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In this Issue:

A Three-Pronged Approach to Increased Private Sector Investment in Africa's Infrastructure

***Mark Belcher** and **Anne Marie Thurber** are co-directors of The Center for Innovation in Social Entrepreneurship (CISE), which provides development strategy and management support for government, business and civil society leaders. We invited them to draw on their extensive experience in economic development and risk management to suggest how some formidable barriers to greater and sustainable investment in African infrastructure might be overcome.*

Africa's infrastructure deficit is constraining the region's current and future economic growth. Annual spending required to satisfy the continent's rapidly growing demand for basic infrastructure—about $93 billion—far exceeds the ability of countries in the region to self-finance or borrow to meet these infrastructure needs. The only realistic way to narrow this gap is to attract private sector investment to this region on an unprecedented scale. Due to the distinctive risk characteristics of infrastructure investments (e.g., large fixed capital costs, technical complexity, political sensitivity, and long payback periods), attracting that level of private investment on a sustainable basis requires new ways of addressing regional investment risk in infrastructure. The challenge of attracting private sector investment in Africa's infrastructure is not new, but it is growing rapidly in scope, scale, and complexity. Host countries, infrastructure investors, and other stakeholders must urgently explore practical, near-term strategies for mitigating investment risk while laying the foundation for long-term, sustainable development of and investment in Africa's infrastructure.

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Trade Sanctions as Political Risk

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A company doing business internationally can be exposed to fall-out from governmental measures that are not aimed at the company, but at other entities or governments. The following is an overview of the nature and variety of such measures. Often the measures take the form of export controls, but the term "trade sanctions" will be used here, as the measures of concern can extend beyond cross-border movement of physical goods and reach electronic and other intangible transfers, as well as financial and contractual dealings. The term is used here to refer to governmental measures targeted toward foreign persons, governmental or private, excluding regulatory measures that affect domestic operations generally. Finally, the terms trade sanctions and trade controls are used to encompass measures taken by the government of the "source" of investment, trade or finance, and not just to measures by government of the "host" or recipient state.

Most U.S. trade controls are administered by the Department of Commerce's Bureau of Industry and Security (BIS), the Department of State's Directorate of Defense Trade Controls (DDTC) or the Treasury Department's Office of Foreign Assets Control (OFAC). Each group of controls is under its own body of regulations and statutory authority. Broadly speaking, BIS maintains lists of "dual-use" items and of countries and persons to whom such items are exported and imposes licensing requirements on such

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listed countries or persons; DDTC controls exportation, importation or manufacture of defense articles and defense services (so-called "munitions" items); and OFAC controls (and mostly bars) financial, trade or commercial dealings with countries and persons upon whom the U.S. has imposed sanctions.

Although it is the U.S. that is widely perceived as having the heavy hand in trade sanctions, investment planners and business operators must take into account the reality that many countries impose and enforce trade sanctions. Some are structured and ongoing, such as those under the Wassenaar Arrangement (WA) that subject exportation of items on agreed lists to review and control by the country from which the export is to be made (the WA website can provide a sense of the scope of the lists). The large group of industrialized nations that participate in the WA includes Russia, but not China. Other multilateral regimes with published control lists deal with nuclear, chemical/biological and missile-related goods and technology. Less predictable are the episodic trade restrictions imposed in response to problematic developments. They may be based upon U.N. Security Council action or upon the decisions of individual states. While these episodic trade sanctions are often of limited duration, they command risk-planning attention, as they can have an impact on conventional flows of trade and finance, not just on highly controlled goods and technology.

The Impact of Trade Sanctions

Suppose that a European company supplies an equipment manufacturing facility in Iran. If, for example, the equipment is found to serve nuclear fuel cycle activity, fairly recent European Union sanctions could affect further technical or financial inputs. Even if the operation were not in a restricted sector, U.S.-sourced inputs could be affected. Under OFAC regulations, a U.S.-national employee in Europe could not facilitate dealings in or with Iran. The European company itself would be subject to BIS and/or OFAC controls if it needed to procure U.S.-sourced inputs for the Iranian project.

It is unlikely, but not out of the question, that a host government would impose trade sanctions that would severely damage an enterprise within its borders. While a particular market or source of energy or raw material might be cut off, alternatives usually exist and should be considered as part of risk evaluation. Nonetheless, there can be extraordinary cases, such as those that faced NBC under its contract to broadcast the 1980 Olympic Games in Moscow after the U.S. withdrew from the games and imposed trade sanctions—a situation in which political risk insurance did play a part.

The type of trade sanction that is more likely to affect the viability or profitability of a foreign business is one imposed not by the host government, but by a government that controls access to a needed market or to needed material or financial inputs for the foreign operation. Controls on financial transactions by persons subject to a sanctioning government's jurisdiction should be seen as a potent aspect of trade sanctions, as illustrated by the impact on operations in Iran of European and American restrictions on bank clearings involved in Iranian trade, which has doubtless been immense.

The Significance of "People" and "Persons"

An aspect of trade sanctions that is easy to overlook is the way in which they can affect the actions of "people" or "persons" in connection with transnational operations.

First, how might trade sanctions affect the role of "people"—that is, of natural persons? Both the Export Administration Regulations (EAR) of Commerce's BIS and the Arms Export Control Regulations (AECA) of State's DDTC define exportation to include the release of technical data to a "foreign national" (EAR) or "foreign person" (AECA) anywhere, including within the U.S. Such an exportation is deemed to be an exportation to the recipient's country of nationality, so if a direct exportation to that country would require a license, so too might the release of technical data (tangible or intangible) to that individual. Many releases will be permitted by license or by regulatory exception, but the existence of such controls can give rise to uncertainty or administrative burdens, making the nationality of key persons in an operation a factor in business risk assessment.

The definition of "person" in U.S. trade sanctions can have a significant effect on risk exposure in international business. Although most export controls under the EAR apply on the basis of the U.S. source of goods or data, not the nationality of the supplier, a different jurisdictional basis applies to others. Some, such as catch-all controls against WMD proliferation, apply to the actions of a "U.S. person," even if U.S. sourced items are not involved. The term is defined in the EAR to include juridical persons organized in the U.S. and their foreign branches, but not entities organized abroad that are owned or controlled by U.S. persons. The definition in the OFAC regulations is much the same, except that those for Cuba define "person subject to the jurisdiction of the United States" to include foreign-organized entities owned or controlled by U.S. persons. Keep in mind that, even if the U.S. is neither the market for nor the locus of inputs into a foreign operation, the possible extended reach of U.S. trade sanctions to third-country activity should be considered.

Managing the Sanctions Risk

Businesses will want to assess these trade sanctions risks—and the many varieties of such risk—both in the transaction planning stage and as the political climate changes during the life of the transnational exposure. The amount of detail in this article is necessarily limited, but readers are encouraged to get more detail on trade sanctions from published works and business planners are encour-

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aged to consult with trade sanctions experts as needed in order to identify, evaluate, mitigate, allocate and compensate for the unusual, but not uncommon risks that trade sanctions can pose.

This risk assessment will likely view some conventional trade controls, such as those on strategically sensitive items, as part of the business environment that can be managed by knowing and following the rules. Even in this context, care should be taken to identify special and potentially problematic factors, such as major dependency on inputs from or sales to countries that historically have been the targets of trade restrictions.

Historically, governments have avoided or greatly limited the imposition of sanctions on trade in agricultural products or medicines. The Reagan Administration embargo on grain shipments to the Soviet Union was a notable (and rather short-lived) exception. A recent, less publicized, exception is Russia's ban on importation of poultry from the U.S. Interestingly, a report published by the *Washington Post* in September 2014 indicates that the impact on U.S. suppliers has been greatly reduced due their development of other markets in the wake of a variety of Russian poultry import restrictions in recent years.

The greater challenge is to determine how to deal with the risk of major trade sanctions that could result from extraordinary and/or less predictable events. In this area, the investment planner and negotiator will need to consider the possible utility (or inadequacy) of *force majeure* clauses in critical transaction agreements. Who will bear the risk if a key source of raw material is embargoed? Will the supplier have to use an alternative, more costly source, or will the customer be forced to try to adapt and use another supplier?

The *force majeure* clause deserves special scrutiny in the context of trade sanctions risk. Such clauses can differ in the extent to which governmental action can be considered a *force majeure* event. Moreover, it can be important to determine whether a clause covers only actions of the territorial government or whether it would also encompass external governmental measures that cut off inputs, financial support or markets.

To this point, these comments have dealt primarily with what might help prior to commitment in identifying and dealing with potential trade sanctions risks. What can be done to avoid or minimize loss from trade sanctions that have been or are about to be imposed?

One possible answer, but only in special situations, is to lobby. A government that is imposing sanctions in response to breaking events may be acting quickly, but it will want to avoid measures that may injure its own business interests more than they affect the target country. Potentially-affected businesses may need to act just as quickly to make their government officials aware of such unintended consequences. We have observed a considerable amount of such "fine-tuning" of sanctions measures in Europe this year in connection with Ukraine-related measures. Another example is the persistent (and mostly successful) effort by U.S. industry to reverse the trade-restricting effect of transfer of control of commercial space exports from the Commerce Department to the State Department.

A caution is in order with respect to another type of possible action in response to trade sanctions. As measures taken by the U.S. can be particularly troublesome, a company may think that it can avoid the impact if it "de-Americanizes" its operations: Perhaps, some companies wonder, contracts could be shifted to foreign subsidiaries. Beware! Such contract actions by or directed by the U.S. company could constitute prohibited "facilitation" of OFAC-sanctioned trade. An attempt to replace direct exportation of products or materials from the U.S. to the sanctioned country by routing the items through a "supplier" in a third country could be treated as a prohibited re-export under the EAR. Even operations that do not involve U.S. sourcing could be affected by the type of involvement that an individual U.S. person abroad has with a foreign supplier's dealings with a target of U.S. trade sanctions.

As measures taken by the U.S. can be particularly troublesome, a company may think that it can avoid the impact if it "de-Americanizes" its operations...Beware!

I do not see a major role for political risk insurance in connection with trade sanctions. A broad statement like that begs explanation or qualification. It may be better to say that I have largely avoided the question in this piece. My role as legal counsel to the Overseas Private Investment Corporation in its early years gave me exposure to political risk insurance, and my later government position immersed me in the complex world of export controls, but I had best leave it to others to address what might currently be available or possible in the political risk insurance market. I shall limit myself to some very brief observations.

Government-backed insurance cannot be expected to cover loss resulting from that government's own actions. Loss-causing trade sanctions could well be actions taken by the government that operates the insurer. As for the private market, the factors that historically inhibited the provision by insurers of land-based war risk cover—the risk of catastrophic loss and the poor prospects for salvage—may similarly constrain the scope and terms of trade sanctions insurance from the private market. It may be interesting to consider, however, the extent to which export credit insurers have sought to limit their exposure to loss caused by trade sanctions.

Thus, I recommend that companies cope with the peculiar risks that trade sanctions can pose by using the risk management skills that applied to other aspects of transnational business, but I urge the addition of some trade controls expertise to the mix. ■

A Three-Pronged Approach to Increased Private Sector Investment in Africa's Infrastructure (*cont'd*)

Major impediments to reaching sustainability arise when changed circumstances cause one or more of the parties to reevaluate their willingness or ability to perform as agreed in the underlying agreements. Effective measures that promote the resilience of infrastructure investments when these situations occur will increase sustainability. In this article, we outline a three-pronged approach to enhance that resilience in infrastructure investments, thus contributing to ongoing efforts to assist African nations respond to increasingly urgent infrastructure needs. This includes:

- Better upfront information about host countries' investment environments to help reduce information asymmetries, promote transparency, and provide a common analytical framework for assessing infrastructure investment risk;
- A limited "business impairment" insurance product to help cushion investors from the immediate financial impact of altered, delayed, or suspended performance by the host country; and
- A solutions-oriented "workout" approach to help the parties explore pragmatic compromise positions before resorting to arbitration or litigation.

Three Trends are Creating an Upsurge in Demand for Infrastructure in Africa

Foreign direct investment (FDI) in Africa is growing rapidly in terms of both the number and value of investments. In 2013, for example, the region's share of global FDI reached an all-time high of $56.3 billion, representing 5.7% of the world total. A number of factors are contributing to a newfound sense of optimism about the promise of "African lion" economies:

Natural Resources: The discovery and exploitation of natural resources—particularly minerals and hydrocarbons—contributes up to a third of Africa's economic growth. While natural resource exploitation in Africa is not new, recent discoveries in East Africa are changing perceptions about the region and its potential as an investment destination. Efficient exploitation of these reserves will necessitate new roads, rail, power and other industrial infrastructure. Mega-projects like the $25 billion Lamu Port-South Sudan-Ethiopia Transit Corridor (LAPSSET) have the potential to reshape regional economies while creating new incentive for cross-border cooperation and coordination. Resource financed infrastructure (RFI) financing has helped fuel an infrastructure construction boom in resource-rich African nations.

Rapid Urbanization and Rising Consumption: A growing middle class is one of the most powerful forces driving economic growth in Africa today. As the populations of Africa's major urban centers such as Abidjan, Addis Ababa, Dar es Salaam, Kinshasa, Luanda, Nairobi continue to grow, an emerging middle class is demanding a wider range of consumer goods and services while placing increasing demands on local and national governments to provide improved public services (e.g., health, education, transportation, public safety). The dynamism of these emerging megacities underscores the magnitude of the challenges that lie ahead for urban planners, managers, and infrastructure service providers. Undersupply of public services is creating opportunity for entrepreneurs, forcing a shift toward increased private sector participation in public service delivery, including basic infrastructure.

Investment Returns: Low growth rates and the central bank policies of more developed economies have spurred investors to pursue higher yields in African "frontier" markets. African stock exchange returns were nearly twice that of the S&P index in 2013 and sovereign debt issuances reached a record $11 billion, many of which were significantly over-subscribed. Countries such as Cote d'Ivoire, Kenya, Morocco, Senegal, and Zambia have had successful issuances with lengthy tenors (in some cases 10 years) at rates much lower than these countries' past performance might suggest (e.g., 6.05%). In response, the International Monetary Fund has recently cautioned African nations against the perils of over-borrowing, particularly in foreign denominated debt.

As these trends illustrate, investing in Africa's infrastructure offers significant opportunity as well as risk. What follows is a brief discussion of a three-pronged approach that will enhance the enabling environment for the private sector to broaden and deepen private sector investment in Africa's infrastructure, focusing on 1) better upfront information on opportunity and associated risk, 2) innovative insurance cover for business impairment, and 3) a solutions-oriented approach to managing investment disputes.

Better Information Contributes to Better Investment Decisions

There is a close statistical correlation between levels of private sector investment in infrastructure and the quality of local public institutions. Empirical research shows that locally prevailing conditions, including government stability and democratic accountability, likelihood of conflict, pervasiveness of official corruption, quality of rule of law, bureaucratic efficiency, and other factors, heavily influence infrastructure investment patterns. Since 2002, however, Sub-Saharan African nations have scored approximately half as well as middle-income countries in the World Bank's Worldwide Governance Indicators. Despite these lower scores, rapid growth that some African nations are experiencing has generated a surge of investor interest. But will it be possible to sustain this level of interest as more mature markets recover from the effects of the global financial crisis?

Addressing the structural barriers of weak rule of law, inefficient

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bureaucracies, and corruption requires a sustained commitment of resources and effort. For many years, bilateral and multilateral donor assistance programs have been working with African partners to build the capacity of governments to plan, implement, and manage public-private partnerships in infrastructure. More recently, some donors have shifted their focus to a more transaction-oriented approach. In the near-term, this approach generates results; however, if the quality of local public institutions remains low, the results achieved may not be sustainable for those projects or extend to newer opportunities.

The tension between achieving near-term results and strengthening the foundation for sustainable private sector participation in Africa's infrastructure is difficult to mitigate. One possible approach in the near-term is to focus on addressing the considerable information gap that exists concerning many African countries' investment environments. This lack of information impedes potential investors' ability to quickly and confidently assess host country investment environments, particularly from the standpoint of political and commercial risks.

Obtaining current, accurate, and complete information on key features of many African countries investment environments is often a time-consuming and costly process that may lead to uncertain results. At times, it is reminiscent of the parable of the blind monks and the elephant. For large investors pursuing large infrastructure projects, this often involves hiring a variety of international and local advisors to perform a lengthy due diligence inquiry. These costs are difficult for smaller investors to absorb, particularly in relation to smaller, non-traditional projects like solar photovoltaic systems. Under these conditions, some of the more risk-tolerant investors will go "whistling past the graveyard" while others will seek investment opportunities elsewhere. If the challenge is to increase private sector investment in African infrastructure, addressing this critical information gap is a practical, cost-effective first step.

"Blind Monks Examining an Elephant"
Hanabusa Itchō

Providing complete, accurate, and timely information about a host country's legal and regulatory environment for infrastructure investment requires three things:

- A common analytical framework to help ensure an "apples-to-apples" comparison across countries and over time;
- A mechanism for collecting and periodically refreshing relevant information to ensure that it remains accurate and complete; and
- Formal channels of communication that afford host countries and potential investors regular, structured input and feedback on specific steps to strengthen and improve investment environment.

Focusing the analysis on elements of the investment environment that are most important to investors helps ensure that host country policymakers are receiving clear signals from the investment community on specific ways that the investment environment can be strengthened. The goal is not to achieve "perfect" conditions, but instead to create the basis for sustained, constructive exchanges of information between the host country and the investment community necessary to facilitate and sustain public-private cooperation in infrastructure development.

There are a number of useful models to draw upon in developing this analytical framework and supporting implementation approach. One is the IMF's General Data Standards Initiative (DSI). DSI is a voluntary membership arrangement in which more than 70 participating nations have agreed to collect and report macroeconomic data using common standards and practices. In this case, host countries could join together to develop and promulgate a common self-assessment framework measuring individual country performance against performance measures that investors believe to be most important in terms of making investment decisions. Bilateral, regional, and multilateral development organizations can support the self-assessment process by contributing technical expertise and financial resources to support the design and operationalization of the self-assessment process. The international investment community, local businesses, civil society organizations, and other stakeholders can contribute to and enrich this effort by providing expertise, insight, and feedback throughout.

Another potentially useful model to draw upon is the World Bank's annual Doing Business report. It uses a standard set of measures to assess a country's progress toward a performance "frontier" in various areas of business regulation. While the Doing Business reports have been controversial, they have also helped create a dynamic tension that has helped countries like Burundi and Rwanda focus and prioritize efforts to address key constraints to increased private sector development.

The benefits of improved and consistent investment measure data collection and dissemination would be considerable. Having relevant information easily available to potential infrastructure investors

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will lower the initial costs of opportunity discovery and due diligence. With better, more complete information in hand, potential investors are more likely to make better, more accurate assessments of the reward/risk tradeoffs in a given country. Making this information publically available will also increase transparency by helping level the information playing field between large and small investors, and between the host country and potential investors. This will streamline negotiations, since the parties will have a common frame of reference for identifying and allocating political and commercial risks. Host countries will be better able to negotiate deals that maximize benefits for their citizens. Finally, creating a constructive feedback loop between the host country and the investment community will facilitate and sustain the increased public-private cooperation that is essential for private sector investment at the levels needed to close Africa's long-standing infrastructure deficit.

> Having relevant information easily available to potential infrastructure investors will lower the initial costs of opportunity discovery and due diligence. …[and] will also…level the information playing field between large and small investors, and between the host country and potential investors.

Providing a Cushion for the Financial Impact of Changed Circumstances During Periods of Business Impairment

For thirty years or more, host countries, infrastructure investors, and lenders have struggled with this "chicken-or-the-egg" challenge: How does one "engineer" infrastructure investment risk to acceptable levels in the absence of a predictable investment environment? Sovereign guarantees have been a popular response, but government finances cannot extend to all worthy projects. Experience has shown that even where recovery under such guarantees is possible, the process is costly and time consuming. Offshoring investment disputes through international arbitration has been another common risk mitigation strategy, but with similar practical limitations. Political risk insurance helps shift "obsolescing bargain" risk to third parties, but without addressing the underlying sources of the investment risk. Indeed, the past decades have witnessed an ongoing dance between investors and insurers over how to define the indistinct boundary between political and commercial risks that is inherent in infrastructure projects.

Infrastructure investments present unique challenges that arise in part from their technical complexity, political sensitivity, and long payback periods. Parties' ability to anticipate and provision against every possible future contingency is limited. During a 20 to 30 year lifespan of an infrastructure investment, circumstances will likely arise that may cause one or more parties to reassess their willingness or ability to perform under the original terms of the agreement. Experience over the past three decades has shown that when such situations arise, resorting to arbitration for breach of contract that results in catastrophic loss is costly and time consuming. In cases where the situation falls short of a catastrophic loss, investors are at a distinct disadvantage. Unable to move the investment assets elsewhere, the investor generally faces significant and lengthy periods of business impairment during this interim period. Business impairment arising from host government action or inaction can take many forms. Take, for example, a few challenges that a power plant project may encounter:

Completion certificate: A green field power plant has been operating at pre-completion levels. The project sponsor believes that the power plant has reached completion and has applied to the regulator for a completion certificate. The certificate will allow the plant to operate at full capacity. The regulator asserts that the plant does not meet agreed-upon specifications. Without the completion certificate, the plant cannot operate at full capacity. This reduces projected investment cash flow and results in delayed payments to the lenders.

Tariff adjustments: An investor purchases power-generating assets through a privatization and operates the assets without incident for several years. In accordance with the investment agreement, the operator subsequently applies to the regulator for an increase in tariffs as permitted by the regulatory regime that was in place at the time of the investment. The country is in the third year of an economic downturn. The regulator denies the application for a tariff increase and threatens to decrease the rate.

Multilateral agreements: A power plant is operating in full compliance with environmental standards that were in place at the time of the investment. The host country later accedes to a multilateral greenhouse gasses reduction regime. Consequently, the host country requires all power producers to meet newly adopted carbon emissions standards. The cost of complying with these standards was not anticipated under the existing tariff calculation methodology.

Tax rates: To attract investment into its power sector, a host country offers tax stabilization incentives as part of its investment agreement. The investor operates for many years without incident. During a severe economic downturn, the host country announces that it is abrogating all prior tax stabilization agreements and increases corporate taxes as part of its overall effort to reduce a large fiscal deficit.

Capacity charges: The host country experiences a multi-year drought. During this period, the host country added coal-fired generating capacity to the grid. A new power company sells its output to a state-owned distributor under a power purchase agreement that includes a capacity payment. Once drought conditions improve, the

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distributor balks at making capacity payments. Payments are late and, when received, much lower than the invoiced amount.

In each of the scenarios above, changed circumstances threaten the project's cash flow and consequently payments to project lenders and sponsors. It is not clear whether the parties can reach a mutually acceptable resolution; however, until a resolution is reached, the project is at risk. Under these circumstances, a cushion to lessen the impact of adverse host government action/inaction would prove extremely beneficial. The cushion offers infrastructure investors flexibility during limited periods of business impairment that arise from adverse host country action/inaction that fall short of catastrophic loss. This helps create much needed "space" to help the parties to seek an acceptable compromise. The general outlines of a host country action/inaction business impairment insurance product include:

- A minimum period of business impairment before coverage is triggered;
- A self-insurance percentage or deductible for business impairment losses arising directly from adverse host country actions;
- A defined indemnity period for business impairment losses;
- Loss limits on both the percentage of lost revenue and the total loss; and
- Subrogation to a portion of the project's future free cash flow as might be agreed during policy negotiation as well as any recovery available as a result of the host country action/inaction.

Unlike traditional political risk insurance, business impairment coverage would not require the insured to show a catastrophic loss arising from a violation of international general principles law. Rather, coverage would be based on demonstration that the host country action places stress on the ability of the project to meet its financial obligations. It would not require any finding of fault. This "no fault" approach assumes that all things being equal, the parties (and their respective stakeholders, including the underwriters) benefit by reaching a mutually acceptable compromise. Business impairment insurance offers the investor critically needed relief during a defined "pre-arbitration" period where the parties' focus will be on reevaluating the original agreement in light of the changed circumstances rather than on finding fault. In cases where the parties cannot reach an acceptable compromise, the catastrophic loss scenario under expropriation or arbitration award default coverage could still be an option available under the policy.

Under what circumstances would it be prudent to offer such coverage? Similar to other insurance products, it should only be offered for investments falling within clearly established underwriting guidelines. Insurers might also limit coverage initially to projects with participation by multilateral lenders such as the International Finance Corporation (IFC) or the European Union-Africa Infrastructure Trust Fund (EU-AITF). Insurers could consider limiting coverage to investments in countries that support international good governance efforts such as the Extractive Industries Transparency Initiative (EITI) or the Open Government Partnership (OGP). More than three decades of private sector investment in emerging market infrastructure give sufficient experience to draw upon to develop the necessary underwriting models. The appropriate terms and conditions for a particular project can be determined only once the insurer thoroughly understands 1) the project financial model and the stress points that might lead to a potential claim, and 2) the investor's risk tolerance as articulated in its enterprise risk management strategy.

Business impairment due to host country action/inaction insurance offers a number of benefits by:

- Reducing the overall risk of private sector investment in infrastructure, particularly in Africa's frontier markets, by enhancing the project's resilience where changed circumstances threaten the performance of an underlying investment agreement;
- Lessening the host country's short-term financial advantage over the investor when investment disputes arise;
- Providing a defined window of time during which the parties can explore opportunities to reach mutual accommodation;
- Enhancing the sustainability of private sector infrastructure investments by giving more flexibility to shift the focus away from faultfinding to solutions discovery; and
- Attracting the longer-term lending from the private capital markets as a result of the enhanced resilience of the project's financial model.

For the insurance market, this business impairment due to host country action/inaction insurance gives the opportunity to respond to a long-standing but unmet need in the risk management marketplace.

> [B]usiness impairment coverage...would be based on demonstration that the host country action places stress on the ability of the project to meet its financial obligations.

Moving from Faultfinding to Solutions Discovery

A common feature of the scenarios presented above is that changed circumstance caused the host country to reevaluate its willingness or ability to meet its obligations under the terms of the investment agreement. In the near-term, the "obsolescing bargain" gives the host country a distinct advantage over the investor.

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Providing a short-term cushion to the investor during defined periods of business impairment will help reduce this advantage while creating a "pre-arbitration" environment to explore opportunities for pragmatic compromise. Under these circumstances, a mediation-based approach to investment dispute resolution will deliver significant practical benefits:

- Substantial savings in terms of avoided litigation costs, senior management resources, financial interruption, and reputational damage;
- Development and simulation of alternative outcomes that can be explored by the parties in a non-attributional environment;
- Modeling of near- and long-term economic and other impacts resulting from a failed investment (e.g., job losses, reduced productivity, constrained growth, increased borrowing costs, damage to reputation);
- Ensuring that other stakeholder interests are weighed by the parties when evaluating tradeoffs associated with different outcomes;
- Offering perspective on the relative strengths and weaknesses of each party's position that could arise in later litigation; and
- Stipulated findings of fact concerning the circumstances giving rise to the dispute that can be used to streamline subsequent litigation, as necessary.

A mediation-oriented approach that emphasizes fact-finding and creative solutions development by highly experienced neutrals can deliver value far in excess of the cost of these services. An international organization—the World Trade Organization, United Nations Commission for International Trade Law (UNCITRAL), International Centre for the Settlement of Investment Disputes (ICSID), to name a few—could assume responsibility for establishing and maintaining a panel of appropriately qualified neutrals. The cost of neutral services could be shared equally by the parties, or paid for from a dedicated trust fund established for that purpose by the World Bank or other multilateral organization.

A mediation-oriented approach that emphasizes fact-finding and creative solutions development by highly experienced neutrals can deliver value far in excess of the cost of these services.

Conclusion

While there is no short path to accelerating and sustaining private sector investment in Africa's infrastructure, there are practical measures that, in addition to those already underway, will make important contributions to achieving this strategic goal. This three-pronged approach will enhance the resilience of the investment in infrastructure by creating a more sustainable environment to attract the private investment that is necessary to meet the promise of the African lion economies by: 1) reducing investment information asymmetries; 2) buffering financial losses occurring during periods of business impairment due to host country action/inaction; and 3) shifting the focus of dispute resolution from faultfinding toward solutions discovery. Individually, none of these proposals represents a "solution" to the challenge. Rather, collectively, they serve as an invitation to innovation and as a call to action for African leaders, for the infrastructure investment community, for the political risk insurance industry, and for multilateral and bilateral assistance programs that support infrastructure development in Africa and elsewhere. ■

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