

**dfe** Centre international de formation européenne  
dfe BERLIN BOULOGNE BOURNAY

## POLITICAL RISK ASSESSMENT

### WHERE DOES POLITICAL RISK COME FROM?



MICHEL-HENRY BOUCHET  
CIFE –NICE APRIL 2021

## WHERE DOES POLITICAL RISK COME FROM?



- Terrorism
- External shock (commodity price volatility)
- 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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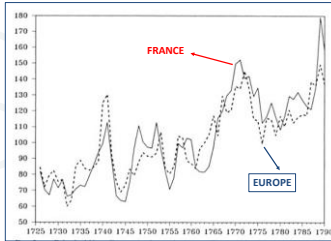
## FOOD STRESS, WHEAT PRICES & REVOLUTIONS: WHAT RELATIONSHIP?

Where does a **revolution** come from?

In the XVIII<sup>th</sup> century, bread constitutes nearly 50% of expenditures of households in France.

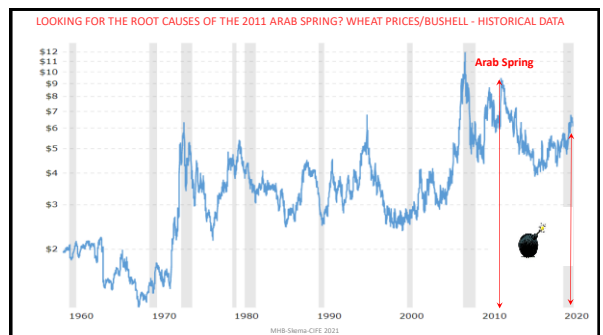
- 1788: bad weather and severe drought
- 1789: Necker's alarmist warnings and urgent imports of wheat
- Very cold winter
- 6 pounds of bread cost 12 « sous », the equivalent of one day salary.
- Fast inflation will continue until 1795

Wheat price index in France and in Europe 1725-1790



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

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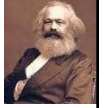
### LOOSENING IDENTITY AND SOCIO-POLITICAL FRAGMENTATION: « THE ARCHIPELAGO »\*

- 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 **aggregate 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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### 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.

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### 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)

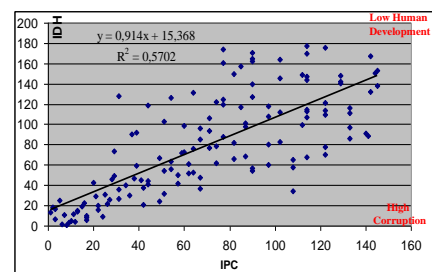


#### The post-industrial society:

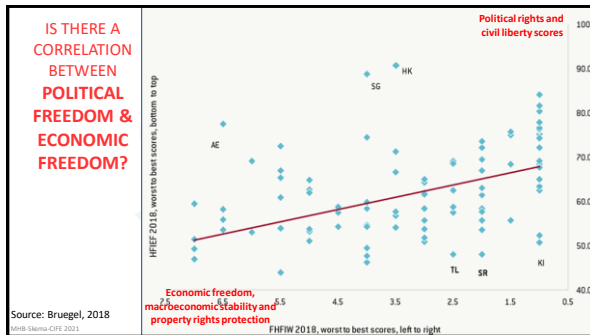
- The Cultural Contradictions of Capitalism: Polarization and social tensions between work and consumption pressures: capitalism is inherently **instable**
- Centrality of the new science-based industries & NTIC
- Rise of new technical elites and the advent of a new principle of stratification

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### CORRELATION HUMAN DEVELOPMENT /CORRUPTION



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### 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.
- 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. Gender Revolution
  4. Underemployment
  5. Global risks (ecological crisis and the crash of global financial markets)



**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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**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

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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!

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SAMUEL HUNTINGTON  
ANALYZING THE ROOTS OF POLITICAL UPHEAVAL

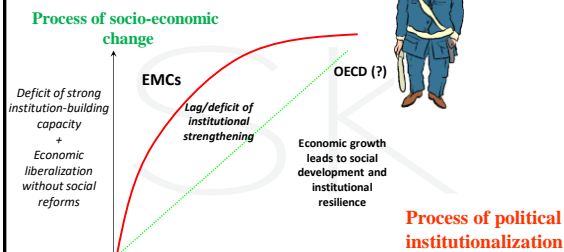
► Primary problem of politics = **lag** in the development of political institutions behind socio- economic change.

► 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



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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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## 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>

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## WORLD BANK ASSESSMENT OF GOVERNANCE IN CHINA

Indicator	Country	Year	Percentile Rank (0 to 100)
Voice and Accountability	China	2018	~10
Political Stability and Absence of Violence	China	2018	~40
Government Effectiveness	China	2018	~70
Regulatory Quality	China	2018	~50
Rule of Law	China	2018	~50
Control of Corruption	China	2018	~40

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## 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

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**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
HDI Rank	42	68	108	115

	ARMENIA	SRI LANKA	NIGERIA	ANGOLA
GDP per capita	\$5000	\$5000	\$5000	\$5500
Life expectancy	75	77	54	60
HDI Rank	81	97	158	1489

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**HOW MOVING FROM GROWTH TO SUSTAINABLE AND INCLUSIVE DEVELOPMENT?**

**Assumption n°1**

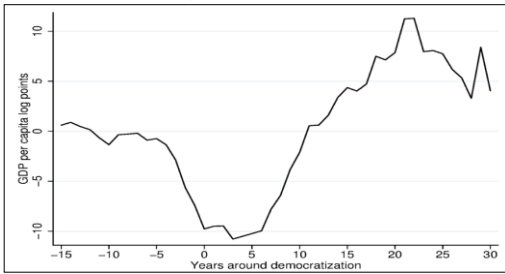
- Primacy of human capital for both growth and democratization: human and social capital shape both institutional and productive capacities of a society.
- Growth in income and human capital causes institutional improvement with better political institutions even with pro-market dictators: **policy choices 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**

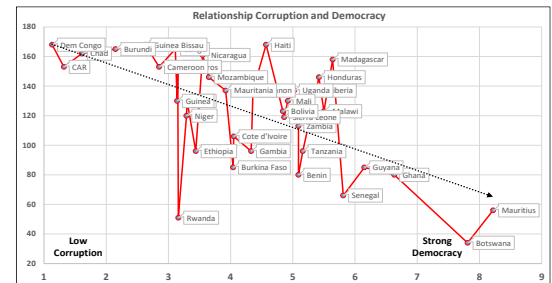
- Democracy and other checks on government are the key mechanisms for securing property rights and boosting growth
- Good and stable institutions will enhance the pace and quality of economic growth
- Robust institutions and good governance matter!

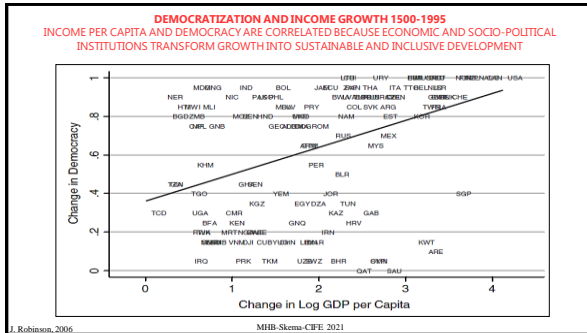
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**DEMOCRACY BREEDS GDP PER CAPITA GROWTH WHILE ECONOMIC GROWTH LEADS TO DEMOCRACY  
(ACEMOGLU & ROBINSON)**



**IS DEMOCRACY SUPERIOR TO AUTOCRACY TO FIGHT POVERTY AND EXOGENOUS SHOCKS?**





## TECHNIQUES TO ASSESS POLITICAL RISK

1. Economic intelligence: in-depth socio-political analysis
2. Checklist approach  
To examine key political factors that affect a country's risk: the **Prince Model**
3. Delphi technique
  - establish surveys
  - collect information and independent opinions
  - analyze results and make predictions
4. Ratings
5. Consultants on political risks



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

- |  |  |
|--|--|
| <ul style="list-style-type: none"> <li>▶ MIG (UK)</li> <li>▶ HISCOX</li> <li>▶ PLATUS</li> <li>▶ AON</li> <li>▶ Global Risk Assessments</li> <li>▶ EIU</li> <li>▶ COFACE, OPIC &amp; MIGA, EULER</li> <li>▶ Howell International</li> <li>▶ Control Risks Group: <a href="http://www.crg.com">www.crg.com</a></li> <li>▶ WMRC</li> </ul> | <ul style="list-style-type: none"> <li>▶ Frost &amp; Sullivan</li> <li>▶ US State Department + US CIA</li> <li>▶ Marsh Crisis Consulting</li> <li>▶ University of Maryland Center for Conflict Management</li> <li>▶ Muir Analytics (Threat Watch, Threat Report, Threat Survey)</li> <li>▶ NYA International</li> <li>▶ TAC (France)</li> </ul> |
|--|--|

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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

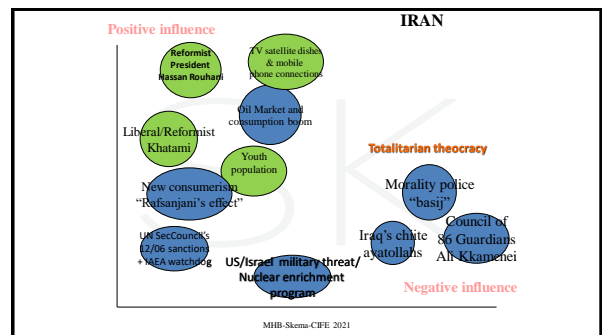
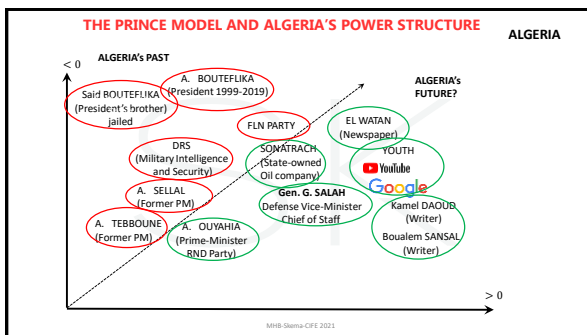
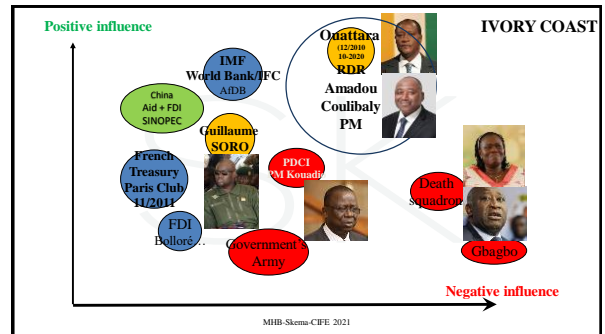
**Frost & Sullivan:** William D. Coplin and Michael K. O'Leary of the firm Political Risk Services.

**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-4/world-leaders-c/cote-divoire.html>





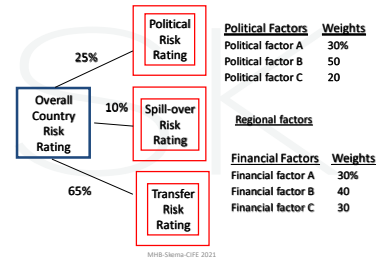
#### 4. QUANTIFYING COUNTRY RISK

##### ► Ratings and Rankings:

- Can one boil things down to numerical indices, when dealing with culture, politics, and ethnic tensions?
- *Problem of “usability” of rankings: number fetishism leads astray by focusing on statistical Delphi-based analyses that are often subjectively biased, misleading and overly narrow. Lack of insight and qualitative research?* ([www.useit.com](http://www.useit.com) Jakob Nielsen's website)

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#### QUANTIFYING COUNTRY POLITICAL RISK



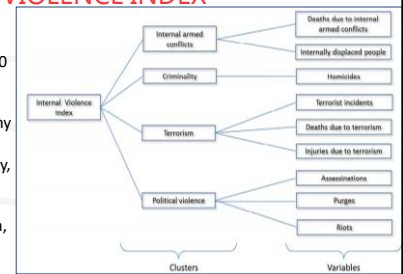
#### POLITICAL RISK INDICES

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

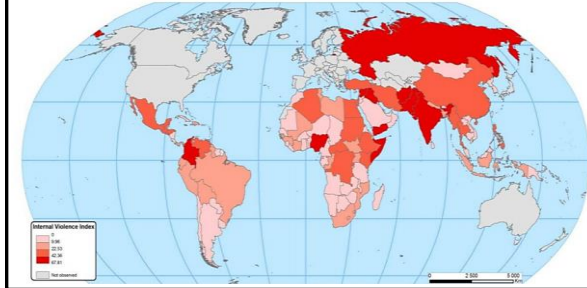
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#### THE INTERNAL VIOLENCE INDEX

The composite index measures a narrow concept of fragility for 130 developing countries through their level of violence in its many different forms: internal armed conflicts, criminality, terrorism, and political violence: Iraq, Pakistan, Afghanistan, Yemen, Syria, and Nigeria.



## THE INTERNAL VIOLENCE INDEX

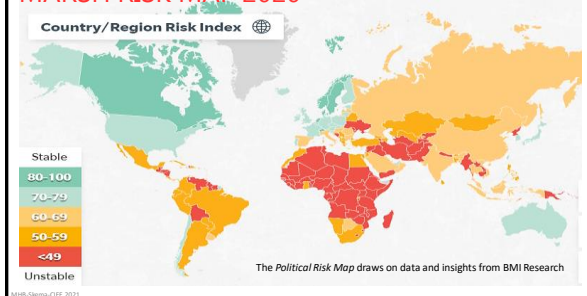


## AON POLITICAL RISK MAP

- ▶ 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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## MARSH RISK MAP 2020



## THE HERITAGE FOUNDATION: ECONOMIC FREEDOM INDEX

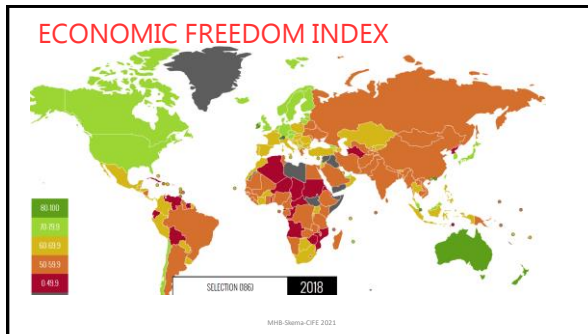
### Q.3. How do you measure economic freedom?

We measure economic freedom based on 12 quantitative and qualitative factors, grouped into four broad categories, or pillars, of economic freedom:

1. Rule of Law (property rights, government integrity, judicial effectiveness)
2. Government Size (government spending, tax burden, fiscal health)
3. Regulatory Efficiency (business freedom, labor freedom, monetary freedom)
4. Open Markets (trade freedom, investment freedom, financial freedom)

Each of the twelve economic freedoms within these categories is graded on a scale of 0 to 100. A country's overall score is derived by averaging these twelve economic freedoms, with equal weight being given to each. More information on the grading and methodology can be found in the appendix.

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### INDEX OF ECONOMIC FREEDOM

Top 10 Countries				REPPRESSED (R6 R-40)			
RANK	COUNTRY	OVERALL	CHANGE	RANK	COUNTRY	OVERALL	CHANGE
1	Hong Kong	90.2	0.4	160	Niger	48.5	-1.3
2	Singapore	88.8	0.2	161	Sudan	48.4	+0.6
3	New Zealand	84.2	0.5	162	Chad	48.3	+0.3
4	Switzerland	81.7	0.2	163	Central African Republic	48.2	-2.6
5	Australia	80.9	-0.1	164	Angola	48.6	+0.1
6	Ireland	80.4	3.7	165	Ecuador	48.5	-0.8
7	Estonia	78.8	-0.3	166	Suriname	48.1	+0.1
8	United Kingdom	78.0	1.6	167	Timor-Leste	48.1	+1.8
9	Canada	77.7	-0.8	168	Togo	47.8	-5.4
10	United Arab Emirates	77.6	0.7	169	Turkmenistan	47.1	-0.3
				170	Mozambique	46.3	-3.6

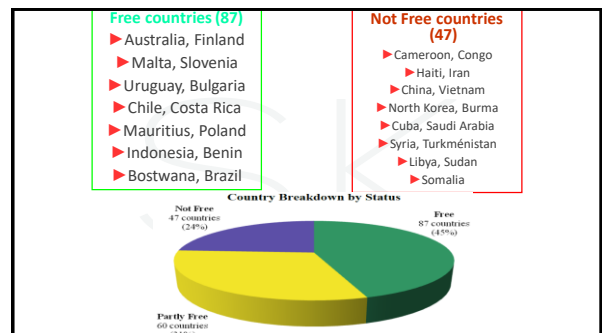
### FREEDOM HOUSE:

FREEDOM IN THE WORLD ANNUAL REPORT (1972-)

► 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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- Founded in 1982, it specializes in strategic research and corporate intelligence, focusing on risks and threats that confront companies worldwide.
- MIG operates in over 100 countries.
- [www.merchantinternational.com](http://www.merchantinternational.com)

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