Teaching Plan: Europe and Latin America's Investment Relationship & Sovereign Wealth Funds

Duration: 3 hours [2 hours and 45 minutes of lesson to incorporate a 15 minute break]

Lesson Objectives:

After completing the lesson, the student will be able to:

- Analyze and explain the current investment relationship between the EU and Latin America, (particularly Spain's role) and be capable of analyzing current and future events related to this relationship.
- Define a Sovereign Wealth Fund (SWF), explain its characteristics in today's context, and provide examples of its structures and actions.
- Articulate the pros and cons of SWFs from the European perspective.
- Identify the key SWF investment-related opportunities for Europe.

Target Audience: Masters-level students from the EU interested in finance and economics

Classroom Size: 20-40 students

Materials: Teaching Plan, PowerPoint slides, and reading materials

Student Preparation:

Before class, each student will complete the following assignments:

1) Read the chapter titled "Sovereign Wealth Funds: A Growing Financial Firepower" in *The Global Context: How Politics, Investment, and Institutions Impact European Businesses*.
2) Skim the *Sovereign Wealth Funds 2014* report.
3) Search for and read news articles published in the last three years about European investment in Latin America.

2 minutes

❖ **[slide 1] Welcome**

10 minutes

❖ **Hook**

➢ **[slide 2]** Tell the students that A.T. Kearney (a global management consulting firm) creates an annual FDI Confidence Index.

- Ask a student to define the term "Foreign Direct Investment" (FDI). Ask if any other students have anything else to add to the definition. Correct any inconsistenies.
- Explain how the Index is created.
  - It is constructed using primary data from a proprietary survey administered to senior executives of the world's leading corporations (spanning all sectors and representing 27 countries). More than one-third of respondent companies were headquartered in developing countries.
  - The Index is calculated as a weighted average of the number of high, medium, and low responses to questions of direct investment in a market over the next three years.
  - The FDI flow figures are the latest statistics available from the United Nations Conference on Trade and Development (UNCTAD). Other secondary sources include investment promotion agencies, central banks, ministries of finance and trade, and major periodicals.
  - Using the data, A.T. Kearney produces a country ranking on how political, economic, and regulatory changes are likely to affect FDI inflows in the coming years.

➢ Have the students guess the top 10 countries on the 2015 A.T. Kearney FDI Confidence Index list.

- Start with the first ranked country (i.e., United States). As the students guess countries for each ranking, uncover the country name by clicking next on the powerpoint presentation.

➢ **[slide 3]** Note that 3 European countries (i.e., UK, Germany, and France) are in the top 10 countries with the highest assessment of present and future prospects for international investment flows.

2 minutes

❖ **[slide 4] Provide the road map for the lesson**

30 minutes

❖ **Content: Investment Relationship between Europe and Latin America**

Method: Engaging Lecture & Case of Spain

➢ **[slide 5] Context: European Investment**

- Show the students the map: "Outward stocks of FDI, EU-27, end 2012." The pie graph is the same data. Briefly walk through the monetary values of EU-27's investments in other regions and the corresponding percentages of the total value.
  - Latin America comprises 16% of the pie.

➢ **[slide 6] European investment in Latin America**

- Ask for 3 student volunteers to talk about what they read about European investment in Latin America in preparation for class. Encourage discussion amongst the other students. Include any additional information you may have.

- **[slide 7]** Ask the students which two European countries are the largest investors in Latin America
  - Correct answer: Netherlands & Spain
  - The Netherlands
    - The Netherlands has now become the largest single investor in Latin America and the Caribbean, accounting for 20% of all attributable inflows, up from 14% in 2013. The share of the United States in FDI inflows, meanwhile, fell to 17%, down from 20% in 2013 and 25% in 2012. (ECLAC 2015) Note, however, that in the past 15 years or so, the U.S. has typically been the top investor in the region.
    - The Netherlands' strong investment position in Latin America is in part due to its role as a conduit for investment from other countries (e.g., SPVs) (ECLAC 2013)
    - The Netherlands' investment in Brazil is particularly strong (#1 investor)
  - Show the graph: "Latin America (selected countries and subregions): origin of foreign direct investment, 2014" to visually represent which countries Europe is investing in and how their

investments compare to investments from other regions in the world.

- **[slide 8] Case: Spain**
  - Second largest investor in Latin America among European countries.
  - Spain continues to be highly committed to the region
    - From 2003 to 2013, the top two foreign companies with the highest shares of announced FDI in Latin America were Spanish companies (1. Telefónica; 2. Repsol YPF)
    - The table on the powerpoint, "Spain: Top-Outward FDI Stock by country EUR Millions," shows that Spain is investing in multiple Latin American countries. The nominal euro amounts went up between 2011 and 2012 for each of the countries, except Brazil and Argentina.
  - **[slide 9]** Spain positioned as a gateway to Latin America
    - Discuss Invest in Spain's 5 main points about why Spain is an attractive hub for doing business in Latin America
      - Common historical, cultural, and linguistic roots. Institutional network relationships.
      - Strong economic and business ties: Spanish companies have invested in strategic sectors in Latin America (banking, utilities, communications and transport, building industry, airport management, etc.)
      - Good communications: Spain is a major connecting hub for airlines traveling between America, Europe and the Middle East
      - Spain has become the European HQ for Latin American multinational companies
      - Multinational companies are increasingly choosing Spain for their Latin American headquarters
      - **[slide 10]** Picture of logos of multiple multinational companies that are managing their operations in Latin America or the EU from Spain
      - Additional point: Latin American development banks have begun extending credit to Spanish firms (Economist)

- **[slide 11] Latin American investment destinations**
  - Shifting away from the US and toward Europe
  - Summarize the following information about Latin American investment in Europe (ECLAC 2011):
    - "Investment by trans-Latins in the European Union has jumped in recent years, from between US$ 2 billion and US$ 2.5 billion during the period 2006-2009 to a record US$ 12 billion in 2010"
      - Show the graph on the PowerPoint

        Note: "The statistics show only FDI flows from Brazil, Chile and Colombia to European Union countries. Among the countries with substantial investments abroad, Mexico is the only one missing: it does not publish official information on outbound FDI by destination."
    - "In just five years the region has invested upwards of US$ 20 billion in European Union countries.

      Brazilian investments make up the bulk of this figure, at approximately 71% of Latin American investment in the European Union between 2006 and 2010, followed by Colombia (18%) and Chile (11%).

      In aggregate terms, 13% of the investments made by transnationals from Brazil, Chile and Colombia between 2006 and 2010 went to the European Union.

      The bulk went to the United States and Canada (29%) and Latin America itself (28%)."
  - **[slide 12] Latin American investment in Spain**
    - Increasing interest to invest in Spain from companies in Latin America (especially from Mexico, Brazil, and Colombia)
      - Show the Latin American countries in the table ("SPAIN Inward FDI stock by country (EUR Millions)")
    - Examples:
      - As of January 2014, Brazil accounted for almost a quarter of Santander's global profits; Mexico accounted for two-fifths of profits at BBVA, another Spanish bank (Economist)
      - More Latin American multinationals are conducting European and int'l operations from Spain, e.g. AjeGroup (Peru)

- Ask the students if they have any **questions or comments** about the investment relationship between Europe and Latin America.

33 minutes

❖ **Content: Introduction to Sovereign Wealth Funds (SWFs)**

Method: Five Ws Lecture complemented by diagram drawing and estimations

- **[slide 13]** Tell the students that you will now walk through the What? When? Where? Why? Who? and How? of SWFs.

- **[slide 14] What?** (8 minutes)
  - A SWF is a government-owned investment fund, typically financed by current account surpluses or commodity revenues (e.g., oil, gas, and copper), yet internationally oriented in terms of investment scope.
  - Click next to show the multiple-layer onion definition of a SWF. Discuss the various aspects of SWFs using the image as a guide.

- **[slide 15] When?** (3 minutes)
  - Swiss central banker Philipp Hildebrand argues that the French Caisse des Dépots et Consignations (founded in 1816), an independent investment vehicle designed to manage government savings and pensions, was the first actual sovereign wealth fund. General consensus, however, places the Kuwait Investment Authority (founded in 1953) as the first of the more modern and active kind of SWFs.
  - In 2005, Andrew Rozanov was the first to coin the term "sovereign wealth fund" (SWF), seeking to differentiate and delineate a new breed of state-owned funds from traditional central bank reserves in foreign currency.

- **[slide 16] Where?** (25 minutes)
  - Ask the students to guess which countries and/or regions are the main SWF players.
    - Tell them the answer (Norway, Middle East, China, and Southeast Asia) as you click next to pull up the map on the PowerPoint.

- Ask the students to get into pairs and discuss for 2 minutes what these countries have in common (telling them that the commonalities fall under two categories). Then ask students to share their answers with the class.
  - Answer: They are either high-growth countries receiving significant foreign direct investment for industrial exports, or are exporters of oil and/or natural gas
- Explain that these SWFs are investing in companies worldwide, but Europe is one of the major destinations.
  - Europe was the main recipient of SWF investment in 2011
  - In 2012, nearly $10 billion was invested in Spanish companies
  - SWFs are opening offices in Europe

➢ **[slide 17] Why?** (6 minutes)

- Ask a student to define the term "Dutch disease." Ask if any other students would like to add to the definition. Correct any inconsistencies.
  - "Dutch disease is the negative impact on an economy of anything that gives rise to a sharp inflow of foreign currency, such as the discovery of large oil reserves. The currency inflows lead to currency appreciation, making the country's other products less price competitive on the export market. It also leads to higher levels of cheap imports and can lead to deindustrialization as industries apart from resource exploitation are moved to cheaper locations." (Financial Times)
- Ask if any student can think of any countries which are resource rich but have experienced Dutch disease. Similarly, ask if there are any resource rich countries who have not experienced Dutch disease.
  - Note: the pictures on the slide are from Norway and Venezuela, two countries that will be discussed later
- Conclude the discussion by saying SWFs can play the role of insulating the domestic economy from large sources of wealth, which might otherwise cause a distortion in the economy
  - Ex. SWFs have played an important role in stabilizing the financial system in OECD countries

- "In OECD countries, Norway, through the Government Pension Fund (formerly the Petroleum Fund), has been one of the most successful examples of this strategy. Similar oil funds in Kazakhstan or the Pula Fund from Botswana are other examples of SWF looking to invest their wealth in asset classes outside the commodity cluster in order to reduce the macroeconomic exposure of their countries to commodity fluctuations (oil and gas in the case of Kazakhstan, diamonds in the case of Botswana)." (OECD)

➢ **[slide 18] Who?** (5 minutes)

- Tell the students that SWFs are the largest investors on earth
- Click next to show the following sentence that includes blank spaces on the screen. Ask the students to guess the numbers the blank spaces represent.
  - _____ *(how much money (US$)?)* are in the hands of around _____ (*how many?)* different SWFs.
  - Correct answer:
    - $7 trillion in the hands of around 80 different SWFs.
- Move on to the 2nd sentence only after the students have guessed the numbers for the first sentence and you have shared the correct answer.
  - The top ten SWFs manage _____ *(what percentage?)* of the $7 trillion.
  - Correct answer:
    - The top ten SWFs manage 80% of the $7 trillion.

➢ **[slide 19] How?**

- Ask the students to guess which four sectors the SWFs mostly invest in. Ask students who have yet to share any guesses to keep the whole class engaged.
  - Answer: financial services, real estate & construction, commodities, and infrastructure
  - Briefly summarize the interactions between SWFs and these sectors

- For more information, see: Santiso, Javier, Javier Capapé, and Tomás Guerrero. "Sovereign Wealth Funds: A Growing Financial Firepower." In *The Global Context: How Politics, Investment, and Institutions Impact European Businesses*, edited by Javier Solana and Angel Saz-Carranza, 66-85. Barcelona, Spain: ESADEgeo, 2015.

25 minutes

❖ **Content: European perspective on SWFs**

Method: Debate of the Pros vs. Cons

➢ **[slide 20]** Divide the students into two groups (Pros vs. Cons) [with a larger group of students, consider making two Pros groups and two Cons groups]. For 5 minutes, Group 1 (Pros) will brainstorm the benefit of SWF investment in Europe from the European perspective and Group 2 (Cons) will brainstorm the drawbacks/concerns of SWF investment in Europe from the European perspective.

- Give the groups each 3 minutes to present to the class their discussion outcomes
- Then ask the groups to rebuttal any points that they don't agree with.

- Regardless of whether the students bring up the following topics, share this information with the class:
  - Political motives
    - Some research shows that SWFs have not demonstrated that they are acting with political motives.
    - Other research finds that they are unable to reject the hypothesis that, on average, SWFs invest in private equity with political motivations in mind. This leaves room for some SWFs to gain politically through potential corporate governance conflicts.
  - To meet the demands for greater transparency, SWFs from 23 countries met in Santiago de Chile in October of 2008 to draft and sign the Santiago Principles
    - Explain and critique the Santiago Principles

25 minutes

❖ **Content: The Paradox of Plenty: Norway vs. Venezuela**

Method: Case

➢ **[slides 21-24] Brief introduction**

➢ **[slide 25]** Review the **key indicators** of each country (population, GDP, etc.)

➢ Both Norway and Venezuela are resource rich

- **[slide 26] Norway**:
  - Largest holder of crude oil and natural gas reserves in Europe
  - 3rd largest oil-exporting nation in Europe
  - World's 3rd largest natural gas exporter in 2014 (after Russia and Qatar)
  - Supplies around 20% of Western Europe's gas needs
    - Click next to show the pie graph "Norway crude oil and condensate exports by destination, 2014" and reference how much of the resources are going to Europe
- **[slide 27] Venezuela**:
  - Contains some of the largest oil and natural gas proven reserves in the world
  - Owned 25% of OPEC proven oil resources in 2014
    - Reference pie graph on slide
  - 3rd largest exporter of crude oil to the United States in 2013
  - World's 9th largest exporter and 12th largest producer of petroleum and other liquids in 2013
  - Venezuela's oil revenues account for about 95% of export earnings. The oil and gas sector is around 25% of GDP.
  - 2nd largest natural gas reserves in the Americas, behind the United States. Much of the natural gas is used to bolster production in its mature oil fields.

- **[slide 28] Key SWF descriptions**

  - **Norway**'s Government Pension Fund Global (GPFG):
    - Market value of around $900 billion
    - Owns 1.3% of the world's listed companies
    - Taken a deliberate decision to give preference to investments in European companies and to penalize stakes in North American, especially U.S., companies (Sovereign Wealth Funds 2014)
    - One of the world's most transparent SWFs and with the best corporate governance (Sovereign Wealth Funds 2014)
  - **Venezuela**'s Macroeconomic Stabilization Fund (FEM):
    - Market value of around $1 billion
    - In December 2001, the fund had about $7.1 billion in assets, but in 2003, the government tapped into the fund to cover the fiscal budget; more than $6 billion was withdrawn. (SWF Institute)

- **[slide 29] Differences in outcomes**

  - Ask the students what have been the outcomes of the resource richness in both countries. Follow up with any additional outcomes the students do not mention.
    - **Norway**
      - Strong institutions
      - Creation of a successful SWF
    - **Venezuela**
      - Dutch disease; Venezuela has not been able to use its huge amount of richness to improve wealth and education of its population
  - Ask the students to look beyond economics to other factors that are in play
  - Show the comparison of index scores found on the slide: Democracy Index, Human Development Index, etc.

25 minutes

❖ **Content: SWF Investment-related Opportunities for Europe**

Method: Group brainstorming followed by sharing with the class

➢ **[slide 30]** Divide the students into 4 groups (real estate, infrastructure, private equities, and human capital) .

Have each group brainstorm for 4 minutes about SWF investment-related potential opportunities for Europe in the sector they were assigned.

Then have each group share with the class what they discussed.

Allow students to ask each other questions.

Ask questions of your own. Use the below information as a guide as to some of the points that could be discussed:[1]

➢ **[slide 31] Real Estate**

- "Since the mid-70s, sovereign investors have poured over $65 billion into the European property markets, half of which was invested in the last three years (Sovereign Wealth Center). Aside from the UK, which was allocated almost $40 billion, these funds have acquired numerous properties and real estate portfolios in France, Italy, Germany, Switzerland, and Spain, amongst others."
- Largest investors are the usual suspects in the SWF space:
  - ADIA
  - Qatar Investment Authority (QIA)
  - Kuwait Investment Authority (KIA) from the Middle East
  - Government of Singapore Investment Corporation (CIC)
  - SAFE from China
- "Sovereign investors will likely continue to focus on developed locations, but given the overcrowded status of London and Paris, they have started to eye European secondary cities such as Manchester, Barcelona, or Milan, in an effort to gain the "first-mover" advantage."
- "From the inbound perspective, this may represent a great opportunity for some of the European financial institutions holding large portfolios of non-core real estate assets and/or those in need of liquidity.

[1] López, Diego. "The Major Role of Sovereign Investors in the Global Economy: A European Perspective." In *The Global Context: How Politics, Investment, and Institutions Impact European Businesses*, edited by Javier Solana and Angel Saz-Carranza, 86-109. Barcelona, Spain: ESADEgeo, 2015.

Depending on the investor's risk profile, it may also scope out additional options such as distressed commercial properties, industrial and logistic portfolios, hospitality assets or developments in peripheral European cities."

- **[slide 32] Infrastructure**
  - Foreign investors were banned from acquiring European airports, ports, and highways until very recently.
  - "The financial crisis changed it all. Governments from the UK first, followed by continental Europe, started to raise money from the partial sale of their national champions. In fact, it has not been uncommon since then for European heads of state to lead roadshows to the Middle East, Singapore, and China."
    - Reference the pie graph on the slide to show today's "Recipients of Infrastructure FDI in Europe"
  - Non-European sovereign entities now own (but do not operate) some of the main European structural assets, including:
    - Airports (Heathrow, Gatwick, Budapest, Rome, and Aena)
    - Power and utilities conglomerates (Iberdrola, GDF Suez, EdP, Enel, Gassled, Kelda, Madrilena Red de Gas, and E.On)
    - Nuclear energy companies (Areva and Hanhikivi-1)
    - Highway operators (Atlantia)
    - Telecoms (Eutelsat and Telecom Italia)
  - "Sovereign investors are setting up direct infrastructure investment vehicles with strong teams of in-house experts that scan global opportunities on a daily basis. As they turn their attention to greenfield projects, there will be great opportunity for European governments, not only to raise money from the privatization of established companies, but also from developing infrastructure projects where the financial muscle of sovereign investors and the operational expertise of their partners can add an even greater value."

- **[slide 33] Private equities**
  - Private equities are generally associated with Small and Medium Enterprises (SMEs), i.e., the backbone of the European economy (European Commission)

  - 99 out of every 100 non-financial businesses in Europe are SMEs
  - Two of every three employees are employed at SMEs
  - 58 cents in every euro of value added are produced by SMEs
- "In addition to the efforts of the European Central Bank and the European Commission, and of several national SME funding programs, sovereign investors and private equity funds will continue to provide the market with liquidity."
- "In terms of industries, the acquisitions of sovereign investors in European healthcare are still relatively small. However, judging from the megatrends and demographic prospects of the continent, this could be one of the main industries of focus in the next few years, in addition to the always-preferred industrial products and consumer-related European companies."

➢ **[slide 34] Human Capital**

- Due to the financial crisis, thousands of skilled professionals – especially young graduates - have left the continent since 2008. Many of those resigning (or fired) from European investment banks have flown into emerging markets and joined SWFs.
- "This brain drain may be a blessing in disguise for Europe if, as in the case of China and Russia, it is reversed, luring these executives back to their home countries after having gained an invaluable experience investing in the global markets."
- At the same time, the new focus of sovereign investors on direct investments, alternative assets, and new geographies can represent an opportunity for European economies, in terms of sovereign investors' offices:
  - Although there are an increasing number of sovereign investors' offices in continental Europe, their presence is still insignificant.

10 minutes

❖ **Content: Summary of today's learning**

Method: Three-minute Paper

- **[slide 35]** Ask the students to write for 3 minutes about what they learned in today's session and why the information is important for EU businesses. Ask if any would like to volunteer to share their answers.

3 minutes

❖ **Conclusion**

- **[slide 36]** Answer any additional questions.

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