WHAT'S IN A POLITICAL RISK? RE-ASSESSING THE POLICIES AND DETERMINANTS OF FOREIGN INVESTMENTS

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Abstract

This dissertation traces the history, methodologies and assumptions surrounding the complex field of political risk analysis (PRA), including attempts at theory-building over the past few decades. It suggests that while the study of politically charged risks has grown to encompass of number of fields and avenues of research—with solid methodological foundations—there is room for further discussion of political risk analysis that takes into consideration the geopolitical realities of the 21st century, specifically in developed economies. For many years, risk analyses often overlooked the potential for political risks in stable developed democracies. Although recent events have guided the field to better contemplate the changing political-economic and social realities in Western democracies, commonly used approaches to the assessment of political risk have hitherto not adequately incorporated new analytical and theoretical tools to more fundamentally consider the fundamentals of political risk in the global North. Through a combination of primary and secondary research, and extensive fieldwork with experts, this project traces the different methodologies behind the study and practice of political risk, and proposes a theoretically informed institutional approach to its analysis. The perspective I put forth appreciates necessary differences in economy types and development levels, the interdependent nature of different types and layers of risk, and the importance of non-quantifiable, qualitative sources of risk. Using an in-depth case study of Italy, I explain how such an approach can work to assess the complex nature of political risk in advanced democracies, and how it can complement the burgeoning advances in the greater field of risk analysis.

This is for my parents and their parents.

E pure questo è fatto…

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Table of Contents

List of Tables

List of Figures

CHAPTER I – Context of Research and Methodological Considerations

"We are heading into a world of unprecedented political risk which calls into question the pillars of the post WWII settlement. It's unsurprising investors are heading for cover." Dominic Rossi, Global CIO Equities, Fidelity International[1]

Blunt statements and warnings such as the one above by global investment firm Fidelity became a more common occurrence in 2016-17. As the global economy slowly moved on from the financial crisis, the mid-decade mark has been accompanied by fits of uncertainty. While the well-known traditional sources of risk to global economic stability (war, civil unrest, kleptocracy, sovereign debt, credit-swaps, financial securities fraud, trade wars, etc.) have been analyzed, the Fidelity CIO is correct to note that such risks have now been abetted by an unprecedented level of *unknown* political risks, which, I would add, are not confined to the halls of authoritarian regimes or to war-torn regions. Although the capacity of a (2017+) Trump presidency to disrupt the post-war geo-political status quo and destabilize the world economy is vast, the 'period of uncertainty' that many political-economic experts and allied world leaders are foreshadowing[2] is just that—*uncertain*.

Granted, there are not many certainties in political-economic life, yet having some sense of stability is certainly beneficial. In the short to medium term, the ability to count on a daily routine, or an annual business plan, a government regulation, policy, or a geopolitical arrangement, is something that determines the success of many individuals, ventures, and countries. This continuity also underpins the institutional foundations of liberal democracies and

[1] Nov 9, 2016. Immediate commentary from a global investment house in the aftermath of a Trump election victory. FX Street, 2016. https://www.fxstreet.com/news/us-elections-we-are-heading-into-a-world-of-unprecedented-political-risk-fidelity-201611090718
[2] CBC News, 2016a. http://www.cbc.ca/news/world/trump-world-reaction-1.3843252 ; Globe and Mail, 2016. http://www.theglobeandmail.com/news/world/washingtons-rifts-deepen-as-trump-presidency-nears/article33630388/?cmpid=PM0117

the relations between many nation-states. Yet the relative certainty in the socio-political and economic arrangements that we had come to rely upon, both formally and informally, has been gradually unraveling in many stable Western democracies. This phenomenon is not breaking news, yet we are seemingly bombarded with more cases of uncertainty that have come to define the political and economic realms in which we live. This speaks to a newfound sense of instability that is plaguing the globalized world, and suggests that we take another look at the assumptions and methods behind traditional risk analysis.

Granted, global trade relations might not be drastically affected by the disruptive Republican President in the long term, and perhaps the US will honour its security obligations without reverting to protectionist doctrines of the early 20th century. On the other hand, assumptions around the American role in the world might change in a disruptive manner. These are the sorts of queries that political-economic forecasters will be grappling with over the next few years as the developed economies of the North Atlantic transition to a new global economic and geo-political order: one where American leadership is potentially absent, and one where the European project faces many obstacles post-Brexit in the context of other member state referenda and elections. For the foreseeable future, there will be a period of deep uncertainty regarding future trade policy directions and the impacts of these changes. The right wing populism, Euro-skepticism, and anti-trade rhetoric that has crept into western political dialogue over the past few years is unique in its nativist and discriminatory actions that seek to incriminate foreign investment and workers as the cause of economic malaise. Threats of trade barriers, nationalism, and withdrawal from multilateralism increase the magnitude of problems for multinational investors. What all this means is that the future of international investments and trade relations as we have come to know them in the liberal and globalized sense over the past 25 years could be at a crossroads. It is thus important to delve into that world to explore the wide-ranging political issues that concern governments, investors, policy-makers and insurers involved in the complex realm of foreign investment. This dissertation thus attempts to shed light on certain aspects of the political nature(s) of investment determinants in developed economies.

1.1. Introduction: Investment Determinants & Political Risk

Political risk is a multi-faceted concept which rests at the intersection of different disciplines in the social sciences. It can be broadly understood as "any occurrence in the international business context where public actions or non-state actors that are active in the host country of the international activities interfere with private international businesses and adversely impact the performance of the international operation" (Meissner, 2017, 29). Exposure to a number of recent global 'shocks', including the latest waves of terrorist attacks in Europe and the Middle East, an impending Brexit (which businesses could expect to be 'hard'[3] and messy), the rise of populist euro-skepticism across the EU, a bitterly divisive election in the US and an emboldened Trump administration, and a failed coup d'état in Turkey, has led to a renewed sense of political and economic instability across the globe over the past few years.

The related interest in political risk has matured to the point where it is no longer confined to the business and insurance worlds. Boutique political risk firms and international business consultants are now a dime-a-dozen, and the more prominent ones such as the Eurasia group, and its founder *cum* public intellectual Ian Bremmer, are now close to household names in global media outlets. Interested officials, intellectuals, investors or curious individuals have a grab bag

[3] Financial Times, 2016. "Business should assume a hard Brexit". https://www.ft.com/content/fbe091c6-d729-11e6-944b-e7eb37a6aa8e?emailid=56b08ef56fee900300791f37&segmentId=2f40f9e8-c8d5-af4c-ecdd-78ad0b93926b

of sophisticated firms to choose from across the world, and many companies have in-house experts doing similar projecting. As I will demonstrate throughout this dissertation, political risk is an important, yet under-theorized subject matter (Sottilotta, 2017) that sheds light on the ways in which business and politics interact in a globalizing world. It is a topic that has rightfully been gaining traction over the past few years; and with this growth, it requires analysis of its own. Under the auspices of a more practical international political economy outlook, I make broad theoretical and empirical reference to two interrelated notions at the heart of political and social sciences: the strength of the relation among democratic institutions, and political and economic stability in the contemporary era. These debates have been approached in a myriad of ways by classical liberals, consolodologists and transitologists, modernization theorists, Marxists, Weberians and neoclassical economists, to name just a few, who tackle the seminal questions of what liberal democratic and free-market development should consist of, and the degree to which it can lead to more economic growth and stability, or not. If one begins with the debatable notion that the future of modern liberal capitalism requires a (somewhat) democratic institutional foundation, it becomes possible to focus on what exactly businesses and investors desire as systems of governance and locations to park their capital, and in the process expand our scholarly horizons around such issues. The diffusion and free flow of investment capital across borders epitomizes modern global capitalism in its current neoliberal form, but it is not always an open-democratic system that it seeks. Above all, it is some form of *stability,* including the assumption of reasonably predictable governments and policies, that investors and multi-national corporations (MNCs) crave in foreign locales, the guarantor of that stability not always being of paramount importance.[4] However, much of the political science literature on the factors that influence Foreign Direct Investment (FDI) deals with that apparently innate relation: type of

[4] See, i.e. Busse & Hefeker (2007); Henisz, WJ. (2000); Jensen (2008 & 2014).

governance and legal system, entry paths, democratization, ideology, fiscal positions, and participation in acceptable multilateral institutions—and investment potential.

History, and with it the ebb and flow of free-market and state-driven economies, has shown that there may not necessarily be one single 'grand' theory of how to determine the potential success and stability of investments, and which systems of governance are most appropriate to do so. As outlined below, the study and analysis of political risk and FDI determinants seems to appropriately tackle these larger questions of foreign investment and political systems, albeit within defined parameters. In this subfield, given the unique political (& socio-cultural, financial, economic, etc.) characteristics of each area or industry that is being analyzed for the potential profitability of an investment, there ought not to be only one way of determining possible risks to private investment.

Undoubtedly, modern market economies require a certain level of risk-taking and this involves an element of uncertainty which cannot be decoupled from the modes of economic production and societal organization. Risk and uncertainty can be defined and understood in different ways, and can be approached from game theoretic to neoclassical economic principles. A major distinction between the two revolves around prediction and quantification: with risk, it is possible to forecast the possibility of outcomes, and seek to mitigate or manage them; while uncertainty is often qualitatively subjective and difficult to measure numerically. Frank Knight's classical work on risk, uncertainty, and profit (1921) explained that the ability to know the probability of potential outcomes is distinguishable from genuine uncertainty where again, outcomes are rather unknown and are not accurately quantifiable. He thus posited that innovation and profit are best achieved in the face of genuine uncertainty, otherwise the rational actor will control for mitigating probabilities, potentially inhibiting innovative actions. From this perspective, in complex systems such as the institutions of government and the economy, the interaction of many economic and political actors means that levels of uncertainty can rapidly change. Political risks work under this logic, and consequently, risk analyses entertain the willingness of the firm or individual to engage (invest) in potentially uncertain areas by seeking to hypothesize on a probable outcome. In this sense, political risk assessments elaborate on specific causes and actors in those potentially uncertain institutional settings (government, army, business, civil society, etc.) to calculate the probability of future risks and/or negative returns. My point is that risk analysis must *a priori* take into account the uncertain nature of risk more broadly.

A predominant goal and contribution I seek to make to the greater body of work in the field will be to bridge political-economic theorizing and the presence and analysis of specific political risk factors into a novel approach, in order to supplement the growing base of literature on political risk. But is it *only* the state institutions and societies that produce risks?[5] This important connection between political stability and economic growth (and their underpinning institutions)—whose relationship is inherent to political risk—will be approached here by referring to theories of economic prosperity and the primacy of institutional determinants of such growth as espoused by Acemoglu and Robinson (2012), North (1990), Przeworski (2004a), Rothstein (2011) and others (see Ch. 2). Creating a 'grand theory' or new model of political risk analysis is not one of the objectives of this study, nor is it to re-design political risk methodologies entirely, but the critiques of actual contemporary risk strategies that follow are important to my research goals.

[5] On risk and causal inference, or extra-governmental sources of risk (elites), see Snider (2005) and Kluge (2017).

In practice, political risk is a loosely defined term that can be understood in a general sense as the possibility of uncertainty or harm to investments and business ventures abroad. These can result from economic turbulence, investment environments, and other factors that stem from events or actions that are *political* (governmental and non-) in nature. To the extent that the definition of *political event* can be contentious, it bears mentioning that I focus on traditional conceptualizations such as legislation and policies, institutions or conditions in a given country, that are spurred by socio-political and economic issues. These political matters have drastic effects on the profitability of business investments abroad, and such risks are increasingly becoming an area of concern to both prospective investors and host governments looking to attract foreign investments (Zonis et al., 2011; Howell and Chaddick, 1994; Meldrum, 2000). The desire to calculate or measure risk and uncertainty for sovereign nation-states has become more urgent in the last decade (Bouchet et al., 2003) as governments and businesses seek to minimize their exposure to risk in an increasingly politically risky and complex global business environment in the 21st century (Jakobsen, 2010). Hence the purpose of political risk analysis is to provide companies and investors with specific information on the protection and profitability of their potential investments and business opportunities abroad, and on the likelihood that the investment will encounter problems specific to a country or region. The terms ‘political’ and ‘country’ risk have often been used interchangeably, and can assess similar factors. Yet the main difference is that while country risk does not necessarily make reference to strictly *political* events or realities, ‘political risk’ clearly stems from risks and factors that are inherently political in nature, whether direct or not. Foreign investments are subject to the operational rules and political-economic environments of sovereign states (Brink, 2004), and political risk analysis (PRA) is thus concerned with the perception of political continuity and stability in given markets and, perhaps more importantly, institutions and policies. Indeed, my own approach to political risk analysis (see Ch. 2-3) is rooted in Jarvis' classifications, which stem from a developmental perspective embedded in political economy: 1) risk is comprised of those "factors and or processes that might hinder, constrain or obviate the operation of political institutions, the exercise of legitimate rule and the functioning of civil (domestic) and international society"; and 2) as simply the "activities of governments (or its agencies) whose decisions, policies, edicts and rulings create outcomes that distort, impact, change or adversely effect the interests of stakeholders (economic and non-economic actors)" (2008, 4-6).

In this dissertation, I focus on the politically charged risks to, and investment determinants of, FDI as conceptualized by the following: international trade in goods and services; horizontal FDI, in which the same type of business operation in the home country operates/opens abroad; vertical FDI, whereby the parent company establishes related (but different) business activities in the foreign country (i.e. parts, supply-chains); greenfield, where a new facility and/or production by a parent company begins in a foreign country; and brownfield FDI, in which a company purchases an existing facility for their business or production (Investopedia, 2017). Each of these investment types requires an investment of human and/or financial capital, and is thus presented with different types of risks than those of strictly financial vehicles. I do not focus much attention on portfolio and shareholder investments in which an investor merely purchases equities of foreign-based companies, and may not have any day-to-day management, influence or control over the company in the host country. These type of investments, while important, likely fall under a separate realm of political risk: more on the side of protecting credit, shareholder loans and financing, than on the side of actual physical assets and business in a country (green and brownfield FDI).

Until fairly recently, common political risks to investments, generally understood to be in the form of expropriation and nationalization threats, or harm to foreign enterprises due to political violence, were considered to be attributes exclusive to emerging economies. Today, the global equilibrium has changed and hitherto clear-cut distinctions in types of economies have become increasingly blurred due to the globalization of finance, trade and even culture. Moreover, the relationship among politics, regulations/policies and the activity of international investors has been further complicated by the inequalities left in the aftermath of the global financial crisis. The political instability in the Eurozone (especially regarding traditional party-lines in the periphery) and the spectre of a Grexit, Brexit and other *exits* from the EU, plus the complex nature of China's economic and political clout, Brazil's socio-economic slowdown, home-grown terrorism in the EU, and a host of other geo-political issues including the uncertainty around the Trump administration in the US, all highlight the need for an increased focus on political risk in an interconnected world, and the public policies that can facilitate or prevent it. The *Harvard Business Review* picked up on this issue in a recent piece, concurring that corporations today need something akin to a 'foreign policy', given the rise in geopolitical tensions, and the inability to 'escape politics' (Chipman, 2016). The article urges businesses and readers to conduct geopolitical risk assessments today: transnational risks, regional political trends, in-country issues; and to develop a corporate diplomacy and policy stance, and diversify relationships at home and abroad in order to mitigate the many global political risks that can currently jeopardize investments.

Concurrently, the specific micro and macro factors that can contribute to differing levels of political risk (see Ch. 3) in a given nation-state have also become more complex[6], which calls

[6] Brink's (2004) *Measuring Political Risk* provides a good outline of numerous political risk factors and their indicators.

for in-depth scrutiny into the study of FDI determinants in the increasingly unstable ‘developed’ markets, a topic which the next section (1.3) introduces. I contend that it is difficult to differentiate all the factors behind political risk due to the expansion of global business, the *trans- and inter*-national nature of capital, and the breaking down of traditional state barriers in complex jurisdictions (i.e. supranational federations like the EU or global free-trade agreements [FTAs]) that have accompanied globalization.[7] The consensus in much of the literature is that a precise definition and assessment of political risk is hard to achieve given its interdisciplinary nature and applicability to other spheres of scholarship. Still, one ought to take political/economic risk evaluations at face value: their purpose is to aid and abet the prospects for foreign investments, economic growth and the accumulation of profit. The settings in which they are analyzed can differ by state/region and industry, and I aim to contribute to situating certain differences as potential risk factors. The institutional, policy and socio-political avenues of research that I will highlight are significant, and indeed require a selective theoretical lens through which to observe and analyze them (see Ch. 2). These allow us to go beyond the typical approaches to political risk that highlight actuarially defined sources of risk, and help underline what these risk factors actually are, how they came to be, and why/how they may be considered political, institutional, or otherwise.

1.2. Research Questions, Objectives, and Contributions

This project engages with important macro political and economic issues surrounding the relationship between institutional characteristics and economic growth. But there exists a tension

[7] See Marchetti (2014) on the complex relation between ‘external variables’ like globalization and political risk.

in the theoretical base of liberal democratic and economic development literature and the institutions that supposedly underpin it. This tension is evident in modern political risk analyses that seek to reinforce the idea of strong and stable foundational democratic institutions that support economic growth and prosperity[8], and vice versa, insofar as not all contemporary democratic societies are on equal institutional and economic footing. Through an examination of the interdisciplinary and interconnected nature of so-called 'political' risks, I will develop this problematique and seek to address the following practical and theoretical queries:

> *-Is there room for deviation from common approaches to the assessment of risk, and what does this mean for the practice of political risk analysis more generally? What can a single-case analysis of contemporary Italy convey about the complex nature of politically-charged risks that characterize an investment location?*

In pursuing this overarching research question, I essentially investigate *what* a political risk consists of throughout its many connotations, and I consider the degree to which political risk analysis captures (or not) the institutional and social realities of a country by focusing on the case of Italy as an example of how to utilize the approach I put forward. By means of this endeavor, I introduce a theoretically informed holistic approach to the study of modern political risk that explains:

> -the ways in which contemporary political risk analysis is conducted, including the discrepancies in risk assessment methodologies and approaches;
> -the attributes/variables that underpin typical risk ratings in emerging/developing economies, vs. developed liberal democracies, and what that suggests about the state of the industry;
> -the degree to which detailed analysis of 'softer' socio-political, policy and institutional factors can be emphasized, especially given the prevalence of financial and quantitative sources of risk.

[8] Jensen (2006 & 2008) presents a good review of the degree to which democratic institutions reduce political risks.

The answers to such inquiries are not always clear from the many diverse risk appraisal techniques that are available to potential investors and curious academics alike. However, in the following sections and chapters, I will situate the discussion of political risk analysis by approaching risk in developed democracies and advanced economies. Following this, I will specify the methodological considerations and research design that I employed in this project. In Chapter 2, I look at the history of attempts to generate theories about political risk and investment determinants, and synthesize different perspectives –critical and institutional—that we might take up to try to reconcile the multifaceted purpose and practice of political risk analysis. Here, I also outline an avenue of theoretical and applied research that explains how investments and government institutions have been, and can be successful (or not), in relying on one another for both economic growth and stability. Using quantitative evidence of these variables (investment, stability, risk), I recognize that this is a useful approach to introduce the concept of political risk and what it represents. Yet we can take these relationships a step further by recounting them qualitatively.

Moving forward in the manuscript, I unpack the ways in which political risks are determined by various private and public risk practitioners (political-economic risk weighting/methodologies) based on primary fieldwork, and hypothesize on what they actually represent in both the theoretical and applied senses. In doing so, I envision a novel approach to the study of political risk that suggests an interdependency of the macro-criteria required to analyse risk factors (Ch. 3). By keeping the focus of analysis constant and focusing on the aspects of political risk in a particular developed economy case such as Italy, I can better isolate and understand what is actually 'behind' political risk for modern investors. Detailed focus on a single case proves insightful for the usefulness of political risk analysis in places like Western

Europe, and opens doors to understanding what is actually happening on the ground today from an investor and governmental perspective (Ch. 4 and 5). Ultimately, a careful analysis of specific investment related policies and characteristics in a comparative light, combined with an overview of interview results in Italy, will support my explanation of *what constitutes a political risk* from theory to practice.

In addressing these questions, my objective is to critically engage with the criteria for political risk analysis with the aim of determining not only what may be missing from current risk assessments, but also to consider the implicit methodology of democratic and economic development as is commonly understood. In sum, I aim to demonstrate that the importance of specific (policy, regulatory, institutional, soft/socio-cultural) factors that one finds *behind* and *within* political risk assessments is essential to a holistic understanding of investment-related difficulties, decisions, and ultimately the success of an investment. Further, such thematic variables do not exist in a vacuum, and ought to be viewed as part and parcel of larger macro and micro political-economic realities. I also consider to what extent institutions—and the policies and regulations they procure—in supposedly more stable liberal democracies of the contemporary West are actually less 'risky', and how this can contribute to theoretical debates on economic and democratic development. In sum, I emphasize that political risk analysis is a complex instrument that requires unique assessment strategies depending on, and specific to, the country and type of economy and/or culture at hand.

This project thus broadly examines the interactions between political risk, investment, government institutions and society, as conceptualized by a case study on Italy. My main objective is to contribute to interdisciplinary scholarship across the fields of International Political Economy (IPE), comparative politics, and business studies, by utilizing authoritative and systematically collected data to answer questions of investment and stability in developed economies from a more qualitative angle. Research methods include firm and sector analyses, in-depth fieldwork, and interviews to evaluate the current field of study and practice of political risk analysis, including actual expert perspectives of the foreign investment realm in Italy. My research produces original scholarship on political risk and the study of investment determinants in developed economies in the forms of a new approach and refined typologies, and my research suggests that common assumptions concerning political risk analysis can benefit from qualitative perspectives on the essential socio-political character of risk.

It bears mentioning that at the time of writing (2017-18), political risk has become a hot topic. Global political and economic stability has been in a constant state of flux due to a changing political order, constant threats of terrorism, sluggish economic growth, and recently a major crack in the armour of the Western liberal and democratic supremacy, as embodied by the UK's referendum vote to leave the European Union, plus a Trump presidency which symbolises an evident break from political predictability. The knee-jerk reaction of markets and investors to both these events was immediate following the results, and uncertainty over how the fallout will progress has prevailed both politically and economically. But we must also be careful not to jump on the 'geopolitical uncertainty' media bandwagon, because shock events such as these, while definitely under the umbrella of political risk, are often symptomatic of larger institutional problems, events or social realities that are the actual underlying causes of political risk. So, while media and businesses may be talking about political risk *more* than they used to, the coverage is still rather superficial.

It is equally important to recognize the shortcomings of predictive models and our collective inability—notwithstanding all the data, modeling, and technology at our disposal—to make accurate forecasts concerning social and political occurrences, and stem from deep-seated societal and changing economic realities. In this sense, investors seek the prospect of relative stability in a chosen economy and its political sphere. And herein lies one of the major contributions of my dissertation: political risk analysis (and the industry itself) can benefit tremendously from a comprehensive, behind-the-scenes and/or on-the-ground analysis of the particular country, economy, or industry at play, and requires careful consideration of a range of factors that do not solely rely on quantitative models and forecasting or predictive elements. While these are undoubtedly useful and necessary, often the intricacies of a society/culture or institution, a specific investment policy, or political decision, will be just as important, though even harder to capture with prevailing techniques.

Moreover, it is my contention that although the topical upsurge in the popularity of political risk is relevant, the recent events that have brought the concept to the forefront of media and business have actually been preceded by major political, institutional and societal shortcomings in many Western economies. In a sense, these events were not without warning, and it is important to hash out the factors that were already in play vis-à-vis stability of investments. It is thus evident that political risk does matter in developed markets as well. These notions have been corroborated by the CEO of PRS Group (2017), who notes that there is "a different kind of political risk we see increasingly – a more nuanced one about which practitioners and those affected by it have to be aware. This is the political risk that makes a distinction between politics and policy, with the former being seen as more 'noise,' relatively unimportant to the longer-term behaviour of assets; the latter being more instructive and indeed more dispositive of its real value."[9] Such an important distinction and connection between 'messy politics' and 'tangible policies', is something I consider throughout this dissertation.

1.3. Narrowing the Scope: Re-Considering Political Risk Analysis in Developed Economies[10]

"After the surprise decision of Britain to leave the European Union, and the election of Donald Trump as American president, there is a lot more talk about political risk than there used to be."[11]

As mentioned briefly above, a majority of scholars and practitioners working in the sub-field of political risk are predominantly engaged with the political and economic factors that affect investments in developing economies—and for good reason. In many such countries, the stability and profitability of foreign investments or business ventures is more difficult to guarantee and to predict due to concerns related to political volatility, social upheaval, and greater policy-regulatory uncertainties. But I will discuss below how this reality is changing, as the above quote from the Economist suggests. Still, developing nations are at the forefront of political risk analysis precisely because of the potentially lucrative business opportunities that accompany fairly rapid economic growth and development in 'frontier' markets. Indeed, recent global FDI flows to developing countries (spurred by growth in Asia) significantly outweighed those to developed ones, as Table 1.1 shows below. It is also important to note how these FDI flows embody the interconnected nature of the global economy, as much of the inflows to developing economies come from developed ones, and vice-versa.

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[9] Christopher McKee, CEO, PRS Group, 2017a. http://www.prsgroup.com/about-us/from-the-ceo

[10] Certain parts and data from this subsection (1.3) have appeared in a previously published article by the author. See Campisi, J. (2016) http://www.jpolrisk.com/re-considering-political-risk-analysis-in-developed-economies/

[11] The Economist, 2017a. http://www.economist.com/blogs/economist-explains/2017/06/economist-explains-8

Table 1.1 - Global FDI Inflows 2012-14, by major economy type (billions of $US)

Type of Economy	2012 & *(% total)*	2013 & *(%total)*	2014 & *(% total)*	2014 growth (%)
Developing	650 *(49.1%)*	677 *(49.7%)*	704 *(55.9%)*	4%
Developed	590 *(44.6%)*	594 *(43.6%)*	511 *(40.6%)*	-14%
Total World Economy	1324 *(100%)*	1363 *(100%)*	1260 *(100%)*	-8%

(Source: UNCTAD, 2015)

Although investing in developing economies has been popular and profitable, multi-national corporations (MNC) and international investors know that with those opportunities come inherent risks. Firms venturing abroad thus procure detailed political and economic risk assessments *a priori* in order to identify potential impediments to their investments. Indeed, in many developing economies, realities of a political nature such as rampant corruption, the threat of nationalization, legal and regulatory insecurity, civil strife or political violence, weak state institutions or abrupt political changes continue to be significant and represent common political risks that foreign firms must seek to mitigate when investing abroad. The foregoing do not include the many more strictly economic factors that must be taken into account in the same assessments. These are important topics that scholars such as Howell and Chaddick (1994), Howell (2001, 2014), Brink (2004), Campisi & Caprioni (2016), Alon and Herbert (2009), Brown (2016), and many others have examined from a variety of perspectives including the issue of capital flight and authoritarian regimes, FDI in the mining industry, the modeling of political risk, or in specific contexts such as instability in Eastern Europe and the South China Sea.

Moreover, in the past few years we have seen the importance of political risk analysis come to light across the developing world as investment flows have increased in some areas, but decreased in others. For example, political-economic uncertainties remain regarding Russian aggression in the Ukraine and peripheral Europe, Argentine debt repayments, Iranian sanctions, Brazilian economic and corruption woes, the Chinese stock-market crisis and difficult transition to lower growth, continuous upheaval in the MENA region, terrorism and ethnic violence in Africa, and a variety of other issues that deserve our attention in both the academic and civic senses.

Essential to this dissertation is my contention that investment, the institutions that underpin policies and regulations in democratic regimes, and risk have a more complex relationship than many risk methodologies often assume. In short, industrialized market economies with democratically accountable governments are not as immune to political risk as once thought, and their geo-political profiles are becoming more complex. I would thus suggest that the greater political risk community, and for that matter global investors as well, ought to be similarly focused on what are often considered to be more stable economies and large advanced liberal democracies – in other words, the so-called ‘developed’ economies of the Global North. There is ample space—and indeed a necessity—to consider similar, if more subtle, causes and consequences of political risks in, i.e., Europe.[12] Granted, there are fewer developed/industrialized economies in the world than there are developing ones, meaning that there may be scarcer ‘new-investment’ opportunities in mature markets. However, the specific factors that can contribute to differing levels of political risk in a given nation-state have become more complex. Again, this calls for in-depth scrutiny into the various political determinants of investments in the increasingly shaky developed markets. Socio-economic indicators in many parts of Europe and North America (see Table 1.2 below) raise a number of pointed questions concerning the stability of business investments that are central to political risk analysis. In fact

[12] Brink (2004) discusses the need to move away from the traditional political risk focus on developing economies in order not divert attention away from other vulnerable issues/places.

there are studies that map the relation between institutional indicators and economic performance (see for example Rodrik et al., 2002), and I build on those here. Moreover, popular analysis of geopolitical risk has recently tuned into these changing developments, i.e. distinguishing among classical risks such as military build-up, proxy wars, failed states, versus socioeconomic risks like declining trust in elites (populism), income inequality, referenda and, more broadly, poor governance, or credibility and stability of institutions and respect for the rule of law, that are presently plaguing developed democracies[13]. Yet while the risk community is starting to better appreciate the existence of political risks in developed democracies, the common methodologies used hitherto do not necessarily capture these realities.

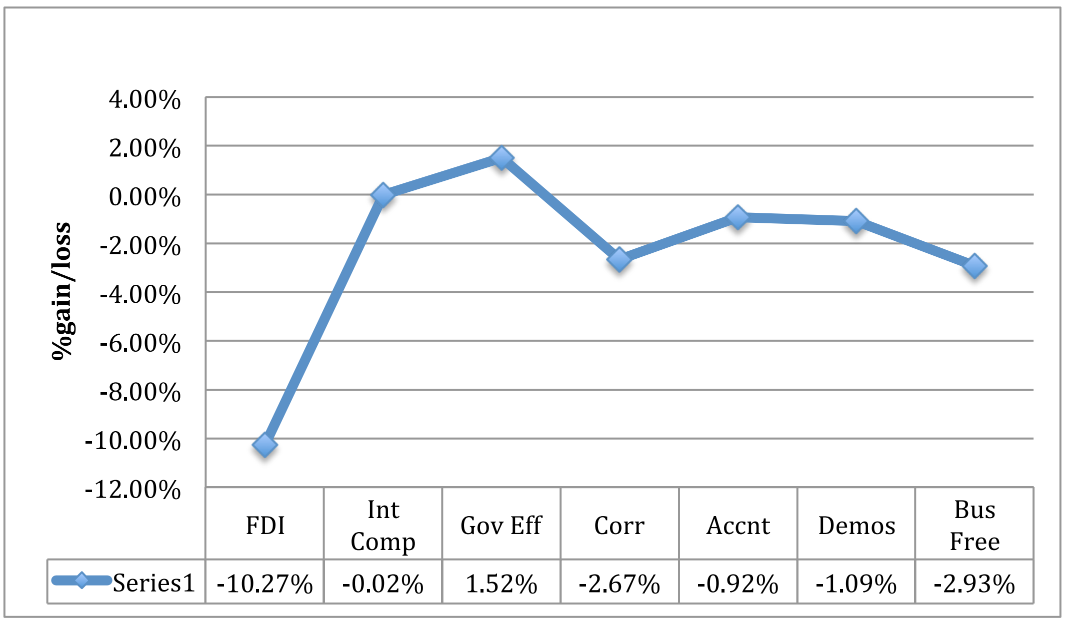
Accordingly, it is important to consider whether past assurances of steady economic growth, an open and accountable political environment and strong investment climate in the West may be on the wane, especially in the post-crisis era. In the context of mature democracies, political risk is more likely to assume forms of adverse policy change, unstable governance, or a negative investment climate; hence, a decline in attributes such as democracy, rule of law, relative political-economic stability and growth, and investor confidence in 'stable' democracies is something that should not be overlooked in the world of political risk (See Figure 1.1[14]). Emphasized in the figure below is a negative trend in the vast majority of governance and business scores in the major advanced economies since the 2007/8 onset of the financial crisis. The combined indicator averages of G7 countries (+ Spain & Australia) were selected due to their status as the larger democratic advanced economies in the world. Together, these measures

[13] Business Insider, 2017. http://markets.businessinsider.com/news/stocks/citis-tina-fordham-on-political-risk-and-trump-2017-1-1001659239-1001659239 ; Bloomberg, 2017a. https://www.bloomberg.com/view/articles/2017-02-21/how-political-risk-is-shifting-to-developed-markets

[14] The 7 indicator score changes are based on calculations made in Table 2 below. The majority have trended negatively since the 2007/8 onset of the crisis. The indicators chosen are: Net FDI Inflows; International Competitiveness; Government Effectiveness; Control of, and Perception of, Corruption; Accountability and Voice; Democracy Quality; Business Freedom, as per the sources below the table. These are better described in Table 1.2.

form a fairly accurate idea of government stability, institutional and policy effectiveness or uncertainty vis-à-vis global investment, which enables us to reflect on the root causes of political risk in democratic regimes. These roots manifest in many different ways, and are often distinct from typical risk perils such as confiscation, expropriation or violence[15] mentioned in chapter 3, that are often quantitatively assessed, and also found in many developing economies.

Figure 1.1: Average Global Indicator Changes in Large Advanced Economies, 2007/8--2014/5



(Sources: EIU, 2015; World Bank, 2015; The World Economic Forum, 2015; Transparency International, 2015; The Heritage Foundation, 2015)

Indeed, the relationship among FDI flows, political risk and democratic institutions (and their authoritarian counterparts) has been well mapped by scholars (Jensen, 2008; Li and Resnick, 2003), and has currency in the literature (see also Ch. 2). In a similar vein, Table 1.2 below

[15] Insurance companies that provide political risk coverage often refer to CEND–confiscation, expropriation, nationalization, & deprivation—as the traditional insurable perils.

highlights various institutional, governance and international business indicators[16] and scores in large developed economies since the financial crisis, in order to underline the importance of a strong investment and policy-regulatory climate to FDI levels. The results are interesting, especially when examined in light of their actual political risk rankings which generally score quite well.[17] Although understandably still ahead of the global averages for most statistics, the relative decrease in each of the indicators is notable, particularly as they coincide with lower FDI levels. It would thus be prudent for students to further investigate the economic, institutional, and social factors that can determine investment successes in democratic regimes and advanced market economies as well as popular developing ones, given the often 'social' nature of political risk, as both Bremmer (2005) and Howell (2007) have noted.

[16] These same indicators are also used in a variety of commercial political risk indices.
[17] In the 2015 Political Risk Index, with the exception of Italy (73), Spain (75), France (76), all other major developed economies scored well over 80/100, meaning they are seen to have relatively low-medium political risk (global mean = 73). See PRS Group, 2015. https://www.prsgroup.com/category/risk-index

Table 1.2: Select Governance/Business Indicators in Large Advanced Economies, 2008-15

		Indicators & Scores						
Country	**Year**	***Net FDI inflows, $bn *2007-14***	***Int'l Compet. <6***	***Gov't Effect. /± 2.5***	****Corruption /100***	***Accountability /± 2.5***	***Democracy /10***	***Bus. Freedom /100***
Australia	2008	44.4	5.2	1.78	84.9	1.4	9.09	90.3
	2014/15	46.3	5.15	1.59	76.9	1.37	9.01	94.1
	Current Global Rank	9th	21st	18th	13th & 11th	14th	9th	6th
Canada	2008	119.9	5.37	1.77	83.3	1.43	9.07	96.7
	2014/15	57.2	5.31	1.76	77.9	1.43	9.08	89
	Current Global Rank	7th	13th	11th	9th & 13th	10th	7th	14th
France	2008	83.8	5.22	1.58	62.1	1.31	8.07	88
	2014/15	7.9	5.08	1.4	60.4	1.22	7.92	80.2
	Current Global Rank	34th	23rd	25th	26th & 27th	21st	27th	33rd
Germany	2008	50.8	5.46	1.52	74.1	1.35	8.82	89.9
	2014/15	8.4	5.53	1.73	77.1	1.46	8.64	88.2
	Current Global Rank	31st	4th	12th	10th & 12th	9th	13th	17th
Italy	2008	40	4.35	0.29	29	1.02	7.98	77
	2014/15	13.7	4.46	0.38	19.8	0.98	7.85	71.9
	Current Global Rank	21st	40th	59th	64th & 83rd	45th	21st	62nd
Japan	2008	21.6	5.38	1.46	62.7	0.92	8.25	88.1
	2014/15	9.1	5.47	1.82	72.1	1.04	7.96	84.1
	Current Global Rank	30th	6th	7th	19th & 15th	38th	23rd	23rd
Spain	2008	73.8	4.72	0.92	54.7	1.18	8.45	77.9
	2014/15	34.2	4.59	1.15	39.6	1	8.3	77.5
	Current Global Rank	11th	32nd	30th	36th & 53rd	42nd	17th	36th
UK	2008	209.5	5.3	1.64	71.7	1.33	8.15	90.8
	2014/15	45.5	5.43	1.62	75.1	1.3	8.31	91.1
	Current Global Rank	10th	10th	16th	12th & 16th	17th	16th	12th
USA	2008	340.1	5.74	1.6	64.7	1.12	8.22	92.6
	2014/15	131.8	5.61	1.46	64.4	1.05	8.05	88.8
	Current Global Rank	2nd	3rd	22nd	16th & 23rd	37th	20th	15th
Totals/ Averages	2008	983.9	5.193	1.396	65.244	1.229	8.456	87.922
	2014/15	354.1	5.181	1.434	62.589	1.206	8.347	84.989
	Net +/-	-629.8	-0.012	0.039	-2.656	-0.023	-0.109	-2.933
% gain/loss	2007/8--2014/5	-10.27%	-0.20%	1.52%	-2.67%	-0.92%	-1.09%	-2.93%
World	Global Statistics 2014/15	(n=185); (world mean=8.2); (world median=0.94); Total FDI '07: 2,985.7 bn; '14: 1,561.3 bn	(n=133); (world mean=4.22); (world median=4.19)	(n=191); (world mean= -0.01); (world median= -0.13)	*weighted avg of 2 corruption indices(n=165+ 191); (world mean=41.3)	(n=192); (world mean= -0.03); (world median= -0.03)	(n=167); (world mean =5.55); (world median=5.84)	(n=182); (world mean=64.2); (world median=65)

(Sources: EIU, 2015; World Bank, 2015; The World Economic Forum, 2015; Transparency International, 2015; The Heritage Foundation, 2015)

When choosing an investment location abroad, firms take into account essential characteristics such as political and legal stability and transparency, domestic and labour market attributes, productivity, infrastructure, social climate, tax regime and flexibility (Ernst and Young, 2014). Additionally, they consider other multifaceted socio-political issues such as the demands of special interest groups (Akhter & Choudry, 1993), and the role of powerful individuals in the political process, which are indeed complex in democratic regimes (e.g. Trump, Clinton, Berlusconi, B. Johnson, and others). This reminds us that in an era when global companies do their due diligence before committing to an investment, the issues of stability, safety, continuity of open markets, clear procedures and the rule of law, are important to both the investor and the host-country looking to attract investment. This is significant given that FDI inflows are known to contribute to economic growth, domestic savings, employment, trade, income distribution, technology transfers, and tax revenues (Whyman & Baimbridge, 2009)—the benefits of which Western governments are critically in need.

Only a few decades ago, some of the issues highlighted above would not have been particularly noteworthy. But today, the geo-political equilibrium is rapidly changing, and it has been further complicated by the sluggish recovery to the crisis, with the accompanying new forms of political instability in the West mentioned earlier. Add to this scores of investment issues, domestic and regional political concerns, competition from the *BRICS* nations, and a negative turn in international rankings as demonstrated in the classifications above. Though certain developed economies have recently returned to the path of economic growth, their future prospects are becoming harder to predict, which presents challenges for political risk forecasting as well. Given economic growth difficulties that EU member states have faced in the post-financial crisis period and recent populist developments in reaction to deep austerity measures that have swept across the continent, real concerns persist on the horizon. This is reflected through the rise of protest parties on the left such as *Syriza* in Greece, or *Podemos* in Spain, as well as populist and anti-establishment activities in the relative centre such as the Movimento 5 Stelle (M5S/5 star movement) in Italy. Further, an unfortunate rise of far-right and nationalist parties and movements embodied by the Euro-skeptic and anti-immigration stances of Le Pen's *National Front* in France, Salvini's *Lega* or Meloni's neo-fascist *Fratelli d'Italia* in Italy, or like-minded right-wing governments and parties in Central-Eastern Europe (such as Austria, Poland and Hungary) continue to threaten the very fragile fabric of the EU.

While the spectre of a Grexit haunted the EU for years, it is now Brexit that is causing EU leaders and international corporations much grief, given the astonishing results of the UK referendum on EU membership on 23 June 2016 (52-48% in favour of a 'leave'). In mere hours after the initial vote counts, tremors reverberated across global financial and currency markets causing selloffs, panic and significant 'unknowns' for investors and European governments. Over the course of the coming discussions between the UK and EU, the only certainty will be *uncertainty*. To make matters worse, the December 4th constitutional referendum in Italy resulted in a resounding defeat for the sitting establishment government (PD) and Prime Minister Renzi, a staunch Europeanist, and the subsequent electoral victory of an anti-establishment coalition government in 2018. This spells even more serious trouble for the already sluggish Eurozone and its many unsatisfied members and struggling citizens. Such an outcome is yet another indirect blow to the European project's leaders. And with these surprising outcomes, Euro-skeptics across the continent feel emboldened to push for further referenda or EU 'exits', meaning that extreme political uncertainty will accompany the market's response and ensuing economic fallout over the next few years. Finally, the continuous migrant crisis from the MENA region and specifically the influx of refugees has seemingly pushed the EU to the breaking point, both socially and politically, with no real resolution to the humanitarian crisis in sight. On top of this, there are persistent threats of home-grown terrorism and political violence[18] at the heart of the EU, which might deter investment and even leisure travel in the near future. There will continue to be key political decisions and elections that will test the fate of the EU, and such realities represent very real political risks, which include referendum and election results.[19] This, coupled with unstable political regimes on Europe's southern borders, continuous corruption and political discontent in places like Italy, Portugal and Spain, high levels of public debt, and an increasingly delicate banking system across the continent, do not bode well for future investments, and contribute to existing political risks.

On the other side of the Atlantic, though economic growth and financial stability may be in better shape in North America, there is no immunity to political risks there either. The continued rise of a President Trump-led anti-establishment Republican Party with increasingly negative rhetoric only contributes to the worsening of American hyper-partisanship and the risk of US government stalemate over key policy issues between a divided partisan Congress and a disruptive President Trump. Moreover, the disengagement of the new US administration from global financial and political governance may create a vacuum of leadership and present problems for international trade and investment.[20] In 2018 this has intensified as the US has disengaged from international responsibilities, a trade war heats up between the US and traditional allies, and disagreements over NATO security issues intensify.

[18] Political Violence is an insurable political risk, one that a few of my respondents have highlighted as significant for the future in Europe.
[19] Societe Generale as produced a useful flowchart showing the key dates for important political events and decisions in Europe over the next year: Market Watch, 2016. http://www.marketwatch.com/story/all-the-potential-political-risks-looming-in-europe-in-one-chart-2016-11-14
[20] See also Wagner, D, 2017. http://www.huffingtonpost.com/daniel-wagner/the-importance-of-politic_b_14130686.html

Within the US, the rise of discrimination and conservative challenges to progressive policies and court decisions on, for example, same-sex couples, LGBT rights, and drug policies, has become commonplace in some states, and has migrated to the business world, enabling large companies to threaten to leave certain states due to such discriminatory policies.[21] Continued racial tensions over the past years across cities in the US were highlighted throughout the primary season and have contributed to social unease under Trump's administration. Finally, political-economic difficulties that have surfaced in advanced economies such as Canada due to housing bubbles and the fall of crude oil prices, or in Australia due to resource-export market slowdowns are worth monitoring, as is Japan's chronic demographic and regional security predicament, that is, the Senkaku/Diaoyu islands dispute with China, in addition to tensions with North Korea. Accordingly, many of these issues have also been picked up by the Economist Intelligence Unit's Global Forecasting Service, which in Spring 2016 ranked the possibilities of a Gr-exit, a Trump Presidency, global jihadi terrorism, and a Br-exit and breakup of the EU as numbers 5-8 out of the top 10 current global risks.[22] Citigroup's Global Political Risk report suggests similar problems have arisen over the past year, and predicts that new socio-economic factors and events such as anti-establishment parties, populism, referenda, and more, will be of increasing importance to risk analysis over the next few years (Citigroup, 2017).

Moreover, there does not seem to be any immediate resolution to these risks in the foreseeable future, meaning that political-economic instability in the West will likely persist, especially as populism clouds the future of US and EU global leadership capabilities. While it has become evident that politically charged risks, though perhaps found in subtler social and

[21]The Guardian, 2016. Accessed 9 April. http://www.theguardian.com/us-news/2016/feb/28/georgia-religious-liberty-bill-first-amendment-defense-act

[22] EIU 2016b, Global Forecasting Service. Accessed 10 April. https://gfs.eiu.com/Archive.aspx?archiveType=globalrisk

institutional forms, are not confined to developing or frontier markets and authoritarian states, but also to developed economies, my research questions the degree to which traditional political risk analysis and methodologies adequately take these complex developments into consideration.[23] Ultimately, these popular notions and conceptions of political risk are realities that all countries have to grapple with in a complex global market, and the first place to start to evaluate and tackle them may be in our own backyards. This is especially true when leaders, even in Canada, have to deal with new protectionist and anti-establishment government rhetoric.[24] Indeed, over the next few months and years, the US and especially Europe ought to be at the heart of political risk analysis—and for good reason.

Although there are not many in-depth studies of political risk in developed economies, this does not mean that some rating agencies and risk assessment providers have not evaluated political and business risks in the West– indeed in this dissertation I cite studies that have. As an example, Italy is often cited as an illustration of unstable government with high leadership turnover, corruption, regional discrepancies, inequities in access to public services, and more, yet it has attracted little academic interest with regard to political risks, save for a few examples, such as Mudambi and Navarra (2003), who looked at political traditions as investment risks. But there are compelling reasons to use Italy as an example of how to use the approach to analyzing political risk in developed economies, and describe in more detail the specific factors that underpin the simple ratings/scores that are often advertised. Other than its longstanding historical membership and contributions to global and financial governance as embodied by the G7, EC/EU, UN, G20, IMF, OECD, etc. there is also the European cultural patrimony and political bona fides in the initial creation of the European Community and later Eurozone that Italy has

[23] On insurers' worries about populism in Europe, see also Bloomberg, 2017b: https://www.bloomberg.com/news/articles/2017-04-13/should-you-be-worried-about-political-risk-hint-insurers-are
[24] For example, see CBC, 2017 http://www.cbc.ca/news/politics/trudeau-trump-meeting-1.3958863

been part of. Indeed, Italy was a central figure in the European project in the 1950s-70s, and while recently it may have been cast to the relative periphery of European governance, over the past years it has again tried to become a more assertive partner (through leaders such as Monti and Renzi). Still, though it is a democratic G7 'rich club' member, and an OECD developed market economy, Italy is well known for its regional discrepancies in terms of uneven growth and inequities in access to public services and political participation.

Indeed, Italy's performance in terms of macro-economic growth and FDI attraction has been disappointing over the past few decades. It has long stood out, as further illustrated in the case study, for its difficulties in attracting FDI and maintaining economic growth and political stability. In fact, when comparing typical Political Risk weightings, one finds that traditional risk scores might not always express the most accurate level of risks to investments in developed economies due to the complex political, institutional and social factors that facilitate FDI. Chapter 4 (see Table 4.5) highlights various risk rankings in three competing Eurozone countries, and shows that the relatively uniform risk scores (in the low to medium range) among Italy, France and Spain do not correspondingly align with the other sets of indicators and economic data that I provided above in Table 1.2, wherein Italy generally fared more poorly than its nearest competitors. While the risk rankings were nearly equal, the political economic fundamentals behind it are clearly not, which calls for a deeper examination of specific processes and institutions.

The focus in specific risk assessments for Italy are often confined to issues such as banking sector vulnerability, high levels of debt, poor growth, inefficiencies and lack of reforms (A.M. Best, 2016; PRS Group, 2015). While these are ongoing valid concerns, there is more to uncover behind these factors. We must look not only at risk assessments through general indices, but to relevant policies, regulations, societies and strategies that foreign investments rely upon. The results of my in-depth study on the major political determinants and business risks to foreign investments in Italy will be described in Chapters 4 and 5 and provide further details. It goes without saying that every state has internal issues to deal with, and faces it own unique political culture and macro economic conditions. Yet Italy is one of the only large developed economies with numerous political and economic attributes often found in the global south or in authoritarian states that are so pervasive in its political system, i.e. corruption, clientelism, organized crime, and systems of patronage. As we move through 2018 and a period of governmental uncertainty in Italy, it is safe to agree that "the combination between political instability and fragile institutions is a real mess, and it's quite dangerous," as Marcello Messori, an economist focused on Italy suggests (CBC, 2016)[25].

1.4. Methodological Considerations

Host government policies and regulatory environments for FDI determine the extent to which political risks exist or not (PWC, 2012). However, coverage of political-economic risks worldwide has become more reliant on specific modeling strategies, big data and statistics, or is related to sovereign financial debt evaluations (i.e. via CRAs). Governmental and business evaluative knowledge of such risks depended disproportionately on probabilistic and actuarial calculations (so called scientific knowledge) which can obfuscate other important theoretical, institutional, or social 'soft factors'. Indeed, Ian Bremmer, president of the popular risk consultancy *Eurasia Group*, appropriately noted that actual political risk analysis is "more subjective than its economic counterpart and demands that leaders grapple not just with broad,

[25] CBC News, 2016b http://www.cbc.ca/news/world/italy-economic-crisis-1.3870825

easily observable trends but also with nuances of society" (2005). And hence, as Howell eloquently noted, "political risk is not just about government decisions, as some analysts continue to insist. It is about *societies* that are governed" (2007, 45). Yet these pieces of advice are often not followed in actual risk analysis. I follow an approach that takes the conceptual insights of Bremmer and Howell on the inherent 'societal character' of political risk as a point of departure for this study. While all kinds of adverse government actions continue to pose a threat, focusing on risk factors from a qualitative perspective enables us to get behind a strictly quantitative firewall.

1.4a) Design & Approach to Research

I thus suggest that in addition to the typical FDI criteria that I will highlight below (Chapters 3, 4, 5), multinational firms can benefit from an awareness of the *softer* risks that underpin their investments, especially in the context of a competitive domestic environment with specific local practices and policies. By 'soft,' I am referring to qualitative variables or factors such as culture, regional tensions, institutions or policies that are not easily quantifiable, as opposed to more traditional 'hard' variables such as economic growth, account balance, inflation, etc. that are often quantified and indexed. It is important to appreciate the essence of the concept of 'risk' that informs the analysis in this dissertation: "While risk is specifically about the size and pattern of future earnings, it is also an indirect prediction about the stability of the social conditions that would help translate potential earnings into an actual stream" (McMahon, 2015, 30). In this sense, we must consider a number of issues that political risk identifies—prediction or forecasting, profitability, social and political stability, policies, culture and bureaucratic systems, and the government institutions that guide them. Following this, we can employ an analysis of a given case to determine which of these various factors apply in that instance.

Political risk analysis and FDI attraction also deal with creating a certain perception in the minds of potential investors, and I seek to investigate this broader issue further. Research has shown that risk assessment, uncertainty and risk perception (Paudyn, 2014) are closely related. The analysis of diverse political risks is highly dependent on the way in which risks are perceived, described, observed or weighted by 'experts'. At a time when 'truths' are becoming contested and skewed by social and traditional media, governments are able to bend the message to their liking, enabling a host of assumptions to gain prominence, even if they are not business friendly. Further, risk perception works both ways: "by this term, one might refer to the perception of risks by the investor, but also to the perception of risk (to the foreign investor) by the host country's policy makers, who might be interested in changing such perception for the better to attract FDI" (Sottilotta, 2017). In reality, political risk is an important part of the decision-making process, and it is a political judgment on the part of the relevant state and firm (Althaus, 2008, 17). In reference to the Italian case, observing the multitude of investment-related difficulties and risks in a single case allows one to reflect upon specific common themes that experts have encountered, thus suggesting additional approaches to risk analysis.

This type of practice urges readers and practitioners involved in the study of political risk to not only consider what risk ratings may tell us on the surface, but more importantly to take into account a conceptually wider and more inclusive approach to understanding the factors behind the diverse types of political risk, to thus complement current practices. These thoughts are important not only for business practices in foreign investment sectors, but also for a deeper understanding of complex elements of FDI. Using something akin to analytical eclecticism, we can draw on Sil and Katzenstein (2010), and the idea of doing comparative politics from the 'messy centre' (Locke, Thelen, Collier, Caporaso, Tarrow, Schmitter, Sartori), which is what I follow in this dissertation. An interdisciplinary and mixed-methods approach will make use of descriptive statistics to map relationships between economic indicators and political realities, the systematic cross-examination of characteristic documentation, literature, and methods used by risk-rating agencies and insurers in addition to the above-mentioned interviews and thematic analysis that follows them. This can be completed by relying on theoretical works on comparative/institutional political economy and literatures on the politics of economic development. By approaching the research subject through a variety of disciplinary perspectives, and without exclusive preference for one research tradition over another, I seek to provide a more rounded, problem-driven approach to the study of modern and complex political risk analyses.

Indeed, seldom have many prominent comparativists wholeheartedly agreed on the direction that the various topics in the subfield should follow. Sartori (1970) warned of the perils of 'stretching concepts' beyond the realm of actual comparison—itself the supposed main task. Munck (2007) discussed the importance of understanding the context of the different historical periods of the field, and points to the increasingly pluralistic tendencies of modern political science. Eckstein too (1998) is a proponent of a more historically-informed approach, praising the continued study of the unique socio-cultural and historical conditions of certain areas of inquiry. Schmitter (2009) conjures up the notion of 'politics at a crossroads' of dominant approaches and theories, and advises us to steer away from heavy institutionalisms or quantitative obsessions, but also to consider the more complex path forward where we confront the messy and noisy centre of political studies head-on.

An eclectic, cumulative and interdisciplinary approach allows us to utilize and draw upon a range of schools of thought from the hard sciences to the humanities in addition to a deeper understanding of a particular area or strong theoretical background, which can illuminate the principles, methods, and skills that can cross the sometimes narrow boundaries of traditional 'singular' disciplines, or more stubborn approaches that are confined to closed methodological borders. We should thus continue to strive for the continued development of mid-range political theories, but not at the expense of relevant socio-cultural understandings and on-the-ground qualitative studies. A combination of these, and other methods, is best suited for the changing academic atmosphere of political risk analysis. Scholars (i.e. Schmitter, 2009) have already noted that new students of comparative politics have begun to embrace the notion of multi-pronged approaches, and I seek to build on these advances. Conducting applied research with a purposeful sample is the intended focus of my methodology. In many FDI-related studies that employ large-N statistical sampling, this may be misconstrued as bias or a weakness; but in this study the logic lies in purposefully selecting information-rich cases from which one can learn a great deal, yielding insights beyond empirical generalizations (Patton, 2002), which is often the norm in many political risk forecasting studies.

I have framed the quantifiable, insurable, qualitative and other possible risks to FDI through a systematic examination of secondary academic literatures, risk-methodologies of various firms, international survey data, examples of political risk assessments, participant-observation and semi-structured interviews (plus a few questionnaires). I did not enter the field with a completely blank slate, but was guided by the interdisciplinary framework of political risk employed by van Wyk (2010), which employs a political systems unit of analysis and takes into consideration the sequential processes of, and conditions for, risk formulation such as global, local and regional environments, politicized events, and a range of 'threats'. I also draw from Jarvis' (2008) conceptual frameworks of analysis, Sottilotta's (2017) theory-building, and categorizations of risk to utilize an additional approach to political risk analysis. Common concepts and variables were used to orientate myself during my research with special attention to the themes prevalent among respondents and enabled the development of a hybrid approach. This framework provides a sufficient basis to help us understand the factors that have hampered the flow of FDI, and serve as the analytical guide to the following sections.

This project integrates scholarship across several disciplines including economics and business, political science and policy studies. My research focuses on economic and business activities, and the political and institutional (policy and regulatory), and social aspects that are associated with them. The multidisciplinary nature of the work is first demonstrated in the objective of this project. The dissertation conducts a comprehensive study of political risk, the economic/business, legal, social and political attributes of it, with reference to an in-depth case on contemporary political risk and difficulties in investing and doing business in Italy. As such, methodologies ought to cover a range of disciplines: A sphere I look into is the differences in political risk methodologies and the risk factors utilized in ratings and Political Risk Insurance (PRI). This has empirical inquiries that can be answered using open-source data from risk-solution providers, secondary academic sources, and primary interview/survey data. An outline of the theoretical approach I employ of different strands of literature in the field of International Political Economy (IPE) (Ch. 2) will be used to unpack and explore the changing nature of political risk and its inherent institutional attributes, and will explain the purpose and goals of political risk. Further 'policy-based' approaches will be employed to put the Italian case into context and to discuss different or advances towards inward investment.

1.4b) Fieldwork, Interviews & Experts

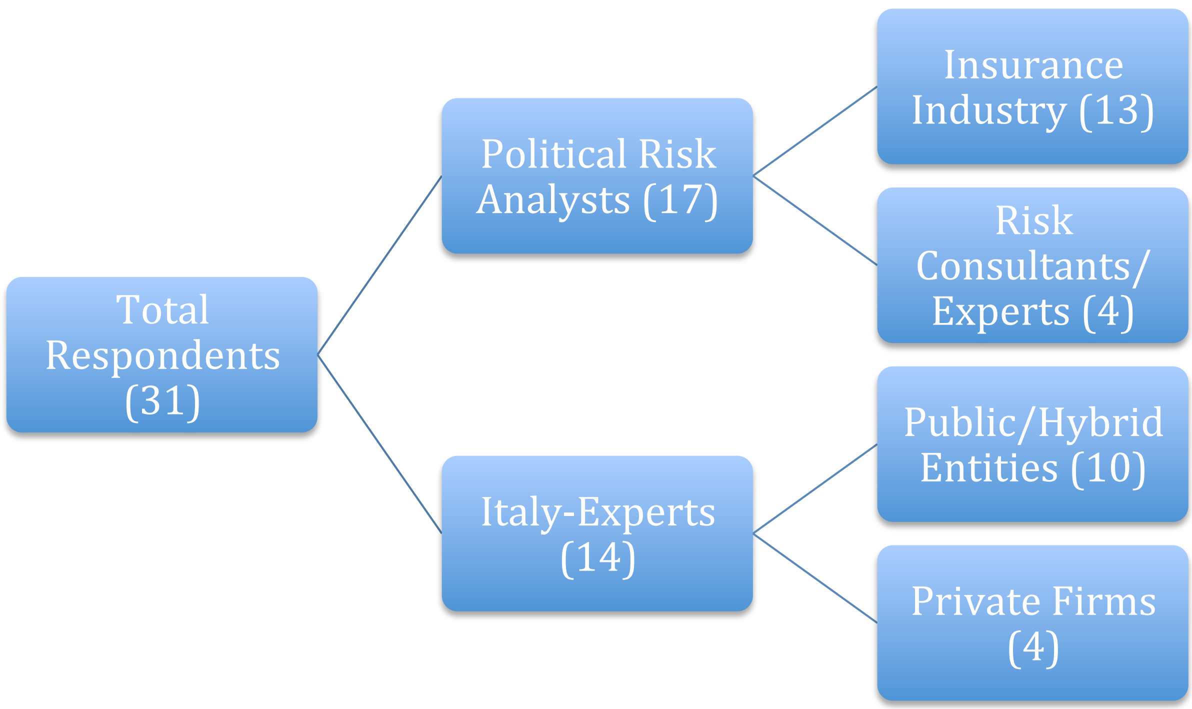
While employing brief statistical analysis and other documentary approaches, this dissertation mainly uses a qualitative approach to analyze and decode the themes and understandings of those involved in the field of political risk and of foreign investment. Fieldwork, key interviews and discourse analysis provide insights that are not otherwise available to the average reader, or to general risk assessment rankings. The information was collected as part of an initial five-month (March-July 2015) and follow-up (April-May 2016) qualitative field study across Europe, during which I was generously hosted as a 'visiting PhD student' at the LUISS University in Rome. This was in addition to other interviews and connections made in Canada and the US in the period surrounding those two research trips. Rome was chosen as the principal research site because of its proximity to other European centres of finance, and it is central to Italian political and administrative sites.

This process enabled me to organize data to distinguish relevant processes and key issues that were important to respondents. I conducted 31 conversations to evaluate expert perspectives on the analysis of political risk, and later specifically on the foreign investment and business realm in Italy. During the meetings, I introduced myself as a neutral PhD researcher, outlined the topic and project aims, and went through an oral consent process regarding research participation. Following these introductory remarks and ethical considerations, I administered semi-structured interviews which lasted approximately 45-75 minutes, using a moderately scheduled interview protocol or guide based on two sub-sets of questions depending on the respondent; one for the risk-practitioners and one for Italy-specific specialists. This ensured that the inquiry was pursued along basically the same lines for each respondent. For further details and methodological reflections, see Appendix A and B.

Conclusions and results were derived from the interview data, and general themes were established inductively, and analyzed through an issue- and question-based approach. By searching for, and finding patterns in the analysis of the primary qualitative research contents (responses and conversations), I was able to identify core consistencies and meanings in the forms of the themes and criteria, otherwise described as 'theme analysis' (Patton, 2002; Flick, 2009), that I lay out in Chapters 3 and 4. Interpretation of the data thus involved arriving at such categories in an inductive manner, which enabled me to create a framework and analyst-constructed typology of risks in a comparative light vis-à-vis common political risk variables, and in reference to Italy-specific investment determinants. Following this, I employed a more deductive type of analysis using the thematic/criteria based framework that I follow based on 'sensitizing concepts' which provide a general sense of reference and direction (Blumer, 1954), in addition to the literature review, common methodologies, and the first batch of interview responses.

Locating clear and common categories from fieldwork data is a challenging task involving careful consideration of recurring terms and themes in order to verify the meaningfulness of the categories. After fleshing out the themes, expanding upon them, and making the relevant connections among different items, one arrives at the 'saturation point' where repetition among respondents becomes more prevalent, other ideas become redundant, regularities and consistencies have emerged, and the analysis seems well integrated and wholesome in its treatment of the themes (Mason, 2002; Patton, 2002). I contend that the themes I developed are substantively significant, insofar as they are consistent with the variables in common risk methodologies, they increase our understanding of the political risk industry, and Italian investment environment, and are useful to inform investment policy and the study of economic development and stagnation in developed economies more broadly. Chapters 3-5 present the main findings and conclusions from field notes. My fieldwork was completed as part of a descriptive and interpretive case study, which explores 'phenomena in need of an interpretation that sheds new light on known data', and using a framework to explain particular cases, and contribute to a refinement of utilized theories (Vennesson, 2008, 227). The division of interview respondents is outlined below.

Figure 1.2: Research Interviews (31) – Types of Interview Respondents (2015-16)

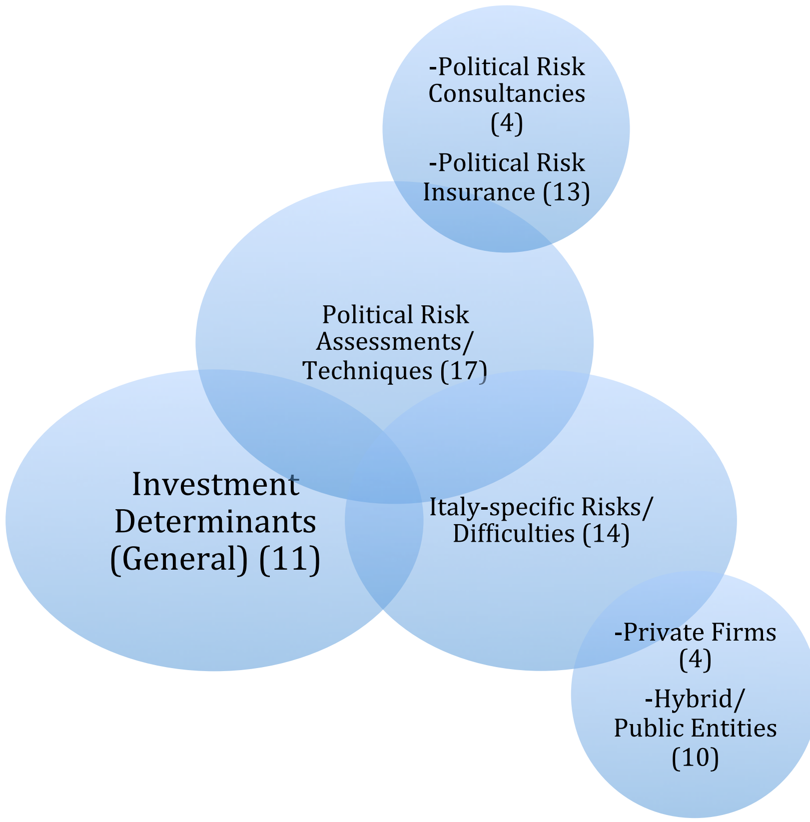


Accordingly, after completing a literature review[26], the first fieldwork expedition in 2015 was conducted, which set out to expand on different understandings and methodologies of risk factors in political risk analysis throughout various industries that assess such risk by identifying

[26] See Chapters 3-5. General FDI determinants and political risks based on: World Bank 2016; BERI, 2003; EIU 2015; PRS 2016; Morgan, 2002; Kasatuka and Minnit, 2006; Ernst and Young, 2014, Bouchet et al. 2003. Italy-specific factors based on: Mutinelli and Piscitello, 2011; Coface, 2016; A.M. Best, 2016; EIU, 2015; World Bank, 2016.

commonly-cited investment determinants and political risk factors globally, in the general sense based on interviews with a host of experts in the field. Based on these results (see Chapter 3), in 2016 during the Italy-specific expedition, the five themes were used as 'sensitizing concepts' to orient myself during the Italy-specific fieldwork. Special attention was paid to the emphasis and common themes prevalent among respondents and enabled the development of the criteria–based approach (Campisi and Caprioni, 2016; Otto 1992, Vivoda 2011, Zonis, 2001) to help understand the issues that have hampered the success of investment growth in Italy, again with a variety of Italy-specific experts. As mentioned above, the analysis of government stability, socio-cultural attributes, institutional and policy effectiveness or uncertainty vis-à-vis global investment (which are reflected in the categories created in Chapters 4 and 5) allow us to re-evaluate the root causes of political risk in democratic regimes that manifest in many different ways. Again, it is common for risk assessments to use variable-based frameworks; and here I seek to employ that approach, in addition to simplifying those criteria into macro-themes. The data were organized topically and qualitatively examined to build a appropriate understanding of the scope of the business, analysis and diversity of political risk assessments, followed by specific inquiry into the risks regarding international business in Italy in the post-financial crisis period, embodied by attempts at liberalization, changes to public sector practices in the 1990s, decaying institutional efficacy, and a changing relationship with the EU and global economy more generally.

Figure 1.3 - Substantive foci and overlap in interview discussions (31 total respondents)



This figure above outlines the major types of interview discussions held, and the number of interviews that had overlapping foci. Among the different types of respondents, both area-specific and general PRA, there was also general discussion of investment determinants at large, as the figure shows. In a competitive business environment such as that which embodies the world of FDI and risk analysis, the researcher can be subject to certain limitations on confidential economic data or methodologies that the firm may deem proprietary in nature. At times, this meant that certain pieces of information would be refused for any number of reasons. Meeting with experts in private firms is also challenging in the organizational sense, as their time is often limited. Moreover, there is a perceived apprehension on the part of some respondents to release information on the firm's successful endeavours, given that (while firm names remain anonymous) the information could be discovered by competitors. There are thus significant obstacles to conducting qualitative research on the topic of political risk and investment determinants/difficulties. In order to increase the number of respondents and gain access to quality in-depth information, one must thus be flexible with selection criteria, the interview process, and indeed the breadth of topic (Caprioni, 2011).

Given the obvious difficulties in the research surrounding a comprehensive topic such as political risk and investment difficulties, I do not profess to provide an all-encompassing picture of all perceived and real risks in the Italian investment environment, or the world of political risk analysis more generally. Rather, one of the aims of this research is to obtain a better understanding of the processes that underpin political risk analysis in their diverse forms, and to specifically draw attention to the actual factors that may concern potential investors, rather than the sweeping claims of macro-risks and shock events that are often mentioned as political risks in media, or likewise, in the traditional risk perils that are more frequently associated with developing nations. Direct immersion in the field allows for greater contextualisation and detail of the state of the industry, which is one of many distinct methodological characteristics of qualitative research (Jelen, 2012). Though smaller in size, a purposeful sample, such as the one I utilized, is open to more diversity and complexity in the analysis of the subject, while respecting the uniqueness of individual cases as well as comparative themes and patterns.

I understand an expert, or in other words a key informant, to be a person with both special knowledge and decision-making power in his/her particular field, for example, upper-level economic, political or governmental decision-makers, individuals in positions of relative power and knowledge in the industry, and those with the experience and qualifications to support their positions. Such informants provide key insights that are particularly useful in helping the researcher understand what is happening and why (Patton, 2002). A benefit of conducting expert interviews is to be able to identify emergent categories rather than imposing *a priori* theories and ideas, and to generate ideas and concepts. The research is able to glean important insights and detailed descriptions which are based on, or offer an interpretation of, the perspective of the participants in the particular setting, in this case the political risk industry and Italian investment environment. Experts possess knowledge otherwise not accessible to average researchers, and have internal, specific knowledge of the structures, procedures and events in a given industry. My respondents allowed me to gather in-depth information on views, attitudes, experience and perceptions of the field that are otherwise beyond regulation observations of the industry, or available through document and risk-methodology analyses. Expert interviews are essential to my project and to the qualitative research questions that I employ, in that the ways in which political risk is conceptualized and analyzed differs among techniques, companies, countries, and experts. Using this type of fieldwork and interview methods, I can better determine which factors are risks, and where, and in what context, in addition to coming to terms with the Italian case, and why certain investment determinants are important, and if they correspond to common risk assessments on Italy today.

A final note on the role of 'expertise' in the analysis of political risk is in order. As noted, I rely on a number of experts in their own fields of political risk analysis, insurance, or Italian-investment specialists. Naturally, one must appreciate the role that subjectivity and human judgement play in the analysis of foreign investment environments, policies, and societies, especially when these are conducted by individuals with a certain type of training and employment-related objective. Even the quantitative and formal modeling tools employed to provide so-called objective 'forecasting' by a variety of firms have to rely on some form of personal estimate, in the sense that some of the data they use is informed by subjective knowledge or indicators. Numerous authors emphasize the importance of subjectivity in the literature (Sottilotta, 2017; Bouchet et al. 2003; Bremmer, 2005), and it is relevant to note that subjective and qualitative aspects of risk analysis can be found in many types of formal forecasting techniques, and equally, some reliance on quantitative data is quite common in the more qualitative risk studies, naturally giving the analysis of political risk a 'hybrid' feel. The industry relies on forms of subjective and objective (if ever attainable) expertise, and as Sottilotta cautions, "it is unthinkable to totally oust expert judgment from the process" of risk analysis (2017, 112).

For these reasons it follows that different firms or experts will arrive at different conclusions when performing risk assessments, even if they might be using overlapping sources of information—and this is not necessarily a bad thing. Behavioural economists and positivist thinkers may frown at the inherent subjectivity involved in political risk, but it is something that cannot be avoided given its socio-political, and essentially, human nature. So even though risk evaluations may be fraught with uncertainty, there is still a need for judgement, human bias, and natural inaccuracies (Redmill, 2002, 91). A related item is the difference in what the person is an 'expert' in. If they are trained in forecasting and modeling techniques, they are experts in that mathematical skill, and not, per se, in political risk underwriting, or a specific area or industry at hand, or in political judgements more explicitly. The experts I spoke with were mainly specialists in their industry, i.e. political risk consulting, underwriting, and thus not solely focused on the forecasting aspect of risk, but more about what happens in the entire risk analysis process. The second set of experts had specific area and industry expertise with respect to the Italian investment environment and political-economic situation of the country. Inevitably, when measuring or analysing ‘soft’ variables, sometimes a reliance on expert judgment is one of the only viable options. This is not unique to political risk, but also occurs in the production of data on many governance indicators (which I, and political risk analysts, also use) such as quality of democratic institutions, corruption, business climate, etc. In all such cases, ‘expert’ political judgment plays a role in indicator choice and actual measurement of risk (Sottilotta, 2017), which can be problematic, but is clearly a subject for another useful discussion.

This introductory chapter sought to capture some of the underlying tensions surrounding the current approaches to political risk analysis. It has presented key questions, considerations and case-selection criteria that are relevant to the findings that will be presented in the following chapters. The next chapter aims to connect the political risk industry to the greater field of political science and comparative politics by surveying the current state of ‘theorizing risk’ and by searching for explanatory perspectives that clarify the importance of an institutional and social focus of the ‘political’ nature of risk.

CHAPTER II – Theoretical Underpinnings: Political Risk, Globalization & Institutions

2.1 Looking Forward, Looking Back: Situating Attempts to Theorize Political Risk Analysis

If, as I proposed in Chapter 1, political risk plays an increasing role in global markets and cross-border transactions, the logical question arises: what have (or should) investors, risk managers or governments do about it? The PRS Group, a leader in the field of risk assessments, recommends that all forms of political risk "must be accepted as a reality in today's investment landscape, made more acute by sluggish economic growth, high levels of indebtedness and joblessness, and rising expectations fuelled by the power of social media" (PRS Group, 2017b). This suggests that as risk assessments become more necessary and ubiquitous for MNCs, there should also be a concurrent focus on the theoretical underpinnings of what such analyses represent. In this chapter, I look at different ways to situate political risk 'theorizing' in its historical and modern forms, and recommend a complementary institutional focus to the approach I use to assess political risks in, more specifically, developed economies.

There have been important developments in the study of political risk over the past decades. As mentioned above, political risk is concerned with the perception of political continuity and stability to ensure investment-related profits, and the possibility and forecasting of potential losses including what may cause them. Investors have been seeking to gauge the stability and potential of their business ventures abroad for centuries, from imperial ages through to early mercantilist eras and the dawn of modern capitalism. One can find the predecessor to the contemporary concept of political risk which gained popularity in the 1950-60s as large (mostly American) multinational firms began to spread through Europe, as optimism and profits soared in the post-war period. In fact, as Hansen (2005) notes, investment insurance for political risks traces its origin to the Marshall Plan, "under which the U.S. government offered to insure certain risks for U.S. investors venturing into post-war Europe. Those insurable risks included currency inconvertibility (beginning in 1948), expropriation (1951) and political violence in 1956"(12).

Moreover, independent and dependent variables were linked as causes of risk, for example: social unrest, ineffective laws, armed conflict, separatism, etc. Kobrin (1979) and Fitzpatrick (1983) added to these ideas and concentrated on adverse government actions, political processes and events, as well as the political and business environments in which these actions could occur. As the field evolved, forecasting 'loss' techniques were developed. The social and political actions/events that could lead to such 'losses' for relevant firms were taken into consideration by specialized theoretical risk modellers, who pondered, *inter alia:* expropriation, inconvertibility of profits, war damage, civil strife, breach of contract, property infringement, personnel security, government interference in contracts, discriminatory taxation, regulations on operations, intellectual property, etc. (Howell and Chaddick 1994, 73). Demand for extra-economic, (in addition to GDP growth, debt levels, inflation, etc.), political risk evaluations began to flourish in light of such factors in the 1970-80s during the cold war, numerous international upheavals, and global macro-economic shocks, i.e. the Iranian revolution, oil crisis, etc. Still, the business community at large did not immediately accept the usefulness, or validity, of the methods, concepts, and theories of the new sub-discipline (Simon, 1985). 'Soft', socio-political indicators were not deemed to be as trustworthy as 'hard' financial data, and thus many firms remained sceptical. Indeed, classifying 'uncertainty' proved much more difficult than creating generalizable 'risk levels', and this was a major reason that indices and scales of 'event likelihood' proliferated (Sottilotta, 2017).

The majority of academic research discusses the macro side of political risk, pointing to broad insights about specific countries or regions, given that micro-political risks are firm or industry-particular and cannot be used to 'generalize' about risk (Alon and Herbert 2009). But as mentioned in the previous chapter, micro-structural realities and institutional path dependencies cannot be overlooked. Regardless of the methodology used, or of the area specialists employed, *prediction* and *forecasting*[27] future occurrences form the basis of the techniques involved. This 'unpredictable' reality, in addition to the competitive nature of risk consulting firms, contributed to the general skepticism surrounding the profession (Simon 1984). Yet as globalization intensified through the 1990-2000s, political risk assessments became more ubiquitous and encompassing in order to keep up with the increase in FDI projects and financing. Concurrently, academic literatures have more recently tuned into this subfield, but it is still largely neglected in the field of political science (Sottilotta, 2015), compared to the realms of international business and economics. However, amidst increased economic instability in the aftermath of the global financial crisis, emerging and established powers (i.e. BRICS, US, EU) and hitherto stable advanced market democracies in the West are becoming more susceptible to major economic upheavals than in previous decades, and this expanded 'perception of risk' calls for more social scientific research on political risk, especially in the developed 'West' (see Chapter 1.3). Finally, in the context of a changing geopolitical order after 2015, defined by increased protectionism and nationalism, the economic realities facing multinational enterprises have evolved. Many large corporations that were successful at the height of globalization have seen their global influence

[27] On the intricacies and science behind 'forecasting', see: Tetlock, P. & Gardner, D. (2015) *Superforecasting: The art and science of prediction*. London: Cornerstone

wane, and now must confront overextension, medium growth levels in developing nations, and smaller profit margins,[28] which only adds to the complexities of local political risk analysis.

Moving to a more *applied* discussion, political risk is often considered to be *one* component of a three-part understanding of country-risk[29], even though there has been significant overlap between general country- and political-risk assessments and capacities. When the terms are used interchangeably, it can be problematic (Brink, 2004), as country risk is in some cases more narrowly focused on credit risk and a sovereign's ability to repay loans, rather than on a country's actual politically charged risks for foreign investors. At other times, country-risk has been interpreted on a larger scale, incorporating specific economic and financial factors of a single country, in addition to the social or political aspects.[30] Bouchet et al. (2003, 10) noted that the "term 'country risk' as opposed to 'political risk' has been gaining ascendency because it has a broader meaning in that it can include any risk specific to a given country, whereas political risk' restricts the risks to those that are exclusively political in nature." Nonetheless, the major difference is that country risk does not specifically (even though it often does) investigate events or risks that are political nature, whereas political risk ought to have some connection to 'political' factors, even indirectly.

Although many political risks are frequently measured as separate variables, and for arguably good analytical reasons too (see Robock 1971; Kobrin 1979; Fitzpatrick 1983; Oetzel et al. 2001), they are highly co-dependent. Conceptual difficulties in distinguishing between

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[28] For example, see The Economist, 2017c. http://www.economist.com/news/leaders/21715660-global-firms-are-surprisingly-vulnerable-attack-multinational-company-trouble

[29] There is not necessarily one wholly agreed upon understanding of the country risk aspects. PRS/ICRG uses political, economic and financial; other interpretations include social factors too.

[30] Broadly, this includes debt rescheduling and the "general willingness of a country to service its financial obligations…default or delays in payment by sovereign borrowers" that can affect international capital flows, trade agreements, 'unproductively invested' foreign funds, and imprudent lending by foreign banks (Hoti and McAleer 2004, 540), GDP growth and unemployment levels, inflation and exchange rate stability. See also the comparison of country-risk vs. political risk methodologies provided by PRS Group, available at: https://www.prsgroup.com/about-us/our-two-methodologies/prs

"economic and political determinants of events [that] are obviously interrelated" are present in much of the literature, as is their distinction "both as abstract phenomena and in terms of their impact upon the firm" (Kobrin 1979, 69; Schollhammer, 1978). Another major issue with common political risk models and projections can be their reliability[31], due to the lack of available data on (un)successful forecasting that PRA firms procure (Sottilotta, 2015), potentially undermining their utility to the investor. For these reasons, a more holistic understanding of what political risk analysis actually considers can be beneficial to the practice at large. In order to gain such an understanding, risk analysis should take into consideration arguments that take up the relation between governance and institutional relations:

> Whereas country risk analysts focused on debt ratios and growth rate indicators in the 1980s, a consensus is emerging to place governance at the heart of the development process … second-generation reforms" that affect the relationship between the state, the market, and civil society. These reforms aim at strengthening the so-called "social capital", a concept that Fukuyama (1992) defines as "group solidarity and trust in human communities". Today, to get market access and show robust creditworthiness to rating agencies, emerging market countries must demonstrate that they adhere to high transparency and governance standards. As Michalet (1999) puts it: "One key aspect of the investment climate is the assessment of political stability as well as transparency and efficiency of the legal and judiciary system." In country risk analysis, governance has become the name of the game. (Bouchet et al. 2003, 64)

So what we have seen in some aspects of the literature is the beginning of an appreciation of such institutional governance factors for political risk.

Historically, political risk appraisals conducted by companies, agencies, risk analysts and academics alike,[32] have attempted to predict the political conditions or events that can affect a firm (and how it should respond to them); to recommend corporate (and government) strategies that can cope with the political situation and/or manage the risk and avoid future losses; and

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[31] For a critical analysis of Risk Ratings and Governance Indicators, see Linder and Santiso (2003).
[32] See Simon (1982) for a good overview of the evolution of earlier political risk assessments (63-64).

finally, to evaluate public policies that affect international business (Brewer 1985; Howell 2001). The preferred methods behind actual political risk assessments depend on the actual evaluator (firm), and on the entity under appraisal, including whether there are specific industry or sector-related attributes that need to be evaluated. Regardless of who or what is conducting the risk evaluation, the industry at large professes to use political risk assessments techniques that are strong and rigorous, but criticisms have also flourished.

A recurrent critical theme has been that the subfield of political risk is *theory-light*. Fitzpatrick already noted in 1983 that a conceptual framework to develop the field was limited. Many other scholars (Alon, Howell, Kobrin, Sottilotta) also lamented the looseness of the concepts, and the absence of a proper analytical framework for political risk that has led to general and superficial decision-making processes on the part of business managers. Simon argued that the lack of theoretical concerns in the field, and the poor attempts at identifying recurring trends across nations, meant that each new 'risk factor' tended to be viewed as unique to the particular country. But political risk is very complex and can be country- or firm-specific, which also led to disillusionment on part of firms searching for immediate results (Simon 1984, 124). A crucial, problematic issue was that the 'sources' of information on risks, both internal and external, were often different and ranked in separate order of importance (Fitzpatrick 1983). There is no single agreed-upon database from which risk appraisers acquire their material or evidence, nor was there sufficient cooperation amongst academic studies to construct proper theories. Assessment model deficiencies have been noted to include: varying definitions of 'risk' and 'political'; competing 'foci' of analysis (creditworthiness vs. government action vs. currency); different variables/data-sets; criteria of causes vs. symptoms (Alon and Martin 1998, 11), and lack of clear theoretical engagement or explanation of what drives the risk-rating models

(Howell, 2014). Further, as the CEO of the PRS Group notes, "political risk is also seen as quite fickle – something that is important but also temporary – which obviously wanes as a watershed event occurs,"[33] meaning that its importance has not always been at the top of investor, or even academic, preoccupations. Chapter 3 takes up the arguments around political risk assessment methodology differences in more detail.

Other frameworks also contemplate the need for similar theoretical grounding, but differentiate between risk dimensions in a 'generalized risk environment', i.e. economic, society, and government-related factors (Alon and Herbert 2009). Howell also claims that "every process of analysis and assessment…[is] dependent on underlying theory [which] determines what kind of predictive variables are examined, how they are measured, and how they are combined to generate an overall risk rating". Such theories ought to take into account many considerations: causality (country characteristics and rational actor decision- making); correlation of variables to risk; interrelation of causes; macro-micro and national-local divisions; and types of international business, among others (Howell 2001, 9-10). But these calls for 'theoretical grounding' do not give us an adequate footing to observe the macro-processes of risk assessments and the knowledge and analysis of variables that underpin them.

It is also important to realize that political risk assessment capacities are innately attached to economic and societal characteristics. Assessments use industry-specific forecasts for three investment areas: "financial transfers (banking and lending), foreign direct investment (e.g. retail, manufacturing, mining), and exports to the host country market" (PRS Group 2014). They are thus tied to fundamental economic considerations, *a priori*. Notably, many objectives of political risk valuations revolve around a given investor's or firm's profitability expectations and interests in a foreign market—a strictly economic consideration. Oetzel et al. (2001) showed that

[33] PRS Group, 2017a. http://www.prsgroup.com/about-us/from-the-ceo

generalized country-risk measures "often compound the problem by lumping key variables into a single index. By doing so, it becomes impossible to determine which variable(s) are actually correlated with risk" (129). The idea that we can analyze certain factors in only *one* of the political, social, economic or financial 'spheres' (e.g. variable isolation) is analytically useful, but given that the three (or more) are highly correlated, their inter-relationships must be considered.

To date, theoretical discussions surrounding political risk are also more concerned with methodological aspects, quantitative and modeling approaches to political/country-risk evaluations and ratings, and often stem from the positivist traditions (Alvey, 2005) that prevail in macro-economics. Studies commissioned or undertaken by international agencies like the World Bank, Multilateral Investment Guarantee Agency (MIGA), and an assortment of banks, insurance companies and private consortiums that discuss pro-investment techniques, use statistical tests and provide 'document-checklist' methodologies (see Ch. 3). These are useful for the forecasting of various risks, but often lack the appropriate analytical edge in a broader world of political inquiry. Another widely used approach is a more realist one that involves concepts in security studies (Petersen, 2012), for example the likelihood of political violence, terrorism, etc. as practiced within a global intelligence framework.[34] In short, a great deal of work on political risk, academic and otherwise, comes from the business community, with fewer critical interrogations from political science.[35]

In response to certain criticisms I have mentioned, approaches to the assessment of political risk have arguably become better developed in recent years. Evaluations are generally made up of country-reports, quantitative modeling, loss predictions, account forecasting and debt

[34] This approach is utilized by intelligence agencies like the CIA, foreign affairs departments, and global security research firms such as RAND, iJet, etc.
[35] Althaus (2008, 18), Simon (1984), Sottilotta (2015) concur that there has been a lack of theoretical attention to political risk.

analyses, with a few qualitative and informal studies (Solberg, 1992), combining a variety of statistical analyses with some local knowledge. Llewellyn Howell, a pioneer of political risk methodologies, notes the important quantitative basis of such risk assessments which allows modellers to convert uncertainty into probability terms, with the goal of objectively evaluating investment environments (1994, 72). This turn is concomitant with the behavioural and modeling emphasis in, and 'quantification' of political science in recent years. Central to political risk 'theories', and to the common critiques of them, is the fact that they are still concerned with improving the 'practice' of political risk forecasting, and understanding the causes of politically charged losses. While these are valuable to risk practitioners and firms, or modeling scholars, etc., they do not add to socio-political and theoretical understandings of risk, which are equally important. Although the econometrics and methods underpinning the evaluations may be rigorous, relating political risk to the more *social* side of political-scientific theory remains understudied. If, as Hoti and McAleer state, "businesses and individuals are interested in the economic consequences of political decisions" (2004, 540), then political risk theorizing must not be limited to the realms of methodology or international business profitability projections, but should be framed among broader questions of institutions and governance, private-public power and government-economy relations. Supporting this notion are Bouchet et al. (2003), who emphasize that:

> Assessing risk, be it economic or political, requires a thorough understanding of the development process. The latter is much more than GDP growth or even GDP per capita growth. It is a sequential process of building, not just macroeconomic stability, but also interdependent factors such as quality of governance, flexible institutions, societal capacity to advance technological capability, and evolving government and corporate organizational structures…Country risk is not to be reduced to straight national government interference. Instead, it must take into account the full range of discontinuity sources that stem from the political power structure as well as the institutional organization that enhances or hinders the development process. What the risk analyst

> should look at are the institutional and structural rigidities that raise the country's vulnerability to internal and external upheavals. (73)

This is especially relevant for developed economy risk, where the likelihood of violence or overt government interference is low, but institutional rigidities are more complex and harder to quantify, and equally important.

Complex model constructions that for example, sought to measure the effects of political risk on the outcomes of FDI projects (Clark, 1997), or reverse models that measured how certain factors such as a centralized fiscal union could create additional political uncertainty and economic risk (Alesina and Perotti, 1998) have been developed. Brink's comprehensive (2004) model for political risk analysis uses problem solving and decision theory in a mainly mathematical model (weights and scaled percentages) in order to plan future scenarios (probability outcomes), while maintaining space for the inclusion and analysis of the qualitative social factors. There are many other such models that provide for similar scenarios.

Exciting scholarly attempts have also been made to bridge certain political science theories and concepts with political risk assessments more directly, for example, Sottilotta (2015) discusses the relation among political risk analysis, democratization and political regime types with a focus on the effects of the Arab Spring movements, while Jensen probed the relationship between risk and democratic institutions and their effect on FDI (2008); and Marchetti and Vitale (2014) explains the importance of external implications, i.e. globalization as a transnational variable of risk, which is also complex. More broadly, significant academic contributions have also analyzed host-country legal system pathways and entry modes of investment vehicles (Lee et al. 2014), investment liberalization and democratic development (Pandya, 2014), capital flight and political risk (Lensink et al., 2000), and more. Others (Jensen, 2003, 2008; Cleeve, 2012, Osabutey and Okoro, 2015) have aimed to map the positive and negative relations between political risk (and institutions), and FDI levels using specific cases, industries, or regions such as West Africa. Moreover, Insurance companies use their own industry risk management techniques to underwrite different political risks and provide actual political risk coverage[36] for premium holders, in addition to providing assessments (see Ch. 3). Fortunately, there have already been some scholarly attempts to differentiate the 'types' of political risk variables through various indices and models that separate, i.e. governmental, economic, external and social factors of risk (Alon et al., 2006; Howell, 2014), and I seek to build upon these advances here with the approach that I put forward.

To that end, I cite Brewer (1985), who prudently noted that the subfield of political risk is the quintessential bridge between the worlds of politics and economics. Concurrently, this leads one to question why it has not been taken as seriously as it should be in fields like Comparative Politics, since political risks are often measured in contrast to other states. In order to establish the requisite epistemological foundations that underline my own approach to analysing political risk, it will be beneficial to make connections from theoretical literatures in political economy. Both critical and mainstream institutional strands of IPE can provide us with such tools, but the latter institutional focus is one I draw from more significantly.

2.2. Thinking about Political Risk through Critical Political Economy Approaches

I have tried to emphasize that the hegemonic discourse of risk is pervasive on a global scale. In an era of social media buzzwords, the terms 'risk' and 'uncertainty' have risen to prominence in the latter half of this decade, especially in political coverage. Whether in terms of

[36] Types of insurance coverage can include, for example, currency inconvertibility, expropriation, political violence and more targeted specialty products (OPIC, 2014). See more in Ch. 3.

environmental crises and climate change, terrorism, security and international conflict, economic growth and finance, global governance, or more recently and specifically regarding Brexit and President Trump, it would seem that this era is symbolized by perceptions of uncertainty and risk, under which we are bombarded on a daily basis with the dangers that may unfold. This uptick in our common obsession with risk identification has also been abetted by the industries of risk management, mitigation and underwriting, which are powerful tools that generate hundreds of billions of dollars annually. Traditionally, 'spheres' of risk have been restricted to the fields of security, safety and crisis/disaster-relief, but more recently have spread to policy (politics) and finance (economics). In a complex and changing world, otherwise characterized by Beck and Giddens as a *risk society*, micro/macro socio-political, economic, and budgetary decisions are increasingly being made through a 'lens' of risk. Even more importantly perhaps, this awareness is demanded by the private sector and established through the public sector (Althaus 2008, 11), and is consistent with modern developments in institutional (political) demands for efficiency and cost-effective platforms. In other words, important decisions are analyzed for their loss/gain potential prior to the implementation of policy or contract, and there is a contestable element of profit-maximization that facilitates policy direction and outcomes. In this sense a renewed focus on political risk analysis in developed democracies can allow us to focus on the politics that enable investments, or not.

I suggested above that the methodologies behind political risk[37]—though often competing, and not without valid criticism—are well established, though 'theorizing' attempts have been more limited. So is it really a 'soft-science'? Why does political risk suffer from a supposed lack of credibility in business and the academy (Howell and Chaddick, 1994)? Perhaps this is due to

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[37] For more on rating methodologies, econometric and risk models, see Bouchet, M. et al. (2003), and Brink (2004).

its cross-disciplinary nature (Simon, 1984), or its inability to foster cumulative knowledge in one field. But if political risk does involve the accumulation of information/conditions that can affect international business activity, this also points to the necessity of investigating the government-economy-society relationships as expressed in the institutions and societal characteristics of a given state. But a lens through which to observe these relations is still underdeveloped in the field(s) of political or country risk. Though these issues would seemingly embrace the very notions that political science scholars engage with, unfortunately, earlier attempts at theory building (in both business and politics) came to an abrupt end as new waves of research appeared and turned its attention to applied (Simon, 1982), practical, and perhaps 'profitable' results. While 'theory building' as explained above made a return in the following decades, it was focused on the methods, conceptual and practical dimensions of political risk *measurement* that were applicable to business environments. The explosion of 'risk' specialists and consultancies over the past two decades demonstrates the need for additional theoretical investigations into the broader implications of risk analysis.

Ultimately, if we can agree that the inherent interactivity between uncertainty and risk in, for example, the forms of (dys)functional state institutions, unwelcoming policies, regulations, civil unrest, and (il)liberal modes of governance can affect the potential interest, and influence of global markets and international investment in a host country, then it is necessary to probe this complex relationship in a theoretical sense. Certain critical IPE frameworks imply that the power of global markets influence or constrain state elements in a pervasive way,[38] to which I now turn.

[38] In a certain sense, classical institutionalist logic would hold that the attributes of/changes to, i.e. the independent variable (state institutions) would normally affect the dependent variable (level of investment/economic growth). On the flip side, the more critical IPE understandings might hold that market forces are the actual independent variable, and state institutions (and democracy) are greatly *dependent* on its power.

2.2a) Global Market Forces, Discipline, and the Discourse of Risk

In this section I entertain the notion of how the prevailing order of globalization relates to political risk analysis, questioning its institutions and social-power relations ([citing Cox] Gill and Cutler 2014, 2) that drive societies and economies. Gill notes that neoliberal[39] globalization "is the latest phase in a project that originated before the onset of industrial capitalism and the consolidation of the integral nation-state" (2003, 118). Throughout the decades of the post-war golden age to the present, the leading forces of contemporary globalization have been "constituted by a neoliberal historical bloc that practices a politics of supremacy within and across nations" (120). Market values and commercialization have been allowed to shape modern society both ideologically and practically, which has also led to the decline of national varieties of capitalism and welfare state regimes.[40] Finally, and accompanying this new reality, is the punitive power of neoliberal forms, exemplified by the idea of 'disciplinary neoliberalism' (Gill 1997 and 2003; Gill and Cutler, 2014). Granted, it must be acknowledged that such a 'historical bloc' is arguably being challenged from within (protectionism, nationalism, anti-globalism, etc.) the centre of capitalism, especially in the Global North.

Still, the penalizing aspects of neoliberalism are not necessarily universal in their macro/micro, public and private forms, nor are they always 'visible.' But the important thing to remember is that they can be institutionalized and bureaucratized in state, economy and civil society (Gill 2003, 131), compelling societies to follow the market imperative and yoking them to

[39] Whereas classical and European liberal traditions see an important and essential place for the state in the maintenance of a society and in the structures of the domestic and global economy, the neoliberalism that defined the North-Atlantic post-1980s is one based on a removal of regulations on capital and trade, a retrenchment of the welfare state, individual responsibility, and a complete market-based ideology that 'shrinks' the state's capacity to intervene in economic and social matters. See also: Clayton and Pontusson, 1998.

[40] See more in Soederberg, S. et al. (2006) (eds) *Internalizing Globalization: The Rise of Neoliberalism and the Decline of National Varieties of Capitalism*

the power of transnational and/or local capital. This can occur in many different ways, but has become most apparent over the past few decades through signals at world economic forums and multilateral gatherings which tout the benefits of coordinated and reinforced 'global economic governance'. Indeed, a 'new constitutionalism', as Gill calls it, is reinforced as a project of governance of the global political economy (Gill and Cutler 2014). Conscious attempts to spread 'market-based' reforms are paramount, and emphasis is placed on reforming the state to provide a political environment more conducive to capital (Gill 1998a, 1). More importantly, the promotion of neoliberal forms of state have been abetted by the prevalence of constitutional models that guarantee—politically and legally—an absolute space for the power of capital, or investments.

Furthermore, this locks in neoliberalism's disciplining capacity by institutionalizing it via quasi-legal reforms to states that are championed by supra-political agencies (i.e. Central Banks, G7, IMF, NAFTA, WTO, EU, etc.) and more directly, by national governments themselves (in the forms of neoliberal restructuring, welfare retrenchment, liberal macro-economic and fiscal policies and free-trade agreements). The key principles of new constitutionalism are found in most Western economies today, and increasingly in emerging markets too: emphasis on market efficiency, confidence, policy and government credibility, budget discipline, trust, consistency and *stability*, and limitations to democratic and popular decision-making. The nature and content of the public sphere is subjected to implicit privatization and commodification, and is now given 'binding constraints' regarding fiscal, trade and social policies (Gill 2003, 131-2). The investment discourse is also of increasing importance in a neo-constitutionalizing world. The policies and legal measures that reinforce the rights and political representation of investors can be outlined via three typical measures. First, the reconfiguration of state apparatuses to favour private determination of economic policy; second, the construction of markets and policies to extend Polanyi's 'fictitious' commodities of land, labour and capital through the adoption of liberal macroeconomic/regulatory policies and the guarantee of international private property rights; and third, "dealing with the dislocations produced by the fictitious commodities", including proactive forms of surveillance by international financial institutions, credit-rating agencies and a "relatively self-policing and normalized policy regime" (Gill 1998b, 25-27).

In sum, new constitutionalist and disciplinary neoliberal initiatives successfully lock in state and international reforms regarding the protection of private property rights and investor freedoms, global macroeconomic stability, and capital mobility (Gill 1998c, 1). These are espoused by provisions in international trade agreements (i.e. NAFTA, Ch.11; CETA, TPP) that protect businesses from so-called arbitrary government decision making. Further mechanisms such as the Investor to State Dispute Settlement (ISDS) are also contentious insofar as they allow corporations to recover damages from adverse government intervention, or failure to uphold 'their end of the deal', so to speak. These investor-protecting solutions are important for international business stability, and lie at the heart of mitigating political risks, but also place a significant burden on states and governments to uphold the terms of the deal, even if it may not/no longer be in the best interest of the host nation. This can be problematic for many governments, both on the financial and social levels. Recent populist turns in Western governments have made the issue of free trade provisions notably contentious and divisive, as part of their cause to return 'power to the people'. This reactionary rhetoric risks major upheaval in global financial and trade markets, and represents burgeoning political risk.

The World Bank's 1997 Development Report '*The State in a Changing World*' provides an interesting lens to observe political risk in a framework critical of the neoliberal model. It focuses on the re-nascent, 'evolving' role of the national-state, but not in its Keynesian or regulatory forms. Rather, it heralds the return of state power as an 'effective' means to uphold the complementarity of governments and markets, which "is vital for the provision of the goods and services and the rules and institutions that allow markets to flourish" (1). According to the World Bank, the modern state can succeed in its larger role, and 'match its capacity' by upholding the rule of law, maintaining stable and non-distortionary economic policies, making regulation flexible or applying self-regulatory mechanisms, and choosing market-based instruments (4-5). In other words, governments need to facilitate credibility, investment, and growth. Contrary to the conception that globalization prefers a 'weak' or minimalist state, it is evident that its disciplinary aspects require state power and administration to prevent infringement upon the free flow of capital across borders. It is in essence a form of self-discipline: states ought to know their 'own limits' and set 'self-restricting rules' (World Bank, 1997), lest they obstruct market forces. This is where political risk analysis can play a pivotal role: its function is to evaluate state policies and business climates, and its seeks to reproduce the 'global market order' of sound economics, trade liberalization, investment protection and attraction, and profit maximization, among others. Indeed, if one refers to the definitions of political risk above, the idea of 'stable political continuity' for international business success comes to fore—a befitting example of what new constitutionalism seeks to explain.

Governments are thus implicitly encouraged to undertake major liberal economic reforms, and a majority have done so throughout the period of neoliberal globalization. If a state wants to play in the profitable game of global finance, it must first show that it is capable of following the 'rules'. Political risk assessments reinforce this reality by publicizing supposed social and political-economic 'risks', and disseminating information on adverse investment environments. Kobrin (borrowing from Haendel et al. 1975) notes that "information about the political environment can help bridge the gap; it can enable investors to convert uncertainty to risk that is, at least potentially, measurable, insurable and avoidable" (1979, 68). PRA essentially seeks to measure whether or not a certain political climate is conducive to investment and profit or not. Political risk assessments evaluate the potential of a single country using factors such as politically driven debt defaults, capital controls, government-forced sale of assets, strikes, regulatory changes, environmental and social opposition (Accenture, 2012) as part of their analytical criteria. Ultimately, the idea that businesses need to invest in places where market efficiency is generally prioritized over social welfare and 'messy' domestic politics is paramount. This is seen in their classification of what constitutes a 'risk' to potential investors, inter alia tax burdens and royalty payments, trade embargoes, supply-chain disruptions, unwarranted labour action, policy instability, and currency inconvertibility, and others which I will describe in Chapter 3. Insofar as these issues are kept to a minimum, or are virtually non-existent, stability and freedom of the market can be maintained and remain attractive to investment. In theory and practice, political risk analysis can influence governments to align their policies to conform with international business standards so that they may be judged 'effectively' and positively (in a manner similar to ratings agency classifications of sovereign liquidity, or in other cases, akin to accession criteria of trade agreements, etc.).

So we can begin to see, in a theoretical sense, how market forces might determine the ways in which institutions and states 'behave' vis-à-vis investment capital and economic growth. But is/has this always been the case? Can we overlook the historical influence of institutional attributes as part of the umbrella of investment attraction and political risk? My sense is that we cannot; they are still an intricate and complex variable that is highly determinant of FDI, although the 'power of the market' in guiding those institutions is something we cannot take lightly.

Nonetheless, though we have seen aspects of state sovereignty being eroded by neoliberal globalization, the state (and its institutions) is still by far the most influential actor in shaping the business and investment environment in a given country (i.e. the investment climate).

2.2b) An Exemplary tale: Changing Economics of European Integration and Globalization

Taking a page from the disciplinary aspects of neoliberalism and globalization, we can apply this logic to what has been written about the history of contemporary globalization in the West, and what it has meant for economies and societies that have embraced it: generally liberalization and growth, accompanied by externalities such as inequality. The pendulum of globalization has been in full swing for several decades, encompassing the developed and developing world alike. Expansive policy liberalizations, bilateral and regional agreements (FTAs), private and state-sponsored investment vehicles, and the internationalization of finance have paved the way for a new era of economic liberalism and globalization into the 21st century. The European Union (EU) continues to play a leading role in global economic institution building and policy-making, international trade, and finance—three of the main tenets of globalization. Looking at the issue of trade, the EU-28 (as a single economic entity) is the largest trading partner in goods of both the US and China. But as I outlined above, not all states trade and attract investment equally. Still, attention ought to be paid to the notion that the European states acted individually and collectively to form a prosperous economic union and set the stage for their future roles as sponsors of globalization. Let us briefly survey how this first came to pass.

Europe was in dire need of assistance immediately following the Second World War. The European Recovery Program (ERP), more commonly known as the Marshall Plan, was 'sold' to populations and media as economic aid for reconstruction efforts in a post-war Western Europe that was beset by economic crisis. The objectives of the Marshall Plan were as political as they were economic, and coincidentally, had dramatic transnational effects. Central to its aims were not only the ideas of European 'recovery' and restructuring in the aftermath of the war's destruction, but more importantly, the condition that the aid be used in a coordinated way: "that it should serve to 'integrate' western Europe, making it into a more closely united area over which certain common forms of economic, social and political existence proper to democracy and the 'free' world would prevail" (Milward 1984, 43). This kind of foreshadowing is in line with the typology of successful market economies and democracies that economists like Acemoglu and Robinson are so fond of, and which represents a certain form of political stability for global investment purposes.

From another angle, Panitch and Gindin (2012) note that as part of its project to 'launch global capitalism', the American state saw an unprecedented opportunity in the aftermath of the war to restore capitalism's future. The path to this goal was with the help of a shattered Europe. The Marshall Plan enabled European states to rebuild their markets, restart trade, buy American products, and facilitate transatlantic FDI and US operations in the continent (90). The plan, in the form of a structural adjustment program, sought to ensure that a free market economy developed in Western Europe without influence from Soviet-style socialism or communist threats (that were already evident especially in Italian and French politics), and that a strong security mechanism and buffer were in place. Furthermore, it should be noted that the American state wanted to ensure that its capital had direct access to open European (and later world) markets, so that the internationalization of production would be intertwined with European market development (Cox, 1987). In reality, one of the most important goals of the Marshall Plan was not only the reconstruction of European infrastructure (as a simple aid program), but the restoration of internal financial stability, and the guarantee that European states would be committed to strong liberal mixed-market economies. In other words, a new Europe was to be politically and economically inclusive, and this paid off.

Thereafter Europe embarked upon a transformation to re-establish its important role in the international system—this time as an open, common market. Hence the precursor to transatlantic globalization had taken off. Part of the Marshall Plan's recovery program involved the European Payments Union (EPU) which set up a trading-payments system that allowed European states to use their own currencies rather than the US dollar in intra-European trade, freeing up much needed space for the movement of capital and investments in Europe (Panitch and Gindin 2012, 100). This was an important first step in reigniting intra-European trade. In essence, the conditional aid in the Marshall Plan was the inherent predecessor to the ECSC. By 1967, the Merger Treaty (or Brussels Treaty) had come into force and the main integrative organizations—Euratom, the ECSC and the EEC—were amalgamated into the European Communities. Moreover, European political and economic development in a certain sense began to emulate and adopt American forms of production and liberalization that had been so successful in the other large 'domestic' market across the Atlantic, which enabled the development of a consumer-driven European economy. This was possible due to integration and the evolution of a barrier-free EC that created such a large 'domestic European market'.

Concurrently, whereas in the 1970s one could still notice tendencies towards a distinct continental European alternative to Anglo-American market-economies (Varieties of Capitalism a' la Hall & Soskice), by the mid-1980s, much of Western Europe had embraced the newfound dominance of neoliberalism (Holman and van der Pijl 2003). Throughout the preceding decade, European production slowed considerably, and unemployment was on the rise. The authors note that the corporate liberalism maintained during the post-war years of European integration was exemplified by Keynesian and Fordist economic systems, intensive bargaining, permissible state interventions, etc. Indeed, many southern European states were especially fond of this type of economic organization, and for a time quite successful with it as well. Henceforth (1980s), modern globalization as we know it in its Anglo-American form became noticeable through the liberalization of private finance from government control, which signalled a departure from the state-society protection complex (Polanyi, 1944). In Europe, this necessitated a form of de-regulation of many industries, lower barriers, and the 'flexibilization' of the labour force that followed, which is representative of the waning European 'coordinated capitalism' and the implementation of American economic liberalism (Panitch and Gindin 2012, 203), which blurred the *varieties* of capitalisms. In this sense, it is not surprising that the contemporary risk assessments that evaluate such criteria do not often consider the developed economies of Europe as risky, given the relative entrenchment of liberalization mechanisms across Western Europe. Arguably, the stark differences between the liberal and coordinated market economies of Europe (Hall and Soskice, 2001) became increasingly harder to differentiate by the early 2000s. Italy perhaps stands out from this development more than any other major economy, as I discuss in Chapter 4.

In any case, the 1980-90s epitomized a significant moment for broader globalization insofar as it is characterized by what could be termed 'the subordination of politics to economics' (Gill, 2003). This process obviously occurred more smoothly in some places than others. An international institutional infrastructure was created to maintain the centrality of market liberalism, i.e. through the ECB, IMF, World Bank, and others, this type of prevailing 'economic thought' became the common denominator of European monetary governance into the 1990s. The success of the Economic and Monetary Union (EMU) and the criteria associated with joining the euro, including synchronization of policies (Talani, 2003), is representative of the influence of globalization and the real desire of European governments (but not always its populace) to join the common currency. Another factor in the 'liberalization' of Europe was the extremely powerful Anglo-American relationship between Thatcher and Reagan, which brought to light the importance and clout of international finance[41], and which eventually spilled over into the continent proper. Finally, the dawn of the euro signalled a loss for autonomous domestic monetary policies in Europe, something which would come to haunt most members a decade or so later during the financial crisis. Whether all EU member states were ready for the sorts of reforms that accompanied a globalizing Europe is another matter, as I briefly touch upon in Chapter 4.

While globalization has undoubtedly blurred the lines of types of state organization, theorizations on autonomy, and general convergence of one type of state are still limited in explanatory power. The institutional and structural rigidities of a state and its political-institutional actors, including its unique ability to create and change policies and regulations for international investment and finance within its borders, render the state autonomous insofar as its institutions are the only sovereign organs that have this power. This does not mean that negotiation, pressure, and subtle (or overt) forms of compliance between states and international organizations and capital do not exist (i.e. on FTAs, taxation, regulations, etc.), but it would be an oversimplification to deem that the state has little or no leeway in these decisions. In fact, since the financial crisis, although restrictions have been placed on states' abilities to interact with

[41] On the importance of the internationalization of finance in the EU, see Grahl (2009).

global capital, many states have also exerted a newfound influence (popular and politically supported or shunned) in their dealings with trade regimes and finance through populist parties. In a way, the critical approaches described above tend to treat states as discreet objects. The macro-structural interpretation of world-systems development understand multinational institutions to have a veil of influence which flows downwards and 'disciplines' states with supposedly relatively little autonomy. This seemingly ignores the structures of power and agency that institutions and societies still wield, and which political risk analysis interrogates.

Boyer (1996) wisely observes that "few of the mechanisms that promote economic convergence are powerful enough to homogenize economic performances. Nor can we imagine the adoption of a single one best practice identical all over the world and applicable to any region or nation" (30). The WTO, World Bank and IMF, though loaded with free-market accession criteria, and able to play the roles of headmaster when a member breaks rank, are limited to *lightly* enforcing the requirements initially accepted by member states. Sovereign Ratings Agencies have sought to use their subtle power to enforce certain mechanisms and agreements on debt-ridden governments (i.e. Greece, Argentina, Portugal, etc.). And to a lesser degree, political risk analysis seeks to evaluate similar abilities, albeit without that explicit global influence. So a 'one size fits all' approach to political-economic management has not worked, and will not, even as the world becomes more financially interconnected, notwithstanding the current protectionist backlash. Boyer, thus far, has been correct: "the 1990s and the next century, too, are likely to be still the epoch of nations. The complex set of contradictory forces that are pushing simultaneously toward convergence and divergence are far from moving toward a single best institutional design" (1996, 59). It is these independent state institutions which create the conditions, policies and regulations that allow capital and investment to flow and take hold, and which, we have learned, can be influenced by both domestic elites and populists.

It is worthwhile noting that one of the main points of political risk analysis is to actually evaluate a sovereign government's decisions and positions on the investment-related issues mentioned above. Hence, we can look at the importance of transnational integration to political risk ratings. In opposition to the common political risk practice of looking at 'internal' or domestic factors of risk, Marchetti and Vitale (2013) suggest the use of globalization as a determining variable for political risk analysis. The authors emphasize the importance the international – or transnational – dimension of political risk derived from globalization and international integration. They hypothesize that "globalization constitutes a mitigating factor that diminishes the level of political risk for any given country: the level of global integration is thus expected to be related to the level of political risk" (2013, 9). By testing the relation between globalization, political (in)stability and governance, they found that a positive relationship exist between globalization and lower political risk, meaning that, the more a country is 'globalized' the less it will be subjected to internal risks related to the socio-economic, political and institutional scenario. In section 2.4 below, I build on this model by testing the relationship of different external and internal variables in order to demonstrate the risk differences in developed vs. developing economies.

Moving forward, the following sections will highlight how approaches that take into account political-economic institutions may be better suited to consider the dimensions in which political risk occurs. In doing so, I explain the importance of understanding political risk under the auspices of political science *grand theories* on successful institutions and forms of stability.

2.3. Cyclical motions: Institutional Inclusivity and Economic Exclusivity, or both?

"Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government." Adam Smith, 1776 (The Wealth of Nations)

From Smith's perspective, the key aspects of a successful economy surround the institutions and rule of laws that uphold a sense of certainty in society. The institutional avenues of research underlined below are important for a broader understanding of political risk analysis insofar as arguments on what the 'ideal-type' of investment environment entails, and given the established literature that shows how stable political institutions ought to breed and attract profitable and safe investments. 'Bringing the State back in', as Evans, Rueschemeyer and Skocpol (1985) put it, is not something new in political economy, nor is the focus on related 'new institutionalisms' (Hall and Taylor, 1996). These approaches have been used to study many comparative, historical and sociological forms of institutional research such as regime transformation in Latin America and East Asia, types of government organization, fascism and democracy, and class relations, etc. Indeed, works such as Thelen (1999), Hall (1986), North (1981, 1990) and countless others have focused on political and economic institutions and their historical roles in the development of modern societies and economies, providing students with a solid base in the literature. A common theme throughout this dissertation speaks to the idea that the role of institutions in globalized economic activity is still very significant, albeit changing in the aftermath of the financial crisis.

Yet recent events might lead one to conclude that the elite, internationalist dream of global governance is dead; that the half-century-long strategies to further regional and global integration based on the ideals of Western liberal democratic institutions have passed their prime. In the context of the developed economies of the West, a struggle is unfolding before our eyes between protectionism and re-emergent nationalism on the one hand, and liberal cosmopolitanism and democratic institutions on the other. This tension is best characterized by the Trump pseudo-protectionist factions in the US, Brexiteers, Le Pen, Salvini and other rising Euroskeptics in Europe, versus the defenders of contemporary globalization in the forms of Merkel, Trudeau, Macron, and others. The challenges to the longstanding liberal order that many forms populism have ushered in require us to ask questions not only about the stability of our international system, but what political institutions supposedly represent, and how they actually have evolved.

The institutions themselves can be the site of struggle as different political, economic and social forces attempt to shape them to produce intended outcomes. Still, there is also a sense of relative continuity in how economic activity is generated and supported by the state and society. So in these contentious periods of change, there is the potential for a new understanding of the state-economy-society nexus, and an examination of the political institutions that underpin the economy, which is something I argue political risk analysis inherently does. We can thus look to new, old and hybrid conceptual tools and analytical explanations to describe these institutional and economic changes, and tie them into the theory-building exercises that political scientists have sought for the analysis of risk.

As a point of departure, I understand 'institutions' as per North (1990): "a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive, or material reasons, and organizations as durable entities with formally recognized members, whose rules also contribute to the institutions of the political economy" (Hall and Soskice, 2001, 9). With that in mind, the literature shows that attributes concerning the quality of institutions and government 'effectiveness' are important determinants of FDI, particularly for emerging economies with transitioning democratic organizations.[42] Arguments addressing the quality and effectiveness of institutions centre upon: strong legal protection of assets, and subsequently less risk of confiscation and expropriation; established and independent institutions that uphold and protect well-functioning markets; good economic and physical infrastructure (Blonigen, 2005); the reasonable expectation of political continuity; and the enforcement of laws, regulations, and policies that govern investments and economic activity. On the whole, good institutions have a positive and significant effect on FDI given that the unpredictable policies, excessive regulatory burdens, lack of enforcement of property rights, and unreliable government partners have been shown to deter FDI flows (Daude and Stein, 2004; Agbloyor et al. 2016).

Yet what constitutes 'good institutions' are up for debate. Does it mean good government, or governance? It could be related to democratization or to marketization in the positive sense, or it could assume quality in government services for citizens. It could also relate to efficiency in policies, procedures, or regulations, or to transparency and accountability, quality of democracy and rule of law, and other issues as well (Holmberg and Rothstein, 2012, 14-24). All of these aspects speak to institutional arrangements that can obviously differ by society, culture, and economy. Yet often the goal of measuring institutional and governmental 'quality' is to find a basic norm (Holmberg and Rothstein, 2012) that characterizes institutional systems with baseline criteria that are universally applicable. As I have suggested, this is significantly more difficult once differences in economic and civic realities come into play. Political risk assessments

[42] For example, see Jensen, 2003, 2008; Jadhav and Katti, 2012; Daude and Stein, 2004

reinforce this line of thinking with their rankings and singular variable selections which propagate the focus on governance indicators.

In his further writings on quality of government, Rothstein (2011), like his institutional predecessors, explains that "the lack of predictable legal institutions that can secure property rights and curb corruption hinders many business people from making investments that in all likelihood would vastly improve their (and their country's) economic situation" (5), which reflects a crucial theme of current IPE scholarship – that of the necessity of effective institutions. There is consensus that theoretically, good institutions breed 'good governance' and vice-versa, which are thus the most important determinants behind economic development; whereas dysfunctional institutions create socio-political problems (i.e. via corruption, instability, uncertainty, ineffectiveness) and undermine development (Rothstein 2011, 40-47) and this is supported by correlated data on government effectiveness and GDP growth. This logic can also be applied to the role of FDI, which is a significant economic growth engine in all types of economies in an era of competitive globalization. Rothstein makes a compelling argument in that 'quality' governance and institutions ought to be concerned with how policies are designed and operate (Rothstein 2011, 12). Ultimately, what counts towards such 'quality' is not so much the indicators that measure it (although still useful), but the fact that impartiality in the exercise of public authority should be the basis for what represents quality governance. This means that while implementing policy, officials should act impartially regarding any vested personal interests, connections, or to any information supplied post-hoc (13). In a normative light, this is a basic, procedural norm for liberal democracies and open economies. In addition to this normative democratic necessity, quality and impartiality also need to be pervasive in the rule of law. Together, these conceptualizations explain the importance of efficiency of government.

Relating this to economic and business investment activity is the next logical step. Consistency of regimes and quality of institutions assuages investor concerns about credibility and continuity of economic entities, whereas volatility erodes investor confidence and generates adverse business climates for risk-averse investors (Shah 2017, 24). In short, good, stable political institutions are essential prerequisites for location selection. Indicators of stability such as democratic accountability, absence of military and religious influences in politics, corruption-free and honest public office holders, and efficient bureaucracy have been utilized for emerging economy studies to demonstrate the importance of institutional variables (Shah, 2017) but similar studies have not been conducted for developed economies. While these relationships may be somewhat obvious, measuring the effect of institutions on FDI is difficult due to the diversity of measurements of institutional activities. Blonigen notes that "most measures are some composite index of a country's political, legal and economic institutions, developed from survey responses from officials or businessmen familiar with the country. Comparability across countries is questionable when survey respondents vary across the countries. In addition, institutions are quite persistent, so there is likely to be little informative variation over time within a country" (2005, 390). Further, Goswami and Haider (2014) also found that in addition to failures in governance-related activities, the cultural factors and development partners' attitude about the country could greatly determine FDI inflows. This suggests that there are similar problems in the measurement of political risks with equally diverse underlying factors, assessments, and measurements.

Following this logic, and in opposition to many critical approaches to modernity and development, Acemoglu and Robinson have (like many others) long argued that the origins of the different economic and political trajectories of nation-states have depended on specific political and economic institutions and societal factors. In what could otherwise be loosely described as ‘requisites for modern liberal democracies’, the central argument in *Why Nations Fail: The Origins of Power, Prosperity, and Poverty* (2012) concerns the link between inclusive economic and political institutions, and prosperity (political-economic success). They are especially interested in understanding why political-economic and social divergences have emerged among nations in different times and places. The focus is on the successes of developed capitalist states in the West, and developing and underdeveloped states in the ‘rest.’ Hence the important question: why do some nations fail? Clearly this manuscript, and previous works by the same authors, including *Economic Origins of Dictatorship and Democrac*y (2006), falls neatly under the literatures on economic development and democratization, and is not necessarily related to political risk factors, modern FDI determinants and risk ratings, though they share fundamental theoretical assumptions. However, I find it useful to draw upon their institutional arguments on the inherent and cyclical relationship between political and economic institutional and societal factors to frame the discourse of political risk in a theoretical light.

The Cambridge History of Capitalism (Neal and Williamson, 2014), defines capitalist market systems as having and exhibiting secure contracts, property rights and markets with flexible prices that can survive long enough to make large investments worthwhile, i.e. stability. This description fits well with Acemoglu and Robinson’s approach, and indeed with political risk analysis as well. By providing the reader with a multitude of pre-modern and contemporary illustrations, the answer to their seminal question, *why nations may fail*, basically lies in the distinction between the historical trajectories of the establishment of extractive and inclusive economic and political institutions. Path dependency, which is a framework for understanding how certain elements and circumstances in a historical period may combine to form a reproductive or dependent character (specifically institutions which exhibit similar characteristics over time) (Greener, 2005), is significant to their argument. Equally important are the 'critical junctures' or specific events that can lead to a deviation from this path, or to historical and institutional developments that ultimately precipitate *virtuous circles* and *vicious cycles*. Basically, these can reinforce the continuation of inclusivity or exclusivity in political and economic institutions, and thus certain nation-states (Acemoglu and Robinson, 2012). They argue that inclusive economic institutions are supported by politically inclusive ones, and that extractive economic institutions lead to exclusive policies, and vice-versa. *Inclusive* (democratic) institutions distribute political power in a pluralistic manner and can achieve some degree of political centralization which ensures law and order, the foundations of secure property rights, and thus an inclusive economy (similar to what investors are looking to see in risk assessments). They claim that a majority of nations have not followed this path, and instead have elected to recreate the vicious cycle of *extractive* institutions. These can still lead to overt political centralization and can generate a certain amount of growth (think authoritarian capitalist states like Singapore & China), but this form of development is unsustainable in the long term because modern growth requires innovation (via creative destruction) and only inclusivity will foster it (Acemoglu and Robinson, 2012).

Ultimately, it is liberal democratic, free-market systems that are the 'ideal' model, especially in comparison to the many erstwhile failures. But the question remains: have all western liberal democracies been equally successful, assuming they followed such a strategy and developmental course? History tells us otherwise, as do diverse sub-state examples and comparisons which this project refers to. On the whole, this theoretical framework is especially valuable and practical because it allows one to appreciate the inherent connection between politics and economics that surround political risk analysis, and permits us to engage more deeply with specific factors of political risk inside various institutions of government and society, especially when taking into account unique political systems, cultures, and types/stages of development. Modern democratic political systems are indeed complex and fluid, whose institutions have the ability to degrade or stabilize economic growth, something which political risk analysis ought to decipher. Even critics of such an overt 'institutional' focus on the determinants of prosperity, such as Diamond, who takes a more bio-ecologically and geographically deterministic view of successful development (1999), concede that good government and quality institutions have important roles to play in the eventual prosperity or poverty of nations. Without effective institutions, it is difficult to attract and sustain investment, domestic or foreign. They are part and parcel of business and societal relationships.

The rational choice and behavioural assumptions put forth by economists dealing with the issue of institutional change posit an economic equilibrium and that actors' preferences and choices are made based on stable criteria, with the hope of efficiency maximizing decisions and outcomes (North 1990, 18). But such a behavioural assumption of maximizing preferences does not take into account the changing nature of institutions and their effectiveness, nor for that matter the politics and policies that institutions rely on, which complicate the regular understandings of equal competition. Even 'wealth-maximizing' behaviours can be influenced by institutional constraints which result in a changing environment (North, 1990) or an unequal playing field, in this case, for investors. The ability of actors to decipher the environment (business climate) before making decisions, cannot be assumed when the predictability of the institution and related policy is unforeseeable, which is the case in elevated political risk rankings. Research has shown that stable institutions and good governance can create the necessary conditions for steady economic growth. Another important aspect of the behavioural economics argument concerns rationality. Thaler (2015) shows how humans bring along behavioural biases, are error prone, and often act irrationally. Institutions are largely made up of individuals, and one has to appreciate the notion that irrationality and emotion are part of decision-making. In this light, institutions might not always 'act' consistently with maximizing their own effectiveness because the people who create them do not either. This train of thought challenges many classical notions of rational economic behaviour, but essentially ties in to the 'uncertainty' doctrine I discuss in this project. Abrupt institutional or policy changes that investors are weary of, are often brought about by irrational actions of politicians and/or the bureaucracy, sometimes breaking the path dependent trajectories they had previously been on. Human behaviour presents us with the endless potential for uncertainty to creep in, especially in light of 'shock' events that the world of political risk forecasting struggles with.

For now, I would like to move away from behavioural assumptions and re-focus on the formal and informal constraints that societies and institutions set, which may or may not be due to rational behaviours. Governance structures, rules and regulations, customs and conventions can all be informally enforced and accepted by members of any society, in addition to the laws and property rights of the state. But in fact, the latter 'formal' rules make up a smaller percentage of the sum of constraints we put on ourselves than the former informal ones do (North 1990, 36). For societal order to be preserved, there must be a combination of these constraints. Indeed, informal institutions and rules, or as Hall and Soskice note (2001, 13) "a set of shared understandings about what other actors are likely to do, often rooted in a sense of what it is appropriate to do in such circumstances", are equally important in the strategic interactions of the political economy, including history, culture, and 'common knowledge', and this is something that is especially relevant, and true, in the sphere of foreign investment.

This begs the question: what types of organizational and institutional elements support the distinctive strategies of economic actors (Hall and Soskice, 2001) seeking to make investments in third countries? Insofar as institutional performance is concerned, North's (1990) pioneering work on the role of institutions and their effects on society forms an important part of the framework I employ. Institutions are implied as the rules of the game, informal or formal, that constrain and guide human and political interactions in a society. Institutions can be 'sticky' insofar as they tend to lock in certain arrangements, rules, or conventions that have emerged over periods of time for unique historical reasons (Boettke et al. 2008). The different performances of economies over time is fundamentally influenced by institutional evolution (North, 1990) and by the policies they produce. There are thus obvious consequences and diverse paths of political-economic performance that institutions can sway, and historically this has been approached by neoclassical economists. Critically important is North's notion that the "major role of institutions in a society is to reduce uncertainty by establishing a stable structure" to human, and as a sub-set, political-economic interactions (1990, 6). The key to this however, is that the degree of change and adaptability of those institutions is not set or stable, and this is where *uncertainty,* the key aspect of political risk as outlined above, comes into play through regulations, policies, and politics that can be surprisingly fickle and volatile.

While in developed economies the changes within institutions are more often than not, incremental and gradual, recent political struggles suggest that the informal constraints on institutional structures are perhaps more discontinuous than we thought, and are more easily challenged (e.g. political upheaval and change in UK, USA, Italy, etc.). Investors prefer gradual change to regulations or political relationships, as the existing structure is only slightly altered each time, so the expectations of how, for example, business deals occur, remain quite predictable. But as North notes, the perceptions of such potential changes "crucially depend on both the information that the entrepreneurs receive and the way they process that information" (1990, 8). Not all policies and regulations that run down the institutional pipelines are created equally, and the communications or marketing strategies on the part of governments are essential to a comprehensive and working investment and sustainable business growth policy. When this goes astray, especially on more than one occasion, business confidence decreases. Institutional and policy changes do have unintended consequences, and investors are aware of this, while risk assessments ought to incorporate it.[43]

I am not the first to attempt to situate ideas on types of regime, stability, and institutions with political risk analysis, but I do seek to contribute to the current debates. The EIU's model to forecast political instability in 2009-2010 took up those questions, as did Jensen's (2008, 2012) modeling of risk in democratic and authoritarian regimes, Cisar's (2007) theory for macro political risk in terms of stability, modernization and development, Brink's political risk-event and contextual model (2004), and more recently, Sottilotta's impressive review of such arguments. Ultimately, we can claim that "there is agreement on the impact of different political regime types on political risk in a given country; whether or not the impact of democracy on risk is positive may to some extent remain a contested notion, also influenced by the definition and operationalization of the concept of democracy" (Sottilotta, 2017, 43).

At the macro-economic level, IMF studies have mapped the positive relation between institutional conditions and economic growth, which supersede the relation between geographic and integrative factors and economic growth (i.e. Rodrik, Subramanian, and Trebbi, 2002). The

[43] Snider (2005) defines an institutional approach to political risk as identifying and understanding the conditions that decisively change the 'rules of the game' that affect firms' calculations of risk.

primacy of institutional performance (property rights, rule of law, transparency) cannot be overlooked, even if it must be said that it is arguably the most important determinant of growth—not the only one. But the question remains, how can we clarify the specific tenets of these diverse theoretical approaches to inform this project? Can political risk analysis be read as another part of large-scale neoliberal globalization, or is it better explained by the institutional intricacies of stable, well-functioning institutions, policies and economies that drive one another? As mentioned above, it is clear that the literature understands political institutions—and their relative stability and quality—as some of the most important sources of political risk insofar as underdeveloped and path-dependent institutional frameworks inhibit "the ability of policy makers to extend credible promises to protect investors' property rights, hence increasing transaction costs and the risk of ex-post government intervention" (Jakobsen 2010, 483). But again, these studies are largely focused on developing economies and authoritarian or hybrid regimes whose institutions are under constant scrutiny by companies, multilateral institutions, and rating agencies. Given the increasing instability and concomitant importance of political risk in the West, we ought to look equally at the quality of institutions there. Essential to this project is a focus on those political-institutional intricacies and development trajectories that can affect economic prosperity, which is quite similar to what political risk analysis attempts to understand.

The underlying element I would like to take from this eclectic theoretical advance to the importance of institutions, is to enable the development of a multifaceted framework to study political risk in the West through an institutional dimension that has room for essential qualitative inquiry into socio-political factors. Jarvis, citing Henisz (2000), explains the idea of working within a similar dynamic model, which:

> Rather than seeing the government in a host environment as a singular agent or unitary actor, complicates the bargaining relationships and policy making processes by adding several layers; interactions between foreign investors, domestic interest groups, government agencies and political actors… The outcome of such a model is a more complex appreciation of the institutional nature of government, policy and decision-making, and of the interface between regulatory bodies, foreign commercial and other stakeholders… Institutions and the policy, regulatory and governance structures they comprise, are understood as part of the dynamic risk environment that international investors and other actors must interface with when dealing with foreign governments. (Jarvis 2008, 63-4).

The point here is to recognize that institutions are near the top of the ladder of abstraction, whose structures and influence flow throughout and within (and back) related regulations, policies, and actors. This complex interface and feedback mechanism enables multiple actors to interact and create or mitigate risk. For these reasons, it is important to identify which political institutions matter, and which institutional elements are of significance in terms of political risk analysis (Jarvis, 2008). Therefore, a theoretically informed approach to political risk analysis that understands the contemporary nature of institutions, how they matter (Haber, North and Weingast, 2008), and in what ways they are influential, is essential to exhibit flexibility in variable selection, and is necessary to analyse the space in which political risk exists: in the feedback between multiple actors, institutions, and the socio-cultures that underpin them.

As mentioned in Chapter 1, my own approach to political risk analysis is rooted in Jarvis' (2008) classifications, which stem from advances in political economy: political risk as a multifaceted function of governmental, political-economic, social activity, or inactivity, that has an effect on the investor/business community. This means that there is an inherent political-economic and institutional focus that ought to be taken up when discussing political risk, as political and government institutions embody the societal characteristics and regulatory regimes that functioning economies both require and build upon. In the following chapter (3), I lay out in more detail an approach to studying political risk that builds on the recent work of scholars who underscore the importance of an interdisciplinary framework of different political systems (structures and institutional input-output) embedded in political economy approaches to institutions (Jarvis, 2008; van Wyk, 2010; Sottilotta, 2017). The next section introduces a quantitative aspect to this dimension in order to clarify the discussion of the economy-type differentiation in PRA.

2.4. From Theory to Practice: Quantitative support for Stability, Risk and Investment

The theoretical advances that have influenced institutional and democratic convergence as prerequisites for economic growth and stability have agreed upon the need for good government and stability in its many conceptualizations. To further this discussion and its strong grounding in the literature, it will be useful to 'test' such relationships empirically, and hypothesize about the typical understandings of the role of our main variable—political risk—to this overall equation. While an exact method to test such complex relationships is subject to debate and different methodological standards of rigour, we can look to previous studies that have attempted to discuss those relationships, and work towards new examination strategies with different sets of data. In an earlier footnote (#38), I mentioned that according to classical institutionalist logic, in the relation between institutions and growth, state institutions are seen as the independent variable, and changes within/to institutions could thus affect the dependent variable (level of investment or economic growth). As I highlight (in Ch. 1, and later Ch. 4/5), the many forms of 'institutional determinants' of FDI have been the subject of intense academic debate. Ultimately, a major strand of the literature shows that institutional quality has a positive and significant effect on FDI by facilitating investment flows and reducing volatility (Buchanan et al. 2012), while at the same time the supportive activities of institutions promote the flow of international capital (financial globalization), and hence the economies with stable and good institutions benefit more from the interactivity of globalization (Okada, 2013). Yet, Przeworksi (2004b) also found that political regimes have no significant impact on the growth of total income across a variety of country conditions.

I contend that these determinants are part-and-parcel of political risk analysis. In fact, scholars across the fields of comparative politics and business studies have taken that relationship a step further, and incorporated various types of risk rankings and economic growth metrics to that foundational rapport. Drawing from Jensen (2008), Goswami and Haider (2014), Agbloyor et al. (2016), and Marchetti and Vitale's (2014) conceptual models and hypotheses on the following explanatory associations, I highlight the interrelationships between risk ratings, FDI levels, and political/institutional (in)stability. These three variables constitute both internal aspects and external ones (dependent), insofar as stability is a judgment on internal political-institutional certainty and policy effectiveness, whereas FDI and risk ratings are together representative of trust in a foreign state by means of investment potential (independent). While assessments and tests of the relation between risk and FDI, or democratic institutions, stability and FDI, or risk and stability have been conducted by multiple scholars who deal with political risk (Jensen 2003, 2008; Rodrik et al., 2002; Agbloyor et al. 2016, inter alia.), my own contribution and test slightly alters the focus. I draw on recent data in the post-financial crisis recovery period from 2011-2016, and before the period of heightened global instability that has emerged via the populist upswings of 2016-17. Many of the studies mentioned use data specifically from developing/emerging economies (Jadhav and Katti, 2013), or data exclusively from the pre-crisis period (Jensen, 2008). I focus instead on the post-crisis and recovery period which allows the data to be more consistent vis-à-vis outliers, and also look at a geographic and economic representation of 9 of the world's major developed economies (G7 + Spain and Australia[44]), and in comparison to the most significant developing or emerging large economies (BRICS + MINE (Mexico, Indonesia, Nigeria, Egypt). This was a purposeful sample that is representative of diverse types of economies, market and resource-driven differences, and geographic locations, which make up commonly used selection criteria in previous studies. The following sections will delineate and define the variables and data used, explain the models and tests conducted, and produce preliminary results of those tests.

FDI

Most definitions of FDI share similar characteristics. As a starting point, UNCTAD (2003, 232) defines FDI as "the sum of all investments by non-residents in the reporting economy in three categories: 1) original investments of equity capital, 2) re-investment of earnings, i.e. the direct investor's share in proportion to direct equity participation of earnings not distributed dividends of affiliates or earnings that are not remitted to the direct investor, and 3) by intra-company loans which are from a foreign 'parent' to a subsidiary within the country". This essentially refers to substantial ownership or control of assets or physical enterprise in a foreign nation, in the forms of private capital, debt-holdings, equity, joint ventures, green or brownfield investments (Jensen, 2003). According to classical approaches to the study of FDI determinants, a company becomes a multi-national enterprise (MNE) when its strategic assets provide ownership, location, and internalization competitive advantages over its rivals in the host country's domestic market (Dunning, 1977). Recent studies have pointed to four major categories of determinants: resource

[44] For these selection criteria, see also Ch. 1

seeking, as in the case of natural resources or human capital; market seeking, when the investment meant to provide market access and circumvent barriers such as high tariffs or transportation costs; efficiency seeking, meaning that the MNE operations may benefit from better labour productivity in the host country; and strategic-asset seeking, as in the case of mergers and acquisitions (M&A), meant to provide the MNE with strategic resources such as specific knowledge (Rajan, 2004; Borin and Cristadoro, 2014). MNCs from countries who have FTAs with the investment destination nation could be considered to be at an advantage both in terms of ease of access and in shared experience or company precedents (Walter, 2002).

For the purposes of this sample and model that spans a short 5-year period, whole numbers of FDI in millions (FDI stock) does not adequately capture the role and importance of FDI to an economy, given the vast differences in sizes of economies among selected nations. For example, the size of the US and Chinese economies vs. the Canadian or Nigerian ones, and the amount of FDI they procure, are not as valuable for comparison as FDI as a % of GDP, which is a more stable comparative indicator that better controls for difference in economy size. I chose to utilize this data (FDI as % GDP) from the World Bank, a reliable source of investment data, to account for this issue for the years 2011-16.

Political/Institutional Stability

As I describe in further detail in Ch. 3 and 4, political stability as a risk factor or measureable variable is quite complicated. Common instability scores and indices are often related to levels of violence and unrest in a country (i.e. World Bank Governance Indicators) or they show the level of threat posed to governments by social protest and civil unrest (such as the EIU). These indices, while useful and arguably methodologically sound, are often created to specifically measure unrest and instability in emerging or underdeveloped nations that display the most common attributes of instability- unrest, violence, or authoritarian regime tendencies. Yet political (in)stability should also have a space for institutional and democratic stability and government quality or effectiveness in the more general sense, which, as described above, lends to policy and regulatory efficacy and accountability, thus having an important bearing on economic potential, and on investment (Busse and Hefeker, 2007). With these shortcomings in mind, we still need to be able to numerically compare the levels of stability, and that requires some sort of quantitative score. The most effective index for this can be derived from the PRS Group's instability scores, paired with its government effectiveness scores. I created a composite score (/100) based on the average aggregate rankings of more traditional political stability measurements such as absence of violence, internal and external threats, ethnic tensions, and including government effectiveness and bureaucracy quality. Together, such an index forms a more valuable and thorough 'stability' score that incorporates not only institutional and governmental stability, but also the traditional definition of socio-political stability in order to control for the realities in developed and emerging economies (democratic, hybrid regimes or otherwise) (Morlino, 2009). It should also be noted that availability of actual 'stability' scores is rather limited to the public. Other than the World Bank Governance Indicators and PRS, many indices are completed by private, for-profit firms, meaning that one would have to pay large sums or memberships fees to access this data. As noted in the paragraphs above, institutions are informal or formal rules and sites that constrain and guide human and political interactions in a society. To the extent that they can be measured in terms of stability, again, the socio-political stability, bureaucratic effectiveness and functionality of institutions is one of the most accurate ways to measure these factors and I have sought to capture that with this index.

Political Risk

There is a plethora of political risk indices to choose from. Again, most of these are done by for-profit consultants and firms that charge large sums for detailed data sets. Regardless, the PRS

Group's scores for political risk indices are some of the most widely cited and available (though limited in time-frame) without exorbitant fees. Their ICRG and PRS methodology is also extensively used among scholars and practitioners of risk, and while it has limitations that I take up in chapter 3, it is one of the available indices for risk ratings for all types of nations and allows users to modify risk components depending on the focus of analysis. In its calculation of risk, the index analyses a combination of factors. For our purposes, the aggregate PRS index for 2011-16 is utilized to model the aforementioned relationships.

2.4a) Panel Data, Model and Regression

A multiple regression analysis seeks to, theoretically, map relationships for correlative activity, and find out the degree to which a chosen dependent variable can be affected, and modeled, by the independent variables. In other words, the regression investigates how much data from a dependent variable can be explained by the independent variables, or changes to them. Panel data techniques augment the variability of the data and allow for greater degrees of freedom. Discovering the statistical significance of the selected measurable variables is important for this endeavor for a number of reasons: 1) it allows us to use new sets of data to shed light on whether or not these relationships have changed over time (in the recent 5 year recovery); 2) if there is a significant difference in the relationships based on type of and development of economy; 3) if political risks in developed economies are overlooked; and 4) if political risk should continue to be brought up in the conversation of FDI determinants. The results of the models below suggest that the analysis of political risk, especially in contested spaces in developed democracies, is more complex than simple relationships of data can describe.

The selected data is FDI as a percentage of GDP, a composite score of political/governmental (in)stability, made up of the PRS ratings of political stability and government effectiveness, and the requisite political risk ratings by the same agency. These data indicate the various relationships between these variables (independent and dependent) over a 5-year period, post financial crisis. The multiple regression tested all three variables in relation to one another, in separate observations, with all 18 economy statistics (A). Following this, the data was divided into developed (B) and developing economies (C), and the models were run again with one-to-one variable observations. Results for all three models and data can be found below in tables 2.1, 2.2 and 2.3. In order to test whether political stability and institutions affect FDI levels or political risk,[45] or the mitigating nature of political risk scores for FDI levels, stability, and vice-versa, a number of simple General Linear Model (GLM) tests were conducted using SAS. These tests aims to show whether or not relationships exist between the level of stability and FDI and risk ratings, or in other words, to determine the explanatory capability of the model, over time. This model was run using each variable, using the *P values* (number in brackets below) to determine statistical significance/probability of the occurrence in relation to the estimate of coefficient value (number above the brackets) –which has been determined to optimize the variable using that coefficient (the optimal model). The *R-squared* values shown establish how effective the model is in explaining the variable[46], or in other words, does the equation (models) below correlate with the variable in question? Finally, the *Prob>F* value is the result of the F test which essentially explains the strength of each model itself (akin to the P value

[45] Again, also a common hypothesis tested in the literature (Jensen 2008, Agbloyor et al. 2016, Goswami, 2014). This model is similar to previous studies (mentioned here and above) employed in this area of investigation.
[46] N.B. to find statistical significance, a P-value (#) closer to 0.0 means it is more significant and the cutoff is 0.05 (5%) for significance. Whereas for an R-squared value, the closer to 1.0, the more significant it is.

but for the entire model vs. a single variable within a model).[47] In this case, the parameter estimates allow us to try to form an equation to model the strength of the relationship through a mathematical plot as per below.

Models[48] & Results

A) All Types of Economies (18)

Model A1: $PSit = \alpha0 + \beta1(FDIit) + \beta2(PRSit) + \varepsilon it$ where $i = 1,\ldots,18$ and $t = 1,\ldots,5$

Model A2: $FDIit = \alpha0 + \beta2(PRSit) + \beta3(PSit) + \varepsilon it$ where $i = 1,\ldots,18$ and $t = 1,\ldots,5$

Model A3: $PRSit = \alpha0 + \beta1(FDIit) + \beta3(PSit) + \varepsilon it$ where $i = 1,\ldots,18$ and $t = 1,\ldots,5$

Table 2.1: Statistical Results – Developed and Developing Nations (18 total)[49]

	Model A1: PS	Model A2: FDI	Model A3: PRS
β_1: FDI	-0.67874		0.630822**
	(0.1757)		(0.0418)
β_2: PRS	1.461773***	0.074147**	
	(<0.0001)	(0.0418)	
β_3: PS		-0.0309	0.566097***
		(0.1757)	(<0.0001)
α_0: Constant	-0.39186***	-0.0135	0.344906***
	(<0.0001)	(0.3467)	(<0.0001)
Diagnostics			
No. of obs	90	90	90
No. of groups	2	2	2
F	212.89	1.59	219.83
Prob > F	<0.0001	0.2150	<0.0001
R-square	0.83033	0.0624	0.834805
MSE	0.044	0.0002	0.0017
Root MSE	0.0666	0.0142	0.0414

[47] In regression models, a low P value / high R-squared combination indicates that changes in the predictors are related to changes in the response variable, meaning that the formula/model explains a lot of the response variability and can act as a guide to understanding the relationship.

[48] Where α is the constant, β is the coefficient of the variable, (i) represents the countries sampled, (t) represents the year (5 measured). FDI represents net inflows of FDI scaled by GDP. PS and PRS represents composite political stability ratings and political risk scores as per definitions and explanations above.

[49] In these tables, ***, **, *represents significance at 1% (0.01), 5% (0.05), and 10% (0.1), respectively for P values. MSE represents the Mean Squared Error value. Root MSE represents the root of the mean squared error value.

B) Developed Economies Subsample (9)

Model B1: $PS_{it} = \alpha_0 + \beta_1(FDI_{it}) + \beta_2(PRS_{it}) + \varepsilon_{it}$ where i = 1,…,9 and t = 1,…,5

Model B2: $FDI_{it} = \alpha_0 + \beta_2(PRS_{it}) + \beta_3(PS_{it}) + \varepsilon_{it}$ where i = 1,…,9 and t = 1,…,5

Model B3: $PRS_{it} = \alpha_0 + \beta_1(FDI_{it}) + \beta_3(PS_{it}) + \varepsilon_{it}$ where i = 1,…,9 and t = 1,…,5

Table 2.2: Statistical Results – Developed Nations (9)

	Model B1: PS	Model B2: FDI	Model B3: PRS
β_1: FDI	-0.09161		0.339547
	(0.8367)		(0.2639)
β_2: PRS	1.211008***	0.087235	
	(<0.0001)	(0.2639)	
β_3: PS		-0.01117	0.574711***
		(0.8367)	(<0.0001)
α_0: Constant	-0.17711*	-0.04168	0.344187***
	(0.0813)	(0.2447)	(<0.0001)
Diagnostics			
No. of obs	45	45	45
No. of groups	2	2	2
F	51.12	1.59	53.24
Prob > F	<0.0001	0.2150	<0.0001
R-square	0.7088	0.0706	0.7171
MSE	0.0026	0.0003	0.0012
Root MSE	0.0510	0.0178	0.0352

C) Developing Economies Subsample (9)

Model C1: $PS_{it} = \alpha_0 + \beta_1(FDI_{it}) + \beta_2(PRS_{it}) + \varepsilon_{it}$ where i = 10,…,18 and t = 1,…,5

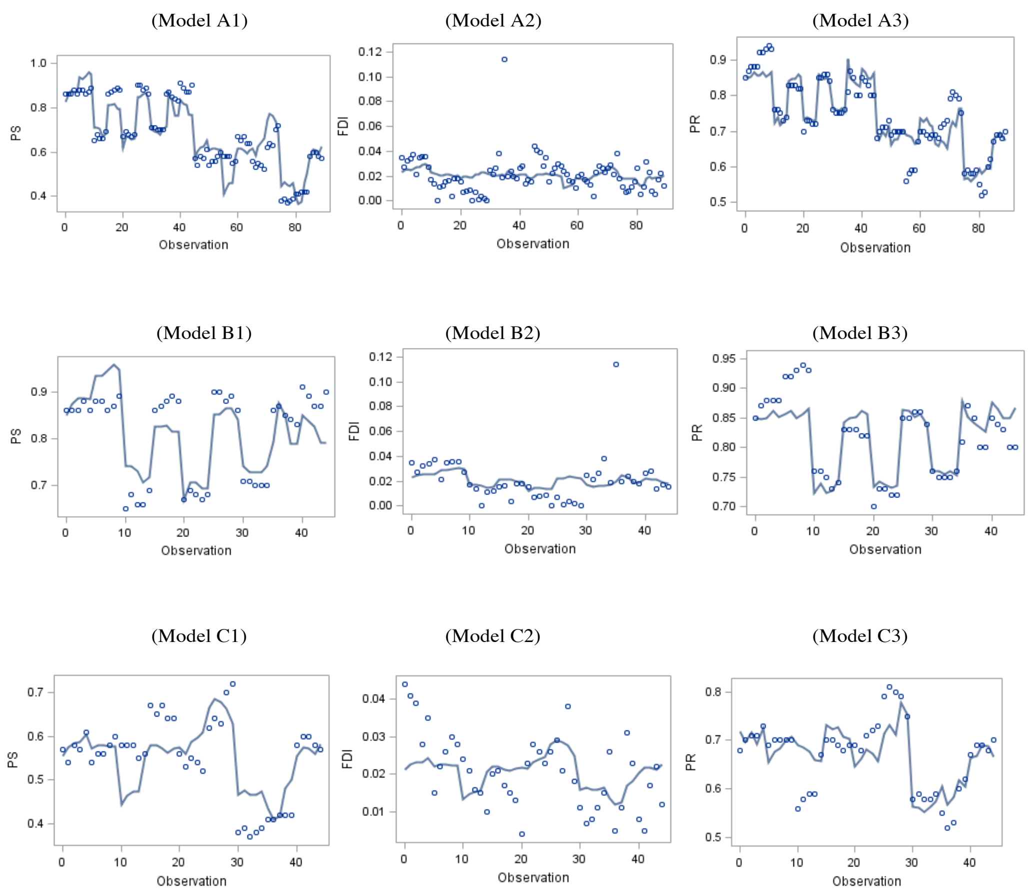
Model C2: $FDI_{it} = \alpha_0 + \beta_2(PRS_{it}) + \beta_3(PS_{it}) + \varepsilon_{it}$ where i = 10,…,18 and t = 1,…,5

Model C3: $PRS_{it} = \alpha_0 + \beta_1(FDI_{it}) + \beta_3(PS_{it}) + \varepsilon_{it}$ where i = 10,…,18 and t = 1,…,5

Table 2.3: Statistical Results – Developing Nations (9)

	Model C1: PS	Model C2: FDI	Model C3: PRS
β_1: FDI	-0.27121		1.666323**
	(0.7997)		(0.0299)
β_2: PRS	0.968397***	0.06442**	
	(<0.0001)	(0.0299)	
β_3: PS		-0.00571	0.5276***
		(0.7997)	(<0.0001)
α_0: Constant	-0.09215	-0.01934	0.344906***
	(0.3176)	(0.1457)	(<0.0001)
Diagnostics			
No. of obs	45	45	45
No. of groups	2	2	2
F	26.03	4.77	31.60
Prob > F	<0.0001	0.0136	<0.0001
R-square	0.5534	0.18506	0.6008
MSE	0.0040	0.0001	0.0022
Root MSE	0.0634	0.0092	0.0468

Figure 2.1: Fit[50] Diagnostic Results for all Models



[50] These graphs are representative of the fit of the models as per variables measured. What this means is the closer the fitted line follows the data points, the better predictive capacity that model has; hence, the stronger the explanatory relationship.

The results above suggest a number of interesting findings. When pooled together, the selection of all types of economies (Model A) indicate that there is relative strength in the explanatory capability of Political Risk Rankings and Political/Institutional Stability scores vis-à-vis one another. As could be predicted, FDI levels are not adequate explanatory variables for changes in stability scores, and the results above show that. By focusing more narrowly on the relationships surrounding political stability (A1), we find that there is statistical explanatory power overall, but this can be explained by the overwhelmingly strong relation between stability and risk scores. In fact, the relation between stability and FDI does not have explanatory value, while the relationship between risk scores and FDI exists, but is limited to below the 5% significance. The clear connection between risk and stability is consistent with the assumption (and results of other tests[51]) that political stability is one of the main components of any political risk analysis model, and usually is the pivotal factor that heavily affects all other variables, as is the case for this model.

When dividing the data by economy type (Models B and C) we find similar overall results, but with palpable differences in relational specificity of the variables. When controlling for Developed economies alone (Model B), again the relative strength in the explanatory capability of Political Risk Rankings and Political/Institutional Stability scores vis-à-vis one another is significant, but they do not have a significant relationship with FDI levels. For standalone Developing economies (Model C), results of the tests again demonstrate that Political Risk Rankings and Political/Institutional Stability scores are strongly correlated (P-values <1%). However, in contrast to the developed economy scores, the relationship between FDI and risk scores for this group is significant at roughly 2%. This indicates that in the overall tests above

[51] See, e.g. Jensen (2003, 2008); Agbloyor et al., 2016; Jadhav, 2012

(Model A), the existing relationship between risk scores and FDI levels can be best explained by the stronger correlative activity of the two in developing nations. This leads to a number of key points:

- political risk scores take into consideration the level of institutional and political stability to a degree that is far more important than FDI;
- better FDI outcomes can be achieved by positive risk scores in large developing economies, but not necessarily in large developed ones;
- stability and FDI do not have a direct significant relationship in this case;
- there is an overwhelmingly positive relationship between stability and risk in all types of economies.

Ultimately, the most significant outcome of these tests (corroborating previous ones) is that institutions do play a direct role in enhancing stability and achieving positive risk scores, and hence, the key attributes of institutional quality and political stability should be considered in the evaluation of political risk scores. Finally the relationship between risk scores and FDI in developed economies does not appear to be significant whereas in developing economies it is. This means that while overall trends in the data show strong relationships, they do not hold in the same way when controlling for type of economy. It also underlines the importance of a key variable of political risk: stability. Yet, one of the main purposes of political risk (PRS) analysis is to assess the stability (PS) of potential investments in a given economy (FDI), and the models above aim to capture that. But again, the results demonstrate that we ought to take a more thorough look at differentiating between developed and developing economies.

This brings up a number of issues that exemplify the shortcomings of simple data analysis of complex topics such as these. One, restrictions on availability and type of data, in addition to the number of total observations, can limit the significance of blanket statements of significance or not. While the P-values may show significance for the explanatory power of risk and stability scores across types of economies, the R-squared values are stronger (closer to 1) for developed economies than they are for developing ones by 10%. This discrepancy can cloud the inherently specific details of both risk analysis and evaluations of political or institutional stability at large. As I seek to demonstrate throughout this dissertation, indicators of stability or quality of political institutions and policies that are of clear importance to risk analysis can be broken down into many factors (corruption, effectiveness, government turnover, policy and regulatory clarity, rule of law, accountability, etc.). Identifying statistical relationships is indeed important and should be a potential first step, but it detracts from the qualitative nature, and essential case-by-case intricacies that economies and institutions maintain, and this is especially relevant for the complexities of developed democratic regimes that have seemed otherwise 'stable' for years.

Previous studies mentioned above have found that political and institutional determinants are positively related to FDI inflows in developing economies such as the BRICS (Jadhav and Katti, 2013), and results of the tests above concur that FDI and growth outcomes could be achieved by better risk scores in the same group. But the reality for large, developed economies is seemingly more complex than that, and requires deeper investigation. One way to begin doing so is to test the model by extrapolating on a case-by-case basis. The previous chapter explained why Italy as a particular case for risk analysis should be studied. Here, we can try to run the same regression using only the Italian data to determine whether or not Italy fits the line of the developed economy model. Using the same equations as the models above, the results below imply that Italy is indeed an outlier.

D) Italy Standalone Subsample (1)

Model D1: $PSt = \alpha 0 + \beta 1(FDIt) + \beta 2(PRSt) + \varepsilon t$ where $t = 1, \ldots, 5$

Model D2: $FDIt = \alpha 0 + \beta 2(PRSt) + \beta 3(PSt) + \varepsilon t$ where $t = 1, \ldots, 5$

Model D3: $PRSt = \alpha 0 + \beta 1(FDIt) + \beta 3(PSt) + \varepsilon t$ where $t = 1, \ldots, 5$

Table 2.4: Statistical Results – Italy

	Model D1: PS	Model D2: FDI	Model D3: PRS
β_1: FDI	-0.21992		-0.60811
	(0.8304)		(0.6649)
β_2: PRS	0.44502	-0.18462	
	(0.3772)	(0.6649)	
β_3: PS		-0.13077	0.87162
		(0.8304)	(0.3772)
α_0: Constant	0.35930	0.22938	0.13378
	(0.3394)	(0.4531)	(0.8242)
Diagnostics			
No. of obs	5	5	5
F	1.22	0.53	1.43
Prob > F	0.4509	0.6540	0.4122
R-square	0.5491	0.3460	0.5878
Adjusted R-square	0.0981	-0.3080	0.1757

In this case, there do not appear to be significant relationships among the selected variables. Both *R-squared* and *P-values* for this data are far less significant than those found in Model B. There does not seem to be a correlation between with stability and risk scores, nor with FDI. These surprising findings are clearly limited by the small amount of data utilized, and the few variables sampled. However, they also warrant a more specific type of qualitative institutional analysis that speaks to the variability of risk and stability assessments that challenge our assumptions of risk analysis in general.

The main aim of this exploratory quantitative analysis was to determine the explanatory significance of FDI, risk, and stability through their relationships with one another, and vis-a-vis different types of economies. The results of these basic regression models leads us to examine in a more detailed and qualitative fashion, the conditions under which factors of political risk are enabled, and how they are monitored, assessed, and incorporated into risk analyses. In doing so, we can draw conclusions as to the ways in which institutional quality and stability can affect political risk, while simultaneously laying out an approach to the application of risk analysis to different types of economies and societies.

Many academic and industry studies on political risk and its importance to institutions and growth have been conducted to reveal both similar and opposing results. The methods used by risk practitioners are varied and complex, but are they sufficiently detailed in their analyses of the policies, politics, and societies that underpin the investment climate? Recent political-economic shocks and failures in forecasting in the West as mentioned in Chapter 1 cast some doubt on the professional classes' predictive capacities, especially vis-à-vis stable developed economies. One way to reconcile this is to probe the expert opinions of investors and industry-players involved in the realm of foreign direct investment assistance, assessment, and promotion, and analyze them through a framework of political risk. I suggest that the political-institutional basis of policy, regulation, investment attraction and stability are integral parts of political risk analysis that can capture relevant factors in detail whether they are political, economic or regulatory, or social in nature. The next chapter seeks to clarify how to better approach this challenge.

CHAPTER III - *Contemporary Political Risk Analysis: Making Sense of Competing Approaches and Searching for New Ones*

"Risk is the true nature of business growth." Wayne Barrow

This chapter picks up on one of the *problematiques* that surrounds the political risk industry – that is, the interdisciplinary nature of political, social and economic forms of risk, how firms determine the variables that are used in the assessment of risk, and how they evaluate and weigh them. In investigating what drives contemporary political risk analysis (PRA), I explain what the different types of macro-analyses are, and what their respective goals are. This is followed by some insights into the insurance industry, and how such risks are determined by various private and public risk practitioners employing a perspective of risk factors, indices/rankings of stability and competitiveness. The objectives of this chapter are to: a) provide an overall outline of political-economic risk methodologies, rankings, industries and aims; b) in doing so, to critically engage with these forms of risk analyses in an effort to expand upon current understandings, and set out to differentiate between risk analysis for developed and developing economies, by c) suggesting new tools for a hybrid, criteria-based perspective. This distinction lays the foundation for the approach I use for the Italian case that follows in Chapters 4/5.

This section is based on literature and primary sources of data that detail and compare types of risk analysis, methodologies, delineated perils, risk mitigation strategies, and forecasting understandings of what could be termed the tripartite industries that conduct political and country risk analysis: Political Risk Insurance (PRI); consultants and stand-alone political/country risk firms; and public/private and multilateral providers of political risk services such as Export Credit Agencies (ECAs), MIGA, OPIC, etc. Data and information are derived from primary fieldwork interviews and communications with experts in the industries, in addition to primary documents and policy guidelines outlining respective methodologies, risk perils, rankings, etc. that are publicly (and/or privately) available. I also include a brief literature review of the small body of secondary academic sources that have discussed political risk analysis and methodologies over the past few decades.

As mentioned in the first two chapters, political risk is a somewhat ambiguous and broadly understood term that can be defined as the potential for uncertainty and harm to business-economic operations that arise from political (governmental and other) behaviours (Zonis et al. 2011). These risks typically arise from national factors such as economic structures, policies, institutions and unique societal characteristics (Meldrum, 2000), and are increasingly becoming a greater concern to prospective investors and governments. Indeed, political risks may resemble political uncertainties, which can be further dichotomized in terms of quantitative and qualitative understandings (Paudyn, 2013).

The ways in which political risks manifest themselves depend on many factors: macro-area, sub-region, industry, players, government relationships, and a host of institutional and societal characteristics. What this means is that political risk should be understood as a 'fuzzy concept' (Sottilotta, 2017), insofar as its conceptual boundaries have fluctuated since the post-war period, throughout the Cold War, and into the 21st century. Similarly, some experts in the field believe that the concept of political risk is too narrowly defined, when in fact it is intertwined with a multitude of factors: "given the transition from investment by major firms to individual investors/crowd-funding/etc., and the extent to which political risk issues can affect tourism (currency, security, tech issues, etc.), it is not just the typical investor who needs political risk insight. It is both large scale and individual investors, individuals running small businesses, NGOs/NGO workers, tourists, rock-stars, students studying abroad, etc."[52] The popularity of risk analysis was buoyed by real estate speculation, complex investment vehicles, and bank deregulation that preceded the crash of 2008, and the ensuing financial crisis. And so the actual *analytical* aspect of risk has grown to include a wide range of economic, social and political considerations, given the multi-disciplinary and entrepreneurial spirit of the industry, combined with the changing nature of geopolitics today.

Sovereign risk ratings (which have their own well-examined methods, agencies, and scholarship) deal more specifically with aspects of government debt, but also overlap with attributes of political risk. Unlike the function of credit rating agencies (CRAs), which essentially evaluate the ability and inclination of a sovereign government to service its debt obligations, the purpose of political risk analysis is to provide information about the country and industry, and determine the probability that political events and conditions therein will, or will not, affect the profitability of potential investments and business opportunities. Importantly, while cross-border investments and mergers and acquisitions (M & A) decreased in the aftermath of the crisis, there was not the same type of scrutiny employed by the public on political risk analysts as there was on CRAs. The latter's decisions to downgrade sovereign ratings, and the role they played in the speculative processes that undermined tertiary and mortgage markets, facilitated the distrust of financial rating institutions and their relationship to the state and its citizens. Political risk, which deals with private entities, and does not precipitate national bond rating changes, was spared the negative coverage that CRAs endured, and was left to its own devices to grow as an industry. Hence the academic attention to political risk analysis and agencies, though currently on the rise, has been rather limited, especially compared to other topics on global sovereign risk.

[52] Interview #13

It should also be noted that the government-financial markets connections have been approached in a myriad of ways. Specifically on sovereign risk, credit rating agencies and their relative 'independence' from regulators (Mattarocci, 2014) have been rigorously analyzed, as have the politics of 'creditworthiness' and the contentious role and power that rating agencies wield (Sinclair 2005, Paudyn 2013, 2014). But these avenues of research have been popular for many years, and, while important, are not the main focus of this discussion. The following sections elaborate the differences and similarities laid out above on political risk techniques in more detail based on primary data from fieldwork, and available methodologies and secondary academic sources.

3.1. Types of, and Variability in, Political Risk Assessments

We look at the political environment of an industry as an arena in which diverse stakeholders pursue their vested interests. By knowing how political risks are interconnected and dynamically change, we help our clients to navigate competitive political environments on both national and local levels. (Berlin Risk, 2015)

This type of claim is indicative of the larger trend in contemporary political risk analysis; that investors ought to seek the advice of specialized political risk consultants and firms who are experts in many industries and areas. The reality is however, much more complex in the private world of commercial political risk which often falls under the radar of public debate. Methodological disputes are common in the industry between qualitative and quantitative methods. Over-reliance on experts might produce biased or arbitrary assessments, but dependence on macro-indices and big-data and model forecasting can be equally problematic in that it will not provide comprehensive analysis of underlying social factors and the inherent cultural differences in acceptable business practices. The micro-side of political risk analysis also complicates the assessment strategies given the large number of industries and companies involved. Such micro-political risks may be different for large MNCs compared to a local financing bank, for a security management company versus a mining exploration firm, or for a SME looking to export abroad, or even a branch of government.[53] Nonetheless, political sources of risk are important factors to consider for many large and powerful corporations and governments, and an elaboration of the government-investor relationship is paramount for a proper understanding of how the industry works.

Akin to the larger debates in comparative politics in general, there is often disagreement on the fundamental character of risk analysis methodology insofar as quantitative models and qualitative information is concerned. Classical 'country scores', maps, or index scales that are driven by mathematical models rely on aggregate comparative data, and are often seen as more 'rigorous' than the subjective nature of expert weighting (Davidoff, 2017). Yet the differences are more nuanced than such a simplistic comparison suggests. Consider what Bouchet et al. describe as the major difference in the quantitative and qualitative divide surrounding risk analysis:

> Qualitative analysis refers to the evaluation of the economic, financial and socio-political fundamentals that can affect investment return prospects in a foreign country. Instead of focusing on a range of ratios, ratings or indices that are supposed to "reduce" a complex situation into one single figure, the qualitative analysis aims at tackling the structures of a country's development process, to shed light on the underlying strengths and weaknesses. Usually, a robust qualitative approach leads to comprehensive country risk reports that deal with the following elements: (i) the social and welfare dimension of the development strategy; (ii) macroeconomic fundamentals; (iii) evolution, structure and burden of external indebtedness; (iv) the situation of the domestic financial system; (v) assessment of the governance and transparency issues; and (vi) evaluation of political stability (2003, 5).

[53] Interviews 1, 2

This relates to what was outlined in Chapter 2 regarding the development process and inclusive institutional feedback mechanisms for economic growth. What is needed is some kind of combination of qualitative detail and quantitative ranking, appeasing investors' numerical needs, yet giving them sound descriptive and analytical evaluation as well. It should go without saying that the two methods are not mutually exclusive, yet are infrequently found in popular contemporary analyses.

Paralleling this development, scholars have shown the complexity and variation in political risks by demonstrating their differentiation into micro and macro risks, i.e. those affecting only certain sectors, and those disturbing all foreign firms in a country (Robock 1971); or internal and external risks, i.e. risks that originate in local political action and risk that is more transnational in nature (Alon and Herbert, 2009). Related to this is the commonly used 'variable' framework, which has currency among the different providers of risk services and their respective indices and rankings, although the differences in factor weighting, modeling projections, and other methodological considerations can be quite significant. Each private study or risk analysis service selects its own variables and factors to be examined, and there is not much consensus in either of the literatures on what those exact 'risk dimensions' should be each time. Of course, this is a natural discrepancy, while at the same time it produces significant overlap. Yet the competitive nature of the business, complex requirements of individual firms, and the lack of a grand theory or methodology facilitate a certain exclusivity of each political risk approach with different analytical criteria and modeling tactics. There are a variety of companies, consultancies and 'risk providers' with opposing (and complementary) methodologies behind the assessments, that may include binary qualitative and quantitative methods ranging from multivariate analyses, Delphi techniques, to 'grand tour' fieldwork practices that exist in opposition to one another, and seldom 'communicate' effectively.[54] Undoubtedly, a host of contemporary political risk firms, insurance companies, and public assessments of investment determinants use similar strategies, most often via forecasting (i.e. PRS/ICRG, Berlin Risk, Coface, Eurasia Group, Aon Risk Services, etc.). These are necessary, accessible, and relevant tools that the average investor or business ought to consult before venturing into a foreign business environment. On the whole, notes Howell:

> Political risk analysis is provided for managers to assist them in making choices about protective or compensating actions. A political risk index calculated as a combination of all sources of political risk does neither. The combined indices of most commercial political risk products in fact hide both the specific sources of risk and the likely measure to be taken by the investor or manager. What we need are separate indices for each managerial decision (2014, 314).

The separate 'indices' idea by industry, type of risk, etc. has currency and many commercial providers of risk services have responded accordingly with a grab-bag of risk indices. There are dozens of definitions, and there is much variability in the categories and theories of political risk which range from country risk, financial/transfer risk, operational risk, 'interference' and ownership risk, to simply governmental and policy risk. Understandings of such risks often overlap and coincide, depending on the assessment and methodology.

The goal of this dissertation is not to conclude which approach or method works best, and which does not. Rather, it is to underscore the importance of the degree of variability in the practice, and to urge interested followers of political risk to understand that there ought to be multiple, flexible ways to assess political risk depending on the country and type of economy to be examined. Most fundamentally, political risk ought to include the assessment of a level of trust and continuity in the institutional (governmental) setting, or more generally, be able to forecast a level of political-economic stability for the interested firm's prospective financial

[54] For a description of these various methodologies and techniques, see Rummell and Heenan's (1978) article on the shortcomings of risk analysis.

interests. Many important questions come to mind from these assessment outlines and risk-variable choices, none more so than *how? Which specific factors are classified as political risks, or political risk perils? Which perils can be 'insured' and why, and does this accurately represent 'true' political risk?* The answers are not always clear from the many diverse risk appraisal techniques that are available to potential investors or curious academics alike. What is certain however, is that the complex and interdependent nature of the factors being analyzed are difficult to define and quantify, especially when taking into account differences in industries. Moreover, the quantification of these political realities is often uncertain and subject to rapid changes via deteriorating geo-political environments.

As an example, we can turn to consultants and boutique risk firms such PRS Group's[55] political risk assessments, derived from the Coplin-O'Leary risk rating system, which considers short (18 months) and medium (5 year) term risk factors. Broadly, it forecasts political risk for investors in two steps: first, isolating the three most likely future 'regime' scenarios for the chosen country; and second, allocating a probability to each scenario over the time periods: "For each regime scenario, PRS's experts then establish likely changes in the level of political turmoil and 11 types of government intervention that affect the business climate." The scores are then amassed and calculated for the country, and are converted into common agency rating-type letter grades (PRS Group 2014b).[56] There are twelve factors considered for the 18 month period: political turmoil, equity restrictions, operations restrictions, taxation discrimination, repatriation restrictions, exchange controls, tariff barriers, import barriers, other barrier payment delays, fiscal and monetary expansion, labour policies, and foreign debt. Four more are added for the five-year

[55]As one of the more commonly cited types of assessment, the PRS system is a good and typical example of how political risk is carried out, though not without valid criticism. For a critique on the PRS model and other ratings, see Linden and Santiso (2003).
[56] See PRS Group's Political Risk 'factors' and its ICRG country risk 'components' at https://www.prsgroup.com/about-us/our-two-methodologies/icrg. Also note the overlap in factors between the two.

forecast perspective: investment restrictions, trade restrictions, domestic economic problems, international economic problems (Howell 2001, 307-8). To assess current political risks in a general *country-risk* assessment, the PRS/ICRG system rates 'weighted components (points)' adding up to a total scale of 100: government stability (12), socioeconomic conditions (12), investment profile (12), internal conflict (12), external conflict (12), corruption (6), military in politics (6), religious tensions (6), law and order (6), ethnic tensions (6), democratic accountability (6), bureaucracy quality (4). (Howell 2001, 24-25). The normative basis and selection criteria of these factors are debatable, but in essence these indicators lead to an evaluation of political-economic 'stability' in a Western, liberal sense that accentuates private property and the freedom of capital and resources. This sort of 'pro-investment climate' perspective I outlined in chapter 2, as espoused by institutions such as the World Bank (and countless free-market think tanks), is not specific to the analysis of political risk, but is well founded in literature on late-stage development in the global south.

From a related starting point, Brink (2004) created a very detailed model to analyze political risk, defining and separating each variable, and giving analysts flexibility in their selection of risk factors, and eventual weightings, which furthermore are dependent on their specific needs. The model is based on three overarching dimensions of risk: 'political', 'economic', and 'social' (each containing dozens of sub-indicators). Other private, multilateral and NGO assessments contain differing degrees of specificity of political risk variables, some preferring very generalized indicators like 'political stability' or 'social unrest' (see others, e.g., OECD, EIU, BERI, Moody's, Eurasia Group), many of which are based on subjective weighting and country-experts. The table (3.1) below shows a selection of political risk variables and/or components that are often used by major players in the industry, divided into a typology I created based on academic and practical factors used in current Political Risk Analysis (PRS, EIU, IHS, OPIC, EDC, MIGA, Marsh, 2015-16). The organization of the types of risk categories was divided based on the author's elaboration of said literature and major themes derived from primary source interviews.

Table 3.1: Sources, Types and Variability of Political Risks[57]

Internal/Domestic Political	Institutional/ Regulatory	External/Global	Social	Economic/Financial	Insurable/Recoverable
Labour market	Bureaucracy Quality	Macro Economic Crises	Ethnic Tension	Budgetary/Debt Concerns	Confiscation
Electoral Issues	Legal System	Multilateral influence	Religious Tension	Investment climate	Expropriation
Government Policy Intrusion	Infrastructure	War	Civil Disturbance	Equity Restrictions	Nationalization
Democratic Accountability	Government stability	Environmental Issues	Regional Violence	Trade Barriers	Currency Inconvertibility
Military Rule	Government Effectiveness		Nationalism	Monetary policy	Non-payment (gov't)
Political Turmoil	Investment Policy		Corruption	Regulatory Regime	Political Violence/Terrorism
Domestic Terrorism	Continuity		Locational	Import/Export Disruptions	Contract Frustration
				Socio-economic conditions	Forced Abandonment
				Balance of payments	Deprivation
				Sovereign risk	Physical Damage
					Property/Casualty/Surety related

This table incorporates a host of potential risk factors that are utilized across the industry. By virtue of the variability and overlap in causes of risk, it demonstrates the difficulty that firms face in deciding which ones to analyze first, or to 'weigh'. Popular risk analyses and scores have to be selective about their choices of variables to score, and this often leads to generalization. Still, there is a large breadth of services and products offered under the umbrella of political risk firms

[57] Note that many of these risk factors can be broken down further, depending on the PR firm doing the actual assessment or providing insurance. Source: PRS, EIU, IHS, OPIC, EDC, BERI, MIGA, Marsh, 2015-16, Interviews, 2015-16.

which include pre-investment due diligence like market entry and regulatory analysis; general country and geo-political assessments; macroeconomic and security risk analysis; PRI brokerage and consulting services; and more generally, dispute resolution and arbitration, crisis management, media training, risk management audits, expert witness, portfolio management, corporate investigations and litigation support, and even the training for country risk management.[58] A related issue revolves around the types of risk factors that companies could be exposed to, and the difficulties that external risk consultants or firms face in delineating the proper variables that the client might be interested in.

Often a client/investor will have a 'profile' of risk needs in mind in order to explain their tolerance to supposed risks which depend on industry, firm-type, and geographical location. In this sense, according to an expert, political risk consultants or external firms would be at a disadvantage compared to internal risk management departments of the actual company doing the investment. This is because consultants often lack the level of insight of a client's operations to truly understand their needs. External teams naturally rely on what clients tell them, and clients might not know what is and is not important to include in terms of their needs. In order to truly understand political risk exposure for a specific investment, there needs to be attention to detail and trust in the process. Consultants and risk firms employ similar assessment strategies to insurance companies, and are often used in conjunction with internal and PRI evaluations. At a minimum, the *right* questions need to be posed to the client, to outline the various factors, layers of exposure and other issues to examine such as market-entry factors, security assessments, regulatory/legal matters, etc. when conducting the risk analysis.[59] The next section moves from these consultative aspects to analyze the important ways in which insurance plays a role in

[58] Country Risk Solutions http://www.countryrisksolutions.com/about.html; Berlin Risk, 2017; Interviews 9-11.
[59] Interview #13

assessing and pricing risk, and at the same time creates a market for the very work consultants and risk firms perform.

3.2. The World of Political Risk Insurance

The Lloyds Insurance market, where live broking and underwriting occurs in 'the box' trading hours, is a microcosm of the greater insurance world. Observing the pace and practice of underwriters allowed me to gain valuable insights into how the process of placing PRI works. A hypothetical example of how actual PRI can work was given to me by a Senior Underwriter in the middle of trading hours: If a broker brings to a PRI underwriter an inquiry sheet or non-binding indication (NBI) [which is basically a statement of interest on behalf of a client (often a bank, investor, creditor)], for a project or financing in somewhere like Bolivia, the outcome is almost guaranteed: the underwriter will not be interested in even looking at the request, because of Bolivia's recent history of confiscations and nationalizations. It is almost uninsurable for those types of perils, nearly market-wide.[60]

The Political Risk Insurance (PRI) Industry is a niche market within the wider, and increasingly important, global insurance industry. There is increased excitement in much of the insurance world, as companies and underwriters deepen their appetites for placing PRI.[61] But as the above observational passage illustrates, the process of insuring political risk takes into account a number of interesting factors which I depict below. From another perspective, Roger Moody claims that PRI can and often should be regarded not so much as an insurance instrument, but more as a 'political tool' used to maintain a project's profitability (2005, 7). In essence, the argument claims that political risk insurance allows firms to remain in a 'risky' business environment for longer than they would normally attempt to, especially those that are risk-averse, and thus facilitating the longevity of the host regime. But that is not necessarily the viewpoint of actual players and stakeholders in the current PRI industry. The complex world of PRI can, in a general sense, be divided among public (national) and multilateral providers of insurance in the form of ECAs and multilateral providers like MIGA, the private market of primary insurers

[60] Passage paraphrased from field-notes, Interview #5
[61] Interviews # 11, 12, 19.

(Lloyds Syndicates and US-based Insurers), and the private reinsurance market that supports both ECAs and private insurers. It is important to note that, as with most insurance policies, the specific policy wording in a PRI policy determines coverage of certain risks and perils, and is not all-encompassing. This is why it is important to delineate the different types of coverage available, and how the PRI coverage is structured in the more general environment of insurance. As I noted above, confiscation, expropriation, nationalization and deprivation (CEND) are some of the more common types of available coverage. More specific ones could include Regulatory Risk, Political Violence/Terrorism, and additional specialty products, if available, but this depends on the private insurance policy.

A point worth noting is that insurers and lenders are often indirectly 'investing' in foreign markets through capital, loan or other financial instruments, and so their risks are somewhat limited to political developments that negatively affect the businesses of their clients or policy holders operating in a country, and/or to events that precipitate a claim/loss (Baas, 2010). This partially explains why most PRI coverage is limited to factors such as CEND, or violence/terrorism. The methodological approaches to assessing political risk on part of insurers is thus more limited in scope than some other PRA firms or boutique consultancies. Finally, these classes of insurance have not historically applied to developed industrial democracies, which lends to the necessity of filling that gap.

3.2a) Export Credit Agencies (ECAs): National and Multi-lateral Support

Multilateral financial institutions and other regional and governmental players aim to mobilize and support capital for businesses seeking to expand abroad, but also have larger geo-political and macro-economic goals. For example, the Overseas Private Investment Corporation

(OPIC) is a powerful consortium that provides businesses with the tools "to manage the risks associated with foreign direct investment, to foster economic development in emerging market countries…", yet it also advances US and allied foreign policy and security goals. It facilitates "footholds into new markets, catalyzes new revenues and contributes to jobs and growth opportunities both at home and abroad", through financing, PRI, advocacy and partnership affiliation (OPIC, 2017). This can be understood in basic economic terms as simply financial assistance and protection for investments abroad, or in political-economic terms that suggest a greater underlying message: that of conditionality[62]. Structural Adjustment policies, liberalization reforms, and other 'strings attached' are common (and contentious) attributes of foreign aid and development, but can also be tied to private investment deals. In this sense, the multilateral agencies seek to ensure that free-market, pro-investment principles are instilled worldwide, by offering political risk insurance and assessments to protect predominantly American firms abroad. OPIC's financial services claim to mitigate 'improper host government interference', as if foreign jurisdictions are directly subject to multinational firms' needs.

A related strategy is to "promote foreign direct investment into developing countries to help support economic growth, reduce poverty, and improve people's lives," by means of guaranteeing investments there, via, inter alia, political risk insurance products underwritten by the Multilateral Investment Guarantee Agency (MIGA, 2017). The agency acknowledges that its goal is to increase free-flowing global FDI (one of the main tenets of globalization) through risk assessment strategies and products. Given the power of market-based globalization today, it is thus in a state's interest to achieve such economic 'integrity', specifically by adhering to liberal

[62] On issues related to development assistance and conditionality in foreign investment and aid, see also: Svensson, 2000; Nelson, 1996.

macroeconomic policy consistency. Consider this excerpt from a MIGA periodical by Moran and West (2005), as a case in point:

> MIGA's objective is to facilitate the flow of foreign direct investment to developing countries by alleviating investors' concerns about non-commercial risks. MIGA has always pursued this objective in a variety of ways. In addition to providing political risk insurance to investors and offering technical assistance in attracting investment to host member countries, MIGA has selectively sponsored research on…risk (ix).

These realities indirectly facilitate the expansion of pro-investment climates and regulatory regimes across borders, and work as a form of conditionality. This is similar to the subtle activities of the World Bank and IMF more generally, as recounted by Gill (2003) in Ch. 2. Still, the reality is that favourable political risk assessments conducted by organizations such as these can assure that the state being measured is considered politically credible and stable for investment on a global scale. More importantly, this can at the very least facilitate investment and economic growth, of which many countries are in dire need. There are of course many valid arguments against liberalization and de-regulation policies that are supported and mandated by multilateral regimes like the WB in developing nations, and many development and post-colonial scholars have taken these up in a number of contexts elsewhere.

Moving to the technical aspects of these agencies, one of their main purposes is to provide support and coverage for political risks. As such, MIGA's system identifies eight main sources of risk: transfer and convertibility restrictions, expropriation, breach of contract, non-honouring of sovereign financial obligations, terrorism, war, civil disturbance, other adverse regulatory risks (2011, 21), which are common attributes of emerging economies. The prevailing methodology is quite similar to some of the others mentioned here. According to an expert in the field[63]:

[63] Interview #14

> MIGA utilizes an economic capital model to calculate expected and unexpected losses for pricing. Claim probabilities corresponding to a rating category and recovery assumptions used in MIGA's risk and pricing models consider the loss experience of MIGA as well as peers (MIGA is a member of the Berne Union, which collects data from its members). The claim probability model parameters are further refined with the help of "peril models" (econometric scoring models) that utilize economic data and data for political risk events over multiple decades. Examples include a country's GDP, external debt level, and interest rates, etc.

Again, part of the main focus is on historical experience of the insured in the country, including claims and loss history. Additionally, there are many determining factors and sources of information to rely upon when pricing and underwriting coverage, as used by MIGA, such as: overall host country rating on political risk; honouring of financial obligations; tenor of guarantee; coverage amount; reinsurance market capacity; the cover type and amount; and other market benchmarks. In sum, multiple covers command higher premiums.[64]

National Export Credit Agencies such as EDC, SACE, EX-IM, ONDD, etc., provide similar services, but they offer support for domestic firms and advance national strategies as government agencies. According to EDC, a provider of PRI, political risks have caused losses to one in three investors in the forms of breach of contract, civil disturbance, transfer restrictions or expropriations. Likewise, investors in emerging markets, which make up the majority of PRI coverage, are most concerned about a number of political risks common to the industry[65]. It is again evident that first, there is significantly variability in what constitutes an actual political risk (or peril), second, what peril can actually be insured vs. non-insurability, and third, the actual 'political' nature of these factors. Similar to rating agencies, ECAs provide a basic sovereign rating and commercial country ceiling. They also rate insurable aspects like political violence, expropriation, and transfer/convertibility risk. Therefore, notes an ECA specialist, agencies

[64] Interview #14
[65] The eight common concerns are around: adverse regulatory change, breach of contract, currency convertibility restrictions, civil disturbance, non-honouring contracts, expropriation/confiscation, terrorism, and war (EDC, 2016).

require methodologies to assess all these risks. They first look at a variety of public sources from everything from World Bank governance indicators to EIU data. But when rating specific transactions, the exacerbants or mitigants of the transaction in question are considered, and then change the ratings and pricing accordingly. For example if political violence is only in, e.g., the northern region of a country, and the insured project is in the southern capital, political violence would be rated slightly better.[66]

3.2b) Private PRI Markets: Underwriting Politically-Motivated Risks

"Lloyd's is Lloyd's, it's not Lloyd's of London. If there is uncertainty for a prolonged period of time, then the industry will vote with its feet. That would mean moving business, or leaving London, more quickly than the renegotiation timetable."[67] John Nelson, Chairman, Lloyds of London

One of the major challenges in insurance underwriting in a broad sense is to specify in the policy which exact perils are insured/able as per the insurer's appetite for risk, and to make sure that is spelled out to the client in the policy wording, without discrepancies. Generally coverage is limited to what is laid out in the policy, and nothing more. For an automobile collision, a medical emergency, or household liability claim, this is generally straightforward, as the insurer would take into account the client's history, the location/area, the likelihood of a claim, environmental factors, etc. and create a policy based on the client's needs and additional pieces of coverage, and price it relative to those variables. However, when looking to insure politically charged losses, this becomes infinitely more complex as geo-politics are often in a state of flux, and there is not always historical precedent to look to, as there is when pricing auto or home

[66] Interview #15
[67] Business Insider, 2016. http://www.businessinsider.com/lloyds-insurance-warning-brexit-could-drive-market-out-of-london-2016-9

insurance policies by means of postal code location history. So insurers have had to narrow the scope of what is insurable, meaning that PRI has become more technical than political, almost out of necessity. For if all 'politically-related' events were deemed to be a peril, insurance would not be affordable or even available, as it would be beyond the risk appetites of all companies. In essence, PRI seeks to mitigate the political risk on foreign assets for MNCs looking for investment and financing opportunities in emerging markets.

Fundamentally, PRI protects foreign assets against the risks of confiscation, expropriation and nationalization, and is often coupled with trade credit insurance. Based on the 'insurable risks' outlined in table 3.1, PRI can further be understood in the context of division of PRI variables. These are represented by common 'risk codes' such as 1) Political (violence, expropriation), 2) Contract (non-delivery) and 3) Credit (default). The Political category would be direct insurance protection for the investor, whereas the Contract/Credit ones would be more for the lender or creditor. [68] A related, perhaps simpler way to approach this breakdown is to divide them by type of risk and insurable peril: a) Asset-based (CEND, divestiture, abandonment, loss due to violence), b) Trade-related (currency inconvertibility, licence revocation, embargo, contract frustration), c) Securitization (credit and debt losses).[69] It is evident that insurable liabilities such as these perils are limited in scope, and the latent factors that can negatively affect investment, such as loss of title, local legal systems, punitive taxes, infrastructural failures, corruption and bureaucracy, etc. cannot easily be incorporated into underwriting models.[70] A current problem in the industry is the limited nature of single peril coverage, where for example, according to the policy, business interruption costs might not be covered if no property damage has occurred.

[68] Interviews 4-6
[69] Marsh Canada (2015), Interviews 3-6.
[70] Interview #3

Lloyds Syndicates, and more recently, insurers based in New York and Singapore, are the main providers of PRI in the private market. It should also be noted that cyber risks are beginning to become incorporated in the larger field of political risk (see Sottilotta, 2017), and can include protections related to intellectual property, data theft and breaches, etc. A host of ‘Speciality’ lines across the insurance industry are digging into the traditional market segments of property and casualty lines, due to the appeal and potential for profit of such lines as political risk. Evan Freely, Marsh’s Global Credit & Political Risk Practice leader noted that the global political risk landscape “continues to be shaped by falling oil prices, geopolitical tensions, and regime change, whether as a result of constitutional elections or otherwise. But these trends have not yet translated into catastrophic losses for insurers. Combined with the lack of profitability in more traditional insurance markets, this has led many insurers to essentially ‘double down’ on their investments in political risk.” Further, between 2003 and 2015 the total market capacity for PRI increased from US$700 m to over $2.4bn (Marsh, 2015). Clearly the market is large and growing, and many underwriters, brokers, and PRI analysts are excited about the future prospects for the growth of the PRI business, and the profit margins to be made.[71]

A political risk underwriter normally makes use of outside risk consultants, country-experts, and has access to boutique political risk service providers and indices such as Control Risks, Economist Intelligence Unit, Transparency International, World Bank, etc. Underwriters can access these subscription-based services, or be in direct contact with an expert, in order to gather more specific information on the country and/or industry under discussion, and the time-period the policy ought to cover. This allows them to supplement the information provided by the brokers on behalf of the client looking for insurance, and allows for a secondary due diligence in

[71] Interviews # 2-4

addition to what they might already know about the host country/industry.[72] Features of most PRI products can vary depending on the level of real vs. perceived risks, coinsurance (and treaty based policies) and the risk of adverse selection, the trustworthiness of the client and their history within the market and industry, the waiting periods and limitations of the policy, the types of recoveries stipulated, and the pricing methodology.[73]

Political risk insurance premiums are based on a number of factors depending on the nationality of the investor, the location and risk associated with the host country, the type, size and value of the investment, perils and financial limits covered under the policy, and the overall ownership structure of the investment (Comeaux & Kinsella, 1997, 183). Further considerations include: overall political stability, the nature of the industry of the investment (benign or politicized), the experience of the insured in that country, claims and loss history in country and company, liquidity, probability of default, security situation, reputation and experience in emerging market business.[74] Ultimately, brokers play an important role in knowing the insurers' appetites for risk, and how interested they might be in insuring a particular project or venture, and similarly, which insurers to approach for larger lines. The industry tracks and benchmarks coverage and prices so there is some variability in price, especially as the business diversifies and more capacity is produced. In the current period of instability and geopolitical uncertainty, insurers themselves are beginning to offer new types of coverage for cross-border deals that might fall apart due to regulatory scrutiny, or opposition from the Trump administration's investment committees, especially regarding Chinese acquisitions and investments in the US. Similar regulatory risks based on political decisions could increase as the administration

[72] Interviews # 6, 8
[73] Interview #5
[74] Interviews 3-9

continues to take bolder 'protectionist' positions and faces off with other nations over trade (i.e. on NAFTA, with the EU, China)

3.2c) The Reinsurance Market for Risk

"In ordinary times, PRI has proven to be an indispensable tool for many businesses that operate internationally in order to maintain growth and profitability. But this is no ordinary time; the winds of change are about to hit us like a hurricane. As the global trade and investment climate deteriorates, and becomes more unpredictable, demand for PRI should soar." Daniel Wagner, Managing Director, Risk Cooperative (2017).[75]

Moving another level deeper into the world of insurance, one finds the reinsurance market that literally insures insurers, generally on a treaty basis, meaning that the risk is spread among multiple reinsurers who take on different levels of risk. Political risk insurance is no different than other types of insurance products in that insurers seek reinsurance to hedge their potential losses from the policies they have taken on. The overall point of the basic reinsurance product is to control the aggregation of risk; if a company has too many large losses (high frequency of loss) and/or too little capital, a reinsurance program protects it from the frequency and severity of claims that it cannot financially absorb on its own, directly ceding the loss to other financial organizations (spread). This is common practice in the insurance and financial industries whose appetites for risk are often high, and need some sort of risk management strategy to protect from losses.

The global reinsurance market is growing in capacity (supply grew to $595 bn in 2016), outpacing the actual demand for reinsurance products, and this despite an overall effort on the part of insurers to optimize their view of reinsurance as capital. This means that there is roughly $600bn in capital available for insurers to trade risk with, in traditional insurance forms and

[75] Wagner, D., 2017 http://www.huffingtonpost.com/daniel-wagner/the-importance-of-politic_b_14130686.html

alternative vehicles on the capital markets such as catastrophe bonds, collateralized reinsurance and 'sidecars', financial structures that purchase all or portions of a policy from an insurance company, in order to share in the profits and risks. Larger reinsurance lines such as property-casualty which include catastrophe (making up the largest portions of insured losses, i.e. storms, floods, fires) continue to see some modest growth, and speciality lines like mortgage and cyber also saw increases. Capacity is especially growing in Asia with new syndicates online in London as well. Reinsurance for political risk is also a speciality line that is beginning to see growth, often bundled with trade credit and surety lines, as part of facultative reinsurance (single spread of risk to one insurer).

A (re)/insurance policy is a contract of indemnity for damages, whereas a bond is more of a guarantee the contract will be fulfilled. A surety bond is better explained as a commitment that if one party defaults on the agreed contract, the other can call on the surety bond to perform the execution of the original contract, meaning that it will be fulfilled in a financial sense. This has obvious overlap with contract frustration wording that is common in PRI policies, and with trade and/or export credit insurance which protects businesses from losses due to credit risks stemming from loan default, bankruptcies, or insolvencies. Trade credit is thus also an innate part of PRI insofar as the risks of non-payment by foreign buyers is concerned. One of the main points to remember, specific to reinsurance, is that the aim is to spread the risk and diversify it in number, type of company, and geographical area, meaning that perhaps more volatile PRI products may be bundled with many other traditional types of property-casualty insurance to reduce the level of risk and make it more appealing to reinsurers. In sum, the reinsurance marketplace must be viewed as a protective vehicle to back-up insurers' growing appetites for risk, especially new 'political' ones. Having a reinsurance program allows insurers to thus take on higher risks by spreading the potential losses.

A typical reinsurer, in a similar vein to the general insurance deals outlined above, will be approached by a broker, or compete for a Request for Proposal/Tender from a potential client who is seeking reinsurance. The risk is most likely spread among a variety of reinsurers and it is the broker's job to put together the package with the agreement of all parties. Reinsurance underwriters will look for much the same information as the insurer did, just on a larger scale: their books and finances, projects insured, claims history, comparative losses, current exposure, limits requested, and overall industry at hand. The client (insured) needs to be transparent with the information provided to the reinsurer in order to encourage trust and comply with reputational costs. Much of the due diligence is expected to have occurred beforehand with the primary insurer and its own coverage, so the personal relationship aspect in reinsurance plays an important role. For insurers with higher PRI placements, the reinsurer will want to know who is backing the project (lenders), if government assets are in play, if a large ECA or MIGA is involved already (safety net), length of tenure, and what the geopolitical environment is like, and then price accordingly. While this is subject to change as the industry evolves, historically reinsurers have been rather conservative in their PRI underwriting given the complex nature and uncertainty of the insurance instruments.[76]

Ultimately, PRI products are an important determinant of cross-border transactions, international investment, and indeed the financial bridges that underpin globalization. Insurance products cover issues of direct loss. Yet it is important to reiterate that the actual factors that can give rise to the losses or 'perils' as listed above, are not easily delineated. Many socio-cultural and political events that occur 'behind the scenes' that give rise to a loss cannot be covered by

[76] Interviews #9-10

private insurance policies or ECAs, unless there is direct evidence of war, violence, contract revocation, or damage to property.[77] However, when it comes to developed economies, it is often subtle political events or institutional realities that are the actual causes of investment-related difficulties, and these require a different focus of analysis, as I outline below. Another common aspect of risk analysis that analysts rely on is the various forms of indices and rankings, which utilize global statistics and information from public and private agencies. The next section explains how these indicators often incorporate and facilitate strong normative assumptions about the relation between political and economic stability, or regulatory, free-market, liberal democratic foundations.

3.3. Stability, Competitiveness & Freedom: Risk Rankings & Models

"The aim of the political risk rating is to provide a means of assessing the political stability of the countries covered by ICRG on a comparable basis. This is done by assigning risk points to a pre-set group of factors, termed political risk components" (Howell 2001, 23).

How do political risk assessments, which often consider the variables outlined above, actually assess one of the most significant ones: 'stability'? Is it the sum of underlying vulnerability and economic distress, i.e. socio-economic, historical, ethnic, social, and financial factors? Or is it stability in a purely political sense that looks at the length and functioning of central governments and policies, or is it based on 'quality of democracy' typologies? A complicating factor is the arbitrary nature of the methodologies used to get 'instability ratings', which includes the normative and definitional issues related to the modeling and rating of

[77] Interview #6

political risk, in addition to the subjective nature of expertise and 'variable-weighting' choices.[78] For example, the PRS/ICRG rating model offers rated components on the basis of pre-set questions for each component, but pre-emptively makes considerations about the country at hand based on the type of governance applicable to that country, i.e. accountable or dominated democracy, one-party state (*de jure & de facto)*, or autarchy.[79] This enables risk experts to essentially make judgments on the prevailing government, which is especially interesting in the context of the PRS Group's premise that "the more democratic the society is, the more accountable it is; and the more accountable it is, the less susceptible it is to sudden or explosive political shocks" (2001, 24). This type of baseline attitude also has currency in the literature, as explained by Jensen's (2008) results on the relationship between democracy, social harmony, and stability, whereby democratic countries thus attracted 70% more FDI than non-democratic ones. This foundational rating principle is not totally surprising, as I alluded to above, given that most free market democracies provide some form of a stable investment climate and legal/regulatory protections. Consider the following similar understanding by Jarvis and Griffiths: "low political risk and high political stability are manifest in systems that are developed, predominantly Western, liberal democratic, and capitalist. By definition, any state that displays dissimilar characteristics represents a political risk and the possibility of instability" (2007, 15). Yet, the political upheaval that has been boiling in the forms of populism, euro-skepticism, secessionism, and general instability etc. has shown that Western, liberal democratic and capitalist systems are generators of political risks as well.

This leads to a number of questions on the transferability of stability indicators across types of economies and governance systems. Can we generalize from the elements that contribute

[78] For a discussion on 'assessing assessment techniques', see Sottilotta, 2017, Ch. 2-3.
[79] See also EIU Democracy Index, 2015, https://www.eiu.com/topic/democracy-index

to political instability? Jarvis (2008, 37) notes that it is unlikely, since the sources of instability in one place are not always relevant to other systems, this being especially relevant in consolidated democracies. Abrupt leadership or party change in parliamentary or congressional democracies does not necessarily equate to major policy changes related to business and trade. At the same time, policy continuity relies on some sort of institutional stability and capacity to function properly in the face of domestic or global challenges (see also Campisi & Sottilotta, 2016). Political instability as a measuring variable becomes extremely complicated when trying to 'export' certain sources of stability across borders, political systems and cultures.

The rankings and measurement systems that deal with things like 'ease of doing business' or 'openness' (WB, TI, Heritage Organization, etc.) are common to risk analysts and global investment indices. These are available to investors and directly used in political risk ratings, which are often comprised of similar methodologies in the context of like-minded normative judgments. Take for example the Index of Economic Freedom (IEF), which is well known to be a fiscally conservative and liberal free-market construct. The aspects of a country's economic climate, and thus its relative freedom, are inherently political in that governments typically exercise effective policy control over such factors. This IEF methodology purports to measure ten such specific components that can be affected by political realities, which can be divided into the following categories and related 'freedoms'[80] Regulatory Efficiency (business, labour, monetary); Market Openness (trade, investment, financial); Rule of Law (property, corruption); Government Size (fiscal, spending). Each of these aspects of economic freedom are given a score of 100, which can then be further added up and divided to scale, in order to form overall scores and

[80] For detailed methodological explanations, see the Heritage Foundation: http://www.heritage.org/index/book/methodology

rankings. Data comes from a variety of Development Banks, Government Statistical Agencies, other popular global indices, WB, EIU, etc.

Further, Oxford Analytica's 'Global Risk Monitor' is a popular type of tool that allows potential clients to track the top-ten perceived risks and helps monitor 'emerging risks and measure their impact on geopolitics, macroeconomics and investment -- all available through a user-friendly, fully interactive interface'.[81] But these macro-risks are decided upon by the actual risk specialist, in this case Oxford Analytica, and may not represent what the actual client needs, or what the real political risks might be. Many of these sorts of reports rely on expert judgment as part of their methods (OECD, ONDD), while others look more to causal assumptions (EIU, SACE) and some (i.e. PRS) incorporate both strategies (Sottilotta, 2015). The important point to note in the scoring of these aspects by country is that in theory, the most openly democratic, accountable, low-barrier and de-regulated country will be ranked the highest. This becomes complicated when, for example, zero is the benchmark for government spending; or labour freedom is related to minimum wage and severance; or no investment constraints would equal the ideal type (100 score). These are fundamentally qualitative yet innately political considerations that are assigned numerical scores based on several other studies. It should be noted that many organizations and think tanks that provide 'competitiveness' or 'freedom' ratings are often concurrently lobbying host and home governments for further deregulation and taxation regime overhaul. Recently, these types of competitiveness rankings such as the World Bank's 'Doing Business Report' have come under fire for portraying significant bias in their methodologies, especially regarding economic reforms in developing nations in Latin America, such as

[81] Oxford Analytica, 2016 https://www.oxan.com/analysis/globalriskmonitor/default.aspx.

Chile.[82]Among other things, this ironically equates to the desire for freedom *from* government, which is the entity that, paradoxically, provides protection for those business assets at the same time.

The usefulness of these scores is of course politically charged, and one must reckon with them. They should not be glossed-over or simply viewed in simple numerical designations, as they supposedly represent complex political, policy or regulatory judgments. A problem is, as I mention below, that companies prefer to see such simple scores/rankings made available for their consideration, and so the business of indices thrives, even if it does not capture the whole story. Another example is related to a Swiss firm's (IMD) 'World Competitiveness Yearbook' which "ranks and analyzes the ability of nations to create and maintain an environment in which enterprises can compete." In sum, this index assumes that wealth creation takes place primarily at the enterprise level (whether private or state owned), and that a national (political) environment which enhances or hinders firms' ability to compete domestically or internationally thus makes up the logic underlying the ranking.[83] The necessity for 'competitiveness factors' such as FDI, institutional framework, society, prices, attitudes and values, and infrastructure, are required to be positively present. Again, these kinds of scores obfuscate inherently political or socially-charged events by assigning them weighted numbers in relation to other 'ideal' situations that may be present in other countries or regions. Although it makes more sense to cross-reference competitiveness or ease of doing business regulations than it does markers of stability across international borders, their relationships can differ on context and location. Other key shortcomings with rankings-based analyses include how indicators of competitiveness are assessed, how stability is measured, or what methodologies, people and assumptions are used to

[82] The Wall Street Journal, 2018. https://www.wsj.com/articles/world-bank-unfairly-influenced-its-own-competitiveness-rankings-1515797620
[83]World Competitiveness Yearbook, 2017. http://www.imd.org/wcc/research-methodology/

make such determinations. These questions relate to the problem or perception and interpretation. Again, this does not mean that 'competitiveness-openness' factors ought to be ignored altogether. On the contrary, they need to be incorporated into political risk analysis, but only as a singular tool of measurement, and not an overarching framework of analysis. It would also help if their underlying assumptions were made explicit from the start.

An interesting point to make as respects the usefulness of international economic indices, political risk rankings, and the prevailing culture of numerical variables or 'ratios' that make up the industry is the issue of popularity and 'Big Data'. With so many quantitative indicators and numerical rankings on risk ratings, government effectiveness, stability, or other sophisticated modeling techniques, investors and financiers are keen to see such statistics made available to them, and indeed rely on them in decision-making. Investors who procure political risk analysis from larger boutique firms or private consultants are also looking for clear data-based projections on their prospective investment, and many companies provide such services for that very reason. A growing concern with the trend toward 'Big Data' in political risk is described by an expert consultant: "Often the data is not as accurate or complete as we hope, and far too often, those dealing with it lack the statistics knowledge of data analysis competence to truly make sense of it. Some of the variables we deal with simply cannot be quantified in any meaningful way and I fear that client demand for "data" without understanding its limitations could yield ever-worse quality assessments."[84]

Another political risk consultant explained that these sorts of PRA variable indices and quantitative ratings run the risk of being quite 'gimmicky' insofar as it is increasingly difficult to aggregate so many variables and factors related to political risk. Thus, the ratings that are

[84] Interview #13

produced can often be unrealistic and might not even actually mean all that much, especially given the very qualitative nature of political risk, which makes it very hard to quantify such factors or variables. But since the production of rankings, figures, maps, etc. related to political and economic risks is popular, and requested, analysts often provide it, regardless of its overall effectiveness or 'predictive' power, which is quite complicated in itself.[85] Other criticisms of the record and capacity of political risk measures to estimate 'correctly' involve the problem of current and evolving data-sets, short-term horizon evaluation of policy, reliability of statistics, interpretation and manipulation of information, and others (Jarvis, 2008).

Deciding which framework to follow, or which ranking system to use, can be challenging. If, according to Baas (2010, 136) "the haphazard application of PRA in corporate decision making is a function of the relative underdevelopment of frameworks for assessing political risk…and this situation is due to the fragmented nature of PRA as a discipline", then further advancements of 'frameworks' are needed for the industry to grow. What remains to be seen is if the risk analysis industry will be able to incorporate factors that can often be overlooked: emerging technologies, cyber issues, intellectual property rights/protections, judicial independence at the micro level, variance in local ordinances, elections and government turnover, and more.[86] From there, we can also branch out into a clearer division of 'perils' that likely affect different types of economies and democratic regimes. It is thus important for academics, practitioners and investors alike to recognize that although numerical country/political risk ratings or rankings provide a quick and comparative tool for assessing risk, one cannot ignore the merits of a qualitative, structural/thematic, approach to risk (Bouchet et al. 2003) which thinks about institutions and development—they are too integral to the analysis of risk to be overlooked.

[85] Interview 1
[86] Interview 13

3.4. A Balanced Approach: Perils, Rankings & Stability/Uncertainty

"We have to provide certainty for trade and investment to succeed". US Representative K. Brady (R) October, 2017.[87]

This overview of the PRA industries and risk ranking factors demonstrates that political risk as it is currently conceptualized and priced by different players in the industry, has been limited in design to cover so called 'perils' that can be quantified. The commonly cited risk factors, such as likelihood of non-payment, *CEND*, non-honouring of contract, costs of political violence, and other commonly recoverable asset losses are established by risk assessments and underwriters, and when necessary, priced accordingly. Yet we have established that the actual social and political factors—which are interdependent—in the forms of institutional stability, investment policies and regulations, bureaucracy quality, corruption, civil unrest, and other related socio-economic conditions, are difficult to price and underwrite. I think that this is where one of the major disconnects lies between practical political risk assessment and insurance. It will remain difficult to expand layers of coverage and types of perils due to the aforementioned reasons, but the insurance industry is looking for ways to incorporate such subtleties and improve their pricing methods as the business continues to grow.[88] In a context of instability in the Western liberal order, there is room to expand our horizons with these approaches.

The fixed insurable assets outlined above, and to a lesser degree, the factors considered in common risk assessments, are attributes more akin to developing countries and emerging markets that exemplify the problems in measuring risk, credit, stability and competitiveness. Perhaps even more interesting is the fact that concurrently, the so-called economic aspects of country and

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[87] Toronto Star, Oct 11, 2017. https://www.thestar.com/news/world/2017/10/11/remember-that-canada-is-americas-biggest-customer-trudeau-tells-congress-in-washington.html
[88] Interviews #11-12

political risk are increasingly significant in the formerly ‘stable’ West, but the reasons for these are fundamentally political in nature. Perhaps a re-classification of the political-economic risk dichotomies would be worthwhile, especially since political stability is at the heart of risk analysis as established quantitatively and qualitatively throughout this discussion, in addition to the fact that ‘stability’ can mean different things in diverse contexts. Political stability in its own right is a variable or concept that is central to the functioning of developed economies, but as we have seen in across the OECD nations over the past few years, challenges to maintaining ‘stability’ are pervasive. From this the question follows: how can we approach the important relationship between political stability and uncertainty vis-à-vis businesses, investment policies and trade, when, for example, in the US and Europe they take on a different aspects than in most emerging economies.

One of my contentions with this research (see also Campisi, 2016) is that it is imperative to focus on the characteristics that facilitate political risk in the liberal democracies in the West. As outlined above, the majority of current approaches, variables, insurable perils, and risk analysis methods often preclude the inclusion of developed economies due to their foci of analysis and examinable variables. Yet the majority of my respondents[89] indicated in some fashion that non-traditional political and business risks to investments in Europe do indeed exist, or are a cause for concern, and require some kind of analysis, even though such an approach may have been lacking. Moreover, popular analysis of geopolitical risk has recently noticed these changing developments, i.e. distinguishing among classical risks such as military build-up, proxy wars, failed states, versus the socioeconomic risks like declining trusts in elites (populism), income inequality, referenda and more broadly poor governance, or credibility and stability of

[89] 22/31 respondents explicitly or informally discussed this issue.

institutions and respect for the rule of law, that presently plague developed democracies.[90] As I noted above, quantitative analyses suggest that political stability and risk share important correlations. Further, Jensen's work (2008) also found that there was a strong correlation between democratic institutions and low levels of political risk.

In this sense it is possible to situate the *ideal* political setting for investment as: (a) an accountable/alternating liberal democracy[91], with (c) constitutional protections and constraints, (e) economic openness, (f) free/fair elections, and (p) personal and property liberty. Thus, such an equation to conceptualize the political factors affecting investment, where Investment Stability (i) = >a + c+ e +f + p, or a combination of similar factors, while useful, may not always conform to the unique realities of the differences among both developed and developing economies and their political or democratic traditions, and that is part of the reason why grand theories of political risk are so elusive. The majority of countries receiving incoming FDI, given that they are in fact developing nations and emerging economies, may not embrace or ensure these 'inclusive' attributes. They are thus inherently risky and would, *ex-ante,* require PRA, while perhaps other developed nations would not. And this has been part of the shortcomings of risk analyses until now: many developed democracies were considered *a-priori* not in need of assessment. In fact, many large organizations do not even list developed nations on their political risk rankings.

Yet as established earlier, a number of *unknowns* currently plague Western democracies on both sides of the Atlantic that feed the problem of global instability and uncertainty. Picking up from Chapter 1.3 which differentiated some of the major points that underscore risk in developed versus developing economies, I highlighted various institutional, governance and

[90] Bloomberg, 2017. https://www.bloomberg.com/view/articles/2017-02-21/how-political-risk-is-shifting-to-developed-markets
[91] On conceptualizing procedural democracy, see also: Morlino, 2011

international business indicators[92] and scores in large developed economies since the financial crisis, in order to stress the importance of a strong investment and policy-regulatory climate to FDI levels. The results showed that most scores have trended negatively since the 2007/8 onset of the financial crisis. Though the main developed economies inside the G20 are understandably still ahead of the global averages for most 'competitiveness and effectiveness' statistics, the relative decrease in each of the indicators is something we need to monitor, particularly as they coincide with lower FDI levels and general instability. The relationship among FDI flows, political risk and democratic institutions (and their authoritarian counterparts) has been well mapped by scholars (Jensen, 2008; Li and Resnick, 2003, Rodrik, Subramanian, and Trebbi, 2002), and has currency in the literature. And this is why I suggest further investigation into the economic, institutional, and social factors that can determine investment successes in democratic regimes and advanced market economies given the importance of institutional and social stability to risk and FDI. There are a number of cases that exemplify this fundamental issue in addition to those outlined in Chapter 1. These relate to issues of democracy and constitutionality, stability and uncertainty, and on the whole, the political economy of institutions.

Granted the economic growth difficulties that EU member states have faced in the post-financial crisis period, and recent populist developments in reaction to deep austerity measures that have swept across the continent, serious problems face the Union. For instance, take the Brexit decision that has devolved into an uncertain mess for the governing Conservatives, and could lead to May's resignation, or the crippling of the British economy and the displacement of millions of European workers and migrants. Concurrently, there is the Catalan separatist

[92] See Table 1.2. The indicators chosen are: Net FDI Inflows; International Competitiveness; Government Effectiveness; Control of, and Perception of, Corruption; Accountability and Voice; Democracy Quality; Business Freedom. Table 1.2. The G7 countries (+ Spain & Australia) were selected due to their status as largest advanced economies/democracies in the world.

movement, which took advantage of the unpopularity of entrenched political parties, the economic status quo, and a distinct Catalan identity. The final outcome of this referendum has yet to play out. In the meantime, investors and businesses have already complained about the ‘legal uncertainty’ resulting from an independence bid, stock equities have fallen, and bond yields have risen, frightening markets and investor confidence in the certainty of regulations due to the threat of suspension of the autonomous government, violent protests, general strikes and more. Several large companies have contingency plans to leave Catalonia, and arrests of Catalan government officials are likely to follow. Likewise, weeks later in Italy, non-binding referenda spearheaded by the once openly secessionist Lega Nord party were held on more autonomy in the two regimes of industrial North (Veneto and Lombardy). Here, much of the dialogue has been the same, along the lines of historical differences, central government control, economic unfairness and tax redistribution. In the Italian case, it was not a secession movement per se, but a push for a ‘new deal’ with *Roma ladrona,* Rome the thief, again, surrounding financial transfers to the centre. But we should not forget that coincidentally, these are some of the richest regions in the most prosperous parts of Western Europe. Not only have they contributed to the well-being of the wider nation, and to the EU at large, but they have also benefitted tremendously from deep integration within the nation and European federation, and via global tourism and commerce.

Most recently, the elections in Italy produced an odd alliance of Euro-skeptics who have destabilized EU negotiations on a number of issues related to migration, budget, and cooperation. These outcomes represent another indirect blow to the European project. And with these surprising outcomes, populists across the continent may feel emboldened to push for further referenda or EU ‘exits’, meaning that extreme political uncertainty will accompany the market’s response and ensuing economic fallout over the next few years. In fact, Eastern Europe is currently witnessing a revival of strong-man leadership, populism, and dangerous relations with Russia which may precipitate further EU instability.

The apparent disengagement of the new US administration from global financial governance may create a vacuum of leadership and present problems for international trade and investment.[93] Ongoing NAFTA negotiations (2017-18) are a case in point in light of Trump's threat/promise to 'rip it up'. As the quote above from US Representative Brady makes clear, the idea behind free trade agreements or investment policies and regulations is to provide a sense of institutional certainty in terms of legislation and rules to facilitate investment and growth, which are not subject to constant or abrupt changes. And while the politics behind free trade and agreements and investor protections in terms of inequality, globalization, equity and employment, etc. are deeply contentious and deserve proper debate, such agreements guarantee businesses the time and capacity to oversee their investments safely (from political interference) in the longer term. The Trump administration's political posturing over NAFTA (and free trade agreements in general) generates increasing levels of uncertainty,[94] and sets a dangerous precedent for investors, as well as host governments looking for growth insofar as trade is concerned. The uncertainty around the future of the deal (and its rules) means that businesses cannot rely on a sense of institutional and legislative stability for their trade and investment plans, and they are less likely to take the associated risks. The global airline, steel, auto, green technology, and countless other industries are suffering from the protectionist trend that certain US government factions are supporting. Further, the Trump administration is presiding over some of the biggest and most dangerous socio-political uncertainties: nationalism is increasingly politicized, racial tensions are

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[93] See also Wagner, D. 2017. http://www.huffingtonpost.com/daniel-wagner/the-importance-of-politic_b_14130686.html

[94] See Toronto star (2017) https://www.thestar.com/news/world/2017/10/11/remember-that-canada-is-americas-biggest-customer-trudeau-tells-congress-in-washington.html

seething, barely affordable healthcare may disappear, partisanship is often confused with patriotism, climate change is being ignored, and international relations with Iran and North Korea are contentious. Again, these issues are wholly representative of the essence of political risk as described throughout this project as respects developed economies, namely the importance of institutional stability and certainty of policies and regulations.

It is thus evident that politically charged risks, though perhaps sometimes found in subtler forms in developed countries, are not confined to developing or frontier markets and authoritarian states.[95] Ultimately, these popular notions and conceptions of political risk are realities that all countries have to grapple with in a complex global market. Indeed, over the next few months and years, the West will be at the heart of political risk analysis—and for good reason. Yet it is still uncertain how the political risk industry will react and begin to analyze these 'stable' economies by extending their coverage or incorporating them into their methodologies.

These are the sorts of issues that have frightened investors for decades in emerging economies, and should thus call for a re-evaluation of our expectations on what stability and risk actually represent. A range of phenomena such as populism, anti-establishment forces, declining trust in politicians, decaying institutions, and other forces that are hampering many developed democracies will inject instability into our institutions, and will negatively affect many social and economic issues along the way, only creating more potential for risks to emerge. Such factors are not easily classified into the lexicon and quantitative nature of risk analysis, but they ought to be considered inherent in current political risk factors. While many such indicators can be (and are) ranked and scored, they are not readily utilized or priced with the same methodological rigour and influence as the aforementioned risk criteria are. This suggests that it could be useful to re-

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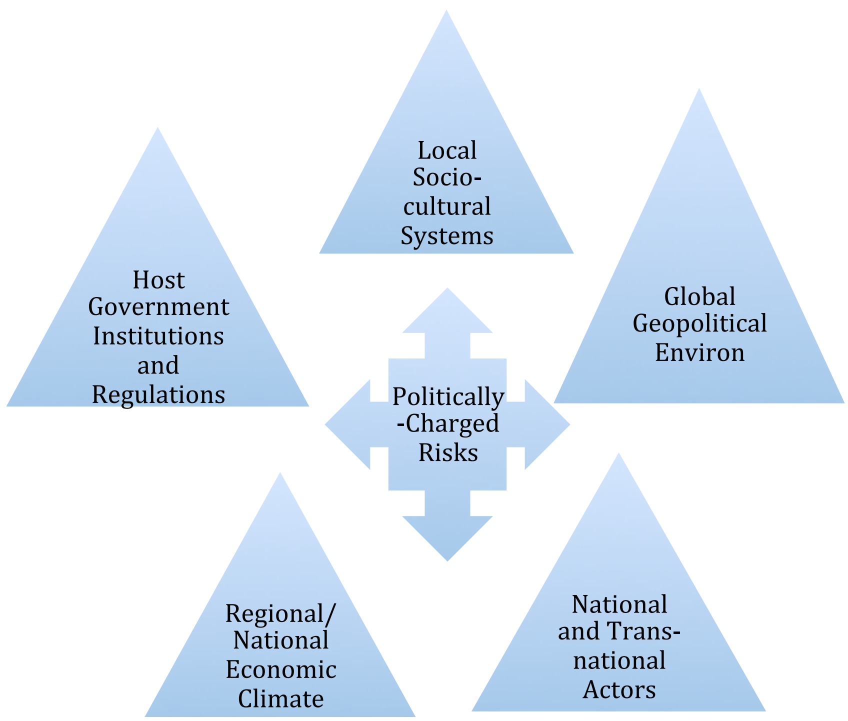
[95] On insurers' worries about populism in Europe, see also Bloomberg, 2017: https://www.bloomberg.com/news/articles/2017-04-13/should-you-be-worried-about-political-risk-hint-insurers-are

evaluate or tweak the variables used in most political risk assessments to better incorporate the political-institutional changes and uncertainty now gripping developed economies. The political risk industry at large exemplifies the difficulties involved with the idea of a clear division of, or 'single-peril', risks, insofar as many of these sources or factors of risk are highly dependent on, and related to one another, as Table 3.1 showed. Consider the 'dependency' paradox of political risk analysis as described by Jarvis:

> While political risk is obviously a function of political activity in domestic settings, it is increasingly experienced as a function of globalization and interdependence, where, on the one hand, globalization promotes the emergence of functional interdependence, transnational regimes and the increasing standardization of international norms and rule governed behaviour, but, on the other hand, where the depth of these regimes and interdependence is not so extensive that it reverses the dominance of sovereignty as a juridical reality in the administration of the national polis, society and economy. The intersection of trans-border activities (commercial and non-commercial) amid persistent sovereignty thus represents one of the primary causal agents responsible for generating political risk (2008, 16).

In light of this, I would argue that the analysis of risk for most types of economies, but especially in developed democracies, is better approached through a 'feedback loop', where risks flow among, and emanate from, global and local geopolitical contexts, specific political-economic and socio-cultural systems and vested interests, home and host institutions and regulations, and their relevant actors, behaviours and threats (see Figure 3.1). The complexity of the possible relationships between these spaces, conditions and/or events can facilitate the emergence of new or different types of risk. For example, although a risk often emerges from a political decision or event inside a state, the essence and flow of politically charged risks may, according to Van wyk, "follow a direct or indirect sequential path until it adversely impacts on the profitability of a firm or industry. However, such flows may be more multifaceted than a mere one or two step process due to the globalized nature of international business, the internationalization of domestic politics, and the transnational activity of organizations such as firms, NGOs, IGOs and governments" (2010, 108). The loop means that analysts must be prudent to understand the interrelated nature of many types of political risks that can spill over to other areas, especially as institutional changes become harder to predict in the West.

Figure 3.1:[96] Risk Factor Feedback-Loop



The notion of a 'causal mechanism' within this feedback loop is equally important for an explanation of how political risk manifests. As illustrated by Jakobsen (2010), this assumption begins with an objective source of risk such as institutions or social instability, flows to the actors through which political risk is realized, i.e. governments or companies, and concludes with the effects of political risk like government intervention or civil unrest. This seems more amenable to

[96] Inspired by Jarvis (2008) and van Wyk (2010) flows of risk analysis.

the realities of 'risk' in liberal democracies that do not necessarily contend with much political violence, threat of *CEND,* etc.

At this point it is useful to neatly divide up the types and evolution of Political Risk Analysis into four different schools or historical approaches to the assessment of political risk, according to Jarvis: 1) the 'catalogue school', whereby practitioners simply develop lists of the possible negative activities of governments in host countries that detract from, or have the potential to detract from, business operations, value and profitability; 2) the 'system-event school', which stresses the identification of events which impact regime stability and detract from the incumbent regime's capacity to govern, or system characteristics which facilitate the emergence of political events and which detract from system stability, political maturation and legitimacy; 3) the 'methods school', which aims less toward grand theoretical correlations and more toward informed micro-analyses that emphasize context, specificity and project level analysis, the general rejection of the grand theoretic tradition of political science and of the possibility of developing objective, prescriptive, and pre-emptory theory with any decree of precision; 4) the 'improvement school' which seeks to better the methods and models used in earlier generations to incorporate understandings of comparative institutional characteristics among nations to create large, accessible data-sets, and to facilitate sophisticated quantitative models (Jarvis 2008, 30-70). The utility of the fourth approach is embedded in its versatility: whether one wants to improve on the models, qualitative surveys/studies, or variables of previous approaches, or if one requires some theoretical connections along the lines of comparative institutional characteristics, there is the possibility to develop unique approaches to the study and assessment of political risk. When coupled with an 'interdisciplinary perspective' (van Wyk, 2010) and institutional outlook as described in Ch. 2, this framework of analysis allows researchers and analysts to be diverse in their subjects, industries, nations and variables under study, and facilitates an expansion of traditional risk analysis into new fields and types of variables, which I would argue is necessary for a better understanding of the complex nature of risk, particularly in the developed democracies of the OECD.

On the notion of 'improvement', the risk analysis industry is consistently looking for ways to advance and develop alternative models, so let us look at a few preliminary suggestions as to how we can do so. Within such a framework, based on the common variables found in a majority of risk indices and techniques as outlined above (see Table 3.1), we can narrow down the focus of analysis by means of the important indicators, by referring to the themes and criteria that were prevalent among respondents and the sourced literature and methodologies.

Table 3.2: Developed Economy Risk Criteria

Criteria/Theme
Macro-Economic Environment
Political-Institutional Stability & Investment Policies
Regulatory Regime and Public Administration
Infrastructure and Location[97]
Socio-Cultural Realities

This type of categorization of risk variables has currency in the literature, and should not oversimplify the variables of tailored analyses. These criteria are not meant to be viewed as stand-alone generators of risks: the inter-connected nature of many of the themes and sub-factors

[97] On importance of location and geography, see also: The Economist (2017) https://www.economist.com/news/leaders/21730412-time-fresh-thinking-about-changing-economics-geography-right-way-help-declining; Koko et al. (2016)

means that they can underpin and build upon one another simultaneously, or over time, as explained through the notion of a feedback loop. Yet these themes, I contend, are more holistically applicable to different types of economies, and while there is some natural overlap with a certain traditional variables (i.e. in the PRS components), the idea is not to assign them points, and then rate the country based on each simple indicator. More appropriately, to better analyze the complicated politics in developed economies of the contemporary era, there is need for a critical understanding of the socio-political factors that stem from, and make-up institutions, civil society, and other realities that do not always produce 'shock' events (at least until recently). It is important to note that the popularity of 'strategic risk assessments' or 'tailored analyses' has increased among current PRA practitioners and firms. IT tools (models) and simple briefings can be created and used based on specific information and requests provided by the client, in order to identify and prioritize risk that could affect a certain project in a specific industry. The overall aim would be to work with the client to ascertain critical risk factors for the project at hand, to present 'exposure' possibilities and continuous monitoring of difficult environments (Berlin Risk, 2015). A majority of projects often require such specific, structured and technical analysis based on clients' particular needs, which understandably differ. Given heightened levels of 'uncertainty' around the stability of Western democratic economies, such a 'tailored' technique allows consultants and firms to better provide sophisticated forecasts and employ better risk assessment methods. Still, it is important to have a general framework before applying tailored analyses to specific countries. The idea of the broader criteria is to give analysts space to modify their evaluations in ways that go above and beyond typical risk variables. In the following chapter, I expand on these explanations in more detail, and put this approach into practice through a case study on the particularities of risk in Italy.

CHAPTER IV - Unbundling Political Risk in Italy: Macro-Economic Climate, Political Stability & Investment Attraction Policies[98]

-Mamma Roma Addio[99]

A Roma salutavo gli amici. Dove vai? Vado in Perù. Ma che sei matto?

Me ne andavo da quella Roma puttanona, borghese, fascistoide, da quella Roma del "volemose bene e annamo avanti", da quella Roma delle pizzerie, delle latterie, dei "Sali e Tabacchi", degli "Erbaggi e Frutta", quella Roma dei castagnacci, dei maritozzi con la panna, senza panna, dei mostaccioli e caramelle, dei supplì, dei lupini, delle mosciarelle…

Me ne andavo da quella Roma dei pizzicaroli, dei portieri, dei casini, delle approssimazioni, degli imbrogli, degli appuntamenti ai quali non si arriva mai puntuali, dei pagamenti che non vengono effettuati, quella Roma degli uffici postali e dell'anagrafe, quella Roma dei funzionari dei ministeri, degli impiegati, dei bancari, quella Roma dove le domande erano sempre già chiuse, dove ci voleva una raccomandazione…

Me ne andavo da quella Roma dei pisciatoi, dei vespasiani, delle fontanelle, degli ex-voto, della Circolare Destra, della Circolare Sinistra, del Vaticano, delle mille chiese, delle cattedrali fuori le mura, dentro le mura, quella Roma delle suore, dei frati, dei preti, dei gatti…

Me ne andavo da quella Roma degli attici con la vista, la Roma di piazza Bologna, dei Parioli, di via Veneto, di via Gregoriana, quella dannunziana, quella barocca, quella eterna, quella imperiale, quella vecchia, quella stravecchia, quella turistica, quella di giorno, quella di notte, quella dell'orchestrina a piazza Esedra, la Roma fascista di Piacentini…

Me ne andavo da quella Roma che ci invidiano tutti, la Romacaput mundi, del Colosseo, dei Fori Imperiali, di Piazza Venezia, dell'Altare della Patria, dell'Università di Roma, quella Roma sempre con il sole – estate e inverno – quella Roma che è meglio di Milano…

Me ne andavo da quella Roma dove la gente pisciava per le strade, quella Roma fetente, impiegatizia, dei mezzi litri, della coda alla vaccinara, quella Roma dei ricchi bottegai: quella Roma dei Gucci, dei Ianetti, dei

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[98] N.B. Select paragraphs, data (tables and figures) and other information located in Chapters 4-5 have been adapted from a previously published article by the author. See Campisi, J. & Sottlilotta, C. (2016). "Unfriendly or Unwanted? Reflections on FDI Attraction Policies in Italy", Italian Journal of Public Policy, no. 2 (August): 223-250

[99] Interlude to the case study. Personal Translation from the Italian original, found at: http://www.ilmessaggero.it/SOCIETA/PERSONE/remo_remotti_mamma_roma_addio/notizie/1424480.shtml

Ventrella, dei Bulgari, dei Schostal, delle Sorelle Adamoli, di Carmignani, di Avenia, quella Roma dove non c'è lavoro, dove non c'è una lira, quella Roma del "core de Roma"...

Me ne andavo da quella Roma del Monte di Pietà, della Banca Commerciale Italiana, di Campo de' Fiori, di piazza Navona, di piazza Farnese, quella Roma dei "che c'hai una sigaretta?", "imprestami cento lire", quella Roma del Coni, del Concorso Ippico, quella Roma del Foro che portava e porta ancora il nome di Mussolini, Me ne andavo da quella Roma dimmerda! Mamma Roma: Addio!

-Remo Remotti

I said my goodbyes to friends in Rome. 'Where are you going,' they asked. 'To Peru,' I said. 'Are you crazy', they replied?

But I was leaving that Rome of selling oneself, of the bourgeoisie, and of fascism; I was leaving the Rome of 'let's have fun and keep going', the Rome full of pizzerias, milk shops, convenience stores, fruit shops; the Rome of chestnut vendors on streets, of cookies with and without cream, of wine biscuits and caramels, of rice balls, lupine beans, and of walnuts…

I was leaving that Rome of spice shops, of doormen, of messiness, of approximations, of tricks, of appointments that are never kept, of payments that are never made; I was leaving the Rome of post offices and government service centres; the Rome of city hall administrators, public servants, and bankers; the Rome that never had fair competition for jobs, where a recommendation was always required…

I was leaving the Rome of public toilets and baths, of fountains, of religious walls, of Right and Left party circles, of the Vatican, the thousands of churches, the cathedrals inside and outside the city walls; the Rome of the sisters and nuns, priests, brothers, and cats….

I was leaving the Rome of penthouses with a view, the Rome of piazza Bologna, the Parioli, via Veneto, via Gregoriana, the Rome of Dannunzio; Rome the eternal, the Baroque, the imperial, the antique, the touristic; the Rome by night and by day, of the orchestras and piazzas, and the fascist Roman footballers...

I was leaving the Rome that is envied by all, the *Roma Caputmundis,* the Rome of the Coliseum, of the imperial forum, of piazza Venezia and its monument, and of the University; the Rome that is always sunny—in winter and summer; the Rome that is better than Milan…

I was leaving the Rome where people piss in the streets; the mean Rome, the Rome of public service, of half litres of wine, of oxtail stew; the Rome of rich vendors, of Gucci, Ianetti, Ventrella, Bulgari, Schostal, the Adamoli sisters, Carmignani, and Avenia; the Rome where one can't find work, where there is no money, the Rome of the 'heart of Rome'…

I was leaving the Rome of the Pieta', of the Italian Commercial Bank, of Campo de' Fiori, piazza Navona, piazza Farnese; the Rome of 'do you have a smoke?' or 'can you lend me 100 *lira*?'; the Rome of the Olympics, of horseraces, of the Roman Forum that honoured, and still honours, Mussolini; I was leaving that shitty town called Rome!.. Mother Rome: Godspeed!

--*Remo Remotti*

The poem transcribed above was written by the Italian actor and poet, Remo Remotti (1925-2015), who, upon returning to Italy in 1960 from a few years working and traveling as a young man in Peru, wrote about why and what he had left behind in the mid-1950s in Rome. What comes across is a colourful recollection of the good and bad of life in Italy in the 1950s. Ultimately, the poem is a lament about the prevailing socio-economic and political realities that one would have found in the post-war chaos that engulfed Rome during that decade. The fascinating thing about this verse is that it was written in (and about) a specific period of time and place (1950s), but its substantive critique still holds today, sixty years later. The Italy of 2016-17 is lamented by its contemporary inhabitants in many of the same ways, and for good reason, as parts of the following case study will show.

Remotti's poem is an appropriate preface to this dissertation's case study for a variety of reasons as it captures the multi-faceted approach that will be employed throughout this research project. By this I mean that not only will the geographic and cultural specifics highlighted be of the same place (Italy), but the substantive topics related to politics and economics--stability, continuity and change—can be conceptualized through the poem, as can the theoretical narrative and qualitative methodologies used. Finally, the poem serves as a clever metaphor for topics inherent to political science and economics—area studies, employment, income, society, class, migration, and government—which are highlighted throughout this study in various ways, both theoretically and empirically.

As established above, international competition for the attraction of foreign direct investment (FDI) is becoming fiercer in an era of extended globalization. This is especially true in developed economies where traditional drivers of growth and consumption have been challenged and as perception of risk has increased. But socio-economic indicators in many parts of Europe point to a number of key questions on the relationship among inward FDI, the stability of business environments and the quality of investment climates. More than in comparable European countries such as Spain, France or even the UK, in Italy there has been significant concern in terms of inward FDI, and poor economic growth on the whole since the mid 1990s. Many of the underlying reasons are in fact geo-political, regulatory, and cultural in nature, and underscore the importance of stability for economic growth.

In this chapter I first contextualize the historical particularities of the Italian case, and its economic difficulties, followed by an explanation of the how the approach to PRA laid out above can be put into practice. After this, I consider the overall Italian macro-economic and business environment, including governmental and institutional support for FDI through investment policies, and the existence of policy risk and instability within that environment, showing the reasons behind Italy's comparatively poor FDI record. Later (Chapter 5), I further explore the interactions and expectations between governments and investors by looking at what businesses and investors (and experts) perceive and have experienced as actual risks and investment difficulties in Italy in their more regulatory, infrastructural, and cultural contexts. This conceptualization can play a pivotal role in understanding the success or failure of foreign investments on a global scale, but with a specific focus on a developed economy, which has been lacking in the literature.

This case study evaluates the benefits of a qualitative single-case analysis of contemporary Italy, and demonstrate the complex and multifaceted nature of politically-charged risks that characterize an investment location. My objective is to thus expand upon the economic, socio-political, institutional, and cultural factors that can affect FDI, and to use the peculiarities of the Italian case as a guide to show the importance of considering other approaches and contemporary political risk variables that are under-represented in traditional political risk analysis as performed by companies today. Taken together, these two chapters provide possible explanations as to why recent FDI levels in Italy have been sluggish, and economic growth has struggled for so long, even in the context of seemingly moderate business and risk rankings. I contend that the government's investment attraction record has been poor, even in the context of a strong Italian 'brand' reputation, robust export figures and a historically resilient local small and medium enterprise (SME) sector. Poor economic fundamentals, political and policy instability and a lack of coordination and effectiveness of FDI attraction policies and incentives have contributed to this comparative shortcoming, especially when contrasted with neighbouring EU member states.

The Italian case is especially interesting for its status as a developed market economy, G7 democracy, and central Western ally, that has, throughout the past few decades of relative peace and prosperity, undergone some of the most uncertain political and economic challenges among its contemporaries. That the major structural changes in the globalizing economy and the pivot towards supra-national governance in Europe coincided with a period of severe political upheaval and instability in the Italian government is relevant. It is no secret that Italy's economy has remained virtually stagnant since the mid-1990s, compared to other major European economies that have experienced moderate to decent growth, as shown in Figure 4.3 below. Yet historically, Italy's actual business 'brand' has fared rather well (see Table 4.1), especially vis-à-vis export markets. Still, that has not necessarily translated into an effective inward FDI policy or strategy on the part of government or private domestic agencies for the attraction of FDI, or in actual investment stock. Indeed, while Western Europe is perceived to be the most attractive region to set up investment operations, even ahead of China and North America (Ernst & Young 2014), Figure 4.1 shows Italy at the bottom of that small list, far below its EU competition. More recent data from Ernst and Young (2016) suggests that although Western Europe as a whole achieved a record level of FDI project and job growth, Italy still remained far outside of the top countries in FDI job and project growth, and in actual attractiveness.[100] Italian cities such as Milan, Turin and Rome are also absent from top European metropolitan areas (London, Paris, Berlin, Madrid, Brussels, Munich) for investment attractiveness. It bears mentioning that this data does not take into account GDP or population, where Italy's comparatively large (4th in the EU) economy would seemingly give it an advantage in these investment indicators and statistics. This suggests raises serious questions as to why this performance has been so abysmal. I suggest that it is at partially due to political risks in the form of policy instability/uncertainty, including inadequate promotional support for inward investment, in addition to the common structural, economic, regulatory-legal constraints, and cultural aspects that prevent Italy from becoming a better (and easier) choice for investment.

[100] Top 10 growth in FDI projects in EU: UK, Germany, France, Spain, Netherlands, Belgium, Poland, Russia, Turkey, Ireland. Top 5 'attractive' countries for FDI: Germany, UK, France, Neteherlands, Poland. (EY 2016)

4.1. Locating the Italian case

To set the context for the characteristics of the Italian case and its poor contemporary economic performance, one must first look at a few historical figures. In the post-war period, in the aftermath of the referendum (1946) on the monarchy, the republican constitutionalists won, and the so-called 'First Republic' came into existence dominated by three main parties who compromised in power: the Christian Democrats (DC), Communist Party (PCI) and Socialists (PSI). The multiparty system enabled a number of parties from across the ideological spectrum to form governments composed of members from opposing parties, creating a kind of 'stable instability'.[101] This compromising tactic enabled the leading DC party to dominate Parliament for most of the 46 years until the collapse of the system in 1992-3. The unique postwar compromise that formed the Italian Republic was designed to prohibit overly strong executives (due to Mussolini's rise to power), and ensure that parties were valorized and essential to the functioning of government. The politics of these multi-party governments were intriguing insofar as they never really agreed with the Anglo-American turn in European capitalism, nor were they wedded to the neoliberalism that European integration sometimes demanded. This Italian socio-political system endured for years, but within it grew rampant 'structural deficits' of democracy during the intense periods of change from the mid-1980s until the new Millenium. These enabled the continuation of massive disparities between North and South, a glaring weakness of public administration, patron-client relations in governance, and widespread corruption and organized crime which would cripple Italy's ability to respond to necessary economic changes that globalization would bring (Ginsborg, 2003). But a system which relied on arrogant patronage

[101] See Hellman, S. & Pasquino, G. (eds), 1992.

appointments eventually came to a head in the 1992-3 *tangentopoli* and *mani pulite*[102] scandals and subsequent restructuring of the system to a two-coalition party system post-1993 (often termed the 'Second Republic'). Notwithstanding what would in many democracies be considered an astonishingly stable tenure, and high success rate in forming governments, there were no less than 29 prime-ministerial changes over 46 years, and 50 different government coalitions led by the DC failing and 'rebooting'. Some of the Prime Ministers formed back-to-back governments after each new election, while others would come back after a few years to form their 4th, 5th or 6th cabinets, and so forth. It was a messy time, and Italy stands out across the developed world for the frequency with which government turnovers occur.

Yet the institutional failures in party governance, administration, and the rule of law (Ginsborg, 2003) were not eradicated by these realities post-1993, but only cleaned the slate for a new type of politics and governance which replicated many of the same shortcomings. This time, the void left by the old ruling parties was filled on the one hand by Milanese media mogul and billionaire Silvio Berlusconi's new, low-tax, neoliberal business-and family-friendly Forza Italia (FI) party and his coalition of right wing allies such as *Alleanza Nazionale* and *Lega Nord*. On the other side of the spectrum was a vast assortment of 'progressive' parties, some of which eventually came together to form the Democratic Party (PD). With the rise of Berlusconian cronyism in 1994, further governments rose and fell successively, generally rotating between the left-coalition and the right wing (led by Berlusconi). Between 1994 and 2016, there were yet another 11 changes of governing coalitions or Prime Ministers within the same coalition. Akin to the period of the 'First Republic', some leaders headed governments more than once (Berlusconi, Prodi), while in other instances "technical" governments headed by people from outside the

[102] The corrupt political system uncovered by the nationwide investigation (termed *mani pulite* -clean hands) into patronage appointments, kickbacks, and public contracts was referred to as *Tangentopoli*.

parties were put in place, as much to reassure foreign markets as to deal with difficult domestic political equilibria.

Suffice to say, the post-war trend is unsettling. 63+ different sitting governments in a period of less than 70 years (which translates into an average of 1.12 year tenures per government) is hardly a model of political and institutional stability. Moreover, part of the problem is the distinct political culture and different conception of social capital in Italy vis-a-vis its European and Atlantic neighbours. It has been difficult to push through needed legislation or reforms (see more in Ch. 4 & 5) when governments turn over every year or so, and the opposition is keen to go on the attack. The Economist (2013) summarizes the difficulties in forming stable governments in Italy, noting in the passage below that this was at least partly by design:

> One aim of the new constitution was to take proper account of Italy's many regional variations. Another was to make sure that Mussolini's rise to power could never happen again. Both of these wishes pointed towards a constitutional system with a weak executive, which is what Italy got. The prime minister needs a majority in both the House of Deputies and the Senate to govern. In a system filled with small parties, this is hard to do. Forming a government, and then keeping it together, depends on the co-operation of a gaggle of groups, often with diverging interests. If a small party falls out with its coalition partners, it can bring down the government.[103]

Such a history of governmental instability in the institutional sense might not in itself suffice for an area-specific case selection. So what about contemporary Italy, especially in the post-financial crisis era? Since 2009, Italy has also been in a state of relative turmoil in the socio-political sense. On the economic front, growth has remained near zero after contracting in the crisis, wages are still stagnant, and unemployment remains stubbornly high. On the social front, an influx of migrants from the MENA region has been met with a meagre Italian immigration and integration policy, poor political will, and no real European support. This has crippled some aid

[103] The Economist, 2013. http://www.economist.com/blogs/economist-explains/2013/04/economist-explains-8

agencies and had lasting repercussions on many citizens who, in a populist-hued Europe, are quick to blame migrants for their own poor socio-economic prospects. Politically this has translated into a further deadlock in national parliaments and typical divisive politics, but this time with a third major party, the Movimento 5 stelle, led by former comedian Beppe Grillo. In the meantime, there have been multiple governments leading the country with shocking democratic deficits such as the 2011 Monti administration, a technocratic government of pro-market Europeanists.

The importance of contemporary Italy to the Eurozone, and to the stability of the European economy in general, should not be understated in this sense. With many upcoming key political events in Europe with the potential to cause further instability, none is perhaps as significant as Italy's constitutional referendum which was held December 4th 2016. The overwhelming victory (60-40) in favour of the *NO* vote against PM Renzi's reform plans, has for the time being halted badly needed fiscal and institutional reforms (including the Senate) and led to Renzi's resignation in January 2017. Italy's teetering banking system is ripe for a collapse in light of a period of governmental instability where such needed banking reforms will not be passed,[104] and government bonds could also lose their A-rating, perhaps causing another contagious crisis and further jeopardizing the Eurozone. As Vincenzo Boccia, President of Confindustria, noted, the results of the referendum highlighted "the need to tackle pressing economic issues like debt, deficit and still-insufficient growth. Growth is the only way to eliminate inequalities and poverty…Italian companies have been making "crucial efforts" to compete in international markets, and need the government to back them up."[105]

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[104] NY Times, 2016a http://www.nytimes.com/2016/12/05/business/italy-referendum-euro-markets.html?action=click&contentCollection=Europe&module=RelatedCoverage&region=EndOfArticle&pgtype=article
[105] NY Times, 2016b http://www.nytimes.com/2016/12/05/world/europe/italy-matteo-renzi.html

A recently passed (2017) electoral law, entitled 'Rosatellum', is a very complex parallel voting system which uses a mixed system of proportional representation party lists (64%) and first-past-the-post (36%) in both houses of Parliament. Parties can stand alone or as part of broader coalitions, but single parties need to win at least 3 percent of the vote to gain seats in Parliament.[106] The new electoral law brings Italians back to the pre-*tangentopoli* scandal days of the 'First Republic' characterized by grand coalitions and backdoor political manoeuvring, insofar as a party or coalition will need at least 40% of the vote to form a government, an unlikely occurrence. Critics of the system, notably the M5S and smaller parties, have lamented that this reform would only sow further political instability by prohibiting non-traditional parties or coalitions from achieving the 40% required to govern.

Elections in early March of 2018 proved the doubters correct, as a large anti-establishment vote for the M5S (33%) and for Salvini's *Lega* (18%), as the new leader of the right-wing coalition (36%) crushed the governing Democratic Party (PD), and threw the system into chaos without a governing coalition for roughly three months. Finally, the strength of the anti-establishment forces seems to be increasing, as the current governing partnership between the populist *M5S* and *Lega* have strained relations with EU members on topics such as migration, budget reform, and free movement, and have tested the market's confidence. This suggests that a period of political uncertainty will continue to prevail in Italy over the next years. Alas, today Italy is still a very divided country, not only economically between north and south—industry and agriculture, language, culture; but most importantly perhaps—politically. The election results demonstrated further political divisions between the North, which overwhelmingly voted for the right-wing coalition now led by Salvini, and the South, which overwhelmingly voted for the anti-

[106] Reutuers, 2017. https://www.reuters.com/article/us-italy-election-electoral-factbox/factbox-italys-election-how-the-voting-law-works-idUSKBN1EM1HA

establishment M5S. This complicates not only the formation of a stable government, but the actual *governance* of these vastly diverse areas, populations, and socio-political or demographic needs.

But before analysing the reasons behind the actual shortcomings in FDI, we should briefly survey the recent historical bases of Italian economic weaknesses, and whether the Italian economy and state was incompatible with, or otherwise unprepared for, the types of growth and investment required by globalization and the expansion of the Eurozone. Why did the transition to the Euro and other market liberalization mechanisms that accompanied the political, legal and economic integration of the EU enable many members to succeed and grow (economically), whereas others, such as Italy stagnated dramatically (see Figure 4.2)? Many factors suggest that prevailing Italian economic principles, civic culture, bureaucracy, trade-union practices, and under-commitment to liberalization reforms made such an economy incompatible with what globalization requires and thrives on: free and open markets, protection of private property, modernizing infrastructure and political and social commitment to liberalism.

Indeed, in the rush to join the Economic and Monetary Union (EMU) in the 1990s and continue with the economic and political integration of the EU, Italian leaders might not have realized the economic implications. In any event, 20 years of stagnation have ensued. Criticism of the EU's rush to economically integrate the Eurozone before adequate political integration had taken place is well founded.[107] Italy is but one example of the externalities of the EMU's creation and the success of financial integration and free flow of global capital (see also: Greece). Before the mid 1990s, many Italian industries were at the height of their success (i.e. the Third Italy SME firms of the Centre-North), and had large domestic and regional footprints, reputations, and output. Quality of labour and production were high-valued commodities, and successful family

[107] See i.e. Brou and Ruta, 2011.

firms dotted the Italian landscape. Yet soon after the Maastricht Treaty, the Italian investment environment began to deteriorate, and this continued well into the new millennium.

Following the logic of Hall and Soskice's Varieties of Capitalism (2001), in which liberal market economies made up of hierarchies and competitive market arrangements with arm's length exchange of goods, fierce competition and formal contracting, including market-influenced employee relationships and wage-setting at the firm level, are most successful under globalization, it is clear that Italy, as a 'hybrid-Mediterranean market economy' (Hall and Soskice, 2001), would be at a disadvantage. It is argued that Italy maintained a "large agrarian sector and recent histories of extensive state intervention that have left them with specific kinds of capacities for non-market coordination in the sphere of corporate finance but more liberal arrangements in the sphere of labour relations" (Hall and Soskice, 2001, 21). Yet, labour markets proved to be very inflexible, and it has historically been nearly impossible to hire and fire employees without major administrative and regulatory hurdles, in addition to the fact that job tenures and pensions were far too over-protected for the requirements of the new, market-based globalization economy in the EU (and across the developed world). Non-market relationships, coupled with informal governance, sub-state associations, organized crime, familial culture, trade unions and specific and sticky legal and regulatory systems played a large role in keeping Italy uncompetitive within the EU over the years. Globalization and EU economic integration facilitated rapid and radical innovation which entailed substantial shifts in production lines, and development of completely new goods and modes of production and types of labour. Italy's institutional structures, bureaucracy, special interests, and apprehension regarding liberalization and market reforms essentially prevented many industries from exposure to enduring competitive forces, and the path to economic stagnation began in earnest.

As costs of living and labour increased with the expansion of the Eurozone throughout the 1990s and 2000s, Italian SMEs were no longer economically viable, as exports dried up, and lower-cost alternatives flooded the domestic and continental markets. At the same time, Italy continued to increase its dependency on public debt and imports, and economic stagnation took hold. In fact, between 1988 and 1995, Italy's debt to GDP ratio skyrocketed from around 90% to 117% (Istat, 2017). Following this, there was a decrease in the ratio back to around the 100% level by 2000 (until 2007) due to efforts to meet EMU requirements, which called for a maximum of 60% debt to GDP ratio, and a 3% budget deficit in order to qualify for Eurozone membership.

The historically rigid, and anti-reform Italian labour movement—grounded in a strong tradition of left-wing trade unions and the enduring strength of the Communist Party (PCI) until 1993—was also shaken by changes to the labour market as a by-product of intensifying globalization and technology. Traditional manufacturing and industrial employment made way for a growth in tertiary sector jobs which led to the growth of precarious classes of workers, and again heightened the divide between societal strata. This time it was not only between North and South, but increasingly among young and old, wealthy and poor. By 1995, the unemployment rate for youth under 26 was 33% in Italy.[108] While the growth in precarious employment would eventually touch all developed economies, in Italy it came early, and was severe. 'Fragmentation' would classify Italian society (Ginsborg, 2003) in its political, economic and demographic permutations for the next two decades at least.

Concurrently, many movements towards liberalizing reforms were met with fierce opposition, frequently precipitating the collapse of government; political instability thus reared its

[108] For context, the youth unemployment rate in Italy remained extremely high, and by 2017, was still around 31% (Eurostat).

head again in Rome. In fact, starting with the perennial power broker Giulio Andreotti's final (DC) party government in 1989—and throughout the Euro transitions in the EU, and the *tangentopoli* scandals that toppled the compromised multiparty system—until the onset of the Euro currency in 2001, there were 10 separate governing coalitions in a period of 12 years. This is clearly not an ideal political situation to navigate a changing economic landscape.

After 2008, when the global financial crisis spread from the US to Europe, Italy was again hit hard, and suffered negative growth rates as its structural economic problems remained unresolved. After the worst of the crisis, austerity and strict budget oversight were the norm across Europe, especially in places like Greece, Spain, Portugal, and Italy, who were consistently 'monitored' by the IMF, ECB and EU 'troika'. While debt to GDP ratios across the developed world spiked in the aftermath of the crisis as part of larger bail-outs and public investments, Italy's ratio grew from roughly 100% in 2007, to 132% by 2016, second only to Greece. In the same period, Italy's per capita GDP decreased from USD$40,000 to 30,000, and has yet to fully recover. Investors in an Italy that never really 'moved on' from the crisis turned out to be correct in their fears that the resulting over-spending, re-nascent protectionism, policy deadlock, or citizen and party backlash to austerity, would negatively affect economic growth and industry stability, thus increasing the level of political-economic risks in certain states. Indeed, ratings agencies, risk assessments, and financial monitors of those especially 'at-risk' EU economies responded by negatively appraising economically stagnant peripheral Eurozone members that were afflicted by such exigencies. Many Eurozone member states were swiftly downgraded by bond rating agencies (Moody's, S & P, etc.), and business confidence in the investment environment was shaky at best. The *acquis*[109] embodied by the EMU requires EU members to

[109] The EU's *acquis communautaire* refers to the binding body of European law accumulated via legislation, legal acts, and court decisions.

follow market-friendly rules, and in the case of the crisis, abide by austerity and reform measures to keep their economies 'solvent' in the eyes of the markets.

Significant reforms began in line with IMF-ECB-EU stabilization, bail-out protection, and growth requirements (i.e. the 2012 European Stability Mechanism), especially in the troubled Euro-periphery. However, between 2011-13, governments in Greece and Italy[110] for example, that did not seem to be able to follow those neoliberal austerity rules coherently—or were deemed a threat to economic stability and the Euro project by the bondholders, markets and central/multilateral institutions—failed on more than one occasion. A number of internal political factors contributed to their demise, but the market's influence should not be overlooked. These governments re-launched when a 'reliable' government was formed that would move ahead with the promised reforms which pacified investors and debt-holders. Indeed, when in November 2011 news spread of the end of the 'volatile' and anti-austerity Berlusconi government, the Milan stock exchange jumped by 2.3% practically overnight. Moreover, noted Informa Global Markets representatives, "markets are interested in people with experience in severe budget situations, and those who are perceived as being willing to do what is necessary", in this case, successor Mario Monti—a reliable technocrat who could bring political-economic 'stability' to Italy (Collins, 2011). Then, when Monti's government fell in early 2013, and a political stalemate ensued, the pursuit of reforms was perceived as threatened and risks to businesses remained high. By September 2013, AM Best's country-risk report on Italy deemed its 'political risk' as moderate, (3 out of 5 ranking), noting its entrenched bureaucracy, corruption, political infighting, and recent proposals to roll back austerity measures, which threaten its stability (AM Best 2013). It remains

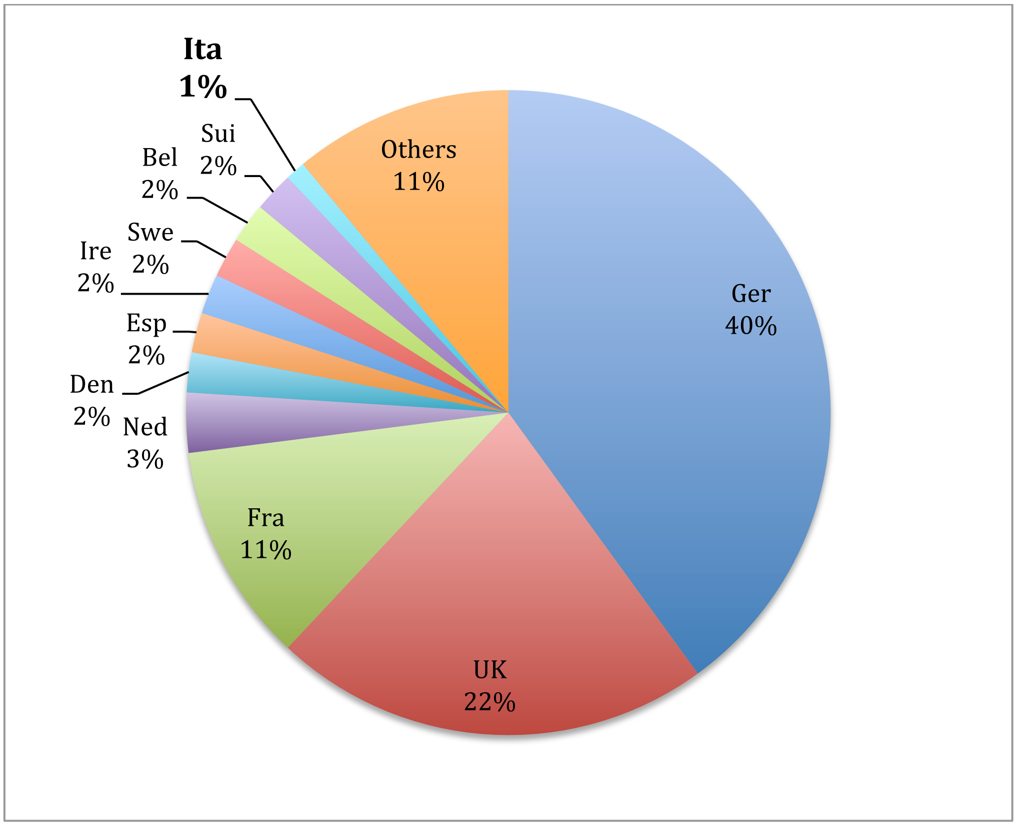
[110] I.e. On Italy's risk in financial media, see Euromoney, 2011.
http://www.euromoney.com/Article/2930668/Category/14/ChannelPage/8959/Berlusconi-departure-essential-to-stabilise-Italy.html

moderate today (see table 4.2) in the face of new economic and populist challenges, yet its economic and investment performance has remained poor.

Jumping ahead to the present day, can we accurately determine the success of globalization and socio-economic convergence worldwide? Or should we focus on a post-modern world where globalization theory might even be *dead*?[111] There is a consensus on the left and right that there has been a major crisis of neoliberal hegemony and globalization over the past few years, but we can still see that global interdependency remains powerful today. Still, European economic integration appears to have reached the point where there may be more push-back than support. Neoliberalism has not been replaced, but it has been challenged by political movements across Europe, especially in Italy in the forms of the 5-Star Movement and the Euro-skeptic *Lega*. Due to institutional path dependencies and the 'stickiness'[112] of informal institutions and coordinated market structures in Italy, the 20-year period of heightened globalization and financialization has scarred the political economy of Italy for a generation at least. Picking up from the discussion above, Italy has struggled greatly as respects FDI job and project growth, and regarding actual investment attractiveness compared to its neighbours; this notwithstanding its comparative advantages.

[111] See more on the end of globalization theory: Rosenberg, 2005.
[112] As mentioned in Ch. 2, path dependency refers to the idea certain elements and circumstances in a historical period may combine to form a continuously dependent character which reproduces elements over time (specifically institutions which exhibit similar characteristics). See also Greener, 2005; Pierson, 2000. In a similar vein, institutional stickiness refers to the 'locking-in' capability that institutions have to maintain arrangements, rules, or conventions that have emerged over periods of time for unique historical reasons (see also Boettke et al. 2008).

Figure 4.1: Most attractive countries in Europe to establish operations, 2014



Source: Ernst and Young, 2014

Yet it must be conceded that Italy has generally been perceived to be a producer of quality luxury goods, especially via skilled entrepreneurs working in the Small and Medium-sized Enterprise (SME) segment, and there is global demand for many Italian products. Small businesses and creative entrepreneurs are well known to exhibit passion and quality in their production modes and final products. Indeed, a positive 'made in Italy' or premium[113] brand marketing has contributed to Italy's relative success in areas related to exports of manufacturing and food-related goods and services, in addition to the many Italian 'luxury' good makers which have had enormous success when investing and retailing abroad. In fact, a country's general

113 On media attention to the 'made in Italy' brand, see Sanderson, 2011.

business and production reputation is an important determinant of investment and trade. In light of the comparative data presented in the following section, it may be surprising to note that the Italian 'brand' scores highly across a variety of industries, meaning it is perceived in a positive light. In *Future Brand's* recent 'Country Brand Index', Italy as a 'country of origin' ranked fifth overall, and, as Table 4.1 shows below, consistently ranks among the top 10 in many important sales sectors of the economy. Italy has also maintained much of its market share in exports since 2000, and consistently ranks highly in manufacturing exports worldwide (ICE, 2015).

Table 4.1: Country Brand Index: Rankings Across Industry Sectors

Rank	Country Brand	Food & Bev	Care & Beauty	Automotive	Electronics	Fashion	Luxury
1	USA	FRANCE	USA	GERMANY	JAPAN	USA	SWITZ.
2	FRANCE	**ITALY**	FRANCE	JAPAN	USA	**ITALY**	FRANCE
3	GERMANY	SPAIN	SWITZ.	USA	GERMANY	FRANCE	**ITALY**
4	JAPAN	USA	UK	**ITALY**	S. KOREA	UK	UK
5	**ITALY**	JAPAN	GERMANY	UK	CHINA	JAPAN	USA
6	UK	GERMANY	JAPAN	FRANCE	SWEDEN	SWEDEN	JAPAN
7	SWITZ.	UK	**ITALY**	SWEDEN	FINLAND	SPAIN	GERMANY
8	SWEDEN	SWITZ.	AUSTRALIA	S. KOREA	CANADA	GERMANY	BELGIUM
9	CHINA	TURKEY	SWEDEN	CHINA	TAIWAN	TURKEY	SWEDEN
10	S. KOREA	BELGIUM	THAILAND	INDIA	**ITALY**	CHINA	SPAIN

Source: Future Brand, 2013

Italy also ranked 8th (>3% share) for number of outward-FDI projects, but fell outside the top 15 (<1% share) for inward FDI projects and investment-related job creation (Ernst and Young, 2015), badly trailing the major EU economies, but also significantly smaller nations like Serbia, Belgium, Poland, etc. Ultimately, Italy's general economic attractiveness for inward FDI has been quite limited despite its positive brands, large market size, location advantages, and skilled labour force (and has only worsened with the financial crisis) (Mutinelli & Piscitello, 2011). Further, the financial crisis has enabled asset prices to remain comparatively discounted in Italy, meaning that, coupled with historically high quality goods, Italy should theoretically be a highly desirable FDI destination.[114] Indeed, the desire is often there, but turning that potential innovative idea into a successful partnership, joint-venture, or greenfield investment in Italy is where the disconnect begins. It is the process that is very difficult to overcome.[115] The next sections take up in detail the reasons behind such poor economic and investment records over the past decade, from the perspective of these peculiar interconnected institutional path-dependencies (refer to Ch. 2/3 for theoretical explanations).

4.2. From Approach to Practice: Assessing Political Risk in Italy

When observing the governance and business indicators and scores of leading developed economies (see Ch. 1, Table 1.2), where, for example, Italy has consistently ranked poorly, and comparing them to common Political Risk weightings, one finds that traditional risk scores might not always express the most accurate level of risks to investments in developed economies due to the complex political, institutional and social factors that facilitate FDI, which for that very reason are not easily measurable in their qualitative forms. Table 4.2 highlights various risk rankings in three competing Eurozone economies, however; it is apparent that the relatively uniform risk scores shown below do not correspondingly align with the other sets of scores, indicators and economic data that I provided in that follow comparatively in this chapter, where Italy generally fared much worse than its nearest competitors. It is because of the intricacies

[114] Interview #23
[115] Interview #17

specific to democratic institutions that we must turn to relevant, policies, regulations, societies and strategies that foreign investments rely upon.

Table 4.2: Select Political, Country & International Business Risk Rankings (2015-16)

	Italy	***France***	***Spain***
PRS Group (100 = no risk)	*PR-73*	PR-75	PR-76
A.M. Best (1 = very low risk; 5 = very high risk)	*Economic – 2* *Political – 2* *Financial – 3* *Investment Class – 2*	Economic – 2 Political – 2 Financial – 1 Investment Class – 1	Economic – 2 Political – 2 Financial – 2 Investment Class – 2
Coface (A1-A4 = low risk; D = very high risk)	*Country Risk – A3 (quite acceptable)* *Business Climate – A2*	Country Risk – A2 (low) Business Climate – A1	Country Risk – A3 (quite acceptable) Business Climate – A1

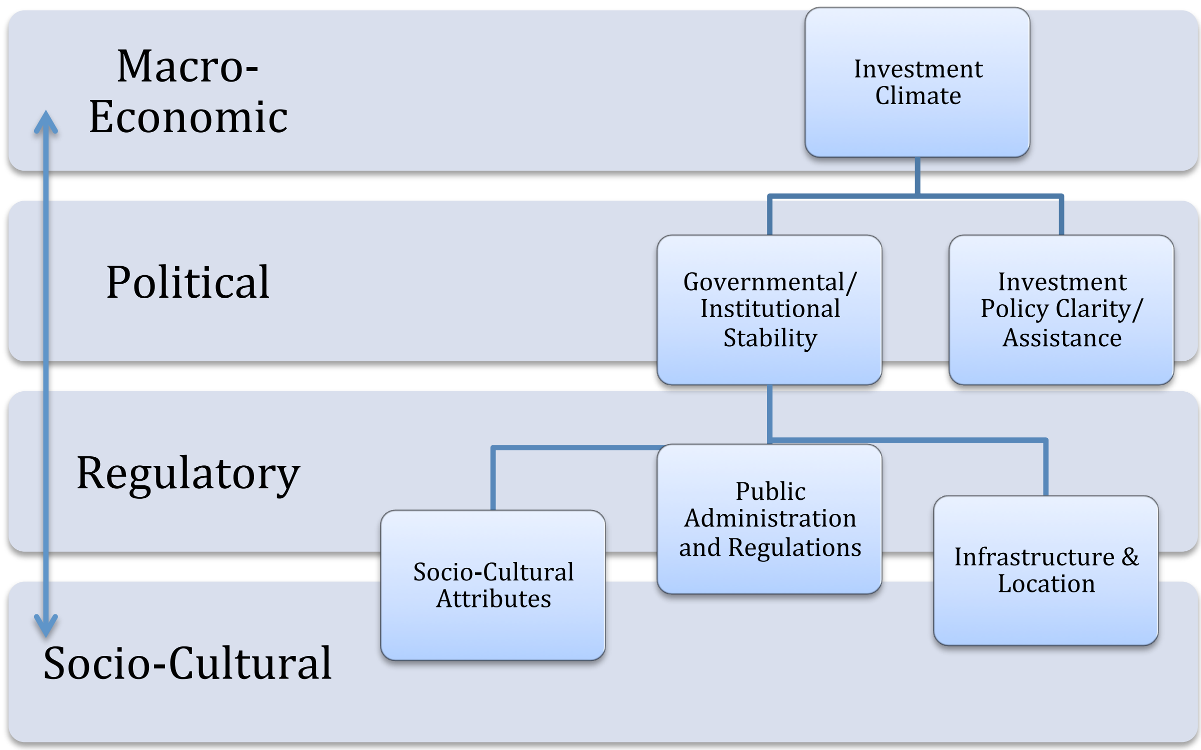
Sources: PRS Group, 2015; A.M. Best, 2016; Coface, 2016

From the risk scores in this table, it seems possible that an investor could easily underestimate political risk, especially when the planned host-location is an apparently 'stable' western democracy, given the uniformity of the rankings. Indeed, the Italian case offers insights into the changing political economy of foreign direct investment, multiplied by the difficulties encountered by the Italian government in ensuring private financial resources at a time of economic crisis and austerity, in addition to the historical snubbing of neo-liberalism on part of government coalitions. The following sections suggest possible reasons for these shortcomings based on results from qualitative interviews in a framework of criteria-based political risk analysis.

As noted in earlier chapters, scholarship maintains that administrative procedures and government agency functions can significantly determine FDI levels (Morgan, 2002). Similarly, Kasatuka and Minnit (2006) show that other FDI criteria include governmental instability, poor socio-economic conditions, conflict, corruption, political terrorism, civil war, quality of bureaucracy, racial and ethnic tensions and religious issues. More recently, Tole and Koop (2010) found that ideally, enterprises prefer not to venture far from their home offices, and when they do, they are strongly attracted to countries with low levels of corruption, and are eager to invest in fairly developed economies that provide a good business environment characterized by predictability, efficient institutions, transparent laws and advantageous tax codes. Insurance companies that underwrite political risks are most concerned with the likelihood and potential of confiscation, expropriation, nationalization or contract deprivation, in addition to political violence, and are rather strict in their scope of policy coverage.[116] With these considerations in mind, we can focus on risks in developed economies, in particular Italy, given the discrepancies mentioned above vis-à-vis economic growth, FDI, and important institutional indicators between Italy and other EU states. The following figure (4.2) diagrams the important risk criteria and themes in order to demonstrate a holistic way of approaching political risk in a fundamentally intersecting manner. Here, I suggest that the theory and approach laid out in Chapters 2 and 3, which discussed the importance of formal and informal institutional attributes as part of a feedback mechanism whereby risks flow from and are created among different contexts and sources, can be put into practice.

[116] Interviews #2-10

Figure 4.2: Using an Interdependent Criteria-based Analysis of Political Risk



In light of Sartori's conceptualization of the ladder of abstraction (1970), which considers such universal concepts as 'data containers', we can observe the interdependent and semi-hierarchical 'layers' of risk that can spill over into other thematic areas (see also Figure 3.1). In order to take into account the socio-political particularities specific to developed economy risk,[117] one can first assess, at the top, the macro-economic situation of the country and region which is conceptually wider and generalizable, containing factors that are applicable to many different countries. This can be followed, moving down the ladder, by an evaluation of the political forms stemming from institutional factors, issues around governmental and political stability, policy

[117] Such as democratic processes and leadership styles, accountability in policy and regulation, developed market-economy structures, civil society, etc.

certainty, and more. Another level down, these also spill over and overlap with the regulatory themes, which are at the same time enabled by political-institutional realities, whereby reform efforts, bureaucracy, judiciary, public administration, etc. come into play and require critical evaluation. Further, regional differences, infrastructural and operational issues surrounding the type and location of the investment, are encompassed by both the regulatory and socio-cultural themes (at the bottom), with constant feedback and dependency among levels. Finally, the same holds for cultural issues like informal governance, corruption, demographics, and more, which are cultural in nature, but affect regulatory factors to a significant degree, as well as political ones. The feedback loops among all these issues and themes are constant, and it is evident that we cannot observe and evaluate political risk in a conceptual bubble, but must appreciate their interdependence.

After completing a literature review[118] and multiple fieldwork expeditions[119], I organized the commonly-cited investment determinants and risk factors (in the industry at large and in Italy specifically). The five themes laid out in Table 3.2 were used as 'sensitive concepts' to organize the variables that inhibited investment in Italy. Special attention is paid to the emphasis and common themes prevalent among respondents (Blumer, 1954) enabling the development of such a criteria–based approach (Campisi and Caprioni, 2016; Otto 1992, Vivoda 2011, Zonis et al, 2011). As mentioned above, the analysis of government stability, economic environment, socio-cultural attributes, location, institutional and policy effectiveness or uncertainty vis-à-vis global investment (which are reflected in the categories below) allow us to re-evaluate the political risks

[118] General FDI determinants and political risks based on: World Bank 2016; BERI, 2003; EIU 2015; PRS 2016; Morgan, 2002; Kasatuka and Minnit, 2006; Ernst and Young, 2014, Bouchet et al. 2003. Italy-specific factors based on: Mutinelli and Piscitello, 2011; Coface, 2016; A.M. Best, 2016; EIU, 2015; World Bank, 2016.

[119] See chapter 3, where fieldwork conducted in 2015 is discussed. This research set out to expand on different understandings and methodologies of risk factors in political risk analysis through a study of various sub-industries that assess such risk.

in democratic regimes that manifest in many different ways. Again, it is common for risk assessments to use variable-based frameworks; here I seek to narrow and simplify those into macro-themes. Their numerical frequency, i.e. the number of times these themes came up as 'important' risk factors affecting possible investment in the 14 Italy-specific interviews conducted in 2016, serve as an introduction to the results, and are summarized in Table 4.3 below. Each theme represents a host of related risk factors that are more specific in nature, which are detailed on the right hand side. In bold are the more specific factors that were most prevalent based on responses (8+).

Table 4.3: Participant Responses vis-à-vis Thematic Importance of Investment Criteria[120]

Frequency– No. of respondents discussing importance of theme(n=14)	Criteria/Theme	Specific Factors/Sub-topics
8	*Macro-Economic Environment*	-*GDP/economic growth -3* -*Government Debt -4* -*Bank liquidity, financing and credit (bad loans) -4* -*Labour market flexibility -2* -*Unemployment rate -2* -*Business Insolvencies -2* -*Manufacturing & Industrial Investment -3*
11	*Political/Institutional Stability & Investment Policy Clarity*	-*FDI Attraction and Assistance (IPAs) -7* ***-Inward-Investment Policy Clarity -9*** ***-General Policy Uncertainty/stability -10*** ***-*Reform difficulties (electoral, labour, constitutional)*** [121] ***-9*** -*Political Interference (national, regional, unions) -5* -*Governmental stability and leadership (populism) -6* -*Concurrent, ambiguous competences (levels of government) -5*
12	*Regulatory Regime and Public Administration*	***-Inefficient/inaccessible public sector/civil administration -8*** ***-Bureaucracy/Red-tape -10*** ***-*Reform difficulties (electoral, labour, constitutional) -9*** -*Stringent penalties/uneven enforcement (i.e. permits, taxes) -6* -*Legal procedures and judicial system (slow) -7*
8	*Infrastructure and Location*	***-Regional developmental and regulation inconsistencies -8*** -*Location Accessibility (transport) -2* -*Broadband and technology prevalence -2* -*Decaying local infrastructure -3* -*Poor R & D and logistics -2*
10	*Socio-Cultural Realities*	-*Corruption, clientelism and nepotism -7* -*(neo)Patrimonialism & informal governance -5* -*Organized Crime -3* ***-Regional disparities (mezzogiorno v. industrial) -8*** -*Family business models (SME) -6* -*Migration/demographics -5*

Source: Interviews 16, 17, 20-31, 2016

[120] Specific factors are in bold where the theme or factor was deemed important by 8 or more respondents (60%).
[121] Note that these ***reform difficulties*** were described in relation to both political/institutional and regulatory/administrative themes, to varying degrees and in different contexts. The nature of the inability of governments to pass various reform packages is a political and institutional failure. But that failure, and concomitant path dependency of certain static legislation, directly affects the actual regulations and administration of government that investors must deal with. It was thus appropriate to place this factor into both thematic criteria.

Each of the risk factors could potentially be divided further amongst themselves, or with more specificity, but such an exercise would open up different sets of questions. As it stands, results in the table also suggest that many of the factors outlined are directly and indirectly affected by one another, and indeed overlap. Because the 'political' nature of risk is so subjective, qualitative, and dependent on a number of social and economic elements, it is thus essential that risk analysis be conducted holistically. At the same time, this represents the usefulness of the 'feedback' or intersectional approach to analyzing risk. As a comparative exercise, Table 4.4 below presents the differences in assessed risk factors among five commonly available political and business risk analyses in a general sense (typical factors utilized for all types of economies) on the left hand side, and Italy-specific results from the table above on the right hand side. The common risk variables were organized along similar thematic criteria as my own results laid out above in order to facilitate a simple comparison.

Table 4.4: Generally Assessed Political & Business Risk Factors, and Italy-Specific Results (Available Assessments vs. Fieldwork Results), 2015-16

Generally-Assessed Political and Business Risk Variables (all types of economies)[122]	Italy-Specific Fieldwork: Important Risk Criteria/Factors
Economic • Socioeconomic Conditions • Macroeconomic risk • Investment Profile • Economic growth • Currency convertibility • Labor costs/productivity • Short-term credit • Long-term loans • Degree of privatization	*Macro-Economic Environment* -GDP/economic growth -Government Debt -Bank liquidity and credit standards (bad loans) -Labour market flexibility -Unemployment rate -Business Insolvencies -Manufacturing & Industrial Investment

[122] A summary of the risk factors used by: A.M. Best, 2016; EIU 2015; PRS 2016; ICRG, 2016; BERI, 2003. Attempts were made not to repeat risk factors more than once, though there was significant overlap in many variables among methodologies.

• Monetary inflation • Balance of payments • Sovereign/credit risk • Foreign trade & payments	
Political • Government Stability • Law and Order • Democratic Accountability • Tax policy • International Diplomacy • Political Stability • Government Effectiveness • Electoral Cycle • Orderly Transfer of Power • Policy Continuity • Economic Policy • CEND (confiscation, expropriation, nationalization, deprivation)	*Political/Institutional Stability & Investment Policy* -FDI Attraction and Assistance (IPAs) -**Inward-Investment Policy Clarity** **-General Policy Uncertainty/stability** -***Reform difficulties (electoral, labour, constitutional)** -Political Interference (national, regional, unions) -Governmental stability and leadership (populism) -Concurrent, ambiguous competences (levels of government)
Regulatory • Bureaucracy Quality • Legal & regulatory risk • Bureaucratic delays • Enforceability of contracts • Legal System • Commitment to pay	*Regulatory Regime and Public Administration* **-Inefficient/inaccessible public sector/civil administration** **-Bureaucracy/Red-tape** **-*Reform difficulties (electoral, labour, constitutional)** -Stringent penalties/uneven enforcement (i.e. permits, taxes) -Legal procedures and judicial system (slow)
Operational • Communications and transportation • Local management and partners • Professional services and contractors • Infrastructure risk • Security risk	*Infrastructure and Location* -**Regional developmental inconsistencies** -Location Accessibility (transport) -Broadband and technology prevalence -Decaying local infrastructure -Poor R & D and logistics
Social • Internal Conflict • External Conflict • Corruption • Military in Politics • Religious Tensions • Ethnic Tensions • Social Stability • Attitude toward foreign investors	*Socio-Cultural Realities* -Corruption, clientelism and nepotism -(neo)Patrimonialism & informal governance -Organized Crime -**Regional disparities (mezzogiorno v. industrial)** -Family business models (SME) -Migration/demographics

Sources: World Bank 2016; EIU 2015; PRS 2016; ICRG, 2016; BERI, 2003; Coface, 2016; A.M. Best; Research Interviews, 2016.

The logical next step will be to query which parts of the above-mentioned criteria, specifically, are of the most pressing concern to experts in the field of investment in Italy? What stands out in the table above is that despite the overlapping nature of the risk factors that appear in various assessments, the level of detail and depth is questionable, and the more qualitative nature of risk-variables can be easily overlooked. Granted, it is not reasonable to expect a risk assessment to identify every single concern that an investor may have for each country. But when, as in the criteria from the general assessments above, the same range of factors are used for all types of countries, regardless of the subtleties of economy, policies, institutions, regulations, and cultures, there is clearly room for improvement in risk methodologies.

As we have seen, explanations of the Italian economy's poor performance are varied, and mostly reflect valid policy, social and structural concerns: relatively poor infrastructure and technology (broadband access); red tape and bureaucracy; energy and procedural costs; scandals, corruption and organized crime; legal and property deficiencies; poor research and innovation; and underdeveloped financial markets (Mutinelli and Piscitello, 2011; FITA, 2014; Coface, 2016, PRS, 2016). To be fair, publicly available risk assessments of Italy do include some of the factors cited above. But we are still left with the question of why Italy is quite close in general risk rankings to its nearest competitors, but fares so much worse in most relevant economic and political indicators.

To my mind, the answer lies in the fact that most risk assessments do not approach traditional developed market democracies in a manner that is adaptable to the complex socio-political realities on the ground. This does not mean that developing or transitional economies do not house complicated societies—they do indeed, and are often granted detailed risk analysis. Each country should be analyzed with its own context and developmental particularities in mind.

The problem has been, until recently at least, that developed economies of the West have generally been granted the assumption that they are more hospitable and welcoming to investment, have better accountability structures, democratic governance and policies, and other similar elements that, as we shall see, are not indicative of all G7 nations to say the least. I would suggest that there is more room to examine many of the socio-political elements which overlap and affect one another (path dependency); and to include the importance of context, history, and culture in such assessments. The remainder of this chapter will expand upon the interconnected themes of macro-economic environment, political stability and investment policy. Chapter 5 will follow with a discussion of the aspects of regulatory, infrastructural, and socio-cultural concerns.

4.3. Macro-Economic Environment

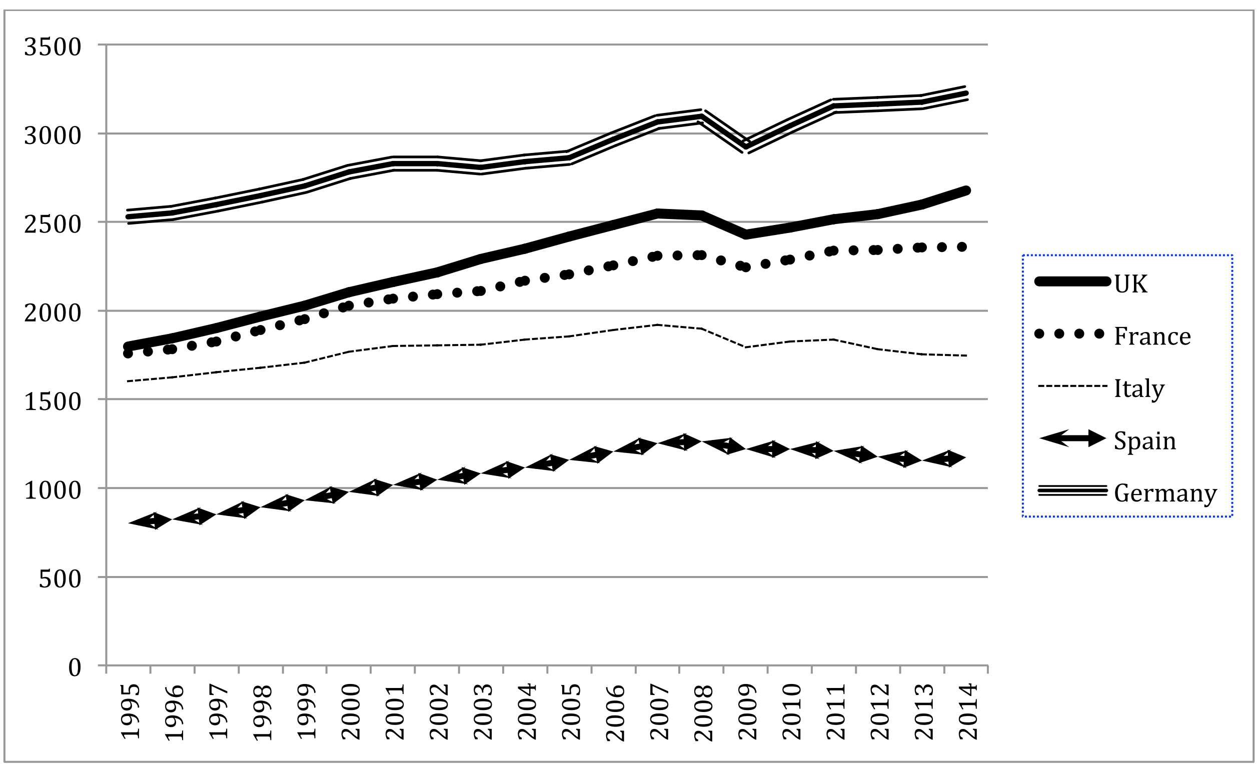
> Italians must be capable of affirming the idea that this nation is not impermeable to reform… serious work is needed to face a massive challenge of finding real growth and modernizing a system that's been weakened by a violent crisis and by innumerable problems that have been dragging on for decades. Italy could emerge as a nation that cannot be reformed, one that bobs more or less happily in stagnant water between the third largest public debt in the world and a banking system in deep coma. G. Gentili, Il Sole 24 ore.[123]

Italy's size, population, and relatively affluent domestic market with high levels of domestic savings, its proximity to emerging economies in the Euro-Med regions, and its excellence in manufacturing, scientific and information technology, allow the county to remain attractive to many investors. Italy is bound by EU treaties regarding trade, but Italian antitrust laws permit local authorities to review mergers and acquisitions based on a complex procedure overseen by the Italian Competition Authority (AGCM), and the Italian government may block controlling investments deemed essential to the national economy or when there is an ongoing trade dispute

[123] Il sole 24 ore, 2016. http://www.italy24.ilsole24ore.com/art/politics/2016-11-28/analisi-103503.php?uuid=ADSg4E3B

(US Department of State, 2015). Still, as seen above, Italy's performance in terms of economic growth and FDI has been disappointing over the past few decades. As a benchmarking exercise, we can briefly compare Italy to some of its neighbours (constant GDP growth in Figure 4.3 below), that is France, Spain, Germany and the UK. While the size of these countries in terms of population and per/capita GDP is somewhat comparable to Italy's, their performance in terms of GDP and investment attraction is quite different. Since 1995, Italy has seen only modest constant GDP growth totalling $143 bn, while the second worst performing economy, Spain, saw growth of more than $370 bn over the same period. It is worth mentioning that relative to GDP, the smaller size of the Spanish economy highlights the size of this economic growth shortcoming, as does the difference between Italy and France/UK which share similar-sized populations.

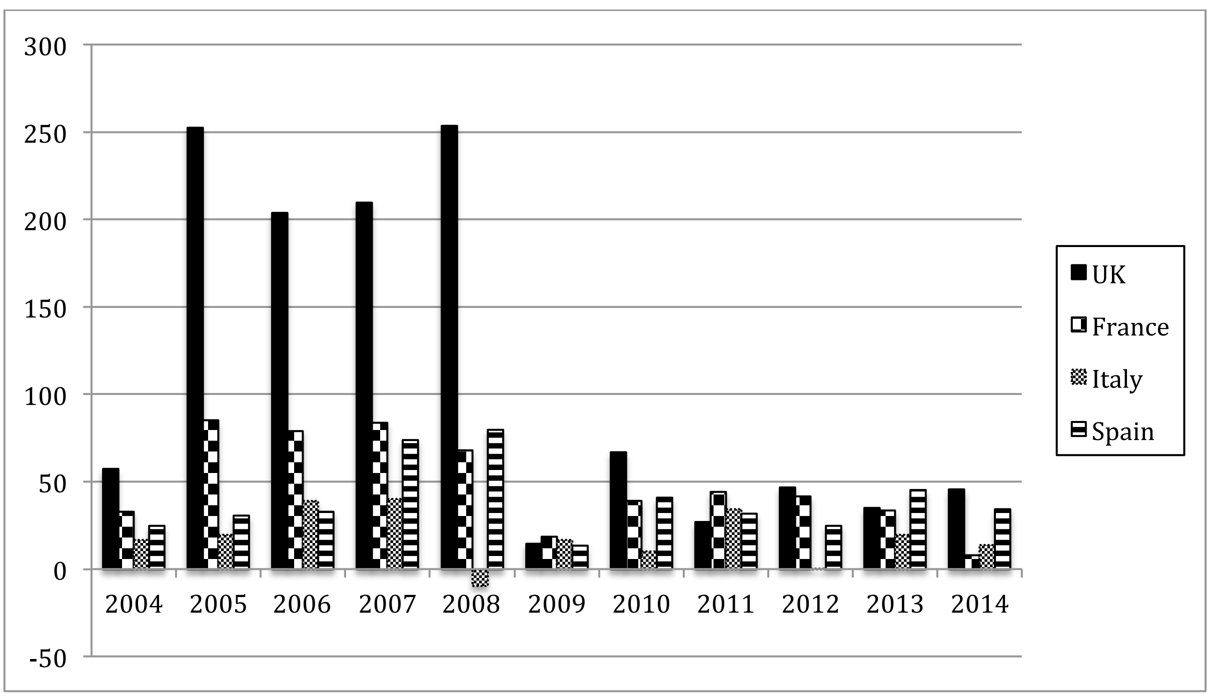
Figure 4.3: Constant GDP Growth, 1995-2015; bn of $US (at year 2000 $US)



Source: The World Bank, 2015; The Global Economy (2016)

Clearly, when economic growth has been close to zero for years, it becomes even more difficult to escape the low-growth trap[124] without major changes to the economic and political fundamentals of the country, or global economy, which is something that Italy has not been prepared – or willing – to do. Italy has long stood out for its difficulties in attracting FDI and maintaining economic growth, in addition to various problems with internal political stability. Compounding this, while the poor financial markers which follow in the statistics below give potential investors many reasons to avoid financing operations in Italy, actual investment promotion has been severely lagging (see more below). If we look at the total value of inward FDI to Italy in the 2004-2014 period (Figure 4.4), total inflows are significantly lower than its neighbours, as is the role of FDI in terms of percent of GDP.

Figure 4.4: Foreign Direct Investment, 2004-14; bn $US



Source: The World Bank, 2015; The Global Economy (2016)

[124] Interview #26

FDI levels and attraction capabilities are inter-related, and insofar as reputational costs are concerned, are highly path-dependent. Of course, the different types and fundamental character of financial sectors, modes of production and specializations in these diverse mature economies play a role in the numerical discrepancies, as do cross-sector differences in FDI transactions. Yet by glancing at such statistics, the gap separating Italy from its European neighbours in terms of ability to attract and sustain investment is clear, and is problematic for economic growth as a whole. The numbers are clear in the correlation between FDI and GDP growth. In terms of value of FDI, Italy also falls below many European neighbours in the number of FDI projects started as expressed in Table 4.5. It is also notable that Italy is conspicuously absent from the European top-20 in investment-led job creation, falling directly behind Moldova, Belgium, Switzerland and Bulgaria (Ernst & Young, 2017),

Table 4.5: Incoming FDI projects in Europe by Destination Country

	2015	**2016**
United Kingdom	1,065	1,144
Germany	946	1063
France	598	779
Spain	248	308
Poland	211	256
Netherlands	219	207
Russia	201	205
Belgium	211	200
Ireland	127	141
Turkey	134	138
Finland	105	133

Romania	98	132
Czech Republic	70	110
Hungary	94	107
Sweden	51	90
Italy	***55***	***89***
Switzerland	90	88
Denmark	63	72
Slovakia	54	70
Portugal	47	59
Others	396	454
Total Europe	5,083	5,845

Source: Ernst and Young (2017)

The breakdown of FDI projects is predominantly (90+%) among financial/business services, transportation and communication, and manufacturing, meaning that it has a number of competitors who are far ahead. While 2016 saw a marked improvement in Italian FDI projects started, the numbers still pale compared to the largest EU economies that Italy has to compete with in an era of cautious economic recovery. It remains to be determined what impact the constitutional reform failure and the instability that continues in the post 2018 election period will have on sustained FDI growth in Italy.

Other specific factors, common to both the literature and my respondents, such as unemployment levels, labour market difficulties, taxation system complexity, rapid insolvencies, and bank liquidity and credit (including the non-performing loan crisis) are part of the macro-economic picture that has been plaguing Italy for years, and are the most typical risks assessed by country, sovereign, and political risk agencies.[125] Indeed, economists note that Italian sovereign risks are likely to worsen through 2018, while in 2017, the yield on Italian 10-year government debt increased from around 1.5 percent to 2.1 percent over a 12 month period.[126] Some of these issues are connected to the governmental and fiscal decisions. Others are the product of decisions made by the ECB. Yet, many of these factors are exogenous to the Italian political and regulatory scene, and have other direct influences that may not be in 'Italian hands' at all. Still, it bears repeating that political risk deals with foreign investments and the challenges – real and perceived—that international investors face when seeking to park their capital, join a venture, or start or acquire a firm in another economy.

Socio-economic indicators demonstrate that this prolonged economic trend has been exacerbated in the post-financial crisis period: Italy has the 12th largest regional disparities in GDP per capita in the OECD, and unemployment rate disparities reach upwards of 15% between regions; per capita income has fallen farther behind the leading economies, its productivity performance continues to lag and its labour force participation remains weak, with inequality rising faster than in most EU nations. General unemployment rates have hovered around 12-14% over the past few years, while youth unemployment has been stuck around 40%, which is one of the highest rates in the developed world. It is estimated that over 2 million Italians between the ages of 15 to 34 are outside of the labour market; they do not study, do not work, and are not actively seeking employment. For those who do find work, most are hired under temporary contracts (US Department of State, 2015). The substantial legal obstacles to hiring and firing workers are well known to inhibit job turnover and growth, and such labour market inflexibility has been a serious issue for generations. 'Reform' efforts in 2011 and again in 2014 appear to

[125] A.M. Best, 2016; American Chamber of Commerce, 2016; Interviews #22, 26
[126] CNBC, 2017 http://www.cnbc.com/2017/05/19/italy-is-the-biggest-political-risk-in-europe-analyst.html

have had little or no effect on the underlying trends,[127] and are currently under attack by the Lega-M5S governing coalition.

Regarding the overall macro-economic picture, there is reason for apprehension. Ambitious reforms regarding the labour market, social protections, and the taxation and judicial systems have been attempted, but their implementation has routinely been stalled due to social and political realities. For example, the 'Jobs Act' labour reform plans, when first introduced, appeared purposefully in the English language which was undoubtedly meant to convey a sense of seriousness, and also affinity with Anglo-American neoliberal practices such as deregulation. Ultimately, stubbornly high public debt (130%+ of GDP) is also a significant issue for overall economic health of the nation, and the ability of governments to finance their expenditures in an age of austerity. This is also related to the problems with private liquidity and bad loans that Italy has been facing for many years. In fact, A.M. Best notes that while progress has been made in raising private capital, the non-performing loans ratio reached a record 18%, and 'bad debt' is equivalent to 21% of GDP. Furthermore, "Italian banks are set to acquire bailouts to ease the financial strain, as Italy's third largest bank is seeking a private bailout" (2016). The fundamental economic bases have not been 'solid' for years, and they continue to strain growth and inhibit much needed investment.[128]

Though it holds the status of a developed democracy, Italy consistently ranks poorly in worldwide governance indicators (see also Table 1.2), i.e. for control of corruption, on political

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[127] The Jobs Act was a labour reform legislation pushed through Parliament in 2014-15 which was meant to open up the labour market and incentivize firms to hire more people by removing firing restrictions for large companies. At the same time, it offered fiscal incentives for firms that hired permanent workers on new, less protected terms. Reuters, 2015. https://www.reuters.com/article/us-italy-employment-analysis/renzis-jobs-act-isnt-getting-italy-to-work-idUSKBN0TX1WA20151214. See also Chapter 5 for further discussion of the Jobs Act.

[128] Interview #26

stability and effectiveness of government (World Bank, 2015), falling well behind many developing nations.[129] Italy also ranks at the bottom of public surveys in civic trust in politicians, wastefulness of public spending, official government favouritism, judicial independence, bribery, red-tape, legal dispute settlement and policy transparency, and organized crime. Italy was also in the bottom half of general investment rankings, and it received a 6/10 (tied for 45th place) on investor protection (World Economic Forum, 2015). While these markers give potential investors many reasons to avoid financing operations in Italy, surprisingly there has not been an equivalent effort on the part of promoting inward-investment in order combat this negative reality, creating a more stable investment environment, as I show below in the next sections on political stability and investment policy.

4.4a) *Political/Institutional Stability*

Indices which measure political stability often take into account and reflect such factors as: disorderly transfer of government power, likelihood of armed conflict, expropriations, political violence, social unrest, international tensions, terrorism, or ethnic, religious or regional conflicts (Political Risk Services, World Economic Forum, EIU, etc.). These are important indicators, and are clearly relevant to prospective investors. But these are prominent occurrences in developing nations, and were not specifically important 'determinants' to my respondents, nor to many assessments of developed economies in general. So while the political risk industry must incorporate these *macro*-measures, they do not represent the complete reality of what is on the ground, specifically in Europe. On that note, until recently, political institutions in the West were

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[129] The indicator scores outlined in that table, again, are: Net FDI Inflows; International Competitiveness; Government Effectiveness; Control of, and Perception of, Corruption; Accountability and Voice; Democracy Quality; Business Freedom. Together, these form a fairly accurate idea of governmental, institutional and policy effectiveness or uncertainty.

seen to be 'strong enough' to protect against potential classical political risks such as those mentioned above.[130] At present, political instability in Italy is in the medium range, and seems to be rising with the tides of Euroskepticism and party-system instability. The World Bank's governance indicators, perhaps one of the most cited sources, ranked Italy in the 58th percentile, with a score of 0.34 (±2.5) on political stability (World Bank, 2016), behind the majority of OECD nations. After the failed referendum, Deutschebank highlighted Europe's most consequential political events for 2017, pointing to the uncertainty around the election in Italy and predicting further instability and challenges to growth on the horizon.[131] The March 2018 elections showed that sentiment proved to be correct, as stalemate ensued following the results which placed the leading vote-getters (Forza Italia & Lega plus their right wing coalition) at below the 40% of votes required to form government. After months of fractured negotiations, the uneasy coalition between the two parties (Lega and M5S) that formed government has so far compromised on most issues, yet their tenure will be on unstable footing throughout 2018-19. Notably, Italian government officials are also aware of the perception of instability in a general sense, and the need to 'stabilize' the Italian institutional environment. Former President Giorgio Napolitano, speaking about the resistance in Italy to electoral reforms, recently cautioned "we are again at the precipice of the theme of governmental instability…the element of uncertainty that we need to remove is the instability of government".[132]

If a central tenet of political risk analysis concerns the reasonable expectation of continuity and stability in related policy and geo-political dimensions that can affect international business, Italy is a major outlier. When discussing stability, one not only refers to government

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[130] Interview #19
[131] The Global Economy, 2017. http://www.theglobaleconomy.com/rankings/wb_political_stability/
[132] Personal Translation. La Repubblica, 2017 http://www.repubblica.it/politica/2017/06/06/news/elezioni_anticipate_napolitano-167428632/?ref=RHPPLF-BH-I0-C8-P1-S1.8-T1

collapse or change, violent unrest, coups d'état, or other classical notions of instability (Alesina et. al, 1996; EIU 2009; Barro, 1991). For instance, Italy has had over 60 different governments in power since 1946, as noted in Chapter 1. This points to a different sort of institutional instability characterized by the First Republic's cabinet volatility as an outgrowth of a rigid part system dominated by the Christian Democratic coalition, allowing hyper-factionalism to take root.

Political events, policies, regulations and institutions, or conditions in a given state can have unwanted effects on foreign investments, and these issues are increasingly becoming areas of concern to international businesses. As Jarvis (2008, 5-6) notes, in relation to the "maturity, transparency and the capacity of state based political institutions to effectively administrate the needs of the national polis, adjudicate and balance the interests and demands of competing constituencies, the independence of statutory bodies like the judiciary, the probity of financial and economic administration of national accounts, and the transparency of elections", political risk can be represented by the ineffectiveness and/ or decay of many such political institutions and systems, and indifference and antagonism to reforms. Italy embodies this as perhaps no other developed economy. In fact, 11 respondents expressed considerable concern over issues related to this type of 'general' political (in)stability, for example, in the forms of governmental stability and tenure, leadership styles and threats of populism, or political interference (i.e. among national, regional, local governments for electoral purposes, or trade union influences).

Above I emphasized the importance of Italy's economic environment and track record of growth and FDI. However, FDI attraction can be boosted, even in the short term, through strategic policy actions aimed at improving the ease and reputation of the investment environment. In this sense, the availability and channelling of information targeted to potential investors is key. After having observed the reality of the Italian FDI and macro-economy, we can further discuss how this may be occurring. Promised reforms of the labour market, government accountability, the electoral system, and other major parts of the Italian government continued under former Prime Minister Renzi's effort to counteract Italy's stigma as a stagnant economy with a creaking bureaucracy, but such institutional reforms proved difficult to push through. While the Jobs Act was passed, and was met with much enthusiasm by the foreign business class[133], many Italians were not on board, starting with the Unions. Ultimately, many of Renzi's liberalization plans met their demise with his 2016 referendum loss and subsequent resignation.[134] This demonstrates how difficult it is to undertake major constitutional changes in a climate of historical institutional stickiness.

The following figure displays aggregate combined scores of rule of law, government effectiveness, regulatory quality, and accountability over the past decade in four roughly comparable European nations (as above). An initial look at Italy's scores again opens the door to further proof of its shortcomings. Also noteworthy is the work on increased policy transparency and FDI completed by Drabek and Payne (2001, 21), whose model estimated that the impact of improvements in transparency on actual levels of FDI inflows was most pronounced in Italy, where a 1% increase in transparency rank could facilitate a 100% rise in FDI, which is quite an interesting simulation result.

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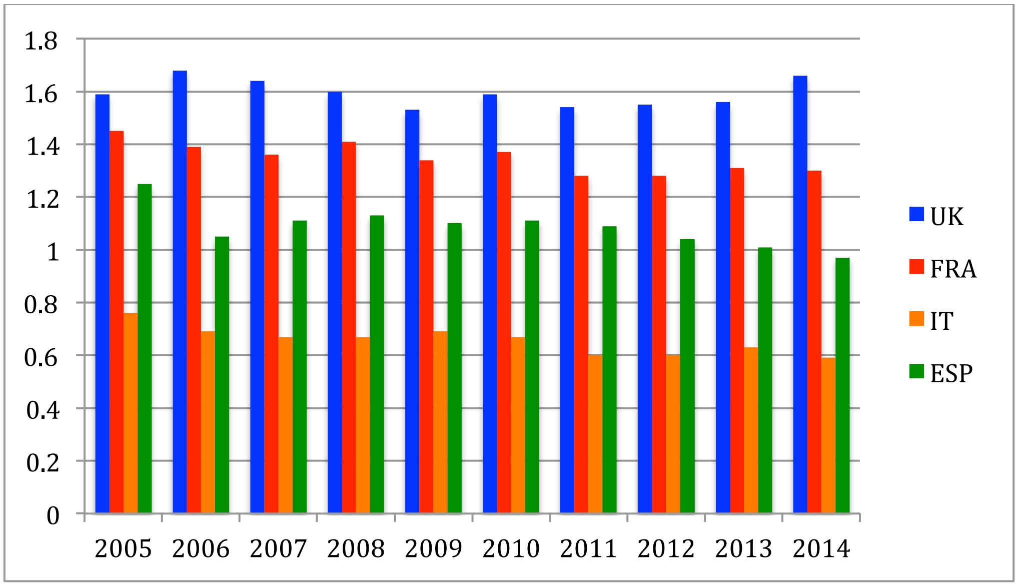
[133] Interview #27

[134] For press on Renzi's first electoral promises and their early results, see Signorelli (2014).

Figure 4.5: Aggregate Scores (/2.5) of major Institutional Indicators[135], 2005-14



Source: The World Bank, 2015

Again there is evidence that Italy's performance along such important dimensions as government effectiveness, regulatory quality, accountability, and rule of law, as well as 'safe' investment locations, are cause for concern.

In the Eurozone economies, it is useful to look at the specific issues that foreshadow instability from an investment perspective, and not only via financial and budgetary indicators, but from a policy standpoint. In non-democratic regimes typical risks encompass the high likelihood of coups d'état, violence, expropriation or nationalizations, while in the context of mature democracies political risk is more likely to assume forms of adverse policy change, and/or unstable or ineffective governance, which is what we see here. Generally, given the unique political (& socio-cultural, financial, etc.) characteristics of each area that is being analyzed for potential profitability, there is more than one way of determining possible political and/or policy risks. The important connection between political stability and economic growth—whose

[135] Average scores of rule of law, government effectiveness, regulatory quality, and accountability; together form a fairly accurate idea of government, institutional and policy effectiveness.

relationship is inherent to political risk—has been approached for decades from a variety of scholarly perspectives (Alesina et. al, 1996; See also Ch. 2). Essentially, political risk assessments seek to forecast the level of trust and continuity in the institutional (governmental) setting for the interested firm's prospective financial interests, and thus produce a judgment on the country in question.

4.4b) Investment Policy Clarity & Climate

Political/governmental stability is essential for 'policy certainty' and a sense of continuity in relevant legislation and investment rules (including major economic reforms), which is something that political risk specialists and investors often highlight. The actual legislation and policies that govern the spheres of foreign investments are directly affected by the cabinet in power that may or may not champion similar ideological views, reforms, and policies. Thus, arguably more important than government turnover *per se*, is in fact policy instability and uncertainty, whereby the clarity, consistency and effectiveness of investment-related policies are in a state of flux, and ambiguity surrounds the procedures for investors and businesses. Here, I am particularly concerned with related 'policy risks', which can be defined as "a risk that arises from legal policy actions–as opposed to illegal government actions–that adversely impacts the financial stability [of a project] (CEPA, 2014, 6), or more broadly, "the risk that a government will discriminatorily change the laws, regulations, or contracts governing an investment—or will fail to enforce them—in a way that reduces an investor's financial returns" (Henisz & Zelner, 2010, 2). In fact, Italy's general policy stability and continuity is in a constant state of flux, and 10 of 14 respondents highlighted this issue as a major inhibitor of investment. Not only are direct investment policies complex, but almost all business-related ones are, i.e. on which level of government has jurisdiction over licencing, permits, etc. Moreover, public and vested-interest resistance to policy changes concerning these issues is extremely strong and contentious.

The World Bank (2011) notes multiple, 'interactive' factors such as market size and ease of access that are significantly associated with FDI inflows, but it holds that the principal means to attract FDI is the quality of the investment climate, i.e. the characteristics of institutions, policies and regulations in the host-economy. A functioning bureaucracy, clear regulations and laws are part and parcel of a consistent investment policy, and directly stem from political decisions made by the sitting government. Thus, a first category of policies to attract FDI are those which can be defined as 'generalist', that is, measures meant to boost the competitiveness of a country by intervening in the overall business climate. Vivoda (2011) refers to them as 'indirect' measures to promote investment (institutional reforms), as opposed to 'direct' ones (advertising a pro-investment policy). Indeed, if inward-FDI is likely to increase when procedural and legal clarity, institutional accountability and transparency are apparent (Vivoda, 2011, 52-54), then governments have an interest in making sure their institutions do so.

Successful investments generally require *effective* host institutions and policies, which according to Jalilian et al. (2007), are determined by factors like fair public provisions, bureaucracy quality, public servants, and accountability/transparency in 'getting the job done' equitably. The perception of excessive procedures, time wasting, and incompetent administration will do the opposite—discourage FDI (Globerman & Shapiro, 2002).[136] The Italian institutional and policy 'hosts' of such prospective investments, often facilitate a non-conducive investment climate, a lack of confidence on the part of investors, policy uncertainty, and inflexibility in

[136] Interviews # 22-24, 26,-7, 30-1

business relations.[137] In addition to policies meant to influence the investment climate, including the pursuit of macro-economic stability and the reduction of costs connected to red tape and administrative barriers, both developed and developing countries have started to deploy investment promotion strategies directly aimed at filling in information and/or perception gaps that may thwart investment inflows (Rajan, 2004). Not only are political stability, security of tenure, policy and budgetary consistency, transparency, and market-openness necessary for inward-FDI, but ideally, active promotional programs to attract investment also constitute valuable tools (Vivoda, 2011).

When policies and regulations concerning investments are constantly changing, or are altogether convoluted, investors are more apprehensive to use their capital. Thus, a clear policy framework, fair competition, and local business support for investors are additional FDI determinants for all types of countries (UNCTAD, 1998), but are especially important for historically low inward-FDI countries such as Italy which do not have the associated reputation for maintaining investments. One could thus assume that a concerted effort on the part of Italian governments to placate the historically negative perceptions of political and economic instability would be in order. Yet it does not appear that Italy has been undertaking efforts to attenuate such a negative perception and investment reality, as there is limited assistance for promoting foreign investment (FITA, 2014). In fact, unlike most EU countries, Italy has never endowed itself with a full-fledged FDI attraction strategy (Mariotti and Piscitello, 2012, 140). This assessment was echoed by numerous (7) respondents who lamented the lack of support and assistance for inward-FDI.

Rajan (2004, 12) lists four categories of tactics for FDI attraction: "(a) image building activities promoting the country and its regions and states as favourable locations for investment;

[137] Interviews #22-25

(b) investment generating activities through direct targeting of firms by promotion of specific sectors and industries, and personal selling and establishing direct contacts with prospective investors; (c) investment-service activities tailored to prospective and current investors' needs; and (d) raising the realisation ratio (i.e., percentage of the FDI approvals translated into actual flows)". Image building activities may also include 'nation branding' policies such as the ratification of bilateral trade and investment treaties, or the exchange of visits between high-ranking government officials, or in general any other public diplomacy initiatives aimed at enhancing a country's "soft power" (Fan, 2008). On the whole, data gathered from my respondents would suggest that Italy is underperforming in each of these four tactics at the national level, while discrepancies remain marked at the regional levels.

We can utilize the issues of stability, continuity, open markets, procedures and the rule of law (all essential to a strong investment climate as described above) in order to conceptualize the idea and importance of institutional and policy uncertainty for attracting FDI. A PwC study found that an 'opaque' policy making environment would be something akin to a 33% increase in taxation (Henisz & Zelner, 2010), obviously creating a major inhibitor to the flow of inward-FDI. Indeed, research has shown that elevated policy uncertainty in developed economies in recent years has been detrimental to macroeconomic performance (Baker et al. 2015, 24). While traditional drivers of political risk such as confiscation, expropriation and direct seizures of investment related assets have fallen dramatically between the 1960s and 1990s, and are essentially negligible in the contemporary era, the perception of increasing policy risks, as exemplified by press mentions, has risen tremendously over the past 20 years (Henisz & Zelner, 2010). Investment policy uncertainty thus directly falls under the umbrella of political risk. The host country—in order to counteract any preconceived notions, and to be seen as an investment-welcoming region—ought to have a decent investment promotion strategy. Policy design in this sense has become particularly complex in the age of globalization, as has the definition of objectives and the selection of appropriate tools to achieve them (Howlett, 2011). Yet both parties--investor and host-country--come into negotiations and agreements with certain assumptions (whether a risk assessment was procured beforehand or not) about the other. Much like political risk analysis, FDI attraction--and the marketing and branding campaigns that can accompany it--is also about creating a certain perception in the minds of potential investors. This points to important questions on the issue of subjectivity that are inherent to political and economic risk assessments and international investments.[138]

A further set of tools available to governments is the introduction of tax and investment incentives such as grants, tax relief or other subsidies.[139] When introduced, incentives can be advertised by Investment Promotion Agencies (IPAs). Wells and Wint, in earlier ground-breaking work, defined these as "activities that disseminate information about, or attempt to create an image of the investment site and provide investment services for the prospective investors" (1990, 2). In sum, typical tasks of IPAs are first, to build a positive image by advertising their country as 'attractive'; second, to assist the investor in their decisions and ensure continuity, target and coordinate business for specific sectors, and finally to conduct policy advocacy and support (Cass, 2007; Morisset, 2003).

Morisset (2003) also demonstrated that greater investment promotional activity is indeed associated with higher cross-country FDI flows, on par with the influence of investment climate

[138] Subjectivity, while not in the purview of the current examination, in this context means that political risk assessments are intrinsically subjective because they are carried out in the interest of, and from the specific standpoint of, a given investor.

[139] It should be noted that, as highlighted by Mariotti and Piscitello (2012, 148), resorting to such incentives may engender problems of cooperation such as 'races to the bottom' among governments competing to attract foreign businesses. In the context of the European Union, state aid, including in the financial sector, is regulated in the context of competition policy.

and market size, hence their significance cannot be underestimated. Most countries have sought to establish an IPA, and there are over 250 sub-national/regional ones as well. In 1995, the United Nations Conference on Trade and Development (UNCTAD) established the World Association of Investment Promotion Agencies (WAIPA), which to date gathers 170 members from 130 countries, and is focused on information-sharing and best-practice diffusion. While the actual impact of these agencies, especially in the developing world, remains an underexplored subject (Morisset, 2003), what is certain is that IPA activities can help to ease the apprehensions of potential investors and their sometimes hesitant reactions to opportunities in foreign economies.

In the last few years, some steps in the right direction seem to have been taken, but with the typical fragmentation that has always characterized Italy's reform efforts. The consensus seems to be that the central government's role in facilitating foreign investment has largely been underwhelming, and in need of immediate improvements.[140] In 2013, Enrico Letta's government presented the 'Destinazione Italia' (literally: 'Destination Italy') plan, a comprehensive set of measures specifically devoted to attract investors. The original version of the plan was described as a 'systemic, unitary vision' meant to provide current and prospective investors with certainties about fiscal rules, clarity in job market regulation, guarantees about the timeline of authorizations and civil justice, with the ultimate objective of enhancing Italy's distinctive assets – that is SMEs, tourism, culture, real estate – and to turn Italy into an attractive place for competences, professions and talents (Ministry of Economic Development, 2014). The national decree 'Destinazione Italia' was meant to follow the government's reform agenda for businesses and investors, which included tax reform, labour market reform (Jobs Act), and the Investment

[140] Interviews #17, 22, 23, 24, 26, 27, 31

Compact Act (IBII, 2015). It was also meant to create a streamlined agency for the promotion of investment in Italy on a par with ICE's mandate to internationalize Italian companies.

Basically, *Invitalia*, which online still purports to be the 'national agency for inward investment and economic development,' supposedly now only focuses on national incentives, start-up and innovation support, and EU project funding, rather than working as an agency for private inward FDI support.[141] So these types of departments, together with provincial agencies, and the other local chambers of commerce across Italian regions are meant to be secondary to a single national IPA – *Invest in Italy*, which falls under the Trade Agency, and hence the Ministry for Economic Development. A few years and reforms later, this department, while currently functioning, has only recently begun promoting Italy as a hub for investment at roadshows across the globe. Though it is available for investment inquiry through a regular online contact portal, the activities and services it offers are yet to be clarified or corroborated[142].

In sum, when the *Destinazione Italia* plan had to be turned into an actual *decreto*[143], or legislative decree, less than half of the measures initially envisaged were maintained. Moreover, one of the main issues at stake, that is the definition of the role and resources for a national IPA, remained basically unsolved (Il Sole 24 ore, 2015). The proliferation of agencies which apparently share the same objective, i.e. acting as a hub for potential investors, is further epitomized by the creation, planned in 2013 by the Italian Ministry for Economic Development,

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[141] This information had also been relayed to the author via recent correspondence with Invitalia.

[142] See http://www.investinitaly.com/en/. Multiple requests for information and meetings by the authors were not replied to.

[143] A 'decreto legislativo' or legislative decree in Italian law is a decree issued by the government (formally, by the President of the Republic) upon delegation by Parliament through a law. It has the same value and force as legislation issued by the Parliament. A 'decreto legge', or law decree is also issued by the government (formally, by the President of the Republic), but under exceptional circumstances of necessity and urgency. It has the same force of a law but lasts only for 30 days, after which the Parliament has to accept it (and it becomes legislation by the Parliament) or repeal it. It is often transformed into a law through Parliament with significant amendments.

of an online 'International Trade Hub'[144] meant to provide information for both outgoing and incoming investors, clearly overlapping with both the core competences of the Italian Trade Agency (ICE) and *Invitalia*. Also symptomatic of a lack of coordination is the fact that regional IPAs such as Invest in Lombardy and Invest in Turin-Piedmont, provide excellent investment-related services and guidance in navigating the complex Italian bureaucracy of diverse sets of laws and regulations at multiple levels and sites of government.[145] This speaks clearly to another well-known 'structural' problem of Italy, that is the above-mentioned underdevelopment of its Southern regions vis-à-vis the wealthier and industrialized North regarding regional economic disparities.

In fact, the difficulties that a potential investor would encounter when trying to resort to a central Italian IPA constitute a good example of what could be defined as problems of accessibility to the Italian business environment. Due to the ambiguity of information disseminated on the web in this respect, for instance, the first obvious problem for a prospective investor would be to understand to which agency assistance requests should be addressed, since both *Invitalia* and *Invest in Italy* describe themselves as countrywide IPAs. The user-friendliness of both these websites can also be highlighted by comparing them to the Spanish and French IPAs, in light of the fact that, as pointed out by the CEO of a leading branding consulting company, "Investors are undoubtedly making more and more decisions about potential investments through online resources, specifically with the act of searching online" (Bloom Consulting, 2015, 2).

[144] "International Trade Hub/Italia (ITH Italia): portale unico per l'internazionalizzazione". See ANIMA (2013).
[145] See more on Regulatory Regime and bureaucracy issues in Ch. 5

Using a checklist approach (see Table 4.6) to assess the accessibility and user-friendliness of the online portals of *Invitalia* and *Invest in Italy* can be useful for a preliminary look at their functionality, especially in comparison those of the Spanish and French IPAs.

Table 4.6: Assessment of Italian, Spanish and French IPA website Accessibility

Agency	INVITALIA	INVEST IN ITALY	INVEST IN SPAIN	BUSINESS FRANCE
Website Url	www.invitalia.it	http://www.investinitaly.com	www.investinspain.org	www.sayouitofrance-innovation.com
Criteria*				
Accessibility	*NO*	YES	*YES*	*YES*
Contacts	*YES*	*NO*	*YES*	*YES*
Languages	*YES*	*YES*	*YES*	*YES*
Activities	*NO*	*NO*	*YES*	*YES*
Updates	*NO***	*NO***	*YES*	*YES*

** Leading questions for checklist evaluation:*

Accessibility: Is the IPA's website immediately accessible from the most used search engines (e.g. Google, Bing)?
Contacts: does the homepage provide detailed contact information such as phone numbers and email addresses?
Languages: Is the website fully available in English and/or other foreign languages?
Activities: Does the website immediately convey practical information on the IPA's activity?
Updates: Are there constant content updates?

*** As far as the English version is concerned.*
Sources Above. Websites last accessed on June 1, 2018.

Empirical evidence shows that well-functioning IPAs, especially those that have reporting mechanisms to high-ranking policy-makers or the private sector, are effective in attracting FDI (Morisset, 2003). On the other hand, there is also evidence of competition effects from neighbouring countries, i.e. diversion of foreign direct investment due to investment incentives offered by other countries at similar income levels in the same geographic region (Harding & Javorcik, 2007), hence the relevance of the present comparison. Unsurprisingly, results are in line with the data presented above: at first glance, leaving aside for a moment the intrinsically problematic co-existence of competing agencies in Italy, the French and Spanish IPA websites are far more accessible and user-friendly. Such comparisons certainly have their limits, but when coupled with a comprehensive account of the state of the investment climate, government indicators, FDI statistics, and the type of empirical evidence that follows in the next chapter, we can clearly point to investment policy and enhanced attractiveness as key issues in Italy's difficult quest for further economic growth.

In sum, prevailing Italian policies towards inward FDI are rather 'laissez-faire', and this is a major problem for a country in dire need of investment and growth: "Italy has not practised any FDI screening policy, and no special treatment has been provided to foreign investors for a long time", note Mutinelli and Piscitello (2011, 6). That observation was been corroborated by 9 of the 14 respondents who lamented the poor quality or (mis)information regarding investment promotion or assistance, the lack of coordinated central and local IPAs, and the confusion surrounding incentives, and simply legislation or policy clarity regarding inward investment. Without assistance from a central agency or 'one-stop-shop', foreign investors feel increasingly isolated and confused, without anyone to turn to.[146] This reputation is widespread, and presents a huge challenge and risk to foreign investors, who are put off by misinformation. Coupled with other factors such as larger questions of division of powers and concurrent legislation among regions and provinces, plus a convoluted political process involving interference, negotiation, and compromise between unions, local governments and politicians, respondents were weary of the political and institutional problems that seem insurmountable.[147] The US State Department tends to agree about these shortcomings, noting in late 2015 that:

> The Italian government's efforts to implement new investment promotion policies to position Italy as a desirable investment destination were undermined in part by Italy's ongoing economic weakness, setbacks to reform initiatives, and lack of consistent progress on structural reforms that

[146] Interviews 17, 20-31.
[147] Interviews 20, 23-29

> could repair the lengthy and often inconsistent legal and regulatory systems, unpredictable tax structure and layered bureaucracy.[148]

Yet, as the Italian economy moves into fragile recovery mode after the longest recession in recent decades, unfortunately the political momentum for improvements to Italy's investment milieu have soured due to governmental and electoral instability, populist and anti-establishment responses to austerity and the Euro, and continued economic malaise. This has facilitated a sustained weariness and distrust of the political classes in the face of much needed reforms, and skeptical political groups and movements (i.e. M5S) have taken advantage of this and worked to stall any support for deeper economic liberalization. Finally, as Italian governmental stability remains a concern, the government is not doing itself any favours by passing electoral laws that are transparently partisan, but nevertheless end up facilitating fragile coalitions. The political bargains struck for yet another electoral system currently in the works will continue to undermine stability and encourage further distrust in the system in this delicate time of post-election uncertainty. The next chapter builds on these inquiries, and discusses the inherent relationship between the political-economic realms of political risk analysis, and the regulatory, locational, and social factors that ought to facilitate investment.

[148] US State Department, Investment Climate Statement, 2015; Interview #22.

CHAPTER V. What's in a political risk? Regulatory, Infrastructural, and Socio-Cultural Investment Determinants in Italy

Having established the importance of focusing on the relationship between a macro-economic climate and the institutional and political (including policy-related factors) experiences of a country, this section addresses the factors that stem from those political and institutional decisions or realities—and thus facilitate political risk. The purpose is to uncover the dynamics and elements of investment-related difficulties specific to Italy that embody political risk as outlined in earlier sections, and to reinforce the point that the context of those complex relations matter. As we saw above, over the past few years, perceived and actual political risks in the larger developed democracies of Europe (and the US) have increased due to concerns related to political stability, poor economic fundamentals, populism, democratic cohesiveness, and electoral anxieties, among other things. A related outcome is to continue to review the benefits of a more detailed, qualitative type of political risk analysis for developed economies, using the case of Italy, where there has been significant concern for growth and investment, and indeed an international lack of confidence in the ability of Italian governments to overcome the global economic and financial crises (SGI, 2015).

Here I provide further explanation as to why this has occurred, by discussing the roles of a variety of specific political and business-related issues that have inhibited FDI in Italy, in the forms of regulatory regimes and reforms to public administration, infrastructure and location, along with socio-cultural factors. This chapter is also based on primary field research conducted in 2015-16 in Italy, supported by literature and statistics, and discusses the practical difficulties that businesses face in the complex Italian market. I aim to demonstrate that, ultimately, the importance of specific (regulatory and soft/socio-political) factors derived from the political and institutional realities mentioned in chapter 4, are found *behind* and *within* political risk assessments, and are essential to a holistic understanding of investment-related decisions, and ultimately the success of a foreign venture. Further, regional differences, infrastructural and operational issues surrounding the type and location of investments, are affected by both the regulatory and socio-cultural factors with constant spill-over and feedback (see Figure 4.1).

5.1) Regulatory Regime & Public Administration

"…there will not be any major reforms, everything will remain as it is. The vote was precisely against any change."[149] R. Marchetti, LUISS University, 5 December 2016

In an era of austerity and neoliberal restructuring, reforms to public administration, labour codes, investment and trade regimes have been attempted across Europe. The realities of globalizing firms, financialization, and the effect on governments that were compelled to administer the regulatory changes, all had difficult consequences for European citizens who had been reliant on robust welfare states, stable jobs, and social protections. Particularly in the southern tier of the EU, the expenditures and budget deficits required to sustain these safety nets were becoming increasingly incompatible with the strict rules of the EMU, and with the demand for deregulation by competitive, globalizing firms.

It is worth mentioning that political and institutional reforms of, for example, the electoral systems and the parliamentary process, policy-making, the banking system, or the constitution in

[149] Valdai Club, 2016. http://valdaiclub.com/a/highlights/after-the-italian-referendum-instability/

general, have become increasingly politicized and politically poisonous in Europe over the past decade or so. Entrenched businesses, lobby groups and EU or IMF leaders have pushed for liberalizing reforms, while anti-establishment parties of the left and right have largely been opposed to them, and to Eurozone integration more generally (e.g., Syriza in Greece, the FN in France, M5S in Italy, etc.). It follows that the character and rule of law, legislative actions, and the administration of regulations (public service) flow from the political/institutional factors as outlined in the previous chapter. Equally, the stability and attractiveness of appropriate investment policies are reliant on the actual implementation and upholding of relevant laws, in most cases carried out by different parts of the state's public administration.

As the next sections explain, it is thus often difficult to separate certain political and regulatory-legal sources of risk, given the nature and complexities of democratic law-making, delivering and enforcement procedures. The American Chamber of Commerce in Italy (2014) studied the relationship between policy making, governmental transparency (rule clarity) and their effects on ease of doing business. In their comparison of regulatory risk and transparency of policy making, they found a positive correlation between lower transparency in policy making and higher burdens of government regulations. This was especially pronounced in Italy, which happens to be at the bottom of the European list. A connection I seek to make between the previous chapter and this one is that parliamentarians and policy makers – through the legislation and policies they enact (or fail to) regarding specific regulations, taxation systems, labour laws, infrastructure, projects, etc. – can greatly influence the behaviours and the economic performance of foreign investors and firms, and as a consequence, the overall level of investment-attractiveness of the country as underlined in the previous discussion. There is, I suggest, a direct connection between governmental and policy stability on the one hand, and the public administration and regulatory regimes that execute those policies on the other. Yet for the sake of clarity and, it is important to highlight and extrapolate certain regulatory issues, even though they stem from clear political issues and processes, and are indeed an important part of political risk. Twelve of fourteen respondents discussed at length the issue of difficulties with a complex bureaucracy, the inefficiency of public administration, reform difficulties, and regulatory complications which dissuades any sort of personal or financial investment in a business project.[150] Here I elaborate on these drawing upon subtopics and criteria in Table 4.3.

Reform Programmes

In Italy, the relationship between elected officials and the public service is complex, and constantly evolving depending on the forces and parties at play (see also Radaelli and Franchino, 2004). Both central and regional governments can be involved with the administration of justice, as well as the functioning of institutions and the greater bureaucracy.[151] The independent and 'responsible' nature of the public service, so integral to Westminster-style governments, is largely lacking in Italy, reflecting a different kind of political structure and culture (Putnam, 1993). Although legislative reforms to 'perfect bicameralism', the electoral system, and constitutional changes to regional/central government competences were passed under Renzi's administration, outcry against those reforms directly led to his unpopularity and inability to push through other changes, ultimately leading to his demise after the failed referendum on constitutional amendments.[152] Whether or not some of these reforms were implemented locally is another question entirely. The (in)ability of politicians to negotiate needed reforms to convoluted legislation is clearly a problem that lies in the relationship between politics, the administration of

[150] Interviews 16,17, 20-31.
[151] Interview 25
[152] This constitutional reform effort was one of the most ambitious reform bills ever to be put forward in Italy, amending 47 out of 139 articles.

government, and the cultural attitudes of the political class and those they claim to represent. Mauro Pisu of the OECD Italy desk lamented that one "can pass all the reforms you like but it won't help if the public administration doesn't work properly because that's what puts them into practice."[153]

Berlusconi's chaotic management of the response to the 2008-9 crisis, and his intemperate outbursts against 'capitulating' to the EU, led to his semi-forced resignation in November 2011. He was unwilling, or unable, to attempt the political and economic reforms required and demanded by technocrats of the major EU powers, which contributed to his exit from power. Promised 'business-friendly' reforms to the labour market, governmental accountability procedures, and other major parts of the Italian administrative system and economy began in earnest with Mario Monti's technocratic government at the end of 2011, which replaced Berlusconi. Notwithstanding the positive response by the bond markets to the technocratic attempt at reform, it was met with dismay by much of the populace, increasingly unhappy with the caretaker government. The 2013 general election resulted in a short-term Letta government (10 months) followed by a tumultuous PD party primary in 2014 in which former socialist Pier Luigi Bersani and the old leadership were displaced by the young, pro-reform and new European darling, Matteo Renzi. Once he became Prime Minister in February 2014, Renzi staked his reputation on passing measures to counteract Italy's stigma as a stagnant economy with a creaking bureaucracy, and promised further reform on a par with European and global agendas, in opposition to much of the party's left-wing old guard. The promise surrounding Renzi's leadership and reform plans was high,[154] as the business community, investors, and other EU

[153] Reuters, 2015. https://www.reuters.com/article/us-italy-economy-reforms-analysis/why-reforms-dont-work-so-well-in-italy-idUSKCN0QZ07320150830
[154] Interviews #22

governments were optimistic it might finally be Italy's time to get the economy back on track. But as has been the case too often, such institutional reforms have been painstakingly slow and difficult to push through, if at all.[155]

Between 2012 and 2016, under the leaderships of Monti, Letta, and Renzi, several pieces of legislation were introduced, many of which were also branded in English, i.e. "Save Italy," "Grow-Italy," "Simplify Italy," "Unblock Italy," "The Action Decree," "Good Schools," "Jobs Act," in order to demonstrate the seriousness and modern aspect of the plans for educational, health, banking, investment, and labour reforms. Among the most important[156], was a new 'doing business act' containing laws which were meant to improve the business regulations measured by the World Bank's 'Doing Business' indicators in order to move up in the ranking. This Act also attempted to simplify the regulatory system for the real estate sector, i.e. to establish a common glossary and new rules to file legal appeals on property claims; objectives to improve business development and start-ups such as simplification and fast tracking of authorizations, elimination of ex-ante controls, granting of permits and licenses for start-ups, reduction of red tape and fees by streamlining citizen access at one-stop-shop civic offices; and various tax credits for the employment of highly qualified staff. Most important was the previously mentioned development of a '*Destinazione Italia'* campaign to make Italy a premier FDI destination with better investment support and a single official contact point for firms.

Another key reform was that of the historically inefficient and cumbersome labour market. Italy's real labour productivity per hour worked was 15% less than the Eurozone average in 2016. Significant restructuring was planned through the 'Jobs Act' in 2015, aimed at easing

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[155] For press on Renzi's first electoral promises and their early results, see Signorelli (2014).
[156] Summarized from Interview responses and materials from 'Invest in Italy, 2016', Ministry of Economic Development.

restrictions for large companies to lay off workers and provide flexibility, and simplify labour laws, while at the same time giving fiscal incentives to firms that hired permanent workers on new terms. Specifically, the Act was meant to catch Italy up to other developed economies on labour flexibility, for example in reducing risks to companies, deregulation of permanent contracts and of the dismissal regime (i.e. indemnity for wrongful dismissal in lieu of worker reinstatement), tax/social security breaks for employers who offer permanent job contracts, and promotion of firm-level collective bargaining. This major reform was met with fierce opposition by many Italian workers and unions, and has not necessarily had the desired effects on the labour market (Reuters 2015b), ultimately reinforcing public aversion to reform efforts more generally.

A number of taxation and civil justice system reforms sought to reinforce the anti-corruption authorities and mechanisms, and create a simplified, fast-paced and accessible judicial system for individuals and small businesses (Justice System Decree for Growth). The idea was to reduce the tax burden on firms and individuals, provide tax credits, strengthen intellectual property regulations, and more. Further, a new form of tax tribunal was made available for companies that intend to invest in Italy and a dedicated desk for foreign investors has been created at the Italian Revenue Agency, in addition to tax breaks and incentives for hiring youth, maintaining energy efficiency, and R & D expenditures (Growth and Internationalization Decree). So the basis for improved growth was put in place through the reform plans to business, labour, and taxation systems, but marked improvements to economic growth and FDI have yet to take hold.

Reforms of policy making and public administration, in theory, aimed to simplify the procedures for passing legislation and the subsequent administering of laws in an equitable fashion by spelling out a clear administrative process, in the form of reduction of red tape, a digitalization and modernization plan, and increased transparency across the administration and levels of government. Indeed, the referendum that Renzi lost in December 2016 was essentially framed to reduce legislative gridlock, which has plagued Italy for decades, by eliminating legislative duplication through a reduction in the role and politicization of the Senate.

Though in the 1990s and 2000s Italians had shunned some neoliberal reforms embraced by their OECD competitors, the opportunity to embrace them again has recently presented itself. Yet fewer than two-thirds of the reform plans have been approved in Parliament (ICE, 2015), and even fewer have actually been instituted throughout the regions and different levels of government. Of those that have, the degree of their implementation across regions and provinces is uncertain. Experts in the field are not optimistic: "Italy needs a cultural, political and administrative revolution."[157] In the meantime, the general bureaucracy continues to stifle many aspects of quotidian life, especially business relationships (see below). A case in point was part of the constitutional reform (Title V) proposed (and failed) which regulates the distribution of legislative powers between the State and the Regions. This part was meant to clearly distinguish between the roles of government and the competences of local authorities, which have historically been subject to confusion and dispute in the courts.[158] It asked Italians to give the government power to remove 'provinces' from the constitution, thus allowing legislation proposed in 2014 to remove overlapping, perhaps wasteful, competences between levels of government (region-province-municipality). Part of the effort was meant to streamline citizen access to the civil service and to alleviate convoluted processes related to permits, etc.

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[157] Vito Tanzi, IMF Public Finances. Retrieved at Reuters, 2015c. https://www.reuters.com/article/us-italy-economy-reforms-analysis/why-reforms-dont-work-so-well-in-italy-idUSKCN0QZ07320150830

[158] For more on quasi-federalist regions in Italy, see: Bassanini, F, 2012.

While these aspects of the constitutional reform did not explicitly address potential investment increases, it was attempted as a way to streamline policy-making, public administration, and to boost the government's executive decision-making powers. By mandating needed structural reforms, and quickly adopting measures to consolidate political stability—which has been determined as a key factor for international investment[159]--the government sought to free Italy from its longstanding reputation as possessing a stifling bureaucracy. Ernst and Young and the American Chamber of Commerce-Italy (2016) attempted to quantify the potential economic impacts of the reform programmes, hypothesizing a 6% increase in Italian GDP over 10 years if all the reforms were carried out properly. Alas, given the referendum results, this does not appear to be feasible. Further attempts at reforms seem to be on hold for the near future, especially given the wavering support for reforms in general, and the consolidation of an anti-establishment coalition after March 2018 elections. Ultimately, as noted in Table 4.3, nine of the twelve respondents who discussed the important issues of regulatory regime and public administration as investment inhibitors, focused much attention on the problems with reforms as discussed above.[160] The characteristic reform chorus of 'limiting public spending' is just one necessity; "improving administrative quality and bureaucratic efficiency in the delivery of public services are equally important" (SGI, 2015, 3), albeit clearly harder to achieve.

Setting up a Business

Part of the problem with investing and setting up a business in Italy is the multiple types of ventures possible. In Italy, foreign investors can establish themselves as sole traders, or set up a new company in accordance with Italian legislation, or decide to open a branch of a foreign

[159] Interview #26
[160] Interviews #20-27

company. The main types of legal forms are[161]: partnerships (e.g. SAS - società in accomandita semplice; SNC - società in nome collettivo); limited (eg. SRL - società a responsabilità limitata, SPA - società per azioni); and cooperative companies, the most common form being the limited liability company (SRL). Once a partnership or investment strategy been decided upon by the parties, the processes for registration and permissions can begin (see Table 5.1 for the extensive times). In order to provide a more complete picture of the 'regulatory' problems affecting Italy's business environment, we also need to look at the World Bank's 'doing business' indicators, the most obvious source of information in this sense.

One finds that there are no fewer than 5 separate procedures that a business must follow in order to have the legal authority to register: 1) execute a public deed of incorporation and pay registration taxes, 2) purchase multiple accounting books, 3) pay accounting fees, 4) register incorporation, tax number (VAT-IVA), social security (INPS) and workers compensation (INAIL), 5) deal with labour offices for employees (and unions). Actual physical construction of plants, factories, etc., depending on the industry, require further procedures (10 or more separate steps) inspections, assessments and permits that could take up to a year to receive, and ends up costing tens of thousands of Euros in fees alone (World Bank, 2015). Italy fares poorly among most of the relevant and comparative indicators, for example the cost of starting a business (14% of per capita income, vis-à-vis the 4.6% and the 0.9% of Spain and France respectively), days needed to deal with construction permits, days needed to get electricity, days needed to register property, pay taxes and trade across borders. These types of pointers represent the main costs associated with running a business, and obviously assume knowledge of such procedures. Matters become even more complicated for foreign investors who may lack such information. One

[161] Interview 27; Regione Lombardia, 2016

respondent familiar with the procedures for opening up a business in the tourism sector lamented the bureaucracy, conflicting information on permit granting from the authorities between regions and municipalities, and the different sets of rules for types of properties, in addition to the sporadic nature of regulation enforcement and controls on locations, sizes, permits and more. Underscored here was the fact that the authorities actively make it difficult for businesses to succeed by 'finding faults' and using the uncertain regulatory regime as a regulation enforcement tool.[162] It is to help prospective investors navigate this bureaucratic jungle that such agencies as *Invitalia* or *Invest in Italy* (mentioned in Chapter 4) and others were established, although their effectiveness is questionable.

Table 5.1: Comparative Indicators, Doing Business Report, 2017

Action	**France**	**Spain**	**UK**	***Italy***
Cost of starting a business, % of income per capita	0.7	5	0.1	***13.9***
Construction permits, days	183	205	86	***228***
Getting electricity, days	71	107	79	***124***
Registering properties, days	64	13	22	***16***
Paying taxes, hours/year	139	152	110	***240***
Enforcing Contracts, days	395	510	437	***1,120***
Overall Doing Business Rank	29th	32nd	7th	***50th***

Source: World Bank (2017)

Evidently, this data underscores the numerous bureaucratic obstacles existent in Italy, which contribute to the political impediments of doing business there, and taken together, constitute risks. Notwithstanding the attempts at economic and administrative reforms listed above, Italy's performance in the overall *Doing Business* rankings has consistently remained well behind its

[162] Interview #20

European peers over the past five years. Still, it must be noted that its relative position is improving due to the passage of some of those reforms, but this also demonstrates that more are needed. On top of this, the slow pace of technological advancement in the public administration--insofar as ease of access to the bureaucracy, digitization and computerization of documents, data, permits, etc. is concerned--is alarming to many investors who lament overlapping 'written documents that need multiple signatures' and the tardiness of postal delivery.[163] Clearly, the central and local bureaucracies, abetted by the uneven and uncertain enforcement of regulations and permits, creates a regulatory burden that dissuades many investments. In fact, the US State Department notes (2015): "a web of contradictory laws and regulations serves as a useful tool at times for vested interests to use against foreign competitors", referring to powerful domestic associations such as the Italian General Confederation of Labour (CGIL), the Italian Confederation of Workers' Trade Unions (CISL), or the Italian Labour Union (UIL), which frequently pressure the government against undertaking liberalization measures. Quasi-protectionist phenomena such as these further deter investors from even attempting to navigate the complex bureaucracy of setting up an active investment.

Taxation

The taxation system in Italy is a burdensome and convoluted set of rules which are excoriated by local and foreign businesses alike. In addition to comparable European general sales or value added taxes (VAT) and individual progressive tax rates (IRPEF), Italy is saddled with a variety of regional, municipal and corporate taxes that need to be filed by all enterprises depending on a number of factors and locations. For example: IRES - corporate income tax (Imposta sul reddito delle società), IRAP - regional business tax (Imposta Regionale sulle Attività

[163] Interview #25

Produttive), taxation of dividends, general VAT (IVA), IMU - municipal tax (Imposta Municipale Unica), and stamp duty (Imposta di registro) (Regione Lombardia, 2016) are some of the mandatory duties. Each tax and its attendant agency has a distinct set of rules, some of which overlap and compete with the others. This makes it very difficult for foreign investors to comprehend and manage, often requiring a joint venture, local partner, or a domestic accounting/legal firm to aid in these aspects of the business.

Taxation compliance and collection rates have historically been low in Italy, and are among the worst in the OECD. A recent report on tax compliance noted the following major points and challenges[164]:

> -Italy is a high-tax country with a relatively high and stable tax-to-GDP ratio. At the same time, levels of compliance with tax laws are low (+30% evasion);
> -60% of Italians are in favour of fighting against tax, and almost one out of two Italians (48%) judges this task as being a priority for the Government;
> -A voluntary tax compliance scheme was introduced in 2015;
> -There is now a need for reforms aimed at generating significant behavioural change, by both taxpayers and tax administration;
> -Tax administration functions in Italy are fragmented across multiple bodies with some roles and responsibilities overlapping. Better coordination and a single authority is needed;
> -Tax debt is exceptionally high and Italy, and Equitalia's powers to enforce the collection of tax debts have progressively been limited by the legislature (OECD, 2017, 7-10).

Obviously, when hundreds of billions of euros in taxes remain uncollected or go unreported, and the different tax agencies compliance models are uncoordinated, this results in serious reservations on the part of businesses and investors to commit to the venture or capital exposure. The Finance Ministry has estimated that approximately 200 billion Euro has been removed from Italy for the purpose of evading taxes. The major issues outlined by respondents focused on compliance, collection of debts and taxes, and unclear/uneven enforcement of taxes and related

[164] OECD, 2017. 'Italy's Tax Administration'.

penalties. There is a significant relationship between taxation reporting and the realities of small or familial business cultures, where evasion can be common. For the foreign investor, this cultural gap (political and entrepreneurial) can be very difficult to comprehend and overcome, especially when the home-country rules on tax evasion are often much stricter. It is common for firms to make roughly 14 annual tax payments for the various types of levies, and take approximately 240 hours to prepare and compile the forms connected to them, as we saw in Table 5.1, in addition to paying taxes on around 62% of their profits (World Bank, 2016), which is quite a significant amount. It had often been the case in emerging economies with loose regulatory enforcement mechanisms that large MNCs take advantage of such lax rules and generate higher profit margins, for example in mining industries in the global South, even if their reputation was at stake. Equally, one could ask if loose enforcement of taxation in Italy could be an incentive to invest there. However, investors and experts have expressed serious concerns about unpredictable tax prosecutions, and unfair investigations for tax evasion into foreign companies in Italy that had been following consistent accounting principles, or even the threats of criminal prosecutions, when civil litigation would have been the norm.[165] These experiences and perceptions of unequal tax treatment add to an aura of protectionism and discrimination, and coupled with the statistics above, all contribute to hindered investment numbers.

Judicial/Legal System & Labour Rights

"Italy is the cradle of law but the grave of justice."[166]

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[165] Interview #22

[166] This saying is a typical taunt in Italy, regarding matters of the law. It is common to speak of the '*legale vs. paese reale*', the 'legal and real countries'. For more information on the historical paradox of the large body of law that hangs over quotidian life, yet the non-existent or uneven enforcement of it, see: Spotts & Wieser, 1986, Chapter 8.

Italy's ailing judicial system is notorious for being one of the slowest and most convoluted in the OECD. Global figures, for example, regarding judicial independence (78th), legal dispute settlement and policy transparency (143rd), place Italy in the bottom half of the entire world (World Economic Forum, 2015). This sort of classification is problematic for not only foreign businesses, but local enterprises are forced into drawn-out court proceedings and litigation over permits, registration, unclear regulations, or civil suits. Often, these cases remain before tribunals for years before being resolved, by which time many investors and businesses have abandoned their projects,[167] again reinforcing Italy's reputation as stiflingly bureaucratic. Italy follows a Civil Law code with several judicial levels where lawyers and judges are essentially civil servants. Many observers argue that this has led to the politicization of the judicial branches with a dysfunctional system that is slow to enforce property and contractual rights. Although, as mentioned in the section on reforms above, the government introduced legislation in 2014 intended to reduce the backlog of civil cases and speed up the processing of new cases, including an emphasis on alternative dispute and other methods of resolution, these procedures remain painfully slow to make it through the system and result in further court challenges to longstanding conventions and legal *modi operandi*. In fact, it is not uncommon for appeals to drag on for up to ten years by the time the Supreme Court (*Cassazione*) rules on them.

Italy's legal rights for borrowers and lenders are also substandard and ranked quite poorly (2/12), well behind European comparators, meaning that collateral and bankruptcy laws are not really suited to facilitate access to credit. As outlined above, simple contract and commercial disputes which require legal enforcement at the court level, can take up to three years to resolve due to civil procedures and complex regulations, and at an average cost to parties of around 23%

[167] Interviews 20-23, 25-29, 31.

of the value of the object of litigation (World Bank, 2017), at which point a business may have already failed, been sold, or simply abandoned. Labour relations and rights, meanwhile, are regulated by both collective and individual agreements. The national collective agreements are often supported by large trade unions and powerful industry associations (i.e. Confindustria). There is a general assumption that mandatory labour protections can only be changed for the benefit of the employee, and it is historically difficult, if not impossible, to lay off public sector workers without just cause. In the case of collective dismissal and/or sale or transfer of the business, unions have the right to be consulted and often contest the sale on behalf of employees (Regione Lombardia, 2016). The Jobs Act reforms as laid out above sought to make some of these laws more flexible for employers, were met with much discontent from organized labour, but were nonetheless passed, which is why the opposition parties such as M5S and Lega campaigned to repeal them.

It is important to recognize that over the past few years, a majority of new foreign investments in Italy have been in the form of takeovers: the purchase of Italian companies with strong brand appeal, or enlarging already existing ones, rather than establishing new production facilities or greenfield investments. This is no coincidence, insofar as investors are weary of all of the bureaucratic and fiscal obstacles involved with on-the-ground operations and physical investments. Popular telecommunications, large sports (football) teams, and even small manufacturer purchases have been increasingly dramatically: 2014-16 saw a sharp uptick in the number and value of foreign mergers and acquisitions of Italian companies, which has been met with much popular backlash and political unease, especially as purchases from China increased. The government response was characteristically convoluted: first promising a quasi-protectionist scheme to protect Italian firms from buy-outs in early 2017, which was then dropped a few months later due to disagreements in the ruling PD government between cabinet ministers and former Prime Minister Renzi who still exerted some degree of control.[168] Ultimately, the theme of regulatory regime and public administration, including the incomplete or failed reforms, present the most significant obstacles to successful business and investment in Italy, and should be re-evaluated as some of the most pressing politically-charged risks. The risk factors outlined here, which together form the problem of 'layers of bureaucracy' require more attention in the realm of developed economy inward-investment because they are often assumed to be amenable to capital and markets; yet in a deteriorating political climate of institutional deficiency and scepticism regarding market logic, the rules and administration of laws that govern investments ought to be considered as political entities that are influenced by the very policies and governments that mandate, or fail to mandate, them.

5.2) Infrastructure and Location

The level and type of risk regarding operational issues are more dependent on the specific company or industry being assessed. Inevitably, more resource-intensive or technologically-dependent sectors of the economy will require better infrastructure and accessibility than other types of investments. That being said, every type of business needs, minimally, a reasonable amount of accessibility, security, and connectivity. At least 8 respondents were concerned about transportation infrastructure with respect to specific cities, and especially remote locations where there is room for economic development, but that are burdened by decaying or inadequate infrastructure. Other issues include substandard or non-existent internet connectivity and

[168] See: CNBC, 2017b. http://www.cnbc.com/2017/02/08/reuters-america-rome-moves-to-shield-italy-inc-from-corporate-raiders.html; and for the dropped plans, Reuters, 2017b. http://www.reuters.com/article/us-italy-mergers-idUSKBN17E1RN

technological backwardness in many areas, and a lack of focus and investment on research and development in a general sense. With regional disparities among the highest in Europe, even with access to Cohesion and Regional Policy funds (ERDFs)[169], Italy has a significant amount of work to do in order to reallocate investment, both public and private, into areas that require it. Again, the opportunity for investment across the peninsula is apparent, especially in underdeveloped regions, but accessibility is underwhelming in the South. Venture capitalists, angel[170] and foreign investors are very apprehensive about funding start-ups or large projects in areas with poor access and infrastructure for reasons mentioned above.[171] Compounding this is the hitherto poor record of the Italian government in providing credit support[172] to firms in southern regions (especially in the context of failing banks and non-performing loans), and difficulties in reforming the real estate sector as well as a chronic lack (or waste) of funds for infrastructure. Thus, despite comparatively discounted assets, successful investments still require accessible and stable infrastructure, and advantageous policies to underpin them.

A related drawback is characterized by a well-known regional gap in terms of economic development, a large disparity visible in the distribution of FDI as shown in Figure 5.1 below. Unsurprisingly, the regions which attract more FDI are also those which are best equipped in terms of territorial policies for the attraction of FDI, including the presence of effective regional promotional agencies and solid infrastructure and transportation connectivity. Such regional discrepancies were important investment determinants for 7 respondents, insofar as the cultures

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[169] Interview #29
[170] Angel investors are high net worth individuals, who invest personal funds at arm's length in businesses owned and operated by unrelated individuals. Smaller amounts of seed funding are invested on a long-term basis in exchange for repayable or convertible debt or equity in the company.
[171] Interview #17
[172] The percentage of individuals in Italy who have Credit registry coverage is only 29% (WB, 2017)

of business, rules and hierarchies to follow, and access to the state were vastly different across the country. The *Doing Business* reports corroborate these sentiments by laying out the discrepancy among Italian cities in business accessibility and processes. The table below (5.2) demonstrates this subnational divide, which really does not follow any logical or geographic order.

Table 5.2: Subnational Economy Rankings – Doing Business Report, Italy (Selected Provinces)

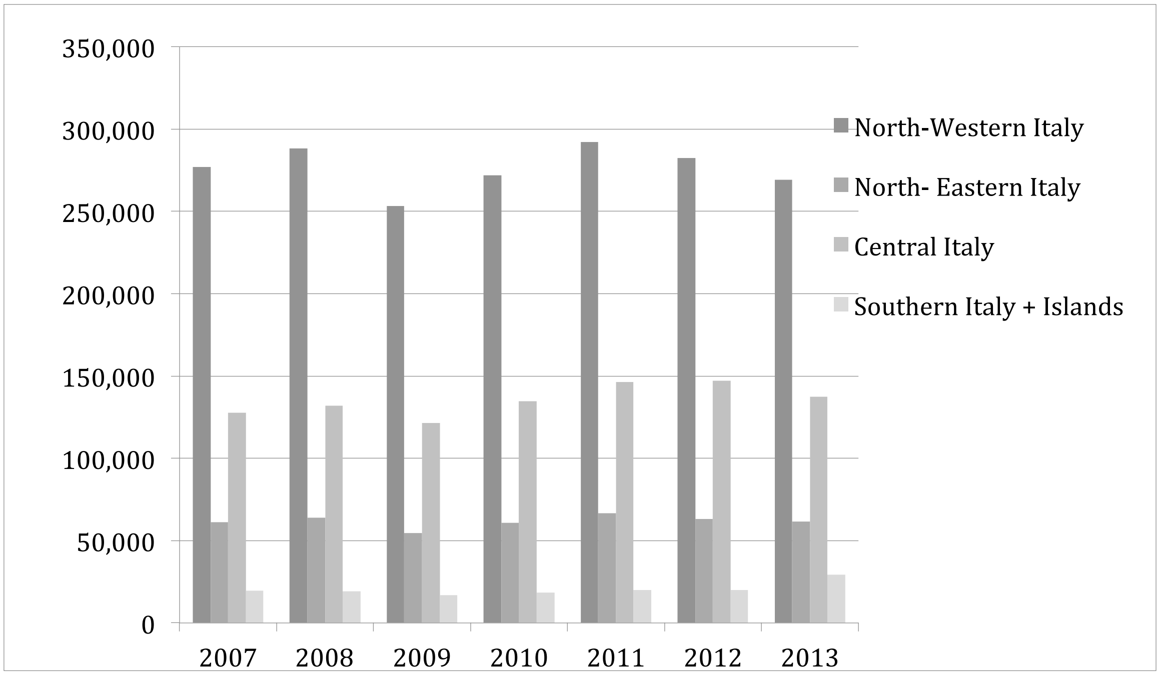
Province	*Starting a Business*	*Dealing with Construction Permits*	*Registering Property*	*Enforcing Contracts*
L'Aquila	9	3	9	8
Padua	2	5	12	12
Bologna	4	1	1	11
Cagliari	11	2	6	5
Campobasso	13	8	3	5
Catanzaro	1	10	5	7
Bari	6	9	7	13
Milan	8	3	7	10
Naples	12	11	3	2
Palermo	5	12	2	9
Potenza	3	13	11	3
Rome	7	6	13	4

Source: World Bank, 2018

While the poorer South-Central city of Campobasso ranks 3rd in registering property, yet 13th in starting a business, the industrial and financial capital of Milan ranks 3rd in construction permits, but 10th in enforcing contracts. This speaks to the chaotic and decentralized nature of business regulations in Italy which can change rapidly over a few years. Foreign investors (and political risk assessments) are especially looking for a sense of security and certainty in the institutional environment in order to plan for the medium term health of their assets. But such regional regulatory incoherence only contributes to their lack of confidence in the political-economic climate. On a more socio-cultural level, the licensing requirements and dealings with state authorities may change at the whim of local politicians and powerful interests, thus contributing to the inflexibility of moving locations or expanding in other parts of the country. This adds to the problem of the lack of harmonization of permission-granting and competences among regions and provinces, which reinforces the roadblocks and 'veto' powers of local governments, complicating important investments in construction and infrastructure[173] which rely on government collaboration with foreign and local firms. Adding to this is the general attitude and conception that "the farther north you go, the more likely that rules and procedures will be followed; and the farther south you go, the more likely they won't". In the southern regions, it is thought that rules are more 'guidelines', while what really matters are the contacts one can make with the right people in the administration.[174] Finally, energy costs like gasoline are prohibitively high for many sectors that rely on transportation of goods, and this is especially worrisome in areas that lack adequate alternative forms of transportation. The figure below demonstrates these issues with statistics on foreign investment discrepancies across the regions. These gross imbalances must be addressed if Italy wants to narrow the regional gap.

[173] Interview 22
[174] Interview #25

Figure 5.1: Revenues of companies with foreign shareholders in Italy, by region (mn of €Euro, 2007-14)



Source: ICE (2016)

Citizens in Italy's regions are acutely aware of the country's regional gaps, and one of the most interesting takeaways from the 2018 election was that the poorer regions from southern Lazio downwards, overwhelmingly voted for the anti-establishment 5-star movement, which promised various basic-income and support schemes for poorer Italians, and took advantage of the longstanding sense of government failures in addressing national inequalities. Compounding the problem of economic and institutional disparity between North and South is the issue of brain drain and emigration from south to north, and from Italy to abroad (see next section).

On the basis of the above, it is safe to say that when it comes to FDI attraction, Italy is not meeting its potential, especially given its comparative advantages in manufacturing, and its FDI attraction policy-making has been fragmentary and contradictory with patchy administering of laws and regulations concerning investments. This sub-section[175] elaborates on the issues of location and infrastructure vis-à-vis policy and instability in Italy as a further dissuading factor for prospective foreign investors by referring to two important infrastructure projects. The construction industry is especially connected to large public infrastructure projects, and is particularly prone to disagreement and contention for several reasons. First, is the vital role of public procurement: the ultimate decision-makers, governmental authorities, etc. are 'political' by definition - meaning that their decisions may be influenced by issues which are not uniquely linked to the profitability of the project. Second, because the development of infrastructure has numerous ramifications in terms of boosting growth for other industries (and thus GDP), meaning that the political stakes are usually quite high. Third, because of the need to rely on contractors, as well as the close relationship between private and public actors for construction permits, which simply means that the risk of corruption in the industry is particularly high (KL & Gates, 2014; PwC, 2014). Thus, given the prominence of actual policy risk in the industry, a brief look at the construction sector in Italy can convey relevant insights. This is an under-explored research area, as studies on political risk in construction tend to be conducted in emerging or developing countries (i.e. Ling & Hoang, 2010). This industry is also important in the context of the Italian government's plan in late 2014 to use €40bn for infrastructure projects, as part of the EU's larger 'Juncker Plan', a massive public and private investment strategy to spur growth in the lagging economies (Santilli, 2014), named for the President of the European Commission. Two events, in Messina (South) and Florence (North) are used to supplement the indicators and discussion above that point to the relationship between FDI levels and discontinuous and unstable investment policies along with lacklustre infrastructure.

[175] See more in the previously published version: Campisi, J. & Sottilotta, C. (2016).

Messina Bridge

This is one of the biggest construction projects ever planned in Europe, namely, to span a the Messina Strait linking the island of Sicily to the mainland (Calabria). This plan has been in the works for decades. In 1969, the Italian Ministry of Public Works first issued an international call for design ideas and subsequently created the sub-company *Stretto di Messina (SdM)* S.p.A. By the early 1990s, the project had gone from a mere idea to a technically sound proposal of a single span suspension bridge (Brancaleoni et al., 2010). In 2005, the Eurolink consortium led by Impregilo, Italy's largest construction company,[176] won the tender for the construction of the bridge at a cost of around €388 bn, and in 2006 it delivered a plan for a 3.3km suspension bridge (Virola, 2008). The project had a strong international character with large MNCs involved since the inception of the project, both as part of the Eurolink consortium and as regards the project management consulting services. As far as this latter aspect is concerned, Parsons Transportation Group, a leading American MNE in infrastructure markets – with a special focus on suspension bridges –was awarded a project management consulting services contract worth €120 mn (Roadtraffic Technology, 2016).

But in April 2006, general elections took place in Italy, producing a change in government. The new government led by Romano Prodi removed the bridge project from its priority list (KHL, 2006), with a subsequent halt to the activities of the general contractor and of the project manager, yet again postponing the plan.[177] The contracts concluded for the realization of the bridge, however, were not rescinded but only suspended. In April 2008, new elections took

[176] In addition to Impregilo, the Spanish Sacyr, the Italian Condotte d'Acqua, the Italian Cooperativa Muratori & Cement - CMC, the Japanese Ishikawaijma-Harima Heavy Industries and the Italian A.C.I. - Consorzio stabile, were part of the consortium.

[177] A bill was passed (Decree n. 262 of October 3, 2006, later converted into Law n. 286/2006), imposing the diversion of financial resources originally destined to the project to other unspecified "infrastructure interventions" in the Sicily and Calabria regions.

place, with a pro-Messina bridge coalition led by Silvio Berlusconi returning to power. Thus, in May 2008, the project was revived, as the contracts signed in 2006 were still valid, although some disputes with contractors had to be settled (Kennedy, 2009). The preparatory works on the railway infrastructure of the Italian mainland began in December 2009, with 2016 slated as the expected completion date. In July 2011, the board of SdM S.p.A. approved the final project and the construction of the bridge was set to start by mid-2012 (Structurae, 2013). Before the works could actually begin, the official approval of the *Comitato Interministeriale per la Programmazione Economica* (CIPE), a governmental committee for economic planning, was needed. However, in the meantime, the Italian political landscape was subject to further upheaval.

In November 2011, in the wake of various scandals and a European sovereign debt crisis, the Berlusconi 'political' cabinet was replaced by a 'technical' one led by Mario Monti, as described earlier. The mandate of the new government was essentially focused on implementing reforms and austerity measures. In fact, in December 2012, the Italian parliament passed a law imposing a redefinition of the contracts between SdM S.p.A. and the contractors in light of Italy's deteriorating financial and economic situation.[178] In particular, the new legislation suspended the effects of the previously concluded contracts, requesting that a new agreement with the contractors be reached by March 1, 2013. As such an agreement was not reached, in observance of the newly introduced legislation, the contracts previously stipulated by the state controlled SdM S.p.A. were considered void, while SdM S.p.A. itself was put into liquidation in April 2013. It should be emphasized that this outcome was in line with the wishes of a substantial portion of the Italian political spectrum, especially centre-left parties, which had traditionally opposed the project for reasons including environmental concerns, and the allegedly superfluous and

[178] Law of December 17th 2012, n. 221.

wasteful/corrupt nature of the project. Further, the likely infiltration of organized crime, a major phenomenon in southern Italian regions, also played a role in turning public opinion against the project and in increasing actual risks for foreign investors (Daniele & Marani, 2010, p.10).

The critical economic-financial juncture of 2011-12 in Europe and in Italy accentuated the perception of the financial unsustainability of the project,[179] which was eventually abandoned, leaving behind a trail of complex legal controversies. The penalties claimed by the Eurolink consortium amount to €700 mn, while Parsons Transportation Group has reportedly claimed about €60 mn (Leone, 2014). Impregilo – the frontline company in the Eurolink consortium – declared its readiness in the Summer of 2014 to give up on compensation claims should the Italian government reconsider its decision, and revive the Messina bridge project.[180] Given the history of the project, a future 'resurrection' of the bridge is not impossible, but for the moment, it is not in the cards.

Florence Airport

Another example exemplifying policy uncertainty in Italy surrounds the works for the enlargement of the Florence Peretola airport. The airport, originally built in 1929, became fully operational for civilian use with flights to Rome, Milan and Venice in the 1960s, and by the 1990s was the third airport in Italy in terms of destinations reached (Taddei, 2012). A relatively small structure, with a single runway, in 2012 the Florence airport was included in a list of 12 'strategic' airports deemed to be of primary importance for the development of the country

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[179] It must be recalled that as emerging from the parliamentary debate over the matter, interest in providing financial support for the project had been expressed by China Investment Corporation, a Chinese Sovereign Wealth Fund. On October 2 2012 representatives of SdM S.p.A. and of the China Communications Construction Company Ltd. met in Istanbul to discuss the modes of a possible participation of the latter in the project. Such manifestation of interest however was not sufficient to tip the decisional balance in favour of the continuation of the project.
[180] See Cerami (2014). https://www.huffingtonpost.it/2014/09/19/ponte-sullo-stretto-di-messina-renzi-ci-pensa_n_5850986.html

(Cottone, 2015) and thus meant to be prioritized by the government in terms of economic potential. The airport indeed is strategic because of its location less than 6 km from the city center, serving one of the busiest tourist destinations in the country.[181] In spite of its – theoretically – high potential, the project has been remarkably controversial, with clashes between the central and the regional governments on the one hand and within the local government on the other. Further complications emerged due to widespread parochialism and pressures to abandon enlargement projects by the municipality of Pisa, where another airport is located, for fear of a diversion of passenger flows toward the renewed Florence structure.

After a ten-year standstill, on September 22, 2014 the Italian Authority for Civilian Aviation (ENAC) finally decided that the runaway of the Florence airport would be significantly extended to 2400 meters which would allow larger planes to land (ENAC, 2014). New of this decision by ENAC produced an outburst of discontent in Pisa, while a further obstacle to the development of the project derived from the negative opinion issued by the *Nucleo di Valutazione dell'Impatto Ambientale*, the technical office of the Tuscan regional government in charge of the environmental impact assessment (EIA). In fact, the data provided by ENAC was judged insufficient and too generic to justify a positive opinion on the 'master plan'[182] of the project. Another episode in the Florence project saga was the attempt by the central government to circumvent such a negative technical assessment by introducing an amendment in December 2015 to the budget for 2016 which removed the obligation to carry out an EIA, an attempt which further ignited the debate over the fate of the project, and was subsequently withdrawn after challenged by the parliamentary opposition and local authorities.

[181] According to the Florence center for tourism study, the city reached the record figure of 9 million visitors in 2015.
[182] One of the arguments against the project was precisely the fact that the decision-makers were asked to provide an opinion about a 'master plan' rather than on a well-defined project.

Although at time of writing, the project is still subject to approval delays[183] before the final phase of permits and permissions are obtained, it remains extremely controversial – to the extent that the legitimacy of an EIA conducted over the master plan rather than on the final project was questioned before the European Commission by some members of the European Parliament.[184] Another piece in the Florence airport puzzle is the fact that, in contrast with the central government's aspiration to attract foreign investors, the role of foreign capital in the project (in the case of the management of Tuscan airports, the central role is played by controlling company *Corporacion America Italia*, led by Argentinian entrepreneur Eduardo Eurnekian) is often portrayed as a negative, insofar as the sentiment that the development ought to be Italian-led is concerned.[185] Policy risks, in the case of the Florence airport, were largely due to the high degree of politicization of the project, and the subsequent delays. In this light, it is interesting to note that the political obstacles that blocked the expansion of the Florence airport, for example, the fear of competition with the Pisa airport and the hostility of neighbouring municipalities (largely ascribable to a 'NIMBY' syndrome), are basically the same that in the past weighed against the construction of a new airport for the city in the first place (Taddei, 2012).

Ultimately, these unsuccessful and/or 'delayed' projects represent the failure of policies and government direction or commitment to important infrastructure developments. In a stable institutional setting, governmental cabinet turnover should not necessarily forsake a regional infrastructure project, yet such examples demonstrate how this can occur via existing 'policy risks' in a general climate of regulatory opacity. It is clear that the Italian government has a steep

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[183] On environmental assessment delays into 2017, see Toscana Il Sole 24 ore, 2017. http://www.toscana24.ilsole24ore.com/art/oggi/2017-04-27/toscana-aeroporti-aspetta-ancora-165428.php?uuid=gSLAeClbIC

[184] See European Parliament (2015)

[185] See for instance Meletti (2014); Turano (2016).

hill to climb when it comes to FDI levels, stable policies, clearer regulations and facilitating investment in general. As shown throughout the previous chapter, Italy displays an evident gap between a strong country brand, which boosts the outwards projection of Italian enterprises especially in the short term, and a poor reputation in terms of investment attractiveness, which discourages long-term foreign direct investment. Interestingly, references to the existence of such a gap were not completely absent from the Italian domestic debate over the fate of the Messina Bridge project. In a report prepared for the Italian parliament, the CEO of SdM S.p.A. raised the issue, highlighting the negative consequences which would possibly derive from a cancellation of the project: as French, Spanish, Japanese, American and Danish firms were part of it, there would be clear and inevitable damage in terms of reputation and FDI attractiveness for the whole country. Equally, the report raises the issue of waste in experience and 'know-how' that would occur from the liquidation of SdM S.p.A., which would cease to exist while its foreign partners would retain and build on the knowledge and experiences built up during the initial stage of the project.[186]

Finally, these two examples are not the only infrastructural and construction industry cases to have had serious complications and institutional failures. Similar examples also include the 2009 earthquake rebuilding process in L'Aquila, which has spanned nine years, and recently culminated in ten arrests regarding the awarding of public contracts for the reconstruction efforts. The charges were laid against several public administrators, civil servants, businesses and construction companies, for corruption and other improper management of funds and contracts for construction companies, funded by the state.[187] Another case involves the Venice 'Moses'

[186] See 'Audizione presso la Camera dei Deputati -Commissione VIII -Ambiente, Territorio e Lavori Pubblici' November 28 2012, Intervento dell'Amministratore Delegato di Stretto di Messina S.p.A. Dott. Pietro Ciucci, p. 22.
[187] Abruzzoweb, 2017. http://www.abruzzoweb.it/contenuti/corruzione-in-appalti-post-terremoto-10-arresti-tra-abruzzo-puglia-e-marche/633067-302/

project which has been in the works for years (now nearly completed), meant to protect the city from high tides and floods by using controlled barricades in the water. Work on the flood barriers was delayed for years thanks to a corruption scandal that the project head was involved with, which included the Mayor's office. Allegations and arrests for bribery and illegal political financing were among the charges, and the investigation pointed to a web of kickbacks that moved up the political chain. In the end, Italy's anti-corruption authority had to appoint a new director for the project in order to ensure that corrupt activities would end as the project reached its final stages.[188] These, and countless other examples, across the country, speak to Italy's undesirable image and reputation as a country that cannot facilitate large infrastructure investments and projects without serious complications (financial and legal). The most recent (August 2018) case of the Genoa bridge collapse only reinforces this stigma. In short, the problem with lack of investment is more than superficial, and involves serious and interrelated institutional, infrastructural, and socio-cultural issues of the type we have just discussed.

5.3) Socio-cultural realities: 'Soft' Investment determinants or deterrents?

"In the short run, culture defines the way individuals process and utilize information and hence may affect the way informal constraints get specified. Conventions are culture specific, as indeed are norms." (D. North, 1990, 42)

Douglass North's seminal work underscores the prominence of informal constraints on our collective political and economic choices, potentially more so than the 'formal' rules governing society. Codes of conduct, norms, behaviours and civic conventions can equally govern our interactions with each other, and by extension this holds true for business relations. Even when

[188] The Guardian, 2015. https://www.theguardian.com/cities/2015/jun/16/inside-venice-bid-hold-back-tide-sea-level-rise

institutional or legal rules change, cultural aspects of a society persist and cannot be overlooked (1990, 39-40). The idea of 'institutional distance' which relates to the gap between foreign investor expectations and host-country attributes, is important, and overlaps with the informal and formal constraints on given economic and political interactions. Even though host institutions and the policies they procure, as outlined above, may be different for foreign investors, the degree to which those foreign firms conform to the local environment, including 'informal' traits, is just as important with formally dealing with such institutions (Conway, 2014). Informal constraints can also be understood, in a context of political risk, as 'soft' or socio-political and/or regionally specific issues, and such determinants were noted to be problematic to the investment realm by 10/14 Italy specialists. In this section I will further develop the point that social and cultural realities need to be better considered for a comprehensive analysis of political and business risk (see also Alon & Martin, 1998; Agarwal & Feils, 2007).

One of the only studies on political risk in Italy (Mudambi & Navarra, 2003) in fact focused on the effects of local 'political traditions' on FDI decisions and risk. The authors found that such traditions were influential only at the margin, playing second fiddle to the more obvious economic, locational, and infrastructural factors. But 15 years on, we can take a closer look at other 'softer', socio-cultural or regional discrepancies and issues that may affect investment. As noted in Chapter 3, a number of types of political risk assessments include the idea of 'social' bases of risk in their typologies, while others incorporate them into more generalized indices, or do not refer them at all. I argue (and have in the past; Campisi & Caprioni 2016) that such 'soft' societal-based issues are some of the most important investment-related determinants. These types of sub-risk are especially relevant for developed economies where societal subtleties often fly under the radar given their presumed political and economic stability. Following from the discussion in Chapter 2 on the importance of theoretically situating the importance of institutions in political risk analysis, I suggest that social relations and modes of organization such as patrimonialism or clientelism come to mind as common realities which embody this concept, and suggest that practitioners consider them more significantly.

The concept of neo-patrimonialism refers to a system in which two types of institutional patterns exist simultaneously: the patrimonial system of "personal rule, clientelism and patronage, and the legal-rational system of modern statehood" (Meissner, 2017; Erdmann 2012), of which Italy provides a vivid example. It describes "a social and political order of conflicting modes of organization and their legitimation" (Robinson 2013, 137), meaning that competing forms of political and economic governance and power can take hold and overlap in certain areas (in Italy, especially the southern regions of Sardinia, Sicily, Basilicata, Puglia, Calabria, Campania). Obviously this means that the formal rule of law and reach of the state is unequal, and individual citizens form their own hierarchical relationships, creating confusion and uncertainty for 'foreigners'. Meissner (2017) notes that authoritarian regimes are the common place for forms of neo-patrimonial governance to take hold, due to the specific structure of institutions and power relations in authoritarian states (i.e. absence of free and fair elections, vertical rule, military power, executive dominance, etc.). Yet in a founding EU democracy, this sort of socio-political and economic organizational type is pervasive in many areas, still today. This is illustrated by much of Italy's institutional ambiguity (among formal and informal institutions) and locational variances as expressed above. As Robinson (2013) notes, there are competing sets of rules and structures to follow, enabling a form of 'known unknowns', confusion, and insecurity about which rules are to be applied, when, and by whom—formally or informally (Erdmann, 2012).

This has obvious consequences for foreign investors (and even local businesses) who, again, are not certain of the set of regulations to follow, and permissions to be granted. Except now, different from the actual formal state's convoluted processes and laws as mentioned in the 'political-policy' and 'regulatory' sections above, one finds competing informal and formal 'authorities' that may need to be approached and dealt with in order to proceed. Such a system is not unique to Italy (though it is especially prevalent there), but it definitely deters investment, as was evident in Figure 5. The problems related to informal governance and patrimonial system relationships were of serious concern to five respondents who lamented the realities of, for example, having to pay consultants or lawyers with connections for advice on the easiest way to register a foreign business in the country, knowing the 'right' people in administrative bodies and councils, or having access to the proper lobby groups or trade unions that can speed up the process of setting up an investment in Italy.[189]

Such a patrimonial system allows for even more severe forms such as outright corruption to take hold with greater ease. In fact, the most significant strand of the 'social' aspects of political risk deal with corruption, which has been approached through industry specific (micro-risks) studies, and more significantly on the causes and consequences of corruption on, for example, FDI, economic growth, and particular modes of corruption (Wei 2000, Mendez & Sepulveda 2006, Rose-Ackerman 1996), which generally deal with emerging economies. Specific factors like functioning democratic political institutions (parliaments), formal stability and law, and freedom of the press (Lederman et al. 2005) are known to relate to reduced levels of corruption, but this is not a certainty in all cases. Even in liberal democracies, a lack of accountability and transparency, poor checks and balances can also lead to lower quality of

[189] Interviews 21-2, 24-5, 29

government (Adsera et al. 2003) which in turn allows for a familial professional culture (clientelism) to persist, in addition to various network and social models of corruption, including the relationship among informal institutions, criminal enterprises, religion, social networks and the elites (Gutterman 2005), as often occurs in Italy.

Samuel Huntington's classic argument (1968), discussing the ubiquity, and often the necessity, of corruption in developing nations' growth strategies and dealings with multinationals, claimed that similar to clientelistic politics, corruption provides "immediate, specific, and concrete benefits to groups which might otherwise be thoroughly alienated from society. Corruption may thus be functional to the maintenance of a political system in the same way that reform is… Corruption serves to reduce group pressures for policy changes, just as reform serves to reduce class pressures for structural changes (63)." These social relations refer to the type of corruption endemic to places such as modern-day Italy, where certain businesses have to deal with nepotism and clientelism, while trying to avoid corrupt practices in order to conduct business. This 'functional' system is maintained by the path dependency that characterize many regions with powerful factions—state sanctioned or otherwise—that subvert reform efforts. This type of resistance to change common practices is challenging to foreign businesses that are not accustomed to such a familial mentality.[190]

The generally accepted definition of corruption, "the misuse or abuse of public power for private gain", is not universally applicable in all contexts. It can take on different meanings specifically when it comes to diverse cultures. Often, firms have to rely on an index like *Corruptions Perceptions* provided by Transparency International. The potential relation between corruption and increased political-economic risk in developed economies is starting to become a

[190] Interview 25

more important consideration, especially in light of the effects of corruption and accountability on political risk, FDI and economic growth (Busse & Hefeker 2007; Mendez & Sepulveda 2006; Tanzi & Davoodi 1998). This relation can be considered as a part of an underlying behavioural-institutional trend that revolves around the public's declining level of trust in officials, democratic processes and institutions (European Commission, 2012a), and also to the 'stickiness' of informal practices of governance in certain regions. Anti-corruption services are also being taken into account in political risk assessments (i.e. Control Risks, a political risk consultant), which supports the call for more research into their inherent connection. A former employee of a large PRA agency (now a private consultant), reaffirmed the important link between corruption and political risk, noting that it is a recurring request by many clients who want to know more about corruption levels and the players involved in a specific industry and country. Also important is the fact that in the West, governments are devoting more attention (i.e. via legislation such as the US Foreign Corrupt Practices Act) to bribery, corrupt business and investment practices or collusion, and thus out-going investors are required to do their due diligence and make sure they are not involved in corrupt practices with host governments or companies abroad.[191] Moreover, political and corruption risk analyses (Berlin Risk, 2015) are often used in tandem for businesses that seek to learn more about the potential for corruption-related losses. Interest in the relationship is gaining traction, but it is hard to accurately track the influence of illicit activities.

Corrupt practices are often cited as principal mechanisms for many risk factors that encompass political 'stability' or even larger risk rankings, yet the degree to which the majority of risk assessments take these into consideration is unclear, given that such qualitative societal

[191] Interview #1

factors are not easily measurable in terms of modeling and forecasting political risks. Indeed, consultants and underwriters alike appreciate the importance of corruption-related risks, but underline the difficulties involved in creating numerical scores for, or 'quantifying' it.[192] What is certain is that corruption can be quite taxing on foreign investors (Wei, 2000), and is something that they would like to see minimized, especially when home governments are eager to prosecute corrupt practices abroad.

Transparency International's Corruption Perception Index (CPI) ranked Italy 60th out of 176 countries in the world in 2016, in Europe ranking only ahead of Greece and Bulgaria, and directly below Romania, Hungary, and Croatia. Using the CPI measures, Italy scored 47/100 (0 = highly corrupt), globally just ahead of Senegal, Serbia, Swaziland and Sao Tome, and just below Malaysia, Namibia and Cuba. Of course, it is now quite well known that Italy is home to significant corruption. In addition to this perception, lost revenues attributable to corruption are estimated at roughly 60 billion Euros per year in Italy, which is nearly 20% of total corruption-related losses in all of Europe—a truly astonishing amount in per capita terms (Mungiu-Pippidi, 2013). In summary, corruption continues to have profound effects on the poor quality of the public administration. As the SGI Governance Report suggests, "the distortions produced in public services and in the economy by the high levels of corruption are incompatible with modernization. This is one area requiring more resolute government action" (SGI, 2015, 3). Major corruption inquiries into government officials, local government actions, and large scandals of public, private sector and criminal collusion in cities like Rome, Milan, Venice, and regions across Italy have all been publicized in recent years. In light of these statistics and

[192] Interview # 1, 2,4

scandals, experts are now well aware of the importance of corruption vis-à-vis foreign investments.[193]

Corruption also relates to the deep-rooted character of organized crime in Italy, especially in the southern regions. This does not only refer to formal mafia clans, which are omnipresent across the south, but have important reach and connections to central and northern regional capitals as well, sometimes in a more subtle manner[194]. Further, there are the informal patrimonial hierarchies of power that are evident in places where the reach of the state is lacking, as is the case in many Italian rural areas, and other (potentially criminally-related) forms of organization step in. Daniele and Marani (2010) found that organized crime is a disincentive for investment, also suggesting that certain levels of crime can be perceived by foreign investors as a signal of an unfavourable business environment, which was corroborated by a number of respondents.[195]

Another complicating factor is the idea of 'untouchable and entrenched structures,'[196] especially vis-à-vis the influence of powerful trade unions and lobbies, which are known to be part of a messy relationship among organized crime, political elites, and public administration which have plagued Italy for years. The main national trade union associations such as CGIL, CSIL and UIL contain large bases and have strong political connections, sometimes enough to hamper reform efforts (see above) and stake out strong labour protections (which also have coincided with decreased labour productivity). Local branches are also politically active and can, if necessary, make it quite difficult for foreign enterprises to set up in certain areas by prolonging timelines, mandating guarantees for groups of workers to be hired, or blocking industrial projects

[193] Interviews 21-28
[194] On the Roman 'Mafia Capital' scandal, see The Telegraph, 2014. http://www.telegraph.co.uk/news/worldnews/europe/italy/11271882/Mafia-capital-Rome-hit-by-mobster-scandal.html
[195] Interview # 21, 24, 25
[196] Interview #31

altogether,[197] which support the argument in Chapter 2 regarding institutional or cultural path dependencies.

On other socio-cultural issues, Italy also ranked poorly in international indicators: 139th out of 144 countries surveyed in public trust in politicians, and in wastefulness of public spending. It was also in the bottom half of such rankings regarding government official favouritism (135th), bribery (74th), organized crime (132nd), and others (World Economic Forum, 2015). These figures underscore the importance of the relationship between accountability, trust, and political risk in developed market democracies. A related point is the fact that the personalization of political leaders continues to play a key role in Italian politics (from Berlusconi to Renzi, plus Grillo's 5-star movement and local candidates) and complicates accountability structures at different levels of government. A pattern of declining popular confidence in political elites and institutions has also been evident in Europe and the US in the recent past, and has led to a deterioration in the overall quality of democracy in the West.[198] The literatures on institutional performance in different regions (La Porta et al., 1999; Lederman et al., 2005; Putnam, 1993) and on civic/political culture and entrenched structures in democracies (Almond and Verba, 1989; Ginsborg, 2003), as well as on the effects of corruption and poor accountability on the economy and public sphere (Djankov et al., 2003; Del Monte and Papagni, 2007; Lederman et al., 2005; Schmitter, 2004) are extensive in IPE, and speak to the problem with societal and regional discrepancies, especially as concerns business and investment. Part of the problem is the mentality and business attitudes that manifest in small business models that have historically been prevalent in most of Italy (though not uniformly), embodied by specific

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[197] Interview 25

[198] See also: Girling, J, 1997; The Economist, 2017. http://www.economist.com/blogs/graphicdetail/2017/01/daily-chart-20;

family-business cultures and management styles that do not translate well to foreigners or buy-outs.[199]

Moreover, where business (SME) success has been lacking in southern regions, government jobs are often the only fall-back, lest one seeks ‘informal work’, which only contributes to the social and economic disparities between north and south. While there is no real way to accurately measure the size of underground or informal economic activity, estimates from across agencies in Italy have approximated the size of Italy’s informal economy at anywhere from 14-22% of GDP, in the forms of tax-evading activity, non-reporting, self-employment, organized crime and illegal activity (Stratfor, 2012), and this is especially pronounced in the south where the informal economy is the only safety net, where the state’s reach is often absent, and where economic prospects are weak.

Adding to the above mentioned issues on economic and infrastructural performance between regions are the serious demographic problems related to ‘brain drain’ and emigration from the South to the North of the country, and indeed from Italy to other EU nations or to North America, which contributes to the continuous ‘self-fulfilling prophecy’ of southern under-development.[200] Italy already faces demographic crises manifested in one of the world’s lowest birthrates and highest life expectancies. When northward and outward migration continue to increase, as they have been for the past decade, this only compounds the issue by way of brain drain, population decrease, and civic disengagement by those most educated and capable of instilling change. Comparisons are beginning to be made with the post-war mass-emigration of Italians looking for better economic prospects. This time, however, it is not a majority of war-

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[199] Interview 28

[200] See Internazionale, 2017. http://www.internazionale.it/reportage/giuseppe-rizzo/2017/01/14/emigrati-estero-sicilia-italia

torn farmers and labourers searching for better opportunities abroad, but educated and motivated youth, disenchanted by the economic and employment prospects in Italy. In 2016, roughly 285,000 Italians (0.005% of the population) departed for work abroad, mostly not intending to return. For the sake of comparison, there were roughly 300,000 emigrants from Italy in 1945 (or 0.0067% of the population) (Il Fatto Quotidiano, 2017).

Ironically enough, inward migration consisting mainly of refugees from across Africa and the war-torn Middle East (approximately 181,000 migrants in 2016) have used Italy as their entry-point into Europe. However, attitudes towards immigration are combative and contentious. Although there have been attacks on migrant camps for some time, the issue culminated in early 2018 in a small, central Italian city, Macerata, when, after a young Italian woman was found murdered by a Nigerian migrant who overstayed his residency permit, a right-wing Italian extremist who had previous ties to the Lega Nord, angrily fired shots at a group of African migrants in a café, injuring six. This tragic incident speaks to the social tensions around underemployment, xenophobia and migration, and the general economic malaise that have hampered Italy for years, and have now reached a politicized pinnacle in the most recent election cycle. Berlusconi characterized this, and the underlying migrant crisis, as a ‘social bomb’, something that his allies have spoken of for years, while opposing politicians laid blame on the dangerous rhetoric and incitement of the right. The ability of all regions, but especially the southern ones, has been lacking with respect to resources for dealing with the migration, causing an internal crisis for Italy, and for the EU at large. It is worth noting that deputy Prime Minister Salvini of the Lega has taken the migrant-blaming to a whole other level, both rhetorically and through his ministerial powers, igniting further social division. The instability around both access to educated and motivated youth and workers, and what to do with the rapid influx of those fleeing war and poverty in the south,[201] have created a deteriorating situation that continues to worry investors (in addition to governments across Europe), while there is no feasible solution in the works.

It would understandably be prudent for political risk assessments to consider clientelism, corruption and accountability, regionalism and economic disparity, political traditions and informal governance modes as important socio-cultural factors that measure the probability of success for an investment. Yet it is not particularly feasible to measure, in a quantitative and succinct manner, the many intricacies related to the socio-cultural character of a prospective investment region. While time-consuming and complex, risk rankings need to make space to adequately assess such factors on a continuous basis, especially when dealing with 'stable' developed democracies, whose own indicators may not suggest many 'societal' shortcomings to investments. Meanwhile, as shown in chapter 4, the 'cosmetic' aspects of working to dispel negative reputational costs could indeed get the ball rolling on increased investment which would in turn set a better precedent for the country and future prospective investors. Political will and coordinated action is crucial in this respect, though it may be difficult to achieve in the short term in Italy. Given the combative and anti-establishment government coalition currently in power (under the leadership of Salvini's *Lega* and Di Maio's *M5S),* it will be very important to monitor Italy's overall macro-economic situation and political situation. FDI attraction policies may again be a subject of debate for a government that rallied against the supra-national European and globalized status quo.

Ultimately, this case study has demonstrated that all the layers of risk criteria are interconnected, and can build off one another in different ways that are otherwise not captured in

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[201] Interview 25-7

traditional risk assessments. The feedback among these issues and themes is especially evident in advanced capitalist democracies that are often assumed to be stable and welcoming to investment, and Italy is an ideal case to demonstrate this complex reality.

Conclusions: Thinking About A Future For Political Risk Analysis

At its most fundamental, this dissertation examined the intersection between politics and international business, governments and experts. I contend that this relation suggests that a feedback loop of mutual benefits or limitations occurs through the analysis of political risk, insofar as most risk analyses seek to evaluate whether or not market liberalism, investment openness, institutional and policy stability and business-friendly reforms, among other things, have been undertaken. As various theoretical and applied studies have shown, such analyses can in theory lead to the free flow of investment into those very countries under the microscope. This, in a sense, is following in the theoretical logic of institutional path dependency and cyclical political-economic relations espoused by classical works on the importance of political institutions and stability to economic growth, and vice-versa (Ch. 2). In fact, political/governmental stability, transparent governance and efficiency of bureaucracy are all of utmost importance to investors, and these affect the relationship between the state, the market, and civil society, which is what political risk analysis actually evaluates. In this dissertation, I emphasize that the political and economic development processes need adaptive structures and institutions (Bouchet et al. 2003), and political risk analysis is inherently connected to understanding and assessing the institutional and structural issues that affect risk ratings in the first place.

I focused on the politically charged risks to, and investment determinants of, FDI as conceptualized by the international trade, joint ventures, greenfield and brownfield FDI. Today, the concept of political risk has risen to the forefront of business, politics, and media. While still an under-theorized topic, it has become a principal issue surrounding transnational investment in the academic and practical senses. The essence of political risk is the likelihood of foreseeable stability based on governmental and other events and decisions of a political nature. It is of core concern to global economic freedom and trade relations, and to international political economy scholarship, insofar as the very notion of 'political risk' invokes values and ideals about what is expected, and what is troublesome in the realm of international business.

Until fairly recently, typical political risks to investments, generally understood to take the form of expropriation and nationalization threats, or harm to foreign enterprises due to political violence, were thought to be exclusive to emerging economies. Today, the global equilibrium has changed, and it is more important than ever to consider subtle forms of risk that relate to the institutions, policies, politics and cultures of 'stable' developed democracies in the market economies of the West. Many global and comparative indicators lend credence to an approach to contemporary political risk that expands on and incorporates important notions related to governance (Ch. 1) that have been trending negatively in developed economies, and ought to be examined further. I have sought to demonstrate that understanding the specific (policy, regulatory, institutional, soft/socio-cultural) factors that one finds behind and within political risk assessments is essential to providing a broader understanding of investment-related difficulties, decisions, and ultimately the success of an investment location in developed economies. In fact, typical political and country risk assessments have not adequately assessed or captured the social and institutional realities of a country (see Ch.3), insofar as they devote more attention to the risky attributes common to emerging economies as mentioned above. Yet developed economies should have a different locus of factors to assess and thus use a modified analytical approach, as I suggest throughout. A holistic analysis of such 'softer' socio-political, policy and institutional factors ought to be employed, especially given the prevalence of financial and quantitative sources of risk in typical assessments of emerging economies, which the case of Italy clearly calls for. In doing so, we can determine not only what may be missing from current risk assessments, but also consider the implicit methodology of democratic and economic development.

Although there is much competition and variation between definitions of political/country risk, and among the most significant determinants of foreign investments, the overlap and flexibility in these areas still allows us to develop a holistic understanding of political risk that incorporates the idea of uncertainty or harm to investments and business ventures abroad. These can result from global economic turbulence, unwelcoming investment environments, and other domestic factors that stem from events or actions that are fundamentally political (governmental and non-) in nature, such as legislation, policies, institutions, levels of stability, and/or diverse social and cultural conditions in a given country. This dissertation has sought to establish that although foreign investments are subject to the operational rules and political-economic environments of sovereign states (Brink, 2004), political risk analysis (PRA) is still concerned with the perception of political continuity and stability in given markets and, perhaps more importantly, specific regulations that are supported and created by institutions and policies, and that this is especially relevant for democratic processes in the North Atlantic.

On a related note, it is my contention that although the upsurge in the general popularity of political risk is relevant, the recent shock events that have brought the concept to the forefront of media and business have actually been preceded by major political, institutional and societal shortcomings in many Western economies. In a sense, these events did not occur in a vacuum, and it is important to analyze the factors that were already in play vis-à-vis stability of investments. To this end, *uncertainty* as a concept is hard to measure in traditional analyses of *risk.* As noted, stability in itself can have different interpretations and dimensions that do not come across in the different indices. Yet as the case of Italy shows, the uncertainty that is behind risk and instability is a real cause of many risk factors to prospective investments.

At the same time, the practices surrounding international investment directly impact the distribution of capital, resources, political power, legitimacy of corporations, and security in the world at large, in addition to the geopolitical balance of economic power. This dissertation considers political risk in this global perspective, and has pondered the following: What is it, and why does it matter? What are some analytical tools and approaches that might help us to think about, describe, and explain political risk, particularly in its comparative and specific developed-economy dimensions? I uncovered the current policies in place that can affect political risk and investment, and suggested which are the most important investment determinants among types of economies. In doing so, I observed the discrepancies that exist between classic risk assessments that focus on emerging economies, and the real, albeit different, types of political risk that exist in the West as mentioned above. Through the case study, I examined the issues that have plagued Italy's efforts (or lack thereof) to increase investment and economic growth, maintaining that a single, qualitative case study can shed light on numerous factors that a multivariate and large N assessment cannot. The crux of the dissertation addressed these important issues, by suggesting a slightly different approach to political risk in the West, and outlining and refining a thematic and criteria-based method to studying political risk in Europe, starting with the case of Italy.

There is clearly significant overlap in cultures, political and economic systems across the developed economies, and the overall trend in investment and governance indicators across those economies (Ch. 1.3) suggests that parallels can be drawn. While it might not make methodological sense to use one example, i.e. Italy, to make generalizations for potential risks to investments across all G7 or more developed economies in the world--each with their unique cultural and political characteristics--it is indeed a useful exercise to demonstrate the benefits of the approach and for an in-depth case study. I do not profess to have created a unique model to predict political risks applicable to all Western market economies and democracies. Rather, the point of this exercise was to suggest an additional strategy for risk assessments that emphasizes the importance of expert knowledge and qualitative understandings of policies and societies to the process of risk analysis, through a lens of political-economic institutions. Indeed, Delphi and other common survey-based methods also rely on experts for risk assessments (generally using a few experts per country), so there is already an established practice to do so. In reference to the number of experts (17 +14) I consulted, each had their own experience and large networks in the industries, and could incorporate their extensive capabilities into our conversations, meaning they were not simply based on singular opinions or views. While many common ranking systems and risk assessments do indicate and corroborate a good portion of the risk factors that my own respondents discussed, one of the issues I highlight is that generalized risk indices produce macro-risk scores which are often the only indicator many investors or firms look at. As Table 4.2 shows, while for example, France, Spain, and Italy exhibit similar risk scores, the actual underlying factors are highly contextual, specific, and ultimately require significant analysis in order to comprehend which articles are driving these scores. The political and social realities of the Italian case seem far more troubling to investors than in many other parts of the developed world, and that emerges when using a holistic approach.

Ultimately, what we have learned from a single case study of Italy is the following: First, each developed democracy has a specific political culture, institutional-policy footing, and civic tradition that is not easily transferable to its neighbours. Second, within each state, there are a number of important political and administrative factors to consider that are more prominent, and different, with respect to the typical risk assessments conducted on emerging economies (See Ch. 3, 4, 5). Third, that it is useful to follow an approach that begins with the role of political institutions in the investment process, is embedded in the geopolitical economic structure, and follows an interconnected path through policies, regulations, investment climate, infrastructure and operational issues, and essential socio-cultural attributes. Finally, as the literature suggests, there is always room for improvement in political risk analysis, and I have sought to contribute to that body of work here. Further development of theory matters to the field, but not just in the form of methodological critiques and new modeling techniques. Conceptual clarification among types and sources of risk is needed, as is differentiation between economy-types under evaluation. Institutions matter: governance, investment policies, bureaucratic regulations, and socio-political cultures work in subtle and interconnected ways, but can have far-reaching effects on investment levels, as demonstrated throughout. As Bouchet et al. (2003) cleverly remind us, "risk is a multifaceted challenge. Reducing risk to a single, abrupt shock such as default, coup d'état or contract repudiation, misses the subtle and gradual forms of risk emergence in cross-border investment" (72). Those subtle forms often fly under the radar in typical risk assessments and large scale rating systems, and through this dissertation I have sought to contribute to the literature by situating those important institutional, regulatory, policy, and cultural forms of risk as significant investment determinants in developed market economies.

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Appendix A- Methodological Reflections

Proceeding from the discussion in Chapter 1 on methodological considerations, a few other comments on interview subjects are in order here. Research subjects were predominantly white middle-aged men, (reflecting the gender imbalance in the investment, insurance and risk industries). The majority were post-secondary graduates with years of experience in their respective industries, and for this reason are classified as experts in the field. I took all available opportunities to converse with them in either English or Italian, whatever they were most comfortable with. I tried to pose similar questions to each respondent to ensure consistency, but these were not formal question and answer settings in every case. Extensive and detailed hand-written notes were made, as most respondents were not comfortable with recording devices being used in their places of work, especially given the subject matter. Further, it is not customary in the Italian context to voice-record extensively based on cultural formalities. Following the meetings, I continued the process of note-taking and clarifying what was said afterwards if I had follow-up questions with the participant. Every attempt was made not to hamper the natural flow of conversation during the interviews (Bardhan, 2013). Confidentiality was guaranteed unless explicit oral consent (or later via email) was given to reveal the names of participants. In fact, some respondents were even eager to have their names attached to some of the data for personal marketing and branding purposes.

In order to assuage certain apprehensions of respondents and increase the *N*, I employed a number of interview tactics: a) initial transparency regarding the purpose and objectives of my research which enabled respondents to feel comfortable in sharing information with me; b) setting and time at the place of their convenience; and c) by using the snowball sampling method based on professional networks to expand the number of respondents. Furthermore, the code outlined in the ethics review ensured that I did not inflict harm on respondents; I upheld their privacy and safety, and I protected myself and my study [an arbitrary control apparatus to the best of my abilities]. Most participants in fact appeared sympathetic to the purpose of the research and were generally pleased to share their thoughts, opinions, and data, whenever possible, and on the whole, happy to share their expertise.

A flexible, non-standardised approach to the expert interviews captures rich, voluminous and complex data and meanings that are otherwise hard to grasp in larger N quantitative or survey-based studies, and speaks to the importance of holistic analysis. This type of fieldwork allows one “to supplement official records, uncover additional contextual elements that traditional quantitative methods may ignore or are unable to capture, and explore the unexplored” (Liang & Lu 2006, 157). I led a mix of exploratory and systematizing interviews in order to gain overview of the (under-investigated) situation and phenomena, and to systematically outline and retrieve information, and developed explanations (special knowledge of the field) (Bogner, Littig, and Menz, 2009).

Appendix B – Ethics Certificate

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Certificate #:	**STU 2015 - 035**
Approval Period:	**04/10/15-04/10/16**

Memo

To: Julian Campisi, Political Science - Graduate Program, -------

From: Alison M. Collins-Mrakas, Sr. Manager and Policy Advisor, Research Ethics
(on behalf of Denise Henriques, Chair, Human Participants Review Committee)

Date: **Friday, April 10, 2015**

Re: Ethics Approval

What's risky? Re-assessing political factors that affect investment in developed economies

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I am writing to inform you that the Human Participants Review Sub-Committee has reviewed and approved the above project.

Should you have any questions, please feel free to contact me at: ------------- or via email at: -----------

Yours sincerely,

Alison M. Collins-Mrakas M.Sc., LLM
Sr. Manager and Policy Advisor,
Office of Research Ethics

RENEWAL

Certificate #: **STU 2015 - 035**

Renewal Approved: **03/09/16**

Approval Period: **03/09/16-03/09/17**

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Memo

To: Julian Campisi, Political Science - Graduate Program, ----------

From: Alison M. Collins-Mrakas, Sr. Manager and Policy Advisor, Research Ethics
(on behalf of Denise Henriques, Chair, Human Participants Review Committee)

Date: **Wednesday, March 09, 2016**

Re: Ethics Approval

What's risky? Re-assessing political factors that affect investment in developed economies

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I am writing to inform you that the Human Participants Review Sub-Committee has reviewed the request for renewal of approval re the above project, and, finding that there are no substantive changes to the methodology or the risks to the participants or participant pool or any other aspect of the project, no further ethics review is required and renewed approval is granted.

Should you have any questions, please feel free to contact me at: ----------------- or via email at: --------------

Yours sincerely,

Alison M. Collins-Mrakas M.Sc., LLM
Sr. Manager and Policy Advisor,
Office of Research Ethics