Perspective

Re-engaging Investors

How the World Bank Group removes generation risks in emerging markets.

By Philippe Valahu

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Infrastructure investors have had their share of pain over the past few years, particularly in developing countries. Disputes over troubled concessions have spilled over into the streets in some communities—fueling the fires of disenchantment with government and the private sector—while some countries unilaterally have cancelled concessions or breached agreements on tariffs, leaving investors foundering to deal with the fallout. As a result, such private investment in infrastructure declined to just $56 billion in 2003, down from a peak of $114 billion in 1997.

The pain is starting to recede for some investors, as cash savings begin to weigh down balance sheets, and governments take steps to institute pro-private sector reforms, as well as tools for offsetting political risks start to take some of the bite away from deals gone awry.

Experienced private investors in infrastructure around the world know all too well that there are significant and unique risks associated with these investments. These projects are often massive in scope, involving multiple parties and complex financing arrangements. And typically, such efforts involve the government, either at the sovereign or sub-sovereign level, further complicating the deal. In developing countries, macroeconomic, legal, and regulatory concerns add a level of uncertainty that can complicate deals even more.

But other challenges might not be as obvious. With the growing trend to decentralize government control of services such as water delivery from national to local authorities, sub-sovereign risk has become an even bigger concern. These are issues that can become serious stumbling blocks to success if not addressed and mitigated.

"These sub-sovereigns may have less experience dealing with the private sector and a weaker understanding of investors' needs, such as a stable regulatory environment that allows for predictable earning streams," says Elena Palei, a senior underwriter in MIGA.

"Sub-sovereigns also may have more trouble accessing credit than federal governments, and projects can be further hindered by interference from local officials or tariff-setting bodies."

Add to the mix a general lack of understanding about the nature of concessions, which can result in intense political resistance to the private provision of services, and it's no wonder that investors—and their lenders—are concerned.

Aside from worries about the safety and stability of the investment itself, investors also face a more expensive cost of capital. "The heightened perception of risk can cause borrowing costs for infrastructure to skyrocket," says Palei. "Banks have suffered losses as well and as a result are more cautious about expanding into these countries."

Mitigating Political Risks

The Multilateral Investment Guarantee Agency, or MIGA, can help in all of these areas. MIGA was created in 1988 as a member of the World Bank Group to promote foreign direct investment into emerging economies to support economic growth, reduce poverty, and improve people's lives. To do so, MIGA offers political risk insurance, in the form of guarantees to investors and lenders, covering the risks of expropriation, breach of contract, currency inconvertibility and transfer restriction, and war and civil disturbance. Often such guarantees can make the difference between a go and a no-go project decision, particularly for complicated investments in infrastructure projects.

The agency also provides complementary services to achieve its mission, including mediating investment disputes and providing advice to developing countries on the needs of foreign investors to help countries attract and retain private investment. In-house sector experts help ensure that deals are sound, projects are viable, and expectations are clear on all sides. And MIGA's guarantee products provide that extra level of comfort needed to protect an expensive investment in a frontier market.

What will it take to get the private sector back into emerging markets? Political risk insurance is one obvious piece of the equation, but that's not all. It will take government goodwill, getting economies back on track, creating better regulatory regimes, and better fiscal discipline. It also will take the creation of legislative frameworks to protect private ownership of projects. The help of multilaterals such as MIGA and the other World Bank Group agencies is critical to make up for the loss of private appetite to provide equity for

MIGA & Infrastructure

Since its inception, the Multilateral Investment Guarantee Agency (MIGA) has issued 207 guarantees totaling more than $4.1 billion for projects in the infrastructure sector. The global infrastructure portfolio currently stands at $1.9 billion, accounting for close to 40 percent of MIGA's outstanding gross portfolio.

MIGA insures new cross-border investments originating in any MIGA member country, destined for any other developing member country. New investments associated with expansion, modernization, or financial restructuring of existing projects also are eligible, as are acquisitions that involve the privatization of state-owned enterprises. Other investments may be eligible as well, and are considered on a case-by-case basis.

Types of foreign investment that can be covered include equity, shareholder loans, and shareholder loan guaranties, provided the loans have a minimum maturity of three years. Loans to unrelated borrowers can be insured, provided a shareholder investment in the project is insured concurrently or already has been insured. Other forms of investment, such as technical assistance and management contracts, and franchising and licensing agreements, also may be eligible for coverage. To qualify for MIGA coverage, projects must be financially and economically viable, environmentally sound, and consistent with the labor standards and other development objectives of the host country.—***PV***

these projects, and to encourage the types of reforms needed to offer a real assurance that private investments will be safe from government interference.

"Developing countries that demonstrate favorable market fundamentals together with stability and transparency in their laws and regulatory systems will have no trouble attracting investors," says William Luraschi, executive vice president with global power company AES Corp.

But none of these factors alone, or in combination, can compensate for the need to get project fundamentals right to start with. Though critical, no amount of financial engineering, or even a favorable investment climate, will make a good project bad. The deal structure has to be sound as well.

Power Investment in Bulgaria

MIGA recently issued €99 million in guarantee coverage to Calyon of France, acting on behalf of a syndicate of banks, and to AES Bulgaria Holdings BV, a subsidiary of AES Corp., to protect a power investment in Bulgaria. The investment involves the construction and operation of a power plant, AES Maritza East 1, near Galabovo, Bulgaria. The guarantees cover €89 million in principal and interest on loans syndicated by Calyon of France, and a €10 million equity investment by AES Bulgaria Holdings BV, which is wholly owned by AES Corp. in the United States. The guarantees extend up to 16 years, and protect against the risks of expropriation (loans only), war, and civil disturbance (loans and equity).

As part of its steady progress toward a competitive market economy, Bulgaria has overhauled its power sector, privatizing distribution, certain generation assets, and restructuring the state-owned grid operator, NEK. Private-sector led generation projects such as AES Maritza East 1 are an integral part of the country's energy sector reform.

"In the case of Bulgaria, southeastern Europe's electricity market is attractive because of its growing need for power," says Lurashi. "The region is estimated to need approximately €15 billion in investments to upgrade its existing power plants or build new ones. Bulgaria has enjoyed annual economic growth rates of at least 4 percent for the past four years, nearly double the average growth in European Union (EU) countries. And when it joins the EU, as expected, that will provide another level of political and regulatory stability to the country, which will further enhance the investment climate."

The new AES Maritza East 1 plant represents a new generation of environmentally compliant, efficient power facilities. The plant is expected to be fully operational in 2009.

The agreement between the guarantee holders and MIGA paved the way for syndication of long-term commercial bank funding, which the arrangers said was dependent on MIGA's involvement.

International lenders are concerned about the risks of transfer restriction and currency inconvertibility, which can drive up financing costs. MIGA's transfer restriction and currency inconvertibility coverage protects investors against losses from an inability to convert local currency into foreign exchange for transfer outside the host country. Even when governments impose a moratorium on moving currency, as members of the World Bank Group they may agree to exclude MIGA-insured projects and permit the transfer.

MIGA's insurance complements support from the European Bank for Reconstruction and Development in the form of A and B loans, guarantees from Coface and Hermes, and local and international commercial banks.

Political risk insurance cannot remove the uncertainties associated with infrastructure investments, but the combination of sound deal structure and clear and reasonable expectations by all parties can mitigate some of these risks.

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