Helpdesk Research Report: Country Risk Indices

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Query: Summarise the available country risk indices. Identify whether they assess political, social, economic and/or other risks. Where possible identify the strengths and weaknesses of these tools for investors and policy makers.

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1. Overview

There are a large number of country risk indices available. These are primarily produced by private companies, though some international organisations make use of these indices to provide aggregate indices. Different risk indices use different combinations of political, social, economic, environmental and other factors, but there is no universally accepted methodology for assessing risk. Comparison between methodologies is made difficult by the relative opacity of the methodologies. Most risk indices are commercial products. Consequently, the majority of companies that produce risk assessments do not make their methodology and sources easily accessible. There are also risk assessment methodologies that are tailored to specific businesses or in relation to the types of activities undertaken.

Amongst the country risk indices from private companies, some of the most notable risks assessors are the ratings from the 'big three' credit risk rating agencies. These credit risk agencies provide credit ratings for debt instruments, but also provide credit ratings for the debt issuers, which include sovereign countries. These country ratings are based on a broad range of risk factors. The Standard and Poor's sovereign ratings, for example, are based on political, economic, external, fiscal and monetary factors.

San-Martín-Albizuri and Rodríguez-Castellanos (2012) argue that the best-known and most widely used country risk indices are the Euromoney index and the International Country Risk Group (ICRG) Index. They also note, however, that although these indices are able to identify certain vulnerabilities, they did not accurately identify the political, economic and/or financial factors that contributed to the recent global economic crisis. Amongst these indices, it is hard to draw comparisons and identify which of these indices are most useful.

International organisations and government agencies do not produce country risk ratings themselves, but do make use of existing ratings from commercial providers. The World Bank World Governance Indicators (WGI), for example, makes use of risk indicators from the Economist Intelligence Unit, iJet, Political and Economic Risk Consultancy, PRS Group and IHS Global insight. The aggregate indicators produced for the WGI, from these commercial risk indices, may be useful in their own right.

Government agencies undertake risk assessments, but these are primarily for internal, or 'enterprise-wide', risk rather than risk for investing. The UK Department for International Development (DFID) does have measures for reducing aid-related fiduciary risk, but rather than specific ratings or a formulaic 'right' answer, the guidelines suggest a context-appropriate assessment involving consideration of a wide range of factors and influences and personal judgement. The United States Agency for International Development (USAID), on the other hand, has a checklist of issues and vulnerabilities to address.

Development finance institutions need to take country risk into account. The CDC Group, a UK development finance institution, largely leaves risk analysis to in-country fund managers. Once the fund managers have been screened, they are allowed to work within parameters outlined in the CDC Group investment code and legal agreements. The legal agreements and investment code does account for some risk mitigation – for example, the rules preclude investment in state-owned enterprises that would entail political risk. But ultimately the CDC Group relies on the fund managers to deal with day-to-day risks and to report on those risks when they are significant.

2. Credit Risk Rating Agencies

Credit rating agencies (CRA) are private companies that assign credit ratings for issuers of certain types of debt obligations, as well as the debt instruments themselves. The 'Big Three' credit rating agencies are Standard & Poor's (S&P), Moody's, and Fitch Group. In addition to looking at other debt securities, the credit agencies provide sovereign debt assessments.

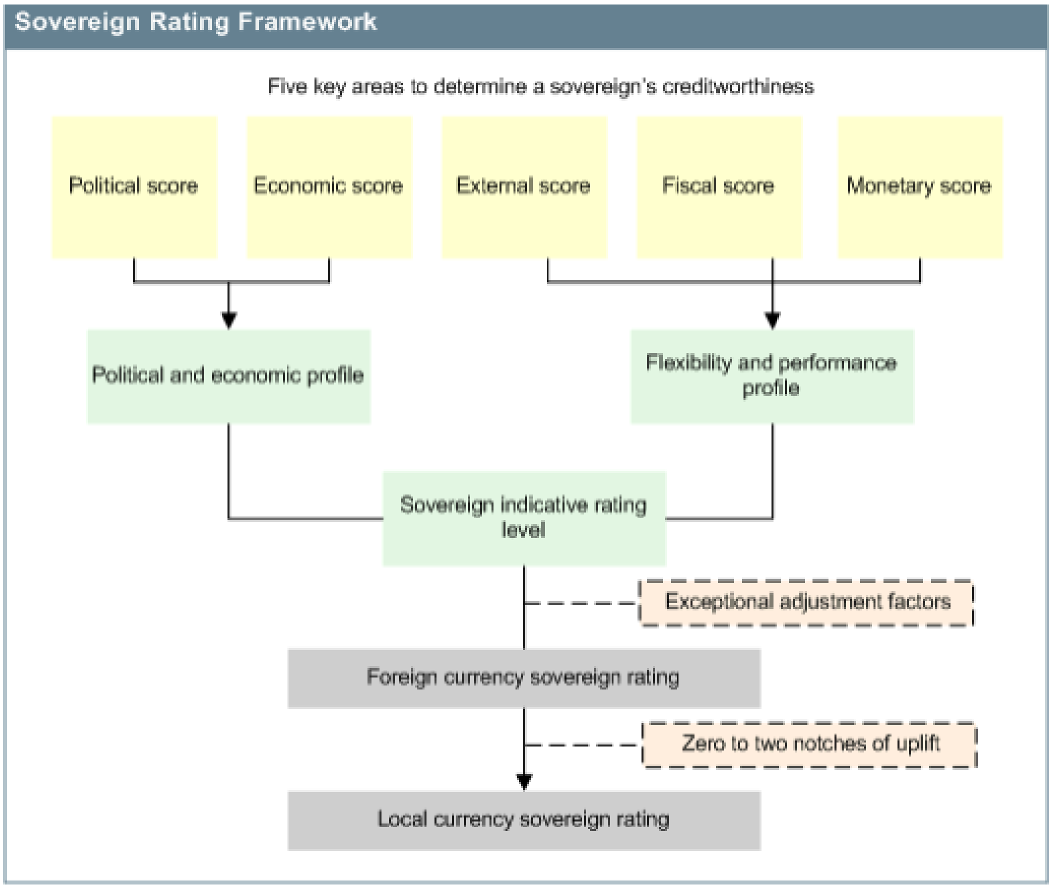
Standard and Poor's Sovereign Ratings

http://www.standardandpoors.com/ratings/sovresearch/en/us

Standard and Poor's (S&P) gives countries a sovereign indicative rating level on a scale from AAA to D with AAA being the best rating. Intermediate ratings are offered at each level between AA and CCC (e.g. BBB+, BBB and BBB-) based on their scores in five factors, listed below. For some borrowers, the company may also offer guidance (termed a credit watch) as to whether it is likely to be upgraded (positive), downgraded (negative) or uncertain (neutral). The five factors and their scores are the following.

- **Political score** (institutional effectiveness and political risks): How a government's institutions and policymaking affect a sovereign's credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks. This includes a view of the transparency and reliability of data and institutions, as well as potential geopolitical risks.
- **Economic score** (economic structure and growth prospects): An analysis of a country's income levels, growth prospects, and its economic diversity and volatility.
- **External score** (external liquidity and international investment position): The status of a sovereign's currency in international transactions, the sovereign's external liquidity, and its external indebtedness, which shows residents' assets and liabilities relative to the rest of the world.
- **Fiscal score** (fiscal performance, flexibility, and debt burden): The fiscal flexibility, long-term fiscal trends and vulnerabilities, debt structure and funding access, and potential risks arising from contingent liabilities.
- **Monetary score** (monetary flexibility): The monetary authority's ability to use monetary policy to address domestic economic stresses, particularly through its control of money supply and domestic liquidity conditions; the credibility of monetary policy, as measured by inflation trends; and the effectiveness of mechanisms for transmitting the impact of monetary policy decisions to the real economy, largely a function of the depth and diversification of the domestic financial system and capital markets.

Figure 1. S&P Sovereign Rating Framework



Source: S&P (2012) *How we rate sovereigns*
http://www.standardandpoors.com/spf/ratings/How_We_Rate_Sovereigns_3_13_12.pdf

These five scores are combined to form a sovereign's political and economic profile (the average of the political score and the economic score) and its flexibility and performance profile (the average of the external, fiscal and monetary scores). These two profiles are then used to determine an ‘indicative rating level’. This indicative rating is used to produce a foreign currency sovereign rating and a local currency sovereign rating.

Fitch Ratings Sovereigns
http://www.fitchratings.com/gws/en/sector/overview/sovereigns

The Fitch Ratings Sovereigns Group provides credit research and opinion on more than 100 countries, and assigns ratings to the foreign and local currency debt of sovereign governments. Like S&P, Fitch produces credit ratings on an alphabetic scale from 'AAA' to 'D', with AAA being the best rating. These ratings are based on analysis on the latest political, regional and economic developments affecting a country. In addition to the ratings, Fitch also provides reports and commentary. Further information on methodology is only available to service subscribers.

Moody’s Sovereign and Supranational
http://www.moodys.com/researchandratings/market-segment/sovereign-supranational/-/005005/4294966293/4294966623/0/0/-/0/rr

Moody's indicate creditworthiness by rating symbols, with each symbol representing a group in which the credit characteristics are broadly the same. There are nine symbols: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C. Aaa is used to designate the least credit risk and C to denote the greatest credit risk. Moody’s analysis examines financial, economic and political pressures impacting sovereign risk. Further information on methodology is available following registration or subscription.

3. Commercial Business Information Providers

PRS Group
https://www.prsgroup.com/icrg.aspx

The PRS Group publish the International Country Risk Guide (ICRG) monthly journal. Each issue includes financial, political and economic risk ratings and analyses of events that affect the risk ratings. There is also an ICRG Annual which is a seven volume set published annually, designed for university libraries. The PRS Group also offers 'Political Risk Services', a form of independent political risk forecasting. As part of these services they offer country reports, online services, country forecasts, a political risk monthly newsletter and a political risk yearbook.

Euromoney's Country Risk (ECR) Ratings
http://www.euromoneycountryrisk.com/

Euromoney Country Risk evaluates the investment risk of a country, such as risk of default on a bond, risk of losing direct investment, risk to global business relations etc. It uses a combined qualitative model, based on expert opinion on risk variables within a country, with three quantitative values: access to bank finance/capital markets, debt indicators, and credit ratings. The risk ratings also consider political risk, economic performance/projections and structural assessment.

Economist Intelligence Unit (EIU) Risk Analysis
Operational Risk Service: http://www.eiu.com/landing/risk_analysis
ViewsWire Risk Tracker:
http://viewswire.eiu.com/site_info.asp?info_name=RB_risktracker&page=rk&page_title=Risk%20Tracker
Democracy Index 2011:
https://www.eiu.com/public/topical_report.aspx?campaignid=DemocracyIndex2011

The EIU Country Risk Service looks at credit, sovereign debt and banking sector risks posed by a country. The service also looks at political, economic policy and economic structure risks. This includes short- and medium-term economic and political country forecasts. The EIU Operational Risk service looks more specifically at threats facing business. This can include analysis risks from politics, security, finance and infrastructure. The service also includes key risk scenarios for each country and a set of tools to benchmark risk across different countries.

The EIU ViewsWire (formerly called Risk-wire) consists of briefings on risks and different industries. The Risk Briefing's section also includes a Risk Tracker which tracks changes in risk scores and ratings. Access requires subscription, but the tool aims to allow users to build a risk matrix by choosing countries, risk categories, industrial sub-sectors and periods of comparison. The Risk Tracker is updated at the end of each week and individual Risk Briefing country scores may change between updates.

The Democracy Index measures the state of democracy in 167 countries. This is based on 60 indicators grouped in five different categories: electoral process and pluralism; civil liberties; functioning of government; political participation; and political culture. The Index was first produced in 2006, with updated lists produced in 2008, 2010 and 2011.

iJet Intelligence Risk Management
http://ijet2.serveronline.net/services.aspx?id=14

iJET specialises in operational risk management, aiming to indentify all threats affecting staff, facilities and operations. iJet produces country security assessment ratings which seem to be related to all manners of security threat. It also produces an online overview tool to monitor and assess threats across countries.

Political and Economic Risk Consultancy
http://www.asiarisk.com/percrpts.html

Political and Economic Risk Consultancy specialises in information and risk analysis for businesses operating in east and south-east Asia. They aim to provide information on how politics and other variables affect the business environment. Such variables include relationships between countries, between different peoples in the region, and between Asia and other parts of the world. They produce a number of publications including a fortnightly newsletter on topics such as corruption, business costs, nationalism, foreign investment trends, a monthly country risk monitoring report identifying near and medium-term business risks, and an annual corruption report on Asia. The annual report is based on perception data and the most recent report involved a survey of 1,763 middle and senior expatriate managers working in Asia. Countries covered include Australia, Cambodia, China, Hong Kong, India, Indonesia, Japan, Macao, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand, the United States and Vietnam.

PRS Group
https://www.prsgroup.com/icrg.aspx

The PRS Group publishes the monthly journal titled International Country Risk Guide (ICRG). Each issue includes financial, political and economic risk ratings and analyses of events that affect the risk ratings. There is also an ICRG Annual which is a seven volume set published annually, designed for university libraries. The PRS Group also offers 'Political Risk Services', a form of independent political risk forecasting. As part of these services they offer country reports, online services, country forecasts, a political risk monthly newsletter and a political risk yearbook.

IHS Global Insight
http://www.ihs.com/products/global-insight/country-analysis/index.aspx

IHS Global Insight provides 'Country Intelligence' services which provide: economic analysis, data and forecasts; political analysis; regulatory analysis; tax laws and impacts; operational conditions; security risk analysis; and daily updated risk ratings. Risk services are focused on finance risk – assessments of the financial stability, creditworthiness and risk factors affecting investment and business decisions.

Oxford Analytica
http://www.oxan.com/Advisory/Practices/Risk.aspx

Oxford Analytica provides country risk studies to assess the macro environment and implications for businesses and organisations acting in the country. They use expert panels and surveys, scenario planning and trend analysis to identify emerging risks. In particular they provide monitoring of political, social and regulatory developments.

Maplecroft
http://maplecroft.com/portfolio/

Maplecroft's analyses focus on political, economic, social and environmental risks impacting business and investors. They produce risk atlases on: global, political, legal and regulatory environment, human rights, climate change, and environmental and natural hazard risks. They also produce a number of reports and briefings. The website has a country or sovereign 'Risk Calculator' that enables comparison of several country/ sovereign risk indices to create customised scorecards.

Country Risk Solutions (CRS)
http://www.countryrisksolutions.com/

CRS examine the sovereign, political, economic, financial, technical, environmental, developmental and sociocultural risks that international businesses encounter in cross-border transactions. CRS provides services including country risk analysis, specifically analysis on geopolitical, macroeconomic, security and regulatory environment risks. Other services include political risk insurance and country risk management training.

Eurasia Group
http://eurasiagroup.net/

Eurasia Group focuses on transitional politics and economics. Their methodology aims to provide an early warning system to anticipate critical trends so as to withstand political, economic, security and social shocks. Every year, the Eurasia Group releases the Top 10 Risks for the coming year, along with a list of 'red herrings' – issues of general concern not deemed a substantial risk by the Eurasia Group. The Eurasia Group produces the Global Political Risk Index (GPRI) – a composite of 20 indicators measuring a country's vulnerability to crises.

The Benche
http://www.thebenche.com/189-countryreports/

The Benche is provided by the SEB Group as a free service to financial professionals from corporates, as well as from financial institutions. The purpose is to encourage sharing of knowledge and experience, open discussions and networking between such professionals. The site includes country risk reports with economic and political information. Registration and membership is required to access these reports. Some of these reports are from the SEB Group; however, the authorship of the remaining reports is unclear.

Business Monitor International (BMI)
http://www.businessmonitor.com/country_risk/

BMI risk analysis focus on political, macroeconomic and financial market risk. They produce analyses and forecasts on economic, political and business environment changes in 175 countries. This includes quarterly Business Forecast Reports (analysis of the latest economic and political developments, together with 10-year forecasts), monthly Monitors (2-year forecasts across a dozen key indicators with BMI's view of the latest developments) and a Daily Financial Alert (breaking views on countries). They also provide a Commodities service that provides short-term targets, medium-term forecasts, and views and analysis on commodities, including oil, industrial and precious metals, 'softs' (e.g. cocoa, coffee, sugar) and grains.

4. International Organisations and Government Agencies

World Bank World Governance Indicators (WGI)
http://info.worldbank.org/governance/wgi/resources.htm

The Worldwide Governance Indicators (WGI) consists of six aggregate indicators which measure six dimensions of governance: voice and accountability; political stability and absence of violence/terrorism; government effectiveness; regulatory quality; rule of law; and control of corruption. The WGI aggregate indicators are based on several hundred variables obtained from 31 different data sources. These sources capture governance perceptions as reported by survey respondents, non-governmental organisations, commercial business information providers and public sector organisations worldwide. The data sources include the following indicators: Economist Intelligence Unit Risk-wire and Democracy Index; iJet Country Security Risk Ratings; Political Economic Risk Consultancy Corruption in Asia Survey; Political Risk Services International Country Risk Guide; Global Insight Business Conditions and Risk Indicators (Kaufman et al, 2010).

Each of these (ostensibly risk-related) data sources are used for more than one of the aggregate indicators which represent the six dimensions of governance assessed. The number and choice of data sources used to make up these aggregates vary from country-to-country. There is, therefore, no unique 'risk indicator' among the six governance dimensions per se, but the political stability and absence of violence/terrorism indicator often includes most of the risk-related indicators listed above. The political stability and absence of violence/terrorism indicator assesses perceptions on the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including domestic violence and terrorism. It also includes data from other sources such as the Cingranelli Richards Human Rights Database and Political Terror Scale, Institutional Profiles Database and the World Economic Forum Global Competitiveness Report.

DFID Fiduciary Risk
http://webarchive.nationalarchives.gov.uk/+/http://www.dfid.gov.uk/documents/publications1/how-to-fiduciary-fin-aid-dec09.pdf

DFID undertakes fiduciary risk assessments (FRAs) to improve their allocation decisions and decisions over aid modality. Fiduciary risk is defined as 'the risk that funds are not used for the intended purposes; do not achieve value for money; and/or are not properly accounted for' (DFID 2009: 4). This DFID note suggests a nuanced and context-appropriate assessment. It states that FRA assessments are effectively a matter of judgement and should take a wide range of factors and influences into account. There is no universal, formulaic 'right' answer and the FRA must be able to stand alone from any public financial management system assessment. An analysis of both formal and informal structures is important, as is the understanding of the dynamics of power. Lessons about the general governance situation in a country should feed into and be informed by the FRA.

CDC Group
http://www.cdcgroup.com/uploads/cdcinvestmentcode.pdf

The CDC Group is a UK development finance institution. As such they are involved in investment decisions in relatively high risk environments. Carter (expert comments) notes that the CDC Group works in countries with intrinsically higher levels of risk. The CDC Group do not have specific risk assessment methodologies, but mainstream risk mitigation through their processes. Day-to-day risk is handled by fund managers who are often based in-country. These fund managers are selected following background checks and due diligence and must comply with CDC Group legal agreements and investment code. The CDC Group only invests in private institutions and consequently avoids the political risks associated with investing in state-owned or partially state-owned enterprises.

USAID Risk Assessment
http://transition.usaid.gov/policy/ads/500/596saa.pdf

USAID bureaus, offices and missions conduct risk assessments to help management: (1) identify and document risks; (2) prioritise them in terms of susceptibility; and (3) determine the adequacy of controls to manage those risks. The assessment guide consists of a series of items to check. Staff are asked to rate each item in the assessment by checking either 'agree/low'; 'sometimes agree/moderate'; 'disagree/high' or 'not applicable'. Answers can be qualified in the 'comments' section. The listed items aim to address all areas of vulnerability, including inadequate policies and procedures, inefficient organisational structures, inadequate training, wasteful or inefficient operations, unauthorised access to classified information.

5. References

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6. Additional information

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