



SOCIAL DEVELOPMENT PAPERS

CONFLICT PREVENTION & RECONSTRUCTION

Paper No. 13 / June 2004

MIGA's Experience in Conflict-Affected Countries  
The Case of Bosnia and Herzegovina

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CPR

## Summary Findings

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This paper aims to draw lessons from the involvement of the World Bank's Multilateral Investment Guarantee Agency (MIGA) in the reconstruction of Bosnia and Herzegovina (BiH). Foreign and domestic companies need certain building blocks to be able to operate effectively—as well as confidence that the conflict really is finished. These building blocks include a legal and regulatory environment that is in tune with the needs of private companies, and a viable financial infrastructure. BiH scarcely met these requirements during the 1990s. In the late 1990s and early 2000s, MIGA was in contact with several potential investors whose projects never took off. Political risk insurance (PRI) is of no value unless would-be entrepreneurs can first identify viable opportunities that are worth insuring.

One of the main lessons of BiH's experience is the need to press for investment-related policy reforms as early as feasible. Donors are now fully aware of this, and are supporting rapid reform accordingly. Opinions differ on the extent to which it might have been possible to accelerate reforms at an earlier stage. It might have been difficult politically. However, there is no doubt that earlier reform would have been desirable, and this is one of the most important lessons for other post-conflict environments.

PRI is of most value to investors when they can identify a turning point in a country's fortunes. The opportunities and the turning points will come to different sectors at different stages in the recovery process. For banks the turning point has already arrived. Partly because of their internal financial disciplines, banks value PRI more than other industries. Recent reforms have opened up new opportunities to foreign banks, and MIGA's BiH portfolio reflects this. Banks are important both as investors in their own right but also because they facilitate the development of other businesses—including SMEs. They are among the building blocks that would-be investors require. It therefore makes sense for policy as well as practical commercial reasons for MIGA to focus on financial institutions at an early stage in the post-conflict recovery process.

If policy-makers wish to promote FDI in post-conflict zones, they should look to small regional companies as well as large multinationals. This conclusion reinforces the arguments in favor of three current aspects of MIGA policy. MIGA is trying to expand its client base among small and medium enterprises (SMEs); it is seeking to promote cross-border investment between developing countries; and it is working to expand the capacity of smaller public insurance providers—such as the Slovene Export Corporation —by providing them with reinsurance facilities. Regional export credit agencies will have far easier access to SMEs in their own territories than MIGA will.

MIGA sources confirm that the EU fund enabled it to begin operations in BiH earlier than it otherwise would have done. This assessment reflects the agency's measured approach to the management of its own risk: MIGA helps private sector clients negotiate turning points in countries' fortunes, but first it needs to get over a turning point of its own. The fund was a success in that it helped leverage investment worth more than six times the value of the capital provided by the EU. Perhaps the key lesson is that it is a good example of MIGA collaboration with another agency. Such collaborations, whether in the form of special funds or reinsurance arrangements, give MIGA the capability to take on larger and higher risks, especially important in post-conflict regions.

In the course of the 1990s, private sector insurers came to play an increasingly important role both in trade-related PRI and in investment PRI. However, even at the end of what had turned out to be an expansionist decade for the private sector, there was an acknowledgement that public sector insurers still had an important role in long-term investment insurance in difficult countries. This is the area that is MIGA's forte. Events in the last three years have reinforced rather than weakened this argument. Post-conflict regions need public sector PRI interventions more than anyone.

# SOCIAL DEVELOPMENT PAPERS

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Conflict Prevention & Reconstruction

Paper No. 13/ June 2004

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John Bray

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## Acronyms

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BiH	Bosnia and Herzegovina
COFACE	Compagnie Française d'Assurance pour le Commerce Extérieur
DFID	Department for International Development (UK)
EBRD	European Bank for Reconstruction and Development
ECGD	Export Credit Guarantee Department (UK)
EDC	Export Development Canada
EU	European Union
FBiH	Federation of Bosnia and Herzegovina
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FIPA	Foreign Investment Promotion Agency
HDZ	Croatian Democratic Union (Hrvatska Demokratska Zajednica)
HR	High Representative
ICG	International Crisis Group
IMF	International Monetary Fund
KM	Konvertible Marka
MIGA	Multilateral Investment Guarantee Agency
NATO	North Atlantic Treaty Organisation
NGO	Non-governmental Organization
OECD	Organisation for Economic Co-operation and Development
OHR	Office of the High Representative
OPIC	Overseas Private Investment Corporation
PIC	Peace Implementation Council
PRI	Political Risk Insurance
RS	Republic Srpska
SDA	Democratic Action Party (Stranka Demokratske Akcije)
SDP	Social Democratic Party (Socijal Demokratska Partija)
SDS	Serb Democratic Party (Srpska Demokratiska Stranka)
SEC	Slovene Export Corporation
SFOR	Stabilisation Force
SME	Small and Medium Enterprise
USAID	United States Agency for International Development





## Foreword

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Post-conflict countries face a major challenge in reactivating private sector activity, especially in attracting foreign as well as domestic investment. Years of devastating conflict affect investors' perceptions of risk, especially those of a non-commercial nature. The World Bank's Multilateral Investment Guarantee Agency (MIGA) was created in 1988 to mitigate non-commercial risks and encourage foreign direct investment through its investment guarantee and technical assistance support programs. MIGA can play a critical role in encouraging foreign direct investment back into a country after the war ends. MIGA is also able to increase its capacity to guarantee projects in conflict-affected countries by partnering with public and private counterparts on co- and reinsurance. The agency is also able to leverage its assistance by offsetting risks through special trust funds. MIGA has played these different roles in supporting the economic recovery of Bosnia and Herzegovina.

This paper was commissioned by the Conflict Prevention and Reconstruction (CPR) Unit of the World Bank in order to draw lessons from MIGA's involvement in the reconstruction of Bosnia and Herzegovina. The study was directed and supervised by Monique Koning (Lead Underwriter, MIGA) and Ian Bannon (CPR). Simon Gray (Principal Country Officer, ECCU4) and Lloyd Edgecombe (Senior Financial Specialist, ECSPF) commented and contributed to the report.

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# MIGA'S EXPERIENCE IN CONFLICT-AFFECTED COUNTRIES

## THE CASE OF BOSNIA AND HERZEGOVINA

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### Introduction

Between 1992 and 1995 Bosnia and Herzegovina (BiH) suffered a debilitating war in which some 250,000 people lost their lives out of a total population of 4.4 million. By the end of the war, an estimated 1.3 million people were internally displaced. A further 500,000 were refugees in neighboring countries, and 700,000 had fled to Western Europe (UNHCR 2000, p.218). Nine years later, the scars of the war are still readily apparent—both in ruined buildings and in the continuing impact on people's lives—but physical reconstruction is well under way. The question now is how far the country's political and economic recovery is sustainable.

The evidence provided by BiH's economic data is mixed. The country has received more than \$5 billion worth of international aid since the end of the conflict. However, if BiH is to 'graduate' from aid dependence, the private sector will need to become the main source of economic growth, and this in turn will require both domestic and foreign investment. Here the picture is disappointing. According to BiH's Foreign Investment Promotion Agency, the country received a mere \$400 million in foreign direct investment (FDI) between 1994 and 2000. In the last two to three years FDI flows have begun to pick up, but by the end of 2003 the total amount invested since the war was still only some \$1 billion, far below the amounts of foreign aid that the country has received.

BiH has many peculiarities, but its economic difficulties reflect a challenge shared by other post-conflict regions: how is it possible to attract FDI when international perceptions of the country are still influenced by the aftermath of war? As recent studies have emphasized (e.g., Nelson 2001, Gerson and Colletta 2003, Collier et al. 2003), the private sector has an important, indeed crucial, role to play in peace building and post-conflict reconstruction. However, the decisions of individual companies are guided not by public policy considerations but rather by hard-nosed assessments of the balance between commercial opportunity and risks. The question is therefore how best to address companies' concerns about risk—particularly political and security risk—in the wider public interest.

Political risk insurance (PRI) can be part of the answer. The mandate of the World Bank's Multilateral Investment Guarantee Agency (MIGA) is to provide political risk guarantees as means of promoting investment in developing countries, and MIGA has been particularly active in BiH—insuring nine investment projects since 2000. This study therefore takes MIGA's experience in BiH as a case study, examining both the features that are peculiar to BiH and the wider implications for the promotion of FDI in conflict-affected regions.

The study draws on interviews in BiH in May 2003 and at MIGA's headquarters in Washington DC in July, and was reviewed in the light of the latest information in early 2004. It begins with an analysis of BiH's political environment and the implications for the investment climate, and then gives a detailed examination of the role of MIGA and other political risk providers. The study concludes with an analysis of the lessons learnt in BiH, the strengths and the limitations of PRI, and the implications for other post-conflict countries.

## Summary of Key Points

### *MIGA guarantees in BiH*

In 1997 MIGA worked with the European Union (EU) to set up the European Union Investment Guarantee Trust Fund: the EU provided capital of EUR10 million to set up the Fund, and MIGA administered it. In 2000 MIGA drew on the Fund to issue its first guarantee for BiH, covering Coca Cola's investment into a new bottling plant outside Sarajevo. The Fund provided coverage of EUR2 million, and EUR21.5 million came from MIGA's own resources. In 2000 and 2001 MIGA again drew on the EU Fund to insure three banks and a kidney dialysis center. The total amount of guarantees issued for these five projects amounted to EUR60 million. The guarantees issued through the Trust Fund facilitated investment worth an estimated \$72.5 million equivalent<sup>1</sup>. The fund's base capital therefore helped leverage investment worth about six times as much.

MIGA has since supported three new projects (a hypermarket and two banks) as well as the expansion of operations of the hypermarket, the kidney dialysis center and one of the banks. The total amount of guarantees issued for these projects is an additional EUR90 million. The total amount of investment facilitated through guarantees by MIGA in BiH to date is estimated at \$273 million equivalent. This is a significant proportion of BiH's overall FDI.

### *Obstacles to investment*

The memory of past conflict still deters foreign investors, especially those from outside southeast Europe. A more significant obstacle has been BiH's obstructive regulatory environment, and the widespread corruption associated with it.

This regulatory environment derives from the post-socialist legacy of BiH, and of former Yugoslavia as a whole. However, BiH's failure to introduce reforms earlier is in great measure the result of its complex post-war political structure, and its continuing internal rivalries. BiH is already a small country, and the fact that it has yet to combine its two 'entities' (Federation of BiH and Republika Srpska) into a single economic space for tax and regulatory purposes serves as a further deterrent.

### *The role of political risk insurance*

Political risk insurance (PRI) is of most value to investors when they can identify a turning point in a country's fortunes. If the risks are too high, and there are few business opportunities, then companies will simply go elsewhere. If stability has already been achieved, there is less need for insurance. However, if opportunities are evenly—or nearly evenly—matched by risks, then PRI can tip the balance. The opportunities and the turning points will come to different sectors at different stages in the recovery process.

### *First movers*

Coca Cola was the first major foreign company to participate in BiH's privatization program, and its investment therefore had considerable symbolic significance, indicating that the country was 'open for business'. Coca Cola has since cancelled its insurance. Nevertheless, PRI appears to have played a significant role in facilitating its initial investment.

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<sup>1</sup> MIGA's Development database collects figures in US dollars (\$).

### *Banks*

The ‘turning point’ for foreign banking investors came after 2000. Partly because of their internal financial disciplines, banks value PRI more than other industries. Banking sector reforms in BiH have opened up new opportunities to foreign banks. It is therefore natural that the financial sector forms the largest category of MIGA clients both in BiH and, for three of the last five years, in its global portfolio (MIGA 2003a, p.22). The banks in turn are playing an important part in assisting BiH’s further economic development by providing loans to new businesses.

### *Infrastructure*

In 2002 infrastructure projects overtook the financial sector as the largest category in MIGA’s international portfolio. In BiH there should be opportunities for foreign investors in the electricity and the telecommunications sectors, and the experience of these industries elsewhere points to the need for PRI. However, delays in privatization mean that the ‘turning point’ has yet to arrive in BiH. If there are no viable investment projects, there is nothing to insure.

### *Small and Medium Enterprises (SMEs)*

BiH’s small size and complex market conditions limited its interest to major international companies. In practice a significant proportion of investment will come from SMEs both from within the country and from the wider south-east European region. MIGA’s support for foreign banks helps SMEs by making it easier for them to get access to loans. By working with the Slovene Export Corporation (SEC), MIGA assists regional companies with whom it might not otherwise come into contact.

### *Implications for post-reconstruction development*

BiH has made significant strides, particularly in the last two years, in nation building and economic transformation. Nevertheless, its complex business environment—continuing regulatory obstacles in particular—continue to deter investors. In this respect, the lessons of BiH go beyond the relatively narrow field of PRI: the question of insurance does not arise until there is a viable business opportunity. Viability depends on a country’s legal, judicial and regulatory infrastructure as well as on purely commercial considerations. Providing this infrastructure is as important as physical reconstruction. Once it is in place, PRI can play a constructive role in giving companies the confidence to invest.

## **1. DEFINING THE PROBLEM: BiH’S DISTINCTIVENESS**

In a recent report on the World Bank’s work on post-conflict reconstruction, Ian Bannon and Colin Scott raise the question how far conflict-ridden states are comparable (World Bank 2003c). Do they share common problems that are susceptible to similar policy solutions? Or do unhappy countries resemble unhappy families? Happy families are said to have many characteristics in common, whereas unhappy families are miserable in ways that are unique to themselves.

### **Three Major Challenges**

Many of BiH’s problems have parallels elsewhere: others are more distinctive. Since the war ended in 1995, the country has faced three major political/economic challenges:

- The first is the task of physical reconstruction. The most vital reconstruction programs are now complete, although Sarajevo, Mostar and other towns still have plenty of ruined buildings. War damage to, for example, the railway infrastructure has yet to be fully repaired.

- The second task is post-socialist political and economic transition. As far as foreign investors are concerned, the major requirements include legal, judicial and tax reform. Here, BiH has much in common with other former communist states in Central and Eastern Europe.
- The third task is the challenge of creating an efficient, self-sustaining state out of the unpromising political materials left by the 1995 Dayton Peace Agreement.

It is the third challenge that makes BiH most distinctive. The extent of international involvement in the country's internal administration prompts comparisons with Kosovo, post-independence Timor-Leste and now Iraq. However, its fragmented political structure differs even from these. BiH's political structure in turn has made it more difficult to achieve the demands of reconstruction and post-socialist transition.

As will be seen below, the Dayton Peace Agreement has left BiH with a weak central administration; two powerful 'Entities' (the Bosnian Federation and the Republika Srpska); and, in the case of the Federation, a third level of decentralization to local Cantons. Over all these presides the High Representative, currently former UK politician Paddy Ashdown, who represents and co-ordinates a variety of different international interests. The High Representative retains the power to dismiss politicians and enact laws by decree if BiH politicians fail to agree.

### **Questions for the Future**

From the perspective of a foreign investor, the involvement of the international community provides a high degree of reassurance. The Office of the High Representative (OHR) has pushed through much-needed economic and legislative reforms. The Central Bank of Bosnia and Herzegovina—which is governed by a New Zealander and heavily influenced by the IMF—has helped ensure a degree of financial stability. The Central Bank's most important achievements include the establishment of a national currency, the Konvertible Marka (KM), which has been tied first to the Deutschmark and now to the Euro through a currency board arrangement. Meanwhile, the NATO-sponsored Stabilisation Force (SFOR) guarantees military security.

However, the extent of the international community's influence also raises questions. Will these reforms become part of the BiH political and social fabric? How far is there a local sense of 'ownership' of the reforms? Will Bosnian leaders seek to undermine or even reverse them once external involvement in the country's affairs scales down? In the worst case, is there even a risk of renewed conflict between rival Bosniac (Bosnian Muslim), Serb and Croat communities? What will happen at the local level?

These questions lie at the heart of all BiH political risk assessments. They are all the more important at a time when the various representatives of the international community are keen to scale down their involvement in BiH. The country has already received more than \$5 billion in development aid, and there are many other international problems that demand attention: it is time that it 'graduated'.

However, many questions concerning the country's sustainability remain unresolved, and these in turn influence its commercial prospects. The next section analyses the political environment in greater detail before examining its impact on the investment environment.

## **2. POLITICAL CONTEXT, POLITICAL RISKS**

An international businessman interviewed for this study concluded his assessment of BiH with what at first seemed like a surprising assessment: Bosnia is dynamic, but in the wrong direction.

His comment was a back-handed tribute to the energy and ingenuity of national and regional Bosnian leaders. There have been no outbreaks of fighting on anything approaching the scale of the 1992-95 conflict. However, politicians have continued to think in terms of ethnically defined power bases, narrow political advantage, and self-enrichment. This has created powerful vested interests that make it more difficult to implement economic reforms and build a coherent policy framework for private sector development. Reform is unwelcome unless—as in the case of privatization—it can be manipulated to serve the same personal and political power struggles. BiH leaders have ‘played their cards rather well’, according to another Western observer, but only in their own, narrowly self-defined terms. The wider community has not benefited.

Similar remarks could apply to other transition economies. The BiH variant of the problem is reinforced by the rules of the political game as defined by the 1995 Dayton Peace Agreement. This section examines how this game has been played.

### **The Dayton Peace Agreement**

The Dayton Peace Agreement was an exceptional solution to an exceptional problem. It was a major diplomatic achievement in that it helped conclude the most tragic conflict of late 20<sup>th</sup> century Europe. This success came at a price.

The Agreement preserved the frontiers of pre-war BiH, but defined a new internal boundary between the Federation of Bosnia and Herzegovina and the Republika Srpska (RS). The boundary was controversial from the start: it awarded some 49% of the state’s territory to RS. Although this was less territory than the Serb military commanders controlled at the time of the ceasefire, it amounted to proportionately more than the Serbs’ 31% share of the total pre-war population, and it left many areas that previously had Bosniac or Croat majorities under Serb control. The Agreement’s critics argued that this allocation rewarded military aggression. Its defenders argue that it amounted to the best settlement that could be negotiated at the time: the priority was to stop the war.

A certain vagueness may have helped make the Agreement more acceptable to the rival Bosnian negotiators. They hoped that they could interpret some of the less explicit clauses to their own advantage—‘winning the peace’—to consolidate gains made on the battlefield and the negotiating table. The main objectives of the Bosnian Muslim, Serb and Croat leaders of the time remained unchanged: to preserve the interests of their ethnic constituencies, to protect them from domination by rival groups, and—in the case of the Serbs and Croats—to achieve maximum local autonomy with the ultimate objective of secession.

Against this background, it is scarcely surprising that implementation of the Agreement has proved a major challenge, and that the resulting political uncertainties have discouraged foreign investment.

### **The Internal Political Framework**

The unusual complexity of BiH’s political structure continues to serve as a brake on policy- and decision-making. In 2001 the International Crisis Group (ICG) noted that—adding together the various levels of government—there were as many as 181 ministers for 3.7m people (ICG 2001, p.2). Arguably, this structure has much in common with the complexities of the old Yugoslavia (ESI 2002, p.8). However, this is scarcely a happy precedent: Yugoslavia’s institutional incapacity to respond to the demands of political and economic reform in the 1980s contributed to its collapse and ultimately to the Bosnian war.

### ***The State government and the presidency***

At the apex of BiH's internal political system is the State government and the presidency. This consists of a three-member presidency (one representative from each of the main ethnic groups), a council of ministers, and a two-chamber parliamentary assembly.

The responsibilities of the State government have been deliberately defined to limit its powers. The State government has explicit responsibility for: foreign affairs, foreign trade and customs policy; monetary policy; finances regulating international debt; immigration, refugee and asylum policies; regulations on international and inter-Entity criminal laws, telecommunications and transport systems and traffic control.

The State government has very limited revenue sources, and limited powers of enforcement. In their respective jurisdictions, the Entities exert all public functions not expressly assigned to the State by the Constitution. Many of the most important powers of government therefore remain in the hands of the Entities. These include the armed forces, tax collection and customs administration. By international standards, BiH has an unusually high degree of expenditure decentralization (World Bank 2003a, p.3).

The World Bank notes that BiH's decentralized governance structure was designed to facilitate nation-building by promoting political stability and democratic representation in the decision making process (World Bank 2003a, p.4). However, in practice, the political and efficiency gains expected from decentralization have not been realized because of lingering disputes among ethnic groups, and the failure to meet many policy and institutional prerequisites needed to operate such a structure effectively. There are serious overlaps and inefficiencies in the delivery of public services, including in the health and education systems. The current fragmentation of the fiscal system has become a serious impediment to economic activity and foreign investment, and hence to growth (World Bank 2003a). The Bank therefore believes that the current system of negotiated State financing will need to be replaced with a system that will provide the State with an adequate share of BiH's tax revenues, and hence fiscal autonomy, in order to eliminate overlap and improve public service delivery. The Bank proposes the establishment of a formal State-led fiscal coordination mechanism across the different levels of administration, and this should be based on a uniform set of principles consistent with EU standards.

### ***Republika Srpska***

Republika Srpska is the Serb entity of BiH. Its leaders originally aspired either to full independence or to incorporation into Serbia. Serbia has now made clear that it does not share these aspirations. However, the RS leadership has tried to preserve as many of the external trappings of statehood as possible, and has tended to resist pressure from the OHR to streamline internal or inter-entity administration. RS's first president Radovan Karadzic, is an indicted war criminal. He was persuaded to resign from office in 1996, but remains at large.

Relationships between RS and the OHR were particularly tense in the first two years after the war. RS boycotted the first BiH donors' conference and received little international aid until 1997. The hardline leadership was then replaced by a notionally more moderate leadership. The new leaders depended heavily on Western backing, but their lack of internal authority—and lack of conviction—undermined their credentials as potential reformers (ESI 1999). RS politics continues to be characterized by nationalist rhetoric and factional intrigue, and the reform process remains slow and uneven.

Symbols remain important. In Banja Luka, the entity's capital, many RS flags are on public display, but there are no BiH flags except in the office of the OHR. In May 2003, posters in Banja Luka advertised a boxing match between sportsmen from the RS and France, two countries apparently on an equal footing. In practice, RS leaders recognize the reality of the BiH state. However, they will continue to cling to the maximum degree of local autonomy, both symbolically and practically.



### ***The Federation of Bosnia and Herzegovina***

The Federation of Bosnian and Herzegovina (FBiH) is itself the result of a political compromise. Between 1992 and 1994, Bosnian Muslims and Croats were at war with each other in and around the town of Mostar and in parts of central Bosnia. Like the Serbs, the Croats aspired either to independent statehood or to incorporation into a neighboring state—in their case Croatia. In 1994 the US managed to broker an uneasy alliance between the Muslim and Croat leaderships. This alliance was reflected in the territorial delineation of FBiH at Dayton.

In FBiH there is a further level of decentralization to the ten Cantons: five of these have predominantly Bosniac populations; three are predominantly Croat; and two have more evenly balanced mixed populations. In the two ‘mixed’ Cantons, the interests of the two ethnic groups are further protected by guarantees ensuring their rights at municipal level.

Despite the emergence of the Federation in 1994, the Croat leadership continued to aspire to the creation of a separate ‘Herceg-Bosna’ centered on Mostar, but including parts of central Bosnia. Bosnian Croats benefited from the support of high-level sympathizers in neighboring Croatia, at least until the death of Croatian President Franjo Tudjman in 1999. However, a more accommodating Croat leadership has begun to emerge in the last three years.

### ***Brcko***

The District of Brcko remained disputed territory after signing of the Dayton Peace Agreement, and was left out of the entity structure. The dispute was put to international arbitration, and in 1997 this resulted in a decision placing Brcko under international supervision. In March 1998, the Arbitral Tribunal extended the supervision period for another year. In March 2000, a final award was issued and the entire pre-war municipality of Brcko (whose territory belongs to both Entities) was declared an Autonomous District of Bosnia and Herzegovina, bound by the State Constitution, but having its own legislative body, judicial system and administrative procedures. Brcko will remain under the transitional supervisory authority of the OHR until the final award has been fully implemented.

### **Parallel Power Structures**

The formal constitutional hierarchy is at best a partial guide to BiH’s internal power structure. The three ethnically-based parties who held power at the end of the war—the Bosniac SDA, the Croat HDZ and the Serb HDS—operated as the heirs of the pre-war communist party (ESI 1999, p.1). This heritage included a *nomenklatura*-style control over local industries and utilities. Party leaders used their control over economic institutions as a source of funds and patronage. The breakdown of the rule of law during the war, and the need to resort to smuggling routes to break sanctions, reinforced the party leaders’ personal control while also providing opportunities for organized crime. They used nationalist rhetoric as a political tool to consolidate support for their regimes.

In the last two to three years, the power of the old-style ‘oligarchs’ arguably has diminished, particularly in Mostar. However, the old attitudes and practices still persist, and form the single biggest obstacle to economic reform. The European Stability Initiative’s assessment from 1999 still holds true: ‘Oligarchs are not easily beguiled by foreign assistance into dismantling their own regimes’ (ESI 1999, p.17).

### **The International Political Framework**

The international community is involved at several levels as a guarantor of the post-Dayton peace process. The resources provided by the international community have assisted the rebuilding of BiH and

helped push through much-needed economic reforms. However, the extent of international involvement also raises questions that continue to concern investors and as yet remain unanswered: how far will the Bosnians themselves retain ‘ownership’ of the reforms without international pressure to comply? Would the Bosnian political structure still stand without the scaffolding provided by outsiders?

### ***The Office of the High Representative (OHR)***

The High Representative has overall responsibility for supervising implementation of the peace Agreement. The High Representative reports to the UN Security Council, and also serves as the special representative of the EU. The Peace Implementation Council (PIC), a group of 55 countries and agencies that support implementation of the peace process, has periodically reviewed his mandate. The four High Representatives have all been senior, internationally respected former politicians or diplomats from Western Europe

The first High Representative was former Swedish politician Carl Bildt (1995-97). In the period immediately following the Dayton Agreement, the High Representative’s authority was limited: his position was analogous to the international mediators who negotiated between the warring parties during the conflict. Under Bildt’s successors—Carlos Westendorp (Spain, 1997-99), Wolfgang Petrisch (Austria, 1999-02) and now Paddy Ashdown (UK, 2002 to date)—the High Representative has adopted a more assertive approach. Since December 1997, he has had authority to dismiss obstructive politicians and, where necessary, to pass legislation by decree. The past three High Representatives have exercised both powers frequently.

Both within BiH and abroad, assessments of the OHR’s interventionist approach have been mixed. The dominant view—which certainly is shared by a majority of business leaders—is a sense of relief that it has been able to push through essential measures that might otherwise have been delayed indefinitely. However, by doing so, it has also allowed local leaders to avoid taking responsibility both for successes and for failures. Arguably, this approach has weakened rather than strengthened BiH’s internal institutions (Cox 2001). Perhaps paradoxically, the understanding that the OHR will intervene on the really important issues gives local leaders an incentive not to compromise on hardline, publicity-making political positions.

In January 2003 the OHR published a revised Mission Implementation Plan (see [www.ohr.int](http://www.ohr.int)). The plan defines one overarching objective for the OHR: ‘To ensure that Bosnia and Herzegovina is a peaceful viable state on course to European integration’. Its six ‘core tasks’ are therefore primarily concerned with the strengthening of BiH’s institutions. They include: entrenching the rule of law; ensuring that extreme nationalists cannot reverse peace implementation; reforming the economy; strengthening the capacity of BiH’s institutions; establishing State-level civilian command over armed forces; and promoting the sustainable return of refugees.

These are all major tasks. There is no prescribed timetable to define when the OHR’s task has been completed, and when it will be able to hand over full authority to BiH institutions.

### ***The Stabilisation Force (SFOR)***

Under the authority of UN Security Council Resolution 1031, NATO deployed an international Implementation Force (IFOR) to oversee the military aspects of the Dayton Peace Agreement. IFOR had a one-year mandate, and in December 1996 a second Security Council resolution authorized its replacement with the Stabilisation Force (SFOR).

SFOR comes under the NATO command structure. However, a number of non-NATO states also contribute, and these included Russia until its withdrawal in June 2003. Its tasks are to prevent a

resumption of hostilities, to promote a climate in which the peace process can continue to move forward, and to provide selective support to appropriate civilian organizations. SFOR's headquarters is in Sarajevo, and SFOR brigades are deployed at Banja Luka, Tuzla and Mostar. NATO has progressively reduced the number of troops deployed, from 60,000 in 1995 to an expected 6,000 in June 2004 (including 50 in Croatia). SFOR may eventually be replaced by an EU peace-keeping force.

SFOR's presence is highly visible, and is intended to be a tangible demonstration of the international community's commitment to the peace process. In doing so, it also contributes to business confidence.

### ***Donors and international agencies***

The first international donors' conference took place in Brussels on December 20 and 21, 1995, shortly after the signing of the Dayton Peace Agreement. The World Bank had been making plans for priority reconstruction assistance even before the Agreement had been signed. The Bank has subsequently played a major role in BiH both in its own right and by promoting co-ordination with other agencies and NGOs.

BiH is remarkable for the number of agencies and donor organizations, that have been heavily involved in various capacities. In addition to the World Bank Group, others include: the IMF; the United Nations High Commission for Refugees (UNHCR); the Organisation for Security and Co-operation in Europe (OSCE), which has been helping strengthen electoral institutions, and promote the rule of law; the EU's Customs and Fiscal Assistance Office (CAFAO); the European Police Mission, as well as many bilateral donors and NGOs. In all, 48 donors have been active in BiH since the war.

The multiplicity of international organizations has often impeded co-ordination between them, and the fact that expatriate postings to BiH are relatively short has softened the collective institutional memory of the international community. Many BiH veterans decamped to Kosovo in 1999; others are now in Iraq.

### ***The South Eastern Europe Stability Pact***

The Stability Pact is an international co-ordination initiative involving some 40 partner organizations and countries. It was launched in June 1999 at a meeting in Cologne sponsored by the EU. The objective is to promote long-term stability in the South Eastern Europe region by promoting democratization and economic reconstruction, and by addressing critical security issues.

The Stability Pact's six core objectives are: promoting local democracy and cross-border co-operation; developing a liberal business environment through interregional trade; developing regional transport and energy infrastructure; combating organized crime; enhancing media standards; and managing the movement of migrants and refugees.

The premise of the Stability Pact is that long-term stability is most likely to be assured through regional integration. This is understood to mean BiH's eventual accession to the EU. However, the country will need to undertake further reforms before it is ready for the first step toward EU membership, which is the signing of a Stabilisation and Association Agreement.

The prospect of European integration, through a Stabilization and Association Agreement (SAA) with the EU, should be a powerful incentive for BiH to continue to make progress on political, democratic, judicial, human rights and economic reforms in line with the Stabilisation Association Process (SAP). The European Commission (EC) has recently stated that SAA negotiations could begin as early as 2004, provided that BiH makes significant progress in these areas. The first step in the direction of an SAA, the implementation of an 18-step Road Map, was difficult and slow, but was 'substantially completed' in September 2002 (EC 2003).

## **Refugee Returns**

During the war, some 2.5 million Bosnians—nearly half the population—were forced to leave their homes. It was hoped that at least some of these would be able to return following the peace settlement. According to the UNHCR's February 2004 figures (see [www.unhcr.ba](http://www.unhcr.ba)), a total of 987,713 refugees and displaced persons have returned to/within BiH. These include 436,238 'minority returns': people who have returned to their homes in regions where their own ethnic group is a minority.

However, hundreds of thousands of internally displaced persons have chosen not to return to their original homes either because their houses had been destroyed, or because they no longer felt safe living in areas dominated by another ethnic group. Others remain outside BiH, and will not return. The population profile of BiH has changed for good.

## **The Political Process**

BiH's complex constitutional structure means that it has more than its share of politicians and officials per head of population. It also has had an above-average number of elections. The first state, entity and cantonal elections were held as early as September 1996. Since then they have been repeated at two-yearly intervals. The politicians elected in the most recent national elections in October 2002 are to serve a four-year term.

At the end of the war the Democratic Action Party (SDA) was by far the most prominent political group in the Bosniac-dominated regions of the country. The same was true of the Croatian Democratic Union of BiH (HDZ) in the Croat areas, and the Serb Democratic Party (SDS) in RS. Their respective leaderships have now changed, and their ideologies have been modified. However all three parties draw on extensive local patronage networks, and are still major players.

After the 2000 elections, the nationalist parties lost ground and the Alliance for Change led by the multi-ethnic Social Democratic Party (SDP) managed to gain control of the government at the State level and in the FBiH. However, the October 2002 elections saw a comeback by nationalist parties. The turn-out at the elections was relatively low at 55%. Paddy Ashdown's assessment of the election—which is widely shared—was that FBiH voters turned to the nationalist parties not because they wanted a return to conflict, but more out of reaction against the deficiencies of the Alliance for Change government (Ashdown 2002). The reform program would therefore continue.

Reform will indeed continue, but persisting political rivalries both within and between the two Entities will continue to delay its implementation.

## **Economics as 'War by Other Means'**

According to a World Bank study, interviews in BiH during June and July 1997 elicited a common view that 'the conflict is continuing in non-violent forms' and would break out in open warfare once more if and when SFOR is withdrawn (World Bank OED 2000, p.26).

Nearly six years later, in interviews in BiH during May 2003, there was still general agreement on the importance of SFOR as a guarantor of security. However, there was less immediate concern about the possibility of outright warfare. As one Bosnian observer in Mostar put it, 'People have no fire. Their main concern is for jobs.' By contrast, the reference to the conflict 'continuing in non-violent forms' still has considerable resonance.

One of the most important issues is the control of economic resources. The three ethnically-based parties inherited a tradition from the socialist period of party control over the command economy. This control was if anything strengthened by the demands of the war, with the additional complication that the conflict created incentives for the growth of the black market and organized crime. The system has continued in modified form since the end of the war. As Marcus Cox wrote in January 2001:

*Political utilities and most industrial enterprises continue to be publicly owned, with the management boards appointed by political parties. Revenue from public utilities is used to subsidize political parties and the intelligence services. Where enterprises have been privatized, companies connected to political parties have often been the main beneficiaries.... Against this background, the main political actors in Bosnia and Herzegovina have no incentive to submit to new institutions which they cannot be sure of controlling (Cox 2001, p.8).*

One much-quoted, and still controversial, example is the Aluminij Mostar company which was one of the most successful companies in pre-war Yugoslavia. The factory is still profitable, albeit much smaller, and is understood to be controlled by the HDZ party (ICG 2001, pp.25-26; Bose 2002, p.132). Before the war, its workforce came from a variety of ethnic backgrounds but now all are Croats. The company is still partly publicly-owned: the sale of the government's share has been delayed by disputes over the company's value and the precise details of its ownership structure.

The link between politics and economics was further underlined in March 2001, when the HDZ leadership called for Croat self-determination in the region of 'Herceg Bosna' centering on Mostar. The High Representative dismissed Ante Jelavic, the Croat member of the three-man state presidency. In early April 2001 the OHR launched a raid on the Hercegovacka Banka in Mostar, which was one of the HDZ's main sources of funding. The raid prompted local riots, a development that reportedly discouraged would-be investors (ICG 2001, p.8).

BiH has now seen off the challenge of 'Herceg Bosna' but, as will be seen in Section 3, political patronage over state-owned enterprises and continued resistance to privatization are still major issues.

### **Financial Sector Reform**

Problematic and slow though institution building has been, there have been some significant successes. The successful establishment of the Central Bank of Bosnia and Herzegovina (CBBH) has been among the most important.

The establishment of BiH's currency board arrangement has ensured that BiH has had a stable currency, the KM, which since 1997 has been tied first to the Deutschmark (DM) and now to the Euro. In the early post-war years, the Croatian Kuna was the currency of preference in areas under Croat control, while the Yugoslav Dinar was in wide circulation in RS. The currency board arrangements were renewed in early 2003, and the KM is now accepted everywhere in the country.

A review of the first two to three years of the Central Bank's operations underlines the significance of this achievement. Warren Coats, who oversaw the IMF's technical assistance to the Central Bank between 1996 and 1999, recalls the difficulty of even finding a name for the currency (Coats 2003). In initial discussions between FBiH and RS representatives, currency units were referred to as 'glasses'. The name 'Konvertible Marka' was chosen as a prosaic but acceptable compromise.

The implementation of the laws governing the Central Bank required a series of tense negotiations with the National Bank of Bosnia and Herzegovina (NBBH) which operated as the RS national bank, and the Mostar ZAP (payment bureau), which operated as a quasi central bank in the Croat area. The Central

Bank has succeeded because of its practical value to all communities—it is a valuable example of a genuinely national institution.

Other landmark reforms include the abolition in early 2001 of the socialist-era Payment Bureaux which had previously dominated all public and private financial activity, including payment transactions, savings and tax collection. This in turn has facilitated the expansion of the private banking sector and, as will be seen below, foreign banks are among the most prominent of MIGA's clients in BiH.

### **Assessment and Outlook**

In the face of BiH's continuing problems, it is easy to underestimate the progress that has been made since the end of the war. Equally, it is important to acknowledge the lessons learnt during the recovery process.

In the immediate aftermath of the war, the international community concentrated on the urgent tasks of enforcing the military aspects of the ceasefire and accelerating physical reconstruction. IFOR/SFOR were largely successful in keeping the peace. The World Bank and other international agencies can take considerable credit for their role in the reconstruction of essential infrastructure (World Bank 2000).

However, institutional reform will continue to be slow and difficult without a common understanding on the respective roles of the State, the Entities, the Cantons and the Municipalities. As the World Bank notes (2002b, p.8), there is still no consensus on how to achieve an administrative structure that is consistent both with the devolution enshrined in the Dayton Peace Agreement and with the greater involvement of the State that is expected of aspiring EU member countries.

One of the challenges facing international and local policy-makers is to combine a sense of urgency with a realistic appreciation of the time needed for attitudes to change. In February 2002 then High Representative Wolfgang Petrisch alluded to the need for this kind of balance when he wrote:

*Some will argue that the process of debate on efforts to harmonize the Entity constitutions with the BiH constitution has already dragged on too long—since the summer of 2000. But it should not be forgotten that an entirely new kind of consciousness has had to develop—this is a process more time consuming and complex than simple negotiation... Time has been needed for the potency of extreme nationalism to evaporate. It has had to be replaced by a civic alternative, a political culture within which compromise and consensus are not viewed as weakness (cited in ESI 2002, p.10).*

As one experienced international observer in Sarajevo put it, 'You must remember that we are still in 1989—meaning that the post-socialist transition process had scarcely begun.'<sup>2</sup> This may have been an overstatement, but it reflects the distance that BiH still has to travel.

The best long-term hope is that the continuing transition will eventually lead to closer political and economic links with Western Europe: the country's internal boundaries may still exist, but their importance will diminish. That remains a distant objective. The country's chances of achieving it depend both on continuing international engagement with BiH and on Bosnian responsiveness. The next section analyses the implications of continuing political uncertainty and the slow pace of reform for the investment environment.

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<sup>2</sup> An Austrian observer put the calendar back even further: BiH reminds him of Austria in 1918 when it had to adapt to its new status as a small, independent country rather than a constituent of a larger empire. In this analysis, the old Yugoslavia is the equivalent of the Austro-Hungarian empire.

### 3. THE INVESTMENT ENVIRONMENT

In a March 2003 speech to the American Chamber of Commerce in Sarajevo, High Representative Paddy Ashdown asked rhetorically:

*Are we [BiH] competitive today? Are we the first place an investor thinks of when he or she has money to spend in Central or South Eastern Europe? Alas not ... It is not the people of BiH who are failing—it is the business environment that is failing... Our business environment scares investors away instead of enticing them (Ashdown 2003).*

This section analyses the links between BiH's political record, its economic performance and the investment environment. What might make the country attractive to foreign investors? What obstacles are in fact deterring them? And who is actually investing?

#### Opportunities

As in other post-conflict and transition economies, the attraction of investment in BiH in theory includes the opportunity to buy assets early and relatively cheaply, and then to reap the benefit as the economy expands. The Bosnian work force is in relatively well-educated, and labor is cheap. BiH's Foreign Investment Promotion Agency (FIPA) lists investment opportunities in local industries ranging from textiles to cement, wood-processing and hydro-energy. New opportunities will eventually come as a result of the privatization process.

For individual entrepreneurs, BiH offers the challenge of creating something new, while also making a personal contribution to post-war reconstruction and rehabilitation.

#### Investment Patterns

Figures from BiH's Foreign Investment Promotion Agency (FIPA) show that Foreign Direct Investment (FDI) more than doubled between 2001 and 2002 (Table 3.1). However preliminary figures show that the upward trend did not continue into 2003, and the overall figures are low, even by comparison with neighboring states.

The comparison with Croatia is particularly stark. In per capita terms BiH receives only 10% of the investment that flows into Croatia. Meanwhile, Serbia has begun to recover from the impact of international sanctions: it has already overtaken BiH and the gap between them will widen. Slovenia, with a smaller population of approximately two million, continues to perform strongly. Further north, the Czech Republic is in another league altogether: its FDI is measured in billions rather than millions of dollars. The same is true of other Central European states such as the Slovak Republic, Hungary and Poland.

**Table 3.1:** Foreign Direct Investment (US\$ million)

	<b>BiH</b>	<b>Croatia</b>	<b>Serbia/FRY</b>	<b>Slovenia</b>	<b>Czech Rep</b>
1994-97	39.56	1,052	740	842	5,826
1998	55.70	835	113	250	3,591
1999	154.07	1,445	112	144	6,234
2000	147.21	1,086	25	190	4,943
2001	130.17	1,325*	165*	338*	4,820*
2002	278.25	970†	300†	553†	8,000†
TOTAL	805.01	6,713	1,455	2,317	33,414

\* Estimate; † Projection

Sources: Foreign Investment Promotion Agency of BiH, EBRD 2002 Transition Report

A breakdown of foreign investment by country of origin (Table 3.2) shows that Croatia is the single biggest investor country, followed, somewhat surprisingly, by Kuwait.<sup>3</sup> It has achieved this status through two major investments by the Kuwait Investment Agency in the late 1990s. These were the purchase of a share in the steel plant in Zenica and the UNIS buildings in Sarajevo. Kuwait has made no further investments on a similar scale, and over the course of time it will be overtaken by other countries that now figure lower on the list.

**Table 3.2:** Foreign Direct Investment by country 1994-03

Country	US\$ million
Croatia	124
Kuwait	117
Slovenia	99
Germany	92
Austria	92
SRCG	69
The Netherlands	62
Switzerland	48

**Source:** Foreign Investment Promotion Agency of BiH.

Apart from Kuwait, the leading investors in BiH are from central or southern Europe. Austria's high ranking reflects its extensive history of involvement in the region (BiH was part of the Austro-Hungarian Empire between 1878 and 1918). Austrian businessmen interviewed for this study commented that BiH—like the rest of the Balkan region—was a natural market with which they felt a degree of familiarity. This made them more prepared to take risks than, say, American companies who 'hadn't heard of Austria, let alone Bosnia'. Austrian statistics give a much higher estimate of Austrian investments than FIPA, as much as Euro450 million since 1996 (AWO 2003). Until now the main emphasis has been on the wood-processing and banking industries. Austrian companies are actively interested in the privatization of telecommunications and the paper industry.

The relatively high ranking of The Netherlands arises in part because Coca Cola's investment in a bottling plant near Sarajevo came via its Netherlands affiliate. Manufacturing industries account for the largest component of FDI by sector (Table 3.3), and this is an area where there is further scope for investment as privatizations of strategic industries get under way. Banking comes second. By 2002, some 50% of BiH's private banking sector was owned by foreigners (UNDP 2002, p.28) and, as will be seen, this is an area where MIGA has been particularly active. In the long term there may be opportunities in areas such as tourism (Sarajevo hosted the 1984 Winter Olympics). However, as the investment figures suggest, the Bosnian tourist industry has scarcely begun to recover from the war.

**Table 3.3:** Foreign Direct Investment by Sector 1994-02

Sector	Percentage
Manufacturing	55.5
Banking	16.5
Services	6.8
Trade	6.2
Transport	0.9
Tourism	0.7

**Source:** Foreign Investment Promotion Agency of BiH.

<sup>3</sup> FIPA's statistics may not be complete, but give some indication of the overall patterns of investment.



## **BiH's Reputation as a Deterrent**

Even now, people outside the region tend to respond to the news that one is visiting BiH with a sharp intake of breath and an anxious question: 'Is it safe?' Experience shows that adverse reputations of countries—and individuals—can linger long after the reality has changed. The tourism industry is particularly sensitive to security anxieties, but the impact goes wider, much wider. A quick glance at the website of the US State Department's Consular Information Sheet will reinforce such concerns (<http://travel.state.gov>). Its BiH Travel Warning (updated in November 2003) opens its summary of risks in Bosnia by stating:

*The Department of State warns US citizens that there are still risks from occasional localized political violence, landmines, and unexploded ordnance in Bosnia and Herzegovina. There is also a risk of getting caught up in local violence. Attacks against minority returnees continue, especially in the eastern and western parts of the country. Increased operations to capture persons indicted for war crimes may provoke local disruptions and protests especially in the eastern parts of the country. The international community, including American interests, continues to be the target of occasional threats.*

The opening statement of the UK Foreign and Commonwealth Office travel advice is rather more hopeful: 'The majority of visits to Bosnia and Herzegovina are trouble-free'. Nevertheless, residual security concerns still discourage business people from outside the region from even looking at the country. BiH still suffers from a 'reputation lag'.

## **A Small Market**

A second limitation is the small size of the market. Before the war BiH's population was some 4.5 million people. There has been no recent census, but it is understood that the current population is approximately 3.9 million.

During the war as many as 250,000 people were killed, and in 2002 there were still some 613,700 refugees of BiH origin outside the country (UNDP 2002, p.73). According to UNHCR figures, some 13,500 refugees returned to BiH in the first 11 months of 2003 (see [www.unhcr.ba](http://www.unhcr.ba)). However, 328,900 of those now resident abroad have 'permanently resolved their status' in their host countries and are unlikely to return. Most of these are likely to be younger, educated people, and this makes their loss to the BiH economy all the more painful.

There is considerable material poverty, affecting 20% of the population (World Bank 2003b, p.i). Unemployment rates are high—leading to low wages—with an official unemployment rate at around 40%. Taking the informal 'gray market' into account, the true figure is likely to be some 16% (World Bank 2003b, p.21). The difference between the two figures arises in part because many small businesses fail to register employees so as to avoid paying insurance tax on their behalf. Others who are not captured by the official statistics may include self-employed and seasonal workers. Although the gray economy keeps substantial numbers of people out of abject poverty, it does not provide them with large reserves of surplus funds. Indeed, most poor households do include someone who does actually work, usually a single earner. In addition, as much as 27% of the adult population in BiH can be considered 'education poor', without having finished primary education (WB 2003b, p.ii). All of these factors contribute to limited domestic purchasing power, a situation that is likely to get much worse in the absence of sufficient progress to achieve sustainable growth.

In principle, BiH's location in south-eastern Europe might provide locally-based companies with a strategic vantage point from which to service neighboring countries. In practice this has not happened, at

least not yet. The country's roads have been repaired since the war, but fall far below western European standards. The rail network is still in disarray: the link between Sarajevo and Banja Luka, and from there to Zagreb, re-opened only in 2001, and there is still only one passenger train a day. There are plans to remove trade barriers with neighboring states, but these are at an early stage.

Still more disconcertingly, BiH itself has not operated as a single economic space. Rather, it consists of two micro-markets: the Federation and RS. The two entities have maintained different tax policies and registration procedures, and only now are beginning to harmonize. Until recently, Coca Cola found it more difficult to export its bottled water from the Federation to RS, than it did to neighboring countries.

## Corruption

Corruption in a variety of different manifestations underlies many of the country's problems. In 2000, the World Bank conducted a corruption diagnostic at the request of the Government of BiH (World Bank 2002c). In 2002 Transparency International-Bosnia and Herzegovina (TI-BiH) conducted a survey of public perceptions of corruption in the country. The two reports have very similar conclusions: corruption is so widespread that it is endangering the legitimacy of the BiH government at all levels, limiting foreign investment, causing rising inequality, and leading to increases in crime. In the TI-BiH report, in both Entities respondents cited unemployment as the most serious problem facing the country, but corruption came a close second, followed by instability (Table 3.4).

**Table 3.4:** The Most Serious Problems, as Perceived by BiH People, by Entity (%)

<b>Problem</b>	<b>BiH</b>	<b>RS</b>	<b>FBiH</b>
Unemployment	25.8	25.6	25.4
Corruption	20.3	17.0	21.9
Political instability	14.0	12.3	14.9
Poverty, low standard of life	12.6	12.5	12.6
Crime	10.9	12.0	10.4
Economic recovery	7.3	11.0	5.5
Poor inter-ethnic relations	3.3	2.3	3.9
Return of refugees	2.3	1.8	2.6
Poor health care	1.7	2.3	1.4
War crime trials	1.2	0.8	1.4
Other	0.4	1.3	0.0
Refused to answer	0.3	0.5	0.1

Source: TI-BiH (2002), p. 21.

Public expectations of government standards of integrity were low with some 60% of respondents assessing the extent of corruption in the Entity governments as either 'much' or 'very much' (Table 3.5).

**Table 3.5:** The Extent of Corruption in the Entity Governments (%)

	<b>Government of the Federation BiH</b>	<b>Government of the RS</b>
Very little	3.3	1.3
Little	7.8	2.8
Medium	21.4	17.0
Much	26.0	33.3
Very much	33.1	28.5
Do not know/refuse	8.5	17.3

Source: TI-BiH (2002), p. 62.

Concern about corruption has engendered considerable skepticism in the privatization process (see below). When asked who had derived most material benefits from privatization, 31.2% pointed to the directors of state-owned enterprises; 26.7% to officials in the agency/directorate of privatization; and 20.9% to officials in entity governments (TI-BiH 2002, p.99).

According to the World Bank diagnostic, some 10% of enterprises had made unofficial payments to public officials in the last three years (World Bank 2002c, p.36), and such payments amounted to 18% of these companies' overall expenditure (p.25). Even more significantly, managers of the average firm spend more than 10% of their time communicating with public officials from various agencies trying to resolve bureaucratic issues. For new firms, and companies with foreign investment, this figure rises as high as 20% (World Bank 2002c, p.6). Obviously, BiH's over-complex and opaque regulatory environment provide fertile ground for rent-seeking behavior by government officials.

As the TI-BiH study pointed out, the perception—and the reality—of high levels of corruption are major disincentives to both domestic and international companies. A survey conducted by Control Risks Group found that some 39% of a sample of 250 international companies had been deterred from otherwise attractive investments on account of a host country's reputation for corruption (CRG 2002, p.6).

### **Regulatory Environment**

BiH's regulatory environment has been a concern since immediately after the war. In 1999, an influential report by the Brussels-based International Crisis Group (ICG) commented that a series of business people had visited BiH after the war, hoping to contribute to its recovery. However, they were disappointed:

*Many of them had their pictures taken in front of ruined buildings, examined the local business regulatory environment, and said they would return in ten years to see if the situation had improved (ICG 1999, p.6).*

The Foreign Investment Advisory Service (FIAS) gave a more detailed assessment of the regulatory environment in 2001 (FIAS 2001). Both reports highlighted a common set of problems:

- Regulations were cumbersome, outdated and, in many cases, contradictory.
- Officials lacked a service culture. They were able to exercise a high degree of personal discretion in interpreting the rules, and this gave them frequent opportunities to demand bribes in order to avoid delays. Political interference in the bureaucracy was common.
- Procedures differed in the Federation and the RS, and there is often little or no co-ordination between the two entities.

### **Commercial law**

BiH adopted The Law on the Policy of Foreign Direct Investment at state level in March 1998, but the process of drawing up follow-up legislation—and of actually implementing reform—has proved slow and fragmentary.

As FIAS commented, the commercial environment for both domestic and foreign business is complicated by a 'labyrinth of formal and informal rules, across the state, entity, municipal and cantonal levels' (FIAS 2001, p. ix). Many laws still on the statute book are the legacy of the socialist period. Talking to ICG in 1999 one businessman expressed the view that 'you can't obey the laws, even if you want to, because they contradict one another' (ICG 1999 p.13). Meanwhile, the judiciary is under-paid and poorly trained, particularly in the commercial law required of a market economy. Even if the courts reach a judgment, enforcement is uncertain.

### ***Business registration***

ICG reported that business registration could take from six to twelve months, ‘depending on the level of corruption and obstruction in the system’ (ICG 1999, p.16). It described the procedures as ‘expensive, time-consuming and intimidating’.

The 2001 FIAS report gave further details (FIAS 2001, pp.40-66). Companies trying to register in the Federation had to go through 14 separate steps including: applying for approval from the municipality office of the Federal Ministry of Defense; registering with the Federal Ministry of Foreign Trade in Mostar; registering with the State Ministry of Foreign Trade and Economy in Sarajevo; applying for registration with the Cantonal Court; applying for a company ID with the Federal Statistical Office; and registering with the Federal Tax Authorities. The process was similar in the RS, and companies planning to operate in both entities had to go through the same process twice. Personal contacts and facilitators were frequently needed to speed up the process.

Registration took longer in the Federation than in the RS. The time take for registration in either entity far exceeded the average elsewhere in the region (FIAS 2001, p.86). Since the registration procedure was sequential, delays at any stage could hold up the entire process. Meanwhile, the business was unable to operate for months at a time and valuable resources and contacts were wasted.

### ***Taxation***

The story on taxation is similar. The ICG report pointed that Bosnian companies typically operated on thin margins and cash flows. BiH had excessively high taxes, and businessmen were ‘unanimous in stating that the high tax levels were destroying their businesses and forcing them to work illegally’ (ICG 1999, p.14). Tax enforcement was often arbitrary.

The FIAS expressed a similar view, pointing to ‘corruption and abuse of powers, lack of transparent and consistent procedures and inconsistency in the application and interpretation of tax laws’ (FIAS, p.xvi). Tax inspections could be highly disruptive:

*According to the experience of one Federation businessperson, the tax inspectors spent one month on his premises for an audit. In the businessman’s view, the inspectors were incompetent and inflexible in adapting to the actual needs of the company’s business practices. He characterized their behavior as “arrogant and furious”. During this audit, about one quarter of the staff of the Finance Department of the company had to be assigned to the work of the Financial Police inspectors (FIAS 2001, p.130).*

### ***Land***

FIAS reported that the land ownership registration system was both cumbersome and poorly managed. This is a highly charged political issue, and an immense practical problem for businesses trying to set up operations.

Current problems reflect changes from an earlier system based on Austro-Hungarian law to socialism and back again (FIAS 2001, pp.67-91). Records are often inaccurate, partly because people may not have registered changes of ownership in order to avoid taxes. The flight of refugees during and after the war has created even more intense problems. The courts are slow to resolve disputes, and court decisions are not always implemented promptly.

### ***Customs***

The customs system has been complicated by the existence of parallel customs administrations in the two entities. The European Commission Customs and Fiscal Assistance Office (CAFAO) has worked hard—

and to a large degree effectively—to introduce reforms, but systemic difficulties associated with existence of three customs services (one for each Entity and one for Brcko District) still persist.

The Dayton Peace Agreement provided the legal framework for the centralization of the customs authorities, but this was not followed through. In principle, the Tariff Law of February 1998 created standardized tariffs for the entire country. However, in April 1999 the ICG reported a continuing lack of standardization: the Bosniac-controlled areas of the Federation were implementing the tariff set in the law, but the Croat-controlled Cantons of the Federation were allowing duty-free imports from Croatia, while RS was allowing duty-free imports from Serbia (ICG 1999, p.16).

Two years later, FIAS reported that there was now a greater degree of co-ordination between the customs administrations of the two entities (FIAS, p.135). However, it was still not possible for a company with a customs registration number in one entity to clear goods in the other entity, and other problems persisted. These included complex procedures, the lack of a service culture, and widespread corruption.

Since then, further progress has been made. In particular, the State and Entity governments have now agreed to set up an Indirect Tax Authority (ITA) in 2005/2006 to introduce VAT and unify the Customs Administration. A commission backed by OHR, the EC, the IMF and the World Bank is working on the preparation process. In the meantime, corruption and customs fraud remains a major problem. One common technique is for smugglers to import goods using the name of fictitious companies, which then disappear without paying the appropriate taxes.<sup>4</sup> The fraudsters are able to sell goods cheaply on the BiH market, thus undercutting legitimate businesses.

## **Labor**

Educational standards in pre-war Yugoslavia were relatively high, and Bosnian workers have a good reputation abroad for hard work and productivity. So far this has been less true of Bosnian employees at home—the reasons lie more with the system than with the individuals.

A recent World Bank study of the Bosnian labor market found that the formal sector workforce had become significantly older since the war (World Bank 2002a, p.76). In the Federation, the average age of the workforce in the formal sector had increased from 36.6 years in 1991 to 40 years in 2000. This reflected emigration by younger, and often better qualified, workers, as well as high unemployment among new entrants to the labor market.

Since 2000 new labor legislation has been introduced, and this is more in tune with the needs of a market economy. However, the rigid wage determination system still stands in the way of job creation and worker mobility. Private firms have been more dynamic in all aspects of job flows, including net employment (World Bank 2002, p.79)

## **The Slow Pace of Privatization**

In the long term privatization should be an important part of the answer to BiH's economic problems, particularly if it leads to the introduction of fresh, innovative management as well as new capital for investment. However, the privatization process has been deeply problematic, and beset by frequent delays.

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<sup>4</sup> Interview with Alan Leon Jenson, Head of Office, Customs and Fiscal Assistance Office to Bosnia and Herzegovina (CAFAO).

In May 2003 the OHR reported that 78% of Small-scale Companies owned by the state had been sold in the Federation and 55% in the RS (OHR 2003). However, the privatization record for SMEs and Large Companies was more problematic, with only 40% of companies in these categories having changed hands in BiH after two and a half years of privatization effort. As for Strategic Companies, only 15 out of 56 companies had been sold in the Federation. In the RS only four companies had been sold in the previous 18 months. The uncertain state of the world economy may have contributed to this poor record. However, the OHR also points to a lack of commitment by political leaders.

Political leaders in both the Federation and the RS express ideological reservations about privatization: why should they sell the state's most prized assets to outside interests? However, there are also practical issues. Funds siphoned off from state-owned interests have helped finance political campaigns, as well as making for the personal enrichment of prominent individuals. Further delays are likely to lead to deterioration in the value of the assets being privatized, thus making them even less attractive to would-be foreign investors.

### **Action Plan for the Enhancement of the Business Environment and PRSP**

In 2001, in the light of the FIAS' findings, the government adopted an ambitious countrywide action plan with support from the World Bank (Business Environment Adjustment Credit, IDA 2002). The plan aimed to improve the business environment by streamlining registration and licensing procedures for new firms, and creating a single registry countrywide. At the same time it would rationalize inspections and regulations, thereby reducing companies' administrative costs. The government will strengthen judicial and extra-judicial capacity to resolve commercial disputes. It will also improve access to credit by creating a countrywide registry of pledges on movable assets, and improve bankruptcy and liquidation laws and regulations in line with EU standards.

This action plan, and the promotion of private sector development and FDI more generally, is at the heart of the Government's Poverty Reduction Strategy Paper (PRSP). By late 2003, this was in its second draft, and included an ambitious list of both broad and more detailed measures to improve the business environment, fight corruption, speed up privatization, reform the labor markets, and reform the country's public administration. The frankness of the report's analysis of current shortcomings in BiH is noticeable and commendable. However, it remains uncertain when and how the recommended reforms will be implemented.

### **Future Prospects: Will the 'Bulldozer' Work?**

In the immediate post-war years, the international community may have been slow to recognize the need for reforms to improve the business environment. However, there is no doubt that this is now firmly on the agenda. The World Bank and major bilateral agencies such as USAID and GTZ have programs to promote private sector development. Public statements from the OHR now express a degree of urgency. The question is how far the same sense of impatience is shared by key BiH decision-makers, and whether reforms will be implemented.

In November 2002 Paddy Ashdown set up the so-called 'Bulldozer Committee'. According to the OHR the committee was intended to 'build a working partnership between BiH politicians and businesspeople and identify specific clauses in legislation that prevent companies from expanding their businesses and creating more jobs' (OHR *Newsletter*, May 2003, p.1). As its name suggests, the committee's task was to bulldoze through the necessary reforms, and it set itself the initial task of having 50 reforms enacted in 150 days.

The committee identified its 50 reforms (Bulldozer Initiative 2003). These included the abolition of outdated legislation such as a redundant but still mandatory business tax to finance non-existent atomic bomb shelters. Several of the proposed reforms were specifically relevant to foreign investors. For example, Reform Nos. 29 and 30 propose to simplify the complex FDI registration procedures outlined above. The proposals were implemented on schedule, and the Bulldozer Committee identified a second set of 50 reforms in the second half of 2003.

Reforms are undoubtedly needed, and quickly. However, both Bosnian and international critics have expressed concern that the bulldozer approach will weaken local institutions, effectively taking decisions out of their hands, rather than strengthening them. If Bosnians have no sense of ownership, the reforms may exist on the statute book, but they will not be implemented.

From the OHR's point of view, the bulldozer approach is a calculated risk. Institutional reform is intended to serve not so much the present generation of political leaders as the next one. Unless BiH moves quickly, it will be left behind as investors move on to other countries or—in the current more cautious international climate—stay clear of developing and transition economies altogether.

The next two sections discuss how far PRI can improve confidence in what remains a very difficult operating environment.

#### **4. MIGA AND THE POLITICAL RISK INSURANCE MARKET**

MIGA was established in 1988, and issued its first political risk guarantee in 1990. It is the smallest and youngest member of the World Bank Group. Its mandate is to promote development by facilitating foreign investment in emerging and transition economies (for the agency's origins see MIGA 1998). From the outset, MIGA has seen itself as an 'insurer of last resort', backing worthwhile projects that cannot easily be covered elsewhere. Political risk insurance (PRI) in post-conflict regions such as BiH falls squarely within this mandate, and the agency is actively seeking to promote this aspect of its work (MIGA 2002a, 2003).

MIGA is a public sector organization, but one with many private sector characteristics. The creative tension between these two aspects of its organizational personality influences the debate about its role in post-conflict regions in two important respects:

- First, how can MIGA best complement other public and private sector insurers? How far is it fulfilling its mandate of providing insurance that has developmental benefits, but is not readily available elsewhere? What is distinctive about the agency's contributions? Is it providing what its commercial clients actually need?
- Second, how does MIGA balance its own risks? If it is to achieve its developmental mandate, it needs to support projects in high-risk regions. At the same time, the agency has a duty to its member governments—who provide financial backing—to use its resources responsibly. How far do these fiduciary responsibilities clash with its developmental objectives? Has it got the balance right?

This section discusses the wider debate about MIGA's role. Section 5 focuses specifically on the agency's experiences in BiH.

##### **MIGA's Political Risk Insurance**

Outside the insurance world, the term 'political risk' could cover a variety of issues ranging from wars and revolutions to campaigns by non-governmental organizations (NGOs). For insurance purposes, the

only definitions of political risk that really matter are the wordings of contracts with individual PRI providers. MIGA covers investment insurance—but not trade insurance—in the following four areas:

- *War and civil disturbance*

MIGA issues guarantees against politically-motivated acts of war or civil disturbance. These include revolution, insurrection, coups d'état, sabotage and terrorism. MIGA insurance does not only cover physical destruction or disappearance, but also covers events that lead to an interruption of project operations if these lead to the investment being considered a total loss.

War and civil disturbance policies have an obvious appeal in post-conflict regions such as BiH, particularly in the first years after the end of a conflict.

- *Currency Inconvertibility and Transfer Restriction*

Currency Inconvertibility and Transfer Restriction coverage protect against losses arising from an investor's inability to convert local currency—in BiH's case the Konvertible Marka (KM)—into foreign exchange for transfer abroad. It also covers excessive delays in acquiring foreign exchange due to host government action or failure to act.

In BiH's case, the Konvertible Marka is tied to the Euro by means of a Currency Board and, as discussed, the BiH Central Bank has been one of the country's post-war success stories. The Currency Board was renewed only recently—in February 2003. Particularly in the financial community, many investors retain a residual concern that the Central Bank will remain vulnerable to political interference if international involvement in BiH's internal affairs is scaled down.

Currency Inconvertibility policies do not cover depreciation arising from market forces, as investors found to their cost in Argentina during that country's recent economic crisis.

- *Expropriation*

Expropriation coverage protect against losses arising from host government actions that may reduce or eliminate ownership of, control over, or rights to the insured investment.

Outright governmental expropriation was the 'classic' political risk of the 1970s, but has been much less common in the last two decades. However, Expropriation policies also cover 'creeping' expropriation' which MIGA defines as a 'series of acts that, over time, have an expropriatory effect'. Examples might include discriminatory taxes or a ban on imports of essential machinery.

Expropriation insurance does not cover bona fide, non-discriminatory measures by the host government in the exercise of legitimate regulatory authority.

- *Breach of Contract*

Breach of Contract insurance protects investors from losses arising from the host government's breach or repudiation of a contract with the investor. The investor must be able to invoke a dispute resolution mechanism (e.g., an arbitration) set out in the underlying contract, and obtain an award for damages. MIGA will pay compensation if the dispute resolution mechanism fails to function properly because of host government actions.

Breach of Contract insurance is a relatively new product. It has particular appeal in cases where private companies take over functions formerly administered by the public sector—for example the provision of electricity, water or health services. In BiH (see Section 5 below), International Dialysis Center B.V. has purchased Breach of Contract insurance to guard against the risk of a future government change of policy in the health sector.

Investors may purchase these coverages individually or in combination. MIGA covers up to 90% of equity investments, and generally covers up to 95% of loans and loan guarantees. It also covers smaller percentages, subject to negotiation with individual clients, either on its own or in co-operation with other



insurers. It would normally be unwilling to cover small percentages of an investment. The agency's view is that premiums on such small percentages would not be sufficient to justify the client coming under the protection of the MIGA 'umbrella'.

From the outset, MIGA has been able to offer political risk tenors (guarantee periods) for up to 15 years and even 20 years in exceptional cases. These tenors were not available on the private insurance market in 1988. In the 1990s, as will be seen below, private insurers were able to extend the tenors that they were able to offer. In the current tighter market conditions, longer tenors are again harder to obtain on the private market.

In 1990 MIGA issued four guarantees, rising to 72 in 1999, and 59 in Fiscal Year 2003 (FY03) (MIGA 2003a). Over the last 15 years, it has issued a total of 656 guarantees worth \$11.7 billion. In doing so, it has facilitated an estimated \$49.7 billion worth of FDI.

In FY03 MIGA issued a total of \$1.4 billion in political risk coverage (MIGA 2003a). By the end of FY03, infrastructure projects accounted for 41% of MIGA's outstanding gross exposure, followed by financial services (29%) and manufacturing (10%). Its largest country exposures were in Brazil (16.3% of its gross outstanding portfolio), Bulgaria (6.6%), Argentina (5.8%), Mozambique (5.2%), Turkey (4.2%), Romania (4.2%), Nigeria (3.9%), Dominican Republic (3.6%), Croatia (3.3%) and Peru (3.0%). MIGA has been seeking to expand its involvement in Sub-Saharan Africa. At the end of FY03, 19% of its gross portfolio was in this region. In 2003 it issued its first political risk guarantee for Burundi, providing Expropriation, War and Civil Disturbance and Transfer Restriction Coverage for a cellular telecommunications project. IDA countries are another priority for the Agency, and at the end of FY03 IDA countries accounted for 34.4% of MIGA's total gross exposure.

### **MIGA's Comparative Advantage**

MIGA's comparative advantage in the insurance world arises from its membership of the World Bank Group, and the fact that its shareholders are made up of member governments. These relationships combine to give MIGA an 'umbrella of deterrence,' discouraging host governments from taking action that will threaten MIGA-insured investments. At the end of FY03 MIGA had 162 full member governments: the majority are from the developing world, and new members are added every year. Afghanistan has been one of the most recent candidates.

MIGA will not issue a guarantee without the approval of the host government. The government may withhold its approval if, for example, it believes that MIGA's resources would best be deployed in support of another sector or in a different part of the country. Having given its approval, the government is much less likely to take action that might threaten the insured project and antagonize its relationship with the World Bank Group. In cases where problems have arisen, MIGA or other World Bank officials have often been able to intercede with the host government to find a negotiated solution, thus avoiding the need for a claim. A recent example concerns the El Paso Corporation power project in Jiangsu, southern China. In 1999 the local authorities unilaterally reduced the price paid for electric power. In May 2002, after a series of protracted negotiations, MIGA was able to help the company and the local authorities to agree on new memorandum of understanding (MIGA 2002a, MIGA News, May 2002). This compromise agreement satisfied the interests of both sides, and avoided a claim.

MIGA's special status also means that it will be in a strong position to recover its losses from the host government if it has to pay out a claim for transfer restriction, expropriation or breach of contract. However, its negotiating advantage will be of much less value in the case of claims arising from war or civil disturbance.

Similarly, MIGA's comparative advantage counts for much less if the local ruling authorities do not constitute a full internationally recognized government, or are less susceptible to World Bank Group influence for other reasons. In such cases, the MIGA 'umbrella' offers limited protection, and the agency will be reluctant to issue guarantees without taking extra measures to cover its own risks. This cautious approach is understandable from a risk management perspective. However, it may conflict with the agency's developmental mandate in post-conflict regions where local authorities have weak institutional foundations.

One solution to this problem is to set up a special fund with financial backing from sources outside MIGA. In 1997 MIGA created the West Bank and Gaza Investment Guarantee Fund in co-operation with the Palestine Liberation Organisation (PLO) on behalf of the Palestinian Authority. The PLO contributed \$10 million to the Fund through a credit from the World Bank's International Development Agency (IDA), and the European Investment Bank (EIB) subsequently contributed some \$6 million and \$5.1 million respectively (MIGA press release, 7 April 1998). The Fund was intended to back MIGA political risk insurance guarantees in the West Bank and Gaza, but continuing instability in the region has severely limited its impact. MIGA has issued only one guarantee through the Fund, and this was cancelled by the client during a brief period of mistaken optimism.

MIGA has had rather more success with the European Union Investment Guarantee Trust Fund for BiH, which was set up through the European Union in 1997. This will be discussed in greater detail in Section 5.

### **Eligibility Requirements**

Article 12 of the MIGA convention makes clear that the agency must satisfy itself as to the 'economic soundness' of any investment that it insures, as well as its 'contribution to the development of the host country' (MIGA 1985). If the project lacks economic credibility, it is in any case unlikely to make a constructive contribution to the host country. As one MIGA underwriter commented, PRI 'cannot turn a bad project into a good project'.

MIGA covers transnational rather than domestic investment. In some cases, the distinction may limit the agency's developmental impact. In BiH's case, it means that investors from Serbia or Croatia—who would have been considered 'domestic' before the break-up of Yugoslavia—may seek MIGA insurance, but local Serbs, Croats or Bosniacs may not. However, MIGA does provide insurance to nationals of BiH if the funds originate from outside the country (i.e. return of flight capital).

MIGA only insures new investments. This includes privatizations and injections of new capital into existing projects. Privatizations are potentially a particularly important area of interest in BiH although, as discussed above, there have been a series of delays in the privatization program.

Investments are expected to comply with MIGA's environmental and social guidelines and policies. On this point, MIGA is pulled in two directions, at least at first sight. On the one hand, environmentalist critics have accused the agency of failing to take sufficient care in the projects that it chooses to back (Friends of the Earth 2001). On the other, the requirement to undergo environmental and social checks introduces an extra layer into the already complicated process of applying for a MIGA guarantee, and may therefore be seen as a commercial impediment. In practice, MIGA's economic and environmental/social objectives may be more compatible than they first seem. Projects that are well-managed from an environmental and social point of view are less likely to encounter political risks.

## **Non-insurance Services**

In addition to its core business of political risk insurance, MIGA also provides technical assistance to governments, helping them to develop their capacity to attract investment. Its *IPAnet* website ([www.ipanet.net](http://www.ipanet.net)) gives a wide range of investment promotion information. PrivatizationLink ([www.privatizationlink.com](http://www.privatizationlink.com)) focuses specifically on privatization opportunities; and FDI Xchange ([www.fdiexchange.com](http://www.fdiexchange.com)) delivers customized information on investment opportunities in developing and transition economies. MIGA is not currently providing technical assistance to the BiH government, although its Internet services include articles on, for example, the latest stage in the country's privatization process.

MIGA's legal department may offer mediation services between client companies and host governments, in disputes that are not related to its own insurance guarantees. For example, it has recently been helping negotiate a resolution to more than 40 expropriation claims relating to actions taken by the Ethiopian government in the 1970s. These unresolved disputes are impeding Ethiopia's current efforts to attract new investment.

## **MIGA's Claims Record**

MIGA has so far paid out only one claim in its entire history, in 1998. This concerned an investment by the US company Enron in a power project in eastern Java, Indonesia. The Indonesian authorities initially approved the project on the basis of projections suggesting a sharply increasing demand for energy, and MIGA insured the project against expropriation. However, the demand projections turned out to be far too high in the light of the country's economic crisis in the late 1990s. After the Indonesian authorities suspended the project, MIGA pursued talks between Enron and the government in the hope of finding a mutually beneficial solution (MIGA 2001). Mediation talks were terminated in mid-2000, and MIGA paid Enron \$15 million for the losses that it had sustained. The Indonesian government subsequently agreed to repay MIGA over a three-year period. MIGA has now re-opened its program in Indonesia. Its recent guarantees include coverage for expropriation and war and civil disturbance for a diesel engine distributorship in Jakarta.

MIGA's excellent claims record means that it is in a strong financial position. In FY03 it earned \$39.5 million in premium and fee income, and a further \$25.3 million in investment income. It has recently completed the main phase of its General Capital Increase, whereby it has sought increased subscriptions from member countries, and effectively doubled its capital base.

## **Other Public Insurance Providers**

Many of the debates on the role of MIGA are echoed in similar debates on the role of other public sector insurance providers. These include questions about the extent to which public insurers complement or compete with the private sector, and whether they have a positive or negative environmental and social impact.

### ***The main players***

Most of the public insurers are wholly or partly owned by individual governments (for an overview of the main public and private PRI insurers see Wagner 1999). The oldest is the UK's Export Credit Guarantee Department (ECGD), which was founded in 1921. The largest is the Overseas Private Investment Corporation (OPIC) of the US. The leading state-owned agencies include Export Development Canada (EDC), Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE) in France, and

Hermes Kreditversicherungs-AG in Germany. Their main role has been to promote business originating in their respective home countries.

The characteristics that the public insurers have in common include:

- A willingness to provide investment insurance for long periods, commonly 15 or 20 years;
- A relatively large capacity, although the amount of insurance funds available to cover risks in individual countries will vary; and
- In principle, the fact that they enjoy backing from governments makes it possible for them to offer a protective ‘umbrella’ similar to MIGA’s, although this depends on the relationship between the investor and host governments concerned.

Typically, the public insurers cover both trade and investment-related political risks. However, the largest single component of their business is export credit insurance, and they are often known generically as Export Credit Agencies (ECAs).

All the main national ECAs as well as MIGA are members of the Berne Union which as of late 2003 had 52 members from 43 countries and locations. In the late 1990s the American Insurance Group (AIG) became the first private sector insurer to join the Union, followed by Sovereign Risk Limited (based in Bermuda) and Zurich Emerging Markets Solutions (based in Washington).

There are now a handful of multilateral insurance providers in addition to MIGA. These include the Commonwealth Investment Guarantee Agency (CIGA) and the African Trade Insurance (ATI) agency, which was set up in August 2001. As its name suggests, ATI has so far concentrated on promoting trade rather than investment insurance.

### ***MIGA collaboration with public insurers***

Although some public insurers may view MIGA, from time to time, as a competitor, most view the Agency as a potential collaborator. MIGA is actively seeking to work with other providers either as a co-insurer, or by providing reinsurance. At the end of FY03 MIGA had signed memoranda of understanding with some 33 public institutions (MIGA 2003a, p.2).

In the case of BiH, MIGA is providing reinsurance for an Oesterreichische Kontrollbank (OeKB) guarantee to Oesterreichische Volksbank AG (see below). Similarly, it is providing reinsurance to the Slovene Export Corporation (SEC) for two guarantees issued for investments in BiH—a bank and a hypermarket. The relationship with the SEC fits in with current MIGA policy of helping strengthen public insurers in developing and transition economies.

### ***The public interest debate***

In many Western countries, the public interest role of the ECAs has been questioned—even to the extent that the reasons for their existence have been challenged.

Particularly in the US and the UK, free-market advocates have questioned whether there is a need for public sector agencies at a time when the private market has successfully expanded its capacity. In 1991 the ECGD’s short-term export credit department was privatized. However, its investment insurance arm remains under state control.

Similarly in the US, OPIC has come under attack from Republican interests who, like their ideological counterparts in the UK, have called for it to be privatized. However, an independent study by JP Morgan in 1996 concluded that privatization would not serve the US’s economic interests because the private

sector would be unable to replicate OPIC's deterrent function or reproduce its recovery rate (Moran 2003). If the US government tried to sell OPIC to the private sector, it would have to offer its assets at a discount. The conclusion has been that OPIC, like MIGA, should focus on projects that cannot easily be insured in the private sector. It should take advantage of its protective 'umbrella' to open up investment in difficult new markets.

Meanwhile, the ECAs also have come under attack from environmentalist and human rights pressure groups, who have formed a collaborative venture of their own—ECA Watch ([www.eca-watch.org](http://www.eca-watch.org)). Members include organizations such as Friends of the Earth (FoE), Rainforest Action Network (RAN), Campaign Against the Arms Trade (CAAT) and various branches of the World Wildlife Fund (WWF). The pressure groups argue that ECAs in general lack accountability, have inadequate safeguards against corruption and have too often been associated with projects such as China's Three Gorges Dam that have a damaging environmental impact.

The ECAs are responding by introducing new procedures to ensure that client companies adopt high levels of environmental and social responsibility. EDC's environmental guidelines are widely respected (see [www.edc.ca](http://www.edc.ca)). However, the extent to which the ECAs as a whole have established adequate environmental and social safeguards remains contested.

In June 2003 an initial group of 10 private banks signed the 'Equator Principles' committing themselves to a set of voluntary guidelines on project finance in developing countries. The Banks said that they would adhere to the International Finance Corporation (IFC) rules for sustainable development, which include guidelines on issues ranging from environmental assessment and natural habitats to indigenous peoples and child labor (see [www.equator-principles.com](http://www.equator-principles.com)). The Principles are a response to growing environmentalist pressure on both the public and the private financial sector, and could serve as a model for the ECAs.

### **The Private Insurance Market**

Since the 1980s the private insurance market has come to dominate the trade insurance market in many countries, and has greatly expanded its role in investment insurance. In the course of the 1990s private insurers were able to expand the time periods for which they were able to offer investment insurance, and by the end of the decade many were able to offer policies for as long as 10 or 15 years (Alington 1999).

The main PRI providers in the private market are Lloyd's of London where there are some ten underwriting syndicates with strong PRI practices, as well as a substantial coterie of brokers. Other leading international players include American Insurance Group (AIG); Chubb & Sons and Zurich Emerging Markets Solutions (ZEMS) in North America; and Sovereign in Bermuda.

Private insurers pride themselves on their flexibility. It is possible to seek a quote and negotiate a PRI policy much more rapidly than in the public sector which is notorious for its cumbersome procedures. It is also possible to insure existing projects as well as new ones. There are no eligibility requirements.

Private PRI policies are confidential: insurers fear that governments are more likely to take action against their clients if they know that they are insured. By comparison with MIGA or the public insurers, the private sector insurers will be poorly placed to deter such behavior. It will also be harder for them to recover assets once a claim has been filed.

### ***MIGA collaboration with the private market***

MIGA offers a variety of arrangements for public-private partnerships:

- MIGA offers a Co-operative Underwriting Program (CUP) with private insurers. Under CUP arrangements, MIGA serves as the insurer of record, but retains only a portion of the exposure for its own account. The remainder is underwritten by one or more private insurers. This arrangement offers both MIGA and the private insurers the opportunity to spread their risks, thus increasing the amount of capacity available for particular countries or projects. MIGA's participation and its status as an international institution provides an extra layer of protection to the private insurer—and to their joint client.
- MIGA has two kinds of reinsurance arrangements. Under MIGA's treaty reinsurance schemes, selected private insurance partners provide MIGA with reinsurance without being consulted in advance on specific guarantees. Facultative reinsurance arrangements are specific to individual contracts. To date MIGA has mobilized some \$2 billion of coverage through treaty and facultative reinsurance (West 2003).

### **Perceptions of Risk: Who Values PRI and Why?**

A variety of different factors influence companies' approaches to risk, and to PRI as a means of managing it.

#### ***Risk management and risk appetite***

Recent changes in the regulations of the major international stock markets have focused attention on risk management. In the United Kingdom the directors of companies listed on the London Stock Exchange are expected to comply with the risk guidelines outlined in the 1999 Turnbull report, officially known as *Internal Control: Guidance for Directors on the Combined Code* (Institute of Chartered Accountants of England and Wales 1999). Its objectives are to ensure that companies establish systems of internal control to assess and manage risks effectively. Similar regulations are now being adopted in other major stock markets.

PRI is one means of managing political risk: another is avoidance. Some companies regard PRI as a standard part of their risk management framework. Others argue that it is better to stay clear of countries, such as BiH, where the risks are so high that they might need special insurance.

Companies differ in their appetite for risk, even in the same sector. In part these differences reflect contrasting company cultures; they also derive from differences in strategy as outlined by company boards. In the petroleum and mining sectors, the 'majors' tend to be more conservative than the 'juniors' who specialize in going to difficult places—indeed see a comparative advantage in doing so (see Bray 2003). They have a culture of taking high risks in the hope of high returns. To some extent a similar pattern applies in other industries: smaller regional companies may see an advantage in going to risky places such as BiH as a means of establishing niches in areas where larger Western-based multinationals might not wish to venture.

MIGA currently is making a particular effort to encourage SMEs. However, SMEs typically operate under tight margins, and may be reluctant to spend money on insurance. A related factor is that they may not know that MIGA even exists: knowledge of PRI is not universal even among larger Western companies.

#### ***Different sectoral views***

Banks are among MIGA's best customers: financial institutions accounted for 29% of MIGA's total portfolio in FY03 (MIGA 2003a), and they have constituted the largest single category in the portfolio for three out of the last five years. This figure does not include the many commercial bank loans that MIGA

insures as part of its project finance activities, especially in infrastructure. As will be seen below, banks form an even larger proportion of MIGA's portfolio in BiH. Many banks require PRI for their own investments as a standard part of their operating procedures. The most successful banks are often more—rather than less—keen to obtain PRI. In principle they may be able to afford the financial losses incurred through political risks, but they do not want to weaken their credit ratings. Similarly, banks frequently require clients to take PRI as a standard condition for issuing loans in environments that they regard as high-risk.

Infrastructure investments account for 41% of MIGA's portfolio in FY03, and constituted the highest category in the last two years. Infrastructure projects such as power stations are particularly vulnerable to the politics of the 'obsolescing bargain' (Moran 1999). They make substantial investments at the beginning of the project life cycle, and may take several years to recoup them. Since their investments are in fixed assets, they cannot afford to withdraw if the political climate changes. This makes them particularly vulnerable to regulatory changes and other forms of political intervention that may undermine their profitability.

### ***Local versus headquarters views***

Locally-based managers often take a more optimistic view of political risks than headquarters staff and—depending on the company's internal power structure—this can affect a company's willingness to pay for PRI.

There are good and bad reasons for this difference of views. Locally-based managers are, or should be, well-informed. They become accustomed to the host country; they may accept difficult conditions as normal; and they often find unorthodox but workable solutions to common problems. A good manager will turn this local knowledge to commercial advantage without compromising company standards. He may not see the need for the extra expense of PRI.

Equally, it is unwise to rely uncritically on the views of the managers on the spot. They may be too close to events to see the wider pattern; their job is to be a commercial manager, not a political analyst; and their personal commitment to the local operation may influence their judgment more than it should. Commenting on this pattern, a Bosnian observer pointed to the metaphor of a frog in a saucepan. At the outset the frog may tolerate tepid water; it may tolerate an increased temperature that would be unacceptable when entering the water for the first time. By the time that it realizes the water is actually boiling, it is too late to escape. With such considerations in mind, headquarters staff often seek PRI as an extra source of assurance, even if locally-based staff do not consider it to be necessary.

As will be seen in the next section, these differences of perspective are particularly apparent in BiH.

### **Recent Developments in the Political Risk Market**

PRI is a dynamic field. It developed considerably in the 1990s, and will continue to develop in the changed circumstances of the early 2000s. Innovative insurers and other financial specialists will develop new products in response to demand.

#### ***Private sector capacity***

Events since the September 11 2001 terrorist attacks have contributed to a sense of political and economic nervousness, and this in turn has led to increased interest in PRI. However, the same events have led to a reduction in insurance capacity in the private market. There is more demand for PRI but, at least in some cases, it is harder to obtain.

This is a result of a combination of factors. The market was already hardening before September 2001, and has further hardened since then. In 2002 the global capacity of the main reinsurance companies shrank from some \$800 billion to \$600 billion.<sup>5</sup> At the same time investors in the insurance market shifted their funds from sectors such as PRI, which were hard to predict, to more familiar and still-profitable areas such as property and casualty insurance. Before September 11 2001 it was theoretically possible to insure as much as \$1.2 billion on the private market. In practice the largest single deal was in the region of \$600 million. Now the theoretical maximum is more like \$600-700 million, and the largest amount of insurance that has actually been issued is approximately \$500 million.<sup>6</sup>

To some extent this reduction in capacity has been offset by a reduction in demand. Investors are nervous, and they are therefore not so likely to go to risky places anyway. Lloyd's brokers insist that there is no major problem in finding cover for a 'good project,' although it may be more expensive than before. Prices have increased by some 10-20%, and it is harder to obtain long-term coverage.

Meanwhile, price increases across the whole range of insurance products mean that individual companies' risk management budgets are stretched: PRI is more likely to be considered a 'luxury purchase'.

### ***Public versus private***

The private sector's expansion in the course of the 1990s raised the question of whether there was still a role for state-owned insurers, even in the market for investment insurance investment. As noted above, there were discussions in the US and the UK about the possible privatization of OPIC and the remaining state-owned part of ECGD. However, events since September 11 2001 have served to confirm the need for state-owned investment insurers, at least for the time being, because of their counter-cyclical role and their greater ability to take on large, long-term risks.

### **Outlook: PRI in High-Risk Areas**

These developments have led to a convergence of views on the relationship between public and private insurers. More than ever, the emphasis is on partnership and collaboration. The special status of MIGA makes it easier for the Agency to operate in high-risk areas. Through its protective 'umbrella', MIGA may be able to play a particularly important role in opening up new investment in post-conflict regions. Section 5 discusses how far MIGA has been able to play this role in BiH.

## **5. MIGA AND POLITICAL RISK INSURANCE IN BiH**

Writing from the perspective of a Lloyd's underwriter, David James comments that he sees 'good', 'bad' and 'ugly' risks (James 1999). He adds that he 'underwrites Assureds—not countries.' It should be possible to find good projects even in difficult countries.

For James a 'good' risk is a 'well-structured deal where risk mitigation is a high priority'. Risk mitigation could include arranging payment offshore by means of an escrow account, the proper use of security consultants, and concepts such as planning reinvestment in the host region, thus increasing the local benefits of the project and reducing the risks of political intervention. 'Bad' risks include 'hare-brained, get-rich-quick schemes'. 'Downright ugly' risks include those associated with fraud and corruption. He expects to see responsible and appropriate due diligence.

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<sup>5</sup> Interview with Swiss reinsurance broker, January 11, 2003.

<sup>6</sup> Interview with Lloyd's broker, May 1, 2003.



The principles he describes apply equally to private and to public insurers. All three categories of risks are to be found in BiH. This section examines the experience of MIGA and other insurers in the country to date.

### **MIGA and the European Union Investment Guarantee Trust Fund**

BiH became a member of MIGA in 1996, and the EU and MIGA set up the European Union Investment Guarantee Trust Fund the following year. The Fund was created at the initiative of the European Commission in response to the demand expressed by the private sector. The EU provided capital of EUR10 million to set up the Fund, and MIGA has administered it.

From MIGA's point of view, the rationale for the Fund was that it enabled the Agency to operate in a region that, at the time would not otherwise have been open for business. In 1997, the institutional foundations of BiH state and entity governments were weak. This was particularly true of the RS where Radovan Karadzic, an indicted war criminal, had only recently been persuaded to step down. In those circumstances the collaboration of the host government was uncertain, and MIGA could not be confident of its ability to deter host government actions against insured investments.

The EU also financed the posting of a full-time MIGA representative in BiH from 1999 to 2001. Her appointment was unusual: MIGA's staff is heavily concentrated in Washington. She played an important role in making MIGA known among actual and potential investors, although many of the companies that initially expressed interest in PRI have not taken it up because their projects never took off. As discussed above, the main reasons for these failures have been the slow progress of the privatization program and the adverse regulatory environment.

In 2000 MIGA drew on the Fund to issue its first guarantee for BiH, covering Coca Cola's investment into a new bottling plant outside Sarajevo. The Fund provided coverage of EUR2 million, and the remainder came from MIGA's own resources. Although the Fund only covered a part of the Coca Cola guarantee, MIGA would have been reluctant to provide coverage without it.

In 2000 and 2001 MIGA again drew on the EU Fund to insure three banks and a kidney dialysis center (see below). The total amount of guarantees issued for these five projects amounted to EUR60 million. This amount facilitated investments worth some \$72.5 million equivalent.<sup>7</sup> The fund's base capital of EUR10 million therefore helped leverage investment worth about six times as much.

MIGA has since supported three new projects (a hypermarket and two banks) as well as the expansion of the hypermarket, the kidney dialysis center and one of the banks. The total amount of guarantees issued in BiH until December 2003 is EUR150 million, facilitating a total estimated amount of investment of \$273 million equivalent.

### **Summary of MIGA's BiH Guarantee Portfolio**

Table 5.1 provides a summary of MIGA guarantees issued for BiH.

**Table 5.1:** Summary of MIGA Activities in BiH

<b>FY00</b>						
Coca-Cola Holdings	Beverage II	Guarantee in the amount of Euro 0.7m for equity investments in Coca-Cola	Coverage against Expropriation	and	the risks of War	and Civil

<sup>7</sup> MIGA's Development Database, which collects figures in US dollars (\$).

(Netherlands)		Beverages B-H DOO and Euro 21.5m for CC Production Services BH. Investments financed refurbishing of Hadzici bottling plant near Sarajevo	Disturbance for 5 years
CCB Management Services GmbH (Austria)		Coverage of Euro 1.8m for management services agreement with Coca Cola Beverages B-H DOO.	Coverage against the risks of Transfer Restriction for 5 years. EU Trust Fund provided coverage for Euro 2m.
Oesterreichische Kontrollbank (OeKB)		Reinsurance in the amount of Euro 2.3m for investment by Oesterreichische Volksbank AG into Volksbank BH dd.	Covered by EU Trust Fund.
<b>FY01</b>			
Hypo Alpe-Adria Bank AG (Austria) and Slavenska Banka (Croatia)		Guarantee in the amount of Euro 15.3m for HAAB equity investments in Auro Banka dd in BiH. Guarantee in the amount of Euro 9.5m for HAAB shareholder loan to Aura Banka	Coverage against the risks of Expropriation, and War and Civil Disturbance for 10 years. Coverage against the risks of Transfer Restriction, Expropriation, and War and Civil Disturbance. EU Trust Fund provided coverage of Euro 2m.
Raiffeisen Zentralbank Oesterreich AG		Guarantee in the amount of Euro 6.1m for shareholder loan to Raiffeisenbank dd (RBBH) in BiH.	Coverage against the risks of Transfer Restriction and Expropriation. EU Trust Fund covered Euro 2m.
International Dialysis Centers BV (Netherlands)		Guarantee in the amount of Euro 2.8m for investment in kidney dialysis centre in Banja Luka.	Coverage against Expropriation, War and Civil Disturbance and Breach of Contract of contract between IDC and Health Insurance Fund of RS for 7 years. EU Trust Fund provided Euro 1.5m of coverage.
<b>FY02</b>			
Hypo Alpe-Adria Bank AG (Austria)		Guarantee in the amount of Euro 0.7 m for increased investment in Hypo Alpe-Adria Bank dd (formerly Aura Bank).	Coverage against the risks of Expropriation, War and Civil Disturbance for 15 years
Raiffeisen Zentralbank Oesterreich AG		Guarantee of Euro 4.8m for increase in shareholder loan to Raffeyisenbank dd in BiH.	Coverage against the risks of Transfer Restriction and Expropriation for 7 years.
Slovene Corporation (SEC)/Banka Domzale	Export	Reinsurance of 50% of SEC cover to Banka Domzale dd (Slovenia) in the amount of Euro 1.2m for equity investment in Commercebank dd	Coverage against the risks of Transfer Restriction, Expropriation, and War and Civil Disturbance for 27 months.
Slovene Corporation/Poslovni Sistem Mercator	Export	Reinsurance of 60% of SEC cover to Poslovni Sistem Mercator in the amount of Euro 1.3m for equity investment and Euro 6.7m for shareholder loan to Mercator Trzni Centar Sarajevo (hypermarket)	Coverage against the risks of Transfer Restriction, Expropriation, and War and Civil Disturbance; 10 years for equity investment; 6 years for shareholder loan.

<b>FY03</b>			
Bank Aktiengesellschaft	Austria	Guarantee in the amount of Euro 4.8m to HVB Bank Bosnia and Herzegovina dd.	Coverage against the risks of Transfer Restriction and Expropriation for 3 years.
Hypo Alpe-Adria-Bank AG		Guarantee in the amount of Euro 13.8m for equity investment.	Coverage against the risks of Transfer Restriction, Expropriation, and War and Civil Disturbance for 10 years.
Raiffeisen Oesterreich AG	Zentralbank	Guarantee in the amount of Euro 9.5m for subordinated shareholder loan to Raiffeisen Bank d.d. Bosna I Hercegovina (RBBH);	Coverage against the risks of Transfer Restriction and Expropriation of Funds for 15 years.
<b>FY04–July to December 2003</b>			
International Center B.V.(Netherlands)	Dialysis	Guarantee of Euro 1.4 m for additional equity investment in kidney dialysis center in Banja Luka	Coverage against the risks of Breach of Contract for 7 years.
Slovene Corporation/Pslovni Sistem Marcator	Export	Guarantee of Euro 2.3m for additional equity investment in hypermarket	Coverage against the risks of Transfer Restriction, Expropriation, and War and Civil Disturbance of 10 years.
Raiffeisen Oesterreich (Austria)	Zentralbank AG	Guarantee in the amount of Euro 19m for shareholder loan to Raiffeisen Bank d.d. Bosna I Hercegovina (RHHB) Guarantee of Euro 23.8m for senior shareholder loan investment into Raiffeisen Bank d.d. Bosna I Hercegovina (RHHB)	Coverage against the risks of Transfer Restriction and Expropriation of funds for 8 years. Coverage against the risks of Transfer Restriction and Expropriation of funds for 5 years.

Source: MIGA yearbooks and records.

## **Coca Cola**

Coca Cola's investment into the Hadzici plant was the first major foreign participation in a BiH privatization. It therefore had considerable symbolic value, marking a turning point in BiH's fortunes. At the time that the investment was made in 1999/2000, the risk profile of BiH—and the wider Balkans region—was higher than it is now. Memories of the Bosnian war were even fresher, and the Kosovo conflict had only just happened. Coca Cola management made it clear that it would not invest in BiH without PRI.

Since then, the company has cancelled its insurance premiums, reflecting a changed risk management strategy and view of the risks that it faces in BiH. This does not invalidate the need for PRI in the original investment. PRI is most valuable near the turning point in a country's fortunes. MIGA fulfilled its developmental role in that it helped an important company get past this turning point, thus providing a positive example for others to follow.

## **Banks**

Banks clearly form the largest single category of MIGA clients in BiH. There are various reasons for this. First, as noted above, banks are by the nature and culture of their business more likely than other sectors to take PRI, and this helps explain why banks are among MIGA's largest customers worldwide. Second—

and of course crucially—the banks themselves saw a business opportunity which fitted into existing plans. MIGA's four 'direct' banking clients—Hypo-Alpe-Adria Bank (HAAB), Raiffeisen Zentralbank, Volksbank and Bank Austria—are all from Austria, and are expanding their activities elsewhere in the region. In 2002 MIGA also issued guarantees to Hypo-Alpe-Adria-Bank for Croatia, and to Raiffeisen Zentralbank for Romania, Russia and Ukraine. BiH is part of a wider pattern.

Third, the timing in BiH itself was right. Since 2000 the investment environment for banks in BiH has improved considerably. Significant reforms included the abolition of the Payment Bureaux in early 2001; the introduction of minimum capital requirements of KM15m at the end of 2001; and the requirement to qualify for deposit insurance by August 2003. These reforms have encouraged the consolidation of the larger and more efficient banks. Another turning point was the changeover from the DM (the most favored foreign currency in BiH) to Euros in early 2002. BiH citizens produced some DM4.3 billion worth of banknotes. One third of the total was deposited in local banks—a sign of greater confidence in the banking system. Another third was kept as KM banknotes; and only the remaining third was converted into Euros.

By 2002 50% of BiH's overall banking sector was in foreign hands. Other foreign banks active in the region included Banka Domzale which benefits from a reinsurance facility to the Slovene Export Corporation (SEC) on account of its equity investment in Commercebank dd in BiH.

#### *The banks' wider contribution to development*

The director of one of the Austrian banks in Sarajevo argues that banks provide one of the key 'building blocks' of post-conflict and post-socialist economic transition. The first building block is physical reconstruction; the second is the establishment of a proper payments system; banks come third. They in turn will prepare the way for new investors once further reforms—for example the establishment of a unified tax system—have been completed.

Over the last three years, the banks have expanded their networks significantly. Volksbank plans to expand by setting up new branch offices from scratch, and expects to have ten banks across the country by the end of 2003. Raiffeisen Zentralbank Oesterreich AG acquired a controlling block of shares of Market banka in July 2000, and then purchased 100% of the Mostar-based Hrvatska postanska banka in May 2001 (see [www.raiffeisenbank.ba](http://www.raiffeisenbank.ba)). Similarly, HAAB is expanding by purchasing existing BiH banks.

The increase in banks' deposits, plus injections of equity from abroad, makes it easier for the banks to issue loans both to BiH companies and to local companies. To give one example, HAAB has issued a business loan to FeAl, a BiH company that produces aluminum profiles (MIGA 2002b). These are used to construct window frames for residential and industrial use, and there is an obvious demand for these products at a time when the country's post-war reconstruction is far from complete. Only some 12-15% of the profiles used each year were manufactured in BiH at the time of the investment.

The banks themselves report that it is easier and safer to make domestic rather than commercial loans as BiH companies frequently lack the skills to make credible business plans. Without such plans, the banks are reluctant to issue loans. One unfortunate side-effect is that many of the domestic loans are used to import foreign materials, and this has an adverse effect on the country's balance of payments.

## **MIGA Collaboration with Other Public Insurers**

MIGA's collaboration with two state-owned insurers—the Osterreichische Kontrollbank (OeKB) and the Slovene Export Corporation (SEC)—has a similar rationale to its work with banks. MIGA's reinsurance increases their financial capacity, and therefore gives them the resources to extend their activities into areas they might otherwise not be able to afford. As noted above, the OeKB's client is Volksbank, while the SEC is working with Banka Domzale/Commercebank and the Mercator hypermarket. MIGA's link with the SEC fits in with current MIGA policy of building up relationships with public insurers in developing or transition economies as a means of building up their capacity.

## **Health Sector**

MIGA's sole involvement with the health sector in BiH is the guarantee issued to International Dialysis Centre BV (IDC) of the Netherlands for a kidney dialysis centre that has opened in Banja Luka (RS). This project is unusual for the region as well as for MIGA: it is the first private investor in the health sector in the whole of the Balkans (MIGA 2002b).

The dialysis center meets a specific need. A form of kidney disease—known technically as Balkan Endemic Nephropathy—is particularly common in RS for reasons that are still unclear to medical researchers. Once the illness is diagnosed, patients will need regular dialysis for the rest of their lives unless they receive a kidney transplant.

In April 2001 IDC injected several million dollars' worth of funds into state-of-the-art equipment in a refurbished medical center in Banja Luka. Patients' treatment is paid for by the RS National Health Insurance Fund. The results are favorable. Half of the patients can now work, compared with only 20% before, and the incidence of jaundice (an unwelcome side-effect of poor-quality treatment) has fallen almost to zero. IDC has now opened a second clinic in Bijeljina, another town in RS, and is looking for further projects.

Potential political risks arise because, among other reasons, this is the first time the state-owned National Health Insurance Fund has worked with a private company. If the project works the Fund can manage its resources better and focus its attentions on other areas of need. Initial reports are favorable, but the fact that the project is to some degree experimental raises the question whether a future administration might reverse policy on government collaboration with the private health sector. IDC's policy with MIGA includes coverage for Breach of Contract, and therefore addresses such concerns.

## **Infrastructure**

Infrastructure accounts for 41% of MIGA's global portfolio, but it has no infrastructure clients in BiH. The main reason is that utilities such as the electricity and telephone networks—which might otherwise have been of interest to foreign investors—have yet to be privatized. MIGA has established preliminary contact with potential investors in both sectors. However, since they have yet to come close to actually starting up operations in BiH, there has been no need for insurance so far.

As noted above, BiH politicians from different communities are heavily involved in both the electricity and the telecoms industries. When and if these are successfully privatized, one obvious concern will be the risk of policy reversals by a future government. Future foreign investors, including the foreign banks providing commercial loans in these projects, will certainly have a requirement for Expropriation and Breach of Contract insurance.

## Manufacturing

According to FIPA figures (see Section 3 above), manufacturing accounts for 54.9% of all foreign investment in BiH between 1994 and 2002. At first sight, it is therefore surprising to find that Coca Cola has been the sole manufacturing client in BiH's portfolio—and it has since cancelled its insurance. A combination of several different factors may account for the manufacturing sector's low level of interest in PRI.

- First, there has been less manufacturing investment in BiH than might have been expected. Many of the most important privatizations of so-called strategic industries have yet to be confirmed, and these are the operations most likely to attract major international companies.

Notwithstanding MIGA's current interest in promoting SMEs, the larger companies are the ones most likely to purchase PRI. Many SMEs investing in Bosnia are from Croatia, Slovenia or Austria. They believe that they know the country well, in some cases because of connections established before the break-up of Yugoslavia. In most cases, they therefore argue that they have no need of PRI: they can manage political risks through personal contacts.<sup>8</sup>

- Second, at least some foreign investors in manufacturing may have bought PRI from other agencies such as the OeKB (see below, 'Other public sector insurers').
- The third and perhaps most important factor may lie in the way that manufacturing companies view risk. Only 9% of MIGA's global portfolio comes from this sector. This in itself may suggest that they see themselves as less exposed than either infrastructure or financial services which are the two largest categories in MIGA's portfolio.

A representative of one of the larger companies interviewed for this study argued that its size in itself gave it a degree of protection ('Our company has an important name, and can arrange appointments with ministers relatively easily'). Politicians would not wish to risk the adverse publicity of causing it to shut down. He also noted that, by international standards, his was a relatively small operation. His company was reluctant to make major new investments to upgrade it because the market was small and the tax environment unfavorable.

Another locally-based manufacturer cited the expense of PRI: his profit margins were low and the need to pay premiums was an unwelcome extra burden at a time when his factory was at a relatively early stage of development.

## The Investment Guarantee Agency (IGA)

The Investment Guarantee Agency (IGA) is owned by the BiH government, and was founded in December 1996 with the help of an IDA credit and co-financing from Switzerland, Sweden, Japan and The Netherlands. IGA wrote its first guarantee in 1997, and has since issued more than KM50m worth of guarantees. It has focused on trade insurance and to that extent has played an important complementary role to MIGA.

### *Political risk services for importers*

At the outset IGA's prime role was to issue political risk guarantees for foreign companies importing goods into BiH, for example for processing or for use in the performance of service contracts. IGA covered political risks such as war and civil disturbance, foreign currency restrictions, import- or export-bans, and other forms of government interference.

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<sup>8</sup> Comments from Emily Talmon L'Armée, former MIGA representative in BiH, June 26, 2003.

Initially, IGA had an agency agreement with ING Bank in The Netherlands. Once IGA had approved a guarantee, ING would issue the exporter a standby letter of credit on its behalf. ING's involvement gave IGA's clients an extra level of confidence. At this stage, the agency's guarantees were fully cash-backed through funds from the World Bank and other donors, which were held in an escrow account.

Guarantees issued in this period covered the temporary importation of machinery to rehabilitate the Sarajevo Airport, power plant equipment, parts for locally assembled radiators and heaters and medical equipment. In February 1998, IGA issued its first political risk guarantee for a business transaction in RS, a DM3.7 million guarantee to Siemens AG which was providing medical equipment and supplies to local hospitals.<sup>9</sup>

IGA's link with ING came to an end in 1999. From then until 2001, it provided similar political risk insurance through Lloyd's of London. Under the revised arrangement, the guarantees were 50% cash-backed and 50% covered by Lloyd's. The revised scheme closed in 2001. Four policies are still outstanding, but these are due to expire in 2004.<sup>10</sup>

IGA never had to pay out any claims. In one incident, the Bosnian authorities confiscated trucks leased out by an IGA client whose Bosnian partner had failed to pay customs dues.<sup>11</sup> IGA and the foreign partner were able to explain to the Bosnian government that the trucks had been leased rather than sold to the Bosnian partner, and that the confiscation therefore constituted an illegal action.

#### *Export credit services*

In 1999—again with World Bank support—IGA started to provide services for Bosnian companies exporting goods abroad. The agency's prime current role is to serve as an export credit agency for Bosnian companies.<sup>12</sup> The services it provides include export financing, export and import trade insurance (including political and war risk insurance), and export guarantees.

IGA's transformation into a conventional export credit agency can be regarded as a form of post-conflict 'graduation'. The special state-backed political risks services that it provided for importers in the early years are either available on the private market, or no longer considered necessary. In that respect at least, BiH has become a more normal country.

#### **Other Public Sector Insurers in BiH**

The public insurers' degree of involvement with BiH naturally has varied according to the level of interest shown by companies in their respective countries. Austria has close geographical and historical links with BiH, and the Oesterreichische Kontrollbank (OeKB) therefore sent a mission there soon after the end of the conflict. Austria is the third-largest investor in BiH.

The OeKB is currently insuring some 40 million Euro in investment and long-term trade with BiH. Many of these are quite small projects, such as saw-mills or factories processing animal foods. In some cases, the amount insured is as low as EUR100,000. As noted above, MIGA has reinsured the OeKB's PRI policy with Oesterreichische Volksbank.

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<sup>9</sup> 'Investment Guarantee Agency approves first guarantee in Republika Srpska'. World Bank Press Release No: 98/1645/ECA, February 13, 1998. [www.worldbank.org](http://www.worldbank.org).

<sup>10</sup> Interview with Lamija Kozaric - Rahman, General Manager, Investment Guarantee Agency, Sarajevo, May 5, 2003.

<sup>11</sup> Ibid.

<sup>12</sup> See IGA's website: [www.igabih.com](http://www.igabih.com).

OPIC issued its first guarantee for BiH only in 2003, for a housing project in Mostar. OPIC's low level of involvement with BiH reflects the limited interest of US companies to date (Coca Cola, which has been a MIGA client, is a notable exception). Relatively few US companies have even looked at BiH. The regulatory environment has deterred many of those that have looked. In yet other cases, US companies have expressed interest in OPIC insurance once projected deals were confirmed, but these deals have not come to fruition.

### **Private Sector Insurers in BiH**

As noted above, Lloyd's of London has worked with IGA to insure trade deals going in and out of BiH. Private insurers do not publish details of the guarantees that they issue. However, anecdotal evidence suggests that the private market has issued relatively few investment guarantees for BiH.

A Lloyd's underwriter interviewed for this report in July 2003 said that brokers had approached her in connection with a handful of manufacturing projects in BiH. She had been reluctant to cover them on her own, and had suggested that the broker try to secure MIGA's involvement in which case she would be interested in collaborating.

### **The Current Need for PRI: Contrasting Local Views**

Almost everyone interviewed in BiH in May 2003 agreed that the country presented a difficult business environment. However, there were differing views on the extent to which the most critical business problems could be presented as 'political risks' according to the classic insurance definitions. In part these differences reflected the extent to which the BiH political environment has improved since the end of the war, despite the many continuing problems.

EBRD representative commented that 'political risk is not at the top of companies' agenda'.<sup>13</sup> The top item on the agenda was the 'business environment', which included issues such as judicial reform as well as purely commercial considerations. Political risk came lower down and, although it was on the list, there were questions about companies' willingness to pay for insurance.

EBRD offers its own clients a form of political risk guarantees: this consists of a 'political risk carve out' which means that it will release borrowers from certain obligations under loan agreements if defined political events take place.<sup>14</sup> There is an extra charge for this facility and, according to the Sarajevo representative, only one EBRD client in BiH had taken it up. Like MIGA, EBRD has an advantage over private commercial institutions in that it has 'preferred creditor' status, giving it preferential treatment in the event of a debt moratorium.

Continuing political and economic rivalries between Bosniacs, Croats and Serbs were taken for granted, but the risk of renewed conflict on anything approaching the scale of the early 1990s was generally considered to be low: people were primarily concerned with jobs and economic development. In the same vein, a Bosnian manager working for an international company reported a discussion with his regional director who had worked in Russia: BiH seemed much safer than Russia, so why was there any need for insurance against war and civil disorder? A common observation was that the international community would not allow a new conflict to break out, at least not now (no one could tell what might happen in a generation's time).

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<sup>13</sup> Interview with Serban Ghinescu, EBRD Sarajevo, May 7, 2003.

<sup>14</sup> Interview with Robert Harada, EBRD London, May 21, 2003.



There were similar comments with regard to insurance against Currency Inconvertibility. The Central Bank had international backing, and the Currency Board underpinning the KM was renewed in early 2003, so there was little to worry about. As a financial specialist put it, the risk of conversion problems was ‘not non-existent’, but it was very low.

In sum, few observers were prepared to dismiss the possibility of long-term political risks in BiH. However, there were differing views on the practical implications for commercial decision-makers. More precisely, there were differing views on how much it was worth paying to secure the comfort provided by PRI.

### **Does PRI Answer the ‘Right’ Questions?**

PRI clearly does not answer *all* the questions associated with investment in post-conflict environments: it may answer some questions for some investors.

As BiH’s experience shows, PRI is of most importance to long-term investors with a culture of risk avoidance, or at least risk mitigation. Banks come into this category. It is unlikely that the international banks would have been prepared to invest in BiH when they did without the extra assurance that PRI provides. By helping them do so, MIGA is making a particularly important contribution to BiH’s recovery.

However, business people in BiH are quick to point out that the categories of risk defined by the main insurance providers address only a part of the risks that they face. Some of these are more obviously economic/commercial: will their product appeal to the local market? Will people be able to afford it? Other hazards may fall within or close to the boundaries of ‘political risk’ as popularly understood, but outside the definitions provided by the policies of MIGA or other ECAs.

Examples of the complex risks that investors face include the problems of manufacturers whose products are undercut by smugglers. The smugglers are of course criminal, but typically benefit from some form of political protection. An employee of a foreign-owned bank gave another example: his organization had recently purchased a local bank that had outstanding loans to a government organization. He would have liked insurance against failure to pay, but his prime PRI contact argued that this was a commercial rather than a political risk.

Overall, however, the most serious political/commercial problem has not been the threat to existing investments, but rather the obstructionism that has delayed reform, and thus discouraged foreign companies from investing in BiH at all. PRI can only make a difference if there is a viable investment to be insured in the first place.

## **6. LESSONS LEARNT AND RECOMMENDATIONS**

Political risk has been an important factor influencing investment decisions in BiH since the war and, at least in some sectors, this continues to be the case. PRI is an important tool to help manage political risks. However, the demand for PRI has varied by industry, nationality, and the attitudes toward risk of individual companies and managers. It follows that MIGA should concentrate its efforts in the areas where they are most likely to be needed. This final section summarizes the lessons learnt in BiH and the implications for future PRI initiatives in other post-conflict regions.

## **The Stages of Recovery**

In his recent studies of civil wars and development policy Paul Collier discusses stages of post-conflict recovery (Collier 2002, 2003, pp.167-9). He makes the point that in the first two to three years after a war, the immediate priority is physical reconstruction. There is a limit in the amount of development aid that the country can actually absorb. Aid may be most effective toward the middle of the post-war decade, and should decline to ‘normal’ levels toward the end of the decade.

A similar point can be made about foreign investment and trade. In the early stages of the post-war period, international companies may be involved in physical reconstruction. However, the country is unlikely to be able to absorb more than a small proportion of international investment. The promotion of trade—including the importing of equipment needed for reconstruction—is likely to be a higher priority. In the initial post-conflict stage, the most effective intervention is likely to be the creation of a guarantee agency focusing on trade into the country. Investment insurance will play a more important role later on.

## **Trade Insurance**

Backed by the World Bank, BiH’s Investment Guarantee Agency (IGA) was able to facilitate trade guarantees for imports into BiH from 1997 onwards. In the first three to four years after the end of the conflict, these would not have been readily available from either public or private sector insurers. As discussed, IGA’s role as an insurer of inward trade is now less relevant as more mainstream public and private insurers have taken over.

Companies seeking export insurance are of course primarily concerned with failure to pay—whether this results from political intervention, the buyer’s incompetence or fraud. All these are possibilities in a post-conflict environment where local companies have yet to build up effective track records. It may therefore be inappropriate to confine insurance provided by an agency such as IGA solely to political risk: it should also cover failures to pay for other reasons.

## **Policy Issues: Investment and Reform**

With regard to investment, both foreign and domestic companies need certain ‘building blocks’ to be able to operate effectively—as well as a degree of confidence that the conflict really is finished. These building blocks include a legal and regulatory environment that is in tune with the needs of private companies, and a viable financial infrastructure.

BiH scarcely met these requirements during the 1990s, and there are major problems even now. It is therefore not surprising that investment levels have been so low. In the late 1990s and early 2000s, MIGA was in contact with several potential investors whose projects never took off. PRI is of no value unless would-be entrepreneurs can first identify viable opportunities that are worth insuring.

One of the main lessons of BiH’s experience is the need to press for investment-related policy reforms as early as feasible. The OHR, the World Bank and other donors are now fully aware of this, and are pressing for and supporting rapid reform accordingly. Opinions differ on the extent to which it might have been possible to accelerate reforms at an earlier stage. It might have been difficult politically. However, there is no doubt that earlier reform would have been desirable, and this is one of the most important lessons for other post-conflict environments.

## **Variations between Sectors**

PRI is of most value to investors when they can identify a turning point in a country's fortunes. The opportunities and the turning points will come to different sectors at different stages in the recovery process. For banks the turning point has already arrived. Partly because of their internal financial disciplines, banks value PRI more than other industries. Recent reforms have opened up new opportunities to foreign banks, and MIGA's BiH portfolio reflects this.

Banks are important both as investors in their own right but also because they facilitate the development of other businesses—including SMEs—by providing loans. They are among the 'building blocks' that would-be investors require. It therefore makes sense for policy as well as practical commercial reasons for MIGA to focus on financial institutions at an early stage in the post-conflict recovery process.

In FY03 infrastructure projects formed the largest single component of MIGA's global portfolio. There are no such projects in BiH, mainly because privatizations have been delayed, and the country has yet to create the conditions for them. If international private sector companies become involved in BiH at a later stage, they will certainly be appropriate candidates for PRI. MIGA's Breach of Contract cover can include regulatory risk and coverage against the non-payment by host governments according to contractual obligations (including at the sub-sovereign level). This will be a useful means of assisting FDI flows in BiH's infrastructure and other strategic sectors where the government's regulatory role will remain important.

The IDC project in BiH is an example of new private-sector involvement in a sector—in this case health—that was previously dominated by the state, and may be vulnerable to future policy reversals. In this respect the project may be part of a wider pattern of companies requiring PRI.

Perhaps surprisingly, there has been less demand for PRI among manufacturing companies, and this appears to reflect their own perceptions that they face fewer political risks. Alternatively, they may believe they can manage risks in other ways, for example through personal contacts with people of influence.

## **Regional Sources of Investment and SMEs**

BiH has benefited from a substantial investment by the Kuwait Investment Agency, but this appears to be exceptional rather than part of a pattern. Coca Cola and Volkswagen have factories near Sarajevo, but both operations are small by these companies' international standards. In practice, the main sources of FDI have been small companies from neighboring or regional countries. Many of the decision-makers in these companies have personal connections with the BiH, often dating back to the period before the break-up of Yugoslavia.

As discussed, local knowledge and contacts give these regionally-based companies a degree of comfort. They have a comparative advantage precisely because the major internationals are less interested—or more nervous—about Bosnia. Similar patterns may well apply in other post-conflict regions. If policy-makers wish to promote FDI in post-conflict zones, they should look to small regional companies as well as large multinationals.

This conclusion reinforces the arguments in favor of three current aspects of MIGA policy. MIGA is trying to expand its client base among SMEs; it is seeking to promote cross-border investment between developing countries; and it is working to expand the capacity of smaller public insurance providers—

such as the Slovene Export Corporation (SEC)—by providing them with reinsurance facilities. Regional ECAs such as the SEC will have far easier access to SMEs in their own territories than MIGA will.

### **Information and Investment Promotion**

The theme of information came up at several points in the BiH study.

- First, there was a general comment that MIGA itself was not as well-known as it might be. In that respect, the posting of a full-time MIGA representative in BiH was welcome, but her contract has come to an end and she has not been replaced. The BiH Foreign Investment Promotion Agency (FIPA) mentions MIGA in its own publications, and displays MIGA fliers in its office. However, it claims that it is under-resourced at a time when the BiH government is itself under pressure to reduce expenditures.

MIGA will need to look for other means of making itself known locally. One possibility is that it could find new ways of working with the IGA, which has excellent contacts with both foreign and domestic companies operating in BiH.

- The second broader question concerns what one interviewee—an expatriate working for a BiH government institution—referred to as an ‘asymmetry of information’. He argued that potential investors were not as well-informed as they should be on the actual level of risks in BiH. In many cases, they were put off by the country’s past reputation rather than by present realities.

One partial solution has now been implemented: BiH has applied to Moody’s, the independent rating agency, and in late March 2004 was assigned a sovereign risk rating for foreign currency debt of B3. Sovereign ratings assess credit risk of the national government, reviewing its capacity and willingness to repay debt. The rating process involves a review of a variety of factors including political risk, fiscal flexibility, debt burden, monetary stability and external liquidity. Although sovereign ratings assess the credit risk of the government rather than private business, they nonetheless give a credible indication of the wider investment environment, and provide a basis for comparison. (Other countries with B3 ratings include Bolivia and Uruguay; Croatia is rated more favorably at Baa3.) The Moody’s rating therefore gives a helpful measure of BiH’s current status—the economic environment is difficult but not impossible, and there is a good prospect of further improvement.

More broadly, MIGA provides technical assistance to governments on investment promotion. BiH—as well as other post-conflict countries—should be among the potential candidates.

### **The Role of the European Union Investment Guarantee Fund**

MIGA sources confirm that the EU fund enabled it to begin operations in BiH earlier than it otherwise would have done. This assessment reflects the agency’s measured approach to the management of its own risk: MIGA helps private sector clients negotiate turning points in countries’ fortunes, but first it needs to get over a turning point of its own.

The fund was a success in that it helped leverage investment worth more than six times the value of the capital provided by the EU. Perhaps the main lesson is that it is a positive example of MIGA collaboration with another agency. Such collaborations—whether in the form of special funds or reinsurance arrangements—give MIGA the capability to take on larger and higher risks, and this is especially important in post-conflict regions.

## **MIGA and the Role of Public Sector Insurers**

During the 1992-95 Bosnian war one Western school of thought argued that Balkan conflicts were of marginal interest: the various conflicting parties should simply be allowed to fight it out. More recently—and particularly since the events of September 2001—there has been a clearer understanding that it is in no one's interests for states to fail. Weak or collapsed regimes can have an impact on security far beyond their borders. There is therefore a clear international public interest in preventing conflict, or in helping war-torn companies to recover.

Cross-border investment has a part to play in promoting this recovery. However, companies invest primarily for commercial reasons, and not out of a sense of developmental altruism. If potential investments carry significant risks, they need to find ways of managing them. PRI is not in itself the complete answer to these risks, but it can be part of the answer.

In the course of the 1990s, private sector insurers came to play an increasingly important role both in trade-related PRI and in investment PRI. However, even at the end of what had turned out to be an expansionist decade for the private sector, there was a general acknowledgement that public sector insurers still had an important role in long-term investment insurance in difficult countries. This is the area that is MIGA's forte. Events in the last four years have reinforced rather than weakened this argument. Post-conflict regions need public sector PRI interventions more than anyone.

## **Annex 1: List of People Interviewed**

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### **MIGA**

Luis Dodero, Vice-president and General Counsel.  
 Angela M. Gentile, Senior Communications Officer.  
 Henning Haugerudbraaten, Operations Analyst.  
 Olimpia Gjino, Special Projects Officer.  
 Monique Koning, Senior Underwriter.  
 Maiko Miyake, Policy and Environment Department  
 Amédée Prouvost, Director and Chief Financial Officer  
 Mark Roex, Senior Syndications Officer.  
 Olga Sclovscaia, Finance, Agribusiness, Manufacturing and Services.  
 Emily Talmon L'Armée, Special Projects - Afghanistan, formerly MIGA representative in BiH.  
 Thomas A. Vis, Senior Risk Management Officer.  
 Gerald T. West, Director, Policy and Environment Department

### **Private Sector**

American Chamber of Commerce. Drenita Becic, Executive Director, Sarajevo.  
 Coca Cola. Fuad Strik, Country General Manager, Hadzici.  
 Euromedic. Tanya Grbic and colleagues, Banja Luka..  
 HVB Bank. Franz Friedl, Senior General Manager, Sarejevo.  
 Hypo Alpe-Adria-Bank. Dracen Mršic, Head of Legal Department, Mostar.  
 OMV Istrabenz. Haris Kuskunovic. Executive Director, Sarajevo  
 Raiffeisen Bank. Azra Vladavič, Head of Correspondent Banking, Sarajevo  
 Rogner Hotels. Klaus Ressman, Vienna (by phone).  
 Roumel Development Corporation. Goran Kapitanovic, General Manager, Mostar.  
 Teraoka Seiko Co. Hiroyuki Nakazato, Manager, Global Business Development, Tokyo.  
 Volksbank. Reinhold Kolland, Director; Belma Sekavic, Management Assistant, Sarajevo.  
 Volkswagen. Mr. Hotte (by phone), Sarajevo.

### **Government And Intergovernmental Agencies**

Austrian Embassy. Dr Michael Scherz, Commercial Counsellor.  
 British Embassy. Tim Hanson, Director of Commercial and Economic Affairs.  
 British Embassy, Banja Luka branch. Fiona McIlwham.  
 Central Bank of Bosnia and Herzegovina. Marko Skreb, Advisor to the Governor.  
 Customs and Fiscal Assistance Office to Bosnia and Herzegovina (CAFAO). Alan Leon Jenson. Head of Office.  
 EC Delegation, Sarajevo. Mark Priestley, Sarajevo (by phone).  
 European Bank for Reconstruction and Development, Sarajevo. Serban Ghinescu, Head of Office.  
 European Bank for Reconstruction and Development, London. Robert Harada, Director, Credit Transaction Analysis; Tanya Normak, Country Risk Credit Manager; Tero Halmari, Senior Syndications Manager.  
 Foreign Investment Promotion Agency of Bosnia and Herzegovina. Marko Tutnjevi , Project Manager, Sarajevo.  
 Investment Guarantee Agency. Lamija Kozaric-Rahman, General Manager.  
 NATO/SFOR. Georg Guntelberg. Political Analyst.  
 Office of the High Representative, Sarajevo. Garold N. Larson, Deputy Head, Economic Department.

Office of the High Representative, Mostar. Jasna Sivric, Assistant Economic Officer; Jasmina Repak, Assistant Economic Officer; Adela Kulukija, Political Assistant.  
 Office of the High Representative, Banja Luka. Mladen Loncar, Economic Section.  
 OSCE. Dale Ellen Ralph. Special Auditor for the Federation of Bosnia and Herzegovina and Republika Srpska.  
 Southeast Europe Enterprise Development (SEED). Alexander Paine, Senior Advisor, Investment Services.  
 US Agency for International Development. John H. Seong, Director, Economic Restructuring Office.  
 US Embassy, Sarajevo. William Cammett, Economic Department (by phone).  
 US Embassy, Mostar office. Jesenka Falak, Economic/Political Assistant; Zrinka Pehar, Protocol Assistant POL/ECON.  
 World Bank. Joseph Ingram, Resident Representative, Bosnia -Herzegovina, Sarajevo.

## **NGOs**

American Bar Association/Central and Eastern European Law Initiative. Patrick J. Wujcik. Director, BiH, Sarajevo.  
 Transparency International - Bosnia and Herzegovina. Boris Divjak. President, Banja Luka.

## **Political Risk Insurance And Finance—The Wider Picture**

Aon Political Risk. Martin Stone, Director, London.  
 Asian Development Bank. Daniel Wagner, Political Risk Guarantee Specialist (by phone), Manila.  
 Berry, Palmer & Lyle. Charles Berry, Chairman, London.  
 Catlin Underwriting Agencies Limited. Jo Everitt, Class Underwriter, Political Risks (by phone). London.  
 Export Development Canada (EDC). Steven Kerbel (by phone), Ottawa.  
 Goldman Sachs International. Kevin J. Ford, Executive Director and Senior Counsel, (by phone) London.  
 Hiscox. Andrew Underwood, Political Risks Underwriter, (by phone) London.  
 International Finance Corporation (IFC). James J. Emery. Principal Strategy Officer.  
 JLT Risk Solutions. Nicholas Robson, Partner, London.  
 Oesterreichische Kontrollbank Aktiengesellschaft (OeKB). Karolina Offterdinger, Head of Underwriting Division; Erwin Marchart, Senior Manager, Underwriting Division, Vienna.  
 Overseas Private Investment Corporation (OPIC). John Moran, US Embassy, Zagreb, Croatia (by phone).  
 World Bank. Lloyd Edgecombe, Guarantees Specialist.

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