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Mar. 28, 1983	Memorandum

Correspondents / Participants
From: Hugh Scott
To: Members of the Managing Committee

Subject / Title
Draft memo on the proposed multilateral investment insurance agency and the question of its link with the Bank.

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Additional Comments

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For consideration on August 10, 1982

R82-225

FROM: The Deputy Secretary

July 14, 1982

MULTILATERAL INVESTMENT INSURANCE AGENCY

Attached is a memorandum from the President entitled "Multilateral Investment Insurance Agency" dated July 14, 1982.

Questions on this document should be referred to Mr. Golsong (X61492) or Mrs. Meigher (X61453).

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council
Vice Presidents, IFC
Directors and Department Heads, Bank and IFC

Gentlemen:
This issue of a multilateral investment
insurance scheme is not a new one.
Mr. Drake described it as a "reasonable issue"
We all realize that it is a new
sensitive and hopefully not controversial
issue. As Mr. Smith has
suggested we are not

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

A. W. CLAUSEN
President

July 14, 1982

MEMORANDUM TO THE EXECUTIVE DIRECTORS

SUBJECT: Multilateral Investment Insurance Agency

At the time of the last Annual Meeting of the Bank's Board of Governors, I suggested that the possibility of creating a multilateral investment insurance mechanism should be explored. Such a mechanism could assist in mobilizing additional investment capital for the developing countries by meeting private investors' needs for reasonable security against certain non-commercial risks which could not be met by the authorities of the host country or by the national insurance schemes of the investor's home country.

The creation of such a mechanism established within the framework or under the auspices of the World Bank Group would fit into our present course of action. We have stressed the increasing importance and role of the International Finance Corporation in providing technical and financial assistance to individual entrepreneurs, enterprises, and institutions and in serving as a catalyst for private investment. We have underscored the need for more intense cooperation with commercial banks in cofinancing and participation in investment projects.

Private investment in developing countries can be a most effective agent for furthering economic development, and it is imperative that its growth be sustained. Establishing a multilateral investment insurance agency (MIIA) supplementing the efforts of governments and the private sector could be one additional factor sustaining such growth.

The staff has examined the matter and prepared a preliminary report. The report: (1) describes the factors taken into account in concluding that further discussions for the establishment of a MIIA are warranted; (2) summarizes the result of the consultations with representatives of member governments, national investment insurance agencies and the international business community; and (3) presents the key principles of a possible scheme as a vehicle for further discussions.

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The discussions and consultations to date have been preliminary and informal. The next steps, to be most productive, will have to be taken on a more official basis. It is, therefore, requested that the Executive Directors take note of the report and agree that staff continue to examine, in cooperation with the Executive Directors, the feasibility of establishing a MIIA within the framework or under the auspices of the World Bank Group with a view to submitting, ~~by April 1, 1983, formal recommendations on establishing a MIIA.~~

2

IN LIEU OF ABOVE

submitting... "a progress report or reports and, as soon as practicable thereafter, a final report on this matter."

President

MULTILATERAL INVESTMENT INSURANCE AGENCY (MIIA)

STAFF REPORT

1. This report represents the current thinking of the Bank staff on the feasibility of establishing a MIIA within the framework of the World Bank Group. It is based on a preliminary examination of national, regional and private investment insurance schemes and on informal consultations with representatives of member governments, national investment insurance agencies and the international business community. The report concludes that there appears to be a need for a MIIA and that the possibility of creating such an Agency should be further, and more fully, explored. An outline of the main features of a MIIA is presented as a vehicle for raising in concrete terms the major issues related to multilateral investment insurance and does not represent the final conclusions of the staff in relation to these issues.

I. The Need for Multilateral Investment Insurance

2. A preliminary examination of the possibility of a multilateral investment insurance scheme indicates that:

(i) the developing countries' continuing need for external financial resources makes it important that loan funds, obtained from official and market sources, be supplemented with direct foreign investment;

(ii) a concerted effort, designed to facilitate the flow of private investment to developing countries and ensure the required additionality in such flow is, therefore, needed;

(iii) investment insurance, offering prospective investors coverage on non-commercial risks could be a useful instrument in this respect; and

(iv) there are considerable gaps in existing national, regional and private insurance schemes, and that the MIIA would be an appropriate facility to supplement these schemes.

The Role of External Resources in Economic Development

3. The availability of sufficient financial resources -- whether as loan funds or direct investment -- is extremely important for economic growth and development. Given their low per capita GNP and concomitant low aggregate savings, developing countries lack sufficient domestic sources of investable

funds and, therefore, have had to supplement these sources with external resources transfers. During the 1960s and early 70s most developing countries were able to finance the larger part of domestic capital formation from domestic savings, with foreign funds providing only between 10 and 20 percent of their capital requirements. External financial flows originated both from official and private sources; the latter were mostly comprised of direct investment and export credits, obtained in connection with capital goods imports. During this period resource flows and economic growth progressed hand-in-hand without major disruptions and external deficits arose primarily from imports of capital goods and other materials, necessary to sustain economic growth.1/

4. By contrast with the preceding decade-and-a-half, the mid 1970s marked a turning point in the pattern of developing country finance, as a consequence of changed conditions in the world economic environment. After 1974, coincidental with the onset of a recession in the industrialized countries and the ensuing deterioration in their terms of trade, oil-importing developing countries were severely affected by the quadrupling of crude oil prices. Although some developing countries continued to benefit from sustained price levels for their exported primary commodities, the aggregate external payment position of oil-importing developing countries deteriorated rapidly. This situation is summarized in Table 1 which shows that from 1973 to 1975 there was a nearly four-fold increase in their combined current account deficits, and that these deficits had risen sharply relative to their aggregate GNP.

Table 1: OIL-IMPORTING DEVELOPING COUNTRIES' CURRENT ACCOUNT DEFICITS 1970-80
(billions of 1978 dollars)

	Low-income					Middle-income				
	1970	1973	1975	1978	1980	1970	1973	1975	1978	1980
Current account deficit	3.6	4.9	7.0	5.1	9.1	14.9	6.7	42.8	20.4	48.9
Current account deficit as % of GNP	1.9	2.4	3.9	2.6	4.5	2.6	1.0	5.5	2.3	5.0

Source: World Development Report 1981.

1/ In 1970 the external deficit of the low-income developing countries stood at $3.6 billion (expressed in 1978 US dollars), or 1.9 percent of their aggregate GNP. The middle-income oil-importing developing countries, meanwhile, had a total deficit of $14.9 billion in the same year, representing 2.6 percent of their combined GNP.

5. The post-1974 period is also characterized by considerable divergence in the patterns of external financial flows to low- and middle-income oil-importing developing countries respectively. Countries in the middle-income group whose external deficit had risen most were increasingly having to rely on borrowings from international commercial banks. Commercial loans thus became their largest source of external finance, while other external sources of funds, notably direct investment decreased sharply in relative terms and in relation to these countries requirements. Low-income countries, by contrast, continued to rely primarily on Official Development Assistance. In their case commercial loans remained relatively unavailable, while foreign direct investment remained minimal or even decreased in real and nominal terms. This is shown in Table 2.

Table 2: FINANCE SOURCES OF OIL-IMPORTING DEVELOPING COUNTRIES 1970-80 (billions of 1978 dollars)

	Low-income					Middle-income				
Item	1970	1973	1975	1978	1980	1970	1973	1975	1978	1980
Net Capital Flows										
ODA	3.4	4.1	6.6	5.1	5.7	3.3	5.3	5.3	6.5	7.9
Private direct investment	0.3	0.2	0.4	0.2	0.2	3.4	5.1	3.8	4.6	4.5
Commercial loans	0.5	0.6	0.8	0.9	0.7	8.9	13.7	21.0	29.4	27.1
Changes in reserves and short-term borrowing	-0.5	-1.1	-0.7	-1.1	2.4	-0.8	-11.7	-12.7	-20.1	9.5

A minus sign (-) indicates an increase in reserves.

Source: World Development Report, 1981.

6. During its initial phase commercial bank lending to developing countries was viewed very favorably. The expansion in commercial bank lending to oil-importing middle-income countries was further stimulated by a number of secondary factors affecting the borrowers' perceived credit-worthiness and debt servicing capacity. Between 1976 and 1979 their terms of trade gradually improved, the price of oil declined relative to that of other internationally-traded commodities, and their own export performance improved in the light of the international economic recovery.

7. From late 1979, however, conditions became less propitious for this type of lending, particularly so as several borrowers experienced debt servicing problems leading to a number of debt reschedulings, conducted under the aegis of the Paris Club. Moreover, there was a renewed deterioration in several of the borrowing countries' terms of trade, under the impact of a new international recession, of further acceleration in the international rate of inflation, and of further steep oil price increases.

8. Spiralling international inflation, in particular, had a destabilizing impact on major developing country debtors. First, the cost of servicing their outstanding external debt was rising rapidly, in line with international interest rates that were reaching unprecedented "real" levels. Second, additional borrowing became necessary to meet the debt service payments.

9. Therefore, as the borrowing countries' current account deficits widened, while their debt servicing capability and perceived creditworthiness deteriorated, it also became increasingly difficult for them to raise more funds from commercial banking sources. This led to the paradox that non-concessional flows were in danger of becoming more difficult to obtain, precisely at the time they were most needed. Meanwhile, the growth of foreign direct investment (FDI) to such countries was stagnating. Far from improving, this situation has continued to deteriorate after 1979 and many countries are now experiencing increasing difficulties in financing their external payment deficits, and in some cases have had to cut back their infrastructural investments. Concern is now expressed in many official and private circles over the impact of reduced -- and more costly -- resource transfers upon the developing countries' long-term growth prospects.

10. With particular reference to FDI, as already noted, its relative post-1973 decline was compensated by the increase in commercial loan flows, at least in the case of middle-income countries. One could thus argue that loans somehow became substitutes for FDI. Moreover, foreign investment took on new forms, which tended to blur the distinction between FDI, non-equity investment and inter-company transfers. In the present adverse conjuncture it is anticipated that the real growth of commercial lending will slow down, making FDI even more significant. However, in light of the difficult economic situation, the possibility of political instability becomes more apparent, inducing caution on the part of prospective foreign investors.

The Need for Investment Insurance

11. From the argument presented in the foregoing paragraphs (3 - 10) it is evident that there is great need for additionality in resource transfers to developing countries. In view of the regulatory and structural

constraints that are likely to impede the future real growth of commercial bank lending to these countries, the growth of FDI should now be addressed as a matter of priority. Such incremental FDI may be more likely to take place if remedies can be found to reduce real or perceived non-commercial risks inherent in FDI and, thereby, stimulate the investors' confidence in stable investment conditions. Many developing countries have already responded to this situation by taking measures to afford private foreign investors substantive and procedural protection, notably through the promulgation of new laws for the protection and encouragement of FDI, and the conclusion of bilateral agreements for the same purpose. The growth of the International Centre for Settlement of Investment Disputes (ICSID), especially during the last five years, to 81 Contracting Parties is evidence of the interest in removing obstacles to foreign investment. In further support of that trend, the idea of providing foreign investors with insurance against non-commercial risks on their investments in developing countries has gained new momentum. As discussed in paragraphs 14 and 29 below, there is now a substantial number of national investment insurance schemes, including schemes in developing countries and private investment insurance has substantially grown in the last ten years.

12. It cannot, of course, easily be shown to what extent investment insurance will trigger additional investment. Political risk considerations play a role only if the commercial soundness of an investment has been established. Hence, protection against such risks is but one of the many elements in the investment decision matrix. However, there are strong indicators that the commercial community is increasingly aware of political risks, that such risks may create a barrier to the implementation of commercially sound investments, and that the availability of adequate protection against such risks will gradually improve the investment climate in the developing countries. Thus, even though additionality in FDI in response to such protection is unlikely to be sudden, every effort should be made to eliminate all non-financial and non-commercial obstacles from the path of such flows. Investment insurance is one of the means available to achieve that effect.

The Availability of Investment Insurance

13. Investment insurance is available under three different types of schemes: (1) national investment insurance schemes; (2) to a very limited extent, regional investment insurance schemes; and (3) the private insurance market.

A. National Investment Insurance Schemes

1. Countries with Investment Insurance

14. Almost all OECD countries have set up national investment insurance schemes; the earliest was established in the United States in 1948 and the latest in Italy in 1980. In addition, some capital exporting develop-

ing countries have recently introduced similar schemes -- Korea in 1972 and India in 1978; in Portugal, legislation is presently pending.2/

2. Objectives, Terms and Conditions

15. A comparative survey of the objectives, terms and conditions of the individual schemes shows a substantial homogeneity.

16. In general, the national schemes share basic objectives, although there are differences in emphasis. These objectives are developmental assistance, export promotion, access to raw materials as well as the promotion of mutually advantageous economic relations. Many of the schemes are designed to be self-sustaining. All schemes operate under the auspices of and have the financial backing of their respective governments.

17. Eligibility is generally restricted to investors who are nationals or at least residents of their respective countries and, with few exceptions, to investment in developing countries. Coverage usually extends to equity participation and loans. Insurance is usually restricted to "political risks". Generally, insurance is available for three types of political risks: expropriation, inconvertibility and war. Premium rates vary among the schemes, but flat premiums tend to cluster between 0.5 percent and 1.0 percent per annum of the insured amount. Schemes do not generally differentiate among host countries as to premiums. Almost universally, the national schemes offer fifteen-year periods of coverage and some go even further in certain circumstances.

18. Under all schemes investors must, upon indemnification by the national agency, either assign their claims against host countries to the insurer or pursue them on behalf of the insurer. Whereas only one scheme explicitly requires the existence of a bilateral agreement with a host country as a precondition for insurance, many other schemes strive to safeguard their exposure by bilateral investment protection treaties.

3. Operation under National Investment Insurance Schemes

19. Although all member countries of the Development Assistance Committee of the OECD (DAC) offer investment insurance, only about ten percent of the total stock of direct investment made by DAC-member enterprises in developing countries is presently covered -- about $12 billion of a total of $120 billion (OECD estimates). As of December 31, 1981, only three schemes had a total amount of investment under cover exceeding $1 billion. A substantial number of schemes appear rather inactive, with total coverages remaining under $100 million, and sometimes even under $10 million. For many

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2/ The following 20 countries have national investment insurance schemes: Australia, Austria, Belgium, Canada, Finland, France, Germany, India, Israel, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom and United States.

20 COUNTRIES

2 THIRD WORLD COUNTRIES

schemes, even the larger ones, their exposure in one single project and in one single country exceeds by far their aggregate premium revenues.

20. Prior to the recent events in Iran, the total net payment on claims (payments not recovered from host countries) on each scheme was kept below its aggregate premium revenues. The Iranian situation has, however, caused heavy losses for many schemes and has absorbed a substantial portion of their aggregate premium revenues. It has become known with regard to at least one major system that losses exceeded reserves and made restructuring necessary in order to recoup the financial and political viability of the scheme. Germany

4. Gaps in National Investment Insurance Schemes

21. The strength and weaknesses of the national investment insurance schemes are difficult to document. In theory, most national investment insurance schemes have no major shortcomings with regard to coverage, eligibility or cost. However, as indicated above in paragraph 19, only a small minority of "eligible" investors are covered by insurance. This is all the more surprising since an increasing amount of investment insurance is being provided by the private market at a higher cost and -- apparently -- on less favorable conditions. While further analysis is needed for a reliable assessment, there are certain difficulties inherent in any national approach which offer an explanation for the sometimes limited practical value of the schemes. This has to be examined in light of the substantially increased number of applications for insurance received by many national schemes since 1979.

a. Lack of Risk Diversification

22. Investment insurance can achieve commercial viability only if it spreads its risks over different countries in a way that its exposure in individual host countries bears a reasonable relationship to its reserves. The information made available indicates, however, that a number of schemes have exposures in single host countries which exceed their aggregate premium reserves.

23. National schemes face limitations in spreading risks by attracting more business because the amount of investment emanating from the home country is limited. This diversification capacity is further diminished in many instances by the fact that investments from one country tend to be concentrated in particular host countries with which the home country traditionally maintains close economic ties.

b. Restrictive Underwriting Policy

24. The reaction to this inherent constraint is the tendency of many schemes to avoid underwriting investment which would result in a gross imbalance in the scheme's portfolio. This has resulted

in gaps in insurance coverage especially for large-scale mining and energy projects at a time when the needs in this area are critical and increasing.

c. Problems with Investments of Mixed Nationality

25. National insurance schemes are also deficient in providing protection for investor groupings of different nationalities since all schemes only insure their own nationals or at best persons or corporations carrying on business in the home country. This creates special problems for large-scale projects, particularly in the energy and mining sectors which are increasingly being financed by international consortia. Theoretically, most members of such a consortium are able to obtain investment insurance from their respective national schemes. Such "parallel insurance" does not, however, provide a satisfactory solution since the terms and conditions of the various insurance schemes tend to be different. Moreover, the involvement of several national insurance schemes in one project leads to a number of parallel negotiations and settlement procedures if any problem arises. The result is inefficiency because of duplicated negotiations and legal difficulties, in particular, if different laws apply to various investments in a single project.

d. Constraints on Reinsurability with the Private Market

26. Due to the lack of diversification, the portfolios of national investment insurance schemes are usually considered high-risk portfolios. As a result, they can be insured with the private market, if at all, only at high cost and generally on unfavorable terms. Thus, many national schemes are in a vicious circle: reinsurance with the private market would spread their risk and thereby alleviate their structural shortcomings. The existence of these shortcomings, however, makes reinsurance difficult to obtain at less than prohibitive cost.

e. Unavailablity of National Investment Insurance for Certain Capital Exporting Countries

27. Finally, a number of important capital-exporting countries, in particular the capital surplus OPEC countries, do not have national investment insurance schemes. In view of the increasing importance of investors from these countries, the need for investment insurance for nationals of these countries is readily apparent.

B. Regional Investment Insurance Schemes--The Inter-Arab Investment Guarantee Corporation

28. The Inter-Arab Investment Guarantee Corporation was established pursuant to a Resolution adopted in 1966 by the Arab Ministers of Industry. The purpose of the Corporation is to provide insurance coverage for Arab investments in member countries against loss resulting from non-commercial

risks. The Corporation was established with an open-ended share capital; at the present time, its capital amounts to K.D. 23,525,000 (approximately U.S. $80.5 million). Membership of the Corporation is limited to members of the Arab League. Since the Corporation's insurance is limited to investments in contracting countries represented by assets which belong to other contracting countries or to their nationals investments in non-Arab capital-importing countries are not covered.

C. Private Investment Insurance Market

29. The private investment insurance market operates both as a primary insurer and as a reinsurer of national investment insurance schemes. The private market has shown dramatic growth in the last ten years. For example, information made available to Bank staff indicates that in 1973 there was probably no more than $2 to $3 million of premiums derived from investment insurance against political risks and that it was difficult to obtain more than $8 million of insurance per project. In contrast, in 1982 premium income for insurance of these risks was estimated at $40 million and it was possible to insure single investments of $200 million or more.

30. There are, however, the following serious limitations which prevent the private market from giving satisfactory service to investors:

(i) As a general rule, war damage is excluded from coverage.

(ii) There is generally an unwillingness to give coverage for more than three years, even though there is the possibility of renewal each year for another three years. This "revolving mechanism" offers investors less security than the fifteen-year coverage most national schemes provide.

(iii) Premium rates tend to be substantially higher than those charged by national schemes.

II. The Possible Role of a MIIA

31. A multilateral investment insurance scheme would appear to be the logical answer to the gaps left by the national and regional schemes and the private market. A MIIA could supplement the existing facilities and mobilize additional investment insurance capacity in the following areas:

(i) insurance of investment from countries without a national investment insurance system; 1

2

(ii) insurance of investment in host countries in which national investment schemes are over-exposed;

(iii) co-insurance of large investments with national schemes;

(iv) re-insurance and co-insurance with the private market; and

(v) insurance of multinationally-sourced investments.

Insurance of Investment from Countries without a National Investment Insurance System

32. The exportation of capital is no longer restricted to industrialized OECD countries but extends increasingly to some developing "threshold" countries, in particular capital-surplus OPEC countries. The major part of their capital export goes into portfolio investment in developed countries. However, investors from these countries show an increasing tendency to invest part of their capital in direct investment, including developing countries. Their interest in investment insurance is evidenced by their purchase of cover in the private market as well as by the fact that some developing countries have recently introduced national investment insurance schemes at the request of their respective business communities. These investors might, therefore, be encouraged to make additional direct investment in developing countries if insurance were available to them.

Insurance of Investment in Host Countries in Which National Investment Schemes Are Over-Exposed

33. The most evident supplementary function of a multinational scheme relates to cases where national investment insurance schemes shy away from covering further insurance of investments in respective host countries for fear of unbalancing their portfolio. The MIIA could provide insurance for investment in such host countries. In view of the fact that investment from many home countries is largely concentrated in a few host countries or host regions, this would add insurance capacity.

Coinsurance of Large Investments with National Schemes

34. A similar advantage exists with regard to investments which are rather large in comparison to the portfolios of national schemes. By insuring part of these investments on their own account and referring another part to the MIIA, national schemes could provide coverage but avoid an unsound concentration of risk. Obviously, this advantage is of particular value for smaller national schemes. By way of national/multilateral co-

insurance, investments in the mining and energy sectors which, because of their size, are practically uninsurable under many national schemes could be insured.

Reinsurance and Coinsurance with the Private Market

35. The private market is an international market operating on the basis of risk diversification. Information obtained by the staff indicates that private market portfolios enjoy a much greater spread of risks than do national investment schemes. The MIIA could be expected to achieve a better spread of risk than national schemes. It would be open to many more investors and, as important, would offset the geographic concentrations of investment from individual home countries. As a result, a MIIA would be in a much better bargaining position vis-a-vis the private market than national schemes are. This advantage would be enhanced by a tie of the Agency to the World Bank. Additional insurance capacity could, therefore, be mobilized at reasonable terms.

Insurance of Multinationally-sourced Investments

36. The MIIA would avoid the difficulties with respect to the insurance of investment emanating from various home countries by providing a uniform protective and procedural umbrella for all investments in one project. In some cases, coinsurance between the MIIA and the national schemes of the investors' home countries would be necessary for such projects. Nevertheless, the desirable uniform unbrella could be provided; the national agencies involved could pool their insurance and the pool could be administered by the MIIA.

III. Preliminary Consultations

37. Since the 1981 Annual Meeting, Bank staff has held preliminary consultations on issues related to the establishment of a MIIA with representatives of some member governments, national investment insurance agencies, the private insurance market and the international business community.

38. Acting at the invitation of governments or at its own initiative, World Bank staff reviewed with OECD member governments, with governments of capital-exporting countries in the Middle East and with Latin American and Asian governments options for the creation and operation of a multilateral investment insurance scheme. In the discussions, governments reacted cautiously, given the fact that they did not want to -- and were not asked to -- commit themselves on any specific scheme or any specific issue. Some governments reacted more favorably than others but the majority of governments consulted indicated their positive attitude towards the further preparation of a specific scheme to be submitted for consideration. It must be noted, however, that certain countries expressed reservations and indicated that they would be unable to agree to any proposal that they would see as detracting from their sovereignty.

39. In addition to discussions at government level, World Bank staff obtained the views of national investment insurance agencies through the Berne Union, a forum for discussion and exchange of information established by such agencies, and through contacts with representatives of individual national investment insurance agencies. National agencies generally reacted with interest, even though they were cautious not to prejudice their respective government's position.

40. Representatives of the private insurance markets in London and New York expressed their interest in reinsurance and coinsurance with the MIIA. They indicated that cooperation with an insurance agency linked with the World Bank could be sufficiently attractive to make them adjust their normal terms, accord favorable rates and make available relatively large underwriting capacity.

41. Staff also reviewed the issues regarding MIIA with the potential clients of the agency, namely, private investors. Discussions were held with business executives from the United States, Europe and the Middle East. A workshop regarding investment insurance was held at the Bank's European office in June. Private investors generally reacted favorably to the idea of creating a multilateral investment insurance coverage mechanism within the World Bank Group. They noted that its establishment would create additional capacity supplementing national agencies' and private insurance coverage. They also noted the need for more comprehensive coverage of, e.g., complex multinational investment projects or of projects of such a scope and cost that they could not be covered fully by national agencies or private insurance.

42. In order to enhance the efficiency of the MIIA, private investors favored a close link of the Agency with the World Bank.

43. Private investors were divided as to whether participation of developing host countries in the sharing of possible losses of the Agency would be useful. Some investors felt that such a participation would substantially sharpen developing countries' awareness of their common interest in effective investment protection and thus improve the overall investment climate; others thought that such participation would raise additional problems with regard to claims against host countries.

IV. A Possible MIIA -- Main Features

44. The MIIA could be established and operate on the basis of the following principles:

1. It would require only limited capital contributions, or none, from members; members' obligations would depend on their use of the Agency, that is, on sponsorship of insurance.

2. It would have a link to the World Bank.

3. For administrative purposes, it would rely heavily on the national investment insurance agencies or other agencies designated by the home countries of the investor, thus eliminating the need for an extensive international bureaucracy.

4. While being open to all World Bank members, it could become operational as soon as a relatively small number of capital-exporting and capital-importing countries joined.

5. Its voting structure would be based on use of the Agency, i.e., sponsorship of insurance.

6. It would provide for participation of host countries in the decision-making process and for adequate arrangements for recovery in case of loss.

45. These principles would result in an Agency which would not supersede the existing national investment insurance schemes but would complement them and would not undercut investment protection based on bilateral treaties.

A Service Facility Based on Sponsorship

46. The objective of the MIIA would be to provide insurance against non-commercial risks for investments in developing countries. The risks covered would be those normally insured by national agencies: (a) expropriation, confiscation or equivalent governmental action or inaction which deprives the insured investor of effective control over or the benefits of his investments; (b) governmental restrictions on conversion and transfer from the currency of the member state in whose territories the investment is to be made into another appropriate currency; and (c) armed conflict or civil unrest. Moreover, the Agency might be given the power to insure additional non-commercial risks having serious adverse effects on international investment. The Agency would only provide insurance in cases where both the home country of the investor and the proposed host country agree to use its services. In other words, a member takes on no obligations (except as indicated below) merely by joining the Agency.

47. While premium income would, after an initial period, cover administrative expenses, other financial sources would be needed to cover initial administrative expenses. If these are not covered by a contribution from the Bank (see para. 54 below), a small capital contribution might be required from all members. Except for this contribution, obligations of a member to the Agency would depend on the use that member made of its services by sponsoring insurance.

48. There would be an expectation that the Agency would, in the long run, become self-supporting. Until that time, losses incurred under

insurance underwritten by the Agency and not covered by premium reserves or possible reinsurance (see para. 49 below) would be financed through a mechanism of sponsorship coverage by member countries. Under this approach, member countries proposing to the Agency the insurance of a certain investment would at the same time incur a loss-sharing obligation towards the Agency in the amount of the insurance sponsored by them. This loss-sharing obligation would apply to the whole of the Agency's portfolio. Any loss incurred would, therefore, be shared among all member countries in the proportion which the total amount of insurance sponsored by a given member country would bear to the total amount of insurance by all countries. (Example: Assume that Country A sponsors 100,000, Countries B and C each 50,000 and that there is a 50,000 loss on the investment sponsored by C. This loss will be shared as follows: Country A, having sponsored 50% of all outstanding insurance, carries 25,000; and Countries B and C, having each sponsored 25%, carry each 12,500).

49. The Agency would explore the reinsurance of part of the insured risks with the private insurance market. If such reinsurance could be arranged, which seems probable, the possibility of a call on sponsoring countries to cover losses would be considerably reduced. The possibility of co-insurance with the private insurance market would also be examined in order to mobilize additional insurance capacity.

50. There are many advantages to the sponsorship concept. No state would undertake any commitment by joining the Agency. Loss-sharing obligations would only arise at the moment investments are "sponsored." Hence, participation in the scheme would be free of charge; essentially, it would provide members with the option, at no cost, of launching an investment through a multilateral mechanism rather than writing national insurance. Moreover, a member's risk exposure could neither exceed the amount of the investment sponsored nor the exposure under nationally written insurance for the same investment. Finally, because of the MIIA's risk diversification possibilities and improved reinsurability with the private insurance market, it can reasonably be expected that each country's budgetary risks related to investment insurance would be reduced.

Relationship with the World Bank

51. The Agency would be endowed with juridical personality and legally independent from the World Bank, but could be established under the auspices of the Bank. This would allow for the consideration of the Agency's Articles of Agreement in a non-confrontational atmosphere.

52. The Agency should be in a position to draw upon the Bank's expertise and benefit from its administrative support. Through a link to the Bank, the Agency could profit from the standing and reputation of the Bank and could from its very start be perceived as being an institution committed to furthering the objectives of the World Bank Group.

53. The Agency could conclude a management agreement with the Bank to take advantage of the professional expertise of Bank staff as well as of the Bank's dialogue with member countries. Certain officers of the Bank could, at least initially, also serve as officers of the Agency.

54. It might be possible for the Bank to finance initial administrative expenditures as a one-time contribution from its administrative budget.

Decentralized Administration

55. Under a sponsorship financing system, every application for insurance has to be supported by the sponsoring state prior to any consideration by the Agency. National agencies involved in the sponsorship decision may be able to carry out many administrative functions more efficiently than an international organization since they are more convenient to the investor and may be more familiar with the investor's internal operations and insurance needs. In particular, small and medium sized investors would benefit from a decentralized administration.

56. Arrangements could be entered into whereby investors would have to file applications for insurance with national investment insurance agencies of their home countries or with the administration designated for that purpose by such countries. The home country agency would then appraise the application and decide whether to deny the application, or to write insurance under the respective national scheme and/or "sponsor" the investment for MIIA. Guidelines, general conditions and, if necessary, technical assistance, would be provided to national agencies by the Agency to ensure a uniform processing of applications. While the Agency would generally rely on the assessments of the national schemes, it would retain the right to undertake its independent assessment of the risk factor as well as of the impact of the investment on its portfolio.

57. Because the initial screening of investments to be insured by the Agency would be done by national schemes, the Agency would have to be careful that it was not asked to insure a disproportionately large amount of more risky investments. This is particularly important if the Agency plans to reinsure with the private market which will not accept a concentration of bad risks. The first safeguard would be careful underwriting decisions by the professional management of the MIIA on the basis of an independent risk assessment. Other possible ways in which the Agency could mitigate this problem include the following:

(i) requiring the country that sponsored the investment on which a loss occurs to carry a somewhat larger proportion of this loss than the other member states; and

(ii) requiring sponsoring member countries to insure a significant part of the investment on their own account (coinsurance with national investment insurance schemes).

Membership and Effectiveness

58. In contrast to past proposals for multilateral investment insurance (see Annex), the MIIA could become operational upon the ratification of its Articles of Agreement by a relatively small number of states (e.g., 12), provided that among these were a certain number of OECD/DAC member states, capital-exporting oil-producing countries and developing non-capital-exporting countries. This is a pragmatic approach in light of prior experience which will allow the Agency to show its usefulness without requiring a consensus based on a large membership.

59. The fact that membership is open to both capital-exporting and capital-importing countries and that membership of states in each category is required for effectiveness is based on the premise that states in both categories have a common interest in the Agency and that the cooperation of both is essential. The capital-importing countries would be able, through membership in the Agency, to participate in its administration and increase the flow of private investment to their countries; the capital-exporting countries, on the other hand, could expect from the capital-importing countries a "better climate" for private foreign investment.

60. The organizational structure of the Agency would depend, to a large extent, on the size of the membership. If there were a large number of members, the effective setting of policies could not be vested in all members and powers would have to be delegated to a smaller body selected by the members in accordance with an agreed formula. It would be essential, however, to have day-to-day operations conducted by a professional management.

Voting Structure

61. The voting structure of the Agency should give the largest voting power to those who have the largest potential obligations to the Agency as a result of sponsoring insurance and should be consistent with the objective of attracting the support of investors from developed and capital-exporting developing countries. At the same time, however, appropriate representation for non-capital-exporting developing countries should be ensured.

62. In principle, voting rights would be determined on the basis of the volume of investment insurance sponsored by the respective member states. However, for an initial period it would be necessary to determine voting rights on another basis. This determination could be made based on objective

criteria such as the share of member states in foreign investment in developing countries over a given period of time preceding the establishment of the Agency, and taking into account the desirability of a regionally balanced approach, which would not give a preponderant position to any member country. After the initial period, voting power would be adjusted to reflect the amounts of investment insurance sponsored by a member state during the initial period of operations of the Agency. Such adjustments would henceforth be automatically made, e.g., on a yearly basis, each time taking into consideration the total amount of then outstanding investment insurance sponsored by each member state. Developing countries would, however, be assured a minimum number of votes which might reflect the volume of MIIA insured investment in those countries.

Legal Arrangements with Host Countries

63. The scheme should not result in the rolling over from host countries to the Agency's member states the cost of expropriations and similar interferences in investors' interests. All existing national investment insurance schemes provide for mechanisms to protect them against taking over host countries' liabilities at the expense of their respective taxpayers. Arrangements with host countries will, therefore, be necessary in order to safeguard the Agency's interest in preventing losses and obtaining redress if a claim is paid. In devising appropriate safeguard arrangements, the Agency would have to be careful to preserve political neutrality and this mandates that it should neither interfere with some countries' perceptions of national sovereignty nor dilute existing levels of investment protection.

64. One possible solution would be for each individual investment to be insured by the Agency to have, as a prerequisite, the approval of the host country. This host country approval would not only state the consent of the respective country to the issuance of multilateral insurance but it would also express agreement with the terms of insurance as derived from the "general conditions" of the Agency and endorse them to the extent that they stipulate the Agency's liability for losses resulting from events for which the respective host country is responsible. An "umbrella agreement" between the Agency and the respective host country would determine the rights the Agency obtains from such endorsements as well as the procedures by which the Agency could assert these rights. In substance, the Agency could obtain a claim against the host country to recover payments it had to make under endorsed insurance terms; procedurally, the umbrella agreement could entitle the Agency to assert its claim by way of international arbitration.

65. An alternative approach could be to require investors to include ICSID clauses in their contracts with host countries and to exhaust this remedy before obtaining a final settlement from the Agency. Advance payment could be made as soon as an insured investor established the credibility of an insurance claim.

MULTILATERAL INVESTMENT INSURANCE SCHEMES PREVIOUSLY CONSIDERED BY THE WORLD BANK

The Bank has in the past been involved in consideration of two proposals for multilateral investment insurance - the International Investment Insurance Agency (IIIA) and the International Resources Bank (IRB).1/

INTERNATIONAL INVESTMENT INSURANCE AGENCY

Following requests submitted to the Bank, first in 1961 by what is now the Development Assistance Committee of the OECD, and later by UNCTAD I in 1964, the Bank's Executive Directors, sitting as a Committee of the Whole, considered for a number of years a proposal for the establishment of an international organization which would insure private foreign investment in developing countries against non-commercial risks (see R73-9, dated January 11, 1973). The discussions of the Committee of the Whole,

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1/ There have been other recent initiatives at establishing multilateral investment insurance schemes. For example, beginning in 1979, the Inter-American Development Bank (IDB) initiated discussions on a proposal to establish an Inter-American Fund for Energy and Minerals (the Fund). The Fund was designed to stimulate the development of Latin America's energy and mineral resources through the provision to eligible investors of insurance against political risks and of guarantees for third party loans to approved projects. At the 1980 Annual Meeting of the IDB, this proposal was not accepted and instead was sent back to management with a request to prepare further studies.

There have also been several attempts during the last ten years to establish within the European Communities a community-wide system to insure investments in developing countries by investors located in one of the Common Market countries against political risks. These attempts are an integral part of a proposal that a comprehensive protection system for European private investment in developing countries be developed. At the present time, the focus is on the general involvement of the Community in investment policy and there is no ongoing discussion of a European Investment Insurance Scheme.

over the years, led to the preparation of several drafts of Articles of Agreement for an International Investment Insurance Agency. However, in spite of the long course of these discussions, little progress was made toward an agreement or even a consensus on a number of major issues.

In early 1973, the 1972 draft of the IIIA Articles of Agreement was distributed to the governments together with a staff memorandum identifying and explaining the principal outstanding issues 2/ and including references to possible alternative solutions (see SecM73-204 dated April 16, 1973). In his covering memorandum, the President of the Bank asked governments whether they were interested in proceeding with the proposal. Since only a very limited number of governments expressed their positive interest, no further work has been done in the Bank with respect to the IIIA proposal since 1973.

INTERNATIONAL RESOURCES BANK

The proposal to establish an International Resources Bank was originally made on behalf of the United States at the Seventh Special Session of the U.N. General Assembly in 1975. It was subsequently submitted to the UNCTAD meeting in Nairobi in 1976 and again to the Conference on International Economic Cooperation in Paris, but on none of these occasions found much support from other governments. The U.S. finally asked the Bank to review the IRB proposal and to determine how the proposed functions of the IRB could best be performed within the World Bank Group structure.

The Bank's review (see Report No. 1588, dated May 4, 1977 and distributed attached to R77-121, dated May 6, 1977) determined that the IRB, as proposed by the U.S. Government, was in essence a multilateral insurance scheme to compensate foreign investors in mining and energy ventures in the event of losses sustained as the result of non-commercial causes. It was anticipated that the proposed scheme would encounter difficulties of the kind which caused the Bank a few years earlier to abandon its work on the IIIA proposal. It was furthermore found that even if it were considered acceptable to insure only a minor portion of each project on

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2/ The staff memorandum identified five principal outstanding issues: the link with the Bank, voting rights, financial participation by developing countries, subrogation and arbitration.

average, the capitalization required would still be very substantial. The Bank's review concluded that these difficulties suggested that the establishment of an IRB would not be feasible or generally acceptable at that time, and that other solutions of the investment problem in mineral resource development should be sought.

The 1977 Report then went on to review the conditions and prospects as of that time of non-fuel and energy minerals and concluded by suggesting an expanded program for World Bank Group lending in these sectors.

8-10-82

Musyorgo - questions whether W/B linkage to MIIA is appropriate. "Support the study" - but basically is against!

Brunton - extraordinarily high debt levels is a strong argument for further exploration! Time is ripe!

① more details + options for initial capitalization + leverage
② Policy options for risk sharing procedures + reasonable assumptions for potential demand.
③ Linkage with the W/Bank. Dangers? advantages.
④ alternative membership + voting schemes.
⑤ Should be flexible - should not crowd out the private sector!

Chen Looks forward to further reports.

Koopman - Lending

Humphrey - advises against pushing too hard or fast!

Drake - don't "press for too early a decision".

Record Removal Notice

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File Title		**Barcode No.**
Clausen Speeches - International Investment Insurance Issue - Multilateral Investment Insurance Agency - Volume 1		1776450
Document Date	**Document Type**	
Nov. 16, 1981	Memorandum	

Correspondents / Participants
From: T. T. Thahane, VP and Secretary
To: All Executive Directors

Subject / Title
Informal discussion on multilateral investment insurance scheme

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

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Ann May	November 03, 2021

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File Title	Barcode No.
Clausen Speeches - International Investment Insurance Issue - Multilateral Investment Insurance Agency - Volume 1	1776450

Document Date	Document Type
10/29/82	Memorandum

Correspondents / Participants
From: Jose German Cardenas, Alternate Executive Director
To: Executive Directors and Alternates

Subject / Title
Some 'final' thoughts - - multilateral investment insurance scheme

Exception(s)
Communications of Executive Directors' Offices

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Ann May	November 03, 2021

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File Title	Barcode No.
Clausen Speeches - International Investment Insurance Issue - Multilateral Investment Insurance Agency - Volume 1	1776450

Document Date	Document Type
10/27/82	Memorandum

Correspondents / Participants
From: H. Golsong
To: A. W. Clausen

Subject / Title
Multilateral Investment Insurance Agency

Exception(s)
Attorney-Client Privilege

Additional Comments

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Withdrawn by	Date
Ann May	November 03, 2021

FORM NO. 75
(9–78)

THE WORLD BANK

ROUTING SLIP	DATE: August 31, 1982

NAME	ROOM NO.
MR. CLAUSEN	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

Some good ideas in this letter that need developing and ought to be considered for your future speeches.

FROM:	ROOM NO.:	EXTENSION:
FRANK VOGL FV	E.828	72468

THE WORLD BANK
Washington, D. C. 20433
U.S.A.

A.W. CLAUSEN
President

August 24, 1982

Dear Bob:

Thank you for your letter sharing your thoughts on some of the items which undoubtedly will be discussed at the Annual Meetings in Toronto.

Your comments about the multilateral insurance agency are much appreciated. I, too, am encouraged by the beginning we have made, though under no illusion about the road ahead. In fact, right now I only will admit to being cautiously optimistic about the final outcome.

The Bank has an important role in helping countries develop a healthy domestic investment climate. The mobilization of domestic resources is an essential element in creating the type of investment opportunities that attract external capital flows from private sources. As a matter of fact, I stressed this in my speech to the Association of Latin American Industrialists in Panama last week. You might be interested in reading it so I am enclosing a copy.

Thank you for your kind words about my work at the Bank. Your counsel always has been appreciated and will be missed. I look forward to seeing you in Toronto.

Warm regards.

Sincerely,

Tom

Mr. Robert D. Hormats
Assistant Secretary of State
Department of State
Washington, D. C.

380

R1

ASSISTANT SECRETARY OF STATE
WASHINGTON

14 AUG 1982

Mr. A. W. Clausen
President
The World Bank
1818 H Street, NW
Washington, DC 20433

Dear Tom:

In anticipation of the upcoming Annual Meeting, I wanted to share a few general thoughts with you.

First, regarding the idea of a multilateral investment insurance agency, on which we collaborated last year, I am encouraged by the progress being made in the Bank. The Bank staff's proposal is a good beginning and contains a number of very constructive features. I am convinced that if it can be perceived as a joint effort between developed and developing nations, rather than one sponsored by the US or a few developed countries, it has a reasonable chance of success. However, I suspect long hours of negotiations may be needed and it may need to start out as a pioneering effort with a few countries, recognizing that some will not join immediately.

Second, we have learned a lot from the Caribbean Basin Initiative. It has led us to the conclusion that a major problem of the developing countries is to retain domestic investment, which frequently goes abroad, as well as to attract investment from abroad. Emphasis in the Bank's programs on the domestic investment climate to hold domestic capital might be useful, as it is less threatening than an approach that is overly preoccupied with attracting external private capital flows. In the final analysis, the better the domestic investment climate the greater the chance that capital will be attracted from abroad.

Third, as you know the US has been concerned for some time with investment performance requirements (mandatory export levels, mandatory content levels, technology structure requirements). You need not, I suspect, deal with the trade distorting aspects of this issue, but could publicly recognize that such programs involve developing countries competing with one another in a sort of "leapfrog" attempt to obtain benefits from foreign investment, and in so doing could actually be hurting one another without enhancing the collective well-being (even though one or two countries would doubtless benefit for a time until others utilize the same types of provisions).

Fourth, it would be very useful to give a strong boost to the GATT Ministerial meeting in November. We are at a real turning point in the world economy. Unless we make the GATT work better in resolving the problems currently under its jurisdiction, and update rules and procedures to deal with the new types and greater intensity of trade problems, it will become increasingly irrelevant to, and by-passed by, trading nations. The present disputes between the US and the EC, and internal problems faced by many economies which force them to look inward, have diverted attention from the Ministerial; support is beginning to flag. Your leadership in stressing that now is not the time to turn inward (because that would have a serious adverse effect on growth, inflation, and the international financial system) but to try to improve the workings and openness of the trading system, despite internal pressures, would be extremely helpful.

Although I am in the process of winding up here, I plan to be at the Toronto meetings and look forward to seeing you then. But in case I don't, I want to express my appreciation for the outstanding leadership you have given the Bank and congratulate you on the innovative approaches you are taking.

Warm personal regards,

Bob

Robert D. Hormats

FORM NO. 1599
(8-80)

THE WORLD BANK

ROUTING SLIP	DATE 8/24

OFFICE OF THE SENIOR VICE PRESIDENT, OPERATIONS

NAME	ROOM NO.
Mr. Clausen	

	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On

REMARKS

Tom -
An excellent and interesting analysis of the MIIA.
Well worth reading.
The author is a retired US Treasury officer, with long experience in the OECD & international finance issues.

FROM

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INTERNATIONAL ECONOMIC LETTER

8-25

Vol. II, No. 8, August 16, 1982

The Case for Multilateral Insurance of Private Investment in Developing Countries

Summary

This Letter examines two questions of importance to both industrial and developing countries. Have financial needs and attitudes toward private investment evolved in such fashion as to call for stimulating a greater flow of foreign capital resources to the developing countries? And, if so, can a multilateral insurance facility be designed that would supplement effectively the existing diverse national efforts and avoid previous obstacles to an intergovernmental insurance plan? We believe the answers to both queries are affirmative. The broad features of a plan are suggested which could meet the indicated needs and permit a cross-section of countries to adhere on an experimental, low-cost basis.

* * *

Introduction

World Bank President Clausen has proposed in recent months that the idea of a multilateral agency for insuring foreign investment in developing countries -- which was debated at length and became deadlocked in 1972-73 -- be examined anew. In this Letter, the changes in world economic conditions are reviewed in conjunction with the changing attitudes toward, and forms of, inter-country investment. The experience of individual governments in offering insurance against the main political risks confronting their investors in developing nations is also summarized as an aid to assessing what role a multilateral investment insurance facility could fill.

Direct Investment by Private Firms

The investment in less-developed countries of real resources brought in and financed from abroad has always played a major part in the economic advancement of less-developed areas. Whether in the productive growth of independent countries like Mexico, the United States, and Russia in the 19th century, or in the development of newly-emerging countries after World War II, private investment from outside sources has been an active force in mobilizing local investment resources, labor, and raw materials. The relative parts played by private investment and by official assistance from foreign governments have varied according to times and individual cases.

Development specialists recognize that foreign direct investment has distinct features that make it a highly useful financial instrument of development cooperation. In deciding to invest in a foreign country, a firm normally not only provides financial resources but channels equipment, technology, training methods, and managerial skills into the new enterprise. Moreover, while its financing may include some lending, direct investment usually involves a high proportion of equity. The transfer burden on the recipient firm (and host economy) thus has a lower component of fixed charges than that involved in some other types of financing.

In practice, those developing nations which have received large amounts of private investment from abroad are countries with a dynamic economic environment, supported by suitable general economic policies by the government, and in particular by stable investment conditions, non-discrimination, and relative freedom of capital movements.

For the post-War period, the most complete source of statistics on developmental finance is the Development Assistance Committee (DAC) of the OECD. Although its data are more detailed concerning financial flows from its own member governments and multilateral institutions, DAC also compiles what figures are obtainable on resources provided from other countries.

Figures on the main categories of financial resources going to developing countries 1/ during the past twelve years show that all categories recorded large and fairly regular increases up through 1979, albeit with yearly differences among groups (see table on next page). Official development assistance on concessional terms (ODA) registered a further rise in 1980, as did grants by private voluntary (charitable) agencies. In the field of private finance, however, there was a 15 percent drop in 1980, when both direct investment and bank lending declined. The total financing from DAC sources thus rose only 0.1 percent in current dollars and fell in real terms. In 1981, preliminary statistics indicate that both ODA and the non-concessional portion of official financing for less-developed countries decreased, as did the grants from private voluntary agencies. Direct investment flows recovered about half of their 1980 drop in 1981 apparently, but bank lending to LDCs surged to a new high in 1981 of about $26 billion. Both of the latter two increases reportedly were mainly attributable to higher transactions by U.S. firms.

Throughout the past decade, DAC information on private direct investment transfers to all developing countries shows that up through 1979 they have increased an average of 15 percent yearly in nominal terms and 5 percent in real terms. This was three times the growth rate of real domestic investment carried out by the (predominantly industrialized) countries of OECD as a group.

1/ The data include developing nations in Europe and the OPEC countries as well as the non-oil developing countries.

The 5 percent real growth of foreign investment in the LDCs compares fairly closely with the rate of increase in domestic investment by the developing country group itself, which was over 6 percent.

Table 1

Net Flows of Financial Resources from
DAC Member Countries to Developing Countries, 1970-81
(Billions of dollars)

	1970	1978	1979	1980	1981p
Type of financial flow:					
A. Official development assistance	6.9	20.0	22.4	27.3	25.5
1970 = 100	100.0	287.7	322.6	392.2	366.4
B. Other official (non-concessional) flows	1.1	5.5	2.8	5.3	4.9
1970 = 100	100.0	489.8	245.4	470.6	433.3
C. Voluntary agency grants	.9	1.7	2.0	2.4	2.0
1970 = 100	100.0	194.8	232.2	275.7	237.2
D. Private financial flows-total 1/	7.0	44.0	48.5	41.2	49.1
1970 = 100	100.0	627.2	691.5	587.2 (−)	699.1
of which: direct investment	3.7	10.8	12.9	9.5	11.3
1970 = 100	100.0	292.7	350.7	256.6	306.0
E. Total Net Flow	15.9	71.2	75.7	76.1	81.4
1970 = 100	100.0	446.3 +	474.6 +	477.2 +	510.5 +

1. Apart from direct investment, the main components are bank credits, bond lending, and private export credits.

Sources: 1970, 1980, and 1981: OECD/DAC Press Release A(82)32, June 23, 1982, p. 14.
1978 and 1979: OECD, "Development Cooperation, 1981 Review", p. 180.

p = preliminary

As to individual countries of destination, about two-thirds of the direct investment volume in recent years has been going to Latin America, with the balance flowing mainly to other middle-income countries. While the totals as well as relative shares coming from individual capital-exporting countries vary from year to year, the United States typically originates about half the direct investment. That country plus the United Kingdom, Germany, and Japan together account for about 80 percent of all foreign investment in developing nations. In every year since 1970, except one, the net direct investment by DAC member countries accounted for between 91 and 100 percent of aggregate foreign investment from all sources into the developing nations.

Among the DAC nations that accounted for most of the foreign private investment, the flow to developing countries became a somewhat larger share of the total during the late 1970s. In the United States, for example, net American private investment in LDCs averaged about 35 percent of total outward investment (including reinvested earnings) during 1977-79, as compared with 22 percent in 1970-72. This was followed by a sharp drop in 1980, however, and the country destination breakdown for 1981 is not yet available.

Governmental Insurance of Foreign Investment

Most of the industrialized, capital-exporting countries have established governmental programs for insuring their firms against certain risks connected with investing abroad. While some of these national programs will insure investments in any area, most of them are limited to the developing countries. Moreover, most of these home (investing) governments require that a project proposed for insurance be aimed at promoting development in the host country and require the latter's approval.

The first government facility for investment insurance was inaugurated in 1948 by the United States in conjunction with the Marshall Plan aid to Europe.

Thus, though it did not originally apply to "developing nations" in the present sense, the context of recovery and reconstruction was roughly analogous economically to the situation of newly industrializing countries. Despite some variations among the home country programs as to their size, their detailed terms, and criteria, there is high similarity among them concerning the general thrust and coverage. Governments of DAC countries, reflecting their generally free-enterprise orientation, have not offered to cover their national firms for business failure or unprofitability of their foreign investments but only for the non-commercial (political) risks. Most insurance programs have from the beginning covered losses due to expropriation, war, and non-transferability; recently several governments have added a coverage for civil disturbances short of war.

The protection usually applies to equity, loan participations, and fees and royalties, whether invested in cash or other forms, up to 90-100 percent of original or re-invested sums. Premiums differ, but generally they lie in a range of 0.5% to 1.0% for the three risks together, with U.S. rates being higher than most. Except for the United States (1948) and Japan (1956), other DAC country investment guarantee facilities were launched in the 1960s and 1970s.

Throughout most of their existence, each of the national insurance agencies recorded net payments to insured firms on claims that totaled less than its annual premium receipts. The 1979 revolution and subsequent events in Iran, however, presented several government agencies with an extraordinary volume of claims, involving some financial reinforcing.

It is difficult to determine either the extent to which investment decisions have been influenced by the availability of insurance or even the exact quantitative volume of insurance taken out. Annual data for new insurance issued are not available for the DAC group, and only at widely-separated dates are there figures on total insurance in force. Indications from World Bank and OECD sources suggest that only a small share of the foreign private investment flow into LDCs is covered by insurance. In 1979 the OECD/DAC estimated that about 10 percent of the outstanding foreign investment stock in developing countries that originated in DAC countries was under insurance cover. For the United States, in most of the past 10 years the insured share of the annual net investment flow into LDCs has been under 10 percent, although it lately has been rising somewhat. Both in the United States and elsewhere, the purchase of insurance varies greatly according to host country concerned, product, individual investing firm, etc. The insuring facility itself is often operating under limiting criteria (of its own or of parliamentary making) as to product, size of project, income level of the host country, etc.

N.B

The volume of investment insurance issued in past periods does not appear to have been restricted from the side of the developing countries themselves. That is, a host government which was willing to approve a given investment project for entering its economy at all was usually not opposed to the home country government's insurance of it, according to available information. Thus the relatively low ratio of insured investment to total direct investment reflected mainly the judgment of the investing firm itself -- in addition to any limiting factors from the home country's insuring agency. The cost of the annual premium does not appear to have been a major deterrent. From available indications, it can be inferred that, for the period of the 1960s and '70s, if the general investment climate in the prospective host country was perceived as favorable, the firm usually would proceed without insurance. If the outlook was not believed favorable, the firm was reluctant to commit its expenditure of effort as well as resources to the project even if the political risks of expropriation, war, and transfer difficulties were formally "covered" by the insurance process.

Previous Proposals for Multilateral Insurance

The possible need for a multilateral facility to supplement the various national government schemes for insuring foreign private investment in developing countries has been newly raised, notably by President A. W. Clausen of the World Bank. In addressing the annual meeting of the Bank's Governors in September 1981 and in subsequent public speeches, Mr. Clausen suggested that the feasibility of establishing such a facility be re-examined. Preliminary study has been carried out by the Bank's staff, and member governments will soon be asked to indicate their willingness to have the subject pursued further within the World Bank framework.

Before we discuss below the possible role and modalities of multilateral insurance in the present world circumstances, it is instructive to review briefly the history of earlier efforts in that same direction. Similar proposals were broached more than a decade ago for an insurance scheme, to be open on a world-wide basis; and in the latter 1970s several limited schemes, usually on a regional or a sectoral basis, were given some consideration.

The most widely studied previous proposal was known as the International Investment Insurance Agency (IIIA), which was given preliminary discussion in the OECD and its development committee (DAC) in the 1960s. Briefly put, the central idea was that not all DAC member governments had (at that time) a national agency for insuring foreign investment, and that an agency of international scope could not only be useful in those cases but would be used for insuring investment projects involving either multiple destinations or a group of investing firms from several countries. Largely for these reasons, negotiations were shifted to the larger forum of the World Bank, where they eventually ended in stalemate in 1973, eleven years after they began in the OECD.

As proposed, the IIIA was to be a financially viable organization, but affiliated with the World Bank. In the developed countries' view, the Agency's charter would lodge the majority voting control in the developed countries, which would bear most of the risk; would expect all members of IIIA to make at least nominal contributions to the covering of losses, so as to give the LDCs incentive to discourage expropriation; would provide for subrogation of the IIIA in place of the investing firm on any claim against the host country on which the IIIA had paid the investor; and would require the host government to submit to international arbitration on a disputed case with the Agency as subrogee. Some industrial countries were indifferent or were skeptical of the value of the proposed Agency, feeling the situation was adequately covered by the existing national schemes.

For their part, many developing country participants also rejected the draft provisions, objecting to the financial participation in losses, the weighted voting arrangement, and the subrogation and arbitration provisions. The latter were regarded, especially in Latin America, as inimical to their international juridical systems and as an infringement of sovereignty. Apart from these specific draft provisions, some developing countries were at that time especially critical of the actual or potential activities that multinational corporations might carry out in their economies, or were inclined on grounds of political philosophy to prefer to seek development along lines of public enterprise rather than private.

Re-emergence of the idea of a multilateral investment insurance agency (hereafter, MIIA) in 1982 reflects several changed conditions which improve the prospects for acceptability of a suitably designed scheme. Factors

N.B.

affecting both the developing and the capital-exporting countries have evolved perceptibly since the plan of 1972-73 reached an impasse compounded from indifference and controversy.

First and perhaps most widely acknowledged of these factors is the ~~aggravated financial position of developing countries~~. In the early 1970s, their export earnings were enjoying a favorable turn in the terms of world trade, and the dramatic rise in the price of imported petroleum had not yet begun. High economic activity in the industrial countries was raising the volume of raw material exports as well as their price. In consequence, growth rates through most of the 1970s were strong, and domestic development could be financed through trade earnings and the official development assistance received at concessional terms, as well as commercial bank loans.

At the turn of the decade this configuration had altered considerably. Both the terms of trade and rate of growth in export volume had declined for the very numerous members of the non-oil developing group, while their expanded economies were now consuming larger quantities of expensive oil. Rates of growth in real GNP had slowed down markedly for the non-oil group, the 1981 growth rate amounting to about one-half the rates prevailing in the period 1975-79. The change in the composition of the developing countries' receipts of financial resources is bluntly shown in the brief tabulation on the following page.

In 1970 the developing countries 1/ received 72 percent of their inflow of financial resources in the three forms of ODA, grants from private voluntary agencies, and direct investment -- each of which involved either no repayment at all, payment on concessional terms, or payment contingent on profitability. By 1980-81, this group of resources had shrunk to 50 percent or less, and the

1/ Including, as before, the OPEC states and the Western European LDCs.

Table 2

Trend of Official Development Assistance, Private Grants, and Direct Investment in Relation to Developing Countries' Total Financial Flows from DAC Members
(Billions of dollars)

	1970	1980	1981p
Total resource flow from DAC countries	15.9	76.1	81.4
	100.0	100.0	100.0
of which:			
Official development assistance	6.9	27.3	25.5
Voluntary agency grants	.9	2.4	2.0
Direct investment	3.7	9.5	11.3
Sub-total	11.5	39.1	38.8
as % of total	72.1	51.4	47.6

Sources: OECD reports, plus Table 1.
p = preliminary

majority of LDC financing was thus coming in at market rates and much shorter maturities. The non-oil members of the developing country group divide into two sub-groups, both of which are vulnerable to the shift in financial composition: the rapidly-industrializing developing countries exposed to the costs and uncertainties of bank borrowing at high commercial rates, and the much larger number of low-to-middle-income countries facing the uncertain future of ODA, which up to now had constituted the bulk of the foreign financial resources acquired by them.

Aid-giving industrial countries of the DAC, whose new ODA commitments are limited by budget constraints and recessionary economies, would welcome an increased flow of private investment into the field of economic development of the poorer countries.

Whether from economic necessity or from recent more satisfactory experience with foreign investing firms, the developing countries have registered signs of more positive interest in attracting foreign direct investment. Indications of a more receptive attitude include the growth in the number of national investment insurance programs. Seventeen OECD members now operate such programs, and three of the more advanced developing countries (India, Israel, and Korea) have likewise followed their example. Legislation for that purpose is pending in Portugal. 1/ A number of developing countries have adopted new laws for the clarification or protection of the status of foreign investors within their borders and have concluded bilateral agreements for these purposes. In addition, the International Center for Settlement of Investment Disputes (ICSID) now numbers 81 contracting parties, its membership having risen especially in the last five years.

It is not unusual for developing countries to offer, to certain approved investments from abroad, special inducements in the form of tax abatement, favorable access to land and buildings, etc. In some cases, however, these inducements exist side-by-side with requirements concerning percent of the product exported, employment of local personnel, financial participation, etc. This host-country ambivalence apparently reflects an uneven trend toward defining a more concrete status for foreign firms which may lead, on the whole,

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1/ Not only have national government insurance agencies become more numerous, but the number of developing countries that have signed bilateral understandings with these agencies has steadily increased. For example, the U.S. agency, Overseas Private Investment Corporation (OPIC), by 1981 had underlying bilateral agreements in force with 98 developing countries.

to a growing role for them.

In the industrial countries also, attitudes and objectives of investors and governments seem to be altering. The multilateral development institutions report that foreign investors are showing realism and flexibility in accepting novel forms of investment financing, such as minority participations, production sharing, and joint ventures. Action by a large proportion of governments of industrial countries to set up insurance programs for foreign investment reflects, of course, the desire of the private sector to have insurance coverage available. Although this demand stems in part from the wish to compete in the developing world with firms from other industrial countries which already possess insurance programs, the potential effect on economic development in the poorer countries is evident.

A further indication of the need to supplement the existing network of national government schemes in the insurance field is the marked growth recently of activity in the private market for investment insurance. One whole session of the recent conference of private insurers in Philadelphia was devoted exclusively to foreign investment risks. Preliminary information on private insurance company activity shows that premium income from covering political risks abroad rose from less than $3 million in 1973 to an estimated $40 million in 1982. Applications for such coverage appear to come to large degree from firms in capital-surplus countries in the Middle East which have no national government programs. The private market facilities are still rather narrow, however, with periods limited to three years, high premium rates, and no coverage generally offered for war damage.

Experience of the national governments with foreign investment insurance programs has now extended over a long enough period to distinguish what are the strong and weak points. On the positive side, (a) the premium rates appear modest to the investor, while usually adequate to cover the administrative costs and benefit payments of the insuring government agency; (b) although the risks covered do not include every potential host-government decision that could affect operations and profitability (such as changes in product export quotas or in use of domestic materials and components), the main risks to assets from expropriation or hostilities are covered, as is the transferability of the earnings realized. The weak points -- some of which are related to each other -- appear to be that (a) some national schemes, especially in smaller countries, have only small resources and exhibit an inadequate diversification of risks as to host country or to sector; (b) projects involving investing groups of mixed nationalities cannot be covered by a single government insurance program, and parallel approaches to each of the governments concerned is awkward because of individual differences and the complications of claim settlement if losses arise; (c) some present or potential capital-exporting countries have no government insurance facility at all for foreign investors. A multilateral insurance scheme could usefully fill the above gaps as a supplement, rather than replacement, for the existing national programs.

Outline of a Possible Multilateral Facility

The foregoing pages have reviewed the balance-of-payments need of developing countries to augment their financial inflow; the suitability of direct investment for this purpose and for promoting industrial development; and the improved climate in both developing and industrial countries toward foreign investment itself and toward the idea of giving it insurance protection. Do these changed circumstances necessarily offer assurance, however, that the world is now ready to accept the establishment of a multilateral insuring agency to supplement the capabilities of existing facilities?

Although this question cannot be answered with certainty, the prospects seem to have become distinctly more favorable than before. A carefully-drawn plan which would take account of present world conditions and apply the lessons of the earlier negotiating experience would appear capable of attracting a sufficient cross-section of governments to permit the plan to be established on an experimental basis. Such a proposal for an MIIA might properly take the general lines indicated below.

1. Membership would be open to all World Bank members, and the MIIA would have a link to the Bank. The individual investing firm could apply directly to MIIA if its government has no insurance agency or if that agency could not handle the given project.

2. Wherever possible, the MIIA would cooperate with and rely on national insurance agencies for reviewing applications and related work. The existing Bank Staff could handle most of the remaining tasks without many additional personnel.

3. The risks covered would be those political risks now embraced by national government programs.

4. During the start-up period before premium income (and reserves) become sufficient to cover losses, the financial obligations for payment of claims would be pro-rated among those member governments which had sponsored projects for investment insurance; i.e., an LDC member whose participation was limited to being a host country for foreign investment would not be obligated for the common loss payments. Whether the pro-rating among sponsors should correspond exactly with their cumulative shares in the total existing portfolio or whether a slightly higher-than-proportional share would be paid by the "home country" of the applicant firm could be negotiated. The need for paid-in capital would be small, if any.

5. Voting structure of MIIA would logically follow, or be based on, the sponsorship principle mentioned above. However, adequate representation for the host countries and other non-investment-sponsoring governments should be assured in the charter of MIIA and in the formulation of operating policies. Day-to-day insurance operations would be conducted by the Agency's management.

6. Most forms of insurance, public or private, embody as a basic principle that, if the insuring company pays the beneficiary for a properly documented loss, the insurer acquires the right to pursue the beneficiary's claim (e.g., in automotive insurance). The developing countries must recognize in some fashion the necessity for following this practice. Perhaps a supplementary agreement (either parallel or covering umbrella agreement) could specify the procedures and safeguards by which MIIA and the host government concerned would reach settlements of claims.

7. After an initial trial period, the formulas for bearing losses and for voting suggested in paragraphs 4 and 5 could be reviewed to take account of the viability of MIIA, its membership, and the volume of transactions.

Conclusions

While some of the past hesitations and differences among governments undoubtedly still persist to some degree, the prospects have substantially improved for a greater convergence of views concerning a multilateral investment insurance facility. This opinion rests on the widely acknowledged increase in the developing countries' need for financial resources less volatile and less costly than their receipts of commercial bank financing at market rates and maturities; more flexible attitudes exhibited by investors and host countries to their respective interests and preoccupations; and the possibility of modifying the provisions of earlier-proposed insurance arrangements to accord more closely with present conditions and attitudes.

The arrangements outlined in the preceding section could, if favorably received, be the basis for a representative group of interested governments to launch the agency on an experimental basis. The possibility of acceptance is enhanced by new features differing from the draft plan of 1972-73. For example, the exemption of most developing countries from financial participation in agency losses should not only appeal to LDC members but should logically be accepted also by developed countries, since some of them regard increased foreign private investment as being a feasible substitute for increased official development assistance, and recipients of ODA do not contribute to its cost.

If the new agency did not result in generating much additional insured investment, the cost of the experiment would be small. If the response was great, the agency would become self-supporting; and the resulting investment projects would benefit the developing host countries as well as the investors.

Weir M. Brown

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The Journal of Commerce

World Bank Outlines Political Risk Agency

By LORI IOANNOU
Journal of Commerce Staff

The World Bank has laid the groundwork for the creation of the first political risk insurance entity that would have global authority.

The bank has completed an interim report that outlines a possible scheme on just how such a multilateral insurance organization should be developed.

World Bank officials said the report has been reviewed by the directors of the bank and will continue to be a basis for further study. The World Bank is making ongoing contacts with governments, public authorities and the international business community, it said, to gauge political and economic factors that demonstrate the need for such a facility.

According to World Bank officials, the global political risk insurance authority would be composed of member countries of the World Bank that voluntarily decide to participate in the scheme.

It would complement the some 16 national investment insurance agencies in existence today that write political risk cover — principally in the member countries of the Organization of Economic Cooperation and Development — by underwriting only that business referred to it through these national insurance schemes. The international authority would also offer coinsurance on many large projects to these national insurance agencies as well as to private insurance markets.

It is expected that if such a supranational insurance agency comes into being, "private markets would reinsure part of its portfolio," one World Bank official said, adding that national investment insurance schemes like the Overseas Private Investment Corp. in the United States have part of their outstanding portfolios reinsured by syndicates at Lloyd's of London.

"The international authority would operate on a loss-sharing basis," another World Bank official working on the project explained.

Under this arrangement, the agency would "call" for loss-sharing by recommending that a sponsor state (the country sponsoring investment into another country) share in any net loss on claims the international organization could not sufficiently cover using its premium revenues, he said.

Private insurance experts surveyed in the United States have expressed a geninue interest in pursuit of this project, as have many government officials in industrialized and Third World nations.

"The time is right for action," said one source close to the World Bank's efforts to create the global investment insurance agency.

There is an increasing demand for political risk insurance by the business community "as a result of an increasing number of political upheavals . . . in countries in the Middle East and in Latin and Central America," he pointed out.

Government political risk insurance agencies also are realizing the need for an international organization that could supplement their growing business, he added.

U.S. government and business officials say Arab countries are especially interested in seeing the World Bank's proposal become a reality. Middle Eastern nations do not have national political risk insurance facilities of their own and are anxious to participate in an international scheme that could help Arab investors insure their investments in the developing world. "Arabs tend to spread their risk throughout the Third World. A multilateral political insurance agency would naturally give them comfort and protection," said Gerald West, director of development assistance at OPIC. "It would be a safe place for Arab petrodollars to go," he added.

A high-ranking U.S. government official agrees. As he observed: "Many Arab members of the Organization of Petroleum Exporting Countries are interested in dishing out start-up capital to get this international political risk agency going."

If the Arab countries agree to pledge funds for the initial capitalization of the global insurance facility it is expected the World Bank will be able to get its members to participate in its founding.

The whole idea of forming an international political risk organization has been played with before by the World Bank, explained Mr. West.

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