

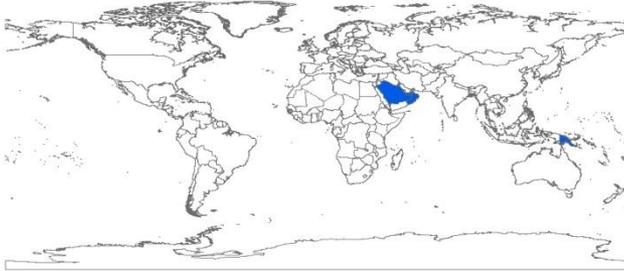
# Fashions and Fads in Finance: Contingent Emulation and the Political Economy of Sovereign Wealth Fund Creation

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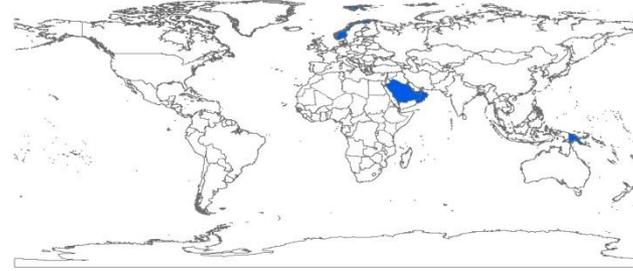
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# The spread of SWFs

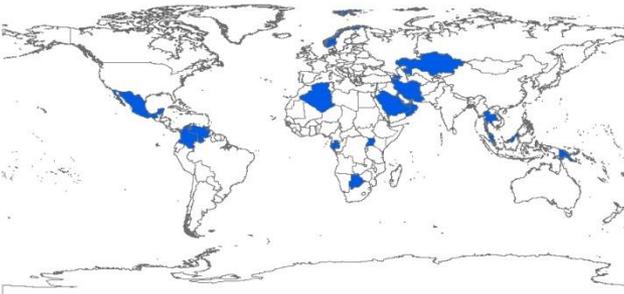
1980



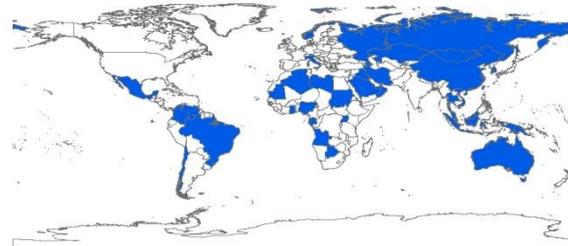
1990



2000



2011



# SWF Creation: Existing literature

- *Economic determinants*
  - Large current accounts surpluses [East Asia]
  - Commodity price boom [Oil]
  - *Aizenman and Glick (2008); Cohen (2009); Drezner (2008); Gieve (2008); Jen (2007); Kern (2008); Lyons (2007); Merrill Lynch (2008)*
- *Political motivations*
  - “Tools of domestic political survival”
  - *Shih (2008)*
- Both imply countries responded similarly, but independent, to similar conditions

# But Policy Diffusion should also matter

- *Uncertainty and bounded rationality*
  - Reserve accumulators and commodity exporters face challenges
    - Funding challenges
    - Resource curse
- *SWFs can*
  - Boost the rate of return on reserve holdings
  - Insulate budget and economy against price swings
  - Facilitate intergenerational saving
  - Minimize corruption

# Yet there are other options

- *Target infrastructure and development needs (Gylfason 2011)*
- *Reduce or match external debt obligations (Das et al. 2009)*
- *Control the pace of resource extraction*
- *Re-cycle surpluses via overseas lending*
- *Permit greater exchange rate flexibility (Truman 2008)*
- *“There are no theoretical models yet for deciding when to set up a SWF” (Das et al. 2009, 5)*

# Contingent Emulation

- *So governments look at the experience of relevant others, but only when they face policy challenges*
  - Common economic structural characteristics define relevant peer groups (*Brooks and Kurtz 2012*), and
  - Condition the responsiveness of countries to their peers
- *Governments follow the “fashions” and “fads” of their peers on a contingent basis*
  - *What “works” for peers will also “work” for them*
  - *Problem-solving motivation*
  - *Search with solutions with social constructs providing the answer*
  - *Logic reflects “threshold” (Simmons and Elkins 2004) or “critical mass” (Finnemore and Sikkink 1998)*

# Contingent Emulation is not...

- *Ritualistic; hence diverges from World Polity and sociological institutionalism (Meyer and Rowan 1977; Meyer et al. 1997)*
- *Based on a systematic search process; hence not rational learning (Mesequer 2005; 2006)*
- *Based on vivid examples or small amounts of information; hence not bounded (Weyland 2004; 2006; 2009)*

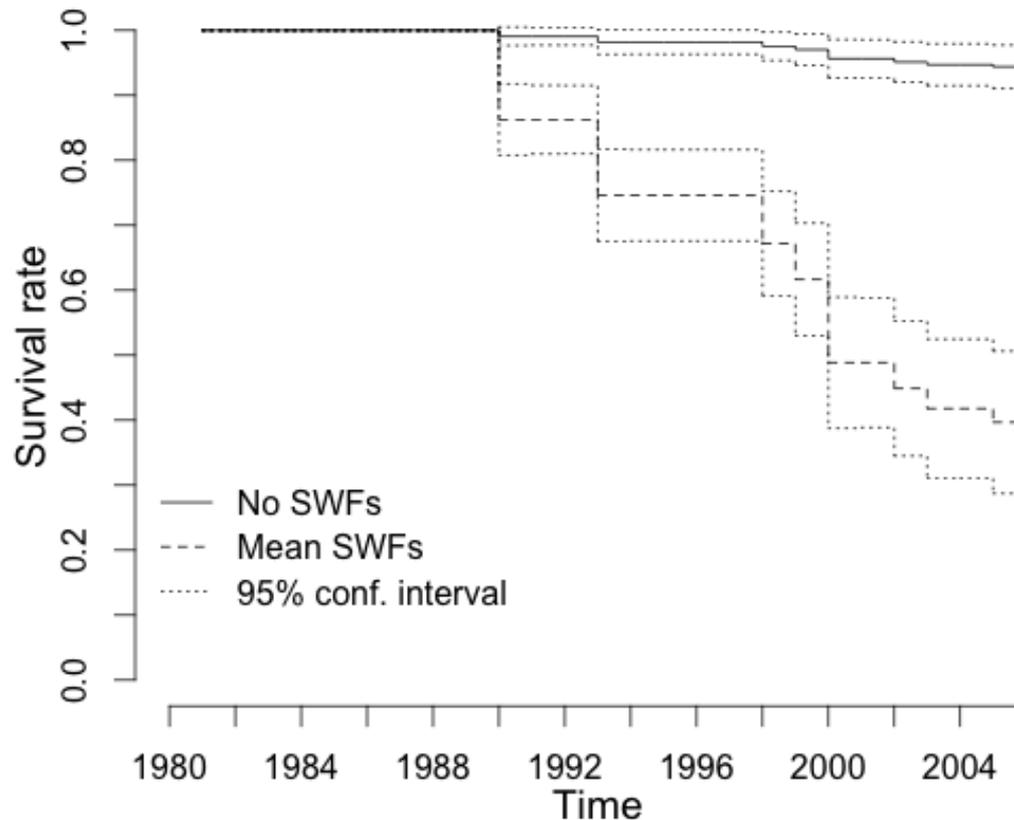
# Data and method

- 148 Countries from 1980-2008 (N = 2738)
- Cox proportional hazard model
- Dependent variable: *Number of years country exists without creating first SWF*
- Independent variable – Three Reference Groups
  - Top decile of reserve accumulators, fuel exporters, and minerals and ores exporters as proportion GDP
    - Binary variable
  - Cumulative Ratio of SWFs Created among the reference groups
  - Binary variable \* Cumulative Ratio

# Alternative Explanations

- Competition (*Simmons and Elkins 2004; Elkins et al. 2008*)
  - Spatial lag for export market similarity
- Alternative reference groups (*Simmons and Elkins 2004*)
  - Spatial lag for regional neighbours and countries sharing common language or religion
- Reserves / GDP
- Fuel Exports / GDP
- Minerals and Ores Exports / GDP
- GDP Per Capita
- Terms of Trade
- Democracy
- Loyalty Norm (*Bueno de Mesquita et al. 2003*)

# Proportion of Countries without a SWF: Effect of Policy Precedents within Fuel Exporter Reference Group



14 countries meet this specification; 11 have created SWFs - 35% of the total number created

# What made SWF creation fashionable?

- Network and communicative links
  - Intergovernmental contacts (GCC, OPEC, IMF)
    - Conducive social environments (*Johnston 2001; 2008*)
  - Dialogue with private actors
    - External asset managers provided advice on setting up SWFs
    - 19 / 21 SWFs relied on such advice (*Hammer et al. 2008*)
    - “Optimal solution” and “sensible thing to do”

# Was it learning?

- No evidence of a systematic search process
  - Commodity exporters do not react to policy precedents of one another
- No evidence that SWF creation systematically improves outcomes related to resource curse
  - *Davis et al. 2003; Bagattini 2011; Crain and Devlin 2002; York and Zhan 2009; Ross 2012*
- Evidence that policymakers looked to broader fad rather than just striking examples
  - Trinidad and Tobago, the Gabon, and São Tomé and Príncipe
- Evidence that policymakers do not react quickly in creating SWFs based on limited information
  - Large and prominent SWFs existed since 1950s

# Robustness Checks

- Frailty
- Non-linearity
  - Smoothing splines (*Keele 2010*)
  - Cubic splines (*Royston and Lambert 2011*)
  - Polynomial transformations
  - Consistent with threshold or critical mass models
- Multiple Imputation

# Conclusion

- Overestimate importance of economic determinants alone
- Study contributes to study of policy diffusion by:
  - Testing perspectives side-by-side;
  - Exploring conditional nature of outcome;
  - Disentangling emulation and learning;
  - Extending it to investigate practices associated with state capitalism.