

POLITICAL RISK ASSESSMENT II

WHERE DOES POLITICAL RISK COME FROM?



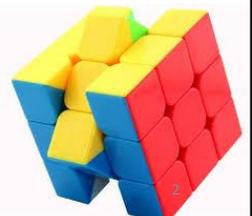
MICHEL-HENRY BOUCHET
CIFE SEMINAR ROMA-BERLIN-NICE 2024

1

1

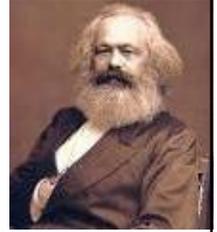
WHERE DOES POLITICAL RISK COME FROM?

- **Exogenous:** Interstate conflict, regional war, terrorism
 - **Endogenous:** Economic recession & Wealth gap
- 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
 - Ethnic/linguistic fragmentation
 - Fragmented identity and “archipelagos”



2

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 = **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 = Instrument of class rule, nothing but 'a committee for managing the common affairs of the whole bourgeoisie'
- Capitalism will inevitably lead to increasing class polarisation and class conflict

Michel H. Bouchet/SKEMA-CIFE 2024

3

3

WEALTH INEQUALITY AND INCOME GAPS = ROOT CAUSES OF SOCIO-POLITICAL TURMOIL!

Table 1: Inequality outlook

	Income		Wealth	
	Avg. Income (PPP €)	Share of total (%)	Avg. Wealth (PPP €)	Share of total (%)
Full population	12 400	100%	32 300	100%
Bottom 50%	1 300	5.3%	-1 600	-2.4%
Middle 40%	8 700	28.2%	13 500	16.8%
Top 10%	82 500	66.5%	276 700	85.7%
Top 1%	272 000	21.9%	1 777 300	55.0%
Top 10% to Bot. 50% Income gap			1 to 63	
Female labor share			36%	
GHG footprint			7.2 tCO2 / pers.	
Transparency index			8.5 / 20	

South Africa in a nutshell : one of the most unequal country in the world!

World Inequality Lab 2023

Figure 1: Top 10% and bottom 50% income shares in South Africa, 1900-2021



Interpretation: The Top 10% income share is equal to 67% in 2021. Income is measured after the operation of pensions and unemployment insurance systems and before income tax.

Sources and series: see wir2022.wid.world/methodology, and Chancel and Piketty (2021).

Michel H. Bouchet/SKEMA-CIFE 2024

https://wir2022.wid.world/www-site/uploads/2022/03/0098-21_WIL_RIM_COUNTRY_SHEETS.pdf

4

4

DANIEL BELL

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:

- The Cultural Contradictions of Capitalism: Polarization and social tensions between work and consumption pressures: market capitalism is inherently **instable**
- Centrality of the new science-based industries & NTIC
- Rise of new technical elites and the advent of a principle of stratification

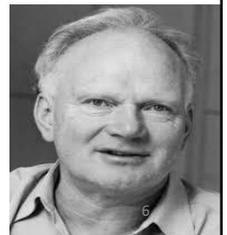
Michel H. Bouchet/SKEMA-CIFE 2024

5

5

ULRICH BECK: "WORLD AT RISK" IN A MODERN SOCIETY

- ▶ 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 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. Individualism is a social cancer!
- ▶ The paradox in late modern society is that risk might be increasing due to technology, science and industrialism rather than being abated by scientific and technological progress.
- ▶ The **world risk society** is full of hazards and insecurities induced by modernization itself:
 1. Globalization
 2. Individualization
 3. Underemployment
 4. Global risks (ecological crisis and the crash of global financial markets)
 5. AI?



Michel H. Bouchet/SKEMA-CIFE 2024

6

6

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

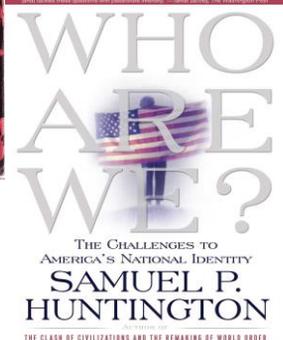
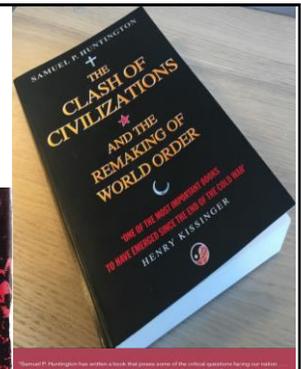
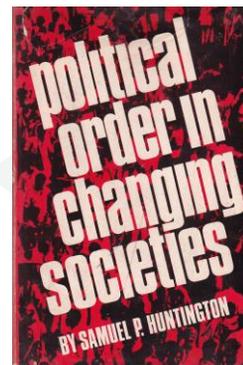
- ▶ Combination of modernization, slower growth, wider wealth gaps, and rapid immigration can produce **eroding national identity and socio-political fragmentation**
- ▶ A « **Nation** » then becomes a « **Country** » where a territory is shared by multiple ethnocultural groups with divergent interests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

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

Michel H. Bouchet/SKEMA-CIFE 2024

7

SAMUEL HUNTINGTON



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

Michel H. Bouchet/SKEMA-CIFE 2024

8

HUNTINGTON AND THE ROOT CAUSES OF POLITICAL TURMOIL

Contrary to the expectations of modernization theory (Kuznet) ,
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!

Michel H. Bouchet/SKEMA-CIFE 2024

9

9

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.



Michel H. Bouchet/SKEMA-CIFE 2024

10

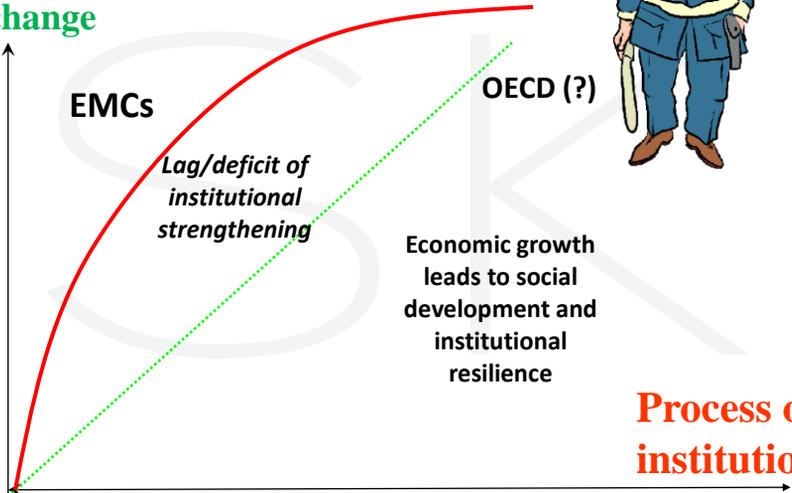
10

POLITICAL DIS/ORDER IN RAPIDLY CHANGING SOCIETIES



Process of socio-economic change

Deficit of strong institution-building capacity + Economic liberalization without social reforms



Process of political institutionalization

Michel H. Bouchet/SKEMA-CIFE 2024

11

11

A DEFICIT IN INSTITUTION-BUILDING ALWAYS LEADS TO SOCIAL UPHEAVAL



Michel H. Bouchet/SKEMA-CIFE 2024

12

12

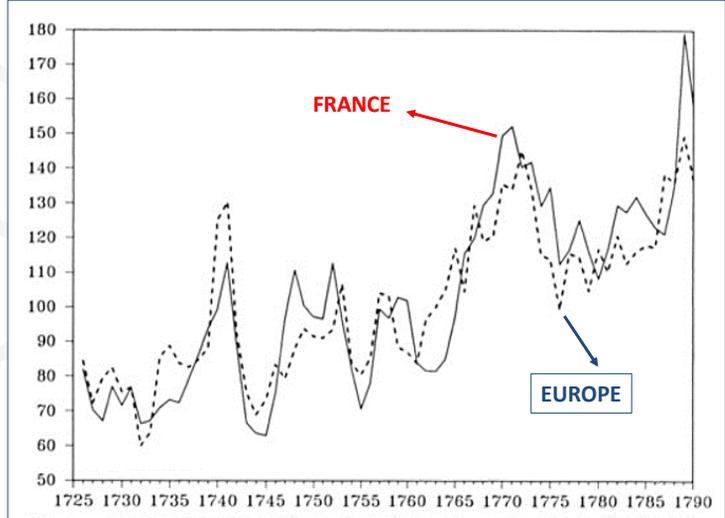
FOOD STRESS, WHEAT PRICES & REVOLUTIONS: WHAT RELATIONSHIP?

Where does a **revolution** come from?

In the XVIII° century, bread constitutes nearly 50% of expenditures of households in France.

- 1788: bad weather and severe drought
- 1789: Necker's alarmist warnings and urgent imports of wheat
- Very cold winter
- 6 pounds of bread cost 12 « cents » = one day salary.
- Fast inflation will continue until 1795

Wheat price index in France and in Europe 1725-1790

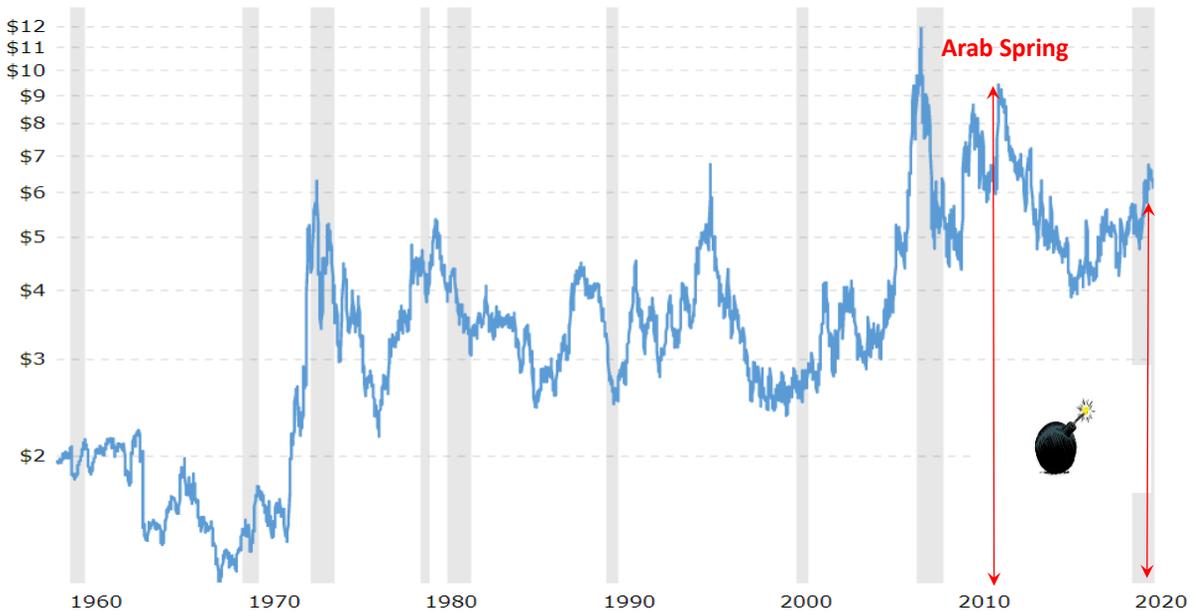


Source: David Weir, Annales, 1991, Vol.46

13

13

LOOKING FOR THE ROOT CAUSES OF THE 2011 ARAB SPRING? WHEAT PRICES/BUSHELL - HISTORICAL DATA



Michel H. Bouchet/SKEMA-CIFE 2024

14

14

**BOUCHET: « DEVELOPMENT = ECONOMIC GROWTH
+ KEY CONDITIONS THAT MAKE IT SUSTAINABLE! »**

	CHILE	COSTA RICA	Turkmenistan	GABON
GDP/per capita	\$15,000	\$11,000	\$15,000	\$14,000
Life Expectancy	80	81	68	65
Global Peace Index	38/163	28/163	103	83
HDI Rank	43/190	62/190	111	119

	ARMENIA	SRI LANKA	NIGERIA	ANGOLA
GDP per capita	\$5000	\$5000	\$5000	\$5500
Life expectancy	75	77	54	60
Global Peace Index	119	145	136	84
HDI Rank	81	72	161	148



Michel H. Bouchet/SKEMA-CIFE 2024

15

15

HOW MOVING FROM GROWTH TO SUSTAINABLE AND INCLUSIVE DEVELOPMENT?

Assumption n°1

- ▶ Primacy of **human capital for both growth and democratization**: human and social capital shape both institutional and productive capacities of a society.
- ▶ Growth in **income and human capital** causes institutional improvement with better political institutions even with pro-market dictators: **policy choices matter** while institutional quality rises as a country grows richer
- ▶ Economic growth and human capital accumulation cause institutional improvement, rather than the other way around

Assumption n°2

- ▶ **Democracy** and other checks on government are the **key mechanisms for securing property rights and boosting growth**
- ▶ **Good and stable institutions will enhance the pace and quality of economic growth**
- ▶ **Robust institutions and good governance matter!**

Michel H. Bouchet/SKEMA-CIFE 2024

16

16

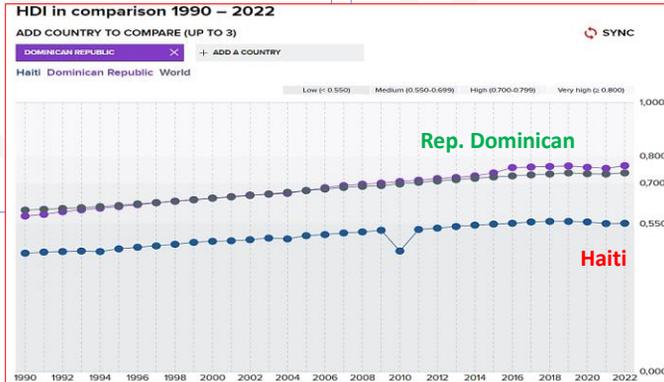
TWO NEIGHBOR COUNTRIES, TWO POLARIZED TRAJECTORIES

► Dominican Republic

- Population: 11,2 million
- GDP growth 2024: 5% Inflation: 4%
- PIB/capita :\$10700 HDI: 92/192
- CPI: 108/180 (Thailande) public debt/GDP: 33%
- Representative democracy life expect: 73

► Haiti: humanitarian crisis

- Population: 12 million
- GDP growth 2024: 0% Inflation: 45%
- PIB/capita : \$2000 HDI= 158/192
- CPI: 172/180 (Eq Guinea) public debt/GDP: 25%
- Protracted chaos life expect: 63



Michel H. Bouchet/SKEMA-CIFE 2024

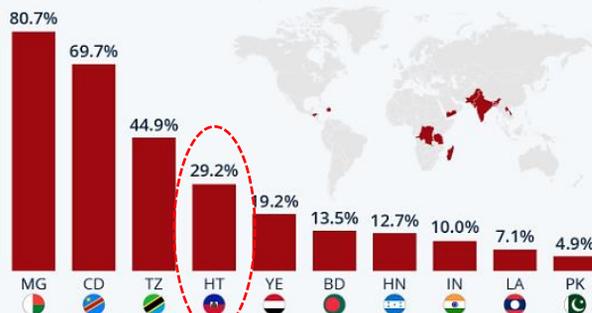
17

17

HAITI AND THE DOMINICAN REPUBLIC SHARE THE ISLAND OF HISPANIOLA WHILE THE ECONOMIES OF THE TWO COUNTRIES WERE COMPARABLE IN THE MID-20TH CENTURY, THE DOMINICAN ECONOMY GRADUALLY IMPROVED OVER THE SUBSEQUENT DECADES. THE REPUBLIC OF HAITI, LONG PLAGUED BY POLITICAL INSTABILITY, IS CURRENTLY THE POOREST COUNTRY IN THE WESTERN HEMISPHERE

Where People Live in Extreme Poverty

Share of people in selected countries living below the international poverty line*

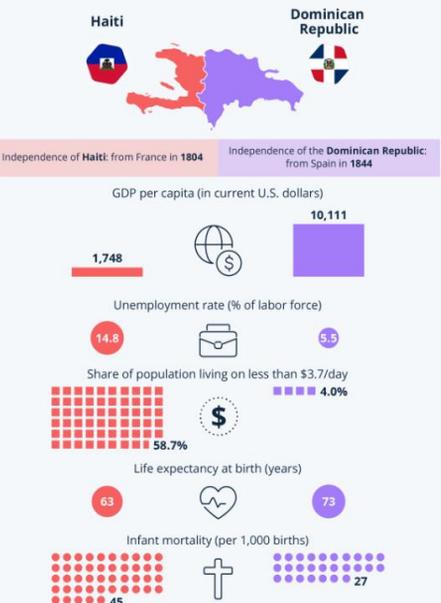


* Currently at \$2.15 a day. Latest available year: 2018-2019. Bangladesh: 2016, Yemen: 2014, Haiti, Madagascar, DRC: 2012. Source: World Bank

Michel H. Bouchet /SKEMA-CIFE 2024

Haiti and the Dominican Republic: Contrasting Fortunes

Comparison of Haiti and the Dominican Republic based on socio-economic indicators



18

Transforming economic growth into inclusive development and stable socio-political environment requires fighting Corruption and strengthening Institutions!

The corruption equation:

$$C \text{ (corruption)} = M \text{ (monopoly)} + O \text{ (Opacity)} + D \text{ (discretion)} + LI \text{ (loose institutions)} - A \text{ (accountability)}$$

Fighting corruption requires eliminating monopoly, reducing discretion and promoting transparency and the rule of law while increasing accountability standards and practices. (Robert Klitgaard)

ECONOMIC GROWTH + POLITICAL MODERNIZATION IN CHINA?



► Shenzhen = home to economic reform in China?

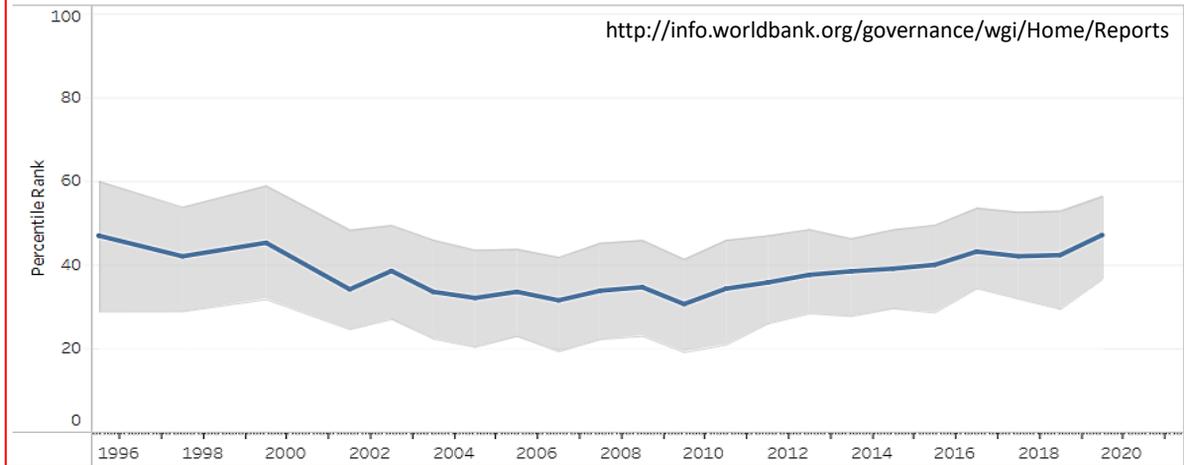
PM Wen Jiabao: « *Political reform is a necessary companion to economic modernization: without the safeguard of political reform, the fruits of economic reform would be lost* »

(August 2010)

WORLD BANK ASSESSMENT OF GOVERNANCE IN CHINA 1995-2020

Worldwide Governance Indicators

China: Political Stability and Absence of Violence/Terrorism et Control of Corruption



Michel H. Bouchet/SKEMA-CIFE 2024

21

21

WORLD BANK'S STRATEGY OF INSTITUTIONAL STRENGTHENING

*“To achieve our goal of ending extreme poverty, we must focus on people living in countries that suffer **from conflict and fragility**.*

*Our new strategy aims to address the underlying causes of fragility and invest in the long-term development that helps create the conditions for **peace and prosperity**”.*

(APRIL 16, 2019 World Bank CEO Kristalina Georgieva)

<https://www.worldbank.org/en/news/press-release/2019/04/16/world-bank-group-launches-worldwide-consultations-on-future-strategy-for-fragility-conflict-and-violence>

Michel H. Bouchet/SKEMA-CIFE 2024

22

22

THE « DEEP » ROOT CAUSES OF POLITICAL RISK I



Since the end of the Middle Age (XIII^e), humanity aimed at optimizing **individual freedom in an environment of scarcity** of time and resources. Gradually, through the European Renaissance and the Age of the Enlightenment until the Industrial Revolution, a **virtuous couple emerged: market economy & liberal democracy.**

The market takes care of the resource allocation of goods & services, and the democratic framework of the allocation of rights and duties. Property rights have paved the way to risk taking and investment in the XIX^e century until today in the LDCs.

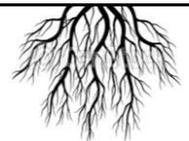
That couple came out in the North of Italy, in Flanders, in Britain, and later in the US, to reach the whole of Europe after the Fall of the Berlin Wall in 1989. Markets need democracy (innovation, transparency, property rights) while democracy needs markets to boost socio-economic development.

Michel H. Bouchet/SKEMA-CIFE 2024

23

23

THE « DEEP » ROOT CAUSES OF POLITICAL RISK II



Tensions arising! Markets are inherently **globalized** since the Industrial Revolution, while democracy is inherently **local** (with a territory and national laws). Markets aim at satisfying **individual** needs while democracy aims at **collective** well-being!

These tensions are managed by local (Parliaments), regional (EU), and global institutions (UN, Bretton Woods).

Institutions play a key role of transmission channels between people and “elites”.

So democratic institutions create a **framework** to offset the myopia of the markets, and to introduce social and economic transfers to keep wealth gaps under control!

Michel H. Bouchet/SKEMA-CIFE 2024

24

24

THE « DEEP » ROOT CAUSES OF POLITICAL RISK III



The “no-End” of History

Since 2000 (China in WTO), the leadership of the liberal capitalist world is increasingly confined: the West has lost much of its **political, cultural and ideological hegemony** in the face of growing populations and economies elsewhere.

The West believed that **exporting democracy** was the same as **creating a liberal capitalism** in its own image. The West assumed that the end of the Cold War or the modernization of the Chinese economy would cause Russia, China (or India for that matter) to adopt Western political, cultural and economic norms.

The loss of the West’s political leadership and the growing confidence of developing countries to choose their own paths and compete for market share outside the G7, create tensions within and between countries.

The **decoupling of market liberalism and democracy** fuels the risk of global fragmentation and military confrontation! Globalization has ended and is being replaced by new regional alliances.

Michel H. Bouchet/SKEMA-CIFE 2024

25

25

POLITICAL RISK, POVERTY, AND SOCIAL REBELLION

What are the root causes of economic growth? What are the ingredients of sustainable development?

► Capital investment-driven growth

1. Cross-country differences in income per capita stem from different paths of capital accumulation and technological progress (Solow, Cass, Koopmans)
2. Institutions are exogenous, and the key issue is initial and local endowments (climate, culture & religion, geography, raw materials, transportations, techniques and capital goods)

► Institutions-driven development

1. Differences in socio-economic institutions are the major source of cross-country differences in economic growth and prosperity (Smith, Stuart Mill, Romer, Lucas, Aghion, North)
2. Institutions provide the rules of the game in social interactions: **socio-political and economic institutions** shape the incentives for investment, production and labor while defining and protecting property rights while influencing resource and income distribution! (Acemoglu, Robinson, Johnson, Rodrik)
3. Some ways of organizing societies encourage people to innovate, to take risks, to save for the future, to find better ways of doing things, to learn and educate themselves, solve problems of collective action and provide public goods. Others do not.

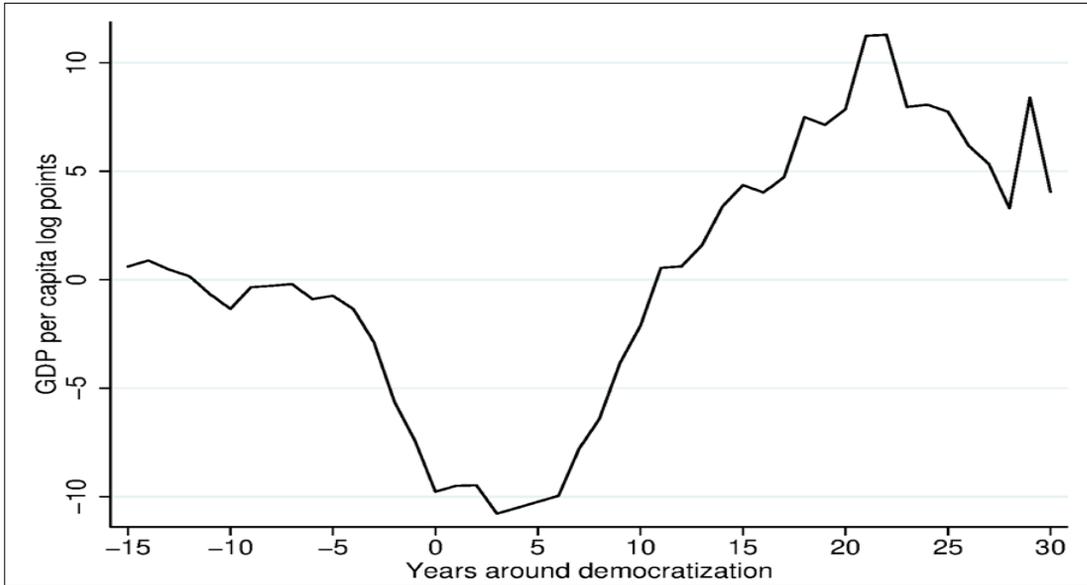


Michel H. Bouchet/SKEMA-CIFE 2024

26

26

**DEMOCRACY BREEDS GDP PER CAPITA GROWTH WHILE ECONOMIC GROWTH LEADS TO DEMOCRACY
(ACEMOGLU & ROBINSON)**

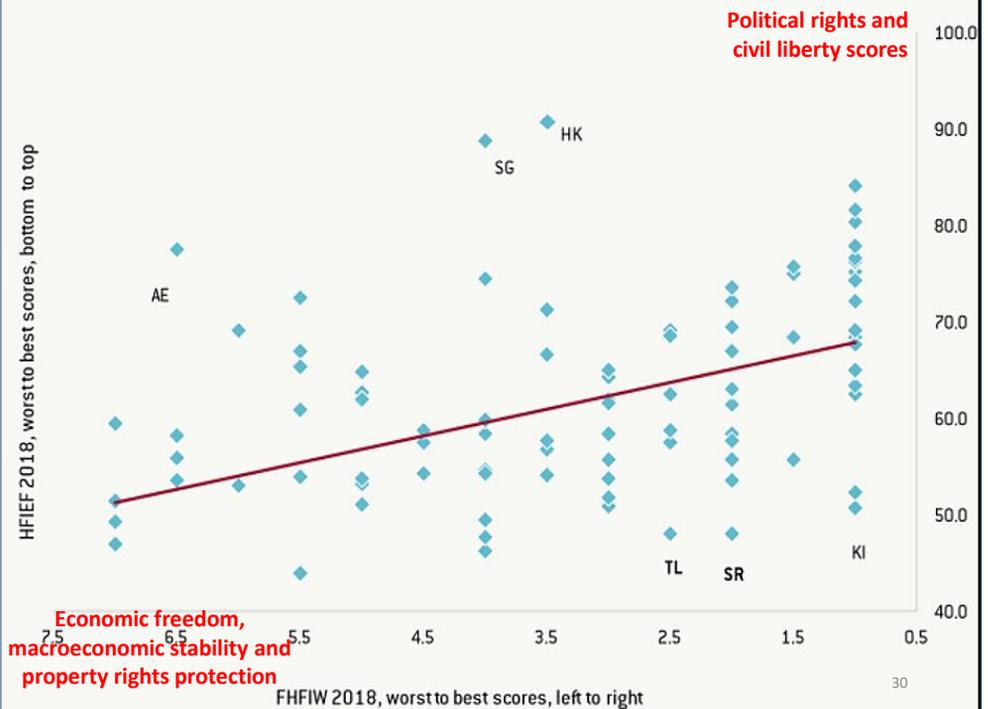


Michel H. Bouchet/SKEMA-CIFE 2024

29

29

IS THERE A CORRELATION BETWEEN POLITICAL FREEDOM & ECONOMIC FREEDOM?



Source: Bruegel, 2018

Michel H. Bouchet/SKEMA-CIFE 2024

30

30



A FEW FACTS REGARDING DEMOCRACY AND DEVELOPMENT



1. Political regimes have **little** impact on **GDP growth rate**
2. **GDP per capita growth does breed democracy**
3. Economic growth provides legitimacy to dictatorships (while increasing demand for political change)
4. **Per capita income grows faster under democracy** (due to human capital and because population rises less fast than under dictatorships)
5. Growth is influenced less by the type of regime than by regime instability: **Democracy provides a stable political environment, hence a positive impact on sustainable growth!**

Since 1980, of the 124 EMCs that have managed to sustain a 5% growth rate for a full decade, 52 % were democracies.
What matters is not the implementation of key reforms for growth and development.

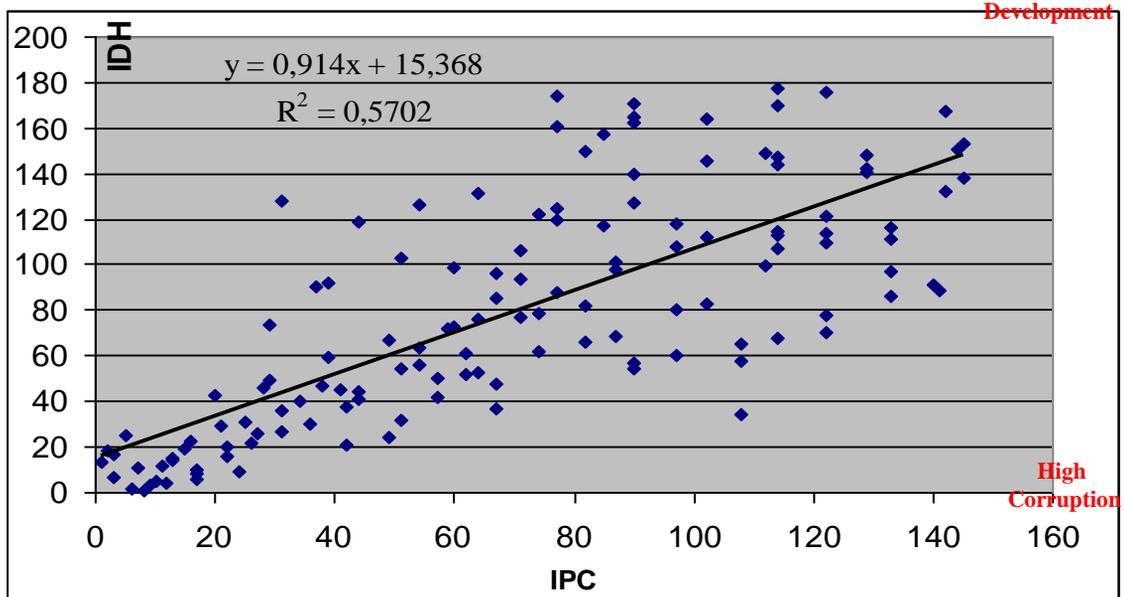
Feng, Y. Cambridge, 1997- Przeworski, A/ NYU- Ruchir Sharma 09/2012

Michel H. Bouchet/SKEMA-CIFE 2024

31

31

CORRELATION HUMAN DEVELOPMENT /CORRUPTION

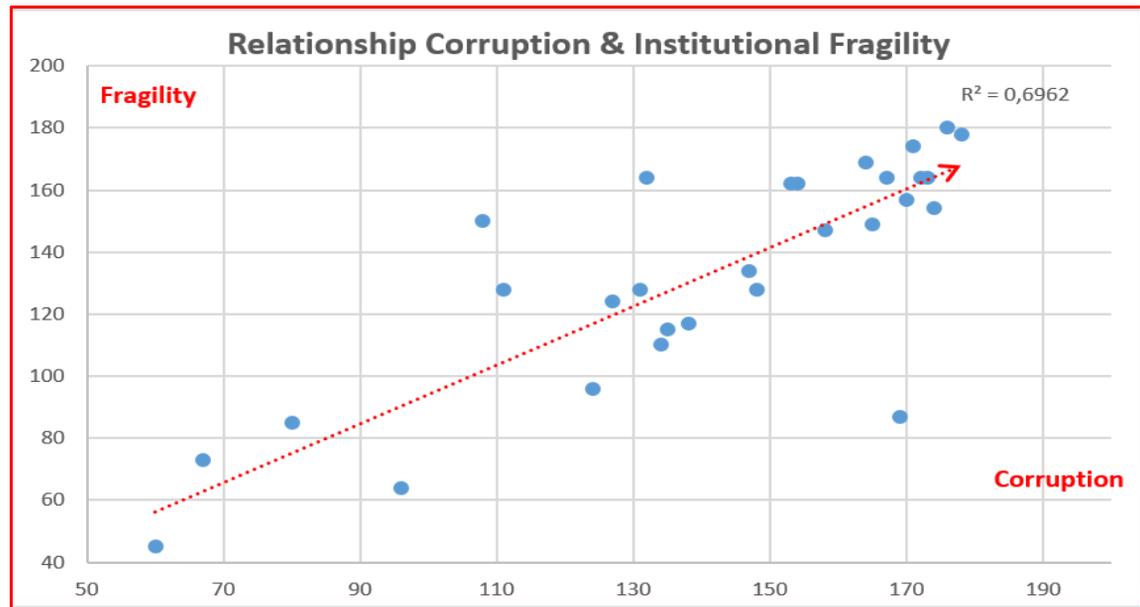


Michel H. Bouchet/SKEMA-CIFE 2024

32

32

26 DEVELOPING COUNTRIES ELIGIBLE TO DEBT REDUCTION!?



Michel H. Bouchet/SKEMA-CIFE 2024

33

33

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 »

Interview by McKinsey Quarterly, 2007

Michel H. Bouchet/SKEMA-CIFE 2024

34

34

