



## DEVELOPMENT IMPACT

MIGA in Frontier Markets

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Bringing new investment into a country characterized by low incomes and high risk is a challenging task. Private investors, driven by the bottom line, are understandably reluctant to invest in nations where infrastructure may be questionable or non-existent, where laws governing contracts and land ownership are not clear, and where relatively simple financial transactions such as obtaining a line of locally denominated commercial credit can be a major ordeal. And for countries emerging from conflict, taking even the smallest steps toward renewed entrepreneurial energy and investment can be an almost overwhelming task.

But success stories attest to the value of the cause. For example, Mozambique, which attracted \$337 million in FDI in 2003, has seen an overall 16 percent reduction in poverty since the end of conflict in 1997, spurred in large part by the massive foreign investment in the Mozal aluminum smelter. The project's success, in turn, has encouraged others to invest in a poor country still recovering from a devastating civil war, leading to today's more positive outlook.

### The Case for Foreign Investment in the Developing World

A new consensus is emerging among thinkers and leaders at diverse ends of the development spectrum, that attracting new, sustainable private investment is critical to improving the quality of life for all citizens—including the poorest—in emerging nations. They have drawn an inextricable link between economic growth and declining poverty, and between increased foreign direct investment and improved local economies.

In addition to donor aid and public sector investment, the private sector can play a key role in reducing poverty, for example, by building roads, providing clean water and electricity, and above all, providing jobs. By taking on



these tasks, the private sector can help economies grow, while allowing governments to use funds to address acute social needs.

FDI flows to the developing world reached \$165 billion in 2004, up by nearly \$13 billion from the year before. While the news is good, a look beneath the numbers reveals that within the large group of developing nations, benefits are concentrated among a relative few. More stable nations, or regions within nations, such as China's coastal industrial corridor, are getting the lion's share of FDI, while others are seeing little interest. Worth noting, however, is that despite the FDI concentration in a handful of countries, the investment that does go into other developing countries generates significant benefits, when considered from an FDI-GDP ratio perspective.



## Frontier Countries Stand to Benefit the Most

Frontier countries are defined as high-risk and/or low-income countries.<sup>4</sup> These are the markets that have the most need and stand to benefit the most from foreign investment, but which most investors are wary of and therefore attract little foreign business. These are also markets where other investment insurers are rarely prepared to enter.

Frontier countries, or sometimes regions within countries, are often underserved by companies that are just beginning to understand the business opportunities in the developing world, as well as ways to mitigate perceived risks. These markets typically exist in low-income countries where the risks of doing business are perceived to be high, and where there is a lack of readily available information about the investment opportunities that do exist. A sub-set of frontier nations are those emerging from a war or conflict, which for investors influenced by years of negative news generated by the conflict, may be seen as holding additional risk.

And herein lies MIGA's role. MIGA is uniquely positioned through its investment insurance program to facilitate the powerful development impact that private investment can make, as well as the strong business case for bottom line profit. This combination of development impact

and business opportunity is now understood as the best chance for long-term improvements in the quality of life for the billions living in poverty today.

## MIGA in Frontier Markets

MIGA's role is complex, reflecting the complicated task of improving the economic prospects of poor countries and increasing the incomes of poor people. The availability of MIGA's political risk insurance is often the determining factor in whether or not a private investor decides to go forward with a key project. MIGA's technical assistance and dissemination of investment information to private companies and public officials alike, helps to improve the chances that projects will bring in positive returns—for both the company and the local community.

MIGA focuses on projects and activities that make a contribution to the overall strategy of the World Bank Group. This means working closely with the Bank, investors, and host governments to identify projects and programs that fit within the context of country assistance strategies and World Bank regional strategies. It also means focusing on countries where there is a strong commitment to improving the investment climate, a critical factor in the site selection process.

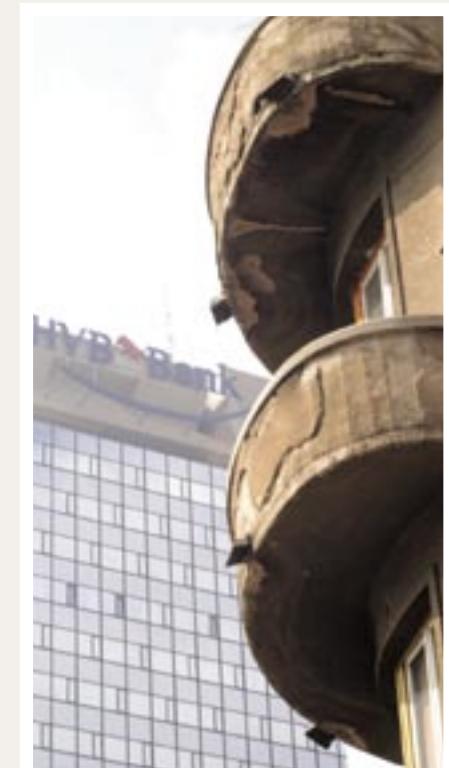
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## Improving the Attractiveness of Frontier Markets

MIGA's outward focus also brings to the development table an understanding of what private investors are looking for when they seek new locations for business expansion. Companies want nations that offer a good institutional framework—with political and macro-economic stability, a transparent and non-discriminatory legal and regulatory environment, and non-bureaucratic procedures and institutional processes.

They also search for a location that offers a viable business opportunity—a strong economic and social framework, a big and growing market, an efficient communications system, a qualified labor force, efficient local suppliers, and a good incentives policy. Frontier nations may lack some or all of these attributes.

On top of this, investors often are not even aware of investment opportunities in developing countries, let alone those considered “frontier.”



<sup>4</sup> MIGA uses the IFC's definition of frontier countries: High-risk countries are those with an Institutional Investor Country Credit Rating of 30 or less. Low-income countries are classified by the World Bank according to gross national income per capita using the World Bank Atlas method.

## Reassuring Investors through Political Risk Insurance

MIGA's political risk insurance is at the core of the agency's product offerings. Guarantees to investors and lenders cover the risks of expropriation, breach of contract, currency transfer restriction, and war and civil disturbance. MIGA guarantees boost investor confidence and can result in lowered borrowing costs, ultimately reducing overall project costs. MIGA, through its expropriation coverage, also mitigates sub-sovereign risk, a major obstacle preventing increased private investment in the critical infrastructure sector.

In fiscal year 2005, MIGA provided guarantees for 20 projects in 11 frontier countries.

## Tailoring Solutions for Countries Recovering from War

Donor assistance alone is not enough to rebuild countries at the end of war. The private sector is critical in laying a new foundation for sustainable growth, from rebuilding the infrastructure needed to get production going again, to creating jobs. MIGA's efforts combine guarantees to mitigate the very real political risks the private sector faces when it invests in such nations, with technical assistance to guide government officials on how to let investors know about opportunities for investment and create an attractive investment climate. These customized solutions are being developed in collaboration with other members of the World Bank Group to address the specific needs of countries under stress. For example, the agency is now looking at industrial estate development as a solution available to conflict-affected countries with highly unstable policy and security environments.

Two cases in particular illustrate the comprehensive, far-reaching effect MIGA can have when it comes to getting frontier, conflict-affected countries back on their feet: MIGA's support for investments in Bosnia-Herzegovina and Mozambique.

### Bosnia: From 'Mattress Money' to Mortgages, a Banking Sector Success

The banking sector is at the core of a nation's health. Aside from physical infrastructure, one of the first things a corporate site selection team considers when evaluating location options is the country's financial set-up. And companies in search of a good location do not want to invest in places where routine banking is a major ordeal.

At the end of the war in 1995, few banks operated in Bosnia. Those that did—mostly small, locally owned enterprises—set loan rates very high, making borrowing next to impossible for the average citizen. In addition, with the requirement of multiple guarantors to co-sign loans, many people avoided the process altogether. The difficulty of getting loans and the high cost of credit also deterred many would-be business owners, adding to the country's post-war economic woes.

Mismanagement of banks was common, as was outright theft by corrupt insiders. Others were faced with massive war-related debts and ended up in collapse, taking with them people's life-savings. Many citizens didn't trust the safety of the institutions, preferring instead to stuff what money they had under their mattresses and into other old-fashioned household financial repositories. In the years following the war, scores of new banks started to spring up, with minimal capitalization requirements and regulations to keep them in check. The banking sector—the lynchpin of a well-functioning economy—was in a state of crisis.

Today, the sector stands transformed. An influx of activity by foreign banks, purchasing locally owned banks or starting anew, has brought a vibrancy and competitive edge to the moribund industry, spurring a wide range of new economic and consumer activity.

"The transformation of the banking sector has been quite remarkable. I have to remind myself of the situation in 1997. There were four currencies in use then, 76 banks, none of which were national, and three banking systems that weren't being used by the citizens," says Peter Nicholl, former Governor of the Central Bank.

The dramatic shift in the banking landscape is in part a result of the introduction of a new Central Bank in 1997, mandated by the Dayton Peace Accord, which established strict capitalization requirements and regulations. Combined with a new law calling for the privatization of all banks, these changes paved the way for an influx of foreign banks.

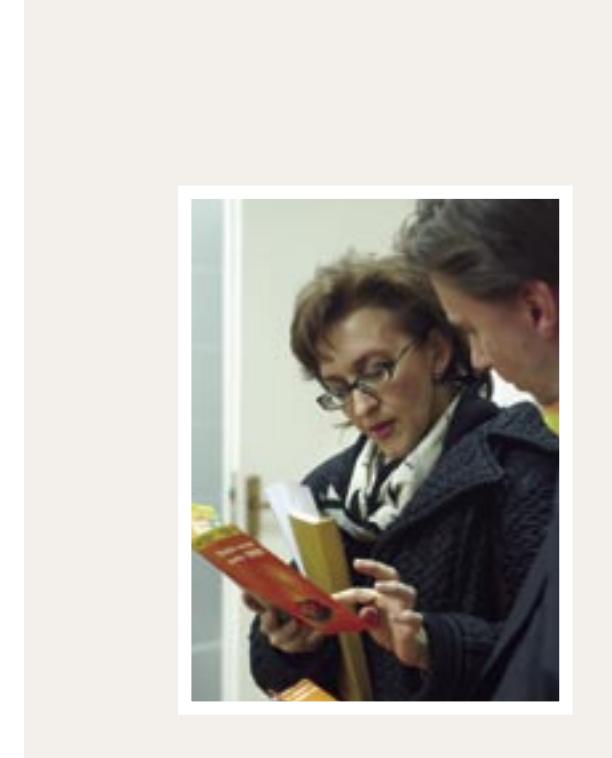


But banking sector reform isn't the whole picture. Foreign banks, which tend to finance expansions through loans from parent banks, generally do not have the risk appetite of their local competitors and therefore tend to seek political risk insurance. In fact, three of the country's top four banks, in terms of market share, have received political risk insurance from MIGA. The banks agree that the agency's coverage was essential to the decision to issue loans from the parent banks.

The impact of foreign banks on the domestic banking scene has been highly beneficial, from a commercial and developmental standpoint. Foreign banks helped reduce interest rates, increased consumer confidence in the banking system, instituted a more aggressive marketing approach with a wide range of services, introduced new tools, such as leasing, and brought in new ways of doing business, making loans accessible to everyday citizens and not just those with connections.

Loan rates, which hovered around 30 percent in 2000, now average 9 percent. Foreign banks have opened up financing options, including long-term loans for big borrowers, who provide key goods and services and tend to be the country's largest employers. Retail banking has also seen radical change, with banking deposits and loans growing rapidly.

Banks supported by MIGA are driving these changes. HVB Central Profit Bank took over a bankrupt domestic bank, with MIGA's support, and is now a market leader when it comes to new products and services. For example, the bank unleashed a torrent of demand with the recent introduction of a new low-interest personal loan that does not require additional signatories. Within weeks of the product's unveiling, eager consumers had received KM 15 million (roughly €7 million) in new loans, well above the bank's target.

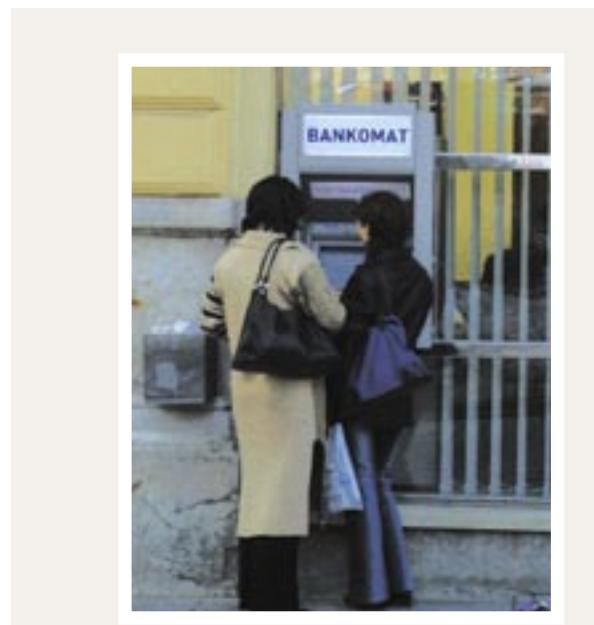


Individual consumer loans, the centerpiece of HVB's portfolio, have traditionally helped finance the reconstruction of property damaged during the war. But now demand for home mortgages is on the rise, along with new home construction activity—a strong driver of economic growth. With default rates low and demand for its products climbing, the bank has uncovered a hidden opportunity to build a strong revenue stream while contributing to the growth and stabilization of an economy that had been in tatters just a few years ago.

MIGA guarantees have also played a critical role in Raiffeisen Zentralbank's commitment to Bosnia. When the Austrian bank first invested in the country, few other banks were operating. Today, RZB is Bosnia's largest bank, with KM 2 billion in assets, 424,000 customers, and 66 branches.

One of RZB's key clients and a critical cog in the daily life of Sarajevo's citizens is Gras, the city's public transportation authority, providing transportation services to nearly a half a million customers a day. Gras' assets were severely damaged during the war, to the tune of some KM 100 million. RZB is supporting the company's repair and modernization plans, which include the ongoing replacement of vehicles, which generally have a 10-year street life, and the introduction of natural-gas powered buses and additional railway tracks for trams. So far, Gras has received KM 20 million in MIGA-guaranteed loans from RZB. "All of these projects are necessary for the city of Sarajevo," says Todorovic Predrag, Deputy General Technical Manager of Gras. "These loans are the only way to achieve a sustainable situation and modernize the fleet."

And because of the new availability of commercial credit and other banking services, as well as the sector's sta-



bility, other companies are growing too, adding jobs and contributing to the public coffers so that the country can continue to rebuild its infrastructure and improve its services.

Despite strong potential, foreign investment in Bosnia has yet to take off in other sectors. Investors point to impediments such as an onerous business registration process, a complicated and inconsistent regulatory structure, and high labor costs. Important reforms are underway, however. For example, the country will be implementing a new value-added tax system in 2006. In addition, the World Bank is currently advising the government on other reforms affecting investment climate, and a program is in the works to privatize utilities, which are expensive to end-users and add to the cost of running a business. These reforms, along with the opportunities afforded by a fully functional banking sector, are important steps towards increasing foreign investments in the country.

### The Mozambique Story

This is a story that has to do with resilience and the recapturing of entrepreneurial spirit. It is an example of how investment from the outside—and the confidence that this activity instills—can trigger tangible, long-lasting change and permanent improvements in the quality of life for a nation's citizens. It is also the story of MIGA in another frontier country.

Mozambique's prolonged civil war, lasting from 1977-92, is one of many conflicts that have scarred the African continent. One of the world's poorest countries even before the war, the conflict caused life expectancies and other

social and economic indicators to tumble even further. And what little formal business economic activity that took place came to a near total halt.

Following the war, the new government actively worked to enact new laws and reform old ones, setting an example for others with its strict adherence to the legislation. The gradual changes and increased political stability allowed investors—and the world—to begin to see the country not just in terms of a haunting conflict, but in terms of what it had to offer. And indeed, Mozambique, with its abundance of natural resources and ideal agricultural climate offers tremendous business opportunities for the right investors.

The careful structuring of one foreign investment in a massive aluminum smelter project, known as Mozal, has begun to rejuvenate a devastated economy. MIGA played a role in the project, the largest foreign investment in the nation to date, by providing \$40 million in guarantee coverage to the Industrial Development Corporation of South Africa Ltd. With the World Bank Group's help, the project sent an all-important signal to other investors that Mozambique was not only open for business, but offered viable commercial opportunities as well. Mozal has also encouraged the growth of a local small business supplier network while providing the kind of social, environmental, and educational support that contributes to sustainable growth and improved quality of life.

Following on the success of this ongoing project, MIGA shifted its focus into another promising sector for the country. A MIGA guarantee issued in FY01 is helping to rehabilitate Mozambique's largest sugar estate, creating thousands of jobs and generating significant economic and social benefits in the country's underde-

### *At a Glance* MIGA in Bosnia and Mozambique

Since its inception, MIGA has issued 32 guarantees totaling \$335 million in coverage for projects in Bosnia. The country currently ranks eighth in terms of MIGA guarantee exposure. FDI into the country was \$438.6 million in 2004.

Mozambique ranks sixth in terms of guarantee exposure. To date, MIGA has issued 27 contracts for projects in the country, totaling \$423 million in guarantee coverage. FDI into the country was \$337 million in 2003.





veloped Marromeu region. MIGA extended \$65 million in investment insurance to the "Sena Group"—a consortium of Mauritian companies—and to the Industrial Development Corporation of South Africa Ltd., covering their equity investments, management and technical assistance contract, and loan for the project.

The project, located on the Zambezi River, entails the rehabilitation and management of the former Sena Sugar Estate, which was severely damaged during the civil war. The investment has so far resulted in the processing of roughly 750,000 tons of sugar cane a year, for both domestic and foreign markets.



The project is one of the largest economic development undertakings and a main employer in northern Mozambique, which has historically attracted little FDI. It has resulted in extensive benefits to the local community and country. The enterprise currently employs 5,000 people, more than half of whom work full-time on a permanent basis. A number of social benefits have made a critical difference for local residents, including higher incomes that allow residents to send their children to school, improve housing, and purchase bicycles. Employees also benefit from a small health clinic sponsored by Sena, while the nearby Beira hospital receives free water, electricity, equipment, and medicine from the company. Sena has itself built a water plant for the community, brought in its own electricity generator, and built the refinery. The investor has also rehabilitated a school that operates three shifts on a 24-hour basis to accommodate three separate classes. Buildings not used by the company are provided free-of-charge to others, including an NGO running an orphanage for HIV orphans. Sena continues to carry out all repairs and maintenance.

This is just a small part of MIGA's ongoing commitment to Mozambique, where agency guarantees have offered protection for investments in a broad range of sectors including mining, oil and gas, manufacturing, agribusiness, tourism, infrastructure, and financial services.

MIGA is also active in helping the country market its investment opportunities. For example, MIGA is supporting the Mozambique Investment Promotion Centre in its efforts to attract foreign direct investment and strengthen linkages with the local business community. The agency is doing this in a number of ways, providing advice on the implementation of a free zone, conducting a tourism sector review, and undertaking an enterprise benchmarking exercise.

Today, life is getting better for Mozambicans, a testament to their resilience and drive, as well as to the positive impact of investment promotion and thoughtful foreign investment, designed with the business needs of the investor and the development priorities of the country in mind.

### Afghanistan: Rebuilding a Nation and its Infrastructure

Ask investors to rank top picks of countries with investment potential, and Afghanistan, stricken by decades of war and strife, probably would not appear on such a list. After all, much of the country's infrastructure has been destroyed. Political uncertainties remain. Financial markets are nascent. And the legal and regulatory framework to support a well-functioning economy is only beginning to emerge. Now, with the hard work to rebuild the economy in its early stages, MIGA is playing a



critical role in a phased approach, in close collaboration with other parts of the World Bank Group.

To encourage more investment, MIGA is focusing on implementing changes that will make the country more attractive from a private investor's perspective. MIGA is working with the Afghan Investment Support Agency to help build its capacity to work effectively with foreign investors, with a focus on marketing investment opportunities in targeted sectors. Efforts aim to identify gaps in policies where new laws might be needed or regu-

latory reforms that would improve the business climate, all directed at attracting much-needed investment in industrial infrastructure and other areas. MIGA's guidance is also providing Afghan officials with a road map on what kinds of incentives would be most effective in attracting appropriate investments.

This technical assistance complements a new investment guarantee facility designed to help bridge the gap between investors' desires to tap business opportunities in the country and concerns about political risks. The Afghanistan Investment Guarantee Facility, administered by MIGA, will mitigate key risks for foreign investors by providing political risk insurance for their investments, while encouraging partnerships with local businesses.

