The current global credit crisis is unfolding in a context in which new dynamics in the engagement of the public sector and the market are taking shape. This article explores some of these dynamics, especially the reemergence of (re)nationalization initiatives, as well as the growing use of private methodologies for asset management on the part of some governments, which behave as both financial market players and domestic economic stabilizers. Hence, the article discusses the return of the state as a traditional “public leviathan” involved in financial regulation, as well as the work of sovereign wealth funds. The author concludes that at the heart of capitalism’s endurance lies this diversity of public responses, which ultimately reveal governments’ adaptable agendas and heterogeneous tasks.

I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organisation which shall be as efficient as possible without offending our notions of a satisfactory way of life.

—John Maynard Keynes, The End of Laissez-Faire, 1926

The all-powerful market which is always right is finished…. We have to have a new balance between the state and the market.

—French president Nicolas Sarkozy, 2008

Keynes is back in fashion. The British economist who heralded the empirical inability of markets always to revert to full employment, and advocated state intervention (through directed fiscal policy) in times when huge imbalances between supply and demand are evident is again a solid source of insight. The French state was never a poster child for unrestricted laissez-faire. But it is perhaps a sign of the times that the “conservative” French president Nicolas Sarkozy delivered a eulogy for unrestricted market capitalism in the fall of 2008. Indeed, the severe problems that the global economy faces today are a test of capitalism, but not a death sentence. National states are not simply returning to fiscalism, but are reinventing their dynamic and diverse relationship with the market. This has been taking place in a context in which global political authority is being questioned. This is clear in Jeffrey Garten’s description of a recent interaction between U.S. and Chinese officials: “When U.S. officials met with their equivalents from China, it was the Americans who preached about how to cut banks loose from the government corset, why the yuan was mismanaged, how and when Beijing should further open its markets and so on. [Recently, however,] it was the Chinese officials who scolded the United States for its lax regulation and the virus it set loose in financial markets.” Moreover, for the United States, being a large debtor may mean “bearing the advice and criticism that we have dispensed ad nauseam to other countries for over half a century” (cited in Friedman 2008).

For the money manager Mohamed El-Erian, we are witnessing a “fundamental realignment of global economic power and influence” (2008, 14). What underlies this realignment is a diversity of versions of state activism in different economies. We see today, simultaneously, the reemergence of state (re)nationalization initiatives, along with the growing use of private methodologies for debt and asset management on the part of some governments, which behave increasingly as financial market players seeking higher returns to public investment abroad.
and using these for countercyclical spending (part of stabilization efforts) at home. Here, it is argued that public responses to the global financial crisis that include both a heightened traditional and interventionist role for governments in the economy and strategic (private-like) investments to diversify and maximize foreign reserves reveal adaptable government agendas that are key to capitalism’s endurance.

Global Transformations and State Reinvention

Throughout the history of state formation, economic crises marked critical junctures for the reorientation of the role of the state in the economy. The unfettered faith in the “invisible hand” of markets, able to function most efficiently when left undisturbed by regulatory or protectionist forces, was finally debunked with the stock market crash of 1929 and the Great Depression that followed. Keynes’s market skepticism fueled a new set of policies toward managed capitalism in which state intervention was key to correcting the imbalances that economic downturns ignited.

The post–World War II Bretton Woods system aimed at international monetary stabilization and the development of financial globalization. The effort was initially restricted by the pervasiveness of what Ruggie (1996) terms the “embedded liberalism compromise,” that is, economic liberalization accompanied by domestic social policies to balance the distributional effects of trade opening. Incrementally, however, the market-oriented reforms supported by Margaret Thatcher in the United Kingdom and Ronald Reagan in the United States gained prominence in developing countries as well. Policies such as trade liberalization, privatization, fiscal austerity, and financial deregulation were largely taken on by Latin American and Eastern European leaders in the 1990s. The effort then was quite ambitious: to transition to or try to consolidate new democratic regimes and, at the same time, implement bold economic reforms, so strongly supported by international financial institutions that they became known as part of the “Washington Consensus” (Williamson 1990). Those reforms were at the heart of neoliberalism, which became the new development mantra, a road map embraced by legions of foreign-trained technocrats in developing countries (Biersteker 1995; Fourcade-Gourinchas and Babb 2002), where trial and error in fighting rampant inflation had—by the early 1990s—exhausted political and social resources in vain.

Moreover, neoliberalism at the time was a vigorous critique of and systematic reaction against state interventionism (Krueger 1990), discredited by both the failure of communist command economies in Eastern Europe and right-wing capitalist prolifigacy in Latin America (where it culminated in the debt crisis of the 1980s). Of the developing regions, East Asia was where economic growth had been most striking. The contrast with Latin America’s “lost decade” of the 1980s led to the conclusion that instead of import substitution industrialization, export-oriented growth was a more solid path to development (see Haggard 1990). Trade expansion, indeed, was a core element of market (or neoliberal) reforms in the early 1990s. With the United States heralding the virtues of the “global economy,” most developing countries joined the bandwagon of globalization, eager to put their comparative advantages—so well identified by neoclassical economists—to their systematic economic benefit.

The component of financial liberalization in the neoliberal agenda was far from an easy ride, however. Financial crises in the 1990s adversely affected capital flows, domestic credit, and, ultimately, output in places such as Mexico (1994–95), Asia (1997), Russia (1998), and Brazil (1999), with effects that later compounded the Argentine crisis of 2001. More disturbingly, crises did not remain confined to their epicenter. Rather, “contagion” effects were felt throughout countries known as “emerging markets” through herd (or mimicking) behavior on the part of international investors. Despite these severe economic downturns, and the costly adjustments different economies underwent, developing countries did not shun neoliberal policies. More populist rhetoric grew in countries such as Argentina, Bolivia, Venezuela, and Malaysia, to name a few. Nonetheless, overall, governments from Brazil to China moved forward with open trade policies, creating newer and broader links with advanced and emerging economies, while following a more mixed model to economic growth than wholesale laissez-faire (Rodrik 2006).

These dynamics fueled a vast literature on global political economy and globalization, which—since the 1990s—has been keen on parceling out the role of the state in the current phase of capitalism. Studies that claimed the state was withering away gave room to more focused analyses of states as negotiators, trying to intersect national law with foreign actors (Sassen 1999), especially through competitive deregulation or reregulation linked to the preferences or imperatives of foreign capital (Cerny 2005; Moran 2002; Vogel 1996). Although the scope of states’ autonomy to control monetary and fiscal policies was constrained by economic globalization, in order to profit from this process, the state (especially in developing countries) increasingly facilitated its development. States’ core purpose became the promotion and institutionalization of global economic policies and practices aimed at increasing competitiveness and the potential for foreign capital attraction (Cerny 2005). To this end, states have endured internal transformations. Sassen (1996) suggests that state participation in implementing this global economic agenda entailed the ascendance of what became strategic agencies within the government apparatus.
namely, central banks, treasuries, and regulatory agencies.4 If this was true of the initial phase of intense financial deregulation, it is bound to be even more of a prominent trend at the present time, when the financial crisis initiated in 2007 has gained historical proportions. Most Western governments have been detecting as culprits unregulated financial tools that created interlinks within the system, promoting contagion among different sectors of the economy, as if in a domino fall (see Datz 2009). The reaction from governments in most of the advanced economies has been to try to contain the credit crisis through large fiscal stimulus efforts and partial nationalization of major financial institutions.

Governments, however, have not been confined to deregulation or (more currently) to reregulation activities. Some are also playing a role as demand for financial innovation and new investment opportunities. In the early 2000s, states in emerging markets became net exporters of capital rather than importers. Emerging market governments, especially in the Gulf and Asia-Pacific regions, became less content to leave large volumes of excess foreign reserves to be invested in risk-free assets with low return. From 2007 to the summer of 2008, more audacious investments made by sovereign wealth funds (SWFs) were pursued. These SWFs challenge the traditional notion of “private–public divide” and public policy literature on market-based governance. On the first, for Sassen, globalization brought about the “restructuring of the private–public divide,” where “forms of authority once exclusive to the public domain [were] shifting to or being constituted in the private sphere of markets” (2006, 184). Indeed, much of the globalization literature focused on this process of increased state marketization. Yet, in an analysis of the SWFs, the private has to do with how, not who. These sovereign funds’ functions are still a responsibility of the state, yet they count on specialized professionals with private experience or outsource some services to be provided by the private sector in serving a public purpose. Also, SWFs utilize models of risk management through hedging, akin to that of private financial players. Hence, SWFs’ competitive strategies take the understanding of a “competitive state” (Cerny 2005) to yet another level of specialization and interaction.

Moreover, the notion of public policy or administrative/institutional change toward private “methodologies” may seem to resonate with the public policy literature on so-called market-based governance (Donahue and Nye 2002). Yet it is important to point out a critical distinction. Analyses of market-based governance emphasize transparency and accountability as the key private attributes imported by the public sector. For Donahue, “market-based governance” can be “characterized (at a high level of generalization) as engineering into public undertaking a greater degree of the intense accountability that typifies markets” (2002, 7). This is so because private actors are concerned with reputation based on past performance and the perception of other players as defining current and prospective business relations.5 This emphasis on accountability, however, overstates the extent to which financial actors do act consistently in a transparent and accountable manner, especially when it comes to risk exposure. If anything, the current crisis offers ample evidence that transparency and accountability are not a given in the operationalization of financial deals. In addition, sovereign wealth funds, in particular, are hardly transparent institutions.

The current phase of capitalism has become increasingly “what actors make of it” (Cerny 2008). What states have been making of it ranges from traditionally “public” activities—such as efforts to set up new regulatory firewalls—to engaging in business transactions, following what is usually perceived as private investment agendas.

Governments as Market Players
After decades of severe indebtedness, by the first quarter of 2008, many developing countries had accumulated a large volume of foreign reserves, made early repayments of their debts to the International Monetary Fund, and bought back foreign-currency debts. The painful lessons from the financial crises of the 1990s had been learned. It became evident for emerging economies that reserve accumulation was an imperative to buffer sudden instability. The rise in commodity prices and record high prices of oil led to trade surpluses in developing countries “unequalled as a percentage of the global economy since the beginning of the 20th century” (ING Investment Management 2007). As Thirkell-White points out, “the build-up of reserves in the postcrisis Asia suggests that the need for finance is not so desperate that countries are prostrate in the face of market pressure” (2007, 36). Such growth is linked to the accumulation of sovereign reserves in emerging markets through trade surpluses. Indeed, many developing countries consolidated their positions as capital exporters. This critical change marks a redistribution of international wealth according to which large flows of publicly owned
funds are moving from developing to developed countries. This is what El-Erian calls a “complete transformation in the systemic role of developing countries in the world economy” (2008, 31). Governments in the developing world—not private players—are in control of “the new international wealth” (Truman 2008, 3), which is, however, not immune to global shocks.

A large volume of this wealth is held by sovereign wealth funds, or government investment vehicles funded by foreign reserve exchange assets that are managed separately from the official reserves of the central bank and the reserve-related functions of the finance ministry (U.S. Department of the Treasury 2007). According to recent estimates, there are currently about 70 SWFs (pension and nonpension funds) in operation in 44 countries, holding approximately $5 trillion in assets—compared to $500 million in 1990 (UNCTAD 2008). Although some SWFs date back to the 1950s, the overall number of funds and their sheer size have only recently become a matter of interest—especially so after China established its SWF, the $200 billion China Investment Corporation, in 2007 (see http://www.china-inv.cn/cicen). Though many SWFs have stabilizing mandates—especially important for countries that are highly reliant on exports of relatively volatile commodities such as oil—these funds are not simply saving for a rainy day. Rather, until mid-2008, they were also investing strategically for the long term (ING Investment Management 2007). In this sense, SWFs mark a departure from the trend of investing foreign reserves in liquid assets such as short-term U.S. Treasury bills and government securities issued by other developed countries toward investment in high-return equities (UNCTAD 2008).

According to the International Monetary Fund, there are five types of sovereign wealth funds based on policy objectives. There are stabilization funds set up by countries that are rich in natural resources to cushion volatility in commodity prices, savings funds that “transfer non-renewable assets into a diversified portfolio of international financial assets to provide for future generations,” funds that operate as reserve investment corporations pursuing policies with higher returns, development funds that allocate priority for socioeconomic projects, and sovereign funds that are in effect pension funds (IMF 2007, 46). Some SWFs are funded through central bank reserves (as in the case of the giant funds from China and Singapore); others are funded through export revenues of state-owned resources (Abu Dhabi, Kuwait), taxation from exports (Russia), fiscal surpluses (Korea and New Zealand), or privatization receipts (Malaysia and Australia).

One of the key financial developments of the turbulent period of late 2007 and early 2008 was the way in which emerging market governments, through their SWFs, acted as early stabilizers of key commercial and investment banks, plagued by ever-increasing losses from the subprime crisis. Examples are many. The Chinese Investment Corporation (CIC) invested $5 billion in Morgan Stanley, which means that the sovereign fund acquired a 9.9 percent share in the company. That happened despite CIC’s losses in a previous $3 billion deal with Blackstone, whose initial public offering prices dropped more than 50 percent after the deal was concluded. Singapore’s GIC and an undisclosed investor from the Middle East invested $12 billion in the giant Swiss bank UBS. The Abu Dhabi Investment Authority injected $7.5 billion into Citigroup late in 2007. The Kuwait Investment Authority invested $5.4 billion for equity capital stake at Merrill Lynch before the latter was acquired by Bank of America in September 2008. Many of these investments, however, led to large losses (Setser and Ziemba 2009). These losses taken on earlier investments are being digested, not only by the funds but also by the domestic public, which, in countries such China, is voicing its discontentment over SWFs’ recent investments in the collapsing U.S. market. Given new domestic imperatives, many funds are now poised to support their domestic financial sectors or to sponsor fiscal stimulus plans to support internal growth. In this sense, SWFs are acting as part of the stabilizing arsenal that countries all over the world are trying to tap into. Ziemba (2009) points out that “even if some of the planned stimulus packages do not come from the SWFs themselves, the diversion of capital from other government sources to offset the withdrawal of private capital at home or abroad will decrease funds available to SWFs.” That may calm some of the recent international inquietude over the role of SWFs as new, hungry “masters of capital” that would potentially try to take high stakes in strategic industries, following a political rather than a purely commercial rationale (Summers 2007). Yet it does not diminish the salience of these funds as rare pools of wealth in a deluge of private financial losses.

Global Finance and the Return of the Public Leviathan

If in some emerging market economies (especially), states have behaved more like market players out of a wish to diversify, hedge, and multiply accumulated foreign reserves, in the United States, recent measures to contain the global credit crisis and inject liquidity into capital markets have entailed the nationalization of private debts. The two developments are coincidental in time, but not in nature. The first has to do with the behavior of governments that try to bring to the public agenda the tools of a money manager of public capital with—so far—limited transparency as to investment strategies and (for the most part) shielded accountability from domestic scrutiny. The second move entails a traditionally public task of state interventionism, displayed clearly in the Keynesian
SWFs themselves are becoming even more diverse a category in this new interventionist phase. For example, France established its $25 billion “strategic investment fund” in November of 2008. The goal was to “take stakes in large and strategically important [domestic] companies vulnerable to [foreign] takeovers because of falling stock prices” (New York Times, November 20, 2008). This is the French state designing a sovereign fund to counter what it sees as the potential threat of foreign and more investment-driven SWFs.

The distinction in different roles of state actors in varied parts of the world is played out in a context so specific, it may well mark a critical juncture in the history of capitalism. For the first time since the wave of financial deregulation and integration started under the guise of the 1980s neoliberal agenda, the epicenter of a global crisis has been in “the West.” As Stephens (2008) points out, “viewed from Washington, London or Paris, financial crises used to be things that happened to someone else—to Latin America, to Asia, to Russia. . . . Emerging nations got into a mess; the west told them sternly what they must do to get out of it.” The way out was through the intervention of the International Monetary Fund, advocating increased fiscal restraint and higher interest rates. The logic was to play a “confidence game” (Krugman 1998; Rodrik 2002) with international investors, aiming at keeping capital flows from exiting or trying to attract them back home. These were usually measures that deepened recessions before they could reverse the economic downtown. For that, they were heavily criticized (Chang and Grabel 2004; Rodrik 2002; Stiglitz 2003). Now, we see something remarkably different unfolding: “[T]he crisis started on Wall Street, triggered by the steep decline in U.S. house prices. The emerging nations have been the victims rather than the culprit. And the reason for this reversal of roles? They had supped enough of the west’s medicine” (Stephens 2008).

Indeed, as mentioned earlier, the crisis of the 1990s taught developing countries how necessary it was to decrease their vulnerability to external shocks by building surpluses and better managing the structure of their foreign debts (Datz 2008). The reserves accumulated by emerging markets were then channeled to finance public expenditures in the United States and in Europe, as “America drowned itself in Asian liquidity” (Stephens 2008).

That is not to say that countries that have accumulated plentiful international reserves in the last couple of years are not vulnerable to the impact of this now fully global crisis. Recently, the marked decrease in investors’ risk appetite worldwide has resulted in a fall in short-term capital flows to emerging markets, raising the cost of credit, pressuring currency devaluations, and, in some instances, leading to negative sovereign risk assessments (IMF 2008; Financial Times, October 13, 2008). At the same time, oil prices have been dropping—as of October 2008—turning the benign tide of large revenues from exports in several emerging markets, especially those that host some of the largest SWFs. Emerging economies that rely heavily on short-term capital inflows or have leveraged banking systems are particularly vulnerable to the “recoupling” of the U.S. crisis. In contrast, as the International Monetary Fund reports, “sizable reserve cushions and favorable external balances in many emerging markets and sound policies continue to provide resilience to global stress” (2008, 10). Such resilience is undoubtedly being tested daily.

The SWFs’ retreat since the fall of 2008 has not represented an exit from foreign investment. As Ziembra points out, Gulf states, for example, have about $150 billion to invest in 2008. Yet “large scale direct investments from sovereign funds may be a thing of the past, particularly given the scale of the shakeup in the financial sector” (2008, 4). More targeted operations, however, are under way. Temasek, Singapore’s SWF, saw the value of its investments plunge about 31 percent (to a total of $81 billion) in 2008. However, Temasek has alluded to plans to invest in Brazil and Mexico (Financial Times, February 16, 2009) and recently announced an expansion of its India operations. This marks an important trend in the nature of capital flows in the global economy. It is possible that SWFs will invest more in (other) emerging markets, reversing a long-standing pattern according to which most capital flows originated from and were destined to developed countries (the so-called Lucas Paradox). Temasek’s investment in India is part of a strategy to...
identify emerging champions that are excellent proxies of economic growth.” In the words of one of the funds’ senior managing directors, “in the current scenario, with prevailing capital scarcity, private equity investments are likely to play a pivotal role in global economic recovery.” Expanding the fund’s operations to the South of India fits Temasek’s “approach of patient long-term investment,” aiming to “create deep value and maximize returns” (Temasek Holdings 2009).

Indeed, a recent survey of senior SWF executives reported in the Financial Times (February 16, 2009) revealed that new investment opportunities will be explored in 2009. According to one such executive, “We are ready to re-enter the market in a major way,” yet not while prices keep plunging. SWFs’ calculations and their strategic interest in emerging markets are unfolding at a time when some of these funds are growing concerned about the way the United States keeps raising its debt bill. This has incited questions about whether Middle East SWFs will remain active buyers of U.S. government debt (Financial Times, February 17, 2009).

Conclusion
In the last two decades, governments have undergone important transformations in the constant challenge to compete, adapt, and innovate in a realm of global financial integration. The malleability of the role of the state in the economy is at the heart of capitalism’s survival, not of its demise. The transformations described here, then, are a story of adaptation and, one predicts, endurance, however modified the rules of engagement between states and markets.

While governments are currently reviewing the freer markets contract underlying financial globalization since the 1990s, some are also following methodologies tailored to corporations, creating benchmarks for risk taking while keeping an eye on opportunities to generate returns that will make them intensively competitive and increasingly innovative.

Notes
1. It is worth noting, however, that even prior to the United States’ and United Kingdom’s “neoliberal turn,” Chile—under General Augusto Pinochet—implemented its own market reforms.
2. The term “emerging market” is said to have been coined in 1981 by Antoine W. van Agtmael, an employee of the World Bank’s International Finance Corporation. Although definitions vary, emerging markets are characterized as transitional, meaning that they are in the process of moving from a closed to an open market economy, while building transparency within the system. These economies usually offer an opportunity to investors who are looking to add some risk, and hence higher than benchmark returns, to their portfolios.
3. In some instances, the state even dared to react assertively to international creditors in complex debt restructuring deals in which the defaulters were far from shunned from the international financial markets—such was the high appetite of foreign investors guided by short-term horizons (Datz, forthcoming).
4. In her latest work, Sassen (2006) extends this argument to include an expansion of executive powers in the United States (continued and deepened by the George W. Bush administration) in a realm of heightened security concerns, withering civil privacy, and increased secrecy.
5. Studies of market-based governance are concerned with the role of government as a customer in, for example, contracting private health care (Eggleston and Zeckhauser 2002) or nonprofits (Frumkin 2002).
6. These calculations do not account for the large losses incurred especially in the third quarter of 2008.
7. Often, these assets still understood as “reserves.”
8. The Washington Times (2008) reported that Chinese Internet sites revealed popular indignation at the
Blackstone and Morgan Stanley investments made recently by the China Investment Corporation. The critique was that “China has enough to address without helping to correct American blunders, and some say the United States is getting what it deserves after lecturing China on its economic management.”

9. On October 13, the U.S. government announced that $250 billion of its $700 billion rescue package would be injected into the domestic banking system. The U.S. Treasury will be talking nonvoting preferred shares in large banks, redeemable after three years. The securities will pay an annual dividends of 5 percent for the first five years, which will rise to 9 percent after that. Also, the government will receive warrants to convert them into common stock. In addition, the Federal Deposit Insurance Corporation is setting up a temporary guarantee of senior debts of all federally insured institutions, along with all deposits in non-interest-bearing accounts (Financial Times, October 14, 2008).

10. In February 2009, the French fund acquired 8.33 percent stake in Valeo SA, the second largest auto parts maker in the country. This was part of an ongoing effort by the Sarkozy administration to help the French auto industry (Bloomberg, February 25, 2009).

References


