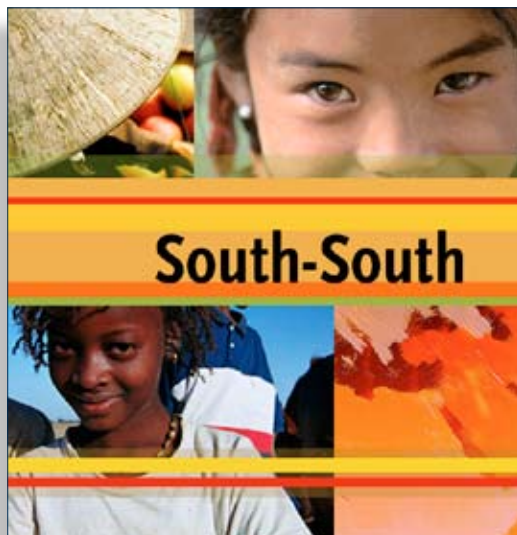




‘SOUTH-SOUTH’ FDI AND POLITICAL RISK INSURANCE: CHALLENGES AND OPPORTUNITIES



Positive global FDI prospects

Global foreign direct investment (FDI) flows reached an estimated US\$1.5 trillion in 2007, according to a recent report by the Economist Intelligence Unit (EIU), and are set to continue on an upward path, with some year-to-year fluctuations.¹ While FDI is expected to decline somewhat in 2008 as global merger and acquisition (M&A) activity slows down, analysts forecast a steady growth over the next three years.² A survey carried out by EIU in the context of the report finds that this growth is largely demand-driven, with much of the demand coming from emerging markets.³

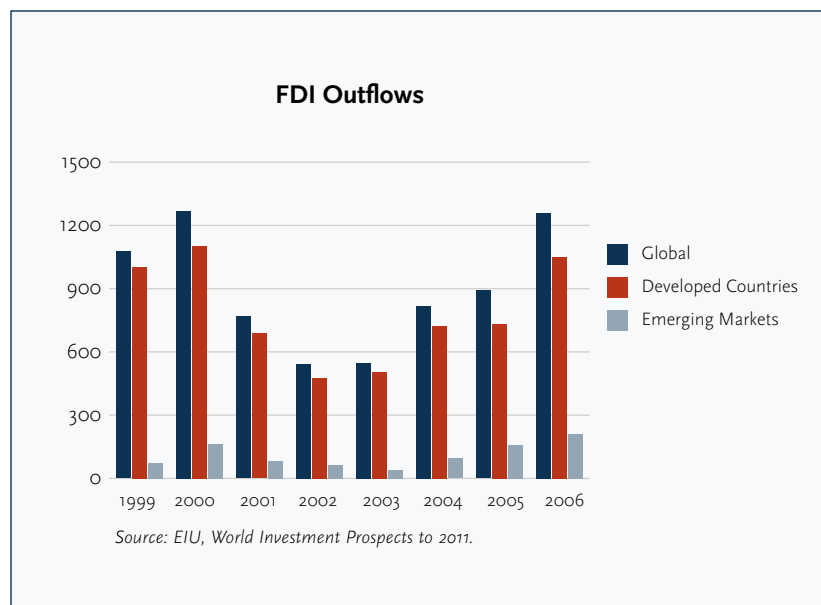
FDI flows going to emerging markets are expected to reach US\$535 billion in 2007, decline somewhat in 2008, and continue growing in the subsequent three years at an annual rate of 3-4 percent.⁴ North Africa and the Asia-Pacific region are expected to fare particularly well. China is expected to retain its position as the largest recipient of FDI. Sub-Saharan Africa is likely to continue to attract resource-seeking investors, while investment flows to Latin America are forecasted to grow modestly. Much of this growth is expected to be driven by the relocation of labor-intensive manufacturing to emerging markets and the offshoring of services.

South-South FDI expected to grow

Emerging markets are also becoming important sources of FDI for the rest of the world. Overall, FDI flows from emerging markets increased from US\$12 billion in 1991 to US\$99 billion in 2000,⁶ and are estimated to be around US\$210 billion as of 2006.⁷ While still small relative to global FDI flows, they have been growing rapidly in recent years (See chart).

“South-South” FDI (investment outflows from emerging markets to other emerging markets) has been growing even faster, increasing from under US\$5 billion in 1994 to over US\$50 billion in 2000.⁸ It is estimated that South-based FDI accounts for about one third of all FDI flows into emerging markets, reflecting the growth of intra-regional investment, the rise of new multinationals and relaxation of foreign exchange controls.⁹ By investing in other developing countries, South-based multinationals, like their North-based counterparts, are looking for new markets, natural resources and lower costs (see Box 1).

The EIU estimates that there are over 20,000 multinationals headquartered in emerging markets, many with significant



potential to expand further their overseas presence. Most of these companies are not particularly large. According to UNCTAD, only a handful of South-based multinationals make the list of the top 100 companies with direct investments abroad (ranked by foreign assets), which underscores the newness of this trend.¹⁰

While investments in the industrialized world by South-based multinationals tend to capture headlines (such as Chinese company Lenovo's acquisition of IBM's Personal Computing Division or the high level of Indian investments in London), their investments in emerging markets go largely unnoticed. Yet many such companies are also active investors in emerging markets. Cemex (Mexico), for example, has built a global presence through a network of business in South and North America, Asia, the Middle East and Europe.¹¹

Box 1. What drives South-South FDI?

A variety of factors encourage South-South investment:

- **Rising demand for energy in emerging markets.** Many national oil companies based in China, and to a lesser extent in India and Malaysia, are actively pursuing joint ventures and other forms of collaboration in Asia (e.g Myanmar), Sub-Saharan Africa (also North Africa; Libya) and Central Asia. Russian energy and mining companies are also turning to Sub-Saharan Africa and Central Asia, while Brazil has oil exploration activities in Mexico and is pursuing more in Sub-Saharan Africa.
- **Increase in South-South trade.** The share of trade amongst developing countries has more than doubled (currently 43 percent of world exports compared to only 20 percent in 1970). Trade interdependence and FDI interdependence go hand in hand given the close relationship between overall trade and trade between multinational enterprises and their foreign affiliates (and amongst foreign affiliates). Regional integration schemes encompassing developing countries also promote this trend.
- **Proximity and cultural affinity.** Being small and medium-sized compared to their peers in industrialized countries, South-based firms' competitive advantages often lie in their ability to operate in economic environments similar to those found at home. They often invest in countries that share the same cultural and ethnic links and heritage, frequently neighboring ones

where they are already familiar with the local business environment through trade.

- **Cost competitiveness.** Like North-based firms, South-based multinationals seek to improve their competitiveness by building international networks of affiliates that take advantage of cost differences.
- **Outward FDI support.** Governments of several developing countries are not only allowing outward FDI, but they are also actively promoting it through loans on preferential terms, tax rebates, and investment insurance. China, for example, is pursuing a 'Going Global' strategy by encouraging its domestic enterprises to invest abroad, including in other developing countries. Outward investment promotion has been supported by a sharp increase in the number of bilateral investment treaties and double taxation agreements concluded amongst developing countries over the past decade. Such agreements are proliferating, according to UNCTAD, with the number of South-South bilateral investment agreements standing at 653, South-South double taxation treaties at 312 and preferential trade and investment agreements between developing countries at 49 as of 2005.

Sources: "South-South FDI flows: how big are they?" D. Ratha and D. Aykut, Transnational Corporations, 2004; UNCTAD, World Investment Report 2007; "Trends in Asian National Oil Company Investment Abroad: An Update", Glada Lahn, Chatham House, November 2007. "South-South Investment Agreements Proliferating," IIA Monitor, UNCTAD, 2005.

South-based firms' perceptions of political risk

Emerging market multinationals are increasingly more conscious of political risk (Box 2). According to a global survey of 602 executives carried out by EIU, there is a growing perception that political risk is on the rise.¹² Over the next five years, political risks and the threat of production disruption arising from such risks, are expected to increase. Political risk is also perceived to be greater than economic risk, and this asymmetry is an important conclusion of the EIU survey. Political risk was identified as the main investment constraint in emerging markets by nearly half of the respondents of that survey.

A recent Ernst & Young report identifies political risk as the single most important risk facing companies based

in developed countries.¹³ However, the report finds that South-based multinationals do not rank political risk as highly as do firms in industrialized countries. Different commercial risks occupy the top two spots, with political risk in third place.

Indian multinationals, for example, seem to have a generally lower perception of political risk when investing abroad,¹⁴ as discussed in the India case study. Some of India's top multinationals (Tata Steel, NIIT—a global IT learning solutions corporation, and pharmaceutical company Ranbaxy Laboratories Ltd.), as well as two recent outward investors, SRF (technical textiles, refrigerant gases) and DCM Sriram Consolidated Limited (DSCL) (chloro-vinyl and agribusiness) all considered investing in the developing world to be politically safe for foreign investors.

Expropriation and transfer of payments restrictions were not viewed as a significant risk by Indian firms. An argument used to support this perception was that host country governments are unlikely to act arbitrarily against foreign direct investors, since such investment is now globally accepted as important for development. Firms based in the broader Middle East and North Africa region also appear to have a higher tolerance for risk compared with other investors, as the case study of the Islamic Corporation for Insurance of Investments and Export Credits (ICIEC) points out.¹⁵ As a result, MENA-based investors have not been active users of political risk insurance. In contrast, the African Trade Insurance Agency (ATI) case study is reporting South-South projects to comprise 46 percent of its portfolio.¹⁶

Box 2. What determines risk perceptions of South-based multinationals?

As in the case of multinational enterprises based in industrialized countries, perceptions of political risk for South-based multinationals depend on a variety of factors:

- **The sector of investment.** Natural resource extraction is viewed as riskier than other sectors, with mining and oil & gas contract renegotiations, nationalizations and rising domestic ownership ceilings on the rise. Illustrating this is the recent experience of Petrobras after Bolivia's demand that all oil and gas companies operating in the country have 180 days to enter into new contracts with the state company YPF. With assets worth US\$1.5 billion at that time, Petrobras was the country's largest foreign investor. In June 2007, Petrobras completed the transfer of all the shares of Petrobras Bolivia Refinancion S.A. to YPF for US\$112 million as the buy-back price.
- **The mode of investing, with greenfield investments,** Greenfield investments, as well as investment in infrastructure or utilities, are viewed as riskier than joint ventures or cross-border mergers and acquisitions. Infrastructure investments are usually sizable, operate in state-regulated industries and companies deal directly with governments. Such investments are more exposed to risk arising from government actions.
- **The location of investment,** with countries with close cultural affinity or geographical proximity perceived to be less risky than others. Examples include Indian investments in South Asia and Chinese investments in South-east Asia. Another notable example is multinational enterprises based in the Middle East and North African region. These companies are more comfortable with political risk in the countries of that region, and this is manifested by the low volume of political risk insurance they seek from political risk insurance providers.
- **The home country environment,** with a higher threshold for political risk associated with operating in a politically difficult or unstable environment at home. A company's experience at home with political and regulatory processes influences both choice of location and tolerance of political risk when investing abroad. Thus, multinationals based in countries with high political risk tend to be less sensitive to political risk when investing abroad. Indian multinationals interviewed, for example, mentioned that their higher risk tolerance arises from having to operate in a domestic environment characterized by greater political and economic uncertainty than firms based in industrialized countries.
- **History and experience in overseas investing,** with investors discounting the importance of political risk for projects run successfully over a relatively long period of time as their level of comfort and experience in dealing with such risk increases.

While South-based firms in general continue to believe that that political risk is not more worrisome now than in the past, this perception is gradually changing. For example, Chinese multinationals in Sub-Saharan Africa, increasingly exposed to labor unrest, civil strife and terrorist attacks, do view such risks as potential threats to their investments there.¹⁷ While these firms are mostly state-owned, and hence may consider themselves to be in a position to discount such risk in lieu of the perceived long term benefits, their demand for investment insurance is increasing.

MENA-based investors, evolving from small, family-owned businesses to sizeable international firms, are becoming more conscious of the need for risk management.¹⁸

The specific risk of terrorism and civil disturbance is also seen as intensifying over the next few years. For example, for the Indian multinationals mentioned earlier, while political risk overall is not perceived to be rising, there is growing concern about the specific risk of terrorism.¹⁹

Indeed, a greater awareness about the presence of political risk appears to be emerging, translating into increased demand for political risk insurance by South-based firms. This is best exemplified in the portfolio of Sinosure, China's national export credit agency, where the share of outward investment insurance has jumped from 0.7 percent in 2004 to 8.7 percent in 2006. While demand for political risk insurance goes hand in hand with the growing exposure of South-based multinationals in other emerging markets, government policy

encouraging such investment, including through the provision of political risk insurance, helps considerably in raising investor awareness, as the case of Sinosure illustrates.²⁰

MIGA investor survey findings

South-based investors becoming more aware of country risk

In December 2007, MIGA's Investment Information Services group conducted a survey of private companies based in developing countries (Box 3). The purpose of the survey was twofold: (i) to shed light into the perceptions of and attitudes towards political risk by South-based private companies; and (ii) assess the extent to which these companies utilize investment insurance to mitigate such risk.

The main findings of the MIGA survey regarding South-based investor perceptions were:

- Political risk is rising in the world today, and it is higher in emerging markets than in industrialized countries. The expected trend is that political risk in emerging markets will stay the same or increase over the next five years.
- Political risk matters a great deal when investing in emerging markets and virtually all companies that consider it important carry out some type of risk assessment. Such assessments are based primarily on published reports and market intelligence, but also own

experiences and informal discussions with other investors.

- Respondents that do not assess political risk feel comfortable with the country in question on the basis of their own positive past experiences or because of close relationships in the country's government.

The findings of the MIGA investor survey reinforce those of the survey carried out by the EIU (mentioned earlier). In that survey, out of the 602 executives of multinational enterprises interviewed, 181 were either headquartered in developing countries, or were foreign affiliates residing there. One of the principal findings was that political risk is posing a considerably greater threat to their business over the next five years than in the recent past. For investments in emerging markets, political risk was identified as the principal constraint, with all forms of political risk expected to increase over the next five years. This was the case as well for the companies headquartered or residing in emerging markets.

Another survey was carried out by Ernst and Young in 2007 in the form of 900 interviews around the world on how risk is being managed.²² Ernst and Young interviewed 435 large multinational companies with headquarters in 12 developed countries and links with emerging market companies in the form of affiliates, joint ventures, customers, suppliers and third party intermediaries. Ernst and Young also interviewed 501 companies in emerging markets, of which 220 were affiliates of companies in industrialized countries and the rest

Box 3. MIGA survey of South-based private companies

MIGA carried out a survey of South-based private companies registered with its investment information online services. The survey was sent out to 832 private firms that had specified a developing country as their headquarters or residence.* The response rate was 4 percent.

In terms of the respondents' profile, more than 90 percent expected their overseas investments to increase over the next five years. More than four-fifths of them planned

to invest in emerging markets over the next year. Overall, respondents had a widespread presence around the world and across sectors. Most respondents, however, were based in Africa (North and Sub-Saharan) and Central Asia and were in agribusiness and oil, gas and mining. Most were either small or medium-sized enterprises with less than 100 employees, or significantly larger with over 300 employees.

* Foreign affiliates of multinational enterprises based in industrialized countries were also included in the sample.

were joint ventures, intermediaries and sizeable customers or suppliers. The principal emerging markets were Brazil, China, India, Russia and Turkey. A principal finding of that survey was that companies from industrialized countries place a much greater emphasis on political, operational and supply chain risk than companies from emerging markets, which are more concerned with market and currency risks. Finally, a report by the World Economic Forum identifies a variety of political risks as possible constraints to economic growth.²³

Risk mitigation gaining ground

The MIGA survey also sought to assess risk mitigation tools used by respondents, especially political risk insurance. More than half of the respondents claimed to have either an in-house risk

assessment team or a process in place. One-third claimed that they did not devote any resources to assessing or managing political risk.

The main findings of the MIGA survey regarding risk mitigation tools and political risk insurance were:

- Some 70 percent of respondents mitigate political risk in some way, and about half do so by purchasing political risk insurance.
- About 50 percent of the respondents that purchase political risk insurance do so only sometimes; another 30 percent does so always.
- For those respondents that do not purchase insurance, the principal reason cited was not knowing how to go about purchasing political risk insurance followed by cost considerations

and being comfortable with the risk profile of the country in question.

- Over two thirds of respondents that do purchase political risk insurance do so for projects under US\$20 million, especially projects under US\$5 million. In terms of sector, the respondents sought PRI cover largely for manufacturing projects; followed by oil, gas and mining, infrastructure, and agribusiness.
- In terms of region where investment projects are located, Sub-Saharan Africa occupied the top spot, followed by North Africa, South Asia and Central Asia.
- Breach of contract topped the list of type of risk, followed by war, civil disturbance and terrorism.

Box 4. India: A new investor with a long history of political risk insurance

Indian companies began to set eyes overseas after the liberalization of outward investment in the 1990s removed restrictions on equity investments abroad and increased automatic approval ceilings. However, it was not until the early part of this decade that India began to emerge as an important outward investor, with FDI outflows reaching around US\$10 billion in 2006, according to EXIM Bank of India. Indian investment abroad is concentrated in both industrialized and developing countries. For these investors, emerging markets in Russia, Sudan, Vietnam and Mauritius have historically been the most popular destinations, although increasingly investment is flowing to a range of emerging markets across all continents. Indian companies are also favoring destinations in the industrialized world (Australia and European countries), a trend that is growing.

Political risk mitigation in India for outward investment is carried out solely by the Export Credit Guarantee Corporation of India (ECGC), which set up its Overseas Investment Insurance program in 1980 to support Indian companies venturing abroad. Like many other export credit agencies based in emerging markets, investment insurance is a small part of its business. Over the past couple of years, it accounted for about 1 percent of its premium income. ECGC's Overseas Investment Insurance Program has been restricted by its limited capital base, the amount of reinsurance it raises from the state-run General Insurance Company and difficulties in raising additional reinsurance from the international mar-

ket. India has also set up the National Export Insurance Account (US\$452 million), with the aim of providing export credit risk covering project exports (for example, related to construction projects) and other large export transactions, thus boosting India's overseas projects.

ECGC protects companies against risks related to expropriation, war, and restrictions on remittances, as well as other political risks as approved by the government. Coverage is up to 15 years and only new investments funded by equity or loans are eligible. Coverage is offered for investments in more than 230 countries for which the agency has political risk assessments. While ECGC's concentration of investment guarantees has been in emerging markets in South-East Asia (especially Indonesia) and a few countries in Sub-Saharan Africa (Nigeria and Kenya), more recently it has issued guarantees for investments in the Middle East, emerging Europe and China. To date ECGC has only paid out one claim in the former Yugoslavia.

EXIM Bank of India, while actively supporting Indian outward investment through a range of products and services, including through direct equity participation, does not provide investment insurance, but does require it as a precondition for lending. However, ECGC and EXIM Bank of India are working together to familiarize Indian investors about the concept of political risk insurance.

Sources: India's Political Risk Insurance Industry, October 2007 and EXIM Bank of India: Developing Countries - Globalizing Through Overseas Investment, December 2007.

- Political risk insurance was a requirement from lenders for about two-thirds of the respondents.

Political risk insurance for South-based multinationals

National political risk providers serving South-based investors

While most industrialized countries offer investment insurance to their companies investing overseas, the availability of political risk insurance to South-based multinationals is not so widespread. Brazil, for example, a country which invested abroad US\$28 billion in 2006,²⁴ does not have a national agency that insures the foreign investments of Brazilian firms. Investment insurance can of course be obtained from private or multilateral organizations.

In other emerging markets, the existence and structure of the agencies offering political risk insurance goes hand in hand with the country's history of outward investment. Many of the national agencies, such as the Export Credit Guarantee Corporation of India (ECGC) and the People's Insurance Company of

China Group (PICC Group) — predecessor of Sinosure—were set up initially to issue export credit insurance. With ECGC established in 1957 (Box 4) and the PICC Group in 1949, these agencies have acquired considerable experience on export credit risk over time. However, only when India and China began to emerge as outward investors did they expand their products and services to offer overseas investment insurance. In the case of China, an altogether new agency (Sinosure) had to be set up in 2001 to specifically address risks associated with cross-border investments, among other things (Box 5).

In addition to national agencies, there are several multilateral organizations that provide political risk insurance, such as the World Bank Group's Multilateral Investment Guarantee Agency, the Asian Development Bank, the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), and the African Trade Insurance Agency (ATI). These agencies provide investment insurance to companies investing in their member countries, and/or for overseas investments. Regional entities are important as providers of political risk

insurance to reap economies of scale in issuance when the small volume of business does not justify the establishment of national agencies.

National political risk providers: diverse structures and governance

Like their counterparts in the industrialized world, the structure and governance of the national and regional investment insurers based in emerging markets varies. ECGC, for example, is a government-owned agency. Likewise Sinosure is a state-owned, non-profit entity whose purpose is to support China's outward orientation policies. The multilateral investment insurers are set up to complement or support similar agencies already in place.

ATI was funded by its member countries using concessionary loans from the World Bank's International Development Association, to facilitate trade and investment flows to the region (Box 6). ICIEC was established to promote the use of Shariah-compatible trade and investment risk mitigation instruments (Box 7). All of these agencies have established partnerships with other institutions

Box 5. China: Sinosure complements a coordinated outward investment drive

With over 10,000 operations abroad to date and over US\$16 billion in outward FDI in 2006 alone, China is emerging as a premier overseas investor. In 2002, China put forward a "Going Global" strategy, which entailed among other things accessing foreign markets and natural resources via FDI. Various measures were introduced across government ministries and agencies to support this strategy, including new regulations, fiscal incentives, information sharing and financial assistance.

Sinosure, China's investment insurance agency for both inward and outward FDI, was set up in 2001 to support the "Going Global" strategy. In tandem with the growth of outward FDI, use of political risk insurance expanded quickly. In 2004, Sinosure set up a separate investment insurance department to address political risk concerns of Chinese companies venturing abroad. As a result, the share of investment insurance in Sinosure's overall business portfolio increased from 0.7 percent in 2004 to 8.7 percent in 2006.

Sinosure's political risk products are designed to support and encourage Chinese firms to invest abroad by providing coverage for expropriation, war and political violence, transfer restrictions and breach of contract by the government. As a government-backed agency, Sinosure is active in promoting political risk insurance as a management tool for cross-border investments.

Sinosure's investment portfolio is heavily skewed in favor of oil and gas, which accounts for 83 percent of the total by liability. By number of projects, Sinosure's portfolio is more evenly distributed across the principal sectors, with oil and gas accounting for 31 percent, followed by power and mining. By region, Africa accounts for 84 percent of the agency's portfolio by number of projects, but only for 20 percent by liability. To date, Sinosure's portfolio is dominated by state-owned firms. The agency has also concluded cooperation agreements with other political risk insurance providers, as well as reinsurance agencies. Sinosure also offers advisory services and mobilizes financial resources.

Source: The Business of Investment Insurance in China, November 2007.

worldwide (other private or public insurers) and multilateral agencies, as well as reinsurers.

It is important to keep in mind that trade remains the focus of all of these agencies. Investment insurance in India's Export Credit Guarantee Corporation (ECGC), the country's export credit agency, is miniscule, accounting for only 1 percent of its premium income in the past couple of years despite the growth of outward investment by Indian firms. ECGC believes that as Indian companies invest more in emerging markets, there will be greater need to raise awareness about the existence of political risk insurance products and build adequate corporate capacity to address such risk.

ICIEC's investment insurance portfolio has also been increasing, but still accounts for only 4 percent of its volume of business. The African Trade Insurance Agency (ATI) is the exception, with investment insurance accounting for 47 percent of its portfolio to date.²⁶

National political risk providers: products and services

In the case of emerging markets, when national export credit agencies or other entities offer investment insurance, their product/service range may vary from

what is offered by their counterparts in the industrialized world. For example, India's ECGC does not explicitly offer coverage for breach of contract, although it allows for such coverage if specifically approved by the government. Related to that are issues of capacity, pricing and access to reinsurance, as well as products tailored to the needs of small and medium-sized firms, which are often the core of outward investment from emerging markets. In general, the products and services offered by political risk insurance providers based in emerging markets tend to be more rudimentary, less sophisticated and not as extensive as those in the developed world.

However, some products offered by South-based investment insurers are better tailored to the needs of investors. One such example is Shariah-compliant investment insurance offered by ICIEC to foreign investors, including from its member countries. Another example transcends beyond political risk insurance: Sinasure offers services to facilitate access to financing for Chinese companies and strives to mobilize financial resources and work out effective solutions for domestic investors seeking to expand overseas.²⁷

Export credit agencies and investment insurance providers in industrial-

ized countries often offer advisory services to potential investors, including country-specific information, to help companies assess risks before deciding on a particular location. Such services are not typically found in South-based political risk insurance providers, which tend to provide only insurance. Sinasure is one exception, providing information regarding laws and regulations and investment approval procedures, among other things, to domestic companies investing abroad.²⁸

MIGA political risk insurance providers survey findings

During November-December 2007, MIGA's Investment Information Services group conducted a survey of political risk insurance providers with the main purpose of (i) gauging their perceptions of political risk and prevalent trends in the industry, and (ii) taking stock of their investment risk mitigation products, with particular focus on South-South instruments (Box 8).

The main findings of this survey were:

- For 40 percent of the responding agencies, demand for political risk insurance had remained steady; and

Box 6. African Trade Insurance Agency: Born out of multilateral development initiatives

With oil prices at an all time high and commodity prices at historically high levels, FDI flows into Sub-Saharan Africa have been increasing rapidly. Interest in the region by investors from all regions has been rising, with China, India and the Middle East making new forays there. South African multinationals are becoming top investors in the region, drawing upon their experience in doing business there.

The African Trade Insurance Agency (ATI), the continent's only multilateral credit insurance agency, was set up in 2001 to provide political risk coverage for trade and investment projects in its member countries. Its genesis came about from a World Bank International Development Agency regional initiative, which provided US\$100 million in the form of individual loans to the founding member countries to set up the agency. ATI is

registered as an international organization. Despite its development orientation in deciding upon eligible projects, ATI's business is very similar to that of other public political risk insurance providers. However, ATI makes a special effort to support private sector participation in the economies of its members through a variety of political risk insurance products.

With a membership of twelve African states to date, as well as other organizations, ATI has been active in leveraging partnerships with public and private sector agencies to insure investments in its members. ATI has also been seeking to expand its membership to other states in North Africa, as well as to countries in other regions, especially India and China. South-based investors from Sub-Saharan Africa and Asia have been active users of ATI's products and services.

Source: Regional Trends in FDI and PRI: The Case of the African Trade Insurance Agency. "Picking up the risk," Africa investor, January 1, 2007.

for 47 percent it had increased over the past five years.

- The total number of investment insurance contracts issued by a smaller subset of respondents that answered the relevant question increased from 362 in 2002 to 502 in 2006.
- Almost two thirds of respondents considered demand for political risk insurance likely to grow over the next five years and less than one third felt that it would stay the same. Some 80 percent of the responding agencies expected demand for political risk insurance by South-based investors to increase over the next five years.
- By type of political risk and in terms of contracts issued, expropriation and war, civil disturbance and terrorism were in the highest demand, followed by breach of contract. Demand for transfer restrictions was ranked as 'medium'.
- By sector of investment and in terms of contracts issued, finance was in top place, followed by infrastructure and manufacturing. East Asia and the Pacific, followed by Latin America, were the biggest investment destinations.
- Most investment contracts for the last available year had been issued for projects in the value range of US\$5-20 million. There were very few projects over US\$80 million. Premiums charged were between 30 and 100 basis points. Companies purchasing investment insurance from the responding agencies employed between 100-300 people.
- The two top factors hindering the purchase of investment insurance by South-based investors were lack of perceived need and lack of awareness of investment insurance as a risk mitigation instrument. Cost was also cited as a relatively important consideration.

The survey findings, coupled with case studies for India, China, ICIEC and ATI, suggest that the increase in South-based FDI and growing awareness on the part of South-based companies about the availability of risk mitigation instruments is translating into an increase in the demand for political risk insurance. This trend is expected to be amplified in the near future. However, for most providers investment insurance is still a small, although growing, part of their overall business volume. South-based political risk insurance providers are responding to this demand in varying extents, and some are facing constraints in terms of capacity. There are concerted efforts to overcome these by leveraging on partnerships with other providers and reinsurers. At the same time, providers are seeking to further boost general investor awareness of political risk insurance, as well as come up with products suited to their specific requirements.

Box 7. ICIEC: Thriving on specialized product offerings

Capital flows from the Middle East and North Africa have been increasing substantially over the past few years, with Islamic nations representing a natural path for growth for multinationals based in that region. FDI flows from the Middle East are estimated by UNCTAD to have increased to US\$14 billion in 2006, with companies investing not only in the same region, but also in Africa, Central and South Asia and South-East Asia.

Founded in 1994, the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), a member of the Islamic Development Bank Group, provides export credit and insurance to its member states across the Middle East, North and Sub-Saharan Africa, and Asia. Apart from export credits and investment guarantees, ICIEC provides reinsurance facilities to member export credit agencies.

A special feature of ICIEC is that it provides insurance facilities to exporters and investors in accordance with Shariah principles. These principles mean that ICIEC: (i) endeavors to achieve mutual cooperation of policyholders through their collective sharing of losses which any one policyholder may suffer; (ii) distributes the surplus

that may accrue from the insurance and any reinsurance operations to policyholders after meeting statutory reserve obligations; (iii) excludes cover of contracts for the sale of goods prohibited under Shariah, as well as interest accruing from export credit or investment loans; and (iv) invests its own funds in accordance with Islamic principles.

Unlike most other political risk insurance providers, ICIEC specializes in the provision of Shariah-compliant products to investors. While investment insurance is still a small share of its total volume of business, it has been increasing significantly, with new insurance commitments rising by 73 percent in the past year. Breach of contract and war and civil disturbance coverage have been particularly popular.

Like other political risk insurance providers, ICIEC has engaged in partnerships with other organizations leveraging them to increase capacity constraints in its investment insurance and reinsurance activities. Recently ICIEC collaborated with MIGA to insure a container terminal project in Djibouti under an Islamic financing structure.

Source: ICIEC corporate Web site; Regional trends in FDI and Political Risk Insurance: The Case of ICIEC, November 2007.

Box 8. MIGA survey of political risk insurance providers

MIGA carried out a survey of 68 political risk insurance providers that are (i) members (public and private) of the Berne Union's Investment Committee and the Prague Club; (ii) members of the Lloyd's syndicate; and (iii) multilateral institutions.* The overall response rate was 35 percent (over 50 percent for Berne Union members alone and more than 80 percent for multilateral institutions).

As regards the respondents' profile, for nearly 71 percent of all responding agencies, revenue from investment insurance constituted less than half of total revenues,

and for 60 percent of them, investment insurance operations employed less than ten people. Projects in emerging markets feature large in their portfolios, with one-third of the responding agencies claiming that such projects account for all investment insurance issued in the last year of operation. Apart from investment insurance, trade insurance and finance are the principal services offered in general by these agencies, while some also offer consultancy services.

* A few agencies indicated that they did not provide investment insurance and were unable to complete the survey.

* * *

As the world becomes a riskier place for investors, it is in the interest of governments to ensure that their companies are protected against political risk when investing abroad. Many countries actively promote outward FDI, and political risk mitigation could become an integral part of such programs. Initiatives may

include expanding the services offered by existing export credit insurance agencies to include investment insurance; raise awareness about different products available; and run campaigns to increase awareness about the presence of political risk and appropriate mitigation tools.

ENDNOTES

1 EIU, *World Investment Prospects to 2011* (2007).

2 *Ibid.*

3 *Ibid.*

4 *Ibid.*

5 *Ibid.*

6 "South-South FDI flows: how big are they?" D. Ratha and D. Aykut, *Transnational Corporations*, 2004.

7 EIU, *World Investment Prospects to 2011*, op. cit.

8 D. Ratha and D. Aykut, op. cit.

9 *Ibid.*

10 UNCTAD, *World Investment Report 2007*.

11 *The 2008 BCG 100 New Global Challengers: How Top Companies from Rapidly Developing Economies Are Changing the World*, Boston Consulting Group, December 2007.

12 Findings reported in EIU, *World Investment Prospects to 2011*, op. cit.

13 Ernst & Young, *Risk Management in Emerging Markets*, 2007.

14 See *India's Political Risk Insurance Industry*, October 2007.

15 See *Regional Developments in FDI and PRI: The Case of Islamic Corporation for the Insurance of Investment and Export Credit*, November 2007.

16 *Regional Trends in FDI and PRI: The Case of the African Trade Insurance Agency*, December 2007.

17 *The Business of Investment Insurance in China*, November 2007.

18 *Regional Trends in FDI and Political Risk Insurance: The Case of ICIEC*, op. cit.

19 *India's Political Risk Insurance Industry*, op. cit.

20 *The Business of Investment Insurance in China*, November 2007.

21 EIU, *World Investment Prospects to 2011*, op. cit.

22 Ernst and Young, op. cit.

23 World Economic Forum, *Global Growth@Risk 2007*.

24 *Much of that was due to the purchase of Inco (Canada) by CVRD for US\$17 billion*.

25 *Regional Trends in FDI and Political Risk Insurance: The Case of ICIEC*, op. cit.

26 *Regional Trends in FDI and PRI: The Case of the African Trade Insurance Agency*, op. cit.

27 *The Business of Investment Insurance in China*, op. cit.

28 *Ibid.*

