiscal policy guidelines were framed as a means to 'take into account certain risk factors' associated with the accrual of petroleum revenues in government reserves, 'such as uncertainties to future oil revenues, growth in pension liabilities or the costs of restructuring the economy' (Eriksen, 2006: 9). From a political standpoint, however, the 2001 fiscal rule was a political tool used by the first Stoltenberg government to ward off calls for spending the GPF's capital from the then increasingly powerful Progress Party. As such, the fiscal rule officially resembles 'a clear rule, but in reality it should be understood as a focal point upon which the decision-making process of the "responsible" parties of parliament can converge' (Tranøy, 2009: 269-70). That is, four percent 'of a fast growing fund translates into a degree of fiscal freedom that would cause most other social democratic parties...to envy the Norwegian Social Democrats who have been spearheading the centre-left coalition which has ruled the country since 2005' (ibid. 370).

strategy. They asked whether the potential costs outweighed the rewards of stabilization given the high degree of financial risk involved (cf. Hartzok, 2004; Tranøy, 2009: 372; Eriksen, 2006: 6-12). Between 1997 and 2004, the GPFG thus lacked a legitimating end-goal towards which its speculative and increasingly risky investment activities could work.

The Government Pension Fund Act ('GPF Act', 2005) was crafted to provide such a legitimating mission to appease these critics. It also represented a symbolic mechanism through which the state's commitment to the SWF policy path could be legitimated to the domestic population. Indeed, the Act formally tasked the GPFG to accommodate the significant projected increase in future pension provisions that began emerging as a problem of concern in Norway, as well as the EU in general, in the early 2000s (see Figure 3). The GPF Act was therefore not solely created to meet the financial interests of GPFG's managers in NBIM, although it did stipulate that NBIM expand the Fund's investment universe in various ways.⁶⁶ It was more importantly created to buttress the government's domestic political interests by strengthening the Fund's perception as a tool for 'intergenerational wealth transfer' (Eriksen, 2006: 7). Indeed prior to 2006, numerous changes had been made to the GPFG's investment universe with little of the same legislative fanfare or publicity as that accompanying the GPF Act.

The 2006 Act therefore served to legislatively – but more importantly for government's short-term interests – symbolically anchor the SWF policy path as

⁶⁶ These changes included: the allowable allocation of equity and fixed income investments being revised to 30 – 70 percent, up from 30 – 50 percent; investment in non inflation-linked and lower grade bonds being permitted; investment in commodity-based contracts and fund units being permitted; the allowable ownership percentage being raised from three to five percent, and then from five to ten percent; and more global manoeuvrability being introduced into the allowable currency and market weights. The universally diversified and riskier investment strategy pursued since 1997 was in fact legislatively embedded into the Fund's mandate. From then on, it was stipulated that the 'actual portfolio shall be composed through extensive use of diversification' (GPF Act, 2005: Section 2).

benefiting the Norwegian public's long-term interests. It redefined the Norwegian SWF's underlying purpose from largely ambiguous terms to a more concrete and comprehensive long-term action path that built off of existing welfare policies. That is, to 'support central government saving to finance the National Insurance Scheme's expenditure on pensions and long-term considerations in the application of petroleum revenues' (GPF Act, 2005: Section 1). This new official task would, however, remain a guideline to which the central government need not adhere in the future (Bergo, 2003: 4; cf. Skancke, 2003: 325; Gjedrem, 2005: 4). As summarized by the chief advisor to the Minister of Finance and a lead authority driving the GPF Act:

'In order to strengthen the public's sense of ownership of the Fund and make it easier to accumulate financial assets for the state, the Petroleum Fund was renamed the Government Pension Fund – Global as from 1 January 2006....The pension system under the National Insurance Scheme will, however, remain financed over government budgets on an ongoing basis ("pay-as-you-go")' – Eriksen, 2006: 7

The GPF Act thus not only sought to legitimate the Government Pension Fund-Global as a fiscal institution of the state, but its SWF identity in particular. Central government actors therefore played a necessary role in supporting the GPF's perception as a legitimate strategy of governance by the Norwegian public. The construction of sovereign wealth fund legitimacy remains critically unexamined in both the financial economist and IPE literatures. To be sure, this task constrained Norwegian state actors to accommodate the GPF's speculative financial practices rather than critically examine whether they exposed Norway's petroleum wealth to an unnecessarily high amount of risk in the short-term. Indeed as Section 5.4 examines, the recent global financial crisis reduced the GPF's value by far more than that compared to its peers. The government would nonetheless be constrained to maintain their support of this fiscal strategy despite the large-scale interventions of public capital that were required to rectify the crisis. In any case, the Chapter now examines

a second instance wherein the government was constrained to reinforce the domestic legitimacy of the GPFG's speculative financial identity.

5.2 Constructing the GPFG's Legitimacy (1997-2005): *Critically engaging the epistemology of speculative finance*

Despite its symbolic significance, the 2005 Government Pension Fund Act did not by itself legitimate the SWF policy path to the Norwegian public as the optimal means of managing their petroleum wealth. The central government also had to actively learn, promote, and ultimately normalize the financial logic upon which the GPFG's SWF identity was based. Indeed building trust and support in the SWF policy path was deemed a necessary task by the government if the GPFG was to be successful as a highly scrutinized strategy of governance (Qvigstad, 2009b). This meant the central government also had to come to terms with this policy path's unresolved contradictions and inconsistencies. This was especially so after NBIM began increasing the portion of the Fund being managed under a short-term oriented and riskier 'active' management strategy. Indeed, whether value can be added through active management over the long-term remains a highly contested issue in financial economics. While it is common in financial practice, active management's ontological assumptions contradict many of those that legitimate the GPFG's long-term investment horizon. The following discussion first outlines the way in which the central government was made aware of these contradictions between the GPFG's underlying logic and its practices. It then charts the way in which they reconciled these problems so as to maintain their SWF's institutional legitimacy. This is to highlight that as the GPFG began to rapidly expand into the 2000s, so too did the government's reliance on the SWF policy path as a means to stabilize their

governance function also grow. As such, the Storting and Ministry of Finance were constrained to maintain their support of this epistemology in the face of domestic criticism they encountered throughout this period.

The Storting first expressed concerns for the GPFG's speculative financial identity and its increasing significance for Norwegian fiscal policy in 2000. They requested NBIM provide more proof that equity investments should be included in GPFG's portfolio following the unprecedented period of financial growth now referred to as the Dot-Com Bubble (Ministry of Finance, 2000). In its March 2001 response, NBIM utilized 'new and enlarged data material' to support its original argument that historical analysis provides reasons to believe a premium will be paid out to riskier portfolios (Norges Bank, 2001; 2005).⁶⁷ NBIM then issued a continuation report in 2003 following the Dot-Com Bubble's crash and ensuing two-year period of negative GPFG equity returns. In this response, NBIM drew from a 2002 empirical study to reiterate their 'unconditional expectations' – or fundamental beliefs – in regards to the long-term profitability of investing in equities (Norges Bank, 2003a).⁶⁸ The primary function of these reports, then, was to remind the government and Norwegian public of the SWF policy path's underpinning financial logic. The fact that the Dot-Com crisis necessitated large-scale government intervention in the US to contain its destabilizing effects was consequently paid no critical attention (cf. Embry and Hepburn, 2004). If it were, the whole rationale for the GPFG's long-term investment logic would be undermined, and the government's desirability as managers of petroleum wealth along with it.

⁶⁷ NBIM did, however, revise its initial estimate of this premium downwards from four to 3.6 percent as it was conceded 'historical estimates are not necessarily good estimates of future returns' (Norges Bank, 2001 referenced in Norges Bank, 2003a: Section 2.2).

⁶⁸ This study, *Triumph of the Optimists*, was conducted using historical equity and long-term bond returns from the United States, United Kingdom, France, Germany and Japan (Dimson, Marsh and Staunton, 2002).

However, these two NBIM reports did not entirely appease either the government or public's concerns for the GPFG's new financial mandate in the wake of the Dot-Com crisis. The Minister of Finance of the time, Per-Kristian Foss, thus also commissioned an external consulting firm, Mercer Investment Consulting, to conduct an independent review of the GPFG in 2003 (cf. Mercer, 2003). Mercer was specifically tasked to explore the 'consequences of a possible change in the mix between equities and fixed income', as well as 'a change in the benchmarks and the inclusion of new investment alternatives' (National Budget, 2004: Section 3.5.1).⁶⁹ It was the first time the Norwegian government went outside of its own knowledge centres for an alternative interpretation of the GPFG's underlying financial logic. It was also the first time NBIM's unconditional beliefs about the nature of speculative finance were contested. Indeed, Mercer's 2003 report critically targeted a number of the basic assumptions upon which the GPFG's institutional legitimacy was originally based.

First, Mercer argued the distinction between short and long-term investment perspectives was inadequately addressed in the Fund's legislation. This was a point of concern considering a departure from a long-term trend – such as an historical equity risk premium of 6.5 percent, for example – 'can correct at any time' (Mercer, 2003: Section 2.4). That is, the 'existence or otherwise of time horizon effects is open to debate', and that 'there is general agreement that *intuitive beliefs* about long term investors being able to "ride out the ups and down of the market" are simply wrong' (emphasis added, Mercer, 2003: 11). Mercer cited the emerging 'time diversification fallacy' literature as quantitatively demonstrating these intuitive beliefs 'are often fallacious...[and] tends to explain observed behaviour rather than prescribe it'

⁶⁹ Mercer is in fact the primary consultancy firm hired by all three of this dissertation's case studies.

(Mercer, 2003: 14-5).⁷⁰ This effectively undermined NBIM's assertions that the Storting need not focus on the GPFG's short-term returns given its assumed long-term profitability.

Mercer also drew attention to the problems with NBIM's use of the Fundamental Law of Active Management (FLAM) to inform them how to develop their financial expertise. In particular, Mercer argued the performance oriented remuneration packages offered to attract skilled investors pressured these managers to enhance GPFG returns in the very short-term. That is, NBIM managers typically assumed an investment horizon of only three to four months. These short-term pressures thus stood in stark contrast to the long-term objectives and management mandate to which the GPFG had been officially charged in 1997. There was thus a 'certain contradiction in NBIM between the amount of sophistication put into the construction of the total Fund, in terms of risk allocation and the monitoring of risk, and the actual bottom-up portfolio investments'. Mercer argued the GPFG should adopt a 'more conventional institutional approach', which was an investment horizon of three to five years (Mercer, 2003: Section 2.4).

Mercer's arguments in 2003 therefore challenged the central government's rationale for why they reconceptualised the GPFG as an SWF in 1997. They thus also challenged the Storting's dominant policy preference in regards to their burgeoning petroleum wealth reserves. First, the distinction between short and long-term market temporalities provided government actors a respite in overseeing this highly scrutinized issue. As such, alternative and equally uncertain wealth management strategies need not be devised as long as Norway retains its faith in the forward-

⁷⁰ It is interesting to note that despite Mercer's criticism of the underlying rationale behind the Fund's diversification campaign, they still recommended the GPFG should assume more types of risk than it held at the time. Mercer recommended that a 'representative investor' approach be taken, which essentially meant adopting a strategic asset allocation that was comparable to that of other large-scale institutional investors, such as CalPERS, ABP Amro, and the CPPIB (Mercer, 2003: 2, 13).

looking imaginary of long-term financial profitability. Second, the notion that NBIM was capable of hiring skilled managers to buttress their financial expertise alleviated the central government's responsibility for overseeing the GPFG's new financial mandate.

The Mercer Report nonetheless had little effect on the government's pre-existing policy preferences given the vested interest they had already developed in the GPFG's SWF identity between 1997 and 2003. This vested interest was in terms of: (i) the Storting's lack of an equally plausible petroleum wealth management strategy (cf. Bergo, 2003); (ii) the sunk costs put into establishing NBIM as operational managers (cf. Ministry of Finance, 2005); and (iii) the four percent spending rule introduced in 2001, which increased government's dependence on the Fund's annual returns (cf. Revised National Budget, 2003: Fiscal Policy).⁷¹ Indeed the Ministry of Finance's response to the Mercer Report stated that its proposals were 'interesting because they challenge some of the rationale underlying the current guidelines' (Revised National Budget, 2004: 11). Nevertheless, they maintained the GPFG's '[long-term] objectives indicates that particular emphasis should not be placed on short-term fluctuations in returns' as substantiated by NBIM's own research (ibid. 13).

The Mercer Report instead led government actors to conclude they should be more active in their legitimation campaign of the GPFG. That is, they came to believe they should more proactively convince the public of the same ideas of speculative finance that had been advocated to them by NBIM five years earlier. Indeed, the GPFG's management strategy as being readily conveyable and perceived as domestically legitimate was of high importance for the Storting since they established

⁷¹ In 2003, for example, NOK50.8 billion of the GPFG's returns were transferred to the government's central account to fill in a gap left between the projected and actual 2003 budget (Revised National Budget, 2003: Fiscal Policy).

the Fund in 1990 (cf. Skancke, 2003: 318-19; Johnsen, 2010; National Budget, 2004: 11; Annual Report, 2007: 75). The government thus not only cavalierly dismissed Mercer's arguments based on NBIM's guidance, but embarked on a campaign to foster a sense of ownership in the GPFG's SWF identity. This was pursued through a communication strategy that sought to publicise the internal deliberations of NBIM and the Ministry of Finance in a 'clear, honest, and effective' manner (Qvigstad, 2009b).

The primary communicative tools used to anchor the SWF policy path's theoretical propositions in the public perception were the Fund's annual reports, as well as the government's National Budgets (Norges Bank, 2009a).⁷² Indeed, NBIM conceded in 2003 that both they and the government actors they advised had to now incorporate a '*qualitative* evaluation of strategic choices' when formulating the GPFG's investment strategy (emphasis added, Norges Bank, 2003a: 3). This was a noticeable change in tone from the quantitative and positivist methodology through which NBIM's 1997 recommendations were presented.⁷³ While the reports still emphasized the Fund's performance, they also began providing a more detailed theoretical discussion of the government's 'fundamental attitudes and assumptions as to how the financial markets work' (Ministry of Finance, 2007: Section 3.1.2;

⁷² The Fund's annual report was one among six nominated for the Farmand award for best annual report and website. However, the same report was also strongly criticised by the Norwegian journalist Per Egil Hegge for its impenetrable language (cf. Hegge, 2009).

⁷³ This is not to say that this ambiguity in founding rationale for investing in equities did not go unnoticed by the investment arm of the central bank. A 2005 NBIM report posited that '[i]dentifying today's [i.e. 2005] consensus view is difficult enough...[i]dentifying the average perception eight years ago, when the basis for deciding the current allocation was formulated, is even more difficult' (Norges Bank, 2005: 5). NBIM also stated in 2003 that 'there is considerable uncertainty associated with risk measurement [such that] Norges Bank cannot base its calculations on a single method of approach and model' (Norges Bank, 2003a). The fact that risk continued to be assigned probabilistic variables in the face of this uncertainty and Mercer's ideational contestation speaks of the supportive role played by an unwavering belief in the calculability of finance. Only by turning to the ideas which supported NBIM's perception that finance was indeed calculable as premised upon a broad understanding of diversification as a risk management strategy could they reconcile their desire to assume more risk for the GPFG's portfolio on the one hand, with their inability to coherently value this risk on the other.

Ministry of Finance, 2008: Section 2.1.2). The assumptions of global financial markets being efficient and comprised of rational and therefore predictable investors were emphasized in particular (cf. National Budget, 2004: Section 3.5.1.3; National Budget, 2007: Section 5.2.4.2). The argument that occasional periods of crisis and volatility are to be expected was also advertised in each year's National Budget (cf. National Budget, 2004: Section 3.5.1.3; National Budget, 2007: 5.2.4.2). Promoting these basic assumptions of the nature of speculative finance therefore reinforced central government claims that the GPFG would be reaping an equity-risk premium into the indefinite future.

To summarize the preceding Section, the central government sought to transform the gap separating the GPFG's underlying financial theories from its practices into resources of legitimacy for the state. This was from 2003 onwards in particular, which followed the losses generated by the Asian Financial Crisis coupled with the Fund's rapid expansion. This development speaks of the constraint the SWF policy path put on Norwegian state agency. This is to say that central government actors were constrained to defend to critics in the Storting and general public why the SWF policy path and its fallacious financial logic should be maintained. Simply put, they were constrained by their desire to retain the stabilizing effects engendered by their SWF in its management of Norway's petroleum wealth. Indeed for governments, the SWF policy path represents a means to manage short-term socioeconomic expectations in regards to problems of uncertainty they face. The Norwegian central government achieved this by turning to NBIM and their superior forms of knowledge about speculative finance to legitimate their SWF's underpinning financial logic when criticised by Mercer in 2003.

This suggests that as opposed to the assumptions of mainstream analyses, Norwegian state managers did not naturally internalize speculative investment by financial experts as a rationally desirable policy preference. Nor should the GPF be understood as substantiated by any objective or scientific theories that accurately reflect financial market reality. Rather, state managers relied on the authority of politically divorced professional investors to promote several authoritative – yet still value-laden – ideas of finance’s profitability and calculability to the domestic electorate. This was to help avoid the central government being accused of taking unnecessary financial risks in their approach to sovereign wealth management. This moreover speaks of NBIM’s epistemological authority in constraining government from developing alternative policy preferences despite the ideational contestation presented by the Mercer Report. The following Section elaborates on this constraining feature of SWFs. It examines a third instance wherein the central government’s policy preferences towards their petroleum wealth management strategy were constrained by the epistemological authority exerted by NBIM managers.

5.3 Constructing the GPF’s Legitimacy (2005-2009): *Reconciling the contradictions of ‘active’ vs. ‘passive’ management strategies*

From 1997 onwards, the proportion of the Government Pension Fund-Global that was managed under an active versus passive-index investment strategy steadily increased: from 0 to 28 percent between 1997 and 1999, to 40 percent by 2000, and then to 67 percent by 2003 (Annual Report, 2002: Section 4.2; 2003: Section 4.2;

2006: Introduction).⁷⁴ The GPFG would then be actively managed in its entirety following a revision made by NBIM's Executive Board in 2005 (Annual Report, 2005: Section 7).⁷⁵ This transformation in investment management strategy proved problematic for the central government between 1997 and 2009. Active management contrasts with many of the basic assumptions upon which the GPFG's SWF identity was originally based. To engage with active management is to believe that markets are not perfectly efficient and prices do not accurately reflect complete information in the short-term.⁷⁶ It assumes heterogeneity versus homogeneity among investors, which produces 'special pricing situations' that can be exploited for short-term financial gain. This consequently entails the assumption of increased levels of

⁷⁴ NBIM initially employed a passive index strategy because it represented a simple means to monitor the GPFG's portfolio. This meant replicating as close as possible the benchmark index determined by the Ministry of Finance (i.e. the FTSE World Actuaries Index for equities and the Salomon Smith Barney's World Government Bond Indices for fixed income). This strategy would enable NBIM to achieve a high degree of diversification of equity investments relatively quickly (Norges Bank, 1999*d*). It thus allowed for the centralization of the GPFG's management and more rigorous governmental oversight despite the universally diversified nature of the Fund's portfolio. Moreover, a passive index approach carried lower transaction costs 'because the administrative work involved in portfolio maintenance is independent of the size of the portfolio' (Norges Bank, 2002*a*: 2; cf. Norges Bank, 2000*a*). Passive investment was also deemed a 'natural' fit for the GPFG given its projected size, primarily because '[a]ccording to established financial theory, it is rational for investors to behave in this way ...[as] over time, markets do not pay for taking specific risk in connection with choosing one or a small number of securities, because many market participants can eliminate this type of risk by spreading their portfolios over many securities' (Norges Bank, 2003*a*). As such, the GPFG became invested in over 2,000 different companies across 9,000 total equity holdings, and owned 500 different bonds in addition to warrants, various money market instruments, futures contracts and foreign exchange positions in the first year of its diversification campaign (Norges Bank, 1999*b*).

⁷⁵ In 2002, NBIM discontinued the use of the passive index approach, instead opting for an 'enhanced index' approach (Annual Report, 2002: Section 4.2). This was rationalized by the belief that 'an investor who follows the index slavishly gives away money to other investors' (Norges Bank, 2002*b*). NBIM believed they should instead 'make better use of the opportunities for excess return by employing active strategies in the management of all index portfolios' (Annual Report, 2002: Section 4.2). For NBIM, enhanced indexing entailed taking advantage of various 'opportunities...that are created by technical or structural aspects of equities or equity markets [which] exist for short periods of time' (Norges Bank, 2002*a*). These opportunities can arise from initial public offerings (IPOs), or changes to market indices – such as various companies entering or leaving an index – and mergers and acquisitions. They can then be exploited by: (1) changing the foreign currency and market distribution of the individual portfolios under management; (2) changing the portfolio's spread between equities and bonds; (3) including sectors or companies in the equity portfolio that are expected to do better than others; and (4) by changing interest and credit rate risk in the bond portfolio. Mercer's 2003 report refers to this enhanced indexing approach as an overtly active approach to investment in its adoption of 'a large number of small amounts of alpha' (Mercer, 2003: Section 2.4). Despite its increased risks, the GPFG's enhanced indexing portfolio would nonetheless remain classified as a passive 'beta' investment strategy.

⁷⁶ This is referred to as weak versus semi-strong forms of market efficiency, the discrepancies of which are engaged with and reconciled by NBIM in a 2003 Staff Memo (Norges Bank, 2003*c*).

financial risk that cannot be controlled for through diversification to the same extent as passive index strategies.⁷⁷ According to NBIM's Executive Director Knut Kjaer, active management 'is about taking risk that the investor is often not paid to take [but] is worth taking when the investor has a specialist skill' (Kjaer, 2006). Active management therefore undermined the main arguments cited by Norges Bank to the central government to legitimate the GPF's reconceptualisation as an SWF in 1997. It also appeared to undermine the arguments substantiating the government's campaign to legitimate the Fund's long-term outlook as detailed in the previous Section. That is, financial markets are generally efficient, comprised of rational utility-maximizers, and would thus pay out a risk-premium to large long-term investors like the GPF.

How to explain why short-term oriented active management was pursued given it contradicted the long-term financial logic that ultimately legitimated the SWF policy path to the government and Norwegian public? Why did central government actors permit NBIM to increase their engagement with this management strategy considering the increased short-term risks it exposed their petroleum wealth to? The following discussion argues that due NBIM's epistemological authority, the central government was constrained to support these managers' desire to increase the use of active management. This is to say it was not just NBIM's being delegated responsibility for GPF management in a functional – read: operational – sense of

⁷⁷ NBIM officials have nonetheless consistently contested the argument that active management entails assuming increased financial risk. They instead argue active management actually reduces the GPF's overall risk. This is because the majority of risk has already been incorporated into the GPF through the inclusion of equities (i.e. systemic risk). Increasing the active management portion, however, would reduce the Fund's investment management risk. That is if concrete and measurable targets were assigned for individual GPF managers, this would enhance the development of NBIM's financial expertise as everyone would be responsible for the 'quality of the fundamental inputs into investment management' (Annual Report, 2007: Feature Article). Indeed, individual responsibility complimented NBIM's conceptualization of financial expertise as being a largely agential affair in which 'each individual employee must have an opportunity to develop his or her specialist expertise...which derives from responsibility and an absence of intervention from superiors' (Annual Report, 2007: Feature Article).

authority that constrained central government agency between 1997 and 2009. Indeed, it was the authority of the ideas from which NBIM strategically drew that enabled them to persuade the Ministry of Finance that active management should be pursued over more conservative passive strategies. To be sure, active management was first resisted due to the increased risks it posed to both the government and central bank's reputation. Large-scale GPFG losses would severely undermine both groups' capacity to effectively set fiscal and monetary policy (Eide, 1997; Slyngstad, 2009; Annual Report, 2007: 75).

NBIM initially argued that managers would want to invest outside the benchmark portfolio set by the Ministry of Finance for two reasons. Both of these reasons were in turn argued to exclusively support the GPFG's financial maximization objective. First, active management would minimize total management costs as it is expensive to own all stocks in the benchmark – a key feature of passive strategies. Second, active management was believed capable of achieving 'a higher return in relation to the benchmark portfolio' (Norges Bank, 1997*a*: Section 2). This benefit was made possible by what NBIM cited as the relative inefficiency of financial markets. Indeed, they began advocating to their government overseers the idea that there may exist 'strategies that offer profitable deviations from the benchmark portfolio' due to 'the existence of erroneous pricing, and the assumption that good management can generate a return in excess of the market return' (Ministry of Finance, 2007: Section 1.3.1; cf. Annual Report, 2007: 74; Norges Bank, 2000*c*: Section 3).

Economists at Norges Bank and the Ministry of Finance were nonetheless initially opposed to active management. These critics were 'well aware' of empirical research indicating how difficult it was for investors to beat the market over the long-

term or whether this was even possible. This was especially in the uncertain environment left by the Asian Financial Crisis of 1997. Indeed this crisis left a ‘high degree of scepticism about active management’ considering it was instigated by the same opportunistic trading strategies NBIM wished to engage with (Annual Report, 2007: Feature Article). NBIM was nonetheless determined ‘to be among the few managers to succeed with active management’ as stressed to the Storting by Norges Bank officials as early as 1997 (Annual Report, 2007: 74; Norges Bank, 1997a: 9). And given the fact they had been delegated operational autonomy over the day-to-day management of the GPFG in 1998, they were put in a position to attempt to do so. Section 4.4 demonstrated that NBIM’s capacity to direct the GPFG’s institutional development grew in congruence with their financial expertise – which became synonymous with their epistemological authority – between 1997 and 2009. It was this authority derived from their superior knowledge of speculative finance that ultimately prevailed over critics in the central government and Norges Bank.

To this effect, NBIM stated two years into their diversification campaign that if ‘it is possible to attain an information advantage, it will normally be of short duration’. Active management for NBIM subsequently hinged upon ‘being able to predict or foresee price trends...by having appropriate analyses of what a “fair” price is and comparing it with the prevailing market price’. This analysis can be achieved through the ‘compilation of many open information sources or more or less unique insight based on comprehensive research’ (Norges Bank, 2000d). For NBIM, then, active management could be utilized in such a way that the ‘general efficiency’ of financial markets was circumvented through NBIM’s acquisition and further development of their financial expertise – their information advantage and level of investment skill in particular (Bergo, 2007; Kjaer, 2006). This belief thus followed

from the guidance provided by FLAM, which provided ‘a good seedbed for applying financial theory and approaching strategy in a structured, near scientific manner’ (Annual Report, 2007: 75). More specifically, FLAM dictated that the profitability of active management strategies ‘increases proportionately with skill...and with the square root of the number of positions’ (Annual Report, 2006: Feature Article 1). Hence the belief that NBIM was coming to possess a satisfactory level of financial expertise lent authority to their argument for increasing the portion of the GPF that should be actively managed (Kjaer, 2006: 4).⁷⁸

Active management was, however, problematic for government officials in their desire to maintain the GPF’s domestic legitimacy. It posed a number of problems the Ministry of Finance found increasingly difficult to reconcile (cf. Mercer, 2003). The government could not legitimate active management in the same way as it could expanding the Fund’s exposure to equities, corporate bonds, or other types of speculative asset. Indeed, the pursuit of active management contradicted the notions of market efficiency and investor rationality that substantiated their belief in the long-term profitability of the GPF’s speculative financial identity (see Section 5.2). The contradictions between active versus passive management strategies nonetheless remained largely unaddressed between 1997 and 2005. This would change in 2005 when the Government Petroleum Fund Act stipulated the GPF would be actively managed in its entirety (GPF Act, 2005: Sections 2, 7). The central government was thus constrained to depend on NBIM to reconcile this discrepancy between the Fund’s

⁷⁸ It is necessary to note that NBIM’s desire to engage with active management was not entirely based on the belief that this strategy could generate additional returns as an end in itself. While this notion indeed played a motivating role, active management also represented a means to legitimate NBIM’s aggressive campaign to develop its financial expertise and increase its authority over GPF management. To be sure, NBIM believed in 1997 that ‘there was no point having ambitions to achieve the highest international standards without the organization having a concrete target to work towards’, and that the target of excess returns through active management ‘was very concrete’ (Annual Report, 2007: Feature Article). Successfully engaging with short-term oriented active management strategies therefore represented a symbolic end towards which NBIM’s budding expertise could aspire (Norges Bank, 1997a; Annual Report, 2007: 74-75).

underpinning long-term investment logic with its increasingly risky and short-term oriented investment strategy (cf. Vik, 2008; Kvam, 2008; Ministry of Finance, 2009: Section 4.2; Gjedrem, 2009a).

Starting in 2005, NBIM began to rationalize active management along alternative lines than those employed in the preceding eight years – i.e. active management was desirable because markets occasionally presented pricing anomalies that could be harnessed to maximize GPFG returns (cf. Norges Bank, 1997a: Section 2). Instead, active management was reframed from a mechanism that would allow Norway to capitalise on short-term financial opportunities, to a fundamentally necessary means to performatively induce the long-term efficiency of markets. In short, NBIM reframed the contestation that existed between the short-term active and long-term passive financial logics as necessary corollaries, arguing the former performatively constituted the latter:

‘Norges Bank...believes that if major investors, such as the Government Pension Fund – Global work exclusively on the assumption that other participants ensure efficient price formation, this can undermine the functioning of capital markets....Overall, an element of active management is necessary for Norges Bank to have legitimacy when carrying out important parts of the management assignment’ – Annual Report, 2008: Section 1.2.1

Active management was therefore reframed from a problematic contradiction to a key source of support for the GPFG’s success; NBIM must be able to make active bets in the short-term to bring about efficient pricing in the long-term (Norges Bank, 2009). It was thus NBIM’s capacity to manipulate the qualitative assumptions and theories of speculative finance that put them in a position of authority over the Ministry of Finance in regards to GPFG management. NBIM would subsequently become increasingly specific and more persuasive in its theoretical arguments from 2005 onwards, positing that:

'a long-term investor will be able to create value by exploiting the opportunities that arise when other investors are forced to adopt a short investment horizon due to special regulations or a short-term need to generate income for their owners. This has led to a modified efficient market hypothesis. The modern version argues that financial markets are close to efficient most of the time, but that active investments help to eliminate mispricings and make markets more efficient' – Norges Bank, 2010; cf. Norges Bank, 2006

Thus the notion that markets were inefficient in the short-term legitimated NBIM's pursuit of active management to the central government between 1997 and 2009. This in turn substantiated why they should be allowed to develop their financial expertise and increase their authority over the GPF's institutional development. At the same time, however, the notion that markets were efficient in the long-term was used to legitimate the GPF as a forward-looking strategy of governance to the Storting and domestic electorate. That is due to the presence of the equity-risk premium, neither state managers nor the electorate should place too much emphasis on the Fund's short-term returns. The preceding discussion then highlighted how this discrepancy between the GPF's long-term financial logic and short-term oriented practices was reconciled by NBIM through their construction and promotion of a new financial narrative between 2005 and 2009. This ensured the SWF policy path would continue to serve both the central government's domestic political interests, as well as NBIM's speculative financial interests. These authoritative financial ideas thus acted as legitimating tools for the SWF policy path once the GPF became an increasingly significant strategy of governance in Norway. They did not therefore provide an uncontested blueprint for action, but were strategically drawn from by NBIM to legitimate the growth of the Fund's investment universe, and then also the use of internal active management. It was these ideas and NBIM's superior knowledge of them that ultimately constrained government's capacity to formulate alternative

policy preferences, or even critically engage with the SWF policy path and the extensive short-term risks it posed to Norway's prized petroleum wealth.

This lack of engagement would prove significant. Indeed the Chapter now examines how the government was constrained to maintain support of their risk-exposed SWF in the face of global financial crisis. More specifically, it examines how the crisis that began in August 2007 put government under increased pressure to maintain the domestic legitimacy of the GPFG's risky investment strategy. This followed from the active equity portfolio accruing losses of 41 percent in 2008 – far above the losses accrued by the Fund's institutional peers (Annual Report, 2009: 30). The crisis and its ramifications thus led central government actors to more aggressively legitimate the GPFG's speculative financial identity to the Norwegian public. This was rather than critically examine whether the GPFG's high-risk investment strategy was in the best medium to long-term interests of socioeconomic stability, as pondered by some in the Ministry of Finance (cf. Johnsen, 2010). This is surprising as the crisis revealed how destabilizing the speculative financial realm could be for not just GPFG returns, but Norwegian society in general. The state-driven recovery the crisis necessitated then also revealed the fallacious nature of the GPFG's underlying financial logic.

5.4 Constructing the GPFG's Legitimacy (2007-2009): *The Global Financial Crisis*

Chapters Four and Five have thus far examined how the central government's adoption of the SWF policy path constrained their agency in regards to petroleum wealth management between 1997 and 2009. This was primarily evidenced in Norges Bank Investment Management's capacity to direct the Government Pension Fund-

Global's institutional development throughout this time. Specifically, their capacity to convince the central government that expanding the Fund's investment universe – as well as increasing the use of short-term 'active' management strategies – was in the state's best interests. Constraint in this sense was thus evidenced in government's approving – as well as actively endorsing – these changes to the GPFPG despite: (i) the significant short-term risks they entailed, and (ii) the various sources of resistance presented by members of the Storting, Ministry of Finance, and even Norges Bank officials (cf. Madslie, 2009; Liinanki, 2008; Anderson, 2009*a*; 2009*b*; Stott, 2010). It was moreover argued this constraint arose from NBIM's epistemological authority. This is to fill in a gap in the depoliticization literature, which only speaks of authority being delegated outside government auspices in a functional or operational sense. Yet depoliticization in this sense cannot adequately account for why state managers' policy preferences continued to change in favour of the interests of modern financial epistemology even after the SWF policy path was adopted in 1997. The authority exerted by identifiable financial ideas to inform action and guide institutional change over competing policy preferences must therefore be paid critical attention to fill this gap in the IPE literature.

The following Section elaborates upon this discussion of the constraint posed by the GPFPG and its SWF identity on Norwegian state agency. It seeks to explain why the global financial crisis that began in August 2007 increased the government's dependence on the SWF policy path as a substantive element of Norwegian fiscal policy and, by extension, their domestic political legitimacy. This increased dependence is witnessed in NBIM and their use of modern technologies of risk gaining more authority over GPFPG management. It is argued this increased dependence on such risk management techniques is problematic as the crisis

demonstrated their ultimately fallacious nature. Indeed, the crisis undermined the speculative financial logic upon which the Norwegian SWF's legitimacy was based. The central government's increased commitment to the SWF policy path is also surprising given the crisis also relegated the GPFG 'right back where it started' thirteen years earlier after it lost a quarter of its value in 2008 (Gjedrem, 2009b). Why did the crisis not prompt the Ministry of Finance to increase their oversight of the GPFG and limit its risk exposure? This was in fact a task the Ministry had been pursuing as early as 2006 (cf. Revised National Budget, 2006: Section 1.5.3).⁷⁹ The following once again demonstrates it was NBIM's epistemological authority that enabled them to authoritatively dictate what the central government's policy preferences should be in the midst of the crisis.

To this effect, NBIM immediately appropriated the financial crisis as a resource of legitimacy when global equity markets began to crash in the fall of 2007. They argued this period of extreme financial volatility was an expected feature of speculative finance, as well as the first major test to the Fund's long-term investment horizon (cf. Slyngstad and Gjedrem quoted in Storting, 2009; Slyngstad, 2009). Thus rather than sell off their most speculative and vulnerable assets, NBIM dramatically increased the size of their equity portfolio by 20 percent between 2007 and 2009 (Annual Report, 2009: 30).⁸⁰ This increased Norway's ownership of world stock markets from 0.49 percent in 2007 to more than one percent in 2009 (Annual Report,

⁷⁹ As summarized by the Ministry of Finance in 2009: '*The National Budget for 2006 described the Ministry's intention to introduce regular due diligences of Norges Bank's management of the Fund and particularly the bank's risk management, in collaboration with consultants possessing suitable expertise...Report no. 16 (2007–2008) to the Storting describes the due diligence project consisting of an external review of Norges Bank's risk management systems (referred to as the Ernst & Young project)*' (Ministry of Finance, 2009).

⁸⁰ Caner and Grennes (2009: 5) found that the significant losses incurred in 2008 'are tangible evidence of the Fund's increased exposure to risk'. 40 percent of the Fund's equities in 2009 were in fact purchased in 2008 (Gjedrem, 2009a).

2009: 12).⁸¹ The Ministry of Finance was nonetheless wary of NBIM's aggressive expansion of the Fund's equity portfolio given the size and global breadth of the crisis. They consequently requested two reviews of the GPF's risk management structure, the first in October 2008 and the second in February 2009 (Ministry of Finance, 2008: Section 1.5; Norges Bank, 2009b). Yet rather than increase the Ministry's authority over GPF management, the reviews would actually increase their dependence on NBIM's financial expertise to support them in their governance of Norway's expansive petroleum wealth reserves.

To this effect, the crisis had demonstrated to both NBIM and government that 'historical relationships between risk factors collapsed' and that the GPF's approach to risk management should be adjusted accordingly (Qvigstad, 2009a; Esmerk, 2009). As such, NBIM and their superior financial expertise were put in a position of authority over the Ministry of Finance to dictate what and how these adjustments were to be made. For example, the Ministry of Finance proposed in 2008 that they should increase their capacity to restrict the types and degrees of risk the GPF could be exposed to. This desire emerged out of the Ministry's belief that numerous firms associated with 'best international practice' in risk management had 'encountered serious problems and have been forced to ask for help from their respective authorities'. The Ministry therefore argued they should be more engaged with the GPF's approach to risk considering 'the international norms for risk management' had fundamentally changed (Ministry of Finance, 2008: Sections 1.5.1, 1.5.4). NBIM, however, perceived this request as encroaching on their authority, as well as a slight

⁸¹ Motivated by suboptimal returns in 2007, the newly appointed CEO of NBIM – Yngve Slyngstad – issued three additional proposals to Minister of Finance Kristin Halvorsen requesting: a higher ownership ceiling for individual company investments (asked for fifteen percent and received ten), the inclusion of more emerging markets such as China, India and the Middle East, and the ability to make pre-IPO investments (Norges Bank, 2008a; 2008b; 2008c). The inclusion of small cap equities in the benchmark portfolio and the classification of real estate as an allowable asset class were also passed between 2005 and 2008 (Norges Bank, 2006; 2007).

to the financial expertise they believed they had developed since 1997 (Vik, 2009). They subsequently countered the Ministry's proposals by arguing 'the expression "internationally recognised practice" is imprecise' in the diverse context of modern financial risk management techniques. Instead, NBIM should be left to make qualitative judgements and use various risk factors, the success of which is contingent on minimal government interference. In so doing, NBIM began implicating an increase in governmental oversight with threatening the long-term interests of the Norwegian state as a whole (Norges Bank, 2009a: Section 4; Storting, 2009).

NBIM was particularly resistant to the Ministry's request that so-called 'extreme loss risk' – also known as 'Value at Risk' – measures be introduced and set by the central government.⁸² NBIM first argued that the Ministry's inclusion of such specific rules would confuse international regulators, market participants, as well as the Norwegian public as to who was actually in charge of managing Norway's petroleum wealth. Specifically, NBIM claimed:

'In the long term, excessively detailed rules and reporting requirements will entail a risk of the Ministry effectively assuming [Norges Bank's] Executive Board's role. Lines of responsibility will then become muddled, and the governance model less robust in the face of new challenges and financial crises' – Norges Bank, 2009a: Section 1

NBIM also argued that these types of quantitative risk measures were in any case incompatible with the GPF's long-term investment logic. That is, these risk measures would have forced the GPF to sell off the majority of its assets at huge capital losses. VaR measures would have thus been detrimental to the GPF's long-term success given the Fund's high-risk investment strategy was pursued on the basis it could withstand such periods of volatility (Norges Bank, 2009a: Section 3). Rather

⁸² Value at Risk models are used to quantify risks in a financial portfolio. It measures the potential future losses a portfolio may incur within a specified period of time, and a specified probability these losses will happen. This risk management technique effectively force institutions to sell off poorly performing assets if these assets fall below a previously determined VaR metric (Jorion, 2006).

than instigate a mandatory fire sale of GPFG assets, then, NBIM should be allowed to make qualitative judgements of how to act in the event of crisis. This was argued to increase their chances of reaping the equity-risk premium into the future, and would thus ensure the GPFG's success as a substantive feature of Norway's politico-economic landscape. In short, they argued the financial expertise they had developed in the preceding years made them far better suited to deal with the ongoing effects of crises than the restrictive quantitative models proposed by the Ministry (Norges Bank, 2009a: Section 3).

Thus despite the fact the crisis undermined the 'near-scientific' approach to active investment they had been developing since 1997 (Annual Report, 2007: 75), NBIM officials were nonetheless capable of resisting the Ministry's attempts to increase their oversight of the GPFG. They did so by framing any political interference that undermined their position as GPFG managers as threatening to both the Fund's financial success, as well as the long-term interests of the Norwegian state as a whole (Slyngstad in Storting, 2009; Norges Bank, 2009a; Qvigstad, 2010a). As a consequence, the push to include VaR measures was quickly abandoned by the Ministry. Instead, NBIM increased the GPFG's institutional complexity by introducing even more measures of risk to guide its investment activities.⁸³ According to NBIM, these measures were more in accordance with the recommendations made by 'authorities and other expert bodies' published in the wake of the crisis than those proposed by the government. The external experts cited – primarily the Institute of International Finance – argued investors should attach less weight to any single quantitative risk measure. They should instead depend on 'aggregates of a number of

⁸³ Based on advice from one of four government-commissioned reports on active management (cf. Ang, Goetzmann and Shaefer, 2009: 23-5) NBIM stated it would use 'different approaches to risk and complementary methods of measurement' in its assessment of various sources of market risk, including: deviation from the benchmark index, risk from price history, exposure to systemic risk in emerging markets, and liquidity exposure (Norges Bank, 2009a).

independent models’, and ensure they ‘combine quantitative measures with qualitative evaluations...[based on] expert judgement’ (Norges Bank, 2009a). NBIM’s implementation and development of these new risk management techniques subsequently secured more autonomy for individual NBIM managers than they had before the crisis. This was despite the fact these new techniques did not really deviate from the same ontological assumptions that had led financial economics to differentiate financial risk from uncertainty in the first place. NBIM’s new techniques remained rooted in the notion that diversification amongst speculative assets remained an optimal and fully legitimate strategy for public capital management (Norges Bank, 2009b).⁸⁴

NBIM was thus capable of convincing the central government they were in possession of more advanced forms of expert financial knowledge than their counterparts in the Ministry of Finance. To be sure, whether NBIM’s recommendations to avoid using VaR models would prove more beneficial for the GPFG’s long-term success was highly uncertain at the time these recommendations were made. Global capital markets had yet to ‘return to normal’ and the GPFG was experiencing heavy losses across its equity and bond portfolios. What was certain was that NBIM believed their recommendations were preferable based on the authority they derived from the prescriptive ideas espoused by modern financial epistemology. As such, NBIM was able to authoritatively dictate what government’s policy preferences should be in the volatile and unstable market environment of the crisis. This effectively stymied the Ministry in its attempts to increase their authority over Norway’s petroleum wealth. It also prevented the Ministry from critically engaging with the actual benefits to be derived from the risk management techniques upon

⁸⁴ For a review of these new risk management techniques, see Norges Bank, 2009b.

which NBIM's epistemological authority was based. After all, such a critical evaluation would render the whole basis for investing Norway's petroleum wealth in speculative assets suspect. Indeed, economists have yet to provide an alternative depiction of speculative finance than that provided by theories that have remained essentially unchanged since the 1960s.

NBIM was also able to dictate what 'lessons' the government should take away from the financial crisis. Their immediate response to the GPF's significant losses was that periods of intense volatility are recurrent and expected conditions of financial markets, as are the recoveries that inevitably follow. They emphasized that despite not having reaped the ERP as expected between 1997 and 2009, the government must hold fast to the GPF's risky investment strategy if it was to do so in the next ten years (Gjedrem, 2009*a*; 2009*b*; Qvigstad, 2009*a*; Johnsen, 2010*a*). Based on NBIM's leadership, the government consequently began emphasizing the necessity of maintaining both the GPF's long-term outlook and speculative investment strategy throughout the Norwegian media (cf. Halvorsen, 2009*b*; Johnsen, 2010*a*). This was despite the Ministry of Finance's disagreement with NBIM on the risk-management techniques that should be used to guide GPF investment strategy. This was also despite the Storting's vocal criticisms of NBIM in private committee hearings throughout this time (cf. Storting, 2009). Instead of present a divided front to the public, both the Ministry of Finance and NBIM worked together to promote the notion that markets will return to 'normal' eventually despite the 'abnormal' situation posed by the crisis. Indeed, speeches made by Ministry and NBIM officials in 2008 and 2009 were nearly verbatim repetitions of each other. Time and again they reiterated the same messages about what the crisis meant for Norway's petroleum wealth management strategy – particularly that the GPF had a long-term horizon

and could thus withstand volatility in the short-term (Qvigstad, 2009a; Gjedrem, 2008; Gjedrem in Storting, 2009; Halvorsen, 2009a; Johnsen, 2010a; 2010b).⁸⁵ The government and NBIM also sought to ‘anchor’ the legitimacy of active management in the public psyche given it was these strategies that heavily contributed to the Fund’s losses in 2008 (Halvorsen, 2009b; Johnsen, 2010a). The Ministry of Finance subsequently commissioned four reports to be written on the subject, each of which sought to legitimate NBIM’s pursuit of active management (Ang, Goetzmann and Shaefer, 2009; Mercer, 2009a; Mercer, 2009b; Norges Bank, 2010). A widely publicized and attended seminar on active management was also organized so as to provide ‘a robust assessment of active management that can stand the test of time’ (Johnsen, 2010a; cf. Norges Bank, 2010; Halvorsen, 2009b).

Hence neither NBIM nor government officials were transparent in their decision-making so much as aggressive in their construction and promotion of a convincing narrative that stabilized the GPF’s legitimacy as a sovereign wealth fund. Central government officials were constrained to work with NBIM to convince the public the crisis did not threaten the GPF’s long-term success as a petroleum wealth management strategy. This was if they wished to preserve the GPF’s legitimacy as a highly scrutinized strategy of governance (Storting, 2009). This reveals the contested and ideationally based origins of SWFs’ institutional legitimacy. Indeed, the funds’ continued existence is contingent on the continued provision of support by political authorities. The Norwegian experience also reveals the problematic nature of this form of constraint on state agency. It prevented the central government from critically engaging with the root causes of this crisis – although the

⁸⁵ Norges Bank officials were heavily influenced by the ideas espoused by crisis psychiatry in their approach to calming Norwegian’s fears of financial contagion. These officials believed that ‘to be successful in managing a crisis, the responsible authorities must be perceived as competent and at the same time have a reputation for openness and honesty’ (Qvigstad, 2009b).

failing of modern technologies of risk management and lack of a transnational regulatory framework did not go unacknowledged by government officials (Gjedrem, 2009a; Johnsen, 2010). This constraint moreover limited the government's capacity to decrease the GPFG's risk exposure so that it would not be so severely affected by another global crisis (cf. Canner and Grennes, 2009).

At the same time, however, the government's commitment to the long-term investment strategy appeared to have paid off in 2009. Indeed, the losses accrued in 2007 and 2008 have been mostly recouped as the Fund's equity portfolio gained 34.3 percent in 2009 versus 2008's losses of 40.1 percent (Annual Report 2009: 30). According to NBIM, this was due to stronger-than-forecast global earnings and 'reduced uncertainty' in equity markets (ibid. 14, 30-37). Seeing their expectations validated in fact built a stronger consensus in government that the Fund can take on even higher degrees of financial risk in spite of its already above-average risk profile (Vik, 2008; Gjedrem and Slynsgstad in Storting, 2009; Halvorsen, 2009a; Esmerk, 2009; Anderson, 2009a). The crisis and its rapid recovery were consequently appropriated to stabilize the SWF policy path's institutional legitimacy; indeed they were used to 'prove' the validity of the Fund's underlying financial ideas. But again, this recovery was not based on speculative finance reverting to an inherent tendency towards equilibrium due to the efficiency of markets and rationality of investors. The global recovery in speculative financial assets in 2009 was only made possible by the large-scale interventionist and stabilizing hand of numerous governments worldwide (cf. Altman, 2009). Investor rationality and market equilibrium had to be actively reinforced by global governments in much the same way as the GPFG's legitimacy was between 1997 and 2009. Thus if it can be assumed the long-term success of these funds is dependant on public capital to stabilize markets in times of recurrent crisis,

the SWF policy path's theoretical benefits may be outweighed by the costs required to support the very system throughout which their public capital is embedded. With the GPF set to double from petroleum revenue allocations in just ten years, the SWF policy path may not necessarily be in the best interests of Norwegian citizens as its supporters are so quick to suggest. Indeed, the financial crisis of 2007-2009 revealed how SWFs constrain states to defer their realizable policy preferences to the interests and contradictions of a crisis prone financial realm.

Conclusion

The preceding Chapter sought to fill a sizable gap pervading the literature on sovereign wealth funds. It demonstrated that the Government Pension Fund-Global's institutional legitimacy was not passively gained through the public's internalization of speculative investment as an inherently desirable strategy of governance. Rather, this strategy's legitimacy had to be actively and aggressively constructed through the collaborative efforts of Norges Bank and the Ministry of Finance in the face of domestic criticisms and ideational competition. This was when doubts of the GPF's underpinning financial logic first began to emerge in the face of its rapid expansion and the various crises it was exposed to in the early 2000s. The Chapter drew attention to four instances in particular where state actors were problematically constrained to actively construct the GPF's legitimacy.

First was through government's formalization of the pension issue into the Fund's mandate with the Government Pension Fund Act in 2006. Prior to this Act, financial speculation as a petroleum wealth management strategy had not been fully anchored with either the minority opposition in the Storting or the Norwegian public. The act provided a symbolic end towards which the GPF's increasingly risk-

exposed portfolio could legitimately work. The second instance regarded the government's efforts to normalize the GPFG's long-term financial logic when faced by ideational competition of the 2003 Mercer Report. This led them to promote the same basic assumptions of speculative finance that Norges Bank had initially drawn from to convince them of the SWF policy path's desirability in 1997. Particular emphasis was placed on the notion that markets were efficient, investors were rational, and thus that the GPFG's speculative assets would inevitably be paid a premium over the long-term.

The third instance regarded the central government's attempts to reconcile the inconsistencies that began to pervade the GPFG's underlying long-term investment logic with its increasingly short-term oriented 'active' investment practices. Due to the increased use – but also the public's increased wariness – of active management, central government officials pressured NBIM to construct a financial narrative that would increase Norwegian's sense of ownership with this strategy. The final instance wherein government was constrained to support their SWF's legitimacy emerged during the financial crisis of 2007-2009. Indeed the crisis and its eventual recovery revealed the fallacious and ultimately problematic nature of speculative finance's most basic assumptions. Central government officials were nonetheless constrained to maintain their support of the SWF policy path and NBIM as its managers. This was given the vested interest they had already developed in the SWF policy path and thus the speculative financial realm in general to support their legitimacy as governors of Norway's prized petroleum wealth.

Hence due to these promotional efforts of the state, by 2009 the majority of Norwegians were in agreement they would not want to pursue an 'uncertain' alternative petroleum wealth management strategy (Lont, 2008). The GPFG's SWF

identity in fact annually receives ‘broad political agreement [...which] strengthens the credibility of, and confidence in, the Fund’ (Ministry of Finance, 2007: 39; cf. Revised National Budget, 1997: Section 3.5.1; National Budget, 2004: Section 3.5.1.1). By 2009, the SWF policy path came to represent a means to strengthen the Norwegian economy, reduce the state’s overall risk, and provide a permanent revenue stream for future generations of the expensive and petroleum-dependant welfare state (Halvorsen, 2009a). Chapter Five thus demonstrated that it was only through the central government’s active endorsement of the ideas substantiating modern financial epistemology that the SWF policy path was anchored as a desirable fiscal vehicle in the minds of the Norwegian public.

The Chapter also drew attention to how the success of these efforts to legitimate the GPF as an SWF hinged on the epistemological authority NBIM had gained for itself between 1997 and 2009. This ideationally-based form of authority was shown to be particularly constraining for state agency. That is, it limited the central government’s capacity to formulate alternative policy preferences in regards to petroleum wealth management between 1997 and 2009. This is to fill in a gap in the IPE literature on depoliticization by emphasizing it was the power of ideas – versus functional or operational capacities – that lent NBIM’s policy preferences authority over competing alternatives. This is to also show that NBIM officials were themselves constrained by the prescriptions of modern financial epistemology when faced with financial crises between 1997 and 2009. They could only hold on to their diversified investment strategy and hope that markets recovered as quickly as possible given a lack of alternative and equally legitimate financial action paths available to them.

Conceptualising SWFs first and foremost as domestic strategies of governance thus enables us to critically examine how the GPF problematically exposed

Norway's substantial petroleum wealth reserves to the logical fallacies and crisis tendencies of the speculative financial realm. Indeed, the GPFG is legitimated by a financial epistemology comprising a number of fallacious presuppositions that do not provide an objective or realistic blueprint for action. Rather, these ideas primarily serve to legitimate increasingly risky speculative financial practices to financial and non-financial participants alike in the face of recurrent and increasingly destabilizing global financial crises. The preceding Chapters thus sought to provide a first step towards developing a more rounded critical analysis of SWFs currently lacking in the IPE and financial economist literatures. Indeed, Caner and Grennes recently concluded that the GPFG 'has been a model of transparency, but whether it has performed effectively as an agent for Norwegian citizens depends on the risk preferences of citizens' (2009: 10). Chapters Four and Five have consequently shown that rather than be fully informed of the risks they were being exposed to, Norwegian citizens were told a wholly convincing financial narrative non-financial experts would be hard-pressed to refute. This suggests that if government's are to pursue the SWF policy path, citizens deserve the right to critically engage with their SWF's speculative financial identity and investment philosophy in a democratic manner currently lacking in Norway. This prevents alternative forward-looking – and potentially more domestically beneficial – petroleum wealth management strategies from being seriously considered (cf. Gjedrem, 2009*b*).

The need for such a critical engagement with SWFs' basic assumptions became most pertinent in the wake of the 2007-2009 financial crisis. To be sure, the GPFG's eventual recovery was in large part the result of ad hoc government interventions into the financial system and not the efficiency of markets or even NBIM's financial expertise. This was well documented by NBIM in their 2008 and

2009 Annual Reports. So while the governor of the central bank was quick to claim that ‘history has seen a number of deep financial crises, and market conditions will return to normal in time’, the fact that government support is crucial for this eventual return to ‘normality’ is conveniently ignored (Gjedrem in Storting, 2009). To reinforce this argument that sovereign wealth fund’s are best conceptualised as domestic strategies of governance that problematically constrain state agency, Chapter’s Six and Seven now examine the dissertation’s second case study: the Alberta Heritage Savings Trust Fund.

Chapter Six: *Alberta's Heritage Savings Trust Fund (1976-1997)*

In 2009, the Alberta Heritage Savings Trust Fund (AHF, or 'the Fund') represented CDN\$3,000 for each Albertan, 80 percent of the provincial government's net fiscal assets, and could finance the provincial budget – the largest in Canada – for a full six months (Gartner, 2007: 16; Gibbins and Vander Ploeg, 2005: 16-17).⁸⁶ While established in May of 1976 on the back of windfall petroleum revenues, the Fund had been subject to such a vast array of changes by 2009 that virtually nothing of its original form or function remained. The only constant throughout this period was the Albertan government's dependence on AHF capital to support annual budgets (see Appendix 2). What did change were the mechanisms through which this role would be fulfilled, the changes eventually culminating in the AHF being reconceptualised as a sovereign wealth fund in 1997. Prior to this institutional transformation, the Fund was tasked to achieve four contrasting objectives. First was to contribute to intergenerational wealth transfer given the finite nature of Alberta's petroleum resources. Second was to strengthen and diversify the domestic economy so as to wean the province off its dependence on non-renewable resources. Third was to improve Albertan's quality of life in the short-term through funding social welfare policies and programs. Finally, the AHF was intended to act as an alternative future revenue source for the government, a so-called 'rainy day' fund (Lougheed, 1976a: 828; Warrack, 1985: 15). Of these four objectives, the AHF's focus on diversifying the domestic economy away from petroleum dependence was initially cited by government as its most important objective (Lougheed, 1976a: 828). Indeed, the first

⁸⁶ Unless noted, currency is calculated in Canadian Dollars for Chapters Six and Seven.

two decades of the AHF would see its capital being almost exclusively used in the name of economic and social development to support budgetary expenditures. It would consequently invest in a variety of socioeconomic assets as disparate as medical research facilities, subsidized housing, parks, irrigation works, and pulp and paper mills.⁸⁷

Yet while initially a source of pride for Albertans, as well as a significant political asset, the AHF became implicated with a budgetary crisis that greatly undermined the government's legitimacy between 1988 and 1994. Indeed not only did this crisis serve to delegitimize the Fund's focus on socioeconomic development, but the government's capacity to manage Alberta's petroleum wealth in aggregate was also cast in doubt. Following its being put into a passive state in 1994, the SWF policy path was eventually adopted as a means to address this crisis of legitimacy. The AHF's broad and lofty goals of improving Albertan society through socioeconomic diversification were replaced with a strictly commercial mandate to maximize financial returns into the indefinite future. As such, the AHF immediately came to embed public capital throughout a variety of riskier Canadian and international financial assets as the only means to achieve this new objective. And while its pursuit of financial maximization would be overseen by the Legislature, it would be operationalized by the Alberta Investment Management Corporation (AIMCo) – an organizationally distinct Crown corporation largely independent from government auspices.⁸⁸

⁸⁷ These investments were to be overseen by the Heritage Savings Trust Fund Investment Committee – consisting of all members of the Legislature's executive council (Cabinet) – which retained managerial authority over 80 percent of the Fund's assets. Only 20 percent of the Fund's assets were subject to legislative debate and approval.

⁸⁸ The Treasury was renamed the 'Ministry of Finance and Enterprise' in 2001. For continuity's sake, the following Chapters refer to the 'Treasury' when referencing the department of government tasked with the oversight of the AHF.

Hence more than two decades after it was established, the AHF was subject to an institutional transformation that saw it come to exhibit the three distinguishing features of the SWF policy path. That is, the AHF: (1) became a pool of public capital invested in traditionally riskier asset classes and markets in pursuit of financial returns above the risk-free rate; (2) began to universally embed this public wealth in both a functional and spatial sense of capital mobility in attempting to control for financial risk; and (3) is governed by the state but operationally managed by a government-linked entity akin to an independent central bank – it is thus neither fully integrated into the state apparatus but neither is Parliament removed from its oversight role. The Albertan case is significant as the AHF's institutional transformation was not driven by government's desire to capitalise on opportunities inherent to the financial realm as would be argued by mainstream SWF analyses. Rather, it was pursued as a politically desirable alternative once the AHF's original mandate and management regime was framed as in crisis by opposition members of the government, academics, and the media. It was thus only after being interpreted as a means to buttress political legitimacy in the short-term that the long-term orientated SWF policy path was internalized as a desirable strategy of governance.

How to explain why both Norwegian and Albertan policymakers came to perceive the SWF policy path as befitting their otherwise unique and divergent interests? Financial economists and neoliberal policymakers have been quick to argue that the diversification of sovereign wealth by financial experts into the long-term is a rationally desirable pursuit government's should willingly pursue. According to such analyses, SWFs enable government actors to capture the inherent profitability of the financial realm for the benefit of current and future generations. Yet such analyses render government and political agency latent unexamined variables in the puzzle

presented by SWFs' global diffusion. Their *weltanschauung* is rooted in modern financial epistemology, preventing them from noting other means through which SWFs can and do serve the short-term interests of political actors. The primary example offered in this dissertation is the funds' ability to stabilize political actors' governance function in time through their ability to manage socioeconomic expectations.

To this effect, this dissertation's analytical approach is grounded in the role played by ideas to induce and guide institutional change through time. It seeks to demonstrate that when faced with unprecedented forward-looking tasks ripe with uncertainty, state managers have only ideas to inform them of what constitutes rational and legitimate action and, ultimately, which policy paths should be pursued. This is not to say that structural factors did not also play a role in influencing the adoption of the SWF policy path in Alberta. Indeed, the rapid expansion of the budgetary deficit on the back of collapsing world energy prices was a key development preceding this transformation. Yet structural factors alone, such as an expansionary budget deficit or the presence of developed capital markets, cannot explain why the SWF policy path met the unique interests of government actors in both Norway and Alberta. Instead, this dissertation emphasizes that ideas embedded in institutions are necessary – albeit often overlooked – prerequisites for the construction of agency (cf. Konings, 2009).

The following discussion therefore seeks to fill in the gaps left by such mainstream SWF analyses that take for granted both political agency and the power of ideas to shape its character. It does so by examining how the authoritative financial ideas substantiating the SWF policy path were framed as capable of supporting the short-term interests of the Albertan government when faced with a politico-economic

crisis in the early 1990s. It then traces how these ideas continued to shape the interests and policy preferences of these actors into 2009. To be sure, the reasons for and necessity of political support underpinning the AHF's institutional legitimacy is taken for granted in mainstream SWF analyses. The SWF policy path must support political actors' short-term interests in some fashion lest there is no incentive for them to preserve their funds' institutional legitimacy. The Albertan case supports this argument, demonstrating the SWF policy path's legitimacy had to be actively promoted by Albertan policymakers in the decade following its adoption lest it be delegitimized as the original AHF had been.

Yet in so doing, the SWF policy path became a constraint on political agency, as Albertan politicians were pressured to promote the legitimacy of the AHF's speculative financial identity. This was rather than critically engage with the underlying ideas that substantiate this strategy of governance. The following argues this constraint is problematic. Indeed, the AHF's SWF identity derived its legitimacy from a number of simplified presuppositions about what speculative finance is and how to successfully engage with it. It is these ideas that provided provincial politicians with an authoritative and readily communicable fiscal management strategy that could be promoted as legitimate throughout the domestic electorate. However, these ideas do not accurately reflect financial market reality so much as legitimate the speculative investment practices through which this reality is performed on a day-to-day basis. This proved problematic as their promotion of these ideas pressured government officials to defer their policy preferences to the demands of a financial realm in crisis throughout the volatile 2000s. This is despite these crises revealing the fallacious nature of modern financial epistemology when relied upon as a guide to action.

The following case study will be divided between Chapters Six and Seven. Section 6.1 details how the AHF developed as a government-managed domestic investment fund between 1976 and 1982. Section 6.2 then examines the way in which the AHF's original form and function was gradually delegitimized by an emergent politico-economic crisis between 1983 and 1994. It was following this crisis that the government opted to reconceptualise the Fund as an SWF in 1997. Section 6.3 then deconstructs how the SWF policy path was internalized as a viable alternative to the pre-existing AHF between 1994 and 1997, and thus how this strategy won over competing alternatives. Chapter Seven will then demonstrate how SWFs' substantive financial ideas came to constrain the Albertan government's political agency between 1997 and 2009. More specifically, it will detail how these financial ideas came to constrain the Albertan government's approach to fiscal governance in two ways. First was by their influencing the AHF to expand its investment universe and deepen its global financial embeddedness. Second was by their giving rise to AIMCo as an independent Crown corporation tasked to manage \$45 billion in additional public funds. These sources of constraint proved especially significant in the wake of domestically destabilizing financial crises experienced between 1997 and 2009. Chapter 7 then summarizes these arguments and concludes.

6.1 The Alberta Heritage Savings Trust Fund (1976-1982): *A 'Vehicle for Social Policy'*

The Alberta Heritage Savings Trust Fund was established by the provincial Legislature in 1976 as a means to manage the accumulation of windfall petroleum revenues in 1973. It was initially tasked with a mandate to achieve three disparate objectives, each focused on benefiting a different element of Albertan society (Smith,

1987: 14).⁸⁹ First, a domestic diversification objective would seek to benefit business interests outside the province's dominant petroleum industry by providing funding for various economic development projects. A social development objective would be focused on improving everyday Albertans' quality of life by funding welfare programs and other not-for-profit projects. Finally, a fiscal savings objective through the retaining of investment income and annual government allocations would ensure future generations would continue to benefit from the AHF's first two objectives into the long-term.

Shortly after its creation, the AHF and its lofty goals became a significant source of pride for everyday Albertans. To be sure, Canada's federal system of parliamentary democracy features a high degree of competition, mistrust, and occasional hostility between provinces.⁹⁰ Feelings of inferiority were especially poignant for Alberta who, prior to the growth of its petroleum industry in the 1960s, was relegated to the backbenches of federal politics. With the AHF, however, Albertans could distinguish themselves from the rest of the provincial pack. Indeed, the Fund was immediately imbued with considerable symbolic meaning for everyday Albertans who grew up in the shadows of more economically heavyweight provinces such as Ontario, Quebec, and British Columbia. The AHF was in fact a highly debated topic in the lead up to the 1975 provincial election, and the popular support it received helped secure its authors in the Progressive Conservative (PC) party another

⁸⁹ A fourth objective – that of becoming a 'rainy day' fund for government – would not be introduced until the early 1980s as budgets began to slip into deficit.

⁹⁰ Alberta is clearly not an independent state as is Norway or Ireland. Yet as a province within the Canadian federal system, it possesses the freedom to govern itself in a number of ways that reflect state sovereignty. Fiscal policy, for example, is a provincially governed affair. The Albertan legislature must nonetheless pay royalties on its energy income to the federal government. This made saving a portion of this wealth outside the reach of Ottawa a highly politicized Albertan issue. Indeed, the AHF has been a significant source of pride for everyday Albertans since its inception in 1976 (Elniski, 2009). The provincial government has consequently retained its sovereign authority to determine the Fund's purpose, mandate, and thus relationship with provincial society throughout these three decades. The Albertan government therefore meets this dissertation's conceptualization of both the 'state' and 'state governance' as outlined in Chapter One: Section 1.1.

parliamentary majority (Warrack, 1985: 2-5).⁹¹ As summarized by one Member of the Legislative Assembly (MLA) reflecting on the Fund's symbolic significance:

'[The AHF] came to mean that finally in this province we were allowed to play on the national scene...That we have a bank account in this province and we have a bigger bank account than anybody else in the country was impressive to the people of Alberta and very comforting. They were able to say, "We don't need handouts," to Ottawa and the rest of the country, "We are rich; we are smart; we're not just out here in the boondocks," and make that stick' – Hewes, 1995: 1477

Yet despite this symbolic importance and lofty ambitions, the AHF's primary function has from 1976 onwards been to support the short-term fiscal needs of government. While not problematic for Albertans in itself given the popular success of the Fund's initial years, the ad hoc and convoluted way in which this dependence on the AHF developed between 1976 and 1997 was heavily criticized. Use of the AHF in this way in fact abetted the emergence of an unsustainable budget deficit. This ultimately led to the Fund – and by extension its owners and managers in government – being framed as in crisis between 1988 and 1994. It was following this period that the SWF policy path was internalized as a viable means to address this crisis so as to reassert governmental legitimacy. Yet before the ascendance of the SWF policy path can be examined, it is first necessary to deconstruct how the AHF's original form and function was gradually delegitimized within Alberta between 1976 and 1988.

To this effect, the origins of the AHF can be traced to the months following the 1973 Oil Crisis when petroleum and natural gas royalties accrued by the Albertan government rapidly increased on the back of rising world energy prices (see Appendix 2). According to the Deputy Provincial Treasurer of the time, the global economy's demand for oil was such that 'cutbacks in production could not be

⁹¹ The Progressive Conservative Party of Canada has in fact held a majority in Parliament since 1971.

considered'. The AHF thus arose out of a desire to save a portion of these petroleum revenues (Collins, 1980: 159). In this sense, then, the AHF's origins are similar to those of Norway in that the sudden accrual of surplus petroleum revenues became a problem of uncertainty the government was expected to solve (c.f. Noreng, 1981: 23-25). MLAs were consequently pressured to design and implement a strategy through which this capital could be managed in a socioeconomically beneficial and domestically desirable manner (Lougheed, 1976*a*: 833). What was uncertain, then, was how this was to be achieved. Should the government save, spend, or invest this wealth?⁹² Indeed, the surplus petroleum wealth accrued in 1973 presented both a problem and opportunity for government. The problem was that spending these revenues in the short-term would create unsustainable socioeconomic expectations (Warrack, 1985: 18). Albertan's deep-seated mistrust of government also led to the belief that such investments should be dampened so as to avoid 'possible overzealous aspirations' of wayward politicians. It was generally believed that such aspirations would only serve to interfere with the natural order of the marketplace (Ghitter, 1976: 869; cf. Pratt and Tupper, 1980: 260).⁹³ Thus within an environment hostile to the government's presence in the private market, the problem of surplus petroleum wealth

⁹² The province of Alberta had and continues to have the highest rates of public expenditure out of any Canadian province. At the same time, it also has the lowest tax rates. As such, the government has always depended on the highly volatile petroleum industry to maintain the high level of services Albertan's had come to expect but without increasing taxes. The provincial government has moreover pursued a spendthrift approach to budgetary politics, increasing services in times of booming petroleum revenues and ruthlessly cutting back in times of deficit (cf. Pratt and Tupper, 1982; Gibbins and Van der Ploeg, 2005; Warrack, 2009). The reasons for this approach to fiscal policy are numerous, but can in large part be attributed to a uniquely Albertan approach to personal and public money management (Elniski, 2009). According to MLA Doug Elniski, Deputy Chair of the Standing Committee for the AHF: 'it's boom time bust time in the kind of economy we've lived in...it's a really interesting phenomenon that everyone is so leveraged all the time...it's not a Canadian trait, no, it's a totally Albertan trait' (Elniski, 2009; cf. Hyndman, 1980).

⁹³ The executive branch of the Albertan parliament (read: the Cabinet) possesses much authority in influencing the character of political debate as well as the development of policy and legislation in Canadian politics (Warrack, 1985). The Lougheed government was consequently put in a strong position to determine how the petroleum-derived wealth rapidly accrued in 1973 should be managed despite these reservations.

management led to a heightened sense of uncertainty within the Legislature between 1973 and 1976 (Pratt and Tupper, 1980: 260; Ghitter, 1976: 867; Notley, 1976: 839).

Yet from the start of legislative debates, it was clear that the PC majority parliament – led by Premier Peter Lougheed from 1971 to 1985, who was also the 1976 AHF Act’s author – wished to pursue all three options at once.⁹⁴ This money could be saved in an extra budgetary account from which government could draw to stabilize future budgets in the face of fluctuating oil prices. When not serving this function, it could be used to diversify the domestic economy away from petroleum dependence, thereby increasing government’s tax revenues (Lougheed, 1976a: 828).⁹⁵ Thus while delineated a savings vehicle for future generations, the original AHF was also tasked to help the government ‘diversify and strengthen’ the provincial economy by investing in projects providing ‘long term economic or social benefits to the people of Alberta but which will not by their nature yield a [financial] return’ (AHF Act, 1976: Section 6 a, c-i).⁹⁶ Social welfare spending was therefore originally intended to work in congruence with the AHF’s savings function. As emphasized by Lougheed in Legislative debates:

‘[The AHF must] offset the probability of declining revenue in the future by its appreciation and by its income. At the same time, it must be a vehicle for diversification and for strengthening our economy...It must do both; not just one, but both’--Lougheed, 1976a: 829

⁹⁴ Based on an initial proposal by Premier Peter Lougheed in 1974, draft legislation for the AHF was developed and presented in the Legislature for debate in the Fall of 1975. This draft was subsequently let to die on the Order Paper, a common strategy used in Albertan politics in matters of potential policy significance, complexity, or controversy (Warrack, 1985: 22). The AHF concept was then widely debated in the March 1975 Provincial election, after which the original draft bill was modified and eventually passed in Spring of 1976. The first \$1.5 billion was transferred to the AHF by late summer 1976 (ibid. 5).

⁹⁵ The Lougheed government opted to allocate a one-off payment of \$1.5 billion to the AHF in 1976, while 30 percent of petroleum income would be allocated to the Fund each year thereafter (AHF Act, 1976: Section 5). In addition, all investment income earned by the AHF would also be retained.

⁹⁶ Premier Lougheed’s 1971 election campaign was in fact premised upon a platform of economic diversification, and its inclusion within the AHF’s mandate can therefore be seen as a continuation of this policy preference. Indeed, between 1971 and 1975, program expenditures increased by 34 percent while resource revenues rose 400 percent (Boothe, 1990: 6).

It was, however, the latter focus on economic diversification and strengthening that initially found the most support across party lines in the Legislature. Indeed, both majority PC as well as opposition Social Credit and Liberal policymakers framed the idea of the AHF in a positively opportunistic light, arguing that: ‘we have such a sum of money in our hands as legislators that we can determine what society is like in Alberta...We can mould it...We can take it and guide it to a greater degree than ever before’ (Speaker, 1976: 878; cf. Smith, 1987: 15).⁹⁷ The AHF was then divided into four divisions through which each of the Fund’s contrasting objectives could be accommodated.⁹⁸ Through these divisions the AHF began to invest in Albertan assets as diverse as provincial parks, hospitals, subsidized housing, medical research facilities, irrigation works, and educational programs. This is in addition to conservative financial assets such as high-grade corporate bonds, government-guaranteed debentures, and other liquid marketable securities (Annual Reports, 1977-1982).⁹⁹

⁹⁷ The government had in fact already developed a rough economic plan dictating in which areas AHF and other assets should be invested before the Legislation was passed. These included: agricultural processing, resources upgrading, technology and skills, tourism, northern development, and financial services. This was in addition to the necessary infrastructural investments required of large-scale economic diversification projects which had always been provided by the public sector in Alberta (Warrack, 1985: 16-17).

⁹⁸ These divisions were the: Capital Projects (CPD), Canada Investment (CDNID), Alberta Investment (AID), and Current Assets.

⁹⁹ The call for flexibility Lougheed cited as so crucial for the AHF’s success only referred to its management objectives and not the way in which the Fund was to be managed on a day-to-day basis. That is, the AHF Act delegated managerial authority for 80 percent of the Fund’s assets to an ‘Investment Committee’ – composed of Cabinet members and high-ranking Treasury officials – who did not require legislative approval for investments. These investments would then be subject to an ex-post review by an all-party watchdog committee, known as the ‘Standing Committee’. Such a concentrated managerial structure within the auspices of the Executive was intended to make the Fund more ‘businesslike’ in the absence of a ‘legislative straightjacket’ that would hamper timely investment decisions to be made in a competitive Albertan market (Lougheed, 1976a: 81 cited in Pratt and Tupper, 1980: 259). Premier Lougheed deflected criticism of the interventionist the AHF presented by focusing on the Fund’s savings dimension, suggesting only the Cabinet could protect this wealth for future generations from a Legislature prone to manipulation by ‘special interest groups’ (Lougheed, 1976a: 833; cf. Warrack, 2009). This argument would at the same time serve the provincial development project – the most immediate and thus politically desirable focus of the AHF – which was argued to require ‘an executive armed with maximum tactical flexibility and all necessary discretionary powers’ to be successful (Pratt and Tupper, 1980: 258; cf. Hyndman, 1980; Warrack, 2009).

Thus by 1980, the AHF had become overwhelmingly focused on socioeconomic diversification such that the majority of its investments earned minimal to no short-term financial return. This emerging gap between financial versus socioeconomic return subsequently became a polarizing issue within the Legislature (cf. Collins, 1980: 163). Indeed, the AHF's managers in the Cabinet and Treasury came under increasing fire for not being more focused on earning financial returns to support government budgets (Smith, 1980: 142; cf. Collins, 1980: 160; Standing Committee Report, 1979; Mirus, 1980; Jarislowsky and Grant, 1980; Hyndman, 1980). In attempting to reinforce the AHF's legitimacy in the face of this criticism, the Commercial Investment Division (CID) was established in 1980, and tasked to earn 'a *commercial* return or profit' by investing in riskier financial assets such as equities and mutual funds. This was compared to the Fund's other divisions which only had to earn a rather ambiguous '*reasonable* return or profit', which allowed them to make investments in long-term socioeconomic development projects (emphasis added, AHF Amendment Act, 1980: 1).¹⁰⁰ The Provincial Treasurer in fact argued this focus on return maximization reflected the 'natural evolution' of the Fund and that the 'goal of maintaining a good return, is the key if not the primary goal of the [AHF, which is] of course a savings account for the future' (Hyndman, 1980: 933). Reflecting the then emerging academic literature on the equity risk premium, Hyndman legitimated the CID's increased risk appetite by citing 'studies [which] have indicated that over the long run, equities have significantly outperformed all major categories of fixed income investments' (Annual Report, 1982: 6). Despite

¹⁰⁰ The CID was, however, limited in that it could only invest in companies that met the requirements of the Canadian and British Insurance Companies Act. This limited the CID to invest in blue-chip stocks with a long history of dividend payments. Thus it cannot be said that the AHF was investing in a financially diversified and riskier way to the same extent it would be by 1997. Moreover, assets invested through the CID would remain less than 1.5 percent of total assets between 1980 and 1985, with investment income earned therein being divided and spent between the Fund's other divisions. Thus little of the CID's investment income actually contributed to the Fund's appreciation.

these arguments from his Treasurer, however, Premier Lougheed maintained that the AHF was not primarily a savings fund, but a socioeconomic development vehicle that would ‘over a decade or so ahead’ enrich the domestic economy and enable Albertans to ‘begin to pay a much larger share of provincial services by way of customary taxation’ (Lougheed, 1980*b*: 936). This conflict of ideas demonstrates there was a motive to adopt the SWF policy path as early as 1980, but it wasn’t yet in the government’s interests to do so. They also demonstrate the AHF was from the very start a strategy of governance whose objectives could be adapted to accommodate the short-term political interests of MLAs.

Indeed shortly after the CID was established, both the Fund’s savings and domestic diversification functions were to be sacrificed in favour of its being used as an alternative source of budgetary financing. This followed from the 1980 amendment to the original AHF legislation. Here, not only was the CID established, but the wording of the Fund’s mandate was also changed: from making investments that would ‘strengthen *and* diversify’ the Albertan economy to ‘strengthen *or* diversify’ (AHF Amendment Act, 1980). This increased the AHF’s flexibility in regards to how its capital could be managed and to what ends. That is, its managers in the Lougheed-led Investment Committee were freed to utilize AHF assets in general ways that would not necessarily diversify the Albertan economy but may, arguably, strengthen it. As a result, a significant portion of AHF capital was used to subsidize domestic taxes in the face of rapidly swelling annual budgets (Smith, 1987: 14-15; Warrack, 1985; 2009). To be sure, public spending had only increased by four percent between 1976 and 1978, but rapidly swelled by 62 percent between 1979 and 1982. This was at the same time as income from petroleum taxation dropped by 29 percent (Smith,

1987: 7-8; see Appendix 2).¹⁰¹ Thus rather than decrease services and raise taxes, the government opted to use AHF assets and investment income to meet the budgetary short-fall by lending money to various provincial Crown corporations in need of funds. They also began redirecting the AHF's investment income back to the government's main budgetary account – the General Revenue Fund (GRF) – in 1992.¹⁰² The importance of the AHF to support government budgets subsequently grew alongside the Fund's expanding domestic investment portfolio, which represented approximately 13 percent of annual government revenues by 1982 (Standing Committee Hearings, 2006).

6.2 The Alberta Heritage Savings Trust Fund (1983-1994): *The Delegitimization of the AHF as 'Vehicle for Social Policy'*

When the Alberta Heritage Savings Trust Fund was established in 1976, its contrasting objectives represented a legitimate and desirable means through which surplus petroleum wealth could be managed. First, saving through annual contributions would preserve this wealth for future generations. Second, investments in underdeveloped sectors of the domestic economy would eventually decrease the government's dependence on the energy sector for tax revenues. Finally, social welfare development would immediately better the quality of life for a vast array of

¹⁰¹ This squeeze between increased spending and decreased resource revenues can be attributed to a number of factors. First, the AHF spent \$1.3 billion on 'deemed assets' through the CPD between 1976 and 1982. Not only did these investments earn no return, but they also set a higher base for operating expenditures covered by the government in the annual budget (Smith, 1987: 8). Second, Alberta was facing recessionary pressures due to a resource-dependant business cycle so government spending was increased to pick up the slack. Third, the Federal government's 'National Energy Program' of 1980 reduced the amount of non-renewable resource royalties accruing to the Albertan government. Finally, interest rates became increasingly volatile from 1979 onwards and AHF money was used to alleviate the pressures this put on Albertan homeowners – albeit just prior to an election, a move for which the government received much condemnation (ibid. 46; cf. Gartner, 2007: 13).

¹⁰² An amendment passed in 1982 saw the portion of resource revenues allocated to the Fund remain at 30 percent, but with all investment income being diverted to the GRF wherein it was used to subsidize taxes (AHF Amendment Act, 1982).

Albertans. Between 1976 and 1982, these objectives served to address the problem of uncertainty posed by this petroleum wealth, and in a way that sustained the Progressive Conservative's dominance in domestic politics. Indeed, the AHF's stabilizing influence on budgetary politics has been a substantive contributor to the PC's popular support since 1976 (cf. Smith, 1987; Warrack, 1985). This support arose directly through AHF expenditures, but also indirectly from the goodwill engendered by the Fund's existence in Federal Canada. Throughout this time, each of the Fund's objectives went to support the government's short-term interests: first to invest in a variety of public works Albertans could immediately benefit from; second to keep interest rates low for home owners prior to the 1982 election; and third to subsidize taxes. This is, in effect, the primary task to which governments apply themselves: they manage domestic expectations by planning into the future, thereby providing social, economic – and hopefully for those in power – political stability in the present. As Seabrooke argues, a government's capacity to influence the shared expectations of domestic society is a substantive feature of legitimacy construction (2006: 21; cf. Hay, 2006: 4-7). Uncertainty as to how to best manage Alberta's petroleum wealth would nonetheless resurface as the Fund's original mandate and managerial structure were gradually delegitimized and cast as in crisis between 1983 and 1994.

This is not to say the Fund was in crisis from a social welfare standpoint given the variety of social programs and economic development projects it had funded (cf. Elniski, 2009; Matheson, 2009). Rather, it would become increasingly apparent that investing in such projects was not the government's primary concern. Nor was it the Albertan public's primary desire, which was later revealed by an extensive survey campaign to be preserving the AHF as a savings fund for future generations (Review Committee, 1995). This uncertainty was thus problematic as not only had the

government become increasingly dependant on AHF capital to support annual budgets since 1980, but they also lacked a viable alternative to replace the pre-existing management strategy. This problem was compounded by the fact that the AHF and its convoluted mandate still held great symbolic significance for the Albertan electorate. Their criticisms were directed more towards what they as well as opposition MLAs perceived to be the government's mismanagement of an otherwise problem-free AHF (cf. Review Committee, 1995: 12; Matheson, 2009). As a consequence, the PCs were repeatedly criticized for lacking fiscal accountability between 1983 and 1994.¹⁰³

A strategy to address the delegitimization of the pre-existing AHF regime was therefore an issue of high importance for the incumbent PC government in 1994. Simply put, the crisis incentivized the government to turn to alternative ideas to inform them how to govern in the face of uncertainty posed by the AHF crisis. This eventually led to the adoption of the SWF policy path in 1997. Yet before the reasons behind this institutional transformation can be further examined, it is first necessary to deconstruct how the original AHF was delegitimized between 1983 and 1994. Indeed, it was the specific way in which the AHF crisis materialized that led government to conclude the SWF policy path and its three distinguishing features would support their short-term interests. The following breaks this crisis into three interrelated sources: a fiscal source, a measurement source, and a management source.

¹⁰³ Such was the embeddedness of their political base, however, the PCs still managed to retain the parliamentary majority following these elections, but by replacing Premier Getty with Ralph Klein (Elections Alberta, 1993). They nonetheless lost a significant share of the vote in the 1993 provincial election to the Liberals on the back of AHF and related fiscal issues. The PCs would then regain the lost support in the 1997 general election following Premier-Klein's efforts to eliminate the fiscal deficit through reconceptualising the AHF as an SWF as well as through implementing a four-year austerity program (Elections Alberta, 1997).

6.2.1 The AHF Crisis - Fiscal

The fiscal source of the AHF crisis is grounded in two interrelated developments. First was the government's decision to gradually eliminate the Fund's savings objective. Second was the way in which this helped facilitate the emergence of a \$30 billion provincial deficit by 1994. This deficit proved highly undesirable for an Albertan public that had been 'conditioned to reject debt' by the government since the 1970s. This is referring to the unique 'boom-bust' fiscal culture of the resource rich, but also resource dependant, province (Elniski, 2009). The deficit also proved highly problematic for the government who would face an electoral backlash if they either cut services or raised taxes. It is hence ironic that the origins of the crisis emerged as a direct consequence of the Lougheed government's decision in 1982 to use the AHF to subsidize taxes. This first manipulation of the AHF in fact established a precedent the government would re-enact twice more. The first was in 1984 when the Fund's annual contributions were halved from 30 to 15 percent of resource revenue, and the second in 1987 when these contributions entirely were stopped altogether (AHF Amendment Act, 1984; 1987; Warrack and Russell, 2002: 7).¹⁰⁴ So while the redirection of investment income to the government's main account in 1982 was meant to last only two-years, it became a permanent fixture of fiscal policy as the budget balance continued to deteriorate throughout the 1980s (Boothe, 1990: 8; see Appendix 2).¹⁰⁵

To be sure, these changes were made in attempts to accommodate Alberta's high level of public expenditure while keeping taxes low in the face of declining

¹⁰⁴ To put this in context, between 1976 and 1987 approximately \$15 billion had been allocated to the AHF from resource revenues, with \$3 billion having been allocated to the CPD.

¹⁰⁵ On the surface, however, the government was still committed to its pursuit of the AHF's long-term economic diversification and social development goals as evidenced by a 1984 White Paper (Alberta Treasury, 1984). The government's actions in regards to AHF's investment following the issue of this White Paper would nonetheless suggest these goals were more or less undermined by the short-term fiscal needs of the government.

resource revenues – which dropped from \$1037 to \$454 per capita between 1986 and 1990 due to collapsing world energy prices (Boothe, 1990: 9). From 1983 onwards, the AHF thus rapidly became a means for the government to reduce its dependence on financial markets for debt financing. As summarized by a member of the AHF Review Committee in 1997:

‘[S]ince 1982 all the income earned from the heritage Fund has actually been used for government spending. Without that income it would have been much more difficult for the budget to be balanced, we’d probably have a larger debt than we do now, and so on’ -- Zwozdesky, 1997: 2

The decision to stem the flow of annual contributions of petroleum wealth in 1987 thus made clear to Albertans the AHF no longer represented a savings vehicle for future generations. It no longer had a steady source of income, was not being proofed against inflation, and was losing money each year through the Capital Projects Division (CPD) on so-called ‘deemed assets’. These included provincial parks and subsidized housing among other ‘quality-of-life’ investments. With no new revenue sources the AHF was left to a fate of gradual decline, a clear violation of the Fund’s savings mandate for which the government received much criticism (Warrack and Russell, 2002: 7; McEachern, Hawkesworth, Piquette, 1987; Smith, 1987; Boothe, 1990; Institute of Chartered Accountants of Alberta, 1992; 1993). So whereas the Fund had been a political asset between 1976 and 1982, it increasingly became a political liability from 1983 onwards as more questions and criticisms were directed at both the Fund and government (Smith, 1987: 46).

These criticisms would nonetheless be weathered by the PCs, who had come to so dominate Albertan politics in the 1980s. What they could not withstand was just how unsustainable the budget deficit would become between 1987 and 1994 on the back of collapsing world energy prices. Hence despite the AHF being used as a lender of first resort, Alberta’s fiscal picture rapidly deteriorated as the budget deficit grew

from \$1561 per capita in 1987 to an unmanageable \$5500 per capita in 1993. Debt servicing costs also skyrocketed by 150 percent, and just as petroleum income fell from approximately 40 percent to less than 25 percent of total government revenues (McMillan and Warrack, 1993: 6; *Alternative Solutions for Albertans*, 1994: 2). Such was the size of the deficit, the rapidity of its growth, and the inability of the government to generate enough revenues to keep it under reasonable control that even the AHF's use as an alternative source for government borrowing became negligible (Standing Committee Hearing, 2006). MLAs were therefore incentivized to reevaluate the Fund's multi-purposed mandate, but in such a way that would not compromise the Fund's ability to support the government's short-term fiscal plan. Uncertainty as to the best means of doing so nonetheless remained when the AHF was put into a passive state and an official review was called in 1994.

6.2.2 The AHF Crisis - Measurement

The delegitimization of the AHF's original mandate is also attributable to its lack of measurability. Calls to liquidate the Fund to address the burgeoning deficit more head on were complicated by the fact that neither its total value nor performance could be readily measured in quantitative terms. Indeed, the AHF had as early as 1985 lent approximately \$6.5 billion to four Albertan crown corporations that met the qualifications for strengthening but not necessarily diversifying the provincial economy (Warrack, 1985: 25-26; *Annual Reports 1980-1987: Introduction*).¹⁰⁶ While these loans were not necessarily controversial in their own right, their repayment was highly scrutinized due to their being paid from already borrowed capital in the

¹⁰⁶ These investments included a \$3.5 billion loan to Alberta Mortgage and Housing Corporation (which provided subsidized housing); two loans of \$1.5 billion each to Alberta Government Telephones and Alberta Municipal Financial Corporation; and a \$160 million loan to Alberta Opportunity Company (Warrack, 1985: 25-26).

General Revenue Fund. The government was accused of engaging with ‘circular accounting’, repaying itself in IOUs that only served to increase the net deficit (Mumey, 1990-1994; AHF Standing Committee, 1992; Mitchell, AHF Standing Committee, 1994). While the Treasury and Auditor General maintained this practice complied with federally regulated accounting principles and the repayments constituted ‘real’ income, the practice was condemned by a number of sources within academia and government (Payne, AHF Standing Committee, 1992; Taylor, AHF Standing Committee, 1992; Mumey, 1990-1994; Matheson, 2009). The debate produced much uncertainty as to how much capital the AHF held and whether it should still be considered an account independent from the rest of public finances. Between 1988 and 1994, for example, consensus could not be reached as to whether the Fund was worth \$12 billion or as little as half that.¹⁰⁷

Further complicating the determination of the Fund’s value was the controversy surrounding the so-called ‘deemed assets’ in the CPD. Debate became particularly pronounced between two of the Fund’s primary overseers – the Provincial Treasurer and Auditor General – between 1990 and 1993. On the one hand, the Auditor General argued that the then \$3.2 billion CPD was not generating any revenues – nor was it ever intended to do so – as it invested in assets such as provincial parks which provided a number of quantitatively immeasurable social benefits. Considering these assets could not be valued let alone sold for profit, they should be excluded from the Fund’s balance sheets. To sell the CPD’s assets would ultimately require changing ‘the whole concept and policy of the government in relation to this Fund’ (Salmon in Standing Committee Hearing, 1992). The Treasurer

¹⁰⁷ For a summary of the different values of the AHF throughout this time, see Mumey, 1990-1994. It was not until 1994 that this debate was resolved when the government commandeered the services of four private market consultants to value the Fund at an officially recognized \$11.4 billion (Review Committee, 1995: 1).

strongly disagreed with these arguments. He interpreted CPD assets as still being a part of the Fund due to the ambiguity of what constituted real versus deemed assets under the AHF Act (Salmon in Standing Committee Hearing, 1992). This was largely motivated by the fact he wanted the public to recognize the government's financial commitment to bettering their quality of life in the short-term.

The AHF's value therefore remained an unresolved and polarizing issue in the Legislature, particularly between 1988 and 1994. This was for both those opposition members that wanted the Fund liquidated to address the swelling budgetary deficit, and the PCs who wished to maintain the status quo. What these camps could agree upon was that the AHF's institutional legitimacy was being undermined by an inability to quantify in an easily communicable manner what it was doing for either the government or public. Indeed, it could not be readily determined just how effective the Fund was in supporting fiscal policy or socioeconomic development. This was significant as the Fund's budget-stabilizing investments in irrigation works, medical research, education, and provincial parks represented approximately 60 percent of AHF assets (Warrack, 1985: 26; Review Committee, 1995: 1-3). Due to this confusion surrounding its value and benefits, the AHF could not be compared to other institutional funds of similar sizes – such as public pension funds, mutual funds, or commodity stabilization funds. Unsurprisingly, this lack of measurability produced great uncertainty as to what the AHF's primary task was supposed to be, let alone how well it was doing it (Review Committee, 1995: 2).

6.2.3 The AHF Crisis - Management

The belief that the AHF's socioeconomic investments were beneficial nonetheless continued to be the narrative from which the government drew to

legitimate maintaining the status quo into the 1990s. They cited the importance of these investments from a ‘strategic basis’ in particular, suggesting the extent to which the AHF had come to support the PCs legitimacy (Orman in Standing Committee Hearing, 1992). What became increasingly difficult was the government’s ability ‘to rationalize and explain what is going on here to the general public of this province’ in the face of the mounting budget deficit (Jonson in Standing Committee Hearing, 1992). The inability to measure either performance or real value resulted in the AHF and its managers in government being increasingly criticized for a lack of transparency and accountability. This served to delegitimize the AHF’s original mandate and management structure from the perspective of both the electorate and opposition policymakers (cf. Toronto Star, 1987; Nikiforuk, 1995; Flanagan, 1998; Mumey, 1990-1994; Smith, 1987; Mitchell in Standing Committee, 1992; Taylor in Standing Committee Hearing, 1992; Dalla-Longa in Standing Committee Hearing, 1994; Warrack, 2009).

The Legislature and Cabinet were accused of managerial incompetence between 1988 and 1994 in particular. The gradual elimination of the Fund’s annual allocations served to confuse Albertans of the AHF’s already ambiguous mandate. Several underperforming and highly publicized investments throughout the 1980s buttressed these negative sentiments.¹⁰⁸ The end result of the fiscal and measurability sources of the AHF crisis was that the government’s hands-on managerial approach was condemned as woefully incompetent and captured by self-interested politicians (Public Meetings, 1997; Elniski, 2009). Performance benchmarks could not even be

¹⁰⁸ Among the most publicly criticized investment decisions were: inter-provincial loans made through the Canadian Investment Division which were characterized as ‘un-Albertan’; lowering interest rates to help homeowners just prior to the 1982 general election; establishing the venture capitalism firm of Vencap; investments in Miller-Western, who defaulted on their loans costing the AHF \$272 million by 1987 – although it was a ‘great investment from an operational and impact on community level’ (Elniski, 2009); and other questionable loans in the name of diversification to AL-Pac, Ridley Grain, and Murphy Oil, all of which were not required to pay interest or any principal until 2005.

assigned to AHF managers in the Cabinet and Treasury, rendering its management seemingly unaccountable to the domestic electorate. With exception to the small percentage of assets being invested under the CID, the AHF's only guidelines were to invest in either 'projects which by their nature will not yield a return of capital', or those that would provide an ambiguous '*reasonable* financial return' (emphasis added, AHF Act, 1976).

The fact that the AHF's government managers could not be 'fired' from their posts therefore led to the AHF being increasingly characterized as a government 'slush fund'. Even outside Alberta, widespread sentiment was that the Fund had been captured by self-interested politicians and rentier special interest groups (Mumey, 1990-1994; McMillan, 1995; Nikiforuk, 1995; Bercuson and Cooper, 1998; Flanagan, 1998; Johnson-Calari, 2007: 51; Cowper, 2007: 224). Many argued the AHF was in fact 'worse than useless' as it gave a false sense of affluence, which then led to the massive budgetary deficit (Review Committee, 1995; Mitchell in Standing Committee Hearings, 1994). A wide variety of policy papers were produced by opposition parties and privately-funded think-tanks between 1982 and 1994 that attacked the government's management of the AHF. They also offered a diverse range of recommendations, from liquidation to an exclusive focus on social welfare spending.¹⁰⁹ Thus throughout the early 1990s, it became increasingly clear that if the PCs were to retain their parliamentary majority, they could not maintain the status quo vis-à-vis the AHF and its role in supporting their unsustainable and highly undesirable approach to fiscal policy.

¹⁰⁹ These papers nonetheless primarily served to act more as a political strategy to undermine the PC's power rather than strengthen the AHF (NDP, 1981; Office of the Liberal Opposition, 1986; McEachern, Hawkesworth, Piquette, 1987; Institute of Chartered Accountants of Alberta, 1992; 1993; Alternative Solutions for Albertans, 1994; Office of the Leader of the Official Opposition, 1980).

6.3 The Alberta Heritage Savings Trust Fund (1994-1997): *Legitimizing the SWF Policy Path*

Section 6.2 demonstrated that while government's management of the Alberta Heritage Savings Trust Fund was criticized as early as 1982, public pressure to reevaluate its form and function became more pronounced between 1988 and 1994. This followed the government's landmark decision to abandon the AHF's savings function so as to support the budget in the face of shrinking resource revenues. This fiscal strategy was taken by Albertans as a gross abuse of the symbolically significant AHF. Indeed without these contributions, Alberta would eventually lose a major distinguishing feature of their provincial landscape. The continued decline in government revenues between 1988 and 1994 then gradually eroded even this function of the AHF, as the fiscal deficit soon became unsustainable (see Appendix 2). The Fund's lack of measurability in terms of both overall value and annual performance also meant that it was unclear as to how much the fund was worth, and even how beneficial it really was to everyday Albertan's. The AHF was thus increasingly referred to as a government 'slush fund' throughout media, accusations the PC majority found increasingly difficult to ignore.

In order to deal with these criticisms, the PC government – led by Premier Ralph Klein after his predecessor was ousted prior to the 1993 election – put the AHF into a passive state in 1994 and called for an extensive review of its form and function.¹¹⁰ In particular, the parliamentary appointed Review Committee was tasked to find ways the AHF could be re-tasked to more successfully support the short-term fiscal needs of government. This was both in terms of helping eliminate the budget deficit, as well as satiate the public's desire for change and increased accountability.

¹¹⁰ Thus in the transition phase of 1994 to 1997, no new investments other than those in the CID and cash and marketable securities portfolio could be made.

Following an extensive public consultation that consisted of provincial surveys, public hearings and roundtable discussions, the Review Committee reaffirmed that Albertans wanted to keep the AHF, but not at the status quo (Alberta Legislature, 1995: 3, 22). More specifically, the Committee recommended: (i) the government's relationship with the AHF should be limited to setting its objectives, (ii) private sector experts should be more involved with investment decisions alongside the Treasury, and (iii) the Fund should be made more transparent in its operations and objectives (Review Committee, 1995: 22-24).¹¹¹

Yet even with the eventual adoption of the SWF policy path in reaction to these recommendations, the AHF would continue to serve the short-term interests of government. What would change was the means through which this supporting role would be achieved, as well as how it was presented and promoted by government. First, the SWF policy path would help support the short to medium-term income needs of the government's fiscal plan. It was also thought capable of preserving the AHF's principle, meaning the Fund could once again be considered a savings fund Albertans could proudly support. Finally, the government would task themselves with promoting the reasoning behind the AHF's speculative approach to public capital management. This would help insulate MLAs from accusations of unaccountability and – perhaps ironically given the AHF's continued use to support annual budgets – shortsighted self-interest (cf. AHF Act, 1997: Sections 2-6).¹¹²

¹¹¹ This is not to say the Klein Cabinet saw the original AHF as all bad given the wide variety of beneficial projects it funded and its ability to stabilize provincial finances (Klein in Standing Committee Hearings, 1994). To say the Fund did nothing for Alberta would do both the government and the Fund itself a huge disservice. Rather, these MLAs recognized their predecessor's decision to redirect AHF capital to subsidize the budget eventually undermined their political legitimacy despite their best intentions. Indeed, redirecting a significant portion of its capital towards budgetary financing enabled Albertans to continue benefiting from Canada's highest level of public services but at no extra cost. Yet this practice proved unsustainable in the face of fluctuating petroleum revenues, for which MLAs were eventually criticized.

¹¹² It should be noted that one of the primary objectives that arose from the recommendations of the 1994 Review Process was to protect the fund's assets against the effects of inflation through inflation-

Yet how did the SWF policy path and the authoritative financial ideas substantiating its legitimacy come into the interests of Albertan policymakers over competing alternatives? Why did the government opt not to pursue these alternatives introduced both in and outside the Legislature from the late 1980s onwards? For example, why not liquidate the fund to pay down the deficit; improve the government's commitment to achieving long-term socioeconomic diversification; or make annual allocations to the Fund a permanent fixture of fiscal policy so as to discipline the budgetary process? In approaching these questions, this Section seeks to reinforce the theoretical claim that SWFs stabilize political actors' governance function when faced with problems of uncertainty. The epistemology of speculative finance upon which SWFs' legitimacy is based authoritatively coordinates socioeconomic expectations into the indefinite future. The funds enable governments to reconceptualise uncertainty as financial risk, while simultaneously placing the responsibility for management of this public capital at one remove of their auspices. For the Albertan government, the SWF policy path was pursued only after the AHF's original form and function was implicated with facilitating a wider budgetary crisis between 1988 and 1994.¹¹³ As such, the crisis not only posed a problem of uncertainty in regards to how the government could reassert the AHF's legitimacy, but also how to reassert their own appeal as ultimate governors of Albertan society. It served to reaffirm a long-standing belief that government could just not be trusted in a PC

proofing (Alberta Treasury, 1996: 4). Priority was, however, given to deficit reduction. The government was only required to inflation proof the fund once the deficit was entirely reduced, and then additional transfers could be made only if 'authorized by a Special Act' (AHF Act, 1997: Section 9-1). Between March 31 2005 and January 2008, the government has, however, transferred a total of \$3.9 billion from investment income and budgetary surpluses back to the fund (Annual Report, 2008).

¹¹³ This crisis was not all about ideas, but also the product of very real structural factors. Primary of these was the collapse of world energy prices which led to the expansion of the deficit in the first place. Thus there is a dialectical relationship between structural factors which can induce periods of uncertainty, and the ability of ideas to inform action in the face of this uncertainty. Emphasis here, however, is ultimately placed on ideational factors as the prerequisite for the construction of agency in situations of uncertainty. Only through analyzing ideas can the specific reasons for which the government opted to pursue the SWF policy path over competing alternatives be revealed.

dominated province where the ‘sanctity of property rights and a hatred of socialism almost constitute a secular religion’ (Pratt and Tupper, 1980: 260). The AHF was thus not reconceptualised as an SWF just as a profitable opportunity to be capitalized on as assumed by mainstream SWF analyses. Rather, it primarily represented a strategy of governance intended to avert a crisis of legitimacy the democratically-elected Albertan government found themselves facing.

6.3.1 The SWF Policy Path and the AHF Crisis – Fiscal

The fiscal source of the AHF crisis regards how the Fund was increasingly implicated with supporting an unsustainable budget deficit between 1988 and 1994. In response, the Review Committee concluded that the public majority demanded the Fund be reinstated as a savings vehicle. However, this conflicted with the government’s desire to have it support their short-term fiscal plan. Between 1994 and 1997, the first distinguishing feature of the SWF policy path – that AHF assets would be invested in a broad range of riskier assets in pursuit of returns above the risk-free rate – was gradually internalized as a means to achieve both these desires. The AHF was thus eventually tasked with new legislation to exclusively pursue the maximization of financial returns to the benefit of ‘current and future generations of Albertans’ (AHF Act, 1997: Preamble).¹¹⁴ It would at the same time be barred from making ‘economic development investments...[and] social investments’ of any kind. Instead, it was to base its investment criteria ‘solely on fundamental investment principles and strategies’ (Alberta Treasury, 1996: 4). This is opposed to the Fund’s original mandate which broadly stipulated ‘a substantial portion’ of resource revenues

¹¹⁴ Following recommendations made by an externally hired consultancy firm – Mercer Consulting – to Treasury officials, it was decided the AHF would invest 40 percent of its portfolio in Canadian and international equities and 60 percent in fixed income.

be 'set aside and invested for the benefit of the people of Alberta in future years' (AHF Act, 1976: Preamble).

Tasking the AHF to exclusively pursue financial returns into the long-term would thus reinstate the perception that the Fund was a savings vehicle for future generations. The epistemological authority exerted by the idea that riskier investments would be profitable in the long-term would then also reassert the government's credibility in regards to petroleum wealth management. Indeed, the AHF would continue to support the government's short-term fiscal plan, but the *idea* of financial profitability would recast it as an intergenerational savings fund. It was the epistemological authority commanded by this idea and the financial expectations it engendered that helped reassert the government's legitimacy in regards to AHF management, as well as overall fiscal policy. This idea of financial profitability meant the Fund would be earning investment income capable of stabilizing budgetary frameworks indefinitely. Investing in risky assets into the long-term would also preserve the AHF's principle, insulating MLAs from criticisms of fruitlessly wasting its capital as they had between 1988 and 1994. The SWF policy path thus appeared to provide a sustainable source of annual revenue not derived from highly volatile petroleum revenues. The first distinguishing feature of SWFs therefore represented a means to stabilize socioeconomic expectations in regards to AHF management, but without sacrificing its use as a supportive feature of Albertan fiscal strategy. How did this strategy, as underpinned by the idea of financial profitability, overcome competing alternatives proposed by various policymakers between 1994 and 1997?

To this effect, recall the AHF was partially tasked to generate financial returns in 1980 following the creation of the Commercial Investment Division. However, the CID managed only a small percentage of total assets and was limited to pursue a

predominantly conservative investment strategy. Beginning in 1988, however, the looming deficit led the AHF Standing Committee to begin recommending there should be an increased focus on generating short-term financial returns. More specifically, they recommended the Fund begin investing in more Canadian equities and that the CID's capital base should be expanded (Standing Committee Report, 1988; 1989). Given the province's fiscal position, Treasury and Cabinet officials by and large agreed an increased focus on returns to be within the government's interests (Treasurer in Standing Committee Report, 1989: 20). But still, they were unwilling to have the AHF exclusively focus on financial maximization as 'it would mean abandoning a balance of rate of return and economic development initiatives' (ibid. 23). In short, it would mean abandoning a major contributing feature to the province's socioeconomic stability and makeup.

It was not until 1993 that Alberta's rapidly deteriorating fiscal picture forced the government to reevaluate the means through which the AHF should be used to support its spending habits. By this time, gross government debt stood in excess of \$29 billion and was projected to grow in excess of \$35 billion in four years (Alberta Treasury, 1993). Premier Ralph Klein subsequently initiated an austerity program that cut government expenditures by 20 percent over four years. He also suspended the AHF's domestic investment activities – which had made these spending habits possible in the first place – and initiated an official review to reevaluate the way in which the AHF could support Albertan fiscal policy. What the Review Committee found was that the primary benefit of the AHF for government in the short-term could be isolated to the Commercial Investment Division (Review Committee, 1995: 7-9). The Cabinet reaffirmed these findings, citing those AHF assets invested in 'safe' debt instruments by the Treasury were 'competently managed on a day-to-day basis' and

required little government involvement (Klein in Standing Committee Hearings, 1994). The Review Committee then took these findings one step further and concluded the Fund should ‘focus on financial diversification using a number of different financial vehicles to maximize return on investments’ (Dinning, 1995; 1418).

While a far cry from the simple objectives demanded by the Albertan public – i.e. to keep the Fund but not at the status quo (AHF Review Committee, 1995: 22) – financial maximization through speculative investment fit well with the principles that motivated the review be held in the first place. Specifically that, should the AHF be kept, it would be tasked with ‘clear and measurable objectives’ and ‘a well defined investment strategy’ to support the government’s budgetary needs (ibid. 3). What were being reconsidered throughout the review process, then, were the way in which this supportive role was to be fulfilled and the official recognition that it was doing so.¹¹⁵ In light of these recommendations, a consensus spanning party lines began to emerge, which called for the AHF to greatly increase its focus on financial yield as a means of supporting Albertan fiscal policy. The lack of financial returns generated by the Capital Projects Division had by then become too much of a drain on the Fund’s institutional legitimacy (cf. Carlson, 1995: 1475; Standing Committee Hearings, 1994). In the face of \$30 billion deficit, anything that would not help stabilize provincial finances was deemed irrational and wholly irresponsible:

‘Any time we have funding in this heritage trust fund that is generating us a lower rate of return on what it is making than what we are paying, there is no

¹¹⁵ The Balanced Budget and Debt Retirement Act passed in 1996 stipulated that any income accrued to the AHF was first and foremost considered income of the government’s consolidated fiscal plan. This officially implicated future AHF revenues with the GRF’s bottom line, and thus the flexibility of setting and meeting annual budgets. In addition, AHF assets would be netted off gross liabilities of the net debt whereas previously they were considered an external government account and thus an unofficial alternative revenue source. This had enabled the government to engage in ‘circular accounting’ practices and ultimately undermined their commitment to the AHF’s savings function.

rationalization. There is no adjective except ineptitude that will describe that particular situation – Germain, 1995: 1433¹¹⁶

The diversified investment of its pre-existing capital base thus represented a means of supporting government's short-term interests, specifically its ability to reduce the destabilizing uncertainty they were subjected to by unsustainable fiscal policies. This is significant for the IPE literature on ideas and institutional change as it was the *belief* that riskier assets would be more profitable than the AHF's existing approach to sovereign wealth management that legitimated this large-scale transformation. The axiomatic notion of the equity-risk premium in particular enabled the government to convince themselves and eventually the public of the AHF's future profitability, thereby reasserting both their and the Fund's legitimacy in the short-term. Indeed, transforming the AHF in this way proved a contributing factor to the PC's success in the 1997 election, where they won 63 of the Legislature's 83 seats and made up the political ground they had lost in the 1993 election (Elections Alberta, 1997). The government argued in particular that 'equities have provided an average annual real return of seven percent and debt investments approximately three percent'. They then projected a financially-driven AHF would generate an annual return of 5.5 percent (Alberta Treasury, 1997: 9; Matheson, 2009). Hence not only could the Fund once again be considered an inter-generational savings fund, but it would also represent a legitimate and substantive feature of a seemingly sustainable Albertan fiscal policy.

Despite the PC's promotion of the ERP as an authoritative guide to action between 1994 and 1997, the minority opposition Liberal Party were initially opposed to recasting the AHF as a long-term financial maximizer. They preferred the Fund to

¹¹⁶ At the same time, however, Germain also argued in the same debates about the AHF in the following year that the government need not get involved with 'high-risk' investments to protect their 'nest-egg' (Germain, 1996: 1547).

be liquidated so as to pay down the deficit more directly (Taylor in Standing Committee Hearings, 1990-1992; Mitchell in Standing Committee Hearings, 1992-1994; Dalla-Longa in Standing Committee Hearings, 1994; Germain, 1995: 1433). The PCs nonetheless overrode this opposition quite easily, it being argued the SWF policy path would accommodate their historically spendthrift approach to fiscal governance into the long-term rather than offer a one-off solution. To do so, they once again called upon the authoritative idea that speculative diversified investment would earn, on average, a substantial 5.5 percent return. The Liberals could not offer a more legitimate or viable alternative to these assertions. Nor could they undermine the epistemological authority exerted by the notion of the equity-risk premium and the vaunted position it had held over the preceding five decades of financial practice and academia.

The opposition nonetheless continued to challenge the assertions of their PC counterparts on the basis that a financialized AHF to eliminate the debt crisis is 'based on pure speculation', and that 'just as likely as the stock market going up next year in this metaphysical bull market, it can go down' (Mitchell in Standing Committee Hearings, 1995: 22; Germain, 1996: 1547). However, such objections were limited to the PCs staunchest critics in the Liberal minority, as the majority of MLAs had trouble disagreeing with the appeal the SWF policy path presented to the future sustainability of Albertan fiscal policy. Here was a strategy of governance that seemed to provide a sustainable source of annual revenues, would appease the demands of the Albertan public, and at the same time insulate them from accusations of squandering public capital in self-interested pet projects (cf. Shariff in Public Meetings-Calgary, 1997: 5; Dinning, 1996: 1418). Thus by 1997, the vast majority of policymakers had fully internalized the idea that the SWF policy path would fill the

gaps left by the government's traditional approach to budgetary management (Doerksen in Public Meetings-Edmonton, 1998: 25; Dunford in Public Meetings-Calgary, 1998: 72; Melchin, 2002: 926; Elniski, 2009).

The AHF as an ardent risk taker and financial maximizer was thus eventually perceived as a means for government actors to stabilize their governance function in the face of criticisms of fiscal irresponsibility. It would effectively coordinate and manage domestic expectations as to how and what end the politicized and symbolic AHF would be managed. Speculatively investing AHF assets throughout the broader financial realm was thus not pursued due to any innate properties of finance as argued by mainstream SWF analyses. Rather, it was the authority exerted by the entirely theoretical and simplified idea of the equity-risk premium that won over competing strategies as to how the government could fill in the gaps left by their previously unsustainable approach to fiscal governance. And despite being introduced as a viable option the government should willingly pursue as early as 1988, it was not deemed as such until it met the short-term interests of the debt-laden Klein government in 1997. Yet recall that the AHF was also subject to a crisis of measurement. The new AHF would thus also need to be more transparent and easily communicable to the Albertan public than its predecessor. The SWF policy path once again provided a means to solve this problem by simplifying the AHF's communicability to the quantitative language of financial risk and return.

6.3.2 The SWF Policy Path and the AHF Crisis - Measurement

The use of risk-based investment techniques to support the AHF's new financial mandate provided a communicable means of measuring the AHF's performance. To be sure, measurement of the AHF's performance between 1976 and

1994 was handicapped by the multiple and often contradictory objectives it was tasked to pursue. This produced much confusion as to what the AHF should be doing let alone how well it was doing it. For example, the long-term success of economic diversification and welfare projects required the government to hand-pick which sectors of Albertan society should benefit from AHF investment and how. This required them to maintain stringent oversight of these projects so as to keep them in line with the popular interests of the Albertan electorate. The success of the savings objective, on the other hand, demanded the government minimize its involvement by delegating oversight to experts in the Treasury more familiar with central bank-style fiscal management strategies.

These contradictory notions of how AHF capital could be legitimately used created much confusion as to how the government should approach Fund management between 1976 and 1994. This made making comparisons to other public funds altogether impossible for Cabinet and AHF Standing Committee members (Dinning in Standing Committee Hearings, 1996). The lack of such comparability proved highly problematic for these MLAs, who were replaced in their oversight capacities every four years. Comparing the AHF to a similar fund would have allowed newly elected or reshuffled politicians to gauge performance. More importantly, it would also provide them with a precedented guide to action in regards to AHF management. Establishing investment benchmarks based on the pseudo-science of financial risk management would thus simplify as well as stabilize the way in which successive governments would approach AHF oversight. No matter their lack of experience with speculation, MLAs would be able to monitor and communicate AHF investments and investment strategy through the prescriptive language of risk and return. According to the Review Committee, this strategy would make the AHF's

objectives and execution of those objectives ‘more simple...more straightforward...more easily comparable to other funds that have an asset mix of where we [the government] want to be’ (Dinning in Standing Committee Hearings, 1996). Indeed if the AHF were to be made more measurable by comparing it to other public funds, it made ‘good, common sense to have a balanced portfolio’ consisting of a diverse range of equity and fixed income assets (Carlson, 1995: 1476). The so-called ‘prudent person rule’ was written into the 1997 AHF legislation to ensure this would occur.

To this effect, the prudent person rule clarified – or perhaps constrained – the means through which the AHF’s now financial performance could be judged. It stipulated the Treasurer as operational manager: ‘shall adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss’ (AHF Act, 1997: Section 3-4). It would thus ensure AHF managers conform to the expectations demanded of modern portfolio theory, specifically that ‘the prudent investor controls risk by intelligent diversification’ (Mintz et al, 2007: 46). Hence from 1997 onwards, only the continuous diversification within and between riskier assets would be deemed a legitimate use of AHF capital (cf. Mitchell in Standing Committee Hearings, 1992). This would at the same time appease the demands of an Albertan public long-since disillusioned with the ambiguities of the Fund’s original form and function (Carlson, 1995: 1476; Mitchell in Standing Committee Hearings, 1992; Review Committee, 1995: 7-9). The expected return of 5.5 percent the government projected the AHF to generate then helped indicate the level at which these performance indicators should be set (cf. Alberta Treasury, 1997). Thus with the guidance provided by the prudent person rule – and its ability to tame the

unpredictability of speculative finance through risk management – the AHF began to actively embed Albertan public capital throughout the global financial realm.¹¹⁷

However, recasting the management of the AHF in terms of financial risk is not without its problems. It seeks to portray uncertain financial futures as predictable and controllable despite the periods of ‘irrational exuberance’ and crisis that render this strategy empirically untenable. Financial economists have yet to deal with the problems early theorists such as Knight (1921), Hardy (1923) and Fisher (1930) encountered when approaching financial uncertainty as a measurable concept (cf. Chapter Three: Section 3.2). What distinguishes socioeconomic or political uncertainty from its financial equivalent is a matter of axiomatic principle: specifically the belief that financial uncertainty is probabilistically measurable as risk, and that this provides an accurate reflection of how the financial realm behaves. Yet it is precisely because these ideas reduce the epistemology of speculative finance into a seemingly manageable language of risk and return that the SWF policy path appealed as a strategy of governance to Albertan policymakers. The continuous diversification of AHF capital to manage risk provided a means against which the Fund’s success or failures could be readily tracked, measured and communicated. Even with this increased capacity to measure performance, however, the management source of the AHF crisis remained unresolved. That is, who could be deemed prudent enough to delegate operational authority for AHF management if, as Premier Klein famously declared in his 1993 electoral campaign, government was ‘out of the business of business’? How could MLAs distance themselves from these experts, but also ensure they remained committed partners in supporting the government’s short-term fiscal plan?

¹¹⁷ Using the prudent person rule as a guideline for rational action, the Treasury determined a basic asset mix of 40 percent equity and 60 percent fixed income best met the government’s preferred risk tolerance.

6.3.3 The SWF Policy Path and the AHF Crisis – Management

Between 1988 and 1994, the AHF was portrayed throughout policymaking circles and media as ‘a politicians’ slush fund, out of which money could be shovelled for whatever happened to be going by at the time’ (Germain, 1995: 1432). Both the Cabinet and Legislature were accused of unaccountability for eliminating the AHF’s savings function, and fiscal irresponsibility for the way in which this decision facilitated the growth of a \$30 billion deficit. While these same Albertans contradictorily demanded a high level of public services but funded by the country’s lowest tax rates, their calls for change nonetheless brought the PC’s pre-existing approach to petroleum wealth management into question. Revision of this relationship thus represented a first step towards ensuring they commit themselves to a more sustainable fiscal strategy (Dinning in Standing Committee Hearings, 1996). The SWF policy path consequently provided a desirable means through which MLAs could define and reassert their uncertain identities in relation to both AHF management and budgetary politics.

To this effect, the SWF policy path would ensure the government increased its reliance on financial experts divorced from the political arena to oversee the day-to-day management of the AHF. This complimented a primary recommendation of the Review Committee, which was to distance the Legislature from Fund management as much as possible. As stressed by one member of the Commission:

‘Albertans want accountability, but they also see the need for external experts to play a more active role in making investment decisions. As one person, I gather, said to the committee: I didn’t elect my MLA to be a banker...I couldn’t agree with that individual more’ – Dinning, 1995: 1419

This suggests that from the very start of the transition period, both policymakers and the general public saw financial expertise as synonymous with increased

accountability and good governance. From a political standpoint, then, placing the government at one remove of AHF management represented a means to support their legitimacy in the destabilizing wake of the broader politico-economic crisis. This is opposed to dominant SWF analyses that treat financial expertise as necessary for strictly financial purposes – i.e. to increase an SWF’s institutional sophistication and hence capacity to earn returns.

It is nonetheless worthy to note that despite its chequered history, the AHF was the driving force behind a variety of beneficial programs and initiatives that would not have otherwise occurred. Throughout this time, however, MLAs became increasingly aware that establishing medical research facilities, venture capital corporations and provincial parks were generating little financial or lasting *political* returns (Elniski, 2009; Matheson, 2009; Warrack, 2005). Opposition Liberals and majority PCs subsequently grew ever more frustrated with the AHF’s shortcomings in the face of the mounting deficit. Between 1994 and 1997, there emerged a gradual consensus that the Fund was and always had been created with the best of intentions, but was contributing little to either fiscal or political stability. These frustrations were compounded by the increasingly vociferous cries the AHF was ‘poorly implemented, poorly administered, and poorly protected for Albertans of the future’ (Germain, 1995: 1432; cf. Sekulic, 1995: 1533; Warrack, 2009; Elniski, 2009). The AHF’s problem was thus gradually understood as not just the product of its socioeconomic objectives as much government’s heavy handed approach to its management. They saw how their predecessors had used the AHF in much the same way they also intended to, but through a confusing, domestically polarizing, and altogether unsustainable approach. It was consequently believed that for the newly financialized AHF to avoid a similar fate, MLAs would be required to distance themselves as much

as possible from its investment portfolio, if not its investment returns (cf. Hewes, 1995: 1478; Carlson, 1995: 1475; Sekulic, 1996: 1533). Depoliticizing this aspect of government's fiscal governance function would thus satiate the public's desire to increase AHF accountability. At the same time, it also appeared capable of increasing the government's ability to reduce the deficit by increasing the AHF's financial returns (Hewes, 1995: 1477; Dalla-Longa, 1996: 1549-1552).

It should be noted that the idea to place the Cabinet and Legislature at one remove of AHF management was a recurrent theme in Legislative debates since 1976 (cf. Lougheed, 1976*a*: 81; Pratt and Tupper, 1980: 259; Warrack, 2009). Yet it was not seriously considered until 1994, when MLAs perceived themselves as unable to maintain the status quo without suffering significant political consequences (cf. Standing Committee Hearings, 1992; Review Committee, 1995). Depoliticizing AHF management was nonetheless resisted even in the months leading up to the Fund's official Review. Premier Ralph Klein would maintain right up until suspending the AHF's activities that, as opposed to his predecessors, he had little input on where or how the Fund's assets were to be invested. Indeed, most of its capital had by then already been locked into various domestic development projects or budgetary outlays. Klein argued further depoliticization of management was unnecessary given the AHF's already substantial commitment to supporting the current budget (Klein in Standing Committee Hearings, 1994). These sentiments were, however, made before the government had resigned itself to the fact that the AHF needed a complete overhaul. To be sure, the Cabinet and then PC majority's opinion towards AHF management changed in early 1994 when it became clear the provincial debt would be approaching an unsustainable \$30 billion following that year's official Budget Report (Alberta Treasury, 1994). This was in addition to the criticism the AHF was

receiving for enabling this deficit to swell uninhibited. According to one member of the AHF Review Committee in the face of these developments, increasing their dependence on financial experts appeared to help solve both of these issues:

'I pushed for a greater private-sector role in the management of the fund [because] I thought private-sector managers would be very aware of the linkages between our debt management strategy and our financial asset management strategy. They would look at what was in the best interests of the province in terms of both strategies' – Percy, 1995: 1421

The SWF policy path was thus never intended to lessen the Albertan government's authority over AHF management so much as arena-shift it. Indeed, the majority of managerial authority in regards to the AHF's form, function and relationship with Albertan society would remain under the purview of the Cabinet and Legislature. What the 1997 AHF Act did ensure was that the Treasury was delegated responsibility for setting and operationalizing the Fund's investment strategy, displacing both the Cabinet and Legislature in this regard (AHF Act, 1997: Section 7).¹¹⁸ This was to be overseen by the Investment Management Division (IMD), a direct descendant of the favoured Commercial Investment Division.¹¹⁹ Also under the new regime, the AHF Standing Committee would now represent the Legislature by reviewing triennial AHF business plans and annual reports written by the Treasury (AHF Act, 1997: Section 6).¹²⁰ This transformed the Standing Committee into an intermediary between AHF management, the Legislature, and Albertan society. It

¹¹⁸ The Act also established the Operations Committee to act as advisor to the Treasury, and was chaired by the Provincial Treasurer and composed of a voluntary group of 'a majority of private sector members with business and financial expertise' (Alberta Treasury, 1997: 14).

¹¹⁹ While the IMD would be responsible for the day-to-day management of the Fund's investment activities, it also played an active role in setting the AHF's strategic asset allocation 'because they are the investment experts' (Matheson, 2009). The IMD would nonetheless remain under the purview of the Treasurer who would ultimately determine how the Fund should be invested at the 'strategic level...because nothing is guaranteed at the investment level' (ibid). Even still, the Legislature would maintain control of the Fund's investment income (both in terms of inflation proofing and allocations to the General Revenue Fund), as well as their ability to change the AHF's investment policies, mandate, and basic objectives. The Legislature would also maintain much informal authority through its ability to exert pressure on personnel within the Treasury overseeing the Fund (ibid; Elniski, 2009).

¹²⁰ Approval of the AHF's Business Plans by the Legislature's Treasury Board was also a new requirement introduced in 1997, thus providing MLAs with another check on the AHF's form and function.

would thus also serve to act as the SWF policy path's promotional agents rather than its watchdog. Their primary task would not be to oversee and manage the Fund's investment strategy so much as to promote the modern financial epistemology from which its legitimacy derived. Incidentally, they would also be promoting the legitimacy of the AHF as a significant supporting feature of fiscal policy in general.

This management structure introduced by the 1997 AHF Amendment Act therefore reinforces the argument the SWF policy path was initially pursued as a means to support the short-term interests of government. This point was reiterated on various occasions throughout the AHF Standing Committee's first promotional campaign:

'By 2005...it's possible that by then there will be a whole new set of circumstances and we'll be able to access as much or as little [of the AHF] as we want. It will depend on how tied to current legislation at that time the government wishes to be' -- Zwozdesky, 1997: 7

What the 1997 Act had changed was the specific means through which the AHF would pursue its supportive role. Yet at the same time and perhaps unbeknownst to MLAs, the SWF policy path not only depoliticized authority away from their auspices in an operational or functional sense of the term. Authority was also ideationally depoliticized in the sense that government actors would be subjecting their capacity to act to the guiding prescriptions of modern financial epistemology. What could be considered legitimate uses of AHF capital would be only those actions that sought to maximize financial return while minimizing risk through extensive diversification. Institutionalization of the so-called prudent person rule ensured this. Put simply, neither Treasury nor Legislative officials could have the AHF engage with capital intensive economic development projects to generate returns, the strategy pursued by venture capitalists. Nor could they simply save by investing in highly-safe fixed-income securities as pursued by central banks, as this would mean incurring large-

scale opportunity costs given an expected 5.5 percent annual return. The SWF policy path was therefore intended to support fiscal policy, make AHF performance more measurable and communicable, make the Fund appear less susceptible to Legislative manipulation, and thus appear more accountable to the Albertan public as a long-term savings fund.

Conclusion

The preceding Chapter demonstrated how the SWF policy path was internalized by the Albertan government as a means to address a politico-economic crisis that grew in intensity between 1988 and 1994. The exclusive pursuit of financial maximization would simplify the Fund's pre-existing objectives, which had gradually lost legitimacy throughout this period. It would also enable investment benchmarks to be set against which the Fund's performance could be readily gauged and communicated in precise mathematical terms. Re-tasking the AHF in this way was not therefore pursued to capitalise on rationally desirable investment opportunities as currently assumed in the SWF literature. Rather, this transformation into financial speculator was meant to increase the Fund's measurability, transparency, and accountability. Indeed, if all managerial decisions were made by financial experts with purely commercial objectives in mind, government actors could not be held to account for losses accrued from expected – albeit unpredictable – market fluctuations and crises. What's more, the SWF policy path was fully expected to help stabilize volatile government revenues by generating financial returns into the long-term. Deconstructing the authoritative financial ideas substantiating the SWF policy path thus reveals an alternative explanation for this fiscal strategy's *political* appeal. Institutionalization of these ideas in a reconceptualised AHF would stabilize MLAs'

governance function in regards to Fund management, thereby helping reassert their legitimacy as governors of Alberta's highly scrutinized petroleum wealth.

As compared to the alternatives strategies proffered by opposition parties, the SWF policy path appeared capable of stabilizing provincial finances while simultaneously insulating MLAs from criticism of their role in AHF management. An investment portfolio exposed to higher degrees of financial risk would provide a renewable source of annual income, while at the same time recasting the symbolically significant AHF as an inter-generational savings fund. Belief in speculative finance's calculability complimented this objective by providing a readily actionable plan through which returns could be maximized and risk of losses minimized. It would also address the problems with the Fund's measurability, which cast the AHF as opaque and unaccountable to the domestic electorate. Finally, the idea that financial experts were more qualified to oversee the AHF's new financial mandate addressed the Fund's managerial problems, which undermined the government's legitimacy as AHF managers. Each feature of the SWF policy path enabled the government to construct and promote forward-looking projections as to how and to what ends the AHF would be used, and in a way Albertan's could identify with. It enabled government actors to stabilize short-term socioeconomic expectations in regards to the AHF's relationship with fiscal policy and Albertan society as a whole.

Yet the fact that political agency was a prerequisite for the AHF's reconceptualisation as a long-term financial maximizer is not a revealing claim in itself. The AHF's public source of funding leads to the logical conclusion that the SWF policy path was favoured by MLAs as it would serve their interests in one way or another. What is worthy of note, however, is the way in which this strategy won over competing alternatives. The way it came to constrain political agency only after

it was institutionalized is also significant. It was the way in which SWFs' ideational underpinnings came to determine MLAs' understanding of legitimate versus illegitimate action that proved problematic. To be sure, the government had no intention for the AHF's financial performance to be as scrutinized an issue as it became from 1997 onwards. Its returns were almost immediately seen as a symbolic representation of MLA's capacity to govern as these returns were meant to finance annual budgets. In this way the AHF actually came to constrain rather than enhance MLAs' capacity to govern Albertan fiscal policy. Given the authoritative prescriptions of modern financial epistemology, MLAs could only continue to more extensively diversify Fund assets in pursuit of the financial returns upon which their political legitimacy would increasingly depend. To be sure, the AHF gradually expanded its investment universe and deepened its global financial embeddedness between 1997 and 2009. Moreover, political legitimacy would become implicated with MLAs' ability to normalize and legitimate the speculative financial ideas upon which the new AHF was based. That is, the government was obligated to promote the narrative of long-term market efficiency, profitability and calculability as capable of benefiting Albertan's in the short-term. This was lest they once again be accused of fiscal irresponsibility and unaccountability. They would consequently have to maintain this narrative in the face of two globally reverberating financial crises between 1997 and 2009. This was so as to recoup the losses that decimated the Fund's returns, as well as to avoid being accused of illegitimately tampering with its management. The following Chapter now further analyzes how the SWF policy path and its ideational foundations came to constrain the interests of government actors in Alberta between 1997 and 2009.

Chapter Seven: *Alberta's Heritage Savings Trust Fund (1997-2009)*

The Alberta Heritage Savings Trust Fund was reconceptualised as a sovereign wealth fund by legislation passed in 1997. The preceding Chapter argued the long-dominant Progressive Conservative majority strategically pursued this legislation in attempts to address a domestic politico-economic crisis undermining their political legitimacy. This account differs from that offered by mainstream analyses that assume diversified investment of sovereign wealth to be a naturally desirable fiscal strategy all government's should willingly pursue. Such accounts render the state and political agency latent variables when accounting for the global emergence of SWFs. They also ignore the influence of ideas and the politics of idea construction to inform agency in the face of uncertainty. Indeed while a continuous presence throughout the AHF's history, uncertainty in regards to the government's relationship with petroleum wealth management was heightened by this politico-economic crisis between 1988 and 1997. This uncertainty served to undermine the original ideas upon which the AHF's institutional legitimacy was based – those of savings, socioeconomic development, and welfare spending in particular. They also cast the legitimacy of MLAs – especially those of the PC majority – as governors of Albertan society in doubt. It was only then that the PC majority promoted the SWF policy path as a viable strategy of governance throughout the Legislature. This was despite similar arguments being recommended by the AHF Standing Committee as early as 1982. Hence between 1997 and 2009, the AHF was restricted to invest in financial assets thought capable of maximizing returns in the long run. Any project or investment opportunity

that did not meet these criteria would be deemed interventionist and threatening to both socioeconomic as well as political stability.

In spite of this dramatic transformation, the re-drafting of the original AHF Act only marked the beginning of the changes the Fund and its relationship with fiscal policy would undergo between 1997 and 2009. Albertan policymakers would continue to be guided by the expectations of legitimate action prescribed by modern financial epistemology. This was in their attempts to better address the fiscal, measurement, and management sources of the politico-economic crisis that led to the AHF's transformation in the first place. In so doing, the SWF policy path not only transformed the institutional structure of government apparatus, but also shifted MLAs' understanding of what constituted best practice in their approach to fiscal governance. This continuing development of the AHF can be attributed to the continued prevalence of uncertainty in regards to AHF management and its importance in supporting MLAs political legitimacy throughout this period. To be sure, a number of questions as to what long-term purpose the Fund actually served continued to plague the Legislature despite the definitive language of the 1997 AHF Act. As stressed by the Minister of Revenue five years after the SWF policy path was adopted, MLAs remained unsure of the AHF's position in overall fiscal policy:

'How should any savings be used in the future and what should the investment objectives of the savings be? Should the savings be maintained in the [AHF] or in some other vehicle? Before we start clarifying even the objective of the [AHF], I think it's important to realize: to what end and what size should that fund be? What would be the investment purposes? Who'd be the beneficiaries of the income?' – Melchin, 2002: 913

The SWF policy path thus initially appeared to increase the government's agency by freeing it from the responsibility of managing the highly scrutinized and politicized AHF. It was also believed capable of providing them a replenishable source of annual income independent of volatile world energy markets to support

each year's budget as they saw fit. Yet between 1997 and 2009, the SWF policy path and its underlying ideas would gradually come to constrain rather than enhance the government's approach to petroleum wealth management, as well as overall fiscal policy. This constraint would come in three forms. First was in terms of its influencing government's understanding of how the AHF could be used to continue supporting annual budgets. This was even after the provincial deficit was reduced. This subsequently led them to approve of an expansionary investment universe, which increased the spatial and functional embedment of AHF capital throughout the financial realm. Indeed, modern financial epistemology dictated the only way through which the AHF could increase its returns was by adopting more types of risk through increased diversification. This had the effect of limiting the ways in which this capital could be used to benefit Albertan society, and arguably facilitated rather than contained the Albertan government's propensity to spend in a sustainable manner.¹²¹

Adoption of the SWF policy path also led MLAs to establish the Alberta Investment Management Corporation (AIMCo) to manage the Fund's expansionary investment universe. This increased MLAs' dependence on the epistemological authority exerted by financial experts to guide their approach to fiscal policy. This constraint grew especially pronounced after an additional \$45 billion was delegated to AIMCo's auspices in 2008. Finally, the government was also constrained between 1997 and 2009 by their increased dependence on the SWF policy path as a strategy of governance that supported their domestic political legitimacy. Indeed, MLAs would see their interests in regards to AHF management be increasingly dependant upon the guiding influence of modern financial epistemology and its fallacious presuppositions. They would also come to preoccupy themselves with actively and

¹²¹ Between 1982 and 2001, expenditures outpaced inflation and population growth by 1.7 percent, then by 0.9 percent between 2001 and 2006. Without the aid of the AHF, the government would have experienced deficits five times between 1994 and 2006 (Milke, 2006: iv-v).

aggressively promoting the validity of this knowledge framework and the risk-laden financial practices it legitimated. As such, the expectations of legitimate action prescribed therein would be rendered increasingly synonymous with Alberta's socioeconomic interests. Indeed, the SWF policy path would be retained and even more vigorously promoted following two socioeconomically destabilizing financial crises between 1997 and 2009. This is despite each of these crises demonstrating the fallacious nature of SWFs' underpinning logic.

These arguments will be explored in three parts. Section 7.1 argues the rapid expansion of the AHF's investment universe was the direct result of the authority exerted by the idea of financial profitability. This increased exposure to risk was, however, pursued in an attempt to enhance the AHF's expected short versus long-term returns, which became a regularly relied upon source of budgetary financing. This served to increase the vulnerability of annual budgets – and by extension socioeconomic stability – to the contradictions and crisis tendencies of the speculative financial realm. Section 7.2 then details how the ideas of financial expertise constrained MLAs' approach to fiscal governance by placing them at one remove of AHF management, and then public capital management in aggregate through the establishment of AIMCo. MLAs would thus come to increase their dependence on the epistemological authority of politically independent financial experts to support both their fiscal governance function as well as political legitimacy. Section 7.3 then examines how MLAs were problematically constrained to maintain their support of these two aforementioned developments in the face of global financial crises between 1997 and 2009.

7.1 The AHF as Constraint (1997-2009): *Increased Risk Exposure*

From 1982 onwards, the AHF's investment income was transferred to the General Revenue Fund (GRF) to meet the day-to-day priorities of government.¹²² Following the 1997 AHF Amendment Act, this income would be generated strictly through speculative financial investment. This strategy was a prominent feature of the PC's electoral platform as they had 'staked out such a huge piece of political territory on debt retirement' in the 1993, 1997 and 2001 general elections (Sapers, 1999: 332; Melchin in Standing Committee Hearings, 2002). Indeed, their commitment to debt reduction with the help of the AHF gained 'overwhelming support' from Albertans from 1997 onwards (Melchin, Hansard 2002: 221, 915; cf. Alberta Treasury, 2003: 5; Mintz et al, 2007). Debt has in fact been directly equated with taking an excessive risk a number of times in the Legislature since the 1970s. MLAs have maintained that debt has the potential to drag Alberta's petroleum-driven growth story to a halt, and the notion that debt 'is like a straightjacket' has been 'hammered into the public consistently'. As such, Albertans are uniquely 'conditioned to reject debt' to a greater extent than their provincial counterparts (Elniski, 2009; Review Committee, 1995). That the financialized AHF was tasked to address such a scrutinized issue highlights the faith government had placed on financial speculation to support their political legitimacy.

In 1997, the AHF was divided into two accounts: one to enhance the Fund's debt reduction capacities, and the other to maintain its appearance as an intergenerational savings account. On the one hand, a 'Transition portfolio' of \$10.6

¹²² This was with exception to some ad hoc inflation proofing in 1997, 1998 and 2000 totalling \$431 million (Johnston in Standing Committee Hearings, 2007). Then following the reduction of the net deficit in 2004 the fund was mandated to be inflation proofed by retaining a portion of its investment income.

billion was to be invested in short-term, highly liquid fixed income securities with an emphasis on immediately generating interest income. At the same time, a \$1.3 billion 'Endowment portfolio' was to be invested in those riskier assets that would maximize and preserve financial returns into the long-term (AHF Act, 1997: Section 2-3). Then over a ten-year period, the Transition and Endowment portfolios would be merged as the deficit presumably shrank. This transfer process was, however, rushed to completion in only five years as the Treasury convinced MLAs the Endowment's riskier and long-term focus could better serve their short-term needs. The Treasury thus began to rapidly expand the Endowment's already aggressive investment universe of 40 percent equity and 60 percent bonds, just as its capital base began to swell. This trend was guided by the assumption that diversification would maximize financial return while simultaneously controlling for increased financial risk. This trend continued such that by 2009, the AHF's investment universe came to include a wide variety of riskier asset classes and markets.¹²³ Thus between 1997 and 2009, MLAs' developed a penchant for risk in efforts to increase the AHF's short-term returns. This was despite financial theory only legitimating such risk levels for long-term investors. How does the ideational constraint of the SWF policy path – in conjunction with structural factors that faced MLAs – help explain this development in Alberta? What future implications would this development pose for MLAs' approach to fiscal governance?

¹²³ This asset mix included: 45 percent public equity (15 percent Canadian/15 percent US/15 percent non-North American); 24 percent fixed income; ten percent real estate; six percent absolute return strategies; six percent private income; six percent private equity; two percent timberland investments; and one percent short term money market securities (Annual Report, 2008). Then in 2009, the Legislature approved a new asset mix for the AHF driven by a wish to increase flexibility of decision-making. The new asset mix would comprise 35-70 percent equity, 30-45 percent money market and fixed income, and 15-40% inflation sensitive (eg. Real Estate) and alternative assets (Matheson, 2009). There are also intentions of diversifying further into emerging and other international markets (Parihar in Standing Committee Hearings, 2008).

To this effect, government spending increased by 27 percent between 1999 and 2001 on the back of increased petroleum royalty revenues following Premier Klein's four year austerity program (Kneebone, 2004: 8; cf. Gibbins and Van der Ploeg, 2005: 15). As such, the AHF once again became a coveted source of support for annual budgets, and not just a vehicle for debt-reduction (Annual Report, 2009: 8; see Appendix 2).¹²⁴ Treasury officials were subsequently pressured to generate speculative financial returns through the now dominant and riskier Endowment portfolio. As commented by the Treasurer in regards to this emerging role of the financialized AHF:

'[It's] very critical that you look not just at how do we spend the money, but how do we ensure that you and I create sufficient wealth to pay for all that we'd want? How do we create a bigger pie? It isn't about just splitting up a pie that's of the size that we know today. How do we make it bigger so that we can have more of all the things that we value, so that we can have more to sustain the self-reliance?' – Melchin, 2002: 915

Constraint was thus witnessed in how the only means of achieving this objective according to financial experts in the Treasury was to expand the AHF's investment universe. This meant subjecting the AHF and, by extension, budgetary stability to increased but seemingly more manageable levels of financial risk.¹²⁵ The Transition

¹²⁴ Between 1997 and 2007 prior to the last crisis, the AHF contributed to 6.3 percent of total government revenues through its investment income, or approximately \$9 billion. This income was, however, primarily derived from the AHF's safer fixed income versus riskier equity assets (Gartner, 2007: 16; Gibbins and Vander Ploeg, 2005: 16-17).

¹²⁵ The Fiscal Responsibility Act (FRA) came on the back of the 1997 AHF amendment and had the effect of further implicating AHF returns with the government's long-term fiscal strategy. Passed in 1999, the FRA stipulated that (i) the government was to eliminate the Province's accumulated debt by March 31 2025, (ii) that annual budgets must be balanced, and (iii) the Treasurer was to inflation proof the fund only when the government had the revenue to do so (FRA, 1999: Section 2.1). The FRA was consequently characterized as an attack on the future growth of the AHF by opposition parties within the Legislature. They argued it incentivized the Treasury to rely on AHF capital and investment income when drafting each year's budget rather than save this money or inflation proof the fund (Sapers, 1999: 332). Thus in order to appease these criticisms and protect the AHF's existing principle, the Alberta Sustainability Fund (ASF) was established by a 2003 amendment to the FRA following a recommendation of the Financial Management Commission (Gartner, 2007: 10; Kneebone 2004: 8). As an account within the GRF, the ASF was meant to provide a cushion for volatile resource revenues, prevent AHF capital from being used in the short-term by deficit-plagued governments and thus appeared to suggest the Alberta government's increased commitment to the AHF's savings objective. By the time the ASF was created in 2003, however, the Heritage Fund had already become a much

portfolio's conservative approach to generating investment income was thus gradually cast as inefficient by Treasury officials between 1997 and 2002, who instead favoured the Endowment portfolio's risk-derived returns. Indeed, these returns swelled on the back of the Dot-Com Bubble, generating approximately \$3.8 billion in investment income from the AHF's \$12.4 billion portfolio between 1997 and 2001.¹²⁶ This booming financial environment lent weight to the Treasury's arguments that, while increased financial risk was profitable in the long-term, it was also potentially profitable in the short-term. More specifically, the Treasury framed their recommendations as befitting the government's short-term interests by arguing they could 'turn the AHF's portfolio over' – or buy and sell equities each year to realize capital gains (Day in Standing Committee Hearings, 1999). This was a much riskier investment strategy than that presented to the Legislature between 1994 and 1997, and contradictorily applied SWFs' long-term investment logic to a short-term timeframe. Yet as argued by the Treasurer of the time:

'[Y]ou're increasing your risk relative to being invested totally in bonds, but you've minimized the risk when buying into indexes....When you see our return this year on the [Toronto Stock Exchange], it's something like 28 percent. If we continued to be weighted on the bond side...then I think our citizens and other people who watch what funds are doing could properly criticize us for being too cautious. People would say: why are you languishing at these lower levels?' – Day in Standing Committee Hearings, 2000

What is noteworthy here, then, is how the expectation of financial profitability led government to strategically rethink the role of the AHF in supporting their governance function. The idea of the ERP legitimated the AHF's creation, while the inherent profitability of risk continued to inform – or perhaps constrain – government's view of how to structure the AHF and its relationship with fiscal policy.

coveted source of annual income to keep budgets balanced. The ASF stood at a value of \$7.7 billion in 2006-2007 (Gartner, 2007: 10).

¹²⁶ On the back of booming equity markets riding the Dot-Com Bubble, the AHF generated \$932 of investment income in 1998, \$1.169 billion in 1999, \$706.2 million in 2000, \$206 million in 2001, but then nothing in 2002 due to an \$894 million investment loss (Annual Reports, 1998-2002).

As will be further examined in Section 7.3, the authoritative influence of these expectations ultimately exposed both government and socioeconomic stability to the volatile day-to-day swings of the broader financial realm. In any case, these ideas led government to accelerate the transfer of AHF assets from the Transition to Endowment portfolio between 1997 and 2002, and just as they were invested in an increasingly diverse array of asset classes and markets. The Treasury believed that this would ‘get those increased returns coming in faster than they normally would have’, never entertaining the notion of this risk’s potential downside (Pugh in Standing Committee Hearings, 2000). When pressured to maximize financial returns, AHF managers in the IMD could only offer recommendations that would increase their exposure to alternative forms and degrees of financial risk (cf. Pugh, AHF Standing Committee, 2000).

This ideational constraint of the SWF policy path is problematic as it limited how the AHF could be used to benefit Alberta’s petroleum-dependant socioeconomy. Indeed between 1976 and 1994, the AHF generated approximately \$21 billion in investment income, earning an average return of 3.98 percent on its investments. Chapter Six demonstrated how this income primarily served to fill the gaps left by petroleum-income dependant budgets, but while simultaneously funding a number of social welfare and economic diversification projects.¹²⁷ While some investments were not well received by the public due to their lack of transparency, a number of beneficial and even profitable foundations established by the Fund remained

¹²⁷ The government accrued \$149.6 billion in resource revenue between 1976 and 2007, \$13.5 billion or 8.3 percent of which has contributed to the AHF’s capital base. Conversely, the provincial government has lost between \$50 and \$100 billion in petroleum resource revenue to the federal government since 1980 due to the National Energy Program (Gartner, 2007).

operational in 2009.¹²⁸ With the 1997 reconceptualisation, however, such socioeconomic investments were deemed incompatible with the maximization of financial returns. The government would instead be constrained to rely upon the AHF's investment income to indirectly fund such socioeconomic development projects through GRF expenditure. As summarized by the Treasurer in 2002:

'[I]t was thought better to let [investment] income go to general revenues so that the overall priorities of government in its business planning set the priorities of how to spend money rather than having a separate heritage fund pot of money that people could come to for separate priorities...Let the income of the fund service part of those priorities, like health and education, rather than creating a separate stream of priorities – Melchin in Standing Committee Hearings, 2004

Thus at first glance, reconceptualising the AHF as an SWF appears only to arena-shift the source of funding for social development and economic diversification projects. In short, direct funding from surplus petroleum wealth would be replaced with the indirect financial returns generated through diversified speculation. This strategy nonetheless subjects the capacity of government to support these typically long-term development projects to a very short-term horizon. Indeed, their success is contingent on highly uncertain extra-budgetary funding given Alberta's high level of public services, low tax-base, and dependence on volatile petroleum revenues.¹²⁹ The ideational constraint imposed by the SWF policy path thus limits government's capacity to approach issues of socioeconomic development, forcing it to rely on short-term and equally uncertain financial returns. Despite it becoming a long-term orientated SWF in 1997, then, the AHF remained a short-term orientated fiscal tool of government – albeit one barred from making non-financial speculative investments

¹²⁸ Of particular lasting significance of early AHF investments include: the Heritage Medical Fund, the Heritage Science and Engineering Fund, the Heritage Scholarship Fund, and the Kananaskis Provincial Park.

¹²⁹ It should be noted that a 'Capital Account' was established in 2002 (from a \$910 million deposit) to fund projects for local authorities (school boards, regional health, post-secondary institutions) and the provincial government. However, since the Capital Account is part of the GRF, allocations to it are dependent on GRF revenues and thus, in part, AHF investment income.

(Miller, 2007: 427). This supportive role of the AHF is in fact under increasing pressure since September 2009 due to the re-emergence of a \$7 billion net deficit.¹³⁰

7.2 The AHF as Constraint (1997-2009): *The Alberta Investment Management Corporation*

Between 1997 and 2009, the AHF's investment universe rapidly expanded, it continued to be used as a source of government revenue, and thus the government increased its dependence on financial markets to support their short-term fiscal plan. This had the effect of gradually transforming MLAs' approach to public capital management in aggregate. Indeed in 2008, \$45 billion in additional public assets spread across 26 individually tasked funds managed by the Treasury would be delegated to the Alberta Investment Management Corporation. This proved a significant break from government's traditional approach to fiscal policy considering this capital would be placed even further from their control in both a functional as well as epistemological sense of authority. Indeed, AIMCo was an independent Crown corporation mandated to be on the cutting edge of financial market developments, innovation, and expertise (Gartner, 2007; Oberg, 2007: 397). Financial experts employed therein were consequently expected to manage this near \$65 billion in provincial assets by following the principles of modern investment theory institutionalized into the AHF a decade prior. That is, they were to 'adhere to

¹³⁰ The results of the 2007 Alberta Financial Investment Planning and Advisory Commission (FIPAC) report – implemented by the Minister of Finance in 2005 – called for increasing the role of a speculative AHF to support Alberta's fiscal future (Mintz et al, 2007). The report generated much comment and support. Deputy Minister of Finance Rod Matheson said in 2009 that 'it was shocking how universal the agreement was that the government should increase the size of the Heritage Fund through savings' (Matheson, 2009). This support was based on the argument that the AHF's financial revenue would replace the province's resource revenue in the future. As of fall 2010, however, the government has yet to officially respond to the report's findings as the province has again fallen into deficit following a drop in global energy prices. Consequently, 'any formal plans for the Heritage Fund have been put on the backburner' due to the government's alternative priorities vis-à-vis the fiscal deficit (Matheson, 2009; cf. Stelmach, 2009).

investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments' (AHF Act, 1997: Section 3.4). The following discussion demonstrates how it was the epistemological authority exerted by these principles and the investment experts who wielded them that led government to reconceptualise their relationship with fiscal governance between 1997 and 2009. It argues the AHF's becoming an SWF in 1997 was a major contributing factor that led government to create AIMCo. Section 7.3 then problematizes the constraint AIMCo's epistemological authority placed on MLAs' political agency during two global financial crises experienced between 1997 and 2009.

To this effect, AIMCo's origins and its significance for fiscal governance in Alberta can be traced to 1997, when the AHF first began pursuing its diversified investment campaign under the Treasury's guidance. Given the Treasury acted as operational manager, democratically elected MLAs would not necessarily be financial market participants. They could influence where and how the AHF invested only in a most indirect capacity: through approving the investment strategy presented to them by financial experts housed in and hired by the Treasury (AHF Act, 1997: Section 6.4). MLAs would instead occupy themselves with actively promoting the AHF's new SWF identity, a task their predecessors had failed to do between 1976 and 1994. This was initially achieved through the widespread circulation of the AHF's 1998 Annual Report, and then later through annual town meetings, press conferences, and regularly distributed information pamphlets (cf. Alberta Treasury, 1999; 2000; 2003; Alberta Future Summit, 2002; Mintz et al, 2007).¹³¹

¹³¹ The Legislature's ready adoption of this promotional role followed from the recommendations offered by the AHF Review Commission in 1995. Primary among these was to improve Albertan's understanding of the Fund, a consequence of the confusing and contrasting objectives that led the original AHF to be cast as in crisis (Review Committee, 1995: 17).

As a consequence of these promotional efforts, MLAs increased their dependence on the authority of financial experts in the Treasury. This was in attempts to better substantiate their claims of the expected profitability of financial speculation, and thus the benefits to be gained from the SWF policy path. The Minister of Revenue was rather tongue-in-cheek when he reiterated this new role for government in 2003, asking the Legislature for advice on ‘how they can manage the markets so that they continually climb versus decline’ (Melchin in Standing Committee Hearings, 2003). This was not to suggest MLAs had grandiose notions of single-handedly facilitating the profitability of the international markets in which AHF capital – and eventually \$45 billion in other public assets – would be invested. What they could control, however, was the domestic perception of the Fund’s fundamental desirability as a strategy of governance as based on the assumption that markets were already efficient and profitable in the long-term. By promoting this narrative – as well as those of speculative finance’s calculability and manageability – MLAs could stabilize public expectations as to how successful the symbolically significant AHF would be in the future.

To be sure, the government’s approach to petroleum wealth management through the AHF continued to be a scrutinized feature of Albertan politics between 1997 and 2009. The Fund essentially symbolised Alberta’s fiscal independence and individuality as a province in a fragmented and highly competitive Canadian federal system (cf. Hewes, 1995: 1477). The AHF Review Commission’s findings in 1995, and then a 2003 Treasury-funded survey, demonstrated that ‘any political party...that would decide to tear apart the Heritage Fund would probably do so at its own peril’ (Liepert in Standing Committee Hearings, 2006; cf. Alberta Treasury, 2003). Thus by drawing from the same financial epistemology that had legitimated the AHF’s

reconceptualisation over competing alternatives between 1994 and 1997, MLAs could also convince the public of the SWF policy path's desirability (cf. Alberta Treasury, 1996: 3; Day in Standing Committee Hearings, 1998). In so doing, the Fund's SWF identity became synonymous with the sustainability of Albertan fiscal policy by its helping to ensure the government could meet the high level of welfare spending the public had come to expect.

As the government's representative, the AHF Standing Committee in particular took a noticeably more vigorous approach to increasing the Fund's communications to the public. They directed fewer hard-hitting questions about how the Fund was being managed to the Treasury as there had been when investing in domestic socioeconomic projects. They were instead focused on getting the message of the Fund's financial performance and reasons for this performance across to the public in years of financial success as well as failure (cf. Day in Standing Committee Hearings, 1998). In so doing, the Standing Committee became a cheerleader of financial experts in the Treasury and less of a government watchdog. Anything more interventionist would be characterized as unnecessary, completely irrational, and even threatening to the success of not just the AHF, but Alberta's vaunted socioeconomic status within Federal Canada.

To reiterate, their promotional campaign's success hinged on the epistemological authority exerted by financial experts in the Treasury. These experts would need to keep MLAs convinced of the SWF policy path's desirability over alternative uses for the Fund. This was especially following crises and equity market crashes such as that which occurred between 2001 and 2003 in the Dot-Com crisis, and more recently between 2007 and 2009 following the so-called Credit Crunch. Throughout these periods, more knowledgeable and long-term orientated financial

experts would pacify the angst of election-wary politicians. MLAs therefore increasingly committed themselves to approaching all matters of public capital management through the prescriptive lens of the AHF's speculative financial epistemology. After all, if it was good enough for the highly regarded Alberta Heritage Savings Trust Fund and its \$15 billion in public capital, why not for the rest of public finances? MLAs' gradual yielding of authority over public capital management to the Treasury also increased alongside the AHF's expansionary investment universe and increased reliance on short-term capital gains. This is to say these government actors' dependence on financial experts, constrained by the language of risk and return, would lead them to reconsider their relationship with public capital management in its entirety.

To this effect, the department specifically tasked with operationalizing the AHF's new financial mandate – the Investment Management Division (IMD) – initially outsourced its management of the more risk-exposed Endowment portfolio to external managers. By 1999, the IMD had hired 18 external investors to manage approximately 24 percent of the AHF's capital, while the Fund's bond portfolio was managed in-house. However, the expansion of the AHF's investment universe to increase returns shortly thereafter led MLAs to reevaluate this managerial structure. IMD officials were particularly vocal in this regard, arguing the government had yet to develop an 'investment management framework' acceptable enough for the AHF to be comparable to its peers (Melchin, 2002: 909-913; Matheson, 2009). The IMD would require 'different analytical tools' such as 'very sophisticated software, hardware, [and] various measurement techniques' to keep in line with a financial industry that 'constantly changes and improves...looks for the best tools...the best and latest of knowledge' (Melchin, 2002: 921).

The IMD's arguments therefore reflected modern financial epistemology's notion of what constitutes financial expertise. It was the authoritative expectations these ideas commanded that convinced MLAs they should defer to professional investors versed in the language of risk and return in matters of sovereign wealth management. In short, it was the capacity of these ideas to inform action in the face of uncertainty that ultimately convinced MLAs more public resources should be diverted to support the AHF in its pursuit of speculative financial returns.¹³² While this was intended to improve the IMD's ability to minimize financial risk and maximize financial returns, it would also help stabilize the public's expectations of how the AHF should and would perform (Melchin in Standing Committee Hearings, 2003). MLAs would therefore benefit from this developing managerial structure not just by way of its potentially increasing returns. It would also help stabilize their political legitimacy in regards to the scrutinized issue of public capital management.

The IMD rapidly grew as a division of the Treasury with the aid of government funding: from approximately 25 employees in 1998, to 44 employees – including 28 Chartered Financial Analysts – in 2001, to 95 employees two years later in 2003 (Pugh in Standing Committee Hearings, 2001; Pugh, 2002: 910). Still motivated by the desire to accommodate the AHF's expansionary investment universe and increase returns, however, the Treasury continued to call for more resources to further specialize the IMD's management function. By the early 2000s, these proposals were in line with the government's ongoing campaign of promoting the AHF's new SWF identity. They fit well with the idea that continued development of the IMD's expertise could better accommodate the whole of public sector funds under

¹³² Operating expenses increased by 50 percent between 2000 and 2003, from approximately \$4.25 million to \$8.5 million (Annual Reports, 2000-03).

Treasury oversight (Melchin in Standing Committee Hearings, 2004).¹³³ The IMD was in fact renamed ‘Alberta Investment Management’ (AIM) in 2004 to reflect its increasing responsibility in supporting domestic fiscal policy through public capital management. Yet even with this growth between 1997 and 2003, the Treasury continued to argue the development of AIM’s financial expertise was being outpaced by the AHF’s accelerated diversification campaign. In response to these calls, the government commissioned a study in 2005 to review and develop ways to improve AIM’s capacity to balance the Fund’s risk-return profile and support annual budgets (Capelle Associates, 2006; MacDonald, 2007: 429). This single study – the Capelle Report – culminated in the passing of the Alberta Investment Management Corporation Act in March 2007, which transformed AIM as a department within the Treasury into AIMCo. The AHF, along with \$45 billion in additional public funds, would now be managed by a privately run crown corporation with a board of governors, staff, and managerial structure formally independent from government auspices (AIMCo Act, 2007; Oberg, 2007: 397).

The Capelle Report’s arguments for establishing AIMCo were two-fold. First, the government hoped that centring a Crown corporation with a ‘critical mass’ of \$70 billion in assets in Edmonton would produce a ‘spin-off financial industry’ for Alberta (Oberg, 2007: 625).¹³⁴ However, a second and more important rationale was that the semi-privatization of AIM into AIMCo was framed as means to increase annual returns through short-term active management: an approach that would greatly increase the AHF’s exposure to exogenous shocks and financial volatility in its attempts to profit from market inefficiencies (Oberg in Standing Committee Hearings,

¹³³ In 2004, these other funds totalled approximately \$45 billion, and included the General Reserve Fund, the Alberta Sustainability Fund, the Capital Account, the Heritage Medical Research Fund, the Heritage Scholarship Fund, and a variety of public pension funds (Gartner, 2007).

¹³⁴ Interestingly, the development of a home-grown financial industry was one of the original intentions for the establishment of the AHF in 1976 (Lougheed, 1976a: 828-833).

2007; Matheson, 2009). This proved contradictory to the rationale that led to the Fund's larger transformation in 1997 – i.e. that riskier and diversified portfolios should earn approximately 5.5 percent in the *long-term* due to investor's natural tendency to be risk-averse in efficient, self-clearing markets. Despite this contradiction in logic, the Capelle Report convinced MLAs of the notion that 'if they moved to an AIMCo type model with better governance and that was more entrepreneurial, they could expect the AHF to generate an additional 100-200 basis points' (Matheson, 2009; Capelle Associates, 2006). AIMCo was intended to establish a corporate environment more conducive to the organic process of value-creation than that which could be developed under the political and thus interfering auspices of the Treasury (Evans in Standing Committee Hearings, 2008).

The establishment of AIMCo was thus made without the democratic input of Albertans. This is significant as it would increase Alberta's exposure to global financial volatility, increase MLAs' dependence on financial experts to inform them of action in the context of this volatility, and hence limit what could be considered legitimate action in all matters of public capital management within a crisis prone financial realm. It was instead framed as a technical decision neither the public nor their elected representatives could fully understand. More knowledgeable experts in the Treasury and externally hired consultants instead commanded the authority to be believed, presenting AIMCo as a means for MLAs to increase the *expected* profitability of their provincial wealth. The AHF Standing Committee then communicated these arguments to the rest of government, asserting that 'it would be extremely difficult for us as a Legislative Assembly to turn our backs on the potential savings, the potential increase in income of close to \$500 million a year, which is what 100 basis points would give us' (Oberg, 2007: 625). Such was the certainty that

annual returns would be enhanced that the Treasurer who introduced the AIMCo Act asked MLAs nervous of relinquishing such authority over the AHF to AIMCo: 'Is there anybody here that doesn't want to make another \$476 million?' (Evans in Standing Committee Hearings, 2008).

In any case, the Treasury also emphasized to MLAs that the independence required for the success of AIMCo would only affect them in an operational sense of authority, and not much at that. The Legislature, through the Treasury, would arguably retain design capacity over both the AHF as well as AIMCo's form and function.¹³⁵ Proponents of these proposals contended that AIMCo 'ultimately exists at the pleasure of the Crown so it's really no different [to governmental control] that way...but it does remove management of the AHF from the government' (Elniski, 2009; Melchin, 2002: 915). So as the government would retain the right to appoint AIMCo Executives, AHF management would not necessarily be depoliticized away from their auspices as much as the 'independent Crown corporation' moniker would suggest. What this dissertation emphasizes, however, is that the government would be distanced from AHF management in an epistemological sense of authority. This would at once both stabilize their political legitimacy, but at the cost of exposing domestic socioeconomic stability to the volatility of a crisis prone financial realm. To be sure, AIMCo's capacity to traverse the ebb and flow of speculative finance immediately became a substantiating feature of the government's approach to Albertan fiscal policy. Only an AIMCo-type entity was thought capable of generating the short-term financial returns that would support both the AHF's institutional and

¹³⁵ The relationship between Treasury officials and AIMCo is largely informal. The Assistant Deputy Minister of Treasury and Risk Management recently stated that they talk to AIMCo on a regular basis, and to remember that they're down the hall: 'If things come up they can wander down the hall and talk to us...They are our service provider and they are investment professionals, so we have good dialogue with them' (Matheson, 2009). The Treasury does not, however, change the AHF's asset mix based on advice from AIMCo.

government's political legitimacy. Only actions that could be deemed as improving the AHF's risk-return trade-off by financial experts in AIMCo would represent legitimate uses of this systematically significant and scrutinized pot of public capital (de Bever in Standing Committee Hearings, 2008).¹³⁶

The delegation of an additional \$45 billion to AIMCo for safekeeping as well as to ensure this capital was 'put to work' through speculation further added to MLAs' dependence on the epistemological authority of AIMCo. Indeed, the government had already committed itself to this prescriptive approach to public capital management, first through their promotion of the SWF policy path and then their supporting the institutional development of the IMD between 1997 and 2004. If AIMCo would improve the AHF's investment returns as government officials believed, it would be a rational and forward-looking decision to have it manage all of public sector funds. These arguments were embraced by PCs and New Democrats alike, with muted criticisms but little formal resistance voiced by opposition Liberals in Legislative debates of the AIMCo Act (cf. Oberg, 2007; Miller, 2007: 428; MacDonald, 2007: 429-430; Eggen, 2007: 430; Elsalhy, 2007: 623).

The government's increasingly distant approach to public capital management was not, however, without its share of critics. Indeed throughout the 2000s, concerns were expressed by 'many public policy commentators that more and more government funds are being administered outside the scope of the public' or democratic input (Macdonald in Standing Committee Hearings, 2005; Miller, 2007:

¹³⁶ AIMCo endeavoured to improve its financial instincts and investment skill by developing its 'corporate services' such as 'big increases in staffing and operation and IT support because we're very weak there right now' as well as focusing attention on risk management (Parihar in Standing Committee Hearings, 2008; de Bever in Standing Committee Hearings, 2008). Indeed by June 2008, AIMCo had 144 employees with 60 of them being investment professionals working for the Chief Investment Officer alone, and had expectations to grow to 188 by year end (Parihar in Standing Committee Hearings, 2008).

426). Particular reference was made to the fact that the interests of money managers were not necessarily in line with those of everyday Albertans:

'[Since 1980] we have a boom in the economy. Then we have a bust in the economy. Then we have public policy exhorted to the benefit of investors, not to the benefit of people that built the province or want to live here in the future...I'm very concerned about the massive amount of money that might be put in the hands of a fund manager whose purpose is just to build the shareholder profit in the fund, which is what he's mandated to do, but to the detriment of Canada, to the detriment of Alberta, and to the detriment of future generations' -- Teghtmeyer, 2007¹³⁷

In spite of these criticisms, the rapid growth of the IMD and then AIMCo – as well as the internalization of the SWF policy path as the optimal strategy for public capital management in aggregate – had gained too much momentum within government to be reversed. By 2009, the creation of AIMCo to manage the AHF and other public funds meant MLAs 'are captive to them, they have a monopoly as service provider'. This represents 'a challenge because they work for government, but they are the managers of the Fund and the government wants to keep that line drawn' (Matheson, 2009). This ultimately means MLAs are limited in their ability to react to a poorly performing AIMCo as without new and most likely unpopular legislation, they can only seek to improve AIMCo's management function rather than delegate management to an alternative organization.

The Albertan case is therefore significant for examining the authoritative role played by a discernable array of modern financial ideas in guiding institutional change. It demonstrates how the prescriptive demands of modern financial epistemology, when institutionalized into the AHF in 1997, eventually gave rise to the

¹³⁷ Aside from the rather significant authority derived from its ability to change the AHF's underlying legislation, one of the government's more significant roles in overseeing the fund was in fact removed in 2007. That is, the purpose of the Endowment Fund Policy Committee and its composition of MLAs was to tie the AHF's investment strategies and government policy closer together through its advisory role to the Ministry of Finance (Melchin in Standing Committee Hearings, 2004). The Endowment Fund Policy Committee was, however, disbanded under the initiative provided by the Minister of Finance in 2007 'because of the newer, expanded view and vision of AIMCo' (Evans in Standing Committee Hearings, 2008). This served to further distance AHF management away from the political auspices of government in a functional sense of authority.

perceived necessity of establishing AIMCo as a semi-independent governmental investment manager. This resulted in AHF management being placed outside the auspices of governmental control and into the hands of financial experts whose interests are rooted in the pursuit of financial versus socioeconomic or even Albertan objectives. Hence, the SWF policy path proved to be a significant constraint on political agency as it limited the realizable action paths government could conceive of in regards to sovereign wealth management between 1997 and 2009. Yet the constraint of the SWF policy path also arose from the fact that AIMCo itself was captive to follow the expectations of modern financial epistemology. This was to inform them of legitimate action in the financially volatile and uncertain period of 1997 to 2009. Indeed, even these financial experts were limited in their capacity to act in the wake of the crises that revealed the fallacious nature of the narrative legitimating the AHF's outward-looking and long-term orientated SWF identity. It is to an examination of the constraint imposed by the prescriptions of modern financial epistemology in the context of these financial crises – as well as their impact on socioeconomic stability in Alberta – that the discussion now turns.

7.3 The AHF as Constraint (1997-2009): *Financial Crises*

Shortly after being reconceptualised as a speculative financial maximizer in 1997, the preceding Sections demonstrated the Alberta Heritage Savings Trust Fund became an increasingly prominent feature of the province's politico-economic landscape. First, its portfolio began to rapidly grow in financial breadth and complexity; second, its expected investment income became a regular and supporting feature of budgetary financing; and third, the epistemological authority of

independent financial experts in the IMD and then AIMCo to direct fiscal policy began to supersede that of the Treasury and Legislature. These three developments indicate that between 1997 and 2009, democratically elected MLAs increasingly deferred their policy preferences vis-à-vis public capital management to the expectations demanded of modern financial epistemology. This proved problematic in the face of the Dot Com bubble burst (2000-2002) and the most recent global financial crisis (2007-2009). In these financially volatile periods, the AHF did not meet government's expectations of earning 5.5 percent on its investments, leaving realized budgets between two to five percent in deficit (see Appendix 2). However, the creation of AIMCo and its management of \$45 billion in additional public funds meant the effects of the 2007-2009 liquidity crisis in particular were not isolated to budgetary shortfalls. They also affected the government's capacity to support a range of domestic constituents, including those benefiting from public sector pension and endowment funds (AIMCo, 2010: c). The most daunting problem posed by the SWF's constraint, then, is how it increased Alberta's exposure to the contradictions and crisis tendencies of the speculative financial realm.

To this end, a third source of constraint imposed by the SWF policy path pertained to MLAs' realizable policy preferences when faced with financial crisis. These government actors were constrained to remain committed to the diversified investment strategy despite the crises revealing the fallacious nature of its underlying financial logic. These crises and the extensive ad hoc government interventions they necessitated revealed that the epistemology of speculative investment does not provide a reliable guide to action as purported by financial economists and practitioners. Nor does it accurately reflect financial market reality. Rather, the narratives of financial profitability, calculability and expertise espoused by these

theorists primarily serve to legitimate modern financial relations and practices. Once these authoritative ideas increased their influence over MLAs' approach to resource management – first through the AHF and then all of public sector funds managed under AIMCo – only they could inform government of how to understand, let alone approach, the globally reverberating crises of 2000-2002 and 2007-2009. This loyalty to the science of speculation is significant considering the fallout from these crises transcended the fictitious borders of the speculative financial realm to impact Alberta's socioeconomic growth and stability (cf. AIMCo, 2010: iii, 9).¹³⁸

Why, then, was the financial uncertainty produced by these crises deemed more manageable – and acceptable – than that which arose out of the politico-economic crisis two decades earlier? Why did the Albertan politico-economic crisis of 1988 to 1994 result in inducing large-scale institutional change in regards to both resource management and fiscal policy, while the global financial crises served to deepen the government's commitment to these changes? These questions speak of the ideational constraint imposed by the SWF policy path on MLAs' political agency. As the government increased their commitment to diversified investment as a domestic strategy of governance, they further committed themselves to modern financial epistemology's understanding of what constitutes desirable action in regards to public capital management.

To this effect, the PC majority government reconceptualised the AHF as a sovereign wealth fund in 1997 in attempts to reassert their legitimacy as governors in the face of politico-economic crisis. Soon after, the newly tasked Standing Committee sought to promote the legitimacy of the financial ideas substantiating the AHF's new

¹³⁸ This impact was most acutely felt following the global financial crisis, the worst hit being Alberta's petroleum, housing, and overall employment sectors. The province slipped into recession in 2008, with government receiving \$4 billion less in tax revenues. The economy contracted by 2 percent in 2009, and a provincial deficit of over \$5 billion re-emerged on the back of increased government spending to support the fledging economy (Government of Alberta, 2009).

direction throughout the Albertan public, a task their predecessors had neglected to do. This was achieved through quarterly and annual reports, media publications, and regularly scheduled meetings throughout the Province. They primarily promoted the notion that the SWF policy path would generate investment income to the benefit of Alberta in the long run. However, this narrative became a constraint as early as 1999 when the Dot Com bubble showed its first signs of bursting. In one revealing exchange of the AHF Standing Committee, for example, Chairman Pham drew attention to the fact that a primary reason for the AHF's financialization in 1997 was to help government keep ahead of debt-servicing costs. Pham went on to ask that considering the AHF did not achieve this objective in 1998 – the fund earned 5.4 percent while the market cost of debt was 5.9 percent – who can the government say is responsible? How were they to 'rationalize' this to Albertan's given the new AHF was meant to avoid such inefficient fiscal policies? In response, the Treasurer and operational manager of the Fund at the time stated:

'Overall this fund was affected by downturns in the market...as were all funds or virtually all funds nationally and internationally...Looking at the shift as we move from transition to endowment, you have to be prepared to ride out some of the dips in the market' – Day in Standing Committee Hearings, 1999

This is one of a number of examples demonstrating that when confronted with crises and extensive volatility, AHF managers in AIMCo and its overseers in government need only cite the dogmatic expectation of financial profitability. Specifically, that losses in the short-term are to be expected when invested in riskier asset classes. Best practice dictates the AHF must maintain its diversified approach to speculative investment if losses are to be recouped (cf. Day in Standing Committee Hearings, 1999; 2003; Annual Reports, 1999-2008: 5-10).¹³⁹ In regards to a particularly

¹³⁹ In the following 2000-01 fiscal year, the AHF earned a 6.3 percent return while the cost of debt servicing was 8.3 percent (Annual Report, 2001: 3). In 2002-03, the Fund experienced a net loss of \$1.3 billion and generated no investment income. The negative ramifications experienced in the wake

turbulent period in 2006 that negatively affected the AHF's financial position, for example, the Minister of Finance stated:

'It was probably one of the most interesting two week periods in the market for some time. You know, it's been a long time since I recall a two-week period that was that unusual. It's the only way you can really put it' – McClellan in Standing Committee Hearings, 2006

Hence given the assumption of a certain level of investor rationality and market efficiency, MLAs are constrained to tolerate even the most unexplainable, uncertain and potentially destabilizing of financial environments. In so doing, MLAs' are constrained to accede to the authority exerted not just by financial experts in AIMCo, but ultimately the modern financial epistemology from which these experts themselves derive their authority.

Constraint of the SWF policy path was thus witnessed in its instructing MLAs to remain loyal to the belief that speculative financial markets would eventually return to profitability. They were prevented from critically examining whether or not diversification of sovereign wealth in the pursuit of financial returns was in the best short or medium-term interests of socioeconomic stability. This ideational constraint is problematic given the origins and causes of speculative asset bubbles remain more or less uncertain in academic and practitioner spheres (cf. Kindleberger, 2005; Shiller, 2001; Dougherty, 2002; Ofek and Richardson, 2001). What is certain is that governments were called upon to reassert investor rationality and market efficiency in the midst of this crisis as regulators of last resort (Embry and Hepburn, 2004). This effectively undermined the unwavering assumptions that made the SWF policy path appear such a desirable strategy of governance to Albertan MLAs between 1994 and 1997. Yet MLAs were nonetheless incapable of deviating from the authoritative logic

of the Dot Com crisis were, however, muted considering the AHF had yet to fully expose itself to the same degree of risk it would by 2009.

substantiated by the idea of financial profitability even within this period of successive losses. Any tampering with the Fund would in fact contradict the reasons they adopted the SWF policy path in the first place. It would also undermine the promotional campaign they undertook to solidify this strategy's legitimacy from 1997 onwards. As demonstrated in Section 7.1, only the continued diversification of sovereign wealth into speculative financial assets could be considered legitimate action by both experts in the IMD and their overseers in the AHF Standing Committee.

The impact of the Dot-Com crisis was, however, rather muted. Its primary significance is it demonstrated how the SWF policy path directly exposed MLAs' capacity to govern to the ebbs and flows of the broader financial realm. This exposure to crises would then prove far more problematic between 2007 and 2009. This was especially considering AIMCo was now managing a total of \$62 billion in public funds under the same approach to financial speculation as was the AHF. In some cases, these funds were in fact exposed to even more risk than the long-term oriented AHF (AIMCo, 2010: 2). The AHF incurred losses of \$3 billion in this crisis period – approximately 18 percent of the fund's capital and an -18.8 percent rate of return, 90 percent of which arose from its exposure to equities (Annual Report, 2009: 3). While these losses were consolidated into the government's bottom-line, they represented a significant shortfall of \$1.6 billion in expected investment income planned into that year's budget. Simply put, the SWF policy path and its high-risk exposure cost the government approximately \$4.2 billion dollars between 2007 and 2009, the impacts of which would have to be spread throughout successive year's budgets. Indeed, these losses contributed to government's creation of a new 'Fiscal Framework' in 2009,

which was rooted in austerity and use of public sector savings outside the AHF to stabilize budgets for the next four years (cf. Fiscal Plan, 2010: 9-21; Stelmach, 2009).

Yet aside from generating a ‘little bit of noise’, these losses had no impact on either the Legislature’s or AIMCo’s approach to AHF management. There was in fact a ‘unanimous chorus of “don’t sell” or tamper with our investment strategy’ (Elniski, 2009; cf. Matheson, 2009). Indeed, recurrent crises are necessary moments that reify and legitimate the expectations promoted by the SWF policy path: the chance of crisis is what underlies risk’s theoretical profitability. However, this crisis of 2007-2009 proved particularly problematic for two reasons. First, it demonstrated how MLAs’ capacity to govern is vulnerable to broader financial volatility. The crisis thus called into question whether the AHF’s exposure to such high degrees of financial risk – i.e. a 75 percent equity exposure – is an optimal management strategy for a systematically significant amount of public capital. Second, the crisis revealed the fallacious nature of SWF’s underlying investment logic given the extent to which governments were called upon to stabilize markets through emergency capital injections. This point was in fact made in AIMCo’s 2010 Annual Report, but was nonetheless glossed over as unimportant for their overall investment philosophy (AIMCo, 2010: 9).

The severity of the crisis and the nature of MLAs’ response – which reflected verbatim the arguments made by AIMCo officials – revealed the extent to which notions of the ERP, risk as distinct from uncertainty, and financial expertise legitimate the AHF’s speculative financial identity. The crisis and its aftermath exposed these concepts for the political tools they are: they were strategically drawn from by MLAs to stabilize socioeconomic expectations in the recession and heightened period of uncertainty that followed. In short, these authoritative ideas were capable of managing short-term uncertainty presented by the crisis. They reinforced

the expectation of market volatility and asset devaluation in the short and medium-terms, but also the ultimate correction and continued profitability of these markets in the long-term. Various financial crises and the deficit years that follow can thus be accommodated by MLAs in their ongoing promotion and normalization of SWF's ideationally derived, forward-looking projections. To this end, the impact of the global crisis on government finances was casually dismissed by all members of the AHF Standing Committee, who posited: 'Yeah, you know, they've [AIMCo] had the odd bad year, but I mean that's not their fault really' (Macdonald in Standing Committee Hearings, 2007). The SWF policy path in Alberta is thus significant as it has demonstrated even financial experts in AIMCo are constrained to follow the expectations of rational action prescribed by modern financial epistemology. Both MLAs and AIMCo managers can only 'hang on' in times of crisis and hope market equilibrium and investor rationality will reassert themselves with as little cost as possible.

This form of constraint imposed by the SWF policy path thus falls outside the explanatory bounds of much IPE scholarship. SWF constraint is not just a matter of governments being captured by exogenous financial interests, nor does it refer to the hegemonic power of finance capital itself. Indeed, these approaches bestow too much agency onto finance capital and markets, which are perceived as collectively working towards a common set of goals or interests (cf. Cerny, 1993; Gilpin, 2000; Bello, Bullard and Malhotra, 2000; Andrews, 1994). What is emphasized here, rather, is that SWF constraint only becomes apparent when accounting for ideas as prerequisites for agency. SWF constraint is thus the product of closely guarded and vehemently reinforced assertions that the financial realm is tameable through a science of speculation. This constraint proved problematic in Alberta as the more diversified and

risk-laden the AHF's portfolio became, the more exposed socioeconomic sustainability became to the global financial crisis – the effects of which continue to plague Alberta as of November 2010 (cf. Flanagan, 2008).

Conclusion

Between 1997 and 2009, Albertan MLAs' realizable policy preferences were constrained by the demands of the SWF policy path. Indeed, the institutional development of the Alberta Heritage Savings Trust Fund as an SWF throughout this time resulted in financial speculation becoming an increasingly important feature supporting their governance function. Section 7.1 demonstrated how the notion of financial profitability led the government to view diversified investment as a means to earn investment income into the indefinite future. This belief in the equity-risk premium as an unwavering feature of speculative finance presented a means to reduce the deficit. It also immediately recast the AHF as a savings fund, which was demanded by a public majority. As the deficit was gradually reduced through investment income earned by the conservative Transition portfolio, however, MLAs opted to increase the AHF's risk exposure. This was again based on the expectation such risk would generate even higher returns in the short-term.¹⁴⁰ Ideational constraint of the SWF policy path in this sense of budgetary financing, then, ultimately led government to (partially) replace the uncertainty of future petroleum revenues with the uncertainty of speculative financial returns. However, the Chapter also argued that MLAs' reliance on the expectation of financial profitability as a guide to action is inherently problematic.

¹⁴⁰ The Legislature in fact delegated an additional \$3.83 billion to the Fund between 2004 and 2007 in attempting to increase the returns generated from its speculative financial campaign (Mintz et al, 2007: 21).

First, the expectation of earning approximately \$1.5 billion in investment income planned into each year's budget has arguably facilitated rather than contained the Albertan government's historical propensity to spend (cf. Alberta Treasury, 1997; Government of Alberta, 2009). Second, it led government to expose Alberta's socioeconomic stability to the destabilizing contradictions and crisis tendencies of the speculative financial realm – the ramifications of which were explored in Section 7.3. However, this was not to demonize financial speculation in general which, while imperfect, provides a ready means of allocating mobile finance capital to productive sectors of the global economy. Criticism is instead directed towards SWFs' exclusive focus on adopting high amounts of risk, which exposes domestic societies to broader financial market volatility. The AHF's assumption of excessive financial risk to support its exclusively financial mandate is, however, unnecessary given the Fund's primary use as a supportive feature of budgets in the short-term.

Section 7.2 then demonstrated how the authority exerted by the idea of financial expertise – as actively promoted and reinforced by Treasury officials – further constrained government agency. This idea and the policy preferences it substantiated limited the Legislature's capacity to influence AHF management. It also limited their capacity to fund non-financial socioeconomic development projects. This authoritative idea convinced MLAs that a specialized task force divorced from the interventionist hand of politics would compliment the AHF's increasingly aggressive pursuit of speculative financial returns. Hundreds of millions of tax dollars were thus channelled first into the IMD and then AIMCo in the expectation such expenditures were in the best fiscal interests of the province. Yet in so doing, this had the effect of limiting what uses this systematically significant pot of public capital could be directed to in attempting to better Albertan's quality of life into the long-term. That is,

government would be prevented from participating in any long-term domestic development projects as the AHF had between 1976 and 1994, which were not possible without AHF support. The SWF policy path would instead constrain government to rely on financial experts in AIMCo to generate budget-stabilizing returns to support short-term socioeconomic stability. Simply put, the seemingly forward-looking and prudent SWF policy path constrained government to take a short-term and highly speculative view of socioeconomic development between 1997 and 2009.

This is not to ignore the variety of managerial problems the AHF was subject to between 1976 and 1994. Indeed, concentrating investment decisions for an ambiguous and easily manipulable public fund in the hands of a PC dominated Cabinet and Legislature produced a number of misuses and abuses. Yet to cast the first two decades of the AHF as detrimental to Albertan growth does the Fund and its original managers in government a great disservice. Alberta has greatly benefited from a number of development projects made possible by the AHF's stabilizing presence and support, a number of which continue to benefit current and future generations. Even under its confusing original management, the AHF's domestic development projects averaged a 3.98 percent return between 1976 and 1986. This is compared to the financialized AHF's negative average return of -3.34 percent between 1997 and 2009. This would suggest that what was problematic with the original AHF was not so much its inward-looking development focus, but the ineffective means through which the ever-shifting and toothless AHF Standing Committee enforced adherence to its convoluted mandate.

Section 7.3 then demonstrated the constraint imposed by the SWF policy path on MLA agency in the crisis prone period of 2000-2009. These crises served to

undermine the long-term investment logic legitimating the AHF's 1997 transformation, as well as highlight the inherent problem of applying this fallacious logic to serve short-term goals. Indeed, Chapter Six argued the SWF policy path was first and foremost internalized by government as a means to stabilize MLAs' governance function and support their political legitimacy in the face of a politico-economic crisis. However, MLAs' reactions to the globally reverberating financial crises experienced between 2000 and 2009 reveal the extent to which these actors' policy preferences were problematically constrained by this policy path. Indeed, only by maintaining and even deepening the AHF's global financial embedment could government recoup the more than \$3 billion in losses incurred therein. Only by maintaining the AHF's risky investment activities could they help stabilize a socioeconomic landscape reeling from both its direct and indirect exposure to global financial volatility. This constraint led the PC majority government to ignore calls from a variety of internal and external organizations to increase the Fund's savings objective by limiting government's access to AHF capital and minimizing its risk exposure (cf. Mintz et al, 2007; Milke, 2006; Alberta Liberal Caucus, 2002; Miller, 2007b). Indeed the re-emergence of the deficit and the beginnings of recession brought on by the financial crisis of 2007-2009 served to further increase pressures on the AHF to generate speculative returns (Matheson, 2009; Standing Committee Report, 2009: 13).

The preceding Chapter therefore argued MLAs' reliance on the SWF policy path to support fiscal policy is fundamentally problematic. The following remark by AIMCo's CEO in the wake of the 2007-2009 financial crisis perhaps best captures the reasoning behind this argument:

'Markets will do whatever they do. Markets are driven by human behaviour. When people are feeling good and they are positively disposed, particularly to

equities, markets will go up. Then you'll get fear setting in, and all of a sudden everybody pulls out of the market and sits in cash... Maybe one of the things that hasn't been done as well as it could have been before in a lot of organizations is to focus on what risk really is' – de Bever in Standing Committee Hearings, 2008

The fallacy of the SWF policy path in Alberta, then, is that even experts in AIMCo recognize the untenable nature of the science of speculation upon which modern financial practices are based. De Bever draws particular attention to the difficulties with treating risk as distinct from uncertainty, although he could have also referred to the ambiguous existence of the equity-risk premium, or the costs versus benefits of devoting scarce public resources to developing financial expertise. Despite these uncertainties, however, financial experts in AIMCo maintain there is some form of order and predictability to the financial realm throughout which Alberta's sovereign wealth is embedded. They maintain that while uncontrollable, financial market reality is nonetheless reducible to the same simplified ontological presuppositions that gained prominence in financial economics in the 1950s. The Albertan experience thus suggests these presuppositions and the theories they substantiate are narratives that primarily *legitimate* rather than *inform* SWFs in practice. These authoritative ideas collectively represent a way, or a set of ways, of rendering uncertainty into a calculable and communicable form. They allow for the creation of forward-looking financial projections that command the authority to be believed by the domestic electorate. This stabilizes expectations of how various socioeconomic problems of governance are to be solved by government. A similar story of SWF development and constraint occurred in Ireland, following the government's establishment of the National Pension Reserve Fund in 1999.

Yet what distinguishes the Albertan and Irish cases is the extent to which political agency was constrained in reaction to the financial crises experienced

between 2000 and 2009. That is for Alberta, the ramifications of the crises were limited to destabilizing budgets in the short-term, and not to unmanageable extents. Constraint was thus primarily witnessed in how MLA's maintained their exposure to high degrees of financial risk and dependence on financial experts despite these crises revealing the fallacious nature of SWFs' legitimating ideas as guides to action. The Irish case, on the other hand, demonstrates how SWFs' ideational prescriptions can actively dictate policy choice when financial crises have more extensive and deeply felt impacts on socioeconomic stability. The dissertation now examines why the SWF policy path appealed to the interests of Irish government actors, and traces its impact on their approach to domestic governance between 1999 and 2009.

Chapter Eight: *Ireland's National Pension Reserve Fund (2001-2009)*

Ireland's National Pension Reserve Fund (NPRF or the 'Fund') was formally established as a dedicated public savings account in April 2001. Its open mandate is to meet 'as much as possible' the cost of social welfare and public service pensions to be paid by the government between 2025 and 2055 (NPRF Act, 2000: 18-1). Through its primary source of income – mandatory annual Exchequer contributions equal to one percent of GNP – assets are projected to grow to €140 billion or 40 per cent of GNP by 2025.¹⁴¹ In attempting to control for a deep-seated mistrust of historically spendthrift governments, the Oireachtas (parliament) ensured through the Fund's legislation that no drawdowns are to be made until 2025. Managerial authority has consequently been delegated to an independent body corporate known as the NPRF Commission (the 'Commission'), and operational authority to the pre-existing National Treasury Management Agency (NTMA).¹⁴² By 2009, assets totalling €22.3 billion were invested in some 2,600 public companies throughout a variety of high-risk asset classes and markets (see Figure 7). Given its public source of funding, arms-length relationship with the state, and speculative financial identity, the NPRF is exemplary of sovereign wealth funds' three distinguishing features.

¹⁴¹ NPRF assets are also derived from: a one-off transfer of all assets in the government's Temporary Holding Fund for Superannuation Liabilities – a €6.515 billion pot accrued in 1999 from fiscal surpluses and the privatization of state-owned Telecom Eireann; and all income earned on its investments (NPRF Commission, 2005: 2).

¹⁴² The NPRF Commission consists of seven members appointed by the Minister of Finance 'who have acquired substantial expertise and experience at a senior level in any of a number of listed areas' (Annual Report, 2008: 25). The NTMA was established in 1990 as a specialized financial institution tasked to manage the then burgeoning national debt.

Figure 7: Fund Value vs. Exchequer Contributions (2001-2009)

Source: Annual Report, 2009: 8

Yet why were Irish state managers willing to support the NPRF and its costly source of debt-based funding given the extent it would constrain budgetary politics into the long-term? To be sure, the NPRF has come to constrain Irish state agency in two ways. First is that since its inception in 2001, its financial performance has become a highly politicized issue. This has implicated the majority Fianna Fail government's domestic legitimacy with the short-term profitability of the Fund's heavily diversified and risky investment strategy.¹⁴³ Much effort between 2001 and 2009 was consequently placed in actively normalizing and promoting the NPRF's speculative financial identity. In so doing, the state has come to increasingly rely on the epistemological authority exerted by the Fund's managers in the NPRF Commission and NTMA to support fiscal policy and, by extension, government's political legitimacy. Indeed, the NPRF is also a constraint on state agency as it has become a central feature of government fiscal policy. In short, it facilitates the state's access to foreign investment capital while simultaneously lowering the cost of debt

¹⁴³ Irish politics has been dominated by two parties that emerged following the 1922-23 Civil War: Fianna Fáil and Fine Gael. At the time the NPRF Act was being debated, Fianna Fáil commanded widespread domestic support due to its presiding over the economic boom of the 1990s (i.e. the 'Celtic Tiger'). In 2007 it was re-elected as majority party for an unprecedented third five-year term although has since suffered domestic criticism due to their oversight of the 2008 Irish Banking Crisis.

servicing. Maintaining Ireland's international investment attractiveness is of particular importance in governing the island's small and highly open economy. As such, any deviation from the NPRF's existing SWF identity is framed as threatening the stability of the Irish welfare state. Such constraint is, however, puzzling. Indeed, the NPRF was established as a public savings account, funded by annual Exchequer contributions, and dedicated to pre-funding future pension liabilities. How did the Oireachtas come to so heavily rely on the SWF policy path specifically – and thus the authoritative ideas that legitimate financial speculation– to support their approach to fiscal governance in general?

To address this question, the following Chapter will be divided into two parts. Part I details why the Oireachtas decided to establish the NPRF. As in Norway and Alberta, it argues that the NPRF was first and foremost established as a strategy of governance to meet the short-term interests of government. Its primary remit is to address two problems of uncertainty facing the Irish state: those of budgetary stability, and the sustainability of state pension provision. This is to fill in a gap left by the existing literature, which assume SWFs to be natural by-products of contemporary finance capitalism. Little consideration is thus paid to their contested political origins. To this end, Part I examines how the NPRF came to exhibit the three distinguishing features of the SWF policy path over the various alternative strategies debated throughout government. Part II then examines the constraint imposed by this policy path on the form and function of state governance in Ireland. Specific reference is made to the NPRF's role in supporting the state's access to bond financing, as well as its influencing the government's approach to rectifying a domestic banking crisis in 2008. Part II argues this constraint is problematic as the NPRF's success as a strategy of governance hinges on its ability to generate speculative financial returns, which are

highly uncertain. It is also problematic as it prevents alternative ways to address the pension issue from being seriously considered, let alone pursued. The Chapter then concludes by drawing attention to the contradictions of the SWF policy path as it currently stands in Ireland, as well as its implications for the future of the state's approach to fiscal governance.

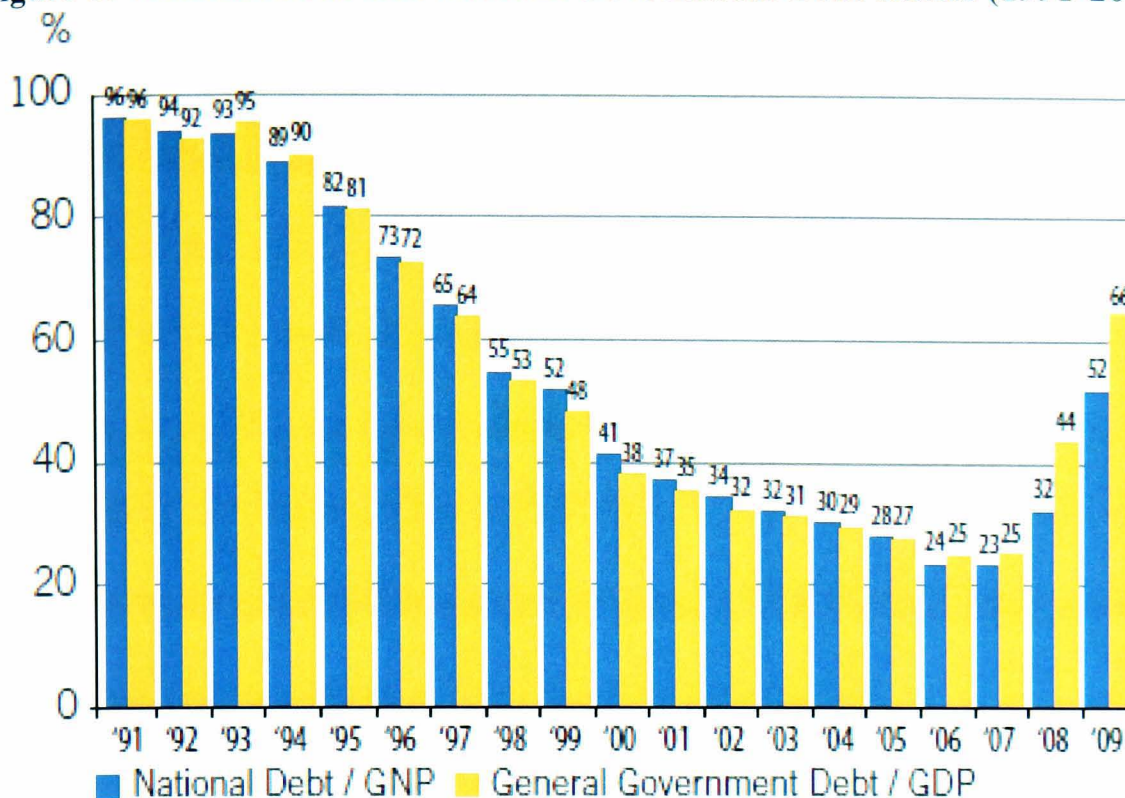
Part I: The NPRF as a Strategy of Governance

Ireland's National Pension Reserve Fund emerged out of a much more ambitious government directive than either the Government Pension Fund-Global or Alberta Heritage Saving's Trust Fund. It has always been understood as a necessary cost the Irish state must incur. This is considering that in years of budgetary deficit, the government must borrow from international debt markets to meet its mandatory Exchequer contributions equal to one percent of GNP. This links the Fund's institutional legitimacy to its ability to earn returns above the cost of debt servicing; anything less would merely shift future liabilities on the public balance sheet from expected pension costs to debt obligations. The NPRF thus represents an anomaly and a challenge to the assumptions maintained in the existing SWF literature. That is, the Irish state is not directing extra-budgetary wealth to take advantage of rationally desirable investment opportunities. Instead, debt-financed capital is being speculatively invested as the primary means to ensure the sustainability of the state pension system – a substantive feature of the state's politico-economic landscape. Sections 8.1 to 8.4 examine why this policy preference was institutionalized by the Oireachtas to support the future of the Irish pension system over alternative strategies.

8.1 Fiscal Surplus, the Demographic Time-Bomb, and the NPRF

The concept of a dedicated savings fund emerged within the Ministries of Finance and Social and Family Affairs in the mid-1990s in reaction to two problems of uncertainty facing the Oireachtas. The first and more immediate concern arose from the accrualment of a significant budgetary surplus between 1995 and 1999 during a period of rapid economic growth affectionately referred to as the ‘Celtic Tiger’. Uncertainty in this regard derived from the fact that Ireland had no experience handling budgetary surpluses but a history of deficit-driven fiscal policies (Noonan, 2000*a*: 83-86; see Figure 8). Indeed by the 1990’s, both the domestic electorate and members of the Oireachtas had developed a deep-seated mistrust of the state in its management of public finances. The surplus of the late 1990s therefore represented a significant turn of events, but one that had to be carefully managed lest the Fianna Fail majority lose the popular support it had gained throughout the Celtic Tiger.¹⁴⁴ Passing legislation that would force the government to save in times of surplus and reduce spending in times of deficit would therefore act as a counter-cyclical instrument of medium and long-term budgetary stability (c.f. Noonan, 2000*a*: 83; McCreevy, 2000*a*: 916; Noonan and McCreevy in Standing Committee Hearings, 2000).

¹⁴⁴ Between 1990 and 1999, Fianna Fail had reduced Ireland’s crippling debt-GDP ratio by more than 50 percent, as well as the high tax rates that stymied the flow of domestic and international investment throughout this period (Treacy, 2000: 1071; Bonner, 2000: 920-21; Noonan and McCreevy in Standing Committee Hearings, 2000).

Figure 8: National Debt and General Government Debt Ratios (1991-2008)

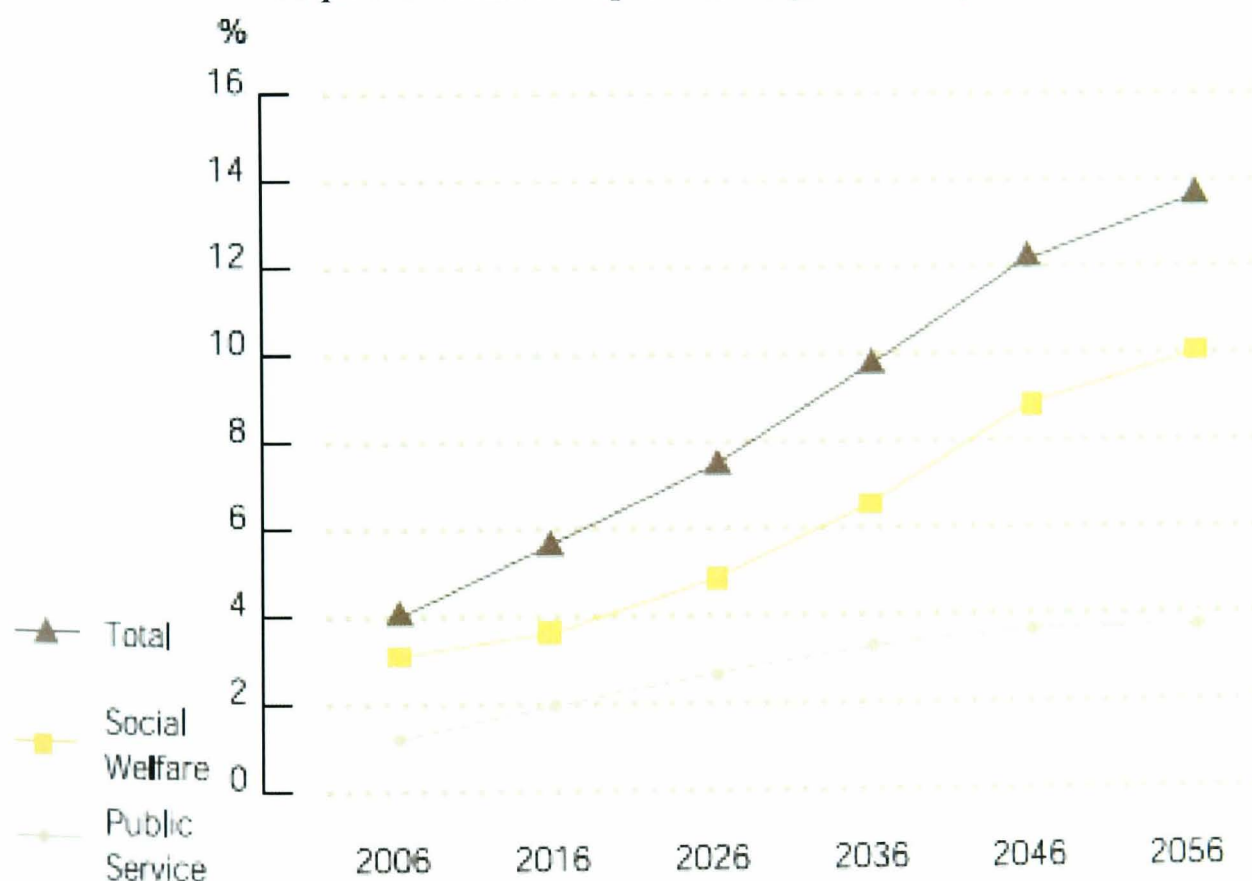
Source: Eurostat, Irish Department of Finance, NTMA Annual Report, 2009: 20

The second and more significant source of uncertainty concerned the future of the state's pay-as-you-go (PAYGO) pension system. Pensions are a property right in Ireland and protected under the constitution. Their continued provision is thus a primary task legitimating the Irish state's role as governors of domestic society. This has been since the government began increasing state-pension coverage in the late 1980s (Coughlan, 2000: 193).¹⁴⁵ However, the sustainability of PAYGO assumes that a certain number of workers will provide sufficient tax revenues to be distributed to pensioners on an annual basis. This sustainability was then cast in doubt by demographic trends published throughout the 1990s. Colloquially termed the 'demographic time-bomb', these trends predicted a higher number of dependants would emerge at the same time the labour force and tax-base would contract (see

¹⁴⁵ For example, one of the government's key priorities throughout the 1980s and 90s had been to improve old age pension provision, the demand for which had risen by 14% in real terms between 1997 and 1999 alone (Collins, 2000: 1557). The government attempted to address various other problems related to private pensions schemes with the Pensions Act and establishing the Pensions Board in 1991. A number of problems with these pieces of legislation nonetheless remained unresolved by the time the NPRF Act was being debated in 1999 (cf. Bonner, 2000: 920-921).

Figure 9). As such, the future of public pension provision became a much publicized and hot button issue throughout the European Union at the time (cf. Cooper-Flynn, 2000: 1559). Officials in the Ministries of Finance and Social and Family Affairs grew concerned for Ireland's own vulnerability to these trends, and commissioned three groups to write more detailed reports on the subject: the National Pensions Policy Initiative (NPPI), the Commission on Public Service Pensions (CPSP), and the Budget Strategy for Ageing Group (BSTAG).¹⁴⁶ The cumulative effect of these reports was that they made Irish state actors aware of a problem of great uncertainty they were expected to somehow address in the immediate term.

Figure 9: The 'Demographic Time-Bomb'
Expected Pension Expenditures (2006-2056)



Source: Pensions Board, Ireland (2006)

¹⁴⁶ The Irish government's initial assessment of the demographic time-bomb concluded that Ireland had the lowest proportion of dependants to eligible workers in the EU: approximately 11 percent aged 65 and over versus the EU's average of 16 percent. But while this proportion would remain constant between 2000 and 2015, it was expected to rapidly increase to 15 percent by 2021, 19 percent by 2031, and 28 percent by 2056 (Coughlan, 2003: 176-7).

To this end, the NPPI and CPSP were specifically tasked to find short and medium-term means of increasing supplemental pension coverage. Of particular note for government was the NPPI's assertion that aggregate pension costs would double between 2000 and 2036, an increase of approximately 4.5 per cent of GNP. The BSTAG Report, on the other hand, was tasked to provide an immediately actionable plan that would ensure the *long-term* sustainability of the PAYGO pension system. It argued 3.5 per cent of GNP needed to be saved annually if the government was to meet its future pension liabilities, and that a 'major initial effort' should be made in light of the recently accrued fiscal surplus. This added extra urgency to their policy recommendations as a later start date would necessitate higher state provisions be made in the future (BSTAG, 1999). As the report argued:

'Put another way, the increased costs associated with ageing are equivalent to a one-sixth increase in the level of taxation – for example, by more than doubling all excise duty rates – or a reduction in other Government non-pay expenditure by mid-century, from its current level of about 11 per cent of GNP to less than 5 per cent of GNP' -- BSTAG, 1999

Hence born out of the principle of tax-smoothing, a dedicated savings vehicle such as the NPRF would spread these expected costs more evenly over time. Raising taxes – a politically disastrous move given Ireland's volatile fiscal history – could therefore be avoided while still preserving the economy's long-term competitiveness (BSTAG, 1999).¹⁴⁷ Mandatory Exchequer contributions thus represented the only means through which the government could adequately support PAYGO when framed as a strictly cost-savings problem. It was approximately one year later that the National Pension Reserve Fund Act was passed, which legislatively mandated the Oireachtas to make budgetary payments to an extra-budgetary account equal to one per cent of

¹⁴⁷ The BSTAG report in fact advocated for the creation of two separate funds: a Social Welfare Pensions Reserve Fund and a Public Service Pension Fund (BSTAG, 1999: 2.1).

GNP each year until 2055 (NPRF Act, 2000: 18-2).¹⁴⁸ The Act moreover stipulated management of these moneys would be placed at one remove of government auspices in a specially created NPRF Commission, and invested in a way that would secure ‘the optimal total financial return’ (NPRF Act, 2000: Section 19-1).

The NPRF was thus never recognized as a means to capitalise on rationally desirable financial opportunities to protect and enhance Ireland’s sovereign wealth. Nor was it created for strictly macroeconomic purposes as would be argued by the dominant paradigm promoted by the SWF literature. There was in fact no short-term incentive for the government to build an SWF like the NPRF from the ground up. Instead, the NPRF has since its inception been framed as a significant yet necessary financial and political cost the state must incur. Indeed, the NPRF Act ensured that pensions would be the state’s biggest financial liability for the next six decades. The NPRF and its SWF identity should therefore be conceptualised first and foremost as a strategy of domestic governance state actors utilized to address two problems of uncertainty that faced them: that of the PAYGO pension system’s sustainability, and the accrual of an unprecedented budgetary surplus. Since its creation in 2001, the Oireachtas has consistently referenced the NPRF’s ability to manage the long-term pension problem in the ‘here and now’, suggesting the government should feel secure in its domestic governance role no matter the size of expected liabilities or volatility of financial markets (c.f. Coughlan, 2003: 170-3, 193). Yet why did the government institutionalize the SWF policy path as the best means of saving given the uncertainty and risks associated therein? From where did these policy preferences derive their legitimacy, and how were objections and competing alternatives surmounted in the Oireachtas? These questions have yet to be addressed in the SWF literature by either

¹⁴⁸ It should be noted here that despite their almost revolutionary significance, neither Act generated much debate in government or media, and discussion in the public domain was virtually nonexistent (Maher, 2001: 14; Noonan, 2000a: 83; Bonner, 2000: 920; Ross, 2000: 926).

scholars of IPE or financial economics. To fill this gap, the following section draws attention to the ideational foundations of the SWF policy path and how they were used to legitimate the NPRF throughout policymaking circles in the face of opposition.

8.2 Financial Ideas, Institutional Change, and the NPRF Act

The following discussion argues that the authoritative financial ideas substantiating the SWF policy path were crucial to the passing of the NPRF Act. In the face of political opposition, they were strategically drawn upon to enable the NPRF's supporters in the Ministry of Finance and Fianna Fail majority to sell the controversial savings concept to the rest of government. This is to once again draw attention to the importance of ideas as explanatory variables of institutional change as argued in the constructivist IPE literature (cf. Blyth, 2002; Seabrooke, 2006; Kirshner, 2003; Schmidt, 2010). To be sure, the problems of budgetary surplus and expected pension liabilities can explain why the idea for a savings account came to the fore of the policymaking agenda in the late 1990s. These structural developments can also explain why the concept of such a savings account was a desirable policy preference for government. What they cannot explain is how, upon its creation, the NPRF came to exhibit the three features of the SWF policy path over competing alternatives. Indeed, the Fund's primary purpose as a long-term savings vehicle was insufficient in itself to justify passing the NPRF Act. The NPRF's funding mechanism in no way met the interests of state actors given it would constrain future government's priorities and handicap annual budgets for at least six decades.

Opponents vociferously argued the NPRF was not just a one-off fiscal or budgetary matter, but a highly debatable political issue that required a democratic

consensus that did not exist. The Fund's optimistic long-term perspective was erroneously supported by favourable short-term fiscal conditions that masked the extent to which a recession – or simply a budgetary deficit – would constrain state fiscal capacities (cf. McDowell, 1999; 2000: 1549; Noonan, 2000*a*: 84; Noonan in Standing Committee Hearings, 2000; Ross, 2000: 926).¹⁴⁹ These critics repeatedly demonized what they saw as the Minister of Finance's intent to 'tie the hands of his successors in a way that has never been attempted before' (Noonan, 2000*a*: 84; cf. McDowell, 2000: 1549-53). So while there would be no problem in 2001 to deduct £600 million from a budget surplus heading for £3 billion, a return to balanced budgets or economic contraction would produce serious politico-economic problems for government (McCreevy, Noonan, and McDowell in Dail Debates, 2000: 530-35; Noonan, 2000*a*: 1546; 2000*b*: 533; Ross, 2000: 926). They saw more immediate and tangible uses for this wealth, such as supporting Ireland's 'infrastructure deficit' which would fall outside the Fund's international investment focus. Health services, the transport system, and average wages were also cited as not benefiting from the booming economy whose profits were disproportionably isolated to a 'small coterie of people' (Costello, 2000: 935). If left unattended, the NPRF Act's opponents argued, the Irish state would be forced to address a variety of different problems than that posed by future pension liabilities.¹⁵⁰

¹⁴⁹ Additional objections to the NPRF Act concerned: (i) the uncertainty of the BSTAG's projections of the demographic 'time-bomb' (McDowell, 2000: 1552); (ii) that so much public capital would 'go towards fattening the already bloated profits of the international and domestic banks' (Higgins, 2000: 1565); and (iii) other more immediate problems demanded attention such as investments in infrastructure that could boost economic growth and could thus also help meet future pensions costs (Costello, 2000: 935).

¹⁵⁰ In response to these proposals, McCreevy stated the NPRF's international focus wouldn't impact present generations who are taken care of by other policies such as 'substantial infrastructural and other capital investment under the national development plan, for continuing implementation of the Programme for Prosperity and Fairness, for further improvements in public services and for ongoing reduction in the national debt' (2000*a*: 914).

But even prior to parliamentary debates, the NPRF Act's authors were aware of the political vulnerability annual Exchequer contributions would subject them to in times of deficit. They consequently attempted to control for these anticipated obstacles by drawing upon the authoritative financial ideas detailed in Chapter Three that seek to render speculative finance into a manageable and predictable exercise. In short, these ideas would be used to demonstrate the NPRF was not just desirable, but wholly necessary given PAYGO's expected unsustainability. NPRF opponents could thus be strategically framed as irrational and divorced from the material realities the Irish state was clearly facing. Such was its supporters' belief in the accuracy and altruistic worth of modern theories of investment, the NPRF's desirability as a strategy of governance never wavered in the face of opposition (cf. Treacy, 2000: 1071; O'Toole, 2004: 1247). As commented by the Minister of Finance, Charlie McCreevy, in legislative debates:

'There are 1,001 reasons Ministers for Finance should not do something like this. There are no votes in it for a start. If I thought of votes I would not be doing something like this. But in the long term I am of the view that...someone might stand up and say "Who was the Minister for Finance who thought up this in the first place?" People will not even remember my name but they will say I must have had some vision for the future' – McCreevy, 1999: 1268

From the very start of its debates in the legislature, the NPRF's supporters argued the NPRF's legitimacy hinged on two factors in particular: that the government's links with the Fund be absolutely minimized, and its managers should be exclusively focused on maximizing its principal. They thus turned to the idea of *financial expertise* to achieve the former of these two goals, and to that of *financial profitability* to achieve the latter.

8.2.1 The Idea of Financial Expertise and the NPRF Act

Since the mid 1980s, the Oireachtas's approach to domestic governance has been rooted in public choice theory, which gives precedence to the market mechanism to organise and coordinate socioeconomic relations. This affinity towards market efficiency arose from the highly influential National Economic and Social Council's 1986 Strategy Report (NESC), which committed the government to reducing its direct involvement with the domestic economy (NESC, 1986; cf. Beary, 2007). The Celtic Tiger that soon followed was then seen as validation for this mistrust of government and was quickly applied to all matters of socioeconomic policy (Beary, 2007). To be sure, the Oireachtas's historical propensity to spend beyond its means regularly thrust fiscal policy and budgetary management into the national spotlight. Throughout the 1970s and 80s, elections were won and lost on budgetary planning. Indeed, items costing the equivalent of just €100k to €200k were 'matters of great public and political consequence' (Noonan in Standing Committee Hearings, 2000).

This modern policy tradition greatly influenced McCreevy and his team within the Ministry of Finance when drafting the NPRF Act. After all, the NPRF's success would be determined by the government's ability to save into the long-term. Thus based on a mistrust of self-interested politicians and apathetic civil servants, the Act sought to ensure managerial authority would be placed as far from government as possible (c.f. NPRF Act, 2000: Sections 5-17, 21, 25). Throughout parliamentary and committee deliberations, the legislation's purported 'cornerstone' was in fact to solidify the Fund's managerial independence so as to protect its state-funded principal. This was thought to ensure its integrity as a savings vehicle (McCreevy, 2000*b*: 529, 535; McCreevy, 2003: 1008). The NPRF Commission – consisting of one

chairperson and six members appointed by the Minister of Finance – was created to serve this purpose.¹⁵¹

While critics argued the selection process granted the Minister of Finance too much authority, neither the concept of the Commission nor the variegated and often non-financial expertise it would comprise were questioned (c.f. Dail Debates, 2000: 518; Seanad Debates, 2000: 1078-88; Ross, 2000: 927, 1094).¹⁵² In short, McCreevy was successful in presenting the Commission as an additional layer of bureaucracy separating the Oireachtas from NPRF assets; its primary remit would be to monitor rather than manage the Fund's investments no matter the official wording of the legislation (c.f. NPRF Act, Section 6.5). To be sure, any references to the Commission's responsibilities in the NPRF Act are invariably followed by clauses that empower – and in some cases encourage – it to delegate these responsibilities to external experts (c.f. NPRF Act, 2000: Sections 5-17, 21, 25). If criticizing the Commission, the NPRF's opponents would be referred to these clauses and reminded of the government's historical inability to save (cf. McCreevy, 2000*b*: 529, 536; 2000*c*: 1573; Seanad Debates, 2000: 911-1121; Treacy, 2000: 1101-2). Yet moving managerial responsibility away from government in this functional sense of authority only partially explains how the NPRF came to institutionalize the SWF policy path. That is, limiting the Oireachtas's involvement would not guarantee the NPRF be successful as a long-term savings account, and thus did not by itself legitimate the

¹⁵¹ The NPRF Commission was officially tasked to 'control, manage and invest the assets of the Fund in accordance with the Fund investment policy' (NPRF Act, 2000: Section 6).

¹⁵² Viable candidates for the NPRF Commission need only possess 'substantial expertise and experience at a senior level in any of a number of listed areas'. These include, but are not limited to: investment or business management, finance or economics, the law, actuarial practice, accountancy, civil service of government or the state, trade union representation, the pensions industry, or consumer protection (NPRF Act, 2000: Section 7.4). The Commission as an extra layer of bureaucracy was in fact questioned only once throughout the legislative process, and this to avoid overcomplicating the Fund's governance structure by having the NTMA assume the Commission's duties (Noonan, 2000*a*: 87).

Fund as a strategy of governance. Additional ideas underpinning the concept of financial expertise had to be called on in this regard.

The National Treasury Management Agency was thus delegated operational authority for managing the Fund's investments so as to fill the gaps left by the Commission's passive role as political buffer (NPRF Act, 2000: Section 6.5). It was, however, acknowledged that the NTMA 'may require some additional skills' and that 'teething issues' must be considered (Treacy, 2000: 1114). But in any case, the NPRF's supporters argued the Agency was more ideologically predisposed to oversee the Fund's commercial mandate than the Commission alone. It was portrayed as possessing a business culture divorced from the clouding influence of politics due to its performance-orientated remuneration structure. It was therefore more 'psychologically geared to doing things rather than agonising over how things should be done...largely because civil servants have no incentive to put their necks on the line' (Somers, 2006; cf. McCreevy, 2000*c*: 1576-77; McCreevy in Standing Committee Hearings, 2000; Doyle, 2000: 1069).¹⁵³

That the NTMA lacked the specific expertise required to manage a diversified investment portfolio was thus framed as being of little consequence for the Oireachtas. This expertise could be either purchased or internally developed in the same way the NTMA had done in the past (cf. Somers, 2003). It was the NTMA's business culture and history of public service that qualified them to operationalize the Fund's commercial mandate 'to secure the optimal total financial return...provided the level of risk to the moneys held or invested is acceptable' (NPRF Act, 2000: Section 19-1). As such, McCreevy and his supporters argued that only the NTMA had

¹⁵³ Another reason the NTMA was selected was so the government could maintain some form of connection with the Fund's managers, whoever they may turn out to be. This is witnessed in the deeply embedded linkages connecting the Minister of Finance with senior staff at the NTMA, as well as the NTMA's CEO being made a permanent member of the NPRF Commission (cf. McCreevy and McDowell in Standing Committee Hearings, 2000).

the capacity to translate the mandate's talk of risk management into prudent and legitimate action. In short, only an NTMA divorced from the clouding influence of politics and versed in the language of financial risk could determine what constituted legitimate financial action and what did not (McCreevy, 2000*b*: 529, 536; c.f. McCreevy, 2000*c*: 1573; Corrigan, 2000: 5; Seanad Debates, 2000: 911-1121).

As a result of these authoritative ideas, any criticisms or amendments that sought to undermine either the Fund's commercial mandate or the role of its arms-length managers in the Commission and NTMA were immediately discredited. They were framed as threatening both the Fund's ability to save and profitably invest.¹⁵⁴ Thus by drawing from the ideas underpinning the concept of financial expertise to inform the government of their interests, not delegating managerial and operational authority to the Commission and NTMA was successfully equated with the failure of the PAYGO pension system. By extension, the failure of the SWF policy path was equated with the failure of the Irish welfare state in general (Corrigan, 2000: 15). In this way the NPRF came to exhibit the third distinguishing feature of SWFs: that the funds are deliberately placed at one remove from regulatory entities such as finance ministries or central banks traditionally tasked with the management of sovereign capital.

¹⁵⁴ Amendment no. 25, for example, was adopted so as to increase the Commission's authority over the NTMA's CEO – a permanent member of the Commission – to demand accountability and information regarding NPRF performance (McCreevy, 2000*b*: 535). On the other hand, failed amendment no. 21 sought to increase the powers of the legislature over investments that might affect the 'common good'. It was argued the NPRF Act divested both the Minister of Finance and the Oireachtas in general from the policymaking role, undermining their governing authority (McDowell, 2000: 529-30; cf. amendment no. 26 in Dail Debates, 2000: 535; amendment no. 3 in Seanad Debates, 2000: 1078-88). This proposed amendment and others like it were quickly rejected firstly on the grounds that neither the legislature nor Minister of Finance should 'have any right to give directions to the commissioners or set the criteria to which they must adhere'. This was meant to avoid 'politicizing' the fund, which would compromise its investment returns and role as a savings vehicle (McCreevy, 2000*b*: 529, 536; c.f. McCreevy, 2000*a*: 1573; Seanad Debates, 2000: 911-1121). More fundamentally, however, it was rejected on the ideational grounds that the NTMA and Commission would already be guided by a commercial investment mandate to secure 'the optimum return over the long term, subject to prudent risk management'. No additional forms of governmental oversight or changes to the existing NPRF Act were therefore deemed necessary (McCreevy, 2000*b*: 529).

8.2.2 The Idea of Financial Profitability and the NPRF Act

The legitimacy of the NPRF as a dedicated savings vehicle was successfully framed as depending on its managerial authority being delegated outside the auspices of the Oireachtas, and to financial experts in the NTMA. Yet considering the NPRF would be primarily funded by annual Exchequer contributions, why the emphasis on returns demanded of its commercial mandate? To this effect, recall that legislating for these mandatory budget allocations was not in the government's interests given the constraint they would impose in times of deficit or economic contraction. However, neither McCreevy nor his biggest supporters in Fianna Fail would shift their position in this regard, arguing that 'any short-term difficulties the payments may cause the Exchequer are more than offset by the long-term gain'. Any deviation, even if it necessitated increased borrowing, was framed as undermining the whole basis of the Fund (McCreevy, 2000*c*: 80). The NPRF's legitimacy thus also depended on the belief it could earn a higher rate of return than the interest paid to service the national debt. Anything less would merely shift these liabilities from one area of the government's balance sheet to another – from pension liabilities to debt liabilities – rather than reduce them in real terms (Doyle, 2000: 919). Promoting the ideas underpinning the concept of financial profitability, specifically that of the equity-risk premium, proved critical to the NPRF's appeal. In short, these ideas' ability to create forward looking projections as to the long-term profitability of diversified finance enabled the NPRF to be presented as a desirable, legitimate, and sustainable strategy of governance to a dubious Oireachtas.

McCreevy and his supporters in Fianna Fail were thus proactive in legislative debates, vociferously arguing the national debt – which stood at 41.5 per cent of GDP

– could be paid down at the same time as pensions were being pre-funded through the NPRF’s Exchequer contributions. This was because NPRF capital would be primarily invested over the long-term in riskier assets such as equities. Citing the unfailing presence of the ERP based on historical studies, it was asserted that such assets would pay a premium on top of the cost of debt servicing. This optimism of speculative finance’s long-term profitability was, interestingly, bellied by the massive short-term gains global investors were experiencing on the back of the Dot-Com bubble (Treacy, 2000: 1072; McCreevy, 2000*b*: 942; McCreevy, 2000*a*: 935). Reinforcing the implicit nature of these assumptions throughout the Oireachtas, details on the quantitative side of these arguments were requested only once (McDowell, 2000: 1553). Indeed, more important were the qualitative assumption that speculative investment was an inherently profitable venture. No such official numbers were therefore provided, and it was generally assumed returns would average around 5.5 per cent annually – the interest charged on maintaining the national debt in 1999.

So while agreeing with the principle of providing for pensions into the future, the opposition attempted to frame the practice of NPRF investment as being flawed. Senator Ross, a former institutional stockbroker, was particularly passionate in this regard:

Mr. McCreevy: Senators Costello and Doyle asked why not pay more off the national debt as against putting it into the fund.

Mr. J. Doyle: We will get a higher return on the investment fund.

Mr. McCreevy: That is exactly the point. If the cost of the debt to the Exchequer is, say, 5% or thereabouts, the rate of return from pension investment funds would be considerably greater than that.

Mr. Ross: How does the Minister know it would be considerably greater than that?

Mr. McCreevy: If one takes a survey published every quarter by the [Irish state] pension fund over the past three years one will see the annualised

return on pension investments has been in double digits for the past ten years or more.

Mr. Ross: It does not mean it will be so in the future...*If the Minister can point to any equity market in the world where the yield is more than 5.4% on average, I will take a punt at it.*

--Emphasis added, Seanad Debates, 2000: 42, 1073

Citing a lack of evidence showing investors could beat equity market indices over the long-term, Ross went so far as to call investment management a ‘completely bogus science’. However, the notion that the NPRF’s diversified investment strategy would pay out some form of premium over the cost of debt servicing nonetheless remained implicit. It was that it would be managed by investment professionals external to the state ‘at huge charges’ that was contested (Ross, 2000: 931, 1134; Costello, 2000: 1070; Higgins, 2000: 1565).

Thus in the end, the NPRF’s critics were overcome by the seemingly impenetrable legitimacy of the SWF policy path as promoted by its supporters in the Ministry of Finance and Fianna Fail majority. The notion of the ERP represented a failsafe against the possibility that the short-term costs of mandatory annual allocations would outweigh the long-term benefits of the NPRF’s diversified portfolio. That the Fund would also be monitored by Commissioners divorced from the political arena and managed by financially prudent experts in the NTMA further buttressed the Oireachtas’s confidence. They portrayed the NPRF as a seemingly bullet-proof means of ensuring balanced budgets and the sustainability of PAYGO. Hence the NPRF’s depoliticized managerial structure and its strictly financial mandate did not just represent efforts to maximize national wealth as would be argued by mainstream SWF analysis. More importantly, these defining features of the SWF policy path and their underlying ideas are the pillars upon which the Fund’s institutional legitimacy is based. That the first decade of NPRF investment would

actually see it generate negative returns of -2.2 percent was therefore of no consequence at the time its founding legislation was drafted (cf. NPRF Annual Report, 2009: 8). Indeed, the NPRF's supporters could have no way of knowing what the future would hold. They could only draw from the ideational tool-kit available – as supplied by modern financial epistemology – to inform them of their interests and the best means to achieve them in the face of uncertainty.

Conclusion of Part I

Part I of this Chapter demonstrated how the NPRF was established to address two problems of uncertainty that faced the Irish state in the late 1990s. First was the problem posed by an unprecedented fiscal surplus, the potential uses for which were heavily scrutinized and debated throughout the Oireachtas and media. This debate followed from a deep-seated mistrust of the Oireachtas's ability to manage public moneys after the fiscal volatility experienced in the 1970s and 80s. Second was the problem posed by demographic trends which indicated the much relied upon state pension system was unsustainable. It was demonstrated how the SWF policy path was pursued so as to deal with these problems of uncertainty. It was not pursued so as to take advantage of rationally desirable opportunities afforded by financial speculation. The fact that the Fund was established as a tool of government is not, however, a surprising conclusion in itself. More interesting were the ideational mechanisms through which Ministry of Finance officials trumpeted the SWF policy path as the only way forward. To this end, two ideas that substantiate modern financial epistemology as detailed in Chapter Three were strategically drawn from to legitimate financial speculation as a strategy of governance. First, the idea of financial expertise was used to convince the Oireachtas they should place management at one remove of

government auspices and closer to financial experts. Second, the idea of financial profitability was used to legitimate why the NPRF should be mandated to invest in speculative financial assets with debt-funded public capital.

As a result, the SWF policy path served to financially depoliticize a systematically significant amount of Ireland's national wealth into the indefinite future. Conceptualizing the SWF policy path as financial depoliticization is necessary if a critical IPE analysis of the funds is to be had. Indeed, it allows us to examine how SWFs limit the way their respective state overseers can act in relation to systematically significant pools of public capital. This is not just by placing authority of SWF management at one remove of democratically elected officials. It is also in the way that SWFs' ideational foundations limit what state actors understand to be legitimate action vis-à-vis the management of their public capital. That is, SWF managers – whether internal to government or externally hired – must act within the expectations of modern financial epistemology, continuously diversifying national wealth so as to control for high degrees of financial risk. Any form of government intervention or directed investment that falls outside the prescriptions of this interpretive framework are deemed irrational and normatively wrong. Indeed, once the NPRF was established, the Oireachtas, NPRF Commission and NTMA were all required to act within the bounds of legitimate action prescribed by this financial knowledge framework. The NPRF subsequently became a highly scrutinized feature of Ireland's politico-economic landscape. To this end, Part II examines how the NPRF's SWF identity constrained Irish state agency between 2001 and 2009.

Part II: The NPRF as a Constraint on State Agency

Part I examined how and why the SWF policy path was institutionalized in Ireland through the government's adoption of the NPRF Act. Part II focuses on how this resulted in constraining Irish state agency in two ways between 2001 and 2009. First, a combination of volatile financial markets and poor returns propelled the NPRF to become a highly politicized issue following its creation in 2001. This pressured the NPRF's managers in the NTMA and Commission to expand the Fund's investment universe – and thus exposure to systemic financial risk – to increase its expected returns. It also put increasing pressure on the Fianna Fail majority to promote the SWF policy path as a legitimate strategy of governance to the domestic electorate. This involved actively promoting and normalizing the speculative financial thought and practices that would define the NPRF's institutional identity between 2001 and 2009. Yet in so doing, members of the Oireachtas – especially the Fund's most vocal supporters in Fianna Fail – came to increasingly rely on the epistemological authority of financial experts external to state auspices to support their governance function. The second source of constraint the NPRF imposed on Irish state agency came from international financial markets. Indeed, the NPRF and its SWF identity became a strong signal of creditworthiness for the foreign investors the government heavily relied on to finance Ireland's small open economy. As such, the NPRF and its financial profitability came to be a central feature of Irish fiscal policy between 2001 and 2009.

These two sources of constraint on state agency are significant as they limited the way in which the issues of budgetary management, as well as the future of Ireland's PAYGO pension system, could be conceived of and addressed. They ultimately reconceptualise these problems of uncertainty as problems of financial risk

management only solvable by financial experts divorced from the democratic arena. As will be demonstrated, limiting the role of the state through such financial depoliticization is problematic in the face of recurrent financial crises, which require government intervention to correct. Indeed, these two sources of constraint shaped the Ministry of Finance's response to a domestic banking crisis that emerged in 2008. They resulted in the state's intervention into this crisis to take the form of a toothless NPRF investment rather than the regulatory overhaul called for by a number of state officials and everyday citizens. A more balanced approach to states' relationships with their SWFs must therefore be considered lest democratically elected governments become suppressed features of a crisis prone financial realm.

8.3 The NPRF (2001-2009): *The Oireachtas's Dependence on Financial Experts*

When passing the NPRF Act, the Oireachtas recognized they were committing the Irish state to embed public capital throughout the financial realm for at least six decades. However, it is unlikely they realised the extent to which they would come to depend on financial experts external to the auspices of the state to substantiate their political legitimacy (c.f. Perry, 2003). Indeed, their dependence on the NPRF Commission, NTMA, and externally-hired investment experts only began to emerge after the NPRF Act was passed. It began with the NTMA's first task as operational managers, which was to hire a consultancy firm – Mercer Consulting – to advise them and the Commission of an investment strategy that best met the NPRF's commercial mandate.¹⁵⁵ Using 'efficient frontier analysis' first introduced by Markowitz in 1956, Mercer advocated the NPRF be constructed around a very-high risk profile of 80

¹⁵⁵ Recall that the AHF as well as GPFG also turned to Mercer to inform its managers in the Treasury and central bank respectively of an optimal investment strategy.

percent equities and 20 percent fixed income.¹⁵⁶ While it was conceded the efficient frontier approach ‘cannot, of course, foretell the future’, it was nonetheless framed by Mercer as the only means through which the NTMA should approach NPRF management (Annual Report, 2001: 13). This was given the Fund’s prescriptive commercial mandate, as well as the fact that this approach’s underlying assumptions – those of investor rationality and market efficiency in particular – were used to legitimate the NPRF Act in the first place.

Citing their lack of financial expertise required to operationalize Mercer’s recommendations, the Commission and NTMA immediately agreed they should employ a ‘buy-not-make’ management approach.¹⁵⁷ This meant that authority for the NPRF’s operational management would be entirely delegated to financial actors external to the Irish state and its domestic interests. Hence the NTMA was selected as operational managers because the Oireachtas thought they possessed the private market mentality deemed crucial for the NPRF’s success. For the financial experts in Mercer, however, the NTMA could not be deemed ‘prudent’ to the extent called for by the Fund’s commercial mandate. That is, only financial experts completely divorced from the political arena and in possession of investment skill – as derived from specialized risk management techniques and embedment in financial information networks – were judged capable of financially prudent action.¹⁵⁸ Whether

¹⁵⁶ This investment strategy was based on: the NPRF’s long-term investment horizon, strong annual cash-flow from Exchequer contributions, the government’s commitment to pre-funding pensions through the NPRF, and an assumed ERP of three percent (Annual Report, 2001: 7; 2002: 15).

¹⁵⁷ This was with exception to the NPRF’s passive bond portfolio which would be managed by the NTMA.

¹⁵⁸ The power of these ideas to guide the NPRF’s institutional development is further witnessed in the NPRF’s approach to passive versus riskier active investment strategies. In legislative debates, McCreevy stressed the Fund would pursue a passive investment strategy of tracking indexes. This was based on an NTMA study of risk and return that claimed it was too expensive to hire specialist managers capable of ‘beating the market’ through active management (McCreevey, 2000a: 1570). However, the Fund immediately adopted a riskier strategy of almost 50 percent active management at the advice of Mercer. This further necessitated the NPRF Commission’s adoption of the buy-not-make strategy and, by extension, the government’s reliance on externally-sourced financial experts.

this argument would prove true or not was not known by the NTMA or Commission at the time. Rather, only the *belief* that these ideas were true advised them that a ‘buy-not-make’ management was appropriate given their uncertainty of how to speculatively invest NPRF assets.

As a consequence of their belief in the necessity of financial expertise, the state was placed one step further from NPRF management than was originally expected in legislative debates. It is through this dependence on financial experts informed by modern financial epistemology that the NPRF came to constrain the Irish state in two ways in its approach to domestic governance. Section 8.4 examines the domestic source of this constraint, while Section 8.5 examines the international source of this constraint. Section 8.6 then examines how these two sources of constraint influenced the Oireachtas’s approach to the domestic banking crisis of 2008. Indeed, they constrained the form of the government’s intervention to take the form of a toothless NPRF investment rather than conditional government bailout. This effectively reinforced the banks’ reliance on the speculative and risky lending practices that led to the crisis in the first place.

8.4 The NPRF (2001-2009): *Domestic Source of Constraint*

Despite its high-risk nature, Mercer’s proposal to invest in 80 percent equities and 20 percent bonds greatly appealed to NPRF managers in the Commission and NTMA. Indeed, the Fund’s institutional legitimacy was premised on the assumption its investments could earn returns above the cost of debt servicing in the long-term. Yet despite this focus on the long-term, the NPRF’s legitimacy immediately became implicated with its ability to earn returns in the short-term. This was in the wake of its

failure to keep afloat of volatile financial markets still reeling from a burst Dot-Com bubble. Indeed, the Fund's average annual return in its first three years was a depressing -2.2 percent. This led members of the Oireachtas to put increasing pressure on NPRF managers in the Commission and NTMA to produce positive returns in the short-term, as 'large paper losses might tend to undermine...political and public confidence [in the Fund]' (Mansergh, 2004: 56; Perry, 2003). The Commission was thus constrained to expand their investment universe through extensive diversification as 'the biggest risk [they] could run would be to take an overcautious investment approach and thus reduce the Fund's potential contribution to Ireland's increasing pensions costs' (Carty, 2005: 5). This is to highlight that under modern financial epistemology, the only means of improving the NPRF's risk-return profile was through embedding its assets throughout an increasingly broad range of riskier asset classes and markets. This consequently increased the government's exposure to global financial volatility, and thus their vested interest in the future profitability and expansion of speculative capital markets.¹⁵⁹ Hence rather than increase the government's caution over financial speculation, the Dot-Com crisis led them to believe they should increase the NPRF's global financial embeddedness. Indeed, the crisis enabled the NPRF's managers in the Commission and NTMA to convince the Oireachtas that the Fund had yet to be diversified to the extent prescribed by modern investment strategies. This is despite the fact that diversifying the NPRF in this manner prior to the crisis would have in fact increased the losses accrued therein.

¹⁵⁹ In 2003, the NPRF's investment universe was expanded to include small cap equities (2 percent), corporate bonds (2 percent), property (4 percent), public-private partnerships (€200 million initially), and private equity (Annual Report, 2003 15). Then by 2008, the NPRF's benchmark portfolio consisted of large-cap equity (61.4 percent), small-cap equity (5 percent), emerging markets equity (4 percent), private equity (3.3 percent), property (4.4 percent), commodities (1.5 percent), bonds (15.6 percent), and cash and currency (2.1 percent). See Annual Report, 2008: 4.

The NPRF thus unintentionally became a highly politicized and controversial issue shortly after its creation. Its financial successes and failures became regular and influential talking points for politicians throughout both the media and policymaking circles.¹⁶⁰ The opposition's political platform in the 2002 national election was in fact premised on the argument that the Fund's assets should be used to address Ireland's expansionary infrastructure deficit (Irish Times, 2003). As with their initial reservations about the NPRF, these critics in Fine Gael and Labour maintained annual Exchequer contributions were too rigid and that the government's 'rather conditional access to bond markets is not quite oil in the ground' (McCarthy, 2009). While they were convinced of the 'need to diversify risk' given the Fund's commercial mandate, they nonetheless argued 'it does not make sense to suggest that it is *always* better to invest a fund of this type abroad' (emphasis added, Ryan, 2004: 1251-2). Instead, they proposed infrastructural investments could help promote economic efficiency and growth, thereby increasing government tax revenues and their ability to finance future pensions (c.f. Bruton, 2004: 17, 23, 27).

Despite their efforts, the opposition in Fine Gael and Labour were unable to convince either the Fianna Fail majority or the electorate that the SWF policy path was not in their best interests. This proved a major reason Fianna Fail retained their parliamentary majority in 2002 as 'raiding' the NPRF to invest in infrastructure was equated with an economic gamble and a financially insecure future (Leyden, 2004: 1256; Mansergh, 2004: 55). Indeed, Fianna Fail's popularity became increasingly associated with their prudent and forward-looking approach to domestic governance following their spear-heading the NPRF's creation (Irish Times, 2003; Irish Independent, 2009; RTE News, 2009). As in Norway and Alberta, however, this

¹⁶⁰ See for example: Hughes, 2004; Geaney, 2003; Suiter, 2001; Howlin, 2001: written question 40; Dail Debates, 2003: 1008; Penrose, 2003: 32; McGinley, 2003: written question 278; Ring, 2003: written question 238; Quinn, 2000: written question 58; Morgan, 2008: 130; O'Shea, 2008: 130.

support was not a natural by-product of inherently desirable legislation. Rather, it had to be actively pursued through their promotion of the SWF policy path and the modern financial epistemology upon which its legitimacy was based.

To this effect, the dominant narrative espoused by the government with the support of the Commission and NTMA was as dire as it was convincing. It was argued time and again throughout the media, public speeches, and review committee hearings that if the financial logic underpinning the NPRF's investment strategy was not sound, it would mean 'the failure of the free world model'. The government would therefore have much bigger problems to deal with (Geaney, 2004: 7; 2003: 11; cf. Annual Report, 2002: 7). This represented a marked departure from the optimistic message of financial speculation's inherent profitability promoted in earlier debates. In short, failure of the NPRF was equated with the failure of modern capitalism as 'equities must outperform bonds because investors must be rewarded for buying riskier assets...otherwise there are no incentives to invest in business'. The Fianna Fail government's commitment to these ideas was then cemented following the 'virtually unprecedented three successive year decline' in global equity markets between 2001 and 2004 (Geaney, 2003). Indeed to withstand the resulting onslaught from the political opposition, the NPRF's supporters could only reemphasize the Fund had a long-term perspective, and argue these short-term losses would most likely never be realized (Dail Debates, 2003*b*: 357-8). At the same time, however, they could only do so with the support and epistemological authority of financial experts in the NTMA and externally hired consultants. Without this support, such arguments could be framed by the opposition as a political tactic by a fiscally irresponsible Fianna Fail majority.

The Oireachtas as a whole therefore conducted regular reviews and presentations of the NPRF's investment strategy to inform them of what constituted rational action in the midst of financial crisis. Mercer, the consultancy firm incentivized to preserve the NPRF's lucrative SWF identity, was tasked to conduct two reviews of the Fund in 2002 and 2007.¹⁶¹ Both reviews unsurprisingly concluded that the rationale for the NPRF's long-term diversified investment strategy was still valid, despite the abnormal volatility in financial markets. Mercer even went so far as to claim that 'the probability of equities outperforming bonds over a 20 year time horizon is 100 percent', and that there was a 60 percent chance of reaping an ERP of four percent over the next five years (Annual Report, 2002: 15). The second review reiterated these arguments to a dubious Oireachtas despite the 'abnormally low returns' of equities compared to safer assets like bonds and cash between 2001 and 2007 (Annual Report, 2007: 13).

The Commission and NTMA conducted three similar internal reviews, and argued the same conclusions as Mercer in mandatory presentations made to the Committee of Public Accounts – a fiscal watchdog committee. But again, these presentations were not meant to critically review the SWF policy path's underlying financial logic in the face of these problematic global crises. Instead they merely served to remind Fianna Fail, Fine Gael, and Labour officials of the legitimacy of the NPRF's underlying financial assumptions, and – by extension – the desirability of the speculative assets through which the Fund would pursue its commercial mandate (c.f. Somers, 2003; 2008; 2009). They were symbolic acts through which the Oireachtas could demonstrate to itself as well as the public it was ensuring national wealth was being managed in accordance with contemporary financial best practice.

¹⁶¹ Between 2001 and 2009, externally hired consultants such as Mercer were paid over 2.6 million to advise the NTMA on how to approach the NPRF's increasingly diversified investment portfolio (Annual Reports, 2001-2009: Fees, Commissions and Other Expenses).

NPRF managers in the Commission and NTMA were also constrained to act within the same prescriptive assumptions about speculative finance when approaching Fund management. After all, the whole basis for the NPRF would be undermined if they were to frame its SWF identity as erroneously informed by modern financial theory, and thus tantamount to gambling. As presented by the Chair of the NPRF Commission to the Committee of Public Accounts following the Dot-Com bubble burst:

'It is hard to look back on 25 years of data and see that there is a large equity premium in the context of falling markets. Joe Kennedy Snr. sold his shares in 1929 because the shoe shine boy told him to but if we said we were running the [NPRF] in that way, people would not be too happy. It would be all right if we did the right thing but let us suppose it was the other way around. We have done the best we can.' -- Geaney, 2003

Here, Geaney is ultimately saying the Commission can only act according to the financial assumptions underpinning the SWF policy path in informing them of how to approach NPRF management. To be able to predict the market is impossible, he says. The government must nonetheless maintain faith in the NPRF's capacity to harvest the ERP over time if it is to be considered a legitimate strategy of governance by the domestic electorate. As such, it was the authoritative ideas substantiating the NPRF's speculative financial identity that prescribed how the government should approach Fund management between 2001 and 2009. It was not just the act of placing the political character of decision-making vis-à-vis Fund management at one remove of government as held in existing approaches to depoliticization (cf. Burnham 2001: 128).

The Oireachtas's acceptance and promotion of the SWF policy path as dogma between 2001 and 2009 therefore cemented the expectation of financial market volatility into the NPRF's remit. To be sure, the NPRF's long-term diversified investment strategy amounted to a political buffer upon which the Oireachtas came to

increasingly rely in the financially volatile 2000s (cf. McCreevy, 2003: 1008; 2003*b*: 1385-6; Coughlan, 2004: 921). In so doing, however, both opposition and majority politicians committed themselves and their successors to framing future pension provision and budgetary management as purely quantitative matters of financial risk management. The NPRF's critics were either unable or unwilling to develop an equally desirable governance strategy than that advocated by the Fund's supporters in Fianna Fail, the NPRF Commission, the NTMA, and externally hired financial experts. Deviation from the SWF policy path – no matter how volatile financial markets became – was consequently perceived by a majority in the Oireachtas as tantamount to a failure of governance. That is, a failure to ensure both the sustainability of state-pension provision and balanced budgets.

In this way the government came to develop a vested interest in preserving the legitimacy of the SWF policy path as a key element of their governance function between 2001 and 2009. As the preceding discussion demonstrated, they did so by reiterating and promoting the authoritative financial ideas upon which the SWF policy path is based. This was necessitated by several years of negative returns following the Dot Com crisis, which brought the NPRF to the fore of domestic political debate. These negative returns also pressured the Commission and NTMA to enhance the Fund's risk-return profile, resulting in them expanding its investment universe and hence the government's exposure to global financial volatility. As such, the Irish state was not just constrained by managerial authority being delegated to the NPRF Commission and NTMA. Instead, the government was also constrained by the ideational authority exerted by modern financial epistemology once institutionalized into the state apparatus. This was by its prescribing what they should consider a

legitimate versus illegitimate approach to NPRF management, and how this approach should be communicated to the Irish public.

8.5 The NPRF (2001-2009): *International Source of Constraint*

The constraint imposed by the NPRF and its speculative financial identity on Irish state agency also originated from international financial markets. This source of constraint became apparent to government in 2001 when Standard and Poor's upgraded Ireland's long-term sovereign debt rating to AAA. They cited that the creation of the NPRF and its long-term approach to diversified investment meant Ireland had more 'ample fiscal flexibility to meet the challenge of an ageing population...than most EU members' (McCreevy, 2001: 508; cf. Cooling, 2002).¹⁶² Ireland and its government bonds thus represented attractive investments for mobile finance capital compared to its competitors throughout continental Europe. Yet while this ratings boost was a bonus in 2001 when the budget was still in surplus, maintaining investor confidence in Irish bonds by promoting the NPRF became a dominant priority for the government from the mid-2000s onwards. This was due to Ireland's entering the EU single currency market in the early 2000s, as well as the re-emergence of an expansionary national deficit from 2004 onwards.

Indeed, the fact that all European government bonds would be denominated in the same multilaterally-governed currency meant Ireland no longer had 'a unique product to sell' on international debt markets. This was a significant development for Ireland given foreign investors owned 70 percent of government bonds in 2003 (Somers, 2003). Ensuring that enough cash was available to meet the government's

¹⁶² For a complete list of Standard and Poor's ratings of Irish bonds between 2001 and 2009, visit: <http://www.ntma.ie/Publications/pressReleaseIntro.php>

expenditure needs consequently became the NTMA's 'core business' and 'main element of concentration' (Somers, 2003). The NTMA was thus aggressively marketing Irish bonds with the NPRF being a central feature of their marketing strategy.¹⁶³ As summarised by Somers, CEO of the NTMA and permanent member of the NPRF Commission:

'One of the benefits of the National Pensions Reserve Fund, with its €20 billion in assets, is that it contributes to the positive assessment by credit rating agencies and international investors of Ireland's credit worthiness. In debt to GDP terms, Ireland stands at close to 25%, but when the NPRF is taken into account...the ratio drops to 14% of GDP' -- Somers, 2009

Thus by 2009, the NPRF and its SWF identity had become central features of Irish fiscal policy. The NTMA's marketing campaign propelled the Fund to become widely viewed as a 'flagship project' upon which international investors and rating agencies positively assessed Ireland's credit worthiness. As a consequence, any change of direction from its diversified investment strategy or mandatory Exchequer contributions would be seen as 'prioritising short-term interests over the longer term sustainability of the public finances'. This would lead financial markets to 'respond negatively to any such changes' and, by extension, hamper the government's ability to finance the day-to-day functioning of the state (O'Connell, 2009). So while the NPRF was always meant to act as a counter-cyclical tool of budgetary stability, it unintentionally assumed a greater significance for the state in its approach to domestic governance.¹⁶⁴ Such a relationship between the state's governance function and the SWF policy path was most evident following the recent financial crisis.

¹⁶³ To be sure, the NPRF is linked to the NTMA in other ways than just being its operational managers. For example, the CEO of the NTMA is a permanent member of the NPRF Commission. Moreover, the Chair of the Commission between 2005 and 2009, Paul Carty, had been a high-ranking NTMA official between 1990 and 2005.

¹⁶⁴ The importance of the NPRF to Ireland's fiscal strategy was solidified following the release of the government-commissioned report of the 'Special Group on Public Service Numbers and Expenditure Programmes' (colloquially known as the 'Bord Snip Nua'). This group was tasked to find ways to reduce public spending following the surge in the national debt between 2006 and 2009. One of the report's recommendations was that the national debt in the medium to long-terms was unsustainable if

To this end, the NPRF was devalued by over 30 percent between 2007 and 2008 – a loss of €6.7 billion, or more than 15 percent of national GNP in 2008 – eliminating more than all the financial gains it had made since inception (Annual Report, 2008: 5, 39). As with preceding crises, the Commission unsurprisingly reminded a reeling Oireachtas of the NPRF's long-term perspective and warned of the 'danger' of taking a short-term view. They claimed the Fund's performance was credible 'given the difficult and unusual decade...similar to the 1930s when equities earned a negative return and bonds strongly outperformed' (Carty, 2010). Thus harking back to an earlier era of finance capitalism, the Commission assured the government no one could be held accountable for the extreme abnormality that was the NPRF's performance in 2007 and 2008. Not even the market could be blamed for such a performance given the extent to which the crisis affected all types of previously uncorrelated asset classes and markets.

Yet what distinguished the government's response to this crisis from that of the Dot-Com bubble was not just its being motivated by Fianna Fail's fear of losing face in domestic politics. Rather, both the Commission and NTMA stressed that a poorly performing NPRF was more significant for international financial markets. Indeed, the Minister of Finance of the time – Brian Lenihan – and his contacts in the NTMA vociferously argued in emergency presentations to the Oireachtas and media that tampering with the Fund's investment strategy in the face of the crisis was unthinkable. The massive losses incurred must be recouped as quickly as possible lest international confidence in Ireland as an investment destination be hurt. Maintaining the NPRF's high-risk profile in hopes market equilibrium and the ERP would prove

the government were to continue its annual GNP allocations to the NPRF (Bord Snip Nua, Volume 1, 2009: 66; Volume 2, 2009: 182). This advice was, however, ignored as these contributions had become fundamental to public spending – i.e. in their capacity to increase the attractiveness of Ireland's bonds on international debt markets (McCarthy, 2009).

resilient on the back of ad hoc government interventions in the US and UK was thus the only perceived means through which such a rapid turnaround could be achieved. It was therefore argued that any deviation from the SWF policy path would lead to ‘considerably difficult circumstances for the State’ (Lenihan, 2009a: 9, 846-7; McDonagh, 2009; Cowen, 2008: 130-1; Mansergh, 2009: 429, 469). This politico-economic environment produced by the financial crisis was, however, made all the more complicated by an emergent domestic banking crisis that hit two of Ireland’s ‘Big Four’ banks: Allied Irish Bank (AIB) and Bank of Ireland (BoI). Deconstructing the government’s reaction to this crisis provides a specific case in which the ideational constraint exerted by the SWF policy path on Irish state agency can be witnessed.

8.6 The NPRF as Constraint *The Irish Banking Crisis of 2008*

The NPRF’s speculative financial identity constrained the way in which the Ministry of Finance approached the Irish banking crisis of 2008. Indeed, it influenced their intervention to take the form of an *investment* rather than a conditional government bailout. This is more than a semantic distinction as the rescue package reduced the government’s domestic regulatory capacity to a matter of ensuring the NPRF secured financial returns on these investments. In so doing, the Oireachtas in fact incentivized the banks to continue using the same aggressive lending practices that led to the crisis in the first place. The SWF policy path consequently prescribed the way in which Irish state actors should approach the banking crisis, and thus the impact their intervention had on rectifying its root causes.

To this effect, the collapse of the global interbank market following the credit-crunch in 2007 resulted in AIB and BoI no longer being able to fund their day-to-day operations. While they held few of the asset-backed securities that had precipitated this collapse, each bank had nonetheless overstretched their lending capacities throughout the 2000s on the back of corporate tax cuts and an abundance of cheap credit. Their risky lending campaign subsequently inflated an Irish property bubble, leaving them exposed to collapsing housing prices when the domestic economy and international credit markets contracted in 2007 (Caolain, 2009: 900; Government Announcement, 2009). So while precipitated by international events, the domestic banking crisis demanded a strictly Irish solution. AIB and BoI consequently pressured the government to front them an interest-free loan so as to avoid bankruptcy. This was after failing to secure funding from private investors. The pressure tactics propelled the Oireachtas to pass the 'Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act' (INPRFMFA) in 2009, which allocated €3.5 billion of NPRF assets to each bank (INPRFMFA, 2009: Section 8).¹⁶⁵ While this represented more than 40 per cent of the NPRF's underlying capital base in 2008, the government believed that leaving these banks to fail was tantamount to economic catastrophe (Lenihan, 2009a: 841; Lenihan, 2009b).¹⁶⁶ At first glance, the Oireachtas's decision to intervene into the NPRF thus appears to contradict the argument that the SWF policy path constrains state agency. If it were truly a constraint then the government would not have endeavoured to use NPRF assets to recapitalise these failing banks.

¹⁶⁵ The Minister of Finance in fact announced the rescue package months before it was actually passed in the Oireachtas. This was after AIB and BoI held emergency meetings with the Minister of Finance, stressing how dire the banking crisis was and how domestically destabilizing their bankruptcy would be (Government Announcement, 2008).

¹⁶⁶ Opposition politicians in Fine Gael and Labour were not so kind, arguing that it was because of the government's 'corrupt relationship [with] dodgy developers, the bankers, and special interests groups' that it had become 'a prisoner of its own alliances' (Morgan, 2009: 898-9).

However, looking at the form of the rescue package reveals the extent of this constraint.¹⁶⁷

To reiterate arguments made in Sections 8.4 and 8.5, the NPRF's SWF identity became a substantive element of state fiscal policy between 2001 and 2009. Its long-term investment perspective and annual source of public funding enabled the NTMA to market Irish bonds as more attractive than its EU competitors. Yet in the midst of the banking crisis the NPRF represented the only readily available pot of public capital from which the Minister of Finance could conceivably draw (c.f. Dail Debates, 2009: 846). This was given that year's budget was already in deficit and the national debt had steadily risen in each of the preceding three years (see Figure 9). An NPRF directed investment in fact meant that the rescue package would not be classified as spending under EU accounting rules, thus giving government finances added breathing room (Bannon, 2009: 901). But if the government were to use the NPRF to recapitalise the banks, they had to do so in a way that 'the markets would believe in' (cf. Dail Debates, 2009: 846-8). This constrained the state to act as an *investor* rather than regulator lest international investors lose confidence in Ireland as an investment destination. In short, an NPRF rescue package the markets would perceive as de facto nationalisation or outright political takeover was out of the question. Only one that fell within the NPRF's existing remit of pursuing optimal financial returns through limited political interference would be deemed acceptable by the market.

¹⁶⁷ While the domestic source of constraint did not hamper the government's decision to use the NPRF in this way, Fianna Fail was still scathed in domestic politics. Support for the Fianna Fail majority government fell by 50 percent following the announcement of the rescue package. Use of the NPRF to fund the bank recapitalization tarnished their image as forward-looking governors, an image largely supported by their creation of the NPRF in the first place (cf. RTE News, 2009). This highlights the domestic source of constraint exerted by the NPRF as the Fianna Fail majority have been deemed untrustworthy in governing the nation's finances like so many governments before them. They will therefore be hard-pressed to maintain their 20 year dominance of the Oireachtas in the 2012 general election, which serves as a warning to the now popular Fine Gael and Labour parties to leave the NPRF untouched (c.f. Irish Examiner, 2009).

The Governor of the Central Bank, the Financial Regulator, his financial advisors, and the National Treasury Management Agency all ratified this argument. The Minister of Finance was consequently led to believe that an NPRF investment overseen by the Commission and NTMA was ‘crucial for [the banks] to be understood by worldwide markets as being subject to normal market disciplines and not political disciplines’ (Lenihan, 2009*b*; cf. Lenihan, 2009*a*: 873, 846-7; Somers, 2008). The recapitalisation package was therefore constructed around the notion that the NPRF would be *investing* in the banks, albeit in such a way that prevented the government from voting on its €7 billion ownership claim. This would ensure the NPRF’s commercial mandate would remain intact – a positive signal for both foreign investors and the domestic electorate – while also providing the banks with a politically-minimalist public capital injection.¹⁶⁸ The importance of managing both the public and markets’ perception of the NPRF’s investment meant the state actors involved had to promote its desirability. They particularly stressed the NPRF would have invested this €7 billion for a return the package sought to ‘guarantee’ anyway (Government Announcement, 2009).

Yet in so doing, the government’s primary concern became guaranteeing it earned a return on these investments. Indeed, the package consisted of a hybrid investment vehicle, meaning it resembled an equity security but required the bank pay the government a fixed annual dividend of 8 percent.¹⁶⁹ While critics railed against the package’s supporters for ‘listening to the banks on each occasion in terms of what they need rather than what the country needs and where we need to get to’, even they became overwhelmingly focused on ensuring that ‘taxpayers’ earn a return on these

¹⁶⁸ For example, the package empowered the Minister of Finance to appoint 25 percent of the banks’ Boards, but at the same time the government would not hold ordinary shares and would possess no voting rights (Government Announcement, 2009).

¹⁶⁹ The package also included an option to purchase 25 percent of each bank in 2014 if the banks shares were still suffering (Government Announcement, 2009: Appendix 2).

investments lest they lose political capital (Mitchell, 2009: 851-2; cf. Burton, 2009: 853-4). The government consequently directed little focus on attempting to prevent another such crisis from occurring after the deal was made. This was despite several proposals introduced by members of the Oireachtas, such as increasing the banks' capital requirements, their transparency and accountability, or the level of political oversight over the fragile financial sector (cf. Hearings of the Committee on Public Accounts, February 10 2010; May 14 2009; June 19 2008). In short, the NPRF's speculative investment package prevented the government from making any regulatory changes that may have threatened the intervention's financial profitability.

The package in fact pressured both AIB and BoI to earn risk-based investment returns as quickly as possible. That is, the deal enabled the government to greatly enhance its ownership share of the banks if they were unable to either make their annual dividend payments or increase their share prices, (c.f. Government Announcement, 2009: Appendix 2; Somers, 2009; Carty, 2010). The government's rescue package thus in no way guaranteed that more credit would be made available to the small businesses and home-owners who were suffering the most. Instead, it represented a symbolic means of supporting the banks' attractiveness to the private investors who would hopefully provide the capital needed to rectify the crisis (O'Donnell, 2009: 849). Indeed, the conditions the package did demand of the banks were more a means to pacify the domestic electorate seething from what they saw as bankers' greed.¹⁷⁰ The government's intervention thus never sought to make any lasting regulatory changes lest these private sources of financial support lose confidence in Ireland as an investment destination.

¹⁷⁰ For example, the deal required the banks to increase their lending standard codes by 30 percent for small and medium sized enterprises and 10 percent for first-time home-buyers. However, this was only for 2009, and a year on the government reported that 'viable business propositions' continued to be refused loans (Government Announcement, 2009). Cuts in senior executive and other directors' pay would also only apply to 2009 as a type of fine for taking excessive financial risks.

The Irish banking crisis therefore demonstrates that the state clearly benefits from the NPRF and its SWF identity, both as an attractive feature of its financial landscape as well as a pot of money available for use on a ‘rainy day’. But at the same time, it has the capacity to constrain the state’s agency when approaching problems of governance they are expected to resolve. Indeed, it encouraged the state’s intervention into the Irish banking system to take the form of largely unconditional speculative investments. This ultimately reconceptualised the government as just another concerned shareholder dependent on the banks’ ability to earn returns and increase their share price. As a consequence, members of the Oireachtas never dwelled on the underlying causes of the crisis or how they could learn from them. They instead focused on how to ensure the NPRF profit from its investments lest they lose legitimacy as governors of Irish society. In short, the financial orientation of the package effectively neutered the Oireachtas in its ability to affect any regulatory changes in the risk-laden Irish banking sector (O’Shea, 2009: 92). It ultimately incentivized the two banks to resume their aggressive pursuit of financial returns by any means necessary. The NPRF’s SWF identity thus led Irish state managers to increase their dependence on a speculative financial system, prone to bouts of panic and crash, in their approach to ensuring socioeconomic stability and growth.

Conclusion

Using Ireland’s National Pension Reserve Fund as a case study, the preceding Chapter sought to demonstrate how the SWF policy path as a state-sponsored strategy of governance effectively replaced one type of uncertainty with another. The problem of how to meet expected pension liabilities that faced the Irish state in the late 1990s was replaced with the expectation that the NPRF will generate financial gains above

the cost of debt servicing. At the same time, the SWF policy path quickly became a substantial source of support for the state's governance function between 2001 and 2009. This was in terms of supporting state fiscal policy and its perceived ability to ensure the sustainability of the PAYGO pension system – a major responsibility of the state. The chapter demonstrated how such constraint is the product of SWFs' ideational foundations and not just the functional effect of placing political authority at one remove of NPRF capital. It then suggested this constraint prevents alternative and equally plausible mechanisms for pre-funding future pension liabilities or balancing annual budgets from being seriously considered.¹⁷¹ The NPRF's expansionary remit is in fact gaining support on the back of the Fund's recent 20 percent gains in 2009. To be sure, these gains and their validation of the SWF policy path resulted in the transfer of €880 million to the NPRF from 10 university and non-commercial state body pension funds in December 2009 (Third Quarter Report, 2009: 3).

In the end, however, the NPRF's success as a strategy of governance is not so much dependant on its actual ability to pre-fund pensions. Rather, it is dependant on how successful the Irish state is in normalizing the contemporary financial epistemology, relations, and practices upon which its domestic and international legitimacy is based. It is moreover dependant on the ability of states in aggregate to maintain financial market equilibrium in the face of recurrent financial bubbles and crises. Indeed, the NPRF's recent 2009 gains would not have been possible without

¹⁷¹ These alternatives presented to the Oireachtas between 2001 and 2009 included: investments in infrastructure to better long-term economic efficiency; investment in diversification projects to strengthen the resilience of the economy, to attract immigrant workers, and to keep young workers in Ireland; investments in education to develop a more skilled, higher paid, and thus taxable workforce; change the nature of indexed-pensions as public sector pensions are far more costly than those of the private sector; and addressing the problem of income-inequality of the female labour force so as to increase tax revenues. See, for example, NPRF Commission (2004) for an extensive debate between the Fund's managers and overseers in the 'Hearing of the Joint Committee on Finance and Public Service' on the subject of why the SWF policy path was preferred over infrastructural investments. See also Noonan, 2000: 85; Dail Debates, 2003: 1008.

the stabilizing influence of ad hoc state interventions throughout the speculative financial realm. This suggests the modern financial epistemology legitimating the SWF policy path is inherently problematic: it demands the Irish government minimise its involvement with the NPRF, but at the same time support the financial system throughout which public wealth is increasingly embedded. This highlights the inherent contradictions of contemporary finance capitalism's overly simplistic state-market dualisms as presented to the Irish public. Analysing SWFs through this polemic relationship limits the ways states like Ireland can approach highly complex socioeconomic problems, such as how to ensure the sustainability of pension provision, how to most effectively manage national wealth, and how to conduct fiscal policy in general. A more integrated approach to SWF-states' relationship with financial markets must therefore be pursued lest the state always play catch-up to the ever-increasing demands of expansionary financial markets. Potential ways such an integrated approach can be realized will be expanded upon in the concluding Chapter.

Conclusion

Summary of Arguments

This dissertation's research objectives were two-fold. First was to provide an alternative explanation for the global diffusion of the sovereign wealth fund policy path than that currently offered in the SWF literature. Financial economists and OECD market regulators, wary of the funds' political origins, have dominated existing analyses. These scholars have been overwhelmingly concerned with questions of whether SWFs should be considered legitimate financial speculators, and thus in what asset classes and markets they should be allowed to invest (cf. Monk, 2009). Why so many variegated state actors of dynamic and competing policy preferences all chose to establish SWFs – and why they have maintained this policy path through time in the face of recurrent and destabilizing financial crises – consequently remains an unsubstantiated assumption. Indeed, such analyses have left the funds' contested political origins unexamined. It is assumed a government would naturally want to maximize the return generated by public capital through financial speculation if capable of doing so. State actors are thus assumed to be forward-looking and altruistic governors attempting to benefit both current and future generations of domestic society. As a consequence, increased financial risk is problematically rendered synonymous with reward such that speculation's negative connotations – those of uncertainty and loss – no longer define its character.

These commentators then somewhat contradict themselves by arguing governments cannot be trusted to manage their SWFs due to their being motivated largely by self-interest. They argue these tendencies would inevitably result in SWF

capital being abused, and the funds' strictly commercial orientations thrown into flux. How, then, can these governments be forward-looking and rational by establishing SWFs, while at the same time self-interested and prone to bouts of irrational behaviour? This gap in understanding represents an especially noteworthy puzzle given that SWFs severely limit a government's authority to use this public capital for any purposes other than financial speculation. SWFs thus remain anomalous black-boxes in critical IPE scholarship: they have yet to be sufficiently examined from a perspective that keeps financial as well as political interests *and ideas* in mind.

Indeed, it is not so much the emergence of SWFs in general that warrants criticism, but the discourses that surround this development. The global diffusion of the SWF policy path has thus far been portrayed as politically unproblematic, and capable of solving many of the ills that face developed and developing market economies alike. Scarce resources are consequently reallocated away from other development projects to fund financial speculation on a global and systematically significant scale. While the funds do provide immediate benefits for governments, corporations, and even 'everyday' people, they also change the parameters of economic policymaking within their respective states to favor more market-oriented forms of knowledge. The funds in turn challenge a government's policy autonomy, demonstrably constraining political actors to defer their interests to those of the speculative financial realm. The funds moreover create new vulnerabilities as governments become more directly exposed to volatile and crisis prone capital markets. These are necessary points for critical IPE scholarship to further examine if SWFs' rapid growth continues into the 21st century. Indeed, a more balanced approach to the relationship binding SWFs, states, and global capital markets must be

considered lest democratically elected governments become increasingly suppressed features of an ever-expansive financial realm.

To this end, this dissertation has argued that SWFs were created only when they were perceived as benefiting state actors' short-term interests. While not a bold claim in itself, what is interesting is the process through which the SWF policy path was first championed, and then sustained through time, over competing alternative fiscal management strategies. This dissertation assumed that maintaining domestic political legitimacy is a primary short-term interest of government officials. It was moreover assumed that in their attempts to gain such legitimacy, governments strategically pursue policies they believe will engender perceptions of socioeconomic stability throughout domestic populations. This is to say that no matter the socioeconomic realities, what matters for state actors is the *perception* this reality is stable and non-threatening to domestic socioeconomic interests. It was then hypothesized that SWFs appeal as strategies of governance because they represent tools state officials can use to construct and reinforce such perceptions of socioeconomic stability. Indeed when faced with destabilizing problems of great uncertainty, states can rely on their SWFs to reconceptualise uncertain futures in the quantitative and communicable terms of financial risk. How a government is to manage the unexpected accrual of extra-budgetary foreign exchange reserves, or how to ensure the sustainability of a public pension system, are long-term problems that can be recast in terms of their SWFs' expected profitability. This has the effect of stabilizing these state actors' governance function in time. SWFs thus enable governments to defer the responsibility to actually solve these problems to speculative financial markets, as well as their political successors.

The dissertation's second research objective was to then draw attention to the implications SWFs posed for their states' approach to domestic governance. It was argued the funds constrain these governments capacity to seriously consider, let alone attempt to pursue, alternative and less risky approaches to public capital management. Simply put, SWFs constrain governments to defer their interests in regards to non-financial industries in favour of their funds' speculative financial interests. However, this constraint is not just attributable to SWFs placing governments at one remove of public capital management in a functional – read: operational – sense of authority. Rather, SWF constraint is attributable to their being rooted in an authoritative array of financial ideas. These ideas compose an identifiable epistemology of speculative finance, which prescribes to state actors what speculative financial market reality is, and how they should engage it. SWF constraint thus comes from the *epistemological* authority exerted by these ideas, which derives from their authority to be believed as well as followed. These ideas' underlying assumptions about the inherent rationality of investors and efficiency of markets are thus key mechanisms through which financial speculation is not just informed, but how it is constituted and legitimated on a daily basis (cf. de Goede, 2005: 7).

This is to emphasize SWF-states are not only constrained by the material power of market forces, but also self-imposed ideational boundaries. These boundaries ultimately limit the range of actions state actors can not only pursue, but more importantly the range of potential actions they view as legitimate. To be sure, the power of finance is derived from its capability to legitimize certain forms of knowledge and to delegitimize others, rather than from financial muscle alone. The constraints of policy autonomy placed on SWF governments are therefore as much ideational as they are material (Rethel, 2010: 95). These ideational constraints were

categorized under the term ‘financial depoliticization’ in Chapter Three. As opposed to orthodox approaches to depoliticization, this term describes how modern financial epistemology constrains government actors’ capacity to set, apply, and enforce the ‘rules of the game’ vis-à-vis public capital management (Kjaer, 2004: 12). They are instead required to passively oversee their SWFs’ frenetic pursuit of speculative – and thus imagined – financial gain. This dissertation has therefore sought to deconstruct and problematize this financial epistemology and its ideationally constraining influence on SWF-government agency by examining three case studies. The following now summarizes the core empirical findings of the thesis.

In Norway, central bank officials successfully persuaded the Storting’s Centre-Left majority coalition they would be incurring large opportunity-costs on their petroleum wealth if it were not exposed to higher degrees of financial risk. Yet this was only after these wealth reserves were projected to rapidly swell into the late 1990s on the back of rising world energy prices. Indeed the central bank’s arguments were only compelling when coupled with the Storting’s desire to avoid re-living the economic turmoil their predecessors had instigated in the 1970s and 80s. The GPFG’s transformation into an SWF in 1997 was then only made possible by central bank officials’ strategically drawing from the epistemology of financial speculation – the idea of financial profitability in particular. This authoritative knowledge framework enabled these officials to construct and inform the Storting of their interests in the context of uncertainty they faced. The SWF policy path was thus pursued as a means to immediately reduce this uncertainty by reconceptualising it in the predictable and altogether manageable terms of financial risk and expected return.

In so doing, the Storting was constrained to actively construct the legitimacy of the SWF policy path throughout domestic society between 1997 and 2009. This

was to avoid being accused of taking unnecessary risks in their approach to petroleum wealth management when faced by three financial crises that greatly reduced the GPF's value throughout this time. Thus rather than critically examine the financial volatility to which this wealth was increasingly exposed, the Storting limited their governance function to a matter of cheerleading the policy preferences recommended to them by more knowledgeable financial experts in Norges Bank Investment Management. The epistemological authority exerted by these experts thus constrained government agency to increase: (i) the extent to which Norway's petroleum wealth was embedded throughout speculative capital markets in both a spatial and functional sense of capital mobility; (ii) the level of financial risk to which this wealth was subsequently exposed; and (iii) their reliance on fallacious modern risk management technologies to support them in their governance of the petroleum-dependant welfare state.

In Alberta, the conservative PC majority government opted to transform the Alberta Heritage Savings Trust Fund into an SWF so as to solve a politico-economic crisis that emerged in the early 1990s. The SWF policy path was thus perceived as a means to appease an Albertan public long since disillusioned with the government's confusing approach to petroleum wealth management. This would at the same time preserve the AHF as a source of provincial pride demarcating Alberta from the rest of federal Canada. Similar to Norway, the Albertan case study demonstrated the SWF policy path was only pursued after it was framed by Treasury officials as benefiting the government's short-term budgetary needs. Indeed, speculative investment had to be framed as capable of preserving the AHF's historical use as an extra-budgetary account before the government was willing to change its management mandate.

The Albertan provincial government was then exposed to a similar set of ideational constraints as was Norway between 1997 and 2009. First was MLAs' increased reliance on financial speculation as supporting feature of budgetary financing. Indeed, the AHF's speculative returns immediately became a means to fill in budgetary shortfalls left by a dependence on volatile petroleum revenues. Similar to the Norwegian experience, this resulted in constraining MLAs to gradually increase the AHF's exposure to different forms and greater degrees of financial risk. Second, the desire to improve the AHF's financial returns led government to increase their dependence on financial experts in the specially created Alberta Investment Management Corporation. This further limited their capacity to determine how and to what end goals this prized pot of petroleum wealth would be managed. These effects of SWF constraint were then shown to be particularly problematic in the wake of the financial crisis that began in August 2007. Indeed, the Albertan government has yet to recover from the effects this crisis had on budgetary financing. This has increased their dependence on both volatile petroleum revenues as well as the AHF's speculative financial returns to finance annual budgets. The SWF policy path as a governance strategy thus remains critically unengaged as everyday Albertans and non-financial industries continue to suffer from waning governmental support (cf. Stelmach, 2009).

Finally in Ireland, the National Pension Reserve Fund was established as an SWF to address two problems of uncertainty the Oireachtas faced in the late 1990s. The first had to do with an unprecedented budgetary surplus the Ministry of Finance perceived as threatening to the small island economy. The second problem followed the emergence of alarming demographic figures, which projected the much relied-upon state pension system to be unsustainable over the next three decades. To address

these problems, the Oireachtas passed legislation that would force them to save this surplus as well as one percent of GNP annually in an extra-budgetary account until at least 2056. This account – the NPRF – was then to be speculatively invested so as to keep ahead of debt servicing costs. The SWF policy path was in any case initially resisted due to the constraints the NPRF's funding source would place on budgetary politics. As such, the NPRF's supporters in the Ministry of Finance and Fianna Fail heavily drew from the ideas substantiating modern financial epistemology to convince their colleagues of the NPRF's feasibility as a strategy of governance. They successfully argued the Fund could be expected to generate significant financial returns in the long run. This would reduce their need to devise alternative and politically damaging alternative strategies to support pension sustainability in the short run, such as raising taxes or cutting services.

The Irish SWF nonetheless constrained the Oireachtas's approach to rectifying a domestic banking crisis that has since sent the economy into a deep recession. Rather than provide two failing Irish banks with a conditional bailout, the government's desire to preserve the NPRF's legitimacy as an SWF led them to *invest* €7 billion in the banks. The case study demonstrated how this limited government's capacity to affect any lasting regulatory change that would prevent another such crisis from being experienced in the future. The government was moreover constrained to maintain their support of the SWF policy path following the NPRF's devaluation by 40 percent in 2008. This was due to their efforts to promote financial speculation's legitimacy as a strategy of governance throughout domestic society from 2001 onwards. They consequently have yet to formulate – let alone seriously consider pursuing – alternative means to ensure the sustainability of the Irish pension system other than speculatively investing debt-funded NPRF contributions.

Caveats and Suggestions for Future Research

Given its focus on only three of a possible 80 plus case studies, the generalizability of this dissertation's conclusions is limited. Further research is needed to chart how the SWF policy path materialized in more authoritarian and less transparent states such as those in Abu Dhabi, China and Singapore. Legitimacy construction for these governments is clearly not as important as in democracies, where the electorate arguably has a better capacity to hold politicians to account. What remains constant for all cases, however, is the role played by modern financial epistemology to provide an actionable blueprint for states wishing to establish an SWF. What remains unanswered is how these ideas were internalized by these more authoritarian state actors and to what ends. Considering that these more opaque forms of SWF constitute a majority of the funds, future research into their emergence and relationship shared with domestic constituents is required (see Appendix 1). Such case-by-case research is a necessary step towards developing an understanding of the funds' significance for SWF-state governance, as well as the nature of sovereign state authority in the global political economy in general.

Research is also required to critically analyze the broader structural factors that have led to SWFs' global emergence, and not just the ideas that substantiate their speculative financial identities. While this dissertation has emphasized ideational sources of institutional change, structural factors have clearly played an equally significant role in SWFs' development. For example, what historical events, trends, processes, rules, and regulations led so many different governments to amass the extra-budgetary capital of which most SWFs are composed? What does this tell us of the sustainability of modern finance capitalism when governments are in possession

of such ‘unneeded’ wealth? Clearly the US Federal Reserve has played an important role in providing the world with enough premier reserve currency to aid and abet SWF-states’ burgeoning foreign exchange reserves (Clarida, 2007). But what strategies have SWF-states employed to attract such vast amounts of currency, and are these strategies in the best long-term interests of SWF-states? What role has ‘neoliberalism’ and its loosely bounded collection of market-favouring policies played in SWFs emergence? How do the funds reinforce certain features of neoliberalism while disarm others? China, for example, has benefited from the West’s dependence on cheaply manufactured goods by taking a hard-line approach to ensuring the stability of the Renminbi. This has led to the rapid growth of their US debt-derived foreign exchange reserves, which now fund the China Investment Corporation. Investigating the different ways in which these macroeconomic processes and domestic policies are generated and enacted by governments to affect the lives of everyday citizens is therefore a necessary task for future research. This is to criticize the IPE literature’s lack of engagement with ‘inside out’ analyses, where financial policy preferences serve domestic interests and institutions first, and the structural demands of (neoliberal) finance capitalism second.

(Re)politicizing Sovereign Wealth Funds

While SWFs and their import for modern finance capitalism remain hotly debated in academic circles, both regulators and practitioners have generally accepted the funds as legitimate market participants (cf. Gurria, 2008). This dissertation has sought to problematize this acceptance by critically engaging the speculative financial epistemology guiding SWF-states in their approach to public capital management. Indeed, the recurrent and globally destabilizing crises experienced over the past three

decades have proven this interpretive knowledge framework to be fallacious when used as a blueprint for action. When it is institutionalized into an SWF, governments merely arena-shift problems of uncertainty from the responsibility of the politico-economic to speculative financial realms. This dissertation has consequently sought to demonstrate speculative financial markets comprise individual investors and regional markets that are capable of producing efficient outcomes, but who are also prone to bouts of mania and panic, asset bubbles and bursts. These markets moreover comprise governments – as both regulators and participants through SWFs, central banks and public pension funds – who have been increasingly called upon to stabilize market equilibrium in the inevitable event of crisis.

A final point to be made is that government actors should not be required to limit their SWFs to pursue strictly passive commercial mandates so as to appease neoliberal markets' fears of political interference. By doing so, SWFs lose the very feature that makes them unique and influential market participants. Indeed they are long-term and state-sponsored strategies of governance capable of affecting real change in both the regulatory and ideational frameworks that not only make financial speculation possible, but which ultimately shape this realm's daily constitution. In short, the funds have the potential to contest and change dominant financial orthodoxies. This is in a way that could limit the frequency of crises, or at least better bridge the gap separating the synchronic versus diachronic financial practices that underpin these crises (Sinclair, 2005: 58-59).¹⁷² This is to emphasize that institutional

¹⁷² Norway's GPFG has been a forerunner in this regard, becoming an increasingly prominent player in promoting global corporate governance reform from 2003 onward (cf. Fini and Rethel, 2009). While these reforms have been focused on making corporate boards more accountable and transparent to shareholders, their intentions are ultimately normative. Indeed these aggressive reforms are meant to deter the GPFG's portfolio companies from engaging with, among other goals, environmentally unsustainable practices and the use of child labour. This, argue GPFG managers in NBIM, will improve the efficiency and thus sustainability of financial market growth and capitalistic enterprise in the long run (NBIM, 2007).

investors, like SWFs, contribute daily to the construction of financial reality by both generating and enacting the rules and procedures through which this reality is iteratively constructed (cf. Deeg and O'Sullivan, 2009). SWFs as systematically significant actors are thus regulated by historically constituted financial ideas and discourses, but they also have the authority to delegitimize existing discourses and create new ones (de Goede, 2005: 10). So while SWFs may not be the sovereign originators of their actions, the speculative financial realm is dependant on their daily performances. As such, they have the capacity to 'reformulate, rearticulate, transform, and even fundamentally question' the synchronic financial orthodoxies that have proven so globally destabilizing in recent years (ibid: 13). If not proactive in this regard, SWFs and the governments to whom they are ultimately accountable become just another class of speculative rentier; either profiting or suffering from others' patchwork efforts to keep modern finance capitalism afloat.

Pursuing a goal of financial maximization through speculative investment should not therefore be considered a beneficial strategy of governance in itself, but a stall tactic. It is highly problematic given the vested interest these governments develop in international financial market versus domestic socioeconomic growth. To be sure, SWFs have the potential to be domestically beneficial in both the long and short-terms, no matter the fears of government inefficiencies in regards to public capital management. Despite the GPFG's massive size, for example, Norway will continue to remain overly dependant on the petroleum sector to ensure the future sustainability of the welfare state. When this petroleum-turned-financial wealth runs out in the next five decades, however, which underdeveloped economic sector will provide the necessary revenues to cover budgetary shortfalls? A similar problem presents itself in Alberta, where petroleum dependence has been as much a burden as

boon for the PC majority government since 1975. Belief in the profitability of the NPRF, moreover, has arguably fuelled Irish spending rather than contained it as initially intended. If the NPRF was to continue earning the double-digit returns of 2009, for example, why should the Fianna Fail government feel the need to curtail that year's budget? Indeed, they can just borrow from debt markets as they had in the past in the belief next year's NPRF returns will cover the spread between short-term budgetary versus debt liabilities.

In the end, however, such speculative approaches to public capital management may prove entirely justified. Indeed, the future of financial market development and growth is unknowable. This dissertation's three SWF case studies may prove highly profitable, and successive governments' use of their capital may affect real positive change in their respective territories. But is increasing these governments' reliance on synchronically minded and ideationally constrained financial experts worth the short-term risks (cf. Harmes, 2001)? Does the theoretical proposition that, in the long run, riskier assets such as equities will earn a three to four percent higher return than bonds justify a state to expose their national wealth to destabilizing speculative asset bubbles (cf. Kindleberger, 2005)? Should governments speculate in the same markets they are expected to bailout with public capital in the inevitable event of financial crisis (cf. Wright, 2010)? These are necessarily complicated questions with which SWF governments and the citizens to whom they are ultimately accountable have yet to critically engage.

Appendix 1: *The World's SWFs*

Country	Fund Name	Founded	Assets (\$bn)
United Arab Emirates	Abu Dhabi Investment Authority (ADIA)	1976	875
Norway	Government Pension Fund - Global (GPF)	1990	322-373
Singapore	Government of Singapore Investment Corporation (GIC)	1981	200-330
Saudi Arabia	Saudi Arabia Monetary Authority (SAMA)	1952	327
Kuwait	Kuwait Investment Authority (KIA)	1960	213-264
China	China Investment Corporation (CIC)	2007	200
Hong Kong	Hong Kong Exchange Fund	1935	152-182
Singapore	Temasek Holdings	1974	131-161
Russia	Reserve Fund	2007	141-157
United Arab Emirates	Investment Corp of Dubai	2006	82
Australia	Queensland Investment Corporation (QIC)	1992	65
Qatar	Qatar Investment Authority (QIA)	2000	40-60
Australia	Future Fund	2006	55-59
France	Pension Reserve Fund	2001	55-59
Libya	Libyan Arab Foreign Investment Company (LAFICO)	1981	50-100
Russia	National Wealth Fund	2007	49
Algeria	Fonds de Regulation des Recettes de l'Algerie (FRR)	2000	44-47
United States	Alaska Permanent Reserve Fund	1976	37-40
Australia	Victorian Funds Management Corporation (VFMC)	1994	36
Brunei	Brunei Investment Agency	1983	25-35
Ireland	National Pension Reserve Fund	2001	31
Malaysia	Khazanah Nasional BHD	1993	16-26
Saudi Arabia	Kingdom Holding Company	1980	25
Kazakhstan	Kazakhstan National Fund	2000	23-26
South Korea	Korea Investment Corporation (KIC)	2006	20-30
Venezuela	National Development Fund (Fonden)	2005	15-21
Canada	Alberta Heritage Fund	1976	17
United States	New Mexico Permanent Trust Funds	1958	15-16
Chile	Economic and Social Stabilisation Fund (ESSF)	2007	17
Taiwan	National Stabilization Fund (NSF)	2000	15
Saudi Arabia	Public Investment Fund (PIF)	1973	10.0-15
United Arab Emirates	Dubai International Capital (DIC)	2004	13
Nigeria	Excess Crude Fund	2004	13-17

United Arab Emirates	Abu Dhabi International Petroleum Investment Company	1984	12
New Zealand	New Zealand Superannuation Fund	2001/03	10.0-11
Bahrain	Bahrain Mumtalakat Holding Company	2006	10
Iran	Oil Stabilization Fund	2000	10
United Arab Emirates	Mubadala	2002	10
Iraq	Development Fund for Iraq (DFI)	2003	8
Botswana	Pula Fund	1993	6-6.5
Oman	State General Reserve Fund	1980	6-8.2
United Arab Emirates	Istithmar World	2003	6-10.0
Saudi Arabia	Sanabil al-Saudia	2008	6.5
United States	Permanent Wyoming Mineral Trust Fund	1974	4
Mexico	Oil Income Stabilization Fund	2000	2-5.0
Azerbaijan	State Oil Fund of the Republic of Azerbaijan (SOFAZ)	1999	2-3.3
East Timor	Timor-Leste Petroleum Fund	2005	2-3.0
United States	Alabama Trust Fund	1986	3.1
Norway	Government Petroleum Insurance Fund (GPIF)	1986	2.9
Trinidad and Tobago	Heritage and Stabilization Fund	2007	2
Colombia	Colombia Oil Stabilization Fund	1995	2-2.1
Vietnam	Vietnam State Capital Investment Corporation	2005	2-2.1
Chile	Chile Pension Reserve Fund	2006	1.4-2.4
United Arab Emirates	Ras Al Khaimah Investment Authority	2008	1.2
Venezuela	Investment Fund for Macroeconomic Stabilization	1998	0.8
Kiribati	Revenue Equalization Reserve Fund (RERF)	1956	0.6
Canada	Fonds des Generations, Quebec	2006	0.6
Gabon	Fund for Future Generations	1998	0.4-0.5
Mauritania	National Fund for Hydrocarbon Reserves	2006	0.3
Sudan	Oil Revenue Stabilization Account	2002	0.3
Angola	Reserve Fund for Oil	2007	0.2
		Total	2,998,737

Sources: Monitor Group, Peterson Institute for International Economics, Deutsche Bank Research, JP Morgan Research

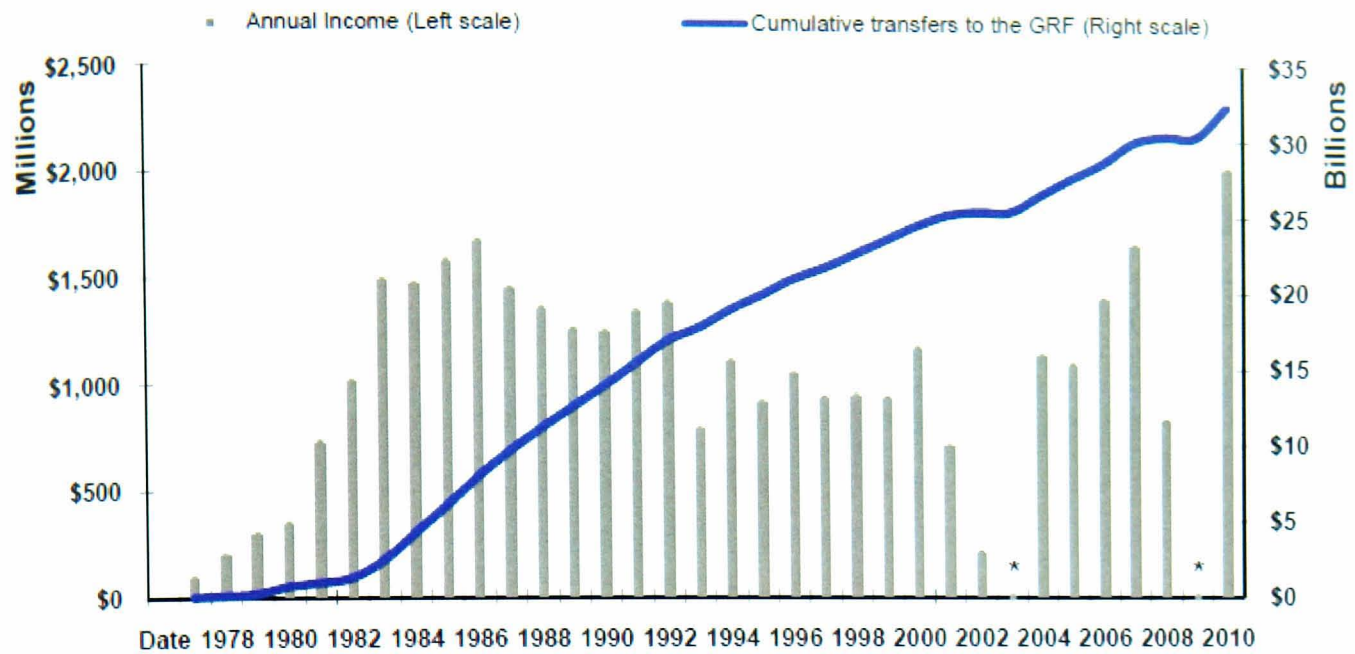
Appendix 2: The Alberta Heritage Savings Trust Fund

Transfers to and Withdrawals from the AHF (1976-2009)

Fiscal Year	NET INCOME (LOSS) (a)	TRANSFERS TO THE FUND			TRANSFERS (FROM) THE FUND		Fund Equity, at cost
		Resource Revenue Allocation	Advanced Education New Deposits	Advanced Education Endowment (b)	Section 8 (2) Income Transfers (c)	Capital Project Expenditures	
1976-77	\$88	\$2,120	-	-	-	(\$36)	\$2,172
1977-78	194	931	-	-	-	(87)	3,210
1978-79	294	1,059	-	-	-	(132)	4,431
1979-80	343	1,332	-	-	-	(478)	5,625
1980-81	724	1,445	-	-	-	(227)	7,570
1981-82	1,007	1,434	-	-	-	(349)	9,662
1982-83	1,482	1,370	-	-	(867)	(298)	11,351
1983-84	1,467	720	-	-	(1,469)	(330)	11,739
1984-85	1,575	736	-	-	(1,575)	(228)	12,247
1985-86	1,667	685	-	-	(1,667)	(240)	12,692
1986-87	1,445	217	-	-	(1,445)	(227)	12,682
1987-88	1,353	-	-	-	(1,353)	(129)	12,553
1988-89	1,252	-	-	-	(1,252)	(155)	12,398
1989-90	1,244	-	-	-	(1,244)	(134)	12,264
1990-91	1,337	-	-	-	(1,337)	(150)	12,114
1991-92	1,382	-	-	-	(1,382)	(84)	12,030
1992-93	785	-	-	-	(785)	(84)	11,946
1993-94	1,103	-	-	-	(1,103)	(71)	11,875
1994-95	914	-	-	-	(914)	(49)	11,826
1995-96 (e)	1,046	-	-	-	(1,046)	-	11,826
1996-97	932	-	-	-	(758)	(d)	12,002
1997-98	947	-	-	-	(922)	(d)	12,027
1998-99	932	-	-	-	(932)	-	12,027
1999-00	1,169	-	-	-	(939)	(d)	12,257
2000-01	706	-	-	-	(706)	-	12,257
2001-02	206	-	-	-	(206)	-	12,257
2002-03	(894)	-	-	-	-	-	11,363
2003-04	1,133	-	-	-	(1,133)	-	11,363
2004-05	1,092	-	-	-	(1,092)	-	11,363
2005-06	1,397	-	1,000	750	(1,015)	(d)	13,495
2006-07	1,648	-	1,000	250	(1,365)	(d)	15,028
2007-08	824	-	918	-	(358)	(d)	16,412
2008-09	(2,574)	-	-	-	-	-	13,838
2009-10	2,006	-	-	-	(2,006)	-	13,838
TOTAL	\$30,226	\$12,049	\$2,918	\$1,000	(\$28,869)	(\$3,486)	\$13,838

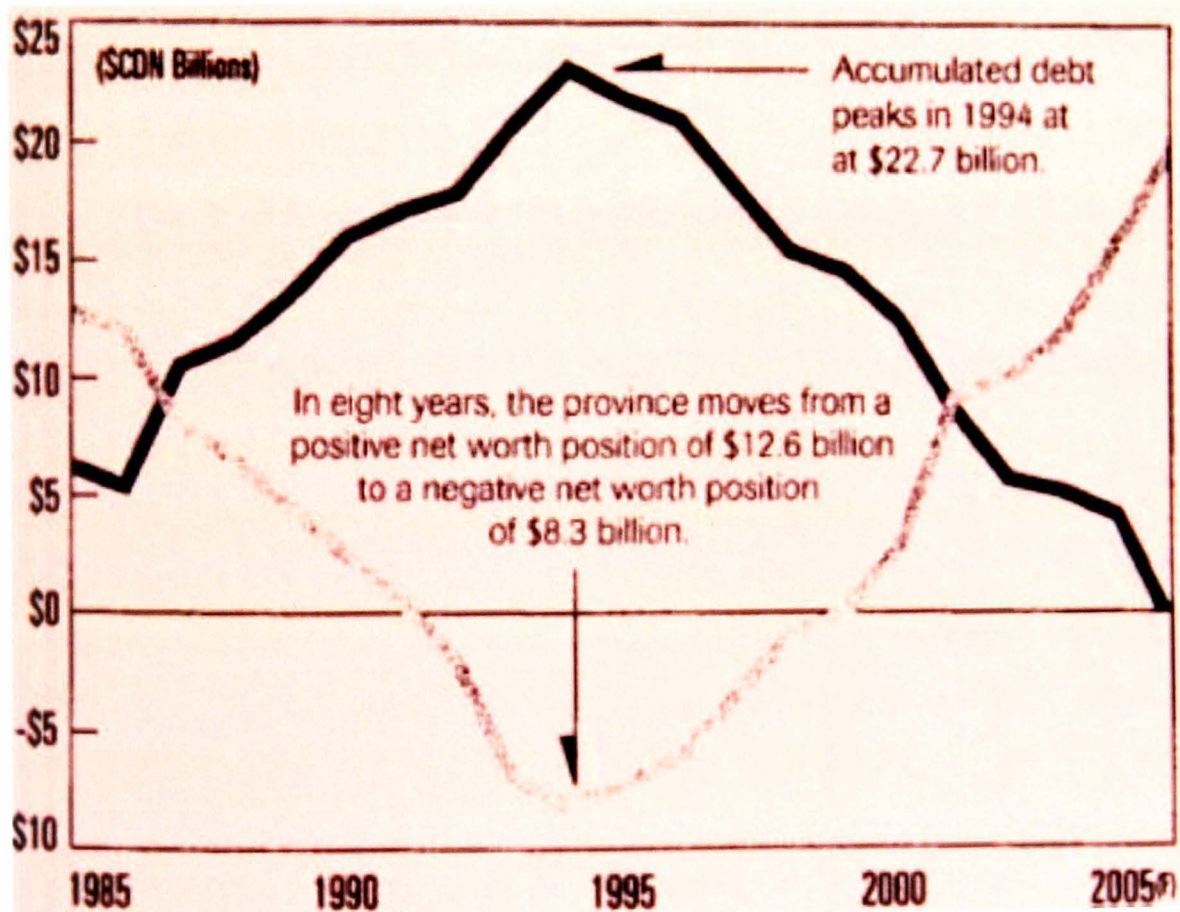
Source: Annual Report, 2009: 16

Annual Government Income vs. Accumulated Transfers to the AHF (1976-2010)



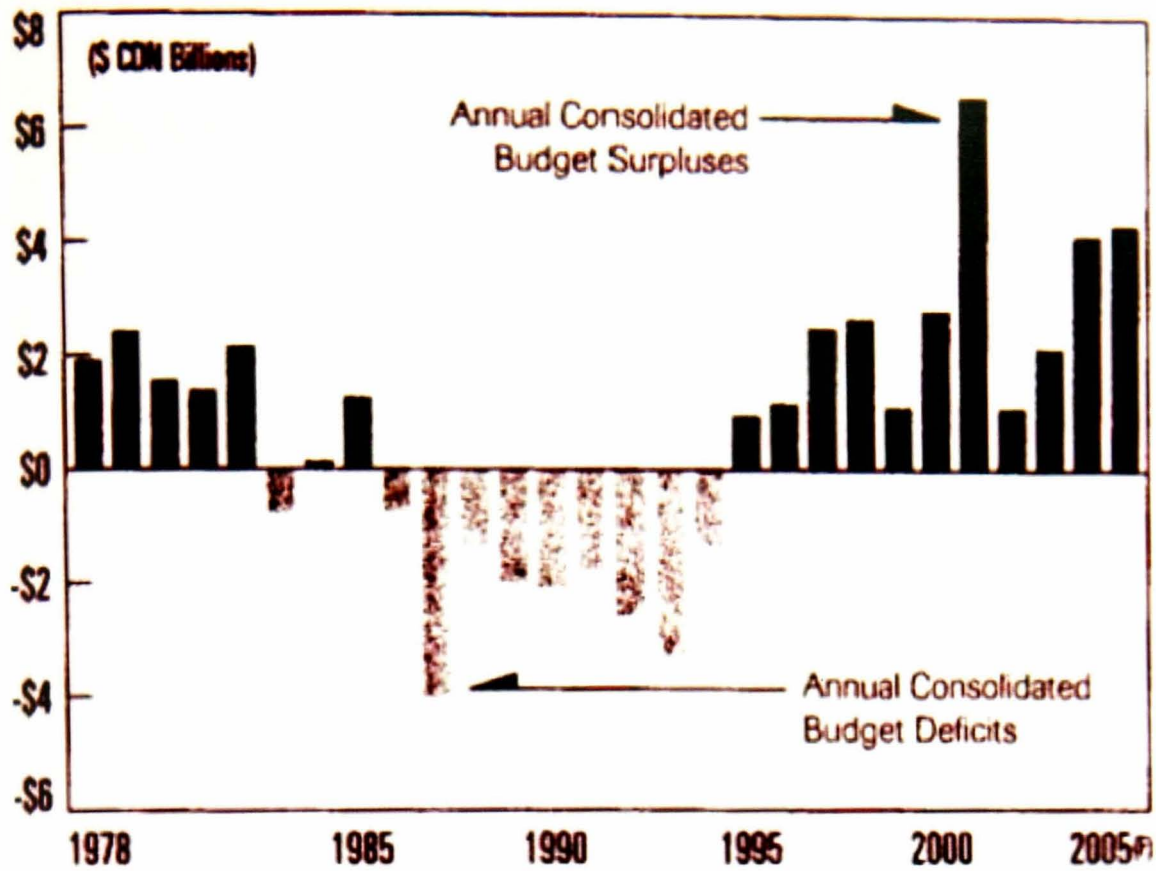
Source: Annual Report, 2009: 5

Accumulated Debt vs. Net Financial Assets (1985-2005)



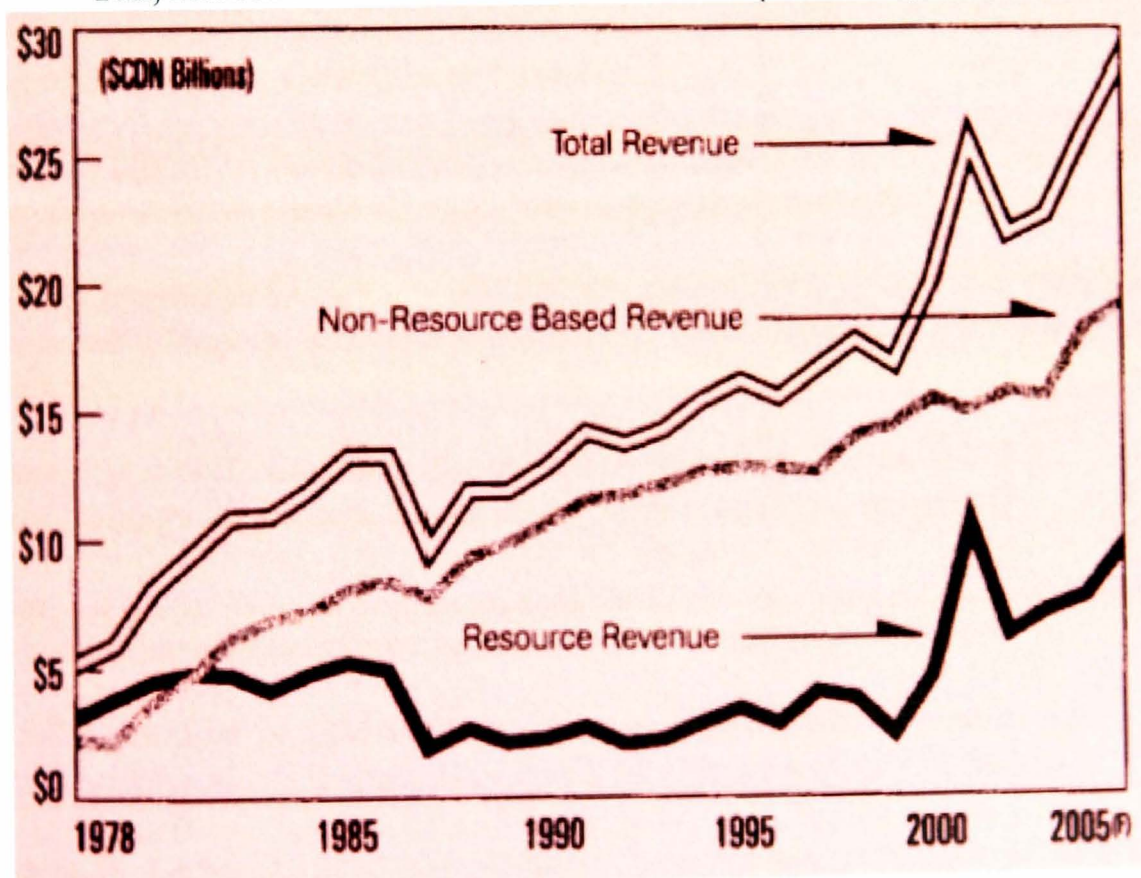
Source: Gibbins and Van der Ploeg, 2005: 14

Consolidated Budget Balance (1977-2005)



Source: Gibbins and Van der Ploeg, 2005: 14

Tax, Resource and Total Government Revenues (1978-2005)



Source: Gibbins and Van der Ploeg, 2005: 14

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Research Interviews:

Elniski, Doug (2010, September) Deputy Chair of the Standing Committee for the Alberta Heritage Savings Trust Fund, Legislative Assembly of Alberta, Edmonton

Gordon, Kathryn (2008, May) Project Manager for SWF Investment and Senior Economist, OECD, Paris

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Matheson, Rod (2009, September) Assistant Deputy Minister, Treasury and Risk Management, Department of Finance, Legislative Assembly of Alberta, Edmonton

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