Political Risk Considerations and Risk Mitigation

May 12, 2005  George Washington University
## Who is MIGA?

### MIGA's guarantees program
- MIGA's guarantees program
- Provides insurance to protect investors and financial institutions from non-commercial risks
- Can provide up to $200 million per project and more...

### Types of investments covered
- Equity and quasi-equity
- Shareholder loans and loan guaranties
- Non-Shareholder loans
- Technical Assistance
- Management Contracts
- Leases
- Franchising and Licensing Agreements
- Performance Bonds
- Interest rate hedging instruments
- and more...
MI GA portfolio - exposure in North Africa

- Latin American & the Caribbean: 38%
- Sub-Saharan Africa: 21%
- Middle East & North Africa: 3%
- Europe & Central Asia: 25%
- Asia & the Pacific: 13%
### MI GA’s portfolio - sector exposure

Outstanding portfolio distribution by sector (approx. $5.5 billion)

Gross exposure in % as of June 30, 2003

<table>
<thead>
<tr>
<th>Sector</th>
<th>FY99</th>
<th>FY00</th>
<th>FY01</th>
<th>FY02</th>
<th>FY03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure</td>
<td>19</td>
<td>29</td>
<td>29</td>
<td>36</td>
<td>41</td>
</tr>
<tr>
<td>Financial</td>
<td>42</td>
<td>34</td>
<td>36</td>
<td>35</td>
<td>29</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>15</td>
<td>12</td>
<td>9</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td>Mining</td>
<td>13</td>
<td>12</td>
<td>9</td>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>3</td>
<td>2</td>
<td>5</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Tourism</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Services</td>
<td>5</td>
<td>8</td>
<td>6</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Agribusiness</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
FDI Inflows to Developing Countries
(US $ billion)

*Estimate
Source: UNCTAD World Investment Report, 2003
Flows to emerging markets

MAJOR DROP SINCE 1997

Net long-term flows to developing countries, 1991-2001

- Capital Markets
- FDI
- Total Net Private Flows


Asian Financial Crisis
Russian Financial Crisis
Tech Bubble Collapse
Argentina Financial Crisis
Financing emerging market investment

- Reduced number of investors: reconsideration of portfolios in emerging markets
- Many of the “bankable” projects identified in traditional markets (middle income emerging markets)
- Failure of privatizations in Senegal, Armenia, Georgia, Mauritania, Ukraine, PNG, Ecuador, Bolivia...
- Undeveloped infrastructure opportunities existed but macro-economic, legal and regulatory concerns affected investor appetite
- Oil & Gas Sector -

- Developed 80%
- Developing 20%
- Latin America & Caribbean 24%
- Africa 16%
- Developing Europe 16%
- Middle East 10%
- Developing Asia-Pacific 34%

Source: LOCOMonitor
Source: LOCOMonitor
- Oil & Gas Sector -

Source: LOCOMonitor
- Oil & Gas Sector -
Peru - FDI Source Markets
(2003-2004)

Source: LOCOMonitor
- Oil & Gas Sector -
LAC - FDI Source Markets By Host Country
(2003-2004)

Source: LOCOMonitor
- Oil & Gas Sector -

Source: LOCOMonitor
- Oil & Gas Sector -
Peru - FDI Projects’ Key Business Functions by Source World Region (2003-2004)

Source: LOCOMonitor
- Oil & Gas Sector -

Source: LOCOMonitor
...more than half of the projects involved less than US$ 250 million investment...

N.B. Investment information is not captured for all projects.

Source: LOCOMonitor
…more than half of the projects involved less than US$ 100 million investment…

N.B. Investment information is not captured for all projects.

Source: LOCOMonitor
### - Oil & Gas Sector -
### LAC - FDI Projects by Source Countries (2003-2004)

<table>
<thead>
<tr>
<th>Source Country</th>
<th>No. Of Projects</th>
<th>% Of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>51</td>
<td>29.10%</td>
</tr>
<tr>
<td>Spain</td>
<td>24</td>
<td>13.70%</td>
</tr>
<tr>
<td>Canada</td>
<td>23</td>
<td>13.10%</td>
</tr>
<tr>
<td>Brazil</td>
<td>15</td>
<td>8.60%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10</td>
<td>5.70%</td>
</tr>
<tr>
<td>UK</td>
<td>9</td>
<td>5.10%</td>
</tr>
<tr>
<td>France</td>
<td>8</td>
<td>4.60%</td>
</tr>
<tr>
<td>Japan</td>
<td>5</td>
<td>2.90%</td>
</tr>
<tr>
<td>Russia</td>
<td>5</td>
<td>2.90%</td>
</tr>
<tr>
<td>Norway</td>
<td>4</td>
<td>2.30%</td>
</tr>
<tr>
<td>Belgium</td>
<td>4</td>
<td>2.30%</td>
</tr>
<tr>
<td>China</td>
<td>3</td>
<td>1.70%</td>
</tr>
<tr>
<td>Australia</td>
<td>3</td>
<td>1.70%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Denmark</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Chile</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>India</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Bahrain</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Germany</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Italy</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Mexico</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>2</td>
<td>1.10%</td>
</tr>
<tr>
<td>Total</td>
<td>175</td>
<td></td>
</tr>
</tbody>
</table>

Source: LOCOMonitor
### - Oil & Gas Sector -
### LAC - FDI Projects by Destination Countries (2003-2004)

<table>
<thead>
<tr>
<th>Country</th>
<th>No. Of Projects</th>
<th>% Of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>34</td>
<td>19.40%</td>
</tr>
<tr>
<td>Brazil</td>
<td>31</td>
<td>17.70%</td>
</tr>
<tr>
<td>Mexico</td>
<td>22</td>
<td>12.60%</td>
</tr>
<tr>
<td>Colombia</td>
<td>21</td>
<td>12.00%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>20</td>
<td>11.40%</td>
</tr>
<tr>
<td>Bolivia</td>
<td>11</td>
<td>6.30%</td>
</tr>
<tr>
<td>Peru</td>
<td>10</td>
<td>5.70%</td>
</tr>
<tr>
<td>Ecuador</td>
<td>9</td>
<td>5.10%</td>
</tr>
<tr>
<td>Cuba</td>
<td>5</td>
<td>2.90%</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>5</td>
<td>2.90%</td>
</tr>
<tr>
<td>Chile</td>
<td>2</td>
<td>1.10%</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Guatemala</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Bahamas</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Panama</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td>Uruguay</td>
<td>1</td>
<td>0.60%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>175</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: LOCOMonitor
How real are the risks?

- Financial crises in a number of regions have confirmed that classical political risks do exist.

- Recent investor experience includes:
  - repossession of privatized assets
  - defaults on government obligations
  - revocation of concessions given by previous governments
  - financing difficulty for new projects
  - contract frustration due to inadequate legal & regulatory frameworks

- Risk arena widening, as sub-sovereign partners increasingly involved.
Some lessons

Projects must be economically viable
- Requires framework of sound sector strategies, good policy planning, willingness to uphold contracts, even in adversity

Poor project economics enhance pressures to renege on commitments (concession agreements etc.)
- Poor project design / poor public policy can hurt
- Good documentation cannot offset weak demand
- Poor projects may exacerbate matters which could eventually increase political risk

Financial engineering / risk mitigation (PCG, PRG, full wrap) can help…but...
- Attract foreign investors, extend maturities, reduce costs, etc. but no substitute for project fundamentals
What role for MIGA and other MDBs?

- As a multilateral agency, less influenced by market forces
- Continued focus on developmental impact of cross-border investments
- Mandate to work together with other public and private insurers even more important now
- Counter-cyclical role
Role for the WBG Going Forward

- General policy fostering macro-economic stability and growth
- Strengthening of institutions – integrating the Bank’s extractive sector policy and transactions with overall country policy
- Development and support of local financial markets
  - Pooling together and legitimizing local investors
  - Deepening bank market and lengthening tenors
  - Guarantee, insurance and credit enhancement instruments
- Funding of and advising on sector designing and restructuring (including implementation phase)
- Sticking with investors through both good and bad times (including incentive/sanction structure encouraging compliance by host government)
- Providing guarantees for certain major risks
What can MIGA and others provide in this environment?

- Member of the World Bank Group
- Umbrella of deterrence – only 3 claims in 15 years
- Objective intermediary between governments and investor countries (successful mediation cases for non-guaranteed projects)
- Extensive resources and knowledge of emerging economies from all parts of the World Bank Group
- Host country approval needed for MIGA’s coverage (no host government counter guarantee required)
Mitigating regulatory/policy risk

More important than instruments: better contracts:
  - Clear guidance to the regulator in contract
  - Specify tariff formulas as much as feasible
  - Clarify appeal process
  - Fast track arbitration - timeline
  - Specified exit payments if no agreement can be reached

Through mitigation instruments
  - PRG and MIGA’s breach of contract (BOC) can mitigate regulatory risk
PRG/ BOC Can mitigate some of performance risks

- Tariff commitments
- Regulatory process
- Non payments by Governments of amounts due (e.g. Output Based Assistance)
- Termination amounts
A good deal is one where the risks are apportioned to the parties most capable of managing them efficiently and cost-effectively. This allows a good investment to go ahead even in a country perceived to be risky.
Thank you!

www.miga.org
nhalkas1@worldbank.org
Oil & Gas, Mining, Chemicals department:
+1-202-458-1012