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Political risk insurance and its effectiveness in supporting private sector investment in fragile states

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About the commission

The LSE-Oxford Commission on State Fragility, Growth and Development was launched in March 2017 to guide policy to address state fragility.

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Executive Summary

Fragile states are unable to attract the private sector investment which is needed for economic development in large part because of high levels of political risk faced by investors. This paper investigates the role political risk insurance (PRI) plays in mitigating political risk and encouraging investment in fragile states. It analyses the private and public market for PRI in fragile states and makes recommendations for how it could be strengthened.

The paper finds that PRI plays a limited and yet important role in enabling viable investments to proceed in fragile states. Currently, provision and purchase of PRI in fragile states is low because it is too costly to purchase on the private market, investors are unfamiliar with it as a tool, or they do not view it as the right instrument to mitigate political risk. Multilateral institutions play a critical role in providing PRI in fragile states where the private market is not able to.

Several recommendations are made for increasing provision of PRI in fragile states, including: increased role of multilateral institutions, development finance institutions and export credit agencies; greater collaboration between public and private providers of PRI through co-insurance and re-insurance; and extending the PRI market to provide insurance to local investors. These policies should be pursued in parallel to host country reform to create a more conducive environment for doing business.

Methodology

The report's findings are based on a review of available literature on PRI and fragile states, and on interviews with the organisations listed below. The views represented in this paper are the author's alone and not of those interviewed.

- Africa Trade Insurance (ATI)
- Berne Union
- GuarantCo
- Liberty Speciality Markets
- Lion's Head
- Marsh Insurance Broker
- Milken Institute
- Organisation for Economic Cooperation and Development (OECD)
- Private Infrastructure Development Group (PIDG)
- Sovereign Risk Insurance
- UK Department for International Development (DFID)
- UK Export Finance
- US Overseas Private Investment Corporation (OPIC)
- World Bank International Development Association (IDA)
- World Bank International Finance Corporation (IFC)
- World Bank Multilateral Investment Guarantee Agency (MIGA)

The paper is structured as follows: the Background section outlines the challenge of securing investment in fragile states due to political risk; the Analysis section analyses the market for PRI in fragile states, and identifies supply and demand reasons for why provision and take-up of PRI in fragile states is low. Due to the limitations of the private market, it discusses the role of the public market in extending PRI to fragile states. The Options section makes recommendations for how provision of PRI in fragile states can be strengthened to support increased private sector activity. The findings of this report are relevant to policymakers, investors, and insurers in the PRI industry.

Background

Fragile and conflict-affected states

Defining the term 'fragile state' is challenging. International organisations use different methodologies to categorise states as fragile and their criteria for inclusion on lists of fragile states often varies.[1] For the purpose of this paper, I follow the approach of the LSE-Oxford Commission on State Fragility, Growth and Development which has identified five broad dimensions of fragility: state legitimacy, state effectiveness, private sector development, security and conflict, and resilience. I will proceed with the assumption that a fragile state has difficulty on at least one of these five dimensions. As discussed below, the extent of fragility in a state is an important factor in determining the availability of political risk insurance.

Issue: Challenge of securing private investment in fragile states

By 2050, almost half of the world's population living in poverty will be found in fragile and conflict-affected states (OECD 2013). Critical to the development of these states and their path out of fragility is a strong private sector which can create economic growth through investment in key industries such as infrastructure, manufacturing, and extractives. Yet fragile states struggle to attract the private sector investment they need in large part because of high levels of political risk which deter foreign investors from investing in these environments.

Currently, foreign direct investment (FDI) makes up a small proportion of flows to fragile states. Official development assistance (ODA) is the largest source of external financing to fragile states, followed by remittances, and then FDI (OECD 2013). While the World Bank estimated that between 2005–2010 fragile states absorbed 5-8% of FDI into developing countries, which was commensurate with their economic weight of 6-7% of developing countries' GDP, this finance was concentrated in a handful of resource-rich economies

1 Widely utilised lists include the World Bank Harmonized list of Fragile Situations and the Fund for Peace Fragile States Index. According to the World Bank there are 35 fragile states in 2017 out of more than 140 developing countries, including: Afghanistan, Burundi, Cameroon, CAR, Chad, Comoros, DRC, Eritrea, Guinea-Bissau, Haiti, Kiribati, Liberia, Myanmar, Niger, Nigeria, Sierra Leone, Solomon Islands, Somalia, Sudan, South Sudan, Timor-Leste, Togo, Yemen, Zimbabwe.

(MIGA 2011). In 2012, the majority of FDI to fragile states went to just six countries—Nigeria, Iraq, Democratic Republic of the Congo, Egypt, Congo, and Sudan—for use primarily in the extractives sector (OECD 2015). Fragile economies suffer from an absence of private debt flows, as they have limited access to private debt markets. Portfolio equity flows, an alternative source of foreign capital, are also extremely limited because of underdeveloped financial sectors and equity markets (MIGA 2010). Despite average rates of return on investment into fragile states being high, fragile states can't attract sufficient private sector investment which is needed for development and progress towards the Sustainable Development Goals.[2]

Political risk insurance

A critical reason for lack of private investment in fragile states is high levels of political risk. Investors cite political risk as the single most important constraint for investing in developing countries over the medium-term, followed by macroeconomic instability (MIGA 2011). Political risk, as distinct from commercial risk, is the risk of disruption to company operations by political forces or events. It covers a range of issues such as political violence and war, government expropriation of assets, breach of contract, wrongful calling of credit letters, arbitration award defaults, foreign currency inconvertibility, and inability to repatriate funds (Ginsberg 2013). Of these political risks, the World Bank Multilateral Investment Guarantee Agency (MIGA) and Economist Intelligence Unit (EIU) 2013 Political Risk Survey found that foreign companies listed adverse regulatory changes and breach of contract as the greatest impediment to doing business in developing economies (MIGA 2013). An example of a regulatory change could include the Tanzanian government's decision in March 2017 to ban foreign exports of gold and copper ore.[3]

The key tool for mitigating political risk is the purchase of political risk insurance (PRI). PRI is available privately through private insurance companies, or publically through multilateral institutions such as MIGA and bilateral institutions such as government export credit agencies. PRI provides protection against the risk that actions of foreign governments or political groups will negatively impact what were otherwise sound commercial investments. It is designed to meet the needs of equity investors and banks making loans to commercial entities in foreign markets and is frequently used in the extractives, manufacturing, construction, retail, and services sectors. PRI typically provides coverage for the various kinds of political risks, like nationalisation and expropriation of assets, restriction on remittances, political violence and war damages, currency inconvertibility, and breach of contract.

2 MIGA calculated that between 2006 -11 average rate of return on FDI into fragile and conflict affected states was 14.5% compared to 9.7% for all low-income countries (Barbour 2014).

3 https://www.ft.com/content/5edcae58-002a-11e7-96f8-3700c5664d30

Analysis of the market for political risk insurance in fragile states

Global demand for PRI has continued to grow since the financial crisis. In 2016, Berne Union members issued $112 billion in investment insurance, which was a 20% increase over the previous year (Berne Union 2016).[4] Of this new growth, 17% was in South East Asia, 15% in former Soviet Union states, 12% in Sub-Saharan Africa, and 12% in Latin America. However, this global trend does not correlate with fragile states, where both availability and purchase of PRI remains low. Currently PRI covers only 10% of emerging market investment. When MIGA surveyed 60 executives of multinational companies (MNCs) investing in fragile states, only 13% reported seeking PRI and fewer still ended up contracting it (MIGA 2011). MNCs are not extensively using PRI in their political risk management strategies despite identifying political risk as the key challenge in fragile states.

The investors who purchase PRI tend to be large institutional investors based in the Global North, with projects in multiple countries. While investors from the Global South are equally affected by political risk, they tend to purchase PRI less frequently and carry less weight in negotiating the terms of a PRI agreement (MIGA 2011; Klasen 2016). Similarly, debt-holders, such as banks, purchase PRI due to regulatory requirements, whereas equity investors and those investing in primary sectors (e.g., agriculture and forestry) often have a higher risk tolerance and purchase PRI less frequently. Banks seek insurance against governments failing to honour contracts for political reasons, whereas smaller and more local investors are less accustomed to purchasing PRI.

The following analysis explains why the market for PRI is failing to provide sufficient PRI for investors in fragile states and why PRI remains a niche product

4 Berne Union is a trade association representing global export credit and investment insurers. It provides the most authoritative figures on PRI across the industry. Although investment insurance includes sovereign non-payment statistics and cross-border trade as well as PRI, these statistics are the most comprehensive on PRI issuance.

in these environments.

Supply side: Limitations of private PRI markets in fragile states

One of the primary reasons for lack of purchase of PRI in fragile states is that it's either not available or prohibitively expensive on the private insurance market.

The private market for PRI is dominated by key providers such as Lloyd's of London and its 32 syndicates, Sovereign, Zurich, AIG, and Chubb. These providers are primarily based in three insurance centres – London, Bermuda, and New York. The range of political risks covered by private insurers is broadly the same as those covered by public insurers: currency inconvertibility and transfer restrictions; confiscation, expropriation, and nationalisation; political violence; and default on obligations such as loans and contracts. PRI capacity in the private market increased by just over 7% to $1.7 trillion between July 2012 and July 2013 (MIGA 2013). Yet, while the private market for PRI is growing, its provision in fragile states remains restricted. Insurance is heavily concentrated in a handful of resource-rich countries, mirroring FDI flows, which absorb over 60% of PRI coverage in fragile economies and has been underwritten by a small number of insurers (MIGA 2011).

There are several reasons why private provision of PRI in fragile states is both minimal and expensive.

- Risk in fragile states is by definition higher than in non-fragile states, and therefore more expensive to price.[5] Risk is logarithmic and rate is linear -- once a risk reaches a certain level, insurers can't charge a high enough premium.[6] The risk, for example, that a sovereign fragile state government will default on its obligations is high, and it is hard to design an incentive arrangement to stop this threat of default.
- Private insurers take a more cautious and conservative view of the market in fragile states than public providers due to a lack of data on defaults.
- It is harder to price risk in fragile states as there is an absence of a credible data pattern to follow. Political events are volatile, losses are unpredictable and it is difficult to build statistical models for actuarial estimates of future losses. There is a high likelihood of a single catastrophic event with cross-country impact that could wipe out years of profits. Insurers therefore need to hold large amounts of equity in anticipation of losses (Hamdani 2005).
- Pricing risk in fragile states requires insurers to have a detailed knowledge of the context of a country, and to carry out significant information gathering and due diligence to write non-standardised and bespoke contracts. Local country knowledge is costly to acquire and pushes up costs.

Private provision of PRI in fragile states is therefore limited and often priced exorbitantly for investors.

5 Although fragile states do not appear to have generated significantly more claims than non-fragile countries (see MIGA 2011:64).

6 See Stiglitz & Weiss (1981) on credit rationing.

Demand side: Lack of investor familiarity and purchase of PRI

The second set of reasons which explains the lack of purchase of PRI in fragile states is that investors are either not familiar with PRI as a tool or they don't view it as the right instrument to mitigate political risk.

The interviews conducted for this research indicate that there are viable commercial investments that currently do not proceed because some investors are unfamiliar with PRI as a tool to support investment. Even when investors are familiar with PRI, they may still not think it is the right tool to mitigate political risk in fragile states for the following reasons:

- Concern that a claim would not be paid by the insurance company due to the difficulty of drafting contracts in fragile states that foresee all possible contingencies. For example, investors and insurers may disagree over what constitutes lack of physical access to a construction site. For this reason, many investors now look to buy comprehensive insurance which is more extensive than named peril policies and covers commercial and political risk.
- Many investors who do anticipate political risk decide to forego PRI because they perceive the risk to be manageable, potential losses to be limited, or that investment can be easily relocated.
- If there is a breach of contract, investors often view contract renegotiation and concession agreements with stabilisation clauses as more effective than PRI.
- Some investors prefer non-contractual tools to mitigate political risk such as joint ventures with local companies, engagement with host government and in-house political risk analysis (MIGA 2011).

These reasons point to the fact that PRI is not a panacea to attract private investment into fragile states.

Moreover, for an investment to proceed, there are several preconditions that need to be met to make an investment commercially viable, such as access to finance, adequate supply of electricity, reasonable assurance on property rights, and banking facilities. Investors must be reassured on these issues before the availability of PRI becomes a relevant factor in determining whether to pursue an investment opportunity. PRI is a secondary tool that acts as a confidence booster to avoid catastrophic loss.

Public provision of PRI

Despite its limited scope, PRI does have a role to play in mitigating political risk and is one instrument that can ease constraints on private investment and enable an investment to proceed that otherwise would not have been viable.

Given the limitation of private provision of PRI, public providers, particularly multilateral institutions, have a key role to play in expanding the availability of PRI in fragile states. Public provision of PRI offers the following benefits:

- Multilateral providers can assume more risk than private providers because they are not driven by purely commercial concerns and can insure projects that would be deemed too risky for private insurers.

- Multilateral institutions can use their standing in the international community, and the support they have from shareholder governments to resolve disputes between the investor and the host government. Multilaterals have a deterrent effect, influencing host governments over the lifetime of a project to prevent claims from manifesting.[7]
- Public insurers offer longer tenure of coverage (e.g. 20 years) whereas private insurers tend to only offer up to five years. Private insurers perceive the risk of long tenure to be high because they are concerned with issues such as election cycle changes and inability to recalibrate risks (Iftinchi 2016).
- Public insurers offer lower and more constant premium levels, whereas private insurance premium levels can fluctuate widely based on the nature of the project.

The key multilateral providers of PRI include MIGA, African Trade Insurance, Islamic Corporation for Insurance of Investment and Export Credit, the Inter-Arab Investment Guarantee Corporation, the Asian and African Development Bank.[8]

MIGA

MIGA is the World Bank's guarantee arm and the largest multilateral provider of PRI. In addition to traditional PRI, in recent years MIGA has expanded its credit enhancement products to cover non-honouring of sovereign financial obligations and non-honouring of financial obligations of state-owned enterprises (MIGA 2017). MIGA emphasises its strong ability to resolve potential investment disputes, due to its status as a member of the World Bank Group. Its leverage over governments means that MIGA has a low claims ratio, which enables it to offer products at more affordable prices.

In recent years MIGA has worked to scale up its investment in fragile states (World Bank 2014). Its exposure in fragile and conflict-affected states was 10% in financial years 2007-2012. This support was highly concentrated in infrastructure, agribusiness, manufacturing, and services sectors, rather than financial sectors (World Bank 2014). Over the financial years 2015-2017 strategy period, MIGA's support of projects in fragile states totalled $0.7 billion out of $9.7 billion. In the first half of financial year 2017, 17% of the $2.5 billion of guarantees issued by MIGA supported investments in fragile situations (MIGA 2017).

As part of the IDA18 replenishment, the World Bank created a $2.5 billion Private Sector Window (PSW) to catalyse private sector investment in IDA-only countries, with a focus on fragile states. Half of these funds will be used in a MIGA Guarantee Facility (MGF) to provide shared first-loss on guarantees and risk participation akin to reinsurance. The MGF will aim to provide PRI in fragile states where commercial coverage is lacking and builds on a previous donor-funded MIGA facility called the Conflict-Affected and Fragile Economies Facility (CAFEF).

The disadvantage of large multilaterals such as MIGA is that they can be

7 Although this will have limited effect if a fragile state government doesn't respond to multilateral pressure or care about international reputation.

8 The development banks offer partial risk guarantee programmes.

bureaucratic and less investor-friendly. While private insurers can rapidly draw up tailor-made contracts, MIGA guarantees must meet various development and sustainability goals. Consequently, the application process for investors can be both lengthy and onerous.

African Trade Insurance Agency

An example of a smaller and arguably more flexible multilateral institution is the Africa Trade Insurance (ATI) Agency. Its mission is to attract investments and facilitate trade in Africa by removing political and credit risk. With a gross exposure of more than $2 billion, capital of $220 million and an income of $29 million, ATI offers PRI, commercial credit insurance, and non-honoring of sovereign and sub-sovereign obligations. ATI's current members are Benin, Burundi, Cote d'Ivoire, DRC, Ethiopia, Kenya, Madagascar, Malawi, Rwanda, Tanzania, Uganda, Zambia, and Zimbabwe, and its shareholders include the African Development Bank and UK Export Finance. ATI insures an average of 1% of their member countries' GDP per annum. ATI is able to offer flexible deals and work in partnership with local banks in its member countries. It has expertise in the energy sector and has, for example, supported the Africa Energy Guarantee Facility together with the European Investment Bank.

Export credit agencies

In addition to multilateral institutions, the other type of public PRI providers are Export Credit Agencies (ECAs) which offer PRI to corporations from their home country. ECAs provide government-backed loans, guarantees, and insurance to domestic corporations that are seeking to do business in developing countries and emerging markets. Like multilateral institutions, ECAs can use their diplomatic networks to resolve disputes with host governments and promote responsible business conduct . Unlike multilateral institutions, ECAs are commercially-focused as their primary aim is to promote their countries' exports rather than conduct development work. Each country's ECA is different. Some, for example, act as insurers of last resort, while others actively market their support. Most ECAs offer limited PRI in fragile states because of high country risk ratings and foreign policy considerations. The UK Export Finance agency (UKEF) for example is not currently active in most fragile states. UKEF has to price to risk and underwrite insurable risks, meaning they cannot take on substantially more risk than the private sector.

Currently multilateral institutions are best placed to provide PRI in fragile states because they don't have to be purely commercially driven and can assume more risk than ECAs and private insurers. However, even the ability of multilateral agencies to provide PRI diminishes in extremely fragile states such as Yemen, Central African Republic, and South Sudan. In the most fragile states, risk is too high for multilaterals and the ability of such institutions to leverage their international standing in resolving investor-state disputes is diminished. If fragile state governments are not concerned with their international reputation, they will be less likely to respond to pressure from multilaterals to resolve investor disputes. In less fragile states, the capacity of multilaterals to provide

PRI might still be limited if countries have over-indebted themselves (e.g., in the case of Zambia) and therefore the insurance market is saturated. The fragile states where PRI tends to be most widely used and most effective is where there is a functioning government of some kind, and PRI can provide protection against nationalist actions of that government. In fragile states where there is no regulatory response from government, it is difficult for multilaterals to provide cover.

West Bank and Gaza (WB&G) case study

- Private insurers shy away from underwriting investments in WB&G because they are unfamiliar with the market and view the risk of Gaza conflict and Israeli government interference as too high.
- Some private insurers provide political violence cover in West Bank but with short-term tenure and without expropriation or currency transfer cover.
- Multilaterals such as MIGA have attempted to provide PRI in WB&G. MIGA established the WB&G Investment Guarantee Trust Fund to specifically underwrite investments in Palestine, however it struggled to attract sufficient foreign investment demand. In 2008, MIGA amended the facility to make it available to local investors in WB&G. This proved more successful, and MIGA was able to support local Palestinian SMEs. This change required MIGA to have a business developer on the ground to explain PRI to local investors.
- While some initiatives focused on local lending and credit guarantees have been successful, the availability of PRI in WB&G remains limited.
- The Arab Export and Credit Agency and Islamic Development Bank offer some coverage, but both are risk averse, shying away from insuring projects in Gaza and investments against Israeli activities. OPIC offers PRI coverage but only to US investors.

Options

As this paper has set out above, the PRI market is composed of private and public (multilateral and ECAs) providers, with multilaterals playing a key role in offering PRI in fragile states. There remains a lack of supply and take-up of PRI in fragile states, despite the activity of multilaterals, thus hindering the ability of fragile states to attract the private investment they need.

The following options set out how this can be remedied. This paper recommends that policymakers in the international community pursue options A, B, C, and host country governments pursue option E as a complementary reform.

A. Increased role of multilaterals and ECAs to provide more PRI in fragile states, supported by funding from Development Finance Institutions

There is scope for multilateral institutions to assume more risk in fragile states and offer an increased supply of PRI. While the IDA18 Private Sector Window (PSW) represents an important step forward in doing this, more can be done. On the PSW specifically MIGA should:

- Ensure they robustly measure the additionality of the PSW against a counterfactual to track new investment in fragile states.
- Ensure they create sufficient demand for use of PSW funds by locating business developers on the ground in fragile states who explain PRI to investors.
- Introduce specialised Trust Funds like the West Bank and Gaza Trust Fund which ensures PRI is available in some of the hardest-to-reach fragile states.

ECAs should extend their coverage to fragile states by:

- Marketing their added value in offering longer tenure of loans than the private market. Focusing on being active in markets which are recovering from conflict.
- Offering cover where the private market is active but short of capacity and so requires reinsurance.
- Rebranding themselves to have more of a stated development impact like the Overseas Private Investment Corporation (OPIC) in the US whose

investments both support US companies and exhibit host country benefit.[9]

- UKEF should refresh their Overseas Investment Insurance to make it more affordable and accessible to investors.

The multilaterals and ECAs will require collateral in order to assume more risk in fragile states while also remaining financially sustainable. This could be provided by development finance institutions (DFIs) such as DFID and USAID. The benefit of aid agencies using their funds to support insurance is that it leverages more impact (e.g., $1 of insurance could leverage $10 of private sector investment). Some aid agencies such as DFID, USAID, and SIDA have already supported such projects, but substantially more funding could be assigned to this.[10]

B. Increased partnership between multilaterals/ECAs and private insurers

While multilaterals and ECAs have an important role to play in extending coverage of PRI in fragile states, there is also a risk of crowding out the private market and creating a situation where investors are overly reliant on multilaterals and DFIs for backstopping deals.[11] The role of public insurers should be to pioneer new markets, providing insurance only where the private market fails to offer it on reasonable terms.

An effective way to crowd in the private market is through coinsurance and reinsurance between private and public insurers. There is already some cooperation between the public and private insurance market, but significantly more business could be generated by the private market co-insuring with ECAs and multilaterals (MIGA 2013). Innovative deals should be supported where, for example, a private insurer provides six years of cover on a rolling basis for a 12-year power project, with reinsurance by a multilateral.

The involvement of a multilateral institution underwriting an investment elevates the standing of a project, gives private insurers the confidence to enter that market, and creates more insurance capacity in the country. Multilaterals and ECAs can be advocates for a project, publically disclosing that they have provided insurance, while private companies can keep their policies undisclosed, to avoid creating moral hazard and unnecessary claims.[12] Reinsurance and coinsurance are particularly important in the PRI market because risks in this market are cross-correlated.

Two interesting examples of collaboration between the private and public insurers include the Amandi power project in Ghana and ATI's Regional Support Liquidity Facility.

9 OPIC is active in fragile states, pays 15% premium on investments, and offers insurance cover on private equity funds and non-honouring of sovereign guarantees as well as standard cover to investors who are unable to find private PRI on acceptable terms.

10 DFID has previously supported MIGA through the CAFEF programme and recently launched the London Centre for Global Disaster Protection.

11 Concerns about multilateral institutions crowding out private insurers have been raised for example in relation to World Bank backed deals in Mongolia and Nigeria.

12 Private insurers will be concerned that if they disclose to host governments that they have insured a project, this will create moral hazard and host governments may be less inclined to resolve issues.

Amandi Power Project Ghana

- Once constructed, the Amandi power plant will produce more than 1,600 GW hours of electricity per year, addressing widespread power shortages in Ghana and increasing power access with 60 million new connections throughout Sub-Saharan Africa.
- OPIC played a pivotal role in the transaction, providing $150 million in PRI and $250 million in financing. The model involved a dual incentive mechanism where OPIC provided reinsurance and a private insurer took the upfront risk.

Regional Support Liquidity Facility

- Investors are often concerned about the liquidity risk of investing in infrastructure projects. They fear they will not be paid on time for power that is delivered and as a consequence won't be able to service their loans.
- ATI has invested in a liquidity buffer that can be called if the off-taker does not pay on time.
- This provides the bank with cash collateral and additional guarantees that it can continue to operate for at least six months in the event of off-taker default.
- With the support of the European Investment Bank, ATI will provide this collateral together with KfW and BMZ in countries such as Cote D'Ivoire, DRC, and Zimbabwe.

C. Extension of PRI to local and regional investors

PRI is frequently only available to foreign investors, as insurance companies have a requirement to insure cross-border investments. However, as demonstrated in the West Bank and Gaza case, often the appetite of foreign investors to invest in fragile states is limited. Instead, the first actors who are prepared to invest in fragile states tend to be small, local investors who know how to navigate the political context of their country. Currently it is hard for these local investors to access PRI. This is a significant gap in the market that should be addressed. There needs to be a greater focus on generating local expertise and capacity, instead of using multilateral funds to bypass the local market.

Multilaterals and private insurers should work to adapt their processes to suit SMEs and regional and local investors. A tailored PRI product needs to be developed which meets the specific requirements of local investors. It would not need to include currency conversion insurance, but cover more country-specific risks. This would be similar to the type of product organisations such as GuarantCo provide, enabling long-term infrastructure finance in local currency.

Extending PRI to local investors would not be without its complications. Issues that might arise include: how multilaterals vet local companies and identify credit-worthy investors; private insurers might be concerned about high concentration of risk in one country; and multilaterals would no longer be able to use their leverage in resolving disputes between foreign investors and host countries. These issues would need to be addressed. However, given the importance of supporting local investors that in turn crowds in foreign investment, this is a gap in the market that merits pursuing.

D. Increased linkage between Bilateral Investment Treaties and PRI

An area of research that has not yet been fully investigated is the link between Bilateral Investment Treaties (BITs) and PRI. While both these instruments are concerned with protecting investments in foreign economies and the presence of a BIT tends to bring down the cost of PRI, the issue of how they can better support one another has not been widely explored (Ginsburg 2013). Policymakers could look to strengthen the link between BITs and PRI.[13] The risk of this option is that BITs have been criticised for being overly stacked in favour of foreign investors. Further research would be needed first to understand if BITs help fragile states secure the investment they require.

E. Host country reform

PRI is only ever a second-best policy for attracting FDI. A first-best policy involves remedying political risk through host country investment policy reform and creating sound operating environments such that PRI would not need to be purchased in the first place. Therefore, parallel to the international community pursuing options A, B, and C, fragile state governments should seek to strengthen public institutions and improve conditions for doing business. Host governments must seek to develop credible commitment mechanisms to protect investments by enhancing accountability, transparency, and developing rules-based means of resolving investor disputes.

13 Fragile and conflict affected states had concluded 450 BITs protecting FDI as of June 2010 (MIGA 2010:33).

Conclusion

This paper has sought to demonstrate that PRI has a limited yet important role to play in securing private investment in fragile states. While fundamental reform of host countries' investment policy is required first and foremost, this will take time, and in the interim extending the availability of PRI will help fragile states attract the private investment they need. Currently there is a lack of provision and purchase of PRI in fragile states, due to both demand and supply reasons. This should be remedied by increasing the coverage of multilaterals and ECAs in fragile states, pursuing coinsurance and reinsurance between public and private insurers, and extending PRI to local investors.

This topic remains an important and under-researched issue. Further avenues for research include: investigation of how PRI usage differs between sectors; analysis of the benefits of comprehensive cover compared to PRI; research on whether PRI creates moral hazard, for example undermining impetus for host country reform or disincentive to resolve investor disputes; and study of the relationship between BITs and PRI.

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