World Investments, Global Terrorism and the New Perception of Politic Risk

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Abstract

Based on economic power struggle, the economic strength began to take the place of military power and economic security has been considered as important as military security in this new world order. Multinational companies and their feasibility studies constitute the agenda of politic risks before entering these markets. Political risk faced by firms can be defined as “the risk of a strategic, financial, or personnel loss for a firm because of such nonmarket factors as macroeconomic and social policies, or events related to political instability”. However, terrorism should be considered as a multiplier effect on some of the components mentioned above. Terrorism itself and these strict measures directly affect investments. In 2012, FDI (Foreign Direct Investment) flows into the Middle East and North Africa have been adversely affected by political risk over the past couple of years. Investor perceptions of political risks in the region remain elevated across a range of risks. The Arab Spring countries have fared worse than other developing countries in the region. The risk perception of civil disturbance and political violence, but also breach of contract, is especially prominent in Arab Spring countries. In other words, global terrorism has created a negative multiplier effect in the region. In this context, Multiplier effect can be summarized as an effect on a target, situation or event which exceed its creating strength than expected. Considering this impact, MNC’s SWOT analysis and investment analysis must signify a redefinition in a wide range by the means of political risk perceptions.

1 Introduction

In 1991, with the Soviet Union's collapse and the end of the Cold War, the World has economically entered into a rapid integration process. Caused by the acceleration of globalization, the world has become a single market and almost all the actors have been involved in this market mechanism. Based on economic power struggle, the economic strength began to take the place of military power and economic security has been considered as important as military security in this new world order. Multinational Corporations play the major role in this system. Multinational companies and their feasibility studies constitute the agenda of politic risks before entering these markets.

2 Politic Risk

In a broad sense, political risk refers to the complications that businesses and governments may face as the results of what they commonly refer to as political decisions - or any political change that alters the expected outcome and value of a given economic action by changing the probability of achieving business objectives. Political risk faced by firms can be defined as “the risk of a strategic, financial, or personnel loss for a firm because of such nonmarket factors as macroeconomic and social policies (fiscal, monetary, trade, investment, industrial, income, labour, and developmental), or events related to political instability (terrorism, riots, coups, civil war, and insurrection) (Kennedy, 1988).

There are many services that measure countries’ risks. The appendix provides information on the following providers:

- Bank of America World Information Services
- Business Environment Risk Intelligence (BERI) S.A.
- Control Risks Information Services (CRIS)
- Economist Intelligence Unit (EIU)
- Euromoney
- Institutional Investor
- Standard and Poor's Rating Group
- Political Risk Services: International Country Risk Guide (ICRG)
- Political Risk Services: Coplin-O'Leary Rating System
- Moody's Investor Services

Each of the index or rating providers must amalgamate a range of qualitative and quantitative information into a single index or rating (http://people.duke.edu) 11.05.2014.

In defining the concept of politic risk, they also take “environmental” factors into account that can constitute an obstacle for operations and investments of foreign economic actors. For instance, these types of factors are represented by political instability and violence. Political risk is a combination of environmental and governmental factors that creates obstacles to the economic activity or represents a threat for the profits of foreign companies (Gori, 1988).

Long-term assessments of political risk must account for the danger that a politically oppressive environment is only stable as long as top-down control is maintained and citizens are prevented from a free exchange of ideas and goods with the outside world (Bremmer, 2007).

There are both macro- and micro-level political risks. Macro-level political risks have similar impacts across all foreign actors in a given location. While these are included in country risk analysis, it would be incorrect to equate macro-level political risk analysis with country risk as country risk only looks at national-level risks and also includes financial and economic risks. Micro-level risks focus on sector, firm, or project specific risk (Robock, 1971).

In the 2012 report on “World Investment and Political Risk” MIGA identifies eight main components, or variables of political risk (Miga, 2012):

- Transfer and convertibility restrictions: risk of losses arising from an investor’s inability to convert local currency into foreign exchange transfer outside the host country. Currency devaluation is not covered.
- Expropriation: the loss of investment as a result of discriminatory acts by any branch of the government that may reduce or eliminate ownership, control, or rights of the investment either as result of a single action or through an accumulation of acts by the government.
- Breach of contract: risk of losses arising from the host government’s breach or repudiation of a contractual agreement with the investor, including non-honoring of arbitral awards.
- Non-honoring of sovereign financial obligations: risk of losses due to non-compliance government guarantees securing full and timely repayment of a debt that is being used to finance the development of a new project or the enhancement of an existing project.
- War: risk of losses due to the destruction, disappearance, or physical damage as a result of organized internal or external conflicts.
- Civil disturbance: risk of losses due to social unrest.
- Other adverse regulatory changes: risk of losses for foreign investors stemming from arbitrary changes to regulations.
- Terrorism: risk of losses due to politically motivated acts of violence by non-state groups.

However, terrorism should be considered as a multiplier effect on some of the components mentioned above. Because while governments are taking strict measures to lessen the impacts of civil disturbance and war, they try to prevent their indirect effects. Terrorism itself, and these strict measures directly affect investments.

3 Globalization and Global Terrorism

Globalization has raised especially since 1940s. The first serious work on this issue was published at the International Encyclopedia of Social Sciences in 1968. In 1983, an American scholar, Theodore Lewitt wrote an article titled “The Globalization of Markets” and entered into the literature as a concept (Zengingönül, 2004. Akt.Ecevit, s.40).

Different sources have different definitions on concept of globalization. U.S. National Defense University describes the globalization as streaming of goods, services, money, technology, ideas, information, culture, and people across the border quickly and continuously. The United Nations Commission on Human Rights defines globalization as a process (Öymen, 2000).

In this regard, the concept of globalization means that particular ideas, opinions, practices, events, technologies and institutions are becoming definable in global scale or national identities, economies, and the boundaries have been resolved and a large part of social life in the world is determined by global processes in global scale. Globalization is a process which is ahead of the markets instead of the borders and knowledge, capital, goods and services can spread to every part of our world without limits and trouble but depending on some specific rules (Garih; 2007).

Globalization can be defined as countries' economic, political, and socio-cultural convergences and interact more strongly with each other (Ecevit; 2008).

However, most important risk posed by the concept of globalization is the easy spread of political instability. As political and economic boundaries between them have disappeared, countries and economies become more dependent on each other, the crisis that broke out in a country easily affected other countries as well.

Terrorism as a politic risk factor has become global terrorism through globalization, the threat moved up from military fronts to homes and factories. While terrorism has increased the impact of strictly taken measures, global terrorism has changed dimensions of these impacts. These new dimensions of terrorism can be defined as:

timeless, placeless and variable targeted activities. Due to the new size of the terrorism, capital flight may occur from the invested host countries.

4 The Concept of Global Terrorism

As the acts of violence have increased since the 1960s and gained an interstate dimension, the concept of global terrorism has found place in the discipline of international relations. International terrorism is defined as "terrorist activity that the content and the repetition has caused international consequences" However, international nature of terrorism is not limited with this definition. Acts of violence that carried out in order to influence of a foreign state’s or an international organization’s policy have got international nature, as well. In addition, terrorist action with the support of one or more state is considered in the same context. Terrorism that is towards to the goals of strangers or foreigners, has got international dimensions, too (Rengin, 2000).

International terrorism is aimed at human lives, internal social dynamics, international peace and security, peaceful relations of states, internal affairs, peaceful settlement of disputes, domestic law and international law to ensure the specific political, social and economic interests (Babaoğlu, 2002).

Terrorist acts involve the violences that affect the international community, and they require a collective action against the problem (Elegab, 1995).

Thus, terrorism has been recognized not only as a phenomenon of threatening world peace, stability and, security of states, but the rights of citizens as an element. In this regard, globalization encouraged and strengthened movements that we call micro-nationalism in the rate of hitherto unseen .Through the developing means of communication; small ethnic groups have the opportunity to be able to introduce themselves and make propaganda to large human populations around the world as oppressed and exploited communities (Kılıç, 2007).

At this point, the relationship between globalization and terrorism have emerged. The purpose of terrorist activities is to try to destroy the system in which terrorist groups are located, and to announce it to the world. Personalities of the victims of terrorist activities are not important, the titles they represent are only important (Özoğlu, 2005).

Global Terrorism is an ongoing struggle against the system but it works outside the system. Globalization as a political movement means that western values dominate the world, global terrorism is a phenomenon that questions the dominance of these values (Başeren, 2006) .And targets of global terrorism are MNCs, which are representing this domination the best.

5 Multinational Corporations, Global Terrorism and Politic Risk

With the simplest definition, a multinational corporation is a union which covers the national affiliate companies and the central offices that have different goals where the company consists of a geographically dispersed group (Ghoshal ve Bartlett, 1990).

Richard Robinson viewed multi-national companies in terms of historical development and has described these companies as follows (Robinson, 1972):

- International Company: After settling powerfully in a country as the parent company, it settled in other countries on the basis of central administration (subsidiary company) company.
- Multi-National Company: It’s a kind of company in which their administrators deliver resources regardless of the identities of the country in order to get profit without a distinction between domestic and foreign activity.
- Trans-national company: The Company is characterized as multinational in which managers are of different nationalities as well as shareholders.
- Supra-national Company: The company would get a transnational form in the future. The company will be registered and audited by an organization established by an international agreement and will pay taxes to this organization, so that the company will legally lose its nationality.

Generally, national companies, which have activities in international arena and established by the national capital in any country, are named as multinational corporations (Akayın, 1972). Therefore, multinational corporations and international companies mean the same thing and there is no difference between them in terms of structure, function or law.

In terms of capital movements, the company with direct foreign capital investments that operates having foreign capital in the country, is called multinational corporation. (Ecevit, 2008)

Multinational companies are active in two or more countries, regardless of engagement fields and legal forms of economic business units. However, they are composed of such commercial enterprises that share information, resources and responsibilities among units (Şatıroğlu,1984).

Multinational companies' headquarters are in particular countries. Economic activities take place in more than one country but decisions on activities are taken centrally. At the same time, these companies hold ownership of the properties in hand and have control and power to decide on affiliated companies. (Özcan, 2011)

It is estimated that multinational corporations, which are the driving force behind economic integration in the world, are about 37,000 with extensions more than 170,000. Depending on the usage of license, these companies can be said to have larger actual influence fields (Angelfire, 2009). Approximately, 50% of world trade is carried out by multinational companies today. 2/3 of world trade and 1/3of world income belong to these organizations. 55% of multi-national enterprises are of U.S origin, whereas 11% are of Japan, 9% are of the United Kingdom and 4.5% are of German (Kar ve Arıkan, 2003).

Approximately, total sales of 79,000 multinational companies and 790,000 foreign affiliates have accounted for nearly more than 10% of the world gross products in the world. (Özyakışır, 2007)

51 of the world's 100 largest economies are multinational corporations. These companies have powerful effects in international relations, thanks to economic power, large financial resources, and the lobby of the work (Rugman. 2003).

Political environment can be described as a platform where the central and local public administration provide its authority and use its power. This platform is composed of players who are against the political system as well (Aydın, 2013).

However, politic risk means political decisions and political and social events which affect the business climate. Terrorism refers to the losses that were made by groups which are called illegal as a result of their politically motivated and supported actions.

Asymmetric threats, summarized by Colin Gray, are unusual in the view of political, strategic and military culture and he lists as follows (Gray, 2002).

- Terrorism
- Weapons of mass destruction
- Economic
- Syber war
- Information operations
- Psychological operations
- Organized crime
- Environmental threat

Components above are put together by the terrorist organizations on a global scale. They determine their targets with these components on acting in multiple countries and try to reach political goals along these lines is called "Global Terrorism".

Thus, the resulting effect is unusual and extraordinary. It cannot be defined, as frightening and threatening in asymmetric dimension. This asymmetric dimension directly influences multinational company's political risk perceptions and will determine MNC's country preferences by the means of investment.

As mentioned above, in long-term basis, the monetary loss suffer cannot be seen as an acceptable risk by MNC's. If the host country does not have a sufficient skill to eliminate the asymmetric threats and global terrorism, MNC's choose the any "safe country" that is a natural consequence.

According to MIGA WIPR Report 2012; **"** (...)In 2012, FDI (Foreign direct investment) flows into the Middle East and North Africa have been adversely affected by political risk over the past couple of years. Investor perceptions of political risks in the region remain elevated across a range of risks. The Arab Spring countries have fared worse than other developing countries in the region. The risk perception of civil disturbance and political violence, but also breach of contract, is especially prominent in Arab Spring countries. Political instability in the Middle East and North Africa has taken a toll on investment intentions and has elevated perceptions of political risk, not only for the Arab Spring countries, but also for other countries in the region. Although the three-year ranking confirms the persistent concern of investors about the state of the global economy and difficulties in access in finance, political risk rises to the top of the list of constraints as the most important obstacle for investing in developing countries. This highlights the strong impact that political risk has on the investment decision-making process such that it overshadows the effects of economic weaknesses around the world."

As an assumption about regional, according to an independent global risk survey and consultancy group "CONTROLRISK 2013 Report" 37 ;(...) "In the short term, the dearth of FDI flows into the Middle East and North Africa is likely to continue, especially in those countries where there is still significant political instability. Nearly 20 percent of the foreign investors in the MIGA-EIU Political Risk Survey 2012 plan to withdraw existing investments from the Arab Spring countries."

In the light of statements above, the presence of the economic, political or social instability is one of most important factors on investment decisions that plays a negative role on which country to invest. In particular, MNCs primarily consider the stability as decisive, and its investment decision based on this matter (Özcan, 2011).

Nevertheless, multiplier effect of global terrorism has increased the fragility of MNC's investments. The reason for that is, the new dimensions of terrorism have been targeted to economically dominant countries that own MNC's by the means of developing new micro-nationalism effects.

6 Conclusion:

Portfolio investors may face similar financial losses. Moreover, governments may face complications in their ability to execute diplomatic, military or other initiatives as a result of political risk. The presence of political risk and its level are more affected by the professional organizations, threat perception risk level and assessment of investors than in the past. Especially multifaceted effects caused by global terrorism and political risks asymmetry have brought a new dimension to the assesment concept. But Political risk, like all other risks, has an adverse effect on any economy. Even though other forms of risk, such as economic risk and financial risk have been studied quite extensively, political risk has not received much attention owing primarily to lack of data, Khan, Mashrur Mustaque and Akbar, Mashfique Ibne (2013). http://mpra.ub.uni-muenchen.de. 11.05.2014

After the Arab Spring, Middle East and North Africa have felt the destructive effects of terrorism on a global scale. These country-based investments have been affected by destructive aspect of this threat.

	2004	2005	2006	2007	2008	2009	2010	**2011**	2012[e]
Middle East and North Africa	9.7	16.8	27.2	27.9	29.6	26.3	22.3	**13.7**	19.3

***Table-1**: Investment Amount in Middle East and North Africa **Resource:** MIGA-EIU – 2013*

Nine-year investment inflows in the regions of MiddleEast and North Africa are shown above. After 2004, investments doubled and have gained momentum since 2006 and investment inflows have followed a vertical increase. Direct investments reached the top especially in 2008, following a few percentage of decline the next year. However, the risks of instability, unemployment, poverty, and disparity in the regions caused a vertical decline in investments. Chaos has totally left its place to the effects of politic risk. Especially in 2011, it caused a regression by the time that Arab Spring occurred. While international direct investment inflows were 16.8 billion dollars in 2005, they fell behind 13.7 billion dollars in 2011(Table-1).

In other words, global terrorism has created a negative multiplier effect in the region. In this context, Multiplier effect can be summarized as an effect on a target, situation or event which exceed its creating strength than expected. Considering this impact, MNC's SWOT analysis and investment analysis must signify a redefinition in a wide range by the means of political risk perceptions.

Terrorism should be assessed with other effects of politic risk's components. Otherwise, this assesment could have given an erroneous result. Especially civil disturbances, war, ideologic climate, political interventions and developing new micro-nationalism affect the perception of investments directly and indirectly in the view of terrorism. Therefore, this multidimensional effect should take place in SWOT analyses with new format especially in the context of global terrorism.

Firms can score this set of questions and obtain a score that could serve as guideline:

- Has the country got a democracy or dictatorship?(1)
- Is the power concentrated in the hands of one person or one political party?(2)
- Does the country normally rely on the free market or on government controls to allocate resources?(3)
- How much of a contribution is the private sector expected for the government to achieve its overall economic objectives?(4)
- Does the government view foreign firms as a means of promoting or hindering its economic goals?(5)
- Are the firm's customers in the public or private sector?(6)
- If firm's customers are in public, does the government favor domestic suppliers?(7)
- Are the firm's competitors are in the public or private sector?(8)
- If competitors are in public sector, will the government allow foreigners to compete with the public firms on even terms?(9)
- When making changes in its policies, does the government act arbitrarily, does it rely on the rules of law?(10)
- How stable is the existing government?(11)
- If the government leaves office, will there be drastic changes in the economic policies of the new government?(12)

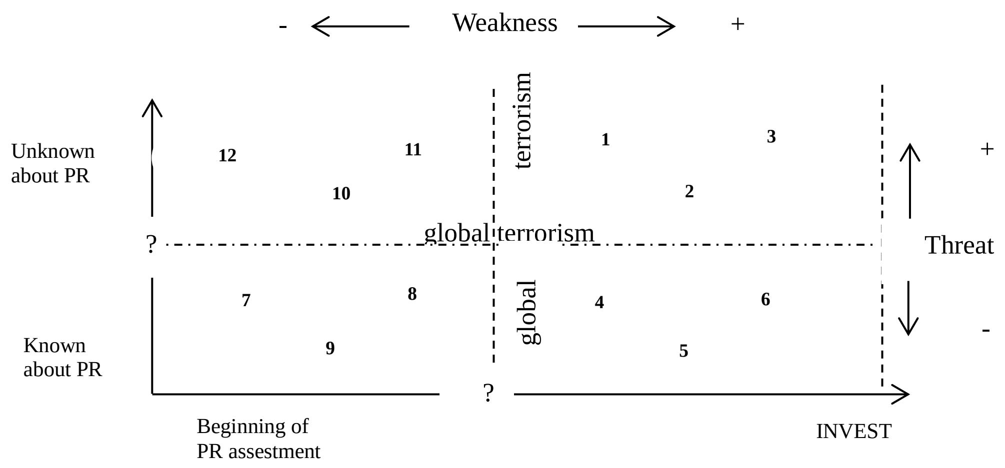

Figure-2: *Global Terrorism, Politic Risk and SWOT (W/T)*

Some sample questions that may influence a firm's political risk assessment and possible answers are tried to put forth above (Figure 2) with the relation between SWOT analysis of threat and weakness assessment by the means of multiplier effect of global terrorism. As mentioned in the previous paragraphs, the impact that terrorism created, causes a threat increasing result on the firm by the means of matters that cannot be assessed and it is predicted that this impact will make the weaknesses of the company more evident in the right time to invest. In other words, while on the road to the investment decisions, uncertainty engendered especially by global terrorism is supposed to influence negatively the politic risk assessment with an increasing effect.

As a result, the perception of politic risk determines the direction of World investments. In this context, on what extent the multiplier effect and uncertainty of global terrorism influences the politic risk should be dealt with appropriate and particular questions to each country and region in SWOT analysis of threat and weakness assessment.

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