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The Ukraine: First Lessons

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Country Risk Analysis: More than a Postmodern Discipline

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Methodological debates about the stages of growth and the way in which a country goes through political modernization are long-established and manifold. Globalization and the new international dialectic that it has brought about, between tension that leads to convergence and tension that leads to divergence, have called many of these methods of evaluation into question. Aside from elaborating the most objective criteria possible, the formalization of future possibilities should leave the way open for uncertainty and a subjective approach.

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Country risk assessment asks two distinct questions about any country: what is the political risk of an investment in the territory? And is the country solvent? The investment may be in the country's currency, bond or equity markets, or it may be in plant, equipment and workforce with the aim of producing goods or services that supply the local or global markets. In either case, the question is being asked of the future, of which we know little. What we can assert with some confidence, is that we will never be able to do more than peer at it through a dark glass.

Thinking about the future of business involves a brief discussion of the changing global context and of the debate on modernization, first prior to, then after the great transformation in world affairs in the years 1989 to 1992 with a view to drawing a matrix whereby country risk methods may be assessed.(see below) Given the nature of the ongoing process of world affairs, we will argue that it is arguably more important to accept the inevitable subjectivity of opinions regarding country risk. The future remains open-ended, and so it is suggested here, should our thinking, even if our judgment and the bet we take closes off futures. Scenarios and options go together.

Country Risk matrix: Global polity dynamics and modernization.

Modernization → Global polity ↓	Stages of growth	Political development	Regime Change	International dimension
US primacy				
Trend to democracy				
Recreation of world market				
Spread of multinationals				

The global system and the debate on modernization

Before discussing our efforts to peer into the future, some contrition is in place. Ex post, we can observe a graveyard of shattered expectations as the promise of one Eldorado after another has turned to stone. From the 1960s on, foreign investors flooded in to Africa, Iran, and Latin America. But in the 1970s Africa spun into unsustainable debt; Khomeini seized power in 1979, and in 1982 Argentina, Brazil and Mexico suspended payments on the interest of their loans from western commercial banks. After the yen's rise in 1985, Michael Porter urged the world to imitate Japan's mercantilism, at the time that Japan entered its decades of stagnation;[1] investors poured into East Asian markets until the sudden withdrawal of confidence in June 1997, with serious knock-on effects in 1998 in Russia and South Africa. Meanwhile, Mexico's crash in 1994 relayed through Latin America; in 2001, the terror attacks were launched on New York and Washington, and Enron, the dotcom boom, Argentina's economy all imploded; China's entry to the WTO in 2002 was accompanied by gloom in China about the likely impact; then in 2008, after unprecedented Chinese growth, the US suffered the mother of all crashes. On each occasion, foresight was minimal.

There are some very good reasons for this. The world is turbulent and unpredictable per se. During the key years of 1989-1992, Germany's move

1. Michael Porter, *The Competitiveness of Nations*, Free Press, New York, 1990.

to unity dismantled the Cold War structure built around the two Germanies, the two Europes, their two alliances and the two great powers,[2] launching the world on the process which came to be called "globalization".[3] Globalization may be said to hold four key components, which inter-act in highly complex ways. The first of these components is the primacy of the US, and the transformation of the state system as the number of states multiplied, from 51 in 1945 to 193 now. The second component has been the relentless retreat of any alternative forms of government to 'market democracy', as various forms of despotism collapsed, populations become better informed, market scope widened, and institutional competition took its toll. The third component was the recreation of the world market under the aegis of the western powers, and by the United States in particular, to reach a level of integration unknown since the first decade of the 20th century, and lubricated by the explosive growth of global financial markets. The fourth element was the growth of the industrial or service corporation, initially based in a home country, and with subsidiaries or market outlets in host countries, towards becoming a transnational group with subsidiaries and markets located around the globe, and with a widely dispersed shareholder community, and a non-national recruitment policy.

This rapidly evolving context prompted at least four significant debates for country risk analysis in the years prior to the great transformation of 1989-92. The first involved theories of modernization and development, prompted by the process of decolonization, combined with bitter ideological disputes between the two lead party-states of the USSR and China over support for revolution in the "Third World". The classic statement of this perspective was Walt Rustow's The Stages of Economic Growth: A Non-Communist Manifesto, published in 1960. Rustow proposed a model of economic growth, whereby economic modernization occurs in five stages of varying length: traditional society, preconditions for take-off, take-off, drive to maturity, and high mass consumption. It followed that the more "well-to-do" a nation became, the more democratic it was likely to be.[4] For

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2. Pierre Hassner, "The new Europe: from Cold War to hot peace", *International Journal*, Vol. 27, No. 1, Winter, 1971/1972, pp. 1-17.
3. The best book on this is David Held *et al., Global Transformations*, Cambridge, Polity Press, 1999. The authors define globalization as "located on a continuum with the local, national and regional. At one end of the continuum lie social and economic relations and networks which are organized on a local and/or national basis; at the other end lie social and economic relations and networks which crystallize on the wider scale of regional and global interactions. Globalization can be taken to refer to those spatial-temporal processes of change which underpin a transformation in the organization of human affairs by linking together and expanding human activity across regions and continents. Without reference to such expansive spatial connections, there can be no clear or coherent formulation of this term. … A satisfactory definition of globalization must capture each of these elements: extensity (stretching), intensity, velocity and impact."
4. Seymour Martin Lipset, *Political Man*, New York, Doubleday, 1960.

Rustow, the process could be advanced by the granting of western aid, state-promoted growth policies, and the rejection of communist methods of class warfare and the suppression of market mechanisms. The Asian developmental state stood as testimony to Rustow's insights.[5]

The second significant debate for country risk analysis dealt with questions of political transformation. In the course of the 1960s, events in Africa and Latin America showed that political developments were far from unilinear. Rapid economic growth was not a stabilizing factor but a surefire prescription for political instability.[6] Too rapid social and economic changes could erode traditional solidarities, widen wealth gaps, multiply sources of dissatisfaction and promote political decay.[7] As de Tocqueville had observed about the French revolution, men tended to rebel [8] as expectations rose but could not be met. Ruling élites would fracture, in their competitive appeals to differing constituencies within the regime and beyond its boundaries.[9] Their people on the other hand, could accept the iron chains of dictatorship as the price to be paid for stability and economic improvement for a large majority.[10] There was not one, but many paths to modernity. [11]

The third significant debate for country risk was the burgeoning literature in the 1970s and 1980s dealing with regime change. The question asked was: how does a democracy come into being in the first place? Dankwart Rustow identified a process in four phases: there had to be a pre-existing sense of nationhood; a prolonged and inconclusive political struggle, prompted often by a new social force of political leaders or modern business groups; a decision point, where the contesting élites agree to compromise; and a habituation phase, where the new rules of the game would be introduced and then implemented. [12] His article laid the conceptual foundations for later work on the decline and collapse of authoritarian regimes in southern Europe, then in Latin America and beyond. The common theme running through this literature was that splits within the regime throughout the whole process would be the detonator of regime change, not "external

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5. See Robert Wade, *Governing the Market: Economic Theory and the Role of the Government in East Asian Industrialization*, Princteon, Princeton University Press, 1990.

6. Mancur Olson, Jr., "Growth as a Destabilizing Force", *Journal of Economic History*, XXIII, December 1963.

7. Samuel P.Huntingdon, *Political Order in Changing Societies*, New Haven, Yale University Press, 1968.

8. Ted Gurr, *Why Men Rebel*, Princeton, Princeton University Press, 1970

9. Juan Linz, Alfred Stepan, *Problems of Democratic Transition and Consolidation: Southern Europe, South America and Post-Communist Europe*, Baltimore, London, The Johns Hopkins University Press, 1996.

10. Crane Brinton, *The Anatomy of Revolution*, New York, Vintage Books, 1965.

11. Barrington Moore, Jr, *Social Origins of Dictatorship and Democracy: Lord and Peasant in the Making of the Modern World*, Boston, Beacon Press. 1972

12. Dankwart Rustow, "Transitions to democracy: Toward a dynamic model", *Comparative Politics*, Vol. 2, No. 3, Apr., 1970, pp. 337-363.

shocks". [13] Consolidation of the new regime would only occur once political parties had alternated in power, and most importantly, that the recently agreed settlement becomes "the only game in town". [14]

Finally, it was observed that political transitions in one country were never just a domestic affair.[15] They are complex, not just because as the momentum towards regime change builds, the stakes of politics are raised, pulling a widening range of people, causes and interests. They are also complex because regime changes in one state occur in a world of states, interdependent among themselves, all in specific geographic neighborhoods, and all effected by the workings of the power balance, by the cyclicality of the global economy, or by the individual perspective of leaders more or less involved in the intimate details of the transitional process itself. This was the arena in which corporations had become co-players with states in the "new diplomacy" between states and corporations, which overlay and differed from the bi- or multilateral diplomacy of states.[16]

A matrix to locate country risk.

Country risk analysis refers to both foreign direct and financial investments on world markets. Both aspects of country risk inter-relate: financial loans will tend to be recorded through the short term capital account of the country, and involve investment in the currency and/or in paper on the local capital market. The risk for both lender and borrower is that investors may withdraw speedily from the market on the receipt of adverse news. A more secure form of investment from the viewpoint of the host country is a foreign direct investment, involving a transfer of technology, and skills, while generating jobs and revenue. Once embedded in the host country, withdrawal is more problematic. Both forms of country risk analysis ask similar though distinct questions. Both attempt to come up with a judgment about the risk of lending or investing in a country in the light of an assessment of the political and economic factors informing a target country prospects. Both face the reality that international business involves taking a bet on the target country's politics and performance. [17]

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13. G. O'Donnell, P. Schmitter, *Transitions From Authoritarian Rule: Tentative Conclusions about Uncertain Democracies*, Baltimore, The Johns Hopkins University Press, 1986. See Yossi Shain, Juan Linz, *Between States: Interim Governments and Democratic Transitions*, New York, Cambridge University Press, 1995.
14. Andreas Schedler, "What is Democratic Consolidation", *Democracy*, Vol. 9, no. 2, April 1998, pp. 91-107.
15. Geoffrey Pridham, *The International Context of Regime Transition in Southern Europe*, Leicester University Press, 1991; Jonathan Story, Richard Gillespie, *Democratic Spain in the International Context*, Abingdon, Routledge, 1995.
16. John Stopford, Susan Strange, *Rival States*, *Rival Firms: Competition for World Market Shares*, Cambridge, Cambridge University Press, 1991
17. Jonathan Eaton *et al.*, "The Pure Theory of International Risk", *European Economic Review*, no. 30, 1986, pp. 481-513.

Given this definition, how has country risk analysis covered the multiple forces at work in the world?

There can be little doubt, looking across the matrix, that the US shaped the development of the state system; promoted the spread of market democracy; fostered an ever more open world market; and was the prime source of multinational corporate foreign direct investment. Because the post-1945 global economy gave a leading role to national governments, into the 1970s, country risk was largely in the hands of rich world governments and of the international institutions, particularly the World Bank. Prior to the first oil price shock (1973-74), most developing countries received foreign funds largely in the form of long term, mostly concessional and project-related, loans from multilateral and bilateral official sources. However; in the 1960s, as countries went for growth, their debt service began to climb.[18] In 1965, the World Bank produced a seminal three volume work on country risk.[19] The report charted debt in developing countries between 1955 and 1962, and derived a model whereby as growth proceeded, external borrowing would rise, and then fall as the trade accounts turned to surplus. The debt would continue to rise, but be serviced by even faster growth of exports. This process was particularly sensitive to the rate of a country's growth, especially its exports, its savings rates, the quality of its investments and the terms of repayment.

This conceptual cycle of development and growth was applied in a cross country analysis in 1971.[20] Two metrics were recommended: the rate of return on investment has to be higher than the interest cost of the external loans used to finance it; the growth of the borrowing economy had to exceed the interest rate on new external debt. Clearly, these formulas would favor export oriented countries, and penalize countries with import substitution regimes.

The major turning point in country risk analysis came with the 1982 crisis, following the second oil shock of 1979-80. The major shareholders of the World Bank did not vote adequate capital increases for the organization to cover the needs of developing countries, which had to rely on private capital flows. There was thus a redeployment of tasks: the World Bank, and the IMF, took to providing advice on rigorous adjustment processes, particularly with regard to Africa and Latin America; financial institutions and agencies acquired their own country risk capabilities; corporations

18. Barend A. de Vries, "The World Bank as an International Player in Economic Analysis", *in* A.W. Coats, *The post-1945 Internationalization of Economics*, Durham, Duke University Press, 1996, pp. 225-243.
19. David Avramovic, *Economic Growth and External Debt*, Baltimore, Johns Hopkins Press, 1968.
20. Barend A. de Vries, *The Debt bearing Capacity of Developing Countries: A Comparative Analysis*, Rome, Banca Nazionale de Lavoro, 1971.

developed their in-house political assessment function. As has been observed, banks had little house knowledge about politics; most managers had ethnocentric views; and perceptions on the political environment varied greatly. [21] That was before the analysts sought to look through the dark glass towards an uncertain future.

Given the multiple problems of assessing country risk, no consensus could be reached on methodology. Instead, corporations, banks and ratings agencies plumped for more qualitative or more quantitative analysis, and most usually for a varied combination of both. A survey conducted by the US Eximbank in 1976 categorized various methods of country risk appraisal[22]:

– Qualitative Method: A typical qualitative report would include a general discussion of a country's economic, political, and social conditions and prospects. Its benefit was to draw attention to the details of a country's evolution. But its drawback was the difficulty in establishing comparability across countries, and the method's failure to yield a number for market participants eager to make decisions among a range of options.
– Structured Qualitative Method: the aim here was to establish a uniform format across countries, augmented by selected economic data, and including observations of a political, cultural or social nature. A widely used example of this was the political risk index provided by Business Environment Risk Intelligence (BERI) S. A. [23] The method's benefit was that it covered all the horizontal dimensions of our country risk matrix, and in the shape of a reproducible format.
– Checklist Method: this involves scoring the country on a scale with regard to a set of economic, financial, legal, or political criteria. An example here is the CRS Group's International Country Risk Guide (ICRG). Each item is weighted, and scaled from lowest to the highest score-an inevitably subjective evaluation. All items are summed on a matrix, whose one side represents say the political/legal dimension and the other side, the economic/financial dimension. The method also allows for the creation of a country profile, comparable to other territories, and over time.
– Other Quantitative Methods: These methods use econometric and statistical studies of country risk analysis. They compare a large set of

21. Stephen K. Kobrin, *Managing Political Risk Assessment: Strategic Response to Environmental Change*, Oakland, University of California Press, 1982.
22. Cited in Hiranya K Nath, "Country Risk Analysis: A Survey of the Quantitative Methods" Sam Houston State University Economics & International Business Working Paper, No. SHSU_ECO_WP08-04, October 2008.
23. For the components of the index, C.R. Harvey, "Political Risk, Economic Risk and Financial Risk" 1996, Country Risk Analysis home page <http://www.duke.edu/~charvey/Country_risk/couindex.htm>

countries, and conclude with a list of variables which their authors consider most explanatory.[24] The problem with these techniques were multiple: their focus was narrow; their models were no better than their assumptions; non-statistical information was not incorporated; the method focused purely on economic data.

Overall, the conclusion that emerges from this overview is how inconclusive the battle of methods remained. This should not come as a surprise. There are deep problems relating to the subject of country analysis. Whatever the method, bias is inescapable; the material, whether qualitative or quantitative, can only be from the past; there is an insoluble problem of causality; the future remains a dark glass. Nonetheless, country risk prior to 1990 yielded a useful debate about comparability of information in a format, while the index method produced a country profile and some numbers, albeit subjective. Not all effort was in vain.

Globalization: convergence or divergence?

With the collapse of the Cold War structure in the years 1989-92, the question was widely asked: Where was the world heading? One view, to become very influential in country risk analysis, was of a world converging on western political norms, on western economic policy, and on a market-driven process of world integration. A cascade of new technologies-in particular the privatization by the US Department of Defense of the worldwide web-would accelerate the pace of innovation. Western corporations would pour technologies into the poorer regions of the world, where labor was abundant, cheap and talented. Global financial markets, no longer under political lock and key, would provide capital, ending the historic savings shortages of developing countries. For those who wanted to tap into international capital, the price would be an end to national capital controls. With global growth rising, productivity levels, living standards and longevity would soar. Better educated populations would help to spread constitutional democracy, promote greater security between states with similar values and regimes, and eventually equalize incomes at an unprecedented high level of well-being. As global civil society developed, a public law would emerge to override state sovereignties as the world progressed to a higher civilization.

The launching of the worldwide web transformed country risk analysis, in providing universal and rapid access to a growing number of

24. See two studies at a 20 year interval: C.R. Frank, W.R. Cline, "Measurement of Debt Servicing Capacity: An Application of Discriminant Analysis", *Journal of International Economics*, No. 1, 1971, p. 327-344. M., Oral, O. Kettani, J. Cosset and M. Daouas, "An Estimation and Model for Country Risk Rating", *International Journal of Forecasting*, No. 8, 1992, p. 583-593.

sites. [25] The availability of a huge amount of information though has been accompanied by a multiplication in the underlying frameworks, assumptions and theories. This may be easily illustrated: the competitiveness websites from IMD and from the World Economic Forum have been greatly influenced by Michael Porter's writings on the competitiveness of nations. The UNDP's Human Development Index has been inspired by Amartya Sen's redefinition of labor from being a "factor of production" to being a bundle of potential, measurable not in terms of prices in commodity exchange, but in terms of life expectancy, educational attainment, and per capita income. The Heritage Foundation' economic freedom index is predicated on classical liberal market theory and measured in terms of trade freedom, business freedom, investment freedom, and property rights. The Berthelsmann transformation index states clearly its approach derives from the theory of Germany's social market economy.[26] The World Bank governance indicators are based on the observation that, as Douglass North [27] and others have argued, institutions matter, and that good governance, the rule of law, and a quality bureaucracy are key in accounting for where investors go.

For their partisans, the benefits of the rankings are self evident: listing countries competing for business in a semi-integrated global market encourages benchmarking, motivates learning, may promote reforms, and allows countries to brand themselves to attract investors. Because the data provided on the indices is either publicly available or based on opinion surveys, there is no possibility for governments to negotiate before, during and after the judgment has fallen, as has been the habit of governments for instance in negotiations with the IMF on structural adjustment programs. Countries and governments face the court of global opinion in the form of the indices: no insider negotiations are possible.

There is, though, an alternative narrative about where the world is heading. Accordingly, the historical world in which we live is one of inherited inequalities among states or classes, and very diverse motivations among peoples of differing religions or cultures. States have different adaptive capabilities which are forged in discrete, historical circumstances,[28]

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25. David Conklin, "Analysing and Managing Country Risks, The Organization", *Ivey Business Journal*, January / February 2002.
26. The Berthelsman's Transformation Index states on its opening page: "It measures successes and setbacks on the path toward a democracy based on the rule of law and a market economy flanked by sociopolitical safeguards."
27. See Douglass C.North, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, 1990.
28. Linda Weiss, *The Myth of the Powerless State : Governing the Economy in a Global Era*, New York Polity Press, 1998.

yielding not one but a diversity of capitalisms.[29] Efforts to pack them onto a single tramline heading to a One World united in "market democracy" is bound to cause accidents, and is as unrealizable as was the communist utopia to create a world-wide communism[30]. Indeed, the cause of divergence is now taken up by radicals who see "global capitalism" as seeking to impose uniformity on a diverse world. Better to assume that the world's diversity is its wealth, and that the system of global governance under construction is a negotiated construct, which reflects the institutional arrangements-national, regional or global- from which they emerged.[31] Overall, future divergence is rooted in a world of history and variety rather than one which demands linearity, integration and convergence.

The websites have no problem in dealing with diversity. The rankings, their composite indicators, and scales facilitate differentiation and on a comparative standard. [32] But that is precisely their problem: the accusation against the rankings is that they are ethnocentric; they tend to promote "neoliberal" agendas; they assume a one-size-fits-all template for a diverse world;[33]they are riddled with methodological problems, such as the fact that the final number in the ranking is an average of distinct observation points; the data which they produce appears objective but their composite indicators derive from a hodgepodge of sources; the weighings of the factors are arbitrary; and not least, they conceal their subjectivity behind a veil of semi-scientific gloss. Having connived in misleading their clients prior to the 2008 crash, the big three ratings agencies-Moodys, S&P, and Fitch-were challenged when S&P downgraded Greece in April 2010.[34] Inversely, their deficiencies indicated that they were arguably open to gaming: Georgia in 2005 was ranked by Transparency International corruption perceptions index as occupying number 122 in the global corruption stakes, and by 2012 ranked number 51- a Pauline conversion towards virtue.

Whether the rankings serve to benchmark or to be gamed, they are no more than rough guides to investors. What is necessary in a global market is

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29. Colin Crouch, Wolfgang Streeck, *Political Economy of Modern Capitalism. Mapping Convergence and Diversity*, London, Sage, 1997.
30. James Goldsmith, *The Trap*, London, MacMillan, 1994; John Gray, *False Dawn: The Delusions of Global Capitalism*, London, Granta, 1998; George Soros, *The Crisis of Global Capitalism*, New York, Public Affairs Press, 1998.
31. Richard Whitely,"Internationalization and varieties of capitalism: the limited effects of cross-national coordination of economic activities on the nature of business systems", *Review of International Political Economy*, vol. 5, no. 3, 1997, pp. 445-481.
32. Ian Bremmer, "Managing Risk in an Unstable World", *Harvard Business Review*, June 2005, pp. 51-60.
33. See *Independent Panel Review of the Doing Business Report*, June 2013.
34. « Barroso attacks rating agencies », *Business Day*, May 6, 2010.

for investors to acquire local knowledge.[35] In particular, in a diverse world, it is suggested that corporations have to consider themselves as political players and not just as economic agents. Just as managers have to know the history which makes their corporations as they are, they also have to learn about the territories they enter.[36] As lobbyists, managers have to develop political capital, join coalitions of interests, master the art of political spin, and "hit the pressure—points of local decision-makers".[37] They have to develop a non-market strategy, not least because they compete for airspace on global media with non-governmental organizations, while governments use regulation to extract corporate resources. The globalized world is a goldfish bowl with few places left to hide, but many opportunities for self advertisement.

The new dialectics and country risk.

The argument here is that the world is both converging and diverging simultaneously, not one or the other. Markets, communications or travel drive integration; differentiation is preserved and accentuated in terms of legacies or collective memories. The new world system to have emerged since 1990 in the course of the 1990s is characterized by complementary opposites: a diversity of states in a non-homogeneous world, penetrated and shaped by global markets, operating powerfully to create a more homogeneous world civilization; alongside aspirations to create a system of global governance out of the world's existing institutional framework as the counterpart to a world of relentless competition between states, corporations or currencies. The impact of the world's driving forces on this system generates the ongoing process of transformation, which is captured by the juxtaposition of present prospects for an increasingly wealthy and inclusive world as global civil society develops towards a higher civilization, and a world of history where the forces of globalization operate as a stimulant to divergence, to conflicts and to a ruthless competition between peoples, states and corporations. It is this double movement between the forces driving towards the prospect of a radiant future and the world's very divergent capabilities to adapt that lie at the heart of the new dialectics in global affairs. Cold War dialectics was structured by the global configuration of the international system; the post-cold war dialectics is a global process working at the level of cultures, markets and politics.

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35. C.K. Prhalad, Yves L. Doz, *The Multinational Mission: Balancing Local Demands and Global Vision*, New York, Free Press, 1987, p. 30.

36. For a politically sensitive view on multinational corporate development, Christopher A.Bartlett, Sumantra Ghoshal, *Managing Across Borders: The Transnational Solution*, Boston, Harvard Business School Press, 1989.

37. Witold J. Henisz, Bennet A. Zelner, "The Hidden Risks in Emerging Markets", *Harvard Business Review*, April 2010.

Reading the future is therefore more of a challenge than ever. What to do? If we assume that nothing is written in advance, my suggestion is to consider our journey into the future in the way proposed by Bertrand de Jouvenel. This world takes the paths it doesde Jouvenel wrote, because humans choose their futures all the time, through a permanent overture and closure of options, of what he called "les futuribles".[38] The statesman, investor or the corporate leader has to make up their minds about what is the most judicious policy. They should have a knowledge of history because therein lies the seeds of the present and the future. In other words, they should articulate a vision of the future, which serves to pull present, and past towards it through policy.[39] The visions may tell of a world quite different to that which has gone before so that the future is purposefully shaped to be radically discontinuous with the past.

If history is an open page for diagnosis, the future for mankind should be envisaged as yet to be written from many different scripts. One clue to the future thus resides in the ideas that people hold about the past. In his dystopian novel, Nineteen Eighty-Four, George Orwell has O'Brien propose a toast to the future. Winston Smith, who works for the Ministry of Truth (MiniTrue) instead proposes "To the past!" 'The past is more important,' agrees O'Brien gravely." "I'd drink to that," replies Smith. Smith of course knows all about the past from his experience at work, where history is being permanently recreated on Big Brother's whim, and to serve as a guide to the Proles, composing 85% of the population. Put more prosaically, what matters for the future is the collective memories that the peoples of the world hold; the often implicit ideas that inform government policy; the behavior and strategies of corporate leaders; or the ideas of key individuals.

The other clue to the future resides in what people think about the present. In ancient Greece, the Delphi oracle fell into a trance before being asked questions about the future. Her answers were then interpreted by the priests, who veiled their interpretations, as the Gods retained discretion for future action. The modern practice of using the Delphi technique retains an element of mystery in that the experts who are questioned ex ante for their opinion, may always come back ex post to explain away what happened. It also retains the key insight that an opinion about the present is always partial, and always out-of-date. Churchill, for instance, during the Second World War, considered it highly likely that Molotov, not

38. Bertrand de Jouvenel, *L'art de la Conjecture*, Paris, Sedeis, 1972.
39. See especially Charles Hampden-Turner, Fons Trompenaar, *The Seven Cultures of Capitalism*, New York, Doubleday, 1993. Chapter 7.

Stalin, was the power behind the scenes. The British Prime Minister could not be sure. Nor can we be sure of the multitude of factors which drive the human story.

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The conclusion for country risk analysis is straightforward: there is a place for all the methods and insights developed. But the one approach which is inappropriate is for country risk analysis to suffer from physics envy-the disease of modern economics, and of econometricians who take their discipline too seriously. Country risk analysis cannot be scientific in the way that the physical sciences are. It must learn from the toolkit of the historian, and of the opinion pollster. The historian seeks to record to the best of his ability what happened in the past, while accepting the open challenge from his peers. He may be well armed in argument; but he does not speak ex cathedra on doctrine. He does not claim to speak Truth. Likewise the pollster records current opinion. In the context of country risk analysis, the rankings and indices are there as proxies to form a country profile of considered opinion as to where a country stands.

That leaves the future. Our country profile represents conventional wisdom on a subject. Conventional wisdom will be clear as to what it considers most probable, and most uncertain. In the Shell formula for thinking about the future, scenarios are fashioned out of the key uncertainties.[40] Since these uncertainties derive from current opinion, they help to explain the boundaries of the present situation. They are extended comments on the present. A different approach to thinking about the future would start with extrapolation, labeled as business as usual; would go on to explore the possibilities of moderate changes to the status quo; examine the nightmare of retrogression; or fill out the story of some possible future which the *bien pensants* consider out of the question.[41] To think about the future, iconoclasm is a must. Otherwise, and even then, we will be permanently surprised. We cannot avoid subjectivity. We should embrace it in country risk, but not as Winston Smith would have us do. In the modern world, the future is not made by Big Brother, but by seven billion sentient humans.

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40. Peter Cornelius, Alexander van de Putte, Mattia Romani, "Three Decades of Scenario Planning in Shell", *California Management Review*, Vol. 48. No. 1, Fall 2005, pp. 92-109

41. See my book, *The Frontiers of Fortune: Capital Prospects and Casualties in the Markets of the Future*, London, Financial Times, 2000, 4th ed.