

# **POLITICAL UNCERTAINTY, INVESTMENT DECISIONS, and DEVELOPMENT POLICY IMPLICATIONS**

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## **ABSTRACT**

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This paper concentrates on the effect of political risk on investment behaviour. We argue that political risk and uncertainty are not discrete, static, and generalizable notions as described by the literature; but are rather perceived, dynamic, and context specific conceptions. The perception of such uncertainties depends on the structure, technology, and competitive nature of an industry. Maintaining that any investment strategy is a dynamic best response taken to match the organization with its evolving environment, we argue that investors manage their political risks by forming alliances by bonding with governments and local firms in a risk-reducing 'trinity'. The choice of such coalitions depends on the sources of risk, its probability, its duration and its possible implications. We find that investors will seek the least cost-most efficient bond to reduce their uncertainties.

The findings in our piece of work add to the general ideas argued in the WDR 2005. First, it shows that there are various forms of political risk and uncertainties and thus the type and source of uncertainty will dictate a completely different response by each investor. Second, our empirical analysis shows that under politically uncertain conditions investments don't halt entirely as investors still undertake business transactions. However, their choice of entry undermines their 'ability' and 'willingness' to fully deliver the development benefits in terms of transfer of know-how (technology and managerial skills) usually associated with foreign investment. Third and based on our analysis, we tackle the policy implications of our research. We show how governments could decrease particular aspects of political uncertainty whenever the sources of such risk are based on complex and fickle regulatory policy. Such policies could take the form of domestic reform, regional cooperation, multilateral assistance (including the World Bank), or supranational regulations.

## **POLITICAL UNCERTAINTY, INVESTMENT DECISIONS, and DEVELOPMENT POLICY IMPLICATIONS**

In its World Development Report for 2005, the World Bank argued that creating a climate in which firms and entrepreneurs of all types- local and multinational- have opportunities and incentives to invest productively, create jobs, and expand, and thereby contribute to growth and poverty reduction is a necessity. It goes on further to argue how improving the climate for investment in developing countries is essential to provide jobs and opportunities for young people and to build a more inclusive, balanced, and peaceful world. The report argues for the need for reform to allow governments to remedy some of the uncertainties and risks created by their fickle policies.

This paper will concentrate on the effect of political risk on investment behaviour. Political uncertainty affects investment decisions by making economic agents lose reference as to the likelihood of an event, the nature of that event, and its impact on their businesses. We argue that political risk and uncertainty are not discrete, static, and generalizable notions as described by the literature; but are rather perceived, dynamic, and context specific conceptions. The perception of such uncertainties depends on the structure, technology, and competitive nature of an industry.

Maintaining that any investment strategy is a dynamic best response taken to match the organization with its evolving environment, we argue that investors manage their political risks by forming alliances by bonding with governments and local firms in a risk-reducing 'trinity'. The choice of such coalitions depends on the sources of risk, its probability, its duration and its possible implications. We find that investors will seek the least cost-most efficient bond to reduce their uncertainties.

We consider two countries (Jordan and Lebanon) and a service industry<sup>1</sup> (Mobile Telecom) and show that investment decisions under political uncertainty depend on the degree of: separation of tangible and intangible assets, capital intensity of the sector, regulation, and tradability and simultaneity of production and consumption of a sector. We find that the perception of the source and level of uncertainty affects investor's choice of bonding within the trinity. We thus argue that political economy generated networks are key strategies used by investors not only to cope but also to actively manage political uncertainty.

The findings in our piece of work add to the general ideas argued in the WDR 2005. First, it shows that there are various forms of political risk and uncertainties and thus the type and source of uncertainty will dictate a completely different response by each investor. Second, our empirical analysis shows that under politically uncertain conditions investments

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<sup>1</sup> The research project considers two other sectors: hotels and banks. If interested in the comparative results across industries please contact author.

don't halt entirely as investors still undertake business transactions. However, their choice of entry undermines their 'ability' and 'willingness' to fully deliver the development benefits in terms of transfer of know-how (technology and managerial skills) usually associated with foreign investment. Third and based on our analysis, we tackle the policy implications of our research. We show how governments could decrease particular aspects of political uncertainty whenever the sources of such risk are based on complex and fickle regulatory policy. Such policies could take the form of domestic reform, regional cooperation, multilateral assistance (including the World Bank), or supranational regulations.

These findings are based on a DPhil dissertation titled 'Managing Political Uncertainty: Investment Decisions in Jordan and Lebanon'. In this paper, we will only present the main findings of that elaborated piece of work and show the implications to the study of development and policy making with reference to the possible involvement of the World Bank. We will also concentrate our presentation on our results of the mobile telecom industry only<sup>2</sup>. We will start off by giving a very brief overview of the literature this paper is drawing upon. Then we will sketchily present our theoretical framework (the Situation-Structure-Performance (SSP) paradigm), our methodology and basic arguments and hypotheses. We will then show the results of our work and pin down the basic conclusions. To do so we will: first, compare the results from our two case studies and link them back to our hypotheses in reference to the SSP framework. Second, and based on this comparison, we will extract the basic implications of our work to the study of political uncertainty and investor behaviour thus highlighting our main contributions. Third, we will discuss the possible implications on development and policy making in general and the role of the World Bank in particular. We will conclude that political uncertainty is a dynamic, evolving, complex, and manageable concept which affects different investors in different sectors differently depending on their political capital as well as their willingness and ability to establish coalitions with domestic political and economic players. Moreover under uncertainty, the financing of investment in service sectors might take the form of equity as well as non-equity arrangements with implications on the composition, type and structure of capital flows and accordingly on development spill-overs.

### **THE LITERATURE: *Overview and Shortcomings***

In looking at how investors manage political risk, three types of literatures need to be reviewed. The first looks at the definition of political risk and uncertainty. Second, one needs to look at the literature on investment flows in particular the literature on investment under

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<sup>2</sup> If interested in results on the other industries please contact author.

uncertainty. Third, the political economy interaction of investors with their environment and other actors needs to be reviewed.

The labelling of political risk hasn't been consistent in the literature. Some define it as being the same as country risk and others treat it separately. The differentiation between the two hinges on the definition of a 'polity'. A polity is not only the government but it is the interaction of the different social groups together. In that sense, what counts as political in the narrow sense could be extended to capture a broader range. The implications of the term political risk vary with the interests and needs of the definer (Haendel, 1979). On a broad categorization level, the controversy over the term 'political risk' could be traced back to differences according to historical context<sup>3</sup> (The 1960-70s were marked by political crises (and thus the start of the notion of political risk), the 80s by debt crises (notion of country risk), and the 90s by financial crises (more or less the notions of sovereign risk and financial risk)), downside (Root (1968) and Simon (1984)) versus totality of risk (Robock (1971), Kobrin (1979), Haendel et al. (1975), Alon and Martin (1998), Miller (1992), Cosset and Suret (1995), Kennedy (1984), Nigh and Schollhammer (1987), Boddewyn (1988), Jodice (1985), Fiels and Sabac (2000)), and according to sources of risk.

The link between the assessment (defining) and management (Heinz and Zelner, 2002) (coping) of risk is not well pronounced in the literature. There is a wide disagreement about what constitutes political risk as shown earlier. In trying to assess risk, the focus is mainly pointed on identifying the key players, the environment, and the causes of risk. In focusing on risk management, authors are interested more in the approach followed towards managing risk and its consequences. However, little is done on linking.

When discussing investment flows one has to look at the flow of capital first on a macro level. Capital flows into countries in different forms. It can thus be decomposed according to maturity, source, and type. Short term flows tend to be more volatile and vulnerable to shocks than long term ones. In terms of source, private and official flows differ in that the former flows according to higher returns while the latter aims at more or less aid purposes. Moreover, foreign aid flows (in principle) in the hope of fostering transparency, accountability, and governance and therefore establish stability as a result and therefore certainty. On the other hand, private investment will be interested more in a country's ability to implement and maintain its economic reform, i.e. they give a lot of weight to political stability (Haley, 2001). The last decomposition is according to type: equity versus debt. Equity tends to be a best response to risk due to few reasons. Equities in the form of FDI replace markets by having control over its own flow of resources. Moreover, shareholders who are interested in their profit returns will try to avoid information asymmetry and the

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<sup>3</sup> Refer to the appendix for a tabulation of the evolution of the definitions

moral hazard problem by taking control of ownership via equity (Hausmann, 2000). Equity owners have claims on the cash flow of an entity that are junior to those of creditors. Therefore the larger the share of equity the safer debt seems. Lastly, Debt increases the Probability of Bankruptcy (Hausmann and Fernandez-Arias, 2000).

Moreover, the literature discusses the determinants of investment according to different theories. The internalization theory argues that the choice of investment comes as a choice of the MNE to replace external markets internally through the firm thus reducing its cost. The OLI model developed first by Dunning identifies the attractiveness of a country for an FDI flow on the basis of ownership, location, and internalization advantages. The gravity model predicts flows according to macroeconomic variables. Such variables include distance to markets, geography, GDP, language, interest rates, inflation, and other variables. The transaction costs model argues that the driving factor for any flow is the advantage in terms of cost structure. The latter theories present markets as being imperfect and thus firms tend to internalize this failure through their own investments.

Given all that one would expect different capital flows to be affected differently under uncertainty. In fact the literature argues the FDIs flow into developing countries precisely because that is the only thing that developing countries could get (Albuquerque (2002)). According to Hausmann (2000), countries that are riskier, less financially developed, and have weaker institutions tend to attract less capital but more of it in the form of FDI. FDI is a form of investment that is best suited to provide risk sharing in a world economy where financial contracts are plagued by imperfect enforcement mechanisms.

In terms of investment under uncertainty, the literature maintains that under economic uncertainty, investment becomes a function of the irreversibility and delayability of that investment. The reversibility and delayability of a project tend to be industry specific. Sectors which are more capital intensive will experience delays in investment, as firms are nervous as to the chances of divesting their projects (Dixit and Pindyck, 1994). On the other hand, sectors based more or less on intangible assets tend to be less prone to risk since there assets are less appropriable (Albuquerque, 2002).

The third body of literature in need of review is a political economy one. Investors don't act in vacuum. They interact with other actors that affect their behaviour and shape their preferences. The most known are governments. The literature mainly focuses on state-MNE interaction. However under uncertainty investors also interact with local investors, rating agencies<sup>4</sup>, insurers, international organizations (MIGA, IFC...) etc.

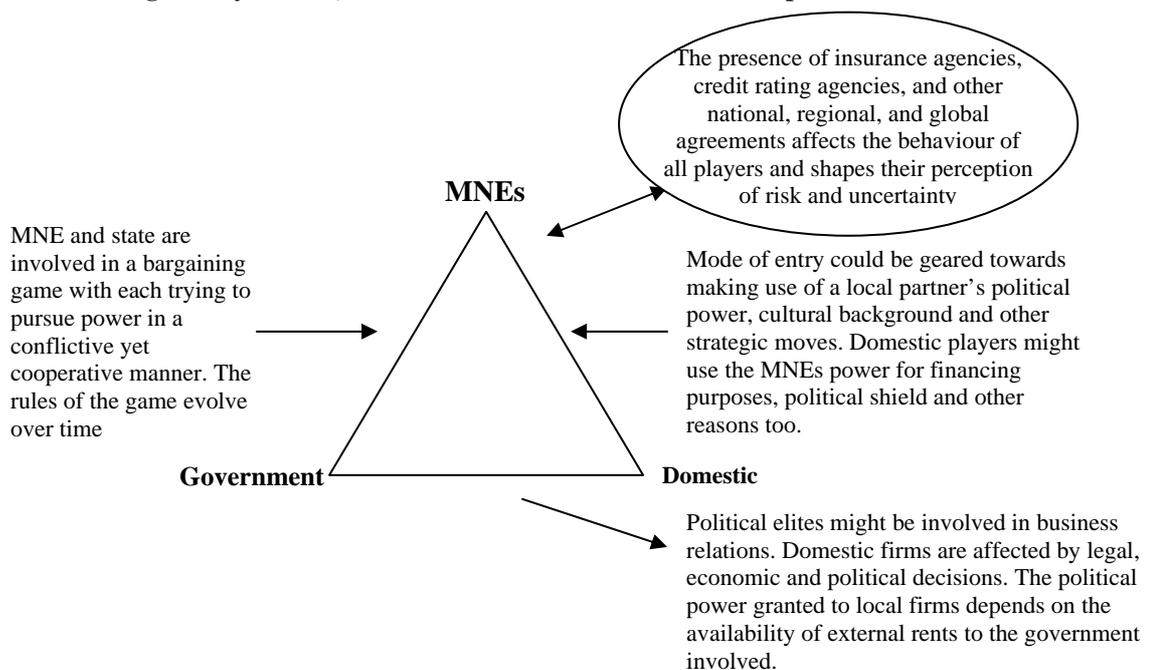
The three combined bodies of literature form the basis of our analysis. However, the literature suffers from basic shortcomings. First, the definition of political risk has been

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<sup>4</sup> Check appendix for more on rating agencies.

confined to a static view. Second, the connection between strategic management and political risk assessment has still been very minimal in the literature. Third, the attempt to create an ‘objective’ consensus on the definition of the political risk implies a general metric that can describe all instances, relevant to all agents at all times. Events, however, are created by context. Fourth, the literature fails to draw the distinction between risk and uncertainty. On the one hand, risk is a dynamic concept that revolves around the probability of change. Current conditions are not risks; the changes in current circumstances are. Uncertainty, on the other hand, deals with lack of knowledge about the outcome of the occurrences (i.e. uncertainty about the event) and uncertainty about the probability of the latter occurring. Moreover, with political uncertainty, the effect of the outcome may be essentially inconceivable. Fifth, investments in certain sectors are affected by political risk and uncertainty differently due to the particular nature of that sector. Therefore, investment decisions are context specific. Sixth, even though the literature discusses how firms try to manage their uncertainties it doesn’t make the connection of that with where this uncertainty is originating from. It also allows only for the interaction of firms with governments and ignores the fact that part of the investment decision hinges on the role of local investors. We thus propose that investment decisions are more an interplay between three agents: governments, foreign firms/investors, and local investors/firms in what we refer to as a risk-reducing ‘trinity’. This interaction is also affected by external players such as rating agencies that affect ex-ante decisions by affecting perceptions and political risk insurers like MIGA which might affect behaviour ex-post by allowing for more risk taking.

#### **Risk Reducing Trinity: MNEs, Government and Domestic relationship**



Our seventh point is about the dynamics of investment decisions. Part of the problem with the literature on investment is the assumption that institutions are stable over time and are given constraints on investors. Institutions have been defined as persistent and connected sets of rules, formal and informal, that prescribe behavioural roles, constrain activities and shape expectations. However with political uncertainty, the institutional structure is prone to change. Individuals' reaction to those changes creates a certain institutional structure which itself will affect the perception of individuals (in our context-investors) (Schmid, 2004). Then investors' interpretation of such signals and changes leads them to a particular strategy choice. Their performance<sup>5</sup> will then lead to a different institutional structure feeding back into this cycle of institutional change.

### **THEORETICAL FRAMEWORK, HYPOTHESIS, AND METHODOLOGY: *The What, Why and How***

As noted previously, the literature falls short on allowing for institutional change and thus a change in the perception of political uncertainties over time. Given all that, our work aims at remedying some of the shortcomings of the literature by establishing a framework where we can understand how the latter conditions interact to affect investors' decisions. The basic framework used has been borrowed from institutional economics and has three elements: the situation (describing the characteristics of an industry); the structure (describing the political structure of a country); and the performance (the behaviour of investors as signified by their decisions). This analytic tool is referred to as the Situation-Structure-Performance paradigm, or the SSP paradigm (Schmid, 2004). The advantages of this frame of analysis lie in that: one, it enabled us to use a behavioural set-up to make the linkage between on the one hand, the set-up of an industry and the political structure of a country and on the other hand, investment decisions. Two, it controlled for the differences in the technological and competitive natures of industries and thus their different implications on the perception of uncertainty. Three, it showed how the particular political structure once interacted with the organizational characteristics of an industry produces an investment decision which is a best response to this interface. Four, it allowed for a possibility of a change in the structure (political institutional set-up) which implied a change in the performance (investment behavioural response) thus allowing for a dynamic analysis of changing perceptions of political conditions.

When discussing the situation we seek to establish the basic characteristics of an industry that are invariant over time. We will focus on services rather than manufacturing.

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<sup>5</sup> North (1997: 13) argues that, "the process of change results from a continuous change in the reality which results in changing the perceptions which in turn induce the players to modify/alter the structure which in turn leads to change in the reality- an ongoing process".

This is due to several factors: first, According to UNCTAD (2004), services accounted for a massive 72% of developed country GDP and 52% of developing countries. Moreover, investment in service industries amounted up to 63% of World FDI flows; second, investment in services is under researched in comparison with manufacturing goods, third service industries tend to be highly regulated, location specific procedures (as opposed to products) which makes them vulnerable to politically complex and risk environments, and fourth services exhibit high degree of non-equity forms of entry which makes them more able to mitigate risk. Within services however we choose to focus on one industry, namely the mobile telecom.

Investment decisions under uncertainty are a function of the irreversibility and delayability of each industry. Those factors when interacted with the characteristics of an industry (in our case the mobile telecom) could form a particular situation. Of particular interest to our project are the following features: Capital intensity and degree of intangibility of asset which allow for the possibility of separation of tangible and intangible asset ownership and thus affects entry and exit options; simultaneity of production and consumption, tradability, and the vulnerability to demand uncertainty (Demand vulnerability being a function of the first moment (average level) and second moment (variance around the level)); producer versus consumer service; global versus local players given the ownership advantages and their ease of replication (and thus the possibility of delayability under uncertainty), and finally the degree of regulatory influence (regulated industries). In terms of the mobile telecom sector the following table presents the basic situational characteristics.

SITUATION		Telecom Mobile
On Entry 'Situation' Characteristics	Global/Regional/Local Player domination	Dominated by Global players who own the know-how. This gives them a higher bargaining power and thus more possibilities to manage risk
	Capital Intensity	Capital intensive but could possibly enter as a strategic partner and owner of the know-how thus decreasing their exposure to physical asset risk especially under politically risky settings
	Regulatory Influence	High regulatory influence causes a lot of risk and uncertainty since it affects market structure, level of competition, tariffs and other operating and entry costs. Although regulation might decrease market risk it still creates political uncertainty.
Post-Entry 'Situation' Characteristics	Tradability and Simultaneity of production & consumption	The non-simultaneity of production and consumption and tradability allows for immunity from demand fluctuations
	Consumer/Producer Service	Being a consumer and producer service allows for flexibility especially in times of uncertainty

Based on the characteristics of the mobile industry, we developed few hypotheses that show how the situation and industrial organization features could determine what options investors have in order to cope with uncertainty. The political structure as well as a change in it, once interacted with our control variable, 'Situation', will affect the actual performance of investors.

On-Entry Performance:

**On Dominant Players H1:** The degree of domination of global/regional firms varies proportionally with their market and political power. (Regional players are increasingly willing to take more risks than multinational players and use more of their regional experiences and connections.) As their ownership advantages increase so does their domination leading to less need for extensive bonding.

**On Capital Intensity H2:** As the possibility of political risk in the form of a conflict/war increases and due to the possibility of separation of ownership between tangible and intangible assets, mobile operators will increasingly opt for strategic partnerships with no ownership of fixed assets, thus reducing the risks of physical capital ownership.

**On Regulatory Influence H3:** In highly regulated ‘politically<sup>6</sup> uncertain’ environments, mobile operators opt increasingly to enter into strategic alliances with local partners or political elites to cope with such possible vulnerabilities.

Post-Entry Performance:

**H4:** Post entry, an increase in demand vulnerability for certain type of services increases segmentation of customer base and product targeting.

In understanding political institutions and their effect on political structure, the focus will be on understanding the vulnerability of investment decisions and business activities to less than perfect ‘politically-motivated’ circumstances. We define political conditions in three ways: political certainty (complexity), political risk, and lastly political uncertainty. The first refers to the status quo of a system. A change in these conditions creates a risk about the possible outcome and its effect. A perception of the outcome of the change and its ‘imagined’ effect is what we call uncertainty.

**POLITICAL CERTAINTY + change in current circumstances= POLITICAL RISK-→ POLITICAL RISK+ perceived judgement of events that are less than certain= POLITICAL UNCERTAINTY**

First, in politically complex structures the cost of getting agreement of another party to a transaction is a function of the number of necessary parties and the complexity of arrangement (Schmid, 2004) given the intricate administrative and regulatory system. Complex business arrangements mean that contracts are necessarily incomplete since it is impossible to specify all contingencies in such a vulnerable system. Second, in politically risky structures the future is not known with certainty but a set of outcomes could be predicted. Risk means that objective estimates are possible for some outcomes but the exact probability of it is only identified by a distribution. Political risk whether created internally or externally will expose an investor to an objective type of uncertainty and make him use specific strategies to cope with it. Third, investments are tied to expectations formed in the face of fundamentally uncertain political structures. It is not uncertainty of an unknown future as much as it is of a non-existent one. In the face of political ‘subjective’ uncertainty,

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<sup>6</sup> The political uncertainty here refers to regulatory uncertainty.

investors will base their decisions on many of their previous experiences, prejudices and subjective interpretations; thus imagining a set of possible outcomes that might result. This type of political structures is one where investors are mostly exposed to ‘politically unfit’ situations.

In our third section of the SSP we consider performance and establish: One, on entry: Which possible alliances, bonds, will forms in the trinity? Two, post entry: How will the performance/strategy, operation, and on going investment be affected by the situation-structure interaction under uncertainty? Each node of the triangle will seek to establish a ‘link’ with the other player whenever deemed necessary to manage the uncertainties. However the established ‘bond’ has to ensure a maximization of that player’s goals and prove to be the least costly. By committing themselves to such linkages, the players are enduring a cost. They have to commit a set of resources which could be used for other purposes. Therefore, in every alliance established there is an opportunity cost incurred. Players will only establish this alliance if it is central to further their goals and help manage their uncertainties. The actual situation-structure interaction will determine this ‘on-entry’ decision and the shape of the actual trinity will depend on the best response outcome given the situation and the particular political structure of the context within which investments take place.

The basic choice of methodology will be based on a comparative case study. The case approach is critical because the key questions are empirical. Cases are valuable because they allow one to examine how the interplay of economics, politics and institutions affects investor’s behaviour (Gomez-Ibanez, 2003). Moreover, by approaching the theoretical underpinnings with real world examples, one could allow for a natural experiment application of the SSP framework. The need for a comparative approach is to examine how given a particular situation (our control variable) the different political structures (political certainty, risk and uncertainty) will affect the performance of investors in the different industries. We pick the Middle East<sup>7</sup> as our region of study and Lebanon and Jordan as our two particular cases. We concentrate on the mobile telecom sector to test the particularity of investment as a function of industry structure.

### **COMPARATIVE CASE STUDY: *Analysis and Implications***

At this point, we would like to clarify that in no way did we consider, on the one hand, Lebanon and Jordan and, on the other hand, the mobile industry for a sole interest in their intricacies. The basic reason we considered this case study approach was to test our

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<sup>7</sup> According to an ESCWA study, “Real or perceived risks related to political tensions consistently lower investment rates and consequently growth rates. Investment rates in the region (MENA) have declined by an average of 2% annually since 1978...Investment growth and development is dependent on regional security. Analytical and empirical research conducted by ESCWA has shown consistently that without security, development is flawed” (ESCWA, 2001).

broader ideas and propositions. Differences in business-government relations across countries can be better understood by examining the institutions through which business and government interact with particular attention to formal constraints such as rules that individuals devise and informal constraints such as culture and norms of behaviour (Hillman and Keim, 1995).

**Political Set-up:**

In the case of Jordan, several significant points need to be marked about the political system in connection to investor behaviour. The tribal system makes the socioeconomic setup tightly knit and based on *wasta*<sup>8</sup>. Almost all economic and political transactions in the country are based on tribal networking. Thus any foreign entry has to take the family/tribal nature of economic transactions into consideration. Moreover, the king is at the center of most economic and political decisions. Any change in the king would thus mean a possibility for a change in the political and economic vision of the country due to the centrality of decision making. However, the most important point is the ‘induced rentier’ nature of the economy- based on the dependency of the country on aid flows- which led to less liberalization and a bigger role for the government. This made the private sector’s development highly linked to the public sector’s initiatives and thus established a circle of rentier-elite where the distinction between public and private became blurred. The economic crisis of the 1980s led to more liberalization but the entrenched bonding between the private and public sectors continued to exist (although weakened). This meant that foreign entry would have to establish its connections/partnerships with either the local private sector or the public in order to be able to access the system. Finally, the geopolitical position of Jordan which puts it in the middle of a politically risky region tainted Jordan’s image with political riskiness and hindered the separation between it and the rest of the politically volatile region.

In the case of Lebanon, several points that are of importance to the analysis of investor behaviour and their assessment of political surroundings need to be stressed. The country’s political riskiness stems from both internal and external conditions. Its location within a chaotic region coupled with its continued domestic political instability (that led to a civil war and continued political bickering) makes it politically risky for most investments and created political uncertainty about its future. Lebanese political setup and distribution of power is based on a sectarian system where divisions according to religious groupings are institutionalized and drive all socioeconomic and political interactions. It is particularly this trait that makes the political system inherently unstable and politically uncertain due to the continuous political rivalry between its different constituencies. This in turn leads to economic uncertainty- as triggered by policy uncertainty. On another front, Lebanon’s

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<sup>8</sup> Equivalent of corruption and nepotism in Arabic

economy is marked by its laissez faire nature where unlike Jordan, the private sector developed with no government intervention. However the interaction between such an economic structure and a sectarian political set-up led to the creation of a ‘sectarian-liberal’ circle of elites with again a blurred distinction between the economic and political sectors. The implication of this political analysis leads us to the conclusion that the Lebanese political system is inherently risky at any point in time and thus politically uncertain over time.

Keeping the above analysis in mind we present a comparative matrix where we contrast the political conditions of Jordan and Lebanon. By doing so, we highlight the basic characteristics of both systems that might be of use for our comparative analysis of the implications of such an institutional setup on investment outcomes/performances.

**Comparative Analysis of Political Conditions between Jordan and Lebanon**

	<i>Jordan</i>	<i>Lebanon</i>
<b>Political Complexity</b>	Tribal nature of the system makes interactions exclusive to tribal and family ties	Sectarian nature of the system makes interactions exclusive to religious affiliations
	Induced Rentier Economy creates a rentier elite society with blurred public-private distinction	Laissez Faire Economy coupled with a sectarian system led to the creation of a ‘sectarian-liberal elite’ circle that seeks economic and political power. This system maintains a status-quo with a blurred public-private distinction.
	Lack of Trust and thus appeal to individual networking, <i>wasta</i> , nepotism and corruption as a means to secure economic and political transactions	Corruption on all levels of transaction. This is elevated by the sectarian nature of the economy which requires networking to secure any deal
	Centrality of decision making to the King. The openness/closeness of a system thus depends on the whims of one man.	Multiplicity of decision making. The openness/closeness of a system depends on the outcome of political debate. Too much political bickering could lead to economic stagnation
<b>Political Risk</b>	Geopolitical risk	Internal risk (sectarian war) and geopolitical risk
<b>Political Uncertainty</b>	The existence of a politically complex system within a risky region at any point in time makes the system politically uncertain in a dynamic over time perspective	Political uncertainty inherent to a system that is based on competing and politically rival interests

With this political analysis as a background, we move now to compare the relative implications on investment performances in both countries in the mobile telecom sector.

**Mobile Telecom Sector: Performance**

In the telecom sector we find different investment outcomes in the two countries. The mobile telecom sector has a high degree of technical and technology driven know-how and thus a high intangible assets component. This makes global operators (owners of the technology) leaders in the sector and thus allows them to dominate not only their national markets but extend to other developed and developing countries. The sector is capital intensive due to its network infrastructure. However, it is possible to separate the ownership of the physical network from the know-how since the network infrastructure could be sold by the few world-wide suppliers of equipment/infrastructure. The mobile telecom sector is also a highly regulated industry which makes it vulnerable to regulatory and policy uncertainty.

Before going further in our analysis we present the following table showing a timeline of the mobile sector's major developments in Jordan.

**Timeline of the Telecom Sector in Jordan**

YEAR	TELECOM SECTOR Developments
1971	Establishment of TCC (Telecommunication company) as government controlled entity under the law no. 29
1973-1985	Telecom network was expanded due to increased demand
1987-1992	Jordan went into a recession. TCC suffered form lack of government funds that would help renovate and develop the sector.
1993	Government initiated a development program for the telecommunication sector that was aimed at increasing penetration rates from 7.8 to 12 lines per 100 inhabitants.
1994	TCC to be privatized
1995	First mobile operator enters the market with exclusivity for five years. Telecommunications Regulatory Commission (TRC) established as an independent body. The Telecommunications Law No. 13 of 1995 was passed, providing the legal basis for reform (as a result, the TRC was created).
1996	TCC name registered commercially as JTC in a first attempt to get ready for privatization
1997	government adopts law to privatize the telecom sector
1998	High debate over privatization; Incumbent mobile operator and government go into legal battle
2000	40% of the JTC was sold to a consortium led by France Telecom and the Arab Bank, the largest independent bank in Jordan, for \$508 million. Entry of 2 <sup>nd</sup> mobile operator
2002	Change of Ownership of the first mobile operator as MTC (Kuwaiti firm) buys Orascom's(Egyptian firm) Share
2003	Signing of 3 <sup>rd</sup> mobile operator with iDEN technology
2004	Signing of 4 <sup>th</sup> mobile operator, Opening of 3 <sup>rd</sup> mobile operator

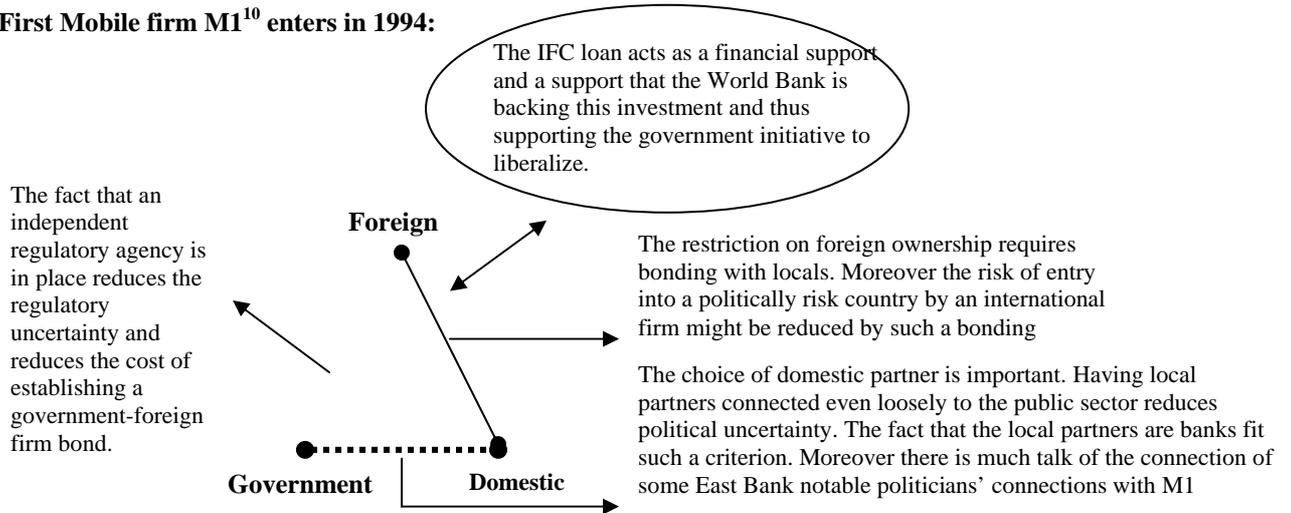
*Source: Jordan Times and TRC website*

In reference to those developments over time, we highlight the following basic features: First, the sector moved from complete government ownership to mixed private sector ownership in the fixed and almost complete private ownership in the mobile. Second, the sector moved from government regulation to quasi government one by the establishment of an independent agency to monitor and regulate the sector. Third, the mobile sector evolved from a monopoly to a duopoly and recently to a more competitive one thus changing the market structure over time. Fourth, the ownership pattern in the mobile sector has been a mixed of regional and international investors with the dominance of the first group. Fifth, the dominant standard in the mobile sector with three mobile licenses is GSM, but the sector also exhibits an iDEN technology supported mobile truncation license. The five stated characteristics provide an interesting example of an evolving sector where our main propositions could be tested. We will thus present each development separately in reference to the possible trinity and see their implications in terms of political uncertainty and investment decisions.

We will divide our study according to the development of the mobile sector starting with phase one from 1994-2000. In October of 1994 the first mobile license was issued with an exclusivity of five years. In that same period, Jordan Telecom was privatized. This phase

thus is the period where the first mobile operator<sup>9</sup> (referred to as M1 from now on) enjoyed a monopoly over the sector.

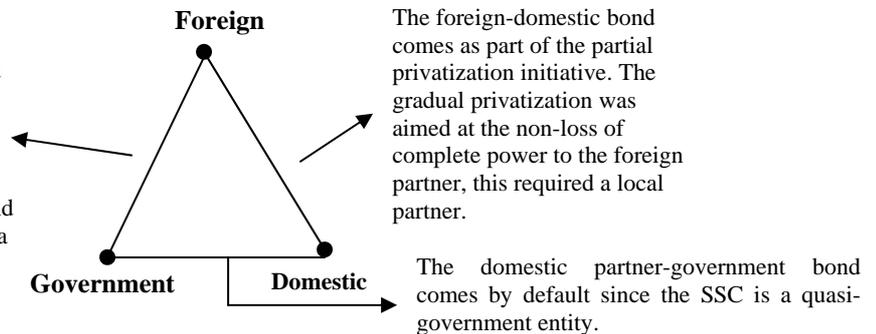
**First Mobile firm M1<sup>10</sup> enters in 1994:**



Phase two from 2000-2003 is marked with a duopoly between M1 and the second mobile operator (from now referred to as M2). Moreover, in this phase we see a change in the ownership of M1. The entry of the second mobile operator came as part of the privatization of the Jordanian Telecom company.

**Second mobile company M2's Entry**

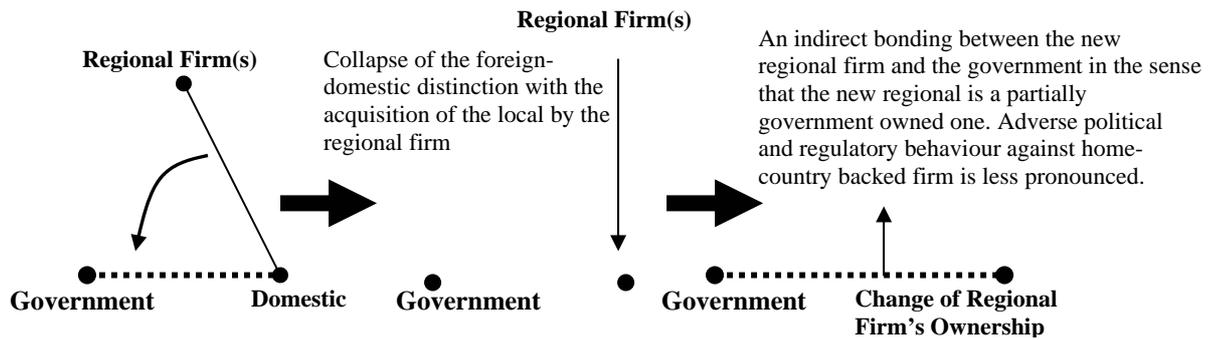
The foreign-government bond is one between two government entities. The fact that Jordan was an induced rentier economy with high levels of foreign debt, meant that a debt equity-swap was attractive. The French have been going into other sectors too including the cement and railway. An important point also is since the two entities are government backed bodies establishing a bond between the foreign company and government comes at a low cost in comparison with a pure private foreign firm and a government joined-venture.



<sup>9</sup> We will not be using the commercial names of the mobile firms in Jordan due to some commercial and legal restrictions. However we will refer to their major shareholders (regional and international firms) with their exact names.

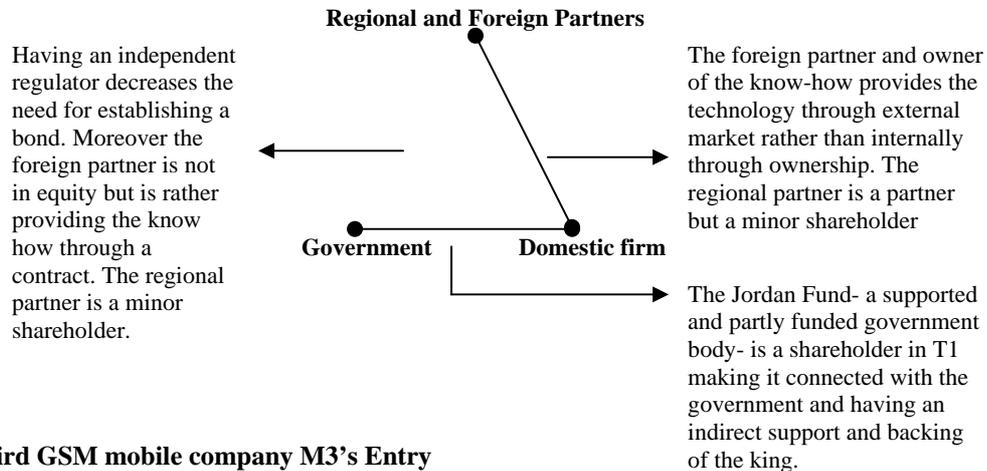
<sup>10</sup> In October of 1994, the first mobile license was given in Jordan. The license was granted to the Jordanian Mobile Telecom (M1) for a 7million JD licensing fee and a 20 % to the government as part of an annual revenue sharing agreement for 4 years- with the first year being exempted. M1 was established by a group of Jordanian private investors including pioneers for investment led by Abu Jaber Group, MID investment for trade, union bank, Arab Banking Corporation, and housing bank (Jordan times, 1995). Motorola was the technical partner and operator and went in equity for about 26% (Jordan times, 1995). IFC also provided loans of \$38 million as part of the need to help Jordan liberalize. Due to restrictions on foreign investment (political complexities), foreign investors had to enter in partnerships with local ones. Moreover, local players could not enter the sector without a strategic partner that could provide the 'know-how'.

**M1 change of ownership**

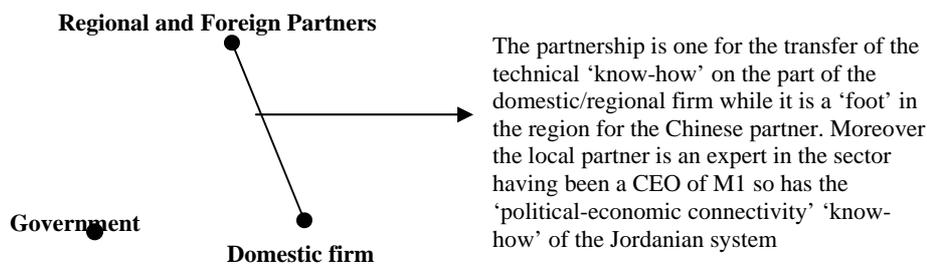


Finally, phase three from 2003-present marks the entry of two more mobile operators, one with a GSM license (licensed but still not operating- referred to as M3 from now on) and one with an iDEN supported technology truncating license (referred to as T1 from now on).

**The iDEN mobile operator T1's trinity-Mode of entry**



**The third GSM mobile company M3's Entry**



Given all that, we find that in Jordan the sector is basically private and characterized by a domination of regional operators confirming to a developing country trend where in the latter group of countries most mobile operators are companies- often themselves partly owned by foreign telecom companies from developed countries- that are willing to take the risk of investing in smaller markets since they are familiar with the environment through their own experience as well as regional and personal contacts. Regional firms' entry modes in Jordan are characterized by their wholly owned subsidiaries entry mode (MTC in the case of first mobile operator (M1), Al Ghanem group in the case of third mobile operator (M3)) rather than just as a provider of a technology as in foreign firms (Motorola in the case of fourth

mobile operator (T1), Huawei (minor equity holder) in the case of M3). The reason is, first, regional firms don't perceive the political risk of Middle East stability as a hampering factor since such risks are ones that exist in its own home country as well (the risks being common to all countries of the region). They have established their businesses strategies and behaviour in similar environments. As for international firms, such risks are better minimized. We find global players entering the market with majority equity only when backed by home country through politically motivated privatization schemes. Second, ownership of the intangible asset could be separated from that of the physical allowing foreign firms to enter as strategic partners without holding equity.

We also find that alliances in the 'trinity' have been private-private reflecting the establishment of an independent regulatory agency which reduced policy uncertainty and political capture and thus the need for extra costly bonding with the government. Moreover, the choice of local partner has been strategic. Local partners have been often and 'almost' always linked to political elites. Furthermore, private-private alliances have made it easier to extend to other regional alliances within one domestic market and across markets. This reflects the nature of the telecom sector where firms don't perceive markets as being the 'local' but rather 'regional' if not global. Finally, the establishment of an independent regulatory agency led to increased competition by licensing more firms and different standards. We showed that such a move entailed a change in both economic and political power. As the market structure moved from monopoly to a duopoly and lately to more competition, firms had to use more political capital and more resources to lobby for changes to happen.

Shifting to the case of Lebanon we present a timeline of the sector's development.

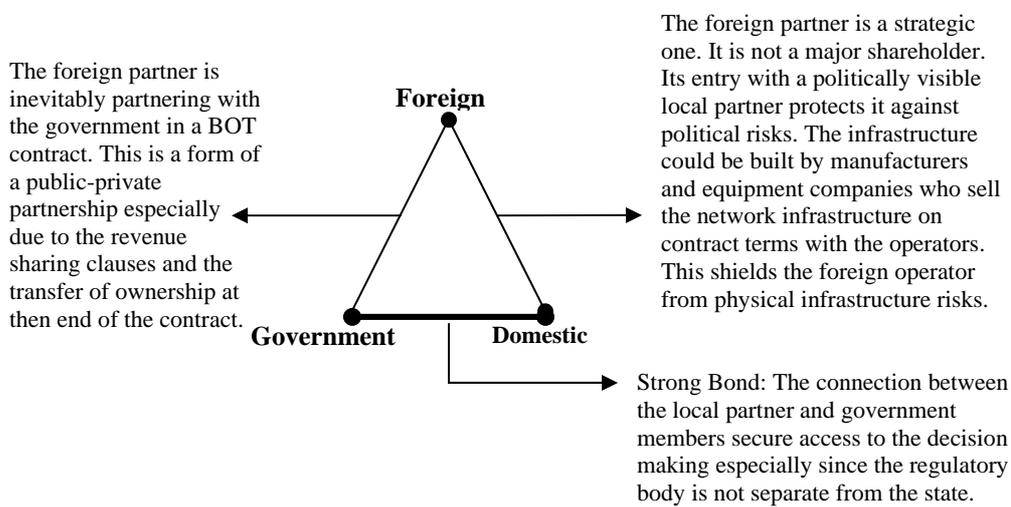
#### **Timeline of the Mobile Telecom Sector in Lebanon**

<b>YEAR</b>	<b>TELECOM SECTOR Developments</b>
1994	BOT(Build operate and transfer) contracts signed with Cell-1 and Cell-2
1999	Dispute between Cell-1 and Cell-2 on the one hand and government on the other over limits on subscribers and state revenues
2000	The 2 companies offer \$2.7 billion to convert BOT to 20-year licences.
2001	Government terminates contracts with two companies before expiry date. Lebanese state council rules international arbitration to be unconstitutional in case of Cell-1. Telecommunications Law 431 proposed as a new telecom law to the Council of Ministers to replace the telecommunications law that was in effect since 1957. The law aims at reforming the telecom sector by creating a regulatory authority for the sector separate from MOT, and corporatizing Ogero into Liban Telecom. Most importantly, the new telecom law separates regulation from operation.
2002	Ownership of networks transferred to state and government agrees to submit dispute to international arbitration. Law no. 431 was approved by the parliament in July 2002. The law was never implemented.
2003	The 2 companies are opened for licensing. The bids are too low and the government decides to delay privatization and proceeding in management contract bidding instead.
2004	Two companies (MTC and Detecon) are awarded management contracts with monthly fees for 4 years to manage the companies on behalf of the government
2006	Talks of revoking the four-year contracts with Lebanon's two mobile operators to pave the way for the privatization of the networks

In reference to those developments over time, we highlight the following basic features: First, the sector moved from private ownership to total government ownership. Second, the government not only failed to establish a regulatory agency and to privatize the sector- as stipulated by Law 431<sup>11</sup>- but also breached a contract with the two mobile companies thus creating a risky and uncertain environment for investment. Third, the mobile sector evolved from a private duopoly to a government one with no incentive for competition given that firms are owned by the same entity, the state. Fourth, the ownership pattern in the mobile sector has been a mixture of local, regional and international investors. Fifth, the dominant standard in the mobile sector with three mobile licenses is GSM. The five stated characteristics make the mobile sector in Lebanon particularly interesting since they provide a clear example of how political complexity could generate political risk and policy uncertainty and consequently affect investment behaviour.

We divide our study according to the development of the mobile sector: Phase one from 1994-1999. This phase is the first phase in the development of the mobile sector in Lebanon. It starts with the granting of two companies Cell-1 and Cell-2 two BOT contracts for 10 years after which the companies will be transferred to the government. This phase is marked by a duopoly maintained by the two private firms. However the phase ends with the state-firms debacle about the terms of the contract.

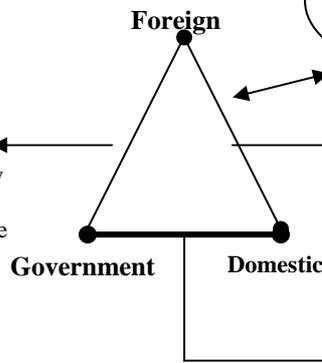
#### **BOT contract Cell-1-‘On-Entry’ Performance (Investment decisions) in the Lebanese Mobile Sector**



<sup>11</sup> Check the appendix V on telecom laws' details.

**BOT contract Cell-2-‘On-Entry’ Performance (Investment decisions) in the Lebanese Mobile Sector**

The foreign partner is inevitably partnering with the government in a BOT contract. This is a form of a public-private partnership especially due to the revenue sharing clauses and the transfer of ownership at then end of the contract. However Cell-2 is owned by the French government which makes it at a better bargaining position than Cell-1 especially since relations between France and Lebanon have been very strong during the Hariri time in office as a PM.



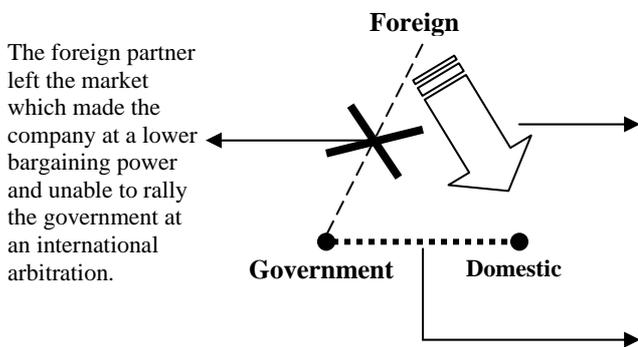
The IFC granted Cell-2 a loan. This acts as a financial support and a cushion against possible risks. The fact that a World Bank entity is backing this investment might attract more investors.

The foreign partner is a major shareholder. Its entry with a politically visible local partner is a strategic move. However the fact that the foreign partner is owned by a foreign government gives it more political visibility than Cell-1.

Strong Bond: The local partner is a politician. This allows for access to the decision making especially since the regulatory body is not separate from the state.

Phase two from 2000-mid 2004: This phase is marked with political bickering within the state and with the state and the two firms. The BOT contracts are unilaterally terminated by the state and the two companies get an extension to manage the sector on the part of the government.

**Breach of BOT contract for Cell-1**

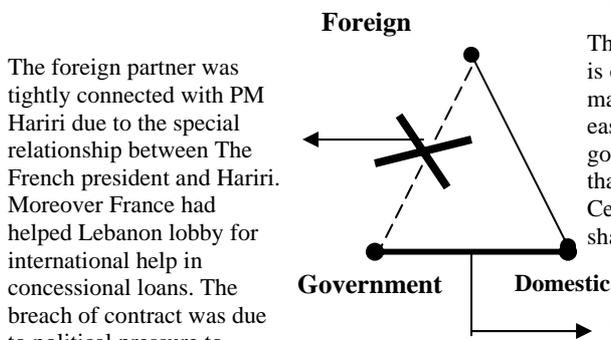


The foreign partner left the market which made the company at a lower bargaining power and unable to rally the government at an international arbitration.

The foreign company preferred to exit the market given the political risk created by the government’s unilateral behaviour. Given the illiquid stock markets the only exit option was through selling shares to the local partner.

With the change in government the Strong Bond between government and private operator weakened. Even when the supporting government came back to power the political pressure was tremendous that the contracts had to be breached.

**Breach of BOT contract for Cell-2**



The foreign partner was tightly connected with PM Hariri due to the special relationship between The French president and Hariri. Moreover France had helped Lebanon lobby for international help in concessional loans. The breach of contract was due to political pressure to embarrass Hariri. The foreign firm decided to take the government to court.

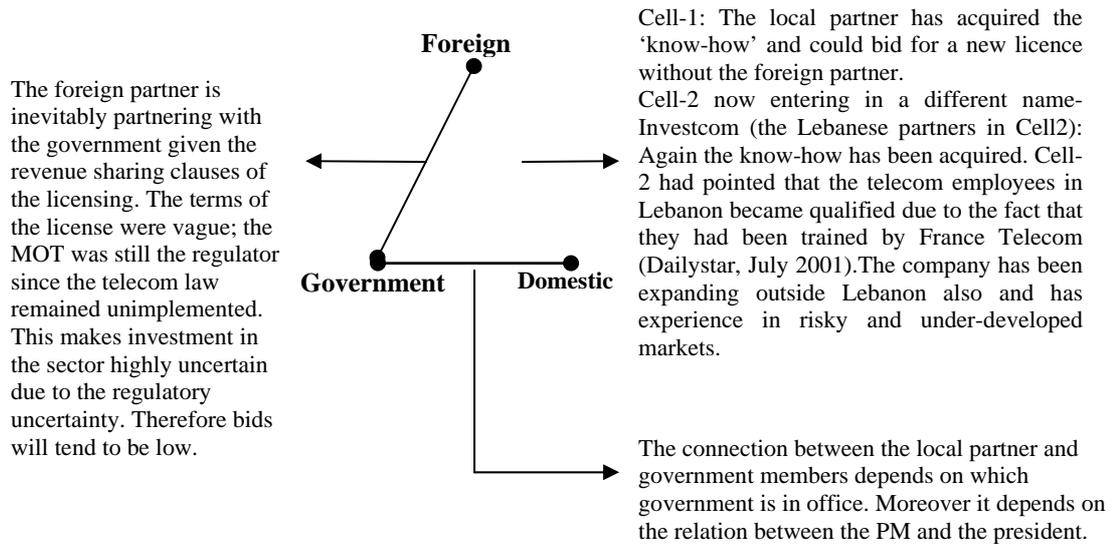
The foreign partner is a major shareholder and is owned by the French government. Being a major shareholder the company couldn’t exit as easily as Sonera did. However it could rally the government on international courts something that the Finnish government couldn’t do since Cell-1 was owned dominantly by Lebanese shareholders.

With the change in government the Strong Bond between government and private operator weakened. To begin with, the local partner was not directly connected to PM Hariri as in Cell-1.

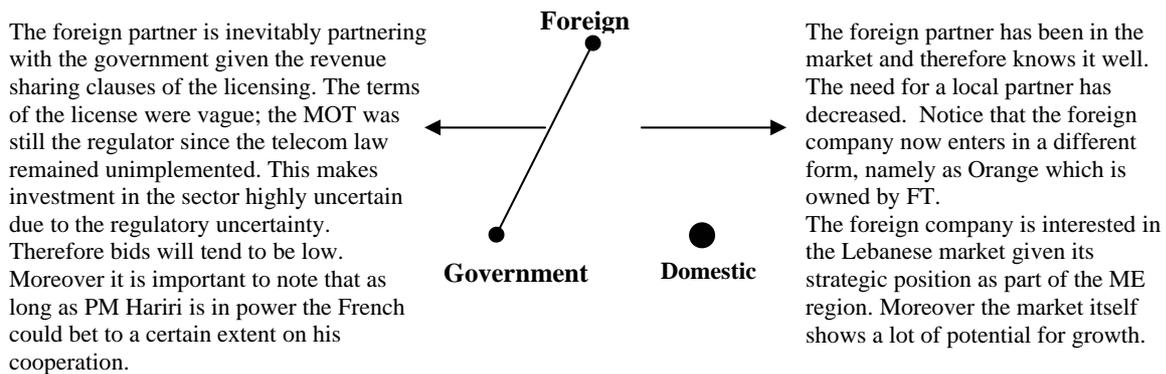
Finally phase three from mid 2004-present. This phase is marked first by a failure to licence the two companies. After this failure, the government decided to issue management contracts. This phase also marks the entry of two new mobile operators as managers of the sector in exchange for a fee from the state. The mobile sector is completely owned by the state and still exhibits a duopoly. In 2006, the sector is undergoing a phase of uncertainty about its future track with revived talks of privatization and thus a possible revoking of the two management contracts.

**Different ‘Licence Bidding’ forms for Cell-1 and Cell-2- UNREALIZED ‘On-Entry’ Performance**

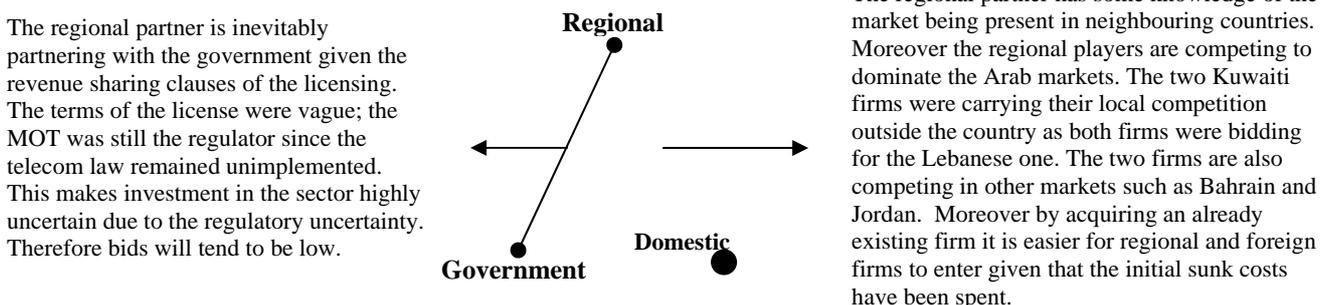
**Form a: Attempt to RE-ENTER the market by the local partners**



**Form b: Attempt to RE-ENTER the market by the previous foreign partner**

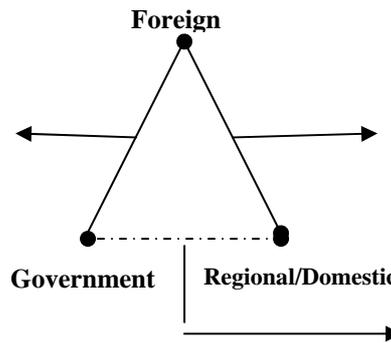


**Form c: Attempt to ENTER the market by regional players**



**Form d: Attempt to ENTER the market by Foreign players**

The foreign partner is inevitably partnering with the government given the revenue sharing clauses of the licensing. The terms of the license were vague; the MOT was still the regulator since the telecom law remained unimplemented. This makes investment in the sector highly uncertain due to the regulatory uncertainty. Therefore bids will tend to be low.



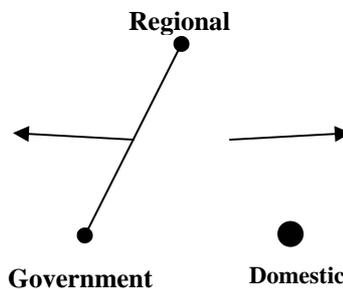
The foreign partner is a strategic one. The firms and their network already exist. This shields the foreign operator from physical infrastructure risks. Bonding with a local or a regional firm for new entrant helps understand the market better especially if the foreign partner has no previous operation in the region.

The regional or local partner is not necessarily connected to the government but could secure an investment with it by using its financial capital. An example of that is the Saudi firm partnering with Detecon which has enough economic capital to transform it to a political one.

**Management Contracts for Cell-1 and Cell-2- ‘On-Entry’ Performance**

**Form a: Regional Player**

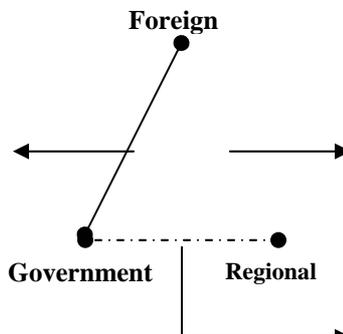
The foreign partner is inevitably partnering with the government given that the owner of the sector is the government. The two companies are not investors anymore they are simply operating the sector in return for a fee.



The regional partner has some knowledge of the market being present in neighbouring countries. Moreover the regional players are competing to dominate the Arab markets. By managing an already existing firm, the regional partner could benefit from the previous experience of Cell-1. Moreover getting aware of the Lebanese market under the protective environment of the government will help the regional player get ready for a future bid whenever the sector is opened again for privatization.

**Form b: Foreign Player**

The foreign partner is inevitably partnering with the government given that the owner of the sector is the government. The two companies are not investors anymore they are simply operating the sector in return for a fee.



Detecon only bid for the management contract and not for the licensing. Bonding with a local or a regional firm for new entrant helps understand the market better especially if the foreign partner has no previous operation in the region. The foreign firm has no interest in owning the company under an uncertain environment and therefore preferred to opt for a secure ‘less-resource’ committed strategy by bidding only for a management contract. This is also a good wait and see strategy. If the political scene changes the company might later on decide to bid for an ownership licence.

The regional or local partner is not necessarily connected to the government but could secure an investment with it by using its financial capital. The Saudi firm partnering with Detecon has enough economic capital to transform it to a political one.

In the case of Lebanon, the early stage was dominated by foreign operator-local partner alliance. This again confirms to the global trend where developing country mobile operators are partnerships between local and developed country operators. Interestingly enough, we find multinationals entering the Lebanese market with majority equity being backed by their foreign governments who are themselves allies with high ranking Lebanese politicians. The entry of the multinationals was strategic given that the political government-to-government connection reduced political uncertainties by establishing a ‘costless’ foreign firm-government bond. This shows (just as in Jordan) the fact that foreign firms, when backed by home countries, will exercise a higher dominating position that grants it both

economic and political power. With the increased uncertainty created by a political risk (breach of contract), we find local and regional firms bidding more aggressively for the sector than foreign ones. This is due to the fact that the former type of firms is more aware of the political scene than foreign ones who in their bidding have factored the lack of government-confidence. This point reinforces our hypotheses that regional and local firms (who have acquired the know-how) are ready to take on board a higher level of political risk given their political capital and awareness of the local political and regional uncertainties. Despite the breach of contracts, we find that investments in the Lebanese mobile sector didn't halt. This is due mainly to the high profit potential in the mobile sector especially in a market like the Lebanese one where there is a great potential for growth. Investors however preferred to bid for the second best option through management contracts where they could separate ownership of tangible and intangible assets and thus reduce some of the risks that come with the higher equity in an environment with low exit options. By entering the market in a management contract they can also explore the market and get to know it thus decreasing the cost of learning incurred by new entrants.

The biggest contrast between the Lebanese and Jordanian cases comes in the degree and type of regulation in the sector. Due to the lack of a legal set-up or an institutionalized system governing the telecom sector, the sector's development has remained tightly connected to the political scene. The ministry of telecom regulated the sector and at a later stage came to own it too. The non-separation of the regulatory power from the government created political risk and policy uncertainty. This meant that most alliances in the 'trinity' required the presence of a strong government bond demonstrating, first, the need to control for the high and direct government interference in the sector; second, the inevitability of government bond due to the form of entry of foreign firms. A BOT contract and later on a management contract required a partnership with the government due to the nature of both contracts (both are forms of public-private partnerships). Third, the choice of local partner has been strategic. Local partners have been 'closely' linked to the political officials. In short, the regulation of the sector depended on the whims of politicians and changed with government change<sup>12</sup>. This created a reputation problem about the integrity of the Lebanese government and created an atmosphere of lack of confidence for investors which lead to the failure of privatization initiatives. Moreover the sector failed to exhibit a competitive set-up and thus shifter from being a private owned duopoly to a government owned one.

Our basic findings show that: first, the fact that the Jordanian system exhibits a high political-private bonding meant that the choice of local partner required bonding with either the public or the private sector whenever political uncertainty or risk arose. The stability of

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<sup>12</sup> Refer to appendix to see the connection between a change in government and change in policy regulation of the mobile telecom sector.

the internal political system however guaranteed a long-term stable alliance. In the case of Lebanon the segregated political system meant a need for bonding with a local partner that is backed up by a powerful entity within the political system. This however creates a new type of political uncertainty since the power of the political entity is not guaranteed to last for long within a politically unstable system. This is exactly what happened when the internal political struggle put pressure on some politicians to let go of their support of investors within the sector. In Jordan, a transparent and independent regulation guaranteed the flow of more investment, new standards and more competition. In Lebanon, the lack of transparency and the non-separation of regulation from the government led to political capturing creating policy uncertainty and a breach of contract. This led to less investment in the sector, less competition, and a stalling in the growth of the sector. Thus in our comparative study we showed how the difference in the political structure of Jordan and Lebanon, given the situational characteristics of the sector, led to contrasting performances and management techniques. The following table presents the basic contrasting 'descriptive' outcomes.

#### Mobile Telecom Comparative Outcomes

OUTCOMES	Jordan		Lebanon	
	1995	2004	1994	2004
<b>Market Structure and Supply Related Outcomes</b>				
Number of Firms	1	4	2	2
Structure	Monopoly	Competitive	Private Duopoly	Public Duopoly
<b>Consumer Demand Related Outcomes</b>				
Tariffs (US \$)				
Cost of 3 minute local call	1.03	0.25		0.39
Connection charge	100	14.08		100 (2002 data)
Monthly subscription	30	7.04		23 (2002 data)
Penetration Rate		30.4		21
<b>Regulatory Outcomes</b>				
Number of Standards	1	2*	1	1
Independent Regulatory Agency	No	Yes	No	No
<b>Investment Flow Outcome</b>				
Volume of Investment (might be approximated with licensing fees or BOT prices when data is not available)	No data on investment by company but Licensing fee was for 10 million	141 million Dollars in investments (TRC data)	Price of BOT contracts (unavailable for the author)	-100 million* management fees. No data on the exact amount of government investment in the sector
Mobile Revenue (million US\$)	---	557.04		
Type	Revenue sharing with 5 year exclusivity: equity participation from foreign investor	Licenses , regional equity and foreign non-equity modes of entry	BOT contracts: Joint venture with foreign firm entering with equity	Management Contracts (Non-equity) of regional and foreign firms

Source: TRC and ITU 2005 CD Rom

\* The Lebanese government has to pay management contracts rather than receive money for its licensing. However it still gains the revenue generated.

Given all that, we will form a matrix where we compare the two counties' 'behavioural' outcome 'Performance' (given the situation and structure) in the mobile telecom sector. This matrix could explain the descriptive outcomes of the previous table.

**Comparative SSP framework for the Mobile Telecom Industry**

<i>Hypotheses: Based on Situation</i>	<i>Structure</i>		<i>Performance: Evidence for Ho</i>	
	<b>Jordan</b>	<b>Lebanon</b>	<b>Jordan</b>	<b>Lebanon</b>
The degree of domination of global/regional firms varies proportionally with their market & political power. (Regional players are increasingly willing to take on risks and use more of their regional experiences and connections.) As their ownership advantages increase, so does their domination leading to less need for extensive bonding.	Local partners coming from prominent families within a tightly knit public-private circle; privatization of the sector politically motivated. Thus Political risk and uncertainty stem from politically complex set-up which features a high degree of public sector presence	BOT contract to avoid political debate over privatization. Foreign partner backed by home country (a political ally of the Lebanese government). Political risk and uncertainty stem from a highly segmented political scene which hampers the consensus on any policy.	Global firms' domination of the technology allowed them to come as partners through contracts but not necessarily through high equity. Regional players internalized the risks through high equity ownership. Equity forms of entry happened only when backed by home country.	Local investors don't have the know-how need regional/global players although they acquire it with time and spread across the region. Global firms' domination of the technology allowed them to come as partners through contracts but not necessarily through high equity. Equity forms of entry happened only when backed by home country. With increased political risk, regional firms entered to play the role of global firms who have been discouraged by the bad reputation of government.
As political risk in the form of a conflict/war increases and due to the possibility of separation of ownership between tangible and intangible assets, mobile operators will increasingly opt for strategic partnerships with no ownership of fixed assets- reducing the risks of physical capital ownership.	Politically unstable region although internally the country is stable.	Politically unstable internally due to political conflicts within the different sectarian groups that had once lead to a civil war. This is compounded by a politically uncertain region	For global players, initial stages going through equity (minimal) with a local partner. For privatization, going with the government (no need for local partner bonding). At later stages, global players enter as providers of know-how (the network is already in place). Regional players enter with local partners or alone (have a global partner in home country).	For global players, initial stages going through equity (minimal) with a local partner. After breach of contract, management contract form of entry with no physical investment. Regional players enter later in stage with a management contract hoping for more spread (have a global partner in home country). A management contract reflects an ability to control intangible assets without acquiring the risk of the physical asset.
In highly regulated 'politically uncertain' environments, mobile operators opt increasingly to enter into strategic alliances with local partners or political elites to cope with such possible vulnerabilities.	Regulation separated from government. Transparency in regulation and different standards in place. This separation decreases the possibility of policy uncertainty	Regulation in hand of government at early stages. A breach of contract followed by regulation and ownership both being held by the government. Political risk and uncertainty stem from this non-separation which subjects the sector to the direct intervention of politicians	Introduction of an independent agency allowed for less capture and less need for bonding with government. Regulation allowed for more competition and thus loss of economic power and need for more lobbying politically (on individual basis cause no role for associations)	The non-independence of regulation from government capture led to a breach of contract. The creation of political risk led to dynamic uncertainty about the future of the sector. This uncertainty meant a failure of privatization and the return of the ownership of the sector to the government with a foreign investor coming in the form of a management contract. Thus forming a government-foreign (regional) bond.
Post entry, an increase in demand vulnerability for certain type of services increases segmentation of customer base and product targeting.	The new independent regulation introduced different standards that increase competition and thus had implications on type of products offered and on prices	The lack of regulatory independence meant a duopoly (private than government owned). This meant no competition neither in type of products nor in prices	With new standards, the new operators introduced new products. This created competition on customers and on prices. This demand vulnerability was created by increased competition. Different operators thus targeted different market segments.	With no separation between regulation and ownership, operators felt no demand vulnerability. Neither segmentation nor price differentiation happened. The market remained uncompetitive, hurting customers the most.

## SCALING UP CONCLUSIONS:

We now move to present some general conclusions. We will start off by extracting the conclusions we derived from our comparative case study analysis. We will then move to scale up our findings and draw some inference on investment in services. Although we don't intend to generalize, some of our findings could be of great relevance to the study of investment behaviour.

### **Micro Conclusions: *Comparative Analysis***

In Jordan, the basic political conditions that affected investor behaviour included tribal nature of the society that tinted all economic and political transactions. This feature coupled with the rentier nature of elites made the political scene complex. It meant a blurred distinction between public and private entities and thus: first, created a strong public-private bond which in some instances made it hard for any third partner to enter, second, in sectors where alliances are required, bonding with either the private or public was a sufficient condition thus reducing the need for a double bonding (with both nodes). This meant that in industries that required a high degree of separation of physical and intangible assets (such as mobile telecom) bonding with only one node was sufficient to manage political uncertainty and capture the benefits of a full trinity without the costs of establishing all the bonds. Another political condition namely, the centrality of decision making, implied stability in policies and political decisions and thus reduced uncertainty. This characteristic implied that in highly regulated industries, policy uncertainty is reduced; and thus investments flow much easily and with less cost. Finally, political risk which is common to the region implied high cost for investments in capital intensive industries forcing them to enter in non-equity forms.

In the case of Lebanon, the sectarian nature of the society dominated all political, economic, and social behaviour. This feature coupled with a laissez faire economic system created a liberal-sectarian elite which created a blurred distinction between public and private sector. However it is important here to note that in the case of Lebanon –in contrast with Jordan- the private sector was not dependent on the public sector but rather developed on its own. Thus in many ways political leaders sought the establishment of this bonding with the private entities rather than the other way round. In any case, this implied a strong bonding which again meant: first, a strong public-private bond which in some instances made it hard for any third partner to enter, second, in sectors where alliances are required, again bonding with either the private or public proved to be a sufficient condition. However, unlike Jordan, the Lebanese public sector is highly segmented within- making the choice of bonding highly dependent on who captures political power at the instance of entry. This meant that the public-private bonds existing at each point in time are more short term and unstable and thus could create uncertainty in a dynamic setting even if viewed to be certain under a static view. Thus in industries that required a high degree of separation of physical and intangible assets,

bonding with only one node was sufficient to manage political uncertainty and capture the benefits of a full trinity without the costs of establishing all the bonds at least in the short term. However, in a more dynamic setting, this bonding created a risk as the effectiveness of the bond was altered causing a transformation in political and bargaining power. In contrast with Jordan, Lebanon's segmented decision making, implied instability in policies and political decisions and thus created uncertainty. This characteristic implied that in highly regulated industries, policy uncertainty dominated the sector and thus investments were reduced as it became more costly. Finally, internally created and externally imposed political risk have long shadowed Lebanon's history thus affecting investments in capital intensive industries which became costly thus forcing them to enter in non-equity forms as strategic partners.

After considering the implications of our case study approach, we shift to extract the basic ideas implied by this empirical work in a more macro setting. We don't hope in anyways to generalize our findings particularly because we argue that the impact of political uncertainty on sectors depends on the structure of each industry. However, we hope to extract some trends based on the characteristics of such industries.

#### **Macro Conclusions: *Implications on Investment in Service Sectors***

Heterogeneity in the fundamental characteristics of either goods or services means that highly stylized models may overlook some important characteristics of some sectors (Copeland, 2003). We chose to consider a specific sector<sup>13</sup> to understand the effect of political uncertainty on investor behaviour. In looking at the bigger picture, we don't aim to generalize any of our findings precisely because as we just mentioned: 'services are heterogeneous'. However, we still reckon that services share- although in different degrees- few characteristics ranging from their intangibility, the importance of physical presence of client and service provider, the significance of public provision of some services, and the complexities raised by regulation of domestic services (Copeland, 2003).

Recall that we divided our analysis of services according to four major criteria<sup>14</sup>: the degree of capital intensity and the ability to separate tangible and intangible assets; the domination of the sector by global players due to the degree ownership advantages uniqueness; the degree of regulation; and finally the degree of tradability and simultaneity of production and consumption. We will start with the degree of uniqueness of ownership advantages and the domination of the sector by global players. Services transfer new technology that is if we define "technology" to broadly include organizational, managerial, information processing and other skills and knowledge (UNCTAD, 2004). In our case, we

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<sup>13</sup> In the larger project we consider three sectors but for illustration we only present one in this paper.

<sup>14</sup> We also had a fifth distinguishing criterion (consumer or producer sector) but decided to use it in connection with our fourth criterion.

have showed in our case study analysis that in the telecom ownership advantages in the form of know-how were unique and in many instances concentrated in the hands of global players. According to their advantages, we noticed that global and foreign investors were able to acquire a higher political bargaining power –at least at early stages of their entry- as they owned indispensable assets for the functioning of the sector. In politically uncertain circumstances, we showed how investors use their advantages to place themselves in a lucrative position within the trinity, engaging in minimum cost- revenue maximizing coalitions. Therefore as the degree of ownership advantages increased so did the ‘ability’<sup>15</sup> of investors to manage their uncertainties by using their political capital and bargaining power to engage in ‘least cost’ and ‘stabilizing’ coalitions. The manifestation of this ‘potential ability’ however depended on the ‘actual’ political circumstances.

In terms of the degree of capital intensity and the ability to separate the tangible and intangible assets, we found that the less capital intensive the industry is the less is its vulnerability to political risk (war, coups, and other forms of physical violence) and political uncertainty (policy uncertainty that might force you to leave the country). This is because the exit option is easier as you don’t have to sell the physical infrastructure. Under politically uncertain conditions and in industries with high capital intensity, investors seek to separate the ownership of tangible and intangible assets whenever possible. Therefore as the degree of capital intensity increases so does the vulnerability of investors to political uncertainty. They therefore immune themselves by sharing the risk with local players yet maintaining control over the industry.

As the degree of regulation increases, we noticed an increased vulnerability to political complexity (level and stability of regulation, non-transparency, tied regulation and government ownership). Therefore an increase in degree of regulation in service sectors makes them more vulnerable to political uncertainty. Investors thus choose forms of entry which require minimal equity commitment in order to secure an exit option. They might also form more alliances that help decrease the source of uncertainty.

The fourth<sup>16</sup> major characteristic we noted was the degree of tradability. The non-storability and non-tradability of some services implies that demand and supply of the service happen concurrently. Therefore as this degree of simultaneity increases, so does the vulnerability of the supply of service to its demand especially since investors are forced to locate in the country where demand is situated. Fluctuations in demand, caused by political

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<sup>15</sup> We emphasize the term ability because even if investors have the ability the actual application depends on the political distribution of power in every instance/circumstance. Ownership advantages increase the scope and power of investors to decrease political uncertainties but doesn’t abolish them completely.

<sup>16</sup> The fifth characteristic of consumer or producer service makes investors less vulnerable to political uncertainty as their options of targeting different market niches increases.

uncertainty, will make investors employ post-entry strategies to manage such risks. Mind you that the four implied conclusions in no way aim to generalize but give a broad idea of how certain characteristics in service sectors increase their vulnerability to political uncertainty and thus require a specific coping mechanism.

### **IMPLICATIONS FOR DETERMINANTS OF INVESTMENT UNDER POLITICAL UNCERTAINTY**

Investment is determined first by the degree of ownership advantage. In the previous section, we argued that ownership advantages under political uncertainty are used to increase the bargaining power of investors not only as economic players but also as political ones. Second, location advantages affect investment decisions. In our case studies, we illustrated that investments are sometimes driven to a certain host country due to politically driven privatization<sup>17</sup> initiatives. This type of liberalization reduces political uncertainties especially if governments of both host and home country are involved in a political alliance.

Third, internalization advantages of reducing transaction costs have been put forth as an influencing factor affecting investment flows. Under uncertainty, FDI is argued to be a best response since firms prefer internal expansion abroad rather than licensing or entering into other arrangements with local firms under uncertain market conditions. This point is valid when, one, the source of risk is a market one that could be internalized within a firm, second, the ownership advantages are easy to duplicate, and third, investment is in tradables (very few services and most goods in general). However, we have showed in our study that in the case of some service sectors –where the degree of separation between tangible and intangible assets is high- non-equity arrangements of licensing and contracting out externally are preferred especially in politically risky situations (if the physical capital is high) and politically uncertain situations (regulation, policy making). Thus the balance between the forces making for internalization and externalization varies among industries and firms (UNCTAD, 2004) depending on the sources of uncertainty and on the structure of the industry and its characteristics.

As for the irreversibility and delayability of investment we have showed that these two conditions depend on the structure of the industry. In our study, we showed that under political uncertainty with high capital costs (high irreversibility due to the non availability of markets to sell the assets), investors will try to separate the ownership of the physical asset and the know-how. As for delayability, with increased uncertainty, investors prefer to delay their entry into markets. This however depends on their ownership advantages. In sectors where competition is high this might not be an option. However under political risk, the risk could be common to all investors and thus delayability an option to all. In such cases, the

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<sup>17</sup> Liberalizations in the form of privatization are very common in infrastructure and service industries.

choice of political alliances will determine who will manage their uncertainties in a timely fashion.

Investment under uncertainty could be determined by the OLI model with some stylized political interpretations. This we argued is possible if one looks at ownership advantages as allowing for the build up of political bargaining power. Locational advantages are not only economic and geographically appealing but also politically feasible. We also argued that internalization is not always a best response to uncertainty especially for services where externalization could offer control but no ownership. In this sense, the pattern of financing (equity or non-equity) reflects the nature of the host economy (in our case the level and variability in political risk and uncertainty) and the nature of the sector as well as its unique advantages.

### **INVESTOR BEHAVIOUR UNDER POLITICAL UNCERTAINTY: *Implications for Development and Policy***

Investments could provide a source of financial capital, physical capital, employment, and transfer of technological know-how among other things. In this section, we will revisit this notion to see if investment decisions (in our service sectors) under political uncertainty actually deliver these intended developmental ends. In our conclusions, we will again seek no generalization but argue that our case studies might imply that under particular ‘uncertain conditions’ the full impact of investment benefits could be undermined.

Investments in our three sectors have development impacts. The efficiency and productivity of those industries are important for the overall competitiveness of their economies since they can raise living standards on a sustained basis especially in countries that depend heavily on them. In particular, the availability, cost, and quality of modern intermediate services such as telecom (infrastructural) and banking (financial) could affect the competitiveness of products in other sectors. However, some sectors (telecom) have a high element of intangible<sup>18</sup> asset to them, one that is usually provided by strategic foreign investors. Thus the availability of foreign investment is at many times crucial for the development of those sectors, and thus to the development of the whole economy. To this effect, we will demonstrate how investment choices under political uncertainty affected both the ability and willingness of investors to deliver the full benefits attached with such flows.

In the case of the mobile telecom sector, involving foreign (international or regional) companies in the provision of the service can bring important benefits, especially in terms of inflows of financial capital, enhanced supply of services, transfer of know-how (in the form

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<sup>18</sup> Since the equipment used by service firms is generally not proprietary, it is also available to local service providers. In this sense, FDI is not essential for countries to access hard technologies. Soft technologies are the main form of knowledge and skills transfer in services FDI (UNCTAD, 2004)

of technical and managerial skills as well as technology), larger employment and increased efficiency. In both cases, we showed that even under politically uncertain conditions (Lebanese case), foreign and regional financial capital still flew into the sector. Moreover, the new established companies allowed for increased employment opportunities in both countries. However, in the case of transfer of technological know-how and of increasing accessibility to communications, we found different outcomes in our comparative cases.

In the case of Jordan, increased transparency and independence in regulation decreased the main source of political uncertainty- regulatory uncertainty. This allowed the development of a competitive market with lower prices, more consumer choice, and transfer of technology with different standards. In the case of Lebanon, however, an increase in political uncertainty led to a collapse of the system and a return of the government to the ownership and regulation of the sector. The weak political commitment to strong rules of the game as well as the lack of clarity in the rules and selection criteria resulted in lower bidding prices. Investors thus chose to enter in non-equity arrangements with no investments in physical infrastructure under a non-competitive system which allowed no updating of standards and offering of services and maintained a high level of prices<sup>19</sup>.

Thus, under political uncertainty- with scarcity of regulatory skills and, in some cases, the absence of an independent regulator- the choice of investment financing and mode of entry is a reflection of the narrowed latitude of mobile operators incentive to enlarge overall accessibility, updating, and technological progression of communications (ITU, 1999) and thus the narrowed willingness of such investors to fully deliver the developmental attributes of their services.

Based on our comparative analysis, we find some key implications to the study of investment under political uncertainty. First, the level of investment as accounted for by financial accounting is not always the best indicator of the effectiveness of such flows in terms of their contribution to development and growth. Thus what is of greater importance is not the level of investment but its quality. This brings us to our second point where we find that under politically uncertain environments, the form of entry of firms secures their revenues and profits by minimizing their economic costs. However, it also restricts their ability and willingness to fully transfer their know-hows. Third and related to the last point, we note that under services, investors might choose to enter in non-equity since they can still control their assets (intangible) without actually owning the enterprise. This means that a large chunk of non-equity forms of foreign entry will not be accounted for in the level of FDI as presented in the balance of payments and thus might give an incomplete picture of foreign involvement in the economy. Fourth, we conclude that in cases where the source of political

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<sup>19</sup> With higher prices for mobile customers are inhibited from further substitution of mobile for fixed.

uncertainty is driven by unstable, complex, or uncertain policies, there is room for some policy intervention to enhance the possibility of developmental benefits delivery.

In the case of telecom, regulatory uncertainty was triggered by the non-independency of regulation from government ownership. Policy uncertainty was also linked to the perception of institutions and regulation. The reputation<sup>20</sup> of a government and its commitment to reform is equally significant in reducing policy uncertainty as is the actual quality of its institutions. Reputation building behaviour is strategically important in incomplete information settings (uncertainty)-where all players are not equally informed about pay-offs, possible strategies, and policy outcomes (Weigelt and Camerer, 1988). One possible way of dealing with this uncertainty in the telecom sector is having a supra-national commitment to credible regulation. This could avoid government non-transparent involvement in regulation setting and decreases the harm generated by negative government reputation. Forms of supra-national commitment devices could be: commitment to WTO regulations or establishing a regional regulatory body. In the Middle East, entry into the WTO forced many countries to reform their systems and establish an independent regulator (Jordan). Other countries who are still observers have thus been lagging behind (Lebanon). Speeding up the entry and thus the reform process might be the best available option to enhance the credibility of regulation in the telecom sector. As for the latter policy recommendation, it is hard to imagine its feasibility especially in a region with politically inhomogeneous regimes.

#### **The World Bank:**

The bank's involvement in political risk issues has been tackled directly by its political risk insurance wing MIGA (Multilateral Insurance Guarantee Agency) and at times through the IFC (by providing loans or investing in projects). MIGA's major activities lie in insuring foreign private investment projects in developing countries against political risk. One of the advantages of MIGA is that it has a lot of flexibility in its coverage. Moreover it undergoes underwriting of project specific risks on a micro level with special attention to investment promotion in developing countries. It was established to fill the gap in the global investment industry where insurance agencies are unable to provide the type of coverage foreign investors needed.

However the WB group's political insurer's major problems lie in: one, its limited resources and inability to implement projects quickly because of the very nature of its role. The agency has to undergo a long process of screening of projects against adverse selection. With limited staff and increased demand for its service this could be problematic. Two, neither MIGA nor any other private insurance company insures investors against unfair

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<sup>20</sup> We define reputation here as being the set of attributes ascribed to an entity and inferred from its past actions. It is an asset that can generate future rents.

regulation which is a major cause of losses in most developing countries. Therefore MIGA's role is limited to 'political risk' and doesn't cover political complexity and political uncertainty according to our definition. Even though political risk insurers have long maintained that commercial risk is commercial and political risk is political and never do the two coincide, the reality is that the difference is being blurred especially since the viability of an investment depends on the implementation of a commercial regulation, which is necessarily a political process (Predieri, 2001). The inability of political insurers such as MIGA to insure against such regulatory risks keeps the investors uncovered against one of the most important sources of risk and uncertainty. Moreover, Multinational conventions and agreements attempt to reduce investment risk but cannot effectively mitigate these risks without adequate support from the legal system. MIGA cannot overcome what domestic law cannot overcome namely, domestic arbitration process, (Zaltman, 2002). Third, MIGA's role in the Middle East is still very minimal.

Still, the presence of IFC and MIGA adds a degree of deterrence against political risk events that could hamper the functioning of a sponsored program (Johnston, 2001). The presence of those insurance agencies could thus be significant to investors not only because of their power to insure and thus compensate against risk but because they deter host governments and allow for extra leverage<sup>21</sup>. Some project sponsors will involve multiple public and multilateral agencies to benefit from the deterrence element even though that reduces efficiency (West and Martin, 2001).

Therefore and given all that, the bank can be more involved in the tackling of political risk and uncertainty. The realization that much of the investment in services goes through contractual non-equity agreements sheds light at the need to study more those forms of entry. More research is needed on understanding the advantages and disadvantages lying behind those different forms of entry. Moreover, expertise in contractual and legal matters is needed in developing countries. The World Bank could help in providing such technical assistance. For instance, in the case of the mobile telecom sector the bank could provide assistance on the choice and form of private participation. Moreover the bank could help in training personnel in regulatory authorities. Another area where the bank could be of assistance is probably having an oversight for instance over the bidding process to insure its transparency.

The importance of the identification of the different sources of political risk and uncertainty may shed a lot of light on the possible remedies. The World Bank has devoted a lot of its research on governance and corruption and the need to combat them. The increased usage of case studies in trying to assess institutional and political risks and uncertainties will

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<sup>21</sup> Extra leverage comes from decreasing country risk and thus provisioning requirement as well as an improvement in the overall risk/return profile of the project.

help the bank tackle the particularities of the different settings as noted by the paper. The variation across industries and countries if ignored could lead to flawed policies. The role of the bank is vital not only in terms of 'policy-making' but in increasing its research on the effect of the different forms of political risk and uncertainty on investor behaviour. By expanding this scope of knowledge the bank could help identify the different sources of risk and uncertainty and thus tailor its policy recommendations in a manner that could reduce the latter.

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## APPENDIX

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### I. RATING AGENCIES:

The literature talks about other institutions and agencies that could help affect the perception of risk and the risk mitigation process. Rating agencies affect multinationals perceptions. However, a major problem with credit rating is their inability to forecast crisis as they tend to be more reactive to crisis rather than predictive of them (Ferri, Liu and Stiglitz, 1999). Most global rating agencies rely on checklists of predetermined indicators which are concerned mostly with the present situation. Those agencies assume correlation between the present current features and possible future problems thus defying the whole purpose of their existence<sup>22</sup>. They have serious problem of the way they set their weights and are usually characterized with a static feature. This is so because the weights seem to be set before hand and are not adjusted as time passes. Some criteria may become more relevant than others over time but this tends to be ignored by those indices. They are ex-ante macro measures of risk, which may be useful in pricing risk insurance but can't be of value in pricing project specific risk (Finnerty, 2001). Scales don't seem to provide an understanding of the underlying political processes other than an impressionistic sense that the chosen variables are important to political risk (Lax, 1988). Political risk indices don't allow for the distinction between political risk at the macro level of a country and at the micro level of particular sectors or projects (West, 2001).

Country credit rating agencies are used for assessing the ability and willingness of a given country's issuer to honour its financial obligations. Their role is to collect data about the creditworthiness of borrowers and issue ratings on the probability of default. The three best known rating agencies in this criterion are Fitch, Moody's and Standard & Poor's. Some credit ratings are also published by Euromoney and Institutional Investor. The major problems with credit rating however lies in their inability to forecast crisis as they tend to be more reactive to crisis rather than predictive of them. Ferri, Liu and Stiglitz (1999) show that credit rating agencies aggravate the impact of a crisis by, one, not predicting it and, two, by becoming extremely conservative after having made blatant errors in predicting crisis and thus making the cost of borrowing for affected countries even harder. They argue that rating agencies have an incentive to become more conservative after crisis so as to recover the damage of their errors and try and restore their reputation.

When it comes to political risk, global rating agencies base their work mostly on static 'macro' political risk definitions. In that sense they have proven to be more reactive

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<sup>22</sup> For instance, the ICRG macro measures of political risk are not adequately fit to deal with political event risk to which projects are exposed namely discriminatory action by government against investors (Finnerty, 2001).

(backward looking) to crisis than active (forward looking) ones. Their ability to predict crisis is so minimal. They focus on establishing a checklist criteria with questionable weights given to each variable. GRAs<sup>23</sup> lack the ability to forecast a certain crisis. They can distinguish between high and low risk countries but are unable to do so in the case of countries in the middle. The basic problem however is the subjectivity of the ratings themselves.

#### Overview of Global Rating Agencies

Global Rating Agencies	Assessed Risks	Methodology
International Country Risk Guide	Political, economic, financial and composite risk rating	Based on qualitative variables and pointed points to each. Calculates a score from 0-100
Business Environment Risk Intelligence	Political Risk Index, Operations Risk Index, Remittance and Repatriation Index, Composite Score	Rating Variables from 0-70 according to experts' views. Provides forecasts up to five years. Uses the Delphi <sup>24</sup> method
Political Risk Service	Political Risk	Based on the prince model which attempts to predict and forecast actions. Divided by type of investment and type of risk
Nord Sud Export	Sovereign financial risk, financial market risk, political risk, business environment risk	using weights from 0-8 according to very narrowly defined individual criteria taken from a series of 60 variables
Economist Intelligence Unit	Political risk, economic policy risk, economic structure risk, liquidity risk	Experts' answers to a series of 77 predetermined qualitative and quantitative questions. Evaluated on a 100 point index
Institutional Investor	Ability of a country to meet its obligations	Reviews 75-100 bankers from over the world asking them to rate countries based on their perception of credit worthiness. Answers are averaged and used in advanced quantitative models. Reflect the banking sector view of creditworthiness
EuroMoney	Ability of a country to meet its obligations	blend of quantitative and qualitative factors coming from surveys with 40 political and economic analysts

*Source: Based on ideas presented in Bouchet, Clark and Gros Lambert. Chapter 5: 'Assessment Methodologies: Rating'*

#### Effectiveness of Political Risk Indices:

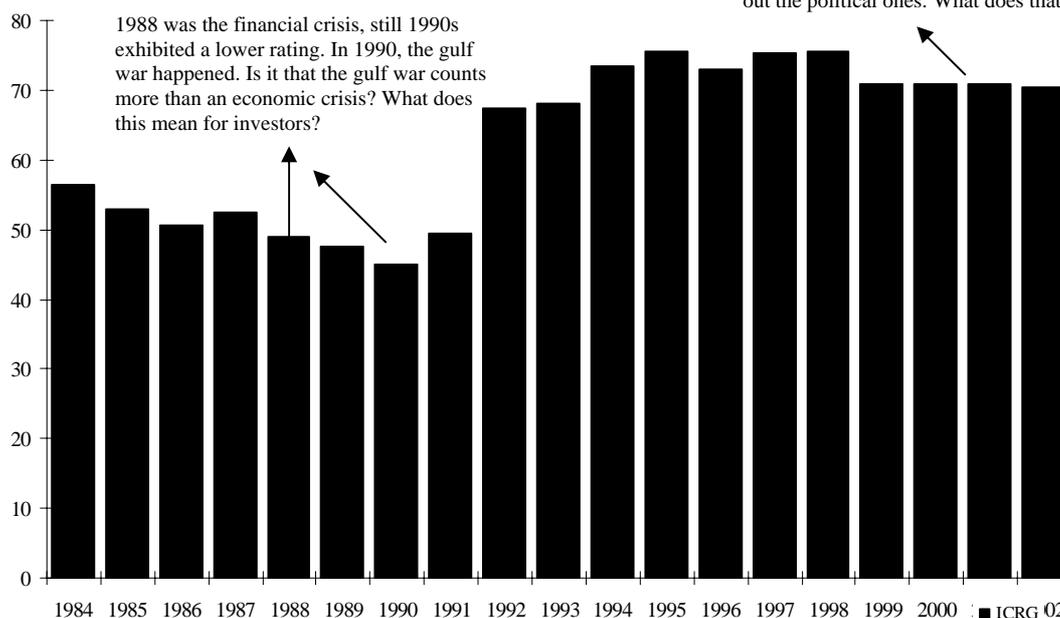
We stressed the need for a multidimensional framework to interpret investors' response to political uncertainty. This allows for sectoral differences and an endogenous response to uncertainty. In this appendix, we present an example of how some political risk indicators could be misleading and uninformative. We use the ICRG index of country risk for both Jordan and Lebanon respectively to show that the index changes over time without actually showing the source of change and its implications. For instance a drop in the composite index from 90 to 70 doesn't signify what has changed and thus makes it hard for

<sup>23</sup> GRAs is an abbreviation of General Rating Agencies as opposed to CRAs which are credit rating agencies. The former aims at achieving a holistic approach to country risk, the latter deals with creditworthiness and debt issues. This is why we don't include S&P and Moody's among these ratings since they are not specialized explicitly in political risk rating as GRAs are.

<sup>24</sup> Delphi method aims at facilitating the formation of group judgement through a well-structured and controlled process. It aims at bypassing the shortcomings of traditional group discussion and other social biases. (Based on Bouchet, Clark, and Gros Lambert's (2003) definition)

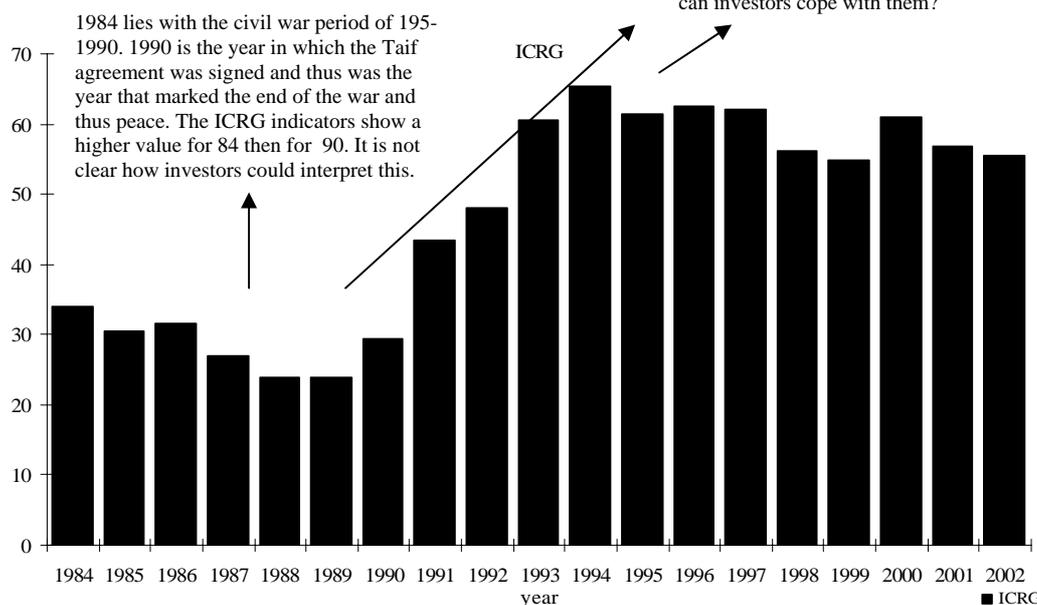
investors to cope with the situation if they are not sure what has cause such a drop. The other shortcoming comes form using the ICRG index to compare across countries. We present a table which shows the index for different countries at a certain year. A higher ICRG index doesn't necessarily indicate what conditions are more favourable at one location versus the other. We are not sure what a 70 at one location means versus a 65 at another. Are both countries similar or is a 5 point difference an indicator of a much more favourable situation?

**ICRG index for Jordan over Time**



Source: ICRG website

**ICRG index for Lebanon over Time:**



Source: ICRG website

**ICRG Indices for Different Countries:**

Selected Countries	2002-ICRG INDEX
Argentina	48
Australia	82.5
Austria	86.8
Cuba	62.5
Denmark	87.8
Egypt, Arab Rep.	67.5
Ethiopia	57
Finland	89
France	81.3
Hong Kong, China	84.3
Iran, Islamic Rep.	63.3
Iraq	44
Ireland	88.8
Israel	65.3
Jordan	70.5
Lebanon	55.5
Liberia	45.3
Libya	70
Nigeria	51
Norway	91.3
Russian Federation	70
Saudi Arabia	72.5
Senegal	65.5
Singapore	90
Somalia	44.5
South Africa	68.8
Sudan	54.3
Turkey	59.8

A composite index of 48 in Argentina in 2002 is most probably a reflection of the economic crisis. However what would that signify? Does a 48 mean that investments in Argentina are as bad as Somalia, Iraq, and Liberia? Are they actually worse than Ethiopia? Is there any reference to which sectors could be riskier in any of those countries?

Is Ethiopia's composite index an indication that it is doing as good as Turkey? By how much less or more? Does that have any meaning?

What does a 70 in both Russia and Libya mean? Are both countries at the same level of risk? Is investing in any country as equally good or equally bad? What does that mean for investors?

Source: ICRG Website

## II. GOVERNMENT CHANGE AND REGULATORY CHANGE IN LEBANON:

We have argued that in Lebanon a change in government led to a change in government policy towards the sector and thus created a regulatory uncertainty. This re-affirms our hypothesis that highly regulated sectors could be more vulnerable to political uncertainty especially if the quality of such regulation is questionable. The behaviour of bidding firms and their entry choices (low bids or no resource commitment) reflects their response to fickle regulation. The following table shows the correlation between government change and policy change.

**Change in Telecom policy as a Result of Change in Government**

<i>YEAR</i>	<i>Government &amp; Political Alliances</i>	<i>Telecom Policy</i>
1994-1998	Hariri as a Prime Minister. The president at the time was Elias Al-Hrawi and had an excellent relationship with the PM. The PM's special relation with president Chirac made the economic and political relations between the two countries quite strong.	BOT contracts were granted to two firms which were connected to MPs and the PM. The BOT contracts came as a quick fix after the war and were a way out given the political opposition to privatization.
1998-2000	Change of Government. The new president was on bad terms with Hariri. A new PM was set in place. The new cabinet was pressuring the two operators.	The government accused the two operators of abusing their contract terms.
2000-2004	Change of Government: Hariri back in power but the new minister for the telecom sector was chosen by the president. The sector thus was controlled in one way or the other by the president.	Breach of contract. Attempt to privatize failed. Telecom law approved but not implemented. Management contracts granted
2004-2005	Change of government: Hariri declines to head new government. A new PM in place	No change in the policy
<b>2005-Present Day</b>	Change in government: After the assassination of late PM Hariri a new government following his foot-steps came to power. The government is pro-privatization.	Hints of revoking the management contracts and privatizing the sector.