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Political Risk and Foreign Direct Investment

Transition and New Frontiers

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<p>The purpose of this work is to analyse how political risk has evolved and changed recently and how its transformation affected foreign direct investment worldwide. By referring to the latest events in the spheres of politics and economics, this paper will provide a detailed analysis of the existing political risk methodologies, as well as thereof adaptability to the challenges of the present.</p> <p>The current views on the nature of political risk will be summarized and evaluated with an attempt to formulate a new definition, which would encompass the latest trends in the development of political risk.</p> <p>Additional factors of political risk are established in this work to complement the existing quantification models. Ideally, this will benefit the models by adapting them to the transforming political risk.</p> <p>Finally, the ways in which more traditional types of political risk exhibit themselves presently will be demonstrated with the example of oil industry, with suggestions as to how these types of risk can be mitigated in the future.</p>	
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1 Introduction

Political risk and analysis thereof in the international context has always represented an important aspect of conducting business in a foreign country, and it is undoubtedly even more significant in the current times of a rapid growth of international trade and investment.

The concept of political risk analysis can be dated back to the time of ancient Babylon, where Hebrew bankers had a network of couriers who delivered political intelligence sourced by their network of spies located throughout the known world (Overholt, 1982). Although social sciences have undoubtedly progressed since then and a much more extensive scope of information can be gathered and analyzed for the purpose of investment decision making, the environment of international business has also become much more complicated, which calls for the constant revision, improvement of the methods of political risk analysis.

Any investment carries the underlying principle of uncertainty of the level of return. In the international context, the return on investment becomes a subject to a whole new myriad of risks, which are outside of the control of an investor. Just as an international investor may enjoy favourable political atmosphere in a host country, in a similar manner the investment may be seized, nationalized or prohibited to transfer the profits. In an absence of a powerful global institution, which would be able to resolve international investment disputes and full sovereignty of states over investments within their territory, there is little to protect a foreign investor from belligerent actions of a host government. Thus, a need in clearly defined political risks analysis arises.

In order to measure the scope of political risk a particular country and compare the potential host countries to one another, various models are used to quantify the level of potential uncertainty. These models, to be discussed more in-detail further in this work, are constituted by factors and indicators of risk, which are to assess the presence of certain risks within a market. Various models vary by the amount of factors used and methods to quantify data.

It is important to note that the phenomenon of political risk is highly subjective, and any attempts to quantify a matter as fluid as political risk is a subject to an analyst's

available information and other factors, as was described by Simon (1984). Nevertheless, comprehensive in-depth analyses are practical for the assessment of a potential host country with the respect to the political risk.

As the global balance of power is changing, new political movements emerge and conflicts flare up, it seems necessary to reevaluate the models used to analyze political risks and examine whether the risks themselves are transforming. The objective of this work is to find out whether the nature of political risk has transformed and the ways in which latest aspects of political risk manifest themselves. Case studies will be used to complement the theoretical findings. This work will also try to suggest what improvements can be made to the existing risk models for the latter to be more adaptable to the transforming nature of political risk. By complementing the risk rating methodologies used today, the findings of this work will assist the risk analysis for it to become more adaptable to the uncertainty prevailing in the markets at present.

2 Political risk and foreign direct investment: a conceptualization

From 2004 to 2012, the total flow of foreign direct investments more than doubled, reaching nearly USD 1,500 billion in 2012 (UNCTAD, 2013). As a way of international investment “by a resident in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy” (OECD, 2013), FDI has become one of the major methods of cross-border investment and one of the most active drivers of economic growth. It plays a significant role in the process of capital formation for countries of the developing world, especially through exchange of technologies and managerial practices and knowledge. By bringing in capital, especially in the form of foreign currency, FDI helps to generate more investment within the host country and improve its balance of trade, thus further enhancing the cycle of growth. Along with certain negative sides, FDI has produced positive externalities and “spillover” effects, such as, for example, infrastructure projects.

Nevertheless, the extent of the flow of foreign direct investment is highly dependent on the political atmosphere of the host country. The well-being of legal institutions, level of corruption, political stability, and ability to protect intellectual rights are only some of the factors affecting the flow of FDI into a host country. The vast variety of organizations seek to analyze and structure the information about countries in order to make an assessment of an economy’s ability to perform well in modern world (World Economic forum, 2015). While the results of this research activity are not specifically tailored for the purpose of the investors, they have a high degree of correlation with the FDI inflows. Therefore, it does not come as a surprise that 4 out of 10 countries that topped World Economic Forum’s GCI Global Competitiveness Index ranking in 2014, namely Hong Kong, the US, UK, Singapore, (World Economic forum, 2015) were also among the 5 largest recipients of FDI in the same year (UNCTAD, 2015). In a similar fashion, 10 leaders of The 2016 IMD World Competitiveness Scoreboard (IMD, 2016) represent 5 out of 10 top host economies by the amount of FDI inflows, namely US, Hong Kong, Netherlands, Singapore and Canada (UNCTAD, 2016).

The examples presented above show that a significant part of an economy’s attractiveness to Foreign Direct investment is defined by a country’s ability to exhibit certain principles – such as basic requirements of stability of institutions and macroeconomic environment, efficiency enhancers, such as country’s educational standards, goods and labour market efficiency, development of financial markets and

technological readiness, and openness to innovation and business sophistication – in the view of the World Economic Forum’s GC Report (World Economic forum: Methodology, 2015); and overall economic performance data, complemented by issues of management practices, corruption, standards of living and environmental issues – in the case of IMD (*Frequently Asked Questions*, 2015). In addition to this, various studies, including those of an econometric nature and empirical analyses, have shown the linkage between the existence of democratic procedures, rule of law and intellectual rights protection and flow of FDI into a host country (Busse, Hefeker, 2015). Similarly, Brunetti and Weder (1998) point out the empirical evidence that certain indicators, which can be grouped into four main categories: government instability, political violence, policy uncertainty and enforcement uncertainty, may be the most detrimental to an economy’s attractiveness to investors. Kaufmann et al. (1999) of the World Bank, in addition to the indicators discussed above, mention government effectiveness and regulatory burden.

Nevertheless, it can be argued that some of the indicators that are traditionally associated with the country’s compliance with the principles of rule of law and democratic institutions have only limited influence on the FDI flow, or only a limited amount of such factors have evident impact. As such, in *“Political Risk, Institutions and Foreign Direct Investment”* by Busse and Hefeker (2005), perhaps one of the most comprehensive studies on the correlation between political risk factors, institutions and FDI flows, it was found that although some factors of risk, such as government stability, law and order and quality of bureaucracy do indeed correlate with the investment inflow in a host country, other factors have exhibited no statistical correlation to the FDI inflow. Similarly, as was suggested by Li and Resnick, democratic institutions may as well have negative effect on the FDI inflow. Li and Resnick (2003) pointed out that in countries under authoritarian rule, the leadership of the country may offer more favourable conditions to the MNEs willing to invest in this country.

Furthermore, Li and Resnick (2003) continue, in the absence of democratic procedures, MNEs may enjoy broad access to the country’s officials with the purpose of seeking protection and promotion of their interests, which makes such a host country more investment-attractive. In a similar manner, as foreign investors favour the principles of rule of law in the host country, they can be discouraged by constraints on foreign capital. Similarly with transitional economies, it may be the case that they first have to consolidate power before they are able to promote property rights protection.

O'Donnell (1978), discussing the transformation of Latin American states into what he referred to as “*Bureaucratic authoritarian states*”, noticed that countries at such state may be able to demonstrate political and economic stability – features that characterized these economies before the change for authoritarian regimes. Bureaucratic authoritarian regimes, O'Donnell's (1978) idea follows, may be better at demonstrating that there is enough political stability in the country to ensure the commitment to securing policies which make an economy attractive to foreign capital, in addition to speculative advantages or “special treatment”, which a state would not be able to offer in presence of democratic procedures.

Therefore, it may be concluded that although international capital seems to be more attracted to countries where democratic procedures are observed, authoritarian regimes may, in some cases, be more effective in the same job, as was found out by Busse and Hefeker (2005) by the means of analyzing the econometric data, and by O'Donnell (1978) in a more empirical study of the transitional Latin American countries. In a similar fashion, only a limited number of indicators of political risk have a significant correlation with the FDI inflow into a host country (Busse and Hefeker, 2005).

2.1 The Many Meanings of Political Risk

Extensive yet fragmentary definitions of political risk can be found in literature on the topic. While most of authors agree that this type of risk is constituted by government action that presents a danger to business transactions, there is a disagreement about the scope of this action, or what aspects of government action can be characterized as political risk.

One group of researchers define political risk as general government's intrusion regarding business transactions, for example Weston and Sorge (p.60, 1972) note that “*Political risks arise from the actions of national governments which interfere with or prevent business transactions, or change the terms of agreements, or cause the confiscation of wholly or partially foreign owned business property*” (cited in Kobrin, 1978, p.4)

Nevertheless, another group of researchers considers political risks to be separate occasions of new pieces of legislation or actions taken against the interest of a particu-

lar company, or the mix of the two. As such, Root (1972) defines political risk as *“possible occurrence of a political event of any kind (such as war, revolution, coup d’etat, expropriation, taxation, devaluation, exchange controls and import restrictions) at home or abroad that can cause a loss of profit potential and/or assets in an international business operation”* (in Kobrin, 1978, p.7).

The two approaches complement each other. However, fuller definition of political risk should be able to take into account both sides of such a complex phenomenon. A broader definition was proposed by Louis T. Wells of Harvard Business School, who defined political risk as *“...threats to profitability that are the result of forces external to the industry and which involve some sort of governmental action or inaction”* (in Moran, 1998, p.15), thus separating risks of political nature from those that are caused by economic conditions and acts of nature. Although this definition successfully accounts for both event and policy-type of government interference, it seems less successful in defining the origins of the risk. For example, a civil war, in the course of which a foreign investor may lose the invested capital, may not be a result of government action or inaction, but rather an outcome of complex historical, political and social conflicts with a state.

A lot of similarities can be found between country risk analysis and that of political risk. Used to forecast possible issues in cross-border transfer of capital, country risk analysis aims to assess the future risks by accounting various factors, such as political, social both macro and microeconomic together with countries’ ratings and other measures of economic performance (McGowan, Moeller, 2009). Although such indicators may be quite useful in assessing the investment climate of a host country, they do not take into full account all the peculiarities of political risk. There may be a country with relatively low levels of country risk but a great exposure to political risk - for example, a wealthy and competitive country that is politically unstable. Brink (2004) speculates about the probability that a country attracting financing from abroad may be able to serve the interest on its loans, but unwilling to do so for reasons of ideological or other sort. This example shows the interconnection between the two types of analysis and the kind of policy problems that could have been foreseen by a more profound political risk analysis (Brink, 2004).

Some other authors (Finnerty, 2001) consider currency inconvertibility as a case of political risk. Brink (2004) mentions imposing high quality standards and safety regulations that, being imposed upon foreign firms, may disadvantage them in comparison

with local competitors. Although the latter definitions are less encircling than those mentioned above, they seem to be rather better at encompassing the complexity of interrelations of a country's economic and political systems.

Therefore, more comprehensive definition of a political risk to FDI should take into account the diverse nature of its origins, including both the event and policy aspects, as well as the possibility of general political and/or economic instability within a state. For the purpose of this paper I would like to define political risk as any potential threat to profitability or assets allocated in a host country that arises as a result of a country's political or socioeconomical turmoil or the government's action, rights violations or restrictions.

2.2 Traditional and new risks

In general, Wells (cited in Moran, 1998) suggests that the variety of types of political risks can be grouped into two main categories: traditional and new.

To the traditional risks, Wells attributed the risks of nationalisation and expropriation, which, although less present in our days, still present a danger for an investor. Nationalisation of Venezuela's oil industry, followed by a more recent example of seizure of Repsol's stake in Argentinian YFP, which was seen as "a measure that threatens to scare off foreign investors" (Bronstein, 2012), indicated that such extreme developments are not in the past, but rather follow many countries that find themselves in the troubles of economic distress. Wars and civil disturbances have not disappeared either. Conflicts in countries of former USSR, complete reconfiguration of powers in the Middle East and centrifugal forces in the EU may lead to investors' uncertainty. Economic nationalism, an example of which was described above with Argentina's YFP, too still exists.

At the same time, new sources of political risk have come into existence. In countries with corrupt political leadership, local businesses may exploit their political connection to gain preference for themselves to the disadvantage of foreign firms. In the current situation of the absence of a powerful international regulatory body, this particular risk seems to have special potential. A risk of sanctions, that had various examples recently, represents another threat for international businesses: it leaves them in the middle

of a political standoff between the governments and bears costs associated with the divesting and selling of their assets.

It would be a mistake, however, to associate political risk solely with the countries of the developing world and volatile political systems. Although it is the case that emerging markets are traditionally believed to possess higher risks of political nature, the potential sources of vulnerability can be found in the most advanced economies too. As such, debt-ceiling negotiations and continuing political polarization in the US are being accounted as political risks in Goldman Sachs's investment strategy (Mossavar-Rahmani, Nelson, 2015).

2.3 Political risk at present

While the world has been long accustomed to the risks originating in the developing world, the changing geography of political risks has been noted by many authors. Gold and Kantchev (2016) mention the environment of increasing uncertainty in the European Union, listing the United Kingdom's withdrawal from the EU, reconfiguration of the political establishment in many European countries, the constitutional referendum in Italy, and the European banking system as some of the risk factors. According to Barclay's head of macro-research Ajay Rajadhyaksha, *"Europe is once again becoming the ground zero for political risk"* (cited in Gold and Kantchev (2016)).

In addition to the previously discussed new developments in the risk classification, there is one aspect of political risk that has received significantly less coverage in the literature but is certainly gaining more and more importance at the time of writing this paper, and which exhibited itself in the areas of world that have been regarded as the least politically risky before. As such, the UK's withdrawal from the EU, a process referred to as "Brexit", and the United States presidential election of 2016 are seen today as potential sources of risk. This represents an interesting phenomenon which could hardly be found in the developed world before: the referendum in the UK and presidential elections in the United States, although normal democratic procedures in their nature, are viewed by many as sources of general political uncertainty of the present (Fleming, Foley; 2016). Although any vote of a national scope, be it Brexit referendum or the presidential elections in the US, is bound to have long-term global and regional implications, already because of the size of the economies where the votes take place, the two events draw especial attention due to the level of significance they have on the economies of these countries, the regions and eventually the world: *"The*

possibility of a Trump victory in the presidential election — which could lead to a significant challenge to globalisation — is one of the looming outcomes that could hit ill-prepared investors.” (Fleming, Foley; 2016). Some economists share similar concerns about Britain’s withdrawal from the EU, mentioning uncertainty as one of the possible outcomes of the event: *“Worse export performance due to inferior EU access for business and financial services; lower potential growth and lower consumer spending from reduced migration inflows; and weaker investment growth, reflecting the above factors plus extra uncertainty.”* (Saunders, cited in Giles, 2016). It can be argued, however, that standard democratic processes, such as elections or referendums, do not constitute political risk – Robock (cited in Kobrin, 1978) points out the necessity of elements of unexpectedness and discontinuity for an event or process to be regarded as political risk, while it can be debated that Brexit or the US presidential elections represent the cases of discontinuity to the regimes of their countries. However, it is also clear that the implications of these events will have far-reaching consequences for the economies of these countries, not only because of the interconnectedness of the political and economic spheres, but also because of changing regulations, revising agreements and revisiting the terms of internal trade and cooperation that will be dictated by ongoing political changes.

The new political risks associated with unpredictable outcomes, of which Brexit and the US presidential campaign serve as perfect examples, are emerging very quickly, while they have not been thoroughly studied, and their repercussions can only be assumed. Multiple strategies of risk mitigation are used to combat the political risks of the past and various unpleasant turns of events can be insured against, but can there be an insurance against a result of presidential elections? For the UK, the outcome of the Brexit referendum may mean losing the access to the single market of the EU and withdrawal from the principle of freedom of movement of labor force, which will in turn have an impact on the currency exchange rates and trade balance, ultimately affecting, for better or worse, the UK’s image of an economy to invest in. On top of that, uncertainty of the future of credit market regulations is certainly adding to the concerns of the international investors who may have planned to invest in the UK.

While it is not clear yet clear what long-term consequences Brexit and the following rapid depreciation of the British pound will have on the UK’s economy, it is obvious that presumptions about political and economic stability of many countries in the West may be revisited: *“The referendum result and the subsequent political vacuum are causing investors to reassess long-held assumptions about stability and continuity. The*

damage here has been done quickly. Repairing it will be a long, slow process.” (Barley, 2016).

Even more troubling consequences may await Britain as a host-country of foreign direct investment. Due to the possible loss of access to the single market of the European Union as a result of withdrawal from the Union, major American companies may revisit their plans of investments in the country, as was stated in a document presented to the British Cabinet Office by the United States Chamber of Commerce – a major business advocacy and lobbying group (Donnan, 2016). According to the agency’s officials, withdrawal from the single market would be associated with the increase in cost of doing business, losing access to the labour pool of the European Union and possible introduction of the new taxes should Britain no longer be a part of the European VAT regime (Donnan, 2016). The agency has warned about almost \$600 billion worth of investments in the UK that may be reconsidered as a result of the ongoing negotiation of terms of Brexit (Donnan, 2016).

Similar concerns are being shared in another part of the world – Japanese investors show signs of uncertainty over the future of their investment to the United Kingdom (Parker, 2016). In a similar fashion with their American counterparts, the Japanese have been benefiting from the EU’s single market system, in which the United Kingdom has been a funnel for their investment in the EU. Parker (2016) further suggests that unless the UK government manages to negotiate an access to the single market, the Japanese businesses headquartered in the country may decide to relocate their operations to elsewhere in continental Europe. Losing access to the single market may be felt especially hard by the Japanese automotive industry in the United Kingdom, return on investments of which in the production plants in the UK may be hit by additional tariffs and taxes should the British government not be able to keep a membership in the single market system after Brexit (Parker 2016).

Similar views regarding the outlook for the British economy after Brexit have also been expressed by Prime Minister May, who said that although it may be too early to predict the final conditions which will define the British-EU relations after Brexit, the economy of the UK will most likely experience some troubles: *“the reaction of the economy has been better than some had predicted after the referendum, but I won’t pretend it will be plain sailing”* (Giles, Parker; 2016).

In the US, similar concerns have arisen in relation to the presidential campaign. The turn of events in which Donald Trump wins the presidency may have a significant impact on the ongoing principles of globalization and liberalization of free trade, particularly the North American Free Trade Agreement and Trans-Pacific Partnership. His tough stance on the terms of trade with some countries, for example China, resembles specific features of economic nationalism, such as plans to introduce a 45% tax on imported Chinese-produced goods, in order to protect American producers and encourage American companies to backsource their production (Navarro, 2016). It seems quite likely that such drastic turns in the country's economic policy would make many investors revise their investment decisions, and possibly affect the investment climate in the United States to a certain degree.

Zandi et al. (2016) argue that economic isolation as a result of Trump's policies will underlie a reduction of foreign direct investment due to the decrease in foreign trade and immigration. A set of other policy proposals, such as raising state-level minimum wages, may also increase the costs of doing business, making America a less attractive destination for international capital. *"His willingness to threaten higher tariffs on U.S. trading partners and his sharp criticism of major trade deals signal a reversal on the long-running expansion of U.S. trade and foreign investment"* was noted by Zandi et al. (2016)

Wolfers and Zitzewiltz (2016) note that Trump's victory may cause major damage to the stock market and a sharp increase in volatility, unprecedented by a victory of any Republican candidate in history. Analysts mention a possible drop in the American, British and Asian stock markets by 10-15%, significant reductions in the price of oil and Mexican peso. Researchers also noted that this development would go against the historical trend set in the 19th century, when the election of a Republican president has usually given a rise to the stock market and a drop if a Democrat was elected (Wolfers and Zitzewiltz; 2016).

In a similar way, Clinton's plans of higher scrutiny over the Federal Reserve Bank may result in a more cautious interest rate policy, which has recently been one of the main drivers of the appreciation of American dollar and thus an incentive for the investments in the American markets.

2.4 Oil industry and political risk

Among other factors, oil - its prices and control over its sources - continues to play a major role in the political stability of the world in the 21st century. To this day, oil is an important source of energy for the advanced economies, and even more so for heavy industries of the developing economies. The spikes in oil prices have proven to be able to test not only economies, but even the foundations of the global order: Peck (2014) brings up the hints of a possibility in which the United States would use military action to capture the oil fields of Saudi Arabia as a reaction to the 1973 oil embargo, which was expressed by Defense Secretary Schlesinger in a conversation with the British ambassador Lord Cromer (Peck, 2014). Even larger political consequences the crisis had in Europe: according to LaFeber (1975) the oil crisis became the pivotal point after which the Western Europe switched to a more pro-Arab position in the Arab-Israeli conflict. The 1973 oil crisis has demonstrated that oil has a potential as a tool of international politics: a striking possibility of using military force on the territory of a historical ally, such as Saudi Arabia, shows the degree to which uninterrupted flow of oil can be crucial for the most powerful countries. Another interesting notion brought up by Schlesinger is the relationship developing between oil-producers and consumers. Countries exporting oil are gaining the level of geopolitical power which would hardly be possible should they not have vast amounts of the commodity at their disposal: "As recounted by Lord Cromer, Mr. Schlesinger told him the United States was unwilling to abide threats by "underdeveloped, underpopulated" countries. The document did not rule out the possibility that Washington would consider pre-emptive strikes if Arab governments, "elated by the success of the oil weapon," (Alvarez, 2004).

Therefore, it is not surprising that a state views its access to oil, its reserves and operation of oil industry as a matter of national security. The *most important geopolitical commodity* (Stratfor, 2014) continues to provide a significant share of many of its exporters' national budgets and play one of the key roles in the formation of conditions for economic growth. It is not surprising, therefore, that the control of the oil industry may seem to be an attractive prey for the government in situations such economic distress, tightening internal policy or more assertive foreign policy, where exports of energy sources may be used as an instrument of foreign influence. It would be a mistake, however, to assume that the impact in relationship between oil and politics is purely unilateral. Oil prices, as prices of any other commodity, are constituted by the Law of Supply and Demand, which in their turn are impacted by production capabilities, resources and government policies, in case of supply, and by economic growth and availability of other energy sources, in case of demand. Oil price is a subject to expect-

tations of the players in energy markets and is affected by the availability of the substitutes of oil and other sources of energy. Therefore, it is fair to say that oil prices have codependent relations with politics and economics, affecting each other to a high degree.

The risk of nationalization of private oil companies has been marked by many examples in the recent past, with some of the most significant examples taking place in the states of Southern America. In the region, taking control over the oil industry has been taking forms of both nationalization and socialization of the assets of oil companies, domestic and foreign alike. Socialization of the oil industry has taken especially extreme forms in Venezuela under the regime of Hugo Chavez, during which the Venezuelan government has acquired the local businesses of Exxon Mobil and ConocoPhillips, with the latter having had to quit the country, and overtook the major stakes in the holdings of Total SA and Norwegian StatoilHydro ASA (Brunnstrom, 2012). While the latter two have been compensated for the loss of their stakes, Exxon's compensation is still to be settled, despite of the New York district court's decision being made in 2015 (Stempel, 2015).

A more recent example of expropriation of the oil sector assets was Argentina's expropriation of YPF, the largest oil company in the country previously controlled by Spanish Repsol. The expropriation took place in the conditions of economic hardships for Argentina less than half a year after YPF made a public announcement about the discovery of the new shale oil site, reserves of which were estimated at up to 1 billion barrels (Plummer, 2012).

This case of expropriation, along with Schlesinger's words and multiple other examples recorded in recent history, point to the special role that oil plays among other commodities. Although to a much lesser degree than in the recent past, the most important geopolitical commodity continues to define politics, affect its consumers and producers alike and remain one of the first private assets to fall prey to the state in time economic distress. Is it merely a result of the global revival of nationalism, which has been long predicted by various authors (Rachmann in 2014 in *The Economist* and 2014 in *Financial Times*; Schwartz, 2014) or a result of a special status of oil, that makes it a *vital resource* to the state where it is situated? A more profound insight into the politics of oil and political risks associated with the business operations in the oil industry will be examined further in this work on the example of the Repsol-YPF case.

3 Political risk: the new challenges

3.1 The transforming nature of political risks: From the Traditional to Uncertainty

Various strategies of mitigating political risk have been developed since the 1970s – which many authors mark as the beginning of this discipline – to our day. Most of these strategies can be divided into two main groups. First was the approach of using qualitative techniques towards assessing a host country as a potential place to invest and analyzing the potential risks. This approach involved techniques such as, for example, scenario and contingency planning (Overholt, 1982) and concentrated on a country's parameters of political, social, economic, international economic and international political sort (Overholt, 1982). At the same time, it is clear that any aspect of life of a society, be it, for example, an economic or political infrastructure, are too complicated to be understood in their totality, and interconnection between them is bound to make any single scenario incomplete. The second approach, sometimes used separately or complementing the first approach, underlies a mathematical method of making a judgement on a country's level of political risk. In this method, a number of risk factors is first listed, after which a particular country can be given a score on each of the factors, with the result, or an average, being a country's risk assessment. Such methodologies are used, for example, by Economist Intelligence Unit, Moody's and S&P (Brink, 2004). Although a number of risk factors used in each of the methodologies vary and some are definitely more inclusive than others, the quantitative modelling may suffer from insufficient information or from the competition of another foreign investor in a host country, who may be more informed or even influence investment conditions in a country to create more favourable options for themselves (Brink, 2004).

Therefore, it is important to note that before any risk analysis is attempted, a specific range of risk factors has to be gathered, including various types of political, economic, social and cultural factors. Multiple concepts come into play when the factors of risk, needed for a research are put together: for example, Herbert Simon's concept of bounded rationality, implying that analyst's decision-making cannot be ultimately rational, but is rather limited by the scope of available information and resources (Simon, 1978). Nassim Nicholas Taleb's Ludic fallacy in the same principle describes how statistical modelling can be counted as productive in their application to real life: the complexity of human society will always have more variables than can be accounted for (Saltelli, 2014).

In my opinion, specific kinds of risk have recently given their place to general instability, therefore it is debatable whether existing risk models can adequately address the transforming nature of risks.

Numerous recent developments in the realm of politics and new challenges of political risk shows the interdependency of the two. To a much greater degree than in the recent past, the political discourses aiming at drastic change to the very foundations of current economic policies are gaining momentum. In addition to the risks associated with the United Kingdom's exit from the EU and the United States Presidential campaign, many other parts of the world are experiencing how politics can fuel political uncertainty. Upcoming election campaigns in France and Germany are marked by a particular rise in popularity of the forces of the right, who share the ideas of Euroscepticism, antiglobalism and a tougher stance on the free trade (Wagstyl, 2016; Crisp, 2015; Riedel, Specht, 2016).

The antitrade sentiment has gained momentum in the developed world too along with the rise of the populist policies. Opposition towards further liberalization of international trade, voiced in the United Kingdom during the Brexit campaign and in the United States by Donald Trump, are fueling uncertainty and may, being materialized in a large economy, have ruinous effect, suggests Christine Lagarde, the International Monetary Fund chief: "*it [new trade barriers] would certainly have a negative impact on global growth*", "*uncertainty... undermines investment appetites and decision making*" (Donnan, Tett, Fleming; 2016). Lagarde has focused her attention in the discussion of protectionism primarily on the developed countries, particularly the United States and the United Kingdom, adding that in the past the rise of protectionism has preceded many wars.

The interconnection between politics and uncertainty is felt in the other parts of the world as well, which became a major topic of discussion for the 2016 meeting of the Group of Twenty of the International Monetary Fund. With the terms of Brexit negotiations and the outcome of the US presidential elections remaining unclear, growth prospects seem anemic. Chinese finance minister Jiwei noted that "*The uncertainties and risks facing the world economy have increased as some major economies have entered the general-election season*," (Talley 2016).

An interconnection between populist policies, mainly those opposing liberalization of trade and imposing new tariffs, and economic growth deserves special attention. The two are interdependent and serve as catalysts for aggravating the effects of one another: as populist policies turn to more protectionist measures of imposing additional trade barriers, these policies weaken long-term economic growth, which further fuels the admiration for such policies, creating a vicious cycle, where the populist agenda and weakening economic growth intensify each other (Azevedo, cited in Talley, 2016). This interdependence has been particularly remarkable in Argentina in the time of Peronism (Ocampo, 2016).

The emergence of uncertainty as a primary source of political risk has been widely noted in recent years (Zeckhauser, 2013; Knight, in Langlois and Cosgel, 1993). Nevertheless, little is done in regards to the development of the strategies of uncertainty mitigation. Moran (1998) cites local business interests, decentralization of power, corruption, organized crime and pressure of NGOs as the “new” sources of risk. While this point of view is in full accordance with the situation in many parts of the world, it does not reflect the recent rise of uncertainty in the developed and developing worlds alike. Overholt (1982) mentions “policy” and “institutional instability”, arguing that in the absence of the policy continuity a foreign investor may face the risks associated with the changes in labour law, taxation and exchange rates; as well as sudden shifts in the separation of powers may complicate an investor’s decision making process.

However, it is debatable that policy and institutional instability fully capture the specifics of modern-day uncertainty. As previously mentioned in this work, the terms “policy instability” or “institutional instability” are in many ways ill-suited if used to describe the Brexit referendum, as well as the presidential elections in the United States: both referendums and elections are the very bedrock of democracy and, to the contrary of institutional instability, represent the standard democratic procedures.

The two events serve as perfect examples of how existing political risk methodologies are unable to account for the growing risks of political uncertainty. Forbes’ Jonathan Webb (2015) did not mention Britain’s referendum or the US presidential campaign in his list of the biggest political risks for business in 2016, concentrating on more conventional sorts of risk, such as terrorism, oil prices, instability in the developing world etc.

Tina Fordham and Jan Techau (2016) of Carnegie Europe, a European branch of the Carnegie Endowment for International Peace, despite pointing out the importance of the “*New Socio-Economic Risks*” referring to the rise of populism and non-mainstream political forces, have only mentioned Brexit as a possible result of the European refugee crisis, rather than a political risk by itself. Marsh LLC (2016), one of the world’s biggest insurance brokerage and risk management firms, in its “Geopolitical Threats for the Year Ahead: Marsh’s Political Risk Map 2016”, has mentioned 2016 US elections as a risk only in relation to tougher foreign policy, while the probability of Brexit was estimated at 35% with a reference to BMI research.

Therefore, it seems arguable whether the existing definitions of the risks are able to cover and explain the ongoing rise of uncertainty in many parts of the world. Various current models of quantifications and mitigation of risks are more equipped for more traditional risks of the past, while more recent signs of political uncertainty, putting to risk investments in the developing and developed worlds alike, demand more in-detail examination, forecast and mitigating strategies. While methods of international insurance, forecasting the turns of the political course, various quantification and qualification approaches were suitable for avoiding the risks of expropriation, nationalization, corruption etc., can they adequately address the risks of losing the value of investments caused by uncertainty after Brexit, or the presidential elections?

The rising challenges of political uncertainty, lately exhibited by investment risks as consequences of Brexit and mounting market volatility as a result of the presidential campaign in the US require newer, more sophisticated approaches to the mitigation of political risks. The new approaches should be adapted to the changing political environment everywhere in the world, taking into account uncertainty along with other factors of risk for the risk methodologies to be inclusive with respect to growing political uncertainty.

The factors of risk that could complement the existing political risk methodologies should include the most recent developments in the political environment of today, thus adapting these methodologies to the new forms of political risk. Special attention must be paid to the risks emerging in the developed world – particularly in the European Union and the United States: while the developing world has been a source of traditional type of political risks, such as revolutions, civil wars and expropriation, the developed world, which has been regarded until recently as a “safe haven” for the

foreign direct investments, has witnessed new, unconventional forms of risk manifest themselves. Moreover, uncertainty originating in these countries may have more global, far reaching consequences due to the size of countries' economies and a number of supply chains originating in the countries of the Europe and North America. Apart from the aforementioned Britain's secession from the European Union and the 2016 United States presidential campaign, many other processes and events comprising political atmosphere of the EU and North America can be the subject of analysis for establishing a number of new factors of political risk.

As such, a sudden rise of the new political forces across the political spectrum and subsequent reshuffling of the of the parliaments and governments of many European countries seems to be an important topic, as in some cases it caused a drastic change in course of policies and further promoted political uncertainty in Europe.

In a similar manner, centrifugal forces in the European Union may present an obstacle to the process of further economic integration of European markets, putting to risk the capital invested in these markets. Although the topic by itself is not new and separatist movements have existed in Europe for a long time, their recent revival and associated new trends must be examined in more detail.

Social consensus has undoubtedly been a factor affecting the political stability of a country. Absence of social consensus is a potential determinant of the state's inability to secure the support of the electorate and function effectively, therefore fueling market uncertainty.

The rise of populism, which has been exhibited by emergence of new political parties and social movements in Europe and the US, has a potential to deepen the political divisions and accelerate political instability. Similarly, with the first two factors, populism has been one of the key determinants fueling political instability in the US and Europe (Speciale, 2016).

Weak governments or inability to form a government coalition has been a feature of the political situation of some European countries during the last 10 years. Stemming from other factors, such as absence of social consensus, this factor can increase unpredictability about the future of the political course of the country, thus adding to the uncertainty of investors.

3.1.1 Social consensus

Ability to forge a social consensus is an important aspect ensuring a well-functioning democracy. It helps to address the most divisive matters, and, as a reflection of the democratic traditions, consensus serves as a way of mutual concessions to ensure that the interests of all major parties of the society are included in the decision-making process, particularly on the most vulnerable public issues. In his work “The Idea of an Overlapping Consensus” (1987) Rawls notes that consensus is the core principle of political liberalism, which helps different groups with different fundamental values agree on certain principles, thus maintaining the stability of basic institutions.

The absence of such a consensus on any problem at a national level, therefore, threatens to bring the political life of a country to turmoil, polarize opinions within one nation, creating a background for social unrest and thus fuel political instability. In the United States, some authors (Smith, 2015) argue that the growing political polarization causes the historically low level of trust in the federal government.

Therefore, given the importance of presence of the social consensus in the society, I believe that it will be an important factor to complement the existing political risk methodologies.

3.1.2 New political parties and movements

The political atmosphere of Europe and the United States alike has been recently marked by the evolution of new political actors. Spanning all across the political spectrum, the new parties and movements can be primarily characterized by a common feature of anti-establishment orientation and deep opposition to the existing, more traditional political forces. Having quickly risen in popularity, these new political parties have proven to be able to push their own agenda, although not necessarily being present in government.

In the United States, a special interest in this regard deserves the Tea Party movement – a conservative group particularly notable for its criticism of the US Government financial crisis rescue plans and Federal Health care system. Some studies (Skocpol and Williamson, cited in Zakaria, 2016) suggest that the main reason behind Tea Party followers’ opposition to the establishment political parties is rather cultural than economic.

In Europe, the main driver behind the emergence of anti-establishment parties was initially Euroscepticism, while later the immigrant and economic crises in the EU periphery furthered the creation of the next generation populist movements (Muddle, 2016).

Perhaps one of the most notable example of the anti-EU movement in Europe is the United Kingdom Independence Party. According to the former leader of the Labour Party Ed Miliband, it was UKIP's rising popularity which made British Prime Minister David Cameron call for a referendum on the Britain's membership in the European Union (Watson, 2013).

Other notable examples include the French National Front and Dutch Party for Freedom, which have similarly been described as parties of anti-EU and anti-immigrant ideologies. Both parties, being represented in the European Parliament, are aiming at restructuring the distribution of power in the EU back to the nation states, including the issuance of national currencies and strict control over immigration (Chrisafis, 2016).

Successful electoral and opinion poll performance of many of the anti-establishment movements show that these parties are able to change the political disposition and affect the current course of political and economic development of the countries of Western Europe.

3.1.3 Rise of populism

Closely related to the previous factor, the rise of populist rhetoric has characterized European politics for the last few years. Catalyzed by economic distress in the European periphery, terrorist attacks and a refugee crisis, populism spurred the political rise of the right-wing anti-establishment movements and paved the way to power for some of them. At the same time, on the other side of political spectrum, unpopular austerity measures and deteriorating economic situation have assisted the popularity of leftist populists, particularly in Greece and Spain (Muddle, 2016).

One of the most striking examples is Hungary, where the government of Viktor Orban is openly set to completely reshuffle the existing liberal order by limiting the independence of the judicial system and the media (Rovny, 2016). Similarly, the Polish Law and Justice Party, currently holding the majority of the seats in both Houses of the Polish Parliament, is set to limit the power of Poland's Constitutional Tribunal,

threatening to prosecute the current head judge, with little regard to the protests of the EU and the US leaders (Kelemen, 2016).

These developments, whether positive or negative for the countries themselves, pose a serious threat to the existing liberal order in the EU, thus fueling political uncertainty in these markets. Therefore, the extent of popularity of populist rhetoric should be closely examined as an aspect of uncertainty and therefore risk.

3.1.4 Centrifugal tendencies

Separatist, secessionist or centrifugal tendencies have been long present in Europe and have recently gained a new pace. In Spain, one of the wealthiest districts, Catalonia, has huge public support for the idea of seeking independence from the central government, with the issue of independence dominating regional elections and the last two presidents being strongly in favour of secession from Spain. Similar trends in Scotland and Northern Italy demonstrate that the risks of separatism are existent throughout Europe, endangering the existing trend for Europe's economic integration.

3.1.5 Weak governments

Weak government coalitions or inability to form a government have been demonstrated, for example, in Belgium, where twice in last 10 years the formation of the government took more than a year, with both cases regarded to be stemming from the cultural differences of the two main groups of Belgian population, whose regions also tend to have significant differences in formations of their economies (Sciolino, 2007). Then there is the more recent example of Italy, where government instability has caused the Prime Minister Renzi to call a national referendum on constitutional reform. Should Renzi fail, however, the results can be even more troubling, bringing more market turmoil and political instability (Balmer, Ognibene, 2016).

Therefore, I believe as the nature of political risk changes, new, uncertainty-adapted factors of risk should be taken into account. The factors of (1) presence of social consensus in a society, (2) popularity of new, extreme political parties, (3) the level of populism in the political rhetoric, (4) presence of centrifugal tendencies and (5) the ability of political parties to form a strong government can further complement the existing models of quantification of political risk for the latter to become more inclusive with respect to the transforming nature of political risk.

3.2 Transition: new frontiers of political risk

The transformation of the political risks discussed previously in this work have come hand in hand with another trend, largely unnoticed in the literature on this topic: the extent of homegrown political risk, or the risk originating in Europe and the United States, most recently marked by the examples of Brexit and the US Presidential elections of 2016. These have broken the traditional view of the developing world as the main source of political risk – a view that was shared by various authors before (Overholt, 1982). At the same time, the surprising result of the British referendum has caused consequences far outside the United Kingdom and the European Union: the International Monetary Fund announced its global growth forecast for the year 2017 (IMF, 2016), following multiple warnings on the potential negative effects of Brexit on the British economy. It is undoubtedly the case that such major changes call for the restructuring of the models that are used to assess political risks, and that political risk now manifest itself in the part of the world that was seen as much less volatile before. It also seems clear now that even in the absence of traditional political risks, such as revolutions and coups d'état, regular elections or referendums can be just as disruptive to the political stability of a country.

A careful examination of the possible outcomes of the Britain's withdrawal from the European Union and its major reasons is necessary to understand how risks of these sort can be mitigated in the future.

In the United States, a similar pattern can be found in the 2016 Presidential elections. Just as in post-Brexit United Kingdom, the opposition to the freedom of international trade may cause many investors to revise their investment decisions, possibly affecting the image of the United States as the host-country for the Foreign Direct Investment. I believe that analyzing the two cases will be helpful in determining how these events are fueling the political uncertainty, why the existing political risk assessment tools were not prepared to estimate the extent of the consequences these events will have and how modelling of political risk can be modified to be able to anticipate risks of this sort in future.

3.2.1 The US presidential elections of 2016

Although it will probably take years for all potential consequences of the US Presidential elections to materialize, there are early signs that the implications, both

positive and negative, will be experienced by many industries of the economy of the US and in many other parts of the world, which can significantly alter the investment climate of the US economy.

Among many others, healthcare can become one of the first industries to experience the results of the election, most particularly in the event of Clinton's victory, given her criticism of the raising of medicines' prices. Similarly, some analysts predict a tougher regulation of the banking industry were she to win (Yglesias, 2016).

In the same manner, the policies that Trump plans to implement may have far reaching consequences both for the United States and the world. The possibility of massive reduction of taxation in the United States may open doors to further raising the federal debt ceiling, which would in turn put significant pressure on the United States budget with respect to its interest payments on the debt. Propositions of tightening foreign trade policies, resembling features of economic nationalism, go against the global trend of liberalization of international trade, thus putting barriers to economic cooperation between the United States and other countries, and specifically endangering countries with high levels of exports to the US and the US investment climate. All of these plans would have a tremendous impact on business confidence within the United States and its investment outlook abroad.

In regard to the rhetoric of economic nationalism, an interesting question is what causes the social demand for these policies. According to Kazin (2016), the appeal to populism, found in the campaigns of Trump and Bernie Sanders, stems from the electorate's demand for greater equality, dissatisfaction with the ruling class and the competition in the labour market.

3.2.2 Brexit

Although the major consequences of Britain's secession from the European Union can only be estimated after the agreement on future terms between the United Kingdom and the bloc, preliminary outcomes can already be drawn. In general, the OECD (2016) predicts the fall of GDP of over 3% in the coming years and a drop in the labour productivity of the British economy. Brexit has already caused the British Pound to plunge against other currencies, while uncertainty about the future of the agreements between the UK and the EU is making many banks relocate their headquarters to continental Europe (Arnold, 2016).

However, perhaps even larger damage was done to the image of the United Kingdom as a host country of foreign direct investment. Due to the potential loss of access to the single market of the EU, some foreign investors may be revising the placement of their production capabilities in the country, particularly in the automotive industry. The financial services industry, the largest line of inward FDI investment in the United Kingdom, may also suffer significant losses should Britain not be able to retain membership of the European Single Market.

Apart from estimating the potential consequences of Brexit, it is important to point out why such a turn of events has not been accounted for in advance, and why the major interested parties have not been prepared for it. Sullivan and Fisman (2016) suggest that the markets have put too much trust in their belief in economic efficiency: while by multiple forecasts leaving the European Union was a less economically viable choice, most of the voters were instead influenced by non-economic factors in this referendum, such as, for example, their personal views of migration and security.

In this regard, Brexit and the US Presidential elections have a number of common features. Both represent the newer generation of political risk, where risk is constituted not by specific factors as before, but rather by general political uncertainty. The two events are taking place in countries, traditionally viewed safe for the foreign direct investment, and the both events were not accounted by the economic agents that are now experiencing its pressure. Moreover, the two events were developing with an influence of the populist appeal, while rational market theories have failed to win the preference of the electorate. I believe that the new factors of risk, which I suggested above should be implemented in the political risk quantification models, will help to address this issue.

3.3 Oil

Of all the commodities, oil is often described as the one “having biggest geopolitical importance” and, according to Klare (2002), is the one to most likely provoke a conflict between states. This does not come as a surprise, given oil’s significant role in economies of many states and its special status as the most widely used source of energy: oil accounts for 40% of total energy consumption, with its products being a key raw material in production of diesel fuel and gasoline, heating oil, plastics and other materials. Due to its multiple applications in various sectors of the economy, oil

continues to be the most important source of energy: *“Petroleum is the most versatile fuel source ever discovered [and is] situated at the core of the modern industrial economy. ... It is the only energy source that can be used across the board – in space heating, as an industrial fuel supply, and as a means to generate electricity...”* (Morse, 1999 cited in Klare, 2002).

Therefore, given the strategic economic importance of oil, it does not come as a surprise that the commodity has been a cause of many conflicts, both within states and internationally. Given that the majority of oil production and reserves are concentrated in just a few states, which enjoy a wide control over its price and distribution, oil prices quite often became a question of politics rather than economics, as it was during the 1973 Oil crisis.

Since not all oil exporters may enjoy such advantage, some of them may seek to control those oil resources that are situated within their borders. Therefore, it is not surprising that the oil industry assets are some of the first that the government nationalizes when it enters the time of economic hardship. Multiple examples can be found, perhaps the most significant being the nationalization of Argentina’s YPF previously controlled by Spanish Repsol. The case has received extensive coverage in the media and literature due to the size of the stake – approximately USD 10 billion, and the fact that the government of Kristina Fernandez Kirchner did not initially propose any compensation for the nationalized assets.

Although it is debatable what was the main motive behind the expropriation of YPF, Argentina’s then-President Cristina Fernandez de Kirchner referred to energy as a *“vital resource”* and a matter of *“public interest”* when submitting the draft of the law to the Senate (Plummer, 2012). Expropriation was believed to have a potential to damage Argentina’s reputation as a place to invest and to deter foreign direct investment in the country (Segura, cited in Buenos Aires Herald, 2012).

Although Repsol has eventually agreed to accept compensation from the Argentina’s government in February 2012 in the total sum of USD 5 billion, the deal could hardly be regarded as satisfactory for the Spanish company given the initial compensation of USD 10.5 billion Repsol suggested. Moreover, Johnson and Webber (2013) have cited the pressure from the investors that the company’s management has been experiencing to accept the deal. According to Johnson and Webber (2013), two of the

three Repsol's largest shareholders – namely Spanish La Caixa bank and Mexican oil company Pemex, have urged Repsol's CEO Antonio Brafau to withdraw the company's initial claim for USD 10.5 billion for its expropriated stake in YPF and instead accept a deal of a 47% stake in a company that has rights to 6% of Vaca Muerta, a major Argentinian shale oil site, which was first discovered by YPF when it was under Repsol's control. Pemex has gone as far as threatening to sell its 9,37% share of Repsol, in case the company would agree to the deal, as reported by Johnson and Webber (2013), according to whom the Repsol's CEO and the Sacyr, the second largest shareholder, were in opposition to the proposal.

It is obvious that seizing the assets of a foreign company, should it fall under a definition of expropriation, taken by the government of Kirchner is a serious violation of international investment treaties, such as International Centre for Settlement of Investment Disputes (ICSID). However, it is also obvious that the government of a country, that exercises the full authority over all the assets on its territory, is much more powerful than a single company, while international investment treaties are usually signed by two governments and does not include a guarantor party.

The contradiction between national law and international investment protection treaties arises due to the lack of mechanisms in which such complex situations can be resolved, thereby adding uncertainty to any potential foreign direct investment. International institutions that would have the power to resolve international investment disputes can also be a factor of further ensuring a more stable flow of investments into the developing economies. For example, such institution may be established by the International Monetary Fund, which would consider the country's compliance with the terms of investment contracts in its decisions of issuing loans or economic assistance to its member states. Similarly, World Trade Organization, which already has a powerful dispute settlement apparatus, has a potential to expand its jurisdiction over international investment disputes.

Alternatively, the United States, the European Union and other large economies may form a new institution for the protection of investors' rights, of which they would serve as guarantors, persuading other countries to follow the principles set by the agency and referring to the policy of economic isolation to the country that breaks the rules of this institution. Since most of the countries of the world have close economic ties with either the United States or the European Union, this institution may become a powerful

tool in protection of the rights of international investors and further incentivizing foreign direct investment.

4 Conclusions

In order to capture the transforming nature of political risk, it is necessary first to establish its definition, which would entail various aspects of political risk in their entirety. For the purpose of this work, various existing definitions were analyzed, it was pointed out that not all of them correctly address the transformation of political risk taking place presently, on the basis of which a new definition was adopted with the purpose of being more inclusive with respect to the trend of growing political uncertainty.

The existing views on sources of risk were analyzed with the intention of assessing of how adequate they are in addressing the most recent political risk challenges. As the challenges of Brexit and the United States presidential elections were to a significant degree underestimated in the risk analyses, this work set out to find new factors of political risk, which being implemented in the existing risk measuring models would be more adapted to the emerging sources of risk. On the basis of the cases mentioned, five new factors were established. The presence of social consensus, as an important factor of a well-functioning democracy, helps the society to overcome the most decisive decisions, thus ensuring political stability. Emergence of new political forces, mainly of anti-establishment and populist nature, threatens to undermine the existing course toward globalization and economic cooperation in developed economies and expose the existing liberal political order to instability. Similarly, populist rhetoric in many countries of the developed world develop a vicious circle, where slowing economic growth spur a social demand for populist measures, which in turn catalyze worsening economic conditions. Centrifugal forces in many countries of the European Union cause a danger to the very existence of the nation states and fueling market uncertainty. Weak governments and inability to create and maintain strong government coalitions, having multiple examples in the European Union, is another factor of political risk, as uncertainty about the future of the political course of the state contributes to the growing uncertainty. Thus, these five factors of political risk, being implemented in the risk quantification models used today, can significantly improve the risk mitigation strategies in foreign direct investment.

Changing geography is another important trend in transformation of political risk. As was pointed out in this work, political risk has been recently exhibiting itself in the countries and regions that were previously considered to be less risky, of which the

Britain's secession from the European Union and the United States presidential election serve as the most recent examples. Further research will be necessary in this regard, as the potential outcomes of emerging homegrown political risk cannot be overestimated – not only due to the size of the economies of these countries, but also due to the amount of supply chains that are originating in the developed world. Analysis of the two cases has also shown that even in the seemingly politically stable countries, such as those of Western Europe and North America, political risks now manifests itself in rather unexpected ways: as such, referendums and elections, which are standard democratic procedures, are now be regarded as sources of uncertainty. The new factors of political risk, pointed out in this work, are to address these issues.

The strategic importance of oil and protection of assets in oil industry is a perfect example of the fact that along with the new types of risk, the more traditional threats of expropriation and nationalization still persist. As demonstrated in the case of Repsol's share in YPF, there is little to protect a foreign investor from belligerent actions of a national government, while international investment treaties, such as ICSID, have a limited power in solving international investment disputes and having its decisions being executed. Therefore, a need in a new institution arises, an institution which would have the power to resolve the investment disputes between governments and investors. Such institution can be established by already existing organization, for example WTO or IMF. These organizations can oversee the compliance with investment agreements by their member states and resort to special procedures should such agreements be breached. For example, IMF could consider a country's standards of investment protection when deciding on issuing loans. Similar organization could be founded by the US, EU and other major economies, where they would serve as guarantors in contract between other governments and international investors, thus ensuring that both parties follow the agreements and resorting to the policy of economic isolation towards the states that persistently disregard the standards of investment protection.

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