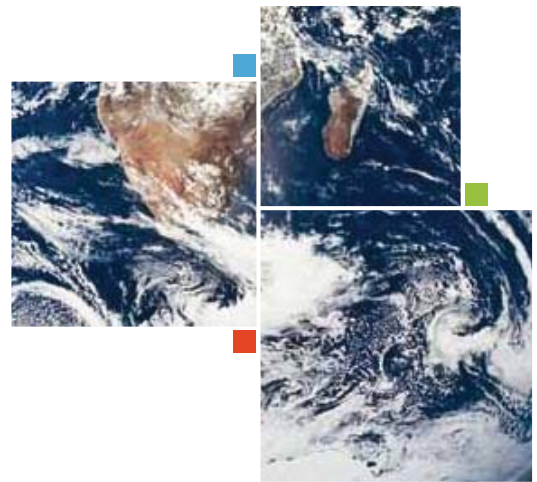


Control Risks



RiskMap 2011



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WELCOME TO RISKMAP 2011

RICHARD FENNING,
CHIEF EXECUTIVE OFFICER



If we could see the future, it would be Asian and urban. Since 2008, the majority of the world's population has been living in a city, and by 2050 only a quarter of us will be clinging to life in the countryside. The rise of the mega-city, particularly in India and China, is one of the most exciting but challenging social transformations of our age. By 2025 there will be 11 cities in Asia with populations over 20m people.

The risk consequences are significant. Crime, corruption, chronic poverty and extremism all prosper when rapid urbanisation is not matched by well-planned infrastructure and good governance. The population of the world's slums is growing by 25m each year. Doing business successfully in these new environments will demand re-thinking all aspects of our business processes; none more so than the management of risk. This year's RiskMap explores the consequences of long-term shifts in urbanisation. These are by no means confined to Asia, but inevitably India and particularly China seem to have a near monopoly on jaw-dropping statistics.

And it is China that figures most prominently in our exploration of how the global geopolitical map is being redrawn. The economic resilience of the rising powers – so key in averting a global catastrophe during the financial crisis – is now reflected in the conduct of international affairs. China, India, Russia, Brazil and Turkey are all, to varying degrees, shaping the way the world is run and want to influence how we fix its problems. Much has been written about the perils of this new multi-polar world where newly self-confident powers jostle for strategic advantage over scarce resources. But a better balanced distribution of power, more accurately reflecting global economic gravity, might bring a new perspective and determination to break political logjams. If 54% of the world's urban population will live in enormous Asian cities by 2050, then fixing carbon emissions, for instance, stops being a multilateral problem and becomes a national imperative for the countries concerned. So there is some room for long-term optimism.

But not yet. 2011 will see few – if any – successful resolutions to the most pressing political and security problems. In the Middle East, the uneasy tension stemming from a decade of war, political dislocation, nuclear ambitions and Islamist militancy will continue, and Iran will remain the preoccupation of US foreign policy in the

region. Military action against Iran remains unlikely in 2011, but the stakes are high and we should remain vigilant. Iraq still faces political and security challenges, but its longer-term trajectory is positive.

Africa is gripped by election fever. National elections in 20 countries are scheduled for 2011. While in some cases this might rightly be a cause for celebration, in others it will increase tension and the possibility of unrest. In Nigeria, Goodluck Jonathan's formal assumption of the presidency in the wake of Umaru Yaradua's death upset the unwritten agreement whereby the presidency rotated between north and south, so the 2011 elections will be even more highly charged than usual. But Nigeria's resilience and ability to find imperfect short-term fixes to seemingly intractable problems are likely to ensure that a major crisis is averted.

In Latin America, Mexico will remain in the grip of its drug wars. The brutality of the violence and its proximity to the US mean that this issue will dominate the headlines. The curse of cocaine affects not just Mexico but the wider Central American and northern South American region, obscuring better news further south. But Mexico remains a stable state and is not about to fail, despite the severity of its problems and the predictions of many analysts.

Much of Europe will be gripped by deficit reduction, encouraging national introspection. There will be little scope for intra-EU bonhomie: it will be too tempting for commentators not to portray next year as the prudent Germans imposing some moral rectitude on the profligacy of their southern neighbours and allies. Russia's improved relations with the US should continue, and by the end of the year we should know the next twist in the Putin-Medvedev psycho-drama and who will be the next president. While conditions for doing business in Russia have undoubtedly improved in certain sectors, and the country continues to present some impressive opportunities for adventurous and resilient investors, companies will still be forced to contend with corruption, weak infrastructure and lumbering bureaucracy.

China's role in the world is the story behind nearly all the major themes for next year and it dominates the thinking of her near neighbours. That China is the regional power is beyond dispute, but relations remain cordial at best and are more often characterised by a persistent prickliness. China's historic reluctance to take an active foreign policy stance beyond protecting its immediate national and economic interests will start to shift. China will be less passive and ambiguous, and more explicit and assertive in its dealings with us all.

Corruption will be the most pervasive operational risk in 2011. The new evangelism with which the Foreign Corrupt Practices Act (FCPA) is being enforced in the US is likely to intensify. With stringent laws being enacted elsewhere (the UK Bribery Act, which will come into force in 2011, is the FCPA on steroids), corruption should be emblazoned across all corporate risk registers. Good intentions are not enough; the new global enforcement regime

requires boards to actively demonstrate real compliance through the tangled web of joint ventures, agency agreements and distributors that is the everyday reality of transnational business.

It all sounds rather grim. As ever it is important to emphasise that the world is more open for business, more pregnant with opportunity than ever before. Hardly anywhere is beyond the reach of ambitious companies. Kim Jong-un's nervous appearance alongside his ailing father at North Korea's recent military parade might even mark a glimmer of hope that one of the last outposts of totalitarian seclusion could change, perhaps for the better.

Like most political leaders, US President Barack Obama is finding that domestic politics can be a tough trade. With increased constraints on his ability to push through legislation at home, he will seek to regain momentum by chalking up foreign policy successes. The great advantage of international diplomacy over national issues for pressurised leaders is that almost everybody is pleased when you show up and nobody really expects you to succeed. So we should anticipate seeing more of Obama on the global stage in the year ahead. There will be plenty for him to do.

I hope Control Risks' RiskMap 2011 provides you with a range of insights into the complex interplay of business and politics for the year ahead. The report demonstrates the considerable academic rigour we apply to shining a light on the world for our clients, which is complemented by our experience of working on the frontline in most of the featured countries.





THE GEOPOLITICS OF BUSINESS

JONATHAN WOOD,
SENIOR GLOBAL ISSUES ANALYST

INTRODUCTION

The world's rising powers are increasingly using their economic strength and resilience, starkly revealed during the global financial crisis and recession, to project global power. Their clout is reflected in major reconfigurations of global governance institutions, from the G20 to the IMF. They have become indispensable to tackling major strategic security problems. Yet it is through their intensifying economic relationships in particular that these key states are building and consolidating geopolitical influence, creating a new status quo beyond the influence of Western powers.

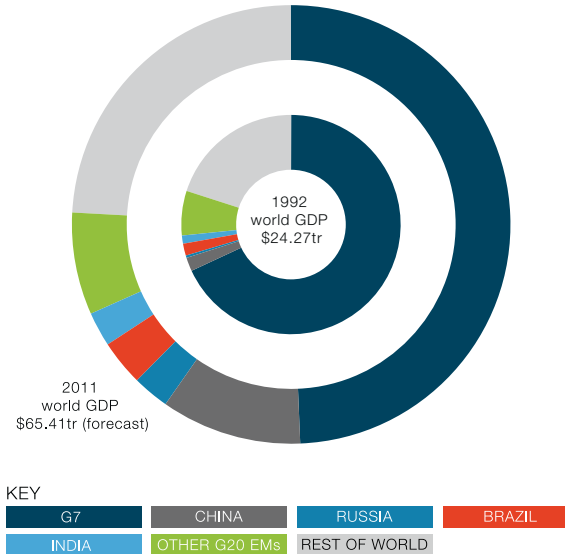
China is well-known as a strategic investor, but regional powerhouses Brazil, Turkey, Russia and India are also leveraging commercial diplomacy in pursuit of their geopolitical agendas. With commercial and strategic interests converging, it is increasingly important for businesses to understand and anticipate the impacts of geopolitical competition and co-operation.

CHANGING TIMES

The rapid rebound and strong growth of emerging countries in the last year is fundamentally altering the global balance of power. This is largely – but not exclusively – a function of the rise of China, shown in its emergence as the world's second-largest economy and the global leader in manufacturing, exports, carbon emissions, energy consumption and vehicle purchases. With China and the other G20 major emerging markets stripped out, the rest of the developing world's share of GDP has barely budged in 30 years. Another significant factor is shifting global trade directions: the rise of 'South-South' trade and investment is fostering an emergent political order outside the institutional and geopolitical frameworks dominated by the West.

Predictably, fundamental food, energy, mineral and water security concerns are firm features of the new balance of power. Emerging markets are smartly availing themselves of opportunities in resource-rich countries that mature economies have ignored or marginalised. The new powers are also beginning to contest

SHARE OF WORLD PPP GDP, 1992 vs 2011



Source: IMF World Economic Outlook

influence in established and frontier production zones alike. The transformation of major emerging countries into urbanised, industrial powerhouses poses significant social, environmental and political challenges, on top of the pressing economic need to fuel growth with an ample supply of natural resources.

How established powers respond to the rise of emerging countries will shape the global business environment, both next year and over the long term. The US under President Barack Obama has set an encouraging example, privileging pragmatic 'engagement' with rising powers over ideological, unilateral action. Its foreign policy has been dictated by the need to enlist rising powers in responding to the financial crisis, managing the denouement of wars in Iraq and – soon – Afghanistan, and containing nuclear proliferation. Yet the consensus behind co-operative engagement abroad is under severe strain from economic malaise at home. It could crack under the weight of another downturn, lingering unemployment and a vocal political constituency convinced that globalisation is a zero-sum game.

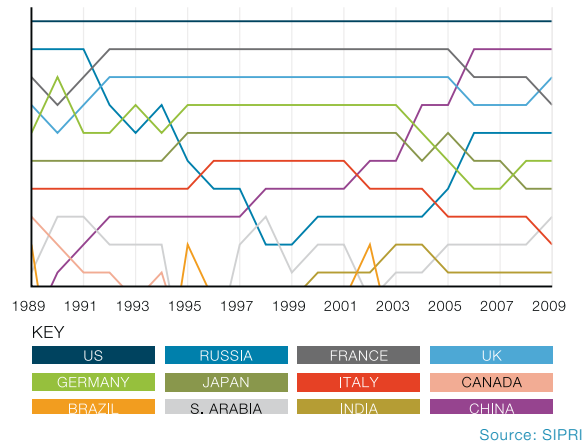
The co-operation and co-ordination that characterised the 'crisis agenda' could not last. A G20 that warded off trade protectionism has been less successful at preventing competitive currency devaluations. Well-meaning efforts to address global systemic risks – such as large US deficits, China's huge surpluses and the failures of transnational banking regulation – have inevitably foundered on domestic political and economic priorities. Instead, we have seen a return to the days when significant decisions, from Greece's bailout to sanctions on Iran's nuclear programme, are being made late at night behind closed doors, by leading powers brutally assessing their national interests.

STRATEGIC DIPLOMACY AND GLOBAL SECURITY CO-OPERATION

The best examples of strategic diplomacy in action come from the arena of global security co-operation. The bilateral, regional and global diplomatic manoeuvres of the last few years are signalling a shift in emphasis away from the decentralised non-state threats, such as terrorism, that have dominated since the September 2001 attacks. The focus is back on state-centred threats: nuclear weapons, cyber-war, regime collapse and territorial disputes. If the 'war on terror' was largely driven by the sole superpower cajoling countries to 'get with the programme', the emerging, ad-hoc security architecture reflects the growing relevance of new stakeholders.

In 2011, for the first time ever, all the BRICS (including South Africa) and most of the world's leading military powers (see chart below) will be on the UN Security Council at the same time. This will provide a natural experiment to gauge how leading powers approach global security management and, in particular, how the five permanent members will adapt to the critical mass of Brazil, Germany and India, all of which are seeking permanent seats.

TOP TEN MILITARY SPENDERS 1989-2009



The return to strategic diplomacy is clearest in the US, which has seen its freedom of global action curtailed by a combination of the fallout of the Iraq war, dire economic and fiscal pressures at home, and emerging states with independent agendas. Unparalleled US hard power has been severely curbed by the erosion of its international prestige and moral authority on a range of issues, from human-rights violations during the war on terror to the traumatic implosion of 'Anglo-American' finance. However, the Obama administration's engagement offensive has achieved significant diplomatic success on a range of issues, from global governance reform to arms reduction and nuclear non-proliferation. With partisanship in the next Congress likely to paralyse US domestic politics, there is a good chance that Obama will become much more of a foreign-policy president for the remainder of his first term.

Hard-won victories will encourage continued pragmatism in US foreign policy, but some nuts may prove too tough to crack. Concerns that the planned US and NATO drawdown in

Afghanistan will embolden the Taliban and other Islamist militants in the region appear increasingly well-founded. Outside Pakistan and Iran, few regional or global stakeholders appear interested in engaging (though China's massive mining investment in Logar province is a potential beachhead). The drumbeat of transnational terrorist plots originating in the Afghanistan-Pakistan border region, affecting the US, Europe, Central Asia and elsewhere, will certainly force the US and NATO to remain engaged for years to come. The odds are also long that the relaunched Israeli-Palestinian peace process will succeed by the self-imposed August 2011 deadline. Even so, Obama has invested significant political and diplomatic capital in the talks, and can be expected to keep driving them, though recalibrating expectations will become a feature of the process as the deadline nears.

Iran, meanwhile, remains defiant in the face of increasingly harsh international sanctions. While crimping its overall economic performance, the sanctions are likely to be consolidating the control of the Iranian Revolutionary Guards Corp (IRGC) over key industrial sectors. Start-up delays at the controversial Bushehr nuclear plant, variously attributed to industrial sabotage or containment problems, are likely to be overcome by early 2011. According to the International Atomic Energy Agency (IAEA), enrichment-related activities continue apace at other locations. While the endgame timeline remains fluid and an eleventh-hour détente is possible, \$120bn in planned US military assistance to Gulf Arab countries and increasingly overt discussion of the 'military option' sing a different tune. We continue to believe that a US or Israeli strike is unlikely in 2011 – risks outweigh rewards in the absence of confirmed intent to weaponise – but the situation is conducive to abrupt reappraisals.

The world's other major nuclear threat – North Korea – presents an entirely different set of issues. The anointment in late 2010 of Kim Jong-un as probable successor to Dear Leader Kim Jong-il has cast the country's upcoming political transition into sharp relief. The sinking of a South Korean frigate in March 2010, attributed to a North Korean mini-sub torpedo, has ratcheted up peninsular tensions to their highest level since the North's 2009 nuclear test. Consequent joint US-South Korean naval exercises have fed into the slow-burning confrontation between China and the US over regional maritime security and freedom of navigation. While North Korea can be expected to muddle through – regime collapse is unlikely – it will continue to rattle regional stability and necessitate robust engagement by the six-party powers (North and South Korea plus the US, China, Russia and Japan).

One of the brightest spots on the global security horizon is the phased withdrawal of US military forces from Iraq, which is expected to conclude with the completion of Operation New Dawn by the end of 2011. While Iraq is still racked by periodic bloodshed and enervating political uncertainty, the vicious cycle of violence has been conditionally replaced by an institutional political process backed by massive oil and gas investment. Few will tout 'mission accomplished' in 2011, but Iraq no longer consumes the geopolitical landscape as it did a few years ago.

Conversely, cyber-security has leapt up the national security agenda and will become even more significant in 2011. While

cyber organised criminal groups and malicious hackers continue to pose a major and growing threat to business, governments are increasingly hyping cyber-warfare and cyber-espionage threats from state or state-sponsored actors. Several states – notably the US, China, Russia, France and Israel – are widely believed to possess sophisticated cyber and electronic warfare capabilities, built in part through liaison with patriotic hacker undergrounds. While state capabilities have been developed covertly over many years, the US has led the way in openly militarising national cyber-security with the launch of a dedicated Cyber Command (CYBERCOM) in 2010, reflecting both routine attacks on defence systems and the growing reliance of military platforms and critical infrastructure on digital networks. Both the US and the UK have recently made cyber-security a central element of revised national security strategies.

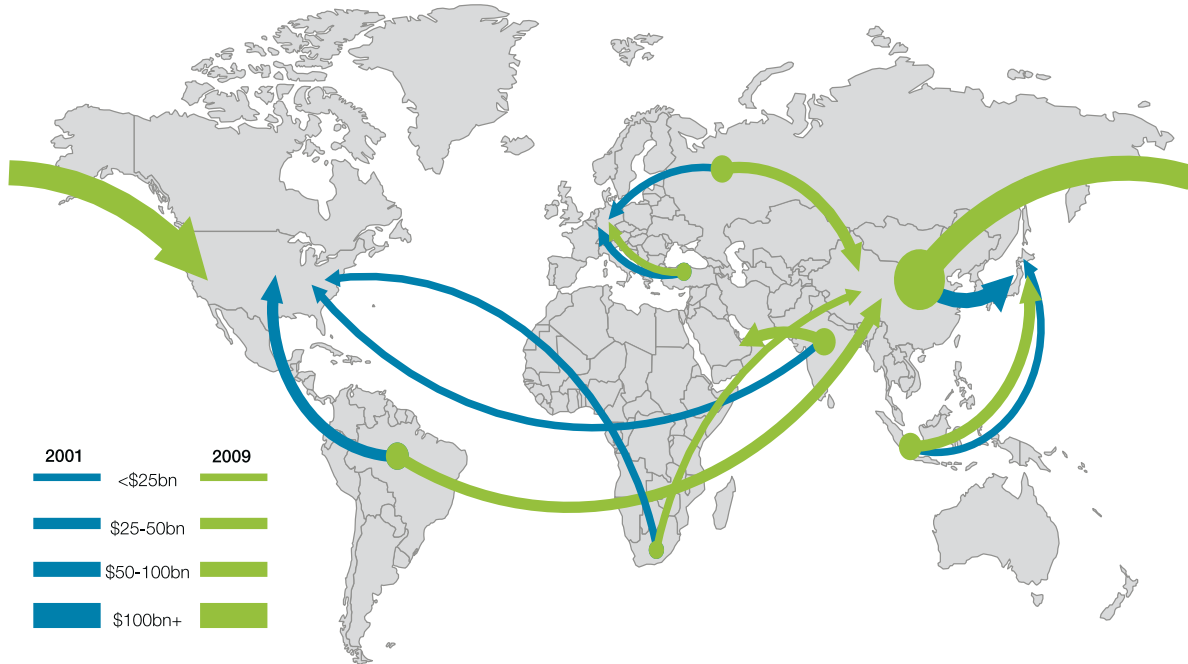
The large-scale cyber attacks on Estonia (2006), Georgia (2008) and Western technology companies (2009) raised thorny questions about how to identify an attacker, determine the level of state involvement and craft an appropriate response. The asymmetrical advantages of cyber-attacks were acutely demonstrated in 2009 when militants in Iraq used a \$26 programme to hack the unencrypted video feeds of US surveillance drones. Finally, the disclosure in 2010 of sophisticated, 'military grade' malware targeting the control systems of critical infrastructure – still unattributed – suggested that cyber-attacks could cause real-world damage to nuclear plants, oil and gas refineries, and water and sewage systems. As these cases suggest, the low cost, global reach and – above all – anonymity of cyber attacks significantly complicate the traditional geopolitical landscape.

THE RISE OF COMMERCIAL DIPLOMACY

While the US devotes its efforts to global security, rising powers are rapidly reconfiguring the basis of global economic power. It is increasingly rare to see emerging-country leaders such as Turkey's President Abdullah Gul without a bevy of investors and corporate executives in tow, or returning from a diplomatic mission without billions in trade deals. The increase in trade and financial ties between emerging economies has clear strategic implications: Brazil demurred in late 2010 when asked to be part of a G20 campaign to pressure China on its currency, not wanting to jeopardise relations with its new number one trade partner.

In the last ten years the direction of trade among major emerging economies has starkly reversed. Where the US and Europe were once centres of gravity, now China, the UAE, Russia and other emerging powers are the key hubs in the global trading system (see map overleaf). Even where the US, Germany or Japan remains the major trade partner – as in Egypt, Turkey and Indonesia respectively – China, Russia or another fast-growing economy is inexorably nipping at their heels. Such burgeoning South-South economic relations are the building blocks of a new geopolitical agenda, inexorably in competition with Western-dominated institutionalism, founded on commerce, sovereignty and national interest.

TOP TRADING PARTNERS OF MAJOR EMERGING MARKETS, 2001 vs 2009



Source: International Trade Centre

Looking at four key examples:

Brazil

Argentina and Brazil may both represent South America in the G20, but the continent's most populous country and largest economy clearly desires the starring role – and wants to lead the region out of the US's shadow. Outgoing President Luiz Inacio Lula da Silva has been the architect of Brazil's extroverted foreign policy, conspicuously courting anti-US regimes both in the region (Venezuela, Cuba) and beyond (Iran). Such moves are in part about commercial ties: the country has become one of Iran's most significant trade partners, exporting more than \$1bn in foodstuffs in 2009.

Brazil accounted for most of Latin American outward FDI over the last five years and its companies, especially in construction and real-estate industries, are major players throughout the region. Flagship oil company Petrobras is investing billions of dollars in Argentina, among other countries. Economic ties with China are also intensifying. A Chinese-financed \$2.5bn port complex and \$5bn steel foundry at the port of Açú near Rio de Janeiro followed a \$10bn oil-supply agreement in 2009. Such mega-deals are a tribute to Brazil's economic growth and geopolitical ambitions, and will help cement relations with other rising states.

Turkey

The crisis and recession have been pivotal factors in Turkey's emergence. Gul is reportedly fond of noting that his country has gone from being the 'sick man of Europe' to one of its healthiest economies, with bonds in late 2010 rated above those of Spain, Italy and Portugal. This newfound economic

power is a platform for building commercial ties to the Middle East – especially in Syria, Iran and Iraq – while keeping a foot in Western projects like NATO and the EU. Turkish companies have piled into the Kurdish region of northern Iraq, dominating both construction, and oil and gas production, and making the region one of Iraq's most prosperous. In exchange, Ankara gains increased flexibility in dealing with Kurdish separatist insurgents in eastern Turkey.

Meanwhile, Turkey and Iran have found common ground on Kurdish separatism, and are strengthening commercial ties. The US has raised concerns that Turkish banks may be filling the void for Iranian transactions as sanctions curtail traditional financial centres. Turkey has also sought to increase its strategic importance by strengthening its role as a natural gas 'energy bridge' to the EU through projects such as Nabucco, a multi-country pipeline connecting Central Asian gas to Western Europe, which is expected to reach a final investment decision in early 2011.

Russia

Russian assertiveness has mellowed after both thwarting a US missile shield and defending its commercial interests in Iran. Its invasion of Georgia in 2008 – the only interstate conflict since the start of the Iraq war in 2003 – faced only rhetorical Western resistance. The disclosure in August 2010 of an anti-aircraft missile battery in Georgia's breakaway Abkhazia region has been met with studious blasé. Relations are tightening with Central Asia – especially Kyrgyzstan – while a pro-Russian government is again installed in Ukraine. The exigencies of firming up the energy-security relationship with Europe have encouraged softer rhetoric on both

sides and progress on major pipeline projects such as Nord Stream. Russia has started to encourage foreign participation in its oil and gas sector after years of hostility, which could further strengthen ties with the US and Europe.

India

Buoyed by years of rapid economic growth, India alternates between confidence that it will gain greater representation on international security and financial organisations, and frustration that progress is not fast enough. India has successfully cultivated its indigenous technology and back-office support industries. Conglomerates such as Tata Group, Reliance, Bharti Enterprises and ArcelorMittal are rapidly internationalising, capitalising on successes at home to expand and acquire interests around the world – though they still lag behind their state-backed Chinese counterparts. Similarly, foreign multinationals are eyeing India as one of the largest upwardly-mobile consumer markets in the world.

However, problems closer to home might undermine India's global ambitions. Troubled relations with its neighbours, including but not exclusively Pakistan, are a persistent problem for Delhi, preventing it from tackling serious challenges such as climate change, terrorism and organised crime. India's quarrels have also allowed China to compete more effectively in its backyard, in Pakistan, Sri Lanka and elsewhere. Equally, India is eyeing every move of the US, whose relations with Pakistan and posture in Afghanistan continue to vex Delhi. Sustaining warmer US relations remains a top priority – periodically advanced by bilateral efforts such as nuclear co-operation and naval training exercises – but India will be anxious to retain its independence. Old friends like Russia will not be cast aside, as illustrated by the weakened but still deeply entrenched defence relationship.

EMERGENT RESOURCE COMPETITION

Natural-resource competition is the essential ingredient of classical geopolitics. But one interesting aspect of today's chief resource contests is that they barely existed 20 years ago. Concerns about access to rare earth minerals are driven by new and growing markets for iPods, computer hard drives and electric car batteries – and the expectation that green technologies will generate future economic growth and jobs. Longstanding maritime territorial disputes in the South China Sea are suddenly more pressing, in part because China's growing naval power is forcing the issue, but also because innovations in deepwater offshore drilling and mining technology might open up commercial oil, gas and mineral deposits. Finally, growing interest in the Arctic is a function of both deepwater technology and the very recent and continuing effects of a warming climate. In all these cases, companies are among the first to be affected by geopolitical confrontation, often becoming proxies of strategic interests.

Rare earth

The commercial and strategic value of rare-earth minerals, used in a variety of high-technology applications, has surged with China's moves to curb exports. The country is the largest global supplier – the

'Middle East of rare earths', in Deng Xiaoping's phrase. An increasing number of countries are concerned about securing supplies to fuel domestic industry: Germany sees rare-earth scarcity as a long-term vulnerability for national champions like Siemens and Bosch; Japan and China clashed in late 2010 over disruption that threatened the supply chains of Toyota's and Honda's hybrid-electric vehicle manufacturing. The US Government Accountability Office (GAO) has assessed that China's dominance of rare earths gives it 'market power' over major US defence contractors, including Lockheed and General Dynamics.

As these examples suggest, access to rare earths is becoming a geopolitical issue in its own right: any export restrictions, price hikes or other disruptions threaten to become sources of bilateral or multilateral tension and fuel simmering trade conflicts. Yet the strategic elevation of rare-earth elements – as well as scarce and concentrated minerals such as lithium, cobalt and coltan – will also drive new exploration worldwide as countries look to diversify and stabilise supply. Germany, for example, has called for Europe to explore and develop prospective resources in Eastern Europe and Central Asia, partly to pip China to the post. Higher prices have also encouraged Australia, Vietnam, Malaysia, Canada, Brazil and India to develop projects. Greenland even overturned a longstanding ban on uranium mining in 2010 to permit access to a rare-earth deposit. In the coming year, we anticipate new opportunities for miners of rare earths and other unique minerals, which could provide a boon to several mineral-rich countries and help tame geopolitical concerns.

South China struggles

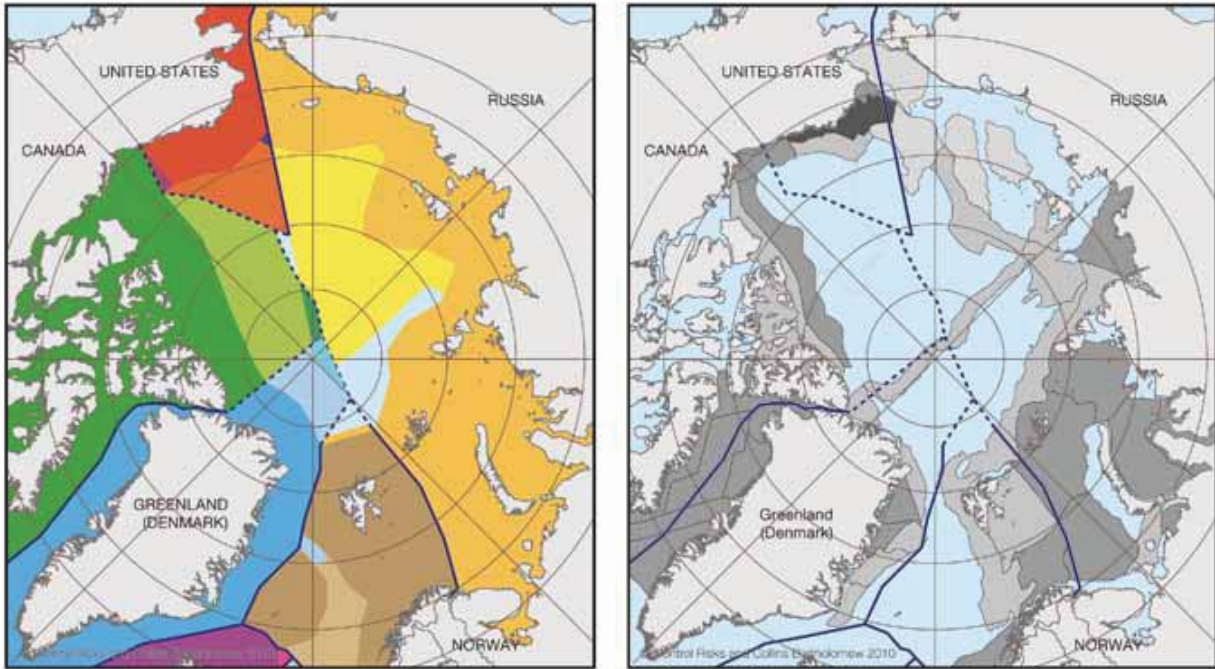
Natural resources are also at the centre of longstanding territorial disputes in the South China Sea. In addition to rich fisheries, there may be substantial energy deposits. Estimates vary widely – the US pegs it at 28bn barrels of oil, while China believes as many as 213bn barrels may be recoverable – but prospects appear promising. Brunei and Malaysia have been successfully exploiting offshore oil and natural-gas fields in the adjacent Brunei-Sabah basin for more than 30 years.

Claims on these potential subsea resources, including those made under the UN Convention on the Law of the Sea (UNCLOS), often include disputed territory, such as the Spratly and Parcel island groups. For years, provocative fishing and offshore exploration activities have tested neighbourly tolerance in efforts to create new facts on the ground, though the overall stalemate has barely budged. With China adopting a more muscular naval posture, however, the stakes are rising. The Association of South-East Asian Nations (ASEAN) has tentatively welcomed US intercession on behalf of multilateral solutions to territorial disputes, leveraging its core strategic interests in Taiwan and freedom of navigation in the South China Sea. The extra-regional dimension complicates things: cooler heads are likely to prevent any major naval escalation, but considerable uncertainty will continue to plague exploitation of the sea's resources.

Cash in the Arctic

Accessing Arctic resources presents a rosier picture. One of the most promising frontiers for energy, minerals, fisheries, water and trade routes, it is slowly – and controversially – being prised open by climate change and geopolitics. The melting of the Arctic

ARCTIC: MARITIME CLAIMS AND BOUNDARIES, AND UNDISCOVERED OIL



KEY



Source: Durham University International Boundaries Research Unit; US Geological Survey

icecap could unlock historic energy and mineral exploration opportunities: undiscovered resources are estimated at 90bn barrels of oil and 47bn cubic metres (bcm) of natural gas.

Countries are already jostling for the day when weather conditions permit long-term projects. Russia provocatively claimed half the Arctic in 2001 and planted a flag on the seabed using a robotic submersible in 2007. Its dispute with Canada and Denmark over

the Lomonosov Ridge is being decided through UN arbitration. The US and Canada, meanwhile, are investing in robotic submersibles, seaplanes, ice-hardened cargo ships and ice breakers, and folding the prospective North-West Passage into long-term military planning.

These manoeuvres suggest conflict, but Arctic issues provide one of the most durable patterns of geopolitical co-operation through

the semi-formal Arctic Council and other multilateral bodies. Russia and Norway recently reached an accommodation on sharing the Barents Sea, which should facilitate future natural gas projects in the mould of Snohvit and Shtokman. Furthermore, Nordic countries have long co-operated through the Nordic Council, settling many territorial disputes in the 1990s. Canada has become more explicit in its Arctic sovereignty claims, but is making progress on resolving a longstanding territorial dispute in the Beaufort Sea with the US. While the Arctic will inevitably become an area of significant competition, the progressive resolution of disputes will help reduce geopolitical risk in the future.

ACCOUNTING FOR GEOPOLITICAL BUSINESS RISK

Business is at the heart of the current geopolitical transformation. Key emerging countries are building political capital with their neighbours and around the world through strategic investments and increasingly dense commercial partnerships. State-backed banks, investment vehicles and resource companies are obviously integral to this strategy, and have generally received a warmer welcome in other emerging and developing economies than in Western countries. The private sector has blazed trails of national interest: emerging-market positions on trade policy, climate change and financial reform have been strongly informed by industry imperatives. Furthermore, in many contexts there may be little differentiation between private-sector and national interests given the close relationship between political and economic elites. Western investors are supplying much of the capital, skills and technology powering emerging-economy development, increasingly joining their emerging-country peers, including state-owned enterprises, to forge world-class partnerships.

The interlocking of state and business naturally creates opportunities and risks for business: on one hand, state interest can secure high-level diplomatic cover, shield companies from adverse regulation, offer recourse to international arbitration and provide access to low-cost financing. Mutual business interests have been a catalyst for geopolitical co-operation, helping to reduce risks for investors across the board in some regions.

On the other hand, companies inevitably become tangled in a web of geopolitical manoeuvring. This ranges from reluctance to allow investment in 'strategic' assets to outright sanctions and prohibitions on doing business in certain countries. Doing business in many emerging countries often means working directly with the government in one form or another, exposing companies to a range of political, reputational and legal risks. With states increasingly interested in pushing their agendas through commercial channels, it is essential that companies understand the relationships between states and assess their exposure to geopolitical risk.

Navigating the changing geopolitical risk landscape begins with a clear assessment of transnational security, political and operational exposure. First-order security risks, including war and transnational terrorism, are obvious but not always paramount. Unauthorised border incursions or other territorial violations remain points of tension that can result in border closures, social unrest or

retaliatory attacks. However, few bilateral disputes currently have the potential to lead to a full-scale conflict. Despite increased geopolitical assertiveness, rising powers are acutely sensitive to the sentiments of the global marketplace and are unlikely to allow anything to escalate that may damage investor perceptions.

The same calculus does not necessarily apply to situations like Iran and North Korea, which are relevant primarily through the impact that any instability or conflict would have on business operations in neighbouring countries. In the case of Iran, a conflict would provoke a sharp increase in regional risk premiums and have a dramatic impact on global oil, currency and equity markets, with significant adverse effects for businesses worldwide. Monitoring security relations between countries is also relevant in the context of trans-border security issues: the strong political and treaty ties between the US and Mexico, for example, are instrumental in reducing the risk of harmful border closures on the back of continuing violence.

High-level political risks are equally significant. Growing assertiveness abroad tends to go hand in hand with indigenisation of the business environment at home, both to shore up supportive political constituencies and provide a firm foundation for projecting state power. Such moves are not always overly harmful to the business climate or investor sentiment – Brazil's move from a concessionary to production-sharing oil and gas regime is a good example – but are always worth monitoring for implications that might affect contractual security or lead to creeping or overt expropriation. Such political risks can also be transnational, as when government policies hit international supply-chain integrity and continuity (export bans, restrictions or tariffs) or subject investments to adverse scrutiny or strict conditions (such as mandatory partnerships with state-owned companies). This is particularly the case when investing in sensitive sectors such as oil and gas, mining, aerospace, infrastructure, IT and telecommunications, aviation and a handful of others subject to government review in many countries.

Transnational operational risks are often less overt – except in the case of legal sanctions – but also significant. Governments often exert pressure on neighbours and trade partners by slowing customs processing, refusing visas, delaying letters of credit and so on. Many such policies remain unofficial and are rarely articulated, making it essential to get first-hand information about the situation. Even if such activities are not state-directed, a geopolitical dispute may affect business relations: China has acknowledged, for example, that traders incensed at Japan's detainment of a Chinese fisherman in late 2010 may have independently slowed or delayed exports. The threat or implementation of formal sanctions and extraterritorial legislation, meanwhile, can significantly raise the costs of doing business in affected countries, both in terms of access to financing and complying with controls. Understanding how both the public and private sectors will react to geopolitical events can provide critical early warning to prevent business disruptions.

-End of preview-

**To request a complimentary copy of the full RiskMap 2011 report, please
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