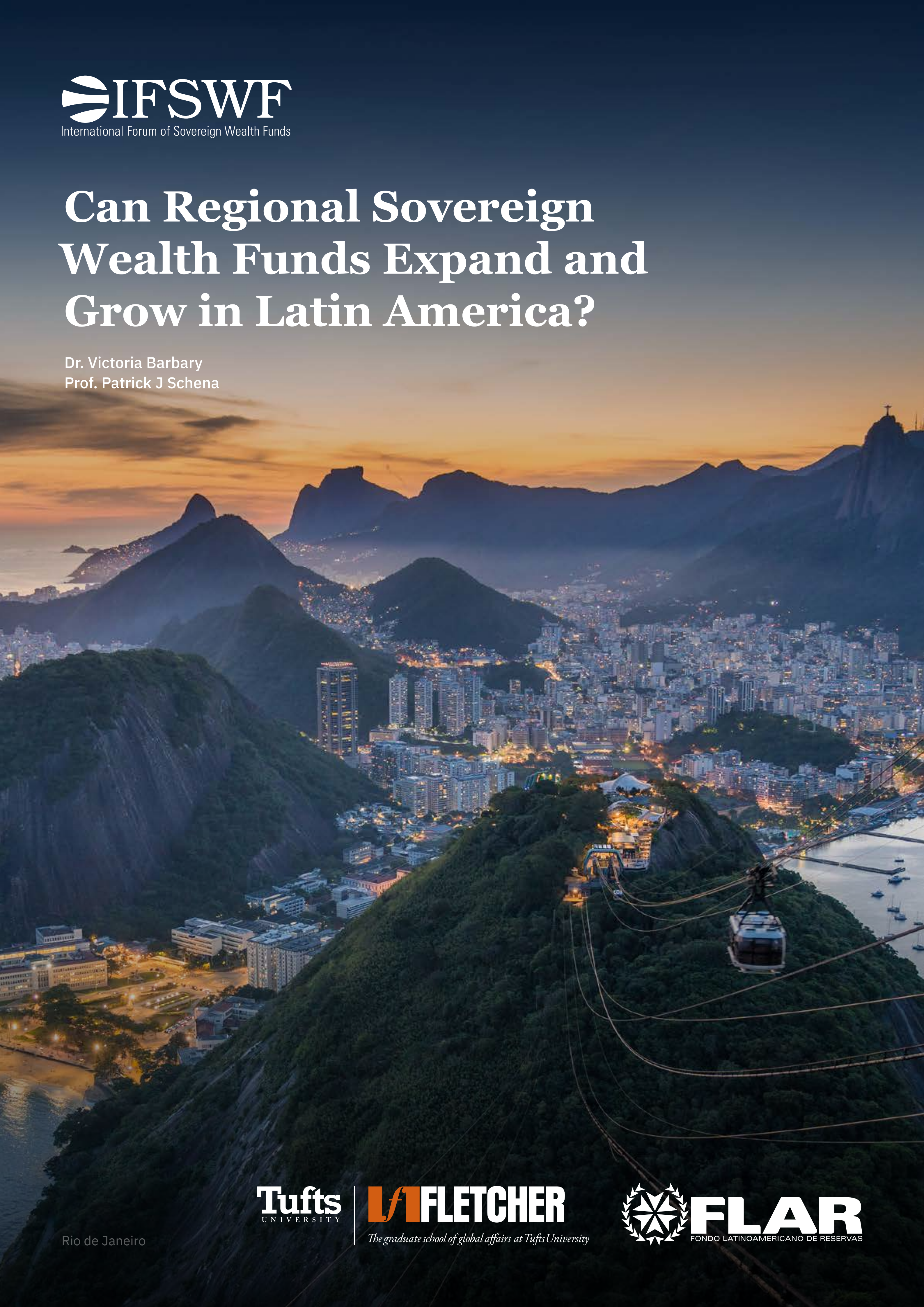
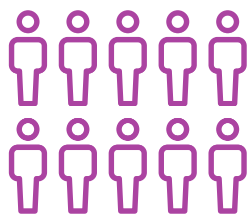


Can Regional Sovereign Wealth Funds Expand and Grow in Latin America?

Dr. Victoria Barbary
Prof. Patrick J Schena

When considering the global dispersion of sovereign wealth funds, particularly recently in Africa and South-East Asia, practitioners and academics share a common query: Why has Latin America lagged in establishing sovereign investment institutions capable of complementing the work of finance ministries and central banks in managing state assets to promote macroeconomic stability, intergenerational savings, or strategic national development?



Young population
50% under 30

Latin America is a continent that is rich in natural resources: oil and gas, metals, and critical minerals. Countries like Venezuela, Colombia, Brazil, and Mexico collectively account for nearly one-fifth of global oil reserves; Bolivia, Argentina, and Chile have over half of the world's lithium, and Chile has the world's largest deposits of copper.

The continent also boasts a young population, around half under 30. These endowments are both material and substantial when compared to other emerging economies, many of which have opted to establish sovereign wealth funds across a variety of mandates, from managing state financial assets to catalysing inward foreign direct investment (FDI), actively developing specific economic sectors and deepening local markets for both goods and capital.

The intent of this research[1] is first to examine the sovereign wealth fund experience as it has evolved in Latin America. We begin with a review of the current landscape. We next review roadblocks and risks – barriers and constraints – to establishing Latin American sovereign funds. Finally, we expand our lens to understand the role that sovereign funds could play in developing stronger and more stable economies in Latin America by expanding development pathways that include reducing poverty and economic inequality, bringing more workers into the formal economy, addressing climate change, and fostering new industries to strengthen sustainable regional growth.[2]

1 We recognise and thank Fondo Latinomericano de Reservas (FLAR), a regional financial agreement for Latin American central banks, supporting members' balance of payments through direct loans or guarantees, enhancing investment conditions for international reserves, and fostering harmonization of exchange rate, monetary, and financial policies among its member countries. Our research benefited from FLAR's support in facilitating interviews with its members' central banks and finance ministries, which provided unique, primary sources insights into the functioning of these institutions and the fiscal contexts in which they operate. The views and conclusions expressed in the study are strictly our own and may or not reflect those of any of the parties involved. We would also like to thank our research assistants, Nani Detti and Isha Vajpeyi at the Fletcher School for their work in supporting this project.

2 IDB Invest, Governors Approve Three Historic, Transformative Changes for the IDB Group to Support the Region, 11 March 2024

The Latin American Sovereign Wealth Fund Landscape

Santiago

The Santiago Principles, so-called because they were promulgated in Chile’s capital and adopted in 2008, acknowledged sovereign wealth funds as a “heterogeneous group, comprising fiscal stabilisation funds, savings funds, reserve investment corporations, development funds, and pension reserve funds without explicit pension liabilities”.

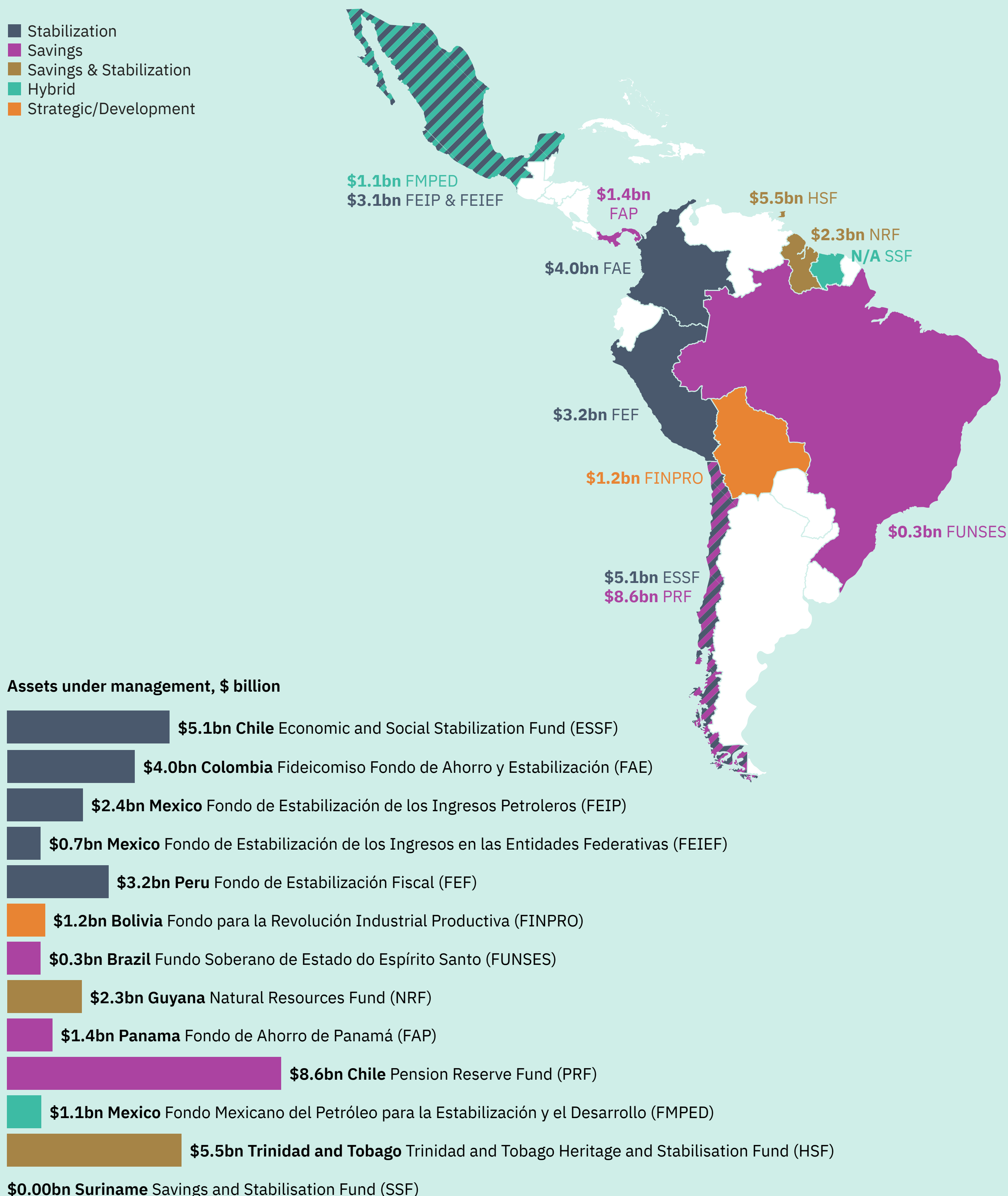
Nearly all **12 sovereign wealth funds** are traditional stabilisation funds

It is striking that, in Latin America today, there are 12 sovereign wealth funds, nearly all of which are traditional stabilisation funds, pools of capital that governments can draw on to manage the impacts of volatile fiscal flows (see Figure 1).

In other emerging regions, such as Africa, sovereign investment vehicles are much more heterogeneous, as governments have innovated on the traditional sovereign wealth fund models to help drive development in their home economies. According to IFSWF data, there are 18 sovereign wealth funds in Africa, of which 11 have some form of strategic or domestic development mandate, with five having a hybrid mandate, requiring them to fulfil more than one function.

That is not to say that pure-play stabilisation funds cannot make a valuable contribution to a commodity-rich nation. Stabilisation funds balance fiscal receipts and expenditures, saving in surplus years and paying out when receipts fall under prescribed withdrawal levels. By helping to smooth out commodity revenues, they can help governments avoid extreme peaks and troughs in fiscal cycles. In addition, governments also use stabilisation funds to help manage adverse currency impacts resulting from macroeconomic shocks. Given that their assets might be called upon at short notice, stabilisation funds are usually invested in liquid, low-risk assets and are typically managed by their countries' central banks or finance ministries.

Figure 1: Sovereign wealth funds in Latin America and the Caribbean (assets under management)



Source FLAR. Note: The values of assets under management vary by fund and are between June 2023 and April 2024.

Colombia's FAEP provided about **12.1 billion pesos** (about $3 billion) to FOME

The COVID-19 crisis effectively highlights the role and recent experience of stabilisation funds in supporting Latin American economies. In Chile, for example, where economic activity fell by 5.8% and unemployment rose to more than 10%, the Ministry of Finance withdrew more than $2 billion from Chile's Economic and Social Stabilization Fund (ESSF) to support the national budget. Chile likewise has a Pension Reserve Fund (PRF). During the pandemic, contributions to the PRF were suspended, and the fund was divided into two portfolios to ensure faster and less expensive access to resources under the fund.[3]

Among other Latin American sovereign wealth funds, Peru's Fiscal Stabilization Fund was also used to mute the negative impacts of the fiscal deficit caused by the pandemic. Similarly, Colombia used its stabilisation fund, Fondo de Ahorro y Estabilización (FAEP), to lend up to 80% of its resources to the Fondo de Mitigación de Emergencias (FOME), a fund created by the government to cope with the health and social emergency caused by the pandemic. The FAEP provided about 12.1 billion pesos (about $3 billion) to the FOME, which were used to finance various relief measures, such as providing subsidies, financing health equipment, and extending credit guarantees.[4]

Panamá established the Fondo de Ahorro de Panamá (FAP) in 2012 as a stabilisation mechanism in the case of state emergencies or economic slowdowns and to create a long-term savings vehicle for the country. FAP's funding includes 50% of any contributions from the Panama Canal Authority to Panama's National Treasury that exceeds 2.25% of nominal GDP for that fiscal year. It also includes earnings of the Fund reinvested until its equity exceeds 5% of the nominal GDP of the previous year. Finally, FAP also receives proceeds from the sale of the shares of Panamanian state-owned enterprises. FAP's mandate is to preserve its capital beyond unforeseen circumstances that require an emergency withdrawal. FAP anticipates only minimal liquidity needs over a five-year window and, as such, invests with a 5-to-10-year horizon.[5] FAP's emergency mandate was exercised effectively during the COVID-19 pandemic when it transferred $105 million, or approximately 10% of its assets, to the government for support and relief.[6]

3 Sovereign Wealth Funds Annual Reports, Minisertio de Hacienda, Chile

4 "¿De dónde saldrán los recursos para financiar el estado de emergencia económica?", *La Republica*, 19 March 2020

5 Fondo de Ahorro de Panamá, International Forum of Sovereign Wealth Funds

6 "Q&A: Panama's Fondo de Ahorro CIO Abdiel Santiago Talks Governance, Navigating Market Dislocation", MarketsGroup, 15 September 2022

In Mexico, the Oil Revenues Stabilization Fund (Fondo de Estabilización de los Ingresos Petroleros – FEIP) employs hedging strategies to insulate the local economy from price fluctuations. FEIP manages the funds used for the world's largest oil hedge, known as "the Hacienda Hedge", under which the Secretaría de Hacienda y Crédito Público purchases put option contracts (i.e. options to sell oil at a fixed price in the future), as a form of insurance against the risk of a significant decline in the price of oil. While hedging has been successful as a stabilisation strategy for Mexico as an oil exporter, net oil-importing countries in Latin America, typically those without a stabilisation platform, have tended to run deficits when oil prices remain high for extended periods.[7]

7 J Calenzani, PR Katz, S Sinai, K Kalia, *Mexico's Petroleum Hedging Program as Counter-Cyclical Insurance*, Jain Family Institute, 6 September 2023

Guyana's Natural Resource Fund has amassed a balance of **over $2 billion** in four years.

In 2013, the Mexican government also established the Mexican Petroleum Fund for Stabilization and Development (Fondo Mexicano del Petróleo para la Estabilización y el Desarrollo, FMPED) to ensure the responsible and transparent management of oil revenues; it became operational in 2015. The fund has three functions: to administer the oil revenues the government receives from Pemex, the national oil company, and other private companies; to manage hydrocarbon exploration and extraction contracts; and finally, to invest a reserve for the long term.[8] The long-term reserve, which started operations in 2018, consists of the excess oil revenues remaining after transfers to the federal government up to 4.7% of GDP and net surpluses after cash has been distributed to FEIP and other stabilisation mechanisms.[9] Like other governments in the region, the Mexican government drew on its sovereign wealth fund to cover the costs of the COVID-19 pandemic to the tune of almost 1 billion pesos (c.$60 million) over three years.[10]

The newest sovereign wealth funds in Latin America are those established in the micro-states of Guyana and Suriname on Latin America's Atlantic coast. Both states will benefit from new-found resource wealth with the discovery of oil in 2015 by ExxonMobil in the Stabroek block, an oil field estimated at approximately 11 billion barrels. Oil production is more advanced in Guyana, the larger of the two states with a population of 814,000. To accommodate and sequester an anticipated massive increase in government revenues, the government established the Natural Resource Fund in 2019, amassing a balance of over $2 billion by 2023, currently held at the Federal Reserve Bank of New York.[11] The objectives of the NRF are to mitigate volatile public spending, ensure against a loss of economic competitiveness, save and transfer natural resource wealth across generations, and finance national development priorities. Thus, in addition to saving, the government has begun to reinvest oil revenues to roll out a national development plan centred on building an inclusive and green economy.[12]

8 What is the Mexican Petroleum Fund?

9 Long-Term Reserve Management, Fondo Mexicano del Petróleo para la Estabilización y el Desarrollo

10 "Venta de petróleo premia al gobierno de AMLO: le da 995 mil mdp en 3 años", *Forbes*, 7 March 2022

11 Natural Resource Fund, December 2023 Quarterly Report, Bank of Guyana

12 Natural Resource Fund, International Forum of Sovereign Wealth Funds

Unlike Guyana, only a small portion of the Stabroek block is in Suriname's territorial waters. In September 2023, TotalEnergies announced that it would begin studies to develop a $9 billion oil and gas project at Suriname's most promising offshore zone.[13] With production lagging that of Guyana, so too has the launch of Suriname's Savings and Stabilization Fund, the legislation for which was originally passed in 2017. Once operational, subject to prevailing economic conditions,[14] the Fund's mandate will include stabilising the resources for financing public expenditures, generating an alternative source of revenue, and saving revenues for future generations.

Suriname's Savings and Stabilization Fund will be funded from a $9 billion oil and gas project.

13 "TotalEnergies to evaluate $9 billion energy investment in Suriname", Reuters, 13 September 2023

14 World Bank, Suriname Systematic Country Diagnostic, June 2023

Navigating Roadblocks and Risks to the Growth and Expansion of Sovereign Wealth Funds in Latin America

Lima

While most governments in the region have implemented stabilisation mechanisms to mitigate the adverse effects of both fiscal and currency crises, these have not facilitated the accumulation of sufficient excess reserves to serve as a store of savings for future generations.

Oil revenues expanded from **$200 billion** to **$800 billion** annually

Consequently, unlike in other oil-rich regions, such as Norway or the Arabian Gulf, Latin American sovereign wealth funds have not, therefore, been able to evolve from stabilisation to intergenerational savings nor to invest at home to catalyse economic development and diversification. A number of reasons can be conjectured, including scale, political capture, fiscal mismanagement, or social unrest demanding attention to immediate needs.

By the mid-twentieth century, economic conditions in the Arabian Gulf were arguably very different to those in most Latin American countries. For example, when oil was discovered in Kuwait and the Trucial States (later to become the United Arab Emirates), these countries had very small populations and economies, enabling the build-up of large fiscal surpluses. Unable to invest excess oil revenues at home, the practical alternative was to recycle oil revenues in international markets such as London, resulting in the creation of what would become the Kuwait Investment Authority and the Abu Dhabi Investment Authority.

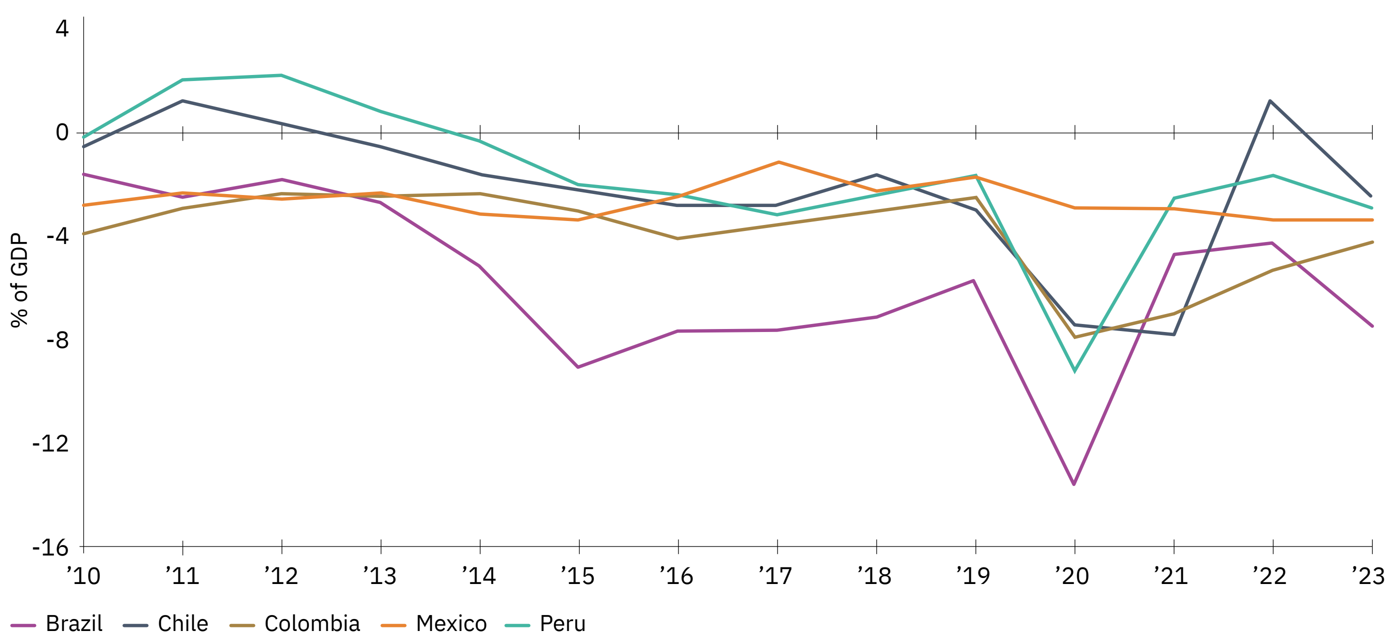
For the Gulf Cooperation Council (GCC) countries (Kuwait, Oman, Qatar, Saudi Arabia and the UAE), the period between 1997 and 2014 is of particular note. Oil revenues expanded from $200 billion to $800 billion annually, significantly outstripping spending, which rose to about $500 billion over the same period, resulting in savings rates of between 20% and 60%, extending the assets of member sovereign wealth funds by nearly $800 billion.[15] In an interesting turn, more recent procyclical policies, some tied to transformative efforts to diversify the region's economies, have reversed these trends, leading to increased spending rates and an extended period of fiscal deficits. Notwithstanding, GCC sovereign wealth funds' balances have continued to increase and supported a substantial increase in government borrowing amid a global environment of lower interest rates.[16]

15 International Monetary Fund, The Future of Oil and Fiscal Sustainability in the GCC Region", No.20/01, 2020

16 Ibid

Conversely, most countries in Latin America have not historically run fiscal surpluses. In the period since 2010, in fact, average deficits in the region have run at approximately 3% of GDP, see Figure 2, extending to nearly 7% during the COVID-19 crisis in 2020 and funded by increased government borrowing.[17] Moreover, even when states have enjoyed sizable resource revenues, governments have been reluctant to strike fiscal balances, frequently opting to run deficits, resulting in widespread macroeconomic instability.[18] In some instances, even when stabilisation funds were created, reserves were drawn down to expand fiscal spending. In this regard, Venezuela proves to be an especially pertinent example.

Figure 2: Latin America (5 countries) Fiscal Balance, 2010–2023*



Source: FLAR through Sistema de Información Económica (SIE).

**For Brazil, Mexico, and Peru, it corresponds to the non-financial public sector, and for Chile and Colombia, it refers to the central government.*

17 Economic Commission for Latin America and the Caribbean (ECLAC), Fiscal Panorama of Latin America and the Caribbean, 2021 (LC/PUB.2021/5-P), Santiago, 2021

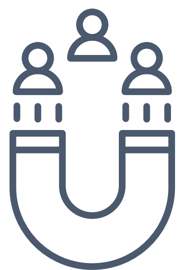
18 C Esquivel, TJ Kehoe, JP Nicolini,“Lessons from the Monetary and Fiscal History of Latin America” in “A Monetary and Fiscal History of Latin America, 1960–2017”, Manifold, 2022

The government of Venezuela established the first sovereign wealth fund on the continent in recent history. The Fondo de Inversiones para la Estabilización Macroeconómica (FIEM), in 1999. The purpose of the fund was to smooth out fluctuations in public spending and revenues caused by the volatility of oil prices.[19] The fund also sought to promote fiscal discipline, reduce external debt, and increase international reserves. However, successive reforms of the fund degraded its governance structure, reducing oversight and control by the National Assembly. Consequently, it was often used as a source of discretionary financing by the government, resulting in a massive expansion of the public sector and a crowding out of private enterprise. Consequently, FIEM and its successors failed to prevent the fiscal imbalances and the macroeconomic instability of Venezuela, as the government leveraged its oil revenues to increase national debt to further increase public spending. The fund was depleted in 2013.[20]

19 FEM Macroeconomic Stabilization Fund Law, Central Bank of Venezuela (bcv.org.ve)

20 El Fondo De Estabilización Macroeconómica: Crónica De Una Crisis Que Tuvo Alternativa (II), ProEconómica

This legacy of challenged fiscal and economic management in Latin America, compounded by limited reserves, economic instability, policy sensitivity – and dependence – on political cycles, and institutional capacity constraints, were continuing themes echoed in independent interviews of staff of regional central banks and finance ministries conducted for this study. For example, several interviewees pointed to political and economic stability as critical to successfully managing a sovereign wealth fund. Another stressed the importance of constructing and managing long-term portfolios capable of generating improved risk-adjusted returns.



Central banks have struggled to **recruit and retain talent**

Given the lack of fiscal discipline in some countries in the region, it is unsurprising that many Latin American central banks have prioritised safeguarding current assets rather than developing the skills to invest longer term in higher-risk, higher-yielding assets.[21] Even where sovereign wealth funds exist, risk aversion is evident. In the case of Mexico's FMPED, its founding legislation gives priority to stabilisation over savings, with almost 95% of transfers being allocated to the government's budget in 2023,[22] while in Chile, the Economic and Social Stabilization Fund and Pension Reserve Fund have been prodded to "consider broader asset classes (including equities or financial instruments linked to real estate) to benefit from higher expected returns and greater diversification".[23]

Lastly, accentuating capacity issues, the interviews conducted suggest that the region's central banks have struggled to recruit and retain talent, significantly limiting their ability to build qualified teams and roll out new reserve management techniques.

21 OMFIF, *Global Public Investor 2020*, p66

22 IMCO Centro de Investigación en Política Pública, "El Fondo Mexicano del Petróleo debe reformarse para financiar la transición energética", 14 December 2023

23 W. Raphael Lam, Yongquan Cao, Andresa Lagerborg, and Alessandro Scipioni, Chile: *Fiscal Considerations in Managing Stabilization Funds*, International Monetary Fund, July 2023

Financing Development in Latin America

Cartagena

While dominant, economic stability and fiscal management are by no means the only issues confronting Latin American economies today. In fact, on the horizon, mobilising capital for investment to grow, diversify, and "green" local economies may prove to be a greater and even more intractable challenge, owing to ever-widening regional infrastructure gaps, estimated by the Inter-American Development Bank (IDB) to be over $2.2 trillion across the Latin America and Caribbean region (with nearly 70% in Latin America alone).[24]

24 Inter-American Development Bank, *The Infrastructure Gap in Latin America and the Caribbean: Investment Needed Through 2030 to Meet the Sustainable Development Goals*, 2021

Targeting water and sanitation (0.52%), electricity (0.81%), transportation (1.37%), and telecommunications (0.41%), the IDB calculates that investments in infrastructure – both new and replaced – will absorb 3.12% of the region's GDP annually to 2030.[25] To close the infrastructure gap, investment at such levels will far exceed the 1.8% annual average of public and private infrastructure investment in the region between 2008 and 2019, potentially accentuating the burden on already challenged fiscal space.[26]

To close the **infrastructure gap**, Latin American governments will need to more than **double** their **current investments**.

At $152 billion and $58 billion, respectively, in total assets, the IDB and CAF, the Development Bank for Latin America and the Caribbean,[27] serve as regional anchors for development finance with common shareholders from among the region's states. Latin American governments have also exhibited a predisposition to redistribute state revenues through state-owned banks and pension funds rather than amassing reserve balances at the government level.[28] In this regard, the IDB reports that National Development Banks (NDBs) in Latin America and the Caribbean have played a central role in addressing the long-term financing requirements of infrastructure projects in the region, second to the private sector and accounting for 20.5% of capital raised between 2004 and 2021.[29]

25 Ibid

26 Ibid

27 Banco de Desarrollo de América Latina y el Caribe (CAF)

28 Comments from a regional expert on the Latin America panel at the IFSWF Annual Meeting held in Madrid in September 2023.

29 Inter-American Development Bank, "New IDB Study Highlights Role of Public Development Banks in Mobilizing Private Capital towards Infrastructure Projects", 5 September 2023

In Colombia, for example, Bancoldex is a state-owned commercial bank that operates as the country's entrepreneurial development and export-import bank, providing long- and short-term financing and specialised financial products to support Colombian exports and other foreign trade-related activities.[30] Similarly, Brazil's Banco Nacional de Desenvolvimento Econômico e Social (BNDES) is a national development bank that provides long-term financing for projects that contribute to the country's development, such as infrastructure, exports, and social investments.[31] In December 2023, Brazil's government announced efforts to raise $10 billion from multilateral and development banks to fund infrastructure projects to promote integration across Latin America. BNDES is expected to invest approximately $3 billion, the majority of which will fund projects that Brazilian states and municipalities initiate. As of year-end 2023, the federal government, in collaboration with the 11 Brazilian states bordering neighbouring countries, had defined 124 domestic projects as foundational to the scaling and growth of five integration routes in the region.[32]

30 Bancoldex

31 BNDES - Brazilian Development Bank

32 "Brazil secures $10 bln from banks for South American integration projects", Reuters, 12 December 2023

While both banks have established track records in helping to develop businesses and projects, other similar institutions in the region have been less successful. For example, the $1.2 billion Fondo para la Revolución Industrial Productiva (FINPRO) was established by the Bolivian government in 2012 as a trust.[33] Administered by the Banco Central de Bolivia, FINPRO is sometimes referred to as Bolivia's sovereign wealth fund.[34] However, its mandate appears to be focused on lending to state-owned enterprises rather than investing more conventionally in risk equity.[35] As early as 2013, just after FINPRO's establishment, the IMF, writing in its 2014 Article IV country report, indeed saw FINPRO as a possible predecessor to a savings fund to manage accumulated fiscal surpluses from Bolivia's natural gas exports.[36] This notion was predicated on FINPRO generating sufficiently positive returns and making investments based on sound financial considerations, all supported by strong institutional governance structures to ensure fiscal transparency.[37] In the intervening period, Bolivia's economy has struggled, putting pressure on international reserves and policy buffers.[38] Meanwhile, FINPRO's potential as a savings fund has not materialised. Perversely, its operating model may, in fact, be exacerbating Bolivia's economic problems.

Pressure on international reserves and policy buffers

33 Ley del Fondo para la Revolución Industrial Productiva (FINPRO) (232) - Infoleyes Bolivia

34 See, for example, International Finance Corporation, Country Private Sector Diagnostic: The Plurinational State of Bolivia,Unlocking Private Sector Potential to Achieve a Sustainable and Inclusive Recovery, December 2021

35 Ibid

36 International Monetary Fund, *Bolivia Staff Report for the 2013 Article IV Consultation*, July 2014

37 Ibid

38 Bolivia: 2022 Article IV Consultation-Press Release; Staff Report; and Statement by the Bolivian Authorities

Transparency and accountability are central to aligning the interests of the public and private sectors

The IFC describes FINPRO as lending on concessional terms with a loan portfolio in 2020 of US$855 million across 14 state-owned enterprises, including the loss-making state airline Boliviana de Aviacion (BoA) and a textile exporter that was nationalised and subsequently closed.[39] A study prepared by former Bolivian Finance Minister Javier Cuevas provides further details of FINPRO's loan portfolio, which includes an analysis of the operating conditions of Bolivian state-owned enterprises. His work is part of a longer, multi-authored report prepared for the Bolivian think tank Fundacion Milenio,[40] entitled "Public Companies Under Scrutiny What to Do with Them?"[41] The report, and Cuevas' analysis in particular, describes the challenges facing Bolivian SoEs, such as undercapitalisation, over-investment, a lack of operating capital, poor liquidity, and inefficient operating and management models where the only client is the state itself.[42] More broadly, Cuevas concludes that public investment must play a complementary role in mobilising private investment while avoiding crowding out the private sector. This requires a robust institutional foundation of clear rules and accountability under a reliable system of justice grounded in legal security, all of which, he argues, is lacking in Bolivia.[43]

Cuevas' analysis is, in many respects, consistent with the IMF's original prescription for FINPRO ten years prior and similarly relevant as a way forward today. Drawing from Cuevas' conclusions, a critical takeaway from his work is to focus on the dual challenges of information and agency: Transparency and accountability are central to aligning the interests of the public and private sectors to enhance productivity and promote the development of the national economy.[44]

39 See IFC, op cit

40 On Think Tanks | Fundación milenio

41 See Análisis No. 33. Las empresas públicas bajo escrutinio ¿Qué hacer con ellas?, Fundación Milenio. Fundacion Milenio's work was motivated by a 2019 government report from the Office for the Strengthening of Public Enterprise (OFEP), of the Ministry of the Presidency that highlighted the critical financial and administrative situation of Bolivian state-owned companies. Parts of the government report were made public through press releases in August 2021.

42 Ibid

43 Ibid

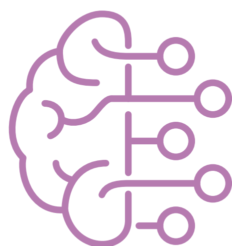
44 Ibid

Reimagining Latin American Development Finance and Strategic Investment for the 21st Century

Mexico City

As development finance institutions, the mandates of local development banks often resemble those of concessionary lenders, i.e. they generally provide credit or guarantee solutions and have limited exposure to other types of "risk" capital, such as equity. Rather, their investments intend to "liberate" private capital and enhance governance by assuming a "first loss" position in a firm's or project's capital structure.[45] However, such arrangements can prove limiting, particularly if or when private capital is crowded out.

45 See Bancoldex, Frequently Asked Questions



Enhance the **quality** of investment decision-making

Sovereign wealth funds, particularly those with stabilisation or savings mandates, invest strictly based on defined risk budgets, which require adequate compensation for the risks undertaken. Such funds are generally precluded from investing domestically and give priority to investments in liquid securities.

However, a class of sovereign wealth funds with domestic mandates has emerged that discreetly target strategic development. This cohort, known as strategic investment funds, is rapidly expanding in emerging economies, particularly in Africa and Asia. These institutions are tasked with both investing *and* mobilising third-party risk capital and offer an alternative and, in fact, complementary means to attract foreign direct investment.

Strategic investment funds have a “double bottom line” mandate to generate both financial *and* economic returns over a long-term, often decades-long, investment horizon. As such, they can use their government-owned funds to support strategic sectors, particularly in greenfield infrastructure deals (which have longer gestation periods) and corporate investments (or restructurings) that require a long time to bear fruit.[46] Consequently, rather than crowding out capital, strategic investment funds multiply the impact of their capital by catalysing investment, often in the form of equity, from a variety of third-party investors, including those from the public, private, or development finance sectors. Strategic investment funds with strong governance, management and investment credentials can serve as credible local partners to third-party capital to reduce risk, enhance governance, and integrate local market knowledge with external expertise to enhance the quality of investment decision-making.[47]

46 S Divakaran, H Halland G Lorenzato, GP Rose, SP Sarmiento-Saher, *Strategic Investment Funds : Establishment and Operations, World Bank Group*, 2022

47 AD Dixon, PJ Schena, J Capape, Sovereign Wealth Funds: Between the State and Markets, (Agenda Publishing, 2023), p75

One institution that is playing a key catalytic role in the region is the Inter-American Investment Corporation or IDB Invest, a member of the IDB Group, whose operating policy is to mobilise capital flows through "blended" financial structures that span co-financing with various financial intermediaries, *including expressly sovereign wealth funds*.[48] However, Latin America largely lacks state-administered investment vehicles, such as strategic investment funds, to complement IDB Invest and to partner directly with foreign investors to mobilise risk capital for inward investment. The regional development finance framework, which includes regional institutions like IDB Invest and local institutions like BNDES, is in place to reimagine a scalable and sustainable economic development model in which strategic investment funds could play an important catalytic role. Focusing regional attention on the potential of the strategic investment fund model is especially timely in light of the IDB's recent (March 2024) decision to commit an additional $3.5 billion in funding for IDB Invest's private sector mandate and to put impact and scale at the forefront of its investment strategy up to 2030.[49]

Consequently, there is a nascent opportunity for the governments of Latin America to change the narrative and establish a new generation of sovereign wealth funds that draws on the experience of regions like Africa. Across the continent, both resource-rich and non-resource-rich, reserves-constrained countries have pooled assets to create vehicles that can act as partners of choice for both local and foreign direct investors in commercially viable projects and domestic companies. There are now 11 sovereign wealth funds across Africa with some form of development mandate.

African SWFs provide key lessons

48 Emphasis ours. Inter-American Investment Corporation, Operating Policy

49 IDB Invest, Governors Approve Three Historic, Transformative Changes for the IDB Group to Support the Region, 11 March 2024

One such example is Senegal's Fonds Souverain d'Investissements Stratégiques (FONSIS). FONSIS has a dual mandate: to boost private sector investments in Senegal by serving as an anchor investor to crowd in local and foreign private investors, manage excess state budget resources, and preserve them for future generations. FONSIS has been successful in attracting and co-investing with global commercial investors, including private equity investors, particularly in projects related to renewable energy and reducing greenhouse gas emissions.

In Gabon, le Fonds Gabonais d'Investissements Stratégiques (FGIS) plays a similar role. With a mission to promote inclusive and sustainable development, the fund's vision is to catalyse the development and economic, social, and environmental transformation of the country.[50] In this capacity, FGIS is tasked with mobilising investment capital through both traditional and blended structures.[51] It also has a more innovative mandate: serving as the exclusive marketing representative for the country's carbon credits, targeted for use to fund infrastructure projects, including hydroelectric power generation.[52]

50 Who We Are, Fonds Gabonais d'Investissements Stratégiques

51 "NZAOA welcomes first African SWF to ranks, following EM recruitment drive", *Responsible Investor*

52 Who We Are, Fonds Gabonais d'Investissements Stratégiques

A Sovereign Wealth Fund Model for Latin America?

San Paulo

The African experience points to the potential for strategic investment funds to pioneer innovations in development finance that can promote improved financial stability and drive inclusive and sustainable growth and economic diversification. A clear catalyst for consideration by Latin American governments is the strategic role of natural resources, particularly metals such as copper, lithium and nickel.

These are key components of next-generation LFP batteries and are essential to achieving the electrification required for the energy transition, particularly in emerging markets. As the global demand for clean energy and electric vehicles increases, so will the strategic importance of these minerals.[53]

Consequently, Bolivia, Argentina, and Chile will receive increased attention from foreign investors and major global powers like the United States and China, which seek to gain technological advantage by controlling the green energy supply chain. However, historically, the region's governments have struggled to harness their natural resource revenues efficiently, largely because operations in the extractive sector have led to challenges such as corruption, negative environmental impacts, and economic losses.[54]

53 T Moerenhout, JC Jobet, Chile's New Lithium Strategy: Why It Matters and What to Watch For, Center on Global Energy Policy at Columbia University SIPA, 2 May 2023

54 Inter-American Development Bank, Transparent Governance in an Age of Abundance: Experiences from the Extractive Industries in Latin America and the Caribbean, p41

Figure 3: Fuelling the Energy Transition?

Latin America is home to some of the world's largest deposits of minerals crucial to the global energy transition (global ranking of mining reserves)

Sources: US Geological Survey; Economist Intelligence Unit.

Indeed, Chile has recognised the opportunity of this increased demand and unveiled a National Lithium Strategy in April 2023.[55] The strategy aims to enhance state control over the industry, including creating a new National Lithium Company to ensure that the state benefits from the surging demand for the lithium carbonate it produces. The strategy also outlines a policy to "prevent lithium income from being spent above a threshold, defined as the average of the previous four years. In this way, the transitory part of the lithium income will be saved to ensure the financing of social, scientific-technological, and productive investments."[56] However, it does not outline a vehicle through which this financing might take place, suggesting that it will likely go through existing budgetary processes, potentially including saving into the country's existing sovereign wealth funds.

55 Chile avanza con litio: Estrategia Nacional del Litio

56 Translation of the original source. Estrategia Nacional del litio, 14 June 2023

However, unlike in Africa, the requisite economic conditions, political will, or skills to establish strategic investment funds, on the whole, have yet to emerge in Latin America. Institutions funded by resource revenues, from mining or even from oil and gas revenues in the near term could play a complementary, if not more effective, role than development banks in mobilising private international capital into the region. Moreover, we believe there are clear indications that strategic development funds are better positioned than development banks alone for driving economic growth and FDI in Latin America.

First, recent IFSWF research has suggested that large institutional investors, like sovereign wealth funds, are keen to explore investment opportunities in new, developing economies, particularly pertaining to climate change solutions. However, they are unfamiliar with the development finance ecosystem, which is often the gateway to direct investing in major projects and companies in these markets. To interact with these institutions, private-sector investors must put considerable resources and time into building relationships and understanding new financing mechanisms on top of understanding a new geography with which many investors are unfamiliar.[57]

Strategic Sovereign Funds have been successful in **attracting co-investors**

Second, most strategic investment funds are established as private companies under local law, with the government as the sole shareholder.[58] Such vehicles are attractive to local and international investors as co-investment partners because of their well-understood legal structures. This familiarity reduces the complexity of interacting with them in structuring deals. Indeed, strategic investment funds like the Indonesia Investment Authority (INA) and the Sovereign Fund of Egypt have been recently established using this model and both, even in their short existence – less than five years in both cases – have been highly successful in attracting co-investors, including from other sovereign wealth funds. INA, for example, has attracted over $4 billion from strategic partners from 10 countries into Indonesian infrastructure and other key sectors since its inception, almost doubling its assets under management.

57 International Forum of Sovereign Wealth Funds, *Powering Change: Building Resilience in a Transforming Climate*, March 2024

58 P Schena, R Collins, *Implementing the Santiago Principles: Lessons from member self-assessments*, International Forum of Sovereign Wealth Funds

Third, a commercially orientated sovereign wealth fund searches for projects with risk and return profiles similar to a private investor's. This alignment of interests makes co-investment with these institutions more attractive and reduces the prospect of principal-agent conflicts of interest. As very long-term government-owned investors, strategic investment funds complement private investors, as they have different, yet overlapping, risk factors. As such, strategic investment funds can invest across the capital structure of an investment to de-risk it for its partners. Similarly, strategic investment funds can de-risk investments by leveraging their government ownership and access to expert local knowledge and networks. For private investors entering new emerging markets, local partners with boots on the ground are essential to giving them confidence in their investments.

Strategic investment vehicles **mobilise and deploy** equity capital

Finally, and perhaps most importantly for many Latin American countries where resource revenues have failed to contribute to macroeconomic stability, the economic and employment impacts of increased investment can bolster the national balance sheet over time, particularly when targeted to strategic sectors. The multiplier and governance effects foundational to the strategic investment model differentiate capital deployed by these funds from government expenditure or funding via development banks. Unlike limited and finite budgetary resources, capital mobilised by strategic funds is multiplicative, i.e. it leverages limited local funding with capital invested by private local or global institutional investors, often in blended structures to accommodate their risk profile. Also, unlike conventional development finance, which often comes in the form of guarantees or concessional loans, strategic investment vehicles mobilise and deploy equity capital, which better aligns the interests of private capital with those of the government as a co-investment partner from a governance perspective.

State-owned institutions taking on greater risk to spur local development is not without precedent in Latin America. Some state financial institutions have committed risk capital to promote commercial and financial market development. For example, four Peruvian pension funds committed approximately $220 million toward a $460 million local infrastructure fund managed by Brookfield Asset Management in 2010.[59] Also, some development banks, despite their focus on providing credit solutions, have, in parallel, established indirect private equity programmes. Bancoldex, for example, invests as a limited partner in private equity funds and also serves as the general partner in a fund-of-funds structure that includes 16 funds that range from venture capital and impact to private credit and buyout.[60] Notwithstanding, these efforts have yet to reach the scale to have a wide-reaching, transformational impact or to attract significant private-sector investment.

Capital mobilised by strategic funds is multiplicative

59 "Brookfield launches Peruvian fund with $460m", *Infrastructure Investor*, 18 October 2010

60 Investment funds, Bancoldex

Lastly, subnational sovereign funds, operating at a state or provincial level, also exist to serve local development needs.[61] In Brazil, we call out Fundo Soberano de Estado do Espírito Santo or FUNSES, established in 2019 and now managing about R$1.5 billion ($310 million) generated from the state's oil and gas receipts.[62] The fund has a dual mandate; up to 60% of the fund is a relatively conservative future-generation savings fund managed by the state commercial bank. The remainder is managed by the state development bank, BANDES, to foster the redevelopment of the state's economy. The BANDES-managed tranche acts as a venture capital fund, investing in the seed and early stages of capital raising to develop a tech hub in the state by investing in high-growth local start-ups that can create jobs, meet strict environmental, social and governance criteria and generate income.[63]

Investing in high-growth **local start-ups**

BANDES has so far taken custody of R$500 million. Half of this is invested in FUNSES 1, a venture capital fund managed by local venture capital firm TM3 Capital, which was launched in 2022 to invest in start-ups and some more mature businesses in a long list of strategic sectors in Espírito Santo, with a mix of debt and equity. The other half – FUNSES 2 – is an ESG development fund managed by BNDES, which aims to encourage innovation and sustainability in industry education, energy, and health.[64] In March 2024, BANDES announced the first four companies that would receive a total of R$150 million in financing from the Programme.[65] The financing took the form of long-term credit, i.e. non-convertible debentures that carry a BANDES credit rating, which will then enable the companies to raise further funding from the private sector in the capital markets.[66]

To assert then, both global and regional evidence suggests that sovereign funds with strategic development mandates could indeed be positioned to catalyse inward foreign direct investment to Latin America by (1) de-risking investment projects and crowding in private flows through co-investments, (2) facilitating policy dialogues to improve the local business and investment climate, (3) contributing to long-term national, sustainable development goals, including (4) supporting strategic sectors and new industries. Moreover, as many Latin American countries have extensive experience working with international donors and both multilateral and bilateral development agencies, strategic funds – such as the case of the FGIS in Gabon – can likewise play a key role in the design of blended financing solutions, particularly those scaled for energy transition projects and carbon sequestration.

61 Selected leading sub-national SWFs worldwide 2023, Statista

62 FUNSES - Sovereign Fund of the State of Espírito Santo

63 For more information on the fund, see: IFSWF Direct, *Brasil's New Generation of Sovereign Wealth Funds*, January 2023.

64 FUNSES, "Programa Funses ESG de Desenvolvimento divulga 14 empresas habilitadas", 18 September 2023

65 Abdo Filho, Bandes anuncia nomes das empresas que receberão dinheiro do Fundo ESG de Desenvolvimento, A Gazeta, 11 March 2024

66 "Bandes divulga projetos selecionados em edital de Chamada Pública para emissão de debêntures", *SiteBarra*, 12 March 2024

Ensuring Success: The Importance of Good Governance

La Paz

We close by returning to the relevance and critical importance of governance. While the practice of strategic investment funds can align investment interests through deal-level governance structures, the model rests on funds, as credible local partners, having robust governance structures at the institutional level. The Generally Accepted Principles and Practices for sovereign wealth funds have created a proven basis for independent and financially motivated sovereign wealth fund governance since 2008.

Chile's sovereign wealth funds were a founding member of the International Forum of Sovereign Wealth Funds; Mexico's FEIP was also a founding signatory and has remained a member, while Panama's FAP joined in 2017, and Guyana's Natural Resources Fund became an associate member in 2020.

Almost **50%** of IFSWF's full members are **strategic investment funds**

Although the Principles were originally intended for implementation by traditional savings and stabilisation funds, the Santiago Principles have now been implemented by a wide range of strategic investment funds. Indeed, almost half of the IFSWF's 38 full members are strategic investment funds. Transparently applying the Principles requires governments to commit – and bind their successors – to the independence of a fund's management and to a financially motivated mandate.

As importantly, the success of sovereign wealth funds of any type relies on a material commitment by governments to establish these at scale and to cultivate a sense of ownership among stakeholders. For a strategic investment fund to have a transformative impact on the economy, it must be able to make major investments and attract large global investors to co-invest. The example of Indonesia's INA is instructive here; its initial funding was $5 billion, which enabled it to attract the support of major global sovereign wealth, pension funds, development finance institutions, and other strategic partners with substantial ticket sizes, particularly in infrastructure. A key residual benefit of commitment at scale is that it can demonstrate both political consensus and political will on the part of the government and guard against misappropriation – or backdoor repurposing – through greater oversight by all stakeholders.

Finally, we revisit the question posed in our title: Can sovereign wealth funds expand and grow in Latin America? Our analysis suggests that the region could benefit materially from rethinking the traditional development finance model and drawing on the global experiences of an emerging model of sovereign investment that acknowledges limited local financial resources and instead leverages available national assets and capacity to mobilise both domestic private and global institutional investment to contribute sustainably to national economic growth and development.

Contributors

About the International Forum of Sovereign Wealth Funds (IFSWF)

The International Forum of Sovereign Wealth Funds (IFSWF) is a global network of sovereign wealth funds established in 2009 to enhance collaboration, promote a deeper understanding of sovereign wealth fund activity, and raise the industry standard for best practice and governance.

FLAR

The Andean Reserve Fund (FAR) was created in 1978 as a Regional Financing Arrangement (RFA), in response to the needs of Bolivia, Colombia, Ecuador, Peru, and Venezuela to have their own financial institution, to address the problems resulting from the imbalances in the external sector of their economies, and to facilitate the regional integration process. It became the second oldest RFA in the world. In 1989, based on the solid foundations of a fully operating body, FAR became the Latin American Reserve Fund (FLAR) due to the interest of the Andean countries in expanding the Andean Reserve Fund (FAR) to all Latin America. Thus, Costa Rica, Uruguay, and Paraguay joined as FLAR member countries in 2001, 2008, and 2015 respectively, and in 2022 the Central Bank of Chile became a FLAR member as an Associate Central Bank.

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