The M.I.G.A. and Its Mission

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I am delighted to be participating in this program at the Columbia Business School.

The World Bank Group has a long-standing and happy relationship with this school. We draw not only on your wisdom. We recruit here as well. Our Young Professional Program recruits young men and women who want to make a career in the World Bank Group. We search for the best and the brightest right across the globe. We have some 2500 to 3000 applicants a year and this year we will be accepting only thirty-five. That is very competitive. Since 1974, nine graduates of this school have won places in the Program. They are among the best. I thought you would like to know that.

When the business and academic communities come together, you can be sure of an interesting exchange of views. In an enlightened society, the interest of each community in the other strengthens both. Mutual respect and support promote shared objectives and sound economic and social progress.

It is my good fortune to be heading a new institution dedicated to the global pursuit of economic and social progress. The Multilateral Investment Guarantee Agency (MIGA) was formally constituted as an affiliate of the World Bank in April 1988. Its basic purpose is to promote the flow of investment resources for productive purposes to developing countries by offering long-term political risk insurance, and by providing advisory and consultative services.

The multilateral guaranteeing of investments in Third World countries is not a new idea. The World Bank was discussing such a scheme as long ago as 1948. But it wasn't until

1981, after several failed attempts to move the idea forward, that a blueprint was devised that commanded the broad support of World Bank member countries. Today, the Convention establishing MIGA has been signed by eighty-five countries, and ratified by sixty-one. This April, MIGA will have been in business for just two years.

Why is this such a significant development? The simple truth is that a scheme that can effectively promote the flow of equity investment into developing countries is the right instrument in the right place at the right time.

Let me suggest some reasons why. In response to a general shortage of external resources, many developing countries have adopted, or are adopting, extensive programs of structural adjustment and economic reform. These typically involve:

- first, revamping of the external trade sector;
- second, liberalization of controls in the domestic economy;
- third, a move to economic pricing of inputs;
- and fourth, and very importantly, a shift in the relative roles of the public and private sectors.

For about three decades after World War II, it was taken for granted in most developing countries that it was the function of the state -- by planning and controlling the economy and by means of public ownership of large parts of the productive sector -- to manage and organize economic growth. In many ways, the developed world encouraged this, if sometimes unwittingly, by the manner in which it provided capital to the poorer nations. Through the Sixties and Seventies, it was taken for granted that aid should go to, and be spent by, governments. In the days of the great petrodollar surpluses, the massive lending by private international banks went likewise mostly to governments. This was an important factor in enlarging the role of the state in many countries.

Times have changed. Today, official development assistance is much harder to obtain, as anyone following the current debate in the U.S. Congress can see. So is commercial bank lending to developing countries. The debt crisis has taken the wind out of those particular sails. At the same time, far-reaching changes are taking place in the Third World.

In more and more countries, controls over private industry are being cut back, market forces are being brought more into play, and state-owned companies are being privatized. And with the historic changes taking place in Eastern Europe, we will see even more of this.

Time does not permit me to go into the reasons for this today, and I am sure that most are known to you already. Suffice it for me to suggest to you that these changes are being implemented by pragmatic politicians who seem to be convinced mainly by their experience of the failures of state-managed economic development, and by the cost of those failures.

Some of the factors that have led developing countries to place greater emphasis on market forces have also led many countries to seek greater inflows of foreign direct investment. In particular, the decline in foreign capital flows (including direct investment) to capital-importing developing countries has led many of them to search for ways of increasing direct investment. A growing confidence on the part of these countries in their own abilities to control abuses and to take full advantage of what foreign investors may have to offer is another factor that has led to increased interest of developing countries in stimulating greater flows of direct foreign investment.

This change of attitude has led many countries to liberalize the policies toward foreign investment. In Sub-Saharan Africa alone, more than twenty countries have revised their investment codes since 1982, or have introduced new ones. Restrictions on the sectors in which foreign investment is permitted have been eased, as have those on the proportion of ownership open to foreign firms, and the rules governing the repatriation of profits have been liberalized. Similar action has been taken by several Caribbean countries. In Latin America, for example, oil exploration and exploitation in Argentina have been opened to foreign investors.

Several Asian countries have widened the area open to foreign investors. In Korea, eighty percent of the industrial sector is now open, compared to only fifty percent in 1980. Meanwhile, new rules in countries as diverse as Ghana, Mexico, the Philippines and Yugoslavia have increased the share of ownership which the foreign investor is allowed.

In some countries, even one hundred percent ownership is allowed under certain conditions. For example, India permits it when the entire output is for export, and Hungary allows it when the investing firm has technology of special importance to the host country.

Restrictions on the repatriation of profits have been a powerful deterrent to foreign direct investment. Korea recently abolished restrictions on capital repatriation, and Colombia and Venezuela have been moving in the same direction.

And last but not least, Eastern European countries are now at various stages of a massive liberalization of policies toward foreign investment.

All in all, there are more encouraging than discouraging trends in the capital-importing countries with regard to improvements in the investment climate. Partly as a result of this, direct investment in these countries has recovered from the 1985 low of just over $6 billion. By 1987 it had recovered to $13 billion, and in 1988 it amounted to at least $417 billion, and probably more.

The increase of net investment flows into Latin America largely reflects debt-equity conversion schemes, some of which have recently been restricted. Increases in flows to Asia reflect a combination of receptivity on the part of most governments and continued striving among multinational corporations to lower production costs. On the other hand, foreign companies are not increasing their investments in Sub-Saharan Africa.

Overall net capital flows to the developing countries remain low in relation to past levels and present needs. Their composition, which remains primarily official rather than private -- the <u>share</u> of official capital in total flows continues to increase -- is not the most appropriate at a time when many governments are encouraging more private sector activity through improved economic management and liberalization of their markets, including their capital markets.

We need, therefore, to explore every avenue to secure a still larger flow of foreign private investment to the developing countries, so that governments can rely less on official capital. This is especially important for heavily-indebted middle-income countries where inflation cripples the country's ability to service its debt.

What these countries need is equity capital of the kind that does not burden the country with more debt, and which, because it is invested on the basis of commercial risk, is most likely to be used efficiently. Equity generates its own profit, and stays in the country. Moreover, it usually brings with it technology, management skills and access to export markets -- elements which are often more valuable than the capital itself in helping to boost manufacturing capacity and the revenues of the export sector.

Debt-equity conversion schemes, which give foreign investors an up-front discount on the cost of their investment while also permitting the host government to prepay some of its foreign debt at a discount, are one of the most promising ways of promoting direct investment in highly indebted countries.

Research has shown that such debt-equity swaps have had a significant favorable impact on direct investment, particularly in Chile and Mexico and particularly for export-oriented projects. Argentina and the Philippines have also established conversion schemes. But the viability of such schemes depends on there being favorable macroeconomic conditions. Getting the macroeconomic framework right through well-designed economic adjustment programs thus remains crucially important.

We all know that businesses invest in the Third World to make money. It's only natural. And that means, as I have said, that economies must attract foreign investment.

Not long ago, an article in the Columbia Journal of World Business listed no less than twenty-four different types of political risk that affect the investment climate, including civil disorder, foreign exchange control and reinvestment requirements.

This is where MIGA can really help. Where investors would otherwise shy away from a commercially attractive project because of perceived long-term political risks, MIGA's guarantee program encourages investment. While investors normally make investment decisions with the idea of long-term commitment to a project, a MIGA guarantee typically commits the agency for a fifteen-year period.

MIGA provides guarantees against restrictions on repatriating investment proceeds in convertible currency as well as protection against losses caused by war, revolution and civil strife -- conceivably even terrorism and sabotage. It also insures against host government breach of contract and against the danger of outright expropriation or indirect and creeping expansion of confiscatory taxes, discriminatory delays in granting import/export licenses, and the like.

In this respect, MIGA complements the activities of national agencies such as OPIC here in the United States, MITI in Japan, Germany's Treuarbeit, France's COFACE, Canada's EDC, and the U.K.'s ECGD. These national agencies provide an important service, but the ultimate objective of each of them is to promote exclusively the business, particularly exports, of its own country. MIGA, on the other hand, works for no single government. It works for all its fifty-six members collectively and impartially.

MIGA provides another special advantage; before it offers a guarantee, it must itself obtain the approval of the host government. This association between the government and the guarantor adds an important measure of protection for the investor. Since the government is a member of MIGA, it will hesitate to take action injurious to the insured investor, the cost of which would have to be borne by its fellow member states. Collective responsibility is therefore a key ingredient to MIGA's effectiveness. No one wants, by his actions, to be the schoolboy whose poor class work brings retribution upon his classmates.

But MIGA is not a one-wheel vehicle. It has two wheels, the second being its Policy and Advisory Service. We are very conscious of the fact that many developing countries need help in making their economies attractive to foreign investors.

Attracting investments calls for dynamic and innovative business procedures, the development of an investment policy and information base, and the nurturing of confidence among the international community. To this end, MIGA's Policy and Advisory Services (PAS) assists the member countries, in collaboration with the World Bank Group, by providing advisory and consultative assistance.

For example, an investment promotion conference organized by PAS for some forty international companies interested in investing in Ghana, is currently in session in Accra. PAS will be holding a similar conference in Hungary in the near future.

These functions of MIGA are entrusted to the Foreign Investment Advisory Services (FIAS), initially a unit in the Bank's affiliate, the International Finance Corporation (IFC), and today a joint venture between MIGA and IFC. FIAS provides advice and technical assistance to developing countries on investment laws, policies, programs, and institutions that promote and regulate foreign direct investment.

MIGA has made encouraging progress pursuing its basic mandate in its first full year of operations. The Guarantee Program has so far received a favorable reception from the international investment community, and its advisory and consultative services have been actively sought by developing member countries.

In January of this year we signed our first political risk insurance transaction, a $50 million coverage providing a US-based mineral concern with fourteen years of insurance against war and breach of contract risks as it expands its copper, gold and silver mining operations in Indonesia. MIGA expects to sign another four to five insurance contracts in the next six months for investment projects in Eastern Europe, Asia, Africa, and Latin America.

Meanwhile, we have received about 180 preliminary inquiries, of which some one hundred are under active consideration. They come from a wide range of industrial sectors as diverse as banking, telecommunications, power generation, steel, animal feed, petrochemicals and electrical applications.

These responses fit well with the various other initiatives launched by the other institutions of the World Bank Group for the purpose of enhancing the flow of foreign direct investment.

Samuel Johnson once said that "the chains of habit are too weak to be felt until they are too strong to be broken."

Maybe the international community has been as cautious as it has in the face of improving investment opportunities in developing countries by habit rather than by logic. And maybe it is through habit that so many developing countries were slow to appreciate the long-term benefits of creating a truly friendly investment climate.

I do not, however, share Dr. Johnson's pessimistic view of what it takes to break the chains of habit. Friends like MIGA are there to help both investors and host countries break those chains and do a lot more good business together.

Thank you.