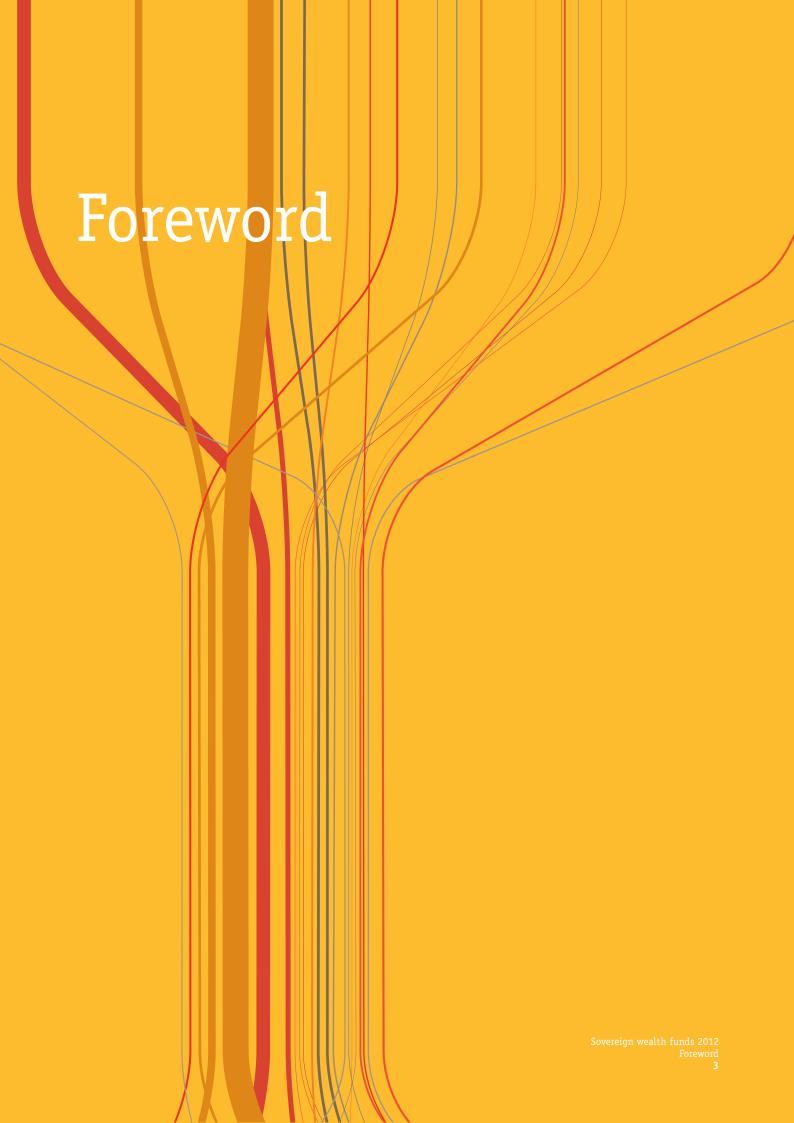


Editor: Dr. Javier Santiso Professor of Economics, ESADE Business School Vice President, ESADEgeo - Center for Global Economy and Geopolitics

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1. Foreword

1. FOREWORD

The global economy is going through a period of major transformation. The traditional centre/periphery model is not up to the job of expressing the complexity of events. The emerging economies are growing strongly, while the European and US economies are stagnating.

Many of the imbalances currently seen in the global economy lead to the accumulation of reserves in economies that control large parts of the world's natural resources or that have successful economic models based on exports. Thus the Middle East, Latin America and Southeast Asia - as well as China — are currently holding the liquidity that Western economies so badly need.

One emblematic manifestation of the economic transformation we are going through is the rise of sovereign wealth funds - huge accumulations of capital, now totalling close to \$5 trillion, that build up in the surplus regions and are spreading all around the globe. Additionally, we are seeing a "me too" effect in regions such as Latin America and Africa, as these regions seek better ways to manage their abundant resources.

Recognising the role played by these new elements of the international economy, we have produced the first Spanish language report on sovereign wealth funds. In a collaborative effort between the public and private sectors and academia, INVEST IN SPAIN (ICEX), KPMG and ESADE Business School came together to carry out this highly topical project.

This report will look at the strategies employed by these funds, the investment decisions taken, the alliances they form with each other to operate in other emerging markets, and their industrial joint ventures in Western countries.

While the main focus is on the funds' actions in Spain, the 2012 Sovereign Wealth Funds report also looks at trends in these global players' actions and considers their impact on other regions, particularly emerging ones such as Latin America and Africa.

Moreover, the case studies on Chile and Brazil will show us that some examples of "best practices" as applied by institutions worldwide come from these emerging countries too (Chile is an OECD member).

Javier Solana President, ESADEgeo

Jaime García-Legaz Secretary of State for Trade

John Scott
President, KPMG España

Introduction

Javier Santiso

Professor of Economics, ESADE Business School
Vice President, ESADEgeo - Center for Global Economy and Geopolitics

2 Introduction

2. INTRODUCTION

This 2012 Sovereign Wealth Funds report is the first produced by ESADEgeo with the support of KPMG and INVEST IN SPAIN, now part of ICEX. We would like to begin by thanking both institutions for their support in bringing about this first annual report on sovereign wealth funds. We also wish to express our very special thanks to Elena Pisonero, at the time with KPMG and now president of Hispasat, without whose enthusiasm and vision this report would not have come to fruition.

This report is not a one-off undertaking. It forms part of a series of activities promoted by ESADEgeo over the past two years. A series of ESADEgeo Globalization Labs were held — lectures on emerging markets focusing on sovereign wealth funds and emerging countries with institutions of this type. On 30 May 2011 a Lab¹ was held on sovereign wealth funds with Victoria Barbary, at the time with Monitor Group, London. On 7 February 2012 we welcomed Christopher Balding of the Peking University HSBC Business School, Shenzhen, China, who presented his latest book². Both collaborated on the report and are associated with ESADEgeo as research fellows.

The report also draws on field work carried out in Colombia and Chile. In mid-2011 we were in Colombia advising Finance Minister Juan Carlos Echeverry, together with Harvard professor and former Chilean Finance Minister Andrés Velasco, on setting up a sovereign wealth fund for Colombia, which was subsequently done later that year. We were also in Chile, towards the end of 2011, for the Latin American Economic Association (LACEA) conference, in which we held a session³ on sovereign wealth funds together with Chilean Finance Minister Felipe Larraín and Ignacio Briones, who is currently responsible for the Chilean sovereign wealth funds and also collaborated on this report.

This "private" initiative, undertaken as a result of many conversations between ESADE and KPMG, received crucial "public" support from INVEST IN SPAIN. The common ground between the public and private spheres in terms of the project's ultimate objectives, the need for a detailed study of these international players, and the specific nature of the content of the report, were agreed on by both sides. Without their vision, initiative and financing, this project would not have been possible.

The structure of the report is as follows: after this introduction, Victoria Barbary addresses the current world situation of and trends in sovereign wealth funds; after that Javier Santiso focuses on the impact of these funds and the opportunities they present in Spain and Latin America. This is followed by two case studies: one on the Brazilian example, by Christopher Balding and Ellen Campbell, and another on the Chilean one, by Ignacio Briones and Francisco Vergara. Lastly Javier Capapé considers the novelty that these funds represent on the African continent. It is also included an interview with Favio Scacciavillani, Chief Economist of the Oman Investment Fund.

Several conclusions can be drawn from the study:

- The rise of sovereign wealth funds now applies to all emerging regions, not just Asia and the Middle East, but Africa and Latin America too. There are currently more than 70 funds of this type in operation, with total assets of close to \$5 trillion.
- In the period 2010-2012 there has been a steady increase in sovereign wealth funds' South-South activity. In particular we have seen Arab and Asian funds investing in Latin America. Some of these transactions passed through Spain, via subsidiaries of Spanish multinationals established in the region, such as Iberdrola and Santander.
- In this way Spain also popped up on the sovereign wealth funds' radar screens, partly as a result of its multinationals' involvement in Latin America. But there were also some transactions linked to the Spanish market, the most prominent being the purchase of CEPSA from IPIC.
- The rise of sovereign wealth funds represents a financial opportunity, but also an industrial opportunity for Spain. This can be seen from the first cooperation agreements between the Mubadala fund and Spanish companies such as Sener, Abengoa and Indra.
- However, it could promote a more systematic strategy of establishing relations with sovereign wealth funds in both the Middle East and Asia, and also with those of Africa and Latin America, seeking to have them establish their European headquarters here, and carrying out actions via business schools, football clubs or Spanish government cooperation.

¹ Available at http://www.esadegeo.com/globalisation-lab/index/page1/1. Victoria Barbary is currently Director of the Sovereign Wealth Center at Euromoney Institutional Investor and Researcher at the Sovereign Investment Lab, Bocconi University.

² Sovereign Wealth Funds: the New Intersection of Money and Politics, Oxford University Press, 2012: http://www.esade.edu/web/esp/about-esade/today/news/viewelement/219441/1/el-economistachristopher-balding-detalla-los-desafios-que-afrontan-los-funds-soberanos-de-inversion-en-unaconferencia-de-esadeaeo.

³ http://www.uai.cl/facultades-y-carreras/escuela-de-gobierno/actividades/2011/sovereign-strategic-funds-the-political-economy-of-sovereign-wealth-funds-in-and-from-latin-america.

These are some of the actions recommended in the report. Relations with sovereign wealth funds need to be built up over time and coordinated at the highest levels of State and of multinationals' management.

In a strategy of systematic attraction, Spain could leverage its football clubs to really spearhead the national brand. Spain's business schools could also be more actively drawn into the endeavour, developing *ad hoc* programmes for these funds, and road shows to train executives working in both the public and private sectors of emerging countries that have sovereign wealth funds.

Lastly, an integrated strategy could include international cooperation. The bilateral development banks of countries like Brazil and China have become major players, like the sovereign wealth funds of many of these countries. Here Spanish cooperation could identify top-level partners to lend their support, particularly in Latin America, where they have exceptional credibility based on experience.



3. SOVEREIGN WEALTH FUND INVESTMENT BEHAVIOUR

It has now become almost impossible to ignore sovereign wealth funds (SWFs). There are now up to 73 sovereign funds investing government surpluses in international equity and debt markets with total assets under management estimated at up to \$5 billion – more than double the size of the global hedge fund industry. While older funds had been quietly investing in a range of assets across the globe without much fanfare for decades (the first SWFs⁴, in Kuwait and what is now Kiribati, were founded in the 1950s), in the mid-2000s the world sat up and took note. The boom in oil prices and world trade endowed a number of emerging economies with vast wealth. Many of these countries saved their surpluses in SWFs, which had the express remit of investing the funds abroad for commercial return, to provide income for future generations when their commodity reserves were depleted, to relieve inflationary pressures, cover future pension liabilities or prevent Dutch disease.

sovereian wealth funds⁵

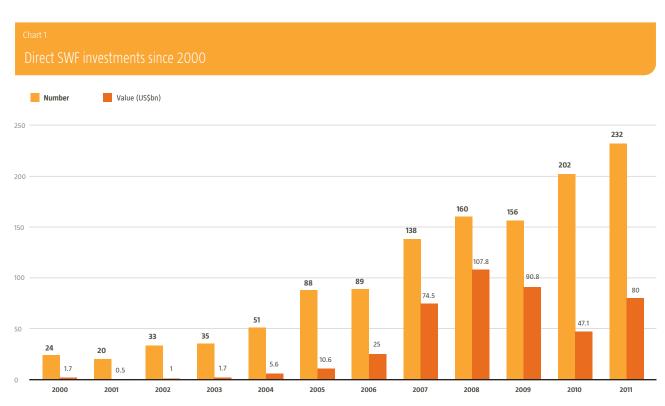
Country	Fund name	Inception year	Source of Funds
Norway	Government Pension Fund-Global	1990	Commodity (Oil)
U.A.E./Abu Dhabi	Abu Dhabi Investment Authority	1976	Commodity (Oil)
China	China Investment Corporation	2007	Trade Surplus
Kuwait	Kuwait Investment Authority	1953	Commodity (Oil)
Singapore	Government of Singapore Investment Corporation	1981	Trade Surplus
Singapore	Temasek Holdings	1974	Government-Linked Companies
China	National Social Security Fund	2000	Trade Surplus
Qatar	Qatar Investment Authority	2005	Commodity (Oil & Gas)
Russia	National Wealth Fund	2008	Commodity (Oil)
Australia	Australian Future Fund	2006	Non-Commodity
Libya	Libyan Investment Authority	2006	Commodity (Oil)
Kazakhstan	Kazakhstan National Fund	2000	Commodity (Oil)
U.A.E./Abu Dhabi	International Petroleum Investment Company	1984	Commodity (Oil)
Brunei	Brunei Investment Agency	1983	Commodity (Oil)
Republic of Korea	Korea Investment Corporation	2005	Trade Surplus
Malaysia	Khazanah Nasional Berhard	1993	Government-Linked Companies
Azerbaijan	State Oil Fund of Azerbaijan (SOFAZ)	1999	Commodity (Oil)
U.A.E./Abu Dhabi	Mubadala Development Company	2002	Commodity (Oil)
Ireland	National Pension Reserve Fund	2001	Non-Commodity
Oman	State General Reserve Fund	1980	Commodity (Oil & Gas)
Bahrain	Bahrain Mumtalakat Holding Company	2006	Government-Linked Companies
New Zealand	New Zealand Superannuation Fund	2001	Non-Commodity
U.A.E.	Emirates Investment Authority	2007	Commodity (Oil)
U.A.E./Abu Dhabi	Abu Dhabi Investment Council	2007	Commodity (Oil)
East Timor	Timor-Leste Petroleum Fund	2005	Commodity (Oil& Gas)
U.A.E./ Ras Al Khaimah	Ras Al Khaimah (RAK) Investment Authority	2005	Government-Linked Companies
Vietnam	State Capital Investment Corporation	2005	Government-Linked Companies
Kiribati	Revenue Equalization Reserve Fund	1956	Commodity (Phosphates)
São Tomé & Principe	National Oil Account	2004	Commodity (Oil)
Oman	Oman Investment Fund	2006	Commodity (Oil & Gas)

 ⁴ US — Texas Permanent School Fund was established even earlier: 1854. It is not clear if it qualifies as a SWF.
 5 In this chapter we concentrate on the activity of this 30 funds directly engaged in the world's equity

In this chapter we concentrate on the activity of this 30 funds directly engaged in the world's equity markets, listed in Table 1. However, there are divergent definitions of a "sovereign wealth fund" as we will check in next chapters of this report. Here we exclude funds controlled by central banks, finance ministries or government agencies (e.g. Saudi Arabia Monetary Agency, China's State Administration of Foreign Exchange, the Hong Kong Monetary Authority, Indonesia's Government Investment Unit and Botswana's Pula Fund), those used for currency stabilisation purposes (e.g. Chile's Social and Economic Stabilisation Fund, Trinidad and Tobago's Heritage and Stabilisation Fund), state pension funds, funds controlled by sub-national governments, with the exception of the United Arab Emirates (e.g. Alaska Permanent Fund, Alberta Heritage Fund) and those that only invest in domestic markets (e.g. Malaysia's 1Molaysia Berhad, Kazakhstan's Samruk Kazyna, and France's FSI). We also exclude stateowned enterprises with large investment portfolios (e.g. Sonangol and King the Abdullah University of

As their coffers swelled, and markets boomed many SWFs became more confident and looked for new ways to invest and founded new vehicles to do so, as Chart 1 shows, there was a spate of founding new SWFs between 2005 and 2007. These funds, and to an extent the older ones, looked to invest with an eye to higher-risk, higher-returns, they also increased the amount of investment they undertook directly, rather than by investing with asset managers or into funds. This made them more visible on the international investment landscape, particularly new funds, which often pursued an aggressive overseas investment strategy.

This was evident as SWFs moved towards bigger investments and deals in OECD markets: between 2005 and 2007 SWFs' publicly reported, direct investment activity increased markedly (by over 50 percent), but with the investment value outpacing this increase, rising from \$10.6 billion to \$74.5 billion (by 600 percent). Much of this growth was focused on developed markets, with the value of direct SWF investments in the OECD rising from \$5.0 billion in 2005, to \$43.0 billion in 2007.



Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. Source: Sovereign Investiment Lab, Universitá Bocconi, 2012.

In the last quarter of 2007 and the first quarter of 2008, the American and European banking sectors went into meltdown as a result of their exposure to the U.S. subprime mortgage debt. As the global economy spiralled downwards, banks looked to SWFs to recapitalise the financial system, which had caved in on its foundation of bad debt. Between November 2007 and January 2008, American and Swiss banks, including Citi, Merrill Lynch, Morgan Stanley and UBS, received \$24.7 billion from SWFs.

Sovereign wealth fund investments in western banks November 2007 - March 2008

Sovereign fund	Bank	Value	Date
Abu Dhabi Investment Authority	CitiGroup	\$7.5 billion	November 2007
China Investment Corporation	Morgan Stanley	\$5.6 billion	December 2007
Temasek Holdings	Merrill Lynch	\$4.4 billion	December 2007
Government of Singapore Investment Corporation (GIC)	CitiGroup	\$6.88 billion	January 2008
Kuwait Investment Authority	Merrill Lynch	\$3 billion	January 2008
Kuwait Investment Authority	CitiGroup	\$2 billion	January 2008
Korea Investment Corporation	Merrill Lynch	\$2 billion	January 2008
Temasek Holdings	Merrill Lynch	\$600 million	February 2008
Government of Singapore Investment Corporation (GIC)	UBS AG	\$10.34 billion	March 2008

These investments played a major role in stabilising the financial system, but the rapid fall in the value of American and European banking stocks saw their market value plummet. The majority of these investments were structured as mandatory convertible notes, paying a coupon of around 10 percent for about two years, which cushioned some of the blow; however, the substantial mark-tomarket losses put SWFs under considerable pressure to retreat from international markets from their governments and domestic popular opinion. The collapse of Lehman Brothers, which precipitated the drying up of global credit and capital flight from emerging markets by Western investors at the end of 2008, exacerbated the situation. Now SWFs had little choice but to turn to their domestic markets. This was particularly obvious in the cases of Kuwait and Qatar. In December 2008, the Kuwait Investment Authority, Kuwait Petroleum Corporation and the Public Institution for Social Security contributed to a KWD1.5 billion (\$5.2 billion) fund to invest in local stocks, KIA also pumped over KWD50 million into the Al Raed Fund, a Kuwaiti mutual fund, and was a major participant in bailing out Gulf Bank, one of the country's major lenders. Likewise, the Qatar Investment Authority, bought ten percent of the four largest banks in the country to keep them solvent – a bailout that was completed during 2011 and cost the fund over \$3 billion.

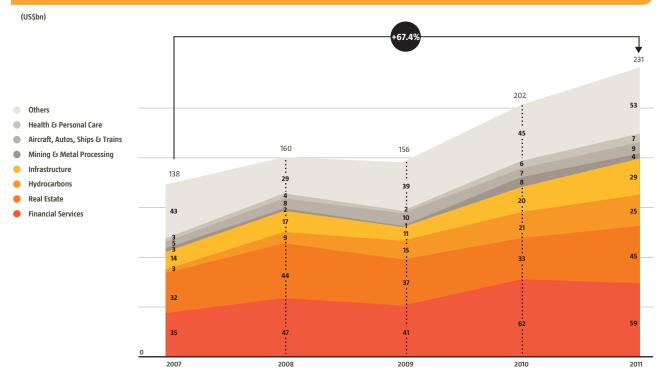
During 2009 and 2010 most sovereign funds retrenched following the heavy losses most SWFs suffered in 2008: Singapore's Temasek Holdings was hardest hit by the downturn, reporting losses of 31 percent (about \$39 billion) between March and November 2008. The Abu Dhabi Investment Authority, KIA, QIA, Malaysia's Khazanah Nasional and Abu Dhabi's Mubadala Development Company were all reported to have made losses of between 20 and 25 percent in 2008. Singapore's other SWF, the Government of Singapore Investment Corporation, fared better, incurring apparent losses of 15 percent, while the Korea Investment Corporation's portfolio only shrank by 14 percent. Even the China Investment Corporation, whose global portfolio was mostly in cash, reported a small loss (2.1 percent) for the year following disastrous investments in private equity house JC Flowers, Morgan Stanley and the Lehman Brothers Reserve Primary Fund.

Criticism of SWFs' losses, from both the domestic and international media, and the insinuation from some quarters that they were politically motivated, as well as being undeniably opaque encouraged many to open up. A voluntary code of conduct, the Generally Accepted Principles and Practices for SWFs (the Santiago Principles) were written and signed by SWFs from 23 countries in October 2008, which bound the signatories to invest commercially and transparently and with respect to the target country's regulatory structures. This has given life to the International Forum of Sovereign Wealth Funds, which meets on an annual basis, and while its work is nascent, its ability to help sovereign funds become more transparent looks promising.

Losses and the move towards increasing transparency encouraged many SWFs to rethink their investment approach and philosophy, particularly their attitude to risk. The economic environment had been fundamentally altered, and they had to reconsider underlying assumptions about asset allocation. This was manifested by restructuring their organisational architecture, changing their investment focus, asset allocation or rebalancing their portfolio. A wider scale restructuring of sovereign investment vehicles was undertaken in Dubai following its decision to suspend debt repayments and bring its sovereign investment vehicles under closer government scrutiny through the Advisory Council of the Government of Dubai, and looking to reallocate the debt burden across the "Dubai Inc." network.

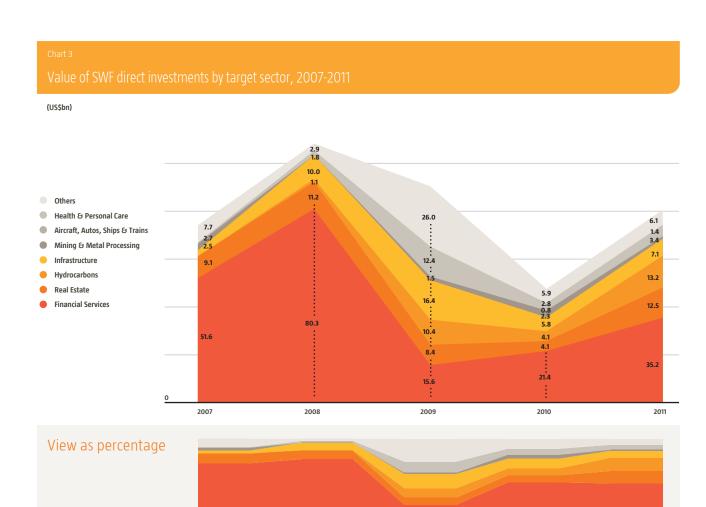
This realignment saw SWFs start investing in companies based in the real economy, as part of a drive to diversify their portfolios. Although the proportion of investments stayed relatively constant across sectors, a greater proportion of sovereign funds publicly reported direct expenditure was directed towards the commodity value chain — petroleum and natural gas, mining and metal processing — while infrastructure both at home and abroad became an increasingly important sector for sovereign funds, as they sought low-risk, long-term investments with sustainable income streams.







Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. Source: Sovereign Investment Lab, Universitá Bocconi, 2012.



Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. Source: Sovereign Investment Lab, Universitá Bocconi, 2012.

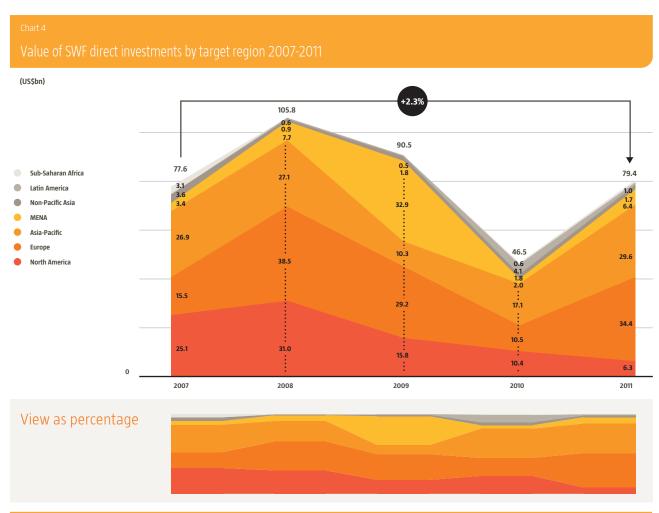
The onset of the Eurozone Crisis in 2010 destroyed the belief that developed-market sovereign debt was low risk and liquid as heavily indebted countries in the Eurozone – first Greece, then Portugal, Ireland and Spain – struggled to pay off their debt, and bailouts were agreed for Greece and Ireland, the investment climate deteriorated. The consequences rippled across the world, and as a result 2010 was a nadir for sovereign fund investments, being at the lowest levels of SWF activity in the "modern era" of SWFs⁶, with the year only seeing them directly invest \$47.1 billion – half their expenditure during the previous year.

Whereas SWFs had previously been content to make big-ticket investments in Europe, the instability in the investment environment saw them try to spread risk by undertaking a larger number of smaller transactions. The exception was Qatar, with QIA purchasing high-end London department store, Harrods (\$2.2 billion), and undertaking a \$2.7 billion investment in Banco Santander's Brazilian unit. The other exception to this rule were obvious growth markets, exemplified by the much-anticipated IPO of the Agricultural Bank of China, in which KIA, QIA, the Chinese National Social Security Fund, and Temasek bought a total of over \$6 billion of stock.

⁶ As the majority of the funds we track have only been founded in the last decade, it is not until 2005 that we have a fund universe comparable to the present day.

SWFs also diversified their portfolios by concentrating on investing in emerging markets, SWFs making a wealth of smaller southsouth investments: Indian healthcare and electricity transmission, Vietnamese banking, Zambian telecoms, South African platinum mining, and a tourist resort in Jordan all received SWF investments.

Consequently, over 80 percent of SWF investments were made abroad in 2010, with a large proportion in emerging markets. Retreat could not be a long-term strategy, and the environment offered some prospect for patient investors with cash to identify under-valued assets.



Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. Source: Sovereign Investment Lab, Universitá Bocconi, 2012.

The global economic environment in 2011 continued to be dominated by the sovereign debt crisis in Europe, but the onset of the political unrest that started in Tunisia and spread across North Africa and the Middle East as well as political deadlock in the United States further dented confidence in the investment climate. In such an uncertain situation, it was a remarkable that SWF investment rose from its 2010 levels. But with oil prices continuing to rise towards \$100 per barrel, SWFs continued to invest abroad despite many governments in the Middle East diverting spending to their home markets. In February and March 2011, Saudi Arabia unveiled benefits worth \$130 billion — 30 percent of its gross domestic product — in an apparent bid to insulate the largest oil exporter from the Arab Spring. Bahrain, Libya, Oman, and Kuwait also increased domestic spending or handed outright cash to its citizens in packages totaling as much as four percent of GDP.

However, with the imperative to continue to diversify wealth away from oil industries, and to prevent inflationary pressures and currency appreciation as a result of large foreign exchange reserves, SWFs continued to be supplied with currency from their governments and put it to work. In 2011, SWF activity rose, with a 15 percent increase in the number of deals completed over 2010, from 202 to 232, but a 41 percent increase in value from \$47.1 billion to \$80.0 billion.

While this may appear to represent an increase in SWF confidence in the global economy, in reality it reflects the continuing impact of the global financial crisis on their balance sheets and investment behaviour. Some sovereign funds are still being called on to capitalise domestic banks. Ireland's National Pensions Reserve Fund, the highest spending fund of the year, was required to inject \$12.5 billion into Allied Irish Banks in 2011, accounting for all its direct investment activity. QIA also continued to be affected by the fallout from the financial crisis, spending \$1.3 billion on continuing the recapitalisation of four of its domestic banks – a bailout that has cost the fund over \$3 billion since 2008. In addition, the fund also came to the rescue of Credit Suisse, which detracted considerably its balance sheet. In February, Qatar Holding and Olayan Group received an aggregate of approximately CHF 6 billion of Tier 1 buffer capital notes to be paid up no earlier than October 2013 for cash or in exchange for Tier 1 capital notes issued in 2008. Such transactions serve as a reminder that investors are still contending with the consequences of the financial crisis. While some funds, notably KIA and GIC have managed to sell out of their ill-fated bailout of the Western banking system to various degrees of success, others — Temasek – have booked enormous losses on those investments, and further funds, such as KIC, are still holding stakes in banks that are worth a fraction of the purchase price.

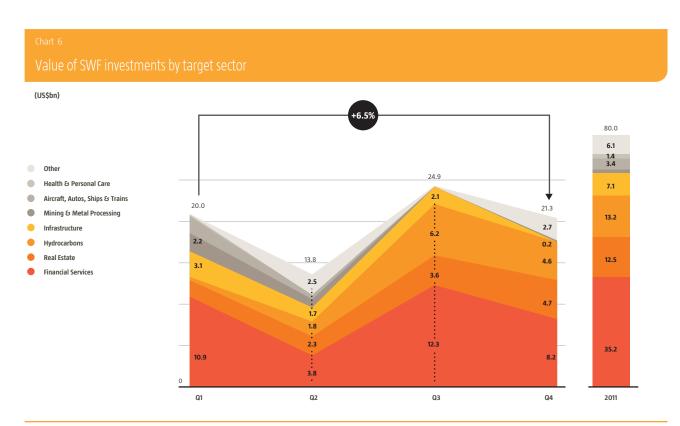
The weight of domestic bailouts on SWFs is evident in the difference between their domestic investment behaviour and their investment patterns in foreign markets. In domestic markets, 80 percent of their publicly reported expenditure and 42 percent of their direct investments were in financial services. In foreign markets, while financial services were the most significant sector for sovereign funds, it only accounted for 20 percent of the investments and 25 percent of the expenditure. This suggests that the overall bias towards financial services is not the result of considered strategising on the part of sovereign funds, but a domestic policy objective to recapitalise and support domestic banks in the wake of the financial crisis.



Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. Source: Sovereign Investment Lab, Universitá Bocconi, 2012.

Outside of domestic bailouts, only eight out of the 23 funds that invested directly in 2011 invested in financial services. The vast majority of these were in emerging economies, with the two Singaporean funds focusing on China. Other SWFs' foreign investments in this sector have been spread across Asia and Africa, with ADIA buying shares in India's largest gold-loan company,

Muhoot Finance, and HDFC Bank, fourth largest bank in India by assets and the second largest by market capitalisation. Temasek established an investment vehicle with the Oppenheimer family to concentrate on Africa, and injected tier one capital into NIB Bank in Pakistan, of which it owns 74 percent. CIC bought a 25 percent share of South African investment group, Shanduka Group.



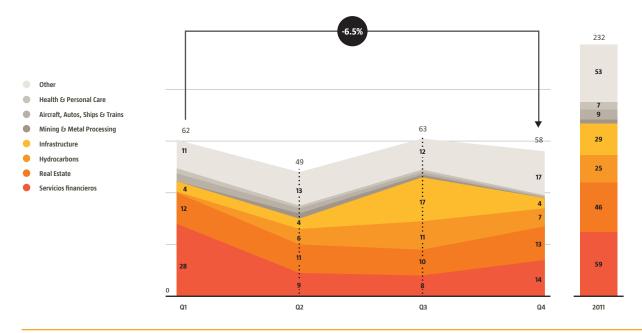
Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. Source: Sovereign Investment Lab, Universitá Bocconi, 2012.

Another sector that has always been a mainstay for sovereign fund investment has been real estate. After several years of sovereign funds diversifying out of properties in to real estate investment trusts and other property funds, 2011 saw a return to bricks and mortar. In particular, properties in London and New York, considered "safe havens", were popular, with KIA returning to the New York property market, and rebalancing its UK property portfolio, divesting noncore assets such as provincial shopping centres, in exchange for central London office buildings, including 1 Bunhill Row, which was announced in December 2011. GIC has taken a slightly different route into the property market. Following a partnership with Deutsche Bank in February 2010 to provide the European property market with debt financing, GIC underwrote the junior portion of Blackstone's purchase of Chiswick Park in London in March 2011, and again financed part of Blackstone's £600 million purchase of eight Mint hotels in the United Kingdom in September.

Emerging market real estate, however, has been of relatively little interest to sovereign funds. Where there has been investment, this has tended to be in development funds, such as Morocco's Wessel Capital, which will develop sustainable tourism projects in the Kingdom, and received investment from QIA, KIA and the International Petroleum Investment Company's, Aabar Investments. The exception to the rule is the Singaporean SWFs — GIC and Temasek – which have been relatively active in the Chinese property market, but again in financing new developments, rather than buying existing properties. For example, GIC Real Estate entered into a partnership with Yanlord Properties to develop a residential site in Jinnan District, Tianjin in China, in which it has invested around \$240 million, while Temasek invested nearly \$700 million in 65.5 percent of the Chao Tian Men development in Chongging with CapitaLand, CapitaMalls Asia, which will which will include a shopping mall and eight towers for residential, office and hotels.

Chart 7

Number of SWF investments by target sector



Publicly available data for direct SWF equity Θ real estate deals, joint ventures and capital injections. Source: Sovereign Investment Lab, Universitá Bocconi, 2012.

As has been widely trailed over the past year, with current market volatility and a need for sovereign funds to diversify their portfolios with assets with stable, long-term income streams, there has also been a wider interest in infrastructure. Toll roads were attractive with the Abu Dhabi Investment Authority, China Investment Corporation, the Future Fund and New Zealand Superannuation Fund all making sizable investments in toll road operators ConnectEast and Transurban in Australia, while GIC participated in a capital increase to enable Sintonia to increase its share in Italian toll-road operator, Atlantia. Utilities were also a target for sovereign funds, with power generation being a particular focus in both Europe and the United States, as sovereign funds sought to diversify portfolios and look for assets with stable long-term income streams in developed markets.

For similar reasons, for many funds, particularly those from Asia whose inflows do not originate from hydrocarbon rents, commodities have become a more important part of their asset allocation strategy. Petroleum, natural gas, and coal assets have remained a focus for SWF acquisition in 2011, accounting for some of the biggest deals of the year: CIC's \$4 billion investment in GDF Suez's Exploration and Production business, as well as a stake in their Trinidadian LNG Liquefaction plant; IPIC's \$5 billion purchase of Spain's CEPSA; and Temasek's \$1 billion investment in US shale

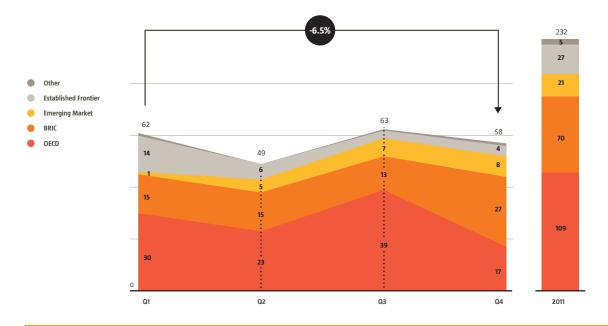
gas producer FracTech Holdings, which it undertook in a consortium with KIC, the Canada Pension Plan Investment Board and RRJ Capital in February. In a notable change from 2010, however, mining and metals, which had become an important sector, appeared to be a less popular target for direct investment. It may be that sovereign funds, wary of a bubble, have chosen to gain exposure to these commodities in other ways, which have a greater exposure to a range of commodities, rather than making substantial bets. Possible examples include exposure through commodity indices, or directly by taking stakes in commodity traders, such as Glencore, whose shares began trading on the London Stock Exchange in May and attracted investments from Aabar and GIC, or Hong Kong's Noble Group, in which KIC bought a 1 percent stake in April.

Developed markets are still receiving the greatest proportion of sovereign fund investment. The OECD accounted for nearly half the investments and 55 percent of the investment value in 2011. However, while this might suggest that sovereign funds remain wary of investing in emerging markets, the headline figure obscures the fact that these investments do not represent a vote of confidence for the developed world. SWFs have invested in commodities, especially North American shale gas extraction, safe-haven assets (London and New York real estate, utilities) and looked for companies with

a large presence in the emerging world. For example, QIA bought into two major Iberian utilities: Iberdrola in Spain (\$2.7 billion for 6.16 percent, and a further 2.24 percent before the end of the year) and Energias de Portugal (\$230 million for 0.05 percent, which brought its total holding to just over two percent). Both of these have extensive operations in Latin America, and it is likely that it was these as much as the desire for exposure to infrastructure assets or their being underpriced due to the economic environment in Spain and Portugal, that attracted Qatar to these companies. It is through

this type of exposure that sovereign funds have appeared to obtain exposure to Latin America, which recorded only three investments, totaling U.S. \$ 1,030 million, representing 1.3% of direct spending that SWFs publicly reported in that year. Indeed, Qatar Holding's investment in Iberdrola was accompanied by a memorandum of understanding to develop new business opportunities in different areas of the global power chain with a focus on high-growth and emerging markets.

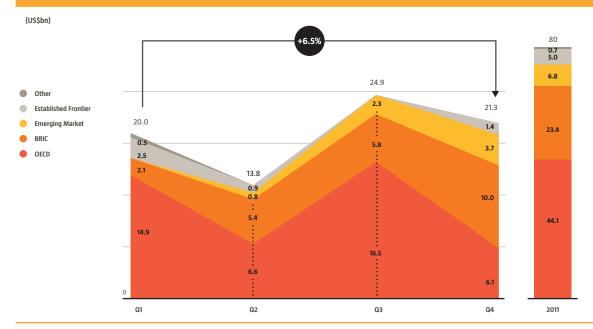




Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. The countries included in "Emerging Markets" and "Established Frontier Markets" are based on those in the MSCI Indices of the same names.

Source: Sovereign Investment Lab, Universitá Bocconi, 2012

Chart 9 Value of SWE direct investments by market type



Publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. The countries included in "Emerging Markets" and "Established Frontier Markets" are based on those in the MSCI Indices of the same names.

Source: Sovereign Investment Lab, Universitá Bocconi, 2012.

This strategy has also been evident in QIA's bet on luxury goods retailers such as LVMH in France (1.03 percent), and Tiffany & Co. in the United States (5.02 percent), which have growing markets in China and the Middle East. In previous years, high-end manufacturing in developed markets, particularly in the automotive and aeronautics sectors, have been attractive to SWFs, particularly those from the Arabian Gulf, but in 2011, little was invested in European or American manufacturing, suggesting that SWFs are not yet bullish on their ability to adapt to current market conditions and that the quest technology transfer is becoming less important than in previous years.

While this may seem to be a footnote in the way sovereign funds invest, it appears to be an important trend. On the face of it, if we compare the market allocations across direct investments from 2007 with those from 2011, we see relatively little change, with proportions of investment to the OECD and BRIC countries staying relatively stable, and the most notable trend being a move into established emerging markets (outside Brazil, Russia, India and China), and away from more true frontier markets (not included on MSCI Emerging or Frontier Markets Indices), as shown below. The conclusion to be drawn appears that sovereign funds are taking advantage of globalisation to get exposure to emerging market

growth through established developed market companies with strong brands, which have substantial growth markets in emerging economies. This enables sovereign funds to get developed market accounting and governance standards and legal protection in their investments, thus taking on low corporate and legal risk, while tapping growth in apparently more risky markets.

Table 3
SWFs investment in 2007 and 2011 by number of deals and volume invested

	BRIC	Emerging Markets	Frontier Markets	Others	OECD
2007 (Number)	28.57%	6.43%	12.14%	8.57%	44.29%
2011	30.17%	9.05%	11.64%	2.16%	46.98%
2007 (Value \$)	39.82%	0.22%	3.94%	1.21%	54.81%
2011	29.25%	8.54%	6.21%	0.83%	55.18%

That said, some SWFs are very involved in investing directly into emerging markets, with 13 funds undertaking 75 direct investments in foreign emerging markets, valued at \$21.2 billion (a quarter of all expenditure) in 2011. As the below table shows, Temasek is one of the largest investors in Asia, investing billions of dollars in Chinese banks and real estate. This is characteristic of Temasek's investment strategy, as the fund has 45 percent of its portfolio invested in Asia, outside of Singapore, 32 percent in its home market and a further

three percent in Latin America, Africa, Central Asia & the Middle East. This table also reveals that, for the first time, QIA is making a real play in emerging markets, with the foundation of its Indonesian subsidiary. However, QIA's investments in Egypt and Morocco are also illustrative of Qatar's desire to be a regional leader, particularly investing in countries, like Egypt, that have been effected by the Arab Spring.

SWF South-South investments in 2011, valued at over \$500 million

Fund	Target	Country	Value (US\$MM)
Temasek Holdings Pte. Ltd.	China Construction Bank Ltd.	China	2,788.47
Temasek Holdings Pte. Ltd.	Festival Walk Mall, Hong Kong	China	2,412.74
Temasek Holdings Pte. Ltd.	China Construction Bank Ltd.	China	2,184.61
International Petroleum Investment Company	RHB Capital Bhd	Malaysia	1,941.86
Qatar Investment Authority	QH Indonesia	Indonesia	1,000.00
China Investment Corporation	LNG Atlantic liquefaction plant	Trinidad & Tobago	852.10
Temasek Holdings Pte. Ltd.	Chao Tian Men landmark mixed development	China	671.35
International Petroleum Investment Company	Wessal Capital	Morocco	625.00
Kuwait Investment Authority	Wessal Capital	Morocco	625.00
Qatar Investment Authority	Wessal Capital	Morocco	625.00
Qatar Investment Authority	"Nile Corniche" in Cairo and resort El Sheikh development in Sharm	Egypt	543.80
Government of Singapore Investment Corporation Pte Ltd.	Hero Investments Pvt Ltd	India	503.50

So what for Europe?

SWF investments in Europe over the past two years have not been a vote of confidence for the European economy, and investment in Europe has certainly been hampered by the Eurozone's failure to come up with a credible solution to the sovereign debt crisis. SWFs have invested in commodities, safe-haven assets (British real estate, utilities) and looked for European companies with a large presence in the emerging world, which provide them with emerging market exposure with the lower regulatory and political risks of the European Union. However, SWFs invested little in European manufacturing suggesting that they are not yet bullish on the region's ability to adapt to more export-orientated world. Even highend manufacturing, which has traditionally been a strong sector for Europe as SWFs have been seeking technology transfer to their domestic economies, received lukewarm support, with Mubadala's investment try in AERnnova and Aabar's follow-on investment in Mercedes Benz Grand Prix being the only notable exceptions.

However, it may not be all doom and gloom. Several fund executives, including Scott Kalb of KIC and his successor Don Lee, as well as Jin Liqun, chairman of the Board of Supervisors of CIC, have been confident in the underlying fundamentals of the European economy, and have said they are looking at undervalued assets in the region, but emphasise the need to be cautious and to control risk amid intense market fluctuations. Moreover, in April 2012, central banks and sovereign wealth funds outside Europe which had shunned the European Financial Stability Facility credit since the end of 2011 made a strong return to the name, buying over 40 percent of the EFSF's inaugural €3 billion seven-year trade, well in excess of what they took in EFSF's five and three-year issues sold in 2012, which saw 10 percent and 18 percent go to that investor base. However, the pile in on seven-year instruments, rather than more near-term bonds suggests that sovereign wealth funds believe that the next few years are going to be rocky ones for the Eurozone, and that the long-term prospects are more compelling than the short-tomedium term.



Sovereign wealth funds and Spain: (re)thinking opportunities

4. Sovereign wealth funds and Spain: (re)thinking opportunities

The emerging countries' sovereign wealth funds have become international protagonists. Although these funds are neither new — some have been in existence for upwards of half a century - nor specific to emerging countries, they have nonetheless taken on unprecedented prominence over the past ten years, springing up from all continents and regions, from Central and East Asia, the Middle East and Africa and from Latin America⁷.

Before the onset of the crisis now affecting the economies of OECD countries, they started to invest in other countries, both developed and developing. By the beginning of the current decade they had become essential players in international finance, transformed as it were from villains into investing angels, courted by European and American governments for their support in buying bonds or investing in banks and industrials looking for liquidity and long-term capital. In the case of Spain, trips to China, Singapore and the Middle East by Ministers, the Prime Minister and even the King now include visits to these funds' offices.

There is no doubt that they represent investment opportunities. However, their new prominence goes beyond that. Above all, from the point of view of an OECD country such as Spain, sovereign wealth funds represent an opportunity to think anew about relations with the emerging economies. These economies are no longer just markets in which to grow, countries to trade with or in which to extend one's corporate presence: they have become leading players in trade and investment, industrial holdings and strategic financial alliances.

In this respect, Spain's relations with the sovereign wealth funds are not confined to investment: they also have an industrial dimension. Sovereign wealth funds, particularly those from the Middle East, seek investment opportunities, but also strategic partners, to help them develop infrastructure and industrial hubs in their home countries. Here Spain has great potential, as shown by the growing success of its engineering and construction companies beyond Latin America, now carrying out projects in Asia and the Middle East too. The recent high-speed train contract for Saudi Arabia, awarded in 2011 to the Spanish consortium, bears eloquent testament to this potential.

Sovereign wealth funds certainly present financial opportunities. But they also present opportunities from the industrial point of view. And as part of a more integrated strategy of rapprochement, one could also imagine finding ways to persuade these funds to locate their European and international headquarters in Spain (for now, London

leads Europe in this regard). Spain's Real Madrid and FC Barcelona football clubs are other attractions that Spain could push harder, as part of an attraction strategy. Equally, Spain has business schools (three of them - IESE, ESADE and the IE — are world leaders) that could put down roots in those markets and develop programmes designed for these groups.

In this chapter we shall see how the sovereign wealth funds are part of the global re-balancing towards the emerging markets. Far from its being a threat, we shall see how Spain could turn this surge into an opportunity. It is already doing so at financial and industrial level. We shall also see how it could promote this move with corporate headquarters and projection through its football clubs and business schools.

Sovereign wealth funds and global re-balancing

Spain and Europe are at a crossroads: they are having to face an unprecedented crisis. However, beyond the immediate economic situation, one can discern a more structural trend: the great economic and financial shift towards the emerging markets that we have been living through for the past ten years.

The crisis of the OECD countries is not a global crisis: its impact is admittedly felt in every corner of the world, yet many emerging economies continue to grow apace, building up reserves and posting unprecedented gains. From this point of view the European crisis is just one more episode in this rebalancing of the world, an event that accelerates the real headline news of the early part of the century, which is the unprecedented rise of the emerging economies.

The spearhead of these economies is the group referred to as the BRICs, a term coined at the beginning of the last decade by the then chief economist at Goldman Sachs. Nowadays these four economies (Brazil, Russia, India and China) — to which one might add South Africa, Turkey or Indonesia, to mention just a few of the most buoyant emerging markets — account for more than 25% of world GDP and 41% of the world's population. In 2011, intra-BRICs trade reached \$230 billion, 8% of the world total. A telling indication of how times are changing is the fact that the emerging economies now trade more among themselves than with the countries of the OECD.

They are increasingly investing beyond their own borders, taking positions in both OECD countries and other emerging markets. Thus China has become the world's fourth biggest investor, channelling

On these players, see also Santiso, "Agentes emergentes en los mercados de capitales: BRIC, fondos soberanos y los nuevos depositarios de capital", Economistas, No. 128, 09/2011, pp. 66 – 71; and Javier Capapé and Javier Santiso, "Los fondos soberanos catalizan el re-equilibrio de la economía mundial", ESADE Center for Global Economy and Geopolitics (ESADEgeo), ESADEgeo Position Paper, no. 18, September 2011. Available in Spanish at http://www.sadeknowledge.com/view/los-funds-soberanos-catalizan-el-re-equilibrio-de-la-economia-mundial-2736.

more and more direct investment into other economies. In 2011, China overtook Spain in foreign direct investment in Latin America, accounting for 9% of the total invested in the region, compared with Spain's 4%. The phenomenon affects every continent, including Latin America, from which home-grown multinationals (also known as multilatinas) are starting to venture forth — mainly Mexican and Brazilian, but also Chilean, Colombian and Peruvian[®]. Among the highest-profile players in this investment trend are the emerging countries' sovereign wealth funds, whose assets under management (AUM) amount to \$5 trillion in 2012, twice as much as those of the UK pension fund industry for example.

Let us quickly review the development of three of the most significant sovereign wealth funds (SWFs) on the international scene. First, Qatar Holding, the investment arm of the Qatari sovereign wealth fund, the Qatar Investment Authority, is one of the SWFs that is most active in Europe, with holdings in companies such as Volkswagen-Porsche, Harrods and Total. Secondly, we have provided some information on the equity holdings of China Investment Corporation (CIC), a Chinese SWF with an estimated \$482 billion in AUM, which recently invested \$1 billion in a Russian state-owned private equity fund, another clear sign of the trend towards investment among emerging countries. CIC may soon become the leading sovereign wealth fund by AUM, since China has the greatest volume of foreign exchange reserves, more than \$3 trillion. Lastly, we have included updated information on Mubadala, a strategic fund of the United Arab Emirates, which has already established industrial relations with several Spanish companies, and which also has substantial growth potential.

These funds saw big increases in transactions during 2011 and 2012°. In 2011 alone they invested more than \$60 billion beyond their borders. They continue to invest in OECD countries, as can be seen from their interest in European assets, Spanish included. The European country in which they invested most in 2011 was the UK (17% of the world total), ahead of France, Germany and Spain. The European crisis in fact presents an unprecedented opportunity to take up positions in the continent, as shown by the agreement between Chinese sovereign wealth fund CIC and the Irish government, in 2012, to explore investments in Ireland. Chinese corporations also made more acquisitions in Europe, with Geely acquiring Swedish auto-maker Volvo in 2010, while in the chemical sector one year later China National BueStar acquired Norway's Elkem, and towards the end of 2011 a Chinese power company took

* See Javier Santiso, El auge de las multilatinas, Madrid, Fundación Carolina y Siglo XXI, 2011.

* Several books deal with the rise in this phenomenon; see in particular Karl Sauvant, Lisa Sachs and Wouter Schmit, eds., Sovereign Investment: concerns and policy reactions, Oxford, Oxford University Press, 2012; Gordon Clark and Ashby Monk, Sovereign Wealth Funds: legitimacy, governance and global power, Princeton, Princeton University Press, 2012; Fobio Scacciavillani and Massimiliano Castelli, The new economics of sovereign wealth funds, New York, Wiley Finance; and Christopher Balding, Sovereign wealth funds: the new intersection of money and politics, Oxford, Oxford University Press, 2012. This last book was presented in ESADE, in Madrid, in the context of the ESADE Globalization Lab which took place at the beginning of 2012; see http://www.esade.edu/newsletter/eng/rrii/

a stake in Energias de Portugal, investing a record \$3.5 billion. For its part, in 2012 Qatar became the main shareholder in the French group Lagardère and also ventured onto the hallowed ground of the French luxury goods industry, taking a stake of more than 1% in LVMH, which owns Christian Dior and Louis Vuitton. Through its sovereign wealth fund Qatar Holding, the emirate now holds close to 13% of Lagardère. In 2012 another Qatari institution, Doha Insurance Company, bought 3% of Siemens for just over \$3 billion.

Table 5 Fauity holdinas of Qatar Holdina

Fond	Company	% Capital	\$ millions	Year	Country
Qatar Holding	Volkswagen-Porsche	17.00%	9,900	2009	Germany
Qatar Holding	Agricultural Bank of China*		6,000	2010	China
Qatar Holding	Xstrata	7.76%	4,375	2012	Switzerland
Qatar Holding	Credit Suisse***	8.90%	3,060	2008	Switzerland
Qatar Holding	Lagardère	12.80%	3,000	2012	France
Qatar Holding	Barclays***	5.80%	2,770	2008	UK
Qatar Holding	Santander (Brazil)	5.00%	2,720	2010	Spain-Brazil
Qatar Holding	J Sainsbury	26%	2,393	2009	UK
Qatar Holding	Harrods	100%	2,300	2010	UK
Qatar Holding	Iberdrola	8.40%	2,270	2011	Spain
Qatar Holding	Total*	2.00%	2,000	2011/12	France
Qatar Holding	London Stock Exchange	20%	1,200	2007	UK
Qatar Holding	LVMH	1%	914	2011	France
Qatar Holding	Goldfields	10%	775	2011	UK
Qatar Holding	Eurobank EFG & Alpha Bank	N/A	685	2011	Greece
Qatar Holding	Songbird Estates	24%	559	2009	UK
Qatar Holding	Hochtief	9.10%	530	2010	Germany
Qatar Holding	Pavilion REIT*	36.10%	397	2011	Malaysia
Qatar Holding	Adecoagro	6.50%	N/A	2011	Argentina
Qatar Holding	Banyan Tree	26.40%	N/A	2010	Singapore

Source: ESADEgeo (2012). *Estimated. ** Swap of a unit of Qatari Diar (Cegelec) for a stake in VINCI. *** Estimated as at 31 December 2011.

4. Sovereign wealth funds and Spain: (re)thinking opportunities

However several new trends can be discerned. One of them, perhaps the most striking, is the ever greater appetite for investing in other emerging markets. These funds are in fact increasingly signing agreements among themselves on joint investment in emerging markets. Thus at the end of 2011 Malaysia and Qatar, through their sovereign wealth funds, agreed to set up a \$2 billion co-investment vehicle to operate in both countries. Qatar, via its sovereign wealth fund Qatar Investment Authority (with \$135 billion in assets) also signed an agreement with Morocco at the end of 2011 for the investment of several billion dollars in the country through a joint vehicle between both countries to promote infrastructure projects. For its part Vietnam, which also has a sovereign wealth fund, carried out more than 600 projects in 55 countries, investing a total of nearly \$11 billion. Laos, Cambodia and Venezuela took the bulk of the investments (nearly \$7.5 billion). PetroVietnam is the main foreign investor, including operations in Peru. In 2012, India and Saudi Arabia, via the Public Investment Fund, agreed to set up a \$750 million investment vehicle to invest in infrastructure projects in India. In 2011 Chinese sovereign wealth fund CIC invested a total of a billion dollars in the new Russian Direct Investment Fund, one of its biggest investments to date and the first of such size in another emerging country's sovereign wealth fund.

In 2012, in a move symbolising the appetite for South-South investments, Kuwait's sovereign wealth fund KIA opened an office in Beijing. It had not opened any international offices since 1953, when it opened one in London, so this shows Kuwait's strong interest in establishing bases and ties with China. The Government Investment Corporation of Singapore (GIC) for its part opened an office in Mumbai, India, in 2011, in another demonstration of growing South-South relations. Temasek, Singapore's other sovereign wealth fund, opened offices in Mumbai (2004) and Chennai (2009). It also has offices in Beijing, Shanghai and Hong Kong, in Vietnam and in Latin America (São Paulo and Mexico City). For the moment Temasek has no offices in Europe, unlike GIC which has one in London (it has a total of nine international offices). GIC also boosted its presence in emerging markets, in particular with offices in Beijing, Shanghai, Hong Kong and Seoul. In 2011 it opened its latest international office, in Mumbai. It has no offices in Latin America, covering this region from New York.

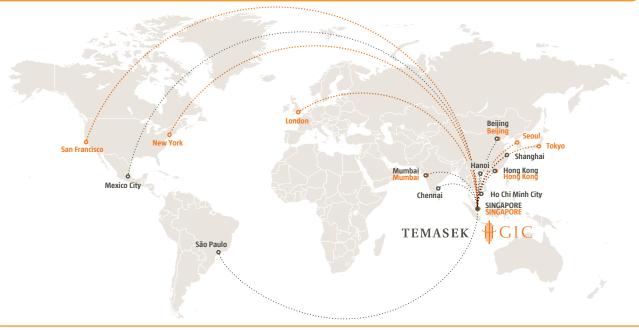
Equity holdings of CIC	

Fond	Company	% Capital	\$ millions	Year	Country
CIC	Morgan Stanley	9.9%	5,000	2007	USA
CIC	GDF Suez	30%	3,240	2011	France
CIC	JC Flowers	80%	3,200	2008	USA
CIC	Blackstone	9%	3,030	2007	USA
CIC	AES	15%	1,580	2009	USA
CIC	Teck Resources	17%	1,500	2009	Canada
CIC	Lexington Partners, Pantheon Ventures Goldman Sachs	, N/A	1,500	2010	USA
CIC	Penn West Energy	5%	1,220	2010	Canada
CIC	Morgan Stanley	N/A	1,210	2009	USA
CIC	Goodman Group	N/A	1,090	2009	Australia
CIC	General Growth Properties	N/A	1,030	2010	USA
CIC	Russian Direct Invest Fund	N/A	1,000	2011	Russia

Source: ESADEgeo (2012)



Source: Kuwait Investment Authority, 2012.



Source: TEMASEK, GIC, 2012.

4. Sovereign wealth funds and Spain: (re)thinking opportunities

The Arab funds have been very active in Latin America, as witnessed in the UAE strategic fund Mubadala's 2012 investment of more than \$2 billion in Brazil, specifically in Eike Batista's EBX Group, in which it took a 5.63% stake. This is Mubadala's most significant investment to date in Latin America and indeed in emerging economies in general. During 2011 Mubadala also entered China, Russia and Nigeria. The Brazilian deal is not unique, coming as it does on top of investments by other Arab funds, in particular ADIA, also from the UAE, which in 2011 invested a total of \$1.8 billion in Brazilian investment bank BTG Pactual, for an 18% stake. Also taking part in this deal were the Abu Dhabi Investment Council and Chinese sovereign wealth fund CIC. In 2012 BTG Pactual floated on the stock exchange, with its equity being valued at \$15 billion. A clear indication of Arab funds' growing investment appetite came in the form of the 2012 hiring by ADIA, the biggest of them all, of asset manager Eduardo Favrin to head up its Latin American division. Now based in Abu Dhabi, Favrin was previously in charge of Brazil for HSBC Asset Management, where he headed a team that managed a portfolio of \$2.6 billion invested in the region.

Equity	holdings	of Mu	badala

Fund	Company	% Capital	\$ millions	Sector
Mubadala	GE Capital	JV	8,000	Capital
Mubadala	Sowwah Island	N/A	3,000	Hotels and real estate
Mubadala	Dolphin Energy	51%	2,448	Energy
Mubadala	EBX Group	5.63%	2,000	Capital
Mubadala	LeasePlan Emirates	25%	2,000	Services
Mubadala	Carlyle Group	7.50%	1,350	Capital
Mubadala	Cleveland Clinic Abu Dhabi	100%	1,300	Healthcare
Mubadala	Tabreed (National Central Cooling Company PJSC)*	26.10%	1,200	Industrial
Mubadala	AMD	19.30%	914	Capital
Mubadala	Pearl Energy	100%	833.3	Energy
Mubadala	Four Seasons Hotel Abu Dhabi at Sowwah Island	N/A	272	Hotels and real estate
Mubadala	Rosewood Abu Dhabi	N/A	218	Hotels and real estate
Mubadala	Arzanah Wellness & Diagnostic Centre	N/A	110	Healthcare
Mubadala	Verno Capital	N/A	100	Capital

Source: ESADEgeo (2012). US\$ millions. Mubadala also has stakes in Piaggio Aero (32%), SR Technics (70%), Saab Spyker Automobiles (22%), Guinea Alumina Corp. (8%) and Etisalat Nigeria (30%). *A \$844 issuance in March and an additional \$400 million in May 2011.

Another way for sovereign wealth funds to boost their presence in emerging markets is to take equity stakes in companies that are highly exposed to or active in these markets. An example of this is the purchase in 2012 of 5% of agricultural commodity trader Bunge, headquartered in New York but with roots in Argentina, by Singapore's GIC sovereign wealth fund, for a total amount of \$500 million. This transaction comes on top of those carried out previously by China's CIC and Korea's KIC in trader Noble Group, and by Temasek in Olam International, both of them competitors of Bunge.

In fact, the appetite of many sovereign wealth funds for European assets, particularly Portuguese or Spanish ones, is ultimately directed at gaining increased access to markets in Latin America, and in particular Brazil. This explains the Chinese investments mentioned previously in Portugal, and those of Arab funds in IBEX 35 companies or their Brazilian subsidiaries as in the case of Qatar Holding's stake in Santander or Iberdrola, with investments of \$2 billion in 2010 and a further \$2 billion in 2011, respectively. The alliance between Repsol and China's state-owned oil company Sinopec, for more than \$7 billion, fits into the same logic, as does the interest shown in 2012 by Chinese sovereign wealth fund CIC in Repsol.

As an example of the funds' active approach to emerging markets in other regions, in 2012 China announced the setting up of a \$1 billion fund with the Inter-American Development Bank (IDB) in a deal led by state-owned China Eximbank. In another illustration of how times are changing, in 2012 the BRICs announced their interest in establishing their own multilateral bank, in parallel with, but separate from, those already in existence, all of which are promoted by OECD countries. So the next BRICs summit, to be held in South Africa (which is now a group member and supports the initiative), is likely to see the birth of a supranational fund, a BRICs multilateral bank, with significant resources.

The proactive stance being adopted by sovereign wealth funds shows just how much the world is changing. At the very least it gives cause for us to reassess the central position of Europe and the United States: we are no longer the centre of the world, and the sooner we realise this, the sooner we shall be able to take advantage of the opportunities arising from this tectonic shift emanating from the emerging markets.

Spain and the sovereign wealth funds: investment opportunities

This global rebalancing, and the increasingly proactive behaviour of emerging countries' sovereign wealth funds, opens up a number of opportunities for Spain, some of which have already been sketched out¹⁰. The most obvious one is financial, as we shall now see. Spanish companies' internationalisation was not just commercial, it was also financial, for as they sought new markets and horizons, so they also found new international investors, some of which were emerging countries' sovereign wealth funds.

Over the past few decades Spanish companies have rapidly become more international. As evidence of this, in 2010 foreign revenues of the IBEX 35 companies exceeded 53% of the total for the first time. Another way of gauging this internationalisation is to look at the attraction exerted by the country's listed companies on foreign investors. At the end of 2009, foreign investors held more than 40% of their capital, another all-time record. However, there are also less encouraging signs. Corporate shareholdings in Spain's banks and savings banks have been drastically reduced, going from 15 to 5% between 1995 and 2010. Looking ahead, the redrawing of the savings banks map and the impact of Basel III will further accelerate this trend. And this dynamic now combines with the imperatives of many non-financial companies which increased their holdings to 26% of total market capitalisation of listed companies, but which are now faced with unsustainable levels of indebtedness.

So we are in a situation in which, in this new decade, 2010-2020, it is quite likely that a large portion of the capital on the stock exchange is going to have to change hands. The case of the oil company Repsol is representative: with more than a third of its capital held by savings banks or (heavily indebted) financial institutions, Repsol in turn holds a third of another blue chip IBEX 35 company, Gas Natural, whose main shareholder is La Caixa. Other companies such as Abertis, Iberdrola, Iberia, Indra, Mecalux, NH Hoteles, Pescanova, SOS Cuétara and Tecnocom (and the list goes on) are also in a situation where a quarter or a third of their capital is held by savings banks. From this point of view the recent transaction whereby Chinese oil company Sinopec took a stake in Repsol Brazil is good news, since it provides the Spanish multinational with a new financial margin (Sinopec paid more than \$7.1 billion for 40% of Repsol's Brazilian subsidiary).

To put it another way: a considerable part of Spain's listed companies could be acquired by industrial rivals. An alternative is for more financial investors, particularly foreign ones, to show interest in investing yet more in our companies. One possibility could

be sovereign wealth funds. However these investment vehicles still have a relatively limited presence in Spanish companies' capital. One exception is the Norwegian fund, the world's second biggest sovereign wealth fund, with investments in the Spanish stock market in excess of €17 billion in 2011. This fund, totallling \$654 billion in AUM, has investments in more than 8,300 companies, 77 of which are Spanish. Santander and Telefónica are its biggest positions in Spain. The Norwegian fund's latest report shows many details about the positions in the various Spanish companies. In a general sense it has reduced its play on Spain, disinvesting 7%. The reduction was notable above all in Treasury bills (down by almost 30% from 2010 to 2011). Telefónica, Santander, BBVA, Repsol and Inditex are the main IBEX investments, as shown in the following table.

Table 8 Government Pension Fund — Global (Norway) in Spain

Top 20	Company	2010	2011	2011/2010
1	Telefónica	1,284	1,145	-10.86%
2	Santander	1,124	1,029	-8.47%
3	BBVA	516	646	25.21%
4	Repsol	375	573	52.73%
5	Inditex	227	404	77.77%
6	Iberdrola	410	341	-16.75%
7	Ferrovial	174	170	-2.77%
8	Amadeus	0	95	N/A
9	ACS	101	90	-10.17%
10	Banco de Sabadell	63	89	40.82%
11	Abertis	55	81	47.11%
12	Banco Popular	66	73	9.63%
13	CaixaBank	0	72	N/A
14	Gas Natural	45	67	48.67%
15	Grifols	33	63	93.28%
16	Enagás	43	55	29.02%
17	DIA	0	52	N/A
18	Acerinox	70	49	-30.07%
19	Indra Sistemas	41	44	7.01%
20	Corp Financiera Alba	45	42	-4.58%
	Treasury Bills*	3,243	2,314	-28.65%
	TOTAL**	18,479	17,174	-7.06%

Source: NBIM, 2012. € millions. * Sovereign fixed income. ** Fixed and variable income.

On this subject, see Javier Santiso's book, ed., Las economías emergentes y el reequilibrio global. retos y oportunidades para España, Madrid, Fundación de Estudios Financieros, 2011. Available (in Spanish) at http://www.ieaf.es/_img_admin/1326987939Binder1.pdf.

4. Sovereign wealth funds and Spain: (re)thinking opportunities

In general terms this fund is highly inclined in favour of OECD countries' equities and fixed income securities (59% and 41% of the portfolio respectively). In 2011 it started to diversify somewhat into real estate assets, mainly in Paris and London¹¹. The bulk of the portfolio replicates stock market indices and is managed in-house, but the fund currently also has 52 external mandates managed by 45 asset management specialists. In 2011 it continued to bet on diversifying somewhat more into emerging market equities, granting three new mandates. In total, its plays on emerging markets take in Brazil, Russia, China, India, South Africa, Malaysia, Indonesia, Thailand, Turkey and Poland. In Spain, the Norwegian fund granted a mandate to Bestinver Gestión¹².

The fund has investments in 68 countries, 50% in Europe, 35% in the Americas, the Middle East and Africa, and the rest in Asia. For equity investments, 47 countries make the cut (in 2011 Colombia was added to the list). The greater part of its investments, both equities and fixed income, is in the US, which accounts for 29.2%, followed by the UK with 15.5%, France 8.6%, Germany 7%, Japan 5.5% and finally Switzerland and Spain, tied. Overall, taking fixed income and equities together, Spain is among the top ten countries in which the Norwegian fund has investments, accounting for just over 4.1% of the total, ahead of countries like Canada, the Netherlands and Sweden. Spain is also in the top ten for fixed income investments. The fund is headquartered in Oslo but also has teams in London, New York and, more recently, Singapore and Shanghai.

However, taken as a whole the presence of sovereign wealth funds in Spanish companies is little more than symbolic – and this despite the fact that 40% of their total assets are invested in Europe. Sovereign wealth funds' relations with Spain date from the 1980s, when the Kuwait Investment Office (KIO) – the financial arm of the London-based Kuwait Investment Authority (KIA) — decided to carry out a number of investments in Spain - Explosivos Río Tinto, Banco Central, real estate assets, etc. -, which produced contrasting results and in some cases considerable losses, and led to them liquidating their investments in Spain. In the mid-1980s, after taking a position in paper company Torras Hostench, the 'petrodollars' also took one of their first steps in Spain through a Basque company, Banco de Vizcaya, in which they ended up acquiring a significant percentage, close to 5%. Since KIO unwound its positions, investments in Spain from these countries have been few and far between. Up until 2005 when the flow started to revive, annual incoming investment from the Gulf was barely €20 million a year.

Since then the presence of the sovereign wealth funds in Spain has been rather symbolic. In Europe, the sovereign wealth funds are investing, at least for now, above all in British, Italian, French and Swiss companies. Spain does not appear in the ranking of the top fifteen countries in the world in which they invest, as drawn up by Monitor and FEEM. There were some ad hoc investments such as those of Aabar Investments in Santander (subsequently sold), or those of Saudi Prince Al Waleed, one of the major shareholders in Africa Mixta SA, a company based in Barcelona and promoting lowcost housing, with a presence in numerous African countries. Others were more symbolic, like the position of almost \$100 million of the Libyan sovereign wealth fund LIA¹³ in Repsol (before the collapse of the Libyan regime, the fund had been very active in Europe, with significant investments in UniCredit and ENI in Italy, and also in Siemens and BASF in Germany and Pearson, owners of the Financial Times, in the UK)14.

In the past few years however, things seem to have changed, and from being practically symbolic, the presence of sovereign wealth funds in Spain has become much more significant, with some substantial deals taking place, particularly those led by the Arab funds Qatar Holding and IPIC. Thus in 2009 International Petroleum Investment Company (IPIC), an Abu Dhabi state-owned company, had already invested more than €3.6 billion in CEPSA, becoming, with 47% of the capital, the refiner's second biggest shareholder after France's Total. In 2010, IPIC had a total of four directors on the Spanish oil company's board, among them Khadem Al Qubaisi and David Forbes, Managing Director and Strategy Director respectively of the Abu Dhabi fund. In 2011 IPIC took a further step and bought all the shares in the refiner for an amount of €3.7 billion, making it Abu Dhabi's biggest Spanish investment to date.

However, this transaction was not the only one. In October 2010 Qatar Holding, the sovereign wealth fund of the neighbouring state of Qatar, bought 5% of Santander Brazil for a price of nearly \$2 billion. A few months later, in March 2011, the same fund made a strong play on a listed Spanish multinational, investing some €2 billion in Iberdrola for a stake of just over 6%. In both cases, as on occasions explicitly stated by Qatar Holding CEO Ahmad Mohamed Al-Sayed, the sovereign wealth fund was looking to increase its play on the emerging markets of Latin America, and in particular that of Brazil. Qatar Holding has also set its sights on Telefónica, another multinational with extensive interests in Latin America built up over the past few decades and for which Brazil has become a major

See anual report of NIBM, the Norwegian sovereign wealth fund: http://www.nbim.no/Global/Reports/2011/Annual%20report%202011/Arsrapport_11_ENG_web%20final%20version.pdf.
 See http://www.bestinver.es/.

¹² See http://www.bestinver.es/.
¹³ LIA's interests in Spain also include a bank, Aresbank, a subsidiary of the Libyan sovereign wealth fund; see annual report: http://www.aresbank.es/memorias/report2011s.pdf

fund; see annual report: http://www.aresbank.es/memorias/report2011s.pdf

* See Sven Behrendt and Deen Sharp, The Libyan Investment Authority: Sanctions and Post-Conflict
Reconstruction, Geoeconomia, 2011: http://geoeconomica.com/index.php/newsreader-9/items/thelibyan-investment-authority-sanctions-and-post-conflict-reconstruction.html

market. In all these cases, Latin America accounts for approximately 40% of total group revenue — more than the percentage coming from Spain. In other words, Arab investors are betting on Spain, but more particularly on Spanish companies whose strategic focus is on the emerging markets, and especially those of Latin America.

Table 9
Emerging market sovereign wealth funds and state owned companies in Spain 2010-2011 (\$ millions)

Sinopec ^a IPIC	Repsol (Brazil) Cepsa	Capital increase Shares	40%	2010	5,160
IPIC	'	Shares			
		Sildies	100%	2011	3,650
Qatar Holding	Iberdrola	Shares	8%*	2011	2,000
Qatar Holding	Santander (Brazil)	Convertible bonds	5%	2010	1,953
China Unicom ^a	Telefónica	Shares	1.37%	2009/11	1,500
Pemex ^a	Repsol	Shares	9.50%	2011	1,150
Mubadala	Sener	Joint-Venture (60 40)	60%	2011	940
Mubadala (Masdar)	Abengoa	Joint-Venture (60 20 20)	60%	2011	600
Sonatracha	Gas Natural	Shares	5%	2011	514
Mubadala	Aernnova	Shares***	N/A	2011	500
Mubadala	Indra	MoU	N/A	2008/10**	N/A
Government Pension Fund-Global		Shares	N/A	2011	17,174
Alaska Permanent Fund		Shares	N/A	2011	148
TOTAL					32,689

Source: ESADEgeo (2012). ° State-owned companies. *The initial percentage was 6.16%; at year-end 2011 it exceeded 8%. **2008 in aerospace technology and security; 2010 in transport and traffic technology. *** The transaction envisaged for 2011 did not come about; the objective was to acquire 71% of the company. Not included in the total

All these deals endorse, as if endorsement were needed, the decision of many Spanish companies to focus on Latin America over the past few decades: thanks to Latin America they have established a narrative and a track record that make them attractive prospects for Middle Eastern sovereign wealth funds, as in the cases of Santander and Iberdrola, or for Chinese investors, as in the case of Repsol. For many, Latin America has become the great trump card. Many Spanish groups' stories are more Latin American than ever, and now often Arab or Chinese too. To an unprecedented extent, these companies seem to have transformed themselves into euroemerging multinationals, multinationals based in OECD countries but with strong links to emerging countries.

The sovereign wealth funds' bursting onto the Spanish scene has also opened the way to industrial alliances. Many of these sovereign wealth funds, particularly the Arab ones, are seeking not just returns but also strategic investments. In this regard Qatar Holding's stakes in Iberdrola and Banco Santander conform to a dual logic, financial and strategic, and thus also industrial. By buying into Spanish companies they are also seeking exposure to emerging markets, and in particular access to Brazil, which is a priority market for Middle Eastern Arab funds. But the industrial logic has been taken to the extreme by the Arab fund Mubadala which seeks not just financial returns from its equity stakes but also industrial returns in the home country, the UAE. Thus its investments in GE and Airbus were also based on considerations to do with economic development, seeking to make Abu Dhabi an aeronautical cluster and to promote Masdar, the eco-friendly city rising up out of the desert.

Mubadala also increased its industrial ties with Spain. In 2011, engineering company SENER and Masdar (a Mubadala subsidiary) signed an agreement under which they are jointly investing €940 million, of the \$2 billion set as the objective for the five-year period 2008-2012. SENER has had strong business links with the Emirate of Abu Dhabi since 2008, when it entered an alliance with Masdar for the establishment of Torresol Energy, a joint venture between the two companies to promote large concentrated solar power (CSP) plants worldwide, in which SENER can make use of its own technology. Indra and Mubadala for their part signed a MoU on cooperation in 2010, establishing a framework for new technological alliances and joint venture projects. Spain's Abengoa Solar, together with France's Total and Mubadala subsidiary Masdar, succeeded in reaching an agreement in 2010 as partners to acquire, construct and operate Shams 1, the world's biggest CSP plant and the first of its kind in the Middle East. On the other hand, some deals failed to get off the ground, such as Mubadala's mooted €500 million acquisition of AERnnova, Spain's biggest aeronautical company.

In Abu Dhabi, apart from Masdar there are other projects of interest to Spanish operators, one of which is Aldar, 30% owned by Mubadala, which shares ownership with other investors including Invest AD — Abu Dhabi Investment Company, another of the country's sovereign wealth funds. Aldar, which is developing the Emirate's tourism infrastructure, has awarded projects worth more than \$75 billion since its establishment in 2005.

But interest in Spain is not confined to Arab sovereign wealth funds. China's CIC, with a portfolio of more than \$480 billion, has also shown interest in Spanish assets, particularly in 2012, setting its sights on Repsol, REE (Red Eléctrica de España, the Spanish National Grid) and Enagás. So far none of the deals has come to fruition. However REN, Portugal's equivalent to REE, lifted restrictions to

4. Sovereign wealth funds and Spain: (re)thinking opportunities

allow 40% to be sold to China's State Grid. In 2012, State Grid and Oman Oil acquired 40% of REN for €600 million. It should be noted that REE and REN have shareholder exchange agreements and that REE holds a 5% stake in REN.

These funds offer several advantages. They are usually long-term investors¹⁵ and by means of their sometimes active influence they can have a positive effect on the return on their equity holdings¹⁶, as with the private equity industry, which is currently very active in Spain. However, unlike private equity or industrial investors, they are usually financial partners, with no interest in managing the group they preside over or invest in. Moreover, with few exceptions, they do not usually demand a substantial presence on the board of directors (in barely 7% of cases) and when they do they generally keep a low profile, especially in companies in OECD countries.

Spain as a base for European HQs of sovereign wealth funds?

Apart from these investments, Spain could also seek to promote itself as a base for sovereign wealth funds' international offices. As far as Europe is concerned, London has become the default location: Kuwait Investment Authority, Libyan Investment Authority, Brunei Investment Agency, Abu Dhabi Investment Authority, Temasek and Government of Singapore Investment Corporation, for example, all have offices in London¹⁷. At the end of 2011, London continued its strategy of consolidating itself as a base for European corporate offices of sovereign wealth funds, managing to attract Korea Investment Corporation (KIC). At the beginning of 2012, the Qatar Investment Authority, Qatar's sovereign wealth fund, bought the London headquarters of Credit Suisse. Malaysia's public pension fund (KWAP), with AUM of \$25 billion, is also considering opening an office in the British capital.

However, many sovereign wealth funds have yet to open international offices, and not all are considering London or New York. China's CIC has opened offices in Hong Kong and Toronto, but not yet in Europe. It is interesting to see how in North America it preferred Toronto to New York, partly for strategic reasons, to distance itself from Washington. In Europe, there could be a similar opportunity, of which Spain could take advantage - Madrid could put itself forward as an alternative to (overly US-aligned) London. In 2012, in a clear indication of CIC's appetite for European assets, it appointed Collin Lau as new head of European private equity.

¹⁵ On this subject, see the World Economic Forum report Measurement, governance and long term investing, Geneva, World Economic Forum, 2012: http://www3.weforum.org/docs/WEF_IV_ Measurement/Covernance/Longtom/pusching.Report, 2012. pdf

MeasurementGovernanceLongtermInvesting_Report_2012.pdf

**On this effect, see Adair Morse, "Activist investors and performance in venture capital and private equity funds", University of Chicago, Booth School of Business, February 2012 (unpublished). See http://faculty.chicagobooth.edu/adair.morse/research/MorsePE_SWFMarch2012.pdf.

**See report TheCityUK and Invesco, Sovereign Wealth Funds 2012, London, 2012. http://www.thepithyk.com/arch2012.pdf.



Source: China Investment Corporation, 2012.



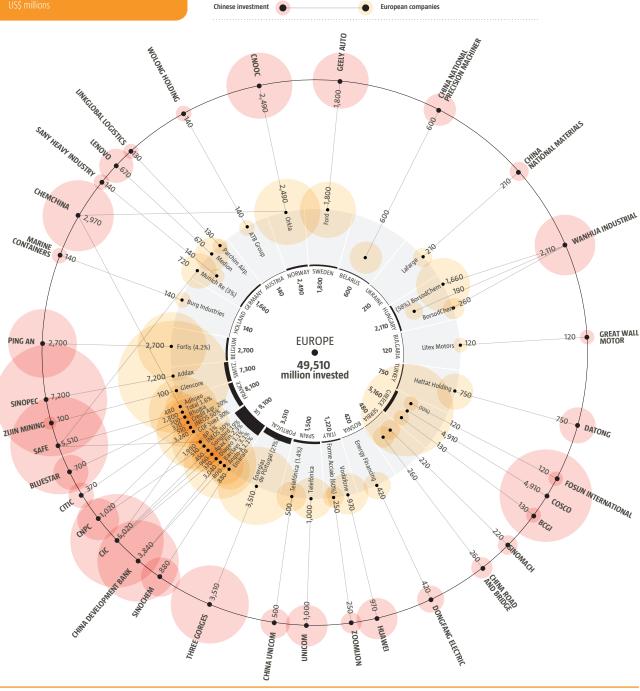
Source: GIC, 2012.



Source: Qatar Investment Authority, 2012.

As shown in the graphics on CIC and SAFE (Chart 15), their investments in Europe are concentrated above all in the UK and France, and to a lesser extent in Germany: Spain does not yet appear on the radar. If we add the investments of Chinese companies in Europe, we see the same concentration. With the European crisis, Greece and Portugal appeared. In the case of Spain, the bulk of the investment is accounted for by China Unicom in Telefónica and Sinopec in Repsol (although in this latter case the investment is directly in the Brazilian subsidiary).

China accumulates in Europe, through its sovereign wealth funds and state agencies, about 50 billion dollars. The most active investors on the European continent are the sovereign wealth fund CIC, very focused on the UK; Sinopec with purchase of Addax and the Chinese agency reserve manager (SAFE) with holdings in BP, Total and Munich Re. Countries that have received major investments are the UK, followed by France and Switzerland, as well as Greece and Portugal. Spain is not objective of these companies, Telefónica received only investment from Unicom.



Source: ESADEgeo, 2012.

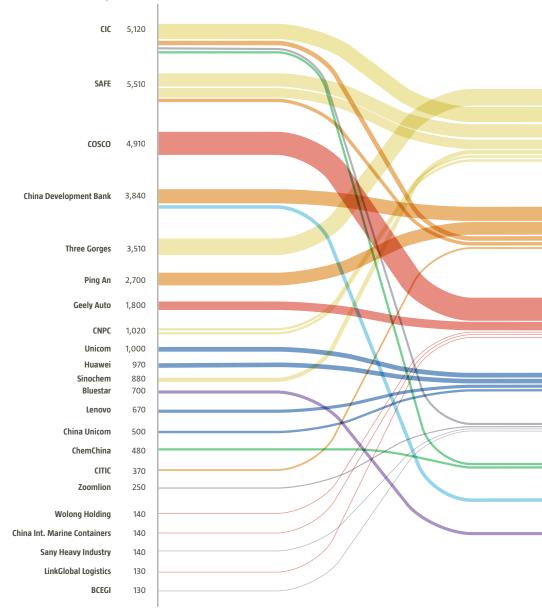
Chart 16

Chinese investments in the EU-15 (by sectors) to 2012

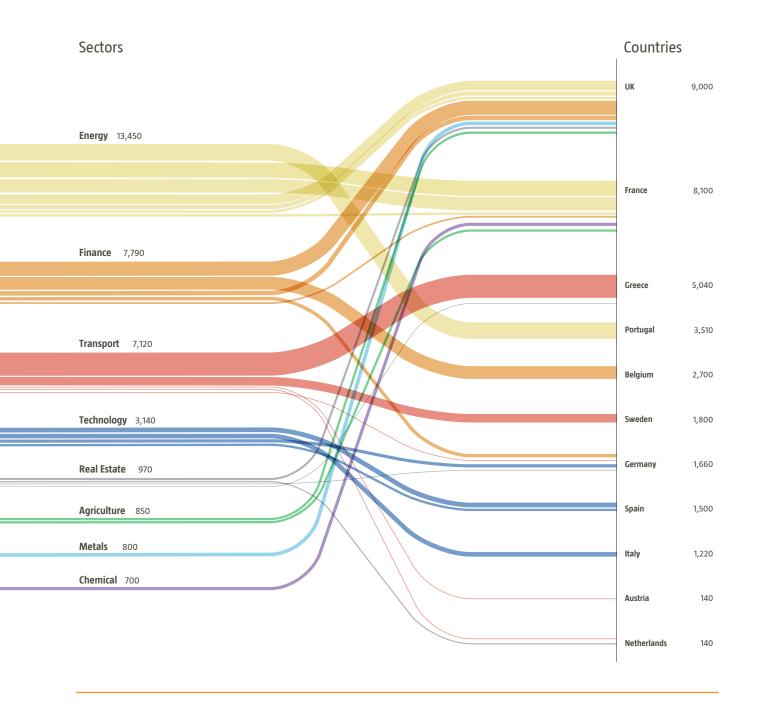
US\$ millions

The sectoral distribution of Chinese investments in Europe shows a clear interest for companies linked to the energy sector (mostly oil): entities as Addax, BP, Total and EDP being funded by sovereign wealth funds and Chinese state-owned entities. At a second level, the financial industry remains important: concentrated on the operations of the China Development Bank (in Barclays) and Ping An (in Fortis). Finally, the transport sector also has an important weight due to Cosco operations in Greece and Geely Auto with the purchase of Volvo from Ford in Sweden.

SWF / National Companies



Source: ESADEgeo based on data of sovereign funds and annual reports, 2012.



Other funds, such as Malaysia's Khazanah Nasional (KN), are venturing for the time being into China and India, but they are also looking more closely at Europe: in 2011 KN made a first substantial investment in Turkey, and it is looking out for opportunities in Europe, including in the new technologies and telecommunications sectors (it partly owns Malaysian operator Axiata) and healthcare. The GSMA Mobile World Congress, which will continue to be held in Barcelona for at least the next few years, could be used as a catalyst for establishing a European HQ for Axiata in Spain. Similarly, the

Spanish private healthcare sector offers significant opportunities that could be exploited with this type of player. The Spanish hospital landscape has changed recently, with the merger of USP Hospitales and the Quirón Group to form the biggest operator by market share, accounting for 9.2% of total revenues in a market which is nonetheless still highly fragmented, and this offers significant investment opportunities. Unlike Brunei, which already has offices in Paris and London, the Malaysian fund has yet to open an office in Europe. This may be an opportunity for Spain.

International offices of Khazanah Nasional Berhad and Brunei Investment Agency



Source: Khazanah National Berhard and Brunei Investment Agency, 2012

The case of IPIC, which acquired CEPSA, is an interesting one, which could set a precedent. IPIC has operations in Calgary, Canada; Vienna, Austria; Cairo, Egypt; Karachi, Pakistan; and Tokyo, Japan, as shown in the following chart. In 2011 it took a significant step into Europe by acquiring 100% of Spain's CEPSA, which as well as operating in its home market is also active in Algeria, Brazil, Canada, Colombia, Egypt, Panama, Peru and Portugal, and sells its products worldwide. IPIC makes no secret of its play on internationalisation, or of the fact that CEPSA will serve as a lever to open up exploration and production business in regions such as Latin America. The Arab fund has also set itself the objective of seeking synergies between

CEPSA and the various other oil companies in which it holds stakes, which include OMV (20%), Cosmo Oil (30%), EDP (4.1%), Parco (30%) and Sumed (15%). Following its IPO, the Swiss giant Glencore (which has a Spaniard on its board) also joined the list of IPIC holdings, and is now the subject of rumours about an alliance with CEPSA, which could thus become IPIC's international spearhead. So why not think in terms of Madrid's becoming IPIC's European base (IPIC also has operations in Germany and investments in Portugal) or even its international headquarters (with a view to Latin America and North Africa)?

International offices of IDIC

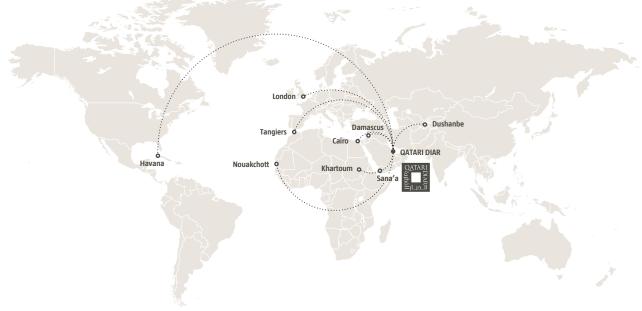


Source: International Petroleum Investment Company, 2012.

The cordial relations between the Spanish royal household and many of the Middle Eastern emirs, sultans and sheiks could also help in implementing a strategy aimed at persuading Arab funds to establish their European headquarters in Spain. Funds such as the Gulf Investment Corporation and Oman Investment Corporation (OIC) do not have European bases. They are interested in the region, as can be seen from their investments, for example those of the OIC in Portuguese and UK companies (Silva Corporation

and Ultra Electronics respectively)¹⁸. Qatar Diar, a subsidiary of the Qatar Investment Authority (QIA), specialising in the real estate and construction sectors, has a European office in London as well as a significant presence in Morocco, Egypt, Mauritania, Sudan, Tajikistan, Yemen, Syria and Cuba. Its interests in Europe and North Africa are thus significant. Why not think in terms of a headquarters for them in Madrid, where there is also a substantial cluster of construction and civil engineering groups?





Source: Qatar Diar, 2012.

As already mentioned, one of the sovereign wealth funds most active in Spain has been Qatar Holding, the investment arm of the Qatar Investment Authority. Why not think in terms of establishing a base in Madrid to cover Europe and Latin America? This fund has embarked upon a major expansion strategy. At the end of 2011 it opened an international office in the Indonesian capital Jakarta, with a capital of \$1 billion for transactions in Southeast Asia, particularly in the commodities and natural resources sectors. In Germany, it holds 10% of Porsche and 17% of Volkswagen, as well as just over 9% of Hochtief, which is now controlled by Spanish construction company ACS (51.1%). In 2012, this German company appointed Francisco Javier García Sanz to its supervisory board. García is Executive

Vice-President of Volkswagen, Chairman of the Board of SEAT and chairman of ANFAC, the Spanish auto makers association.

Two regions deserving special attention are Latin America and Africa. Many of the sovereign wealth funds created over the past ten years come from these two regions. As far as Latin America is concerned, Venezuela, Trinidad and Tobago, Mexico, Chile, and recently Brazil (2008) and Colombia and Panama (2011) have all set up sovereign wealth funds, and in Panamá, Peru, Guatemala, and Bolivia discussions are underway on setting up vehicles of this type. None of these countries has opened international offices. In the case of Brazil, the mighty BNDES (Brazilian Development Bank) opened

¹⁸ See annual report of OIC, Oman's sovereign wealth fund: http://www.omaninvcorp.com/new/images/Brochure.pdf.

an office in London in 2011. This is an important move, since BNDES is currently a major shareholder in many of Brazil's multinationals, including Petrobras, Vale, JBS and Eletrobras.

Table 10 Equity holdings of BNDES (04 2011)

Company	\$ millions
Petrobras	22,898
Vale	6,027
JBS	3,998
Electrobras	2,959
Fibria Celulose	1,581
Copel	1,354
Brasiliana	1,157
CPFL Energia	1,132
Light	474
Others	11,699
TOTAL	53,278

Source: ESADEgeo (2012) with data from BNDES (2012).

The circular Latin American connection could be completed by thinking of Spain in terms of a European base for Latin American sovereign wealth funds seeking opportunities in Europe or wishing to maintain a representative office here. Some of them, such as Chile's have become benchmarks and models (see also article on the Chilean fund in this report). Admittedly the Chilean model does not contemplate (for now at least) investing much beyond international bonds, although recently it opened the door to the possibility of equities, including foreign ones¹⁹.

African funds have also proliferated. Angola, for example, set one up in 2011. It has become the second biggest oil producer on the continent, behind Nigeria, which has also established a sovereign wealth fund²o. Angola's ties with Portugal have grown notably closer over the past few years, but the crisis has brought about a transformation in the relationship, with mass Portuguese emigration to Angola (there are now more than 91,000 Portuguese living in Angola, compared with 26,000 Angolans living in Portugal); and Angolan investments in Portugal have soared, reaching more than €2 billion in 2011, with 4% of the Lisbon stock exchange controlled by Angolan entities.

And so it is that the oil company Sonangol has become the major shareholder in Millennium BCP, one of Portugal's major listed banks, while Angola's Banco BIC, controlled by Isabel dos Santos, the eldest daughter of President José Eduardo dos Santos (in power in Angola since 1979), holds 10% of Banco BPI, another major Portuguese bank. Sales of state shareholdings in TAP Air Portugal, ANA Aeroportos de Portugal or Galp Energy could provide further footholds in the future.

Table 11 Angolan investors' holdings in Portuguese companies (March 2012)

Investor (Angola)	Company (Portugal)	%	Sector
Sonangol	Millenium BCP	14.59%	Banking
Sonangol	Banco Fomento Angola	49%	Banking
Sonangol	Totta Angola	25%	Banking
Banco BIC	Banco Português de Negocios	100%	Banking
Banco Internacional de Crédito	ZON	10%	Telecommunications
Sonangol & Isabel Dos Santos	Amorim Energia	45%	Telecommunications
Isabel Dos Santos	Banco Português de Investimento	10%	Banking
Isabel Dos Santos	Condis-Sonae	N/A	Supermarkets

Source: ESADEgeo (2012).

In other words, Angola is looking intensely towards Europe, focusing for the moment on Portugal. Why not think in terms of drawing its attention towards Spain, too, where the financial sector is being redesigned?. The crisis in Europe is attracting the attention of many sovereign wealth funds, including African ones. As well as Angola, Ghana or Nigeria (which established SWFs in 2011), Namibia, Mozambique, Uganda, Tanzania, Botswana, and others (up to 12 from the 21 SWFs now under discussion) are on their way to establish sovereign wealth funds. Not all of them are able to invest abroad, but they will become so as they develop. Except in the case of Libya, none so far has an international office. Some of them have looked to Europe for their model of governance, as in the case of Ghana and Nigeria with Norway.

And that is not all: we could also look towards Central Asia, which has seen many powerful sovereign wealth funds spring up, such as Azerbaijan's SOFAZ, with US\$33 billion in AUM, or Kazakhstan's Samruk-Kazyna, whose AUM at US\$78 billion are equivalent to 40% of the country's GDP. In 2011 SOFAZ redesigned its investment strategy to encourage more investments in international equities and real estate assets.

¹⁹ On the Chilean model, see also Javier Santiso, SWFs: The Chilean Model, Financial Times, September 23rd 2011, see http://blogs.ft.com/beyond-brics/2011/09/23/guest-post-swfs-the-chilean-model/#axzz1r9QbMH9Q.

²⁰ On Nigeria's sovereign wealth fund, see the Fletcher School Tufts University report: http://fletcher.tufts.edu/SWFI/~/media/Fletcher/Microsites/swfi/pdfs/2012/NigeriaSWFFinal.pdf.

Football clubs and business schools

Spain's football clubs, particularly Real Madrid and FC Barcelona, have huge followings, not just in Europe but in Asia, the Middle East and Latin America too. The "clásicos" encounters between the two rivals attract many heads of sovereign wealth funds, which sometimes travel to Madrid or Barcelona from Kuala Lumpur or Abu Dhabi just to see a match. Just as China once unleashed its ping-pong diplomacy on the United States, so we could imagine Spain deploying football diplomacy and leveraging the prestige that both teams have in the world, and in particular in the emerging countries and among sovereign wealth funds.

In fact relations between emerging countries and football clubs are often very direct (Chart 20). Several European clubs have been acquired by Arab sheikhs or Russian oligarchs, all from countries with sovereign wealth funds. For example in 2008 Manchester City was acquired for €250 million by Abu Dhabi United Group for Investment and Development Ltd. ("ADUG"), which is owned by Sheikh Mansour bin Zayed Al Nahyan, a member of the Abu Dhabi royal family.

Since then, in less than three years, the new owner has spent more than \in 480 million on signing new players. This gamble is not mere caprice: on the contrary, it is dictated by investment logic: in 2011 the club announced the launch of an urban development plan on its land, valued at £1 billion (more than \in 1.12 billion). Moreover, since its arrival in Manchester, ADUG has increased its investment lines, among other things landing an \in 800 million contract to produce films in Hollywood.

In 2011 Qatar's sovereign wealth fund acquired 70% of Paris Saint-Germain (PSG) for an amount estimated at €50 million, to which must be added the new owners' commitment to take charge of the club's debts, which amount to more than €30 million. In the UK, football is almost dominated by powerful multimillionaires. Manchester United and Liverpool are both American-owned, Chelsea is owned by Russian tycoon Roman Abramovich, and Manchester City is owned by Sheikh Mansour. Much media coverage was also given to the recent investment in Italian football by Libya's sovereign wealth fund (LIA), which holds 7.5% of Juventus.

Table 12 Investment in and sponsorship of football clubs (Middle East and sovereign wealth funds)

Ranking*	Team Revenues (€m) SWF		Revenues (€m)SWF Investment				
1	Real Madrid 438.6 x		Х	2009: Saudi Telecom Company (International Sponsor) 2012: RAK Investment Authority (Real Madrid Resort Island theme park in UAE: Revenues €25m, investment €758m)			
2	FC Barcelona	398.1	Х	2010: Qatar Sports Investments (Sponsorship of Qatar Foundation until 2016: €165m) 2009: Etisalat (Four-year agreement: €16m)			
5	Arsenal	274.1	Х	2004: Emirates (15-year agreement, name of stadium and advertising on shirts: €146m)			
7	AC Milan	235.8	Х	2010: Emirates (Sponsorship for five seasons: €60m)			
10	Juventus	205	Х	2010: Lafico (Libyan Arab Foreign Investment Company, part of Libyan Investment Authority: 7.5% of capital			
11	Manchester City	152.8	X	2008: Abu Dhabi United Group for Development and Investment - ADUG (Purchase of 90% of the capital: €251m) 2009: Etihad Airways (Sponsor for 10 years: €400m, Etihad Stadium) 2009: AAbu Dhabi Tourism Authority (Commercial agreement) 2009: Etisalot (Three-year agreement) 2009: Aabar			
13	Hamburger SV	146.2	Х	2012: Emirates (Sponsorship for three seasons: €21m)			
20	Aston Villa	109.4		2008/09: Acquisition rumours (Qatar Investment Authority)			
N/A	Málaga x :		Х	2010: Sheikh Abdullah bin Nasser Al-Thani (Purchase of capital and debt: €36m)			
N/A	Racing de Santando	er	Х	2010: Ahsan Ali Syed (Purchase of capital and debt: €16-26m)			
N/A	Zaragoza		Х	2011: Rumours of takeover by Royal Emirates Group			
N/A	Paris Saint-Germain (PSG) x		Х	2011/12: Qatar Sports Investments (70% capital: €100m) 2011: Qatar National Bank (Sponsorship for two seasons) 2008: Emirates (Sponsorship for six seasons: €36m)			
N/A	OLYMPIACOS		Х	2011: Emirates (Sponsorship for two seasons)			
N/A	Everton FC		Х	2008: Rumours of takeover by Qatar Investment Authority (€252m)			

Source: ESADEgeo (2012). * Teams ranked by revenue (Deloitte, 2011)

(Numbers in Euro millions)



MANCHESTER CITY

2008 Abu Dhabi United Group for Development and Investment - ADUG (Acquisition of 90% of the capital: €251m)

2009 Etihad Airways (Sponsor for 10 years: €400m, Etihad Stadium)

2009 Abu Dhabi Tourism **Authority** (Commercial agreement)

2009 Ftisalat (Three-year agreement)

2009 Aabar



ARSENAL FC

Emirates (15-year agreement: stadium name and advertising on shirts)



PARIS SG

2011/12 Qatar Sports Investments (100% capital: €100m)

2011 Qatar National Bank (Sponsorship for two seasons)

2008 Emirates (Sponsorship for six seasons: €36m)



AC MILAN

2010

Emirates (Sponsorship for five seasons: €60m)

Emirates (Sponsorship for three seasons: €21m)



JUVENTUS

2010 Lafico (Libyan Arab Foreign Investment Company, part of the Libyan Investment Authority: 7.5% of capital)



HAMBURGER SV

OLYMPIACOS

Emirates (Sponsorship for two seasons)

Source: ESADEgeo, 2012.

In Spain too there have been investment deals of this type, particularly in 2011. The Malaga was acquired by Sheikh Abdullah bin Nasser Al-Thani, a member of the Qatari royal family: he paid €36 million. Here too investment logic applies. In 2011 the regional government of Andalusia announced the award of the contract for the extension and operation of the port of Marbella to none other than Nasir Bin Abdullah & Sons, one of the sheikh's companies. The extension is estimated to be worth €84 million, and will allow the port to be operated for 40 years.

So Malaga is the second Spanish club in the hands of foreign investors, following Racing de Santander, which is owned by Indian entrepreneur Ahsan Ali Syed, who paid between €16 million and €26 million for capital and debt.

However, in Spain's case the links with emerging countries and sometimes their sovereign wealth funds are not confined to these acquisitions. In 2012 Real Madrid and the government of the Emirate of Ras Al Khaimah (UAE) presented the Real Madrid Resort Island, a tourist complex and theme park to be built in the UAE. This complex, which will be located a 45-minute drive away from Dubai airport (the world's fourth biggest in terms of volume of traffic) will cost approximately €760 million. There are also significant sponsorship links with football clubs, as in the case of Saudi Telecom with Real Madrid, as international sponsor. FC Barcelona has Qatar Sports Investments as a sponsor, via the Qatar Foundation, for an amount of \$235 million over five years, and it has another sponsorship with UAE telecommunications operator Etisalat, for an amount of €16 million over four years. These sponsorships can also be compared with those of the airline Emirates with Arsenal (\$160 million for 15 years) and AC Milan (\$83 million for five years). In 2011 Emirates also signed a five-season sponsorship agreement with Real Madrid.

These football clubs constitute powerful levers for forging closer links with sovereign wealth funds. Their managers often travel to see matches, some invest in them, while others are simply fans. In any case football would enable a systematic strategy of rapprochement to be deployed, building sustainable, long-term, trust-based relationships. The financial success of both Real Madrid and "Barça" (pronounced "Barsa", the familiar Spanish abbreviation for FC Barcelona) is shown by their heading up the list of football clubs' annual revenues compiled by consultants Deloitte (Table 12). In 2010 for the first time Spanish First Division teams headed the ranking with total revenues of approximately €190 million in sponsorships, merchandising and licensing, according to consultants Sport+Markt, with nearly 80% of this revenue accounted for by just two clubs: Real Madrid and FC Barcelona.

But Spain does not have only football clubs with which to attract funds. Uniquely for Europe, it also has a wide range of first-class business schools, with no fewer than three (IESE, ESADE and IE) ranked at the very top worldwide. We could imagine developing *ad hoc* training programmes with and for executives and civil servants from emerging countries with SWFs. IESE and ESADE already have programmes for CEOs bound for China or India. Why not design programmes to train executives from sovereign wealth funds?. This type of training could be particularly attractive in the cases of Latin America and Africa, both of which are seeing a proliferation of sovereign wealth funds with a need for technical training in a neutral environment (i.e. not "offered" by investment banks or asset managers).

One could also think in terms of scholarship programmes sponsored by Qatar, Brazil or China, enabling their nationals to study for MBAs and Master's degrees at these Spanish institutions, which in turn could step up their information campaigns and road-shows in those countries, or even set up bases in countries with SWFs (as the IESE has done with Ghana and its cooperation with the CEIBS in Shanghai). This is something that ESADE too is looking to promote. ESADE increased the number of Chinese students by 30% in 2011 (to more than 40 in total). On the course of 2001-2002 there were just four Chinese students in ESADE. In this way, over the past ten years, the number of students has increased by 89%, and over the past five years, by 69%. ESADE now has 180 Chinese alumni who have passed through its classrooms in the last ten years.

Spanish business schools' commitment to and presence in emerging countries has been groundbreaking. In 1994, IESE responded to the European Union's call for China Europe International Business School (CEIBS) to be established. A decade later, it is China's most prestigious business school and one of

the most influential in the world. In 2012 the CEIBS and the IESE also launched a doctorate training programme, with classes in Barcelona and Shanghai.

Development banks and sovereign wealth funds

Another sign of the times is the breakneck speed of growth of emerging countries' development banks. In 2011, China Development Bank (CDB), with almost \$700 billion in credit lines, is twice as big as the World Bank. In 2009 it started its international expansion with an office in Hong Kong. By 2010 CDB already had more than 35 projects in Africa in which it invested more than \$5.6 billion by way of international cooperation.

Brazil's BNDES for its part doubled its lending from 2007 to 2010, bringing the total to more than \$230 billion (equal to the GDP of Finland). In 2011 it signed an agreement with the Japan Bank for International Cooperation (JBIC) for an amount of \$3 billion, and is planning to open an office in Asia to support Brazilian multinationals in their expansion. In 2011 CDB and BNDES thus came in ahead of the World Bank in terms of international development banks. The agreement between JBIC and BNDES also illustrates a growing trend: emerging countries and OECD countries joining together to invest in development projects in third countries. The resources are to be used for infrastructure projects, especially in the transport sector, seeking to support projects of mutual interest to Brazil and Japan. Relations between the Brazilian bank and JBIC are not new, indeed they go back more than half a century, but the new agreement involves cooperating in Asia and other emerging markets.

China's and Brazil's development banks have continued to become ever more active. In 2011 Brazil signed an agreement with the African Development Bank to strengthen its support for the African continent. In all, Brazil contributed \$12 million to the recently created South-South Cooperation Trust Fund to promote technical cooperation and technology transfer, particularly in the areas of agro-industry, healthcare and renewable energy. These amounts are still modest in comparison with those committed by China to the African multilateral bank (more than \$122 million), but they show Brazil's growing involvement in Africa. Chinese initiatives in Africa have continued to proliferate, witness for example the China Africa Development Fund and many more others²¹. At the end of 2011, CDB donated \$1.5 million for the China Europe International Business School (CEIBS) to develop an educational project in Ghana. In 2011, also in Ghana, it opened its African representative office, the fourth in the continent following South Africa, Ethiopia and Zambia.

On Chinese cooperation in Africa, see the report published in 2010 by the OECD: http://www.oecd.org/dotaoecd/34/39/45068325.pdf; and that published in 2011 by the African Development Bank (AfDB): http://www.afdb.org/en/news-and-events/article/china-africa-relations-scrutinized-in-afdbs-new-book-8375/.

This rise of the emerging countries' development banks is an opportunity for Spain to rethink its international cooperation strategy. The 2012 budget made deep cuts in that of AECID (*Agencia Española de Cooperación Internacional para el Desarrollo*, the Spanish Agency for International Development Cooperation), a total of more than 71%, leaving just €240 million. The budgets for the Fund for the Promotion of Development and the Water Fund were also cut by 72% compared with the previous year, leaving both at €300 million. These cutbacks are perhaps the cue to deploy a new international cooperation strategy that seeks to activate and promote investment instruments for joint development with countries like China, Brazil or Qatar, for example.

In this respect one could imagine using the €300 million of the cooperation funds referred to in order to create binational funds with these countries:

The Sino-Spanish Fund for Latin America could start with a capital
of €100 million from each country, China and Spain, and then
grant venture capital mandates in and for Latin America and
thus promote productive sectors in the region's countries.

These sectors could cover infrastructure and agro-industry, but also the new technologies and new sources of energy. We could also imagine that private business sectors in the case of Spain and state ones in that of China might each contribute a further €100 million.

The instrument thus created, a fund of funds, would have a total capacity of €400 million. It would be a public-private fund of funds set up by one OECD country and one emerging country, for developing countries.

- The Brazil-Spanish Fund for Latin America would follow the same logic as the Sino-Spanish fund, with contributions of €100 million from each country. Private sectors would also be able to contribute and participate with €100 million from Brazilian companies and another €100 million from Spanish companies. The fund would also be able to invest in similar sectors to the China fund.
- The Qatar-Spanish Fund for Latin America would be another
 possible example of cooperation involving an Arab country that
 is very interested in Latin America, as shown by Qatar Holding's
 transactions with Iberdrola and Santander Brazil. The case of
 Qatar is just by way of illustration, because one could equally
 well imagine promoting something similar with the UAE or
 Saudi Arabia.

²² See OECD economic reports: http://www.oecd.org/dataoecd/38/45/49165941.pdf.
²³ On this subject, see Rolando Avendaño and Javier Santiso, "Are Sovereign Wealth Funds Politically Biased? A Comparison with other Institutional Investors", International Finance Review, Vol. 12, 2011.
²⁴ See estimates and the report of asset manager Blackrock: http://www.blackrock.co.uk/literature/whitepaper/sept-2012-the-future-of-sovereign.pdf.

These funds of funds could be managed by teams based in Madrid, who would select the entrepreneurial and risk capital funds that would then execute the mandates, in a similar way to the CDC Group, the UK's development finance institution, Norfund in Norway, or SIFEM in Switzerland. These development finance institutions constitute the spearhead of modern cooperation. Here we could also imagine including development banks and emerging countries in the equation.

The IFC, a subsidiary of the World Bank, has in fact taken some steps in the direction here sketched out. It created IFC Asset Management Company, which in 2011 had just over \$4.1 billion in AUM, of which \$3 billion in equity investments. Since its establishment it has made disbursements of nearly \$1 billion in nine countries, ranging from Paraguay to Vietnam. Also, in 2010 it set up the IFC African, Latin American and Caribbean Fund, with \$1 billion, which has already carried out investments in Brazil, Trinidad y Tobago, Mexico and Nigeria. This fund was established with contributions from the IFC itself, but also from the Saudi Arabian, South Korean and Azerbaijani sovereign wealth funds.

Conclusion

Over the past few years, sovereign wealth funds have proliferated as emerging markets have prospered. Some countries, such as India and Tunisia, are still thinking about whether or not to set up a fund of this kind. Others, like Syria or Colombia²², have already taken the plunge. Some countries, such as Malaysia, China, Singapore, Saudi Arabia and the UAE, have created more than one fund.

In the West, SWFs have gone from being regarded as villains to being hailed as saviours for many banks and OECD countries. In any case they no longer arouse the suspicion of being driven by political rather than financial motives in their investment strategies²³. Also, many of them have proven to be examples of best practices of institutional governance and of the quest for excellence in terms of returns on their investment strategies. In any case, the amounts that they manage (almost \$5 trillion in 2012) are not insignificant, for any OECD company or country. These assets represent just part of the \$20 trillion managed by official public institutions in fixed income, equities, cash or gold²⁴. In 2012 it is striking that 80% of world central bank reserves are in the hands of emerging countries; and the same is true of sovereign wealth funds.

The good news from the past few years is that emerging countries' sovereign wealth funds have turned their sights on Spain. In 2010 and 2011 there was a sharp increase in the number of deals, some of them substantial, which contributed to the increase in foreign direct investment in Spain in 2011 (nearly €28.5 billion, representing an increase of more than 18% on the previous year.) In this regard the investments made by Qatar Holding in Spain were particularly noteworthy, constituting the biggest investment to date from an Arab country. In less than two years China, Qatar and Abu Dhabi have invested €18.5 billion in Spain's major multinationals, making an impact on their capital.

However we could imagine rolling out a broader strategy and seeking to persuade sovereign wealth funds to establish European offices in Madrid or Barcelona. We could also imagine making active use of football clubs Real Madrid and FC Barcelona in a strategy of rapprochement, just as we could also develop ad hoc programmes at the country's leading business schools. Lastly, Spanish international cooperation could derive a boost from working together with emerging countries' banks and bilateral funds, designing instruments for co-investing in third countries, in particular in Latin America, where Spain has presence, experience and standing.

Strategies to	increase rela	tions with s	sovereign	wealth	funds

Strategy	Objective
Hub for European corporate HQs	To make Spain a base for European corporate headquarters of sovereign wealth funds from Latin America, the Middle East and Asia. Considering the newly created African funds in their expansion into Europe.
Football clubs (Real Madrid and FC Barcelona)	To strengthen long-term relations. Maintaining regular contact with the managers and owners of sovereign wealth funds to develop long-term relationships. Possibility of holding face-to-face meetings with Spanish companies seen as candidates for sovereign financing.
Business schools (ESADE, IE, IESE)	To make Spain's business schools a benchmark for the training of SWF managers. Taking advantage of the privileged position of these three schools in the world rankings to attract the international talent that sovereign wealth funds will seek to staff themselves and train their managers.
Cooperation funds	To establish relations in the field of international cooperation between Spanish institutions and sovereign wealth funds in order to carry out coordinated operations. Perhaps centred on Latin America, where Spain has internationally acknowledged expertise.



Latin american sovereign wealth funds

5. Latin american sovereign wealth funds

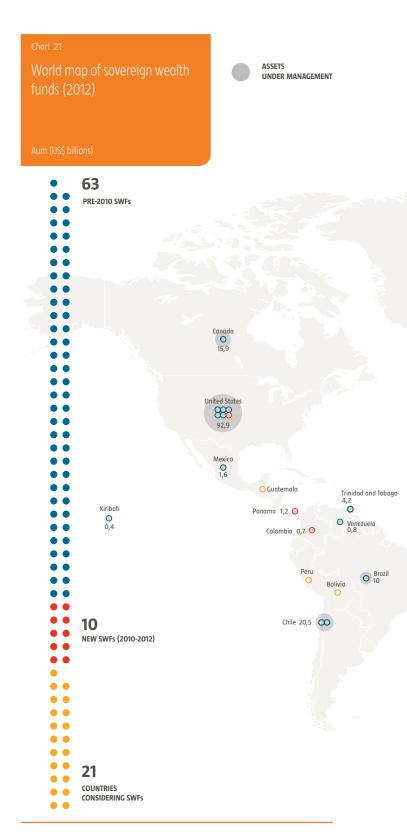
5. LATIN AMERICAN SOVEREIGN WEALTH FUNDS

Sovereign wealth funds are more in style than ever. In Spain, Qatar Holding, Qatar's sovereign wealth fund, recently made an impact with significant investments, particularly in Santander and Iberdrola (see the chapter on Spain in this report). In each case the investment totalled €2 billion, and in each case interest in Latin America lay behind the investment. Arab funds in particular are seeking to increase their exposure to this emerging region.

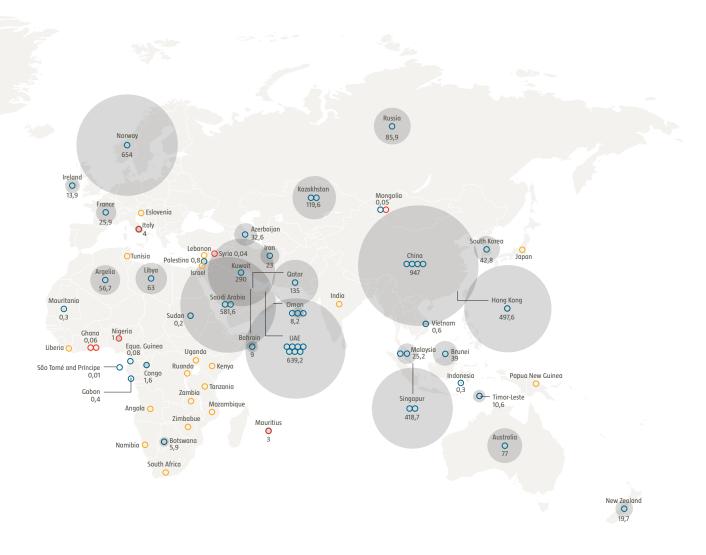
There are currently 73 sovereign wealth funds in existence, and a further 21 countries are considering establishing one. From Uganda to India, through South Africa, Israel and Japan, there are a host of candidates for this kind of instrument. In Latin America, some countries such as Chile, Trinidad and Tobago and Venezuela already have theirs. Brazil, with more than \$250 billion of reserves, joined them in 2008, together with Colombia and Panama. Peru, Guatemala and Bolivia recently started discussions on setting one

All these countries now have abundant reserves, and are faced – particularly the Andean countries – with the challenge of managing the raw materials bonanza. Their investments and exports are still highly concentrated in this area, which is of low intensity in terms of added value and employment. Consequently they are keen to find better ways of taking advantage of this abundance to make a productive leap and diversify their economies – something they have not yet been able to do. Sovereign wealth funds can be a strategic vehicle for this, providing the institution is well looked after, manned by first class professionals and equipped with the proper processes.

In this chapter we shall see how, beyond the sovereign wealth funds' interest in investing in other regions (the Middle East in particular, but also Asia), Latin America has also been remarkable over the past few years for its increasingly proactive stance as regards sovereign wealth funds. These have so far tended to be more like stabilisation funds, with relatively conservative strategies, with which they achieved the level of best practices (the shining example being that of Chile). There are alternatives however; sovereign wealth funds that are above all strategic, where countries like Brazil or Colombia could gain inspiration by looking towards the UAE's Mubadala or Malaysia's Khazanah as examples to emulate.



The world currently has 73 active sovereign wealth funds. Middle East, China, Southeast Asia and Norway are the four most active centers of SWFs. Assets under managed sum up to 4.98 trillion dollars. The phenomenon of SWFs has a recent wide diffusion: in the last two years 10 new funds were created and 21 other countries are considering implementation. Debates for new SWFs are increasing in Eastern and Southern Africa and Latin America.



Source: ESADEgeo (2012) with information obtained in the reports and websites of each fund. When it is not present, we have come, among others, estimates of Ashby Monk (Oxford Project, now in Institutional Investor), Sovereign Investment Lab (Bocconi University), Monitor Group and geoeconomic.

5. Latin american sovereign wealth funds

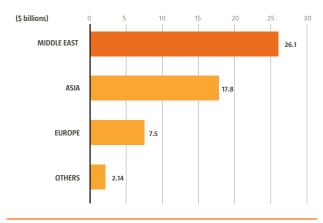
Latin America and the sovereign wealth funds

Among the changes we are witnessing, one thing that stands out is the intensification of economic relations among emerging countries. China is obviously at the centre of these changes, as we shall see, but new commercial, financial and industrial networks are also springing up among regions that until recently had only low-density links. One of these emerging networks is that between Latin America and the Arab world. But these links are not new.

The historical Middle Eastern diasporas also reached Latin America. These migrations are symbolised by the Syrian and Lebanese traders who settled in Latin America and in some cases built up empires. It is estimated that there are some 20 million Latin Americans of Arab origin in the region, including seven million in Brazil). The highest profile one is probably Carlos Slim, the continent's richest person, owner of Grupo Carso, Telmex and América Móvil, among many other companies. However, until recently relations with the Arabian Peninsula were less developed.

In the years 2000-2010 links proliferated with unprecedented intensity, in particular due to the activities of these countries' sovereign wealth funds. In all, Middle Eastern funds invested more than \$26 billion in the region, more than Asian funds (nearly \$18 billion) and European and US funds (nearly \$8 billion, the most active being Norway).





Source: ESADEgeo, 2012.

These investments are only part of total "sovereign" investments: we do not count, for example, investments made by Chinese state corporations in Latin America, which are estimated to have

reached a record of almost \$70 billion during the period 2005-2011, according to the Heritage Foundation.

Year	Month	Investor	\$ millions	nillions Country Partner/Target Sector		Sector	Subsector	%
2009	July	China Railways	7,500	Venezuela	Venezuelan State (JV)	Transport	Railway	40%
2010	October	Sinopec	7,100	Brazil	Repsol	Energy	Oil	40%
2010	November	CNPC	5,990	Cuba	(Cienfuegos Project)	Energy	Oil	N/A
2011	November	Sinopec	4,800	Brazil	Galp Energy	Energy	N/A	30%
2010	March	CNOOC	3,100	Argentina	Bridas	Energy	N/A	50%
2010	May	Sinochem	3,070	Brazil	Peregrino field	Energy	Oil	40%
2010	October	Minmetals	2,500	Peru	(Galeno Project)	Metals	Copper	N/A
2010	October	Sinomach	2,490	Argentina	(Belgrano Project)	Transport	Railway	N/A
2010	December	Sinopec	2,470	Argentina	Occidental Argentina	Energy	Oil and Gas	100%
2010	June	Sinohydro	2,300	Ecuador	(Coca-Codo Sinclair Project)	Power	Hydroelectric	N/A
2008	May	Chinalco	2,160	Peru	(Toromocho project)	Metals	Copper	N/A
2005-2011		TOTAL	69,300					

Source: ESADEgeo (2012) with data from the Heritage Foundation (2012).

Nor do we include here the financing made available by Chinese (sovereign) state banks, which reached \$75 billion during the period 2005-2011, i.e. more than the amounts granted by the World Bank or the IDB in the region²⁵. In 2010, Chinese loans to the region (\$37 billion) actually exceeded all lending by the IDB, the World Bank and the US Eximbank combined²⁶.

Country	Total	World Bank	IDB	China
Venezuela	44,528	N/A	6,028	38,500
Brazil	39,628	15,338	12,559	11,731
Mexico	27,410	14,739	11,671	1,000
Argentina	26,774	7,164	9,610	10,000
Colombia	12,118	6,241	5,877	N/A
Ecuador	8,914	153	2,457	6,304
Peru	6,113	3,045	2,868	200
El Salvador	2,954	1,196	1,758	N/A
Guatemala	2,887	1,176	1,711	N/A
Panama	2,811	591	2,220	N/A
Costa Rica	2,741	698	1,743	300
Dominican Republic	2,555	854	1,701	N/A
Others	14,079	2,169	6,730	5,180
TOTAL	193,512	53,365	66,933	73,215

Source: ESADEgeo (2012) with data from Gallagher et al. (2012).

²⁵ On relations between China and Latin America, see Kevin P. Gallagher and Roberto Porzecanski, The Dragon in the Room: China and the Future of Latin American Industrialization, Stanford, Stanford University Press, 2010.

26 See report of US Tufts University: http://www.ase.tufts.edu/gdae/policy_research/

Analysis Of Chinese Loans In LAC. html

5. Latin american sovereign wealth funds

From the UAE, ADIA (Abu Dhabi Investment Authority), the world's biggest sovereign wealth fund, together with Chinese funds SAFE and CIC, recently started to invest in Latin America, through managed Latin American funds such as Southern Cross Group and other global asset managers. In 2010, the private equity fund Southern Cross, closed the biggest investment vehicle of this type on nearly \$1.7 billion. It was made possible in part by the support of local pension funds, but also, and above all, that of sovereign wealth funds, among other Middle Eastern funds. ADIA has properties in Rio de Janeiro, holdings in the São Paulo stock exchange (Bovespa), and Brazilian government bonds. Al Qudra Holding for its part is interested in the Brazilian agro-industrial sectors, while Abu Dhabi's private equity fund Mubadala (20% of whose investments are outside the UAE) is also planning to diversify into Brazil. In 2009, a delegation from Abu Dhabi visited 14 countries in the Western hemisphere, seeking to broaden the range of possible investments.

In January 2010 the Emir of Qatar, Sheikh Hamad Al-Thani, visited Argentina, Brazil and Venezuela, in search of opportunities. Arab investors such as port operator DP World have also participated in the construction of the port of Callao in Peru. DP World is also planning a \$250 million investment in Cuba, with the aim of transforming the port of Mariel into a world-class port. Others have also made significant investments, approximately \$330 million, for example in Banco Santander in Brazil, by Aabar Investments, also from Abu Dhabi. In October 2010 Qatar Holding acquired 5% of this same Brazilian subsidiary of the Spanish bank for an amount close to \$2 billion. Middle Eastern investors and sovereign wealth funds such as ADIA, ADIC (now Invest AD), Mubadala, AIC and KIA, are studying agri-businesses, food, oil and gas, commercial property, hotels, renewable energy sources and mining in Latin America.

In December 2010 Brazil saw nine investors, three of them sovereign wealth funds, invest more than \$1.8 billion in investment bank BTG Pactual. This deal was led by three sovereign wealth funds, one from China (CIC), another from Singapore (GIC) and the third (ADIC) from the UAE. Each one invested between \$200 million and \$300 million, making it the biggest investment deal to date by funds of this kind in Latin America. In 2012 the UAE's Mubadala closed one of the biggest investments ever made by a sovereign wealth fund of this kind, taking a stake in Brazil's EBX, controlled by magnate Eike Batista. The total deal amounted to \$2 billion for just over 5.6% of the company. The EBX Group comprises Batista companies such as the oil company OGX, shipbuilder OSX, mining company MMX, logistics company LLX and energy company MPX, all 'open capital' companies. The Abu Dhabi fund will also take stakes in Batista companies that are not 'open capital', such as gold miner AUX, property company REX and sporting and entertainment company IMX.

The agro-industrial sector, and anything to do with water (a scare resource in the Arabian Peninsula), is of particular interest. Companies such as Hassad Food (a subsidiary of Qatar's sovereign wealth fund) and Al Dahra Agricultural Company (from Abu Dhabi) are seeking to extend their presence in the region. Cosan, the world's biggest producer of cane sugar and ethanol, established a subsidiary specialising in locating and valuing agricultural land, Radar Propiedades Agrícolas, which has Arab countries among its investment clients. This interest in the region should not surprise us: Latin America has nearly 30% of the world's total water reserves, and Brazil alone has just over 13%. If oil is "black gold", then water is "blue gold", and becoming just as valuable.

The Arab funds are not in fact alone in taking an interest in Latin American land and property. In mid-2010 for example Singapore sovereign wealth fund Temasek invested \$200 million in Mexico's Impulsora Mexicana de Desarrollos Inmobiliarios, an agricultural land developer in Querétaro State. At the same time commodities trader Olam International, also from Singapore and 14% held by Temasek, spent nearly \$80 million on acquiring NZ Farming Systems Uruguay Ltd., a Uruguayan company with its roots in New Zealand.

Sovereign wealth fund China Investment Corp (CIC) spent \$850 million on buying 15% of the shares in Hong Kong-based grain trader Noble Group, whose business consists of extraction commodities from South America (Brazil and Argentina) to supply East and South Asian demand (China and India). South Korea for its part invested nearly \$26 million in buying land in Uruguay and Paraguay, where companies such as Allied Venture specialise in facilitating this type of transaction.

So far only two Latin American banks, Banco Itaú and Banco do Brasil, have small representative offices in Dubai, while Brazilian mining giant Vale has established a \$1 billion iron ore pelletizing plant in Oman. Emirates Airlines recently started daily direct flights between Dubai and São Paulo, and since June 2010 Qatar Airways has operated daily flights connecting Doha with São Paulo and Buenos Aires. In 2010 Arab countries became Brazil's third biggest trading partner group, taking more than \$10 billion in Brazil's exports, nearly 11% of the total.

With a view to furthering relations between the two regions, in 2009 a group of Latin American entrepreneurs created the Gulf Latin American Leaders Council²⁷. In April 2010, a group of about 25 Latin American businesspeople travelled to a number of Arab countries. In 2005, through official channels, Brazil promoted the first ASPA (South American-Arab Countries) Summit, which was held once again in 2009 in Doha, Qatar²⁸. A third summit was scheduled

²⁷ See http://www.allc.org

²⁸ For a historical account of these relations, see http://www2.mre.gov.br/aspa/history.html.

for February 2011 in the Peruvian capital Lima. The magazine Latin Finance started organising events between the two regions, and in 2010 in Abu Dhabi it held a second edition of the Latin America Mid-East Investors Forum²⁹, in which Abu Dhabi sovereign wealth funds Invest AD and ADIA took part. Argentina has also made moves, hosting a conference with the UAE at the end of 2010. In 2010, the UAE announced their intention of extending their network of embassies in Latin America, with the opening of a representation in Chile. In July of that same year the prime minister of Kuwait went on a three-week tour of the whole region.

This show of interest in Latin America is actually linked to a wider trend, in which we see many sovereign wealth funds seeking to boost their investments in other emerging countries, over and above those in OECD countries. One example of this is the Kuwait Investment Authority, which in a short space of time has reduced its European and US portfolio from 90% to 70% of the total in order to push investments in emerging markets, which have gone from just 3% to more than 9% of the total portfolio.

Equally noticeable is how both Latin American and Arab countries are seeking to intensify their relations with Asia in general, beyond just China. The most recent example was Venezuela's offer to set up a \$100 billion fund for joint investment in the energy sector with India, another country that is seeking to secure its supplies of raw materials so as to be able to sustain its growth and continue to feed its huge population³⁰. Another demonstration of sovereign wealth funds' appetite for investing in Latin America was the participation by several of them in the biggest private equity fund ever raised for the region (nearly \$1.7 billion), by Advent International in 2010, as a result of which this global private equity firm now has more than \$5 billion under its mandate. We also find Southern Cross Group, another private equity firm, with a similar amount, in the creation of which several emerging country sovereign wealth funds were involved.

²⁹ See http://latinfinance.com/event.aspx?ArticleID=2311715

³⁰ On relations between India and Latin America, see http://induslatin.com.

5. Latin american sovereign wealth funds

Latin American funds

Relations among emerging countries are intensifying. The speed with which they are taking shape is remarkable in itself. In this regard the ties between Latin America and the countries of the Arabian Peninsula are another illustration of this global trend towards a much less fragmented world. Apart from the Arab funds, we are also seeing how Asian interest in the region, from China to Singapore, has been growing, largely driven by state-owned banks and sovereign wealth funds.

However, Latin America is remarkable not only as an investment target for foreign SWFs, but also because, together with Africa, it is one of the regions in which this type of institution has proliferated most. Latin American SWFs are still relatively modest in size, with Chile's main fund scarcely reaching \$15 billion, which is almost a third more than Brazil's. That of Trinidad and Tobago is only about \$4 billion. Those of Panama and Colombia would also start with modest amounts, but are likely to see high growth rates over the remainder of the present decade. The region is building up reserves at an all-time record rate: in 2011 total foreign reserves (excluding gold) almost reached \$700 billion, seven times more than in 2001, when they barely surpassed \$100 billion.

rable 16 Latin American sovereian wealth funds (\$ billions'

Country	Year	Name	AuM	Reserves ^c	Strategy
Chile	2007	Fondo de Estabilización Económica y Social (FEES)	14,8	41,3	66.5% sovereign fixed income
					30% money market instruments
					3.5% inflation-indexed sovereign bonds
Brazil	2008	Fundo Soberano do Brasil (FSB)	10	357,9	Fixed income (Bonds classed as Investment grade)
Venezuela	1998	Fondo para la Estabilización Macroeconómica (FEM)	5,7	29,9	National stabilization, non-commodity sectors
Chile	2006	Fondo de Reserva de Pensiones (FRP)	4,5	41,3	48% sovereign fixed income
					17% inflation-indexed sovereign bonds
					15% equities
					20% corporate bonds
Trinidad and Tobago	2000	Heritage and Stabilization Fund	2,9	9,9	62% fixed income
					31% equities
					7% cash
Mexico	2000	Fondo para la Estabilización de los Ingresos Petroleros (FEIP)	1,6	149,3	Corrección de ingresos presupuestarios
					Inversiones financieras de cobertura sobre el precio de hidrocarburos
Panama	2011	Fondo de Ahorro de Panamá (FAP)	1,2	3	
Colombia	2011	Fondo Soberano de Colombia	0,7*	32,3	
Peru ^a	N/A	N/A	N/A	53,3	Foreign assets
Boliviab	N/A	N/A	N/A	10,8	
Guatemalab	N/A	N/A	N/A	6,1	

^a Announcement of the Minister of Economy in March 2011. ^b Talks on the creation of the fund started in 2011. ^c Foreign exchange and gold reserves (CIA World Factbook, 2012). Source: ESADEqeo (2012).

Some have been in existence for several years, while others were established or remain to be established in this decade, Brazil and Colombia heading the list together with Panama. Brazil set up its own sovereign wealth fund in 2008 with a view to intervening in the foreign exchange market. In 2010 then President Lula created the Deliberative Council on the Sovereign Wealth Fund, a necessary step for the fund to be able to trade on the local foreign exchange market. Brazil's sovereign wealth fund started out as a currency stabilisation fund, with over \$10 billion.

One year later Colombia and Panama entered the fray, and Peru, Guatemala and Bolivia started debating whether to create instruments of this type³¹. In an indication of the growing interest in the subject, the CAF (*Corporación Andina de Fomento*, Development Bank of Latin America) held a regional seminar on the subject of sovereign wealth funds in the present decade³². Some of the regions' leading experts on sovereign wealth funds have become advisers, much sought after by countries such as Colombia, Mongolia or Nigeria to help design their sovereign wealth funds, as in the particular case of Andrés Velasco, former Chilean finance minister, and Eric Parrado, formerly in charge of Chile's sovereign wealth fund³³. At the end of 2011 the Latina American and Caribbean Economic Association (LACEA), together with ESADEgeo, organised a panel discussion on the subject of sovereign wealth funds, within the framework of its annual meeting, held in Santiago de Chile³⁴.

Colombia has set up a sovereign wealth fund in which to save royalties from oil extraction. Approved in mid-2011, the fund is partly inspired by the Chilean funds, in that it was enacted in a Fiscal Responsibility Law. In fact several funds and instruments have been created to promote saving and stabilisation, science and innovation and regional development. Between 2012 and 2020 the Colombian government will apparently be rolling out a strategy to galvanise manufacturing, technology and innovation based on structures deriving from sovereign wealth funds, emulating best practices in the area as exemplified by the UAE's Mubadala or Malaysia's Khazanah.

At the end of 2011 Panamanian president Ricardo Martinelli indicated that there were plans to set up a sovereign wealth fund with the revenues generated by the Panama Canal, to be used for investing in future social projects. In 2012, Finance Minister Frank De Lima said that the sovereign wealth fund might be created by taking as its initial capital the entire \$1.3 billion of assets of the FFD (Fondo Fiduciario para el Desarrollo or Development Trust Fund), which is considered Panama's savings³⁵. According to his ministry's projections, savings could build up to between \$3 billion and \$7 billion. As well as the additional income generated by widening the Canal, the authorities are also considering including mining royalties. Each year, part of the revenue generated by the Canal, the equivalent of 3% of GDP, will go to the National State Treasury, and the surplus will be earmarked as savings. The fund could accumulate nearly \$12.5 billion by 2025. In 2011 Panama scarcely felt the effects of the European crisis, and its economy grew by 10.5%, one of the highest growth rates in the world.

In Peru the debate intensified from the end of 2011; see in particular the presentation by the director of the Central Bank to CEPLAN (Peru's National Centre for Strategic Planning) reporting to the President: http://www.ceplan.gob.pe/conferencias;jsessionid=4B46782D18670A4BBAB169C974179 1EC.

³² See http://www.caf.com/view/index.asp?ms=19&pageMs=75400.

³³ Together with other partners, these two set up a global consultancy on these subjects: SCL Partners, see http://www.sclpartners.com/en/.

³⁴ Taking part in this event were Chilean finance minister Felipe Larraín and Ignacio Briones, who was in charge of Chile's sovereign wealth funds under the Sebastián Piñera administration. See http:// www.minhda.cl/sala-de-prensa/archivo-audiovisual/fotografias-de-las-noticias/ministro-larrain-en-laconferencia.html.

³⁵ On Panama's sovereign wealth fund and national economy, see the presentation by the Finance Minister to the Americas Society and the Council of Americas in New York: http://www.as-coa.org/files/ Presentation_FrankdeLima.pdf.

5. Latin american sovereign wealth funds

The Chilean model

The existence of sovereign wealth funds in Latin America is not new, however. In some cases, such as that of Venezuela, funds were used for political ends that differed from the initial objectives. At the same time, however, there are sovereign wealth funds in the region that have become world benchmarks thanks to their exemplary performance and track record.

This is exactly what Chile achieved in a masterly manner (see the chapter on Chile in this report for more detail)³⁶. Mid-way through the first decade of this century, it set up two sovereign wealth funds, with rigorous rules and first-class human and institutional capital. This has made Chile a world benchmark, on a par with Norway, in the field of sovereign wealth funds. In the case of Chile, the funds are framed by a strict Fiscal Responsibility Law, passed in 2006, which states that the 0.5% of the previous year's surplus must be transferred to the first fund (the Pension Reserve Fund); the next 0.5% of fiscal surplus be used to capitalise the Central Bank, and any further surplus above that goes to the second sovereign wealth fund (FEES, the Economic and Social Stabilisation Fund).

A number of lessons can be drawn from this successful Latin American experience. The first is that this type of instrument is indissociable from fiscal policy. The second is that very rigorous regulatory and institutional frameworks are needed, particularly in the case of emerging countries. Lastly, it is equally essential to ensure that the institution has the right human resources. In the case of Chile, whether under the previous government or the present one, we are talking about first class professionals and economists, starting with the two Finance Ministers who have supervised the funds, first Andrés Velasco and now Felipe Larraín, both of whom hold doctorates in economics and have long professional track records.

The Chilean funds however are not strategic funds, i.e. they are not aimed at promoting business development and diversification. Some emerging countries, such as the UAE, Singapore and Malaysia have established strategic funds with the clear objective of contributing to business development and the diversification of manufacturing. One can imagine that Chile might well establish a third sovereign wealth fund with this objective. The beauty of the Chilean structure is that it offers what is potentially the right incentive structure for this: it is not hard to imagine that, on top of the three existing successive layers for fiscal surpluses, a fourth could be designed for a strategic fund. This would only be activated once the first three levels were covered, i.e. only above a significant fiscal

surplus. The strategic fund could then operate as a fund of funds, accelerating diversification of production towards technological sectors or even industrial suppliers of the mining industry, for example.

It is indeed striking that, despite being the world's leading producer and exporter of copper, Chile has no world-scale multinational of its own as supplier of vehicles, excavators or explosives for this sector. They are all foreign: Caterpillar and Joy Global are listed in New York, Komatsu in Tokyo, Atlas Copco and Sandvik in Stockholm, Boart Longyear, Leighton and Orica are Australian, Weir Group Scottish and Hatch Canadian. All of them generate large-scale and high value added employment. Chile's Codelco, the world's biggest copper producer, employs less than 20,000 people, far fewer than Swedish multinationals Sandvik (44,000 employees) or Atlas Copco (30,000). Its revenues are just one seventh of those of Caterpillar, which also employs nearly five times as many people.

On Chile's track record and its exemplary standing even for OECD countries, see the study by Harvard professor Jeffrey Frankel, Jeffrey A., "A Lesson From the South for Fiscal Policy in the US and Other Advanced Countries", HKS Faculty Research Working Paper Series RWP11-014, February 2011. See http://web.hks.harvard.edu/publications/workingpapers/citation.aspx?Publid=7646.

Stabilisation funds or strategic funds?

Latin America has no shortage of natural resources, and this is undoubtedly a blessing. However, with the exceptions of Mexico and Brazil, which have a broad range of industries, product diversification has been limited. Overall, more than half the subcontinent's exports are still closely linked to raw materials or commodities, and over the next five years it is expected that more than \$150 billion will be invested in these sectors.

Having raw materials is not a curse, but it all depends what you do with them, as is shown by economies that are highly dependent on raw materials yet also highly developed, such as Norway, Australia and Canada. Ultimately, the question for a country that has, for example, lithium (as do Chile, Argentina and Bolivia) is where they wish to be positioned in the added value chain: in the lithium raw material market, which is estimated at over \$1 billion; in the lithium battery market, which is put at over \$25 billion; or want to be in the market for electric cars that use lithium batteries whose market is estimated at 200 billion dollars?

It is possible that part of the answer to this question lies in setting up strategic funds. The experience of other countries, particularly those of the Arabian Peninsula and Southeast Asia, may provide a point of reference³⁷. In the UAE for example, the Mubadala fund is Abu Dhabi's strategic vehicle for diversifying its oil-based economy. With some \$48 billion in assets, this institution, established in 2005, is the owner of Masdar, a city that aims to become the Silicon Valley of renewable energy sources. It has carried out investments and entered into strategic agreements with multinationals such as America's giant General Electric (in which it holds a 0.7% stake), which set up R&D centres in the Masdar complex. Mubadala and GE jointly promoted an investment fund which now manages \$2 billion. The UAE is keen to position itself as an aerospace hub, and to this end it managed to associate itself with the European multinational EADS (Airbus), in which another Arab sovereign wealth fund, Dubai International Capital, holds a stake of just over 3%. Strategic agreements with multinationals such as France's Veolia Water and, at the end of 2010, Spanish technology firm Indra, have also proliferated thanks to Mubadala, which in 2010 also embarked upon a strategy of aggressive diversification into emerging markets, signing agreements with Malaysia's sovereign wealth fund (\$7 billion).

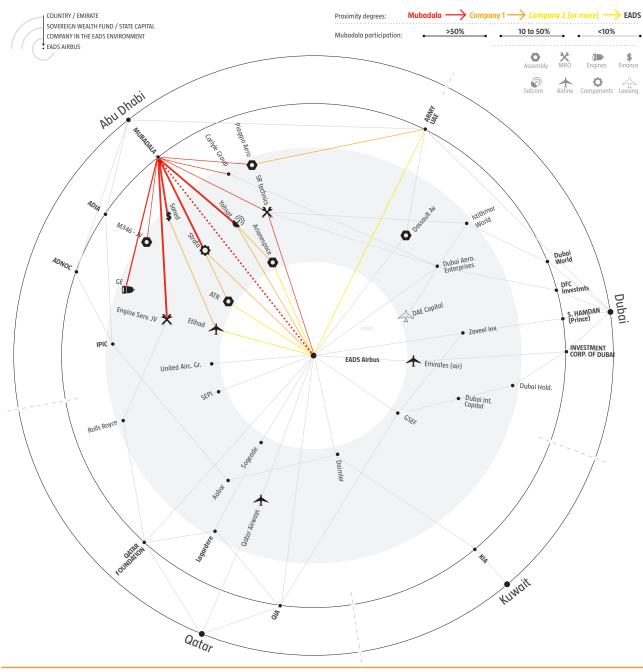
³⁷ On sovereign wealth funds' investment strategies and strategic funds in particular, see papers by Shai Bernstein, Josh Lerner and Antoinette Schoar, "The Investment Strategies of Sovereign Wealth Funds", Harvard University and MIT, Working Paper, 2009 http://www.people.fas.harvard.edu/~bernst2/papers/SWF0811.pdf; and above all the paper by Alexander Dyck and Addir Morse, stressing the dimension of strategic funds with financial and economic development objectives, "Sovereign Wealth Fund Portfolios", University of Toronto and University of Chicago, Working Paper, December 2011 (unpublished). See: http://faculty.chicagobooth.edu/adair.morse/research/DyckMorse_2012AFA_SWF.pdf.

5. Latin american sovereign wealth funds

Chart 23

Mubadala's strategic interes around EADS

Mubadala has developed a strategic investment policy in non-oil dependent sectors: aerospace and renewable energy, predominantly. In the aerospace sector it has achieved through investments in key value-chain companies. Thus, we find a significant Joint Venture with GE, the acquisition of Strata, and SR Technics: engines, components and assembly, respectively. With attention on Mubadala, we note that other SWFs have also invested in companies involved in this sector, in whose center is the European giant EADS. Qatar, Kuwait and the emirate of Dubai have also invested in this sector.



Source: ESADEgeo, 2012.

Singapore and Malaysia also offer interesting examples of successful strategic sovereign wealth funds. Temasek was created in 1975 by Singapore, and has played a crucial role in the island state's industrial growth. It has 380 employees, many of them foreign (it has two presidents, one American and one French) and, as at July 2012, it managed nearly \$160 billion. Its portfolio is still heavily centred on Singapore (32% of total assets), where it has operated as a private equity firm, contributing to the development of national giants: in 2010 Temasek held equity in six of the country's ten biggest multinationals. For example it is a shareholder and driver, and has been since 1993, of multinationals such as SingTel, one of the giants of the telecommunications sector, with operations in Australia and India (where it is the second biggest shareholder in Bharti Airtel, the leading Indian multinational in the sector). It has also played a key part in the development of Keppel Corporation (shareholder since 1975), a global supplier of infrastructure for the oil industry with nearly 40,000 employees. It has contributed to the roll-out of Hyflux, a multinational in the water treatment sector established barely twenty years ago and now present in Southeast Asia, the Middle East, North Africa, Europe, China, India and the United States.

For its part, Khazanah, Malaysia's sovereign wealth fund, with \$22 billion in AUM, also carried out strategic investments in some fifty companies, including the telecommunications group Axiata, a world leader in which it has a 45% stake, and auto maker Proton, currently Southeast Asia's biggest, of which it holds 42%. It has interests in airports, airlines, hospitals and banks throughout Malaysia, where 90% of its portfolio is concentrated. It has also embarked upon a process of international expansion in accordance with the country's industrial strategy of positioning itself as a regional healthcare hub. Thus in 2010 it took control of Parkway Holdings, Asia's leading private hospital operator, for a record amount of nearly \$3.5 billion. Based on these successes, at the end of 2009 Malaysia established a second sovereign wealth fund, 1Malaysia Development Berhad, and concluded various cooperation agreements with the Qatar sovereign wealth fund (creating a \$5 billion co-investment vehicle) and with the oil company PetroSaudi International (investing \$2.5 billion).

These examples show the extent to which sovereign wealth funds can be strategic players in the diversification and development of an economy. In the case of Latin America, Brazil, through BNDES, has operated *de facto* as an instrument of this type, producing giants like Vale and Petrobras, in raw material sectors but also in leading edge sectors like aerospace, with Embraer. Now countries like Peru and Colombia, heavily dependent on natural resources, are debating whether or not to set up sovereign wealth funds. They could look to Chile to design strategies, but they could also look beyond, towards the UAE, Singapore or Malaysia, and think about structures that would also allow them to have a strategic fund, something that Chile itself could also consider.

Conclusion

Latin America, like the rest of the emerging markets, is going through a major transformation. The rise of sovereign wealth funds in the region is just one more confirmation of this. Equally, the attractions of Latin America are confirmed by the interest aroused in SWFs of other continents. Proof of the region's attractiveness is that in 2011, while Europe continued to slide deeper into crisis, Latin America received record foreign direct investment of more than \$138 billion.

These funds, in their strategic version, also constitute a powerful lever for economic development, as is shown by the historical cases of Singapore and, more recently, Qatar, the UAE and Malaysia. These Arab and Asian examples deserve Latin America's close attention. Admittedly the history of industrial policy in the region invites caution. But as the example of Chile shows, more recent history has also produced better institutional practices. Chile has become a world reference for fiscal policy and good practices in terms of SWFs, as confirmed by its admission in 2010 to the select club of the OECD. So why not think in terms of Chile's setting up a strategic SWF in addition to the funds that it already has, with built-in incentives for virtuous economic policies?

This fund would be added to only if a certain threshold of fiscal surplus were reached, and we could imagine that, like Mubadala, it would invest only in foreign companies, thus also avoiding local conflicts of interest, to promote industrial diversification. In parallel, the Chilean government's holdings, like mining giant Codelco and others, could perhaps be grouped together in a holding company, a sovereign wealth fund drawing its inspiration from Malaysia's Khazanah. A country like Colombia, which has the necessary institutional backbone, also as an example of institutional governance, could follow this same route.

Latin America stands at a crossroads. In the decade 2010-2020 it has a unique opportunity to diversify its economy and raise it to higher levels of added value, i.e. to leverage its raw materials to develop industrial diversification. In this, the sovereign wealth funds can be powerful instruments. The example of Brazil and its development bank (BNDES) proves it: nowadays the bulk of the continent's multinationals are from Brazil, many of them driven and promoted by BNDES which acts as a de facto strategic fund.



Sunken treasure: Brazil, deepwater oil, and Brazil's sovereign wealth fund

6. Sunken treasure: Brazil, deepwater oil, and Brazil's sovereign wealth fund

6. SUNKEN TREASURE: BRAZIL, DEEPWATER OIL, AND BRAZIL'S SOVEREIGN WEALTH FUND

Introduction

In 2007, the Tupi oil field was discovered by British Gas Group off the coast of Brazil, revolutionizing the future of the Brazilian economy. Then President Lula da Silva went so far as to call this windfall "proof that God is $Brazilian^{\prime\prime}$ 38. Brazilian reserves above and below the salt layer in the deep water off its coasts have subsequently increased to more than an estimated 14 billion barrels. The enormous discoveries indicate that these reserves rival in quantity the total in the North Sea, making Brazil a major player in global oil and increasing its geopolitical importance. Countries strewn throughout history that viewed oil discoveries as a path to economic development and financial wealth should provide cautionary tales to Brazilian dreams. Most countries with large oil reserves extract large resource rents with industrial over dependence, stagnant non-oil sectors, and excessive bureaucratic public sectors. The ability of Brazil to prudently manage its oil wealth will determine its economic fate for many years to come.

Our analysis of the nascent Fondo Soberano do Brasil (FSB) and its ability to manage its oil bounty focuses on a number of economic and financial factors unique to Brazil. First, due to structural factors within the Brazilian economy, the expected growth in oil production without proper policy may actually *worsen* the Brazilian current account deficit. Second, given the lack of a structural current account surplus and lengthy time frame for production increases, the expected wealth may not materialize for many years. Third, given the overtly political nature of the FSB, its management, policy pronouncements, and oversight, Brazil would be well served to place strict and transparent limits on its investment mandate and regulations for fund capital withdrawals. Economic history is replete with examples of countries that suffered from natural resource windfalls and Brazil would be wise to limit its reliance on the oil extraction industry or the temporary wealth it brings.

³⁸ Descoberta de Tupi prova que 'Deus é brasileiro', diz Lula" November 21, 2007 (online at www.ambiente.sp.gov.br/proclima/noticias_novas/2007_4/noticiasnovembro2007/21112007f.htm).

Rio of oil?

Brazil's proven oil reserves reached 14.0 billion barrels in 2012 according to the EIA, although the largely state-owned Petróleo Brasileiro (Petrobras) alone claims 15.71 barrels of proven reserves in Brazilian waters. Furthermore, discoveries are ongoing. Regular announcements of new reserves mean current estimates are an inadequate measure of future activity. Petrobras's reserve replacement ratio was 152% in 2011, meaning they discovered one and a half times more oil than they produced³⁹. They forecast that continuing discoveries will cost no more than \$2 per barrel in 2012, due to their high success rate in locating new fields and improved expertise in deep water operations⁴⁰. Accordingly, due to reduced exploration risk, the Brazilian government recently instituted highly preferential treatment for the mainly government-owned Petrobras. Brazilian law now requires that all future production in the region have production-sharing agreements with Petrobras. Petrobras can additionally claim 30% of any project in these 'pré-sal' fields. Requirements for local sourcing of production inputs have also been implemented, although local technology is not yet advanced enough to meet the requirements for deepwater production⁴¹.

The exploration risk for Brazilian oil may be low, but the development risk is high. Oil in the pré-sal layers is located in very deep water and through multiple layers of ocean floor. While North Sea deposits frequently lie less than 1 kilometer below the surface, pré-sal oil can be deeper than six⁴². S&P predicts Petrobras may have difficulty overcoming limited financial and engineering resources in order to develop its huge oil reserves⁴³. This would result in delays, which are already being seen⁴⁴. Most recently, Petrobras cut its planned production for 2012 by 30% in February, citing delays in ship building⁴⁵. However, given the nature of Brazil's deep water oil reserves, Petrobras is uniquely situated to take advantage. With only 3% of global oil production, Petrobras produces 22% of the world's deepwater oil, a specialization that will be necessary to exploit the Tupi, Guara, Lula, and most other Brazilian oil fields.

A greater constraint for the oil industry and national finances concerns the lack of refining capacity to process increased production. Brazilian oil production reached 2.6 million barrels of crude per day in 2012 while refining capacity is only 1.9 million barrels per day⁴⁶. National consumption in 2009 had already reached 2.5 million barrels per day — far greater than what they can refine themselves. This means to meet national oil demand, Brazil must export crude and then re-import refined oil products. Exacerbating this deficit, Brazil produces a heavier brand of crude that is harder to refine and trades at a \$6-\$10 per barrel discount from Brent. In its investment budgets, Petrobras continues its focus on discovery, with a projected investment budget of only 38% for downstream activities compared to 48% for upstream activities. Although the EIA expects refinery capacity to increase to 3.1 million barrels per day by 2020, Brazil expects to continue importing refined oil.

³⁹ Additionally, the success index for 2011 was 59%

⁴⁰ Petrobras, AQ2011 Earnings Call Transcript and Presentation. (online at www.petrobras.com.br/ri/Show.ospx?id_materia=eh3z4UjiieY+nPVYitYTKQ==&id_canal=wyqR1+3aDC/YOtv/TRNk3g==&id_canalpai=/zfwoC+leAQcwFyERVZzwQ==) (hereinafter "Petrobras 4Q2011 Earnings Call Transcript and Presentation")

⁴ Interview with Gabrielli, http://www.worldoil.com/April-2011-Petrobras-builds-technology.html ⁴² Economist, "Filling up the future", Nov 5th, 2011. Online at http://www.economist.com/ node/21536570.

⁴³ "However, we see its exploration success and large domestic oil reserves being offset by limited financial and engineering resources to develop them, which may lead to delayed project execution" SSP report on Petrobros, March 24, 2012. https://research.sharebuilder.com/uploadhandler/203ae110ar3s511e86i9464bao5f522af20af6957.odf.

⁴⁴ For example, in fourth quarter 2011, Petrobras planned to open sixteen new producing wells but only succeeded in opening nine. Unplanned maintenance needs further reduced production by 33 thousand barrels per day. Petrobras 4Q2011 Earnings Call Transcript and Presentation.

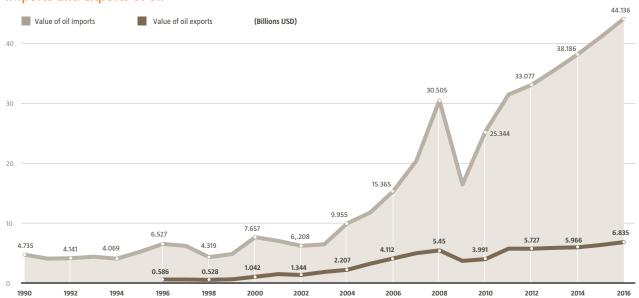
⁴⁵ Reuters, "Petrobras cuts goal for 2012 Brazil oil output", Feb 14th, 2012. Online at http://www.reuters.com/article/2012/02/14/petrobras-idUSL2E8DE20R20120214.

⁴⁶ U.S. Energy Information Administration. (online at http://www.eia.gov/countries/country-data.cfm?fips=BR).

6. Sunken treasure: Brazil, deepwater oil, and Brazil's sovereign wealth fund

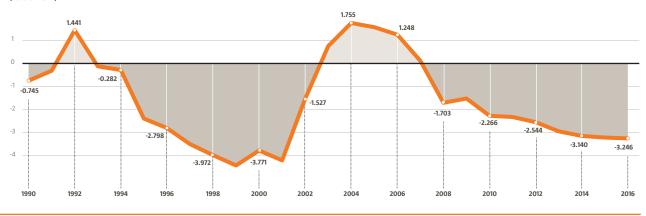


Imports and exports of oil



Current account

(As % of DGPD)



Source: IMF, World Economic Forum, 2012.

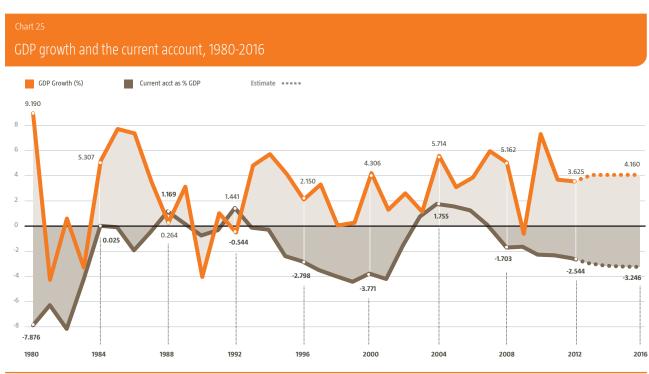
While Brazil sits atop enormous oil reserves catapulting it into one of the most important producers in the world, many significant obstacles remain even within the extraction and processing phases. In the absence of large investments in refining capacity, importing

higher priced refined products to meet projected demand could eliminate a major portion from the expected structural surplus generated by oil production. Brazil needs to meet these challenges to realize the full extent of the oil bounty.

The Brazilian Economy Should Avoid Petroleo Gras

Brazil operates a small oil net export surplus volume. However, the export of crude and import of refined products results in Brazil spending currently approximately \$27 billion dollars more on oil imports than it earns on its exports, with the difference expected to increase markedly as Brazil's development leads to increases in

domestic consumption⁴⁷. The question is, in the longer term, can Brazil increase its refinement capacity or export sufficient crude oil to overcome the gap between the more expensive imported refined oil and its exported crude oil?. Otherwise revenue from increased crude production will stoke domestic demand for higher priced refined products, perversely worsening the Brazilian current account deficit.



Source: IMF, World Economic Forum, 2012.

Given the enormous potential of Brazilian oil reserves, prudent management could promote long term sustainable development of the Brazilian economy, or long term stagnation with GDP growth subject to gyrations in the global price of oil. The development record of oil reliant economies is not encouraging. The potential for a sustained structural surplus driven by oil exports to finance development and higher levels of social spending intrigues many in Brazil. However, given current and projected budget deficits and the history of poor fiscal management, the expectation of oil wealth should cause as much concern as hope. Brazil's government runs

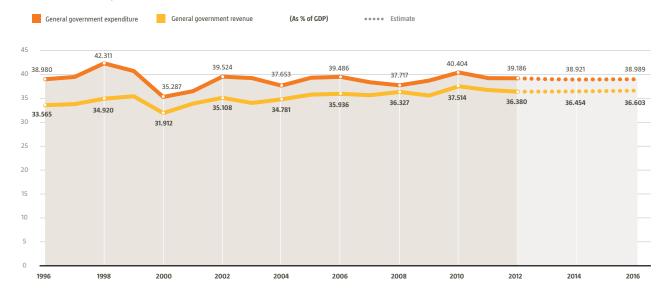
sizeable deficits driven by rapid increases in spending particularly on social programs. Recent big-ticket initiatives, such as President Roussef's "Brasil sem Miseria", do not indicate there will be a reversal in this trend. Brazil may not be able to or even be interested in restraining its inclination to try and spend away its development problems. These programs have received much acclaim in the development community, but if Brazil expects to finance them through oil sales, they need to beware the volatility of this income as well as the production challenges.

⁴⁷ IMF WEO Database September 2011. U.S. Energy Information Administration data.

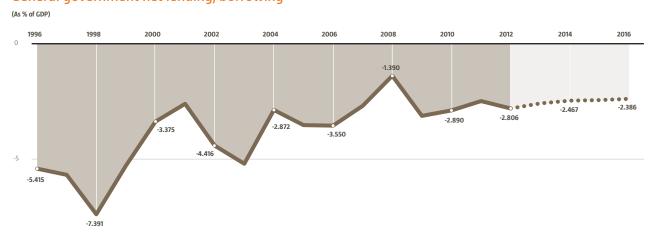
6. Sunken treasure: Brazil, deepwater oil, and Brazil's sovereign wealth fund



Income and expenses



General government net lending/borrowing



Source: IMF, World Economic Forum, 2012.

There are two specific risks for the windfall from oil money. First, increased spending levels could increase inflationary pressures and delay needed reform. Second, a structural surplus and reallocation of domestic resources could increase appreciation pressures on the Brazilian currency and a loss of competitiveness for the Brazilian economy. Due to its level of development and the tendency of oil economies to fix their currency to prevent appreciation, Brazil will

face both pressures. Brazil has a long and ongoing history of trying to manage its currency value. With comments indicating that the FSB may engage in currency speculation, this should cause concern about its investment mandate⁴⁸. Furthermore, given the poor track record of public interventions designed to target specific currency values, it would seem a poor investment strategy for the FSB.



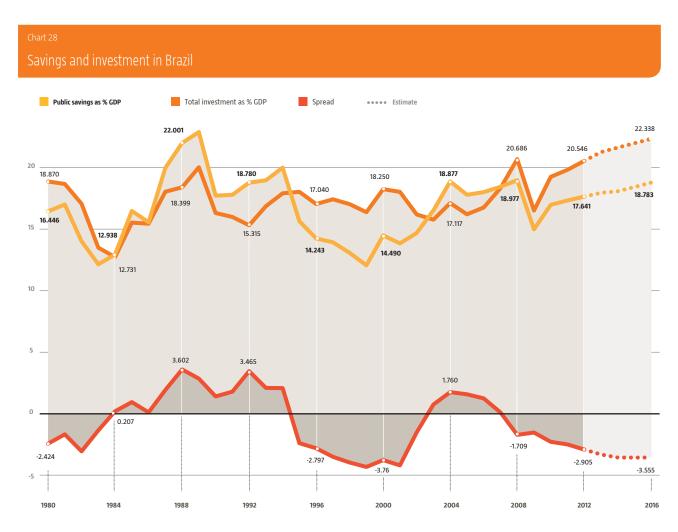
Source: IMF, World Economic Forum, 2012.

⁴⁸ Wall Street Journal Market Beat Blog, "Brazil Wins Round 1 of Currency Wars", accessed at http://blogs.wsj.com/marketbeat/2012/03/22/brazil-wins-round-one-of-currency-war/ on March 26, 2012.

6. Sunken treasure: Brazil, deepwater oil, and Brazil's sovereign wealth fund

The economic history of Brazil presents a mixture of poor monetary policy and delayed reforms that have depressed economic growth levels to the lowest of the major emerging market economies in the past decade. Adherence to the strict Fiscal Responsibility law passed in 2000 remains imperfect, though, a combination of fiscal prerogatives, restrictions, and the efforts of the Tribunais de Contas improved policymaking efficacy⁴⁹. Inflation remains a very real concern especially given the close link in oil dependent economies to

inflation and oil prices as shown in Chart 28. While low by Brazilian historic standards, interest rates remain high and well above the average of other emerging market inflation targeting regimes⁵⁰. Such high interest rates choke private borrowing that would lead to long-term growth with some calling this Brazil's most binding constraint to growth. Public investment, which could fill some of the gap, remains low and does not counter this tendency.



Source: IMF, World Economic Forum, 2012.

^{**} http://siteresources.worldbank.org/EXTLACREGTOPPUBSECGOV/Resources/PANEL4-SCARTASCINI.pdf.
** See Segura-Ubiergo, "The puzzle of Brazil's high interest rates", IMF Working Paper, February 2012, available at http://www.imf.org/external/pubs/ft/wp/2012/wp1262.pdf.

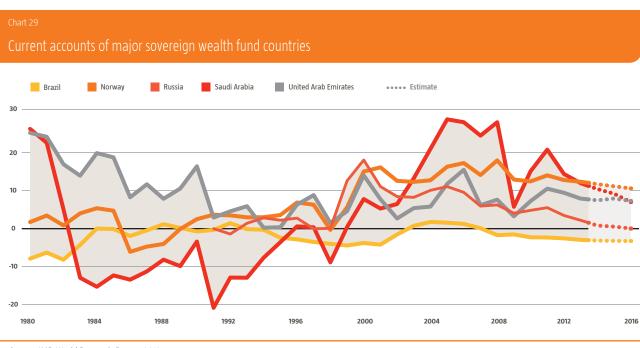
Brazil will need to maintain strong and credible macroeconomic policies that benefit from domestic microeconomic reforms. They cannot depend on oil prosperity alone. Though Brazilians consider this windfall strong proof God shares their nationality, without proper management they will become another cautionary tale on how best to squander opportunity. In a country with so many citizens living in poverty, the temptation to spend the funds on immediate social spending exists. Furthermore, in authoritarian states, governments spend lavishly to ease public discontent. In a democracy such as Brazil, politicians will wish garner favor with constituents to reap electoral benefit by increasing spending. However, such efforts are not only unsustainable, but link the country's wellbeing to volatile oil prices. Brazilian politicians must restrain their inclination to spend as the key to Brazilian prosperity.

The Fondo Soberano do Brasil: The Fund from Ipanema

The Brazilian sovereign wealth fund, the Fondo Soberano de Brasil (FSB), was inaugurated in 2008 and presently holds a mere \$10 billion. This amount however, will increase as the oil fields enter production. Currently the government takes about 21% of the profits

from oil production, above and beyond corporate income taxes. This means that unlike the SWFs in countries whose assets grew rapidly because of oil price appreciation, the Brazilian SWF will increase gradually as production capacity is added. As the Tupi fields are not expected to be in full production until 2020, there remains a lengthy period during which the FSB will grow slowly. However, given the global supply constraints and Brazilian fields coming into production as some older fields wind down, the FSB also stands to benefit from price appreciation and higher production levels from ongoing discoveries.

Unlike most other countries with sovereign wealth funds, Brazil runs current account deficits not projected to improve in the next few years. IMF estimates indicate they will do so for at least the next four years, bringing into question Brazilian suitability for a sovereign wealth fund. Coupled with their reliance on more expensive imported refined oil which exacerbates their current account deficit and the time horizon prior to large scale export production, this should cause concern about whether the sovereign fund is coming before the wealth.



6. Sunken treasure: Brazil, deepwater oil, and Brazil's sovereign wealth fund

Future excess oil revenue will accrue in the FSB improving access to capital available during downturns in the business or oil price cycle. The FSB should have a clear, non-politicized investment mandate. FSB fund returns have the specifically political purpose to reduce economic downturns. Research on SWF finds a poor track record of reducing macroeconomic volatility due to oil price fluctuations. SWF however can assist at smoothing out pubic consumption over the business cycle with the existence of strong and transparent limits to accessing fund capital removing political temptations. However, with the Finance Minister, Planning Minister, and central bank president as sole members of the advisory board, the FSB can be expected to play a quasi policy role more than other sovereign wealth funds. For example, one investment strategy open to the FSB is the purchase of United States dollars in the local market to prevent the Brazilian real appreciation⁵¹. The council of the FSB has made statements questionable for a country running a current account deficit such as "there are no limits for the fund to buy foreign exchange" and "the investments will not affect the budget, since these are funds of National Treasury and do not constitute public spending"52. The public ownership and political oversight belie these assertions to the contrary but even more worrying is the lack of understanding of what causes oil dependent economies to stagnate and the importance for fiscal restraint. The FSB needs to resist the urge to operate as a currency control operation or engage in profligate spending, while working to balance the destabilizing effects of the oil boom.

Oil revenues should be managed under clear rules, in order, among other things, to prevent political interference and provide budgetary transparency. For instance, Norway implicitly links fund capital withdrawals and public budget growth to the nonoil economy by limiting the government deficit to 4%. This both limits withdrawals of fund capital and links growth in the public budget to the non-oil economy rather than the more volatile global price of oil. Conversely, in Russia which eschewed the expenditure constraints and restraints on fund capital withdrawals, since 2006 public spending has grown at an annualized rate of 18% and risen from 31% of GDP to 38%. Brazil would be wise to place strict and transparent limiting rules on public spending linked to the non-oil economy and rules about capital withdrawals from the FSB to limit politically motivated and wasteful spending. Regular spending by the FSB should be linked to growth in the non-oil economy to reduce oil dependency and unsustainable growth in public spending.

Many oil producers like Saudi Arabia and the UAE, as relatively small countries, maintain de facto dollarized economies. Brazil is too large to do the same, but also will want to prevent currency appreciation that results from sustained surpluses. Buying foreign denominated assets with SWF capital would sterilize currency appreciation, and is not as troubling as the current policy of purchasing foreign reserves with debt to deflate the real. Additionally, the stated policy of preferring fixed income and currency purchases will help act as a buffer to large financial changes through increased exports. The primary risk of the Brazilian strategy stems from its increased dependency on oil exports as a macroeconomic strategy. Data indicates the economy may be heading that way, as the correlation between Brazilian GDP percent growth and oil prices through 2006 was merely 7%, but rose to 20% in the 2007-2012 time period. Even so, the Brazilian economy is far more diversified than that of other countries with commodity-based SWFs, which will help diffuse this risk⁵³. Using FSB capital to purchase foreign denominated assets sterilizing any structural surplus will limit appreciation pressures on the real and encourage non-oil export growth. While governments and central bank have a poor record of currency price targeting, using FSB capital to purchase foreign currency assets will implicitly limit appreciation pressures.

The FSB is limited legally by the returns it must earn with both overseas and domestically being pegged to LIBOR and the Brazilian Long Term Interest Rate. If Brazilian interest rates remain as relatively high as they are now, earning this rate will be difficult on international markets without taking on an unacceptable amount of risk. It remains to be seen how this will operate in practice, specifically with regards to any equity investments. An ideal Brazilian SWF would act to hedge commodity price and volatility risk and minimize liquidity risk. As an oil exporter that might experience currency appreciation depending on the size of the surplus, the Brazilians would be well advised to allocate a higher percentage of their portfolio to high credit quality international fixed income. As has been demonstrated theoretically and empirically, a portfolio heavy in high credit quality major currency fixed income assets will act as an implicit hedge against oil price volatility, while international equities would keep portfolio volatility high⁵⁴. A certain amount of hedging in the futures commodity markets will limit currency risk and smooth the high levels of volatility associated with oil prices. The Brazilian SWF needs to maintain high quality liquid investments. The purpose of these funds is to reduce

⁵¹ Wall Street Journal, 2010 and Thomson, 2007.

Will steet Journal, 2014 of minimum, 2014 of minimum, 2015 of minimum, 2014 of minimum, 2014 of minimum, 2015 of minimum, 201

brazil%E2%80%99s-sovereign-debt-sorry-wealth-fund-to-the-rescue/.

Bain & Co, 2009, "Oil and Gas Industrial Development and Production Chain in Brazil", Sao Paulo.

This was first demonstrated theoretically in Gintschel, A., & Scherer, B. (2008). Optimal asset allocation for sovereign wealth funds. Journal of Asset Management, 9, 215–238 and then empirically in Balding, C. and Yao, Y. (2011). Portfolio Allocation for Sovereign Wealth Funds in the Shadow of Commodity Based National Wealth. International Finance Review. 12, 293-312.

public expenditure volatility smoothing government revenues and macroeconomic volatility when oil prices drop. It defeats the purpose of the fund to invest in other high risk, high volatility investments typically highly correlated with oil prices and the global macroeconomic environment.

Conclusion

Brazil suffers the greatest of curses trying to manage a windfall of wealth. In order to avoid becoming another country in the list of stagnant oil dependent economies and benefit long-term from their oil windfall, Brazil must restrain the urge to spend on unsustainable social spending misguided political motivated currency manipulation attempts or investments. Countries that depend on oil rents to increase public spending or maintain stability suffer significant long term declines in their economies. We have identified a number of factors that could cause significant problems in the prudent management of Brazil's oil windfall. First, due to structural factors within the Brazilian economy, the expected growth in oil production without proper policy may actually worsen the Brazilian current account deficit. Second, given the lack of a structural current account surplus and lengthy time frame for production increases, the expected wealth may not materialize for many years. Third, given the overtly political nature of the FSB, its management, policy pronouncements, and oversight, Brazil would be well served to place strict and transparent limits on its investment mandate and regulations for fund capital withdrawals. Economic history is replete with examples of countries that suffered from natural resource windfalls and Brazil would be wise to limit its reliance on the oil extraction industry or the temporary wealth it brings.



Principal factors justifying the existence of Chile's sovereign wealth funds

7. Principal factors justifying the existence of Chile's sovereign wealth funds

7. PRINCIPAL FACTORS JUSTIFYING THE EXISTENCE OF CHILE'S SOVEREIGN WEALTH FUNDS

Introduction

Chile has two sovereign wealth funds, the FEES (Fondo de Estabilización Económica y Social or Economic and Social Stabilisation Fund) and the FRP (Fondo de Reserva de Pensiones or Pension Reserve Fund). They are used to save the resources deriving from the application of the structural balanced budget rule which came into force at the beginning of the previous decade. The two funds have different objectives. In the case of the FRP, the objective is to contribute to the financing of future fiscal obligations for pension payments. In the case of the FEES, the objective is to accumulate resources to finance fiscal deficits or amortise public debt. At the end of January 2012, the FEES had assets of \$14.786 billion and the FRP had assets of \$5.760 billion.

Several factors have justified the existence of these sovereign wealth funds in Chile. Possibly the main factor has been the success of fiscal policy that enabled Chile to face the financial and economic crisis of 2008-2009 better than many developed countries. This is particularly true of the FEES, given that a significant part of its resources were used to cushion the impact of the crisis. This was accompanied by investment policies that were designed to be consistent with the objectives of the funds and which produced good results, and all this was further reinforced by solid institutional foundations which made it possible to administer them with a view to the long term and to resist any political pressures there might have been as to how to use the resources and how to invest the funds. Finally, Chile's active participation in international initiatives to improve its administrative practices and transparency placed Chile's sovereign wealth funds among the most transparent in the world, which also helped to endorse them in the mind of the Chilean and world public. We will now go on to discuss each of these factors in greater detail.

The success of fiscal policy

Chile's fiscal policy and its sovereign wealth funds are reputational assets. Chile's fiscal policy over the course of the past decade, and its sovereign wealth funds, are considered successful both nationally and internationally. At home, their prestige led to the crosssectional support of broad sectors of the country. Internationally, they enabled Chile to establish itself as a benchmark for many countries at different levels of development. Chile has benefited considerably from its reputation in this regard. One of the most important benefits to the country has been its ability to reduce the volatility of fiscal spending and of the economy as a whole, increase public savings in expansive cycles, and reduce risk perceptions of the Chilean economy. It has also enabled it to reduce interest rate volatility and has helped in maintaining a more competitive and less volatile real exchange rate, which in turn enabled it to safeguard the export sector's competitiveness in spite of the increase in the price of copper over these past few years⁵⁵. In this section we describe the main characteristics of Chilean fiscal policy and how the sovereign wealth funds relate to this, and we explain some of the abovementioned benefits in more detail.

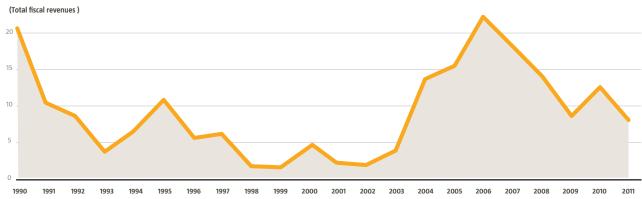
Chile's fiscal policy is based on a rule that targets structural budget balance. The rule's aim is to establish a level of annual fiscal expenditure that is in keeping with the central government's structural revenues. By means of this rule, fiscal expenditure is insulated from cyclical fluctuations in economic activity, the price of copper and other factors that determine effective fiscal revenues. This is particularly important for Chile, where the volatility of its fiscal revenues depends in large part on the price of copper (see Chart 30).

⁵⁵ Larraín F., Costa R., Cerda R., Villena M. and Tomaselli A. (2011). "Una política fiscal de balance estructural de segunda generación para Chile" ('a second-generation fiscal policy of structural balance for Chile'), Studies in Public Finance, Budget Directorate, Ministry of Finance, Chile (page 7).

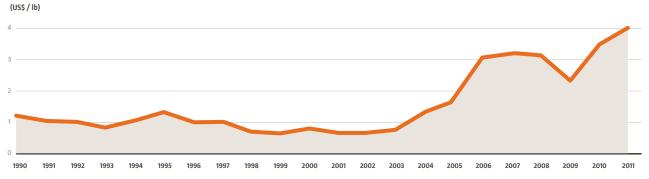
Chart 30

Fiscal revenues from copper (CODELCO) as a percentage of total fiscal revenues

Fiscal revenues from CODELCO



Price of copper



Source: Budget Directorate of the Chilean Government.

The rule on structurally balanced budget is explicitly countercyclical. This means savings are set aside in times of surplus, thus avoiding drastic fiscal cutbacks in periods of adverse economic conditions. At the same time it supports the monetary policy in a natural way, since it saves surplus fiscal revenues when monetary policy is restrictive and uses them when it is expansive. In this way, and through this policy, the volatility of fiscal spending and GDP has been significantly reduced.

It is important to stress that structural revenues are estimated using the long-term trends of the main variables that influence them. These variables are determined by independent experts, affording continuity and credibility to the structural balanced budget rule.

The structural balanced budget rule was first applied to the budget for 2001, and has since been adjusted in light of experience gained and the international economic situation. The method used to calculate structural balance has undergone continuous fine-tuning, mainly associated with the cyclical adjustments that have to be considered in order to obtain structural revenues. For example the latest changes, introduced in the 2011 budget, involved eliminating adjustments for transitional tax measures with legal expiry dates, cyclical adjustments to the "other revenue" heading and cyclical adjustments to interest income on the Treasury's financial assets. These changes were made based on a study entrusted to an Advisory Committee by the Ministry of Finance. The structural balance target has also changed over time. In 2001, the target was initially set at 1% of GDP. Subsequently, in the 2008 budget, it was lowered to 0.5% of GDP in view of the substantial resources being accumulated in the sovereign wealth funds. Later, in 2009, the ex ante target was cut back to zero, to face the crisis existing at the time. Finally, as a

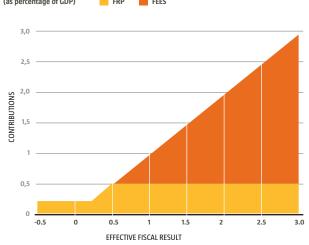
7. Principal factors justifying the existence of Chile's sovereign wealth funds

result of the change in method previously referred to, the target for 2009 was changed to a structural deficit of 3%, and since then it has been adjusted each year to converge to a structural deficit of 1% in 2014.

The institutional arrangements for fiscal policy have also been enhanced over the years. At first, the structural balanced budget rule relied on the political will of the government at the time. However, as it became more and more accepted among the country's various sectors, it became possible to set formal rules for accumulating the savings that were being generated. Thus the second half of 2006 saw the promulgation of Law No. 20,128, the Fiscal Responsibility Law, which established the rules and the institutional framework for the accumulation, administration and operation of fiscal savings. The Law created the FRP and empowered the President of the Republic to create the FEES, which was officially established in February 2007. The same Law obliges each government to announce, in its first year in office, what its objective will be as regards the structurally balance budget rule. Additionally, in 2011, the Ministry of Finance announced the creation of a Fiscal Council, the main role of which will be to ensure independence in the estimation of the structural variables and to validate the estimates of structural balance⁵⁶.

The resources deriving from application of the structural balance rule are accumulated in the sovereign wealth funds. The rules for accumulation, illustrated in Chart 31, were established by the Fiscal Responsibility Law. The FRP is increased each year by a minimum amount equivalent to 0.2% of the previous year's GDP. If the effective fiscal surplus is more than 0.2% of GDP, the FRP receives a contribution equivalent to this surplus, up to a maximum of 0.5% of GDP. The FEES is increased each year by the balance (only if positive) resulting from subtracting the contribution to the FRP from the effective fiscal surplus, not counting amortisation of public debt or any advance contributions made to the fund. As at the end of January 2012, total contributions made to the FEES stood at \$21.162 billion and those made to the FRP at \$3.867 billion.

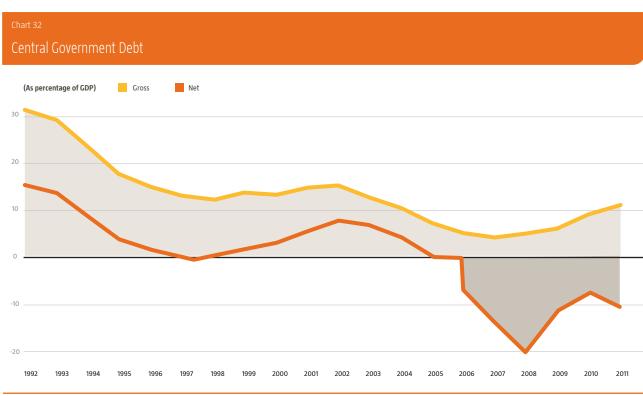
Contribution rules for Chile's sovereign wealth funds (as percentage of GDP) FRP FRES



Source: Ministry of Finance, Government of Chile, 2012.

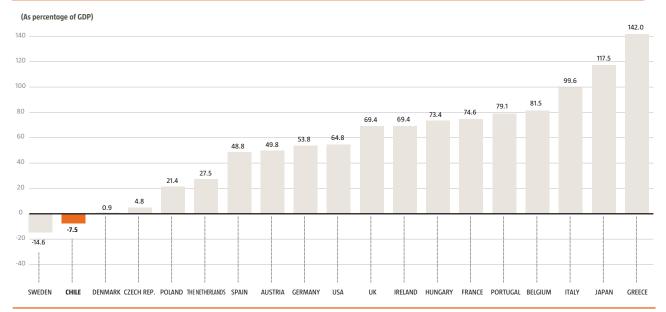
The fiscal policy and the resources saved in the sovereign wealth funds have enabled Chile to show one of the best fiscal positions in the world. Thanks to the structural balance rule, since 2006 Chile has had a net creditor position, which as of September 2011 amounted to 10.5% of GDP (see Chart 32). This has positioned Chile favourably relative to many developed countries (see Chart 33).

^{*}S The Fiscal Council will take part in meetings of the consultative committees on Trend GDP and Reference Price of Copper, and will verify the estimates of the structural variables; it will be supported by a Technical Secretariat based in the Budget Directorate, for the validation of the expost calculations of structural balance, and will forward any changes in method proposed by the authority to a technical body for discussion. It may also be called upon by the Minister of Finance to study specific matters relating to structural balance.



Source: International Monetary Fund and Ministry of Finance, Government of Chile, 2012.

Chart 33 Net Central Government Debt, 2010



Source: International Monetary Fund and Ministry of Finance, Government of Chile.

7. Principal factors justifying the existence of Chile's sovereign wealth funds

In turn, the resources saved in the FEES enabled Chile to face the financial and economic crisis of 2008-2009 better than many developed countries. Consistent with the purpose for which the fund was created, a substantial portion of the resources of the FEES was withdrawn during 2009 to finance a \$4 billion fiscal stimulus plan and to finance the effective budget deficit caused by the fall in tax revenue and in revenues associated with copper mining. For the latter, an additional \$4 billion were withdrawn starting in the third quarter of that year. Additionally, \$441 million from the FEES were used to amortise public debt, and \$837 million were used to make the capital contribution to the FRP. Thus total withdrawals from the FEES in 2009 amounted to \$9.28 billion. This can be seen reflected in the decrease in the creditor position in Chart 32.

The prudent macroeconomic management resulting from the fiscal policy and the capacity for economic and financial recovery have been reflected in continual upgrades in Chile's credit ratings. For example in June 2010 Moody's raised the government's debt rating from A1 to Aa3, and in February 2011 Fitch raised its rating from A to A+ in foreign currency and from A+ to AA- in local currency.

This has also enabled Chile to successfully access foreign capital markets. In 2010, after a six-year absence, the Chilean government returned to the international capital markets with two bond issues: one in US dollars, for \$1 billion and, for the first time in Chile's history, another denominated in pesos (CLP), for an amount equivalent to approximately \$520 million. In this transaction Chile obtained its best ever borrowing conditions, but these were once again bettered by further issues later that year, one of which actually achieved the lowest rate ever obtained by any Latin American country.

Additionally, there are other benefits that stem from the fiscal policy. For example, the real exchange rate has been kept competitive, given that the money saved in the sovereign wealth funds is invested abroad. In this way the effect that fiscal revenue from copper exports might have on other export sectors, especially in the past few years, has been kept to a minimum. Also, given that the fiscal policy is countercyclical, it indirectly supports the monetary policy pursued by the Central Bank, which has led to a reduction in interest rate volatility.

Investment policy consistent with fund objectives

The investment policies of the sovereign wealth funds have been defined in consonance with the purposes for which they were created, and rely mainly on the characteristics of their underlying "liabilities". As is explained in this section, the investment policy designed for the FEES is consistent with its objective of accumulating resources to finance fiscal deficits or amortise public debt. For the FRP, the beginning of 2012 saw the implementation of a policy that is more in line with its objective of contributing to the financing of future fiscal obligations for pension payments. We now go on to describe the main characteristics of both funds' investment policies and to present a summary of the results obtained.

The main objective of the FEES' investment policy is to maximise the cumulative value of the fund so as partly to cover the cyclical shortfalls in fiscal revenues, subject to a low level of risk. This risk aversion is reflected in the selection of a highly liquid investment portfolio with low credit risk and low volatility, allowing ready access to the resources when they are needed to finance deficits and avoiding significant losses in the value of the fund. Specifically, the policy's strategic asset composition is 30% money market instruments, 66.5% sovereign bonds and 3.5% inflation-indexed sovereign bonds, with a currency composition of 50% in dollars, 40% in euros and 10% in yen. Thus its policy is to invest in fixed income securities in reserve currencies, which typically hold up well in times of crisis. This not only allows the cumulative value of these resources, measured in foreign currency, to be maximised, but also facilitates their conversion into pesos (in which the bulk of fiscal spending takes place) at times when it is most necessary to make use of these resources.

The FRP's investment objective is to generate resources to contribute to the financing of fiscal obligations in respect of pensions. The specific objective set is to maximise the expected return, subject to a risk tolerance established as a 95% probability that the fund will not suffer, in any one year, losses in excess of 10% of its value in dollars. The investment horizon is considered to be medium to long term, in view of the size and timing of the obligations to be financed. At the beginning of 2012 a start was made on implementing an investment policy more in line with its objectives, which establishes a portfolio composition of 48% in nominal sovereign bonds, 17% in inflation-indexed sovereign bonds, 15% in equities and 20% in corporate bonds. It is important to mention that all resources are invested outside Chile. In the long term, this strategy is expected to produce better results than those obtained with the policy in force until the end of 2011. If we compare the new investment policy with those of Chile's pension fund administrators (AFP), as far as asset classes and risk profile are concerned the FRP would be invested in a very similar way to a pension fund, which would be more consistent with its investment objectives⁵⁷.

⁵⁷ In Chile the "A Fund" is the most aggressive and the "E Fund" is the most conservative.

The importance of consistency between the investment policy and the funds' objectives has been clearly shown, especially in the case of the FEES. During the crisis of 2008-2009 this fund's performance benefited considerably from being invested in fixed income securities in reserve currencies. This afforded protection to the fund's resources just at the time when it was necessary to withdraw them to finance the deficit. This performance was in contrast to those of other sovereign wealth funds around the world, which suffered considerable losses at that time. In the case of the FRP, the investment policy in place from inception until the end of 2011 was similar to that of the FEES, mainly because the crisis delayed implementation of the new policy. As previously explained, from 2012 on, the fund will have a policy more in consonance with its long-term objective, which is to contribute towards the financing of future fiscal obligations relating to pensions. In Table 17 we present a summary of returns on the funds as at the end of January 2012.

Table 17 Profitability of Chile's sovereign wealth (in percentages)

Returns in dollars	January	Past 3 months	YTD	Past 12 months	Past 3 years (annualised)	From launch (annualised)
FEES	0.72%	-1.25%	0.72%	3.57%	3.97%	5.13%
FRP	1.18%	-0.80%	1.18%	4.04%	4.07%	5.17%

Increased emphasis has been placed on the passive aspect of the sovereign wealth funds, avoiding any kind of tactical deviations. This was made clear for example when in 2010, among much speculation as to what would happen if the US Congress did not approve the raising of the government's debt ceiling, and the possible downgrading of its credit rating, Chile's Finance Committee, in coordination with the Ministry of Finance, evaluated the situation and recommended leaving the investment policy unchanged, which is consistent with the long-term view needed to define investment policies.

The institutional structure of Chile's sovereign wealth funds has helped fulfil the purposes for which the funds were created. This has been achieved mainly by means of: (i) a legal framework ensuring clear rules for contributions to and withdrawals from the funds; (ii) an organisational structure ensuring appropriate separation of roles and responsibilities, which in turn facilitates reporting and operational independence and (iii) a process for establishing investment policies that ensures their consistency with the funds' aims. We now go on to describe these factors in detail and to explain how the institutional structure has made it possible for the funds to be insulated from political pressures and how it in turn protects the Minister of Finance from criticisms that could arise when any of their investments suffer losses.

The rules on contributions and withdrawals are set out in the legislation applying to the funds. As already explained, the rules on contributions are clearly defined in the Fiscal Responsibility Law. Their uses are established in that same Law, in Decree Law No. 1 of 2006 of the Ministry of Finance and in the 2008 Pensions Law⁵⁸. This legal framework has enabled the sovereign wealth funds to be protected from any political pressure that might be exerted when examining financing alternatives for facing new priorities. This was made clear for example in the aftermath of the 2010 earthquake, when all the financing for the reconstruction effort came from sources other than the sovereign wealth funds. We should point out that any use of the funds that is not permitted within the abovementioned framework requires the approval of Congress.

The main entities forming part of the organisational structure of the sovereign wealth funds are established in the Fiscal Responsibility Law. This law stipulates that the funds, which are owned by the Chilean Treasury, are to be managed in accounts that are separated from the ownership of the General Treasury of the Republic. At the same time it assigns the Minister of Finance the responsibility of deciding on their directors and investment policies. This law also envisages the Minister of Finance relying on the advice of a Finance Committee in establishing investment policies. This Committee was set up in 2007. Furthermore, it grants the Minister power to delegate the operational management of the funds' resources

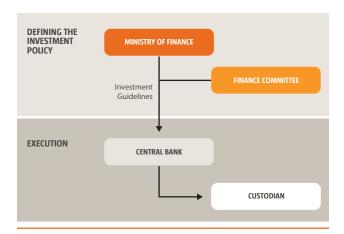
Solidly institutional

According to this legal framework, in the case of the FEES, its resources can be used at any time to complement the fiscal revenue needed to finance authorised public spending in the event of a fiscal deficit. They may also be used for the regular or extraordinary amortisation of public debt (including Bonos de Reconocimiento, former pension system bonds) and to finance the annual contribution to the FRP when the Minister of Finance so decides. In the case of the FRP, at present and until 2015 only the income on the fund's investments from the previous year may be withdrawn to complement the financing of the fiscal obligations deriving from the state guarantee of the basic old age and disability pensions, as well as the forecast contributions to these pensions. From 2016 on it will be possible to withdraw both the capital and the cumulative gains. It is important to mention that the annual amount of resources withdrawn from this fund must not exceed one third of the difference between the expenditure of the year in question on forecast obligations and the forecast expenditure for 2008, adjusted for inflation.

7. Principal factors justifying the existence of Chile's sovereign wealth funds

to Chile's Central Bank⁵⁹, which he did from the outset, in March 2007. It is important to point out that, until the end of 2011, the Central Bank was solely responsible for investing the resources of both funds. However, from 2012 on, as a result of a new investment policy for FRP, the Central Bank has appointed external managers to invest that fund's equity and corporate bond portfolios. Lastly, the custodian performs the work normally associated with this role and also carries out certain middle-office functions which are complemented by Ministry of Finance personnel (see Chart 34).

Chart 34
Institutional structure of Chile's sovereign wealth funds



The funds' organisational structure lends itself to effective operation and appropriate reporting. Policy is set by the Ministry of Finance, with advice from the Finance Committee. The Committee's members are independent of the Ministry of Finance. The Ministry issues investment guidelines which define investment objectives and limits. These guidelines are used by the Central Bank, and, in the case of the FRP⁶⁰, its delegated external administrators, in investing the fund's assets. This system has made it possible to use the Central Bank's technical know-how and its operational infrastructure developed to administer the country's foreign reserves. It also ensures that all investments are executed using purely financial criteria. Monitoring of compliance with investment guidelines on the part of the Central Bank and its external administrators is carried out by an independent entity, the Custodian. The Finance Committee in turn issues periodic reports on its activities. The Ministry of Finance issues monthly, quarterly and annual reports on the status of the sovereign wealth funds. Additionally, the Treasury, which is responsible for accounting and for drawing up the funds' financial

statements, publishes information on them on its website. Lastly, the Controller General's Office, an autonomous body, has competence to audit the sovereign wealth funds.

The investment policy of the sovereign wealth funds is based on technical aspects. Starting out from parameters set by the Ministry of Finance, such as risk tolerance and target returns, and bearing in mind the funds' objectives, the Finance Committee issues recommendations on how to invest the funds. So far all the Committee's recommendations have been accepted by the Finance Ministers. Furthermore, the funds invest passively, in accordance with the benchmarks defined in each policy. This has made it easier to keep a long-term perspective and to avoid any temptation to deviate from the guidelines when certain issuers run into short-term economic difficulties.

This structure protects the funds' investments from political pressures, and the Minister of Finance from criticisms that are bound to arise at negative times in the investment cycle. Maintaining a Finance Committee, independent of the Ministry of Finance, composed of highly reputed experts and primarily responsible for designing the investment policies, has provided continuity to the sovereign wealth funds' investment, insulating them from the shifting priorities of the government of the day. It also enables the Minister of Finance to share with the Committee, at least from a reputational point of view, expected short-term negative results in accordance with the risk tolerance defined. This in turn enables the investments to be kept in line with their investment horizon, avoiding hurried, short-term decisions that could have significant financial consequences.

⁵⁹⁹⁶⁰ For the new policy of the FRP, the Central Bank has appointed delegated administrators for the new asset classes. The Fiscal Responsibility Law also allows the Minister of Finance to delegate the administration directly upon external administrators or to administer it directly.

Santiago Principles and transparency

The commitment of Chile's sovereign wealth funds to the Santiago Principles and to improving the quantity and quality of information available on them has enhanced the legitimacy of our funds in the eyes of the public in Chile and internationally. We now go on to give a brief description of Chile's active participation in activities relating to the Santiago Principles, the enhancements to the published information on the funds and the international recognition of these practices.

As part of Chile's commitment to best international practices, the government has taken an active part in the international initiatives aimed at establishing an operational framework for sovereign wealth funds and promoting their transparency. This was demonstrated for example by Chile's participation in the drawing up of a list of principles and generally accepted practices, endorsed by the world's leading sovereign wealth funds, which, after a series of meetings, were agreed in Santiago de Chile in 2008 (the Santiago Principles). Subsequently, it has continued to play an active role in the International Forum of Sovereign Wealth Funds, the main vehicle for the world's various sovereign wealth funds to meet and share their experiences in administering and implementing the Santiago Principles.

Chile's sovereign wealth funds have implemented a number of improvements, particularly relating to the quality and frequency of the information made available to the public. For example since 2008 an annual report has been produced, with comprehensive details of the funds' investments. Since 2010 the returns on their investments have been published monthly. A self-assessment of the degree of compliance with each of the Santiago Principles was published for the first time in 2011. In 2012 audited financial statements will be published for the first time. Nearly all this information is published in both Spanish and English and is readily available on the website⁶¹. This is part of the Chilean government's systematic effort to improve the information it delivers to the public both at home and abroad, the better for them to understand the results obtained from their investment.

These efforts have been reflected in international recognition regarding the level of transparency of our funds. In particular, since the third quarter of 2009, the Sovereign Wealth Fund Institute has awarded Chile top marks in its Linaburg-Maduell transparency index, which measures the transparency of the major sovereign wealth funds.

Conclusion

The success of the fiscal policy, the funds' investment policies, their institutional framework and all the efforts made to improve their transparency, have helped to consolidate Chilean and world public opinion about whether Chile's sovereign wealth funds should be maintained. However, challenges remain. Many of these achievements will be put to the test in the future, possibly with the FRP's new investment policy which, unlike that of the FEES, includes equities and corporate bonds, and the results of which will be subject to greater volatility in the short term. However, the long-term view taken in defining the funds' investment policy, the institutional framework described above, their administration and transparency, together with an ongoing public education process, should enable the Chilean funds to continue to enjoy an excellent reputation at home and abroad.

⁶¹ http://www.hacienda.cl/funds-soberanos.html.



Africa and sovereign wealth funds

8. Africa and sovereign wealth funds

8. AFRICA AND SOVEREIGN WEALTH FUNDS

In 2010, during the last session of Columbia Global Thought devoted to sovereign wealth funds, James Wolfensohn, former World Bank President, spoke of the need to take account of a continent which by 2050 will be home to a quarter of the world's population: "This is not a group that you can just forget about" he said.

Sovereign wealth funds, stimulated by Robert B. Zoellick's "One Percent Solution", represent an opportunity and a challenge for the continent. Will they be capable of making good use of Africa's potential?. Will Africans be capable of growing with investment from the funds?.

Africa has before it a fundamental decade in which to achieve integration in the world economy. The first decade of this century saw Africa grow at an average annual rate of 5.2% in terms of real GDP⁶². China's phenomenal economic growth, Latin America's positive development and the expected advent of giant India and other emerging markets from Southeast Asia (Malaysia, Indonesia and Thailand) place Africa in a newly advantageous position in view of the growing South-South flows.

Africa's economy is based essentially on raw materials, and it has "benefited" from the substantial increases in commodity prices since 2009. While this trend undoubtedly has a positive effect on countries that export oil and other commodities, many further steps need to be taken before it can be affirmed that these increases really have a far-reaching and lasting impact on the economy. It was precisely a fall in commodity process that led to the region's serious recession after the crisis. In order to escape this dependency, which is potentially very harmful to African economies as a whole, a crucial factor will be better distribution of the profits obtained from these natural resources, leading to economic diversification.

The "paradox of abundance" that potentially affects many African countries can be overcome by means of sovereign wealth funds, if they are set up and used properly. Almost half of all African countries' economies are highly concentrated in exports of commodities (oil and minerals); exports of commodities alone exceed 25% of total exports⁶³. The appreciation of currencies due to this export activity leads to a deterioration in the competitiveness of other sectors of the economy; the volatility of revenues from these commodities, and the corruption associated with this source of easy

winnings, leads many countries with potential to see their growth prospects fade.

A sovereign wealth fund, if properly set up, can serve to avoid the appreciation of national currencies by accumulating foreign currency. Moreover, a properly designed corporate governance system allows the fund's activity to be insulated from opportunistic political decisions and can limit the ability of the people in power to influence the use to which the profits obtained are put⁶⁴.

Sovereign Wealth Funds in Africa

A recent event in Cape Town with some of Africa's best known institutional investors might provide us with the answer as to where African sovereign wealth funds are headed.

In the course of the lectures and among the participants, two apparently opposite approaches took shape. On the one hand, the Western approach proposes a "Norwegian-style" model that would follow the guidelines of the Government Pension Fund, invest all its capital abroad and have as its ultimate goal the financial returns that serve to increase that capital. On the other hand, the African approach calls for the funds to become more involved in the domestic economy, focusing on development objectives.

As proposed by Ashby Monk⁶⁵, we can find an intermediate solution. This would be a similar model to what Mubadala in the UAE or Temasek in Singapore have done in achieving a difficult balance between financial returns and development criteria. The political authority would first establish a series of objectives or areas of special interest for development. The fund must then be left entirely free to act based on exclusively commercial considerations. In other words a team of experts is set up to seek, in a purely business-oriented way, a financial return on key areas for the country's development, such as infrastructure, agriculture and private equity. Thus we propose a mixed model that could work in Africa.

The African funds are characterised by a lack of transparency and reputation. According to Triki (2011), the four African funds (Botswana, Libya, Algeria and Nigeria) are among the lowest ranked in terms of acceptability of investments. This situation can be attributed to these countries' poor reputation for standards of governance rather than to defective management of the funds (Balding, 2012).

⁶² African Economic Outlook, 2010. Available at http://www.africaneconomicoutlook.org/en/data-statistics/.

At least 12 sub-Saharan countries' exports are 75% concentrated in three natural resources or fewer. The Director of the Africa Department in the IMF, in the recent Conference on Management of Natural Resources in sub-Saharan Africa, wondered whether sovereign wealth funds were the solution to this problem. In any case, this shows that it is essential to improve technical knowledge so as to be able to implement these savings instruments in the long term. See http://www.institutionalinvestor.com/blogarticle/2999994/Blog/Behind-the-Scenes-at-the-Timor-Leste-Petroleum-Fund.html?ArticleID = 29999946:IS=EMSG28994.

⁶⁵ Ashby Monk at http://www.institutionalinvestor.com/blogarticle/2989922/Blog/Fascinating Roundtable-in-Cape-Town.html?ArticleID=2989922&LS=EMS621374.

Table 18 African sovereian wealth Fund

Country	Region	Fund Name	AUM (\$bn)	Fund type	Founded
Libya	North Africa	Libyan Investment Authority (LIA)	62,9	Sovereign Fund	2006
Algeria	North Africa	Fond de Regulation des Recettes (FRR)	56,7	Stabilization Fund	2000
Botswana	Sub-Saharan Africa	Pula Fund	5,9	Stabilization Fund	1994
CEMAC	Sub-Saharan Africa	Fonds de Stabilisation des Recettes Budgétaires	3,1	Bank Fund	2006
Mauritius	Sub-Saharan Africa	Mauritius Sovereign Wealth Fund	3	Stabilization Fund	2010
Republic of the Congo	Sub-Saharan Africa	Fonds de Stabilisation des Recettes Budgétaires	1,64	Bank Fund	2005
Nigeria	Sub-Saharan Africa	Nigerian Sovereign Investment Authority	1	Sovereign Fund	2011
CEMAC	Sub-Saharan Africa	Fonds pour les générations futures	0,5	Bank Fund	2006
Gabón	Sub-Saharan Africa	Fonds Souverain de la République Gabonaise	0,4	Development Fund	1998
Mauritania	North Africa	Fonds National des Revenus des Hydrocarbures (FNRH) 0,3	Stabilization Fund	2006
Sudan	Sub-Saharan Africa	Oil Revenue Stabilization Fund (ORSF)	0,2	Stabilization Fund	2008
Equatorial Guinea	Sub-Saharan Africa	Fonds pour les générations futures	0,08	Bank Fund	2002
Ghana	Sub-Saharan Africa	Ghana Stabilization Fund	0,05	Stabilization Fund	2011
Ghana	Sub-Saharan Africa	Ghana Heritage Fund	0,01	Sovereign Fund	2011
São Tomé and Príncipe	Sub-Saharan Africa	National Oil Account	0,01	Sovereign Fund	2004
Namibia	Sub-Saharan Africa	Minerals Development Fund	N/A	Development Fund	1995
Angola	Sub-Saharan Africa	Reserve Fund for Oil*	N/A	Stabilization Fund	N/A
Kenya	Sub-Saharan Africa	Kenya SWF*	N/A	Sovereign Fund	N/A
Liberia	Sub-Saharan Africa	LiberiaSWF*	N/A	Sovereign Fund	N/A
Mozambique	Sub-Saharan Africa	Mozambique SWF*	N/A	Sovereign Fund	N/A
Namibia	Sub-Saharan Africa	Namibia SWF*	N/A	Sovereign Fund	N/A
Rwanda	Sub-Saharan Africa	Rwanda SWF*	N/A	Sovereign Fund	N/A
South Africa	Sub-Saharan Africa	South Africa SWF*	N/A	Sovereign Fund	N/A
Tanzania	North Africa	Tanzania SWF*	N/A	Sovereign fund	N/A
Tunisia	Sub-Saharan Africa	Tunisia SWF*	N/A	Sovereign fund	N/A
Uganda	Sub-Saharan Africa	Uganda SWF*	N/A	Sovereign fund	N/A
Zambia	Sub-Saharan Africa	Zambia SWF*	N/A	Sovereign fund	N/A
Zimbabwe	Sub-Saharan Africa	Zimbabwe SWF*	N/A	Sovereign fund	N/A

Source: ESADE geo~(2012)~based~on~an~original~work~of~Victoria~Barbary~(mimeo).~* Potential~new~funds~now~under~discussion.

Angola

The IMF has recommended the creation of a sovereign wealth fund in Angola in order to separate fiscal expenditure from short-term fluctuations in oil prices. Angola does not have an official sovereign wealth fund, although Sonangol (Sociedade Nacional de Combustíveis de Angola) functions as a de facto sovereign wealth fund with a capital for domestic and foreign investments of between \$4 billion and \$5 billion. In 2011 Sonangol obtained more than \$33 billion from oil sales.

Sonangol is now a holding company with business in sectors such as oil distribution and refining as well as an airline and a shipping

company. This giant business group has investments in Banco Africano de Investimentos, Millennium BPC (15%), Banco Caixa Geral Totta Angola (25%), Banco Privado Atlântico and ESCOM (Espírito Santo Group). It holds 20% of construction company Mota-Engil Angola, a subsidiary of one of Portugal's leading construction companies. It financed the Clinica Girassol private hospital, and the list goes on.

In 2004 it set up a joint venture, China Sonangol International Holding (CSIH), based in Hong Kong. The purpose of this institution is to invest in sectors linked to oil and gas, as well as large-scale infrastructure projects. In Angola, it focuses on the real estate and infrastructure sectors⁶⁶.

⁶⁶ See http://worldwtrade.blogspot.com.es/2012/02/la-alargada-sombra-de-sonangol-angola.html.

8. Africa and sovereign wealth funds

Gabon and Namibia

Another sub-Saharan country, Gabon, recently announced the establishment of a new sovereign wealth fund, FSRG (Fonds Souverain de la République Gabonaise or Sovereign Fund of the Republic of Gabon), which will have a capital of nearly 500 million dollars. Gabon is the fourth biggest country in sub-Saharan Africa in terms of oil reserves, and 60% of state revenue comes from the oil sector. The fund will focus on financing major development projects, so its investment will be predominantly domestic. It seems therefore that the idea is that this fund should inject professionalism into local investment made with funds from the national budget. In order to achieve this it will be necessary for the fund's corporate governance to be correctly established.

Namibia has a fund (Minerals Development Fund) with a strongly local character and centred on the mining sector. The fund assists small and medium enterprises involved in mining, facilitating improved research and planning to raise local miners' standard of living. This fund is still far from being considered as a sovereign wealth fund, due to its definition and investment strategy.

Libya

The Libyan fund (Libyan Investment Authority, LIA) is in quite a different situation. Since the Arab Spring and the overthrow of the Gaddafi regime, the situation in the country has tended to return towards normal, as has the functioning of the sovereign wealth fund

In May 2011 some previously confidential information was made public, with an analysis of the fund's portfolio. Thus we discovered that LIA held deposits of more than a billion dollars with the UK's HSBC. In September 2011 another declassified report showed that LIA also had among its external managers the Bank of New York Mellon, Nomura and Western Asset, with investment mandates of \$500 million.

The case of LIA demands a more in-depth explanation of what went so wrong with corporate governance systems as to lead numerous European and American institutions to establish financial ties with a fund controlled by the dictator Gaddafi. We know that the relationship between the fund and the London School of Economics cost the then director of the institution, Howard Davies, his job in 2011.

The situation in Libya is still far from normal. Despite the lifting of sanctions on Tripoli by the United States, the United Nations and the

European Union, the fund's investments in East and West Africa as yet have no solution. LIA has a subsidiary investment vehicle called Libyan African Investment Portfolio (LAP), with assets in East and West African countries. The United Nations Security Council's doubts relate to the ultimate beneficial owner of these investments: do they belong to Gaddafi family members linked to the fund, or to the Libyan government?

LIA, through its subsidiaries, is one of Africa's most active funds: it has assets in telecommunications in Uganda, Rwanda, South Sudan, Zambia, Sierra Leone, Côte d'Ivoire, Niger, Guinea and Benin; it also owns hotels, textile factories and a food processing plant in Uganda; as well as oilfield engineering and retail businesses in Kenya and Uganda⁶⁸.

Mauritius

Mauritius is another African country with the intention of launching its own sovereign wealth fund. This Indian Ocean archipelago may become the first country of the African continent to establish a fund that is not fed by commodities. In the period 2006-2010 Mauritius succeeded in attracting more foreign direct investment than in the previous 40 years. This accumulation of foreign exchange reserves has led the country's government to decide to establish a fund in order to diversify the risk beyond the country's borders. The fund will have an initial capital of nearly \$3 billion⁶⁹.

Nigeria

Nigeria established a sovereign wealth fund in 2011. With the promulgation of the law establishing the Nigeria Sovereign Investment Authority (NSIA) in May 2011, the government set aside \$1 billion from the old Excess Crude Account to constitute the new fund, which is scheduled to begin operations in May 2012. Nearly 700 applications were received for the three top management positions (CEO, CIO and CRO). Nigeria had been one of three OPEC countries with no sovereign wealth fund (the others being Iraq and Ecuador).

The new investment body (NSIA) will be responsible for distributing oil revenues among three sub-funds: the Future Generations Fund, the Nigeria Infrastructure Fund and the Stabilisation Fund. This last fund will have a role as lender of last resort in periods of commodity price slumps. The intention of these three funds will be to reduce the economy's dependency on oil in the long term, to insulate the economy from the volatility of oil prices in the short term and to serve as a catalyst for investment in infrastructure⁷⁰.

 $^{^{67}}$ Ashby Monk at http://www.institutionalinvestor.com/Article/2974610/Welcome-Gabon-To-The-Club. html? ArticleId=2974610.

⁶⁸ See All Africa at http://allafrica.com/stories/201202190127.html.

Mauritius advertised for an international expert to supervise the launch of the country's sovereign wealth fund. See http://www.thecommonwealth.org/job/191203/167709/243027/pg_mus_0569.htm. 70 http://allafrica.com/stories/201106061200.html.

Two failures: Equatorial Guinea and Chad

Not all is good news; some funds have failed. Such is the case of the funds established in Equatorial Guinea and Chad.

Equatorial Guinea is the second richest country in Africa in terms of per capita income measured in purchasing power parity, and ahead of such countries as Argentina, OECD member Chile, Lithuania or Croatia. Oil accounts for 77% of the country's exports. And yet 77% of Equatorial Guinea's population lives below the poverty line.

Equatorial Guinea has an opaque fund called the Fonds pour les générations futures (fund for future generations). The volume of assets under management is close to \$80 million and ties to the Obiang family are strong. Equatorial Guinea has not found a way to transfer the wealth of its subsoil to its inhabitants, and there are no clear signs that a sovereign wealth fund can meet these challenges. Nor do the political conditions exist in which to make a direct transfer of income to the population to enable it to escape from the poverty in which it is trapped, as proposed by the Center for Global Development⁷¹.

The case of Chad is similar. A country that was branded the most corrupt on earth did not start out with the best conditions for making independent management of the fund a reality. And so it was, just as predicted: the oil-fed fund that the IMF imposed as a condition for a loan to finance the construction of a pipeline was soon taken over by the political authorities and its impact severely diminished.

New Funds

We are currently seeing a veritable boom in the establishment and planning of new sovereign wealth funds in Africa. Angola is planning to establish a fund separately from the Sonangol conglomerate, and it seems that newborn South Sudan intends to capitalise its oil reserves in the long term, forming a sovereign wealth fund with technical support from the Norwegian fund. Ghana established recently (2011) two new SWFs. Discussions for new funds is heating up in twelve African countries (Table 18). Countries such as Zambia, South Africa and Kenya are debating the benefits and risks for implementing these kinds of investment vehicles. Concretely, more than half of the new funds projects are African. Recent oil discoveries in Namibia, Mozambique, Uganda and Tanzania open up possibilities for new funds in the region. As an intriguing case, Rwanda created in 2010 a fund called "diaspora fund" (Agaciro Development Fund), it intends channeling remittances from Rwandans across this fund. We will see if this innovation comes to fruition.

$\frac{1}{n}$ Center for Global Development, 2011. See these two articles on direct distribution of revenues: http://

South-South Cooperation

One trend that might be seen in the next few years is a convergence of investment objectives between African and other sovereign wealth funds. One area in which both groups might find what they are looking for is infrastructure. According to World Bank information, Africa has an infrastructure gap of more than \$93 billion a year.

To plug this substantial gap, one could think in terms of three-tiered financing transactions in which the IFC would act as a catalyst. The local sovereign wealth fund could provide the expertise needed to undertake the transaction, the foreign sovereign wealth fund could contribute stable financing, and a third player, from the private sector, could carry out the execution of the infrastructure project.

This type of joint transaction involving more than one fund (South-South) has not been much in evidence to date, but it is a growing trend: the transaction carried out in Brazil with BTG Pactual with the involvement of funds from the UAE (ADIC), Singapore (GIC) and China (CIC); the recent collaboration between Mubadala of the UAE and 1Malaysia Development Berhad of Malaysia: with the creation of an \$8 billion joint venture which will serve to attract the global finance sector with interests in Southeast Asia, as well as aluminium production and derivative industries in Malaysia.

Infrastructures

Africa has an infrastructure gap estimate at \$93 billion a year. This is a fundamental necessity for Africa, which also represents one of the major barriers to investment. Despite the downturn that led to the crisis, the infrastructure gap exerts an attraction on potential investors. The UNCTAD estimates that returns on African FDI are the highest among emerging countries, which, if we accept the risk/return trade-off theory, implies that the investments are riskier.

Specifically, sovereign wealth funds have an ideal investor profile for an African infrastructure plan based on the private equity industry: they have a long time horizon and limited or sometimes even non-existent liabilities.

The involvement of sovereign wealth funds in some of these transactions would imply an assurance of solvency in the financial execution of the projects. It might prove to be the support needed to persuade the private sector to take part in these projects.

www.cgdev.org/doc/initiatives/Oil2Cash/EG_Goldman_Formatted_Version_Final.pdf y http://www.cgdev.org/content/publications/detail/1424714.

72 Information obtained on the fund's web site http://www.1mdb.com.my/news-2/mega-deals-abu-dbabi

8. Africa and sovereign wealth funds

Sovereign wealth funds' investments in Africa

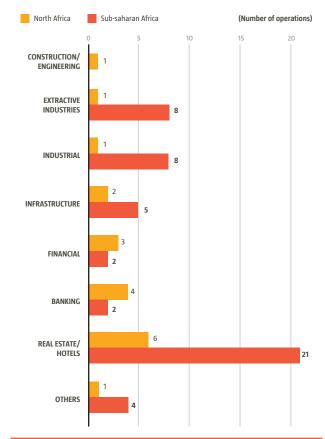
Towards the end of 2011, China Investment Corporation invested nearly \$240 million in Shanduka Group. Shanduka Group is a South African conglomerate with investments in non-renewable resources, financial services, real estate, energy and other sectors.

From a list of nearly 70 investments carried out by sovereign wealth funds in Africa, we find that the sector that has received the most investments is that of real estate and hotels, followed by industrial and then extractive industries. A regional analysis shows that the major part of sovereign wealth funds' investments in the continent is carried out in sub-Saharan Africa, centred on the three abovementioned sectors. The North for its part receives investment mainly in the banking and finance sector.

During 2011 Temasek set up a joint venture with the E. Oppenheimer family-office to invest in the African continent. With an initial capital of \$300 million, Tana Africa Capital focuses mainly on the consumer and agricultural sectors, although it is also open to new opportunities in this young continent.

This joint venture is not an isolated case of investment this past year: in March 2011 the US financial group Carlyle decided to venture into sub-Saharan Africa in sectors such as consumer goods, financial services, agriculture and infrastructure, while German giant Siemens plans to invest \$254 million in Africa in 2012⁷³.

Chart 35 Sovereign wealth fund's investments in Africa; breakdown by sector and region



Source: Thouraya Triki and Issa Faye, 2011. Africa's Quest for Development: Can Sovereign Wealth Funds help? International Finance Review 12, pages 263-290.

⁷³ Reuters, 2011. See http://af.reuters.com/article/investingNews/idAFJOE7740DV20110805.

China, a new emerging partner

Relations between Africa and China were given a boost in 2006 by the Forum on China-Africa Cooperation held in Beijing, where 48 heads of state (the only ones missing were the five that still maintained diplomatic relations with Taiwan) came together to study possibilities for greater integration between the two regions.

Chinese investment in Africa is slated to grow to \$50 billion by 2015, according to estimates made by Standard Bank, the leading bank in South and sub-Saharan Africa. This investment has a new characteristic: it focuses essentially on public-private concessions. China has won 50% of the public works initiated in Africa in the past few years. Chinese companies dominate the highway infrastructure throughout the continent⁷⁴. In this area SWF China Africa Development Fund plays a crucial role, as we shall see presently.

Bilateral trade between China and Africa is expected to reach \$300 billion in 2015, double the figure for 2010.

Companies such as Aluminium Corp. of China and China National Petroleum Corp. are looking to make acquisitions in mining sectors like iron ore, oil and copper. This is driven by the growth of China's economy and its demand for raw materials.

Between 2006 and 2011, 47% - more than \$39 billion - of the investments made by Chinese companies on the African continent went into energy or metals (mainly iron, steel and copper). Oil is the sector with the biggest deals: in 2010 China State Construction Engineering Corporation signed a contract with Nigeria National Petroleum for a value in excess of \$28 billion for the construction and financing of three refineries in Nigeria.

In 2011 four transactions of over a billion dollars each were carried out. The first one, worth about \$1.5 billion⁷⁵, was Chinese stateowned Shangdong Iron and Steel Group's purchase of a 25% stake in African Minerals, of Sierra Leone, for an iron ore project in the country and the associated construction of a railway line and a port to support growth in exports to Asia. Secondly, CNOOC (China National Offshore Oil Corporation) acquired 33% of Tullow Oil's Ugandan oil exploration and production operation, with French giant Total taking another 33%.

The third and fourth transactions concerned copper. In South Africa, China's Jinchuan Group acquired Metorex, the country's leading

copper producer, for \$1.4 billion. The last major deal of the year took place in September, with China's Minmetals' acquisition of Canada's Anvil Mining for \$1.3 billion. The main asset of this Torontobased company is its copper mine in the Democratic Republic of the Congo⁷⁶.

Along with these financial investments, investments are also often made in infrastructure to allow the African economies to increase their capacity, and this represents a legacy of potential development. To what extent can Africa leverage its commodities to plug the infrastructure gap that is having such a braking effect on growth?. Africa's path to growth will depend on the answer to this unknown.

Another sector in which Africa paradoxically has great potential is agriculture. China has just 9% of the world's arable land, but 16% of its population; China is now dependent on food imports.

This accounts for the increasing number of projects aimed at securing food supplies: in Mozambique, having leased land in the Zambezi valley, China hopes to provide work for more than 3,000 Chinese farm workers. With a view to boosting agriculture, an evaluation is underway of the region's hydrographical characteristics aimed at linking Lake Malawi with the rivers of Mozambique.

In Uganda, China has acquired more than 10,000 acres for farm production, while in Zambia it has applied to acquire two million hectares (roughly 4.9 million acres) for the production of biofuels.

2011 saw the completion of the African Union's headquarters in Addis Ababa, which was officially opened on 24 January 2012. With an investment de \$200 million, this 20-storey high-rise symbolises the power of Chinese investment on the continent.

In 2006, during the Forum on China-Africa Cooperation to which we have previously referred, President Hu Jintao announced eight measures to strengthen the new strategic alliance with Africa. The third of these eight measures, which seek to promote greater and closer bilateral cooperation, was the creation of the China-Africa Development Fund (CADFund).

CADFund has been operating since 2007. Its mission is to promote economic cooperation between China and Africa, and to facilitate Africa's economic development. The fund recently received an injection of \$2 billion ((bringing total AUM to \$5 billion) from the

⁷⁴ Since 2006 Chinese companies have won contracts worth \$7.8 billion in overland transport infrastructure (The Heritage Foundation, "China Global Investment Tracker", 2012, available at http://www.heritage.org/research/reports/2012/01/china-global-investment-tracker-2012).

75 Financial Times, 2011, at http://www.ft.com/intl/cms/s/0/d2863ade-bc49-11e0-80e0-

⁰⁰¹⁴⁴feabdc0.html#axzz1pUq3LUC0.

⁶ Financial Times, available at http://www.ft.com/intl/cms/s/0/9f85e210-5960-11e1-abf1-00144feabdc0.html#axzz1pUq3LUC0.

8. Africa and sovereign wealth funds

China Development Bank to increase its investments in Africa. This cooperation takes the form of direct investment in Chinese companies with operations in Africa. Many of the companies that have won competitive public bidding processes for infrastructure projects in the past few years have received investment from CADFund.

The fund's investment policy focuses on four sectors: agriculture, manufacturing, infrastructure and related industries (electrical, transport, telecommunications, etc.) and natural resources. The fund also invests in the industrial estates established by Chinese companies in Africa. Investments are undertaken with a view to making a profit, and to this end the fund's governance is in line with market standards. CADFund invests in companies at all levels of development: from start-ups to mature companies⁷⁷.

Five years on from its inception, this private equity fund has yet to complete a successful disinvestment. Investing in Africa is proving more difficult than the fund managers initially foresaw. New complications have arisen, with workers being kidnapped and the recent expulsion of a managing director. To face up to these situations, Chinese companies have started to operate in tandem with entities of other nationalities with experience in the region; such is the case of CNOOC with Total in Uganda and of Chinalco with Rio Tinto in Guinea⁷⁸.

The fund has helped Chinese companies to build a power plant in Ghana, a port in Nigeria and cotton farms in Malawi and Mozambique. In all these transactions the fund took a noncontrolling stake in the company. The fund plans to receive an additional \$2 billion from China Development Bank at the next Forum on China-Africa Cooperation, which will take place before the end of 2012.

Conclusion

The sovereign wealth funds and Africa have before them a decade (2010-2020) of potential interaction. Sovereign wealth funds from other regions of the world are looking to Africa in search of resources (energy and food, mainly) that their countries need in order to maintain high growth rates in their economies. But we have also observed that sectors such as tourism, telecommunications and real estate are starting to arouse the interest of these new global investors. African countries have before them the challenge of making good use of the influx of financial resources to diversify their economies. They need to build models for sustained growth to lift them out of the paradox of abundance in which they may find themselves trapped due to their dependence on natural resources.

African sovereign wealth funds, both present and future, have other challenges before them: adopting rules of corporate governance that ensure real independence from short-term political interests and promote appropriate incentive structures (in this, certain funds have been advised on their design and implementation by experts from highly regarded funds such as those of Chile and Norway); training of investment heads; interaction with the development banks, private funds and sovereign wealth funds from other regions to promote large-scale infrastructure projects (in this regard, the infrastructure facilitating integration of African economies is of vital importance). Similarly, African countries receiving investment must seek gradually to move up the value ladder, rung by rung. In doing so they can look at what has been achieved by other sovereign wealth funds, such as the UAE's Mubadala fund, to have an effective impact on the development of their economies.

China Development Bank, 2011: http://www.cdb.com.cn/english/Column.asp?ColumnId=176.
 Reuters, 2011: http://www.reuters.com/article/2012/02/24/us-china-africa-idUSTRE81N06J20120224.



Interview with Fabio Scacciavillani, Chief Economist, Oman Investment Fund

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9. INTERVIEW WITH FABIO SCACCIAVILLANI, CHIEF ECONOMIST, OMAN INVESTMENT FUND

Fabio Scacciavillani, a Ph.D. in Economics from the University of Chicago, is the Chief Economist and member of the Investment Committee of the Oman Investment Fund. In his career he served as Director of Macroeconomics and Statistics at the Dubai International Financial Centre, Executive Director at Goldman Sachs, Senior Economist and Adviser at the European Central Bank and held several positions at the International Monetary Fund.

In 2012, he published with Masimiliano Castelli "The New Economics of Sovereign Wealth Funds" (Wiley). The book makes a detailed analysis of the SWF's activities and their relation with global finance. From the economics of their funding source and the fears raised in Western politicians, the book explains the influence of SWFs in today and future global economy.

OIF was established in 2006 to invest in long- and medium-term projects within and outside Oman. The Oman Investment Fund is a SWF with a mandate to transfer the revenues from Oman oil exports to future generations. Over the years the OIF has built a globally diversified investment portfolio including Real Estate and Private Equity assets across various sectors. There is not estimation about the assets under management OIF holds.

Proposed questions

As this report is mainly focused in Spain's relationship with SWFs, which is the image Spain has in Middle-East's countries as a potential target for investment?

At the moment, viewed from outside Europe, the situation not only in Spain, but also in the rest of Euroland, including the so called core countries, raises serious concerns. In essence the diagnosis on the cause of the crisis is completely missing and therefore no coherent set of solutions is emerging beyond periodic squabbles and half baked measures. We observe dismayed an endless stream of EU summits that at best try to react to the increasingly graver events, but are unable to forge a consensus on a long term strategy.

The crisis in Europe stems from the political folly of trying to counter a long term economic decline by raising public and private debt well beyond a sustainable level. Bail outs from the EU and the IMF are bound to fail as they did in Greece, unless governments re-establish the conditions for a return to efficiency and productivity gains in the private sector and drastically cut waste in the public sector. Unfortunately politicians continue to refrain from harshly confronting powerful interest groups among civil servants and in the banking sector.

Europe is suffering a deep crisis, which investment opportunities may arise for a SWF as OIF in this context?

At present perspectives in Europe are dim. A global asset manager can find more attractive opportunities in emerging markets rather than in mature economies. Furthermore, from several quarters demagogues of all stripes are mounting a hate campaign against "finance" which is extremely worrisome for foreign investors fearful of being exposed to expropriation risk (as Spain has painfully learned in the case of YFP) or political backlash.

Some funds, e.g. Mubadala in the Middle East, have been embarked into a national strategic transformation of their economies. Are other SWF also pursuing strategic national objectives in their investments?

SWFs have different mandates. Some focus predominantly on domestic development, others more on intergenerational wealth transfer. The demarcation line between the two approaches is often blurred and might change depending on circumstances. OIF has a very broad mandate and in general evaluates opportunities based on their merit, irrespective of the location.

It is often underscored that stronger South-South relationships are taking place in the global economy. How does this process affect SWFs?

SWFs are one of the main vehicles for South-South relationships. In general they are a powerful element behind the emergence of a multipolar world and a transition to a decentralized financial sector (as opposed to the Hub and Spoke model with London and New York as their pinnacles). Since SWFs focus on long term drivers of growth, such as demographics, natural resources, urbanization of the middle class, logistic and international trade, they are more inclined to explore opportunities in corners of the world where these factors, demography in primis are strongest and will have a long lasting impact.

Given the high demand for natural resources in the last years and therefore higher prices in commodities, regions as Latin America or Africa are establishing SWFs. Do you consider them as potential partners in their home countries?

Yes. SWFs tend to have a similar investment horizon, do not face redemptions, and are willing to venture into illiquid markets.

A partnership among SWFs would be an excellent vehicle for tapping opportunities that would be hard to detect from afar.

Furthermore, closer and stable relationships could be instrumental in strengthening broader bilateral relationships between countries.

Given those growing South-South linkages, have you co-invested with other SWFs? Do you have the intention to do so? Which difficulties should be overcome?

We have had contacts with other SWFs, but we are at an initial stage of a much broader process. I know that other SWFs are on our same wavelength, but I guess that a major obstacle so far has been the coordination of decision procedures. With time I expect this not to be an overriding impediment. It would also be beneficial to establish a Forum where SWFs could share experiences and analyses. So far there have been several occasional initiatives in this sense, but a more structured approach would be desirable.

It is said that Africa represents the next investment frontier. Special attention from international investors has received the infrastructure sector. Also, from their long-term investment profile, SWFs fit well with these investments. Would you agree?

Yes Africa is in the mind of many the last frontier. China's demographic wave is ebbing, India's is about 15-20 years behind China, while Africa's population is still expanding strongly. This will be the last demographic wave before the world population will stabilize around the mid of the century. So Africa is a major focus for investors with high risk tolerance, although the governance shortcoming and the backwardness of the financial system are holding back its potential.

You used the expression "barbarians at the gates" to refer to Sovereign Wealth Funds image in the West; so, what challenges SWFs have faced, or which strategies has been used, in building its reputation in the West?

I perceive that the attitude in the West has changed from a few years ago. The hysteria and nationalistic overtones have subsided especially because the public opinion has realized that the activity of the SWFs brought benefits to companies and economies. Now SWFs are openly courted by governments and firms, hence such a better atmosphere should be conducive to progress also on open issues such as transparency and reciprocity of foreign investments treatment

Economist, Oman Investment Fund



Appendix. ESADEgeo ranking - Sovereign wealth funds 2012

Appendix. ESADEgeo ranking - Sovereign wealth funds 2012

Appendix.	ESADEgeo	ranking -	Sovereign	wealth	funds 2012*

	Government Pension Fund Global	654,00	Norway	1990
	SAMA Foreign Holdings	577,70	Saudi Arabia	1952
	Exchange Fund	497,60	Hong Kong SAR, China	1993
	China Investment Corporation	482,00	China	2007
	Abu Dhabi Investment Authority	450,00	UAE	1976
	SAFE Investment Company	324,00	China	1997
	Kuwait Investment Authority	290,00	Kuwait	1953
	Government of Singapore Investment Corporation	260,00	Singapore	1981
	Temasek Holdings	158,70	Singapore	1974
)	National Social Security Fund	136,00	China	2000
	Qatar Investment Authority	135,00	Qatar	2005
2	National Wealth Fund	 85,85	Russian Federation	2008
3	Samruk-Kazyna ^		Kazakhstan	2008
1	Australian Future Fund	77,01	Australia	2004
· 5	Investment Corporation of Dubai ^	70,00	UAE	2006
 5	Libyan Investment Authority	62,96	Libya	2006
, ,	Revenue Regulation Fund ^	56,70	Algeria	2000
3	International Petroleum Investment Company	49,00	UAE	2000
9	Mubadala Development Company PJSC	48,20	UAE	2000
<u> </u>	Korea Investment Corporation			2002
0 1		42,80	Korea, Rep.	
	Alaska Permanent Fund	42,40	United States – Alaska	1976
2	Kazakhstan National Fund	41,60	Kazakhstan	2000
3	Brunei Investment Agency	39,00	Brunei Darussalam	1983
4	State Oil Fund of Azerbaijan (SOFAZ)	32,60	Azerbaijan	1999
5	Texas Permanent School Fund	26,90	United States — Texas	1854
6	Strategic Investment Fund ^	25,89	France	2008
7	Oil Stabilisation Fund	23,00		
8	Khazanah Nasional Berhard	22,02	Malaysia	1993
9	New Zealand Superannuation Fund	19,60	New Zealand	2001
0	Heritage Fund	15,90	Canada	1976
1	New Mexico State Investment Council	15,20	United States — New Mexico	1958
2	Fondo de Estabilidad Económica y Social (FEES) ^	14,79	Chile	2007
	National Pensions Reserve Fund	13,90		2001
4	Timor-Leste Petroleum Fund	10,60		2005
5	Sovereign Fund of Brazil	10,05	Brazil	2008
6	Emirates Investment Authority	10,00	UAE	2007
7	Abu Dhabi Investment Council	10,00	UAE	1999
8	Bahrain Mumtalakat Holding Company BSC	9,00	Bahrain	2006
9	State General Reserve Fund	8,20	Oman	1980
0	Pula Fund		Botswana	1994
1	Fondo de Reserva de Pensiones		Chile	2006
2	Permanent Wyoming Mineral Trust Fund	5,60	United States — Wyoming	1974
3	China-Africa Development Fund	5,00	China	2007
<u> </u>	Heritage and Stabilization Fund		Trinidad and Tobago	2007
" 5	Italian Strategic Fund ^	4,00	Italy	2000
5 6	Public Investment Fund	4,00 3,90	Saudi Arabia	2008
о 7	1Malaysia Development Fund Bhd (1MDB)			
		3,20	Malaysia Mayritius	2009
8	Mauritius Sovereign Wealth Fund	3,00	Mauritius	2010
9	Alabama Trust Fund	2,48	United States — Alabama	1985
0	Ras Al Khaimah (RAK) Investment Authority	2,00	UAE	2005
1	Fonds de Stabilisation des Recettes Budgétaires ^	1,64	Democratic Republic of the Congo	2005
2	Fondo para la Estabilización de los Ingresos Petroleros (FEIP) ^	1,60	Mexico	2000
3	Fondo de Ahorro de Panamá (FAP)	1,20	Panama	2011
4	Nigerian Sovereign Investment Authority	1,00	Nigeria	2011
5	Fondo para la Estabilización Macroeconómica (FEM) ^	0,80	Venezuela	1998
6	Palestine Investment Fund	0,80	Palestine	2003

57	Fondo Soberano de Colombia	0,70	Colombia	2011
58	State Capital Investment Corporation	0,60	Vietnam	2006
59	Revenue Equalization Reserve Fund	0,40	Kiribati	1956
60	Sovereign Fund of the Gabonese Republic ^	0,40	Gabon	1998
61	National Fund for Hydrocarbon Reserves ^	0,30	Mauritania	2006
62	North Dakota Legacy Fund	0,30	United States — North Dakota	2011
63	Government Investment Unit ^	0,30	Indonesia	2006
64	Oil Revenue Stabilization Fund (ORSF)	0,15	Sudan	2008
65	Fund for Future Generations ^	0,08	Equatorial Guinea	2002
66	Ghana Stabilization Fund ^	0,06	Ghana	2011
67	Human Development Fund ^	0,05	Mongolia	2008
68	National Investment Fund	0,040		2012
69	Ghana Heritage Fund ^	0,014	Ghana	2011
70	Permanent Fund for Future Generation	0,009	São Tomé and Príncipe	2004
71	Stabilization Fund ^	0,003	Mongolia	2011
72	Oman Investment Fund	N/A	Oman	2006
73	Oman Investment Corporation	N/A	Oman	2005
	Total (Trillions of dollars)	4.981,64		

Source: ESADEgeo (2012). We have compiled this information looking first at the reports released by each fund through their websites. When we need to estimate we use, among others, the following reliable sources: Ashby Monk (Oxford Project, now at Institutional Investor), Sovereign Investment Lab (Bocconi University), Monitor Group and GeoEconomica.

74	Slovenia SWF	N/A		N/A
75	Papua New Guinea SWF	N/A	Papua New Guinea	N/A
76	Japan SWF	N/A	Japan	N/A
77	India SWF	N/A	India	N/A
78	Israel SWF	N/A	Israel	N/A
79	Peru SWF	N/A	Peru	N/A
80	South Africa SWF	N/A	South Africa	N/A
81	Lebanon SWF	N/A	Lebanon	N/A
82	Fundo Soberano Angolano	N/A	Angola	N/A
83	Bolivia SWF	N/A	Bolivia	N/A
84	Tunisia SWF	N/A		N/A
85	Kenya SWF	N/A	Kenya	N/A
86	Uganda SWF	N/A	Uganda	N/A
87	Zambia SWF	N/A	Zambia	N/A
88	Mozambique SWF	N/A	Mozambique	N/A
89	Namibia SWF	N/A	Namibia	N/A
90	Zimbabwe SWF	N/A	Zimbabwe	N/A
91	Rwanda SWF	N/A	Rwanda	N/A
92	Tanzania SWF	N/A	Tanzania	N/A
93	Liberia SWF	N/A	Liberia	N/A
94	Guatemala SWF	N/A	Guatemala	N/A

[^] Following the definition set by Capapé, Aguilera and Santiso (2012), these SWFs would be excluded from this ranking (i.e., funds fully devoted to stabilization duties; those focused solely in domestic assets or just in risk-free assets).

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Chart 15, 16, 20, 21 y 23

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