

Managing Country Risk

A Practitioner's Guide to Effective
Cross-Border Risk Analysis

Daniel Wagner



CRC Press

Taylor & Francis Group

Boca Raton London New York

CRC Press is an imprint of the
Taylor & Francis Group, an **informa** business

A PRODUCTIVITY PRESS BOOK

Contents

List of Tables xiii

List of Figures xv

List of Maps xix

Preface xxi

Acknowledgments xxv

The Author xxvii

Abbreviations xxix

CHAPTER 1—Country Risk in Perspective 1

Introduction 1

Insight into the Foundation of the Arab Spring 2

How Political Change in MENA Is Impacting Country Risk Analysis 12

Perception versus Reality of Risk: Does Terrorism Negatively Impact
Foreign Direct Investment? 14

 Empirical Studies Can Yield Contradictory Results 15

The Impact of Perception on Investment Decisions 18

 Risk Management versus Profit Maximization 20

 Be Wary of Statistics 20

 What Statistics Say about the Global Recovery since 2009 23

Managing Country Risk in the “New Normal”	26
Notes	28
CHAPTER 2—Foundations of Country Risk Management	31
Introduction	31
Economic Nationalism in Pakistan	32
Extractive Enterprises Are Particularly Vulnerable	33
The Danger of Focusing Too Much on Net Income	34
Bolivia’s Mass Nationalizations	34
The Importance of History	35
Ramifications	36
Papua New Guinea’s Natural Resource Curse	37
It Takes Two to Tango	38
Systemic Corruption Creates Risk	40
Lessons Unlearned	40
Defining Country Risk	42
Country versus Sovereign versus Political versus Transactional Risk	43
How Banks Approach Transactional Risk Management	44
The Lessons of the Asia Crisis	45
Elements of an Effective Risk Management Process	46
The Boardroom Vacuum	48
The Impact on Firm Performance	51
Separating Fact from Fiction	52
Notes	53
CHAPTER 3—Assessing Country Risk	55
Introduction	55
Information Sources	57
Are Rating Agencies’ Ratings Worth Using?	59
Measuring Political Stability	63
Comparing Indonesia and Vietnam	68
Notes	73
CHAPTER 4—Country Risk Assessment in Practice	75
Creating a Risk Management Framework	75
Selecting Country Risk Management Tools	82
Economic Measures	86
Mapping Out a Country Risk Analysis Methodology	87
Alternative Measures of Country Risk	90
Corruption Perceptions Index	90
Democracy Index	90

Freedom in the World	91
Gini Coefficient	92
Global Peace Index	93
Human Development Index	93
Youth Unemployment	95
Conclusion	95
Notes	96
CHAPTER 5—Political Risk Insurance	97
What Is Political Risk Insurance?	97
Who Needs PRI?	101
An Overview of Investment Insurance	101
Expropriation	102
Forced Abandonment/Key Operator's Endangerment	104
Financed-Asset Nonrepossession	105
Deprivation/Contingent Deprivation	105
Currency Inconvertibility/Nontransfer	105
Political Violence	108
Breach of Contract	109
An Overview of Trade Insurance	110
Contract Frustration	111
Non-Honoring of Letters of Credit	112
Wrongful Calling of Guarantees	112
Trade Disruption Insurance	113
Other Categories	113
Export Credit Insurance	114
Underwriters and the Underwriting Process	115
The Private Sector Players	116
Chartis	116
Lloyd's	116
Sovereign	117
Zurich	117
Market Capacity	117
Private Underwriters	117
The Public Schemes	117
The Underwriting Process	118
Underwriting Trade Transactions	120
Underwriting Export Credit Transactions	121
Premium Rates	122
Pricing Methodology	124
Recoveries	124
Reinsurance	125

Case Study: Assessing the Risk of a Power Plant in Indonesia 125

 Case Study 127

 The Project 127

 Technical/Financial Viability 128

 Host Country Benefits 128

 Insurance Requirements 128

 Risk Assessment 129

 Expropriation 129

 Currency Inconvertibility 131

 Political Violence 133

 Breach of Contract 135

The Impact of the Asia Crisis and Lessons Learned 136

Notes 138

CHAPTER 6—Tales from the Battle Zone 141

How Easy It Is to Make Costly Mistakes 141

 A Telecommunications Company in Pakistan 141

 A Paper Company in Russia 142

 A Power Company in Brazil 142

 An Arab Oil Company in Saudi Arabia 142

 An Oil Company in Russia 143

 A Fast Food Chain in Palestine 144

 A Media Enterprise in the Czech Republic 145

 An Energy Company in Venezuela 145

 A Technology Company in South Korea 146

 A Bank in Ecuador 146

 A Pharmaceutical Company in Yugoslavia 147

 An Oil Company in Peru 147

 A Power Company in Canada 147

The Failure of a Bank’s Country Risk Management Program 148

 How the Program Was Revised 151

 Underwriting Information 152

 Creating an Operational Foundation 153

 Recoveries 154

Note 155

CHAPTER 7—The Importance of Understanding China and Its Place in the World . . . 157

Introduction 157

Geopolitics with Chinese Characteristics 158

China as the Aggressor—The Case of the Spratly Islands	162
Asia Looks Nervously over Its Shoulder	165
The Maturing Chinese–Saudi Arabian Alliance	168
FDI with Chinese Characteristics	171
China’s Rare Earth Bravado	177
China and the Power of the Dollar	179
China’s Great “Development” Challenge	180
China’s Real Estate Syndrome	182
The Enigma of China’s Middle Class	185
Investor Beware	187
Notes	189

CHAPTER 8—Shifting Pendulums, Pressing Concerns, and the State of the World	193
Introduction	193
Brazil’s and Turkey’s Messages	194
Brazil’s and Turkey’s Nuclear Ambitions	195
Rising Tension with Turkey	196
The Lesson to Be Learned	196
Turkey’s Foreign Policy Vision	197
Turkish Foreign Policy: Moderation in the Extreme	198
Is Turkey Really Rethinking Its Place in the World?	199
Upheaval in the Middle East: An Opportunity for Turkey	200
The Folly of Brazil’s Exceptionalism	202
To BRIC or Not to BRIC—That Is the Question	203
Too Big for Its Britches	204
Pursuit of Autonomy versus an Adversarial Role	205
Aid Recipient and Provider	205
Its Own Worst Enemy	206
BRICs Form Unstable Foundation for Multilateral Action	206
Iraq’s Democratic Experiment	208
Bolivia, Ecuador, and Nicaragua: Lofty Idealism versus Hard-Nosed Politics	212
India’s Ongoing Concerns about Pakistan and Afghanistan	215
Globalization Will Not Change Some Things	218
Notes	226