

Political Risk Traps In Latin America

Elizabeth Salamanca, Doctorate

Robyn Lynn Johnson, DBA

Francois Bernard Duhamel, PhD

International Business, Universidad de las Américas Puebla (UDLAP)
San Andrés Cholula, Puebla, Mexico

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Abstract

The purpose of this paper is to analyze salient political risks common in Latin America identifying the contexts in which they take place and the reasons for their recurrence, insofar as they affect international business investors in this region. Through a comparison of past and present political patterns in Latin America, this study assesses political risk traps, or combinations of repeatedly unforeseen political risks that international businesses may encounter in Latin American countries. The article identifies eight critical questions that investors must address looking at political risks in Latin America, as political situations faced by Latin American countries tend to be similar throughout time. It also shows the combination of political risks factors leading to a particular political risk configuration in the region. Political risks in Latin America appear over and over again because of enduring, vested interests of entrenched power groups in Latin America. Current techniques and methods to forecast country political risk are insufficient for international investors to grasp the full range of risks they may confront while investing in Latin America. Previous literature has not analyzed political risk combination and recurrence in an integrative approach. Therefore, the originality of our article is to present a framework of political risks, with a specific application to Latin America, highlighting the specific reasons for their recurrence there.

Keywords: Emerging markets; Political risk; Country risk analysis; Latin America

Introduction:

Emerging Markets (EMs) remain a driving force behind current growth and expansion in today's globalized business world (Khanna & Palepu, 2013; Ernst, Kahle, Dubiel, Prabhu, & Subramaniam, 2015).

Companies from around the globe continue to enter into these dynamic markets, either eagerly or reluctantly. Whichever the case, they are spurred by waning home markets and escalating competitive pressure. Strong EMs presence in world market portfolios is no longer an option; it is crucial to a healthy and enduring bottom line. However, EMs also represent a source of added volatility for firms.

To mitigate risks, firms tend to adopt a cautious process whereby they limit risk exposure through a gradual entry process. Firms may take an active role, assume a high level of risk and adopt long-term commitments through alternative modes of entry such as joint ventures, greenfield investments or acquisition (Meyer, Estrin, Bhaumik & Peng, 2009). Before entry decisions are made, common sense demands country political risk analysis (CPRA) to be conducted; to identify and assess potential hazards such as expropriation or difficulties to repatriate profits for example.

Numerous CPRA approaches, guidelines, websites and services are readily available (Howell, 1998; Bouchet, Clark & Gros Lambert, 2003; McKellar, 2010). However, most approaches remain generic and do not sufficiently consider factors derived from specific and complex EMs contexts, particularly in Latin America. They do not study sufficiently possible factor combinations, limiting the range of the analysis. Despite the blossoming opportunities that Latin American markets offer to multinational corporations (MNCs) and global investors, political risks continue to be a major hindrance to the benefits of entry and permanence in this region.

Some studies analyze specific risk scenarios in the Latin American region, such as the nationalization of the pension system in Argentina and of the oil industry in Venezuela, the presence of organized crime in Central America or the Venezuelan commercial blockade against Colombian imports (Rarick, 2000; Eljuri & Treviño, 2010; De Villa & Rajwani, 2013). However, there is a lack of integration regarding the most common political risks, the context in which they take place and the combinations of risk factors at the regional level. Furthermore, literature has not addressed the reasons accounting for the recurrence of such risks in Latin American countries. Identifying the risk situations or traps that are prone to recurrence matters because this knowledge could improve the degree of predictability in the analysis of political risks that directly affect international businesses.

It is noteworthy that the contexts surrounding these risk traps, or situations which are repeatedly unforeseen; regardless of the host government, include stakeholders such as terrorist groups, activist groups, drug cartels, political opponents, rebel groups and members of local communities. Consequently, the presence of one kind of risk in a specific country of this region is normally attached to the existence of other types of risks. Hence, the importance of analyzing and evaluating the factors involved

in a political risk situation as a whole. This multi-factor risk-analysis approach enhances the assessment of the current political and economic situation of Latin American EMs; so necessary for MNCs expansion decisions.

Thus, we propose that there are significant commonalities in Latin America regarding CPRA, in spite of the heterogeneity of the countries composing the region in terms of institutional structures, political orientations, population sizes, kinds of industries and overall economic development. The two research questions in our article are: is there a combination of political risk factors common to Latin America? How can we account for the recurrence of the combination of such risk factors in the region?

The analysis of Latin America from a risk perspective is both relevant and timely. On the one hand, most of the countries of this region are commodity-dependent economies which tend to have higher levels of political risk (Jensen & Johnston, 2011) due to the fact that in these economies once the resources have been discovered there is little incentive to build the necessary institutional capacity to manage resource rents' (Askari, Rehman & Arfaa, 2010: 61). Such issues are also relevant as they are envisaged within a historical context marked by political shifts between neo-liberal policies and neo-populist pressures (Knight, 1998; Weyland, 2004).

The organization of this paper is as follows. First, in the theoretical section, we summarize literature on political risk identification and assessment. We then present a synthesis of the most frequent indicators of political risk that we identified from news events and literature reviews, to establish our own list of what we refer to as [risk traps] or situations in which companies are caught unawares. The next section illustrates such risk traps through six selected country cases in which we compare the current state of politics with major events of the past. We then discuss the main findings of our risk analysis in Latin America. Finally, we conclude with a summary of the key findings, further research directions and the main limitations of our work.

Literature review

Political risk is one of the most important challenges for MNCs, especially when they expand their business into developing nations. It is one of the major constraints on foreign investors who seek to expand into foreign markets (Baek & Qian, 2011). As Sepúlveda and Bonilla state (2011), in order to have a global view of the factors that may affect the decision to start or continue a business venture, it is necessary to analyze the specific characteristics of some countries having a high level of political risk. It is important to mention that political risks do not always stem from

governments but may be also initiated by nongovernment forces such as war, terrorism, revolution, to name a few (Rarick, 2000).

Overview of Methods for Assessing Political Risk

Haendel (1979) refers to political risk as the probability of occurrence of some political event(s) that will change the prospects for the profitability of a given investment. Howell and Chaddick (1994: 71) define political risk as ‘the possibility that political decisions, events or conditions in a country, including those that might be referred to as social, will affect the business environment such that investors will lose money or have a reduced profit margin’. As argued by Kobrin (1979), political risk deals with the probability that a sovereign state will be unwilling or unable to guarantee a favorable business and investment environment as a result of state-pursued policies or due to events outside its control. Moreover, Álvarez and Urbano (2011) suggest that political stability has a positive relationship with private investment, entrepreneurial activity, and economic growth.

CPR analysts need a comprehensive knowledge of national and international events, macroeconomics and an understanding of the historical and socio-political institutions in the particular country to make a thorough identification and assessment.

Comprehensive political risk identification and assessment requires both quantitative as well as qualitative approaches. The existing literature describes a variety of methods for CPRA (Nath, 2004). Qualitative methods help to identify intangible factors that may be of prime importance. Some examples include: events, processes, customs, traditions, tendencies, social climates, grievances, political rifts, inter-country disputes, and other subtleties that do not fit into quantitative models. While the structured qualitative method uses a standardized format with specifically stipulated scope and focus of analysis (Nath, 2004), our assessment follows a qualitative method in discussing the political conditions of particular Latin American countries.

Our assessment complements composite indexes which are comprehensive, consolidated and aggregate measures of overall risk. They are made up of groups of critical factors organized using standardized systems whose goals are to provide useful statistical or numerical measures of country performance, trends over time and perceptions of what is believed to be in store for the future. Usually, these composite indexes encompass a large number of factors which are averaged (or weighted and ranked according to the relative importance experts believe they exert on overall risk and then are averaged) to arrive at final scores. These scores permit analysts to compare different countries all at the same time and have the advantage of providing common denominators for comparison. Composite indexes are

available from several different sources and provide different perspectives from which countries may be compared (Baek & Qian, 2011; The PRS Group, 2012; Deng & Pheng, 2012).

Country Political Risk Approaches

Numerous approaches are available for identifying and assessing country political risk. The following paragraphs summarize these approaches. Most country-political risk services use an eclectic mix of economic or social-political indicators based on criteria arising from experience and judgment (Meldrum, 2000). Deng and Pheng (2012) suggest that political risks can be attributed to political events, discriminatory actions taken (or lack of action) by the government or power groups in the host country, resulting in changes or discontinuities in the business environment and affecting negatively the operation of firms. Berlin (2004) distinguishes instability risks (sabotage, labor strikes, rioting and civil wars) from government risks (deliberate legal or illegal actions of the government).

Factors that normally appear in the political/legal category are: type of political system, political stability, degree of social content/discontent, protectionist tendencies, unfavorable attitudes toward countries and FDI, nationalist tendencies and track record for expropriation/confiscation, international trade policies, reputation for corruption, degree of bureaucracy, protection of property rights, type of legal system and capacity for enforcement of the law.

CPR identification and assessment may also contemplate a country's capacity for payment of its external debt and its currency stability as key factors. Its ability to meet obligations is of paramount importance for stability and integration in global markets. High rates of fluctuation suggest high economic risk, price instability, political issues and unfavorable investment climates. Both capacity for payment and currency stability are highly related. Indeed, the perception of all the aforementioned political/legal and economic risk factors also enter into the overall equation and influence the relative value of the country's currency.

Khanna, Palepu and Sinha (2005) offer insight into factors that are peculiar to EMs and should be assessed when formulating strategies either to enter the markets or avoid them entirely. Those authors provide a comprehensive list of factors that they deem critical for analyzing EMs. Their research focuses on infrastructure and development gaps commonly present in EMs from around the world, divided into five major contexts: political and social system, openness, product markets, labor markets and capital markets. The type of government in place has a direct impact on the nature of the institutional voids and firms' leeway in maneuvering around them or integrating them into their strategy. Within this five-context analysis,

country risks are inherently addressed.

As far as Latin America is concerned, several studies have examined specific political risks in this region as we present in Table 1.

Table 1. Types of Recurrent Political Risks in Latin America

| Types of Political Risk Identified | Recurrence in Latin America High/Medium/Low | Author(s) |
|---|--|---|
| Expropriation/ Confiscation/ Nationalization. | High | De la Torre and Neckar, 1988; Eljuri and Treviño, 2010; Baek and Qian, 2011; Deng and Pheng, 2012 |
| Swings in international policy. | High | Eljuri and Treviño, 2010; Baek and Qian, 2011; Aguiar et al., 2012; Deng and Pheng, 2012 |
| Disguise and manipulation of information. | High | De la Torre and Neckar, 1988; Aguiar et al., 2012; Deng and Pheng, 2012 |
| Political turmoil. | High | De la Torre and Neckar, 1988; Solomon and Ruiz, 2012 |
| Over-stepping of authority. | Medium | De la Torre and Neckar, 1988; Rarick, 2000; Eljuri and Treviño, 2010; Jensen and Johnston, 2011; Aguiar et al., 2012 |
| Irreverence for sovereign obligations. | Medium | Eljuri and Treviño, 2010; Baek and Qian, 2011; Aguiar et al., 2012 |
| Presence of organized crime or terrorist groups. | Medium | Baek and Qian, 2011; Solomon and Ruiz, 2012 |
| Politically-induced exogenous shocks. | Medium | Eljuri and Treviño, 2010; Baek and Qian, 2011; Aguiar et al., 2012; Deng and Pheng, 2012 |

Source: Authors' own elaboration.

The aforementioned approaches to CPRA represent valuable practices that will help firms choose the best countries for investment, formulate strategies adapted to the conditions of the market and to monitor changes which, in turn, help to protect assets. Nonetheless, the literature approaches CPRA by analyzing and/or comparing the situation variable by variable, of some scale or another, instead of studying it as a complex combination of factors. We propose the examination of the relationship of multiple and evolving variables that compose political environments and their recurrence from one political administration to another one.

Method

In our approach, we compare past patterns and present political situations to identify common risk factors necessary to assess political risk. We believe that relating the current state of the economy and politics with major events and ideologies over the past will provide more insights into the risk traps businesses may encounter in the future rather than solely

measuring/assessing isolated indicators. We also argue that the combination of those factors matters for CPRA.

The case analysis is useful for understanding and predicting political behavior in EMs. Thus, from the identification of the most common indicators of political risk from the literature, in Table 2 we derive a framework composed of eight critical questions that firms, considering continuity, investment or expansion in Latin America, need to address.

Table 2. Eight Questions to Help Firms Avoid Risk Traps

| Question | |
|----------|---|
| 1 | Historically, has the country demonstrated a reverence (or irreverence) for sovereign obligations? |
| 2 | How vulnerable is the country to politically induced exogenous shocks? |
| 3 | Historically, have there been huge swings in international policy from one presidential administration to another? |
| 4 | Does the country have a history of political turmoil? |
| 5 | Over the years, have there been incidences of expropriation/confiscation and nationalization? |
| 6 | Have there been signs of over-stepping of authority (resembling totalitarianism) that places the autonomy of public entities at risk? |
| 7 | Is there evidence of the involvement of political authorities to disguise, manipulate or hide key information or is there transparency? |
| 8 | Is the presence of organized crime or terrorist groups so extensive that it hinders or prevents the firm's operations? |

Source: Authors' own elaboration.

It is not enough to entrust others, including professional risk analysis sources, to provide relevant information to manage risk; too many firms fall inadvertently into risk traps that inextricably form part of the context of Latin American markets. We believe that this can be prevented by looking for trends occurring over a span of time; from the pre-globalization of the 1980s to the present. The eight critical questions we propose are designed to help firms identify key trends that have an impact on risk.

These questions (Table 2) are related to recurrent political risks (Table 1) we believe may help firms anticipate, maneuver around and/or create contingency scenarios to overcome adversities. Risks derived from these situations, we observe, are pervasive in Latin America and combined make this socio-economic zone distinctive from the rest of the world.

Case Findings:

Illustration of risk traps

We provide illustrations for the aforementioned questions in the form of select cases which reflect situations occurring under analogous populist social structures. Given this common bedrock, we refer to political risks which are recurrent and that, in one way or another, ultimately affect the operations of MNCs established in those countries. We present typical examples for specific countries which may be generalized to many Latin

American countries. Most portray two or more types of political risk.

Argentina

The economic and financial history of Argentina is well known for provoking almost all type of crises: exchange rate, banking, debt, inflation, political, social and institutional crises. The most severe crisis Argentina has faced in recent years is undoubtedly that of 2001-2002; mainly characterized by the loss of financial deposits. It was a period in which mistrust ruled, currency restrictions were imposed, and in which most pesos slipping out of the financial system sought safe haven in the USD. Financial institutions, in particular, suffered extraordinary losses and the value of the shares of publicly traded banks plunged. The legacy of ten quarters of recession that began in 1998 (contagion from the Brazilian economic crisis), a record fiscal deficit and the deteriorating conditions of access to credit markets were triggers of the crisis. An inflexible currency peg combined with central bank mismanagement exacerbated the crisis. By the end of 2001, Argentina's country risk reached a record: 9.588 points (Dabós, Secco & Olaiiz, 2007). Social chaos and the collapse of the economic system threatened the survival of both domestic and international businesses.

In the midst of the crisis, Argentina defaulted on USD \$100 billion debt (Reuters, 2011a). One direct consequence of these events was Argentina's inability/unwillingness to honor its sovereign debts; precisely the first risk trap we consider as part of our questions. Still, Argentina is largely cut off from access to the global credit markets (The Economist, 2013a).

Argentina illustrates a second kind of risk trap: swings in international policy. Approximately a decade ago, the country instigated a series of privatizations. Former president, Néstor Kirchner, late husband of former president Cristina Fernández, championed this process. Ironically, in 2012 former president Fernández executed one of the most controversial of all of Argentina's expropriations with the Spanish oil firm, Repsol. Former president Fernández defended her posture with arguments hinging on the "overly dominant" position of the firm in the local fuel market, a pending tax debt, absence of a solid plan to raise production, lack of domestic reinvestment and development, and a breach of agreements on several fronts (Reuters, 2012). These political swings have frequently been motivated by populist policies in Argentina as well as in other Latin American countries.

New forms of populism have emerged by targeting vulnerable sectors of the population mainly through alleviation programs which have been well received in a context of economic crisis and institutional weaknesses (Roberts, 1995). Populist policies have been geared toward the working classes with the main objective of gaining political preference. In the short/medium term, they generate an improvement in standards of living thereby justifying the re-allocation of resources. In the case of Argentina, this

'redistribution' has been accompanied by constant wage increases and large subsidies for several public services; a practice which leads to a significant fiscal deficit and, consequently, the inability to meet debt payments. The budget deficit is further aggravated by high inflation rates and capital flight. In the long run, the population experiences a severe drop in its standard of living manifested in higher prices, decreased purchasing power and dramatic shortages. Investors and MNCs have encountered in Argentina a third kind of risk trap: disguise and manipulation of information. Inflation figures announced publicly in recent years, through the National Institute of Statistics and Censuses (INDEC), have raised suspicions in the international arena because estimates of external agencies indicate inflation rates much higher than the ones published officially. According to information provided by Reuters (2011b), Argentina's economic consultants (for example, the consultancy firms Economía & Regiones and M&S Consultores) and market leaders, intimidated by government fines and the prospect of government retaliation, failed to accurately provide their inflation estimates which far exceeded the official data.

Kirchner's government (2003-2007) and then Fernández' government (2007 to 2015) have been accused by economists, opponents and even employees of INDEC of manipulating data to underestimate inflation for political and economic gains. Sufficient evidence suggests that the INDEC has been underestimating inflation and poverty leading to a lack of legitimacy of the official figures. Furthermore, disguise and manipulation of information has been exacerbated through the approval of some laws (such as the Audiovisual Communication Services Law) that may undermine freedom of expression (Macrory, 2013).

The lack of transparent and accurate reporting is not uncommon in certain Latin American countries. The ultimate result is misinformation for weighing the risks and making appropriate business decisions.

Mexico.

Today, Mexico is an example in the region for its monetary discipline, record reserves, world-class industry development of cement, telecommunications, steel, oil, petrochemicals, glass, foods and most notably high-tech specialization in automobile parts and aerospace. It is also a favorable place for investment given government streamlining of requirements for both domestic and foreign investors, its firm commitment (since 1986 on) to free trade and a hospitable environment for business. To a large degree, its success has been due to Mexico's integration in the North American Free Trade Area (NAFTA) with the United States and Canada. Its international trade and openness to FDI have been key drivers for economic growth, the development of manufacturing and well-diversified export base.

Mexico's economic stability and prosperity, despite ups and downs, is

less than two decades old. The current situation is a diametric contrast to the 1970s-1994. During past years, Mexico was a country in almost perpetual crisis with devastating monetary and economic crashes invariably occurring between the close of the six-year presidential administrations and beginning of the next. Many MNCs operating in or with firms in Mexico were adversely affected by the economic and political turmoil.

The case of Mexico provides a lesson concerning politically induced exogenous shocks. First, the Banca Central (Mexican Federal Reserve Bank) pegged the peso to the USD which gave the illusion of stability but prevented the peso from responding to market forces and revaluing over time. It was held artificially high thus inviting speculation and capital flight. Second, a lack of separation of power (system of checks and balances) between the reserve bank and the executive power virtually gave presidents the indisputable authority to use reserves to maintain the pegs, finance programs, or pay debts. They also had power to print money and incur new debt (bonds, and treasury notes) at exorbitant interest rates to cover public expenses. These two conditions alone were sufficient to drain the country's reserves. However, another factor added in to further aggravate the situation: Mexico's extreme reliance on commodity exports, particularly oil.

Fortunately, today there is no longer any pegging-related risk; currency risk is the similar FOREX risk as in industrialized markets. Furthermore, the reserve bank is managed independently from the executive powers and has achieved relatively stable currency. Lastly, the country has made substantial progress in diversifying and upgrading its export base thus reducing its dependence on oil exports.

Bolivia.

The presence of numerous and contentious indigenous groups in Bolivia, which fervently espouse the belief that natural resources must not be tapped if exploitation threatens the ecosystem, portray two types of risk frequently faced by MNCs. While their demands are justifiable, they have nevertheless culminated in intense protests leading to the death of several civilians. Such violence has induced President Evo Morales to nationalize companies and even entire sectors in an attempt to appease these groups. Such is the case of the Canadian mining South American Silver and of the tin and zinc mine Colquiri operated by the Swiss group Glencore. Morales has nationalized industries by presidential decree without previous warning or negotiations. Industries affected include hydrocarbons, telecommunications and electricity industries. Bolivia faces several lawsuits before international tribunals for the nationalization of foreign firms.

It worth noting the difference between the nationalization of the hydrocarbon and mining sectors. In the hydrocarbon sector, foreign firms were providers of state services while in the mining sector, firms were

partners with minority ownership and thus had stakes in the profits. One of the arguments that Morales has used to defend nationalization was the need to increase Bolivia's international reserves which in turn would make the country more solvent and, therefore, eligible for new international development loans. In the case of Bolivia, much like Argentina, avoiding current account deficits, maintaining its currency value and protecting foreign reserves are key concerns behind nationalization. However, most analysts and international organizations (including the European Commission) consider that such measures send negative signals to international investors who consequently may not consider these markets for future ventures.

Venezuela.

Perhaps, the main political risk faced by multinationals established in Venezuela is nationalization. Until 2008 when former President Hugo Chavez made the decision to nationalize the cement industry, the Mexican firm CEMEX, the French firm Lafarge and the Swiss firm Holcim were the major cement producers in Venezuela holding 50 percent, 25 percent and 25 percent respectively of the market (AFP Agency, 2008). Both CEMEX and Holcim requested arbitration proceedings before the International Centre for Settlement of Investment Dispute (CIADI) to arrive at an acceptable settlement.

The cement industry is only one example of the numerous nationalizations and expropriations that Chávez orchestrated during the last thirteen years he was in office. According to the information agency Reuters (2011c), the government has faced more than twenty cases of arbitration with various international bodies. The list of examples is vast and far-reaching; according to local newspapers, the incredible number of 499 expropriations occurred in the industrial sector in 2011 alone!

The major detriment for MNCs is that in the last decade they have received compensation for only 10 percent of over a thousand assets claimed by the state. Among the companies that received compensation, the fair price agreed upon by the negotiating parties has not matched going market values (Reuters, 2011c). Unexpected nationalization has become a common risk in Latin America that discourages potential and current investors despite the attractiveness of some industries in terms of volume and profit.

Honduras.

Over-stepping of authority has caused major problems to MNCs in some markets where democracy has been absent or where, as Pearce (2004) acknowledges, extra-constitutional manoeuvres have been used to retain, usurp or augment power. Such is the case of American firms Nike and Gap, as well as the German firm Adidas, which have seen some of the complicated consequences of the Honduran *coup d'état* in 2009. The companies

outsourced production through *maquila* operations in Tegucigalpa, Honduras. These operations represent significant savings for producers and a substantial source of income and employment in the region especially important after Honduras broke-off relations with the International Monetary Fund (IMF) and consequently the international financial community (Comisión Económica para América Latina y el Caribe, 2010). Honduras has become a major maquiladora centre and attracts firms from developed parts of the world.

An unexpected military *coup d'état* ousted President Zelaya from office and sent him into exile. Zelaya supporters believe he was attempting to increase minimum wages and improve worker conditions which enraged the country's elite who financed the coup. Conservatives who composed the opposition believed Zelaya was leaning too far to the left in Chavez fashion, trying to modify the constitution to serve his own re-election interests. What is certain, curfews, strikes, demonstrations prevented workers from getting to the factories. Meanwhile importing raw materials and exporting finished goods became close to impossible creating major disruptions in production. Many major companies rescinded their contracts in the political upheaval with plans to move to more stable and even lower-cost countries.

In the case of Nike, two of their local subcontractors closed their plants. According to Honduran law, these subcontractors were responsible for two million USD in severance pay for their workers. The arrangement was advantageous for Nike and other foreign subcontractors; they minimized risk and investment, took advantage of low costs, and let the locals worry about meeting legal requirements of their countries. However, in today's stage of globalization, such solutions can backfire.

Legally, the subcontractors in Honduras were responsible for severance pay for workers. The only problem was: where would the money come from? The plants were insolvent and the government had no way of enforcing its worker protection laws. Although Nike was not directly liable for severance pay, pressure from global consumer groups, athletes and shops that carry Nike goods from around the world held Nike morally responsible. In the end, Nike contributed more than 1.5 million dollars into a relief fund for workers, healthcare and ongoing support for vocational training and skill enhancement (Padgett, 2010). As unlikely as it may have seemed when Nike first entered Honduras, its chance of making a clean exit from the country is slim. In sum, President Zelaya's attempt to go beyond his authority by amending the constitution, led to a coup that triggered a series of events that had long-term effects on business when, at the onset, the *maquila* scheme seemed to offer the least amount of commitment and close to 100 percent transfer of risk to the Honduran outsourcers. Overstepping of authority does not only erode democracy but also causes indirect consequences which can

be devastating for investors.

Colombia.

The presence of organized crime in Latin American countries has become in the last decade one of the most obvious political risks in this region. Furthermore, political instability can facilitate the expansion of criminal activities (Salvatore, 2013). More than a decade ago, Colombia was the scene of clashes between leftist guerrilla groups and right-wing paramilitaries forcing the government to order military intervention. The city of Medellin was considered in the late 1980s and early 1990s the most violent of the country and hosted the powerful drug cartel led by Pablo Escobar (Reuters, 2013). Traffickers and guerrilla leaders vied with the government for political and economic power until the mid-1990s. However, the death of Pablo Escobar and former President Uribe's introduction of a comprehensive security strategy, in the mid-2000s, overcame the resistance of the illegal armed groups. Hoping to stimulate private investment, particularly in the hotel sector, the government launched a program in 2003 offering 30 years tax exemption for all construction or reform projects launched until 2018 (Universia Knowledge Wharton, 2012).

Despite Colombia's gains in curbing drug-related violence, during 2011 and 2012 there was renewed insecurity due to the resurgence of the guerrilla. The number of acts of sabotage against the national infrastructure in the first half of 2012 has been extraordinarily high and the most affected sector has been oil (ElEspectador.com, 2012). The Revolutionary Armed Forces of Colombia (FARC) attacks on oil pipelines, causing spills to rivers, have reinstated their show of power and halted the exploration and production of MNCs such as the North American firm Occidental. However, the Colombian government and the FARC held peace talks shortly thereafter. The results have been clouded by the intervention of the National Liberation Army (ELN) (the second largest guerrilla group in Colombia) which has taken the opposite position and has resorted to kidnapping to show dissatisfaction with the government for not including it in negotiations with FARC (The Economist, 2013b).

Although Colombia's progress in the rehabilitation of its reputation is remarkable, the country's image continues to be mired by its grisly history of violence; one of its biggest impediments to growth. With respect to MNCs, it has been difficult to cleanse the image of Colombia because, in the past decades, firms in particular have been the target of theft, robbery, fraud, and violence.

From the literature review and the set of examples we have described, Tables 3a, 3b and 3c summarize the commonalities that the Latin American region exhibits in terms of political risks. As shown in Table 3a, these commonalities are grouped according to the institutional context from which

those risks emerge; in Table 3b, we show the common combination of risks factors leading to a particular political situation, and Table 3c displays the recurrence of those risks within the region at different time periods.

Table 3a. Political Risks' Commonalities in Latin America: Institutional Context

| INSTITUTIONAL CONTEXT | CORRESPONDING RISK TRAPS |
|---|--|
| Central Bank Mismanagement. | <ul style="list-style-type: none"> Disguise and manipulation of information. Politically induced exogenous shocks. <ul style="list-style-type: none"> Over-stepping of authority. |
| Reliance on commodity exports. | <ul style="list-style-type: none"> Expropriation/Confiscation/Nationalization <ul style="list-style-type: none"> Irreverence of sovereign obligations. Politically induced exogenous shocks. |
| Numerous and contentious indigenous groups, accentuated levels of inequality. | <ul style="list-style-type: none"> Political turmoil Expropriation/Confiscation/Nationalization |
| Design of democracy | <ul style="list-style-type: none"> Over-stepping of authority. Swings in international policy. |


Source: Authors' own elaboration.

In the following table, we identify specific risk combinations in different countries.

Table 3b. Political Risks' Commonalities in Latin America: Combination of Risk

| LATIN AMERICAN COUNTRY | TYPE OF POLITICAL RISK IDENTIFIED | | | | | | | |
|------------------------|--|--------------------------------|--|-------------------|----------------------------|---------------------------------------|---|--------------------------------------|
| | Expropriation/Confiscation/Nationalisation | Swings in international policy | Disguise and manipulation of information | Political turmoil | Over-stepping of authority | Irreverence for sovereign obligations | Presence of organized crime or terrorist groups | Politically-induced exogenous shocks |
| Argentina | X | X | X | | | X | | |
| Mexico | | | | | X | | | X |
| Bolivia | X | | | X | X | | | |
| Venezuela | X | | X | | X | | | |
| Honduras | | | | X | X | | | |
| Colombia | | | | X | | | X | |

 Explicit manifestation

 Implicit risk

Source: Authors' own elaboration.

Table 3c provides some examples of the appearance and reappearance of risks in Latin America. Evidently, the list is not exhaustive; it refers only to some specific political events.

Table 3c. Political Risks' Commonalities in Latin America: Recurrence of Risks

| RECURRENCE OF RISK FACTORS | TIME FRAME |
|--|---|
| <ul style="list-style-type: none"> Expropriation/Confiscation/ Nationalization. | <ul style="list-style-type: none"> 2006: Bolivia. 2008: Venezuela. 2009: Bolivia. 2012: Argentina. |
| <ul style="list-style-type: none"> Swings in international policy. | <ul style="list-style-type: none"> 1992: Privatisation of Yacimientos Petrolíferos Fiscales (YPF): Nestor Kirchner 2012: Nationalization of Repsol: Cristina Fernández de Kirchner |
| <ul style="list-style-type: none"> Disguise and manipulation of key information (inflation figures) in Argentina. | <ul style="list-style-type: none"> 2003 – 2007: President Nestor Kirchner. 2008 to date: President Cristina Fernández de Kirchner. |
| <ul style="list-style-type: none"> Political turmoil. | <ul style="list-style-type: none"> 1964: Brazil. 1968: Peru. 1972: Bolivia. 1973: Chile and Uruguay. 1966/1976: Argentina. 2002: Venezuela 2009: Honduras. |
| <ul style="list-style-type: none"> Over-stepping of authority: coups d'état. | <ul style="list-style-type: none"> 1964: Brazil. 1968: Peru. 1972: Bolivia. 1973: Chile and Uruguay. 1966/1976: Argentina. 2002: Venezuela 2009: Honduras. |
| <ul style="list-style-type: none"> Irreverence for sovereign obligations in Argentina. | <ul style="list-style-type: none"> 1998 – 2002: systemic (financial) crises. 2014 up to now: debt crisis. |
| <ul style="list-style-type: none"> Presence of organized crime or terrorist groups. | <ul style="list-style-type: none"> 1980s and 1990s: Colombia. 2000s: Mexico. |
| <ul style="list-style-type: none"> Politically induced exogenous shocks in Mexico. | <ul style="list-style-type: none"> 1970s. 1994-1995. |

Source: Authors' own elaboration.

The cases described in the previous paragraphs provide the basis for the formulation of our aforementioned framework consisting of questions we believe management should ask, in order to complement their CPRA, regarding the eight risk categories identified in Table 1. The cases we included also provide a practical way for managers to conceptualize the issues raised in Table 2. If management is able to foresee potential political risks that may put their firms in dangerous situations, it will be better equipped to develop strategies to deal adroitly with these events. Lastly, we

contend that the aforementioned risks are prevalent in Latin America and these specific combinations of recurring risks set the region apart from others of the world.

In the second part of this case section, we analyze the reasons underlying the recurrence of the risk situations described. The constant economic crises that this region faces, in one country or another, provokes the enforcement of populist measures, despite any economic model officially endorsed.

Political risks in Latin America appear over and over again because social and institutional structures remain fairly static. The enduring, vested interests of entrenched power groups remain a factor explaining the lack of change and recurrence of political risk traps in Latin America. We have witnessed that government promoted changes that were actually insignificant and/or unsustainable. Those changes were not material in reducing poverty levels, increasing the quality of education, and in improving the distribution of wealth.

Legal order may change and improve, but the application of the legal system remains sketchy because the underlying informal institutions persist. Accordingly, the recurrence of risks is explained to a certain extent by the permanence of the aforementioned institutional arrangements; politicians' personal interests continues to be the rule. The events in Latin American countries strongly suggest that their orientation towards the past is neither due to romanticism, nor to resentment, nor for psychological reasons; it is rather because it suits the interests of a select group of people.

Resurrecting past policies and reliving the same errors committed throughout time is emblematic in Latin America.

Discussion

Our research questions in this article were: is there a combination of political risk factors common to Latin America? How can we account for the recurrence of the combination of such risk factors in the region? To answer these questions, we analyzed the institutional context in which those risks take place, determining the simultaneous presence of different types of political risks and the recurrence of such risks. The Latin American context gives rise to the application of economic models (neoliberal, populist or neo-populist) bounded by political matters that, in most cases, fulfil individual interests at the expense of the common good. With respect to the first question in particular, we presented cases to illustrate combinations of political risks identified.

Previous literature has not analyzed those two aspects: risk combination and recurrence, in an integrative approach applied to this specific region. We believe that our approach is relevant because, despite the

geographical, geological, and even social diversity of Latin America, many of these countries share significant commonalities in terms of political risks.

Literature has considered the context surrounding the manifestation of such political risks by studying institutional voids (Khanna et al., 2005; Khanna & Palepu, 2013). Fewer authors dealt with Latin American settings. Authors who did so, remarked that the institutional design of democracy favored a strongly clientelistic style (a small number of patrons and a large number of potential clients) (Power, 2010). Tedesco and Diamint (2014) also recognized this extreme clientelism, presidentialism and populism as factors that have characterized the political leadership style in Latin America during the last decades. By the same token, Latin America is a good example of the dual political risk that Berlin (2004) labelled as instability risks and government risks. It is also an example of what Rarick (2000) defined as government and non-governmental forces because many of the political hazards faced by the region involve not just governmental instances but paramilitary groups, organized crime cells, and terrorist groups as well.

The aforementioned groups often display power that surfaces and subsides over time. As we have seen through the illustrated risk-traps, the eight types of political risks in the region occur in virtually all Latin American countries at one time or another, under one or another political regime. Furthermore, the situations faced by Latin American countries throughout time tend to be similar, one event experienced by a country is likely to be replicated in another at a given time. In spite of the recurrence of such political risk traps, some managers continue to be stunned when this happens. Not surprisingly, foreign firms operating in Latin America have often incurred hefty losses. What is surprising is that they tended to fall into very similar risk traps time and time again. Some management teams have failed to anticipate these high-risk situations, underestimated them and/or misjudged their propensity to change when they were assessing foreign markets for feasibility and attractiveness. Thus, they need to ask the right questions when analyzing the nature of risk in the region to take full advantage of both blossoming and ripe opportunities. Otherwise, firms will be ill-equipped to stand up to the challenges, react swiftly and carry on with strategies suited to business situations in Latin America.

Conclusion:

In this article, we offer a complementary approach to CPRA by insisting on three facts that characterize Latin American countries:

1. The weak institutional context leads to the implementation of neoliberal, populist or neo-populist economic models restrained by political matters which continually privilege personal over common interests.

2. Political risks imply a combination of several factors. Due to the aforementioned institutional voids, a kind of risk does not occur isolated; it brings with itself other kinds of risks simultaneously. Consequently, a 'domino' effect is depicted which affects several systems at the same time (labor market, social system, level of openness, product markets, financial system....).

3. The recurrence of political risks is not just attached to cultural issues; it is also closely linked to the central facts surrounding our discussion: institutional weaknesses and satisfaction of individual interests at the expense of the collective ones, and very importantly, the understanding of the occurrence and recurrence of such risks cannot be disassociated from the countries' historical evolution.

In order to identify and assess the most common risk-traps, we referred to specific country situations. Likewise, we assessed these risk-traps from a multi-factor approach. Avoiding such risk traps will aid managerial teams in identifying and anticipating diverse risk situations, developing contingency plans, and more adeptly managing their investments.

Acknowledgement of potential risk at the opportune moment is the first step in responding promptly by formulating the appropriate strategies. Despite the constant change and regional complexities, MNCs simply cannot afford to miss the opportunity to gain a strong foothold and assert their presence in Latin America; the region is far too large and profitable to omit from any portfolio of international activities.

Our analysis focused on the identification and assessment of potential political risks in Latin America. A ripe area for future research might cover mitigation and monitoring of these risks traps in the region. It would be enriching also to document any potentially significant changes and structural reforms that are now taking place in Latin American countries, and which will bring with them new risks and challenges for companies operating in this region. Likewise, it would be interesting and informative to make this analysis on a subnational basis to reveal contrasts that may occur between states or provinces with different levels of institutionalization. In the same vein, a comparison of Latin American countries with other emerging markets would be timely and necessary following the three dimensions that we identified in our study: namely, the nature of political risks involved, their specific combination and their recurrence.

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