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COUNTRY RISK RATING: ASSESSING GOVERNANCE, CORRUPTION AND SUSTAINABILITY?



CIFE SEMINAR NICE MAY 6-8, 2020
MICHEL-HENRY BOUCHET


Source: www.krg.com

COUNTRY RISK SPECIFIC INDICES: ASSESSING GOVERNANCE, CORRUPTION AND SUSTAINABILITY?

ICRG
Euromoney
Institutional Investor
Freedom House
UNDP
CPI

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ICRG




- The *ICRG* model for forecasting financial, economic, and political risk was created in 1980 by the editors of International Reports (weekly newsletter)
- To meet the needs of clients the editors created a statistical model to calculate risks and backed it up with analyses that explain the numbers and examine what the numbers do not show.
- the *ICRG* model allows users to make their own risk assessments based on the *ICRG* model or to modify the model to meet their specific requirements.

Source: www.krg.com

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INTERNATIONAL COUNTRY RISK GUIDE (ICRG)

- Monitors 140 countries
- The *International Country Risk Guide (ICRG)* rating comprises 22 variables in three subcategories of risk: political, financial, and economic.



- Testing has proven *ICRG*'s reliability and its uniqueness:
 - Claim to have the longest history of country risk data for analysis
 - Easy to customize and merge with in-house systems
 - Useful for multinational firms, banks, and equity and currency traders

Source: www.krg.com

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ICRG: POLITICAL RISK COMPONENTS

Weights	ICRG's Political Risk Assessment Criteria
12	Government Stability
12	Socio-Economic conditions
12	Investment Profile
12	Internal Conflict
12	External Conflict
6	Corruption
6	Military in Politics
6	Religious Tensions
6	Law and Order
6	Ethnic Tensions
6	Democratic Accountability
4	Bureaucratic Quality
100	Total number of points for weighted influence

Source: www.icrg.com

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ICRG: ECONOMIC RISK COMPONENTS (50 MAX)

GDP Per capita	10 points
Real GDP Growth	10 points
Annual inflation rate	10 points
Budget Balance	10 points
Current account/GDP	10 points

Source: www.icrg.com

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ICRG: FINANCIAL RISK COMPONENTS (50 MAX)

Foreign debt	10 points
Debt service/XGS	10 points
Current account	15 points
Net liquidity	5 points
Exchange rate stability	10 points

Source: www.icrg.com

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EUROMONEY : RATING METHODOLOGY

- ▶ 186 countries
- ▶ 15 criteria
- ▶ Delphi Technique: Panel of 250 leading economists in international financial institutions evaluating performance in the financial markets (market access, bond issue, spreads, sell-down, terms and maturity...)
- ▶ Scoring between **100** (excellent) and **0** (high risk)
- ▶ Panel of political analysts to measure short-term risk of destabilization

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EUROMONEY: RATING WEIGHTS

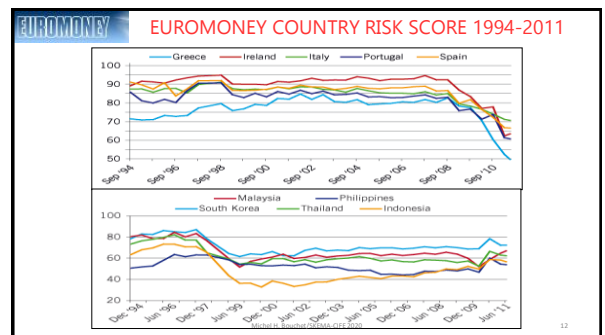
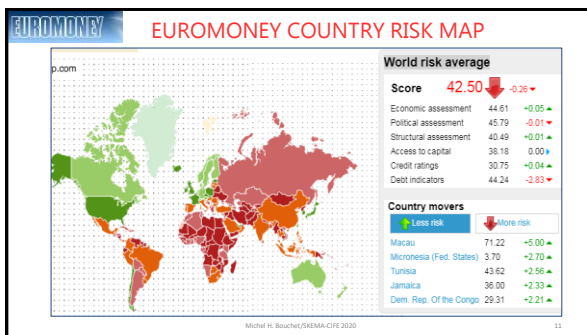
1. Growth performance: 25% (GDP projection)
2. Political risk: 25%
3. External debt indicators: 10% (debt/GDP and debt/X)
4. External payment default and rescheduling: 10%
5. Credit rating Moody's or S&P: 10%
6. Short-term credit market access: 5%
7. Commercial bank MT credit: 5%
8. Capital markets access: 5%
9. Spread over US Treasury bills: 5%

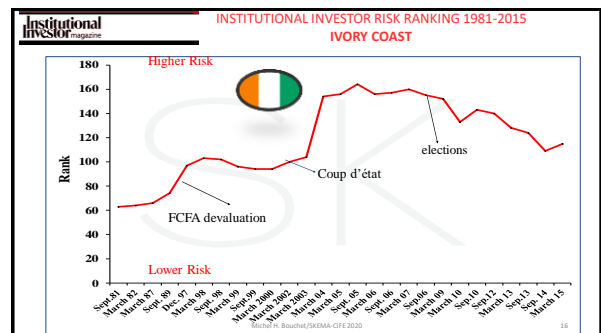
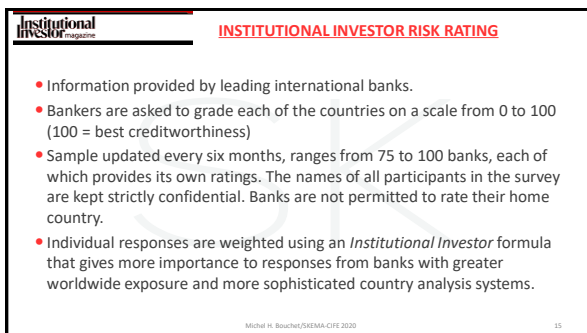
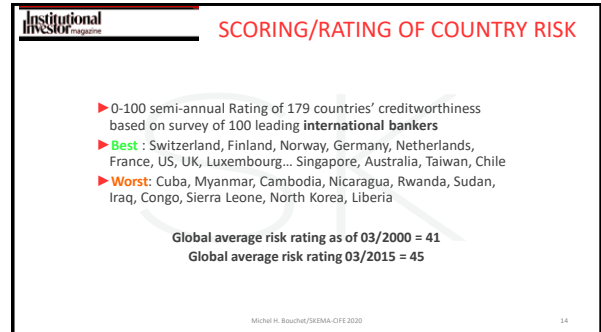
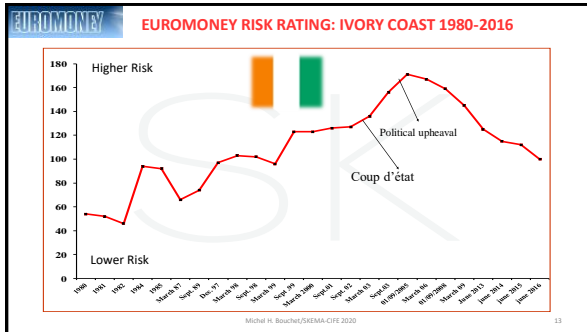
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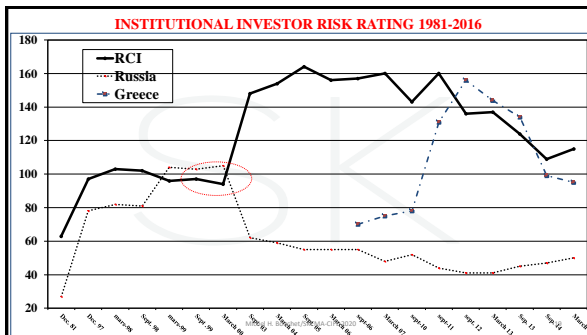
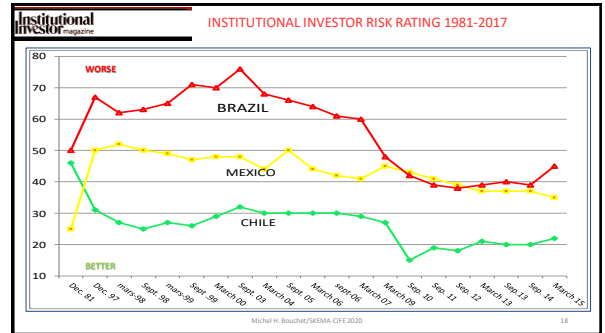
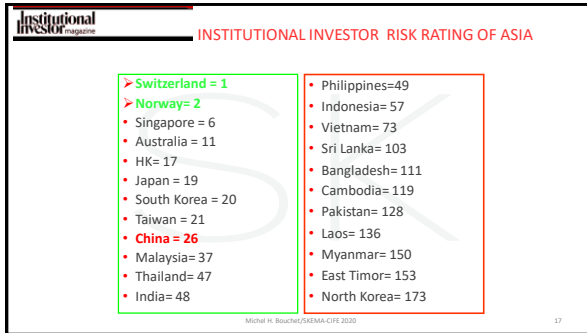
EUROMONEY COUNTRY RISK RATINGS 2001-2016

End-2001	End-2005	End-2006	End-2012	End-2016
14= Singapore	9= Ireland	20= Singapore	11= Singapore	1= Singapore
28= Taiwan	19= Singapore	41= Hungary	15= USA	
30= HongKong	22= New Zealand	44= Poland	19= Chile	
40= Chile	24= Taiwan	52= China	41= Hungary	
39= Hungary	35= Hungary	62= Russia	44= Poland	
40= Brunei	58= China	77= Algeria	46= China	
41= Greece	73= Iran	79= Iran	49= Russia	18= Taiwan
42= Poland	74= Vietnam	82= Vietnam	76= Indonesia	
45= China	77= Russia	85= Indonesia	79= Vietnam	
56= Malaysia	85= Algeria	167= Ivory Coast	100= Greece	
89= Romania	96= Indonesia	178= Congo	127= Algeria	
93= Bulgaria	127= Ivory Coast	182= Cuba	141= Ivory Coast	
163= Congo	182= Cuba	185= North Korea	178= Congo	

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COUNTRY RISK: GOVERNANCE MATTERS!

- ▶ Corruption
- ▶ Regulatory framework
- ▶ Business conditions
- ▶ Transparency
- ▶ Corporate and sovereign governance

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Singapore	1	Nigeria	169
New Zealand	2	Yemen, Rep.	170
Denmark	3	Djibouti	171
Korea, Rep.	4	Cameroon	172
Hong Kong SAR	5	Timor-Leste	173
United Kingdom	6	Bangladesh	174
United States	7	Syria	175
Sweden	8	Congo, Rep.	176
Norway	9	Afghanistan	177
Finland	10	Guinea-Bissau	178
Taiwan, China	11	Liberia	179
Macedonia, FYR	12	Equatorial Guinea	180
Australia	13	Angola	181
Canada	14	Haiti	182
Germany	15	Chad	183
Estonia	16	Congo, Dem. Rep.	184
Ireland	17	Central Af Rep	185
Malaysia	18	Venezuela	186
Iceland	19	South Sudan	187
Lithuania	20	Libya	188
		Eritrea	189

**WORLD BANK:
« DOING BUSINESS »
RANKING**

189 Countries
10 Parameters

Russia= 51
South Af= 73
China= 84
Brazil= 116
India= 130

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DOING BUSINESS IN CHINA?	
TOPICS	DB 2019 Rank
Starting a Business ✓	128
Dealing with Construction Permits	179
Getting Electricity	124
Registering Property	37
Getting Credit	71
Protecting Minority Investors	132
Paying Taxes ✓	120
Trading Across Borders	98
Enforcing Contracts	35
Resolving Insolvency	53

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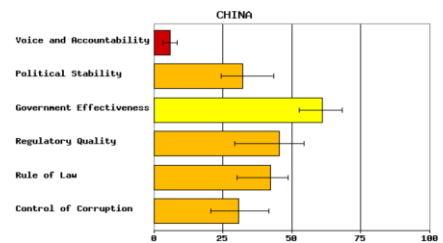
BLOOMBERG DOING BUSINESS RANKING

2014 Rank	Country	Less-tangible costs score	Readiness of local consumer base score
1	Hong Kong	88.8	75.2
2	Canada	91.5	76.2
3	United States	79.7	71.1
4	Singapore	89.5	71.9
5	Australia	83.3	71.6
5	Germany	86.2	74.7
7	United Kingdom	85.2	71.1
8	Netherlands	88.8	70.7
9	Spain	76.0	68.5
10	Sweden	87.1	72.9

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GOVERNANCE =
TRADITIONS AND INSTITUTIONS BY WHICH AUTHORITY IS EXERCISED
= OVERALL QUALITY OF PUBLIC AND PRIVATE MANAGEMENT PROCESS



Source: World Bank

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HOW ASSESSING CORRUPTION? TRANSPARENCY INTERNATIONAL'S CPI

- ▶ Germany-based NGO, founded in 1993
- ▶ Global network with national chapters in >70 countries
- ▶ Annual **Corruption perception index** ranking 180 countries
- ▶ Annual Bribe index

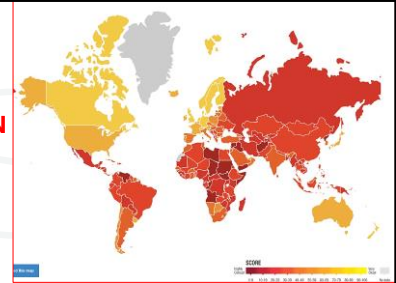
CPI is a composite index: poll of polls conducted over a 3-year period, drawing on 13 surveys from 8 independent organizations

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TI WORLD MAP OF CORRUPTION

South Africa = 73
India = 78
China = 87
Brazil = 105
Russia = 138



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MEASURING CORRUPTION? TRANSPARENCY INTERNATIONAL CPI



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1	Denmark
2	New Zealand
3	Finland
3	Singapore
3	Sweden
3	Switzerland
7	Norway
8	Netherlands
9	Canada
9	Luxembourg
11	Germany
11	United Kingdom
13	Australia
14	Austria
14	Hong Kong
14	Iceland
17	Belgium
18	Estonia
18	Ireland
18	Japan
21	France

160	Zimbabwe
161	Cambodia
162	DR Congo
163	Haiti
164	Turkmenistan
165	Angola
166	Chad
167	Congo
168	Iraq
169	Venezuela
170	Burundi
171	Libya
172	Afghanistan
173	Equ. Guinea
174	Guinea Bissau
175	Sudan
176	N. Korea
177	Yemen
178	South Sudan
179	Syria
180	Somalia

EMCS & SHADOW ECONOMY

Sources: World Bank
Hernando de Soto

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Country ↓	% GNP informal Economy
Georgia	67.3
Bolivia	67.1
Panama	64.1
Azerbaijan	60.6
Peru	59.9
Zimbabwe	59.4
Tanzania	58.3
Nigeria	57.9
Thailand	52.6
Ukraine	52.2
Guatemala	51.5
Uruguay	51.1
Honduras	49.6
Zambia	48.9
Belarus	48.1
Armenia	46.3
Russia	46.1
Benin	45.2
Nicaragua	45.2
Moldova	45

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UNDP HUMAN DEVELOPMENT INDEX

► What is development?

► **Economic growth** + those conditions that make growth **sustainable** over the long-term

=

► Σ life expectancy, education, health, infrastructure, institutions, governance...

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HUMAN DEVELOPMENT INDEX

► HDI developed by UNDP

► A composite index measuring average achievement in three basic dimensions of human development—a long and healthy life, knowledge and a decent standard of living, as measured by real GDP per capita on a purchasing power parity basis.

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1. Norway	170. Malawi
2. Australia	171. Sudan
3. United States	172. Zimbabwe
4. Netherlands	173. Ethiopia
5. Germany	174. Liberia
6. New Zealand	175. Afghanistan
7. Ireland	176. Guinea-Bissau
8. Sweden	177. Sierra Leone
9. Switzerland	178. Guinea
10. Japan	178. Burundi
11. Canada	180. Central African
12. Korea	181. Eritrea
13. Hong Kong	182. Mali
14. Iceland	183. Burkina Faso
15. Denmark	184. Chad
16. Israel	185. Mozambique
17. Belgium	186. Niger
18. Austria	186. Congo (DR)
19. Singapore	
20. France	

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CONCLUSION: ASSESSING COUNTRY RISK?

1. Market consensus: rating agencies
2. Macroeconomic analysis
3. Balance of payments analysis: liquidity & solvency
4. Socio-political analysis
5. Business environment: corruption, bureaucracy, institutions, transparency
6. Economic Intelligence!

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HERITAGE FOUNDATION: INDEX OF ECONOMIC FREEDOM

- ▶ **Economic freedom** = *absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself.*
- ▶ The Index includes a broad array of institutional factors determining economic freedom: corruption, non-tariff barriers to trade, the fiscal burden of government, the rule of law, regulatory burdens, restrictions on banks, labor market regulations, black market activities...

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CRITERIA OF ECONOMIC FREEDOM

- ▶ To measure economic freedom and rate each country, the *Index* is based on 50 independent economic variables within 10 broad categories of economic freedom:

1. Trade policy,
2. Fiscal burden of government,
3. Government intervention in the economy,
4. Monetary policy,
5. Capital flows and foreign investment,
6. Banking and finance,
7. Wages and prices,
8. Property rights,
9. Regulation, and
10. Black market activity

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HERITAGE FOUNDATION'S INDEX OF ECONOMIC FREEDOM

- ▶ 1. HongKong
- ▶ 2. Singapore
- ▶ 3. Luxemburg, New Zealand
- ▶ 5. Ireland
- ▶ 6. Denmark, Estonia, USA
- ▶ 9. Australia, UK
- ▶ 11. Finland, Iceland, Netherlands, Sweden
- ▶ 15. Switzerland
- ▶ 16. Chile
- ▶ 18. Canada
- ▶ 19. Austria, Belgium, Germany
- ▶ 40. France

- ▶ Trade + Fiscal Burden, + Government Intervention, + Monetary Policy, + FDI + Inflation + External Competitiveness + Banking sector

WORST:

Argentina, Colombia, Venezuela, China, Russia, Vietnam, Romania, Ukraine, Nigeria, Iran, Syria, Cuba...

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FREEDOM HOUSE:

POLITICAL FREEDOM IN THE WORLD ANNUAL REPORT (1972-2011)

- ▶ Since 1972, Freedom House has published an annual assessment of the state of freedom in all countries in the world, based on a checklist of questions on political rights and civil liberties that are derived from the Universal Declaration of Human Rights. Each country is assigned a rating for PR and a rating for CL based on a scale of 1 (best) to 7 (worst).

- ▶ <http://www.freedomhouse.org/ratings/index.htm>

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FREEDOM HOUSE: FREEDOM IN THE WORLD ANNUAL REPORT

Free countries (89)

- ▶ Australia
- ▶ Finland
- ▶ Malta
- ▶ Slovenia
- ▶ Uruguay
- ▶ Bulgaria
- ▶ Chile
- ▶ Costa Rica
- ▶ Mauritius
- ▶ Poland

Not Free countries (47)

- ▶ Cameroon
- ▶ Congo
- ▶ Haiti
- ▶ Iran
- ▶ China
- ▶ Vietnam
- ▶ Burma
- ▶ Cuba
- ▶ Saudi Arabia
- ▶ Syria
- ▶ Turkmenistan

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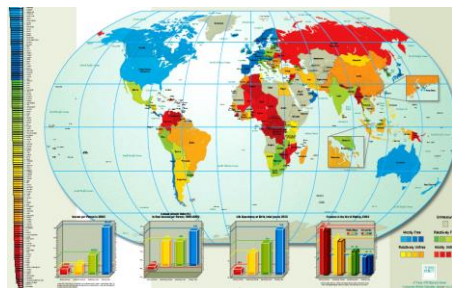
FRASER INSTITUTE

- ▶ Since 1975
- ▶ Annual Indices of Economic & Human Freedom in the world: reliable measure of cross-country differences in economic freedom, using third-party data to help ensure objectivity
- ▶ **Criteria:** government quality, legal structure, security of property rights, access to sound money, personal choice, freedom to exchange with foreigners and to compete in markets, quality of regulations and institutional strength...
- ▶ **The Economic Freedom Annual Report** is the measurement of economic freedom, ranking countries based on five areas: size of government, legal structure and security of property rights, access to sound money, freedom to trade internationally, and regulation of credit, labor and business. The report compares 159 countries and territories

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FRASER INSTITUTE'S ECONOMIC FREEDOM WORLD MAP



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Economic Freedom of the World: 2017 Annual Report

— Sep 28, 2017

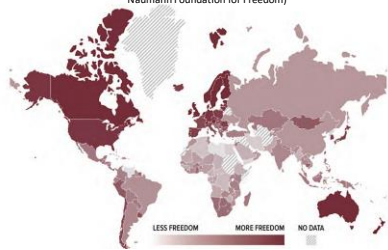


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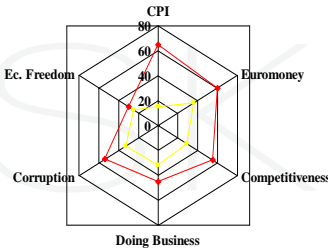
FRASER INSTITUTE: HUMAN FREEDOM INDEX

The index ranks 159 countries and jurisdictions based on 79 indicators of personal, civil and economic freedoms (joint project with the Cato Institute in the U.S. and Germany's Friedrich Naumann Foundation for Freedom)



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COUNTRIES X & Y: A MULTI-INDEX COMPOSITE GRAPH



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