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BOOK REVIEW

MULTILATERAL INVESTMENT GUARANTEE AGENCY AND FOREIGN INVESTMENT. By Ibrahim F. I. Shihata.† **Dordrecht, The Netherlands: Martinus Nijhoff, 1988, Pp. 540. \$152.00.**

*Reviewed By T. Modibo Ocran**

The establishment of the Multilateral Investment Guarantee Agency (MIGA) in Washington, D.C., in April 1988 makes the publication of this book very timely. Equally important, however, the book was written by one of the leading insiders in the evolution and drafting of the substantive agreements and regulations relating to the organization of MIGA. Since 1983 Dr. Ibrahim F. I. Shihata and the legal staff of the World Bank have worked feverishly on the establishment of this agency. This book, which is a product of that endeavor, is rich in detail and analysis; a remarkable achievement considering MIGA has just become operational.

The author traces the evolution of MIGA in the context of encouraging foreign investment in developing countries. He discusses the relative merits and demerits of various sources of international capital movement such as debt and equity and concludes that for most developing countries the risks associated with debt make it a less attractive alternative than equity investment. Commercial lending creates liabilities for the borrower country that are not necessarily related to the contribution of those loans to its debt-servicing capacity; whereas equity investment establishes a claim to repayment only to the extent that it yields returns. If equity investment is the more prudent way out of the dearth of capital in the developing countries, the creation of the appropriate investment climate logically becomes a critical issue. Unless the climate is right, the rate and

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types of investments needed by the developing countries are unachievable.

Dr. Shihata recognizes the importance of this topic and insightfully discusses the creation of the appropriate investment climate. He emphasizes that while the concept has many interrelated aspects, these components can be classified into three categories: institutional, including its policy aspects; infrastructural; and legal. All of these aspects have their national as well as international dimensions. National action alone, however, cannot create the appropriate investment climate; rather it must be buttressed and supplemented by appropriate international policies and institutions. At the core of the creation of this climate are institutions aimed at the protection and promotion of foreign investment.

Not only are positive programs needed to promote foreign investment from the developed to the developing countries and between the developing countries themselves, but institutions that regulate foreign investment in a manner that contributes to the development of the capital-importing countries are also necessary. Nevertheless, unless foreign investment is promoted and foreign investors decide to establish themselves in the developing countries, there will be nothing to regulate. A question of priorities is raised here. The original emphasis on the *regulation* of foreign investment is shifting to the *promotion* of foreign investment because the latter functions as a condition precedent to the exercise of the former. The organization of MIGA is one effort to create the appropriate international investment climate.

MIGA's basic concept is the creation of investment guarantee schemes in which foreign investors purchase insurance against non-business or noncommercial risks. Insurance is purchased against risks associated with the political environment and the economy as a whole as distinct from traditional business risks. Generally, foreign investors are most vulnerable to noncommercial risks and need special protection in that area. Parties exposed to business risks usually have ample time to determine the risks involved and procure insurance against those risks through the insurance industry.

Insurance or guarantee schemes should be analyzed against the backdrop of related arrangements, such as bilateral and multilateral investment protection treaties which contain the substantive reciprocal assurances between contracting states as to the treatment of foreign investments within their borders. Also relevant are the national constitutions and foreign investment codes of the capital-importing countries. The existence of these substantive norms on treatment, however, does not in itself satisfy the concerns of investors. Despite these arrangements, certain host countries have exercised adverse measures against foreign investors. This has led to the introduction

of guarantee schemes, which seek to indemnify the injured investor irrespective of the presence of an investment protection treaty. The substantive rules on investment protection and promotion are reciprocally connected to the schemes of investment insurance. The substantive investment protection provisions define the incidents of injury while the insurance schemes provide the mechanism for indemnification of those injured in terms of the appropriate substantive law.

Four categories of such noncommercial risks have been defined and covered under the MIGA convention. The first risks are associated with currency transfers resulting from host government restrictions and currency conversion and transfer, as distinct from the devaluation risk. Second are expropriation risks, or risks of loss resulting from legislative or administrative action of the host government that deprives the investor of his ownership, control, or substantial benefit from his investment. The third group are risks resulting from the repudiation of a contract by the host government when the investor has no access to a competent forum, faces unreasonable delays, or is unable to enforce the final judgment. Finally, there are war and civil disturbance risks.

Of course, investment guarantee schemes can be national or international in their institutional dimensions. Dr. Shihata explains the drawbacks of the current national investment schemes to emphasize the need for an international one. For example, he points out that the investment coverage of the national agencies, which attempt to protect investors, fluctuates markedly from year to year and is extended only to a small fraction of the investment flows. In contrast, a multilateral agency could provide more diversified protection by aggregating investments from many countries, offering uniform protection regardless of nationality, and providing coverage to multilaterally financed investments. Consequently, a multilateral investment agency would complement the work of the various national agencies presently operating such as the U.S. Overseas Private Investment Corporation (OPIC) and the Canadian Export Development Corporation.

After outlining the concept and rationale of an international guarantee agency, Dr. Shihata describes the evolution and establishment of such an agency, MIGA. He discusses the early initiatives to create an international investment guarantee facility in the 1950s and the resurfacing of the idea in the early 1960s in various international fora, including the World Bank, the Organization for Economic Cooperation and Development, the Inter-American Development Bank, the United Nations Conference on Trade and Development, and the European Economic Community. Among the efforts of the World Bank itself, earlier drafts refer to a multilateral investment guarantee

agency drawn up in 1966, 1968, and 1972. Nothing concrete, however, emerged out of these proposals. The only international investment guarantee agency successfully established before MIGA was the Inter-Arab Investment Guarantee Agency, a regional institution established by the Arab countries and limited to investments made by Arabs in Arab member countries.

The 1981 assumption by Mr. A. W. Clausen to the office of World Bank President saw the resurgence of the Bank's interest in a multilateral guarantee agency. A number of studies prepared in early 1983 laid the foundation for the drafting of a convention for such an agency. These papers and drafts, prepared by the World Bank staff, slowly cleared the way for the successful developments that followed in mid-1983.

The history of MIGA, from the making of the first drafts to the final adoption of the Convention that established the institution, was not smooth. Dr. Shihata points out some typical objections made by the developed and the developing countries during the formation process. The developed countries, motivated by their perceived national interests, initially preferred to continue with or establish their own national programs for political risk insurance. Some of these countries apparently feared the competition from an international agency. Some developing countries, on the other hand, feared that the Agency's guarantees would deprive them of their privileged position as the hosts of foreign governments or take away some aspect of their national legislative discretion, which they would retain if no international commitments existed as to the treatment of foreign investments.

Given this antagonistic background, the World Bank mounted intensive efforts to create an awareness both inside and outside the Bank of MIGA's uniqueness and importance and to build up the support required to assure positive outcomes at subsequent meetings of the Bank's Executive Directors. Dr. Shihata gives a personal account of the steps that were taken to assure these outcomes. The Executive Directors of the Bank, at their meeting on September 12, 1985, approved the draft convention and the related documents and transmitted them to the Board of Governors, who gave their approval at their annual meeting in Seoul in October 1985. The Bank's Board of Governors opened the Convention establishing MIGA for signature on October 11, 1985. The Convention, however, did not become effective until April 12, 1988, because it had to be ratified by nine industrial countries and twenty developing countries whose subscriptions amounted to 578 million dollars of authorized capital. On June 8, 1988, Mr. Barber B. Conable, the current President of the World Bank, held an inaugural meeting of MIGA's governing council in Washington to adopt bylaws, elect members of the Board of

Directors, and adopt terms and conditions for future members. As a result, MIGA became operational as the first truly global multilateral investment guarantee agency.

Parts 2 and 3 of the book, which constitute the majority of the material, deal with the operations of MIGA and underlying policy and institutional concerns.¹ The MIGA Convention contains several elements that are common to treaties dealing with investment insurance. Included among such provisions are:

- (1) sections requiring approval of the investment projects by the participating governments and parties;
- (2) limits on the types of insured investments, and standards of professional and administrative treatment to be accorded the investments;
- (3) methods of valuation and compensation in the event of expropriation;
- (4) recourse provisions defining the forum for dispute settlement and provisions regarding consultation upon request of either party; and
- (5) limits on the scope of protection, and explanations of subrogation procedures. These issues are dealt with in Part 2 of the book.²

The first step in analyzing an investment insurance scheme is the determination of eligible investors. To qualify for MIGA guarantees an investor must be a national of a member country or, in the case of a corporate investor, either be incorporated and have its principal place of business in the member country or have the majority of its capital owned by nationals of member countries. One distinguishing element of MIGA is that insurance eligibility can cover not only nationals of capital-exporting countries, but also nationals of the host state if they transfer back assets to be invested. Dr. Shihata points out that this provision is intended to assist member countries in attracting flight capital³ back to their own countries.

Among the relevant provisions of the investment insurance scheme are sections requiring agreement on the nature of the project or investment being insured. Investment eligibility requirements

¹ Notably, the book was published before MIGA became operational. The discussion, therefore, is based entirely on the Convention, draft bylaws, and regulations to which the author had access as an insider.

² At the end of Part 2, Dr. Shihata also draws attention to some other nonguarantee operations that MIGA is expected to carry out. These include consultative and advisory services such as performing relevant research, disseminating information to investors and host countries, providing technical assistance and policy advice to improve investment conditions, seeking to remove barriers facing the movement of capital and technology across national boundaries, assisting in the amicable settlement of disputes, and facilitating agreements on the treatment of foreign investments.

³ This is the transfer of capital to avoid a risk of financial loss. Often the risk involved is the result of an unstable currency, and the capital transfer is to a more stable currency.

under MIGA will initially include equity investments and equity-type loans. Equity-type loans are loans and loan agreements held by equity holders in the investment project with maturities of three or more years. Unlike most bilateral schemes, however, MIGA will also extend coverage to nonequity forms of direct investment. These include contractual agreements falling between traditional investments and export credits such as production sharing, profit sharing, management, and turnkey contracts, as well as franchising, licensing, and operating lease agreements. MIGA's Board of Directors is also authorized to extend coverage to additional forms of direct investment.

Assuming that the investors and the investments themselves are eligible for protection under the Convention, the next step is to evaluate the scope of coverage or protection. Under the MIGA Convention the covered risks, as previously mentioned, include currency transfer risks, expropriation risks, loss of forum risks, and war and civil disturbance risks. In the future, coverage may be extended to other noncommercial risks such as acts of terrorists directed at the investors, kidnappings, or politically motivated strikes.

Of all the provisions included in investment insurance agreements, those defining the rights of the insuring agency against the host state are the most critical. Here the notion of subrogation is cardinal. Essentially, subrogation constitutes the assignment of an existing claim from the investor to the insurance agency. In practical terms, the agency makes payment to an investor under the guarantee agreement in connection with an injury in a member state, and the host state recognizes the transfer by the investor to the insurance agency of any currency, credits, assets, or investments for which payment was made under the coverage. The host state must also recognize the subrogation of the insurance agency to any related right, title, claim, privilege, or cause of action that the investor may have against the host state.

The MIGA Convention affirms the subrogation principle. Upon payment of a claim to the investor, MIGA becomes subrogated to the investor's rights against the host country or third-party obligors. Because the insured investors will not be parties to the Convention, subrogation will be based on covenants in the guarantee contracts between MIGA and the investors. Article 18(B) of the Convention requires the host country and all other member countries to recognize MIGA's subrogation without the need for any further agreement.

With respect to underwriting requirements, MIGA will offer investors a choice between coverage against individual risks or package coverage comprised of protection for several or all of the risks. In contrast, most national investment guarantee agencies offer just one package coverage, normally at a flat rate. Under the MIGA provi-

sions, premiums payable for insurance will be differentiated in accordance with actual risk-taking within a range of 0.3 to 0.5 percent of the guaranteed amount per annum for each type of risk covered. Within this range risks will be rated on a case-by-case basis rather than on the economic and political stability of the host country. Investors purchasing coverage against several types of risks will qualify for a discount of up to fifty percent of the coverage rates that comprise the package.

Part 3 of the book deals with the general policy and institutional issues that are raised within the context of the projected operations of MIGA. One of the basic issues raised by Shihata, which is also of interest in general international law, is the question of the applicable standards for determining the presence or absence of injury to a foreign investor and thereby triggering the guarantee obligations under the MIGA agreements. As previously indicated, even though insurance or guarantee agreements ensure the subrogation of the investor's rights to the insurance agency, these agreements themselves do not spell out those rights of the investor constituting the subject matter of the subrogation. Rather, these rights are dealt with elsewhere in bilateral investment protection treaties, multilateral conventions, general principles of international law, the national investment codes, investment-related legislation, and the constitutions of host states. What the MIGA Convention perceives as the appropriate standards for treatment is, therefore, a relevant inquiry.

The provisions of the MIGA Convention do not include a list of the substantive and procedural standards that should apply to investments made in the territories of other parties. This does not mean that the Convention belittles the importance of available standards. Indeed, the Convention requires the Agency to satisfy itself that fair and stable standards exist before launching guarantee operations in a given country. As Dr. Shihata explains, however, the Convention refrained from creating standards or obligations on members because of the variations in prevailing standards and to avoid conflicts with member states' constitutional or legislative requirements. MIGA seeks to maintain a careful balance between the respective rights of the host country, the investors, and the Agency itself. Its regulations assume that the legal protection accorded to foreign investments will be adequate for the Agency's purpose when an applicable agreement exists between the investor-state and the host country. Thus, whatever identifiable standards requirement exists in the MIGA Convention should be interpreted in the light of Article 2, which speaks of the *encouragement* of investment flows among its members.

Dr. Shihata discusses six types of disputes in which the Agency would be either directly involved or in which it would have a clear

interest even though it was not a party to that dispute. These include:

(1) disputes between the Agency and a member state regarding the interpretation or application of the MIGA Convention;

(2) disputes concerning claims of the Agency against the government of a host country where the Agency acts as a subrogee of an investor whom the Agency has paid or agreed to pay compensation under a contract of guarantee;

(3) disputes between the Agency and a member other than those disputes already mentioned above, as well as disputes between the Agency and a state which has ceased to be a member;

(4) disputes between the Agency and a holder of a guarantee or reinsurance policy issued by it;

(5) disputes between the Agency and other third parties based on contractual or tort liability; and

(6) disputes between a holder of the Agency's guarantee and the government of the host country.

Dr. Shihata then discusses at length the methods of dispute settlement when the Agency becomes a party. Disputes with members over the interpretation or application of the Convention's provisions are to be settled by the Agency's Board, subject to possible appeal by the member concerned to the Agency's Council of Governors. Other disputes between the Agency and its members, and all of the Agency's disputes with a state that has ceased to be a member will be settled in accordance with the procedures detailed in Annex 2 to the Convention.⁴ Disputes between the Agency and a holder of its guarantee or a beneficiary of its reinsurance would be settled by arbitration, which can be conducted in accordance with modified International Centre for Settlement of Investment Disputes (ICSID) arbitration rules unless the parties agree otherwise. When the Agency is subrogated to an investor and, as a result, becomes a party to disputes with the host country, such disputes will be settled according to the procedures mentioned in Annex 2 to the Convention unless an alternative method has been agreed upon beforehand between the Agency and that country. Creditors other than members of the Agency, guaranteed investors, and claimants deriving their claims from members can still sue the Agency before domestic courts that have jurisdiction pursuant to either their respective law or explicit provisions in an agreement with the Agency. Such agreements also may specify other methods of resolution such as arbitration.

Finally, Dr. Shihata discusses the organizational and voting structure of MIGA. Article 30 of the Convention denotes MIGA's

⁴ This Annex envisages negotiations, possibly conciliation, and, failing a solution of the dispute, compulsory arbitration.

three organs: The Council of Governors, the Board of Directors, and the President and staff. This structure differs from the one created by the Articles of Agreement of the International Bank for Reconstruction and Development (IBRD) or the World Bank. While a great similarity exists between the constitutive provisions of the World Bank and MIGA, the Agency is not a carbon copy of a "Bretton Woods" institutional model such as the World Bank. The most important difference is the requirement of the MIGA Convention that, after an initial period, parity in the voting power should be established between the two categories of member countries, which are divided into developed and developing countries, or capital exporting and capital importing countries.

The author discusses at length the unique voting structure finally negotiated under the MIGA Convention. He gives an interesting conceptual description of the various types of voting options available to international development institutions. He speaks of the Bretton Woods Institutions pattern, first adopted in the Articles of Agreement of the IBRD and the International Monetary Fund (IMF), as well as "the voting blocks pattern," which is typical of the international commodity organizations. In the former pattern a certain number of votes are distributed equally among members while the rest are allocated according to the number of shares held by each member. The result is that the wealthier countries have more say in the decision-making process of the organization. In the voting blocks pattern, members are divided into two or more categories with a certain portion of the total votes allotted to each category. While in most cases each block will have an equal number of votes, the votes allotted to each member within the block differs according to its financial contribution or its interest in, or utilization of, the institution. In both patterns weighted voting is mitigated or emphasized by requirements related to the quorum for meetings and to special majorities for passing certain resolutions. Probably because the author is concerned primarily with financial institutions, he does not mention the third pattern of international voting adopted by the United Nations General Assembly and its various organs. This consists of one country, one vote, which of course is the most democratic form of voting. Dr. Shihata mentions the conflict between two important objectives of the Convention in relation to the selection of the appropriate voting pattern. These are voting parity between the two categories of members and allowing each member to preserve its relative share in the Agency's capital on the occasion of each capital increase.

The voting structure eventually agreed upon was a formula by which there would be equal voting power between capital-exporting countries and capital-importing countries when all World Bank

members have joined MIGA. Each member country would then receive 177 membership votes and one additional vote per share subscribed. In MIGA's first three years, each of the two groups of countries is assured a minimum of forty percent of the total voting power by the allocation of supplementary votes if necessary. All decisions during this initial period will require a special majority of at least two-thirds of the total voting power, representing fifty-five percent of the subscribed shares of MIGA's capital stock. While the supplementary votes and the special majority requirement will be canceled at the end of the three year period, unsubscribed shares will then be reallocated to achieve voting parity of the two groups of countries on the basis of membership vote and subscription votes.

As to the operational structure of the organization, the author notes other differences between the Bretton Woods-type institutions and MIGA. For example, the respective powers of the Board and the President are different in the two types of institutions, and MIGA's Board, unlike the Boards of IBRD and IMF, will not function in continuous session except at such future time as the need arises. Although the Convention is silent on the question of the internal organizational structure of the Agency, and the MIGA regulations provide few details, MIGA will likely have a Guarantee Department, a Technical and Advisory Services Department (both corresponding to the two main operational activities of the Agency), as well as a Legal Department, which would serve the other two departments.

Dr. Shihata's book concludes with some very useful appendices, including the Convention establishing MIGA, commentary on the Convention, discussion papers preceding the establishment of the Convention, and the draft rules and regulations of the Agency. These papers, in addition to the main body of the book, constitute a wealth of information for the researcher who is interested not only in the specific institutional history of MIGA, but also in investment guarantee schemes as part of the overall institutional mix for the protection and promotion of foreign investment. This level of detail, however, may prove unnecessarily extensive even to a specialist in the field.

One excellent feature of this volume is the author's efforts to place the details concerning the institution's history in perspective. For example, the introductory chapter places the entire text in the general framework of public international law and international business transactions, and helps mitigate the essentially historical account that follows in Part I of the book. Similarly, Chapter 6 of Part 3, entitled "MIGA and the Standards Applicable to Foreign Investments," places in perspective some of the broad ranging international law issues concerning the proper treatment of alien property.

This holds the reader's attention through the descriptive account of the Agency's organization and voting structure.

Although the book's primary place in the literature on foreign investment is as a reference on MIGA, it provides important commentary on larger issues such as the notion of an investment climate, the general role of foreign investment in the developmental process, and the links between investment protection treaties and investment guarantee agreements as mutually supporting institutions. Dr. Shihata has increased his stature as an international law scholar and diplomat by the publication of this book. The basic advantage of having an insider write on a topic of this sort is in the credibility of the source and the probable reduction of factual errors and second guessing. Nevertheless, a possible drawback is that the insiders may be too optimistic about the historic role of the institution and too convinced as to the wisdom of particular institutional choices they made in the course of their duties.

Clearly, beyond its technical job of investment insurance and consultative and advisory services, MIGA could serve an even more important function that cannot be addressed adequately by bilateral investment agreements and schemes. MIGA could create a broader forum for international policy cooperation on investments among capital-exporting countries, capital-importing countries, and foreign investors. Moreover, by treating the issues of international investment insurance and attendant dispute settlement on the multilateral plane, one hopes MIGA will act as a buffer against state diplomatic intervention and thus lessen bilateral confrontation in the investment dispute settlement area. Whether this arrangement will also lead to significant depoliticization of investment disputes, as has been claimed, or to a mere multilateralization of the politics of investment disputes is not yet known.

