



SK
SKEMA BUSINESS SCHOOL
What is Country Risk all about?
"Converting risks into springboards of success"
Michel Henry Bouchet

skema   



TOP COUNTRY RISKS 2019-2020?

EMCs currency volatility: peso, lira, rupee, real
Turkey-NATO
North Korea-US
Mexico-US-Canada
US-Iran
Erosion of institutions
Wealth gaps
€ Zone fragmentation?
UK Brexit
Africa: governance & corruption, LC/\$ debt

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WHY IS COUNTRY RISK ON THE FRONT BURNER IN FALL 2019?

- Political upheaval in Tunisia, Cataluña, Turkey, Brazil, Greece, Venezuela
- Debt default in Cuba?
- US-Iran
- Trade protectionism US-China
- European export headwinds
- Soft/Hard landing in China? Bubble bursting?
- Global economic slowdown
- Risk of currency crisis in EMCs + Capital flight

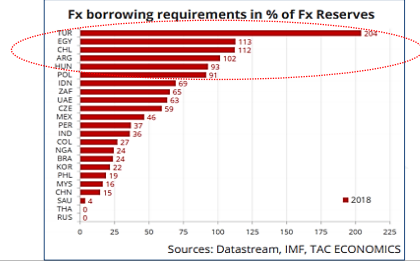


Risk of spill-over is permanent!

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TURKEY'S VULNERABILITY =

EXCESSIVE BORROWING REQUIREMENTS IN FOREIGN CURRENCY + LARGE ST DEBT TO BE ROLLED-OVER + LARGE AMORTIZATION ON LT EXTERNAL DEBT (\$170BN DUE FOR THE WHOLE YEAR) + SUBSTANTIAL CA DEFICIT



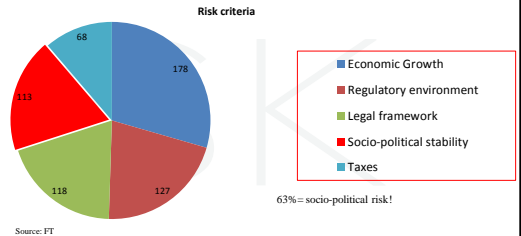
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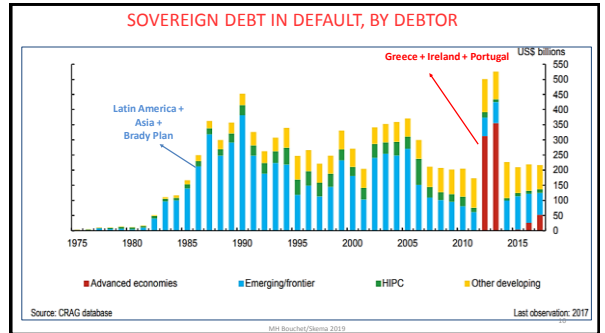
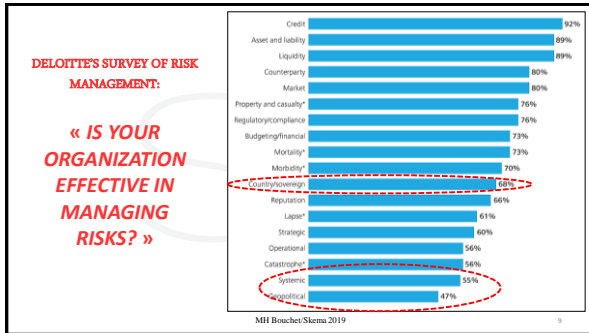
FRANCE'S 10 YEAR AVERAGE RATE OF BORROWING 1999-2019



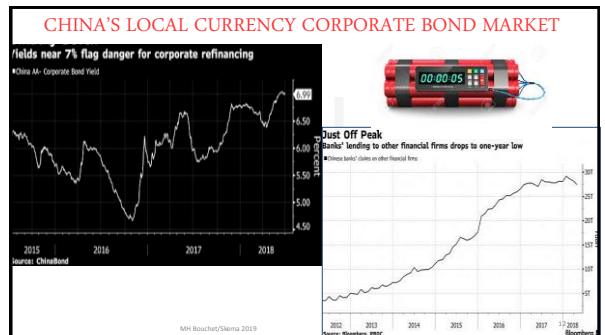
THE BANKER GLOBAL RISK ASSET MANAGEMENT SURVEY=

WHERE DOES RISK COME FROM?



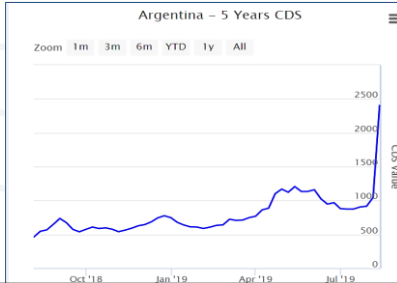


- SOME OF THE BIGGEST SOVEREIGN DEFAULTS SINCE 2000:**
- 1. Argentina, \$82 billion, December 2001:** Insolvency cycles since 1827. New partial default in end-2014
 - 2. Ecuador, \$3.2 billion, December 2008:** Default on \$31 million interest payment, in the wake of Ecuador's 1999 default. In June 2014, \$2 b. of 10-year bonds in return to capital markets
 - 3. Jamaica, \$7.9 billion, February 2010:** Public debt as a share of GDP (both domestic and external) reached 130% in 2010.
 - 4. Greece, \$138 billion, March 2012:** (first sovereign default in the 4th century BC, by 10 Greek municipalities). Greece failed to record a budget surplus since 1973. **€110 billion** bailout from the European Union and IMF in May 2010 + **€86 billion** bail-out in mid-2015
 - 5. Debt defaults in EMCs in 2017-2019, including Mozambique, Congo, and Cuba in 2019?**
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AUGUST 2019: ARGENTINA'S FREE FALL STOCK MARKET AND RISING DEFAULT PROBABILITY

The Argentina 5 Years Sovereign CDS reached a maximum value of 19387 (06/2016) and a minimum yield of 218 (01/2018) before jumping to 2640 in 08/2019, hence a 44% implied probability of default, on a 40% recovery rate



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FMI COUNTRY RISK SEMINAR

► Five key objectives:

1. Identifying the key components of country risk (economic, financial, socio-political, regional)
2. Grasping the new challenges of country risk in the global economy (**spill-over and contagion!**)
3. Identifying the **sources of information** and economic intelligence
4. Exploring the various techniques for **risk analysis and risk mitigation**
5. Focusing on both EMCs ... and OECD

► 5 Academic tools

1. Book (McMillan-Palgrave 2018)
2. Introduction seminar
3. Mooc UDEMY (15 videos + slides + quiz)
4. Background documents
5. Course (Amaury Goguel)

<http://www.developingfinance.org>

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TEXTBOOKS, MOOC & RESEARCH PAPERS

1. Bouchet & Goguel: « The shortcomings of country risk models »: Journal of Risk Management, 2019
2. Bouchet, Goguel, Fishkin: « Country Risk Management », Palgrave, 2018
3. Bouchet, Clark & Gros Lambert, « Country risk assessment », N.Y. Wiley
4. Bouchet, M & Gros Lambert, B: « Governance & Country Risk », In Governance and Risk in Global and Emerging Markets, Palgrave
5. Bouchet MH, « In search of a country risk barometer? », World Financial Review, Summer 2013
6. Bouchet MH: « Capital Flight as early warning indicator of country risk »: Oxford Economics-2015
7. Peter Bernstein, « Against the gods- The history of Risk »: Wiley 1998
8. L. van Efferink, Country risk analysis, FMS, NIBESVV, Amsterdam

ALL FILES on : www.developingfinance.org
<https://www.udemy.com/country-risk-in-the-age-of-global-turbulences/>

+ Skema Knowledge K2

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GETTING READY FOR SEASONED COUNTRY RISK ANALYSIS!

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COUNTRY-RISK-ANALYSIS¶ Republic-of-Solvenca-and-the-International-Capital-Markets¶

MICHEL-HENRY-BOUCHET¶

Annex¶

Background-Information-for-Solvenca's-Eurobond-Request-to-CASINO-BANK¶



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For further information:¶

www.developingfinance.org¶

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FMI 2014		Source: Skema National Statistics Agency (SNA) - October 2014													
COUNTRY RISK ANALYSIS		SOLVENCIA													
		2002	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CONVERTIBLE DEBT															
BANKING (CONTRAP (contra pass))															
Net GDP (incl currency adjust)		1,362	1,362	1,362	1,362	1,362	1,362	1,362	1,362	1,362	1,362	1,362	1,362	1,362	1,362
Interest (incl currency adjust)		11,108	10,380	10,100	10,100	10,100	10,100	10,100	10,100	10,100	10,100	10,100	10,100	10,100	10,100
GDP Adjus. % (orig)		5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%	5.88%
Interest/GDP (orig)		0.81%	0.76%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%	0.74%
Interest/GDP (net cap)		1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Exchange Rate															
Rate of Exchange															
LIABILITIES															
Trade Balance		-1,136	-471	-1,137	-2,104	-4,100	-7,102	1,104	1,104	305	200	-1,100	4,000	2,100	200
Merchandise exports		4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100
Merchandise imports		4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100	4,100
Balance on Services, Income & Transfers		400	400	400	400	400	400	400	400	400	400	400	400	400	400
Services Income receipts		400	400	400	400	400	400	400	400	400	400	400	400	400	400
Receipts of services		400	400	400	400	400	400	400	400	400	400	400	400	400	400
Interest receipts		100	100	100	100	100	100	100	100	100	100	100	100	100	100
Other income & income receipts		0	0	0	0	0	0	0	0	0	0	0	0	0	0
Balance & income payments		-1,136	-471	-1,137	-2,104	-4,100	-7,102	1,104	1,104	305	200	-1,100	4,000	2,100	200
Receipts of services		400	400	400	400	400	400	400	400	400	400	400	400	400	400
Interest payments		400	400	400	400	400	400	400	400	400	400	400	400	400	400
Other services & income payments		0	0	0	0	0	0	0	0	0	0	0	0	0	0
Transfers net		100	100	100	100	100	100	100	100	100	100	100	100	100	100
Private transfers, net		100	100	100	100	100	100	100	100	100	100	100	100	100	100
Official transfers, net		0	0	0	0	0	0	0	0	0	0	0	0	0	0
Current Account		-1,136	-471	-1,137	-2,104	-4,100	-7,102	1,104	1,104	305	200	-1,100	4,000	2,100	200

COURSE ORGANIZATION-FMI PARIS CAMPUS SEPTEMBER 9, 2019

SESSIONS 1 & 2 morning

S1. Introduction: What is Risk about?

S2. What is Country Risk about?

SESSION 3 afternoon

G1: Political risk and early warning signals: Case studies

G2: Political risk and early warning signals: Case studies

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ORGANIZATION

- ▶ ✉ Michelhenry.bouchet@skema.edu
- ▶ Appointments ☎ 0493954596
- 1. Urgency 1: ☎ 0033-658176702
- 2. Urgency 2: ☎ 0034-633335422
- 3. Urgency 3: ☎ 00216-21016000

▶ Course slides on Skema-K2

▶ Web site of Global Finance:
<https://www.developingfinance.org>

▶ Country Risk in the Age of Global Turbulences
<https://www.udemy.com/course-risk-in-the-age-of-global-turbulences/learn/v4/overview>



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COUNTRY RISK QUIZ TIME!



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What is Risk all about?

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Skema EFMD EFMD EQUIS EFMD AACSB

CAN YOU PREDICT RISK?
RISK = UNCERTAINTY = INFORMATION DEFICIT



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WHAT IS RISK?

Risk stems from all the negative consequences of the unknown

- ▶ "Risk means more things **can** happen than will happen." (Elroy Dimson)
- ▶ "It is always wise to look ahead, but difficult to look further than you can see." (W. Churchill)
- ▶ "Risk" derives from the early Italian *risicare* = "to dare"
- ▶ Risk is a **choice** rather than a fate
(Peter L. Bernstein- *Against the Gods: The Remarkable Story of Risk*)

**Risk is always related to Uncertainty, i.e.,
a deficit of information!**

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WHAT IS RISK ABOUT?

- ▶ Risk stems from all the uncertainty regarding current or future situations, where information about the situation's outcome is insufficient, lacking or simply wrong
- Information availability = Measure of risk (BOP, debt data, governance, corruption, life expectancy, education...)
- Information scarcity? = Taking action might produce negative and costly consequences (investigation time, transaction cost, delays, losses...)

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ANALYSIS AND INFORMATION SOURCES

IMF, World Bank, IFC & MIGA
 UNCTAD & UNDP
 Fed Reserve Bk of St Louis
 BIS, OECD, EBRD, EIB
 Coface, Euler-Hermes
 Moody's, S&P, Fitch, Dagong
 Euromoney, Institutional Investor
 CIA & US State Dept, ICRG
 Transparency International
 Hiscox, AON, Control Risks, Marsh
 DEFI www.developingfinance.org

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RISK & UNCERTAINTY

▶ Frank Knight: 1921 Risk stems from outcomes that are unknown but can be tackled with probability distribution.... Uncertainty stems from a deficit of information, hence randomness of results	▶ Harry Markowitz: 1959: Risk = probability of loss = historical volatility in returns as measured by standard deviation or Beta. But risk diversification and tolerance also matter!
▶ J M. Keynes: (Treatise on Probability 1921): Non-linear nature of risks and danger of expecting the future as simple projection of the past: Role of animal spirits in volatility spill-over and herd behavior.	▶ Ulrich Beck: 2010: « Global risk society where current decisions and technological developments trigger long-term global impact » (warming, terrorism, pollution, financial deregulation...)

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Strong Uncertainty	Weak Uncertainty	Ambiguity	Complexity
<ol style="list-style-type: none"> Substantive uncertainty = Lack of all the information necessary to make decisions with certain outcomes Fundamental uncertainty = List of possible events is not predetermined or knowable ex ante, as the future is yet to be created Procedural uncertainty = Lack of complete knowledge on the part of the economic agents about the very structure of the problem they face given the available information 	<p>Risk = Decision-makers use homogenous data for additive and fully reliable probability distributions to measure uncertainty</p> <p>Individuals can act on the basis of a probability that is objective (any reasonable person would agree on it) and known.</p>	<p>Unforeseen contingencies and « Judgmental uncertainty » = How specifying which of a set of distributions is appropriate in a given situation?</p> <p>High ambiguity even with ample quantity of information due to conflicting opinion and evidence, or poor understanding of the causal process</p>	<p>Individuals are exposed to the occurrence of unexpected events with wide range of ramifications and risk of spill-over effects</p>

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ILLUSTRATION OF COUNTRY RISK EXAMPLES OF EVENT UNCERTAINTY

Country Risk-Event:	Strong uncertainty?	Weak & measurable uncertainty?	Ambiguity?	Complexity?
Economic events:	FDI decision in the UK post-Brexit	Exchange rate depreciation	Inflation decrease	Sharp fall in commodity prices
Socio-political events:	Revolution, strikes and coup d'état	New market-oriented and pro-business government	High rate of electoral abstention	Upcoming elections
Financial events:	Nationalization of banking system	Interest rate increase	Over-valuation of tech companies	Abrupt external debt default
Spill-over events:	Regional crisis, contamination and capital flight	US economic recession	USD appreciation	Regional crisis contamination

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THE EMERGENCE OF RISK
XIII^e CENTURY:
GRADUAL SHIFT FROM
CIRCULAR TIME TO
LINEAR TIME

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RISK HAS TO DO WITH UNCERTAINTY REGARDING THE FUTURE, HENCE THE NEED OF TACKLING FUTURE PROSPECTS!

« Ancient times » = circular time... until the Middle Age

XV^e century Renaissance = « Modern time » = Merchant time = linear time of economic & financial transactions!

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THE DISCOVERY OF THE MEASURE OF RISK

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THE « DISCOVERY » OF RISK

Pascal 1654 Fontaine 1654 Fermat 1656
Markowitz 1959 M. Scholes 1990 B. Mandelbrot 1990

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NICOLAS DE CONDORCET: 1765: PROBABILITY DISTRIBUTION AND STATISTICS (BEGINNING OF BIG DATA?)

Robert Brown: Scottish botanist: in 1827, while examining grains of pollen suspended in water under a microscope, Brown observed minute particles ejected from the pollen grains, **executing a continuous jittery motion**

Jules Regnault (1863): « Le calcul des chances » : random walk model of stock price variations (good/bad speculation)

Louis Bachelier (1900): **stock price forecasting** is impossible due to endless number of influences though it is possible to study **probability distribution of price variations** (sigma) = volatility risk

Alfred Cowles (1933): forecasting stock market prices is impossible (large gap between actual stock prices and professional forecasting)

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LOOKING TOWARD EARLY WARNING SIGNALS OF UPCOMING FINANCIAL AND SOCIO-POLITICAL CRISIS?

- ▶ IMF reports?
- ▶ Rating agencies?
- ▶ CDS prices?
- ▶ Stock market volatility
- ▶ Spreads and yields
- ▶ Minsky's speculative bubbles and herd-instinct
 - ▶ B. Mandelbrot's fractal geometry
 - ▶ N. Taleb's Black Swans
- ▶ D. Sornette's Dragon-Kings (extreme events)
 - ▶ Capital Flight?

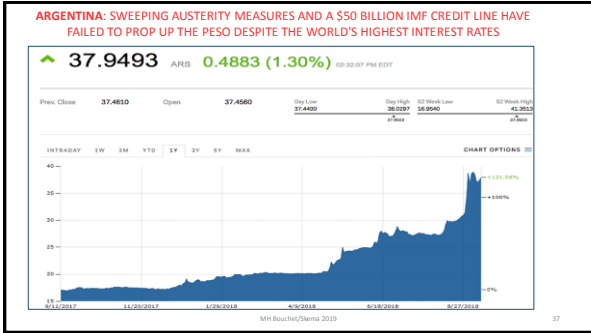
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CHALLENGE? HOW PREDICTING A CURRENCY CRISIS?

Seven emerging economies at risk of an exchange-rate crisis: Sri Lanka, South Africa, Argentina, Pakistan, Egypt, Turkey and Ukraine (Nomura Holdings)

Source: International Monetary Fund, Bloomberg Economics; *2018 data are IMF projections

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CHALLENGE? HOW PREDICTING A CURRENCY CRISIS?

Liquidity indicators

- ▶ Inflation
- ▶ Foreign-exchange reserves
- ▶ interest rates differential
- ▶ Import cover
- ▶ Debt servicing ratio and current account

▶ **Socio-political and behavioral indicators**

- Political turmoil
- Capital flight
- Bank run : number of customers withdraw their deposits simultaneously due to concerns about banking solvency

Solvency and structural indicators

- ▶ Debt levels (Debt/GDP, Debt/X, ST Debt/R)
- ▶ Worsening terms of trade
- ▶ Productivity's protracted weakness

▶ **Exogenous and global indicators**

- Systemic crisis
- Regional contagion
- Commodity prices
- \$/€ Exchange rate volatility

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BUT HOW TACKLING AN « ABNORMAL » RISK?

LARGE, ABRUPT, AND OUTSIDE THE STANDARD TOOLKIT OF RISK INDICATORS?

Gradual trend of mounting riskiness

- ▶ Liquidity indicators
- ▶ Solvency ratios
- ▶ Ratings and rankings
- ▶ Surveys and polls
- ▶ Behavioral change
- ▶ Institutional weaknesses
- ▶ Growth slowdown
- ▶ Mounting wealth gaps

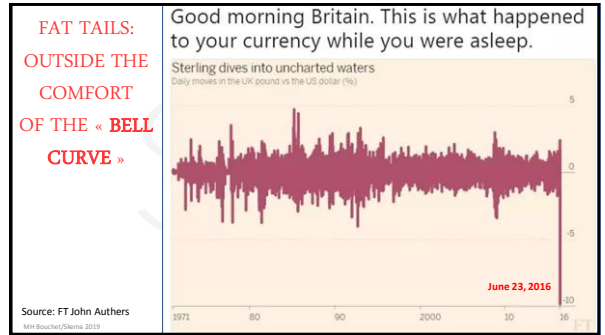
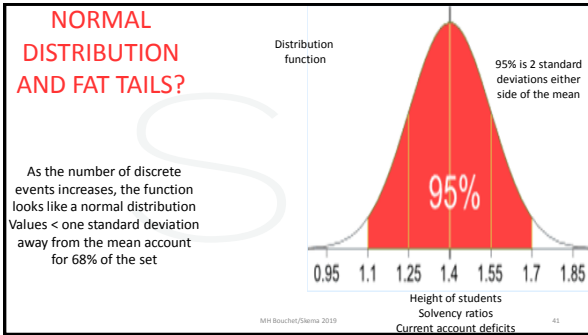
= « Gaussian law »

Abrupt turmoil and crisis

- ▶ War, Coup d'état and revolution
- ▶ Strikes and turmoil
- ▶ Commodity crisis
- ▶ Exchange rate devaluation
- ▶ Bank run
- ▶ Debt crisis and default
- ▶ Nationalization & confiscation

= « fat tails and black swans »

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BLACK SWANS AND DRAGON KINGS

➤ **Nassim Taleb's Black Swans:** Major catastrophes are just events that started small and did not stop growing to develop into extreme sizes. These events are **unpredictable!** Black Swans are quantified by heavy-tailed distributions of event sizes ("fat tails" in Gaussian distributions). These outliers are anomalies with an abnormal distance from other values in a random sample from a population.

➤ **Sornette's Dragon Kings:** Very large in impact and born out of unique origins: non-linear systems. These **extreme events** are generated by herd-instinct, feedbacks, and unsustainable super-exponential acceleration before collapse. DKs are beyond the extrapolation of the fat tail distribution. Their occurrences **can be diagnosed ex-ante**, bringing back responsibility and accountability.

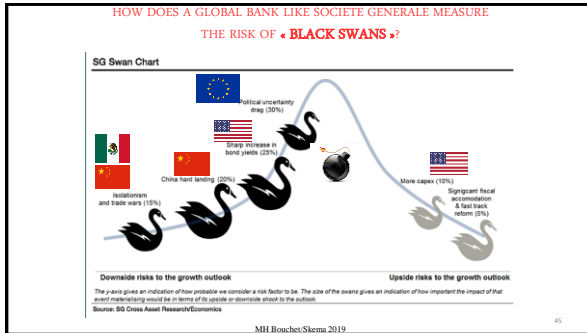
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POWER LAWS AND EXTREME RISKS?

Power law probability distributions = Functional relationship between 2 quantities, where a relative change in one quantity results in a proportional relative change in the other quantity, independent of the initial size of those quantities: one quantity varies as a power of another.

- Considering the area of a square in terms of the length of its side, if the length is doubled, the area is multiplied by a factor of four!
- Car exhaust is distributed according to a power-law among cars : very few cars contribute to most contamination
- Wealth gap and Pareto distribution: The net worth of Americans is distributed according to a power law with an exponent of 2 (the average income hides fat-tails!)
- Power-law distributions are plotted on doubly logarithmic axes, which emphasizes the upper tail region ("extreme events")
- Log-log plot and power-law graph of cumulative distribution of ranking of popularity: right= long tail and left= the few that dominate, also known as the 80-20 rule

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CONCLUSION

► Transforming information into economic intelligence = Best risk mitigation strategy!

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What is Country Risk all about?

«YESTERDAY'S» COUNTRY RISK

► Traditional definition of cross-border financial risk:
Assessment of a foreign entity's ability and willingness to meet its external obligations in full and on time

► Foreign entity? Private firm, country government, bank, investment fund, supplier, client, partner...

► Country risk is composed of a complex combination of political, financial and macro-economic risk

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« TODAY'S » COUNTRY RISK IN THE AGE OF GLOBALIZATION

Operational definition:

Set of interdependent economic, financial and socio-political factors, specific to a country in the global economy, which can affect both domestic and foreign economic agents

- ▶ Domestic agents? Private firms, households, banks, merchants, exporters and importers, students...
 - ▶ Country risk is composed of a complex combination of **political, financial and macro-economic risk that must be assessed in the globalized system**

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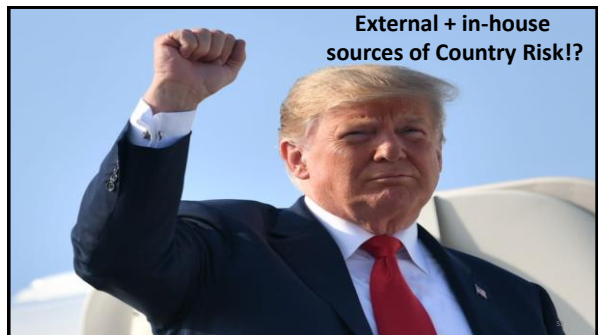
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WHAT COUNTRY RISK IS NOT

- Country risk is **not** a monopoly of foreign creditors, exporters, importers, or investors
- Domestic residents (households, investors, corporate sector) also face country risk from their own country's socio-economic and political situation: The country's government can take **arbitrary** decisions that will affect the residents' well-being
- The country can be **contaminated** by adverse regional or global forces
- A deterioration in the risk perception by capital markets and rating agencies will **feedback** on domestic residents' environment: downgrading + capital flight!

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COUNTRY RISK IN THE AGE OF DONALD TRUMP

Direct «Hard Risks»

- Risk materialization directly hurts US business: outbreak of a military conflict between North Korea and the United States; sharp rise in interest rates and fall in bond prices; stock market crash; large weakening of USD; trade retaliation by Mexico, China, and Canada; mounting trade and geopolitical tensions with China and Russia

Indirect «Surrounding Risks»

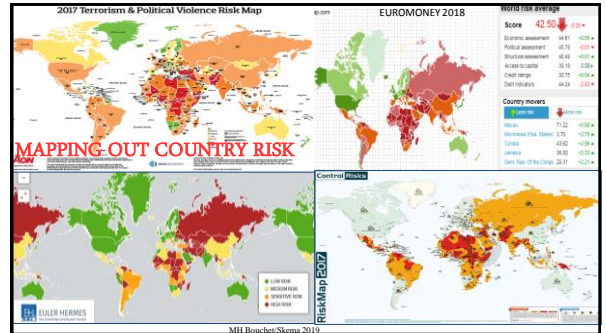
- Risk materialization stems from a more hostile environment: protracted stalemate between White House and Congress regarding budgetary policy and National Security Strategy; ongoing saber-rattling with Iran, Turkey, and Pakistan; regional crisis in the Western Hemisphere and in the Middle East; protracted renegotiation of NAFTA

Collateral damages

- Risk materialization as byproduct of unfavorable interactions between power groups: impeachment of Donald Trump; global protectionism; geopolitical volatility; mounting wealth gap; pressure groups and hostile NGOs; rising protectionism in OECD



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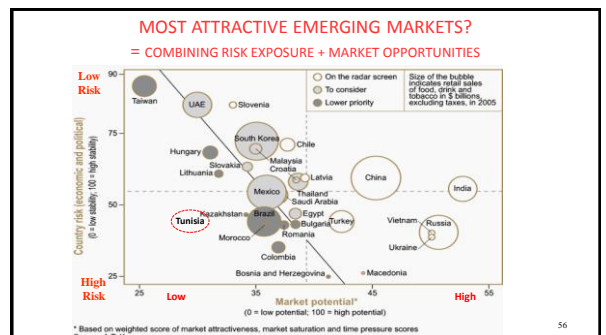


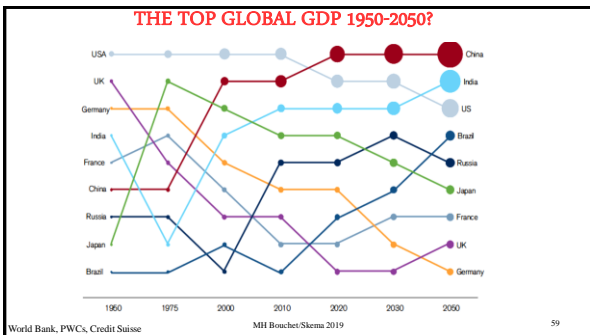
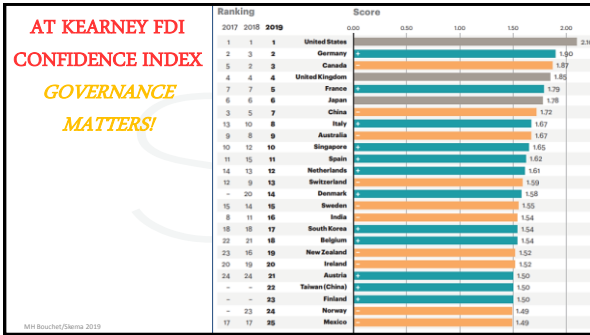
TACKLING COUNTRY RISK

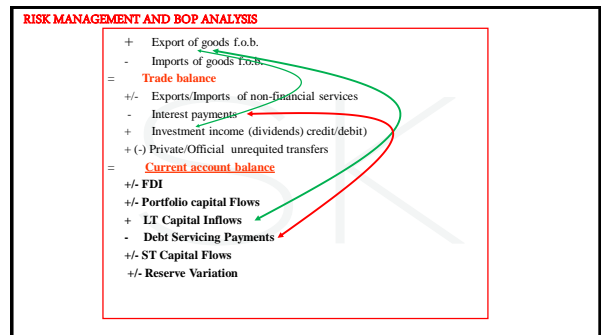
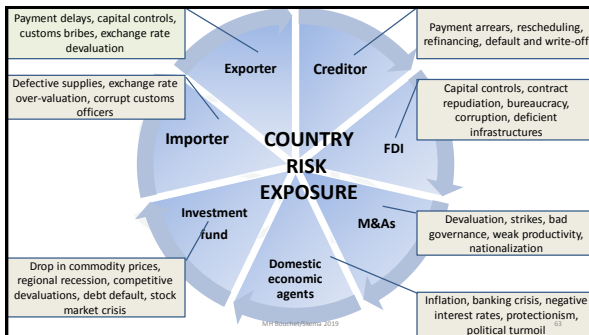
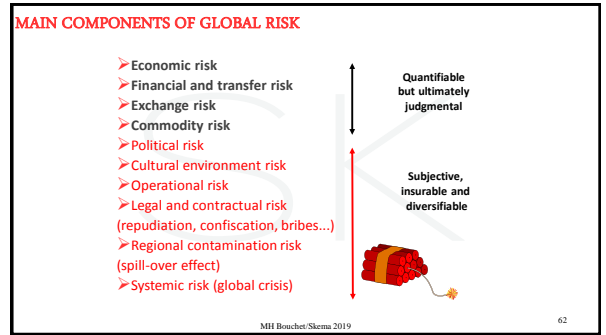
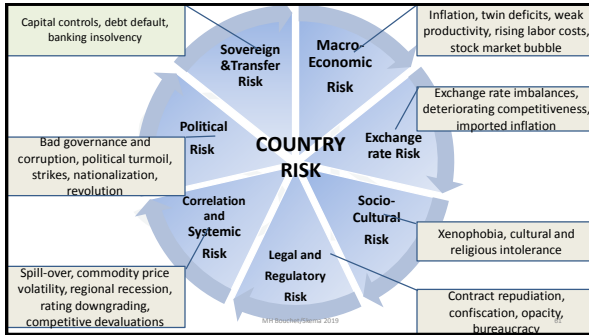
COUNTRY + RISK

- ▶ **Country** = sovereign entity, culture and values, geographical distance, national laws and regulations, socio-political parameters
- ▶ **Risk** = lack of perfect information in real time, spill-over effect, abrupt changes

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**EXTERNAL DEBT ANALYSIS:
THE DUAL FACE OF COUNTRY RISK**

Liquidity Risk	Solvency Risk
<ul style="list-style-type: none"> ▶ Debt Service Ratio: (P+/X) ▶ Interest Ratio (I/X) ▶ Current account/GDP ▶ Growth rate of exports/ Average external interest rate 	<ul style="list-style-type: none"> ▶ Debt/Export ratio ▶ Debt/GDP ratio ▶ Debt/Reserves ▶ ST Debt/Total Debt ▶ ST Debt/Reserves ▶ Reserve/Import ratio

Michel Henry Bouchet (c) 65

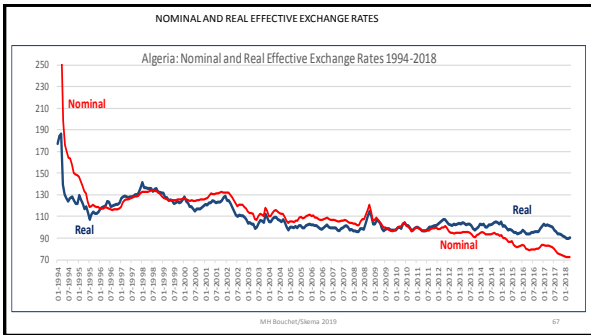
LIQUIDITY AND SOLVENCY THRESHOLDS

Stock variables

- ▶ **Solvency** = Debt/GDP < 100% (66% = EMCs)
- Debt/Exports < 150%
- Reserves/months of Imports > 6 months

Flow variables

- ▶ **Liquidity** = Debt Service ratio < 33% of X
- Interest/X ratio < 25%



BETTER OFF IN TUNISIA OR IN ALGERIA?

TUNISIA

- ▶ GDP Per capita = \$10500
- ▶ HDI= 97
- ▶ Life expectancy f = 78
- ▶ Infant mortality= 13/1000
- ▶ Gender inequality: 0,28
- ▶ Doing Business= **80/190**
- ▶ Corruption = 73/180


ALGERIA

- ▶ GDP Per capita=13500
- ▶ HDI= 83
- ▶ Life expectancy f= 75
- ▶ Infant mortality= 22/1000
- ▶ Gender inequality: 0,43
- ▶ Doing Business= **157/190**
- ▶ Corruption = **105/180**

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MOROCCO


- ▶ GDP per capita ppp= \$7200
- ▶ HDI = 123
- ▶ Life expectancy= 76
- ▶ CPI corruption= 73/180
- ▶ Gender inequality = **0,49**
- ▶ Infant mortality= **23,7/1000**
- ▶ Doing Business = **60/190**
- ▶ **FDI= Tunisia * 2** (=2,4% GDP)



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BOLIVIA

- ▶ GDP per capita ppp= \$7500
- ▶ HDI = 118
- ▶ Life expectancy= **69**
- ▶ CPI corruption= 112
- ▶ Gender inequality = **0,49**
- ▶ Infant mortality= **30/1000**
- ▶ Doing Business = **156**
- ▶ **FDI = minimal**



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COUNTRY RISK ASSESSMENT

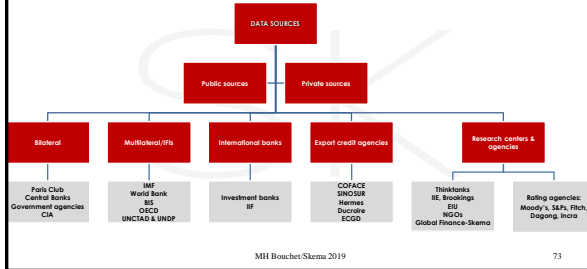
Reliable and updated information
= Economic intelligence

→ **Robust risk analysis**



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MAJOR SOURCES OF COUNTRY RISK INTELLIGENCE



4 MAIN APPROACHES TO COUNTRY RISK ASSESSMENT

1. **Qualitative « macro » approach:** financial, macroeconomic, legal, regulatory and political parameters
2. **External debt analysis:** Balance of payments + liquidity and solvency
3. **Quantitative approach :** rating, ranking, and scoring
4. **Econometric approach** and modelization

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UNCERTAINTY AHEAD!

HOW TACKLING POLITICAL RISK?

INSTITUTIONAL WEAKNESSES, POWER CONCENTRATION,
CORRUPTION AND POLITICAL VIOLENCE



MICHEL-HENRY BOUCHET

PARIS CAMPUS FMI

SEPTEMBER 9, 2019

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WHAT IS POLITICAL RISK?

- ▶ **Country 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

Political risk stems from the unexpected unfavorable consequences of the arbitrary exercise of power by a government or private groups over foreign and domestic agents

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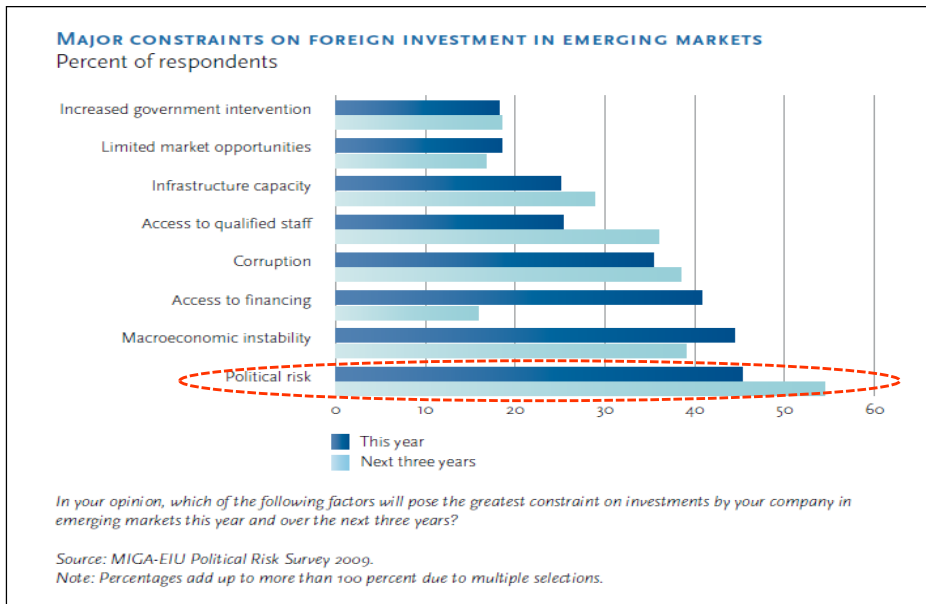
RANKING OF TOP RISKS REPORTED BY FTSE 100 FIRMS (FT JULY 2017)



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MIGA: THE KEY CHALLENGE OF POLITICAL RISK

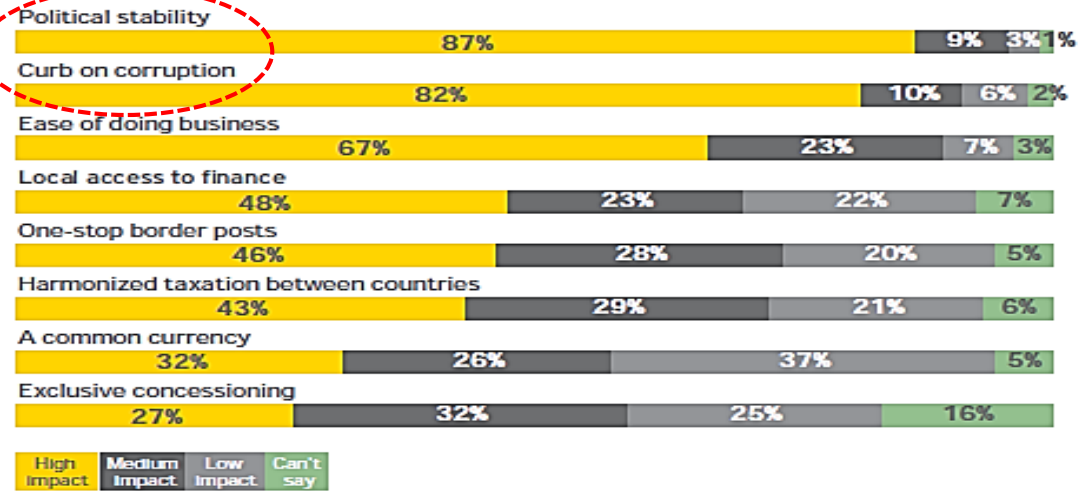


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BOOSTING FDI IN AFRICA?

What impact would the following changes have on Africa attractiveness?

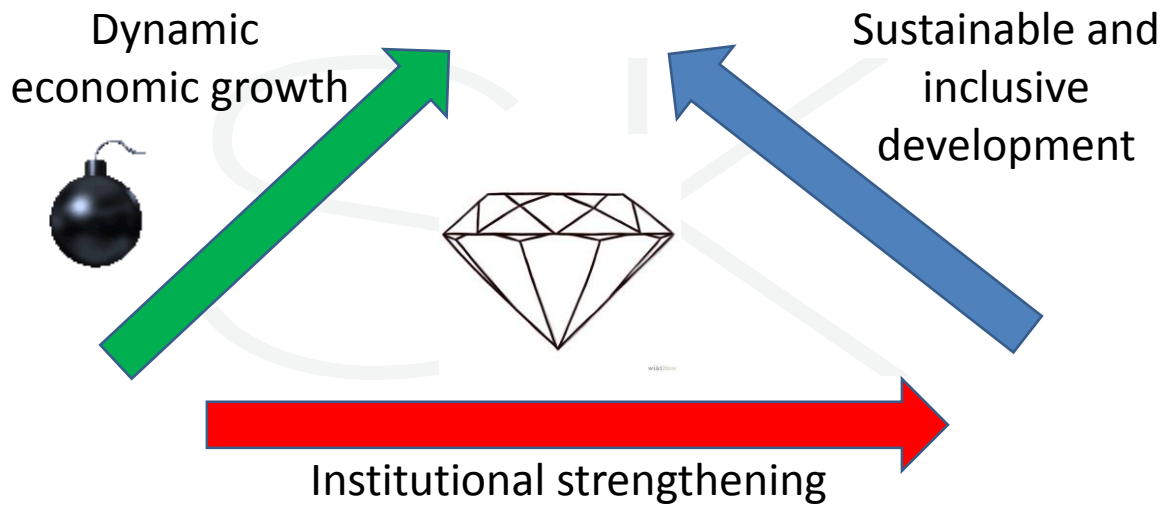


Source: Ernst & Young's 2012 Africa attractiveness survey. Total respondents: 505.

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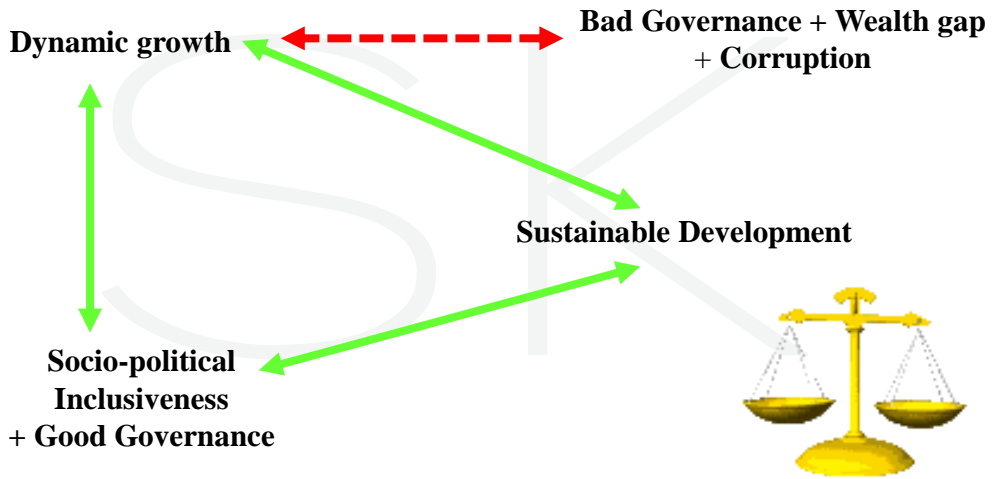
THE REQUIRED POLITICAL STABILITY TRIANGLE



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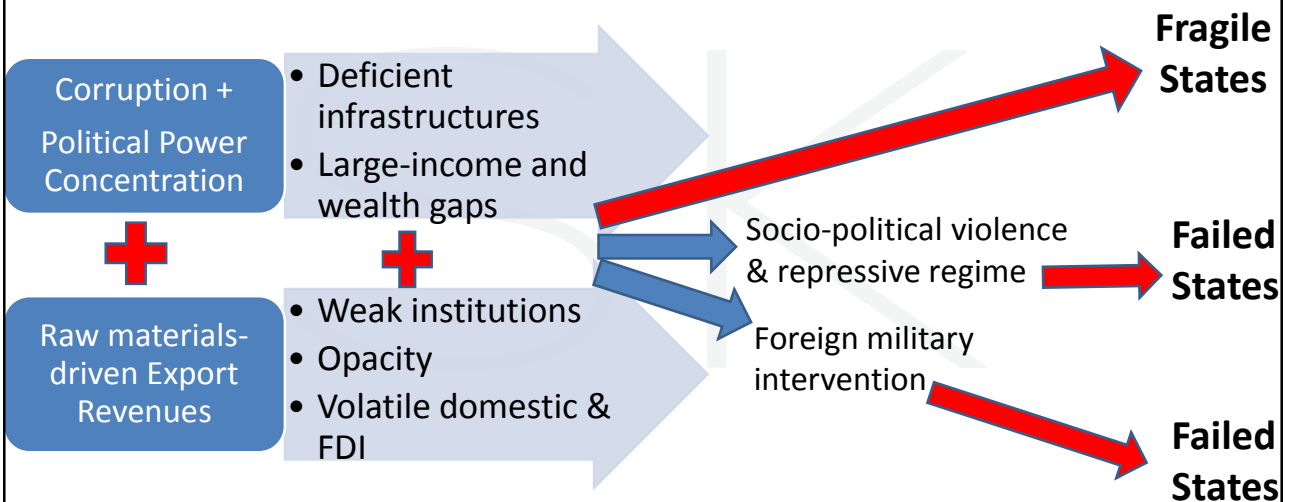
TRILEMMA OF GROWTH AND DEVELOPMENT?



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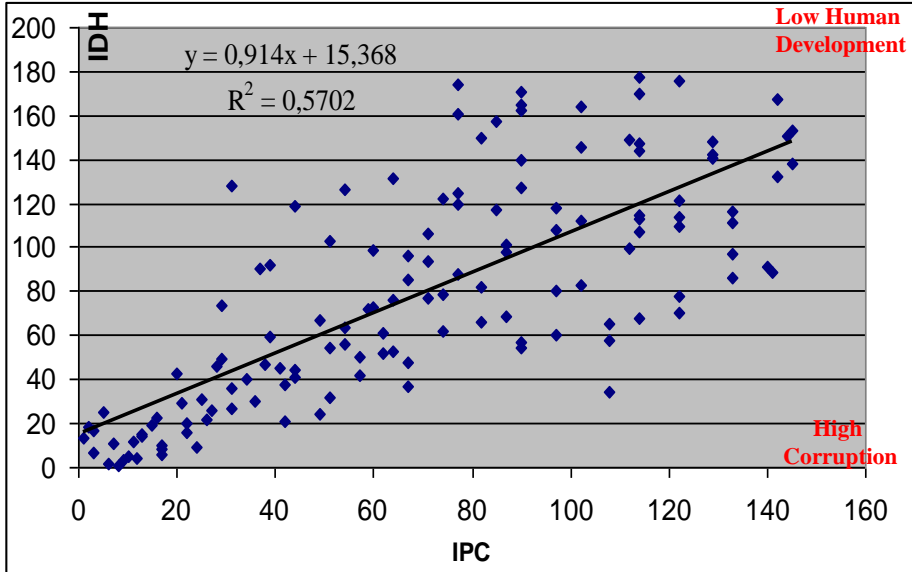
THE UNFOLDING OF STATE FAILURE



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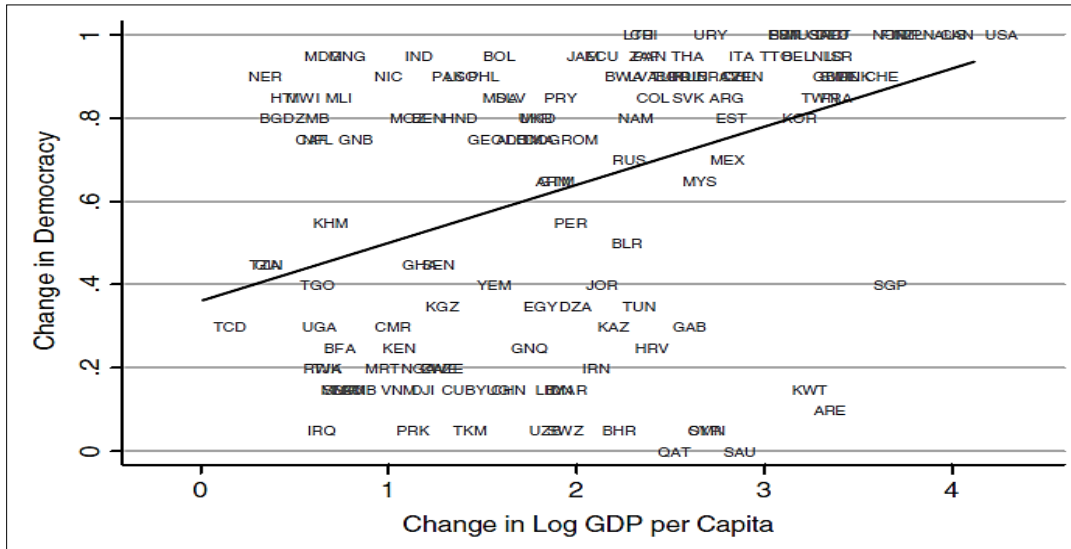
CORRELATION HUMAN DEVELOPMENT /CORRUPTION



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DEMOCRATIZATION AND INCOME GROWTH 1500-1995

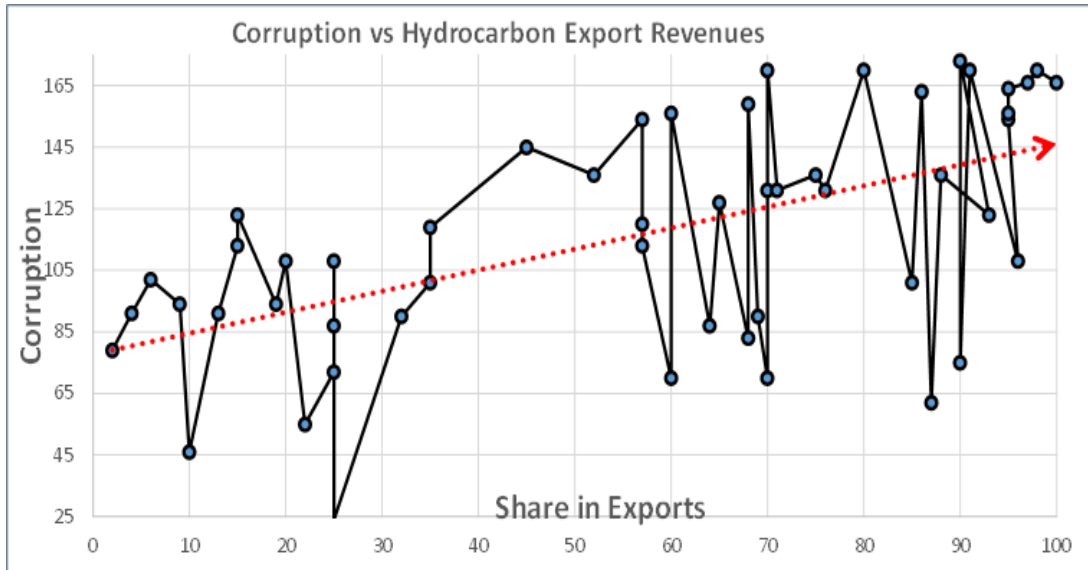
INCOME PER CAPITA AND DEMOCRACY ARE CORRELATED BECAUSE ECONOMIC AND SOCIO-POLITICAL INSTITUTIONS TRANSFORM GROWTH INTO SUSTAINABLE AND INCLUSIVE DEVELOPMENT



J. Robinson, 2006

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OIL-BASED GROWTH LEADS TO POWER AND WEALTH CONCENTRATION, AND CORRUPTION (EXCEPTED IN NORWAY!!?)



Source: Bouchet & alii Palgrave 2019

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DEVELOPMENT = ECONOMIC GROWTH + KEY CONDITIONS THAT MAKE IT SUSTAINABLE!

	CHILE	COSTA RICA	RUSSIA	GABON
GDP/per capita	\$15,000	\$11,000	\$15,000	\$14,000
Life Expectancy	79	80	67	61
HDI Rank	40	62	55	106

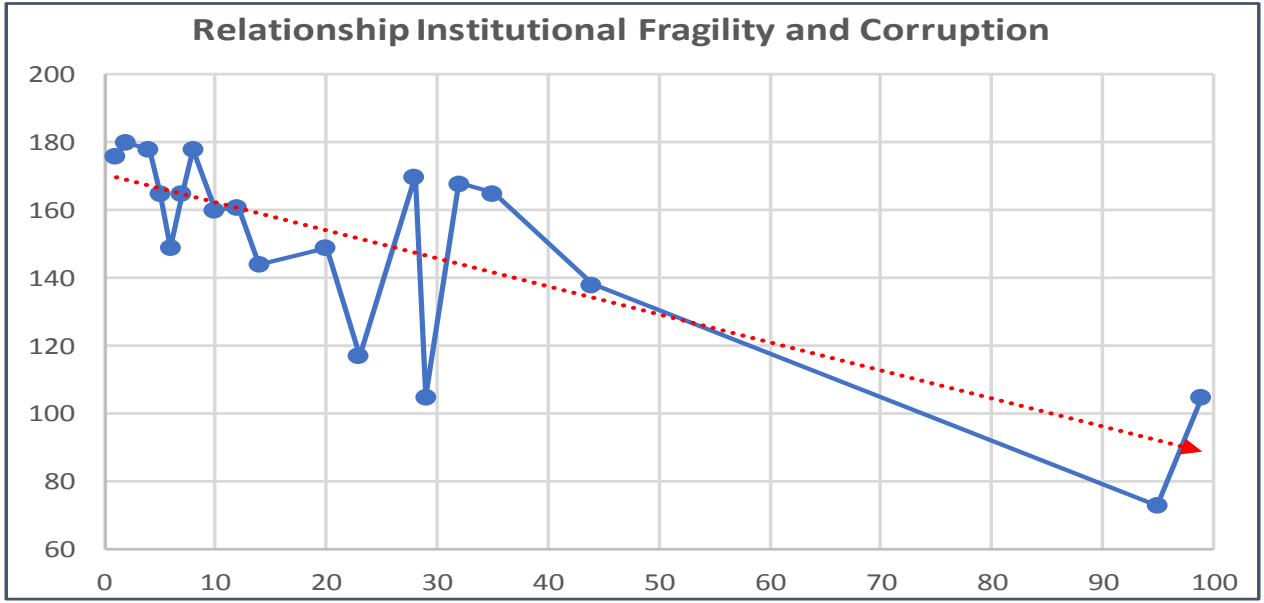


	ARMENIA	SRI LANKA	CONGO	ANGOLA
GDP per capita	\$5000	\$5000	\$5000	\$5000
Life expectancy	74	75	57	51
HDI Rank	87	97	142	148

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INSTITUTIONAL FRAGILITY AND CORRUPTION



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MEASURING SOCIO-POLITICAL RISK



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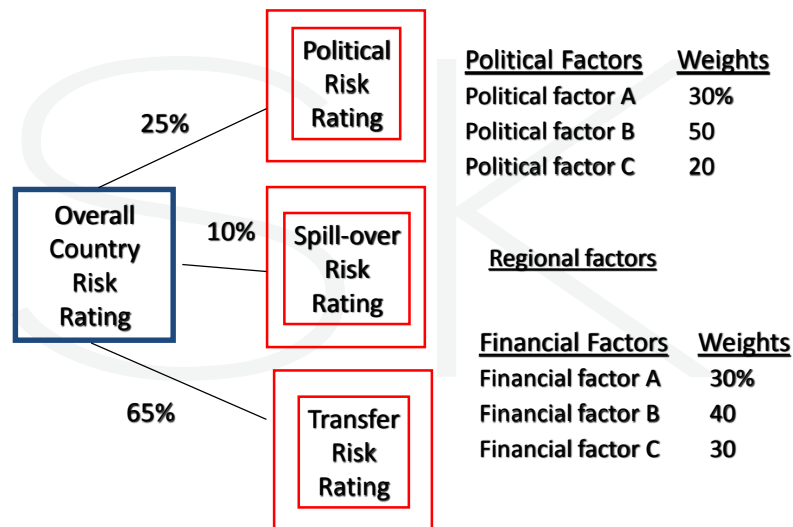
POLITICAL RISK INDICES

- ▶ Heritage Foundation
- ▶ Freedom House
- ▶ Cato Institute
- ▶ Fund for Peace
- ▶ Transparency International CPI
- ▶ PWCs: Opacity Index
- ▶ LB: Legsi
- ▶ Asiarisk
- ▶ Marsh
- ▶ World Bank (Governance)
- ▶ Euromoney (25%)
- ▶ Institutional Investor
- ▶ IMD
- ▶ ICRG-PRS
- ▶ MIG
- ▶ WMRC
- ▶ University of Maryland
- ▶ Ibrahim Index of Governance

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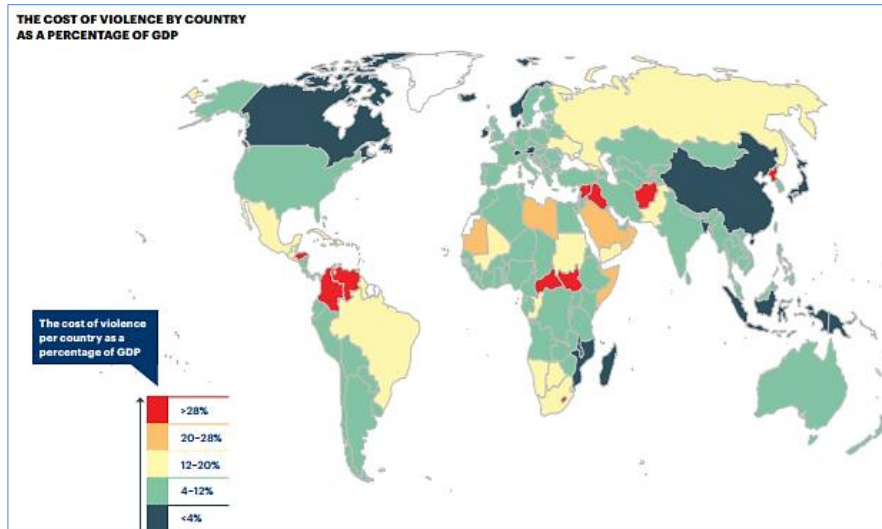
QUANTIFYING COUNTRY POLITICAL RISK



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THE COST OF VIOLENCE IN % OF GDP (WORLD ECON FORUM: THE ECONOMIC VALUE OF PEACE REPORT)



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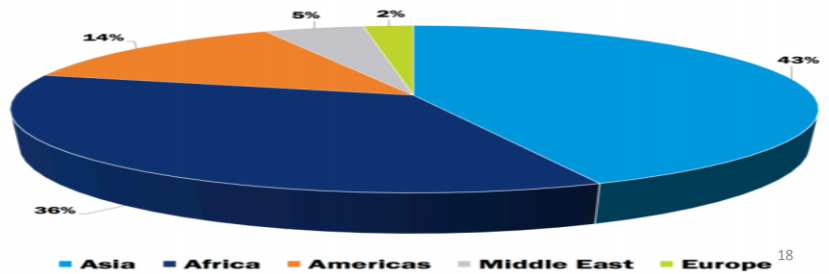
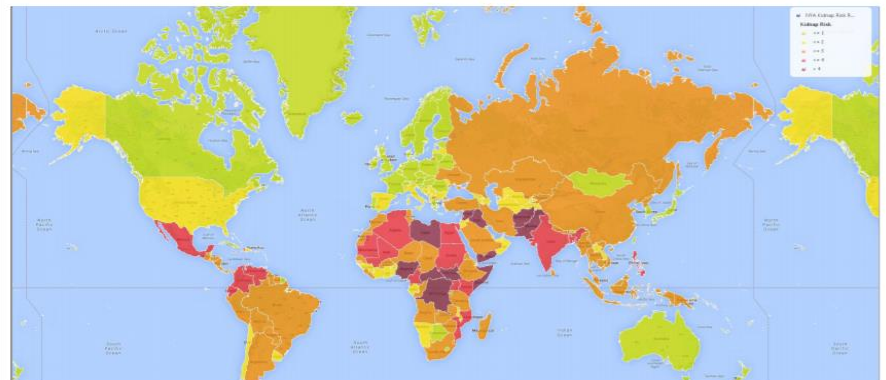
TOP 20 KIDNAP RANKING



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

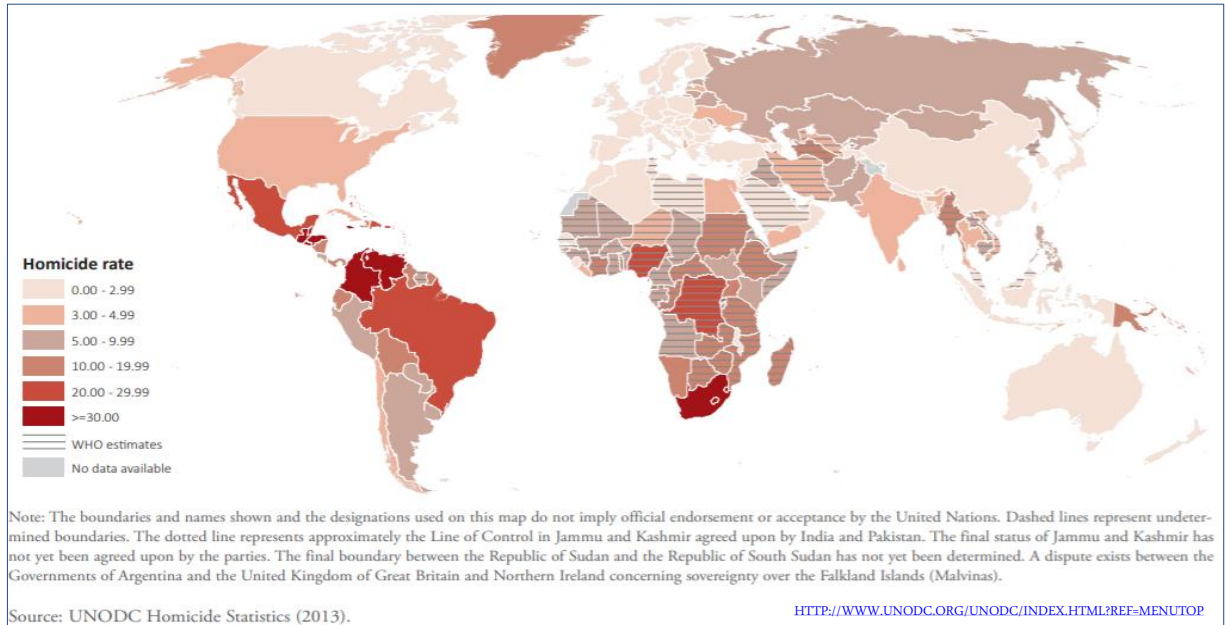
: >7,770 kidnaps for ransom!

Source: Hiscox Group/FT/ AIG



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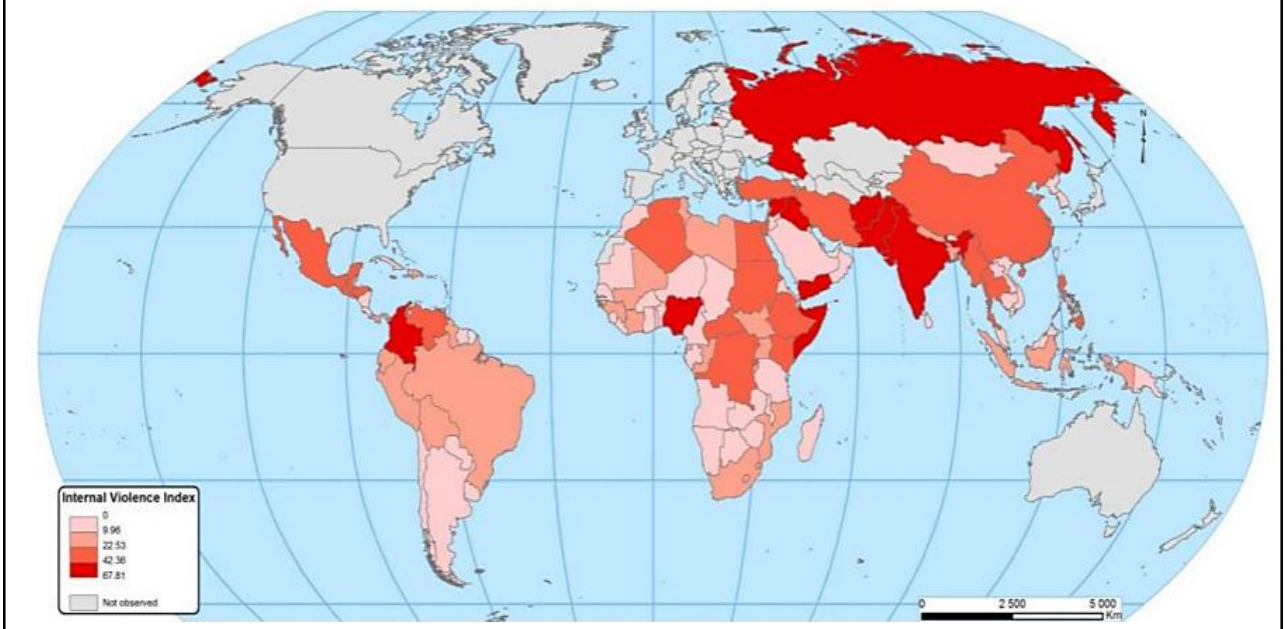
Homicide Rate Map (Source: UNODC)



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THE INTERNAL VIOLENCE INDEX

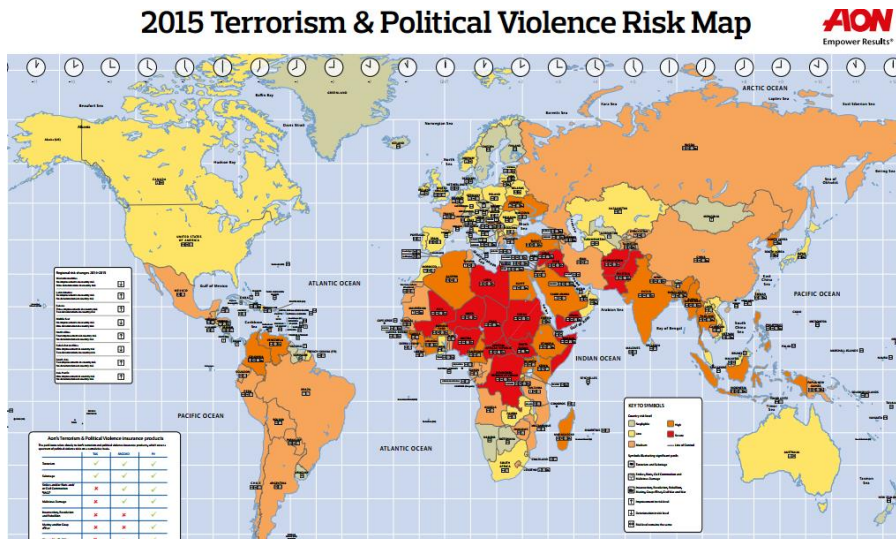


AON POLITICAL RISK MAP

- ▶ The Aon Political Risk Map measures political risk in 163 locations and territories.
- ▶ Risk ratings are standardized across each location, on a six-point scale ranging from low to very high, with all risks updated once per quarter.
- ▶ EU and OECD countries are not rated in the map!!
- ▶ Political risk is calculated as a simple average of six core risk measures :
 1. • Political Violence
 2. • Exchange Transfer
 3. • Sovereign Non-Payment
 4. • Political Interference
 5. • Supply Chain Disruption
 6. • Legal & Regulatory

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



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

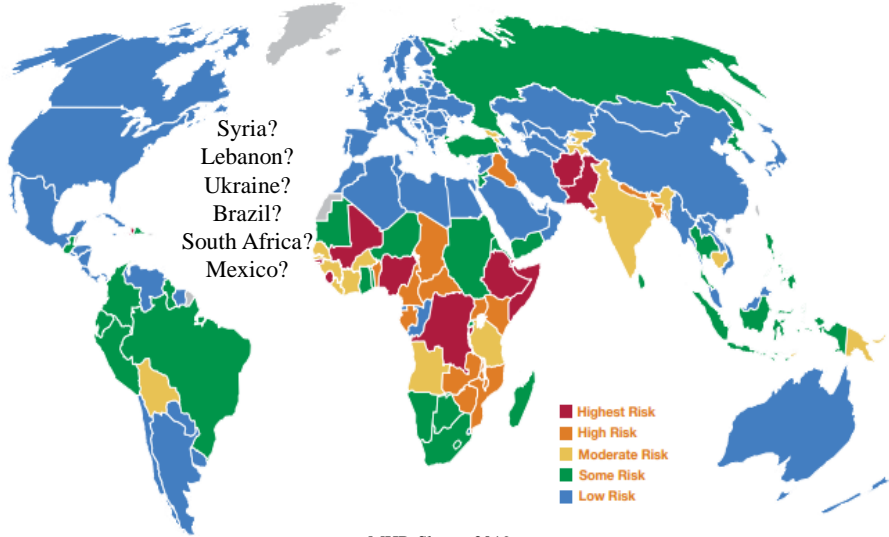
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BLINDNESS? RISK OF FUTURE POLITICAL CRISIS 2010-12

SOURCE: UNIVERSITY OF MARYLAND CENTER FOR CONFLICT MANAGEMENT

Figure 2.1 Risk of Future Instability, 2010-2012

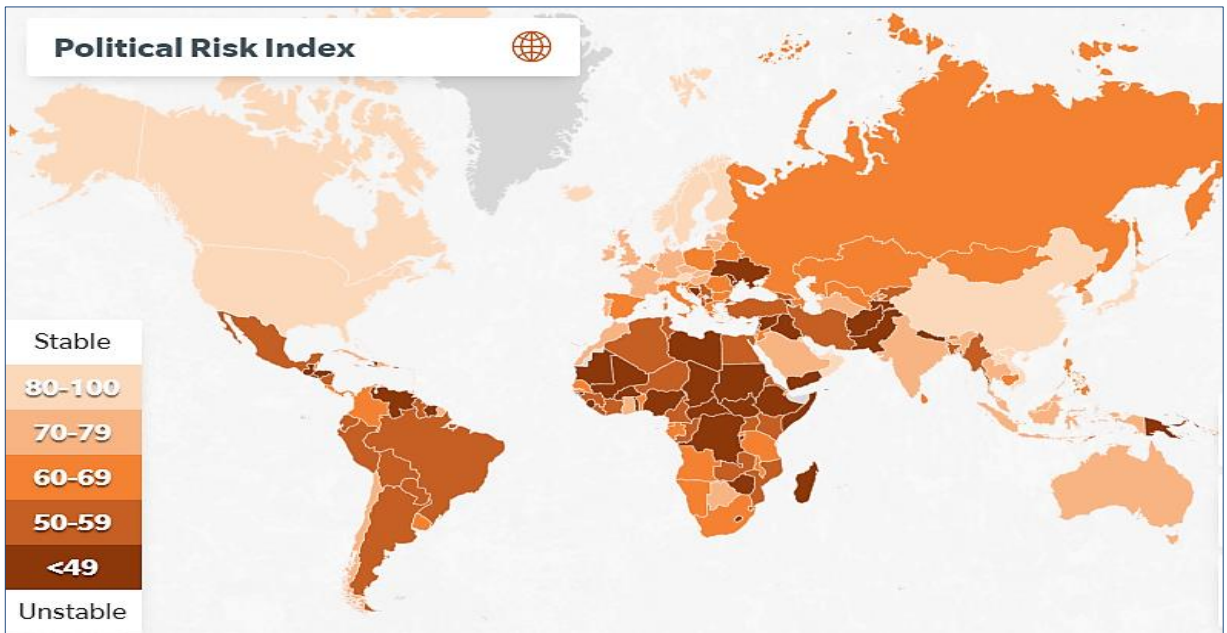


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MARSH POLITICAL RISK MAP 2019



Political risk materialization

THREAT

▶ 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

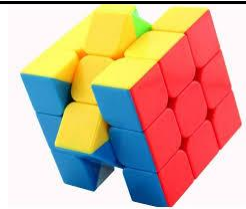
Collateral «soft risks»

- **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

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WHERE DOES POLITICAL RISK COME FROM?



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

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LOOSENING IDENTITY AND SOCIO-POLITICAL FRAGMENTATION: « THE ARCHIPELAGO »*

- ▶ Combination of modernization, slower growth, wider wealth gaps, and rapid immigration can produce **eroding national identity and socio-political fragmentation**
- ▶ A « **Nation** » then becomes a « **Country** » where a territory is shared by multiple ethnocultural groups with divergent interests
- ▶ Weakening institutions (parties, associations, unions, religious entities...) are unable to **agregate diverse socio-political and cultural interests**, hence growing tensions and violence.

* See for instance: Jérôme Fourquet, L'Archipel Français, Seuil, 2019

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SAMUEL HUNTINGTON



Political order in changing societies
The Clash of Civilization

• http://markweatherall.wordpress.com/2009/10/12/political_order_in_changing/

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HUNTINGTON AND THE ROOT CAUSES OF POLITICAL TURMOIL

▶ 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!

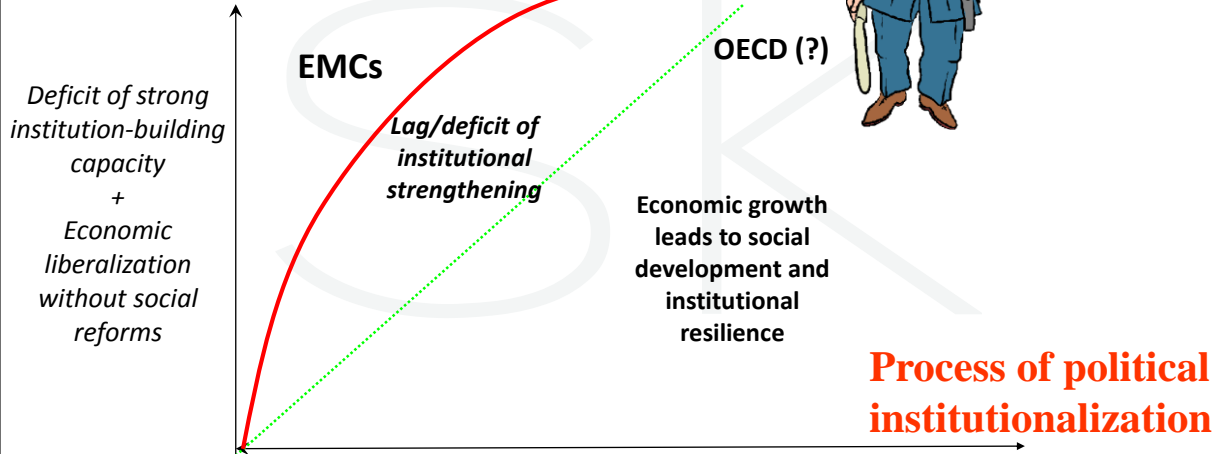
SAMUEL HUNTINGTON ANALYZING THE ROOTS OF POLITICAL UPHEAVAL

- ▶ 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.



POLITICAL DIS/ORDER IN RAPIDLY CHANGING SOCIETIES

Process of socio-economic change



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What is a Failed State?

State fragility and state failure...

A “FRAGILE AND WEAK STATE » IS A STATE WHOSE INSTITUTIONAL FRAMEWORK IS TOO WEAK TO MAINTAIN SOCIAL COHESION THROUGHOUT THE PROCESS OF DEVELOPMENT

INSTITUTIONAL WEAKNESSES, CONSEQUENTLY, GENERATE A CRISIS OF SOCIAL MEDIATIONS WHERE PARTIES, UNIONS, SOCIAL INSTITUTIONS AND LOCAL ELITES LOSE CREDIBILITY FOR ADDRESSING SOCIAL FRUSTRATION AND DEMANDS, HENCE RISING TENSIONS.

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A DEFICIT IN INSTITUTION-BUILDING ALWAYS LEADS TO SOCIAL UPHEAVAL



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ECONOMIC GROWTH + POLITICAL MODERNIZATION IN CHINA?



► Shenzhen = home to economic reform in China?

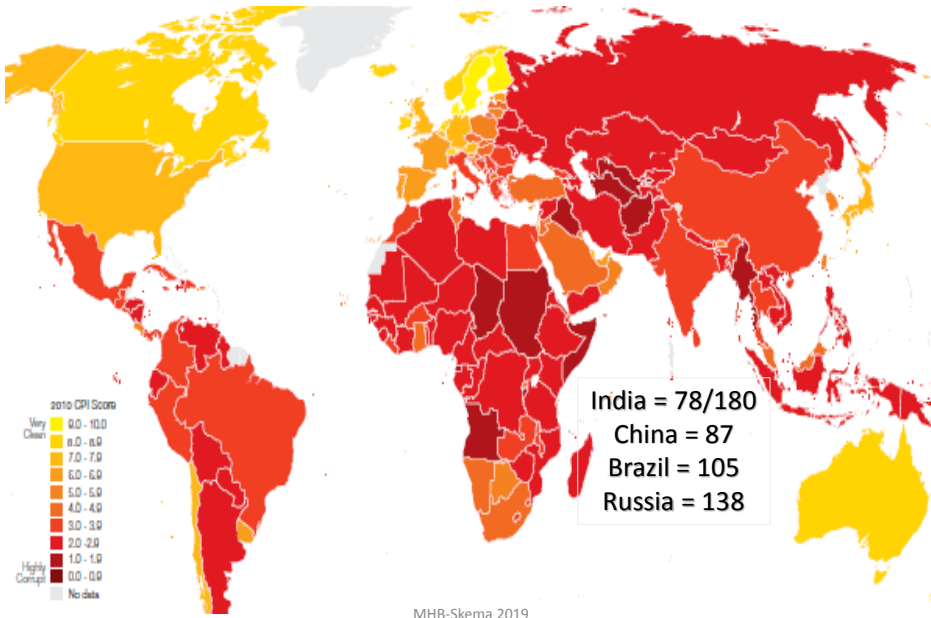
PM Wen Jiabao: « *Political reform is a necessary companion to economic modernization: without the safeguard of political reform, the fruits of economic reform would be lost* »

(August 2010)

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TI WORLD MAP OF CORRUPTION



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MEASURING CORRUPTION? TRANSPARENCY INTERNATIONAL CPI

1	New Zealand	162	Guinea-Bissau
2	Denmark	162	Kyrgyzstan
3	Singapore	162	Venezuela
3	Sweden	168	Burundi
5	Switzerland	168	Equatorial Guinea
6	Finland	168	Guinea
6	Netherlands	168	Haiti
8	Australia	168	Iran
8	Canada	168	Turkmenistan
8	Iceland	174	Uzbekistan
11	Norway	175	Chad
12	Hong Kong	176	Iraq
12	Luxembourg	176	Sudan
14	Germany	178	Myanmar
14	Ireland	179	Afghanistan
16	Austria	180	Somalia

France = 21

Brazil = 105

Russia = 138

India = 78

China = 87

South Afr. = 73

STOP CORRUPTION

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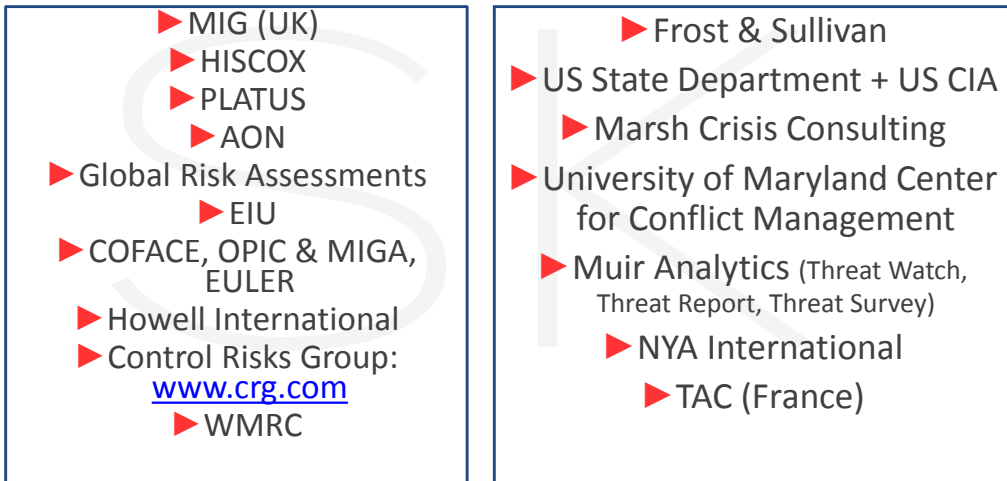
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POLITICAL RISK DECISION MATRIX (0-10 FROM BETTER TO WORSE)

COUNTRY	1	2	3
1. Political violence			
2. Corruption			
3. Institutions			
4. Transparency & Regulations			
5. Competitiveness			
FDI DECISION	Y/N	Y/N	Y/N

1. INFORMATION SOURCES ON POLITICAL RISK: KEY ROLE OF **ECONOMIC INTELLIGENCE**



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2. POLITICAL RISK ANALYSIS

Mapping out the **power structure** and identifying the roots of political legitimacy:

- ▶ ideological (North Korea)
 - ▶ charismatic (Cuba)
- ▶ economic/financial (Brunei)
- ▶ authoritarian populism (Thailand)
 - ▶ ethnic (Ivory Coast, Ghana)
 - ▶ religious (Iran)
- ▶ military (Burma, Venezuela)
- ▶ patron-client relationships (Togo, Congo, Gabon)

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3. POLITICAL RISK ANALYSIS: **PRINCE** MODEL

Frost & Sullivan: William D. Coplin and Michael K. O'Leary of the firm Political Risk Services.

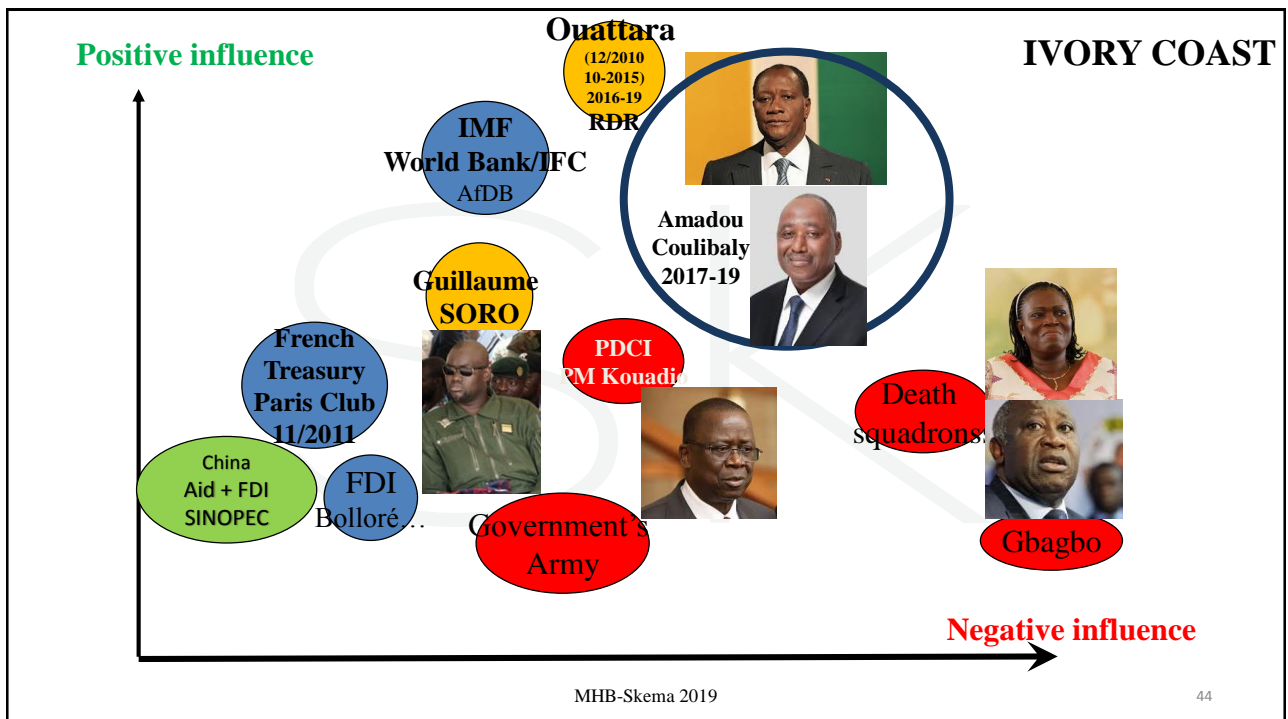
PRINCE = Probe, Interact, Calculate, and Execute

Emphasis on the power structure of a nation by identifying key individuals or groups that can influence a specific risk outcome: destabilization, nationalisation, expropriation...

Political risk forecasting model to produce probability of loss from political instability by relating relative importance in decision-making and relative political orientation towards radical or incremental change (+/-)

DATA= <https://www.cia.gov/library/publications/world-leaders-1/world-leaders-c/cote-divoire.html>

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