

**Economics and Security:
Political Risk Analysis**

IR427

Spring 2008

Dr. Pamela K. Starr

Office: STO L1

Office Hours: W 4-5; Th 12-1; and by appointment

Phone: 740-4122

Email: pkstarr@usc.edu

Course Description and Content:

Governments have long understood the need to measure the relative risk of political instability and opposition as a prerequisite to the formation and implementation of an effective foreign policy. Multinational corporations with fixed investments overseas are also intimately familiar with the importance of political risk analysis to the success of their business enterprises. But in recent years the number of firms with foreign investments exploded while currency and bond traders and equity investors dramatically expanded their operations in emerging markets. These developments have broadened the recognition that politics can matter as much as economic fundamentals in measuring the degree of risk associated with a particular investment.

This course will introduce students to the analysis of political risk. It will illuminate the different aspects of political risk that affect the interests of governments, equity investors, and traders, and how the nature of risk varies among countries and regions and over time. Students will learn different methods for measuring political risk, apply these techniques to real world cases, and employ different techniques to present their findings, including stability assessments, base cases, risk maps, and probability sets (since the future can never be perfectly divined). The ultimate objective of the course is to provide students substantive knowledge and hands-on experience in assessing political risk in emerging market economies and presenting this information in written form and through oral presentation.

Requirements:

In addition to the weekly assigned readings, students must read the *Economist* magazine every week and are highly encouraged to read either the *New York Times* or *Los Angeles Times* daily. Class discussions will draw on recent real world events in key emerging markets to exemplify the concepts being presented. These discussions and class participation more broadly are critical elements of the learning process for this course. Students are thus required to complete the assigned readings for each prior to class and are strongly encouraged to participate actively in class discussions and exercises.

Students are required, by the second week of class, to choose an emerging market country from a short list provided by the instructor for which they will be an analyst throughout the term. Students will write three short reports/updates (800-1000 words) during the term analyzing political risk in their country. They will also prepare a term project that incorporates a more complete analysis of political risk in their country, including a base case, key downside risks for different kinds of investors, explanation of the sources of these risks, three scenarios for the

future, and a brief comparison with a comparable emerging market country. This content and findings will be presented as an extended essay (3000 words) preceded by a short, executive summary (300-400 words). Each student will then present the main “takeaways” from his/her report orally before the class (10-12 minutes) during one of the last two sessions of the course.

Grading:

Class Participation:	10%
Country Updates:	30% (10% each)
Mid-term Examination:	25%
Final Paper:	25%
Final Presentation:	10%

Required Readings:

Inter-American Development Bank, *The Politics of Policies, Economic and Social Progress in Latin America, 2006 Report*, Washington, DC 2005 (in USC bookstore).

Harvard Business School Case Studies available for purchase on line:

“Note on Political Risk Analysis” HBS Case Study, 9-798-022, 1997.

“Note on Currency Crises”, HBS Case 9-799-089, March 1999.

Huw Pill, Mexico: The Tequila Crisis, 1994-1995. HBS Case 9-702-093, October 2002.

Rafael di Tella and Ingrid Vogel, “Argentina’s Convertibility Plan”, HBS Case 9-702-002, February 2004.

“Royal Dutch/Shell in Nigeria (A)”, HBS Case 9-399-126, August 2006

“Royal Dutch/Shell in Nigeria (B)”, HBS Case 9-399-127, August 2006

“White Nights and Polar Lights: Investing in the Russian Oil Industry”, HBR Case 9-795-022, June 1996.

National Intelligence Council, *Mapping the Global Future, Report of the national Intelligence Council’s 2020 Project*, Washington, DC: US Government Printing Office, December 2004 (available on line).

Detailed Course Outline

January 16: Introduction

Mutual introductions and country selection among the following options: Russia, China, Brazil, India, Thailand, Turkey, and South Africa.

January 23: What is political risk and why does it matter?

Harvard Business School, “Note on Political Risk Analysis” Harvard Business School Case Study, 9-798-022, 1997.

Sam Wilkin, “Four Experts Discuss the Science and Art of Country Analysis” in Sam Wilkin, ed., *Country and Political Risk: Practical Insights for Global Finance*, London: Risk Books, 2004 : 127-145.

Eurasia Group and Price Waterhouse Coopers, *Political Hotspot Map*, <http://www.pwc.com/extweb/service.nsf/docid/FE926B4A5CE358A5852571D8005F0B12#>

International Crisis Group, *Crisis Watch*, <http://www.crisisweb.org/home/index.cfm>

January 30: Approaches to political risk analysis

Llewellyn Howell, “Defining and Operationalizing Political Risk” in *Political Risk Assessment: Concept, Method, and Management*, The PRS Group: 2001: 1-16.

Walter Molano, “Approaches to Political Risk Analysis”, in *Political Risk Assessment*: 17-35.

Ian Bremmer, “Managing Risk in an Unstable World”, *Harvard Business Review*, June 2005: 51-60.

Preston Keat and Alexander Motyl, “State Stability and Political Risk in Emerging Markets”, in Sam Wilkin, ed., *Country and Political Risk*: 57-70.

Economist Intelligence Unit (EIU), *Country Report* (most recent quarter for your country).

February 6-13: Analyzing Politics and Policy-Making

Bert Rockman, “Institutions, Democratic Stability, and Performance”, in Metin Heper, et al eds., *Institutions and Democratic Statecraft*, Westview Press, 1997: 11-34.

Inter-American Development Bank, *The Politics of Policies, Economic and Social Progress in Latin America, 2006 Report*, Washington, DC 2005: chapters 1-5.

Gary Cox and Mathew McCubbins, “The Institutional Determinants of Economic Policy Outcomes” in Stephan Haggard and Mathew McCubbins, eds., *Presidents, Parliaments, and Policy*, Cambridge, 2001: 21-63

Jeffrey Frieden, *Debt, Development and Democracy in Latin America*, Princeton University Press, 1991: chapter 1.

“The Logic of Collective Action”, a summary of Mancur Olsen’s argument.

Therese Feng, “Domestic and External Political Factors and Country Risk: The Case of China”, in Sam Wilkin, ed., *Country and Political Risk*: 171-191.

Examples of Political Risk Analysis.

February 20: Scoring Macro Political Risk: Exercise I

Stanley H. Kaplan, “Making an Educated Guess” in Samantha Ettus, *The experts guide to 100 things everyone should know how to do*, Clarkson/Potter Publishers.

Handout on scoring risk.

February 27: Foreign Direct Investment and Political Risk

OECD, *International Investment Perspectives: Freedom of Investment in a Changing World*, 2007, chapter 2, “Trends and recent developments in foreign direct investment”.
<http://www.oecd.org/dataoecd/62/43/38818788.pdf>

Louis T. Wells, Jr., “God and Fair Competition: Does the Foreign Direct Investor Face Still Other Risks in Emerging Markets?”, in Theodore Moran, ed., *Managing International Political Risk*, Blackwell, 1998: 15-44.

Sandy Markwick, “Trends in Political Risk for Corporate Investors”, in Moran ed: 44-56.

A.T. Kearney, “Corporate FDI Plans Constant Despite Credit Market Turmoil”,
<http://www.atkearney.com/main.taf?p=1,5,1,201>

Eurasia Group, “Top risks, 2007-2008”.

March 5: Nigeria and Russian Oil Case Studies

“Royal Dutch/Shell in Nigeria (A)”, HBS Case 9-399-126, August 2006.

“Royal Dutch/Shell in Nigeria (B)”, HBS Case 9-399-127, August 2006.

Eurasia Group, “Analyses of electoral risk in Nigeria”, 2007.

“White Nights and Polar Lights: Investing in the Russian Oil Industry”, HBR Case 9-795-022, June 1996.

March 12: Mid Term Exam

March 19: Spring Break

March 26-April 2: Financial Markets and Political Risk

“Note on Currency Crises”, HBS Case 9-799-089, March 1999.

Roger Shields, “Managing Country Risk in Large Financial Institutions”, in *Political Risk Assessment*: 111-132.

Huw Pill, Mexico: The Tequila Crisis, 1994-1995. HBS Case 9-702-093, October 2002.

Pamela Starr, “Argentina: Anatomy of a Crisis Foretold”. *Current History* (February 2003): 65-71.

Rafael di Tella and Ingrid Vogel, “Argentina’s Convertibility Plan”, HBS Case 9-702-002, February 2004.

April 9: Scoring Macro Political Risk: Exercise II

April 16: Political Risk in Foreign Policy

National Intelligence Council, *Mapping the Global Future, Report of the national Intelligence Council’s 2020 Project*, Washington, DC: US Government Printing Office, December 2004.

Eurasia Group, “Risk Watch: An overview of global political risks”, October 2007.

Pamela K. Starr, “Mexico’s energy crisis: How bad can it get?”, report prepared for the National Intelligence Council, November 2007.

April 23-30: Student Presentations