

June 8, 2015

## **The Importance of FIFA**

On May 27<sup>th</sup>, Swiss authorities arrested several top officials affiliated with Fédération Internationale de Football Association (FIFA) on various charges, mostly related to corruption. Later that day, the U.S. Attorney General and the U.S. Department of Justice (DOJ) unveiled indictments against FIFA officials, indicating that the Federal Bureau of Investigation (FBI) had been conducting investigations of corruption for some time and had evidence of illicit schemes going back 24 years.

The ongoing investigation into this scandal continues to unfold as we write this report. Therefore, we will not spend too much time on arrests or new charges. Instead, we will offer a short overview of the arrests and the election and resignation of FIFA President Sepp Blatter. We will discuss the structure of FIFA and how this organization is prone to corruption. We will follow this discussion with the most important part of the report, the extension of U.S. law enforcement into the international realm as a function of the superpower role. As always, we will conclude with potential market ramifications.

### **A Tale of Corruption**

The arrests of 14 FIFA officials are probably just the beginning of the process. U.S. Attorney Lynch noted that the FBI has been investigating FIFA for some time and that further indictments are possible. Despite the growing scandal, FIFA held elections for president on May 29<sup>th</sup> and the incumbent,

Sepp Blatter, won in the second round of voting. He was defiant in his victory, accusing the U.S. of trying to affect the outcome of the election through the timing of the arrests. However, five days later, on June 2<sup>nd</sup>, Blatter unexpectedly resigned. He will remain in office until a new president is elected early next year.

There have been a number of interesting developments since the scandal broke. Russian President Putin blasted the U.S. for its internationalization of American law, calling it an “overreach.” Several officials, most notably Chuck Blazer, an American who has held several positions in FIFA including the head of the Confederation of North, Central America and Caribbean Association Football (CONCACAF), and the executive VP of the U.S. Soccer Federation, have admitted to taking bribes ahead of the 1998 and 2010 World Cups. We suspect other FIFA officials will start “talking” soon in order to gain favor with prosecutors.<sup>1</sup>

President Blatter has not been indicted yet, and so his decision to step down has led to speculation as to why he decided to resign. There are three theories. First, sponsor pressure may have led to his exit. FIFA sponsors, as we will note below, are a major funding source and thus have some power.

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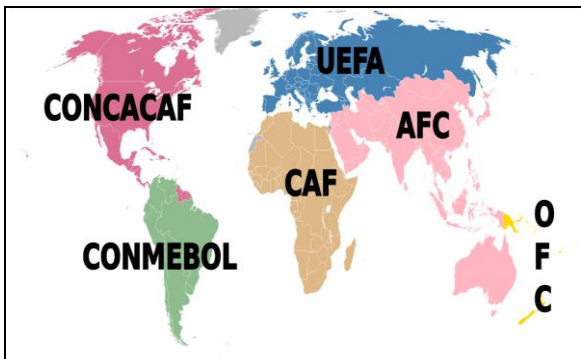
<sup>1</sup> In fact, this process appears to be underway. Jack Warner, a former FIFA VP, is warning that he will tell investigators what he knows. See: Bilefsky, D. (2015, June 4). Ex-FIFA Official Jack Warner Threatens to Spill ‘Avalanche’ of Secrets. *New York Times*.  
Schipani, A. (2015, June 5). Warner Promises Investigators an ‘Avalanche’ of Information. *Financial Times*, p. 2.

Second, there have been rumors that some of the developed world soccer organizations, likely Europe, were threatening to leave FIFA and create their own organization to compete with FIFA. The loss of Europe and perhaps the U.S. could result in the loss of sponsorship and remove some of the important soccer nations. However, to make a serious difference, this emerging group would likely need to attract South and Central American nations. So far, there isn't much evidence to suggest this mutiny has gathered momentum and probably isn't a major factor in Blatter's decision.

Third, it is highly probable that U.S. DOJ officials have indicated that Blatter may be indicted in the future and stepping down from the presidency may have been an informal plea bargain. Again, we don't know if any of these three are true. But, Blatter's decision to step down just after he won reelection does suggest he did not go willingly.

**The Structure of FIFA**

FIFA has 209 member states and six regional confederations. FIFA's stated purpose is to promote global soccer. It builds practice facilities and pays coaches all over the globe.



(Source: Wikipedia)

This map shows the regional organizations that make up FIFA. Each nation within FIFA gets one vote. And so, power is

gained within the organization by gathering lots of votes. Swaying those votes is easier and costs less money in a poor, small nation than in the U.S. or Europe. Simply put, Montserrat, an island in the Caribbean that is 10 miles wide and seven miles long with a population of 5,879, is just as important as the United States in terms of voting. Thus, a decision to build a facility in Montserrat will have a much greater impact on sentiment toward a FIFA president than anything done in the U.S. Each national association gets a \$250k annual grant from FIFA and, most recently, \$500k in funds from the last World Cup. Thus, small nations are going to be more beholden to the organization.

FIFA gets most of its money from broadcast rights, with sponsors as the second major source of funding. The 2014 World Cup was the most watched event in history. It is estimated that 30 billion viewers watched all the games. From December 2010 to December 2014, FIFA grossed \$5.7 bn, with broadcasters funding \$2.5 bn and sponsors \$1.7 bn. On the spending side, \$358 mm was given as prize money for the last World Cup. FIFA had expenses of \$2.2 bn and has cash reserves of \$1.5 bn. This leaves around \$1.6 bn that is unaccounted for.

It does appear that FIFA presidents have used spending in small nations to build a base of support that ensures reelection. There are many tales of graft and corruption. The aforementioned Chuck Blazer has accepted a plea agreement that acknowledges he took bribes and kickbacks in 1992 to ensure France would host the World Cup in 1998. He admitted to similar activities that began in 2004 to facilitate South Africa's bid to host the 2010 games. He became an informant to the FBI and his information was key to the recent indictments. Reports show he wore a wire and, from this information, DOJ officials

indicate that there will likely be more to follow. According to reports, investigators are now looking at the FIFA decisions to award Russia the 2018 World Cup and Qatar the 2022 World Cup. It has been strongly suggested that similar corrupt activities were responsible for these decisions.

“Unsurprising, then, is that the progression of World Cup venues during Blatter’s reign have charted a line straight down the Democracy Index; beginning with South Africa (30<sup>th</sup> place) and continuing to Brazil (47<sup>th</sup>), Russia (107<sup>th</sup>), and finally, to Qatar (137<sup>th</sup>).”<sup>2</sup>

As noted above, President Putin of Russia has reacted angrily to the U.S. prosecution of FIFA and its officials. This is not just because of his anger at America’s extension of its legal system. It is possible that the bidding may be reopened for both tournaments. Qatar’s financial markets have been under pressure on fears that it may lose the World Cup.

Ultimately, the problem for FIFA is the combination of money and the voting structure. Soccer is extraordinarily popular and helping build the game in poorer nations is a noble goal. One solution would be to separate the function of building the game from the production of the World Cup. However, this change would likely starve the business of building global soccer.

There are many structures in business, government, philanthropy, etc. that suffer from conflicts of interest and not all can be solved by structural changes. Sometimes these situations can only be resolved with transparency and oversight. Unfortunately, when a function is global in nature, there is no transnational body that can enforce rules of behavior. It is in these circumstances that

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<sup>2</sup> Breiding, R.J. (2015, May 31). Hail to the Thieves. *Foreign Affairs*.

“somebody” must step in and force legitimacy. For better or for worse, this is one of the roles of the global hegemon.

### **America’s Hegemonic Role<sup>3</sup>**

The global superpower always struggles with how to enforce its will beyond its borders. Britain primarily used its navy and colonies to establish its power. Its role as importer of last resort and supplier of the reserve currency were additional levers of power. As Britain’s economic power began to wane after WWI, it tried to woo the U.S. into helping it maintain its hegemony. The decision by the Chancellor of the Exchequer, Winston Churchill, to return to the gold standard in 1925 was done, in part, to keep Britain as the center of global finance.

The U.S. didn’t adopt the British approach to hegemony. Instead of colonies, the U.S. created a group of international organizations and treaty groups to extend its power. By dominating the World Bank, the United Nations (U.N.) and the International Monetary Fund (IMF), the U.S. could extend its dominion without the costs, both actual and moral, of colonization. Of course, this method only works if the U.S. can dominate these organizations. For the most part, the U.S. has been able to maintain strong influence in the World Bank and the IMF. American power at the U.N. has been marginalized through the proliferation of nations. In the general assembly, with each nation getting a vote, it is difficult to maintain control. The U.S. retains blocking power at the U.N. Security Council, where it holds veto power, but it struggles to use the U.N. to project power.

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<sup>3</sup> Much of this analysis is reflected in a recent op-ed. Rachman, G. (2015, June 1). What FIFA Tells Us About Global Power. *Financial Times*.

Since the end of the Cold War, the U.S. has been forced to resort to “coalitions of the willing.” Operations against Serbia in the late 1990s were done under the auspices of NATO because Russia would have blocked them at the U.N. The war in Iraq was done without the U.N.; President Bush simply created his own coalition to attack Saddam Hussein. The U.N. did give approval for operations against Libya but Russia has indicated it believes the U.S. and EU overstepped the mandate and says it won’t approve future operations of a similar nature.

In a sense, as many neoconservatives have pointed out, using international organizations to project power doesn’t work if the hegemon doesn’t dominate the organization. At the same time, as the Wilsonians suggest, international organizations offer legitimacy but only if they are not “rubber stamps.” Since the end of the Cold War, the U.S. has struggled to create mechanisms that will allow it to enforce its goals on the international community. Going to war isn’t a desirable or universal solution to fulfill America’s goals.

The FIFA situation shows yet another method the U.S. can use to enforce its will. The United States has a deep and efficient financial system. Any entity with large financial needs will almost certainly, at some point, need to access the U.S. banking, insurance and brokerage industries. This nexus is where the power lies. Adding to this influence is the dollar’s reserve currency status. Most commodities are priced in dollars and many vendors prefer dollars. Poor, small nations would rather hold and receive dollars due to their nearly universal acceptance. Although there are other major currencies, they all have flaws. The euro, for example, has no single bond like

Treasuries. Investors can only buy EU national bonds which have a wide dispersion of credit quality, as the last five years have shown. The British pound is a widely accepted legacy reserve currency but it only represents Britain, which has an ever-shrinking global footprint that may narrow further if the country exits the EU. Japan has a deep financial market but its interest rates have been very low for so long that it scarcely offers much return. Also, none of these nations have a formidable military, meaning that in times of stress, any currency other than U.S. dollars is simply less attractive.

Increasingly, the U.S. has been using its financial system as a tool of foreign policy. In fact, it has been called the “weaponization of finance.”<sup>4</sup> FIFA touches the U.S. in a number of ways. The head office for CONCACAF is in Miami, FL. Because of the huge amounts of money FIFA controls, it eventually used the American banking system to conduct business. It was through this nexus that the U.S. was able to enforce American law extraterritorially.

The ability to force foreign entities to adopt U.S. law in order to use the American financial system is very powerful. It forces foreign nations and companies to observe U.S. sanctions against other nations. Even operations not based in the U.S., like the Society for Worldwide Interbank Financial Telecommunications (S.W.I.F.T.), found they had to do America’s bidding with regard to Iranian sanctions or risk losing business from the U.S. banking system.

The power to set global rules is a goal of hegemony. To a great extent, this is why the

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<sup>4</sup> To quote Ian Bremmer of the Eurasia Group. Campione, J. (2015, January 14). Ian Bremmer: "Almighty dollar" more powerful than nuclear weapons. *Yahoo! Finance*.

U.S. usually does not join multinational treaty groups like the United Nations Convention of the Law of the Sea (UNCLOS) or the World Court. The U.S. has no interest in joining groups it can't control and, in any case, it doesn't need these groups to enforce its goals.

There is one other important power the U.S. possesses that other nations generally don't have, which is a court system that is relatively transparent and fair. The U.S. legal system is far from perfect. There are plenty of examples of miscarriages of justice that occur in the United States. However, compared to the rest of the world, America is an oasis of fairness with the power to enforce its decisions.

No other nation on earth has this power as fully developed as the U.S. China, due to the size of its economy, can exercise power by denying nations access to its economy. On the other hand, no one is clamoring to use China's legal system to solve disputes, and its financial system is hardly transparent. China is clearly pressing to have its currency reach reserve status; although we doubt the leadership of China would be comfortable with the costs of reserve currency status, which include being an importer of last resort, the loss of domestic industries to foreign competition and the loss of control of its financial system, it does appear the leadership has concluded that reserve currency status is an absolute necessity if China is going to become a global hegemon.

The two pending trade agreements, the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership, are additional examples of the U.S.

extending its rule-setting power. If these agreements become law, it will almost force China and other nations to abide by their rules to gain access to these trade blocs. This is the primary reason these trade proposals are important. They won't necessarily create additional U.S. jobs; if anything, they will likely be mostly a wash as some jobs will be lost and others gained. But, both agreements will enhance U.S. power, which is why the political establishment is lining up to support them.

So, the decision to investigate, indict and reform FIFA is, we believe, an exercise in U.S. power. It is to show the world that, if the U.S. decides it's important enough, corruption in an international organization can fall prey to U.S. prosecutors. This exercise in power will infuriate other nations but, in the end, there is little they can do to stop it.

### **Ramifications**

The market impact of the FIFA investigation is probably more at the company level; if sponsors or broadcasters are found to have facilitated corruption, they could be pulled into court. We would expect some banks to face fines from their activities with FIFA. Overall, the more important issue from a geopolitical perspective is that the U.S. has this power and can exercise it. A successful prosecution of FIFA officials will act as a warning to others that such behavior can trigger the full weight of the U.S. legal system.

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June 8, 2015

*This report was prepared by Bill O'Grady of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.*

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