



Hamburg Institute
of International
Economics

BRAZIL AND THE 2014 WORLD CUP

Strategy 2030

— WEALTH AND LIFE —
IN THE NEXT GENERATION.
— AN INITIATIVE OF —
THE HAMBURG INSTITUTE OF
INTERNATIONAL ECONOMICS
— AND BERENBERG —



BERENBERG
PARTNERSHIP SINCE 1590



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Berenberg: Neuer Jungfernstieg 20 · 20354 Hamburg · Germany
Hamburg Institute of International Economics: Heimhuder Straße 71 · 20148 Hamburg · Germany

Authors

Berenberg: Wolfgang Pflüger, Dr Jörn Quitzau
HWWI: Professor Dr Henning Vöpel
Final editing: Alexa Reinck (Berenberg)
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Available from:

Berenberg · Corporate Communications
Neuer Jungfernstieg 20 · 20354 Hamburg · Germany
Phone +49 40 350-60-410 · Fax +49 40 350-60-9820 · E-mail: presse@berenberg.de

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Strategy 2030 is the name given to a series of studies that our organisation has published jointly with the Hamburg Institute of International Economics (HWWI) since 2005. With this series, we aim to spotlight trends that already concern us today but which will also have an impact tomorrow. Indeed, our behaviour now will decisively shape and affect the life of the next generation.

The world is experiencing a period of ever-faster change – caused by continued leaps in technology, ever greater volumes of knowledge and a globalising economy. Political, social, technological and economic changes have a reciprocal effect – sometimes intensifying but sometimes inhibiting one another – and thus seem more and more complex and less tangible. This is all the more so because they extend far into the future, in the case of demographic change even across generations.

Set against this backdrop, we have dedicated the series entitled »Strategy 2030 – Wealth and Life in the Next Generation« to long-term economic issues, looking at processes of social change outside of the traditional financial market framework. The studies unite the expertise of economic analysts recognised beyond the borders of our country and the comprehensive experience of a leading private bank that is rich in tradition.

We hope to have provided readers with an interesting and informative study.

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Synopsis

The opening game of the 20th FIFA World Cup in Brazil will kick off in São Paulo on 12 June. Two years later, Brazil will again be under public scrutiny around the world when Rio de Janeiro hosts the XXXI Summer Olympics. These events are giving Brazil the chance to present itself to the world as a powerful, safe and modern country. But in the run-up to the World Cup, massive protests against the country's political leaders have erupted among large parts of the population. Even though few countries are as sport- and especially football-mad as Brazil, many Brazilians view the World Cup as a symbol of corruption and mismanagement. Some stadiums are still not finished a few weeks before the start of the World Cup, and massive security concerns prevail. Things are not going all that smoothly for the host country in economic terms either. Given the difficult situation at present, Brazil's chances of winning the World Cup are certainly much greater than of it being able to catch up with the world's leading economies any time soon.

Brazil has great hopes that in particular the World Cup and the Olympics will provide a decisive impetus for its further economic development. Host countries often pin high economic hopes on staging major sporting events. Yet the macro-economic effect of such events is generally negligible. Cost-benefit analyses drawn up in the run-up to major sporting events regularly overplay the positive effects. Disappointed economic expectations in the host countries are inevitable. Furthermore, the Olympics in particular – the sporting facilities for which rarely find subsequent use – bear the risk of misdirected investments and investment ruins («white elephants»). Emerging markets thus take on considerable risks because there are plenty of other »building sites« in these countries that require investments. Related to this is the awarding policy of the organising sporting associations (IOC, FIFA): up until now, the impression had to be given that highly restrictive conditions were imposed on the host and hardly any of the direct gains would remain in the land.

Consequently, political decision-makers should not succumb to the fallacy that a perfectly organised and run major event can even start to compensate for negative developments in other political fields. No more than a certain feelgood factor among the population should be expected. Over the last ten years, there have been a number of host countries that have experienced remarkable economic developments in the aftermath of the sporting events. The only thing is, none of this had anything to do with the role as host country. It is rather the case that newly industrialising nations are for the first time reaching a point where they can stage such events. The message this gives is clear: despite the immense social significance that the Olympics and major football tournaments have, the economic development of a country does not depend upon being allowed to stage one of these events. Prosperity increases as a result of good economic policy, a well-trained workforce and the right long-term political decisions. In the final analysis, mega-events are not more than a spotlight making the country visible for a limited period of time.

Turning to the sporting side, the World Cup has essentially lost some of its exclusive, exotic allure due to the globalisation of club football over recent years and decades. Long gone are the days of only getting to see the world's best footballers every four years at the World Cup. To over-

simplify, the championships involving the world's best players are played out these days week by week, month by month, and year by year in the stadiums of Europe. Nevertheless, the World Cup boom continues unabated and national teams remain extremely popular. In contrast to other areas of political and social life where aspects of the nation-state are being suppressed, national teams in football are still extremely important.

So the key question remains: Who's going to win the World Cup? To make forecasts, economists frequently turn to the markets – in this case the betting markets – as this is where all the relevant information is processed and evaluated. We have used the betting odds to determine the probability of winning the trophy for each country. Accordingly, hosts Brazil are given the greatest chance of winning the World Cup, with a probability of just under 20%, followed by Germany and Argentina with almost 15% each. Defending champions Spain have a 10% chance. All this means that Brazil are the big favourites. When measured by these probabilities, however, many other countries can have legitimate hopes of lifting the trophy. And this is precisely what makes football so fascinating – the unpredictability of the beautiful game.

Introduction

The opening game of the 20th FIFA World Cup in Brazil will kick off in São Paulo on 12 June. Two years later, Brazil will again be under public scrutiny around the world when Rio de Janeiro hosts the XXXI Summer Olympics. These events are giving Brazil the chance to present itself to the world as a powerful, safe and modern country. But in the run-up to the World Cup, massive protests against the country's political leaders have erupted among large parts of the population. Even though few countries are as sport- and especially football-mad as Brazil, many Brazilians view the World Cup as a symbol of corruption and mismanagement. To this is added the fact that a few weeks before the start of the World Cup, some stadiums are still not finished and massive security concerns prevail.

This means that Brazil is joining the ranks of other emerging markets like South Africa and Ukraine which, as hosts of the 2010 World Cup and 2012 European Championships respectively, similarly had to deal with negative coverage before the event. Sporting matters were often just a side-show. Organisational shortcomings and concerns that it would hardly be possible for the tournaments to run smoothly dominated the sentiment.

In economic terms, Brazil is considered to be one of the major emerging markets alongside Russia, India and China, sometimes also known as the BRIC countries. Even though Brazil can look back on good years with strong economic growth, today many unresolved economic and social problems have become apparent. These days, Brazil is included in the »fragile five« together with Turkey, South Africa, India and Indonesia, which are considered particularly susceptible and vulnerable to global economic turmoil.

On the sporting front, the chances of Brazil becoming football world champion in its home country seem to be better today than the likelihood of the economic promises of the past being kept. Thus, anticipation and scepticism exist side-by-side in Brazil in the run-up to the World Cup. The event is expected to be an important, trend-setting happening for the country and its people, coupled with plenty of hopes – in both sporting and economic terms. It is by no means certain that all of Brazil's hopes and dreams can be fulfilled. But at least one question will be answered over the next few weeks: who will win the 2014 World Cup?

1 Portrait of Brazil

1.1 Economic prospects and development issues

In terms of surface area and population, Brazil is the fifth-biggest country in the world. Its economic output of around USD 2,400 billion puts the country in seventh place. As one of the key emerging markets, it enjoyed strong economic growth for many years. With per-capita income of around USD 12,100, however, it still lags the major western economies by a large margin. Income in Germany, by comparison, totals around USD 39,700 (figures based on purchase price parity in 2012).

Brazil is a country with a colourful political tradition, interrupted by the period of military dictatorship between 1964 and 1985. The country has been a presidential democracy since 1993 (decided by popular referendum), with the president enjoying wide-ranging political powers. The party system is fragmented and weak. Nonetheless, the system is stable. There have been just three presidents in the meantime (Cardoso, Lula and Rousseff).

The economic history of the past 35 years can best be described as turbulent. From the start of the 1980s to the mid-1990s, it was dominated by rampant inflation. At its peak (in 1990), the annual inflation rate reached 30,377%. The main cause of this is viewed as the policy of priming the central bank presses to fund the state, not covered in the slightest by tax receipts or borrowings. In July 1994, the (old) cruzeiro was replaced by the (new) real with a fixed peg to the US dollar (currency board).

By 1997, inflation had fallen back to 7%, although it still rose faster than its counterparty in the United States. The national budget remained in deficit. The Brazilian currency should have depreciated (which it could not do). De facto overvaluation was the inevitable result. The country's exports collapsed. When the large federal state Minas Gerais stopped servicing its debts in 1998, the result was massive speculation against the real. The Asian crisis cast a shadow. Starting in January 1999, the real fell by up to 50%. The consequence was a renewed bout of inflation and a severe recession. This in turn resulted in Argentina declaring national bankruptcy on account of the close economic ties between the countries.

Change of course effective to this day

This double shock led to a new desire for stability within a few years. The central state budget has run at a primary surplus (before interest and debt repayments) ever since. Despite the global financial crisis, the national debt was reduced and has been maintained at just under 62% since then. The central bank has kept interest rates high, most recently (February 2014) standing at 10.75% after several rises. The pace of price increases slowed to reach almost 6%.

Investing in human capital

A further aspect of the change of course started in 2002, thus covering the three terms of office to date of left-leaning presidents, with the battle against poverty and the expansion of the social infrastructure (education, healthcare and housing). The programmes succeeded in releasing around 40 million people from poverty. A high-spending middle class arose. Even though income distribution in Brazil remains one of the most imbalanced in the world, the social gap has been narrowing. This is reflected in a Gini coefficient that has been falling since 1993. At that time, it was 60.4 and most recently (2012) 51.9.¹ This sets Brazil apart from many other countries where the gap between rich and poor has been getting wider and deeper.

The introduction of a minimum wage should be seen as a key element in this process. In 2002, for instance, BRL 200 per month was prescribed. In 2014, after the annual increment (of 6.8% this time round), BRL 724 was due. Wages are payable 13 times a year. This means that an increase of 262% has been recorded in 12 years.

The state pension scheme was expanded. But it may be too much of a good thing if you can already retire at the age of 54 at 70% of your most recent pay. The state and companies are being overburdened. As a result of such social generosity, the incidental payroll costs to be covered by companies operating in Brazil amount of 58% of nominal pay.

In percentage terms and as a proportion of GDP, Brazil invested just as much in its education system as Germany over many years. Given that its population is two and a half times the size, this was not enough, as the ongoing shortage of skilled workers attests.

Burst of growth causes mistakes to be forgotten

Two factors have granted Brazil a long-lasting boom since the start of the new millennium: a strengthening of mass purchasing power and the rich deposits of commodities that have allowed the country to benefit greatly from the upsides of globalisation and the inexorable rise of China. The state-owned oil corporation Petrobras is one of the leading members of its industry worldwide. Its reserves have been boosted by offshore deposits, and Brazil has become a net exporter of crude oil. The mining conglomerate Vale boasts the largest iron ore deposits in the world. Indeed, the country is seen as the world's third-biggest exporter of agricultural products. The focus is on soya products together with sugar and coffee.

The economy expanded by 7.5% in 2010, the fastest rate in a quarter of a century. This helped to paper over fundamental imbalances and structural deficits in the economic framework: the heavy bias towards consumption on the economic cycle, the dependence on commodity prices and severe under-investment. What is needed is higher spending to expand the public-transport, energy and education infrastructure. The country currently invests a mere 1.5% of GDP for such purposes. The global average is 3.8%. The value of total public infrastructure amounts to 16% of GDP. In developed economies, the total is 71%.

1 The Gini coefficient is a measure of the evenness of income distribution. The lower the value of the Gini coefficient, the more evenly income is distributed. The figures range between 0 and 1 or – expressed as a percentage – between 0% and 100%.

This has inevitable consequences. As only around 20% of the road network is properly paved, the transport costs from the agricultural producer to the end customer are twice to three times as high as in other countries. Where there are no closed cold chains, large amounts of the goods go bad on their way to the shelves in stores. This is yet another reason for the high underlying rate of inflation in the country and the related high interest rates.

Those high interest rates have constrained private investment in fixed assets. In many cases, high yields from supposedly security government bonds were preferred to long-term capital investment in production facilities. This was also the case with foreign investors. They even took out loans in low-interest currencies like the US dollar, the Japanese yen or the Swiss franc on a large scale in order to buy Brazilian treasury bills. The wide interest rate spread proved attractive. While this did help to close the gaps in the current account deficit, the external value of the real increased unduly. Exports became less competitive. The country became vulnerable to abrupt changes of direction in hot foreign money.

Current macro-environment – medium-term prospects

The whole bandwidth of commodity prices has been contracting since summer 2011, serving to reveal the structural weaknesses in the Brazilian economy. The economic upturn proved to be a child of the global commodity boom. The extraction and processing of commodities accounted for around 25% of GDP in the peak year of 2011. Their export value rose by a good one-third in just one year (from 2010 to 2011) to USD 160 billion, representing 62% of all exports from the country. The industrial sector, on the other hand, lost much of its significance between 2007 (24% of GDP) and 2011 (13.3%). Between spring 2011 and spring 2014, the prices for oil, ores, sugar and the like (measured by the Thomson Reuters/Jefferies CRB Index) fell by almost 20%. The pace of growth enjoyed by the Brazilian economy slowed sharply in parallel: from 7.5% in 2010 and 2.7% in 2011 to just 1.0% in 2012. 2013 saw a rebound to 2.3%. Numerous state interventions in the run-up to the presidential elections (October 2014) were intended to reinforce mass purchasing power. The underlying conditions for the private sector, however, remained largely unchanged.

Permanently stronger growth is possible

However, more than short-term political zigzagging is required if the country wishes to leverage the advantages it still enjoys and return to its long-term potential of 4 to 5% GDP growth.

The positive factors include the following:

- A young population. 48 million Brazilians are aged under 14. The average age of the population is 30.3 years (37.1 in the United States and 45.7 in Germany).
- The country enjoys political stability.
- The country possesses enormous natural resources.
- The level of industrialisation is relatively advanced for an emerging economy.

Investment is needed in the social and traffic infrastructure.

- Despite free medical care for all, the healthcare system is considered antiquated. Schools and universities need to provide better education in order to alleviate the shortage of skilled workers. This is one of the main causes of poor productivity in the Brazilian economy, excessive pay rises, the formation of a wage-price spiral and excessively high underlying inflation.
- Domestic security needs to be improved. Not in the sense of doing more surveillance, but by employing more and better paid police. Indeed, there are still more than 40 million Brazilians living in urban slums or favelas, where crime/murder rates are intolerably high. Corruption is widespread among officers.
- The influence of the state on economic activity must be curtailed. The government failed to reform the public sector and the tax system during the »years of plenty«. There are 39 ministries at federal level, for instance. The corporate sector is too heavily burdened with taxes, levies and incidental payroll costs. This is one of the reasons why Brazil ranks 53rd out of 144 countries analysed on a list of the most competitive countries drawn up by the World Bank.
- Positive signs: Under the PAC2 growth programme initiated in 2011 (Programa de Aceleracao do Crescimento), BRL 1,000 billion or around EUR 370 billion is being made available for urban development and housing construction as well as for investment in the power and water supply and also the transport sector. For example, 1,900 kilometres of motorway have been built since 2011; 7,400km are currently still under construction. The rail network grew by 2,600km. Furthermore, foreign investors can bid for concessions to operate railway lines, ports and airports.

1.2 Next big economy?

Brazil has for many years been considered the next big economy. It is one of the so-called BRIC countries alongside Russia, India and China. Jim O'Neill from Goldman Sachs coined this acronym to describe the four high-population lands enjoying fast economic growth. In actual fact, Brazil has recorded a strong economic performance over many years. In recent years and months, however, Brazil's pent-up problems have become more apparent. Even if the level of development has improved constantly, massive protests have erupted against corruption, mismanagement and social inequality. Some of these protests have also targeted the World Cup, seen to some extent as a symbol for policies that run contrary to the interests of large swathes of the population.

Per-capita income in Brazil has risen fast since 2003 (see Figure 1). Nevertheless, Brazil still has much catching up to do in many areas, most notably on the welfare side and in the quality of its institutions. Both of these are important factors for sustainable, socially compatible growth. Brazil lies in 130th place in the Doing Business Indicator and 85th in the Human Development Index.² The Doing Business Index reflects factors like protection for investors and ownership rights and access to credit. The Human Development Index measures the social development of an economy in terms of factors like education, healthcare, sustainability and equal opportunities.

In the course of the latest global economic developments, Brazil is counted among the countries that are considered particularly susceptible and vulnerable to the macro-economic fault lines in the global economy. Together with Brazil, Turkey, South Africa, India and Indonesia are deemed the »fragile five«. These countries have high current account deficits and at the same time depend heavily upon short-term capital imports. This combination makes Brazil vulnerable to a withdrawal

² See World Bank (2013); United Nations (2013).

Per-capita gross domestic product in Brazil

Purchasing Power Parities, in US dollars, 2005

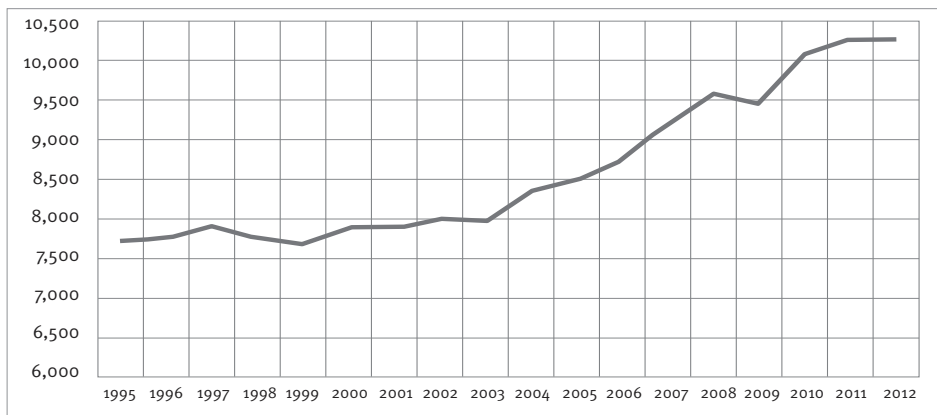


Fig. 1

Source: World Bank (2014a).

of capital. In particular, should the Federal Reserve put an unexpected and quick end to its ultra-loose monetary policy, Brazil could be affected by a withdrawal of capital and a devaluation of the real. If the conditions are right, currency turmoil can even turn into currency crisis. Although the stock of currency reserves is relatively high in Brazil, this can very quickly become depleted, as other financial and currency crises have shown in the past, in the face of speculative attacks if the central bank intervenes on the current market to prop up the exchange rates or raises interest rates. As the Asia crisis of 1997 demonstrated, institutional weaknesses in the domestic financial markets and the banking sector contribute largely to the macroeconomic vulnerability of emerging markets, as the fear of losses on the part of investors can quickly spiral out of control in such a scenario. In March of this year, several rating agencies downgraded Brazil's credit rating. Brazilian government bonds do indeed feature a substantial default risk. This means that the interest rates for refinancing are rising, to the detriment of the government finances. Brazil could also be drawn into the after-effects of general speculation against emerging markets by contagion. Emerging-market funds have lost up to 50% of their value over recent years.

Developments over recent months have similarly been double-edged. The Brazilian economy finished 2013 unexpectedly robust. Following the »almost-stagnation« of the summer months, record harvests gave a big boost to the agriculture industry. Consumers remained happy to spend in response to the numerous tax breaks and subsidies granted by the government of President Dilma Rousseff one year ahead of her bid for re-election. These two factors provided for annualised GDP growth of 2.7% during the fourth quarter of 2013. Thus, the economy grew by 2.3% over the year as a whole (after 1.0% in the previous year). Now, however, the outlook has become much bleaker in the year of the World Cup and the presidential elections scheduled for October. The pillars of the economy to date have started to wobble. The ongoing drought in central agricultural provinces will lead to a badly failed harvest. Food prices are already rising. What normally represents a big plus for Brazil's ecological balance sheet and electricity costs – the high proportion of hydroelectric power in the total energy volume generated (70%) – has gone into reverse, as the dams are almost empty, expensive oil- and coal-fired power plants are having to be activated, and the costs for industry and consumers are threatening to rise sharply.

But even before that, consumer confidence had fallen to its lowest level since May 2009. The central bank has raised its benchmark rate nine times since April 2013 (by a total of 350 basis points) to 10.75% today. Although this has depressed the inflation rate close to a 12-month low of 5.7% recently, an increase in the coming months is, however, very probable: further interest rate hikes are likely. Private consumption will lose momentum.

Industry is still having to cope with high payroll costs, repressive tax burdens, poor infrastructure and possibly also power outages. These factors will tend to dampen future economic growth. A similar picture emerges for the export side on account of low commodity prices. This is also demonstrated by the high current account deficit, which reached a record of USD 11.6 billion in

January 2014. Already in 2013, a deficit of USD 81.4 billion (2012: USD 52.3 billion) had accumulated. This corresponded to 4.1% of GDP and was one of the main reasons behind the temporary weakness of the national currency, the real. This vulnerability is likely to persist, as government spending is not expected to stabilise the situation greatly in this election year either.

Whereas the government and central bank predict growth of 2.5% in 2014, slightly higher than in the previous year, the consensus figure of professional analysts is just 1.7%. An increase of 6.1% is anticipated for consumer prices. Benchmark interest rates of 11.5% are considered likely.

The growth euphoria in and around Brazil of past years has given way to a certain disenchantment. Observers never tire of predicting a glowing future for Brazil. However, the country has not lived up to these expectations for just as long. Brazil has failed to modernise and reform the country during the period of strong economic growth. In this typical phase of economic development for emerging markets, social conflicts of the distribution of wealth become apparent alongside structural and institutional deficits. The upcoming global sporting events may well serve to restore lost solidarity of Brazilian society in places and only temporarily – even should Brazil actually win the World Cup in its own country.

2 Football – sports and economic factor

2.1 Economic effects of the World Cup in Brazil

»And the winner is ...« With these words, FIFA President Sepp Blatter announced the decision of which country would have the privilege of hosting the FIFA World Cup. One winner is already certain: FIFA itself. FIFA made a pre-tax profit of more than USD 2.3 billion over a four-year period with the last World Cup in South Africa in 2010. The total revenues amounted to USD 3.7 billion, while expenses came to around USD 1.3 billion. The TV rights contributed USD 2.4 billion and the marketing rights USD 1.1 billion to income.³

The countries vying to host the World Cup also anticipate positive economic effects, as almost half a million tourists visit the country, and the final is watched by more than a billion people across the globe on TVs, PCs or smartphones. This worldwide attention is intended to sell the country to tourists and investors alike in order to trigger a sustainable economic upturn. Once FIFA's decision has been announced, the host has seven years to make all the necessary preparations. The role of host was entrusted by FIFA to Brazil, the only candidate at the time, on 20 October 2007. From that date on, the preparations went into full swing. Investments were needed in the transport infrastructure, the stadiums and security. Over EUR 10 billion was set aside for this purpose in Brazil. The latest reports on the status of the preparations are alarming, however. Many stadiums were handed over to FIFA incomplete, just a few weeks before the World Cup kicks off. It is already clear that not all of the construction work will have been completed by 12 June and much will have to be improvised.

The costs of major sporting events are so high these days that staging such events must be viewed less as consumption and more as an investment that should yield as high a return as possible. In many cases, only the »white elephants« of oversized sports facilities remain as »souvenirs« of major sporting events for which there is no subsequent use. These investments in sports facilities must be weighed against investments that could otherwise be made in schools and hospitals. In emerging markets in particular, the return on investments in urgently needed economic public goods is often very high, which explains why opposition arises to the staging of major sporting events as was recently also the case in Brazil. In this context, the economic return of major sporting events is extremely hard to measure as it also contains »emotional returns« and a feel-good factor alongside the economic growth effects. Less important, albeit often discussed, are the temporary income and employment effects arising from spending by foreign visitors and the capital investments. Much more important, though, are the intangible effects, although these are hard to measure as they are almost impossible to isolate and only emerge in the long run. These include image and publicity effects that are expected to have a positive impact on the decisions of tourists, skilled workers and investors. Table 1 shows a list of possible effects.

The experiences gained to date by the hosts of the World Cup vary greatly. The regional economic effects and economic benefits and costs of major sporting events like the football World

3 See FIFA (2014a).

Economic effects of major sporting events

	short-term	long-term
Benefits	<i>tangible</i> <ul style="list-style-type: none"> • Income and employment effects • Fiscal effects 	<ul style="list-style-type: none"> • Tourism • Sports infrastructure
	<i>intangible</i> <ul style="list-style-type: none"> • International flair • Feelgood 	<ul style="list-style-type: none"> • External: publicity and image • Internal: motivation and identification (civic pride) • Location attractiveness
Costs	<i>tangible</i> <ul style="list-style-type: none"> • Planning and execution • Infrastructure works • Security 	<ul style="list-style-type: none"> • Maintenance costs • Dismantling work
	<i>intangible</i> <ul style="list-style-type: none"> • Congestion • Noise 	<ul style="list-style-type: none"> • Opportunity costs • Space usage

Table 1

Source: Vöpel (2010).

Cup or the Olympics are the subject of numerous empirical ex ante and ex post studies. The results differ widely; the empirical evidence is highly inconsistent as a consequence.⁴ This allows the conclusion to be drawn that how great the economic benefits are, and whether staging such an event represents a worthwhile investment, apparently depends on the actual case in question and the specific circumstances.

In Germany, for instance, the 2006 World Cup served to add around 0.4 percentage points to the real annual growth rate.⁵ Employment only rose for a short time and primarily in basic service sectors. Hardly any permanent jobs were created. On the other hand, the 2006 World Cup is a good example of how a World Cup can have a positive impact on soft factors. The image of Germany and the perception of what is considered typically »German« abroad changed and improved throughout the world. Germans are not necessarily inhibited, humourless people, they certainly know how to enjoy themselves with people of all stripes. Particularly in the run-up to the World Cup, there was a national debate about intolerance and xenophobia.

The experience of South Africa holding the 2010 World Cup is a good reference point for Brazil. Even if it is still difficult to measure the direct economic effects, looking back after four years it is clear that the World Cup has contributed to the nation-building and nation-branding of South Africa.⁶ The identification and civic pride of the inhabitants have increased, and are having a positive impact on motivation and community spirit, which in turn is reflected economically in greater productivity. Very similar effects may be more important in and for Brazil than the direct and only temporary effects on income and employment. The sum total of all these effects determines the legacy of an event, the legacy and memories that, if possible, carry on over generations and become part of folk history as a result.

⁴ See Ahlert (2005); Allmer/Maennig (2009); Kesenne (2012); Porter/Fletcher (2008).

⁵ See Brenke/Wagner (2007).

⁶ See DIW (2010).

Sporting events have become so popular around the world these days, and have such a media reach, that they are highly coveted as promotional media and flagships, not only for global companies through sponsoring activities but also for cities, regions and countries. There is a type of bidding war for such events accordingly. (Note: The award of the 2014 football World Cup to Brazil as the only candidate at that time is a major exception and should be viewed to some extent as a tribute to Brazil's footballing tradition.) The »providers« of the global sporting events are the great and mighty global associations like the IOC and FIFA, which leverage their monopoly position to gain most of the profits from licensing and copyright. The effects are often overestimated by the candidates, especially by those who get the nod at the end. This phenomenon is known as the winner's curse.⁷ Added to this is the fact that the decision by politicians to enter the fray is not

⁷ See Andreff (2012); Horne (2007); Humphreys/van Egteren (2012).

»Bread, not circuses« and »Schools, not stadiums«?

Particularly for newly industrialising countries, the opportunity costs of staging a sporting event like the World Cup are generally very high, as the investments could alternatively be made in education and healthcare. Of course the money put into stadiums and sports facilities instead of schools and hospitals cannot resolve a country's social problems. Public spending on education and healthcare represents around 15% of gross domestic product in Brazil. The investments made in connection with the World Cup, on the other hand, »only« account for no more than 1% of gross domestic product. Even if these investments later prove to be completely wasted, they would be little more than a »drop in the ocean« for the social problems facing Brazil as a one-off.

At the same time, hosting the World Cup or the Olympics can very well generate positive and also sustainable effects – especially for emerging economies. The potential effects of making the country attractive as a market for foreign direct investment or domestic exports by successfully running a smooth event, and providing evidence of the necessary logistical and institutional conditions, can provide a major fillip. By staging major sporting events, such countries are in a way sending a »signal« for their desire and ability to appear as an open, modern nation. In established markets and developed economies, the opposite is true: the opportunity costs are relatively low and the economic effects likewise. There is no getting around the fact in the end: the decision of whether it is worth a country hosting major sporting events must be examined on a case-by-case basis. Neither does the scientific literature contain any generally accepted evidence for or against such a decision.

Box 1

always adequately legitimised by the popular vote. As has been the case over recent months and all the more so during the staging of the Confederations Cup (a type of test tournament a good year ahead of the World Cup at featuring the hosts of the next World Cup and representatives of the FIFA confederations), it is possible that large swathes of the Brazilian population will take part in massive protests against the World Cup. »Schools not stadiums« and »Bread not circuses« – even in sports-mad Brazil, the people are taking to the streets to protest against high spending on oversized stadiums and pointless infrastructure. In part, the protests are not directed against the World Cup per se, but it has become a symbol of corruption and mismanagement in Brazilian politics.

The image of the IOC and FIFA among the public at large and in the media has suffered badly of late. Sochi 2014, Russia 2018 and Qatar 2022 have done little to defuse such discussions. One key motivation when awarding the events is no doubt the strategic desire tap new, commercially lucrative markets. In addition, the question is increasingly being asked whether democratic countries are still capable of getting the nod or whether autocratic states have an advantage when it comes to implementing the often highly restrictive conditions of the IOC and FIFA over the heads of their own people.

Time and again, politicians and dictators have tried to misuse the glitz of sporting events for propaganda purposes and self-aggrandisement. It is easier for autocratic states to make major concessions in the candidacy than democracies – forcibly relocating whole villages or concreting over conservation areas, for example – and bid huge sums of money. This is convenient for the organisers, but not good for sport in the long run. By contrast, the IOC and FIFA maintain – possibly not without good reason, even if the evidence is weak – that the countries are thrust into the full glare of global publicity by hosting the Olympics or the World Cup, forcing them to open up and modernise. The IOC also considers it crucial for sport not to be used as a means of political or ideological demonstration. Some IOC decisions, such as not being allowed to show personal grief in competition, have caused heads to shake in disbelief. As always, it is very difficult to know where to draw the line. Indeed, how should the IOC position itself ideologically in a world of pluralist values without endangering the unity and ability of sport to integrate as a result?

Nevertheless, it is important for the global sporting associations to consider new ways and change the method of awarding events and simultaneously the philosophy of mega-events. It is important for major sporting events to once again be a project for the people locally. The IOC and FIFA are being challenged to change the philosophy and concept of major sporting events in such a way that hosting is made possible for many, very different countries – not least for the good of sport itself. To achieve this requires the events to take on dimension that are socially and ecologically compatible. This would certainly also be in harmony with the values and ideals of sport, which are crucial for the long-term credibility and responsibility of sport alongside its major commercial and economic significance that is these days undisputed.

Conclusions

The discussions to this point have shown that it is not possible to draw universal conclusions regarding the benefits of hosting major events like the Olympics, the football World Cups or the European Championships. It is necessary to analyse each case individually. Nonetheless, the experience gained and results of empirical analyses can be consolidated to create a practical basis for decision-making.

- The macro-economic impact of major sporting events can be disregarded. At best, emerging markets with low gross domestic product can record growth effects in the low single-digit percentage range from the tourist spending and infrastructure investments induced by the event. Economic winners can only be found at industry and company level.
- Cost-benefit analyses drawn up in the run-up to major sporting events regularly overplay the positive effects. Disappointed economic expectations in the host countries are pretty much inevitable.
- The spending required to stage major sporting events in the host countries is in competition with other government programmes such as education investment. So it is important to set any social-welfare gains from the World Cup or the Olympics against the social-welfare gains yielded by alternative measures.
- The Olympics in particular bear the risk of misdirected investments and investment ruins (»white elephants«). In hosting such events, emerging markets take on considerable risks. Related to this is the awarding policy of the organising sporting associations (IOC, FIFA): up until now, the impression had to be given that highly restrictive conditions were imposed on the host and hardly any of the direct gains would remain in the land. Even if FIFA and the IOC aim to be politically neutral for thoroughly good reasons, sport can be even more of an ambassador for tolerance and fairness, including and especially in politically difficult countries. To achieve this would certainly require reforms within the associations to ensure greater openness and transparency.
- While the measurable social-welfare effects can be pretty much disregarded, major sporting events give the host the chance to indulge in some free – albeit non-measurable – location marketing. In addition, the population of the host country enjoys a certain feelgood factor at least for a short period of time.

Major sporting events with their multi-faceted economic effects are also a worthwhile field of research for economists. There are a number of detailed aspects that have not been adequately investigated to date. Despite all the imponderables outlined, experience shows that neither the Olympics nor World Cups or European Championships are suitable for turning around the economic destiny of a given country. Consequently, political decision-makers should not succumb to the fallacy that a perfectly organised and run major event can even start to compensate for negative developments in other political fields. Over the last ten years, there have been a number of host countries that have experienced remarkable economic developments in the aftermath of the sporting events. The only thing is, none of this had anything to do with the role as host country.

- Greece (2004 Olympics) and Portugal (2004 European Championships) benefited at first from the healthy underlying economic conditions in the eurozone, before both countries needed bailing out during the course of the global financial crisis and sovereign debt crisis.
- Germany (2006 World Cup) has experienced a small economic miracle since the World Cup in the country. However, the reforms known as Agenda 2010 are responsible for this and not the good humour of the population during the World Cup or the reputation of the Germans abroad, which were no doubt boosted by the successful World Cup.
- China (2008 Olympics) achieved fantastic economic growth well before, during and also after the Beijing Olympics. The major event merely served to focus international attention more than usual on China for a couple of weeks – in purely economic terms, it was pretty much a non-event.
- Despite considerable concerns in the run-up, South Africa (2010 World Cup) ran a smooth, successful tournament, quite rightly a source of great pride to the South African population. However, the organisational success of the World Cup was unable to prevent South Africa again having to cope with a series of economic and political problems in 2014: a high degree of corruption does just as much to deter foreign investors as the recurring labour disputes; and the high current account deficit makes the country vulnerable in macro-economic terms.
- International observers took a highly critical view of Ukraine (2012 European Championships) in the run-up to the European Championships that was shared with Poland. Although the European Championships ran trouble-free, the events of the first couple of months of 2014 have shown that the country's political destiny can of course not be altered by hosting a major sporting event.

The economic effects of Carnival in Brazil

The annual Carnival in Brazil has enormous economic effects for Brazil. Estimates suggest earnings of USD 3.2 billion from tourism alone during the Carnival, of which around USD 628 million goes to Rio de Janeiro, where the Carnival attracts 850,000 visitors. With the big parade, Rio turns over USD 42.7 million from ticket sales, sponsoring and advertising as well as the TV rights.⁸ These figures put the Carnival among the best-known events in the world with the greatest economic impact.

The Brazilian Ministry of Economic Affairs estimates that the 2014 World Cup will yield around USD 5.5 billion in earnings from tourism. Neither will the 2016 Olympics in Rio have a much greater direct economic effect than the annual Carnival. Meanwhile, providing the proof that a country or city should host the World Cup or the Olympics has a very different quality to the Carnival. Moreover, the target group for this signal is surely a very different one.

Box 2

⁸ See Bloomberg (2012)

The message this gives is clear: despite the immense social significance that the Olympics and major football tournaments have, the economic development of a country does not depend upon being allowed to stage one of these events. Prosperity increases as a result of good economic policy, a well-trained workforce and the right long-term political decisions. In the final analysis, mega-events are not more than a spotlight making the country visible for a limited period of time.

2.2 Football sociology: national team and globalisation

The world is growing together, Europe is growing together, football is globalising – are national teams obsolete?

That World Cups and European Championships are hard to beat in terms of mass attractiveness is all too obvious: sold-out stadiums, packed fan areas, euphoria on the streets and record TV ratings are clear evidence. In Germany, 31.1 million viewers watched the 2010 World Cup semi-final between Spain and Germany, representing a market share of a good 83%. According to FIFA, more than a billion people around the globe watched the final between Spain and the Netherlands, at least if the crowds at public events (like public viewing) are included. During the entire 2010 World Cup, 3.2 billion people (46.6% of the world's population) turned on at least once briefly to watch World Cup reports.⁹

European Championships attract almost as much attention within Europe as the World Cup. Around 28 million viewers turned on to watch the semi-final of the 2012 European Championships between Italy and Germany. And all the other games involving the German national team also achieved very high TV ratings (see Figure 2).

⁹ See FIFA (2011).

TV viewers for the games involving the German national team at the 2012 European Championships

TV viewers (millions)

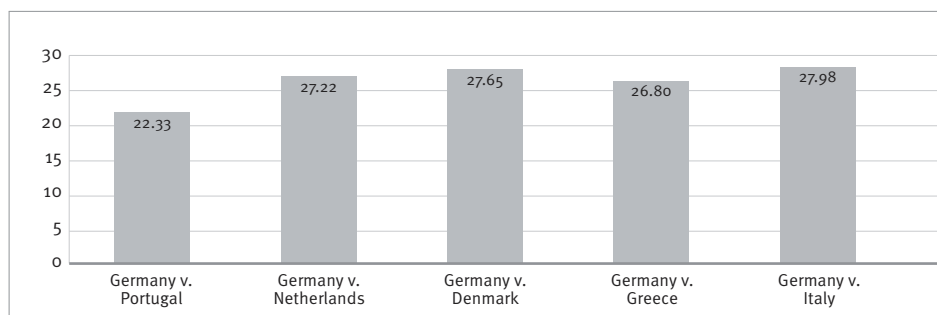


Fig. 2

Source: Statista.de.

Even at first glance, it is already apparent how much major football happenings fascinate people all over the world. In addition, economists from the University of Münster calculated how much Germany winning the 2012 European Championships would be worth to the Germans financially.¹⁰ Even given all the method deficiencies that such surveys necessarily entail, the results are very interesting. The average German was willing to pay a good EUR 47, which is much higher than the average amount for first place in the medals table for the German athletes at the 2012 Summer Olympics (a good EUR 37). Extrapolated for the German population as a whole, this yielded a value of EUR 3.3 billion for winning the 2012 European Championships.

In light of all these figures, questions regarding the long-term viability of the World Cup and European Championships must seem very wide of the mark. And yet that are social, political and sporting developments that might theoretically be likely to take some of the attractiveness out of the World Cup and European Championships in future. A major role in this respect is played by globalisation, complete with its consequences for society as a whole as well as for sport. Until well into the 1980s, the World Cup was practically the only way for football fans to see world stars from Brazil, Argentina and other exotic countries playing live on TV. This exclusive, exotic component has in the meantime largely been lost from the World Cup. The best footballers in the world now play week in, week out in the German Bundesliga and the other major European leagues. Thanks to both conventional and new media, football fans are in a position these days to watch top stars (like the Argentine Lionel Messi who plays for Barcelona) at work at any time, even in other European countries. All in all, in terms of the provisional squads (as of April 2014), around 70% of the World Cup participants play for European clubs and around 50% play in the five major leagues: England's Premier League, Spain's Primera Division, Italy's Serie A, France's Ligue 1 and Ger-

10 See Dilger/Kiefer/Wicker (2013).

Share of registered players in the German Bundesliga who are non-German
in %

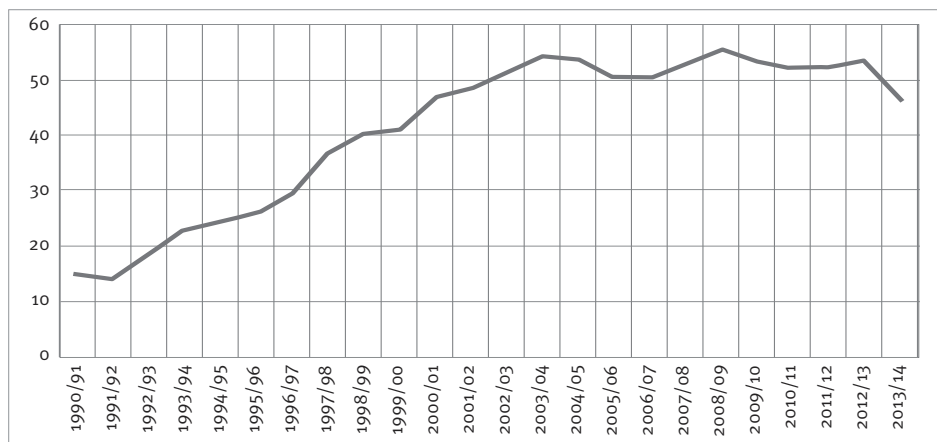


Fig. 3

Sources: Transfermarkt.de; own calculations.

many's Bundesliga (see transfermarkt.de). Furthermore, the best players in the world regularly face each other in European club competitions (UEFA Champions League and Europa League).¹¹ Thus, 15 of the 19 Brazilians in the provisional World Cup squad are under contract to a European club. To oversimplify, the championships involving the world's best players are played out these days week by week, month by month, and year by year in the stadiums of Europe. In the final analysis, all this is left at the FIFA World Cup is the chance for a majority of these footballers to play against each other in a different line-up based on nationality. The theoretically popular exclusive and exotic nature of earlier years has, to a large extent, been successively lost by the World Cup.

11 For the background, see also Szymanski (2014).

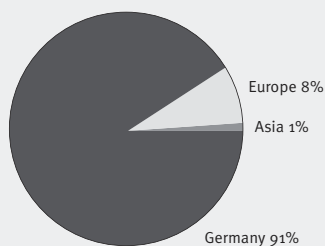
The globalisation of football

Globalisation has also swept through professional football. In the 1980s, the proportion of non-Germans playing in the German Bundesliga remained constant at around 10%. By shortly after the start of the new millennium, the proportion of non-Germans had risen to 50%, a level at which it has persisted to this day, with slight fluctuations. How greatly football has become globalised during this time is demonstrated by a closer analysis of the figures: 30 years ago, in the 1983/84 season, 34 non-Germans (representing a proportion of 8.8%) from 20 different nations played in the German Bundesliga. Within this total, only five players came from countries outside of Europe (two South Koreans, one Congolese, one Japanese and one South African). Not a single player from the South American football strongholds of Brazil and Argentina had found their way into the Bundesliga.

By contrast, we are now living in a totally different world. In the 2013/14 season, 234 Bundesliga players were non-German, coming from a total of 56 nations on all five continents. 14 players come from the World Cup host country Brazil alone, including members of the Brazilian national team. Over the last 30 years, the Bundesliga has thus evolved from a national into a highly globalised event.

Origins of Bundesliga players

1983/84 season



2013/14 season

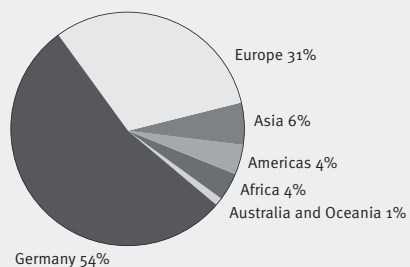


Fig. 4

Source: Statista.de.

Box 3

Furthermore, globalisation has made national borders politically and socially more permeable over the last 20 years. During the course of the global financial crisis and the subsequent crisis of confidence in the eurozone, numerous leading European politicians undertook considerable efforts to tie the countries of Europe closer together politically. The idea of a »United States of Europe« is being touted more and more often. In Europe at least, there are identifiable leanings towards transcending nation-states. If Europe – the most important football market in the world – should actually evolve from a federation of sovereign states into a federated state over the next couple of decades, would it not then be logical to send a »Team Europe« to the FIFA World Cup instead of national teams from Italy, Spain, the Netherlands, France or Germany as before? Would such a development not make it obsolete to stage the UEFA European Championships? And would there still be a meaningful place at all for a World Cup of nation-states in an environment where the nation as a concept is increasingly being transcended? Would it not be more appropriate in this day and age to upgrade the existing FIFA Club World Cup in such an environment, using it to replace the FIFA World Cup?

Looked at rationally, there are several good arguments suggesting that, as the importance of the nation-state declines, the significance of the national teams and the European Championships and World Cups also falls. But football is primarily an emotional phenomenon, in which rational aspects play a lesser role at best. So it comes as no great surprise that the internationalisation of football as described has done nothing to date to tarnish the attractiveness of the UEFA European Championships or the FIFA World Cup. On the contrary, interest in both events has gone on rising in recent years.¹² The national teams are faring like football as a whole: the euphoria is uninterrupted.

The enthusiasm may have much to do with the fact that football connects people with each other and that it is a group event. Although the sporting side is important to many football fans, it is not the only consideration. Interesting insights are provided by a study entitled »Wir sind Nationalmannschaft« (»We are the National Team«) conducted by the Institute for Sports, Business & Society at the EBS Business School. In a survey of supporters of the German national team, 80% of respondents said that they like the team's playing style. This means that a sporting consideration is the most important motivation to support the national team. However, 67% of those surveyed also cited the social experience as the reason for their support.¹³ This fits in with the findings of other studies which indicate that people draw greater pleasure from talking about sport and celebrating the results than sitting through the event personally in the stadium.¹⁴ Alongside the sporting event, the whole experience also plays a very important role. The European Championships and World Cup in many cases also electrify people who are not normally interested in football.¹⁵ Ever since the 2006 World Cup at home at the latest, Germany's population has collectively been in an emotional state of emergency during the respective finals. The euphoria is similarly great in other countries. At just about every World Cup and European Championships, the media report on great enthusiasm

12 According to FIFA, the average number of viewers in private households was 6% higher for the 2010 World Cup than for the 2006 World Cup. See FIFA (2011).
13 See Bergmann/Schmidt (2013).

14 See Dilger et al. (2013). Includes references to other studies.

15 See Bergmann/Schmidt (2013).

and great national pride among the population at large – this was the case in South Africa in 2010 and also in Poland in 2012.¹⁶

The UEFA and FIFA football associations possess the knowledge needed to leverage the brand status of the national teams, the FIFA World Cups and the UEFA European Championships into the future. Even if football is highly globalised these days – as outlined at the start of this section – and pretty much the same players appear in the World Cup as in the UEFA Champions League, the World Cup and European Championships still have a special allure for the fans. Alongside the reasons already mentioned above, the fact that, unlike in club football, no transfers are possible between national teams may well play a role, meaning that the squad for the national team must comprise a fixed pool of players and hence greater continuity and greater distinctiveness dominates with national teams. This gives national teams something of an anchor function.¹⁷

To some extent, the football associations are practicing product differentiation with the various competitions. As this generates both sporting interest for the fans and considerable financial value added, national teams and the World Cup and European Championships are set to remain a model of success for a long time to come, despite all globalisation trends. This fits with the Nations League approved by UEFA in March 2014, under which Europe's national teams are expected to line up against each other every other year starting in 2019. UEFA evidently still rates the significance of national teams for the future very highly.

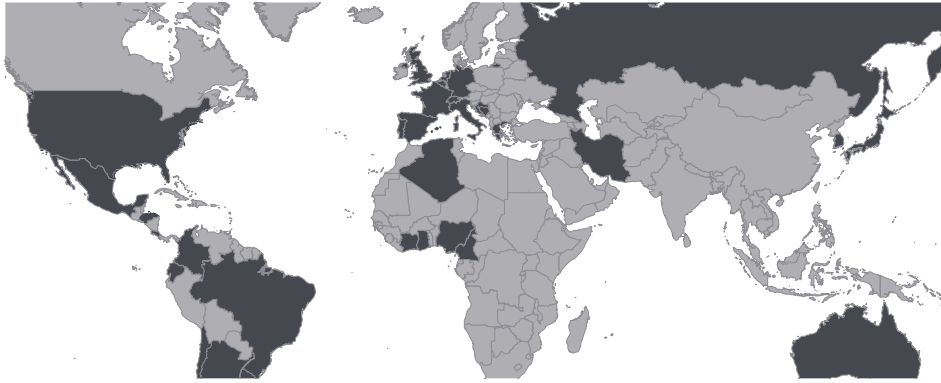
As an aside, the views of the fans give rise to interesting (economic) policy implications. According to the study »Wir sind Nationalmannschaft« mentioned above, the German national team is a meaningful source of community identification.¹⁸ The study's authors point out that, at a time when social, political and welfare institutions (such as churches, trade unions and political parties) are becoming less significant, football is increasingly assuming an identity-creation function. Football is thus setting a clear counterpoint to the political-social trend for important decisions to increasingly be taken at European and international level. The preferences and behaviour of football fans indicate that large parts of the population are not yet far enough on to transcend today's nation-states. We do not wish to over-interpret this finding, but these are least indicators that, although there is room for individual areas of policy to be coordinated across Europe, local political solutions of nation-states are still fully justified and a political union would not reflect the majority attitude to life adopted by the citizens of Europe.

¹⁶ For example: see Hawkey (2010).

¹⁷ See Mutz (2013).

¹⁸ See Bergmann/Schmidt (2013).

Nations participating in the World Cup 2014



Country	FIFA-world ranking April 2014	Per-capita income (Purchasing Power Parities, US dollar), 2012	Human Development Index (ranking), 2012	Active football players (in millions), 2006
Spain	1	32,043	23	2.83
Germany	2	41,245	5	16.31
Argentina	3	11,573	45	2.66
Portugal	4	25,389	43	0.55
Colombia	5	10,436	91	3.04
Uruguay	6	15,776	51	0.24
Switzerland	7	53,281	9	0.57
Italy	8	33,134	25	4.98
Brazil	9	11,716	85	13.2
Belgium	10	39,751	17	0.82
Netherlands	11	43,105	4	1.75
England	12	37,456	26	4.16
Greece	13	25,331	29	0.76
USA	14	51,749	3	24.47
Chile	15	22,363	40	2.61
Croatia	16	20,964	47	0.36
France	17	36,104	20	4.19
Russia	19	23,501	55	5.80
Mexico	20	16,734	61	8.48
Bosnia-Herzegovina	21	9,392	81	0.20
Ecuador	23	9,637	89	1.03
Cote d'Ivoire	24	2,006	168	0.80
Algeria	25	8,447	93	1.79
Costa Rica	34	12,733	62	1.08
Ghana	35	2,014	135	0.99
Honduras	36	4,174	120	0.42
Iran	42	11,310	76	1.81
Nigeria	47	2,666	153	6.65
Japan	48	35,178	10	4.81
Cameroon	50	2,312	150	0.79
South Korea	60	30,801	12	1.09
Australia	63	44,598	2	0.97

Fig. 5

Sources: United Nations (2013); World Bank (2014b); FIFA (2007); FIFA (2014b).

2.3 Is it possible to make money from football?

Football is booming. The German Bundesliga is bouncing from one record to the next. Revenues amounted to EUR 2.17 billion in the 2012/13 season, up 4.4% on the previous season.¹⁹ UEFA recorded turnover of around EUR 1.5 billion with the Champions League alone last season, while FIFA generated almost EUR 4 billion over a four-year period.²⁰

The supposition seems likely that it is possible to make pots of money from football. But this does not hold true for all of football's stakeholders. Many clubs are making a loss, some are even facing bankruptcy. In European football, the aggregate club debt has risen to EUR 1.7 billion.²¹ There are various reasons for this, related to the (economic) peculiarities of football as a sport. First of all, the main focus of clubs needs to be considered. Unlike »normal« business enterprises, football clubs do not pursue the goal of maximising financial gains. Instead, the objective is for maximum sporting success while avoiding economic insolvency at the same time.²² A further peculiarity is that, whereas competition is a positive-sum game in business, league sport is a zero-sum game. As the clubs compete for placings, an improvement in the table for one club automatically means another club sliding down the table. So what matters most is being ahead of the others in the table, because this enables a club to qualify for the Champions League, for instance, and this is the only way of pocketing the really big money. This contest for the best places in the table creates strong incentives for investment spirals at the clubs, which can finally lead to a race to the bottom (»ratrace«). The winners of this investment spiral are generally the footballers, because the bidding war between the clubs is reflected directly in the salaries of the players.

The competition is regulated in order to mitigate these incentives to over-spend and to maintain the sporting balance of a given league.²³ Redistribution and licensing are intended to retain financial stability and the tension of the sporting competition. At European level, UEFA introduced its Financial Fair Play regulations with effect from the 2014/15 season under which clubs are only allowed to spend as much money as they have earned from football-related sources.²⁴ For these reasons, investments in clubs rarely yield any returns. Spending like that of Roman Abramovich or the arrival of major corporations as club owners are consequently either a form of patronage (sometimes also known as sugar daddies) or strategic in nature.

Football as a whole is an absolute monopoly. FIFA, for instance, is the only world association that stages the World Cup, and UEFA the only association to organise European competitions. From a sporting point of view, the monopoly should be seen as a positive. It is good for fans and spectators alike that – unlike in boxing – there is only one football world champion and only one Champions League winner. In economic terms, the monopoly enjoyed by FIFA is coupled with very strong market power, which leads to the skimming of monopoly profits (see Figure 6).

19 See DFL (2014).

20 See UEFA (2013); FIFA (2014a).

21 See UEFA (2013).

22 Every club defines sporting success in its own way. For some clubs, winning the title is the only form of success, for others

it is reaching the Europa or Champions League, and for many simply not being relegated counts as a major success.

23 For the special nature of league competition and its regulation, see Szymanski (2003); Vroomann (1995).

24 For a detailed discussion, see Quitzau/Vöpel (2013).

Direct and indirect football markets

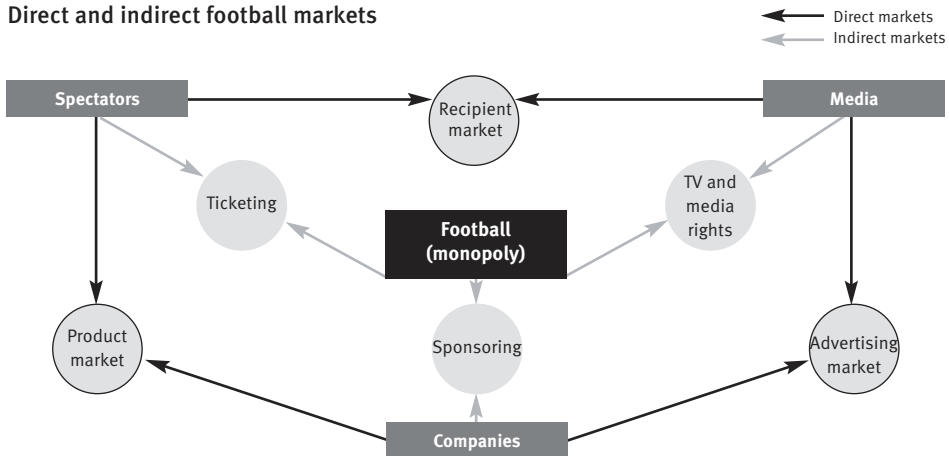


Fig. 6

Source: own chart.

The same also holds true for the indirect markets. For example, all the potential advertising revenues of the public or private TV stations are already included in the bids when the TV rights are marketed. The TV stations know that they can sell advertising slots at high rates if they have football in their schedule. FIFA uses this mechanism to skim the advertising revenues of the TV stations at the same time. Sponsoring offers a similar picture. Strict licensing rules and trademark rights serve to keep the sponsoring opportunities for companies in short supply for a World Cup, enabling FIFA to maximise the profits from sponsoring. But why should companies still want to advertise at the World Cup at all, if FIFA skims all the potential economic effects anyway? The companies that typically act as sponsors at major sporting events operate in global markets that they share with a few other vendors. If a company decided not to act as a sponsor at the World Cup or Olympics, one of the competitors would do so, resulting in a loss of market share. This means that there is a type of »prisoners' dilemma« in oligopolies: for strategic reasons, no company can afford not to act as sponsor. Which drives up the bids for sponsorships – and money into FIFA's coffers.

Notwithstanding these mechanisms, the manufacturers of sporting goods and equipment in particular enjoy booming sales in every World Cup year. Advertising campaigns featuring the stars are launched and new products rolled out. But even the World Cup ball is of course protected by trademark. The revenues booked by manufacturers of sporting goods rise at around World Cup time, and share prices shoot up well in advance, as the economic effects of a World Cup are well known to the stockmarkets.

Why the superstars earn so much from football

Why do the top players earn so much money? This question has no doubt been asked by quite a few people when they've raged against the star player in their team when he once again demonstrated the turning circle of a tanker. In economic terms, it is easy to explain why the top players earn so much money.²⁵ They possess a skill that not many have: namely the ability to change the outcome of a game, to make the difference between winning and losing. And this difference can be worth millions in today's football. The winners of the Champions League final, for instance, receive ten million euros more than the losers. Thanks to their market power over the clubs, the top players can negotiate for precisely these millions.

In other words, the growth of the football market is migrating into the pockets of these players. A player like Cristiano Ronaldo or Lionel Messi would of course keep playing football for an annual wage of less than ten million euros, instead of doing some other job. These players earn an economic scarcity rent. They make the difference and cannot be replaced by other players. What's more, good players also make their team-mates more effective. The greatest passes from midfield have no effect unless the forward is capable of turning a through ball into a goal.²⁶ Every football fan in the world wants to watch precisely these players and is willing to pay for the privilege. The player does not have to perform in front of every fan; the TV pictures are marketed throughout the world at a cost close to zero. This involves what are known as media levers in compensation. For the most part, the proceeds go to the players.

The World Cup is always a great opportunity for a player to draw attention to himself and boost his market value. This effect is seen every time after the World Cup. Player transfers immediately after the World Cup are typically also very expensive, because the top clubs start a bidding war for the stars. The danger of overvaluing players is, however, particularly great. This phenomenon is known as the winner's curse. Someone who has impressed in a maximum of seven games in the World Cup may not necessarily be able to perform like that over a whole season. The current information and quality signals of a player are mostly weighted too highly. The later disappointment is sometimes all greater than the expectations regarding the player had been in the first place.

²⁵ See Rosen (1981).

²⁶ See Vöpel (2013).

3 So who's going to win the World Cup?

From 12 June to 13 July, 32 teams will do battle for the title of World Cup winner 2014. As always, the question is who is going to win the World Cup. Just about every fan also believes he or she is an expert. There are accordingly just as many »theories« of what makes for success in football, who should play and who not, or what tactical formation should be used. Economists also frequently devise forecasting models at the time of the World Cup that are intended to predict the winners. The most accurate predictions are generally provided by the betting odds, as they incorporate all the information available *ex ante* and evaluated »by the market«. The odds, in turn, can be used to calculate the probabilities of winning the title.²⁷ The probabilities derived from the current odds are calculated and shown in Figure 8.

Brazil are given the greatest chance of winning the World Cup, with a probability of just under 20%, followed by Germany and Argentina with almost 15% each. Defending champions Spain have a 10% chance. Belgium, Colombia and Uruguay are considered decent outside bets, ahead of established footballing nations like England and Italy. Chile are also relatively well fancied. In this context, the continental home advantage of the South American teams is reflected in the odds.

The influence of chance is very great accordingly, although it is almost always underestimated. Good and bad luck turn up in very different guises, including hitting the woodwork and suffering bad decisions by the referee or injuries to key players. It is sometimes the case that what is good or bad luck at first evolves into the famous momentum, although this can quickly go into reverse as well. If the World Cup were played a second and third time under otherwise identical conditions, a different winner would presumably be crowned at the end each time. The actual course of the tournament thus represents the realisation of a »random event«. Repeated often enough, the outcome

27 See Quitzau (2006).

Probabilities of winning the World Cup

in %, as of 1 April 2014

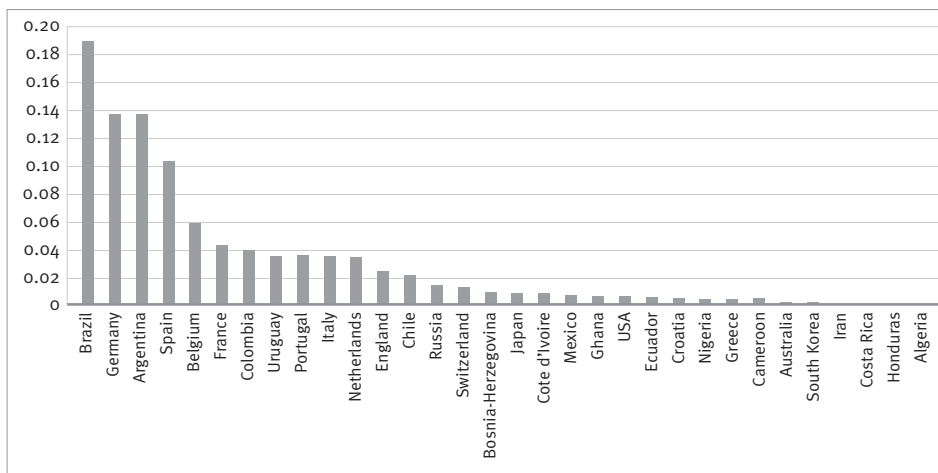


Fig. 7

Source: bwin.de; own calculations.

of the World Cup converges to form a certain probability distribution. Betting odds generally reflect the probabilities very well; they directly incorporate all the available and relevant information. The efficiency of markets was a paradigm of economic theory for a long time. Eugene Fama won the Nobel Prize for Economics for his theory of efficient capital markets in 2013.²⁸ This theory does not, however, mean that the markets know the »true model«, but that the current prices represent the best available forecast. Nonetheless – as the second Nobel Prize Winner in 2013, Robert Shiller, demonstrated in his research – bubbles and irrational exuberance can build up time and again in information markets, if the valuation of the market becomes detached from fundamental factors.²⁹ This phenomenon could be observed on a fictitious stockmarket run by Spiegel Online to coincide with the 2010 World Cup.³⁰

To this extent, the betting markets accurately reflect what experts and observers consider important overall: Brazil with home advantage, Spain as defending champions and the other usual suspects like Germany, Italy and Argentina are the favourites. Even the dark horses are no longer so dark, as this insider information is also included in the public odds. Uruguay, Chile and Belgium are being tipped to go a long way in the tournament. But in the end, they probably will not win the title. In the history of the World Cup, there has never yet been a real sensation when it comes to the winner. What is apparent, however, is the clear significance of home advantage (see Table 2).

28 See Fama (1970).

29 See Akerlof/Shiller (2009).

30 See Berlemann/Vöpel (2012).

A brief history of the World Cup

Year	Host	Winner	Host's position	Germany's position	England's position
1930	Uruguay	Uruguay	Winner	Did not enter	Did not enter
1934	Italy	Italy	Winner	Third	Did not enter
1938	France	Italy	Quarter-final	Round of last 16	Did not enter
1950	Brazil	Uruguay	Runner-up	Did not enter	Group stage
1954	Switzerland	Germany	Quarter-final	Winner	Quarter-final
1958	Sweden	Brazil	Runner-up	Fourth	Group stage
1962	Chile	Brazil	Semi-final	Quarter-final	Quarter-final
1966	England	England	Winner	Runner-up	Winner
1970	Mexico	Brazil	Quarter-final	Third	Quarter-final
1974	Germany	Germany	Winner	Winner	Did not qualify
1978	Argentina	Argentina	Winner	Second round	Did not qualify
1982	Spain	Italy	Second round	Runner-up	Intermediate round
1986	Mexico	Argentina	Quarter-final	Runner-up	Quarter-final
1990	Italy	Germany	Third	Winner	Fourth
1994	USA	Brazil	Quarter-final	Quarter-final	Did not qualify
1998	France	France	Winner	Quarter-final	Round of 16
2002	Japan/South Korea	Brazil	Round of last 16/Fourth	Runner-up	Quarter-final
2006	Germany	Italy	Third	Third	Quarter final
2010	South Africa	Spain	First round	Third	Round of 16
2014	Brazil	?	?	?	?
2018	Russia	?	?	?	?
2022	Qatar	?	?	?	?

Table 2

Source: FIFA (2014c).

France won the World Cup at home in 1998, as did Argentina in 1978, Germany in 1974 and England in 1966. At the first World Cup in Brazil in 1950, the hosts came second only behind the eventual winners, Uruguay. The reason for the clear home advantage may be the level of support in the country and in the stadiums, or the more familiar climatic conditions. In addition, no European national team has yet won the title in South or Latin America, and no South American team has won in Europe (with the exception of Brazil in Sweden 1958). As is well known, though, performance may well suffer when the pressure to succeed is excessive.

So which factors are relevant when it comes to determining the odds and hence to assessing the chances of winning the trophy? A simple regression model (statistical method) shows that the probabilities of winning can be largely explained by the average market value of a team and a so-called dummy, which assumes the value 1 if the team comes from South America and the value 0 if it does not. The coefficient of determination in this calculation is 0.85. This means that 85% of the probabilities of winning can be explained by the market value of the teams and the South American home advantage. South American countries have a – statistically significant – three percentage point greater probability of winning the title than teams that do not come from South America.

Regression Analysis of winning probabilities

$$\text{Probability} = -0.020 + 0.005 \text{ market value} + 0.03 \text{ dummy}$$

$$(-3.91) \quad (7.40) \quad (2.72)$$

Coefficient of determination: $R^2 = 0.85$

The t value in brackets shows the significance of the influence. In this computation, the influence of the market value and the dummy is statistically highly significant.

The homogeneity of a team becomes more important the longer the tournament wears on. A second important factor, albeit one whose significance is only reflected weakly in the computation, is how balanced a team is. If a team relies too heavily on a few stars or even just a single player, the danger is great that the team is easier for the opponents to neutralise or the team performance is lessened greatly if this player is injured or out of form. This factor is presumably not statistically significant across all teams in the computation, because it only becomes important in close matches. In a match between Spain and Costa Rica, the differences in the market value can be explained exclusively by the different probabilities of victory.

In Table 3, however, the fact that Portugal at EUR 11.4 million has a higher average market value than the Netherlands at EUR 8.3 million stands out, for instance. This difference is caused almost exclusively by Cristiano Ronaldo. The standard deviation is correspondingly large, or the balance

of the Portuguese team correspondingly low. As a result, the chances for Portugal are therefore considered slighter than for the Netherlands. Indeed, should the key player Ronaldo be injured or perform poorly, this would have a major impact on the whole Portuguese team. Ronaldo would be impossible for Portugal to replace.

As the odds show, we can expect a close World Cup. We are all looking forward to exciting games, innovative tactics and spectacular goals. The related atmosphere will build in good time in both football-mad Brazil and here in the bars and public-viewing areas in Germany. The German parliament has just adopted legislation allowing for public viewing in outdoor areas after midnight. Let the fun commence.

Success indicators for the World Cup participants

Country	Odds*	Probability of winning the title	Average market value (EUR millions)	Standard deviation
Brazil	3/1	19.0%	23.0	15.7
Germany	5/1	13.5%	21.1	16.6
Argentina	5/1	13.5%	19.3	25.4
Spain	7/1	10.5%	26.3	13.6
Belgium	14/1	5.9%	15.6	12.0
France	18/1	4.7%	17.9	10.1
Colombia	22/1	4.0%	7.4	9.5
Uruguay	25/1	3.5%	7.4	11.4
Portugal	25/1	3.5%	11.4	20.3
Italy	25/1	3.5%	13.0	6.0
Netherlands	25/1	3.5%	8.3	8.5
England	33/1	2.7%	12.9	9.0
Chile	40/1	2.3%	5.9	10.2
Russia	66/1	1.4%	7.6	5.7
Switzerland	66/1	1.4%	7.7	5.7
Bosnia-Herzegovina	125/1	0.7%	5.0	6.3
Japan	125/1	0.7%	4.1	5.2
Cote d'Ivoire	125/1	0.7%	5.9	7.9
Mexico	150/1	0.6%	3.6	3.3
Ghana	150/1	0.6%	4.7	5.1
USA	150/1	0.6%	2.6	1.9
Ecuador	150/1	0.6%	2.7	3.7
Croatia	150/1	0.6%	8.5	9.3
Nigeria	250/1	0.4%	3.9	5.5
Greece	250/1	0.4%	3.5	3.6
Cameroon	400/1	0.2%	4.9	4.6
Australia	500/1	0.2%	1.1	0.7
South Korea	500/1	0.2%	2.4	3.0
Iran	1500/1	0.1%	0.9	0.6
Costa Rica	1500/1	0.1%	1.3	1.8
Honduras	1500/1	0.1%	0.7	1.3
Algeria	1500/1	0.1%	1.9	2.0

Table 3

Sources: bwin.de; Transfermarkt.de.

* As of 1 April 2014

Why World Cup sweepstakes are almost always won by football novices

It is a well-known fact, a bit of a nuisance and definitely a mysterious paradox: the World Cup sweepstake among family, friends or at work is won with monotonous regularity by people who are believed beforehand to have the least understanding of football. There are two reasons for this.

The first reason has to do with the volume of information and the way it is processed. Experts have more information at their disposal and also tend to put too much weight on this mostly very specific insight, like whether an important player is injured or currently out of form. Novices filter information much more, which explains why it has less of an influence on their choice. The winner of the Nobel Prize for Economics, Daniel Kahneman, who is actually a psychologist by trade, describes these two types of approach as »fast thinking« and »slow thinking«.³¹ In fast thinking, information is processed and evaluated in accordance with simple, yet highly applicable heuristics. Past experience is »matched« with the new information. Kahneman calls these processes anchoring and framing. In the case of anchoring, there is an »experience anchor«, such as that Brazil is a footballing nation and now also has home advantage or that Portugal has that great player, Cristiano Ronaldo.

Framing sets the framework and defines the situation in which the information is to be processed. In sweepstakes, novices try to process the information available to them using a very general and above all simple algorithm. Experts, on the other hand, want to demonstrate their prowess, which causes them to over-interpret information and process it using an overly complex »model«. The second reason for the relatively poor performance of experts is that they deliberately wish to set themselves apart from novices and go for outsiders too often. Although this does help them look good with their peers, it does not make them any the more successful.

³¹ See Kahneman (2011).

Conclusion

On 13 July 2014, the final of the 20th FIFA Football World Cup will be staged in the famous Maracana Stadium. All of Brazil is hoping the country will win the trophy for the sixth time. Anything else apart from reaching the final would be a huge national disappointment in football-mad Brazil. In economic terms, the euphoric growth of previous years has long since given way to deep disillusion and frustration with Brazil's political class. The country urgently needs investment in healthcare and education together with a reform of its institutions and their credibility. The anger of the population has even been vented on the much-loved football. Not necessarily the game itself, but the World Cup has for many become a symbol of the self-aggrandising decisions of politicians and functionaries.

The presidential elections are due to be held in autumn 2014. It remains to be seen whether, and in what form, these efforts surrounding the World Cup will then also be continued in the run-up to the Summer Olympics to be staged in Rio de Janeiro in 2016. The country certainly deserves a smooth, exciting tournament. Brazil's chances of winning the trophy at the World Cup are, moreover, many times greater than those of finding a rapid solution to its deep-seated economic and political problems. As brilliant as the improvisation skills of the Brazilian players on the pitch may be, they are not much use as a principle for running an entire economy.

Winning the World Cup could, however, unite the country for a couple of months at least and form the foundation for a process of renewal borne by broad swathes of society. The World Cup can achieve much, even for a country where investment is urgently needed in healthcare and education, and especially for a country where society is as badly divided as it is in Brazil. But it is no cure-all either. Whether the sporting hopes will be fulfilled remains to be seen on 13 July.

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