

# SK

SKEMA BUSINESS SCHOOL

## Political Risk Analysis

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Michel Henry Bouchet



### COUNTRY RISK AND POLITICAL RISK ASSESSMENT

- ▶ **A reminder: Sovereign Risk** is the possibility that a foreign country may be **unable** or **unwilling** to fulfill its obligations fully and on time, towards a foreign lender and/or investor, or exporter, or domestic residents!

Whereas political uncertainty refers to instability and threats in the socio-political system, **political risk** is the unexpected unfavorable consequences of the arbitrary exercise of power by a government and its ramifications at home and abroad, as well as by non-governmental actors

## WHAT IS « GOOD GOVERNANCE »?

XIV<sup>o</sup> century Sienna: the allegory of **Good Government** =  
Balance between Wisdom, Justice, Strength, Prudence, and Peace



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## MARXIST APPROACH TO ECONOMIC DEVELOPMENT AND CLASS STRUGGLE



The developing forces of production give rise to increasing conflict with the existing social relations of production, hence class struggle.

The **state** does not represent the interests of 'the people' or a common 'general will'. Nor is it a force which stands above or beyond the clash of class interests.

The state is essentially an instrument of class rule. The state in capitalist society is a bourgeois state: it is nothing but 'a committee for managing the common affairs of the whole bourgeoisie'.

Capitalism will inevitably lead to increasing class polarisation and class conflict.

## DANIEL BELL

- ▶ **One of the most important cultural critics of the postwar era** : Sociologist and professor emeritus at Harvard University. Bell was among the original New York Intellectuals, a group of anti-Stalinist left-wing writers. Best known for his contributions to post-industrialism. Masterworks: *The End of Ideology* (1960), *The Cultural Contradictions of Capitalism* (1976) and *The Coming of Post-Industrial Society* (1973)

### The post-industrial society:

- ▶ Polarization and social tensions between work and consumption pressures: capitalism is inherently **instable**
- ▶ Centrality of the new science-based industries
- ▶ Rise of new technical elites and the advent of a new principle of stratification

## ULRICH BECK: "WORLD AT RISK"

- ▶ Modernization challenges the institutions and structures of traditional societies in the name of individual freedom and autonomy. What began to emerge in the late 20th century was a radical shift in the locus of meaning in western societies from a culture where meaning and identity were grounded in loyalty to traditional institutions and structures to one in which meaning and identity are grounded in the self as the primary agent of meaning.
- ▶ The paradox in late modern society is that risk might in fact be increasing due to technology, science and industrialism rather than being abated by scientific and technological progress. This is the **world risk society** full of hazards and insecurities induced by modernization itself:
  1. Globalization
  2. Individualization
  3. Gender Revolution
  4. Underemployment
  5. Global risks (ecological crisis and the crash of global financial markets,)

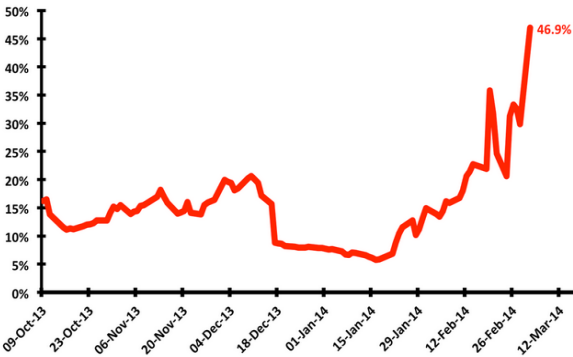
**RANKING OF TOP RISKS REPORTED BY FTSE 100 FIRMS** (FT JULY 2017)



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**YIELD ON 6-MONTH UKRAINE GOVERNMENT BOND**



**UKRAINE:**

**THE PRICE OF POLITICAL RISK IN THE WAKE OF THE REVOLUTION AND THE RUSSIAN INVASION OF CRIMEA IN 2014**



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**Sept 2017:** back to market access?  
 bond swap with \$3 billion global bond issue over 15 year, with 7,375% in exchange for bonds maturing 2019-20

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## THE COST OF GLOBAL POLITICAL RISK

### The Annual Economic Impact Of Global Violence

Economic impact of violence/conflict to the world economy (in trillion U.S. dollars)



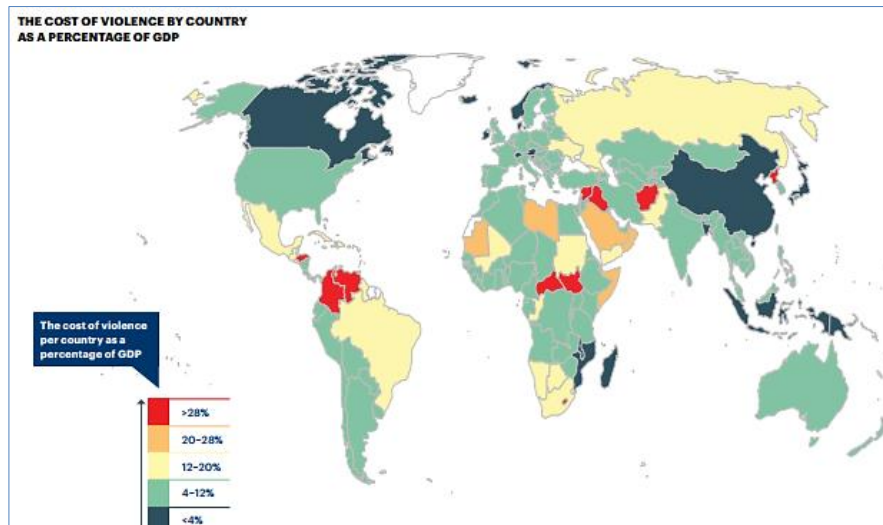
<https://www.statista.com/chart/3948/the-annual-economic-impact-of-global-violence/>

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## THE COST OF VIOLENCE IN % OF GDP

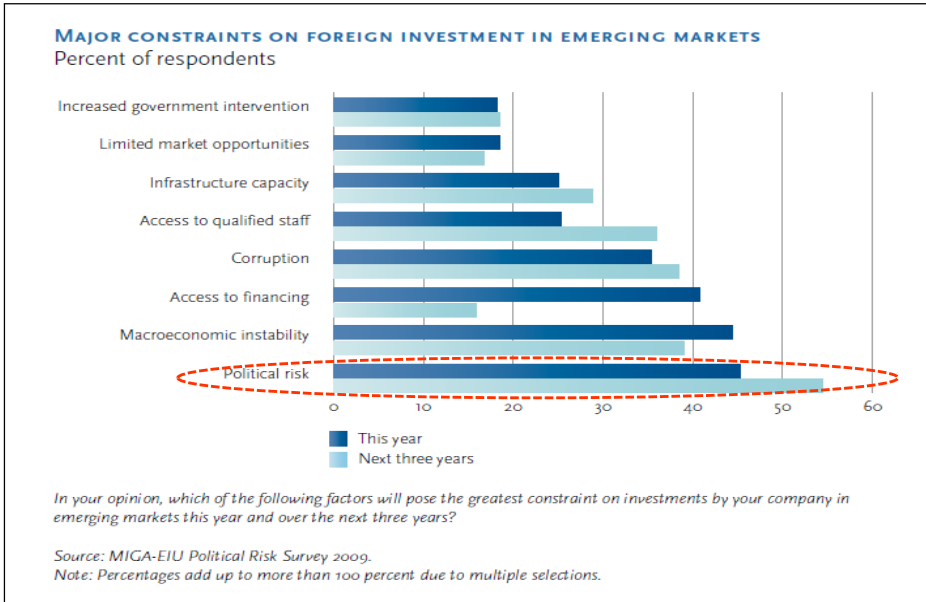
(WORLD ECON FORUM: THE ECONOMIC VALUE OF PEACE REPORT)



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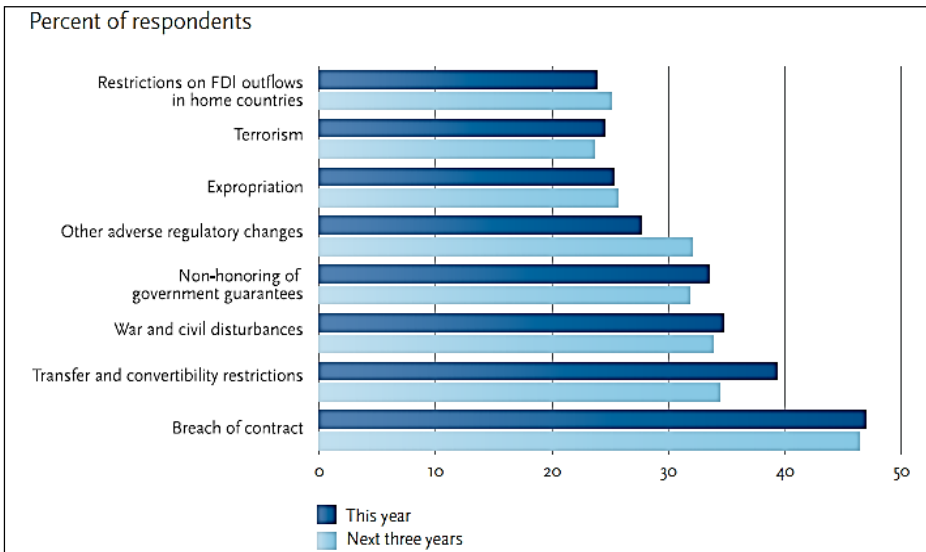
## MIGA: THE KEY CHALLENGE OF POLITICAL RISK



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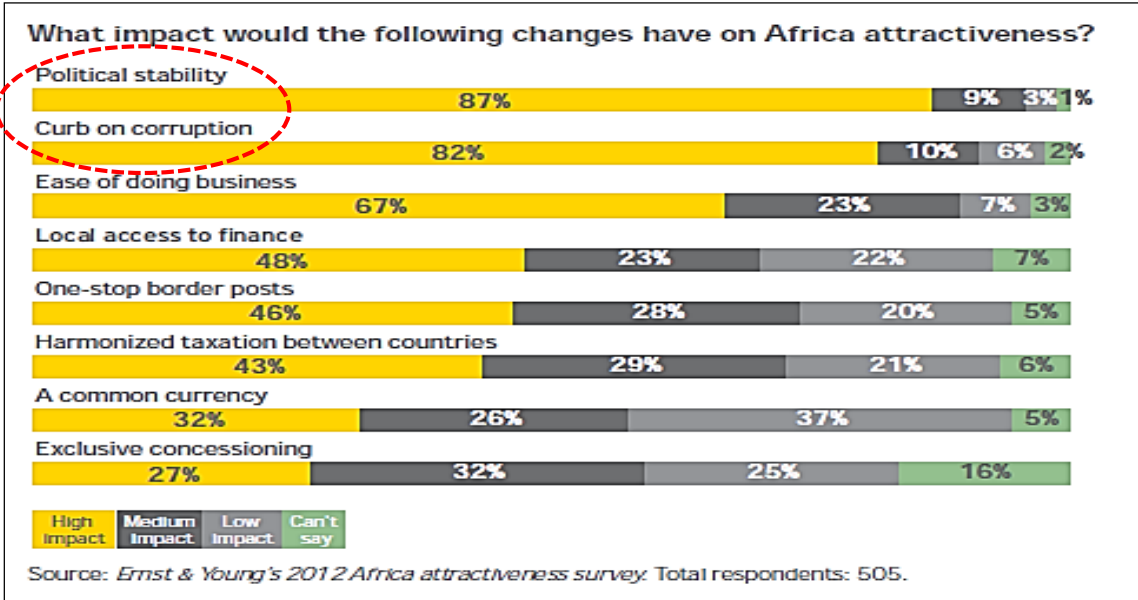
## MIGA: TYPES OF POLITICAL RISK OF HIGHER CONCERN TO MNCs IN EMCS



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## BOOSTING FDI IN AFRICA?

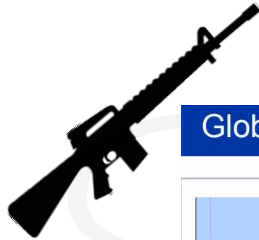


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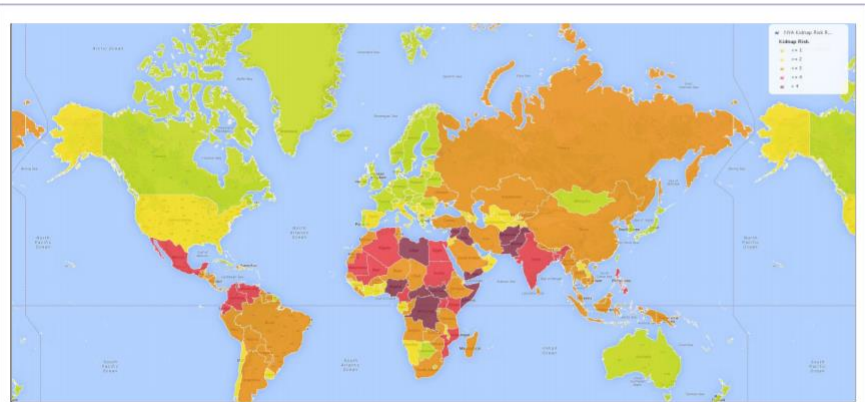
## TOP TEN KIDNAP RANKING 1992-2017

1. Mexico
2. India
3. Nigeria
4. Pakistan
5. Venezuela
6. Lebanon
7. Philippines
8. Afghanistan
9. Colombia
10. Iraq
11. Syria
12. Guatemala
13. Yemen
14. Libya
15. Egypt
16. Brazil
16. Kenya
18. Nepal
19. Malaysia
20. South Africa



: >7,770 kidnaps for ransom!

### Global Kidnap Review 2016

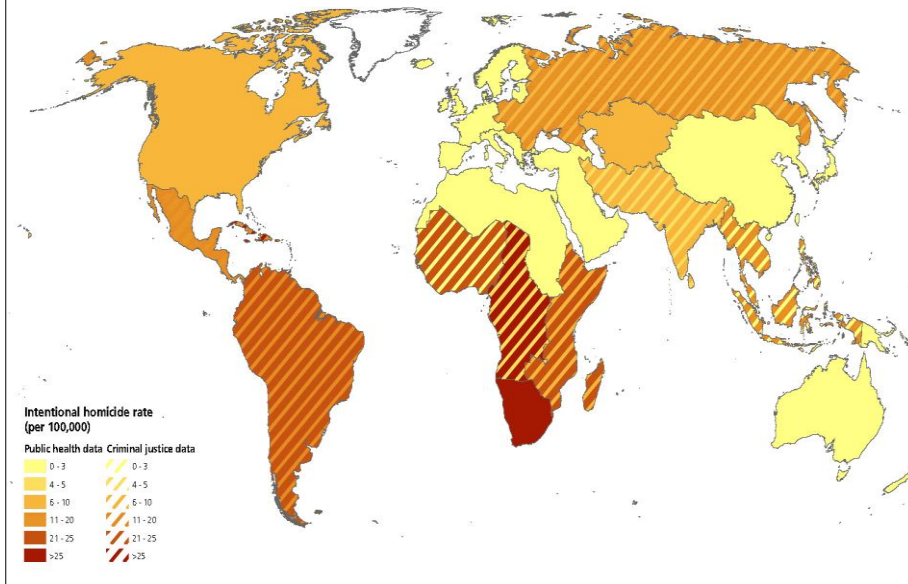


NYA International

Source: Hiscox Group/FT

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Intentional homicide rate by sub-region and for two sources, latest available year



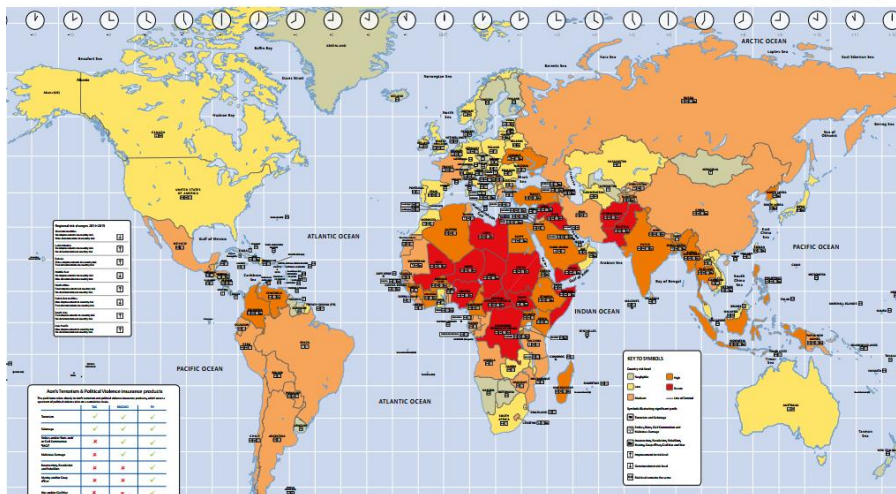
[HTTP://WWW.UNODC.ORG/UNODC/INDEX.HTML?REF=MENU](http://www.unodc.org/unodc/index.html?ref=menutop)

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### MAPPING OUT POLITICAL RISK: FRANCE AS RISKY AS BRAZIL?

#### 2015 Terrorism & Political Violence Risk Map

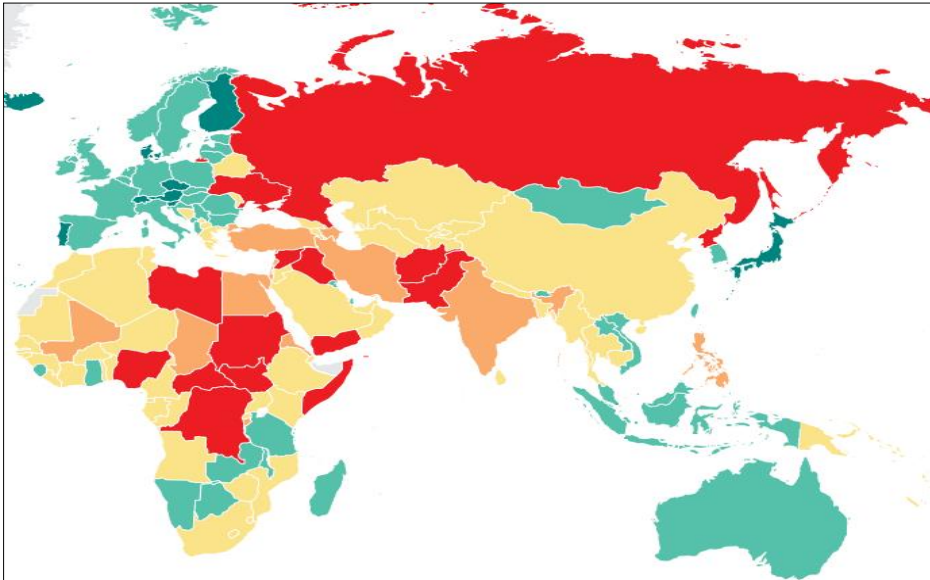


<http://www.aon.com/terrorismmap/2013-Terrorism-Map-14-05-2013.pdf>

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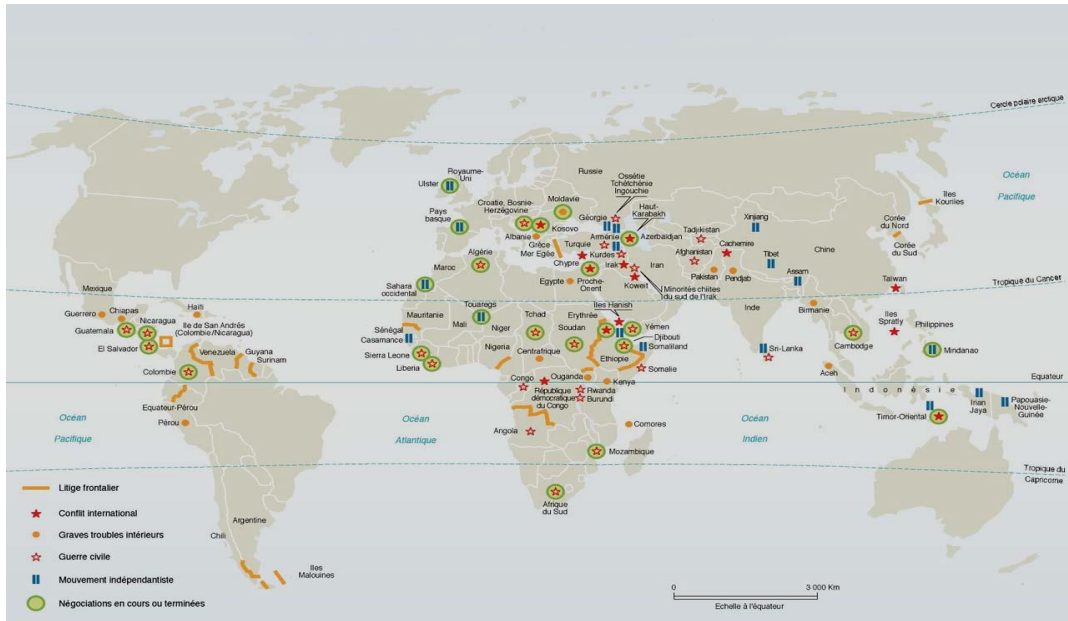
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### PEACE AND SECURITY INDEX



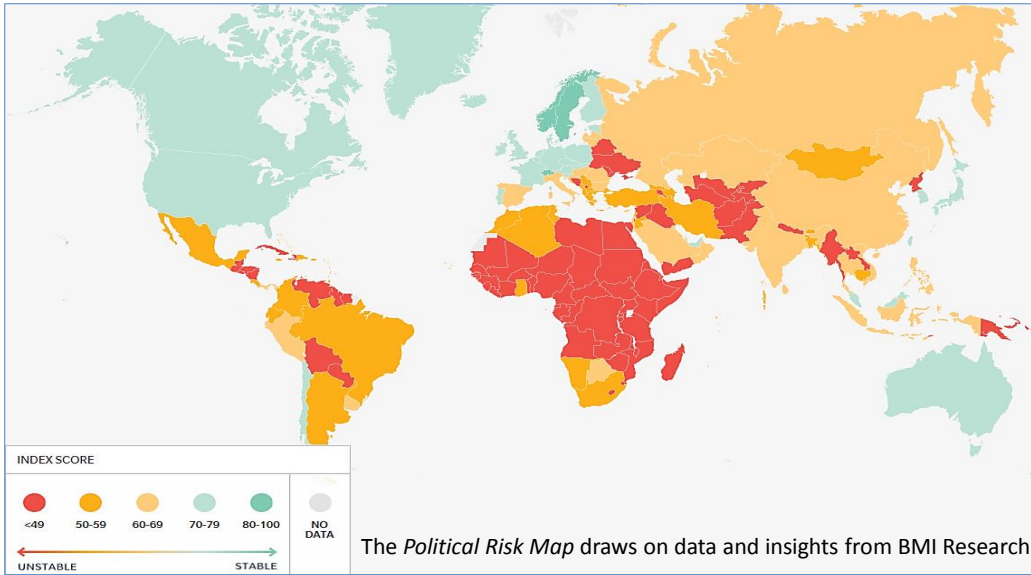
[http://www.visionofhumanity.org/sites/default/files/Global%20Peace%20Index%20Report%202016\\_0.pdf](http://www.visionofhumanity.org/sites/default/files/Global%20Peace%20Index%20Report%202016_0.pdf)  
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### Wars and armed conflicts all over the world



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# MARSH POLITICAL RISK MAP



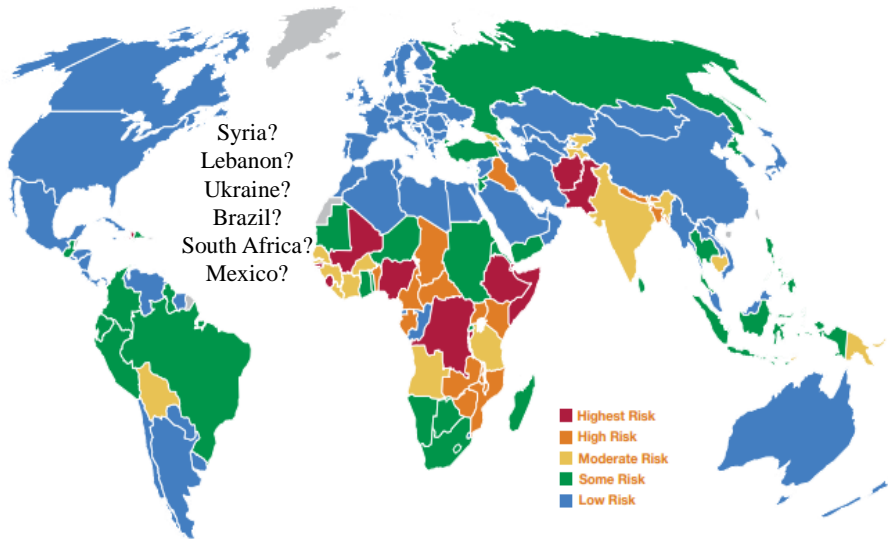
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## BLINDNESS? RISK OF FUTURE POLITICAL CRISIS 2010-12

SOURCE: UNIVERSITY OF MARYLAND CENTER FOR CONFLICT MANAGEMENT

Figure 2.1 Risk of Future Instability, 2010-2012



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## POLITICAL RISK ASSESSMENT IN THE GLOBAL FIRM

- ▶ **Origins?** Political risk stems from the overall **uncertainty** related to the exercise of power by a foreign government and its ramifications, as well as by non-governmental actors in the country.
- ▶ **Impact?** Arbitrary political decisions, conditions, and events in a country will affect the business climate in such a way that investors, exporters or creditors will confront losses.

## Threat materialization

- ▶ **Contract repudiation, capital controls, currency inconvertibility, sham contracts and bribery, corruption, blocked funds, ideological shift, political upheaval, strikes, expropriation, nationalization, coup d'état, martial law, revolution, civil strife damage, terrorism, war damage, kidnapping, crimes....**

## Three Sources of Political Risk



### Direct «hard risks»

- **Risk materialization directly hurts the company:** Nationalization, expropriation and confiscation, contract repudiation, sham contracting, bribery and corruption, blocked funds, kidnapping, crimes

### Indirect «surrounding risks»

- **Risk materialization stems from the hostile environment:** Revolution and civil unrest, martial law, terrorism, war damage, ideological and cultural shifts. Capital and dividend remittance constraints, ineffective legal and regulatory systems, non-compliance, strikes, currency inconvertibility, regional crisis and volatility spill-over

### Collateral «soft risks»

- **Risk materialization is the byproduct of unfavorable interactions between power groups:** Legal and ethical risks, protectionism, fiscal uncertainty, wealth gaps, bureaucracy and weak institutions, pressure groups and hostile NGOs, ethnic/linguistic fragmentation

## WHERE DOES POLITICAL RISK COME FROM?

- Terrorism
  - Ethnic/linguistic fragmentation
  - Gap between socio-economic and political/institutional evolution
  - Cultural fragmentation (riots, upheaval, government crises, corruption)
- Internal violence and power struggle (martial law, coup d'état, guerrilla warfare...)
- Rapid pace of urbanization coupled with religious fundamentalism
  - Regional contamination

## SAMUEL HUNTINGTON



### *Political order in changing societies* *The Clash of Civilization*

• [http://markweatherall.wordpress.com/2009/10/12/political\\_order\\_in\\_changing/](http://markweatherall.wordpress.com/2009/10/12/political_order_in_changing/)

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## WHERE DOES POLITICAL TURMOIL COME FROM?

▶ Contrary to the expectations of modernization theory, **violence and instability stem from:**

1. **rapid social change**
2. **Centralized** decision-making system
3. mobilization of **new groups into politics**
4. **slow development of political institutions.**

▶ As societies modernize, they become more complex and disordered. If the process of **socio-economic** modernization is not matched by a process of **political and institutional** modernization with political institutions capable of managing the stress of modernization—the result is violence.

**SAMUEL HUNTINGTON**  
**ANALYZING THE ROOTS OF POLITICAL UPHEAVAL**

- ▶ Primary problem of politics = **lag** in the development of **political institutions** behind socio- economic change.
- ▶ Instability = (rapid social change + rising mobilization of new groups into politics) > development of political institutions.

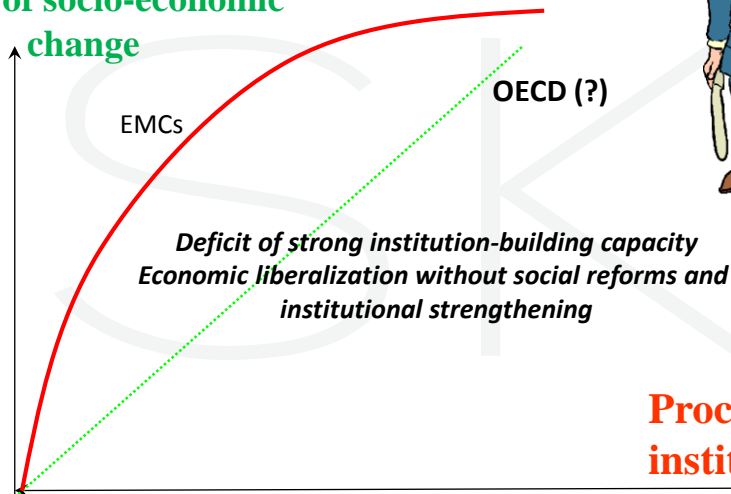


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**POLITICAL DIS/ORDER IN RAPIDLY CHANGING SOCIETIES**

**Process of socio-economic change**

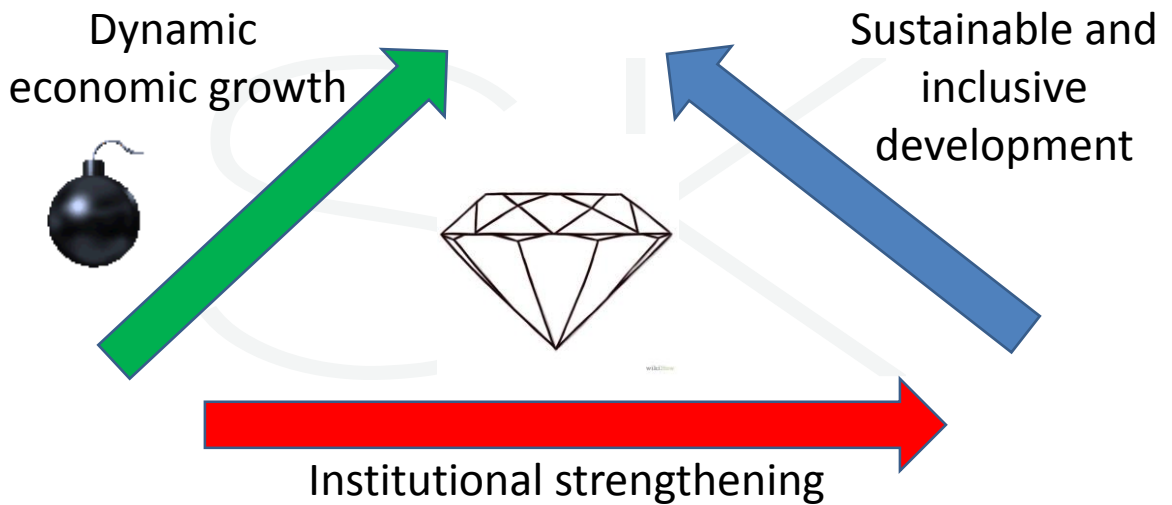


**Process of political institutionalization**

### A DEFICIT IN INSTITUTION-BUILDING ALWAYS LEADS TO SOCIAL UPHEAVAL



### THE REQUIRED POLITICAL STABILITY TRIANGLE



## POLITICAL MODERNIZATION IN CHINA?

- ▶ Shenzhen = spiritual home to economic reform in China?

PM Wen Jiabao: « Political reform is a necessary companion to economic modernization: without the safeguard of political reform, the fruits of economic reform would be lost » (August 2010)

## INSTITUTIONAL STRENGTHENING, ECONOMIC DEVELOPMENT AND POLITICAL STABILITY: CHALLENGING TRIANGLE!

- ▶ **Chile's President Bachelet:**

links between democratic strengthening, economic growth and social protection

- ▶ ***In Latin America , there are countries where people are uneasy about the process of economic liberalization, because structural economic reforms were not accompanied by the social policies that were necessary! The problem has not been with open economies per se but rather the lack of action in addressing poverty and social injustice***