Control Risks

RISKMAP

REPORT 2015

Control Risks is an independent, global risk consultancy specialising in political, integrity and security risk. We help some of the most influential organisations in the world to understand and manage the risks and opportunities of operating in complex or hostile environments.

We support clients by providing strategic consultancy, expert analysis and in-depth investigations, handling sensitive political issues and providing practical, on-the-ground protection and support.

Our unique combination of services, geographical reach and the trust our clients place in us ensure we can help them to effectively solve their problems and realise new opportunities across the world. Working across five continents and with 36 offices worldwide, we provide a broad range of services to help our clients to manage risk.

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RISKMAP REPORT

2015

Control Risks is delighted to launch RiskMap 2015, our authoritative guide to business risk in the year ahead. Drawing upon expertise from across our organisation worldwide, we forecast the major challenges and opportunities of doing business in the world's most complex environments next year.

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The coming year will continue to astound us with risk that is new, perplexing and, at times, violent. In the midst of this turmoil, the business world needs to – *has to* – do more than persevere. It must seek new ways to engage, to thrive. RiskMap 2015 aims to point the way around uncertainty, to make sense of what seems chaotic. Join us as we look for clarity in the new world disorder.

– Charles Hecker, Global Research Director, Control Risks


SYRIA
Homs
Damascus
Mosul
Tabriz
Rasht
ELBURZ
EUPHRATES
IRAQ
An Najaf
Baghdad
Hamadan
Arak
ZAGROS MTS
Isfahan
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SEA -1,286
Sakaka
Tabuk
Basra
KUWAIT
Ahvaz
Abadan
Kuwait
NEUTRAL ZONE
PERSIAN GULF
Bushehr
SAUDI ARABIA
Medina
HEJAZ
NEJD
Dhahran
Ash Shagra
Riyadh
Hotuf
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Manama
Lengeh
QATAR
Doha
Sharja
Abu Zabi
TRUCIAL
Al Hadida
Jabal Sham
9,902
RUB AL KHALI
(Desert)
Al Lith
Sabya
BAHR AS SAFI
(Desert)
YEMEN
Sana
Hodeida
Shibam
SOUTHERN YEMEN
Madinat ash Sha'b
Salalah

POLITICS WITHOUT POWER, BUSINESS WITHOUT BORDERS

RICHARD FENNING,
CHIEF EXECUTIVE OFFICER

Welcome to RiskMap 2015. The coming year will see the news dominated by turmoil, from Iraq to Ukraine to the South China Sea and beyond. RiskMap 2015 explores many of these issues, looking past the immediate political theatre to examine the forces that are reshaping international relations and the global economy.

A central theme is how international business has to navigate a narrow and sometimes perilous channel between an increasingly globalised market and a resurgence of national self-interest by individual countries. We highlighted this in RiskMap 2014, and the trend has accelerated rapidly.

Multinational companies design business plans not in terms of nations and countries, but in terms of geo-markets, on the assumption that access to capital, talent, technology and customers is increasingly less constrained by national boundaries. Those that have reinvented themselves as global, not national, companies are now run by senior executive teams (albeit still male dominated) that are often a veritable United Nations of nationalities. This alters not just how they look on the corporate website, but how they think.

By contrast, politicians are responding to an ever narrower set of local and short-term concerns, as well as reconciling themselves to the fact that they lack the power they once had. The business and political worlds are on divergent paths, and the relationship between the two is increasingly fractious.

BAD RELATIONS

Not only is the relationship between business and politics at an all-time low, relations between states are at their worst since the height of the Cold War. Far from the spread of liberal democracy heralding the end of history, the world seems more discordant and on edge than at any time in recent memory. Business thrives on multilateralism and can cope with moments of unilateralism, but it really struggles with the *anti-lateralism* that now defines international relations. Old enemies have become new enemies, and old friends we now spy on.

Nowhere is this more apparent than in the cyber world. There is little immediate prospect that the threat of cyber crime will diminish. For that to happen there would need to be a degree of international agreement, co-operation and policing that is years away. So long as nation states of all shapes and sizes battle each other online (it is the cheapest form of warfare since the bow and arrow), there will be the space and technological spin-off for criminals and others to target companies, with only the lightest of curbs on their malevolent ingenuity.

TOP: New York financial district.
BOTTOM: Ebola virus.

The debacle in relations between Russia on one side and the EU and US on the other over Ukraine is probably the most graphic example of how investors have been caught short by international relations being thrown into reverse gear. What is notable is how unsympathetic Western corporate leaders are to their own governments – at least in private, but increasingly in public – over how events have unfolded. And even among the Russian oligarchy, now more at home in the ski resorts of France than the industrial cities of the Urals, there are muted whispers of discontent.

In China and Japan, senior corporate executives act much more in lock-step with their governments and are reluctant to criticise their political counterparts. Yet there is a sense of near despair that the governments of two countries whose inter-woven economic fortunes could be so highly complementary are engaged in such a bitterly destructive war of words and alarming military brinkmanship.

THE LIMITS OF POWER

The Middle East illustrates just how difficult the exercise of political power has become. The dramatic spillover of the Syrian conflict into Iraq is a brutal illustration of the limits of both global and regional powers to impose their will. The extraordinary realignment of sworn enemies making common cause against Sunni extremist group Islamic State (IS) – US special forces and Iranian-backed Shia militias, for example – demonstrates just how fractured the Western political consensus has become. The result is a more sober realisation of the limits of power, and far less expectation that conflict or Ebola-style epidemics or another locked round of trade liberalisation talks will be resolved by the great powers acting together.

It is hard to imagine that the mostly peaceful transition in Eastern Europe in 1989 could happen today. In the intervening 25 years we seem to have lost the ability to act with that degree of farsightedness, not because of a diminution in the ability of politicians, but because power has leached away from politics. That is readily apparent in Europe and North America. But it is also true for the new Chinese administration embarking on corruption campaigns in part to wrestle power back to Beijing; it is true in Turkey and South Africa, as Presidents Recep Tayyip Erdogan and Jacob Zuma realise (or don’t) that longevity in office brings its own risks; it will become apparent to Prime Minister Narendra Modi in India; and it is true in Russia – despite appearances to the contrary – as money and talent leave the country.

CONFLICTING INTERESTS

This disjuncture between the political and business worlds spreads beyond geopolitics. As political power recedes and companies realise that politicians either will not or cannot solve many of the main problems they face, moments of conflict between global companies and national governments will increase. There should always be a distinct tension between the regulated and the regulator. That is entirely proper. But governments looking to exercise their diminishing power are likely to come into conflict with companies that operate within their jurisdiction.

During the year from September 2013 to August 2014, US regulators levied $80bn of fines against global financial institutions. If these fines were a country, their GDP would make them the world's 63rd largest economy. This is not to argue that banks are unfairly regulated or that post-2008 we should all feel sorry for them, but rather that this cannot be a sensible way to supervise a vital part of the global economic ecosystem. We should expect that in future banks and multinational companies will be more vociferous in their demands for a different form of regulation. In the meantime, the scale and complexity of international compliance, and the jolts to corporate life when it goes wrong, will intensify.

2015 will be a difficult year for business. Not due to a lack of opportunity – there will be an abundance of that despite the continued slowdown in some emerging markets – but because the nature of modern political power makes fixing international problems so difficult. As a result, nationally focused governments and globally minded companies will operate increasingly out of kilter. I hope RiskMap 2015 helps to shine a light on the key geopolitical issues and acts as a useful guide in an unpredictable world at a difficult time.

"As political power recedes...moments of conflict between global companies and national governments will increase."

THE CHALLENGE OF NATIONALISM

JONATHAN WOOD,
ASSOCIATE DIRECTOR,
GLOBAL RISK ANALYSIS

- **Nationalism is becoming more influential in shaping the environment for international business.**
- **Multinationals are a prime target for nationalist pressure, and attendant security threats and operational disruption.**
- **In 2015, Russia's periphery, the India-Pakistan border, the East and South China Seas, and the Middle East will be key hotspots.**

As Richard Fenning notes in the previous article, power has leached away from politics, driving a wedge between the business and political worlds. This has not been a deliberate process, but an unwitting outcome of the impersonal forces of economic globalisation unleashed by the end of the Cold War. These days, a country's key players are just as likely to meet in an airport's business-class lounge as in a presidential palace. Foreign policy success is measured by investment deals closed more than treaties signed. In today's world order, the people with power increasingly earned it by leveraging global integration.

It's no surprise, then, that nationalism is rediscovering its voice. Russia's policy of extraterritorial defence of Russian-language speakers, China's maritime sovereignty disputes, right- and left-wing populism in Europe and the US, and the deconstruction of post-colonial states in the Middle East indicate that nationalism is an increasingly influential force in the global political and security risk landscapes.

Proponents of nationalism believe that it can inoculate them against and reverse the perceived ills of globalisation, from financial 'contagion' to rising inequality to obtrusive Western culture. Liberals want to tame multinational business, conservatives to restore national greatness, revolutionaries to carve out new homelands. Nationalism justifies a strong central government and is the base from which major emerging markets – such as China, India and Turkey – are beginning to exercise global power. It is also the rearguard of major European powers concerned about their relative decline. The consequence of all these drivers is the same: contrary to the promises of globalisation, borders are re-emerging as key contours of the risk landscape for international business.

POLITICAL PRESSURES

International business is a ready target for nationalist pressure. First and foremost, companies are within reach – literally, when speaking of the fire and health inspectors – when more desirable or strategic targets are not. Second, action can be asymmetric, particularly when factoring in the symbolic value of high-profile brands. Third, disrupting business carries low political and geopolitical costs: few will take to the streets to uphold the right of a faceless multinational to trade or win contracts – and the days of sending the navy to protect private investment are long gone.

Toying with business rarely provokes an existential crisis. At the official level, the worst governments can expect is retaliation in kind and perhaps stern words at the next global summit – both small prices to pay for asserting national prerogatives and reinforcing pillars of national identity. It falls to markets and international arbiters to mete out true punishment, but even that fails at the nationalist extreme, where oil and mineral wealth tends to provide ample insulation. And markets tend to have amnesia where yield is concerned, though memories last longer when a sector is nationalised outright and turned over to regime supporters. All told, business is much more resilient: companies will get back to work as long as the commercials make sense, but governments have generational memories.

In broad terms, nationalists view international business as instrumental to national strategy. They want to extract benefits – processes, technology and expertise – that support national development without sacrificing control of the economy. Concessions become service contracts, direct investment requires joint ventures. Naturally, this agenda tends to go hand-in-hand with indigenisation and local content policies that promote domestic industry and reward political supporters. Multinationals have generally embraced this bargain for the chance to tap new resources and markets, seeking to manage the political and operational risks. But many are re-evaluating its terms as shifts in underlying fundamentals, such as higher wages in emerging markets and shale fracking in stable democracies, make submitting to national agendas less profitable and palatable.

PROXY BATTLES

The centenary of the First World War is a good time to consider how non-state actors motivated, directed and resourced by nationalism can tip order into conflagration. Thankfully, World War Three is not on the cards for 2015, but there are plenty of worrying situations, from Ukraine's separatists and Pakistan-based militant groups to fishermen in the South China Sea. With each attack or clash, these nationalist proxies threaten to escalate latent tensions into full-blown conflicts that would have debilitating consequences for global business.

More prosaically, business is a juicy front in national competition. The private sector runs critical infrastructure, generates vital innovations and is often closely associated with government. Its informational safeguards are demonstrably lax and susceptible to

TOP: National competition can lead to cyber threats to business.
BOTTOM: A Taiwanese factory burnt by protesters, Binh Duong province, Vietnam, May 2014.

human and cyber intrusion. Any national security apparatus worth its salt targets business, with industrial espionage as either an objective or side effect, and many rely on a range of 'patriotic' non-state proxies to do so.

When not actively motivating attacks, nationalism may inspire governments to tolerate or turn a blind eye, at least temporarily, to security threats targeting select foreign businesses. Consider anti-business unrest in China and Vietnam in recent years: in the context of bilateral disputes, 'spontaneous' protests outside foreign factories – sometimes violent and destructive – are portrayed as national catharsis. The trick, of course, is maximising political bark while minimising economic bite. But in the end, nationalism demands that domestic political legitimacy always takes priority over the investment climate. As nationalism becomes more pervasive in geopolitics, so too will security threats to international business.

Finally, it's not just inter-state tension or conflict that companies need to worry about. Nationalism can be a purely political concept, but often prioritises particular ethnic or sectarian notions of citizenship, political participation and economic power. Nationalist leaders – from India to France – risk aggravating existing social and communal tensions through exclusionary politics, thereby contributing to civil unrest and political violence.

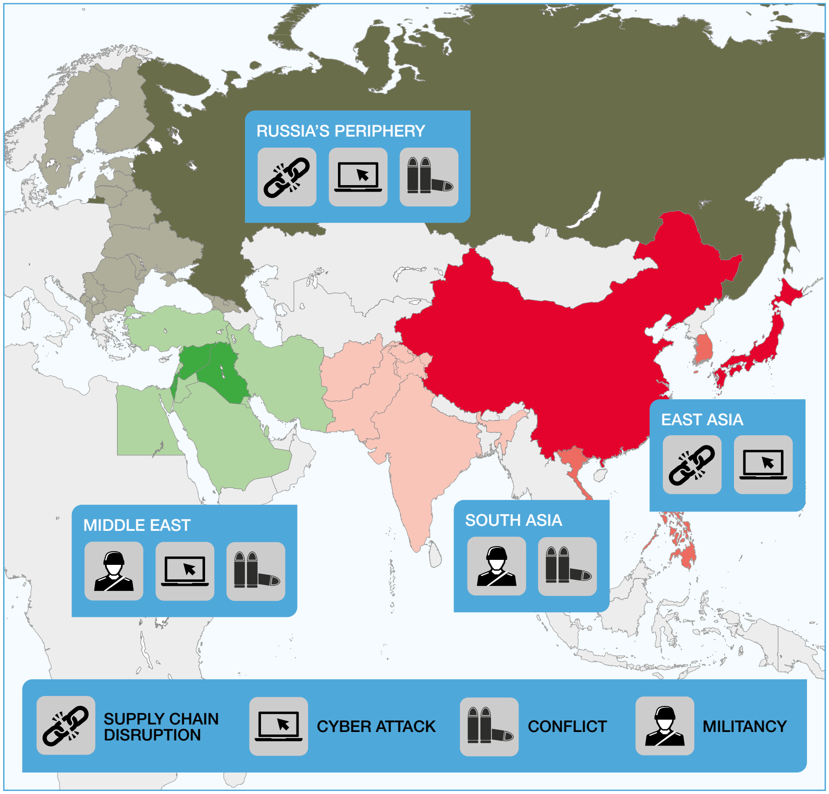
OPERATIONAL CHALLENGES

Nationalism provokes operational challenges for three key reasons. First, international business is often snared in regulatory campaigns geared to shore up national identity and political legitimacy. Foreign companies have a history of being officially or popularly scapegoated for economic dysfunction and subjected to increased scrutiny, regulation or harassment. Nationalism is likely to compel further such episodes, from anti-corruption crackdowns to price controls.

Second, international supply chains are vulnerable to national disputes. In the same vein as business being a 'soft' target of national competition, customs and border controls are indirect, deniable and low-risk methods of articulating and enforcing national policy, with well-known cases involving both China and Russia in the last few years. As borders get more problematic for business, the significance of global and regional negotiations on trade harmonisation and facilitation will increase.

Finally, economic nationalism tilts the competitive landscape in favour of domestic players, particularly when it comes to government tenders and licensing. When it doesn't simply restrict or deny foreign investment, it goes hand-in-hand with onerous red tape, from difficulties obtaining visas for foreign workers to delays in permitting, to adversarial and politicised judicial processes. Western

Global flashpoints and their wider impacts



countries are among the most enthusiastic adopters of policies that preserve national control over the 'crown jewels' of domestic industry. Emerging markets, meanwhile, are reconsidering constrictive international investment agreements to regain national control over their economies.

PROBLEM AREAS IN 2015

Several regions stand out as areas to watch in the year ahead: Russia's periphery, the India-Pakistan border, the East and South China Seas, and the Middle East.

Recalling 19th-century tsarist pledges to protect Orthodox Christians inside the Ottoman Empire, Russian President Vladimir Putin's policy of defending Russian-language speakers applies an extraterritorial logic to his project of revitalising Russian nationalism. After the onset of the Ukrainian conflict, it justifiably set

TOP: Indian army patrol near the Line of Control.
BOTTOM: Unmarked military vehicles, Donetsk region, Ukraine, November 2014.

alarm bells ringing throughout Eastern Europe and at NATO headquarters – even more so because Russia's 'hybrid war' (read: non-state) tactics stymied a definitive Western response. That said, territorial aggrandisement is not Russia's aim in the year ahead. Rather, it will look to deter erosion of its sphere of influence while avoiding a major confrontation. Deniable non-state tactics will remain central to its playbook in 2015.

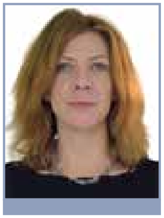
Meanwhile, the inauguration in 2014 of a nationalist government in India has not overly upset relations with Pakistan; both countries have plenty of domestic challenges to deal with. The real risk lies in how nationalist sentiment on both sides of the border could bind political leaders in a crisis. Conspicuous paths to a provocation include continued friction along the militarised Line of Control in Kashmir, renewed in late 2014 and at risk of aggravation after NATO withdraws from Afghanistan, or a terrorist atrocity conducted by a Pakistan-based extremist group. Al-Qaida's Indian affiliate, announced in September 2014, looms large in this respect.

Sabre-rattling in the East and South China Seas is likely to remain just that in 2015, but it could, as in the past, unsettle markets and have unintended disruptive consequences for business in the region. Disputed borders, particularly those intertwined with historic grievances and possible resource bonanzas, are ripe for nationalist posturing. But the steady accretion of facts on the ground is a drama in which non-state actors – private oil companies and patriotic fishermen – are the key players. Mind the threat of escalation from seemingly minor confrontations and the scope for accident and miscalculation in 'routine' engagements.

The global power vacuum we identified in last year's RiskMap continues to impinge most powerfully on the Middle East. With the US trying to keep the region at arms' length, national competition to shape the region's future will continue to heat up. Some of this will fall within the rubric of strategic competition between Saudi Arabia and Iran for regional primacy: literal proxy warfare in Syria and Yemen is a worrying harbinger for other countries on the frontline of the Sunni/Shia divide. Some, however, will simply reflect newfound freedom of action in pursuit of individual national interests. In a region where politics traditionally prizes subtlety and discretion, expect to see more naked and diverse efforts to build foreign ties, develop local proxies and demonstrate military capability.

THE CASE FOR RISK CULTURE

- A company's culture plays a vital role in its approach to risk management.
- Deeper, underlying assumptions – a company's unspoken rules – often conflict with its stated values, but are critical to understanding organisational culture.
- A full understanding of corporate culture can make the difference between the success and failure of risk management change.



ALISON TAYLOR,
SENIOR MANAGING DIRECTOR,
AMERICAS

Modern organisations – particularly those with global operations – face a staggering variety of risks. Geopolitical tensions can spark armed conflicts or trade sanctions that swiftly upend the best-laid business plans. An increasingly complex web of anti-corruption regulations and data privacy laws, combined with new levels of scrutiny from the Twittersphere, makes regulatory investigations likelier than ever. And cyber attacks are growing in both number and sophistication, raising the odds that organisations will have to confront a substantial data breach.

These risks have such fundamentally different characteristics, it is no wonder that companies struggle to respond across the full spectrum. Unable to address everything, most businesses prioritise specific types of risks – and favour certain responses. These preferences are a reflection of an organisation's risk culture. Of course, the best risk management approaches develop organisational muscles that can be flexed in different ways, not a one-size-fits-all approach. Still, ingrained cultural assumptions about risk drive most company responses.

Companies that have strong internal control systems and a cautious, compliance-based approach to risk often struggle to react quickly to market developments and to be competitive and nimble; their response to the external environment is slow and highly controlled. Meanwhile, companies that focus on strategic and commercial responsiveness often harbour cultures that resist rigid compliance processes; the ability to be fluid in responding to changes in the external environment does not easily flourish in a strong compliance framework.

Companies that deal with a complex web of regulations and government interactions are often inclined to leave risk management to the legal department. Companies that face particularly challenging external risk environments may assign risk to the security team. Companies with aggressive investment plans highlight the opportunity dimension of risk. Companies that focus on reputation and customer perception are more inclined to incorporate ethics and governance terminology in their risk management approach.

RISK MANAGEMENT

Numerous studies have determined that rules and processes do not exist in a vacuum, and that organisational culture is critical to explaining employee behaviour. This has led to fashionable talk of 'a culture of compliance'. The norms and assumptions that determine responses to ethical guidelines are more important than procedures that cover every eventuality. If employees do not believe that risk management is an essential component of organisational success, processes will not solve the problem.

Indeed, processes that exist but are widely ignored cause more damage than having no processes at all because they can generate a false sense of security among senior leaders. The danger is that risk assessments focus too exclusively on process and structure, ignoring more subtle drivers of employee behaviour.

Comprehending a company's risk management strengths and weaknesses is greatly enhanced by gaining an understanding of its risk culture. This can be viewed as a subset of wider organisational culture – commonly summarised as 'the way we do things around here'. The importance of culture is often underplayed, as it appears to be a function of human irrationality, and is difficult to measure and describe.

But ignoring culture is a mistake. When mergers and acquisitions run into trouble, this is often the product of nebulous 'cultural factors' – the difficulties that members of different organisations encounter working together – rather than poor planning, pricing or market strategy. Cultural factors also explain why 70% of organisational change efforts fail.

CULTURE CHANGE

According to Edgar Schein, a pioneer in the organisational culture field, culture is the most difficult aspect of organisational life to alter. It can outlast leadership transitions, and changes in products, services, geographic footprint and other physical, measurable attributes of a company. Schein describes three levels of culture. The first, an organisation's artefacts and rituals, are easily observable. They include facilities, offices, furnishings, the way employees dress and behave, and the myths and stories the organisation tells about itself and its history. A company that names conference rooms after major global cities is saying something about its culture and aspirations, as is a company whose line managers sit in cubicles, along with their teams.

The second level, espoused beliefs and values, reflects an organisation's statements about what it stands for: its primary goals and modus operandi. This includes statements such as 'we put our customers first' and 'we value diversity in our employees'. The values of a company will include perceptions an employee has about its reliability

and trustworthiness, and will also determine its approach to risk. An organisation focused on aggressive expansion into new markets will have a different risk culture to a domestic operation in a highly regulated industry.

The second level of culture can conflict with the third level – an organisation's underlying assumptions. This level describes traits that are rarely, if ever, discussed; they are taken for granted. Employees become acclimatised to these 'unspoken rules' over time and may not even be conscious that they exist. Yet they are critical to understanding organisational culture. For example, employees may avow belief in open communication around risk and integrity issues, while communicating a strong, unstated belief that concerns should not be shared with the boss. A heavy focus on internal processes, and checks and balances can be undermined by implicit signals that it's OK to game the system. A CEO may speak regularly about transparency and inclusiveness, but make opaque, highly political promotion decisions. The existence of this third layer explains why so many organisations engage in apparently contradictory behaviour.

CULTURAL LEARNINGS

By gaining a deeper understanding of organisational culture, it is possible to enhance risk management efforts. As a consultant, I have used employee surveys, confidential interviews and focus groups to understand a company's risk culture. It is particularly useful to highlight gaps between employees' experience of risk and an organisation's standard responses. Any attempt at risk management change that does not take into account organisational culture across divisions, locations and levels of seniority will never be 'owned' by the organisation. It cannot take root or succeed.

The business world is awash with different tools and techniques for risk management, many of which are quite sophisticated. Yet any risk framework that fails to account for the importance of organisational culture will be of limited use. It is no accident that state-of-the-art enterprise risk assessments so often end up on a shelf, ignored.

This is an extract from our white paper 'Risk: an Organizational Perspective', written in consultation with Columbia University in New York.

Control Risks is pleased to announce a new joint venture with Oxford Economics, the world's leading macroeconomic forecasting and research firm. We jointly believe that the pace and scope of risk in the 21st century have manifested in ways that make it more important than ever to seamlessly marry politics and economics. Please talk to us about how this new offering can help your business.

THE 21ST CENTURY RISK VORTEX

MICHAEL MORAN,
MANAGING DIRECTOR,
GLOBAL RISK ANALYSIS,
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SCOTT LIVERMORE,
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- **The impact of Russia's adventures in its near-abroad and resulting sanctions will leave it facing recession and stagnation.**
- **Falling commodity prices will benefit importers, but will expose exporters that have not addressed structural problems.**
- **Rising risks in emerging markets are countered by improving prospects in the developed world – though risks persist there too.**

In the 41st-floor conference room of a major US multinational, the normally sedate décor has given way to a quiet urgency. Just beside an august portrait of the company founder, we stood around a laminated map of the Middle East. Green markers denote company facilities, red lines chart the latest risk to those investments: the Islamic State (IS) in Iraq and Syria.

This is not the only addition to the conference room's wood-panelled walls. Since the start of 2014, executives have sketched three other makeshift maps, each charting a different fault line where acute geopolitical and macroeconomic crises collided, roiled global markets, scuppered talk of further trade liberalisation and turned quarterly revenue projections to confetti.

Just when exposure to emerging market economies is at an unprecedented high, a constellation of conflicts, disputes and macroeconomic policy issues have made mincemeat of corporate strategy exercises. To focus separately on the political or economic risks inherent in modern business invites a kind of myopia. This is not how modern corporate strategy should work.

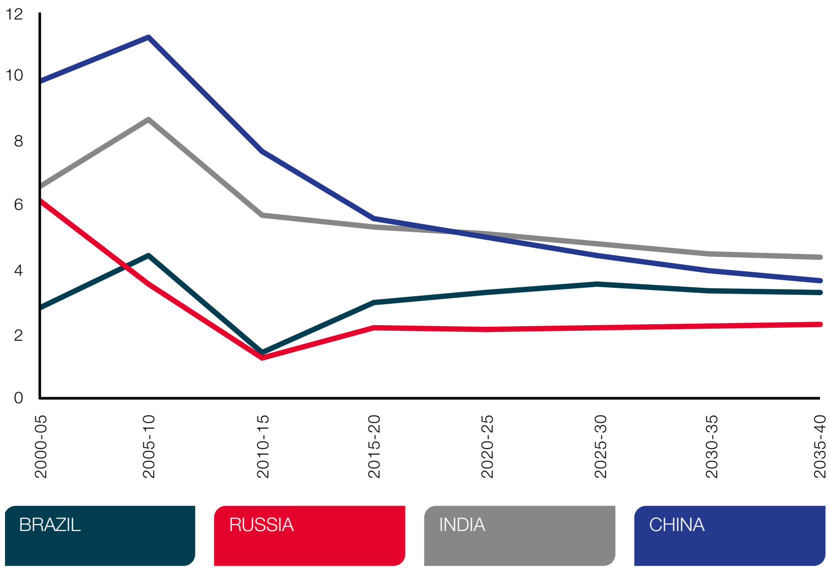
Take 2014. Few of the issues above loomed large on firms' radars as the year began. In some cases, they weren't there at all.

The outbreak of serious conflict between Russia and Ukraine, and the Western sanctions that followed, made no one's 'top ten' list of global risks to growth in 2013. Yet the conflict engulfed Crimea, revived Cold War rhetoric, and caused losses across sectors including finance, agriculture, automotives and energy. The Russian economy itself – previously hoping to use strong hydrocarbon revenues to bolster strategic sectors – has been degraded by uncertainty, trade restrictions, capital outflows and a weaker currency. The swooning price of a barrel of oil administered the final blow: Russia will enter a recession next year with a period of stagnation, and perhaps pariah status, extending for years ahead.

CHINA'S GROWTH

Similarly, the nerve-wracking game of naval brinkmanship in the East and South China Seas between China

BRIC growth forecasts (% per year, period average), 2000-40



Source: Oxford Economics

and its smaller neighbours Vietnam, the Philippines and Japan is pregnant with macroeconomic and geopolitical risk, and poorly priced into corporate risk equations. In 2010, a fall in Chinese rare earths exports to Japan was widely suspected to have been linked to a diplomatic dispute between the two countries (the article on page 69 examines the economic fallout of more recent spats). What might a larger confrontation between the world's second and third largest economies bring?

Together, China and Japan account for around 16% of global trade; a serious slowdown in their economies would have major implications for both the Asia-Pacific region and the world. The relationship between Japan and China is unbalanced: Japan relies more on exports to China than the other way around, so Japan would seem to be more at risk in this straightforward sense. But other factors are at play. China could suffer more depending on the international reaction to any dispute – especially if it were perceived to be the aggressor. Sanctions and a possible drying up of foreign investment might put at risk the opening up of China's economy and dent the longer-term outlook.

As it is, slowing Chinese growth already represents the greatest risk stemming from emerging markets in the year ahead. China's credit boom – partly fuelled by an opaque and poorly regulated shadow banking sector – has given way to rising non-performing loans, a fragile-looking property sector and the prospect of economic growth falling below the 7% mark. The risk is that the adjustment is much more abrupt – if not next year, then in the not too distant future. The Chinese authorities' ability to successfully navigate a transition in the country's growth model away from investment and towards consumer spending was always going to have serious implications for the global economy, trade and financial markets. But Beijing is also struggling with an extremely serious debt problem that will sap potential growth and slow the very transition it is trying to effect. Even without a serious dispute with Japan, China – like other BRICs – will find that internal contradictions and a politicised financial system pull it further and further from the double-digit growth of the first decade of the century.

COMMODITY PRICES

Talks on Iran's nuclear programme, a diplomatic initiative that might dominate risk calculations in a more placid era, seem uncharacteristically low on everyone's list today. Overlook Iran at your peril: these fraught negotiations are likely to continue – albeit with delays – and in a best case scenario will result in a deal bringing substantial renewal of Iran's participation in global markets, even if some sanctions will remain in place.

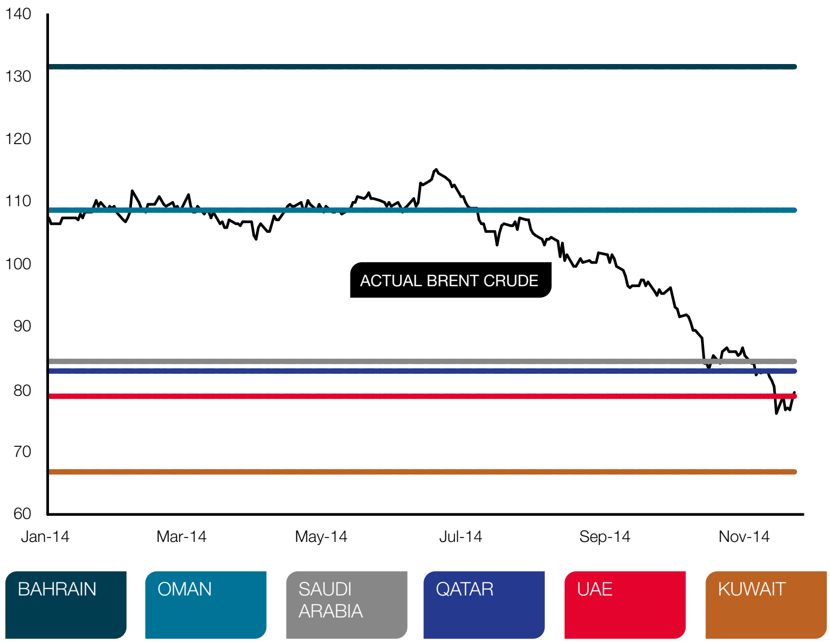
In the event, the return of around 1m barrels per day of currently shut-in Iranian oil could represent a further downward shock to oil prices at a time when OPEC's capacity and desire to support them seems to have uncharacteristically waned. Indeed, OPEC's internal divisions over price and output levels could yet sour the already complex country-level relationships between its three heavyweights – Iran, Iraq and Saudi Arabia – that are central to regional stability.

From a risk perspective, lower commodity prices would be a double-edged sword. Falling resource revenues would harm those governments ever more reliant on them to deliver jobs and social stability – including Russia, Iran, Bahrain, Nigeria and Algeria. Several have already warned of fiscal trouble ahead as prices hover near the $85 a barrel mark. But in other countries, particularly major importers like the US, Japan and EU, lower commodity prices would reduce costs, support disposable incomes and provide a much-needed boost to growth. And wisely managed emerging economies could use the buffer of lower energy prices to do away with ruinous energy subsidies without sparking social unrest.

SHIFTING BALANCE

At a broader, global level, the risk landscape for international businesses and investors has undergone an important, if subtle

Budget breakeven oil prices for 2014 ($ per barrel for Gulf Co-operation Council countries)



Source: Oxford Economics

shift. Emerging markets have retained their status as the world's fastest growing, with expanding economic and geopolitical clout. But their growth prospects have dimmed and risks seem skewed further to the downside.

On top of weaker economic prospects in China and Russia, key emerging markets such as South Africa and Turkey look vulnerable to capital outflows – perhaps sparked by tighter monetary policy by the US Fed – because of a combination of weak external balances and low real interest rates. In Brazil, meanwhile, the re-election of President Dilma Rousseff in October 2014 has raised concerns that the economy's structural challenges, including persistently high inflation and low productivity, will not be properly addressed.

In developed markets, by contrast, although challenges remain, prospects have improved and the risks look more balanced. Important in this has been the recovery – albeit fragile and tentative – that seems to be taking hold in the previously moribund Eurozone economy, where growth looks set to pick up in 2015.

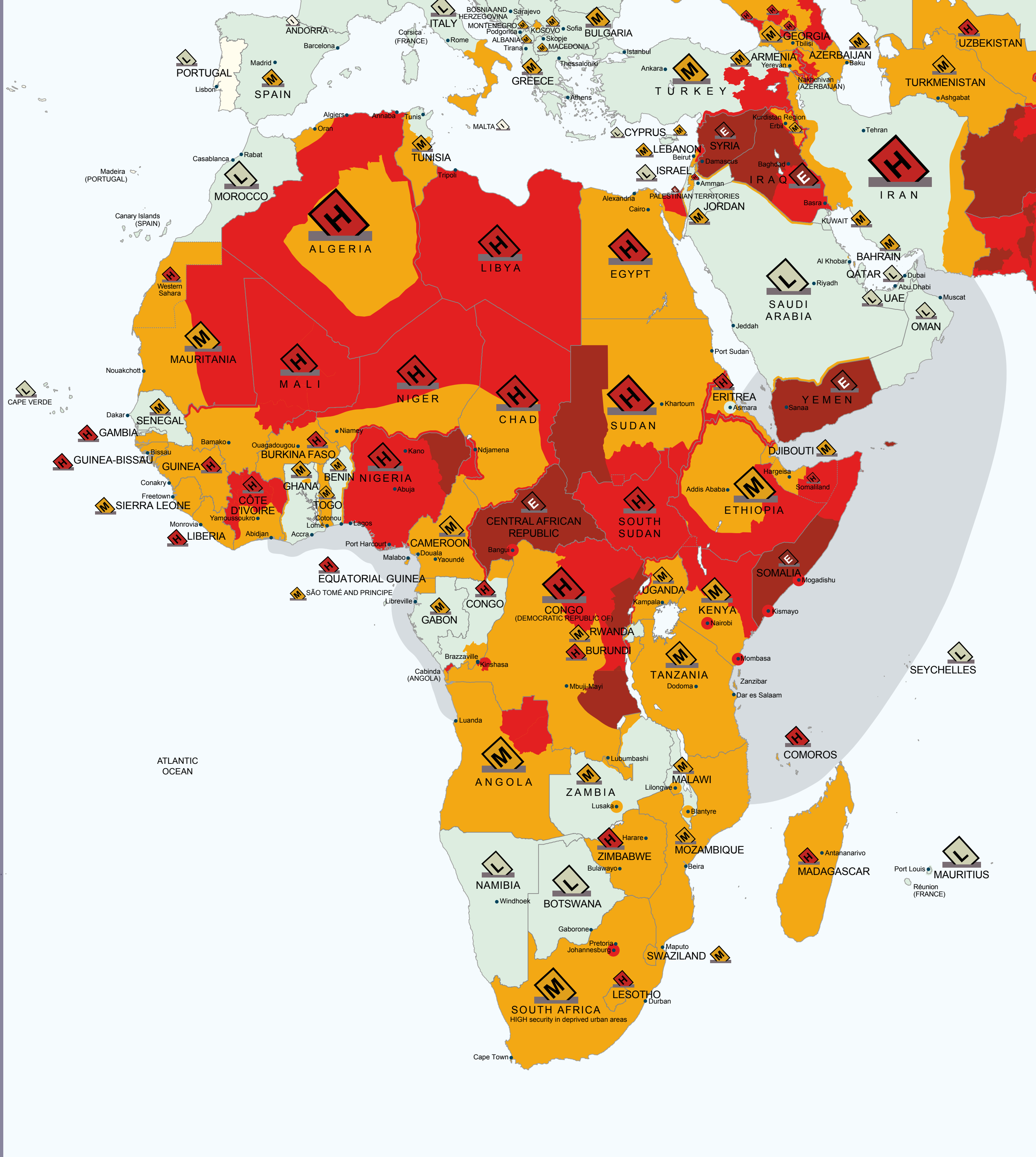
TOP: Iranian Foreign Minister Mohammad Javad Zarif at nuclear talks in Muscat, Oman, November 2014.
BOTTOM: The falling oil price will have wide impacts.

Even here, however, the nexus of politics and economics has arguably proved to be the crucial ingredient. European Central Bank President Mario Draghi has somehow managed to balance the need to deliver a boost to weak and cash-strapped peripheral economies such as Greece against the need for German fiscal and monetary orthodoxy. By talking both the euro exchange rate and market interest rates lower, and promising cheap loans to support feeble bank lending, his monetary easing strategy managed to effect economic stimulus without costing member states a bean. Crisis may yet return to the region, but such deft economic and political footwork has been in desperately short supply in Europe in recent years.

The net result of these opposing trends in developed and developing markets is a narrowing of the growth differential between the two groups. As a result, the need to identify both opportunities and future hotspots has become more difficult – and more necessary.

These and other 21st century problems call for 21st century solutions. With few exceptions, events in the previous century simply did not move this quickly, nor were the tendons of the international economy as intertwined with the muscles of geopolitics. A fissure has opened between those worlds in our century through which no corporate strategy dare fall.

AFRICA



ANDORRA
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KOSOVO
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Damascus
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IRAQ
IRAN
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PALESTINIAN TERRITORIES
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OMAN
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Hargeisa
Somaliland
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BENIN
NIGERIA
GHANA
Abuja
Addis Ababa
Freetown
SIERRA LEONE
CÔTE D'IVOIRE
TOGO
Yamoussoukro
Cotonou
CENTRAL AFRICAN REPUBLIC
SOUTH SUDAN
ETHIOPIA
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Malabo
Yaoundé
SOMALIA
Mogadishu
EQUATORIAL GUINEA
SÃO TOMÉ AND PRINCIPE
Libreville
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Nairobi
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Cabinda (ANGOLA)
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Luanda
ATLANTIC OCEAN
COMOROS
Lubumbashi
ANGOLA
MALAWI
Lilongwe
ZAMBIA
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Antananarivo
MADAGASCAR
Bulawayo
Beira
NAMIBIA
BOTSWANA
Port Louis
MAURITIUS
Réunion (FRANCE)
Windhoek
Gaborone
Pretoria
Johannesburg
Maputo
SWAZILAND
LESOTHO
Durban
SOUTH AFRICA
HIGH security in deprived urban areas
Cape Town

A CALIPHATE SOUTH OF THE SAHARA?

RODDY BARCLAY,
SENIOR ANALYST,
AFRICA

The coming year will see few significant shifts in terrorism patterns south of the Sahara.

- **Despite aspiring to mimic the Islamic State (IS) campaign in the Middle East, Islamist militant groups south of the Sahara will remain more limited in their capabilities and localised in their focus.**
- **The February 2015 elections in Nigeria will prompt an increase in Boko Haram violence, elevating the risk of high-profile attacks in major cities, notably in the north.**
- **A major southerly geographic expansion of Islamist militant activity is not on the cards. In particular, a feared infiltration of conflict zones such as the Central African Republic and South Sudan remains unlikely.**

Terrorism will undoubtedly continue to make headlines in Africa in 2015. But fears that domestic and regional groups – stretching from Mauritania in the west, to Kenya and Somalia in the east – will replicate the campaign of their Middle Eastern counterparts are largely misplaced. In 2015, extremist ideology and militancy south of the Sahara will retain a distinctly local flavour.

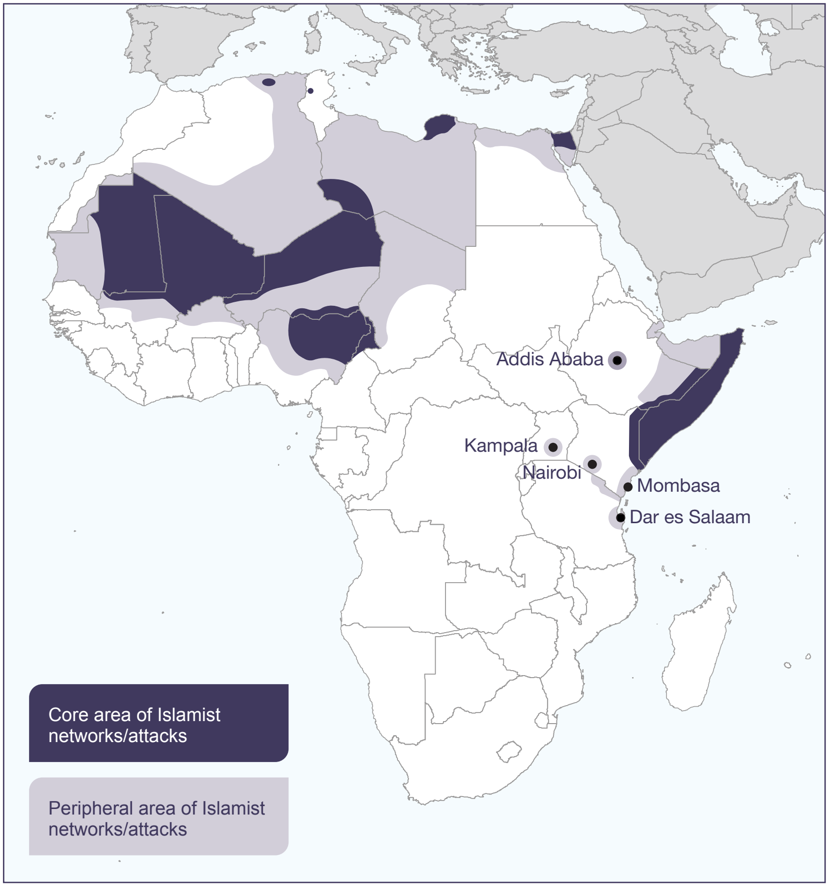
Ultra-conservative brands of Islam have grown rapidly in popularity in parts of sub-Saharan Africa, spurred by an often well-founded sense of inequality and economic exclusion. Extremist Islam is seen as a refuge from hardship and perceived injustice, particularly among the most marginalised communities in the region, such as Kenya's Somali population, or the Tuaregs and Arabs in northern Mali. The leap from religion to militancy is, of course, a big one. But militant networks have both fuelled and exploited the spread of ultra-conservative Islam to expand their reach south of the Sahara, while their leaders have become particularly adept at using volatility and dysfunction to deepen their local footprint.

TAKEOVER AND OUT

Sub-Saharan Africa in 2012 witnessed its own IS-style Islamist extremist takeover in Mali. However, this failed to take root, cut short by limited local support for the radicalism of the Islamist alliance that seized control of the north, and a relatively robust response from France and its African partners.

Similarly, the Boko Haram insurgency in northern Nigeria has recently sought to emulate IS, with the group declaring a caliphate in August 2014. However, Boko Haram's ability to hold territory beyond a collection of small, remote towns and villages remains limited. Although the February

Islamist militant threat in Africa



2015 general elections are likely to fuel a rise in Boko Haram violence, the group is unlikely to seize meaningful stretches of territory, and will revert to more conventional guerrilla tactics.

Unlike IS, Boko Haram will remain firmly embroiled in domestic political and security dynamics, and will not develop a transnational focus. Nevertheless, as southern President Goodluck Jonathan seeks re-election, the group will exploit northern dissatisfaction with the government and turbulence around the polls to stage nationally significant attacks. The risk of a high-profile attack in the capital Abuja will rise early in 2015, while commercial

TOP: Aftermath of a Boko Haram attack in Kano, Nigeria.
BOTTOM: African Union soldiers resting after clashes with al-Shabab, Somalia.

capital Lagos may witness isolated smaller-scale incidents.

LOOKING EAST

Over in East Africa, Somalia-based al-Shabab is likely to lose further territory to African Union forces (AMISOM) following the elimination in September 2014 of its hardline leader, Ahmed Godane. In 2015, Somalia will see a campaign of hit-and-run-style terrorism. Al-Shabab will retain capabilities to conduct large-scale attacks in the heart of the capital Mogadishu, but could also strike strategic locations such as Kismayo and Barawe. Its new leadership will also continue to target countries that contribute troops to AMISOM: Kenya, Uganda, Ethiopia, Burundi and Djibouti. Attacks on major targets in Nairobi, Mombasa, Kampala or Addis Ababa are possible in 2015 via affiliates and networks in the wider East Africa region.

ANOTHER MALI UNLIKELY

Islamist militant networks will continue to find fertile ground in which to operate in the Sahel-Sahara, retaining a far-reaching network across territory stretching from Mauritania to Chad. Further high-profile terrorist attacks in the region are likely. Northern Mali remains restive, while south-western Libya provides a safe haven devoid of state authority for militants. However, French-led regional counter-terrorism operations should keep further Islamist militant expansion in check, with increasing surveillance and targeting creating setbacks for militant networks. As a result, the risk of 'another Mali' will subside. Nonetheless, given the experience of the last few years, the mobility and dynamism of these groups show that they can adapt to changing circumstances, and will retain their expansionist ambitions.

Advance into other trouble spots, such as South Sudan or the Central African Republic, is unlikely. The ethnic groups that make up the bulk of terrorist units across that region – most notably ethnic Arabs – have little in common with ethnic groups south of the Sahara, and would struggle to make inroads in these local conflicts.

LOOKING GLOBAL, THINKING LOCAL

More broadly, sub-Saharan Africa lacks the historic legacy and strategic significance that attracts the transnational terrorist groups drawing funding and fighters into the Middle East. Without question, the crisis in Syria and Iraq will influence terrorist networks in Africa. On the surface, they will share common trappings, tactics and strategies. But beyond that, African Islamist militant campaigns will remain largely local in the year ahead. ■

EAST AFRICA: RESOURCE PROSPECTS

With new resource discoveries in East Africa making progress towards commercial production, Charles Hecker, Global Research Director, talks to Associate Director for Africa Jean Devlin about the relationship between resource finds, political dynamics and regulation of the extractive industries.

WITH JEAN DEVLIN, ASSOCIATE DIRECTOR, AFRICA

Q Jean, since we first started looking at this issue, we've seen changes in the regulatory frameworks for extractives in East Africa and anticipate more in the year ahead. As oil and gas finds move closer to production, do you see a danger of a 'resource curse' emerging that would undermine governance in the region?

A The volumes of investment in exploration remain an exciting prospect economically for the region. That said, it's still early days to judge how revenues from production, when they start flowing in three or four years' time, will affect governance. The key factors are the political system and the degree of influence the leadership or political elite has to capture the spoils; legislative and regulatory changes being proposed; and existing capacity within bureaucracy and industry more broadly.

Take Mozambique, for example: elections have just been held returning the incumbent Frelimo government, which has been negotiating a political settlement with the opposition Renamo after an 18-month guerrilla campaign. The big question is how transparently will the new government manage the offshore gas sector and the expected windfalls it will bring?

Frelimo took advantage of its two-thirds majority in parliament ahead of the elections (which has since fallen to 57%) to push through new legislation. But decision-making over the sector is likely to remain concentrated at the executive level under new President Filipe Nyusi, which will limit checks and balances on revenue management. This raises concerns over the impact on governance, but also brings reputational risks for investors, especially in light of increasing civil society scrutiny of the sector.

Q What about the so-called 'honeypot' effect – will these resource finds exacerbate conflict, or is that a leap too far?

A Some have raised alarm bells over the potential for resource-based conflict in the region. I think it's unlikely, but it's not a simple yes or no. When we think of the classic 'honeypot effect', we think of the Niger delta, where abundant oil wealth created an incentive for militant and criminal groups to fight for control of resources. In the East African context, we only really see such dynamics in South Sudan – and even there, control of resources is an instrument to increase access to power, rather than something the rebels are focused on gaining profit from.

We don't have the same dynamics elsewhere in the region. This is partly due to the industry's stage of development – oil is not yet flowing, and gas is much harder to divert. So it depends on the nature of the commodity. It also hangs on local drivers of conflict around resource finds, and how those are understood and managed by governments and industry.

Kenya is perhaps the most interesting case. The largest finds to date are in very remote regions, where there are existing conflict dynamics around competition for land, water, and grazing and cultivation rights. Combined with that you have a flow of small arms from surrounding conflicts, and traditionally these areas were very much beyond the state's reach so there are few established government structures and little security force presence. However we're still far away from a 'honeypot' effect.

Q **We've seen more unrest in Tanzania in recent years, and we raised our security rating in October last year from low to medium following increased protests, social unrest and religious violence. Is this another potential hotspot?**

A Tanzania is a different case in terms of what drives conflict: ethnicity plays a far less prominent role in politics than in Kenya, and it's not really a political issue. This is largely the legacy of Julius Nyerere, Tanzania's charismatic leader after independence, and his concept of African socialism ('*ujamaa*'). Having said that, there are problems with how the benefits of economic growth overall are distributed, with the north of the mainland being traditionally better off. The south, where the offshore gas discoveries in the Rovuma basin are located, has long been economically and politically marginalised.

The issue in Tanzania is that political opposition is pretty weak, so there hasn't been a well-organised challenge to government plans, even though there's been more noise recently. The governing party, the Chama Cha Mapinduzi (CCM), has been in power for decades and still has a strong handle on the reins of power. It's been confident enough to push ahead with plans for a constitutional referendum despite widespread criticism of the consultation process. At a national level, the biggest issue is how Zanzibari aspirations for increased sovereignty are addressed. At a more local level, again I think it's unlikely we'll see an organised militant movement emerge, but we can expect continued unrest in the form of protests.

IT'S NOT JUST THE ECONOMY

Sub-Saharan Africa may maintain competitive levels of growth in 2015, but investors ignore political developments at their peril.

- **Politics will remain a key factor driving risk for investors in Africa, with improvements in governance remaining elusive.**
- **Although levels of debt are increasing, a debt crisis is not imminent.**
- **Continued commodity dependence and failure to diversify leave some economies vulnerable to global price fluctuations.**

THOMAS HANSEN,
SENIOR ANALYST,
AFRICA

High commodity prices and expanding markets for goods and services have propelled Africa's economies to spectacular growth in the last decade. But breakneck economic change across Africa has not sparked a transformation in how it is governed. Politics from the Sahara to the south remains as messy as ever, with growth coming despite government, rather than because of it.

Africa's growth is genuinely dizzying – even statisticians can't keep up. In April 2014, Nigeria released updated GDP figures of $510bn for 2013 to overtake South Africa as the largest economy in sub-Saharan Africa. Not to be outdone, Kenya followed suit with a 25% increase in its recalculated GDP.

Africa's average economic growth of 5% in 2013 outstripped the 3% global average and dwarfed sluggish growth in the developed world. But political change has not kept pace. In a key indicator of the quality of governance across Africa, the Ibrahim Index of African Governance, the continent's overall governance score has not budged since 2008.

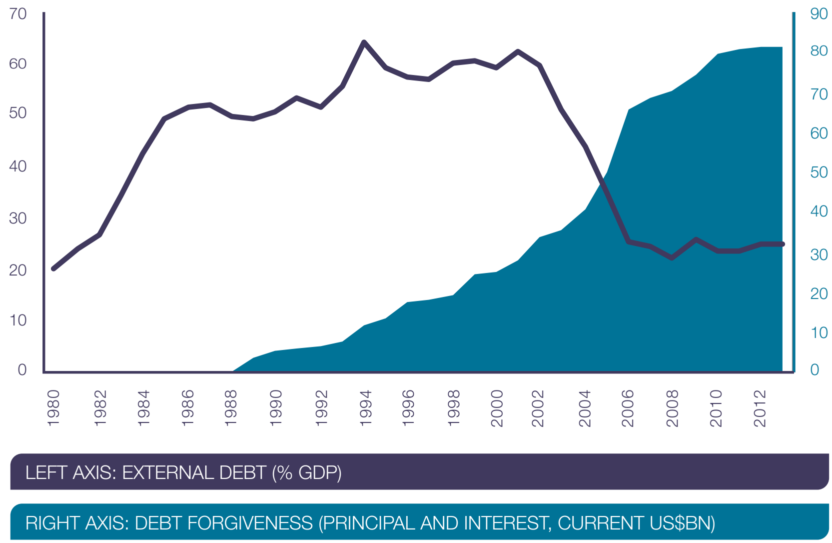
SHORT-TERM PAIN, NO LONG-TERM GAIN

It's not for lack of trying. Policymakers across Africa have tinkered with their economic policies. Governments from Cameroon to Kenya have sought to bolster their tax take. But in most places, the fundamental character of politics has not changed. Even in most of the continent's democratic states, politics remains fractious and riven by ethnic, regional and religious divisions. Meanwhile, superannuated rulers remain in charge in Angola, Uganda and Zimbabwe.

The pace of political change may seem of little concern to investors focused on market fundamentals. But in reality, politics remains a central risk factor for investors with exposure to Africa. Even in politically stable states, sound macroeconomic management depends on ruling elites adopting a benign attitude and taking a long-term view.

Modern African history contains few such role models. In the continent's democratic states, the main concern of power-holders – as elsewhere – is re-election. The election cycle and the

Sub-Saharan Africa: external debt and cumulative debt forgiveness, 1980-2013



Source: International Monetary Fund, World Economic Outlook Database, April 2014

threat of political turnover make it hard for governments to take a long-term view. Africa certainly has no monopoly here, but weak accountability and mobilisation among the burgeoning middle class mean that governments are rarely held to account, particularly for pork-barrel spending.

No country is immune – the laggards and the best-in-class are equally at risk. The democratic, relatively stable governments of Senegal, Ghana, Kenya and Nigeria are running budget deficits, despite economic growth of between 4% and 7% a year. According to Oxford Economics, all four governments will run deficits until 2017. By then, the external debts of Senegal, Ghana and Kenya will have doubled, with Nigeria not far behind. True, debts are increasing from a low baseline and are not necessarily out of control. But other risk factors suggest additional worries. Both Senegal and Ghana are running 'twin deficits' – both their current account and public finances are in the red – underscoring potential economic fragility.

African governments aren't overwhelmed with debt. IMF figures suggest that external public debt stands at 24% of GDP on average. Moreover, high growth rates boost the sustainability of African debt. But memories are short. Africa's sovereign and external debt levels are at historic lows only because of successive waves of public and private debt relief

TOP: Independence Arch in Accra, Ghana.
BOTTOM: Angolan President José Eduardo dos Santos.

and restructuring. Only with the 1996 Heavily Indebted Poor Countries initiative and the 2005 Multilateral Debt Relief Initiative did debt levels fall, to a low of 22.3% by 2008.

Prudent policymaking cannot take the credit for Africa's lower indebtedness. Debt is increasing, rapidly in some countries. Still, the continent is not headed for an imminent debt crisis. Oxford Economics' debt projections suggest that sovereign debt levels will remain moderate for most of Africa towards 2023 in light of sustained economic growth, with Cameroon – where debt levels are expected to gradually rise – the main exception.

DIVERSIFY OR DIE

There are additional causes for concern. Despite increased investment in services and other sectors, Africa's economies remain commodity-dependent. A drop in energy or commodity prices can render debt unsustainable. The economies of Angola, Nigeria and Equatorial Guinea, for example, are vulnerable to a sustained drop in oil prices, and if the low prices of late 2014 are sustained this will likely cause significant damage to their economies. Côte d'Ivoire and Cameroon are more diversified.

Here again, politics comes into play. Oil-rich Angola is attempting to boost its non-oil GDP through infrastructure investments, and has seen sustained growth since a slump in 2009. But all is not resolutely well. Concerns are rising over the viability of state-backed projects after a bad loans crisis in 2014 engulfed the Angolan subsidiary of Portugal's Banco Espírito Santo. It's still too early to tell whether other investments will go bad and take Angola's sovereign risk profile with them.

In Angola, and elsewhere in Africa, political accountability will remain the key factor behind economic management and sovereign risk. Few governments will be able to take a long-term view on public finances when their political survival, and potentially state stability, are at stake. High investor returns will remain at the mercy of risks stemming from gaps in macroeconomic governance.

ADDING VALUE BEYOND COMPLIANCE

- **In Africa, the most attractive growth opportunities are in some of the highest risk countries.**
- **As companies spend more on compliance, there is an opportunity to draw more value from this investment.**
- **By breaking down internal walls, companies will get the full benefit of intelligence-led due diligence for other areas of risk mitigation.**

MARIA KNAPP,
ASSOCIATE DIRECTOR,
AFRICA

A leading international bank in late 2014 announced that it will spend €1bn on compliance in 2015. Other banks have made heavy one-off investments to meet their regulatory requirements in the field of anti-corruption. In most cases, the budget is earmarked to grow compliance departments themselves. But with such a strong focus on spending, are businesses putting sufficient focus on value?

Most companies have policy statements banning bribes to secure business, but only a small minority have anti-corruption risk assessment procedures for entering new countries. This suggests most companies see routine compliance measures as a necessary exercise. But too few, it seems, are drawing the full benefit of intelligence-led due diligence as something that could feed into their business and operations strategies. In the best case scenario, those businesses are just missing a trick, or losing a competitive advantage. In the worst case, the narrow application of compliance procedures leads to unexpected side effects that can have significant operational implications. A look at recent activity around Africa helps to illustrate the point.

FINE LINE

Shipping, logistics and customs clearance are booming industries as investment mushrooms around new oil and gas finds and multi-country value chains. Amid the boom, it is becoming clear that international regulations to cut out low-level bribery are being circumvented by officials who grasp the rules for foreign companies and are ‘working the system’.

Instead of asking for cartons of cigarettes in exchange for clearance certificates – a request that would breach most companies’ zero-tolerance anti-bribery policies – customs officers have turned to issuing semi-official fines. The fines are usually based on manifestly spurious grounds, or linked to misdemeanours previously considered too minor to sanction. Fines vary, but we have seen some ranging from a few thousand dollars to $10,000. The amount is totally unpredictable, but this much is clear: the dollar sums in question are significantly higher than the cost of a few cartons of cigarettes. The fines are backed up by an official-looking invoice and a stamped, signed receipt. In most cases, these spurious fines are cosmetically indistinguishable from legitimate documents, making them difficult to dispute on the spot.

This fiction has stood the fight against bribery on its head: a simple piece of paper subverts the spirit of the law. What's worse, it has taken a bribery problem and turned it into a financial and operational problem.

TAKING THE LONG VIEW

The regulatory framework is changing quickly in Mozambique's oil and gas sector and Kenya's mining sector, moving towards strict legislation on local content. Foreign investors are searching for a way to enter these markets without compromising on compliance. And for companies that plan to capture the real high-growth opportunities on the continent – like emerging manufacturing opportunities in Ethiopia or large-scale infrastructure development in Nigeria – only a joined-up approach will do.

Barring a few standout examples like Ghana, Botswana and Namibia, most African countries still cluster at the bottom of international perception rankings of corruption risk. The region's most attractive growth opportunities are in some of its highest risk countries. These involve setting up multi-jurisdiction value chains and have a longer average lifecycle than in more developed markets. For an ordinary private equity investment, most companies are looking at a seven- to ten-year commitment, often set at aggressive growth targets. The most straightforward capital investment into one of East Africa's port development projects will take longer to see returns than in developed markets. It is clear that compliance teams alone will not provide businesses with the information they need to forecast the potential hurdles in these investments. The opportunity lies in capturing the benefit that information can add to risk mitigation in other parts of a business.

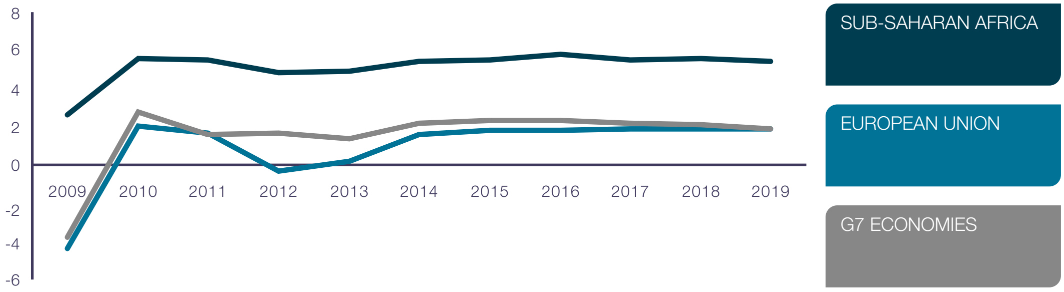
So how can businesses get the full benefit of their investment in compliance tools to mitigate other areas of risk? When dealing with customs, intelligence-led planning that combines mandatory compliance procedures with operational objectives would bring to light the likely hurdles. This should include identifying the local decision-making hierarchy and mapping out possible options for recourse when faced with these spurious fines.

Investment banks, caught out for being so far behind the curve on compliance a few years ago, are catching up quickly by taking a much more holistic approach to this issue. For example, compliance teams and business development teams are working together at an early stage to agree on streamlined terms for pre-investment risk assessments that balance elements of due diligence with local market and political intelligence. Breaking down internal walls is a good first step to switching from calculating these measures as a cost, to capturing their commercial benefit.

AFRICA SNAPSHOTS

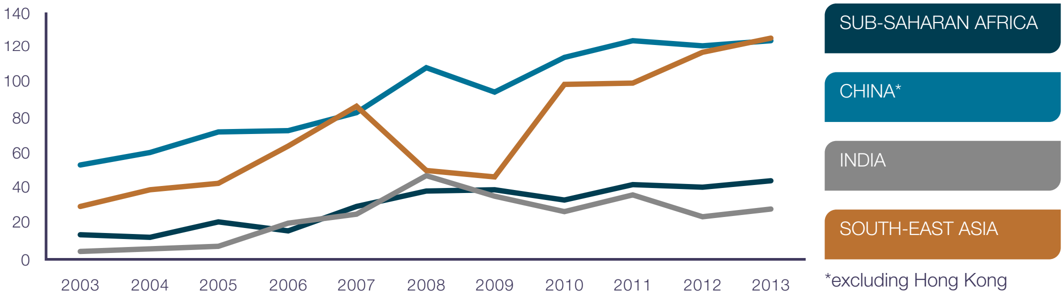
ECONOMIC PROSPECTS

AFRICA'S GROWTH WILL CONTINUE TO OUTPACE THAT OF DEVELOPED ECONOMIES...



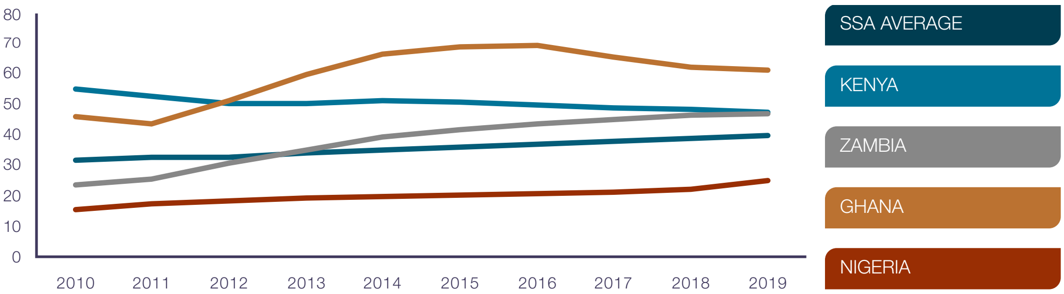
GDP GROWTH RATES (%), 2009-19 | Source: IMF

...BUT FOREIGN INVESTMENT TO THE CONTINENT REMAINS WELL BELOW LEVELS IN ASIA...



INWARD FDI FLOWS (US$BN), 2003-13 | Source: UNCTAD

...AND DEBT LEVELS ARE CREEPING BACK UP FROM HISTORIC LOWS



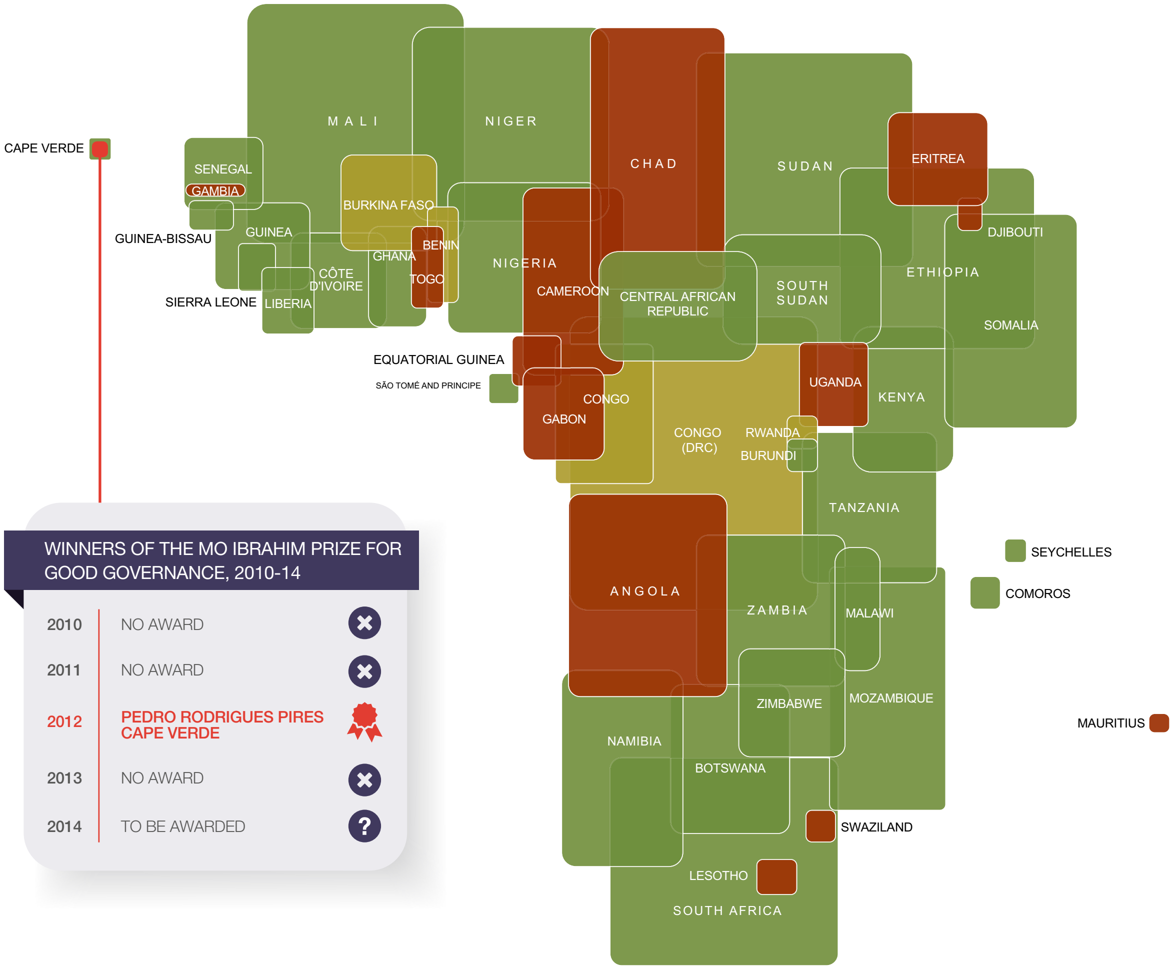
GENERAL GOVERNMENT GROSS DEBT (% GDP), 2000-19 | Source: IMF

GOVERNANCE

AFRICAN GOVERNANCE IS IMPROVING, BUT ONLY SLOWLY

Countries that have removed or are attempting to remove term limits on heads of state

TERM LIMITS IN PLACE | NO TERM LIMITS | CURRENTLY ATTEMPTING TO REMOVE



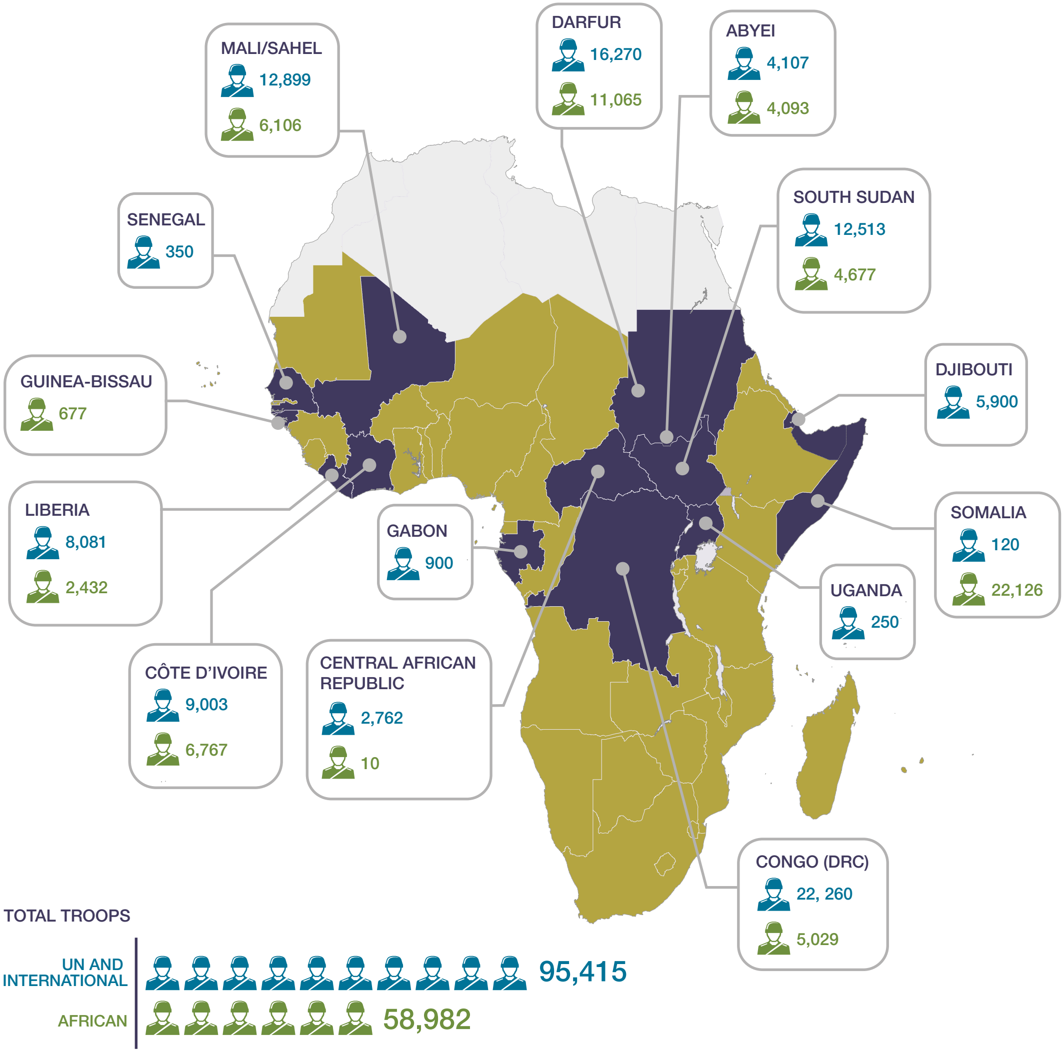
WINNERS OF THE MO IBRAHIM PRIZE FOR GOOD GOVERNANCE, 2010-14

2010	NO AWARD
2011	NO AWARD
2012	PEDRO RODRIGUES PIRES CAPE VERDE
2013	NO AWARD
2014	TO BE AWARDED

SECURITY

DESPITE SUBSTANTIAL GROWTH IN AFRICAN PEACEKEEPING, INTERNATIONAL TROOPS STILL OUTNUMBER AFRICAN COUNTERPARTS ON THE CONTINENT

Peacekeeping troops in Africa (2014)



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Miami
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Monterrey
MEXICO
Tampico
Havana
CUBA
TURKS AND CAICOS
Guadalajara
Cancún
DOMINICAN REPUBLIC
BRITISH VIRGIN ISLANDS
Mexico City
CAYMAN ISLANDS (UK)
Port-au-Prince
Kingston
Santo Domingo
ANGUILLA (UK)
SINT MAARTEN
Belmopan
JAMAICA
HAITI
PUERTO RICO
ANTIGUA AND BARBUDA
Acapulco
BELIZE
US VIRGIN ISLANDS
GUADELOUPE
GUATEMALA
San Pedro Sula
ST KITTS-NEVIS
DOMINICA
HONDURAS
MARTINIQUE (FRANCE)
Guatemala City
Tegucigalpa
ST LUCIA
San Salvador
EL SALVADOR
NICARAGUA
ARUBA
CURAÇAO
ST VINCENT AND GRENADINES
BARBADOS
Managua
BONAIRE
GRENADA
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Montevideo
ARGENTINA

BOLIVARIAN SUNSET

The death of Venezuelan president Hugo Chávez (1999-2013) has shown starkly how out of step his revolutionary dreams were with Latin America's more stable reality.

- **Chávez's influence was always overstated and was dependent on spending power – frittered away by mismanagement and corruption.**
- **Elsewhere, democracy and institutional stability are maturing.**
- **The main concerns for business on the continent are shifting away from political risk and towards social issues and corruption.**

SIMON WHISTLER,
DIRECTOR, AMERICAS
GLOBAL RISK ANALYSIS

Chávez's death in February 2013 robbed both his country and the region of its most charismatic and polarising leader. It also removed any pretence of success from his once-lofty aims of fulfilling the dreams of his role model, 19th-century Latin American independence hero Simón Bolívar. Bolívar's vision was to create a united Latin America with political power and economic resources in the hands of the 'people', an often deliberately nebulous, but still powerful, concept. Since his death, little has been heard of Bolívar's grand ideals from Chávez's successor, Nicolás Maduro, as he struggles with myriad domestic problems. Other leftist leaders initially tipped to take on Chávez's mantle in the region, such as Ecuador's Rafael Correa, have shown little interest.

Where did it all go wrong? In truth, the influence of Chávez and his Bolivarian Revolution in the wider Latin American region was always overstated: in life, as in death, he attracted as much opprobrium as he did adoration. Moreover, what influence Chávez had was always closely tied to his ability to match verbosity with spending power. Venezuela's economic struggles in recent years, triggered by misguided policy and staggering levels of corruption, are likely to deepen in 2015, ensuring that the focus for the government will be on managing domestic problems rather than expanding its regional presence.

Economic mismanagement tells one side of the story of the revolution's failure to carry Latin America along with it. Take the July 2014 technical debt default of another heterodox government in Cristina Fernández de Kirchner's Argentina. This undermined any claims that 21st-century socialism is somehow a more effective way of managing the economy than its 20th-century equivalent. Leftist presidents in Ecuador, Nicaragua and Bolivia have bucked this trend – for now – but only by adopting more orthodox stewardship of the economy (and in Nicaragua's case bolstered by significant financial aid from Venezuela).

TOP: Man with an image of late Venezuelan president Hugo Chávez, Santa Cruz, Bolivia, June 2014.
BOTTOM: Colombian President Juan Manuel Santos.

GROWING MATURITY

More fundamentally, Chávez misunderstood the evolving nature of politics and society in Latin America. The Venezuelan leader believed that the deep-rooted inequalities common to all countries in the region made them naturally fertile ground for his grandiose promises and those of like-minded leaders. But Venezuela's relative demise – its hollowed out institutions, the excessive personality cult around Chávez and deep economic problems – also threw into stark relief just how politically mature many other Latin American countries are becoming.

While far from perfect, the signs from Latin America are that democracy and the institutions required to uphold it – an independent judiciary and vibrant civil society, for example – are increasingly promising. Witness the handovers of government, and checks and balances on executive power in Mexico's former one-party state. The left and right in Chile have alternated power at successive elections with no significant deviations in economic course. Colombia's Juan Manuel Santos, a rightist former defence minister, was re-elected president in 2014 on a platform of peace with the Revolutionary Armed Forces of Colombia (FARC) guerrilla group and backed almost unanimously by the country's political left.

Kirchnerismo will almost certainly be replaced by a more moderate political force in next year's presidential election in Argentina.

A DIFFERENT LEGACY

But it would be wrong to say that Chávez's dreams have had no long-term impact on Latin America. On the contrary, key tenets of *Chavismo* are now seen as standard in the region: strengthening the role of the welfare state and direct government support for the poorest sectors of society; increasing the state's capture of a country's natural resource endowment; and the creation of regional talking shops, such as the Union of South American Nations (UNASUR), where the shadow of the US is no longer perceived to hang constantly over Latin America.

Business now operates in a much more self-confident continent where a (generally) growing consumer class creates new opportunities for the foreign capitalists Chávez so derided, but also holds companies much more accountable than before. This points to the evolution of the type of risks that companies face in the region. Expropriation and nationalisation – Chávez's most potent economic weapons – are no longer investors' key concern. For many businesses, corruption and social risks will be the top risk management priorities in 2015.

This localisation or 'socialisation' of risk underlines why there is no rush to fill the vacuum left by Chávez's death. The left vs right paradigm of even three years ago in Latin America has broken down as each country seeks to find its own solutions to the end of the commodities super-cycle. In a changing regional economic and political context, the limits of populism are apparent. Far from being the centre of a reinvigorated Latin America, Venezuela will find itself at the region's extremities in 2015 – its grandiose Bolivarian dreams broken by political, social and economic discord.

Economic policy does not always match official ideology

BRAZIL AND MEXICO: CHANGING FORTUNES

The last half-decade has seen a remarkable shift in Latin America's balance of power. Mexico is increasingly seen as the region's rising star; a relatively weak economic performance has tainted the image of emerging market darling Brazil. A closer look at the region's two largest economies reveals a nuanced competition, particularly for foreign investors. Global Research Director Charles Hecker talks to Control Risks' senior analysts Dwight Dyer, based in Mexico City, and Thomaz Favaro in São Paulo.

WITH DWIGHT DYER, SENIOR ANALYST, AMERICAS

AND THOMAZ FAVARO, SENIOR ANALYST, AMERICAS

Q: What factors are shifting investors' preference from Brazil to Mexico?

A: DD: The Mexican economy is performing marginally better, not only in terms of growth – forecasts for GDP growth in 2015 are for 3.7% in Mexico and only 1% in Brazil – but also in macroeconomic fundamentals, with lower inflation and a stable exchange rate. Investors rightly perceive that the Mexican government has been very much involved in improving the business environment with a raft of structural economic reforms. However, this progress is offset by persistent concerns about the ruling Institutional Revolutionary Party's unwillingness to fight widespread and markedly growing corruption.

TF: Meanwhile, the recently re-elected Worker's Party government of President Dilma Rousseff has done relatively little to tackle the so-called 'Brazil cost' – the operational costs of doing business in the country. This includes elements like high and complex taxes, deficient infrastructure, rigid labour legislation and onerous red tape. In fact, Rousseff has also fuelled concerns about the future of the local business environment with a lax macroeconomic policy and preference for partial state intervention. This gap is expected to widen in 2015, particularly given the long-awaited opening of Mexico's energy sector.

Despite this divergence, it is interesting to note that the two countries have some shared vulnerabilities, notably on the fiscal front – both registered significant fiscal deficits in 2014. Still, Brazil remains a preferred investment destination and many companies worldwide have shown continued interest in tapping its potential: levels of foreign direct investment have plateaued since 2012, but remain robust and among the world's highest. The question remains whether either of these two countries can effectively enforce the rule of law, at least at a minimum standard acceptable for global companies.

Q Is Mexico more likely to benefit from the economic recovery in the US?

A DD: Mexico is reaping the benefits of two decades of openness to free trade, which have produced 12 different free-trade agreements with more than 40 nations around the world. While the country undoubtedly struggled in the early years of the North American Free Trade Agreement (NAFTA), its open economy has been a key driver of efficiency and competitiveness. Today, China's rising labour costs are proving a barrier to long-term investments, reversing earlier labour trends back in Mexico's favour.

TF: In contrast, Brazil's inward-looking strategy has proved costly, particularly in the context of global value chains. Brazil has focused instead on a small group of neighbouring countries, and the progress made during the 1990s under the Mercosur common market has been partially reversed by a succession of protectionist governments in Brazil and Argentina. Protectionism often translates into an uneven playing field for companies and locks in high costs for local consumers and firms.

DD: Latin America's geopolitical divide is increasingly seen as responding to differences in trade policy rather than ideological affinity, with Mexico successfully leveraging its influence over countries that are willing to embrace liberalisation. This is already showcased in the Pacific Alliance, which since its foundation in 2011 has made sustained progress towards removing barriers to trade and investment between its four members (Mexico, Chile, Colombia and Peru). The bloc also provides a platform for increased engagement with the Asia-Pacific region, as reflected in the Trans-Pacific Partnership negotiations. In contrast, Brazil increasingly struggles with the baggage of Mercosur's political alliances.

Q What about integrity risks in the two countries: how does the outlook differ?

A TF: Corruption remains a significant risk for companies operating or looking to operate in either country, despite efforts to tackle endemic malpractice. There are some differences between the two – cross-country comparisons systematically place Brazil in a better position than Mexico, and ahead of most countries with similar level of development. The issue is very likely to feature at the top of the agenda in 2015 on both sides. After a hard fought re-election, Rousseff is expected to deliver on her promise to crack down on corruption – allegations of wrong-doing in state-owned oil giant Petrobras almost derailed her campaign.

DD: In Mexico, President Enrique Peña Nieto is very likely to undermine expectations about the country's take-off with his lacklustre performance in guaranteeing the rule of law. His lack of effort in promoting anti-corruption institutional reform, a problem that involves the opposition parties just as deeply, is likely to mark his administration and persist well into the future. Last but not least, endemic corruption within Pemex is likely to pose a significant risk for companies looking to partner with the state oil company. ■

COMPLIANCE: GETTING AHEAD OF THE GAME

MICHELE WIENER,
SENIOR MANAGING DIRECTOR,
AMERICAS

GREG ESSLINGER,
SENIOR MANAGING DIRECTOR,
AMERICAS

Company expansion often exceeds ability to effectively manage risk. How can compliance improve things?

- **Consider behaviour-based training, rather than bogging employees down in legalese.**
- **Recognise the value of intelligence – both as a consumer and as a creator to re-inform – and be a facilitator of the business.**

We see it play out a hundred times in a hundred ways every day. A multinational company doing business in a difficult market faces a challenge: how do we deal properly with allegations of misconduct and use what we learned to prevent their reoccurrence? It is a conundrum shared in varying degrees largely by compliance and legal teams. And, in 2015, it is a challenge made more difficult by an ever-shifting series of regulatory requirements, risk and local enforcement. Unfortunately, due to resource constraints and silos of responsibility, it is typically 'too little, too late' to make a real difference. Growth and expansion of the organisation all too often outrun its capability to govern itself effectively and manage risk efficiently, at a cost of hundreds of duplicated hours and millions of dollars.

Can compliance catch up? Imagine an organisation where things work like this: Senior management and the board are considering expanding the business into a new market or diversifying within a market through a strategic partnership. At that very moment, they engage legal and compliance to 'stress test' the idea by answering some critical questions at an early stage. How does the transaction change our regulatory reporting obligations? Are we being exposed to broader whistleblower laws? Who is going to absorb this increased compliance and risk management burden? And what are the anticipated costs of this expanded need for training, policy oversight and internal audit?

This may seem fantastical, so perhaps a more realistic question is: How can we position compliance so that we are ahead instead of always behind? While there is no silver bullet solution here, consider some or all of these resolutions for 2015. They might just make a huge difference.

RETHINK TRAINING

The legal landscape is shifting fast, from new whistleblower laws in France to the Brazil Clean Company Act to a sea change in Chinese enforcement. Understanding the nuances at a global level is difficult even for Ivy League law grads. Don't expect it of your sales team. Instead of spending training time on the nuances of facilitation payments, consider behaviour-based training as an alternative. The idea is that employees won't remember exactly how to spot a government official, but they will remember that they need to act carefully and ethically. This approach resounds much better from a cultural perspective too, when you get the feared feedback 'those laws don't apply to us in this country, do they?'.

GET TRULY CONNECTED TO THE BOARD

A once-a-quarter spot at a board meeting is important optically, but what does it accomplish? Does the board really understand what you do and why? Some of the most successful compliance officers connect with directors outside those meetings for focused, quality time. Even a brief lunch or call with the chair of the audit committee can give you a level of connectedness that will be important in keeping the board up-to-date and understanding what they need to hear from you at that next meeting.

BECOME A CONSUMER OF INTELLIGENCE

Compliance officers are too often caught in a 'learn-as-you-go' exercise, especially in a crisis. In 2015, escalating geopolitical issues can and will have an impact on your organisation and how you respond. Look for and absorb new sources of analysis of regulatory, political and legal trends, particularly in fast-moving, sanctions-ridden markets such as Russia and Iran. Work with the board to understand how company strategy may play into future changes in risk profile.

BECOME A CREATOR OF INTELLIGENCE

Remember that a truly functional compliance programme is constantly re-informing the business. Your programme should be developing internal intel for your organisation and pushing that information out to the stakeholders on a regular basis. Look around your programme and find new and more efficient ways to do this. From trends and issues related to employee management to understanding the risks – and benefits – of distributor relationships, your programme can help the business to run more smoothly by providing critical information that is often being gathered ineffectively by another department.

ADD VALUE BY BEING MORE THAN A POLICE DEPARTMENT

Despite great strides in perception from the early days (read: 2005), compliance is still seen as the company 'traffic cop', there to pull over an errant business developer and write a ticket, or worse. As organisations move into 2015 with expansion and growth at the front of their minds, compliance officers are well placed to look at their operational and strategic partners, and work together to streamline due diligence procedures and revisit the M&A process, helping the business to drive revenue more efficiently. Ask around the business the question, 'how can we improve compliance and make your job easier?'. You might be surprised what you learn.

DRUGS IN THE AMERICAS: CHANGING MARKETS, CHANGING RISKS

GAVIN STRONG,
SENIOR ANALYST,
AMERICAS

Decriminalisation in parts of the US and rising consumption among Latin America's middle classes will change the dynamics of the region's drugs trade.

- **Mexican cartels will vie for control of production territory and trafficking corridors, potentially affecting promising locations for energy investment.**
- **Cartels will compete fiercely for the growing middle-class market, bringing more street violence and further erosion of institutions.**
- **Despite increasingly vocal opposition to the 'war on drugs', enforcement will remain the watchword. Drug-related violence will not abate in 2015.**

COMPARE THE MARKET

The basic dynamics of the regional drugs trade are well understood: South American countries grow and refine the product, Mexican and Central American gangs move it north, and the voracious US market consumes it. However, recent moves in the US to legalise – or at least decriminalise – some narcotics directly challenge this model. If Americans can get their fix legally at the local dispensary, there is less demand for cartel services. Less demand for imported drugs means less money flowing back through the cartel supply chain.

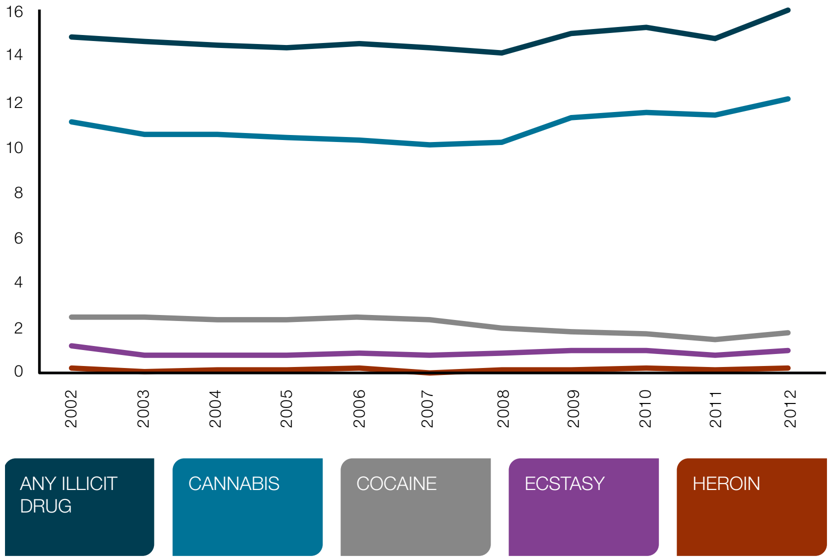
Like any multinational enterprise, drug cartels will try to adapt to shifting market dynamics. We see three distinct trajectories – not necessarily incompatible – in 2015 and beyond.

1. Fight for share in the illicit market

Mexican cartels can try to compete with legal drugs by increasing the quality of comparable products, shifting activities into synthetic drugs that are still illegal or seizing a greater share of the illicit market by displacing rival groups. Each of these strategies – or, more likely, a combination – is a recipe for conflict.

Gangs pursuing high quality will fight to control optimal areas for marijuana production – above all Mexico's Sierra Madre (Chihuahua and Sinaloa states). Those moving into synthetics will try to dominate port cities on the Pacific coast where precursor chemicals are imported, including Lázaro Cárdenas (Michoacán) and Manzanillo (Colima). The fight for the illicit market will prioritise the main transit corridors into the US, such as the northern border states of Nuevo León and Tamaulipas. Many of these traverse just those areas along the US border where the government hopes to lure foreign investment into the energy sector in 2015.

Prevalence of drug use in the US (%), 2002-12



Source: UNODC World Drug Report 2014

2. Enter the legal market

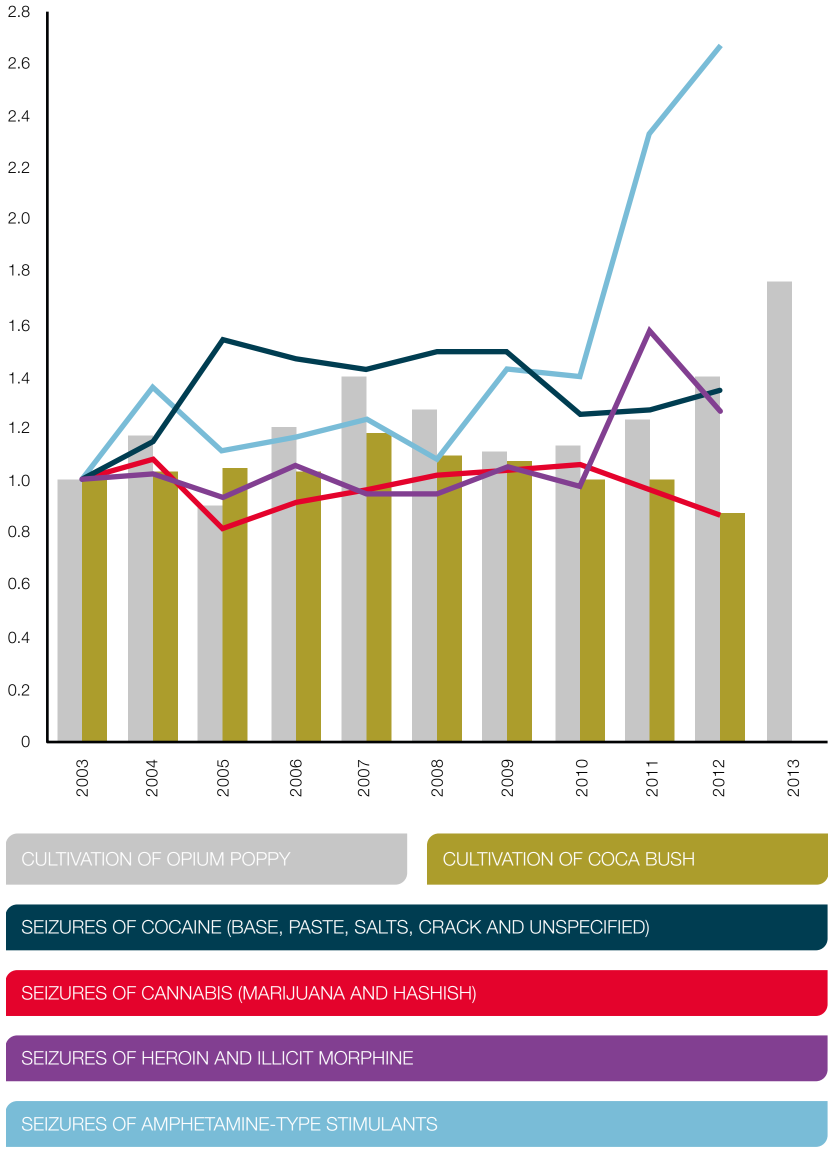
Cartels could also begin to move into emerging legal markets in the US, either directly or through investment. After all, they have the seed capital and process knowledge to run large growing operations; all that's required are the legal permits. Cartels – many of which already illegally grow product on public land in the US – are almost certainly considering how to add legal marijuana cultivation to their portfolios.

3. Target new markets

If legalisation in the US is changing the market from the top, expanding middle classes throughout Latin America are changing it from the bottom. This enticing market segment is armed with disposable income and increasingly permissive attitudes towards drug use – and selling within the region is a lower-risk proposition than trafficking across the militarised US border. If legalisation erodes margins in the US trade, regional markets will become more attractive.

This will stimulate competition among gangs to control these markets. Street violence has already accompanied the cartels' push into Central America over the last five years. Further expansion will see further insecurity and subversion of institutions.

Global trends in drug supply and supply reduction (index: 2003 = 1), 2003-13



Source: UNODC World Drug Report 2014

TOP: Port of Lazaro Cardenas, Mexico.
BOTTOM: Mexican police officers with cocaine seized in the port of Manzanillo.

CRACKDOWNS WILL CONTINUE

It is an article of faith in Latin America that the 'war on drugs' has done more harm than good over the last 40 years. Politicians across the region – from Colombian President Juan Manuel Santos to left-wing Ecuadorian firebrand Rafael Correa – are jockeying for leadership of an incipient peace movement that seeks to trade some tolerance of narcotics for greater security and stability.

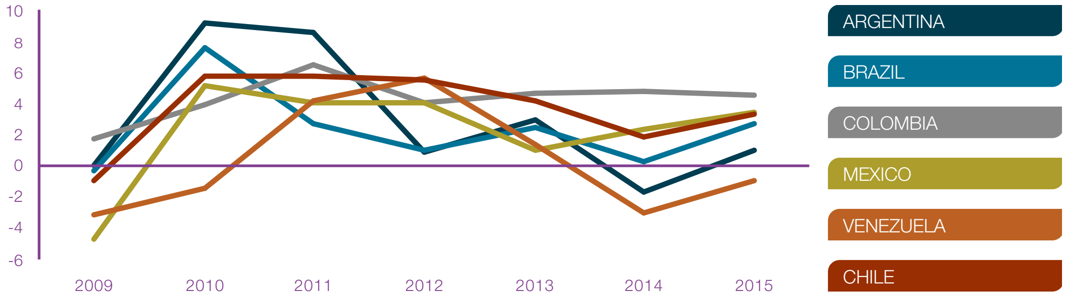
But 2015 will see no significant changes in drug policy in the region. Policy emphasis and political attitudes remain firmly on the side of strengthening law enforcement and cracking down on cartels and their customers. Far from the stoner heroes of US folklore who played a role in shifting cultural attitudes far enough to permit legalisation, Latin America's drug users are generally stigmatised and repressed.

This means that the violence that has come to characterise the drugs trade in Latin America will persist. Such violence usually avoids legitimate business and preys most on local nationals, rather than foreign expatriates. This is likely to continue, even more so if trafficking capitalises on rising middle classes. The cartels' entrenchment in new markets will also bring greater infiltration and corruption of institutions – politicians, courts, police, customs. It is this – far more than the headline-grabbing violence – that most erodes the environment for business.

AMERICAS SNAPSHOTS

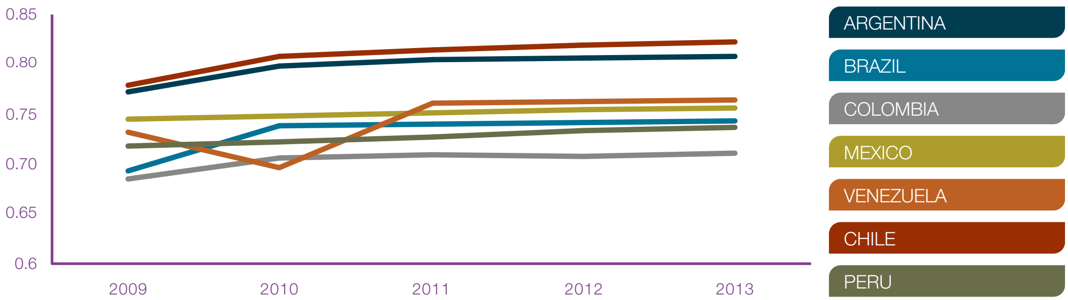
ECONOMIC PROSPECTS

GROWTH IS RUNNING INTO HEADWINDS



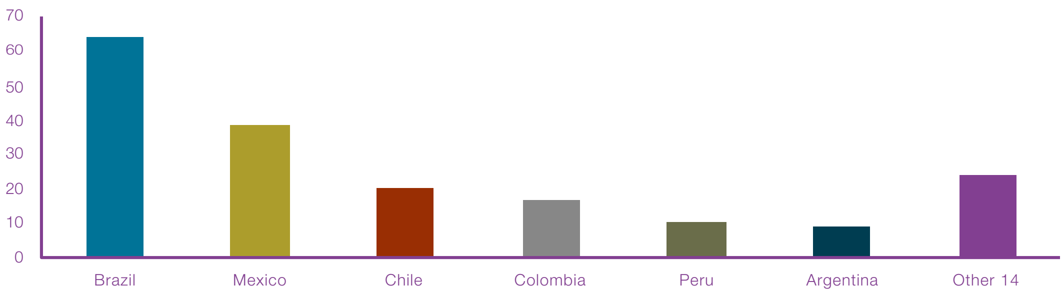
GDP GROWTH FOR SELECTED COUNTRIES (%), 2009-15 | Source: IMF

YEARS OF STRONG GROWTH HAVE BROUGHT ONLY LIMITED IMPROVEMENT IN LIVING STANDARDS



HUMAN DEVELOPMENT INDEX, 2009-13 | Source: UNDP

FDI REMAINS CONCENTRATED IN THE REGION’S GIANTS

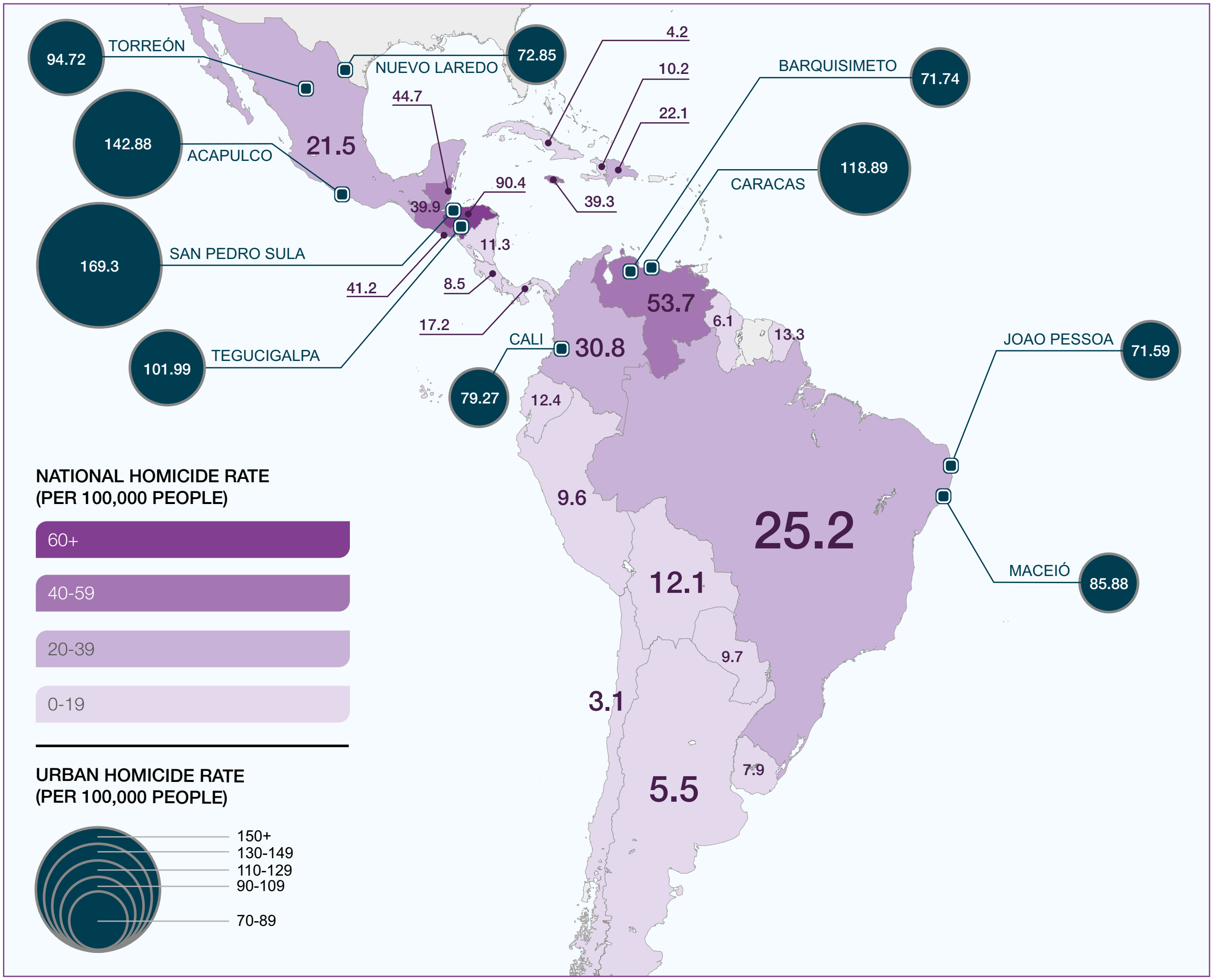


FDI IN SOUTHERN AND CENTRAL AMERICA (US$BN), 2013 | Source: UNCTAD

SECURITY

SEVERE URBAN VIOLENCE IS A SIGNIFICANT PROBLEM ACROSS THE REGION

National crime rates and top ten most dangerous cities in Latin America



Source: UNODC Global Report on Homicide 2013 (national rates); Citizen Council for Public Security and Criminal Justice (city rates).

OIL PRODUCTION

OIL PRODUCTION REMAINS LARGELY STAGNANT

OIL PRODUCTION (THOUSAND BPD) 2010-13 | Source: US Energy Information Administration (EIA)

BRAZIL, MEXICO AND VENEZUELA CONTINUE TO DOMINATE LATIN AMERICA'S PRODUCTION BUT THEIR PROSPECTS VARY

	PROVEN RESERVES	OUTPUT 2013	PLAN
BRAZIL	13bn BBL	2.7m BPD	5m BPD BY 2021

Brazil's production will continue to increase as firms exploit the massive offshore pre-salt fields. However, over-ambitious capital expenditure plans for state company Petrobras, relatively unattractive contractual terms for foreign operators and tight local content requirements also place a question mark over whether longer-term goals are achievable. Still, the positives outweigh the negatives and steady growth with a major role for foreign investors is likely.

	PROVEN RESERVES	OUTPUT 2013	PLAN
MEXICO	10bn BBL	2.9m BPD	3.5m BPD BY 2025

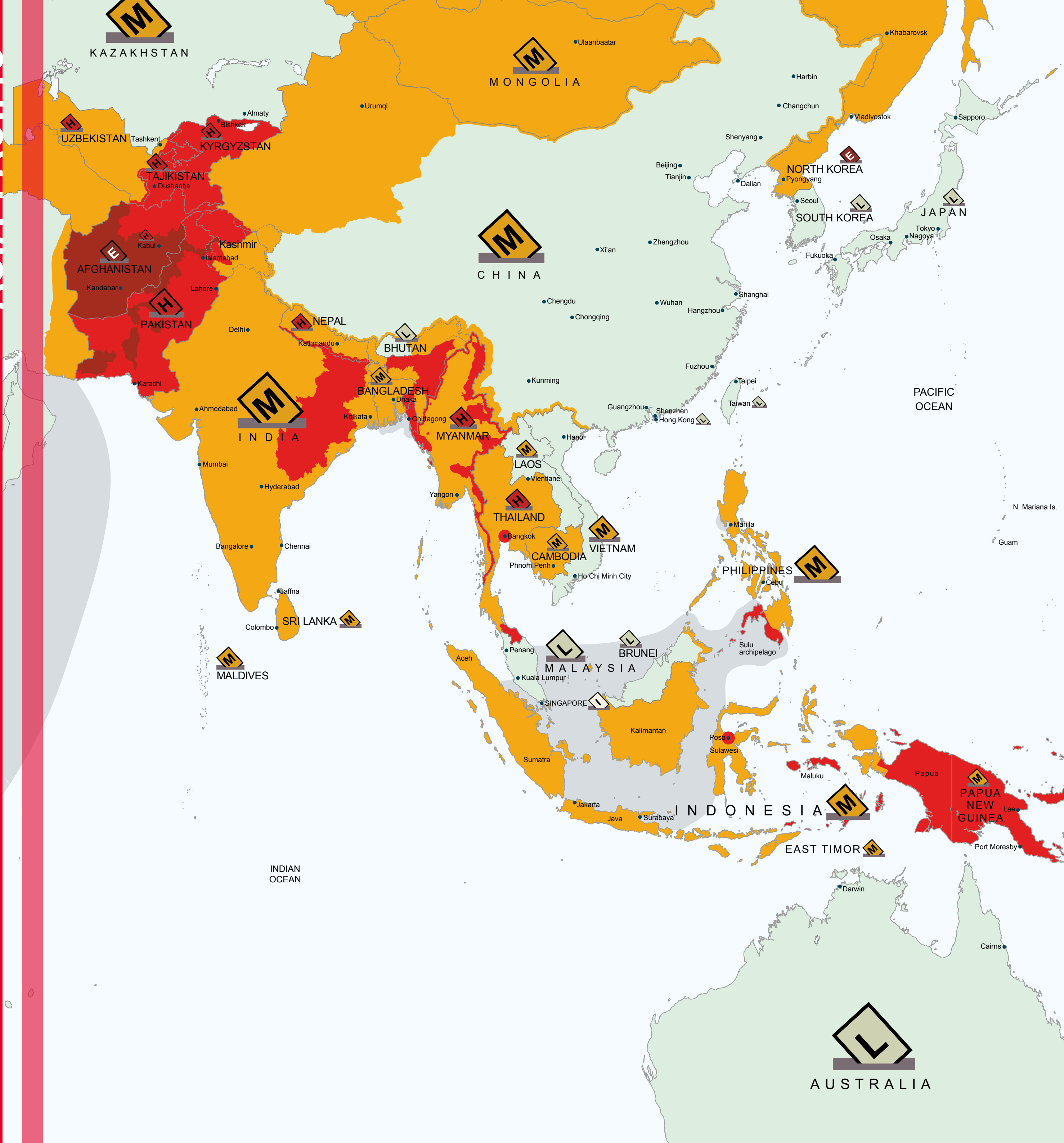
In Mexico, the government's 2014 energy reform promises a wave of new investment in the industry, as state oil company Pemex loses its monopoly on exploration and production. However, implementation is likely to prove difficult, with challenges such as corruption, security, social and labour issues, and judicial shortcomings.

	PROVEN RESERVES	OUTPUT 2013	PLAN
VENEZUELA	298bn BBL	2.5m BPD	6.5m BPD BY 2020

Venezuela remains more complicated for various reasons – targets for 2020 are pie in the sky given the steady erosion of technical and financial capacity at state-owned PDVSA, while the complex political and economic environment acts as a brake on all but the most determined or hardy of foreign investors.

Source: EIA (reserves and 2013 output)

ASIA-PACIFIC



CHINA'S NEW FRONTIER FOR REGULATORY RISK

ANDREW GILHOLM,
HEAD OF ANALYSIS,
ASIA

Stricter regulatory enforcement is posing significant risks to business.

- **Foreign companies are seen as fair game and face potentially severe impacts.**
- **Zero-tolerance policies against bribery and corruption can be a long-term net positive for business performance, but require major commitments from senior business leaders.**
- **Adjusting to this environment requires new strategies combining political and regulatory risk understanding with a range of other risk management disciplines.**

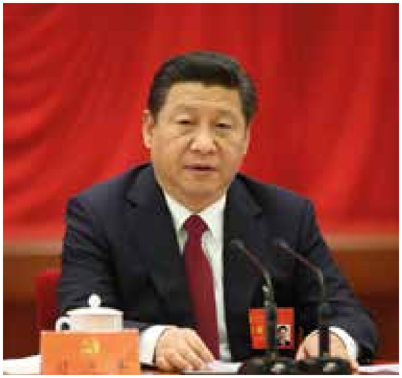
In 2012 and 2013, RiskMap highlighted three troubling China trends: tougher regulators, slower growth and deteriorating diplomatic relations. In 2014, these turned out to be among the top causes of stress for many business leaders, and there will be little relief in 2015. In particular, regulatory developments show signs of becoming a defining challenge for integrity and political risk management.

Diplomatic conflict is going to be a long-term feature of the environment in East Asia, and these days it can have real business implications (see page 69). Slower growth is also here to stay, and has risk implications beyond revenues. Two of the many scenarios we have seen previously (and recently) under these circumstances are 'rogues revealed' and 'restructuring gone wrong':

- Slower growth and cautious credit sees loans called in or dubious investments fail. Without cash to cover them up, previously hidden rogue practices like fraud, embezzlement or corrupt activities are unravelled and exposed. Liabilities and losses, and disputes and desperate measures often follow.
- A struggling economy brings restructuring, cutbacks or M&A, often amid local fears and resistance. Among other things, these situations typically pose some very complex labour and government relations challenges, which can get out of hand if not carefully managed.

NO COUNTRY FOR OLD CHINA HANDS

Troubling as these scenarios are, many large foreign firms in China have seen tough times before. Dealing with the fallout from diplomatic chills and economic strain is not unknown ground. But the trend taking even the most grizzled China veteran into nasty new territory since 2013 is the emergence of new regulatory risks – or, more accurately, political-regulatory risks. Several regulators have started to



TOP: Chinese President Xi Jinping at the Fourth Plenum in Beijing, October 2014. BOTTOM: Jin Mao Tower & Shanghai World Financial Center.

enforce anti-bribery and anti-monopoly rules with unprecedented vigour. While domestic companies are also targeted, it is clear that foreign companies are now 'fair game' (see box).

Even for those who think they've seen it all before in China, this is new. A few years ago, regulators back home were foreign companies' only real source of corruption and anti-trust enforcement concerns in China (unless they faced merger review). Mao Zedong said the revolution is not a dinner party. For some multinationals, this regulatory evolution is no picnic either. Competition and corruption enforcement are the key risk areas, but others – notably tax – may follow. Pharma, health, autos, technology, energy and telecoms have borne the brunt of scrutiny so far, but this too could change.

Companies already faced a growing dilemma: head offices continue to demand strong growth from their China business, but that has been getting harder to deliver amid the slowdown, stronger competition and a more selective government welcome for investment. The new regulatory risks compound this dilemma, leaving business leaders under pressure to drive growth while improving compliance to avoid becoming 'the next GSK'. These goals can conflict. Chinese police saw aggressive GSK sales targets as tacit acceptance of corruption (the assumption being that targets were unrealistic without bribery). Makers of LCD panels, communications technology, autos and infant nutrition products have been found to be in violation of competition and anti-monopoly laws in their efforts to raise prices and profits.

RHETORIC TO REALITY

There is evidence that effectively enforced, well-communicated, zero-tolerance policies on anti-bribery and corruption (ABC) can be a net positive for business performance even in complex emerging market environments. With years of increased international enforcement (under legislation such as the US Foreign Corrupt Practices Act) now followed by a surge in domestic scrutiny in China, the case is more compelling than ever. The problem, of course, is that implementing zero-tolerance ABC policies in a complex environment like China is very difficult. Companies therefore face some pretty stark questions:

- Are they really serious about ABC compliance in emerging markets? Or deep down do business leaders implicitly accept different standards there as part of the operating realities and 'local business culture', and keep risk management at arm's length while hoping for the best?

Enforcement against multinational companies

ANTI-MONOPOLY

Regulations: Anti-Monopoly Law (2008); Price Law (1998); Anti-Unfair Competition Law (1993)

Regulators: National Development and Reform Commission (NDRC); State Administration for Industry and Commerce (SAIC); Ministry of Commerce (MOFCOM)

RECENT CASES:

Jan 2013: NDRC fined foreign LCD panel makers for cartel pricing; the largest – Samsung and LG – were fined more than RMB 100m ($16.3m) each.

Aug 2013: NDRC fined several infant formula companies a total of RMB 670m ($109m) for resale price maintenance.

Sep 2014: NDRC fined 12 Japanese auto parts makers a total of over RMB 1.2bn ($196m) for co-ordinating prices to limit competition.

Also in 2014: In the technology and communications sectors, Microsoft, Qualcomm and InterDigital faced investigations from SAIC and NDRC.

ANTI-CORRUPTION

Regulations: Anti-Unfair Competition Law (1993); Criminal Law of China (2006)

Regulators: SAIC; Ministry of Public Security (MPS); Central Commission for Discipline Inspection (CCDI)

RECENT CASES:

Mid-2013: Following news of bribery investigations into GlaxoSmithKline, numerous other foreign pharmaceutical companies were also reported to be under scrutiny.

Aug 2014: Chinese executives at Volkswagen-FAW joint venture were investigated by the CCDI for suspected disciplinary violations.

Oct 2014: A Changsha court fined GSK nearly RMB 3bn ($491m) for commercial bribery, and imposed prison sentences on local company executives.

- Assuming that a major tightening in compliance can hurt short-term competitiveness and have other costs, are senior global business leaders willing to accept this? Are they ready to make real commitments, without which ABC policy implementation in China rarely gets beyond rhetorical initiatives?

There is a parallel here. In the 1990s, some leading companies in extractive industries began to move from rhetoric to reality on their CSR commitments. While the sector remains a focus of criticism over its social, environmental and other impacts, even many activists recognise improvements. These include success stories where major commitments to manage such impacts have had real results, even in very difficult environments (BP's Tangguh LNG project in Indonesia is one example). Today we may be seeing the start of a similar shift on ABC commitments, as trend leaders are looking much more seriously at trying to make ABC policies stick in markets where this is very difficult to do. China is the frontier of this trend.

2015 signposts

Following the CPC's fourth plenum in October 2014, 2015 looks set to bring changes to regulators and regulations, alongside continued enforcement activity against MNCs:

- SAIC is fast-tracking amendments to the Anti-Unfair Competition Law, while anti-money laundering changes are also possible.
- October also saw personnel changes at NDRC's key Anti-Monopoly Law bureau, while speculation persists that the three competition regulators will eventually be merged.
- There are signs that environmental and tax regulations, and their enforcement, may also be a focus of activity in 2015.
- The plenum suggested China will develop its first specific anti-corruption law, while an anti-graft body at the Supreme People's Procuratorate will be upgraded.

REDEFINING RISK

ABC-related integrity risks stand out for the potentially severe costs of compliance failings. But, more broadly, evolving political-regulatory risks are demanding new approaches. They will also accelerate a long-standing trend: understanding macro-level 'country risk' and 'geopolitical risk' undoubtedly remains necessary, but have long ceased to be sufficient for companies with increasingly complex demands on them, and therefore increasingly sophisticated risk management needs. Pre-entry basics and descriptive analysis were long ago overtaken by demand for support, characterised by:

- Practical tools such as threat, vulnerability and risk assessments, stakeholder mapping, recommendations and training. This can inform an overall China strategy, but is often highly targeted to help solve a specific problem or achieve a particular goal.

- Blending political risk analysis with disciplines such as ABC consulting, crisis management, strategic government relations advice, corporate-level research and internal compliance support. Solutions are typically feasible only through extensive research on the ground.

These trends are not unique to China. In India and Indonesia, for example, anti-corruption enforcement remains selective and problematic, but has been moving up the political agenda. Tougher enforcement of competition laws might follow. However, in 2015 China is likely to remain the main frontier, particularly with a new anti-corruption law and a regulatory restructuring likely following the Communist Party of China (CPC)'s Fourth Plenum. It is not on the way to being a high-risk market where truly arbitrary, predatory government agencies threaten investment security. But multinationals lulled by long experience must adjust to new regulatory realities… fast.

ANTI-CORRUPTION: THE BEST OF TIMES, THE WORST OF TIMES

The surge in regulatory investigations in China is increasing pressure on – and the importance of – compliance teams.

- **A sharp rise in whistle-blowing confronts companies with vague allegations; knowing how best to respond will be increasingly tough.**
- **A populist movement against corruption will see this issue replicated in other jurisdictions.**
- **Companies are getting smarter about using compliance-related intelligence for commercial benefit.**

CORENE CROSSIN,
DIRECTOR,
ASIA

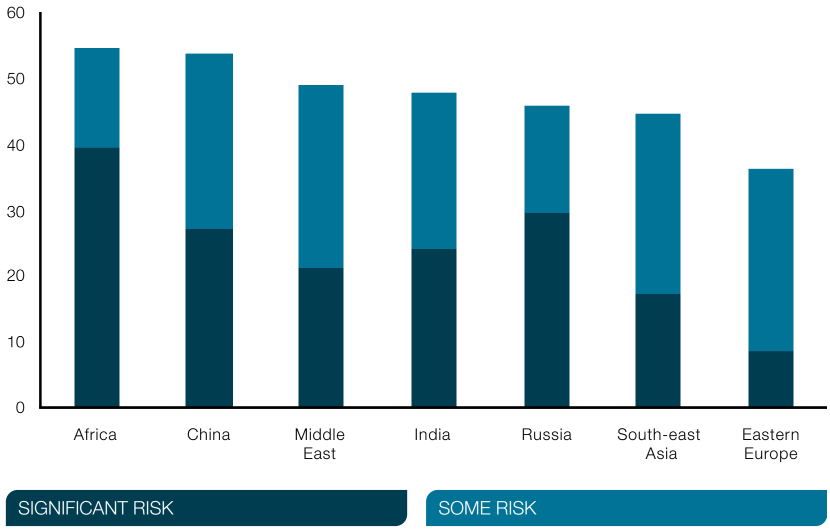
There has never been a worse time, or a better time, to work in compliance. The upsurge in China's aggressive enforcement of its anti-corruption laws and other regulations has shaken legal and compliance teams of foreign companies operating in China, leaving many uncertain about the adequacy of their programmes. At the same time, many compliance managers are silently rejoicing that finally, after years of urging senior managers to take anti-corruption seriously, their message resonates. There will be no sign of slack for compliance teams in 2015.

CHINESE CRACKDOWN

The pace and quantity of regulatory and criminal investigations launched in China since 2013 are unprecedented. Sure, inconsistent enforcement has long been a characteristic of China's legal system and business environment – and this once meant little or no enforcement at all against foreign companies. Those days are over. The overall direction of legal and regulatory reform in China suggests that tougher enforcement against foreign and local companies will continue. Unsurprisingly, these events are seriously challenging assumptions of the adequacy of tick-box approaches to international regulatory compliance.

While large fines and prison sentences grab the headlines (and senior management attention), the emergence of 'corporate criminal bribery' is only one of a multitude of increasing penalties, coming at a time when many international companies are facing slowing growth in China. Penalties that would have been under RMB 100,000 ($16,000) two years ago are now in the tens of millions of dollars – add in blacklisting and threats to business continuity for good measure. Cold cases, too, are fair game, revived because they were not 'investigated fully'. Forecasting the likelihood and impact of such regulatory investigations is becoming a critical business issue for many foreign firms, leading to ever increasing pressure on legal and compliance teams.

Countries or regions posing significant corruption risks to respondents' organisation (% of respondents)



Source: Control Risks International Business Attitudes to Corruption Survey 2014-15

As if this were not concerning enough for compliance teams, there has been a sharp rise in the volume of whistle-blowers reporting to Chinese regulators. These whistle-blowers provide enough tantalising allegations and vague evidence to entice regulators to act, often as they simultaneously extort the company to pay for their silence. Regulators are not obliged to reveal the source of their suspicions, or the evidence they have (or lack). Companies confronted with vague and confusing allegations must devise a strategy to deal with authorities under the threat that if they don't come up with something and 'confess', the penalties will be harsh. As official investigators grow in confidence and experience, and gradual improvements in the clarity of regulatory powers emerge through reform, knowing just how much evidence regulators have and how best to respond will be an increasingly difficult call to make.

WHERE NEXT?

The question for regional and global compliance managers is whether events in China are a bellwether for other emerging market economies. For now, no other non-OECD country appears to have the capability, or the intention, to imitate China's vigour. Yet this does not mean business-as-usual for global anti-corruption compliance.

Until recently, the US Foreign Corrupt Practices Act (FCPA) and UK Bribery Act tended to be the key drivers of anti-corruption compliance programmes. However, a populist movement against corruption continues to gain momentum, forcing governments from India to Brazil, and from Egypt to Indonesia, to reconsider their stance on the issue. Growing public demand for greater accountability for corrupt and illegal activities by government officials, and by local and foreign businesses in China and beyond, necessitates fresh approaches to anti-corruption risk management by international companies.

INNOVATIVE APPROACHES

Anti-corruption risk management is no longer strictly a legal and compliance issue. To stay ahead in this new era of increased and politicised regulatory scrutiny and enforcement, the most innovative international companies overhaul their approach to compliance. For instance, forward-thinking companies are recognising the commercial utility of information and intelligence gathered during compliance-led due diligence, and are using this to make better business decisions. This is particularly crucial in China, which targets how companies work with third parties. Agents, distributors, consultants and other such parties are critical to success in large, fragmented markets like China. In the high-growth period of the last ten years, companies often brought on third parties without sufficient planning or due diligence.

Shifts in anti-corruption enforcement and increased public scrutiny are also leading to innovation and adaptation in strategy and branding. Corruption risk assessments based on detailed on-the-ground intelligence on the precise nature and prevalence of corrupt practices in sub-markets and specific locations are being used to inform and stress-test market entry strategies, and to bring a dose of much-needed realism to ambitious plans for growth and expansion. Given public interest in corruption, a clear and firm position on integrity and ethics is also increasingly seen as a brand enhancer and a way of attracting local talent in highly competitive employment markets.

In short, in response to changes in China and beyond, smart companies are now using the tools and knowledge that come with best practice anti-corruption compliance to enhance their long-term competitive advantage in emerging markets. Perhaps there has never been a better time to be in compliance.

ASIA: DEMANDING ENERGY

With the US shale boom, Russia's confrontation with the West and the rise of IS, supply questions have dominated recent debates on the global energy outlook, but Asia remains at the heart of demand growth. Charles Hecker, Global Research Director, talks to Head of Asia Analysis Andy Gilholm, based in Shanghai, about prospects for key Asian energy issues in 2015.

WITH ANDREW GILHOLM,
HEAD OF ANALYSIS,
ASIA

Q Andy, all the activity that might have a disruptive impact on global energy supply is happening outside Asia. What's it like on the demand side in and around Asia?

A A lot of the determining factors for global demand come from this region, and will play out quite visibly in 2015. Relatively weak economic growth – by local standards – means we could hear a lot in 2015 about soft demand and downward pressure on prices. But keep your eye on the long-term story, which is still going to be all about the struggle to keep up with demand growth. The ways that key countries are trying to meet this challenge are being heavily influenced by political dynamics.

Q What's the key energy story for 2015 for China?

A We're looking for signs of more aggressive moves to boost domestic gas production, in particular through price reform and rises, and movement on unconventional gas after recent political pressure on China's national oil companies (NOCs). China has massive potential in theory, but won't get far exploiting it without a lot more liberalisation than we've seen so far. If 2015 sees the government tell the NOCs with the best acreage to 'use it or lose it', make tender terms more attractive for foreign companies and follow through with ensuring pipeline access for would-be producers, then a 'shale boom' will look like a less remote prospect.

At the macro level of course, the biggest question is about economic growth. China is by far the largest source of the world's growth in demand for primary energy. A real slump there – if it was severe, if it was sustained – would change everybody's assumptions about the outlook for demand growth globally. We're not expecting any such drastic slump, but nor will there be much of a rebound, and that will be a big test for policymakers. They need to accept some short-term pain to deleverage and adjust, so while a resort to stimulus might please the markets and boost 2015 growth, it would be a bad sign for longer-term sustainability.

Q One of the biggest news items we had in 2014 was the $400bn, 30-year gas deal signed during Russian President Vladimir Putin's visit to Beijing. In the context of Russia's confrontation with the West over Ukraine, and China's thirst for energy, what's the likelihood that these two countries will use energy as part of their response to the perceived threat from the US?

A We need to separate two concepts here. One is the simple fact that China-Russia energy co-operation is going to increase. That's only going to grow with the developments we've seen in 2014. This is all being confused, though, with the second concept – that of a political alliance. We'll see a lot more co-operation and leveraging of that relationship to balance perceived Western dominance and threats, but beneath all the positive spin on the relationship, they're also balancing against each other. There's a very deep mutual mistrust and threat perception that leaves little scope for the political relationship to go beyond the existing marriage of convenience.

Q Let's move away from China: Japan and South Korea are also right up there among the world's leading energy importers. North-east Asia takes about two-thirds of global liquefied natural gas (LNG) imports. With so many LNG export projects coming onstream, what are the key things to watch for in North-east Asia for 2015?

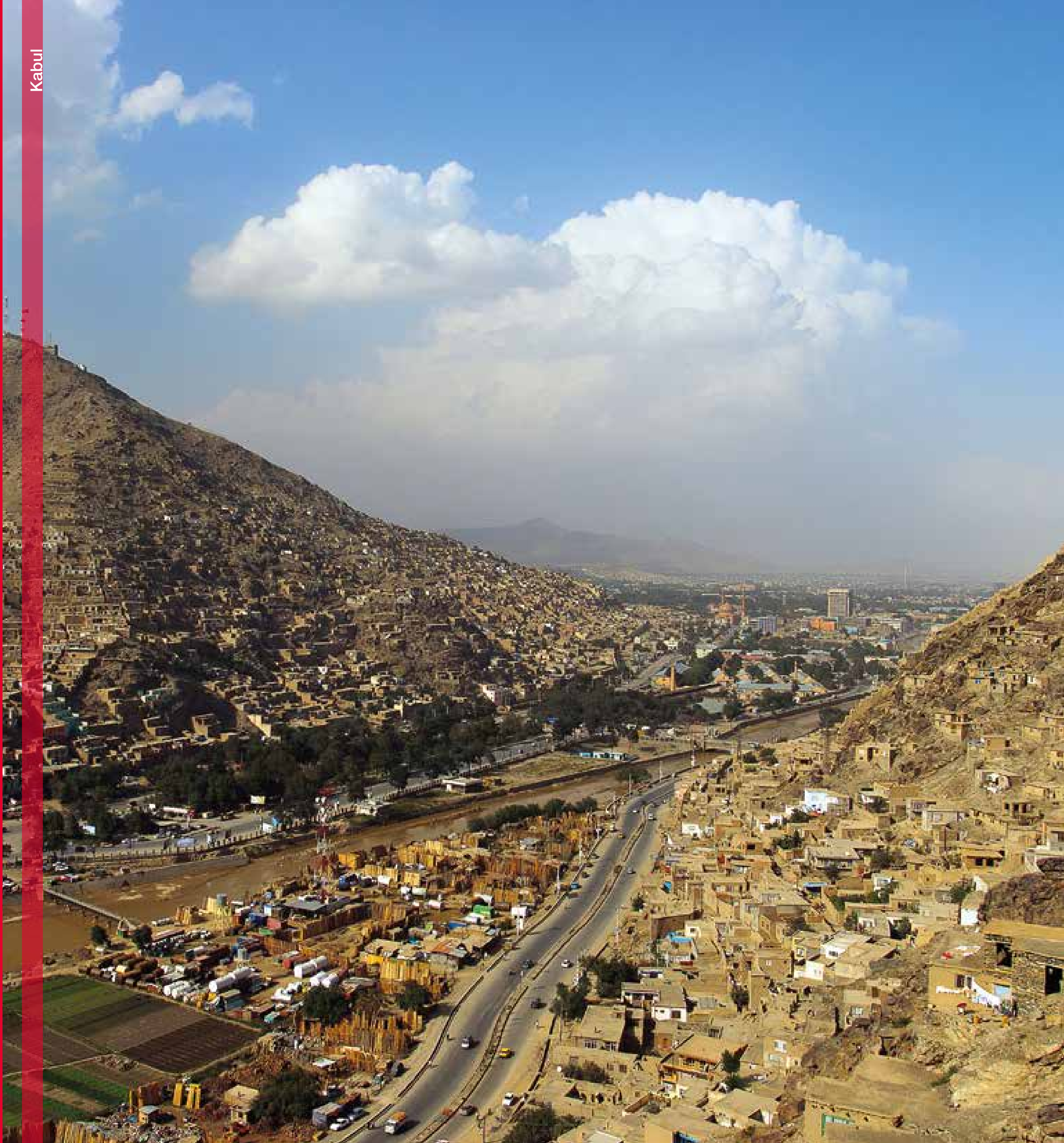
A High on most East Asian gas buyers' minds is the huge premium they pay compared with buyers in the US and Europe. There have been a lot of initiatives to try to deal with that – the big players are looking to co-operate, even by forming buyers' clubs – to bring the price of LNG down. Ultimately, however, competition is likely to trump co-operation. That's another reason why the periodic talk of a gas glut in the region won't last. In the long term, we're going to see North-east Asian players competing for resources again.

Another important issue is nuclear policy in Japan, a big factor in gas markets since the Fukushima disaster, when Japan shut down its nuclear plants. We are going to see some nuclear restarts in 2015, but it's still an extremely thorny domestic political issue. We'll only see limited restarts, which means Japan is going to remain a big buyer and a big factor in regional markets.

Q We need to discuss two other big players – India and Indonesia. They both have new governments elected in 2014 with high hopes for change, including for foreign investment in the extractives sector. Do we think these hopes are going to be realised?

A In Indonesia, President Joko Widodo has set a more positive tone on energy and extractives after a pretty dire period for foreign investors in the sector, and for the first time in years there's some hope for downstream projects. But he's going to face a lot of political problems pursuing his wider agenda and energy won't be the priority, so less progressive figures and vested interests will probably frustrate a lot of changes and prevent really fundamental sector reforms.

Similarly in India there's still a lot of economic nationalist sentiment and policy dysfunction wrapped up in the sector. We've seen little sign from Prime Minister Narendra Modi that energy is an area where we can expect breakthroughs. ■



ETHNIC FAULT LINES: OVERLAPPING RISKS IN AFGHANISTAN AND PAKISTAN

HUMA YUSUF,
SENIOR ANALYST,
AFGHANISTAN AND PAKISTAN

- **A new Afghan government will work to balance ethnic divisions to improve prospects for stability.**
- **These efforts could have serious impacts on local stability, while ethnic fragmentation in the security services may undermine security.**
- **Ethnic dynamics and inter-provincial relations in neighbouring Pakistan also have implications for security and political stability.**

2015 is a milestone year for Afghanistan. Under a new national unity government, the country is tackling the resurgent threat from the Afghan Taliban with only minimal support from international troops. As militants escalate attacks in southern and eastern provinces, the government is likely to remain focused on balancing complex ethnic dynamics. This emphasis on inclusive politics is key to stability: ethnic fragmentation will only exacerbate the fragile security situation. Within and beyond its borders, the situation in Afghanistan is a reminder to business of how political and security risks can overlap in a way that affects operations in ethnically diverse markets.

UNDER NEW MANAGEMENT

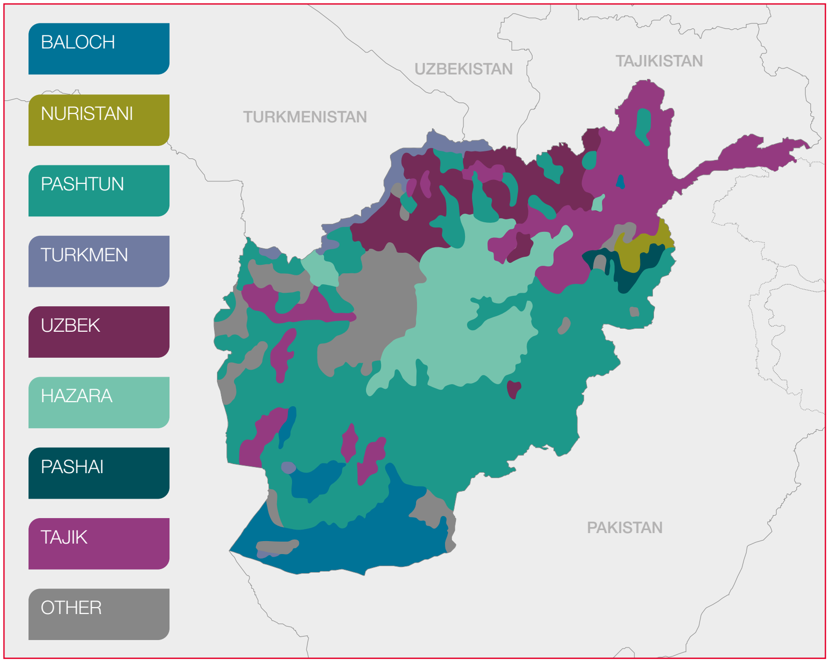
The goal of managing ethnic diversity informed the new structure of the government, which since September 2014 includes a chief executive officer – a post scheduled to evolve into prime minister in 2016. Afghanistan's electoral process has long been dominated by ethnic identity as Pashtuns, Tajiks, Hazaras and Uzbeks vote in blocs, supporting candidates from the same ethnic group. By starting the transition from a presidential to a parliamentary system, Afghanistan has acknowledged the importance of neutralising ethnic rivalries through inclusive politics.

But attempts to balance ethnic divisions are likely to paralyse governance in the coming year. President Ashraf Ghani is Pashtun, while Dr Abdullah Abdullah, the country's first CEO, is Tajik. Power struggles between ethnic blocs will hamper Ghani's efforts to jumpstart the economy. Both leaders instead will seek to accommodate members of their ethnic constituencies in key government posts or placate them through lucrative contracts.

Ethnic rivalries can affect business operations at the provincial level. Afghanistan's relatively stable northern provinces are most vulnerable to ethnic competition between Uzbeks and Tajiks. The political bargains struck in the national unity government can stoke local rivalries that affect investments in energy, mining and infrastructure in these areas.

Ghani contested the 2014 general elections alongside Abdul Rashid

Distribution of ethnic groups in Afghanistan



Source: GREG project, Swiss Federal Institute of Technology (ETH)

Dostum, a former warlord of Uzbek ethnicity with influence in the northern provinces. Dostum was promised the position of first vice-president, but Abdullah's appointment as CEO has undermined Dostum's political prospects. This is likely to intensify existing rivalry between Dostum and Atta Muhammad Nur, an ethnic Tajik and one of Abdullah's staunchest supporters in the north. Such overlapping political and ethnic rivalries have the potential to fuel insecurity if Dostum and Atta's supporters clash, but will also complicate the business environment as the groups compete for contracts and investment opportunities.

Ethnic dynamics also have the potential to increase broader security risks in Afghanistan. The Afghan National Security Forces (ANSF) – likely to be the Afghan Taliban's main target in 2015 – will struggle with internal ethnic resentment. Despite government efforts to balance ethnic representation in the security forces, Tajiks dominate command posts; Pashtuns from the south remain under-represented. In the coming

TOP: Afghan President Ashraf Ghani.
BOTTOM: Baloch activists stage a protest in Islamabad, March 2014.

years, ethnic fragmentation at the government level could lead to corresponding splits within the ANSF – and greater conflict overall.

ACROSS THE BORDER

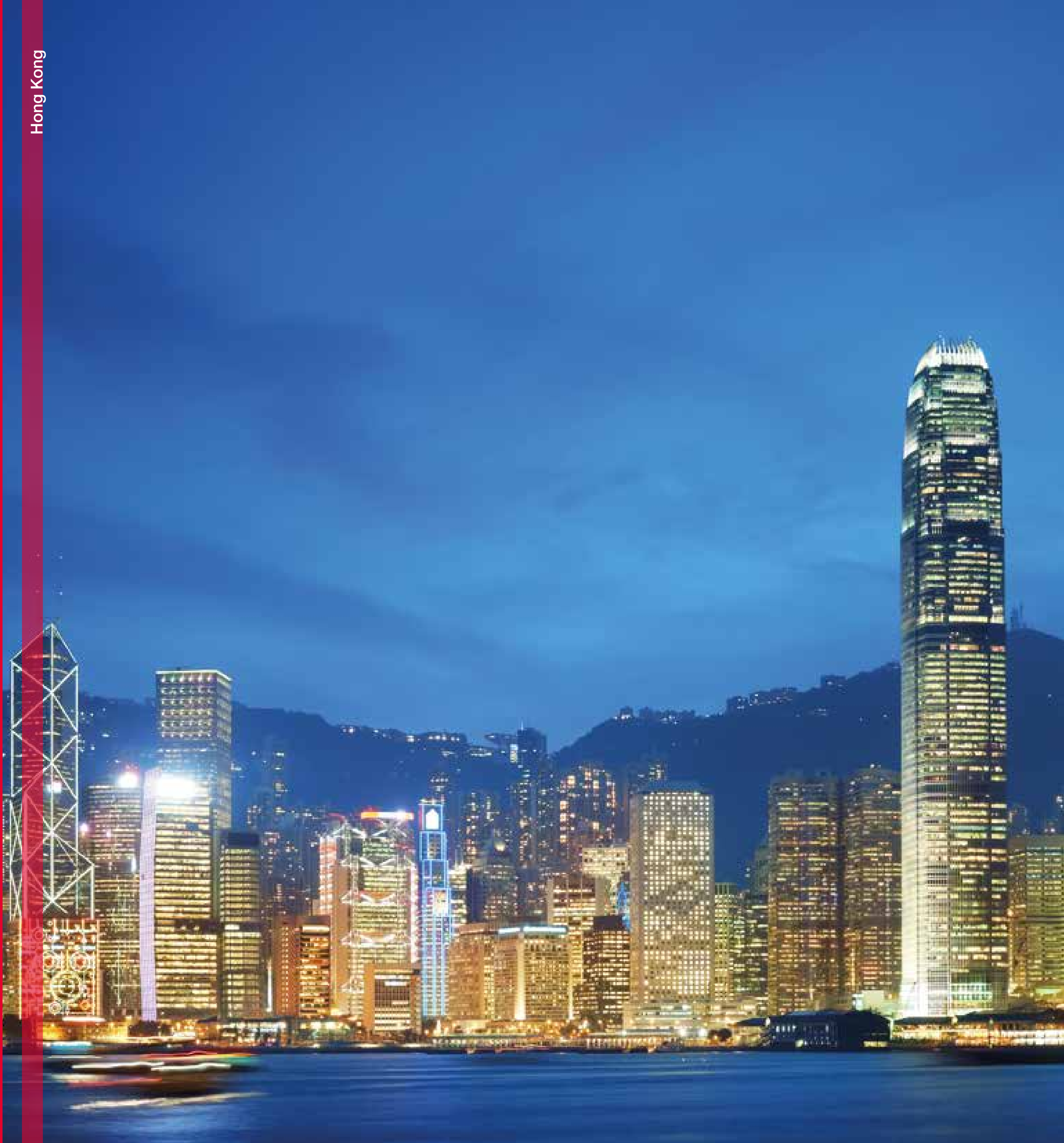
The ethnic dimension of Afghanistan's political and security contests will continue to affect Pakistan. Islamabad has long called for a political role for the Pashtun-dominated Afghan Taliban, believing Pashtuns are more likely to defend Pakistan's interests in Kabul, and as a means of placating the Pashtun population in Pakistan.

However, tacit support for the Afghan Taliban within elements of Pakistan's security forces is likely to lead to further instability within Pakistan as well. As the Afghan Taliban gains control of districts adjacent to the countries' border, Pakistan-based militants – of all ethnicities – are poised to seek sanctuary in Afghanistan and increasingly conduct cross-border attacks against the Pakistani security forces.

Internal ethnic rivalries are also likely to lead to a deteriorating security environment in Pakistan. Separatist Baloch militants in the western province of Balochistan, who have long resented the federal government's exploitation of the province's oil and gas resources, are likely to continue to wage an insurgency, though a long-running military operation has significantly reduced their capability. Baloch separatists are currently the only militants in Pakistan who directly target commercial and industrial assets, particularly oil and gas pipelines and railway infrastructure.

Ethnic dynamics will also influence major development projects in Pakistan. Since the passage of a constitutional amendment in 2010, the government has devolved power to the provinces, which are defined along ethnic lines. As provinces are increasingly empowered in terms of regulatory and legislative influence, they are likely to introduce new policies and tax regimes to benefit the province – and with it, the ethnic constituency – at the expense of others. Major development initiatives such as dams and energy projects are therefore increasingly likely to be contingent on ethnic dynamics.

In both Afghanistan and Pakistan, ethnic rivalries can influence daily business operations, for example by sparking labour unrest, or skewing access to real estate or utilities. Taking a lesson from this region, businesses should plan for the operational impact of local factors such as ethnic diversity, and the resulting potential for political and security risks.



WHAT EAST ASIA'S GEOPOLITICAL COLLISION COURSE MEANS FOR BUSINESS

ANDREW GILHOLM,
HEAD OF ANALYSIS,
ASIA

Maritime disputes in the South and East China Seas will remain the main source of friction in East Asia in the coming year.

- **Although major military conflict in the region remains highly improbable, China will continue to actively challenge the status quo in 2015; occasional maritime incidents and diplomatic crises are likely.**
- **There is evidence that bilateral disputes are increasingly likely to manifest in impacts on trade and the performance of individual businesses in certain sectors.**
- **Diplomatic spats will also retain the potential to cause regulatory disruption, and in some cases localised security risks, to foreign companies' China operations.**

One of Asia's biggest geopolitical shifts in recent years has seen maritime territorial disputes in the South and East China Seas eclipse the region's long-standing 'top three' flashpoints – India/Pakistan, the Taiwan Strait and the Korean peninsula. North Korea under Kim Jong-un will continue to periodically elbow its way to the front of the crisis queue in 2015 – Kim may have been in power for three years, but his regime is still less stable and predictable than his father's, and remains firmly on the watch list. But barring an unprecedented escalation (or implosion) involving North Korea, Asia's geopolitical troubles will mainly arise from conflicts between China on the one hand, and the US, Japan, Vietnam and the Philippines on the other, with maritime disputes now established as the main fulcrum of frictions.

Analysis of these disputes tends to get bogged down in debates over military balances, historical arguments and international law, further complicated by strong opinions on all sides. Although it is crucial that investors in the region understand the implications of the situation, that means figuring out their own vulnerability to various scenarios, then monitoring the relevant risks. This is not helped by analysis that focuses on decrying threats to national interests and prescribing policy responses. From the investor perspective, the overall outlook, at its core, need not be that complex.

UNSTOPPABLE FORCES

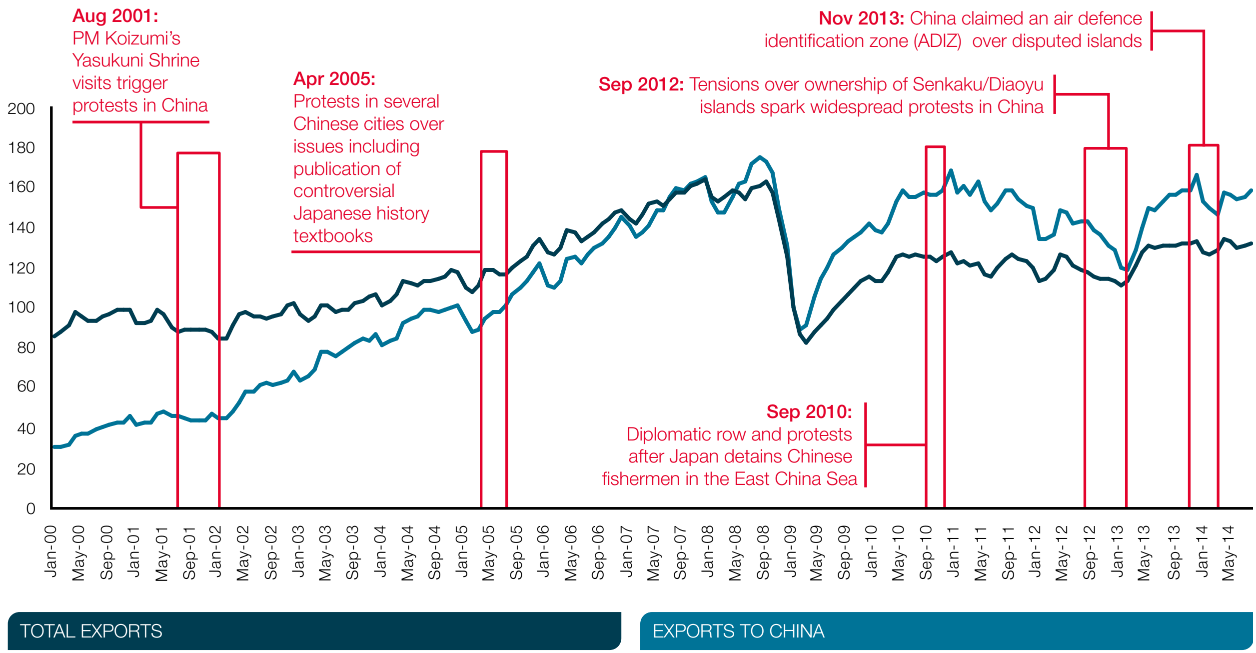
China does not and will not accept the current status quo in East Asia. It will continue to take active means to change it, and will have increasing capability to do so. The US and many of China's neighbours are determined to resist any Chinese efforts to unilaterally change the status quo. You do not need to be a die-hard realist or forecaster of new Cold Wars to see obvious scope for collision: the unstoppable force of China's rise meeting the immovable object of US primacy in the western Pacific.

Things are not quite that grim. To some extent China (unless it suffers severe and long-lasting economic derailment) will have to be accommodated. It is just a matter of how, how far and how fast the process unfolds. But it is a process rife with risk. Simplistic though it may sound, current trajectories plus the laws of probability suggest that occasional accidents or incidents are bound to occur, and to trigger some level of diplomatic or military crisis.

INTENDED CONSEQUENCES

A 2001 mid-air collision between a Chinese air force jet and a US surveillance plane, a 2009 incident involving the USS *John S. McCain* and a Chinese submarine, and a 2014 stand-off between China and Vietnam over deployment of a Chinese drilling platform in disputed waters are just three examples of potential triggers. With increased naval and air traffic in disputed areas, they will not be the last. Riskier moves such as seizures of disputed features in the Spratly Islands are also now a real possibility.

Japanese exports to China and total exports (index 2009=100), 2000-14



Source: Japanese Ministry of Finance

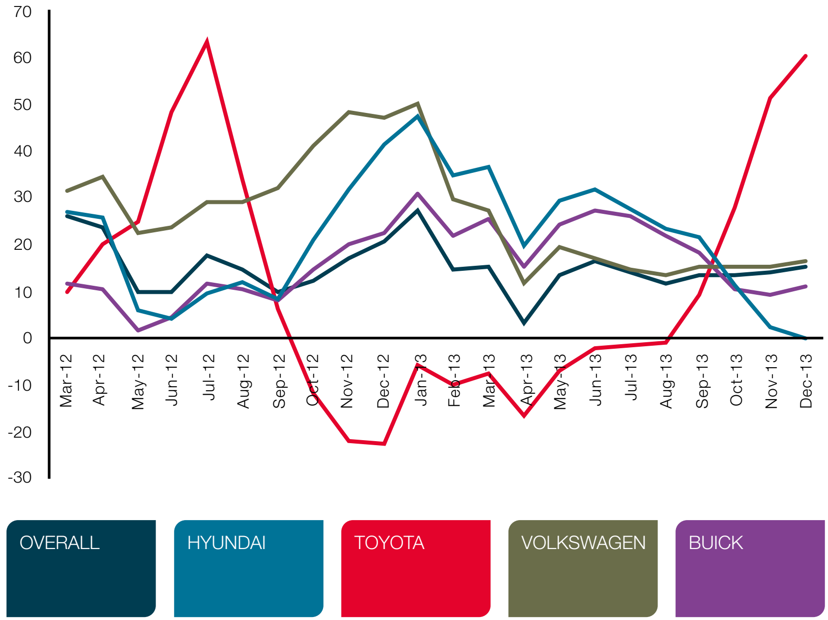
Serious military conflict or much-hyped 'economic warfare' is now credible enough to be worth factoring into companies' and investors' 'shock' scenarios, but remains a remote contingency. It is the less extreme but more likely scenarios that warrant more attention because the risk of impacts on trade, and on individual companies, appears higher than a few years ago, on at least three fronts:

- Trade targets: Diplomatic crises used to have little obvious effect on overall trade relations, but in 2012-14 impacts have been more visible, at least in certain cases – notably China-Japan and China-Philippines. Full-year China-Japan trade volumes fell in 2012 and 2013, even as their overall trade volumes grew. China seems to be exerting more economic leverage through trade, at least in temporary, targeted ways. Countries with high trade dependence skewed towards China are more vulnerable. If South Korea's lesser-known maritime disputes with China ever got out of hand, it could perhaps be uniquely vulnerable through its big *chaebol* exporters.

- Business performance: Companies in particular sectors and situations are especially vulnerable. The classic example of this is the impact on the China sales of Japanese auto manufacturers following the September 2012 diplomatic crisis over a territorial dispute and subsequent anti-Japanese protests in China. However, such issues are not unique to autos, or to Japanese and other Asian companies. Anti-Western sentiment can spike too, as seen in 1999 following the bombing of the Chinese embassy in Belgrade, and in 2008, when several French companies faced protests. Some research also suggests that diplomatic crises can affect the share prices of companies selling heavily into China.

- Operational impacts: There is substantial anecdotal evidence of a range of regulatory and other impacts on foreign companies from diplomatic spats. Norwegian companies suffered a bureaucratic chill after a Chinese political dissident was awarded a Nobel prize in 2010, and bilateral ties have yet to return to normal. China in the past has warned the US, UK and France that hosting the Dalai Lama would result in unspecified negative consequences, and companies in these countries have subsequently speculated that this lay at the root of lost contracts, or delayed meetings and approvals. Some Japanese companies linked customs blockages – and in one case the detention of staff for 'spying' – to diplomatic crises, and in 2012 faced problems ranging from

Sales growth of selected car makes in China (year-on-year %), Mar 2012 - Dec 2013



Source: POLK

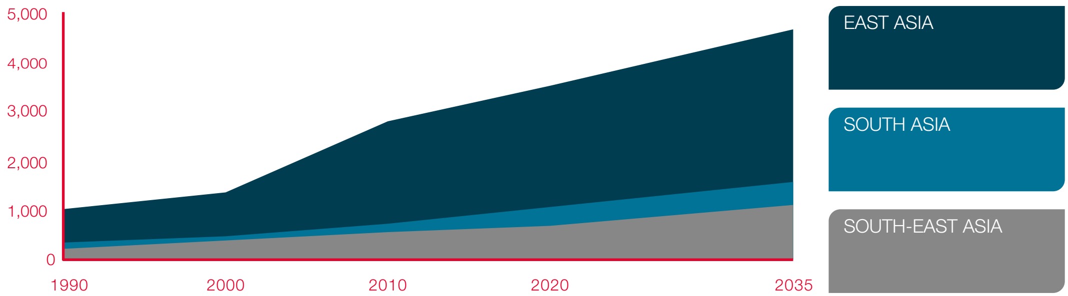
vandalism and precautionary suspension of operations to physical security incidents.

Recent claims that China's regulatory crackdown on competition and corruption issues (see page 53) constitutes 'foreigner-bashing' linked to diplomatic disputes are more doubtful. However, government-level frictions can probably be a supplementary consideration in targeting, and an additional complication when handling regulatory scrutiny. In the current environment, the old truism of 'politically cold and economically hot' international relations in Asia looks increasingly doubtful. Some investors could feel the chill in 2015.

ASIA SNAPSHOTS

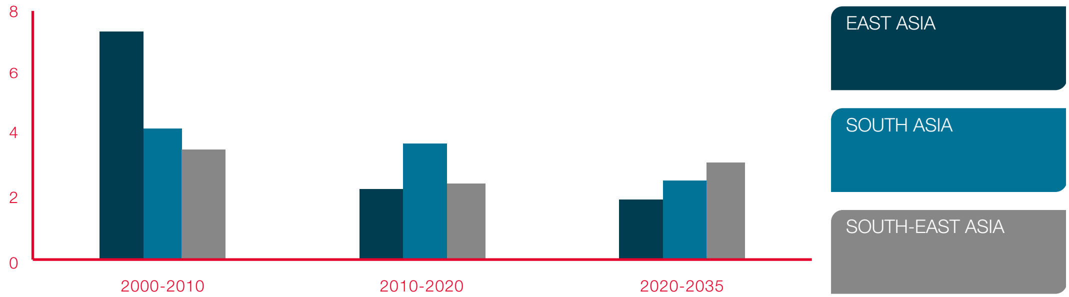
ENERGY DEMAND

ASIAN ENERGY DEMAND WILL CONTINUE RISING



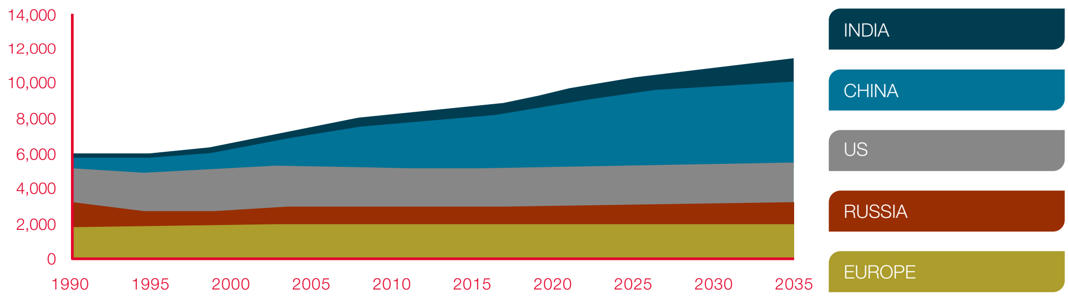
PROJECTED ASIAN ENERGY DEMAND (MTOE), 1990-2035 | Source: Asian Development Bank (ADB)

SOUTHEAST ASIA DEMAND GROWTH OUTSTRIPS OTHERS FROM 2020



PROJECTED ASIAN ENERGY CONSUMPTION GROWTH RATE (%), 2000-35 | Source: ADB

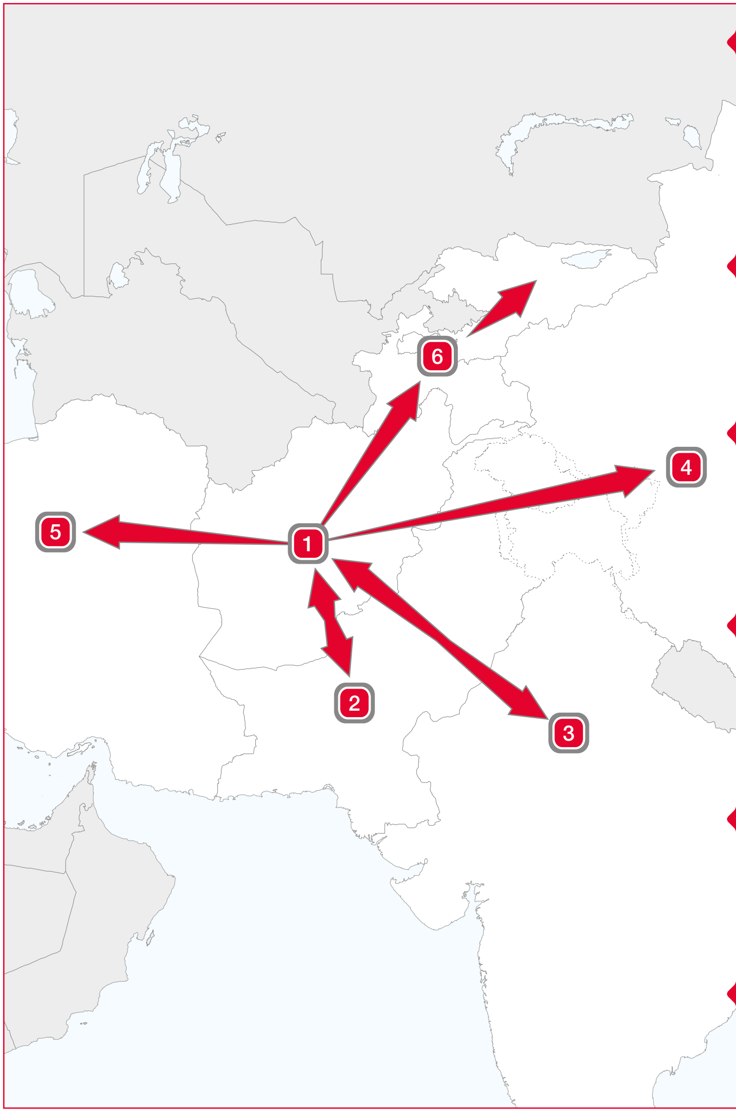
CHINA WILL CONTINUE TO DOMINATE ENERGY DEMAND



PROJECTED ENERGY DEMAND (MTOE), 1990-2035 | Source: BP

SECURITY IN SOUTH ASIA

THE US AND NATO TROOP DRAWDOWN FROM AFGHANISTAN WILL HAVE A RANGE OF KNOCK-ON EFFECTS IN THE REGION



1 AFGHANISTAN

- Pakistani and other regional militant groups establish sanctuaries in Afghanistan
- Afghan National Security Forces are the primary focus of militant attacks, though civilians are increasingly targeted
- The potential for Pakistan/India proxy war increases as militants target Indian assets, northern provinces

2 PAKISTAN

- Increase in cross-border attacks by Pakistani militant groups based in Afghanistan targeting state security forces and religious minorities
- Militant attacks in urban areas increase as militant groups continue to fragment and seek control of new areas

3 INDIA

- Pakistani militants in Afghanistan target Indian assets; India increases protection for embassies and consulates in Afghanistan
- India increases indirect support for Afghan National Security Forces
- Limited impact on militancy in India-administered Kashmir and across India as militant groups focus on conflict in Afghanistan

4 CHINA

- Uighur radicalisation in border areas (with Afghanistan or FATA) increases; China puts pressure on Pakistan to check rise in Uighur militancy
- China increasingly collaborates with Afghanistan to stem Uighur militancy

5 IRAN

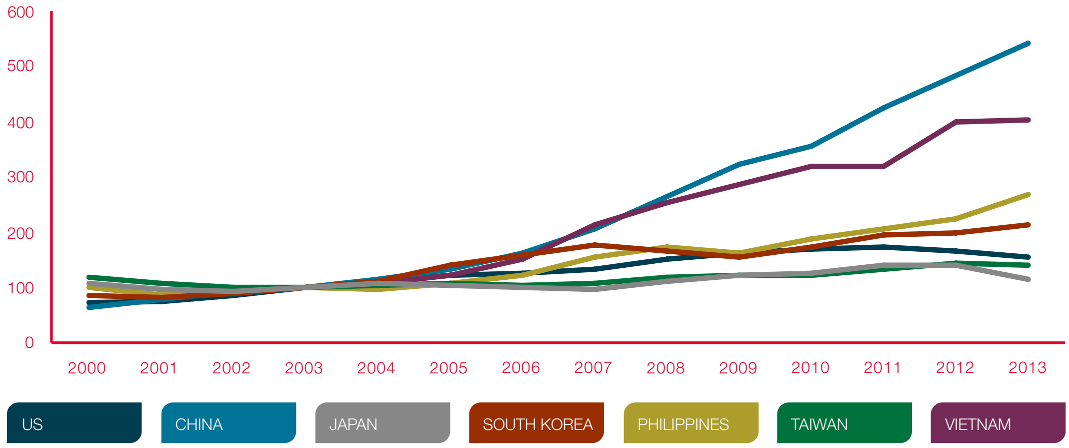
- Iran puts pressure on Afghanistan to prevent militant attacks against Shia Muslims
- Resurgent Afghan Taliban funds activities through drug trafficking; Iran enhances controls on border with Afghanistan

6 TAJIKISTAN AND KYRGYZSTAN

- Cross-border drug trafficking continues, strengthening organised criminal networks

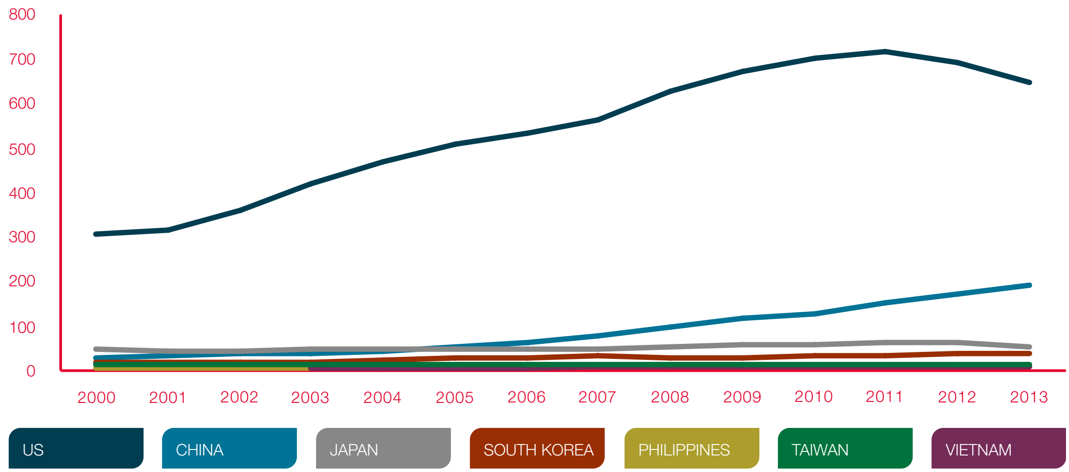
DEFENCE SPENDING

CHINA'S MILITARY SPENDING IS ACCELERATING FASTEST IN THE REGION...



MILITARY EXPENDITURE BY COUNTRY (INDEX: 2000 SPENDING = 100), 2000-13 | Source: SIPRI

...BUT REMAINS FAR BELOW US SPENDING



MILITARY EXPENDITURE BY COUNTRY (CURRENT US$BN), 2000-13 | Source: SIPRI. Note: Philippines, Taiwan and Vietnam have very similar spending.


Faeroe Islands (DENMARK)
NORWAY
Oslo
SWEDEN
Stockholm
Gothenburg
FINLAND
Helsinki
St Petersburg
RUSSIAN FEDERATION
Moscow
Nizhniy Novgorod
Samara
Rostov on Don
ESTONIA
Tallinn
LATVIA
Riga
LITHUANIA
Vilnius
Kaliningrad (RUSSIA)
BELARUS
Minsk
DENMARK
Aarhus
Copenhagen
Northern Ireland (UK)
IRELAND
Dublin
UNITED KINGDOM
London
NETHERLANDS
Amsterdam
BELGIUM
Brussels
LUXEMBOURG
GERMANY
Berlin
POLAND
Warsaw
CZECH REP.
Prague
SLOVAKIA
Bratislava
AUSTRIA
Vienna
HUNGARY
Budapest
UKRAINE
Kyiv
MOLDOVA
Chisinau
ROMANIA
Bucharest
FRANCE
MEDIUM security in deprived urban areas
Paris
SWITZERLAND
Zürich
Berne
Geneva
LIECHTENSTEIN
SLOVENIA
Ljubljana
CROATIA
Zagreb
BOSNIA AND HERZEGOVINA
Sarajevo
SERBIA
Belgrade
MONTENEGRO
Podgorica
KOSOVO
ALBANIA
Tirana
MACEDONIA
Skopje
BULGARIA
Sofia
GREECE
Thessaloniki
Athens
ITALY
Rome
Corsica (FRANCE)
ANDORRA
Barcelona
SPAIN
Madrid
PORTUGAL
Lisbon
MALTA
TURKEY
Istanbul
Ankara
CYPRUS
GEORGIA
Tbilisi
ARMENIA
Yerevan
AZERBAIJAN
Baku
Nakhchivan (AZERBAIJAN)
SYRIA
Damascus
LEBANON
Beirut
ISRAEL
PALESTINIAN TERRITORIES
JORDAN
Amman
IRAQ
Kurdistan Region
Erbil
Baghdad
Basra
KUWAIT
Al Khobar
MOROCCO
Rabat
Casablanca
ALGERIA
Algiers
Oran
Annaba
TUNISIA
Tunis
LIBYA
Tripoli
EGYPT
Alexandria
Cairo

REFOCUSING ON SECURITY CHALLENGES

DAVID LEA,
SENIOR ANALYST,
EUROPE

In 2015, Europe will have to set aside continued economic distractions to deal with a number of security challenges.

- **Europe will remain ill-equipped to respond to continuing Russian aggression, and too dependent on the latter's gas to seriously rethink its approach.**
- **Continued security concerns will see increased political pressure for a rethink of the Schengen agreement on free movement within Europe.**
- **The prospect of radicalised individuals returning from Syria and Iraq to commit terrorist acts on European soil may grab headlines, but an extensive campaign of such attacks is unlikely.**

Europe has spent the last five years looking inward, beset by an economic crisis that has settled in like a chronic case of flu. Depending on whom you believe, the persistence of the crisis stems from the rigid austerity orthodoxy of Brussels and Berlin, or from the reform-resistant politicians and electorates of Europe's periphery. It almost doesn't matter. Europe has been concentrating on keeping the euro and the wider EU functioning, and seeking to prevent a total economic meltdown on its southern fringes.

There were a few advance warnings that this inward stare would have to end – most notably the Arab spring, which erupted just a few hundred miles from the EU's extremities. More recently, 2014 brought external challenges once again front and centre in the EU's thinking. The Syrian crisis has reached its most acute point yet, with EU membership candidate Turkey on the slow but steady road to inevitable involvement. Meanwhile, the prospect of Ukraine signing an Association Agreement with the EU was one of the triggers for that country's descent into a scarring regional conflict. Elsewhere, the number of migrants arriving in Europe by Mediterranean crossing in 2014 had surpassed the 2013 total by June; the Spanish exclaves of Ceuta and Melilla have experienced their worst year for unlawful access attempts since 2008.

The coming year is going to see these trends accelerate, and new conflicts on Europe's periphery will pose fresh security challenges at its core.

BLOWBACK

The highest-profile security challenge facing Europe on its home turf is 'Syria blowback': the potential for individuals returning from involvement with Islamist extremist groups in Syria and Iraq – particularly Islamic State (IS) – to commit acts of terrorism on European soil. As the conflict continues in the Middle East, returnees have been implicated in terrorist actions, most notably the

TOP: Russian Prime Minister Dmitry Medvedev and President Vladimir Putin.
BOTTOM: A migrant trying to escape from police in the Spanish exclave of Melilla in North Africa, May 2014.

shooting at the Jewish museum in Brussels in May 2014, in which four people were killed; a French national who had returned from a spell fighting in Syria was subsequently arrested.

Returnees are likely to either commit or inspire further such incidents in the coming year. Evidence from recent plots suggests that small-scale attacks on targeted individuals or sites are more likely than complex plots involving large groups and major logistical effort.

Much of the media focus in the UK has been on 'Jihadi John', the British-accented figure appearing in a number of apparent IS execution videos. However, this – and similar national-interest stories elsewhere in Europe – does little to facilitate serious, coherent national and European strategies for countering an outbreak of Syria-related terrorism should it occur. The gradual shift away from a crisis response approach to a policing strategy on counter-terrorism, dating back to the relatively peaceful days of the 'late al-Qaida period', may need a rethink.

Nonetheless, despite media fear-mongering, a mass return to the West by foreign fighters based in Syria and Iraq is unlikely in the coming year, given the likely continuation of the conflicts there. What's more, levels of support for IS among Muslim communities in Europe appear low, even relative to that enjoyed by al-Qaida in the mid-2000s.

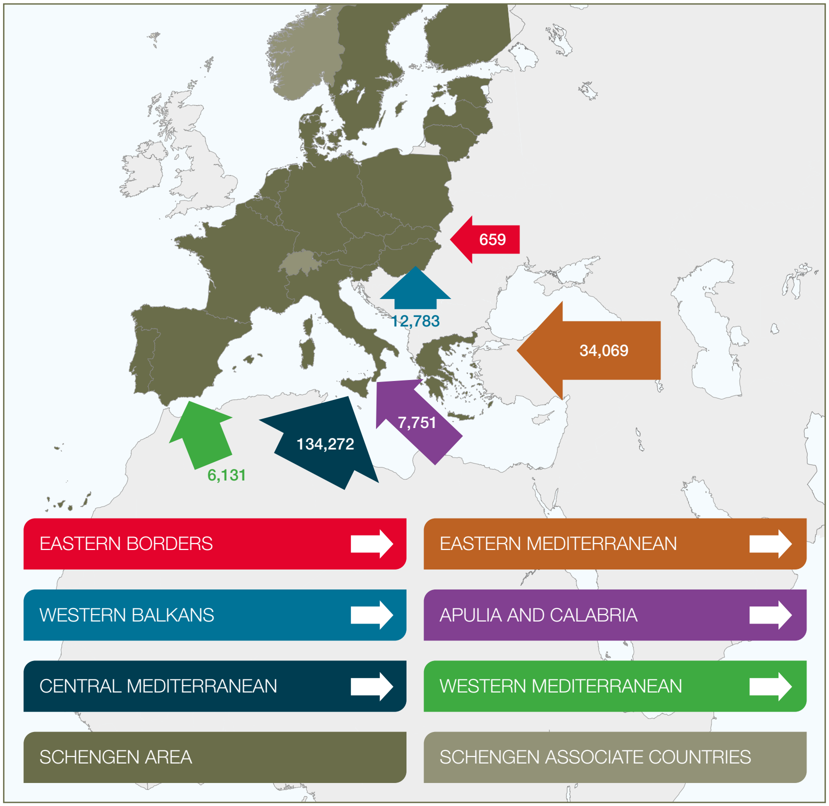
NO RESPONSE TO RUSSIA

If the Ukraine crisis has proven anything about European security, it is that Europe is not equipped to respond to Russia. Russia's annexation of Crimea may never be accepted elsewhere in Europe, but there is no prospect of any practical measures being taken to reverse it. Russian military flights passing just over the borders of the Baltic states and Finland in the third quarter of 2014 generally encountered a response that could be called stern, but fell far short of outrage.

This is a function of the post-Cold-War move away from viewing Russia as an enemy and a threat, and towards seeing it as a partner and potential business destination. The need to reassess that perspective in the second presidency of Vladimir Putin has been sudden and stark. However, the solution does not lie in knee-jerk military spending sprees. The economic crisis is not over, and the money is not there. In any case, too much of Europe will remain too reliant on Russian energy for a new Cold War – let alone a hot one – to be practical.

IMPLICATIONS

These security issues raise wider questions about the European project. In particular, will the Schengen agreement on free transit across Europe withstand the populist assault in many EU member states on free movement of labour and residence, Illegal migration routes and numbers into the EU by land and sea, Jan-Sep 2014



Source: Frontex

and a potential spike in inward migration and Syrian refugees? A number of Schengen signatories are already quick to suspend the accord at times of particular security threat. Might the Schengen project be seen as an experiment that was nice while it lasted, but was ultimately overtaken by events?

Major changes to Schengen would only be accepted with the utmost reluctance at EU level. Nevertheless, political and security conditions are now dramatically different to those when the accords were signed. Political pressure for a redraft will continue to build, though a return to full internal borders is not on the cards.

RUSSIA: CHANGING RELATIONS

2015 will see the continued impact of a fundamental shift in the relationship between Russia and the West. Sporadic, sometimes heavy fighting continues in eastern Ukraine, and there's an equal level of political and economic hostility between Russia and the US, the EU and a host of other countries. Global Research Director Charles Hecker talks to Senior Russia Analyst Steven Eke about how this will develop in 2015, and the implications for business in Russia.

WITH STEVEN EKE, SENIOR ANALYST, RUSSIA

Q: Steve, set the scene for 2015: what's still to come in this shift in the relationship between Russia and its partners?

A: As we look to 2015 and even further ahead to the next five to ten years, it looks like Russia and the West have entered a fundamentally new stage of relations. I do not believe that we're looking at a new Cold War, but Russian President Vladimir Putin has said the relationship will be one of competition for influence – not one of co-operation.

So, I think we're looking at a situation in which there will be mutual suspicion and competition between Russia and the West for geopolitical influence, particularly in Central and Eastern Europe. That translates to a much more complicated business, financial and economic relationship than we saw during, say, 2002 to 2013.

What's happening, of course, is based directly on events in Ukraine since late 2013. Russia believes the West has installed a government in Kyiv that is fundamentally hostile to Russia's national interests. And it doesn't like it. Russia is going to be much more assertive, if not aggressive, in staking out its role in the region. While I don't think we'll see any physical moves against the Baltic states, Russia's interference in Ukraine is likely to persist. Moscow simply will not countenance loss of influence over that country.

Q: What about the scenario for business in 2015? Politics are crucial, but the economy also looms large in how we view Russia and how we see it as an investment opportunity. Tell us what to expect on the business landscape and the interaction between business and politics.

A: There are two factors. The first is that the existing sanctions framework applying to oil and gas, aerospace, defence and dual-use technologies is due for revision towards the end of summer/early autumn 2015. These sanctions could be extended for a further 12 months, or we could see movement by the Europeans and North Americans towards easing them.

Much of that decision will be based on Russia's actions towards Ukraine in the early part of 2015. Should Russia intervene in eastern Ukraine, or indeed at a high level politically in Kyiv, it would boost the possibility that the sanctions framework would be extended. I think the poor condition of the diplomatic relationship points towards a continuation of sanctions anyway.

Economic troubles are also looming, with significant depreciation of the ruble in the last quarter of 2014 and the government actively using reserves to both prop up the ruble's value and bail out state companies affected by the Western financial sanctions. Western companies won't abandon Russia, but their interest is likely to be curtailed, and that means investment and expansion plans put on hold. I don't think we'll be seeing any sort of rapid bounce-back in 2015.

Q **Let's look beyond 2015. How do we get to a new relationship with Russia? It's changed its attitude towards the West and the international community fairly dramatically, but it's a big place and a big market. Clearly, doing business in Russia and co-existing with Russia politically is going to require a new mindset. Give us an idea of how to get there.**

A There have always been major disagreements between Russia and the West. But Russia is a big player in European affairs and some form of common language will need to be found, quickly. Here I think we'll see the Germans in particular come to the fore again in 2015.

German Chancellor Angela Merkel has been very critical of Putin personally in Russia's actions in Ukraine, but there is growing pressure from the German industrial community to restore a normal working relationship. The same pressure is coming from the City of London, which of course is a major destination for Russian money.

Let's not forget that Putin still seems to be in good health and constitutionally can remain Russia's leader until 2024. I really don't see a possibility of a palace coup or a hidden challenger coming out of the shadows to try to unseat him. That means he's going to be in place at the end of 2015, and for a long time beyond. Western politicians and Western business still need to find a common language with him.

CENTRAL ASIA: CHALLENGING TIMES

ANNA WALKER,
HEAD OF ANALYSIS,
EUROPE AND CIS

- **Central Asian leaders overstate the terrorist threat to the region; the main external source of instability is transnational drug trafficking and local complicity.**
- **The region faces an economic squeeze as Russia's economy deteriorates, putting pressure on trade and export of labour.**
- **The two longest-serving leaders are set to win new terms in 2015 and 2016, but long-term succession risks persist.**

2015 has the makings of a challenging year for Central Asia. A difficult external economic environment looks set to jeopardise the flow of remittances that has underpinned much of the recent growth – and political stability – in the smaller countries. This will brush uncomfortably against long-standing but still unaddressed security threats posed by corruption and drug trafficking. And leadership transitions in the two largest countries are looming on the horizon, with all the political risks these entail.

TERRORIST SMOKESCREEN

Central Asia's leaders would have us believe that the withdrawal of international forces from Afghanistan and the resulting potential for a spillover of Islamist militancy presents the most serious threat to the security environment in 2015. They often cite the region's previous encounter with such groups as justification.

After all, the Islamic Movement of Uzbekistan (IMU) has its roots in the Fergana Valley region in the early 1990s, from where a decade later it declared its goals of overthrowing Uzbekistan's President Islam Karimov and establishing a caliphate across the region. After several failed incursions, the IMU withdrew into northern Afghanistan, where its bases were largely destroyed in the US-led military action in 2001. The IMU has since regrouped along the Afghanistan-Pakistan border, winning new recruits not just from Uzbekistan, but also the wider Central Asian region.

The group's growing strength adds weight to the claim that the downgrading of US strategic interests in the region from 2015 might lead to a resurgent IMU across Central Asia. However, the pattern of attacks in recent years shows that the IMU has clearly shifted the focus of its activity to supporting groups such as the Tehrik-e-Taliban Pakistan (TTP, the Pakistan Taliban) and, since September, Islamic State (IS) – activity taking place outside the region.

The region's leaders also claim that young Central Asians will return radicalised from participation in jihadist conflicts in Syria and Iraq, intent on

TOP: Central Asian presidents with their Russian and Chinese counterparts in Dushanbe, Tajikistan, September 2014. BOTTOM: Uzbekistan's border with Kyrgyzstan in the Fergana Valley.

perpetrating terrorist attacks at home. There is no doubt that some of the region's youths are participating in these conflicts. Recruitment of Central Asian labour migrants in Russia, who travel on to Syria and Iraq, is believed to be one well-trodden route. What is unclear is their numbers: estimates range from several thousand (the figure often cited by government sources) to a more credible figure in the low hundreds. Anticipating the scale of potential returnees presents even more of a challenge, but it is safe to conclude that this number will be relatively small.

Elaborating the jihadist threat is an attractive narrative for governments keen to retain Western financial support once attention has shifted from Afghanistan. But the main external security threats to Central Asia's stability in 2015 – as in previous years – stem from a more familiar source: drug trafficking and other organised criminal activities. Central Asia lies on one of the main routes for the smuggling of illicit narcotics from Afghanistan northward to Russia and Europe, with around 25% of drugs trafficked out of Afghanistan passing through this route. Efforts to tackle the threat will remain ineffective as long as the individuals charged with disrupting it remain complicit.

ECONOMIC PRESSURES

The region also faces a more difficult external economic environment in 2015, with implications for domestic security. Central Asia exports as many as 2m labour migrants to Russia each year, receiving substantial remittances in return – remittances make up around 40% of Tajikistan's GDP. Yet as Russia's economy deteriorates in the face of sanctions and lower oil prices, demand for this labour is likely to shrink, forcing migrants to return.

Tajikistan would simply not be able to cope with an extra 1m people in its labour force. Over the past two decades, exporting labour has provided an important safety valve for an economy where there are few real employment opportunities. The situation is similar, if less stark, in Kyrgyzstan and Uzbekistan. Combined with frustration at pervasive corruption and long-standing grievances over socio-economic inequalities, the potential for destabilising unrest will grow as long as these issues remain unaddressed.

TESTING TRANSITIONS

Yet none of these factors is likely to pose as serious a threat to the business environment in Central Asia as the persistent political risks associated with forthcoming leadership transitions in a region that has largely been outwardly stable for most of the 23 years since independence.

Take the two largest countries. Both Uzbekistan and Kazakhstan face presidential elections in the coming 18 months: Uzbekistan in March

Central Asia: long-lasting leaders, low levels of freedom and economic vulnerability

Country	KAZAKHSTAN	KYRGYZSTAN	TAJIKISTAN	TURKMENISTAN	UZBEKISTAN
President	Nursultan Nazarbayev	Almazbek Atambayev	Emomali Rahmon	Gurbanguli Berdimuhamedov	Islam Karimov
Years in power since 1989	25	3	22	8	25
Economic freedom[1]	63.7	61.1	52	42.2	46.5
Rule of law[2]	3	4.5	3	2.3	2.3
Emigrants as % of population[3]	23	11.2	11.2	5	7
Remittances as % of GDP[4]	0.1	31.5	42.1	0.1	11.7

Source: 1. Heritage Foundation 2014 (where 100 is most free); 2. Bertelsman Transformation Index 2014 (where 10 is best); 3. World Bank (2010 figures); 4. World Bank (2013 figures)

2015, with Kazakhstan following in April 2016. The long-standing incumbents – Islam Karimov and Nursultan Nazarbayev – are likely to win re-election comfortably, but at 77 and 75 respectively at the time of the polls, each is probably contesting their final term.

Neither country has experienced a leadership transition since it became independent, and neither's president has an obvious successor. With political and economic power so closely intertwined, this heightens the risk of a disputed succession. At best, a contested transition will result in a continuation of the autocratic but outwardly stable political system in which vested interests continue to influence policymaking. At worst it will degenerate into a struggle for power between rival clans that destabilises the business environment and leaves investors associated with the losing side at a serious disadvantage. ■

2015: THE NOISIEST YEAR IN BRITISH HISTORY?

DAVID LEA,
SENIOR ANALYST,
EUROPE

Hard on the heels of the Scottish referendum, the UK faces another crucial vote in 2015.

- **The wildcard UKIP factor means a narrow Labour win or a hung parliament are the most likely outcomes.**
- **The next government will be weak, unlikely to survive a five-year term and prone to populist, short-term policies.**
- **Debate over the UK's future in the EU will reduce the country's attractiveness to business.**

Much like the bulk of the British political establishment, the rest of the world only belatedly took an interest in the Scottish independence referendum in September 2014, and then only when it looked as if a vote to separate from the UK was possible. Predictions of doom and massive political instability followed, mostly to be swiftly withdrawn amid sighs of relief when 55% of the electorate rejected separation.

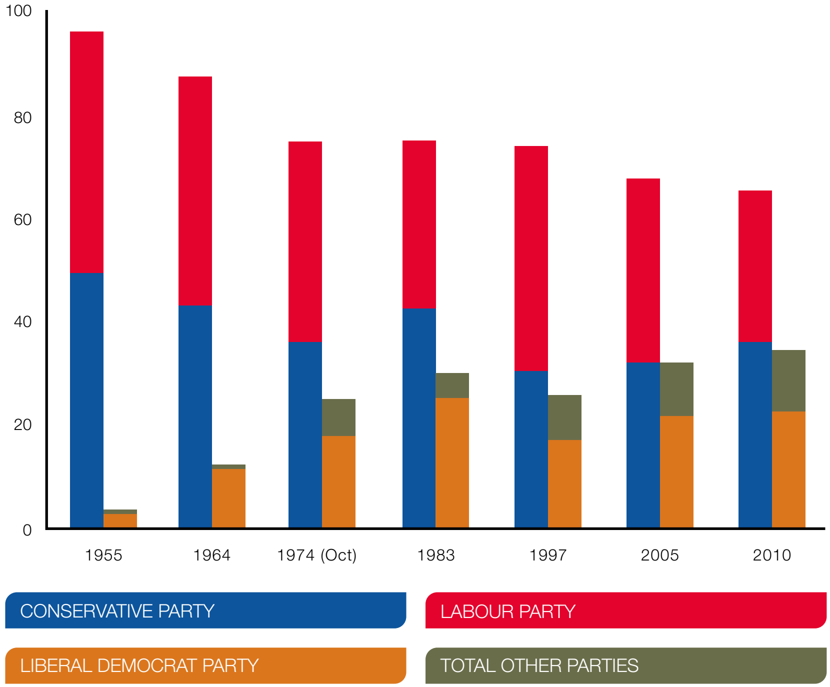
In truth, there was never any doubt of a No vote. But that was 2014. 2015 is shaping up to be one of the most uncertain, confrontational and potentially unstable years in recent British political history. The fact that Scotland has decided to remain a part of the UK hasn't really made the upcoming struggles any easier. The country is more or less back where it started.

Chief among these struggles is a general election in May, with a pre-polling political picture as confused as at any time since the early 1970s. The Conservative-Liberal Democrat coalition is unpopular outside the Conservative heartland of suburban/rural southern England, yet the main opposition Labour party can't seem to capitalise on that weakness. Labour's inability to land a hit on the coalition primarily stems from leader Ed Miliband's unconvincing public image, and the lingering penalty of having been in power at the onset of the global financial crisis. Labour enjoys a fairly stable, but slight poll lead. Under normal circumstances, it would not be enough for a parliamentary majority.

FRINGE BENEFITS

These are not, however, normal circumstances. The key destabilising factor comes courtesy of the breakthrough of the UK Independence Party (UKIP), an anti-EU fringe movement that has become a significant force on the populist right of British politics. UKIP primarily targets hardline Conservative areas with ageing populations, but is increasingly attracting votes in post-industrial

The electoral share (%) of the two main parties has fallen, while that of the third and other parties has grown



Source: UK Electoral Commission

districts in the centre and north of England that either contain or are close to significant immigrant communities. This is normally Labour's stomping ground. UKIP has had no problem so far in appealing to these seemingly mutually exclusive groups with a populist and polemical anti-EU, anti-immigration, anti-politics platform. Now that UKIP is the focus of immense scrutiny and curiosity, that dual strategy may become more difficult to sustain, but UKIP leader Nigel Farage should be able to carry his campaign through to election day without much trouble.

The UK's simple plurality electoral system means that dozens, possibly hundreds, of seats have become more unpredictable now that a new player has entered the field, even if UKIP is likely to win only a handful of them. UKIP's impact will be greater in Conservative seats, leading the Conservatives to say 'Vote Farage,

TOP: The Scottish referendum campaign.
BOTTOM: UKIP leader Nigel Farage.

get Miliband', believing that UKIP votes could allow Labour to win enough seats to form a government. This is actually the most likely outcome, but only marginally more so than a hung parliament necessitating a new coalition. Given Labour's potential collapse in Scotland to the benefit of the Scottish National Party (SNP), a Conservative lead cannot be ruled out either, though a majority is probably just out of reach.

A weak government – no other sort seems possible at this stage – will lack confidence and struggle to survive a full five-year term. Moreover, the populism and short-termism that such political circumstances foster are likely to produce policies with little appeal for business. Further restrictions on immigrant labour are a likely first step from all parties. A Conservative-led administration would be likely to edge even further towards budget-cutting, with Labour attempting to reverse some of the current government's more controversial austerity policies, such as partial healthcare privatisation.

IN OR OUT?

Farage has hinted that he would ease the pressure on the Conservatives if they agree to hold a referendum on the UK's withdrawal from the EU, his overarching goal, immediately after the election. Prime Minister David Cameron says a Conservative government will hold a referendum, on renegotiated terms of membership, in 2017. This assumes that Cameron can successfully reformulate the UK's relationship with the EU. Progress on that front is likely to be difficult, given the small number of member states that share the UK's anti-Brussels sympathies. This will further jeopardise the UK's EU membership.

Miliband is coming under increasing pressure to match Cameron's referendum commitment, but is unlikely to do so, believing that the uncertainty will be harmful for the British economy. He has a point. Business will frown on a country that spends the next two years beating itself up over its relations with its neighbours in an increasingly fact-free and unedifying fashion (mirroring the Scottish referendum); inward investment may look elsewhere. The more realistic a withdrawal from the EU becomes, the more credible the prospect of business relocating away from the UK. Even taking symbolic steps closer to the exit in the next two years could spook the deep-rooted financial services sector in London, which may want to retain closer ties to the EU.

REWRITING THE UNWRITTEN

Meanwhile, rumbling away in the background is the debate – yet to be aired – on the future shape of the UK itself. Cameron, Miliband

TOP: Prime Minister David Cameron at an EU summit in Brussels, Belgium, October 2014.
BOTTOM: Labour leader Ed Miliband.

and other political figures promised greater powers for Scotland in the referendum campaign, but were unclear on how they may be granted, and how the rest of the UK might be governed in response. As a result, an immediate rewrite of the UK's unwritten constitution is unlikely, and the process will last way beyond 2015.

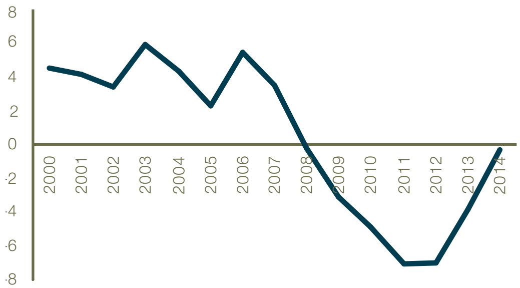
Scotland may gain full power over tax and spending within its borders. But then, what of Wales? Will differential tax rates from nation to nation become a reality? Might Northern Ireland choose to emulate the Republic of Ireland's example of low corporate tax rates, triggering a flood of company re-registrations? On a governance level, how is England to be distinguished from the UK? An English parliament? Regional devolution? Full federalism? None of the options appeals to many, and all anger quite a few.

On this, as on so many other issues, 2015 in the UK appears set to be unstable, divided and loud.

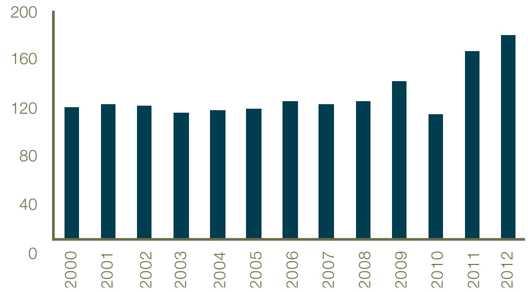
EUROPE AND CIS SNAPSHOTS

GREECE

GDP GROWTH IS BEGINNING TO HEAD IN THE RIGHT DIRECTION, BUT DEBT REMAINS HIGH

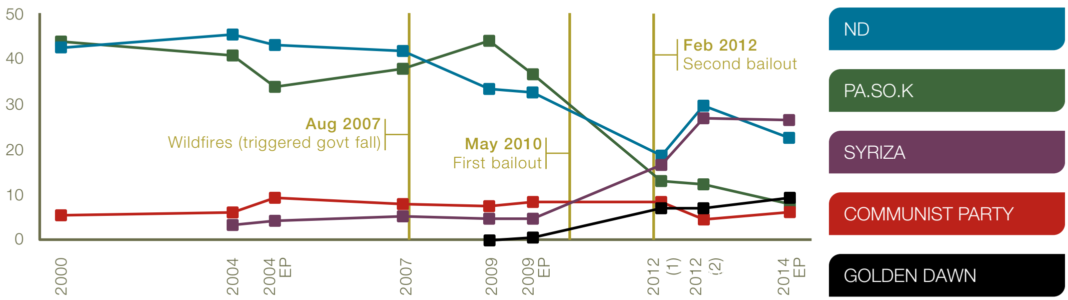


REAL GDP ANNUAL CHANGE (%), 2000-14 | Source: OECD



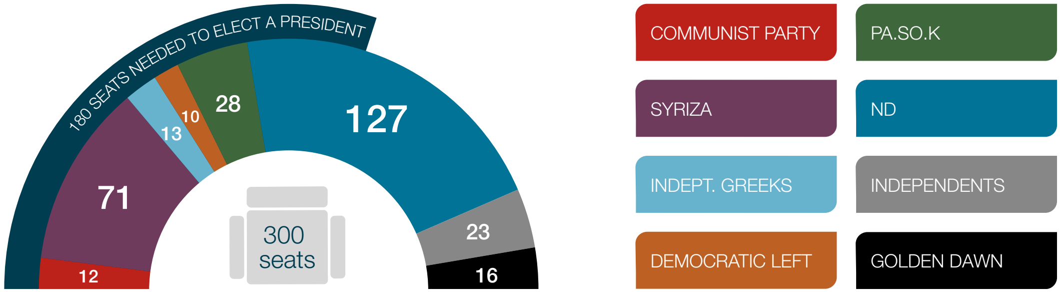
PUBLIC DEBT (% GDP), 2000-12 | Source: OECD

ELECTION RESULTS SHOW INCREASING FRAGMENTATION AND THE RISE OF EXTREMIST PARTIES



NATIONAL AND EUROPEAN ELECTION RESULTS SINCE 2000 | Source: European Parliament, European Election Database

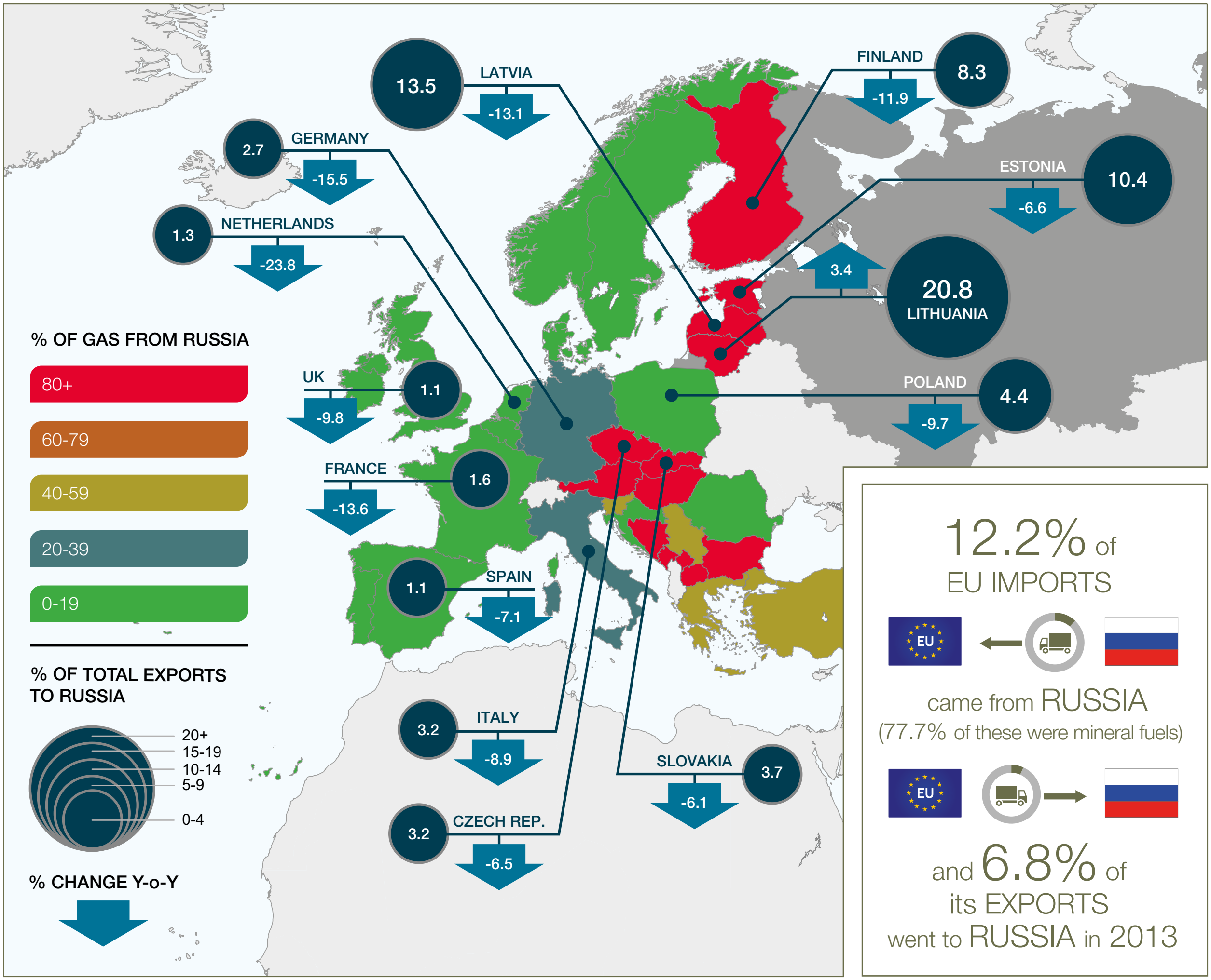
THERE IS NO CLEAR MAJORITY IN PARLIAMENT, WHICH MUST ELECT A PRESIDENT NEXT YEAR



Source: Greek parliament

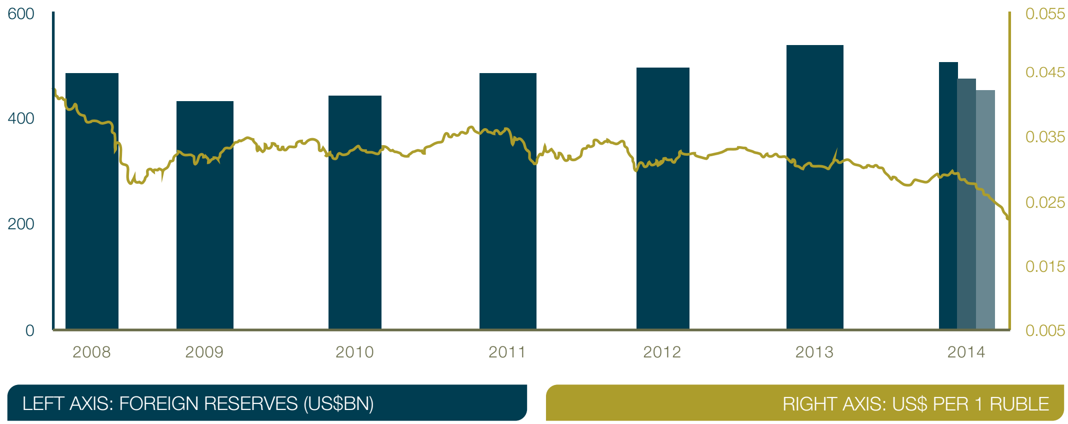
EU AND RUSSIA

MOST COUNTRIES HAVE SEEN A NOTABLE DROP IN TRADE WITH RUSSIA, BUT SOME REMAIN HEAVILY DEPENDENT ON RUSSIAN ENERGY



Source: Eurostat

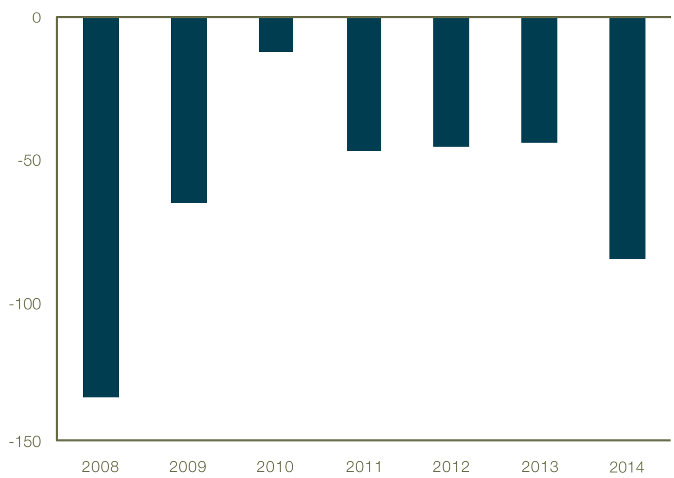
RUSSIA HAS INCREASED SPENDING OF FOREIGN RESERVES AMID A FALLING EXCHANGE RATE...



RUSSIAN FOREIGN RESERVES AND RUBLE EXCHANGE RATE, 2009-14

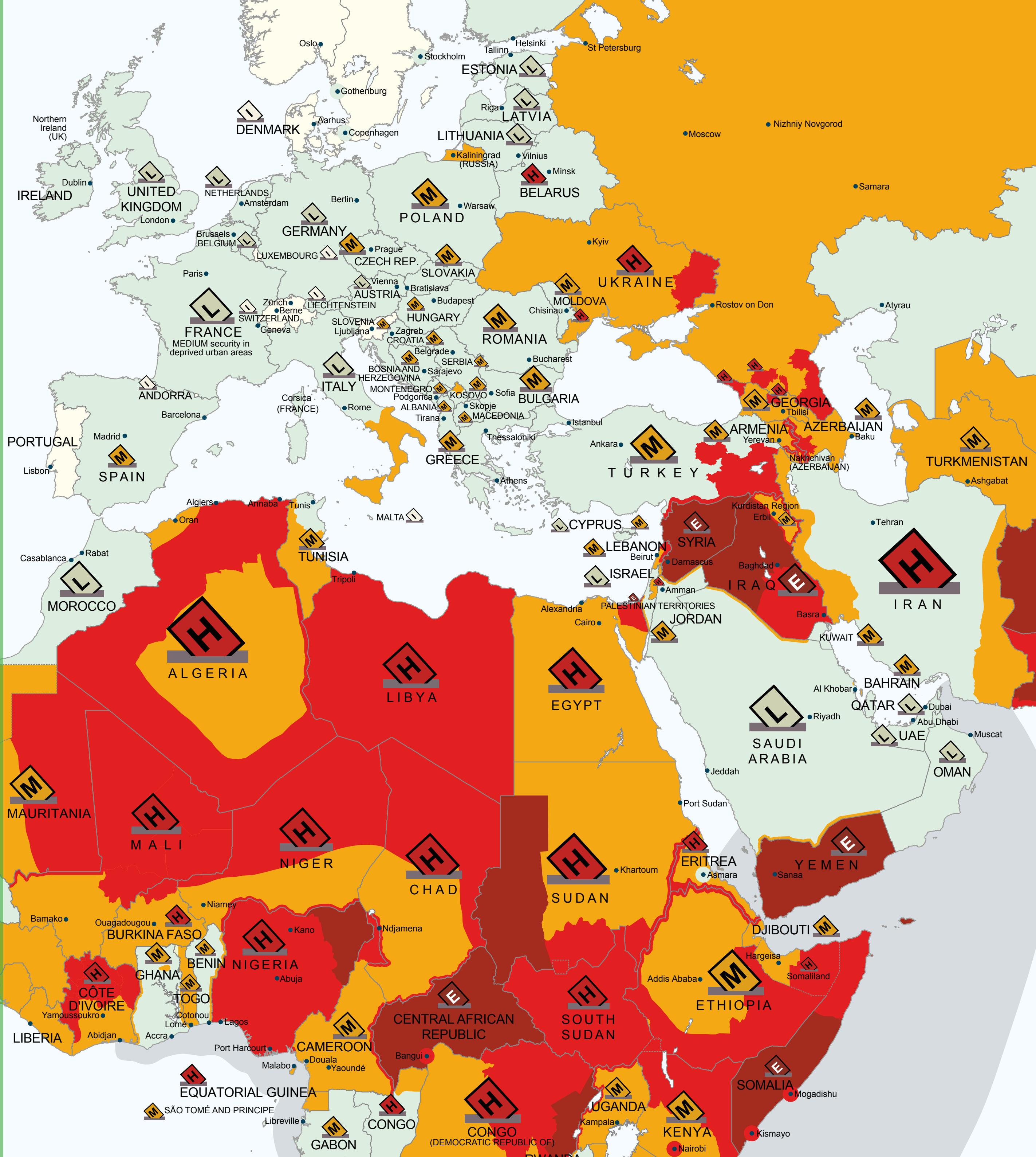
Source: Central Bank of the Russian Federation (CBRF),XE. 2014 reserves show Jan, May and Oct figures.

...AND SEEN CAPITAL OUTFLOW



NET INFLOW/OUTFLOW OF CAPITAL (US$BN), JAN-SEP 2008-14 | Source: CBRF

MIDDLE EAST & NORTH AFRICA



IRAQ AND SYRIA: NO END IN SIGHT

GALA RIANI,
HEAD OF ANALYSIS,
MIDDLE EAST AND
NORTH AFRICA

The Middle East's war zones will see little relief in 2015.

- **The greater assertion of powerful ideological, ethnic and sectarian interests is driving conflict and undermining the authority and coherence of the states of Syria and Iraq.**
- **National borders will come under greater pressure as momentum builds in both countries towards a solution to conflict rooted in decentralisation and self-governance.**
- **Iraq's federal government will struggle to reconcile myriad competing interests, while its efforts to combat Islamic State (IS) are in danger of complicating its position.**

Civil wars in Iraq and Syria will still rage in 2015. In their wake, borders will continue to fragment along increasingly complex communal lines.

IRAQ

The central task facing Iraq's government in 2015 will be addressing the drivers of the crisis that culminated in IS's takeover of territory in north-central Iraq in mid-2014. IS's advance was swift and dramatic but was not as sudden as it may have seemed. It was the result of prolonged political dysfunction and mistrust. In recent years, the government in Baghdad has been widely accused of deepening divides between communities.

Prime Minister Haider al-Abadi is likely to be less divisive than his predecessor, Nuri al-Maliki (2006-14). Even so, Abadi will struggle to muster the considerable political capital required to tackle the challenges that limit the government's authority and performance. If Abadi is to achieve this goal, he will need to enfranchise the Sunni community and empower its leaders; fulfil Kurdish political and economic ambitions; and, most importantly, take concrete steps to decentralise a state that has become increasingly centralised against the demands of large parts of the population. If he fails, Abadi's government will become paralysed by the deeply conflicting interests of his Shia allies and the demands of the Sunnis and Kurds, and remain effective only in so far as it is propped up by the coalition of international partners engaged in fighting IS.

FIGHTING ISLAMIC STATE

The war against IS must be waged on both political and military fronts, and requires co-operation by political and military forces that remain essentially antagonistic. The government needs to win the trust of the Sunni community to have a chance of winning the war, but the fight against IS risks eroding any

TOP: The 2nd Battalion of Female Peshmergas, Kurdistan Region, Iraq.
BOTTOM: Syrian troops in Damascus.

such trust for three key reasons. First, a group such as IS cannot be fought without incurring large numbers of civilian casualties and vast collateral damage. Second, many Sunnis will continue to view the security forces as sectarian, and will be alienated by the government's reliance on Shia militias, whose political clout will grow in 2015. And finally, the government will rely on external support in the form of airstrikes, which will become increasingly unpopular as the war progresses.

The formation of localised Sunni militias and armed tribal groups to fight IS offers some hope for a move towards increased engagement with local communities. If managed correctly, this strategy could pave the way for a broader political arrangement with the Sunnis. That said, without the support of a bold government and a well-organised non-sectarian army, Sunni militias and armed tribal groups risk being pulled into a prolonged war with IS and its affiliates. Such a scenario would leave the situation in Iraq taking on characteristics of the Syrian war, which has pitted a proliferating number of groups against each other.

SYRIA

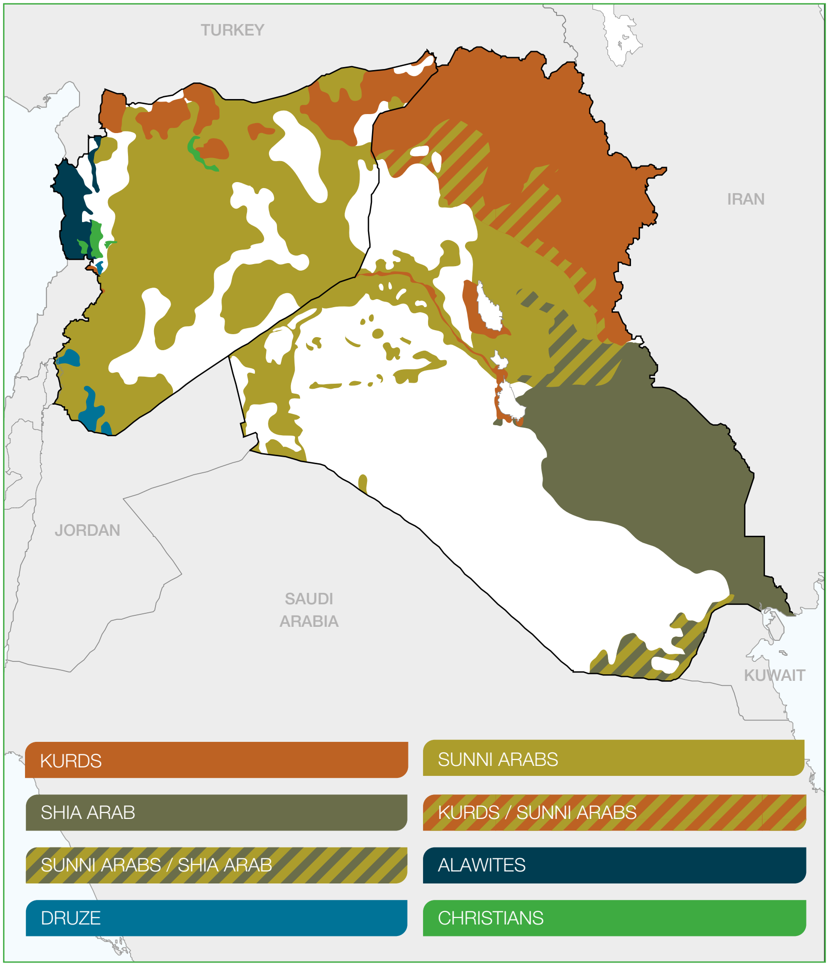
Continued international military involvement in Syria will not change the dynamics of the conflict. With the idea of deploying foreign ground troops widely dismissed, the air campaign will degrade – but not defeat – the capabilities of IS and other targeted groups. Meanwhile, efforts to combat IS will continue to periodically result in alliances of convenience between otherwise antagonistic groups, such as elements of the Free Syrian Army and the Kurdish People's Protection Unit (YPG). The US-led coalition may perceive such groups as ideal proxies in a ground war, but these alliances are unlikely to endure.

The coming months will continue to expose the vastly divergent political goals of the main players: President Bashar al-Assad's regime, the Kurds, moderate Islamist fighters and radical Islamist elements. Competition will intensify for control of territory to protect parochial interests.

BORDERS CONTINUE TO ERODE

The increasing power and attraction of ideological, ethnic and sectarian groups challenging the authority of central governments in Iraq and Syria will further erode borders. It is the strength of these interests that has been a key driver of conflict escalation. In the absence of nationally and internationally acceptable state-based political solutions in Syria and Iraq, localised self-governance remains the most likely long-term alternative for affected communities – sometimes across internationally recognised borders. As the resonance of national identity continues to weaken, so does the relevance of borders.

Distribution of ethnic groups in Syria and Iraq



IRAN: SANCTIONS OUTLOOK

Talks in late 2014 between Iran and the P5+1 (the five permanent members of the UN Security Council, plus Germany) and changing strategic imperatives in the face of the rise of Islamic State have brought fresh hopes that sanctions on Iran may be lifted in 2015. Charles Hecker, Global Research Director, talks about the likelihood of movement on this issue to Henry Smith, Senior Consultant, based in Dubai.

WITH HENRY SMITH,
SENIOR CONSULTANT
MIDDLE EAST AND
NORTH AFRICA

Henry, we're here to talk about Iran's trajectory for 2015, particularly in the context of talks on Iran's nuclear programme and the sanctions surrounding the country. Can you give us your view on which of these sanctions could be lifted and which could remain in the coming year?

There are three different layers of sanctions against Iran. There are those in place because of allegations of human rights abuses in the country, those addressing its perceived support for terrorism outside its borders and finally measures linked to the country's nuclear programme and its alleged purposes. The talks in 2014 were focused on the nuclear programme, and this will remain the case with the dialogue that will continue in 2015. So if negotiations lead to a more comprehensive agreement, the sanctions that would move in 2015 are those linked solely to the nuclear programme. At the moment, there is no reason to expect that measures linked only to alleged sponsorship of terrorism or humans rights abuses will change. However, this is still quite important for companies looking at Iran because the most significant measures are those tied – at least in part – to its nuclear programme.

So the most important sanctions from an economic and investment perspective are the ones currently being discussed in the talks in Geneva. Is that right?

Broadly speaking that's correct. In terms of how they could be repealed, clearly that's linked to a comprehensive agreement or another interim deal being reached. Then we're likely to see measures repealed in exchange for Iran fulfilling commitments it has made about the level and nature of its uranium enrichment to the P5+1.

Henry, what's the likelihood of the remaining sanctions coming up for discussion at any point in the meaningful future?

The measures linked to alleged human rights abuses and state sponsorship of terrorism have not really featured in the talks over Iran's nuclear programme. On the Iranian negotiating side, I think there was an acceptance that those measures were too politically sensitive for a number of Western countries, though the success of IS in Iraq seems to have emboldened Iran to try to fold other regional issues such as IS into the negotiations. However, Western countries – principally the US – seem to have rebuffed those attempts in late 2014.

If the aim of Iran's negotiators is to rehabilitate Iran into international affairs and therefore also rehabilitate the domestic economy, then focusing on the measures linked solely to the nuclear programme is probably sufficient for now.

Q Can you describe the sanctions? What are the specific inhibitors to investment that are embedded in the sanctions associated with the nuclear programme?

A There are essentially two types of sanctions. First, there are measures linked to individuals and entities associated with the country's nuclear programme, which are put on a blacklist. Second, there are more sweeping measures that essentially prohibit foreign companies from participating in entire sectors of the economy, or engaging in certain types and sizes of transaction. The incentive for foreign companies to comply with these measures is that, if you fall foul of them, you run the risk of prosecution by any of the countries enforcing the sanctions. One of the key elements of sanctions against Iran that has changed over the past few years is that the US has put in place extraterritorial measures. So the US can attempt to prosecute companies that aren't operating in or don't strictly have an interest in the US economy if they break the sanctions. Essentially, the US is giving companies a choice – you do business with Iran, or you do business with us.

Q Some of the sanctions were relaxed in 2014. What does that say about what may or may not happen in 2015?

A The pattern that we've seen in 2014 is that when Iran has fulfilled certain obligations, certain amounts of frozen money have been released. This has been a degree of tit-for-tat confidence building. What the Iranian negotiation team is hoping for in 2015 is an agreement for a much more comprehensive, if still staggered, roll-back of some of the measures, particularly the broad-brush sanctions against certain types of transactions and economic sectors. We are expecting that in 2015 we will see a continuation of these tit-for-tat changes in sanctions, in response to Iran's fulfilling certain commitments and obligations.

Q Is it possible to become comfortable with the level of risk that Iran poses?

A You see a limited number of international companies operating in Iran that are comfortable with their exposure there because they operate in specific sectors. Your first decision point from a market entry perspective is having the necessary legal assurances that you are compliant with the various sanctions the country faces. But then a whole series of other challenges come into play, which need to be identified and tackled as they would in any market. Iran poses its own unique challenges in that regard. However, once the sanctions hurdle has been overcome in a compliant way, a company's risk appetite and degree of comfort with Iran is then very much dependent on that organisation. This will be a major point of internal debate for any company considering opportunities in Iran in 2015.

GULF STATES: STEPPING UP ON REGIONAL SECURITY

JAMES FALLON,
SENIOR ANALYST,
MIDDLE EAST AND
NORTH AFRICA

The wealthy monarchies of the Arab Gulf will take a more concerted role in regional security in 2015.

- **Gulf states view involvement in regional conflict as inseparable from their national security goals, and will seek to shape outcomes to prevent conflict reaching their own soil.**
- **The complexity of this task is likely to see the Gulf states take a more direct and consistent role in fighting wars abroad.**
- **A gradual shift away from security dependence on the US means that the global superpower will have less influence on when and where Gulf states use military force.**

In the decade since the ousting of Iraqi dictator Saddam Hussein (1979-2003), the Gulf Arab states have become the Arab Middle East's powerbrokers. Saudi Arabia and the UAE have by far the greatest financial capacity, and have built militaries with advanced Western training and equipment. Meanwhile, circumstances both near and far from the Gulf have boosted the importance of states in the region.

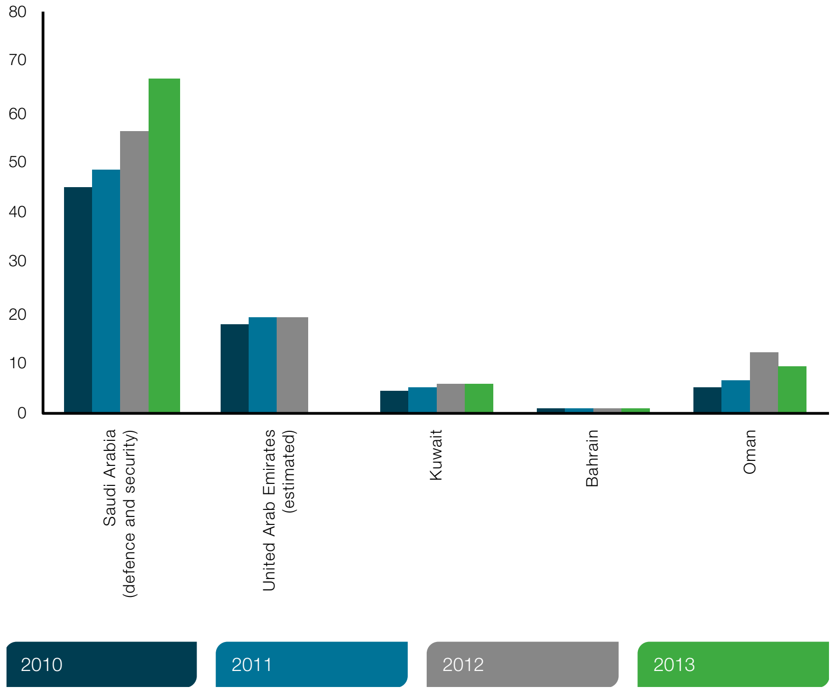
First, US guarantees that have underpinned regional security for decades are now perceived as less reliable. Someone has had to pick up the slack. Second, the collapse of governance and rising instability in Egypt, Libya, Syria and Yemen have elevated the geopolitical importance of the Gulf states and driven a shift in their defence priorities. In this new environment, Gulf states have started to conduct complex military activities beyond their borders. More are likely to come.

TAKING TO THE SKIES

In August 2014, unidentified fighter jets conducted aerial raids against Islamist militias in Tripoli, Libya. The incident left the US and other Western powers on the back foot. Anonymous officials from these countries subsequently told international press that fighter jets from the UAE operating from Egypt had conducted the raids unilaterally. (The UAE has not officially confirmed the strikes.) Unilateral military operations of this complexity are typically the preserve of advanced industrial economies. An intricate aerial operation conducted by a Gulf Arab state against non-state militants in a country more than 2,500 miles away – without Western involvement – is unprecedented.

In September 2014, photos of Saudi and Emirati fighter pilots graced the pages of national media outlets, following the first foreign airstrikes in Syria since the outbreak of that country's brutal civil war. The pilots

Gulf Arab states' defence spending (US$m), 2010-13



Source: SIPRI

had participated in US-led airstrikes against Islamic State (IS), in which three other Arab states – Jordan, Bahrain and Qatar – had offered additional assistance. One of the pilots was a son of Saudi Crown Prince Salman. The Emirati strikes were pointedly led by a female fighter pilot. This was no cloak and dagger operation. The political establishment and national media in both countries sat proudly behind the strikes, and were actively involved in making the argument that they were necessary to ensure national security.

Syria will continue to demand sustained Gulf attention in 2015. Iraq will also be a focus, but direct participation by Gulf Arab states is less likely because of Iran's influence and the US's more extensive commitments in that country. In Yemen, the collapsing state and rise of the Houthi militant group creates a situation with unpredictable outcomes. Saudi Arabia fought a war with the Houthis in 2009, and is on high alert. Gulf involvement in North Africa will also continue, with strong Egyptian co-operation.

TOP: An F-16 fighter of the UAE airforce. BOTTOM: Saudi Arabian air force pilot Prince Khaled bin Salman (standing, second from left) with other pilots, September 2014.

SOFT POWER FAILURES

The Gulf is not about to become the regional policeman. Intervention will remain selective and conflicts kept at arms' length where possible. However, regional political dynamics will continue to draw the Gulf states closer to the battlefield. Soft power has not achieved the security outcomes that the Gulf has sought since 2011.

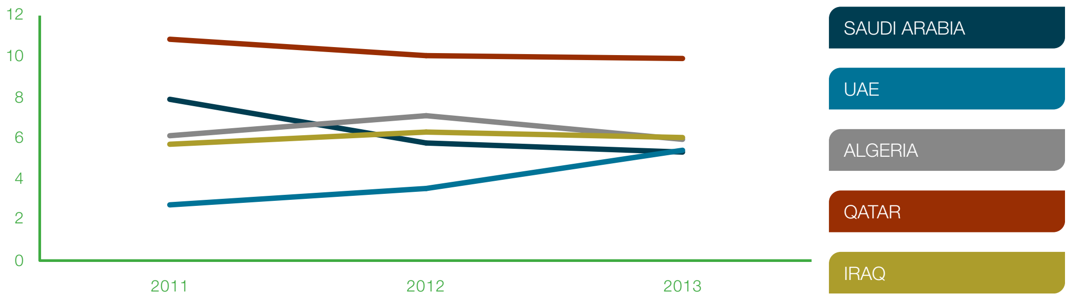
For decades, conflicts involving Muslim communities have drawn the interest and attention of private citizens and governments in the region. Money from Gulf donors, regional media and the personalised attention of officials – the tools of soft power – were used in bids to shape conflicts. These tactics were tried with the outset of the Arab spring in 2011 but without result. Instead, conflicts and political crises in Syria, Iraq, Libya, Egypt and Yemen have given rise to new threats to Gulf security. The failure of soft power has drawn the Gulf states closer to these conflicts just as shifting US defence priorities mean regional defence is being devolved to states that were previously dependent on outside support.

Despite the US drawdown in the Gulf, no other global power is likely to fill the gap. Whatever the size of its presence, the US is likely to be the pre-eminent global power in the region for some time to come. However, a gradual erosion of the US security umbrella will result in a greater devolution of responsibilities to US Gulf allies – and more room for manoeuvre for both Gulf states and anti-status quo powers such as Iran. This means that, even as the Gulf states assume a more prominent role in underpinning the security status quo, they will pursue their own priorities with greater independence – including unilateral action in cases where the priorities of international allies are no longer aligned.

MIDDLE EAST AND NORTH AFRICA SNAPSHOTS

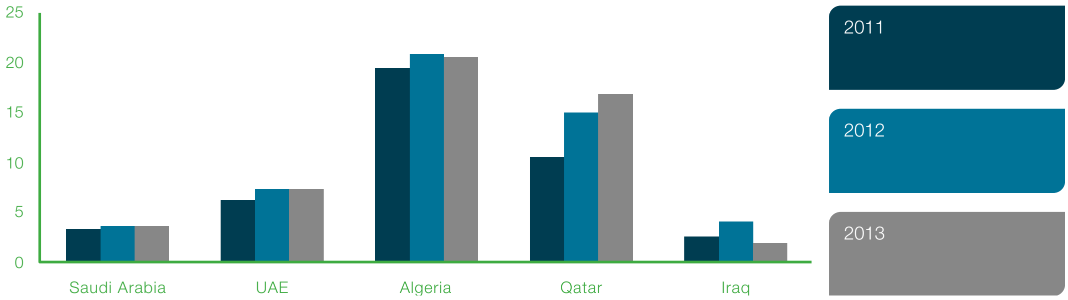
BEYOND OIL

ONLY THE UAE IS MANAGING TO ACCELERATE NON-HYDROCARBON GROWTH...



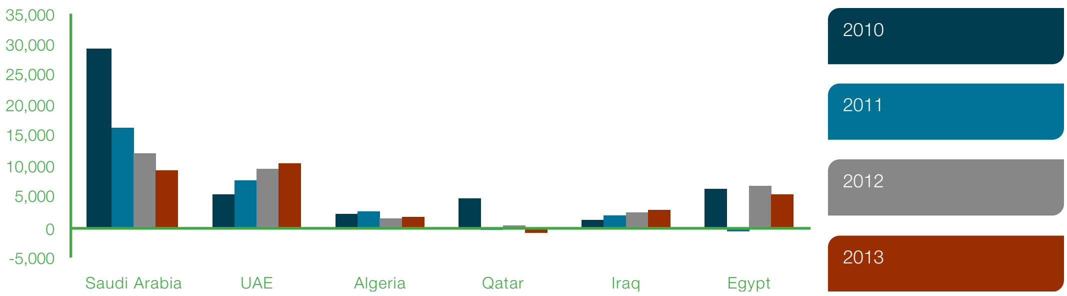
NON-HYDROCARBON GDP GROWTH (%), 2011-13 | Source: IMF

...BUT NON-OIL REVENUE REMAINS ONLY A SMALL ELEMENT OF GDP



NON-OIL REVENUE (% GDP), 2011-13 | Source: IMF

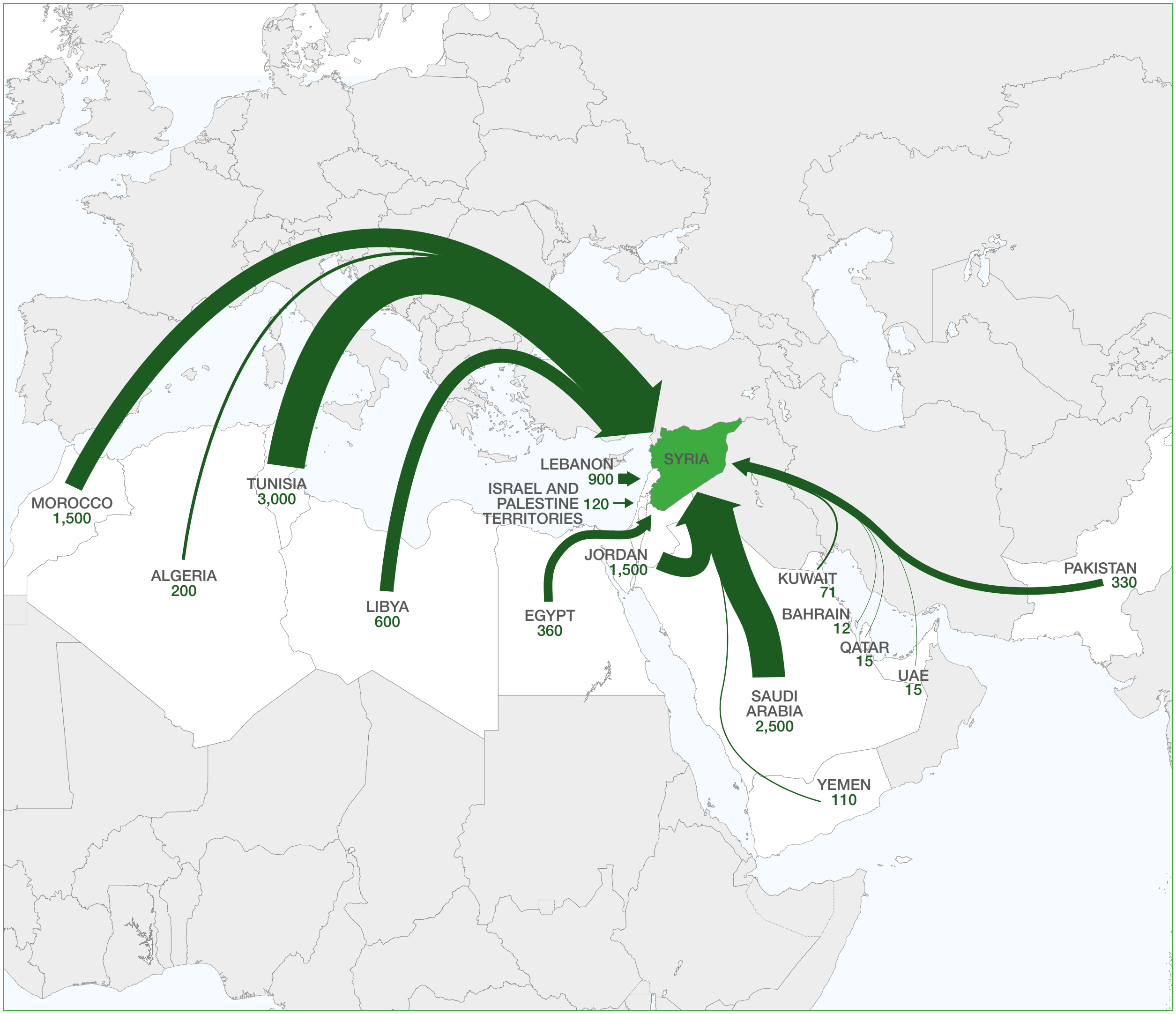
THE UAE AND SAUDI ARABIA ARE ON VERY DIFFERENT TRACKS FOR FDI



FDI (US$M), 2010-13 | Source: UNCTAD

SECURITY

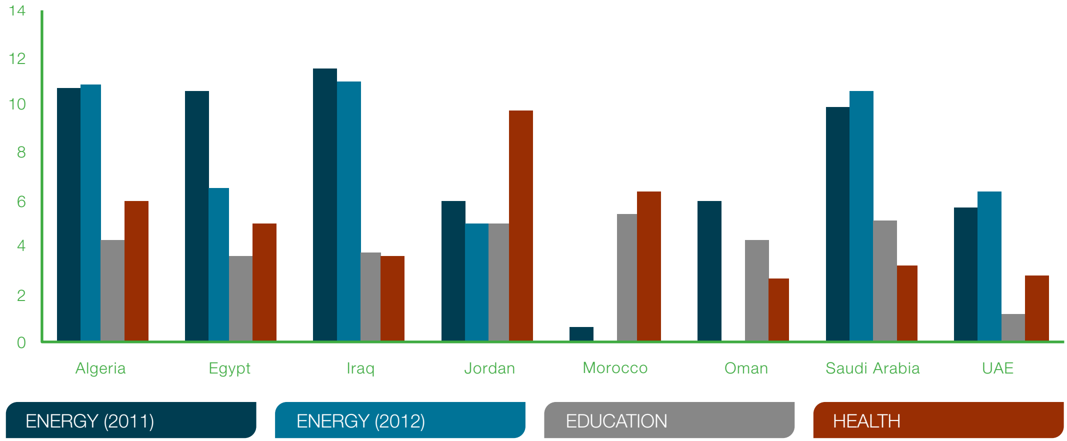
THE CONFLICT IN SYRIA IS DRAWING IN FIGHTERS FROM AROUND THE REGION



Source: International Centre for the Study of Radicalisation

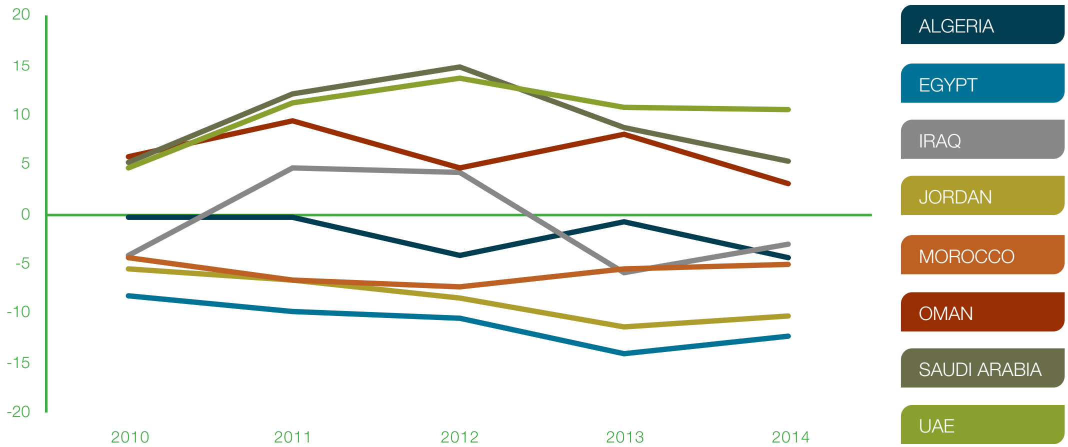
STATE FINANCES

ENERGY SUBSIDIES ARE A MAJOR PRESSURE AND GENERALLY OUTSTRIP HEALTH AND EDUCATION SPENDING



SUBSIDY SPENDING (% GDP), 2011-12 | Source: IMF, IEA, World Bank

BUDGET SURPLUSES FOR EXPORTERS ARE FALLING BUT IMPORTERS' DEFICITS ARE TURNING THE CORNER



GOVERNMENT NET LENDING/BORROWING (% GDP), 2010-14 | Source: IMF

TERRORISM OUTLOOK

JONATHAN WOOD,
ASSOCIATE DIRECTOR,
GLOBAL RISK ANALYSIS

Three broad factors are likely to shape global Islamist terrorism in 2015.

- **Competition for leadership of the global jihadist movement will drive further fragmentation and reward high-profile attacks.**
- **Increased incitement of homegrown attacks is likely in response to expanded global counter-terrorism efforts and jihadist propaganda.**
- **Government intervention will continue, encompassing military strikes and sponsorship of militant groups.**

COMPETITION AND FRAGMENTATION

On the strength of its military exploits and effective propaganda, Islamic State (IS) in 2014 emerged as the first credible challenger to al-Qaida for leadership of the global jihadist movement. Its declaration of a caliphate and demands of allegiance directly peeled some groups away from al-Qaida. Others, including key al-Qaida franchises, were convinced to at least hedge their bets by making statements supportive of IS's project. Even if al-Qaida and IS reach some kind of tactical armistice in Syria, they are likely to remain global strategic competitors.

In the year ahead, this competition is likely to fragment the global jihadist movement and increase the likelihood of high-profile attacks, for two reasons.

First, IS is likely to push abroad in the year ahead. If it can consolidate territorial control in Iraq and Syria, IS may seek to expand its influence abroad directly by funding and training foreign militant groups, emulating al-Qaida's activities during the 1990s. Like al-Qaida in Afghanistan, it could leverage foreign fighter networks. Alternatively, local and international military pressure in the Middle East might force IS to diversify and pursue asymmetric retaliation abroad. Either way, expansion would aggravate the schisms within the jihadist movement over leadership and legitimacy.

Second, whatever its trajectory, IS has severely damaged al-Qaida's credibility and legitimacy. Some jihadist groups and sympathisers still respect al-Qaida's theological credentials and historic pedigree, but many prefer IS's tangible accomplishments and want to replicate its successes. The jihadist movement has always been a fluid constellation of local groups; inspired by IS, more of these might strike out on their own as independents.

Both of these factors are likely to increase the threat of high-profile attacks. Upstart local commanders and rump al-Qaida franchises will want to announce and assert themselves – and perhaps seal changing declarations of allegiance or affinity – with demonstrative violence. Mass-casualty ‘spectaculars’, high-profile hostage-taking and sophisticated attacks on hard targets (government, military, aviation and so on) will remain expedient methods of making a point.

HOMEGROWN INCITEMENT

Events and developments within the global jihadist movement are likely to modestly increase the threat of terrorism in Western countries. Returning foreign fighters are an obvious and high-profile concern that security and intelligence services will prioritise in 2015. Equally, counter-terrorism activities in Iraq and Syria could provoke attempts at retaliation in Western countries.

The rise of IS is also likely to increase the attractiveness of ‘lone wolf’ tactics in 2015, for several reasons. First, IS has crafted its image around intimate, explicit videos of attacks distributed by social media. Sophisticated production and searing imagery send a message that – for maximum impact – the style of an attack is as important, if not more important, than its scale. IS has learned from groups such as al-Qaida in the Arabian Peninsula (AQAP), and appeals specifically to Western sympathisers using targeted media outlets.

Secondly, in contrast with al-Qaida, IS earns credibility in the jihadist community through deeds, rather than religious or political arguments. Its pronouncements are calculated to document tangible progress towards establishing an ‘Islamic state’ and appeal to jihadists who value action over words. Finally, IS maintains that attacking Western nationals and interests anywhere is essential to preserving the ‘Islamic state’. This allows sympathisers unable to travel to Iraq or Syria to still support the caliphate by carrying out attacks at home.

AIR STRIKES AND RIDING THE TIGER

Government intervention – and the fragmentation and incitement it engenders – will be an important driver of the terrorism threat in 2015. Most concretely, the accumulation of airstrikes and other military operations in Iraq, Syria, Yemen, Libya, Somalia and elsewhere will increase the intent of jihadists (not just IS) to target Western and allied interests. This intent will express itself in direct retaliation and in fostering radicalisation as civilian casualties mount.

Sponsorship of foreign militant groups is also likely to become a bigger concern in 2015. This is partly because powerful militias will remain the most influential political and security players – and often geopolitical proxies – in fragile

TOP: Islamic State flag.
BOTTOM: US Global Hawk surveillance drone.

states from Libya to Afghanistan. In several contexts, mainly in the Middle East and South Asia, they are already the shock troops of national and sectarian competition. As the global power vacuum continues to expand geopolitical space to play, more states will seek to strengthen ties with – and pursue strategic objectives through – non-state armed groups.

State sponsorship – funding, training, supply, strategic guidance – will increase the capabilities of some groups to conduct attacks. Otherwise, the main terrorism trends affect intent, implying that in 2015 ambitions will continue to exceed capability, particularly in Western countries.

CYBER SECURITY OUTLOOK

JOHN NUGENT,
SENIOR ANALYST,
CYBER SECURITY

The cyber threat landscape will continue to evolve rapidly in 2015.

- **Advanced tools and techniques will increasingly spread among and between nation states, cybercriminals and cyber activists.**
- **Significant global political developments will continue to shape the cyber threat environment.**
- **New hubs of cybercriminal activity and new targets will emerge, driven by economic change, the relative strength of cyber defences and changing connectivity.**

CYBER THREATS

Understanding the often confusing and alarming phenomenon collectively called the 'cyber threat' is not necessarily as difficult as it first seems. Looked at up close, this landscape can be broken down into three principal categories: cyber espionage, cybercrime and cyber activism (or 'hacktivism'). Each of these pose pernicious, but qualitatively different, threats to business.

Cyber espionage, typically perpetrated by nation states or attackers linked to nation states, commonly involves the theft of proprietary or sensitive corporate information for the benefit of another commercial enterprise. This erodes the target's competitive advantage within its marketplace and, subsequently, its profit.

Cybercriminals are motivated by financial gain. First and foremost they go after a company's customer base, stealing personal details or credit card information to use in fraud or to re-sell. Almost uniformly, the targeted organisation is left to foot the bill.

Lastly, cyber activism thrives on disrupting business operations or generating public embarrassment. A diverse range of motives can spur this behaviour, including personal amusement, environmental concerns, anti-capitalist sentiment, nationalism and religion.

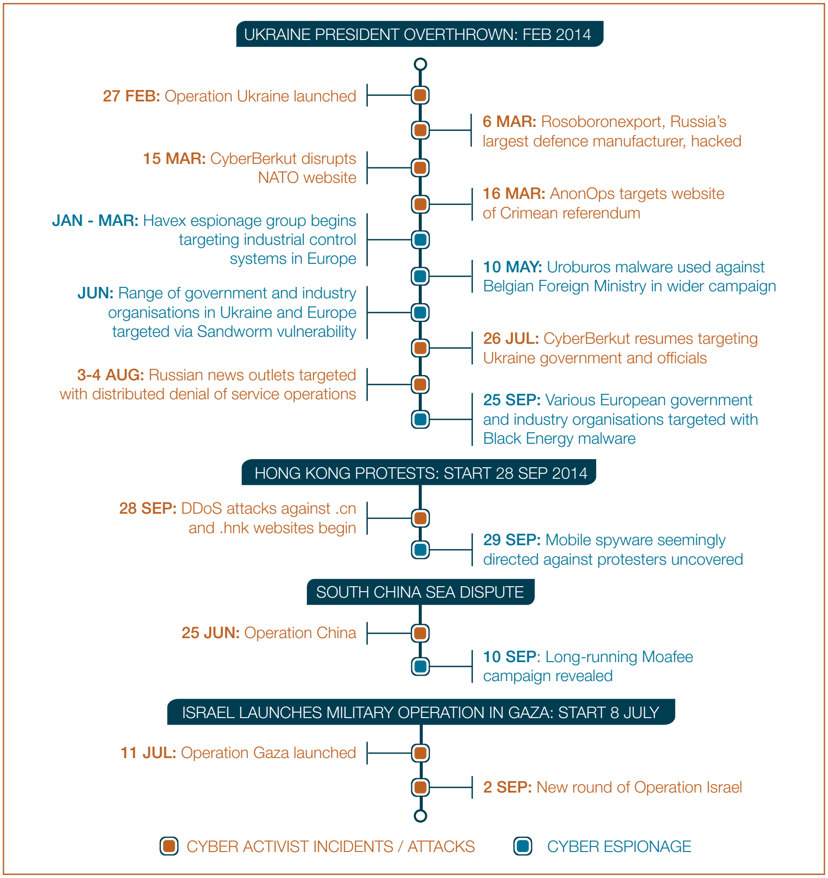
TRENDS TO WATCH

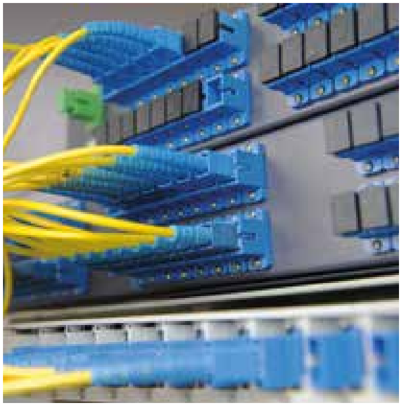
Despite the contrasting goals of the attackers, one of 2015's prevailing trends will be the continued spread of capability among different types of assailants. What happens, for example, if cyber jihadist factions start to use the relatively advanced hacking capabilities of cybercriminals? The technology is available for purchase online in criminal forums on the dark web (a subsection of the unindexed areas of the internet collectively known as the deep web). These outlets provide particularly fertile ground for the development and distribution of increasingly advanced malicious software (malware) and may also have facilitated the repurposing for criminal use of malware used initially in state-sponsored espionage campaigns.

This is just one of a range of recent indicators of greater interaction and overlap among traditional cyber threat groups. Others include nation states' increasingly routine recruitment of skilled elements from cyber activist communities and 'hackers-for-hire' offering espionage as a (criminal) service. This looks to be a trend that will persist.

The role of geopolitics in shaping the cyber threat environment will be another core trend to monitor in the year ahead. During 2014, cyber espionage, cyber activist and (seemingly) cybercriminal campaigns were initiated in response to developments in Ukraine, Hong Kong, Israel and the Palestinian Territories, Iraq and

Cyber events linked to real world crises





Syria, and the South China Sea. In 2015, expect sustained geopolitical tension to catalyse further targeting of the industrial control systems at the heart of critical national infrastructure. We also expect to see the emergence of new, ostensibly independent, cyber activist groups cultivated by nation states to further their foreign policy objectives.

Cyber attacks do not take place in a vacuum. They are spurred by a range of social, political, cultural and economic factors. For example, the central role of economic influences can be seen in other trends we will be monitoring over the next year. Chief among these is the emergence of new hubs and targets of cybercriminality, appearing and developing where IT-literate populations are not restrained by law and/or where law enforcement is lacking. Examples of these environments include India, Brazil and South Africa. Noticeable changes in the location of targeted entities and individuals will occur gradually, but any shift will be based on a combination of economic considerations – for instance, wealth – and the relative proficiency of cyber defences, potentially placing the inhabitants of certain oil-rich Middle Eastern nations in attackers' sights.

Two final developments to watch out for in 2015 are both products of cultural and social change. First is the increased focus of attacks on multinational companies' supply chains. As companies' security becomes more robust, complex supply chains can be a point of vulnerability, allowing attackers to ultimately seize data belonging to the company. Second is the creation of malware able to operate across a range of operating systems, taking advantage of consumers' reliance on an expanding array of different devices.

PROTECTING YOURSELF

As the business community continues to seek protection in this rapidly morphing environment, a company's defence should rest on five key principles. First, cyber security is a business issue, not solely a technical one, and should be treated accordingly. Second, understand the cyber threat landscape and the specific type of threat that your organisation faces. A company's strategic, commercial and operational decisions often determine the magnitude of the threat it faces. Third, above a certain level, not every asset requires the same protection; define what is critical and prioritise it. Fourth, organisations should prepare for attacks from the most advanced threat actors, accept that standard information security processes and procedures are insufficient, and designate resources appropriately. Finally, accept that you will suffer a breach. By ensuring you are fully prepared for that eventuality, you can reduce the potentially severe financial and reputational consequences.

MARITIME RISK OUTLOOK

TOM PATTERSON,
ASSOCIATE DIRECTOR,
MARITIME RISK ANALYSIS

Piracy will remain the main focus for maritime operators, with varying trends in the main hotspots.

- **Piracy levels off East Africa are set to remain low, but local capability remains undented.**
- **A small rise in activity is likely in West Africa, where the outcome of Nigeria's February 2015 elections is likely to influence longer-term trends.**
- **Activity in South-east Asia is more likely to adversely affect local rather than foreign operators.**

Piracy is likely to remain the primary security concern for the maritime industry in 2015, though the outlook differs for two of the world's hotspots – East and West Africa. But despite piracy dominating much of the coverage of maritime risk, onshore instability in the form of political uncertainty, civil unrest and inter-state conflict is also likely to directly affect a greater number of operators in the year ahead.

Events in Egypt, Syria, Libya, Iraq and Ukraine in recent years have underlined the potential consequences of broader political and security developments for maritime operators. Protests and curfews in areas adjacent to strategic ports can cause delays in cargo supply and distribution. The closure of trade arteries forces companies to consider and implement costly alternatives. Insecurity in transport hubs frustrates crew changes. Meanwhile, civil conflicts often result in a rise in outward migration, triggering an increase in stowaways and migrant vessel traffic.

EAST AFRICA

Levels of pirate activity are likely to remain low off East Africa over the next year, reflecting a decline in hijacking-for-ransom by Somali pirate groups since mid-2011. The reduction in successful attacks – no large merchant vessel has been hijacked since May 2012 – can be attributed to three external factors that are by now well-known: a better educated maritime industry, a more robust naval strategy and a better protected merchant fleet.

Yet despite these notable gains, a re-emergence of activity remains a risk. This is because Somalia's pirate networks remain largely intact, with the exception of a handful of high-profile arrests. A weak central government, an absence of local security provision in key coastal communities, and a proliferation of materiel and experienced personnel from four years of successful operations mean that most groups remain operational, albeit currently focused on other financial pursuits.

TOP: The Japan Maritime Self-Defence Force guards a Japanese cargo ship off the coast of Somalia. BOTTOM: The US Navy trains Nigerian special forces to combat piracy.

Although the actions of the international community may have temporarily curbed the intent of pirate groups, they have not dented their capability.

Despite widespread acknowledgement among stakeholders in the counter-piracy community that the recent gains are 'reversible', efforts are already mounting to dismantle the security measures that have proven so effective in combating the crime. Understandably, cost-squeezed operators are seeking to dispense with expensive guards, hardening measures and re-routing. Meanwhile, politicians ponder redeploying naval assets elsewhere. The coming year could see the risk-reward ratio swing back in the favour of Somali pirate groups.

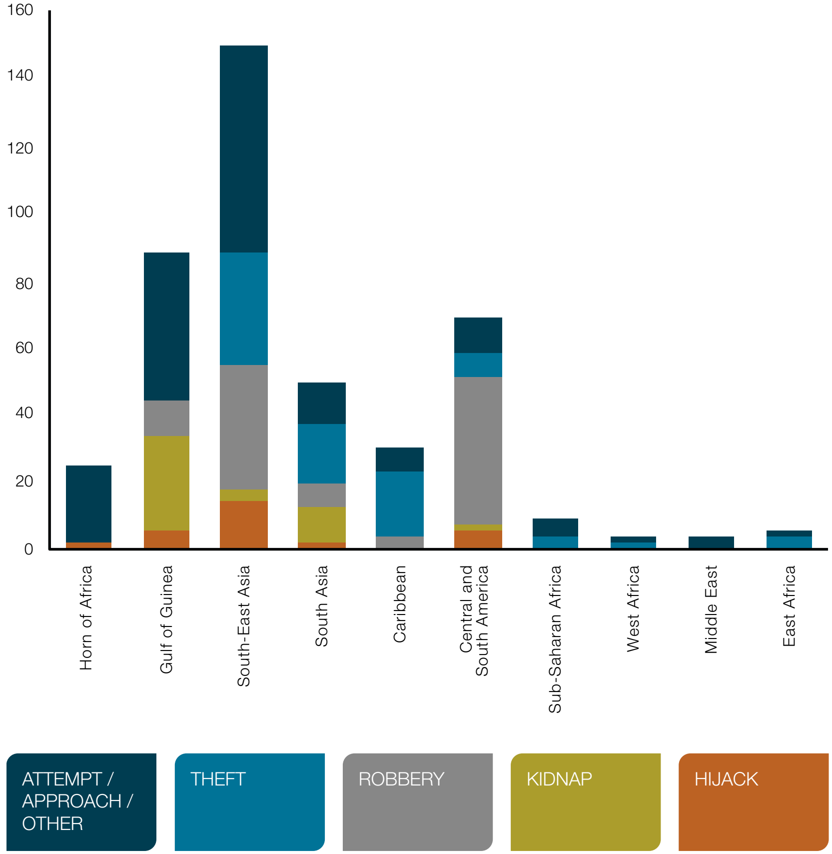
WEST AFRICA

Nigeria is likely to remain the global hotspot for piracy in the year ahead. Maritime operators are bracing themselves for negative spillover from the February 2015 general elections. While some may anticipate an increase in offshore attacks in the months preceding the elections, there is limited evidence for such a trend. The fate of the government amnesty programme for Niger delta militants after the polls will be perhaps more important to determining the trajectory of Nigerian piracy. The continuity of stipend payments to rank-and-file members – and of business opportunities for influential former militant leaders – will be key.

The absolute number of incidents registered off Nigeria will rise marginally in 2015, following a relative decline in 2014, with periodic small spikes in attacks largely driven by the activities of certain key pirate groups. Kidnapping is likely to remain concentrated off the southern Niger delta. However, as recent trends have shown, the increasing range of such groups threatens personnel operating across a wider area encompassing the waters off Cameroon, Gabon and Equatorial Guinea.

Across the wider region, the hijacking of product and chemical tankers for cargo theft has declined year-on-year since 2011 despite an expansion in pirates' operating area, which stretches from Côte d'Ivoire to Angola. The number of incidents will remain low in 2015 amid increased awareness of the threat among operators and the development of mitigation measures, such as secure anchorages. Nevertheless, sporadic hijacks off Togo, Ghana and Angola in 2014 attest to the enduring capability of pirate groups, which are motivated by the significant profits to be made trading stolen fuel oil on the black market. Periodic attacks are likely to the west and south of Nigeria in the year ahead.

Reported incidents of piracy, armed robbery and theft by region, 1 Jan – 31 Oct 2014



SOUTH-EAST ASIA

Piracy remains a source of concern in South-East Asia. The region continues to register high levels of activity, but in most cases the severity of incidents is low. Port and anchorage crime – opportunistic theft and robbery – is likely to be the most persistent issue facing the maritime sector in 2015. A number of product tanker hijacks were recorded in 2014, and the hijacking of tugs in the Singapore Strait and the South China Sea for theft remains a sporadic threat. However, most cases have involved locally registered vessels. Such activity will therefore have a limited impact on international operators in the year ahead.

KIDNAP AND EXTORTION OVERVIEW

TOM NEWELL,
ANALYST,
RESPONSE

Technology is changing the face of kidnapping and extortion.

- **Criminals are extorting ransoms from families without even kidnapping a victim.**
- **Social media provides a source of information about victims and a communications channel for kidnappers.**
- **The threat of cyber extortion will rise as criminals develop new techniques.**

VICTIMLESS CRIMES

Technological advances are transforming the dynamics of kidnapping and extortion. The ease and security of communications now available to kidnappers have fast-tracked the pace of negotiations in even the most remote parts of the world. Twenty years ago, kidnappers often had no option but to communicate furtively using payphones, typed communiqués and even crackly high frequency radios. Today, they can issue demands within minutes of an abduction using mobile (cellular) phones and encrypted emails.

A fast-growing extortion technique known as ‘virtual kidnapping’ is one of the clearest examples of how the communications revolution has fostered innovation in criminal activity. Virtual kidnaps – most common in Latin America – typically involve criminals contacting a family by phone and claiming to have abducted a loved one. The criminals often purport to be members of an organised crime group, and threaten to harm or kill the victim if a ransom is not immediately paid by wire transfer. In reality, no abduction has occurred, and the ‘victim’ is usually going about their business safely in another location, temporarily out of reach in a place such as a cinema, airplane or hotel. Virtual ‘kidnappers’ are simple extortionists, hoping that the person on the other end of the line will fall for the scam without verifying that a kidnap has actually taken place.

Given the widespread incidence of kidnap-for-ransom in some Latin American countries, few families targeted by virtual kidnappers doubt the call when it comes. They often fail to check whether the victim has been kidnapped before paying the ransom. Those who try to call the victim and fail to make contact become convinced that a crime is in progress.

Virtual kidnaps are as efficient as they are brazen. In contrast with a traditional kidnap, where kidnappers generally need several accomplices and access to a safe house, anyone with a phone and information about a person’s

TOP: Interpol and Philippine police after arresting members of an online extortion syndicate, May 2014.
BOTTOM: Kidnappers and extortionists use information from social networks.

movements can carry out a virtual kidnap. Virtual kidnappers do not need to be in the same town, or even the same country, as their victims. This alters the traditional balance of kidnaps: virtual kidnap offers potentially high returns on ransom payments, and low risks of capture by law enforcement.

ANTI-SOCIAL NETWORKING

Kidnappers and extortionists have benefited greatly from the rise of social networking websites, using them as rich mines of personal information that can be leveraged for financial gain. Making an extortion more credible only requires revealing knowledge of the victim's life – the car they drive, where they work or the names of their children. Even an innocuous status update on Facebook provides valuable information to a would-be kidnapper. A lax attitude towards the details we share online plays into the hands of criminals more than ever before.

Kidnappers use social media for more than simple research. They also exploit it as a platform to make demands, intimidate the families of their victims or propagate their ideology. Prominent Islamist militant groups in Africa and the Middle East have tweeted details of attacks in real time and uploaded footage of foreign victims on YouTube. These online media strategies have enabled militants to put pressure on foreign governments and attract new supporters on a global scale.

CYBER EXTORTION

The borderless nature of the internet provides myriad opportunities for technically minded criminals to extort individuals and businesses remotely. In some cases, the human element is almost redundant. A burgeoning form of cyber extortion uses ransomware, a type of malware that blocks access to an infected computer system and demands a ransom for the restriction to be lifted. CryptoLocker was among the best known and most lucrative ransomware applications, generating millions of dollars in illicit funds before it was taken offline in June 2014. Expect newer versions to emerge in 2015 as increased competition between developers results in the production of new forms of malware that are harder to detect and disrupt.

Technology, data connectivity and social media will continue to play a role in kidnap for some time. Most prominently, the development of new and resilient cyber extortion techniques will increase the threat to business in the coming year. Meanwhile, amid all this progress, traditional kidnapping-for-ransom will remain a key risk across the world, particularly in states where weak law enforcement, socioeconomic disparities and the ready availability of weapons create strong incentives for groups to engage in more customary methods.

Top ten countries for kidnap-for-ransom in absolute terms in 2014 (to 30 Sep)

COUNTRIES	2014	2013
MEXICO	01	01
INDIA	02	02
PAKISTAN	03	04
IRAQ	04	10
NIGERIA	05	03
LIBYA	06	14
AFGHANISTAN	07	08
BANGLADESH	08	26
SUDAN	09	20
LEBANON	10	06

MUDDYING THE WATERS OF POLITICAL VIOLENCE

ZACHARY ROTHSTEIN,
ASSOCIATE DIRECTOR,
ONLINE SOLUTIONS

Changes in how groups involved in political violence operate and raise funds are complicating the risks for business.

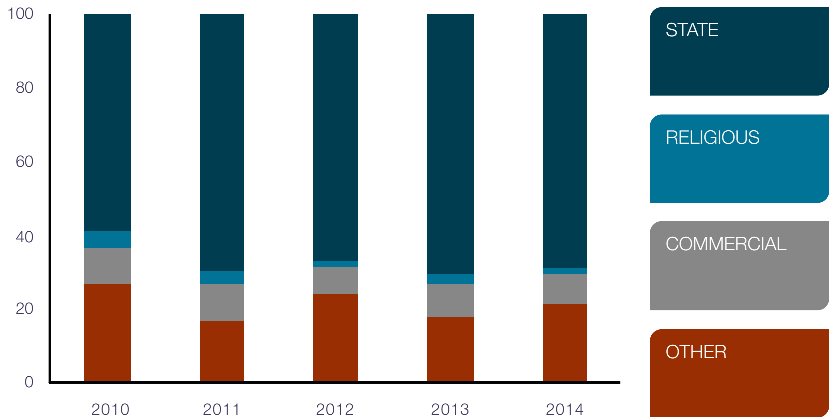
- **The growing reliance on criminal sources of funding is causing a convergence between the tactics of political violence and organised crime.**
- **The blending of crime and ideology changes groups' motives and composition, and in some cases perverts their original cause.**
- **These shifts underline the importance of a detailed understanding of local actors and the constantly evolving threats they pose.**

Strictly speaking, political violence can usually be neatly divided into three categories – terrorism, civil unrest and conflict. But for businesses trying to assess the risks they face, the reality has become a great deal messier.

Over the last decade, the international clampdown on terrorist financing, coupled with a decrease in state sponsorship and private financing, has taught political violence groups an important lesson: crime pays. More and more, criminal activity has become the primary means of funding political violence.

This critical shift is not without its costs. Although the targets haven't changed, reliance on organised crime alters a violent group's tactics, motives and composition. The result blurs the boundaries

Targets of global political violence (% of total), 2010-14: most incidents consistently affect government, military and law enforcement targets.



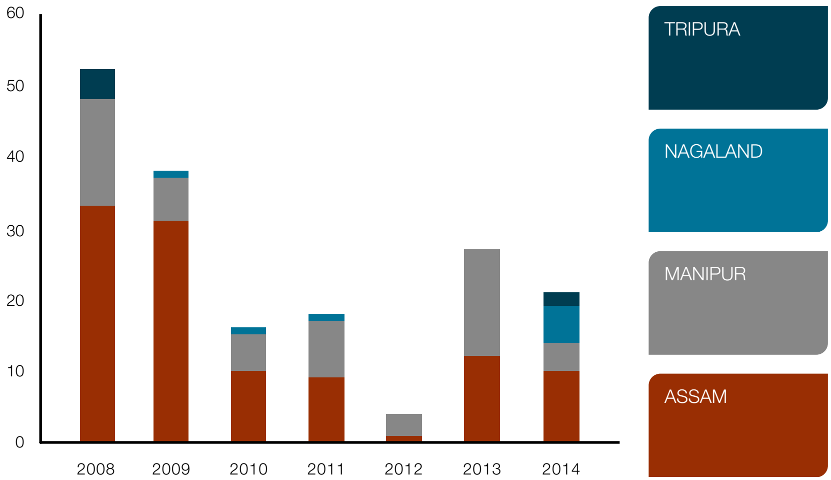
Source: Control Risks Analytics and Incident Mapping (AIM) database between the categories of political violence – making it more difficult for today's international businesses to understand the true nature of threats on the ground.

OLD DOG, NEW TRICKS

Even in areas where criminal financing of political violence is well established, the trend is sharply gaining momentum. For the Afghan Taliban, which arguably would not exist in its current form without the cash from its smuggling and drug trafficking networks, organised criminal activity has become even more widespread. Other organisations have gone the route of Somalia-based extremist group al-Shabab, which has consciously abandoned its ideological opposition to crime and instead embraced it as a practical means of solving its financial difficulties.

Further complicating matters, the process also works in reverse: many criminal groups are adopting terrorist-style tactics. Criminal groups in northern Kenya use grenade attacks on food storage facilities to deter humanitarian aid. *Bacrim* (paramilitary successor) groups in Colombia deploy small explosive devices in retaliation for unanswered extortion demands. For businesses in regions marked by this brand of conflict, the overlap between political violence and organised crime means that examining tactics alone won't help identify who is behind an individual attack.

Militant attacks in north-east India, 2008-14: attacks tend to decrease when criminality rises; militant violence has fallen significantly but extortion rackets remain prevalent.



Source: Control Risks Analytics and Incident Mapping (AIM) database

TOP: Aftermath of a bomb attack in Nairobi, Kenya, May 2014.
BOTTOM: Clashes between the military and Islamic militias in Benghazi, Libya, October 2014.

MISSION CREEP

The growing links between political violence and organised crime have also altered the motives of terrorist and militant organisations. As groups focus on financial objectives, their criminal and ideological agendas often compete for attention. Sometimes, crime and ideology fuse. In Somalia, for example, warlords seeking economic and political power temporarily align themselves with terrorist groups when it is in their interest to do so.

Prolonged blending of ideology and crime, though, tends to transform the identity of a group and dilute its political motives. Myanmar's United Wa State Army opposes central rule, but only because that stance protects its (legal and illegal) business interests, rather than because it genuinely believes in local government.

Political violence sometimes covers ulterior motives, including those of political elites trying to extract concessions from foreign companies. In remote areas of Tanzania, political leaders target oil and gas companies with made-to-measure protests and other unrest, solely to pressure them to use certain contractors or pay political contributions.

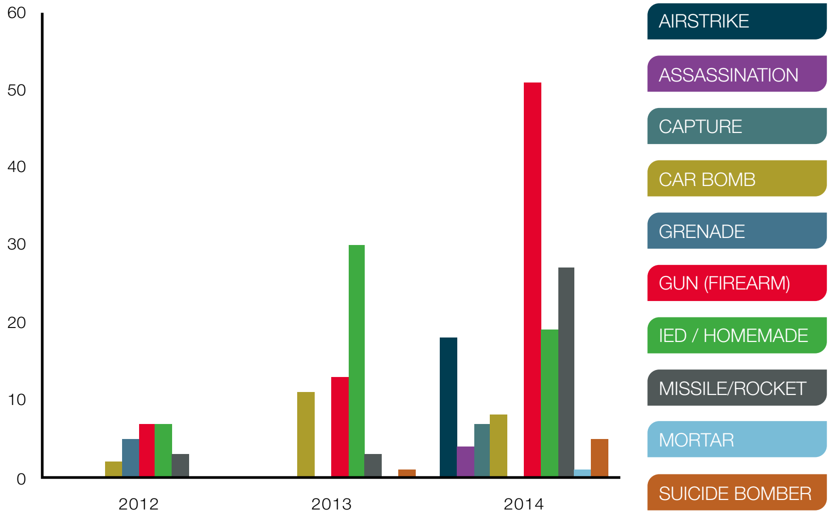
UNINTENDED CONSEQUENCES

Criminal activity may be lucrative, but it can erode political violence groups from the inside out. The Revolutionary Armed Forces of Colombia (FARC) and Peru's Shining Path show that as politically motivated rebel groups lose public support (if their cause becomes less relevant or conditions change) they find new life as criminal organisations. But once that shift is made, it becomes harder to maintain ideological purity. Criminal gangs tend to attract criminals, not ideologues. In the end, the mission suffers, the message gets diluted.

It's not always about the money: the involvement of foreign fighters and mercenaries in political violence also has a distorting effect. In Libya, there has been a subtle shift in the capability and intent of militant groups operating in Benghazi, largely because of the return of fighters from the front lines in Syria. If previously the city sustained low-level attacks such as opportunistic improvised explosive devices (IEDs), the last few years have brought an increase in car bombs, beheadings and more sophisticated assassinations, as well as a willingness to target civilians and commercial interests. The significant numbers of foreign fighters involved in Syria, Iraq and other conflict zones mean Benghazi is unlikely to be the only place where we see this shift.

PLAYING IT SAFE

The global evolution of political violence poses an important challenge to business leaders. Amid a constantly shifting landscape, how do you accurately assess threats and make business-critical decisions on topics such as security planning and design, Political violence attacks in Benghazi (by type), 2012-14: an increase and diversification of attack types has followed the return of foreign fighters from Syria.



Source: Control Risks Analytics and Incident Mapping (AIM) database

risk management, people and asset protection, or investment strategy?

International oil and gas operators in the Niger delta are well aware of the complex security dynamics in the region, but largely saw threats there as localised criminal phenomena. In early 2006, however, the threat coalesced with the emergence of the Movement for the Emancipation of the Niger Delta (MEND). MEND kept criminality close to its core, but escalated into a co-ordinated militant campaign that resulted in a wave of attacks against the oil industry.

The costs of getting it wrong can be enormous. Before the Arab spring, many companies operating in North Africa had only purchased standalone terrorism insurance. Those narrower policies left the business community exposed to a broader set of more complex political violence threats, including rebellion, war and civil war.

The constantly evolving threat landscape strengthens the need for robust risk management. Broad political violence insurance coverage, as well as specialist additional cover for organised crime and cartel violence, can be a useful risk-transfer mechanism. Proper risk assessments and a detailed understanding of local threat actors can help companies to navigate the threat environment in which they operate, provided they are prepared to change along with it.

RISK RATING FORECAST 2015

This section presents our forecast of the political and security risks prevalent across the world in 2015.

RISK RATING DEFINITIONS

POLITICAL RISK

Political risk evaluates the likelihood of state or non-state political actors negatively affecting business operations through regime instability or direct/indirect interference. It also evaluates the influence of societal and structural factors – such as corruption, infrastructure and bureaucracy – on business. Political risk may vary according to factors such as industry sector and investor nationality.

INSIGNIFICANT

The environment for business is benign. For example: political stability is assured, investor-friendly policies are entrenched, there is no threat of contract renegotiation or repudiation, and infrastructure for business is excellent.

LOW

Political and operating conditions are broadly positive. Occasional and/or low-level challenges do not significantly impede business. For example: government policies are investor-friendly with some exceptions, contracts are generally respected, non-state actors have little adverse influence over government decisions, infrastructure is generally robust or there is little risk of reputational damage.

MEDIUM

While the environment provides generally sound conditions for business, significant challenges can and do emerge. For example: hostile lobby groups exert disproportionate influence over government policy, political instability delays essential reforms, contracts are subject to uncertainty or occasional change, elements of the infrastructure are deficient, or the activities of unions or protest groups impede operations.

HIGH

The political and operating environment presents persistent and serious challenges for business. For example: there is a credible risk of contract repudiation or renegotiation by state actors, political instability threatens fundamental alterations to the nature of the state, government policy is capricious or harmful to business, corruption is endemic across all levels of officialdom, or regulations are onerous and their implementation is capricious.

EXTREME

Conditions are hostile for business. For example: direct intervention such as nationalisation or expropriation of assets is likely, systemic political instability leads to the absence of rule of law, the nature of the regime brings severe reputational risks, government structures are inadequate or infrastructure is almost entirely deficient.

SECURITY RISK

Security risk evaluates the likelihood of state or non-state actors engaging in actions that harm the financial, physical and human assets of a company, and assess the extent to which the state is willing and able to protect those assets. Security risk may vary for companies and investment projects according to factors such as industry sector, investor nationality and geographic location.

INSIGNIFICANT

The security environment for business is benign. For example: the authorities provide effective security, there is virtually no political violence, public disorder is rare and there are no known active domestic groups or issues likely to fuel terrorism.

LOW

Security conditions are broadly positive and occasional and/or low-level challenges do not significantly impede business. For example: the authorities provide adequate security, organised crime only marginally affects business and protest activity rarely escalates into threatened or actual violence. Rare but large-scale terrorist attacks may pose indirect threats to personnel or assets, or low-level attacks do not target business and are not aimed at causing casualties.

MEDIUM

Aspects of the security environment pose challenges to business, some of which may be serious. For example: there are some deficiencies in state protection, organised criminal groups frequently target business through fraud, theft and extortion, domestic terrorist groups stage regular attacks that cause disruption to (but do not target) business or there are infrequent large-scale attacks and/or opportunistic small-scale attacks on foreign or business assets and personnel.

HIGH

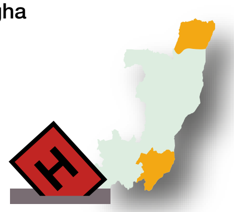
The security environment presents persistent and serious challenges for business; special measures are required. For example: state protection is very limited, insurgents are engaged in a sustained campaign affecting business, kidnap poses a severe and persistent threat to foreign personnel, terrorist groups stage regular attacks against foreign or business assets, or weak security forces are incapable of dealing with the terrorist activity.

EXTREME

Security conditions are hostile and approaching a level where business is untenable. For example: there is no law and order, there is outright war or civil war, personnel constantly face the threat of targeted and potentially life-endangering violence, a terrorist group (or groups) is staging a sustained, high-intensity campaign that severely hinders business, or terrorists frequently target foreign personnel or business activity.

COUNTRY	POLITICAL RISK	SECURITY RISK
AFRICA		
Angola	M	M; H in Lunda Sul, Lunda Norte provinces, north-east of Cabinda exclave
Benin	M	L; M on Nigerian border
Botswana	L	L
Burkina Faso	H	M; H in Oudalan, Soum, Loroum provinces
Burundi	H	M; H in Bujumbura Rural, Cibitoke, Bubanza provinces
Cameroon	M	M; H in Bakassi peninsula, Extreme North region, border with CAR
Cape Verde	L	L
Central African Republic	E	E; H in Bangui
Chad	H	M; H in Borkou, Ennedi, Tibesti regions, eastern areas of Wadi Fira, Ouaddaï, Sila, Salamat, on CAR, Cameroon, Sudanese borders
Comoros	H	L; M in Anjouan, Moroni
CONGO	**H**	**L; M in Pool, far north of Likouala, Sangha regions bordering CAR**

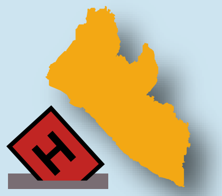
Local elections in 2014 underscored President Denis Sassou Nguesso's absolute power. In 2015, he is likely to launch a constitutional referendum to remove term limits on the presidency in a bid to challenge for a third mandate in 2016. The move is likely to be relatively uncontested, and major violence is unlikely. However, considerable political jockeying is likely, while an increase in co-option and patronage at elite levels means that corruption will deteriorate to unprecedented levels, complicating business operations.



Congo (DRC)	H	H; E in Ituri district (except Bunia), northern Katanga, North Kivu (except Goma); M in Bas-Congo, Equateur, Kasai Occidental, Kasai Oriental, Maniema provinces, southern half of Katanga province
Côte d'Ivoire	H	M; H in west, north
Djibouti	M	M; H on Eritrean border
Equatorial Guinea	H	M
Eritrea	H	M; L in Asmara; H on borders
Ethiopia	M	M; H in Somali region and areas bordering Eritrea, Kenya, South Sudan, Sudan

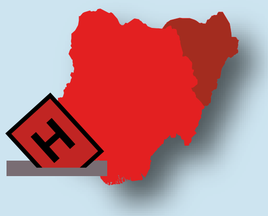
COUNTRY	POLITICAL RISK	SECURITY RISK
Gabon	M	L
Gambia	H	L
Ghana	M	L; M on south-eastern border with Togo, border with Côte d'Ivoire, areas around Gushiegu, Bawku
Guinea	H	M
Guinea-Bissau	H	M
Kenya	M	M; H in Nairobi, Mombasa, northern and eastern areas
Lesotho	H	M
LIBERIA	**H**	**M**

The Ebola crisis has taken a particularly devastating toll in Liberia and will continue to have a profound impact not just on the economy, but also on the social and political system. The government's weak handling of the crisis has further undermined its popular support. The risk of a slide back into instability and conflict is likely to be averted as the international response gathers momentum, but greater political turbulence and operational challenges are likely in the year ahead.



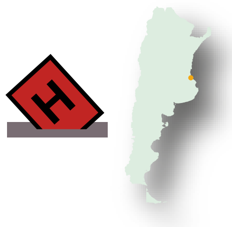
COUNTRY	POLITICAL RISK	SECURITY RISK
Madagascar	H	M
Malawi	M	L; M in major urban centres
Mali	H	M; H on border with Mauritania, Mopti, Gao, Kidal, Timbuktu regions
Mauritius	L	L
Mozambique	M	M
Namibia	L	L
Niger	H	M; H on Mali, Nigeria borders, Agadez region, northern half of Tahoua region
NIGERIA	**H**	**H; E in Borno, Yobe, northern half of Adamawa**

The security environment will deteriorate around the February 2015 elections. President Goodluck Jonathan's decision to stand again has proved contentious, potentially fuelling post-election unrest. Many influential governors are to stand down, driving violent political rivalry at state level. Unrest and sporadic politically motivated violence will strain public security provision, increasing the threat from criminal and militant groups, particularly in the north, where Islamist militant group Boko Haram will step up its activities. The risk of high-profile Boko Haram attacks elsewhere, notably the capital Abuja, will increase.

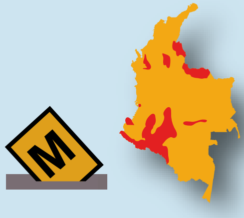


COUNTRY	POLITICAL RISK	SECURITY RISK
Rwanda	M	L; M on border with Congo (DRC)
São Tomé	M	L
Senegal	M	L; M in Casamance
Seychelles	L	L
Sierra Leone	M	M
Somalia	E; H in Somaliland, Puntland, areas disputed between Somaliland, Puntland, Khatumo state	E; H in Eastern Somaliland, Puntland, areas disputed between Somaliland, Puntland, Khatumo state; M in Western Somaliland
South Africa	M	M; H in Johannesburg, deprived urban areas
South Sudan	H	H
Sudan	H	M; H in South Kordofan, Blue Nile states; E in Darfur
Swaziland	M	M
Tanzania	M	M
Togo	M	M
Uganda	M	M; H in border areas with Congo (DRC), South Sudan
Zambia	M	L; M in Lusaka, parts of Copperbelt
Zimbabwe	H	M
AMERICAS		
Anguilla	I	I
Antigua and Barbuda	L	L
ARGENTINA	**H**	**L; M in Buenos Aires**

2015 is shaping up to be a watershed year. President Cristina Fernández is constitutionally barred from seeking a third term, and her political movement is increasingly weakened by an acute economic contraction and faces electoral defeat amid growing opposition. A more moderate government is likely to backtrack on state intervention and regain access to international financial markets. However, economic distortions such as high inflation and capital flight will continue to undermine the local business environment.



COUNTRY	POLITICAL RISK	SECURITY RISK
Aruba	L	L

COUNTRY	POLITICAL RISK	SECURITY RISK
Bahamas	I	L
Barbados	I	L
Belize	L	L; M in Belize City
Bermuda	I	I
Bolivia	H	M
Bonaire	L	L
Brazil	M	M
British Virgin Islands	I	I
Canada	L	L
Cayman Islands	I	L
Chile	L	L
COLOMBIA	**M**	**M; H in border areas with Venezuela and Ecuador, areas affected by guerrilla activity**
The re-election of President Juan Manuel Santos in July 2014 underlined political continuity and has greatly increased the chances of a peace deal between the government and the Revolutionary Armed Forces of Colombia (FARC) guerrilla group. However, security risks will remain complex: infrastructure and the security forces will remain the main targets of the FARC, but the threat to company personnel and assets will remain high in certain areas.		
Costa Rica	L	L; M on Nicaraguan border, Limón province
Cuba	H	L
Curaçao	L	L
Dominica	I	I
Dominican Republic	M	M
Ecuador	H	M; H in Colombian border areas
El Salvador	M	H
French Guiana	L	L
Grenada	L	L

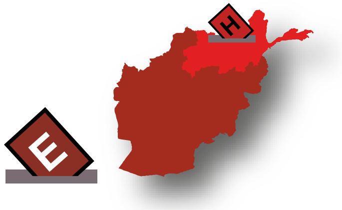
COUNTRY	POLITICAL RISK	SECURITY RISK
Guadeloupe	I	L
Guatemala	M	H
Guyana	M	M
Haiti	H	H
Honduras	M	H
Jamaica	L	M; H in West Kingston, Spanish Town
Martinique	I	L
MEXICO	**M**	**M; H in Chihuahua, Coahuila, Tamaulipas, Sinaloa, Durango, Jalisco, Guerrero, Michoacán, Morelos, México states**

Insecurity will top President Enrique Peña Nieto's agenda as the focus moves away from the structural reforms of his first two years in office. The ruling Institutional Revolutionary Party (PRI) needs opposition support to rebuild persistently corrupt public security and judicial institutions, but with midterm elections set for July 2015, co-operation will be in short supply. Violence by organised crime groups will remain a threat in many areas, with patterns changing in response to security efforts; progress in Nuevo León will be offset by further deterioration in México state.

COUNTRY	POLITICAL RISK	SECURITY RISK
Nicaragua	M	M
Panama	L	M; H in Darién
Paraguay	M	L; M in eastern border, tri-border area
Peru	M	M; H in Ene, Apurímac and Mantaro River Valley (VRAEM)
Puerto Rico	L	M
Sint Maarten	L	L
St Kitts and Nevis	I	L
St Lucia	I	L
St Vincent and Grenadines	I	L
Suriname	M	L
Trinidad and Tobago	L	M; L in Tobago; H in Laventille, Beetham (Port of Spain)
Turks and Caicos	L	I

COUNTRY	POLITICAL RISK	SECURITY RISK
United States	L	L
Uruguay	L	L
US Virgin Islands	I	I
Venezuela	H	M; H in Caracas, Colombian border areas
ASIA-PACIFIC		
AFGHANISTAN	**E; H in Kabul**	**E; H in Badakhshan, Baghlan, Balkh, Kunduz, Panjshir, Samangan, Saripul, Takhar provinces**

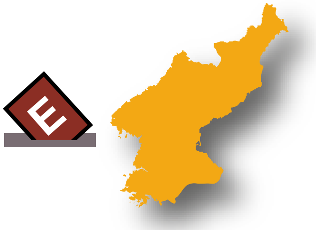
The national unity government faces governance challenges and internal power struggles as different ethnic groups vie for greater political representation. Taking advantage of the drawdown of international troops, the Afghan Taliban will escalate targeting of national security forces, and regain control of districts in southern and eastern provinces. It will also attack some high-profile political and security targets in northern provinces, but business activities will continue in the north and west.



Australia	L	L
Bangladesh	M	M; H in Chittagong Hill Tracts
Bhutan	L	L
Brunei	L	L
Cambodia	M	M
China	M; L in Hong Kong	L; M in non-central districts of cities in Guangdong Province, remote border areas, Xinjiang Uighur Autonomous Region (XUAR)
East Timor	M	M
Fiji	M	M
India	M	M; H in Assam, Manipur, Nagaland, Tripura, Bihar, Jharkhand, Chhattisgarh, India-administered Kashmir, non-coastal districts of Odisha (Orissa), eastern districts of Maharashtra
Indonesia	M	M; H in Papua, Poso, Maluku
Japan	L	L
Laos	M	L
Malaysia	L	L; M in coastal areas, island groups of eastern Sabah

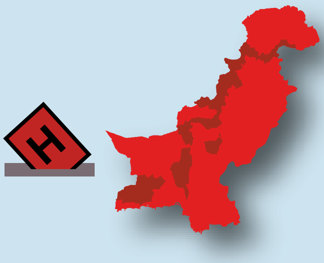
COUNTRY	POLITICAL RISK	SECURITY RISK
Maldives	M	L
Mongolia	M	M
Myanmar	H	M; H on borders, insurgency affected areas
Nepal	H	M; H in south
New Caledonia	L	L
New Zealand	I	L
North Korea	**E**	**M**

The risk of major military conflict or regime collapse remains low, but developments in 2014 confirmed that uncertainty on both fronts has increased under the leadership of Kim Jong-un. Foreigners in the country are closely supervised and rarely allowed beyond basically stable, safe areas; detentions of foreigners are largely limited to individuals who engage in banned religious or reporting activities. However, visitors failing to exercise caution face significant risks, and detentions have become more common under the current leadership.



PAKISTAN	**H**	**H; E in FATA, western Khyber-Pakhtunkhwa, central and western Balochistan**

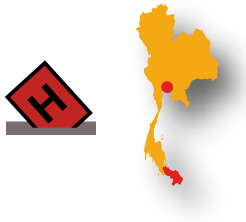
The security landscape will remain complex as the government struggles to develop and implement effective counter-terrorism strategies. Islamist militants will escalate targeting of state security forces, including in urban areas, in retaliation for military operations against their hideouts in FATA. Sectarian militant groups will increase activities in Sindh and Balochistan, while organised crime, extortion and kidnap-for-ransom will rise in cities as militant groups look to fund terrorist activities. However, such groups will not directly target foreign companies or commercial and industrial assets.



Papua New Guinea	M	H
Philippines	M	M; H in areas of insurgency, especially Mindanao and Sulu Archipelago
Singapore	I	L
Solomon Islands	M	M
South Korea	L	L
Sri Lanka	M; H in north	M
Taiwan	L	L

COUNTRY	POLITICAL RISK	SECURITY RISK
THAILAND	**H**	**M; H in Bangkok, areas of insurgency, especially Narathiwat, Yala, Pattani and Songkhla**

After taking power in May 2014, the military junta intends to implement a comprehensive political ‘reform’ programme in 2015 that is likely to comprise a regressive package of measures that dilute democratic rights. The junta also intends to politically marginalise the ‘red shirt’ protest group associated with former prime minister Thaksin Shinawatra (2001-06). There is a significant risk of violent social backlash. The potential for a messy royal succession to merge with this elite power struggle means political risks will be high in the coming year.



COUNTRY	POLITICAL RISK	SECURITY RISK
Tonga	L	L
Vanuatu	L	L
Vietnam	M	L
EUROPE		
Albania	M	L
Andorra	I	I
Armenia	M	M; H on border with Azerbaijan
Austria	L	L
Azerbaijan	M	M; H in Armenian border regions, Nagorno-Karabakh
Belarus	H	L
Belgium	L	L
Bosnia and Herzegovina	M	L
Bulgaria	M	L
Croatia	M	L
Cyprus	L; M in TRNC	L
Czech Republic	M	L
Denmark	I	I; L in Copenhagen
Estonia	L	L
Finland	L	L
France	L	L; M in deprived urban areas

COUNTRY	POLITICAL RISK	SECURITY RISK
Georgia	M; H in Abkhazia, South Ossetia	M; H in Abkhazia, South Ossetia
Germany	L	L
GREECE	**M**	**L**

Greece's economic and political troubles are far from over, but the picture is beginning to brighten slightly, with a first year of economic growth since the global financial crisis a real possibility in 2015. The scale of protests and frequency of violent incidents have both declined from their 2011 peak. The threat to business, while still real, is not as significant as in earlier phases of the crisis. Possible early elections may see this relative calm tested, but a major new upsurge in political violence is unlikely.

Hungary	M	L
Iceland	I	I
Ireland	L	L
Italy	L	L; M in southern regions
Kazakhstan	M	L
Kosovo	M	L; M in Mitrovica, surrounding areas
Kyrgyzstan	H	H
Latvia	L	L
Liechtenstein	I	I
Lithuania	L	L
Luxembourg	I	I
Macedonia	M	L
Malta	I	I
Moldova	M; H in Transnistria	L; M in Transnistria
Monaco	I	I
Montenegro	M	L
Netherlands	L	L

COUNTRY	POLITICAL RISK	SECURITY RISK
Norway	I	I
POLAND	**M**	**L**

In the run-up to the 2015 elections, Ewa Kopacz's centre-right coalition government is likely to resort to populist spending and policy measures to boost its re-election chances in the face of growing antagonism from the conservative opposition Law and Justice (PiS) party. Growing policy and regulatory uncertainty is amplified by the prospect of a PiS electoral victory, the anti-business policies it would introduce and an overall deterioration in the political stability that helped the country to avoid recession during the economic crisis.

COUNTRY	POLITICAL RISK	SECURITY RISK
Portugal	L	I
Romania	M	L
Russia	M; H in North Caucasus	M; H in North Caucasus republics of Dagestan, Ingushetia, Kabardino-Balkaria
San Marino	I	I
Serbia	M	L
Slovakia	M	L
Slovenia	M	I
SPAIN	**M**	**L**

As Spain's prolonged economic crisis finally begins to ease, the political ramifications are only just starting. The blocking of the Catalan independence referendum means the issue will become a destabilising dispute in an election year, with a clear sense yet to emerge of how the country's structure may change. The two-party system that has prevailed since the return of democracy is also under threat, as voters finally tire of corruption and new parties such as the left-populist Podemos poll strongly.

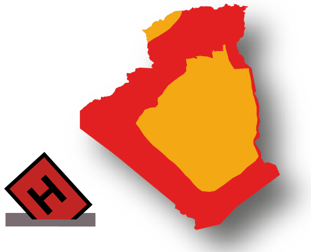
COUNTRY	POLITICAL RISK	SECURITY RISK
Sweden	L	I; L in Stockholm and surroundings, Gothenburg, Malmö
Switzerland	I	I
Tajikistan	H	H
Turkey	M	L; M in urban areas of south-east; H on Syrian border, rural areas of south-east and Tunceli
Turkmenistan	M	M

COUNTRY	POLITICAL RISK	SECURITY RISK
UKRAINE	**H**	**M; H in Donetsk, Luhansk regions**

The government in 2015 will attempt to carry out wide-ranging constitutional, political and regulatory reform aimed at reducing corruption, some of which will be very divisive. The pro-reform parliamentary coalition is likely to be fractious and prone to collapse. A significant part of the eastern Donetsk and Luhansk regions remains under the control of pro-Russian armed militias. Clashes between militias and government forces are likely to continue and may be serious, though the government is unlikely to try to remove the militias by force.

COUNTRY	POLITICAL RISK	SECURITY RISK
United Kingdom	L	L
Uzbekistan	H	M; H in Afghan, Kyrgyz, Tajik border areas, Fergana Valley
MIDDLE EAST AND NORTH AFRICA		
ALGERIA	**H**	**M; H in rural areas of north-central and north-eastern provinces, non-oil- and gas-producing areas of southern provinces**

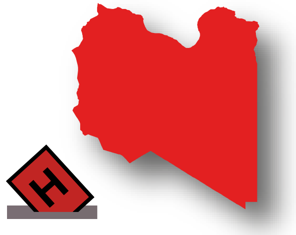
The April 2014 re-election of President Abdelaziz Bouteflika has brought to the fore questions about his ability to complete a fourth term. His poor health means he is likely to die in office, raising the prospect of a struggle between the main power centres over the succession. However, the president has set in motion a process of constitutional reform that will be used to line up a successor, and we expect the succession process to be managed without destabilising the country.



COUNTRY	POLITICAL RISK	SECURITY RISK
Bahrain	M	M
Egypt	H	M; H in North Sinai
Iran	H	L; M in Sistan and Balochistan, Khuzestan provinces, areas within 60 miles (100km) of Turkish, Iraqi, Afghan borders
Iraq	E; M in Kurdistan Region	E; M in Kurdistan Region; H in Kurdistan Region borders, south
Israel	L	L, M on Egypt, Syria borders, western Negev
Jordan	M	L; M on Syrian border
Kuwait	M	L
Lebanon	M	M; H in northern, eastern borders with Syria (North, Bekaa provinces), Tripoli

COUNTRY	POLITICAL RISK	SECURITY RISK
LIBYA	**H**	**H**

Libya continues to experience an extremely volatile transition process. Various groups are battling for control over institutions, territory, the formal and informal economy, and what remains of the fast-collapsing political process. Tensions will remain significantly elevated over 2015; further political crises and outbreaks of violence are likely. The situation is likely to fall short of civil war as a stalemate emerges in which the various sides accept a fragile status quo in control of assets and territory. However, improvements in stability are highly unlikely.

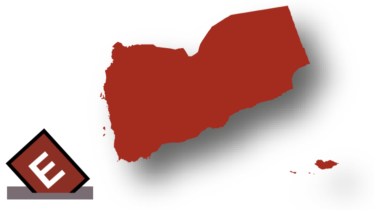


COUNTRY	POLITICAL RISK	SECURITY RISK
Mauritania	M	M; H in eastern desert areas
Morocco	L; H in Western Sahara	L; M in Western Sahara
Oman	L	L
Palestinian Territories	H in West Bank; E in Gaza	M in West Bank; E in Gaza
Qatar	L	L
Saudi Arabia	L	L; M in Qatif, Iraq border, Yemen border
Syria	E	E
TUNISIA	**M**	**L; M in south, interior**

Tunisia in 2014 made significant achievements in its transition process: ratifying a constitution in January, holding parliamentary elections in October and appointing a president in November. Renewed momentum in the political process means that investors will begin to see some stabilisation in the political, security and operational |environments. Nevertheless, several factors continue to threaten stability, including poor socio-economic conditions; the economy's structural weaknesses; tensions between Islamists and secularists; the fragility of coalition governments; and insecurity across the Sahara and Sahel.

COUNTRY	POLITICAL RISK	SECURITY RISK
United Arab Emirates	L	L
YEMEN	**E**	**E**

The subversion of the state in 2014 by a non-state actor – the Zaidi Shia Houthi movement – has increased uncertainty over the state's ability to govern and provide security. The Houthis seized the capital Sanaa and sidelined Sunni Islamist political group Islah, their primary political opponent, injecting considerable tension into the political environment. The Houthis have continued to expand their control of territory despite a UN-brokered ceasefire, raising the likelihood of civil war and the fragmentation of territorial control in 2015.



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