EXTRACT FROM:
WORLD BANK PORT REFORM TOOL KIT
Financial Implications of Port Reform, Part II,
Principles of Financial Modelling, Engineering and Analysis

The Country Ranking developed by Nord-Sud Export (NSE)

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The Country Ranking process by NSE aims at ranking a hundred or so emerging economies according to, on one hand, market opportunities, and on the other, the risks those countries may represent for international operators (industrialists, bankers, insurers), either for mere export operations or for investments. This ranking is made possible thanks to an objective rating system based upon more than 100 criteria, coming out of a database having been developed by NSE for 18 years.

1. What is included in the country risk ?

Strictly speaking, the country risk concept includes 3 main kinds of risks:

- The political risk, which may affect property rights through confiscation, expropriation or nationalisation, with or without compensation, through contract or debt repudiation;

- The transferability risk, when a country's Central Bank cannot convert resources in local currency into international means of payment;

- The payment risk for Governments themselves, or for public enterprises, when the public buyer or debtor does not meet its financial commitments.

These 3 risks make up the basis of the country risk, i.e.:

- For lawyers, the *Act of Government*, knowing that recourse against a foreign government is for all practical purposes a very difficult undertaking;
- For bankers, the "sovereign risks", knowing a sovereign guarantee often constitutes the financial safety scheme;
- For insurers, the "political risks", knowing those risks can be interpreted as catastrophe risks, and as such should be covered by specialised insurance companies acting either on behalf of governments or within the market reinsurance framework.

2. Country Ranking Methodology proposed by NSE

NSE developed a two-step methodology: a rating of risk factors identified and distributed by categories; and use of weighing coefficients for each identified risk factor.

(a) Rating of Country-Risk Factors

The country risk assessment is established based on the following classification:

- Parameter 1: Sovereign Financial Risks
  - Importance of public debt and debt service (6 criteria)
  - Sovereign default risk (6 criteria)
  - Inconvertibility risk (3 criteria)

- Parameter 2: Market Financial Risks
  - Command of fundamental economic balances (5 criteria)
  - Exchange risk/sudden currency devaluation (4 criteria)
  - Systemic risk and economic volatility (6 criteria)

- Parameter 3: Political Risks
  - Homogeneity of the social fabric (4 criteria)
  - Government and regime stability (7 criteria)
  - External conflicts (4 criteria)

- Parameter 4: Business Environment
  - Conditions for foreign investments (6 criteria)
  - Labour conditions (4 criteria)
  - Good governance (5 criteria)

(b) Weighing of the Risk Factors

There cannot be any country ranking without weighing of the risk factors. The exercise is all the more difficult to carry out than there are about 100 criteria to assess. Furthermore, the specificity of NSE's country ranking method is to provide for a differentiated weighing system depending on whether a country is being assessed form an exporter's standpoint (taking a risk on less than 18 months), or from an industrial investor's standpoint (local long-term development). This leads therefore to proposing 2 specific weighing systems.

One needs to know how to make a good use of country rankings, which are, as far as the method goes, questionable approaches, for at least four reasons:

- It is hazardous to compare countries as different as South Korea and Egypt, for instance, speaking of countries within the *newly industrialised economies*;

- Country ranking methods make a mix between various risk factors according to a necessarily subjective weighing system;

- Most of country rankings are made after experts' assessments, and therefore reflect more their own perception of the risks involved, rather than the sheer reality of the countries;

- Finally, country rankings have as an objective to deter commercial operations in countries deemed to be-objectively or subjectively-"high risk", when no country ranking system is able to foresee events of a revolutionary type. As a result, most of country ranking systems have to go through sudden and ex-post downgradings, an impediment to effective decision-making. In other words, it may be questionable for a company to decide on long-term commitments on the only basis of country rankings, which, by definition, offer only some limited reliability.