

Control Risks



RiskMap 2007

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Definition of risk levels

Political risk

INSIGNIFICANT

The environment for business is favourable and likely to remain so. Government policy is stable and the economy is secure. Business faces no legal or regulatory disadvantages. There are no significant non-state threats to operations.

LOW

Business can operate with few problems. Political institutions are stable but there is some possibility of negative policy change. Legal guarantees are strong but business may face some regulatory or judicial insecurity. Non-state actors may occasionally hamper operations.

MEDIUM

Foreign business is likely to face some disruption from state or non-state actors OR long-term investment security cannot be guaranteed. There is a risk for business of exposure to some or all of the following: corruption; strong and hostile lobby groups; absence of adequate legal guarantees; restrictions on imports or exports; weak political institutions; and capricious policy-making. In some Medium risk countries there is a latent threat of military or other illegal intervention.

HIGH

Business is possible but conditions are difficult or likely to become so in the near future. Political institutions effectively do not function, the regulatory framework is poor and judicial decisions are arbitrary. There is little security for investments. Business may be exposed to the following risks: economic and political conditions may become rapidly unstable; international sanctions are possible; non-state actors actively target business; or there is a risk of contract repudiation or re-negotiation by state actors.

EXTREME

Conditions are hostile to/untenable for business. There is no investment security. The following conditions may apply: the economy has collapsed; law and order has broken down and state bodies have ceased to function; there is a state of war or civil war; non-state actors cause suspension of operations; or the state is actively hostile to foreign business and expropriation of assets is likely.

Security risk

INSIGNIFICANT

Assets and personnel are not at risk except from isolated incidents or petty crime. Levels of violent crime are low, the authorities provide effective security and there is virtually no political violence.

LOW

Assets are generally secure and the authorities provide adequate security. Companies and personnel face only infrequent exposure to violence from terrorists or criminals; companies are unlikely to be systematically targeted for asset theft.

MEDIUM

There is a reasonable possibility of security problems affecting companies, but there is no sustained threat directed specifically against foreign companies. Targeted crime or violence poses some risk to foreign assets and personnel OR they are at reasonable risk from violence by terrorists or unrest. State security is inadequate.

HIGH

There is a probability that foreign companies will face security problems; special measures are required. Assets and personnel are at constant risk from violence or theft by state or non-state actors OR there is a high risk of collateral damage from terrorism or other violence. State protection is very limited.

EXTREME

The severity of security risks to assets or personnel is likely to make business operations untenable. There is no law and order; conditions may verge on war or civil war. Foreign companies must strongly consider withdrawal.

Definition of risk categories

Political risk

The political risk rating evaluates the likelihood of state or non-state political actors negatively affecting business operations in a country. It assesses the extent to which the state is willing and able to guarantee contracts and the extent to which non-state actors may threaten the viability of business operations. State actors can include domestic and foreign governments, parliament, the judiciary and the security forces; non-state actors can include insurgent groups, labour unions, lobbies, organised crime, environmentalists, ethnic and indigenous groups as well as international organisations. The impact of political risk on companies can include negative government policy, judicial insecurity, exposure to corruption, reputational damage, expropriation and nationalisation, and international sanctions. It assesses the extent to which political, economic and institutional stability may enhance or diminish the likelihood of these risks taking place. Political risk may vary for companies and investment projects because of factors such as industry sector and investor nationality.

Security risk

The security risk rating evaluates the likelihood of state or non-state actors engaging in actions that harm the financial, physical and human assets of a company. It assesses the extent to which the state is willing and able to protect those assets and the extent to which state or non-state actors are capable of harming those assets. Actors that may pose a security risk to companies can include political extremists, terrorists, the security forces, foreign armies, petty criminals, organised criminals, computer hackers, protesters, workforces, local communities, indigenous groups, corrupt officials, business partners, and in-country company management and staff. The impact of security risk on companies can include theft, injury, kidnap, damage to installations, information theft, extortion, fraud, expropriation and loss of control over business. Security risk may vary for companies and investment projects because of factors such as industry sector, investor nationality and geographic location.

Introduction

The annual preparation of country forecasts for RiskMap always provides vital insight into broader patterns in world developments. As we survey the national landscapes for clues to the year ahead, we also build a collective understanding of global trends and their potential risks for business. It is clear that 2007 promises to be a year of seismic activity in the global geopolitical and security environments.

Several issues that have been brewing over the last decade will come to the fore. It's decision time for the big players. The international community will respond to the nuclear challenges posed by Iran and North Korea, but solutions will remain elusive; Russia will maintain its course of resource nationalism; and US policy in Iraq will signal a retreat from the grand Middle East restructuring programme. This augurs a period of uncertainty, before clarity will emerge towards the end of the year.

Changing leaders

Elections loom large in a number of key countries. Venezuela's Hugo Chávez will win another term in power, but will become increasingly reliant on the instruments of state to maintain his regime, abandoning in all but name the redistributive socialist aims of the 'Bolivarian Revolution'. For better or worse, Nigeria will weather an election – and an election campaign – that will test its moves to liberalise the economy and redistribute power and oil revenues.

Further distant, the US presidential election will cast its long shadow over US domestic and foreign policy as Bush's term comes to an end. In Kazakhstan and South Africa, manoeuvring will begin among those competing to succeed leaders whose time is near.

Elsewhere, new – or newly elected – leaders will try to bed in. At the heart of Africa, Congo (DRC) will need to seize the chance to consolidate 2006's electoral experience to emerge from the chronic insecurity of the post-Mobutu era. In China, Hu will establish his position, and bring a subtle change to the

direction of economic and market policies. More difficult will be Lebanon's recovery from war, and Mauritania and Thailand's efforts to re-establish democracy after military intervention.

Act local

As a consequence of these and other issues, the main security challenge in 2007 will be to focus on the immediate risks, rather than the big-picture threats. Terrorism will continue to dominate the headlines, but its real threat to business needs balanced, local assessment. Likewise, local government failures, corruption, capricious policy-making and intractable militancy will all claim more management time and lost profitability than the threat of nuclear sanctions. In essence, while it is important to think globally, it is vital for business to act locally to mitigate security risks.

Across all these issues will blow the rhetoric of global warming and climate change, which is attracting recognition as a crucial security issue. The debate is unlikely to monopolise governments' attention in 2007, but will be loud enough to command regional and local action. Where international organisations and member states have failed to act effectively, sub-national entities and municipalities will continue to step in – witness California's leadership within the US, and the efforts of cities such as New Delhi and London to legislate to reduce emissions and conserve energy.

One of our 'bite-sized' articles looks at one of the longer-term consequences of climate change: a functional North-West Passage joining the Atlantic and Pacific. The scientific consensus is that climate change demands immediate attention, regardless of the imminence or otherwise of a crisis. Businesses are already facing localised resource conflicts and environmental disasters, and these issues show no signs of abating.

Jennifer Harbison, Research Director
London, October 2006

Emerging global risks to business in 2007

Thailand's bloodless military coup in September 2006 was a useful reminder that changes of government or political difficulties can cause problems for investors in a specific country, or – as North Korea's nuclear test illustrated – a wider region.

However, underlying such threats are broader challenges to global business that have little respect for territorial borders.

James Smither and Matthew Hulbert address the fact that risk, like business, is a globalised phenomenon.

The onus remains squarely on businesses to establish measures to limit the impact on their assets and operations from issues such as global terrorist threats, climate change, natural resource depletion, pandemic disease and economic shocks. At the same time, there is growing pressure for business' role in these trends to be more closely monitored and constrained.

The general array of transnational threats in 2007 is likely to be similar to that of 2006, but in an era of global inter-connectedness and global supply chains, international business must always be prepared for new and unforeseen risks to reputation, security and – ultimately – profitability.

Terrorism tops the agenda

Terrorism – or perceptions of the terrorism threat – have a disproportionate and pernicious impact on political and commercial decision-making. The global threat is unlikely to recede in 2007, and the annual Transatlantic Trends survey conducted in the US and 12 EU states shows that concern about terrorism continues to rise.

Terrorism remains largely regionally focused. Most active terrorist groups have a narrow agenda that focuses on a specific state or geopolitical claim. Headline figures on the number of attacks can appear alarming: according to the US National Counter-terrorism Center (NCTC)/State Department 2006 report, there were 11,111 attacks in 2005, compared with 3,168 in 2004 and 208 in 2003. However, these figures are significantly distorted by the Iraq insurgency and changing definitions make year-on-year comparison difficult. The number of terrorist incidents outside the Middle East and Asia has been falling – though average lethality is rising – and outside Iraq, incidents with ten or more deaths have remained at roughly the

same level as 2003-04. Despite the rhetoric, this is not an age of catastrophic global terrorism.

No end in sight

Islamic extremists worldwide are increasingly informed by a common *jihadist* outlook. Groups within al-Qaida's ideological orbit that historically received its support now emulate it. They have evolved to follow the vision and mission of a universal *jihad*. Al-Qaida's most enduring impact has been to instil other groups with a sense of duty to fight local enemies, but also the distant enemy – the US.

Al-Qaida actively promotes its connections to regional and local Islamic extremist groups, such as Jemaah Islamiyah (JI) in South-east Asia; Kashmiri separatist groups; and organisations operating in North Africa, Europe and elsewhere. The fact that terrorist networks are increasingly diverse, dispersed and independent complicates the threat and encourages heightened threat perceptions. Al-Qaida has effectively engineered a process of self-radicalisation, with major implications for counter-terrorism measures over the next decade and beyond.

Targeting trends

The sense of fear associated with terrorism is reinforced by trends in targeting methods and tactics. The number of attacks targeting private citizens and property has continued to increase, and 2007 is likely to see non-combatants remain in the cross-hairs. There will be a continuing focus on 'soft' civilian targets – particularly tourist sites or mass transport infrastructure – that require limited expertise and resources to attack using suicide or other bombs. Islamic extremists will also prioritise recruiting female and white volunteers and seeking ever more innovative explosive-delivery systems. They will continue to exploit thousands of online sources to ensure that new recruits do not appear on the authorities' radar by physically travelling to Afghanistan or Pakistan to be inspired or trained.

Energy and environmental vulnerabilities

A persistent terrorist focus on explicitly economic targets, illustrated by a February 2006 attack on a Saudi oil installation, is just one in a range of threats to energy and environmental security in 2007 and beyond. These threats are linked to instability in the

Barking up the wrong money tree

US-led efforts to combat terrorist financing are prompting growing business concern over their increasing costs and the protection of confidential data. The US claims that these measures have had some success, pointing to the arrest in 2003 of the Indonesian militant Hambali, who orchestrated the 2002 Bali bombings, and the August 2006 disruption of a plot to attack airliners departing from the UK.

Yet these measures are not a complete solution and have several limitations. Terrorist financing is a complex, constantly shifting process; terrorists do not need to rely on one method to fund their activities. While banks struggle to comply with new legislation to combat sophisticated money-laundering, terrorist cells are increasing their reliance on cash to leave a minimal trail.

At the same time, the evolution of autonomous 'home-grown' cells means that laundering large amounts of money is often unnecessary. Such cells are self-financed via legitimate jobs, personal finance and low-level crime. The perpetrators of the July 2005 London bombings raised the necessary cash through work, small personal loans and credit cards, methods that would be extremely difficult to identify as related to terrorism or other serious criminality.

In addition, the trend for attacking 'softer' targets such as bars, hotels and public transport means that the average cost of a terrorist attack is falling. A single suicide bombing may cost as little as \$150; the London bombings cost only a few thousand pounds.

These trends are balanced by a parallel (and paradoxical) adoption of more sophisticated methods of financing involving connections to criminal activities such as drug-smuggling, counterfeiting and fraud. The terrorists behind the 2004 Madrid bombings raised money by selling counterfeit CDs and trafficking drugs.

This combination of methods, along with exploitation of the global free market, means that terrorist financing will remain difficult to intercept. The impact on business of new regulations will be onerous; the impact on terrorists is less clear.

Middle East and Nigeria, capricious OPEC decision-making, economic nationalism in Latin America and state 'expansionism' in Russia. All those involved – from Venezuela's president to militants in the Niger delta – have an increasingly sophisticated understanding of their leverage on oil price and supply.

Tight supplies, rising demand (especially in India and China) and geopolitical instability combined to push crude oil prices to \$78 a barrel in 2006. The macroeconomic impact was more moderate than expected, but any new major shock would be likely to disrupt oil markets to the detriment of global economic growth. The impact would be more severe in low- and middle-income countries, with potential repercussions on often fragile political and security stability.

The uncertainty of energy supplies from Russia and the Middle East has prompted a number of EU states to start thinking more seriously about reducing demand. The current consensus is that this thinking may

be 'too little, too slowly'. As carbon emissions continue to escalate, research shows that the world temperature has increased by one degree Fahrenheit (0.6 degrees Celsius) and that sea levels have risen by four to eight inches (5-10cm) in the last century (a rise of three feet (just under 1m) would inundate low-lying areas from Florida to Bangladesh).

Without urgent action, global warming could lead to an increase in resource conflicts, mass human displacement and disruption to agriculture and food supplies over the next 15 years. Some estimates claim that, by the end of the 21st century, rising sea levels and crop failures could result in 150m refugees. Long-term solutions will be required to reduce the likelihood of this occurring and to mitigate the impact if it does.

The continuing problem of failing states

Acute vulnerability to the sharper effects of environmental degradation characterises many of the world's weak and poorly

governed states. These will continue to pose a significant threat to international security and foment difficult environments for many emerging-market business operations. International institutions are already stretched in their efforts to manage a proliferation of fragile states. Since the mid-1980s, around 50% of 'resolved' conflicts have relapsed within five years; this percentage could increase in 2007.

According to the World Bank, the number of 'fragile' states has risen from 17 to 26 since 2003, with Nigeria, Kosovo, Cambodia, East Timor and Gaza joining the list. Fragile states are now home to more than 500m people, half of whom live in severe poverty, and often offer safe havens for drug production and weapons-smuggling. Corruption also presents an endemic problem to businesses operating in these jurisdictions. The global result in 2007 is likely to see regional spill-over of conflict, terrorism, mass migration and a failure to manage epidemic diseases, undermining business environments.

Sophisticated transnational crime

Cybercrime

Cybercrime will maintain its exponential growth rate, while the electronic channels that criminals exploit will be used by other non-state actors. Global business integration will be mirrored by an ever more mobile criminal and campaigning community. A US government report highlighted information technology infrastructure as highly vulnerable to terrorist and criminal attack. While the links between cyber attacks and terrorism are expected to grow as terrorist organisations become more technologically sophisticated, conventional cybercrime remains the pre-eminent problem. Manufacturing and financial services sectors are the principal business targets for attack. Globally, the US continues to suffer the largest number of cyber attacks, with China and Russia being the main sources.

Illicit trade and counterfeiting

Despite well meaning initiatives, some concrete legislative steps and much lip service, intellectual property rights (IPR) theft and counterfeiting will show no sign of abating. The global trade in illicit goods is growing; according to Interpol, the number of counterfeits has grown eight times the speed of legitimate trade since the early 1990s. This has caused global commercial losses in the region of \$500bn (5%-10% of the total

value of world trade), for the most part around the same complex global distribution chains associated with legitimate trade flows.

Although China has made legislative improvements, it remains a key IPR offender; estimates suggest that more than \$16bn of counterfeit goods are sold each year *in* the country, with exports worth in excess of this figure. Other major offenders include Taiwan, Vietnam, Philippines, Malaysia, Russia, other former Soviet republics, parts of Latin America and Africa. Corporations are at risk through their own partners, suppliers and customers. The internet is another factor – conservative estimates place the annual value of illicit goods traded on the web at \$25bn. This trade remains a high-profit and low-risk exercise for criminal syndicates, but is linked to more violent organised crime and occasionally terrorism (the Madrid bombers raised money through counterfeiting rings).

Human-trafficking

Human-trafficking is one of the fastest-growing illicit trades in the world. Cautious estimates of cross-border trafficking stand at 800,000 people per year according to the US State Department, while inclusion of internally trafficked people brings the total to between 2m and 4m people. Human-trafficking generates \$9.5bn annually through links with organised crime, money-laundering and corruption; China alone has a \$1bn-\$3bn annual trade in people.

Many countries lack legal provisions to enforce anti-trafficking measures; there were only 58 convictions in 2005 for human-trafficking in Africa and 59 in the Americas. The persistence of dual labour markets – one legal, the other underground and unregulated – means that the trade will continue. As well as the human tragedies, trafficking fuels organised crime and funds terrorism.

Tied up in red tape

The corruption and regulatory weaknesses that can facilitate such illegal trafficking also have a significant impact on business. Requirements affecting registration, taxation, operation and import/export arrangements can seriously affect profit and business viability. This is compounded by overlapping problems such as bribery demands, smuggling and copyright infringement. Regulatory procedures can also be vehicles for nepotistic or anti-competitive practices, not least because the countries that regulate

the most are often least able to enforce their rules.

Despite this, the World Bank has noted improvements in regulatory environments in 2005-06. The key improvements were generally around starting a business, with 43 countries taking active steps to simplify procedures and reduce costs and delays. Progress has also been seen on reducing tax rates and the administrative burden. The top ten reforming countries were Georgia, Romania, Mexico, China, Peru, France, Croatia, Guatemala, Ghana and Tanzania, albeit many of these started from a low base. Interestingly, the bank's studies indicated that, even in top-performing economies, nearly 85% of reforms occurred within the first 15 months of a new administration.

Reputation and responsibility

Even as emerging markets are urged to reduce regulatory obstacles to business, companies are facing a proliferation of international expectations, principles and best-practice guidelines. These combine with the threat of national and extraterritorial litigation, notably through the US' Alien Tort Claims Act (ATCA), Patriot Act and Foreign Corrupt Practices Act (FCPA). Other countries are also acting to regulate domestic business: Denmark introduced a law as early as 1995 calling for 'green accounts' and France in 2002 passed an act obliging listed companies to include social and environmental evaluations in annual reports. A crucial development will come in March 2007, when the UN Special Representative on business and human rights issues will decide whether existing human rights guidelines that affect business will be given legal teeth and become more enforceable.

Amid rising concern about corporate responsibility, a key challenge for globally integrated enterprises is to ensure that standards of governance, transparency, privacy, security and quality are maintained even when producers and operations are handled by various organisations worldwide. There are roughly 70,000 transnational companies, together with approximately 700,000 subsidiaries and millions of suppliers. This underlines the need for effective management of these issues across the supply chain.

The more obvious risks include association with repressive governments; involvement in criminal activities, such as corruption and money-laundering; and complicity in third-

party abuses, especially when working in conflict areas. Other concerns include environmental degradation and social dislocation, such as that linked to disruption of local indigenous populations, concerns around forced labour, and health and safety issues. Association with such issues can translate into negative publicity, consumer boycotts, non-governmental organisation (NGO) campaigns and protests. As well as damage to reputation, companies could face business interruption, blacklisting for future contracts, loss of operating licences, high-level security risks to operations and personnel, and loss of financial backing – all of which hit the bottom line.

Scrutiny at every level

As multinational companies have become increasingly powerful, social actors – both local and transnational – are looking to provide countervailing pressures. NGOs use international corporate social responsibility (CSR) instruments to hold multinational companies to account, especially in difficult emerging markets where transgressions are often viewed most critically. The level of scrutiny is severe: 30,000 NGOs now operate international programmes; 1,000 have memberships drawn from three or more countries. Significant reputational damage can result when companies are accused of defaulting on obligations.

Western-based corporations complain that the higher ethical and reporting standards to which they are expected to adhere are rendering them uncompetitive against increasingly strong emerging-country parastatal and private companies, especially those from China and India, which are typically less subject to such constraints. A long-term question is the extent to which such companies will gradually conform to 'Western' standards to secure presence and capital in the West, but in 2007, this will remain distant.

At the extreme lies the militant anti-corporate agenda, a phenomenon ranging from indigenous campaigns against high-profile energy projects in ecologically sensitive areas through mass protests at international summit meetings to the extremist tactics favoured by some animal rights groups. These problems will be perpetuated throughout 2007. In some ways, this is the perfect encapsulation of the risk landscape facing companies. Such groups learn sophisticated targeting and propaganda lessons from terrorist campaigns and each other, are prodigious in their exploitation of

Bird flu: Don't count your chickens

Bird flu largely disappeared from the news in late 2006, following a brief frenzy of Western media coverage of the first cases of the highly pathogenic H5N1 strain in Europe. The swift containment of the outbreaks and the lack of human infections seemed to refute predictions of an imminent health crisis. However, the nucleus of the threat is and will remain in Asia, where countries such as Indonesia show that the risk of a pandemic will remain undiminished in 2007.

Indonesia saw the first confirmed human-to-human transmission of the virus in mid-2006, but the long-term threat is posed by its seemingly unstoppable spread in poultry. The front line of the battle is again Indonesia, where woeful under-funding has left the authorities vainly trying to control a virus that is endemic across a vast territory. Further isolated cases of human transmission are likely in 2007, and Indonesia remains the probable setting for the emergence of a more threatening strain.

Even countries that seemed to beat the virus in 2006, such as Cambodia and Thailand, have suffered renewed outbreaks. South-east Asia and China will see further upsurges in 2007, with more isolated human cases. The same is true across Africa, central Europe and Central Asia. If wild birds are the main vessel for the virus' spread, North America will see outbreaks during the migration season in 2007, and western Europe will again have its response strategies tested.

The risk of a pandemic remains as strong as ever, and businesses must remain vigilant, ensuring that contingency plans are in place and monitoring the development of vaccines to minimise disruption from any serious outbreak.

new technology and the mass media, and self-consciously benefit wherever and whenever possible from gaps in state capacity and regulatory frameworks. With the environment and energy security rising up the political agenda, resource exploitation and emissions are likely to become an increasing focus for such activity.

2007 and beyond

Global business in 2007 will hope for improved global security and a sense of order and predictability, but this will be increasingly hard to achieve in an age of manifold globalised as well as local threats. Corporations must also set against this uncertainty the fact that 'south-south' corporate investment – investment among and within emerging markets – now stands above \$60bn annually. If developed markets are not willing to take on the risks of investing in frontier countries and their small but often highly profitable markets, developing markets assuredly are.

Furthermore, they are doing so on their terms. Asia accounts not only for 40% of the world's population but also for 20% of global production. China is expected to have a larger economy than the US by 2040, and the Indian economy is set to outstrip the Japanese by 2032. These states' high growth rates, hunger for natural resources

and growing political and economic power are reshaping the world economy, and with it the risk landscape. Both New Delhi and Beijing are shifting from being recipients of international aid to major donors. China has committed to provide \$10bn in concessional loans and preferential export buyers' credits in the next three years, and is now the world's third-largest donor of food aid. India is also considering increasing its funding provision to Africa to roughly ten times the level of 2004-05. Emerging powers are strengthening their position in the developed world, challenging Western businesses. The developed world will soon need to respond.

What could happen in 2007

Terrorists acquire CBRN capability...

The use of co-ordinated suicide attacks on commercial aircraft using improvised explosive devices (IEDs) remains a persistent threat as the UK's failed August terrorist plot illustrated. However, a number of terrorist organisations have long harboured the ambition to acquire a chemical, biological, radiological or nuclear (CBRN) capability. The global Islamic extremist network's ambition to stage a CBRN attack can be assumed to remain undiminished following an upsurge in reporting relating to mass-casualty CBRN programmes. While al-Qaida is unlikely to

have already obtained both suitable radiological material and a reliable means of delivering it, this is almost certainly a focus of current activity. Intent and any form of concrete capability would make for a catastrophic mix.

... or shift their focus to the shipping sector?

The linkages between terrorism and maritime security could grow. A number of high-profile maritime terrorist attacks have occurred in recent years, including on the USS Cole in 2000, the MV Limburg in 2002 (both off the Yemeni coast) and the MV Superferry in the Philippines in 2004. The methods range from the relatively straightforward to the complex, but it is worth noting that such attacks are generally even more difficult to carry out than attacks on aviation. Scenarios could include militants ramming vulnerable vessels or blowing up vessels in ports. Cargoes could also be infiltrated, with containers used to convey hazardous materials into target jurisdictions or serve as weapons. Such an eventuality is yet to materialise, but port and container security measures remain weak.

A natural catastrophe...

Natural disasters pose major operational risks to business and society, as shown in recent years by the Asian tsunami, Hurricane Katrina and a series of major earthquakes. The UN calculates that there has been a five-fold rise in the number of natural disasters worldwide between 1975 and 2005, with losses per year increasing from \$10bn to \$159bn. The World Bank estimates that 3.4bn people – more than half the world's population – live in areas where at least one hazard could significantly affect them.

More than 90% of the populations of Bangladesh, Nepal, the Dominican Republic, Burundi, Haiti, Malawi, El Salvador and Honduras live in areas at high relative risk of death from two or more natural hazards. The areas most critically exposed are largely those that would be least able to cope with the impacts. However, areas of Japan are also notably vulnerable, and another business hub, Taiwan, is one of the most vulnerable areas to natural hazards on earth. The impact on the global economy of a major incident in such a location could be severe: the 360 natural disasters recorded in 2005 accounted for \$159bn in damages, though \$125bn was caused by Hurricane Katrina in the US alone.

... or a global pandemic?

Depending on the severity of a possible bird flu outbreak, a combination of lost output due to illness, deaths, absenteeism, and private and public efforts to avoid infection could lower global GDP by between 2% and 5%. A 5% fall would imply a global recession. One crucial caveat is that the likelihood of a severe outbreak remains highly limited.

Protests reborn...

The Singaporean authorities clamped down on activism during the 2006 World Bank/IMF meetings, but this is not to say that anti-globalisation dissent does not remain high. 2007 is likely to see a higher level of activism against multilateral institutions, and in the vicinity of their meetings, as such bodies continue to be seen as failing to make sufficient progress towards development objectives. However, recent protests have generally not been marked by the extreme violence that had accompanied previous events in Genoa and Seattle, more because meetings have since been held in more remote (or closed) locations than because of any decline in protest sentiment.

... and a new age of urban unrest?

Anti-globalisation movements are likely to be paralleled by increased levels of more locally motivated urban unrest in 2007, a development of particular interest to urban-focused retail and service companies. Increasing domestic and international migration to cities, and arguably an ever-diminishing level of participation in recognisable democratic discourse among large sections of the world's urban populations, combine explosively with tenacious socio-economic problems in deprived areas.

It is fair to speculate that there will be no shortage of catalytic 'spark' events in 2007, with the potential to ignite tensions among and between alienated ethnic or religious communities, along similar lines to the Danish cartoon controversy. More than a decade after the notorious Los Angeles riots, the US witnessed a virtual state of anarchy in New Orleans in the post-Katrina period, while Europe has seen serious riots in the Netherlands and France. Latin America continues to tread a delicate path in keeping disparate social strata content, and China has seen a rise of activism in second-tier cities such as Guangdong following land acquisitions and Anhui province after perceived police corruption.

Brazil: Growing pains

Risk ratings

Political

Security

M

L

Rio de Janeiro, São Paulo, Salvador da Bahia, Recife, tri-border area

M

A continent-sized country with vast economic potential, yet plagued by persistent inequality, corruption and crime, Brazil seems forever on the cusp of great power status. Americas analyst Nicholas Watson examines the economic and political challenges facing the country over the next four years.

There are few clichés more hackneyed than the one that says 'Brazil is the country of the future... and always will be'. However, like all good clichés, it expresses a great truth. Brazil's role on the world stage has increased strikingly since Luiz Inácio 'Lula' da Silva of the leftist Workers' Party (PT) assumed the presidency in 2003. Yet if Brazil is to mature into a confident international player, it must first tackle a number of pressing economic and political challenges. Otherwise, that other cliché that Brazil never misses an opportunity to miss an opportunity will surely resurface.

Brazil on the world stage

Via its leadership of the G20 group, Brazil has successfully presented a unified front of developing countries while pushing for the elimination of international trade barriers. Closer relations with India, South Africa, China and the Middle East have made Brazil a leading proponent of 'south-south' relations among developing countries. Brazil is also a member of the BRIC group of leading emerging economies, along with Russia, India and China.

Within the western hemisphere, Brazil leads the UN Stabilisation Mission to Haiti (Minustah), while continuing to dominate the Southern Common Market (Mercosul/Mercosur). Additionally, Brazil represents a moderate voice in South America amid the political din caused by Venezuela's President Hugo Chávez, who continues to project his increasingly confrontational brand of populism throughout the region and beyond.

However, despite such headline-grabbing gestures, the reality is that Brazil is punching above its weight on the international stage. The country must overcome a number of obstacles before it can achieve full recognition as a major international player.

Within the BRIC group, Brazil risks being seen as something of a poor cousin; it had the lowest economic growth of the four countries in 2005 and still accounts for less than 1% of global trade. If forecasts that the BRIC countries will overtake the G7 leading economies within the next 40 years are to come to fruition, Brazil must improve its performance or risk sinking into the so-called N11 – the Next Eleven countries (after the BRIC group), comprising the likes of Mexico, Indonesia, Egypt and Iran.

Equally, Brazil's aspiration to secure a permanent seat on the UN Security Council may yet cause ructions within Latin America; Argentina has already voiced its opposition to the plan amid concerns over Brazil's putative ambition to become a regional hegemon. Mercosul remains economically and politically stagnant; with Venezuela's recent entry, the bloc threatens to become increasingly politicised and inward-looking. Meanwhile, Bolivia's nationalisation of its gas industry has created a headache for Brazil, its principal investor.

Overcoming domestic obstacles

Brazil's realisation of its international ambitions will hinge on its ability to resolve a range of thorny domestic issues over the coming years. However, campaigning for the October 2006 presidential election offered encouraging evidence that a consensus had been reached on how these challenges might be addressed. Both of the leading contenders – Lula and former São Paulo governor Geraldo Alckmin – recognised the need for far-reaching political and economic reforms. Indeed, one of the notable features of the contest was the lack of clear differences between the two candidates' policy proposals. Either candidate would face similar challenges and pursue broadly comparable policies in office.

Barring external shocks, the direction of economic policy will remain largely unaltered over the next four years, reflecting the positive economic progress made under the Lula government. Fiscal discipline aimed at reducing the debt burden will continue and monetary policy will remain tight; inflation is expected to remain below 4% in 2006. This



The Saudi Arabia of ethanol?

In his 2006 State of the Union address, US President George W Bush unveiled plans to move the US 'beyond a petroleum-based economy'. Key to this ambition was the increased use of biofuel derived from plants such as sugarcane, corn and maize.

The US is not alone in seeing biofuel as a cheap, renewable alternative to foreign oil. China recently built the world's biggest ethanol plant, while many European countries are increasing their biofuel output. But one country has led the way in biofuel production for three decades.

Brazil is the world's biofuel powerhouse; ethanol production hit 16.5bn litres in 2005. Three out of four new cars have 'flex-fuel' engines that run on ethanol, petrol (gas) or a mixture (gasohol). Ethanol powers 40% of ordinary cars in Brazil and is available at 95% of the country's 30,000 filling stations.

Can Brazil become a world leader in alternative energy? Its low production costs and vast capacity will sustain its biofuel leadership. However, tariff barriers will impede participation in the US market. Furthermore, the US and other developed countries will be reluctant to swap dependency on Middle Eastern oil for reliance on Brazilian biofuel. Consequently, Brazil is more likely to export its expertise than its ethanol.

So what can the Brazilian experience tell us? Its attempts to wean itself off oil dependency have not been easy. Enthusiasm for alternative fuels could wane if oil prices drop significantly. Global take-up of biofuels will also require governments to provide incentives for both production and consumption.

Meanwhile, questions remain over biofuel's benefits. The production process is energy-intensive and requires significant fossil fuel inputs. Concerns also persist that increased production might crowd out land needed for food cultivation and accelerate deforestation of the Amazon rainforest.

Nonetheless, governments worldwide appear set to embrace biofuels, and technological advances will improve the efficiency of their production. This should ensure that biofuels represent one of the most significant energy and agricultural developments of the century.

should allow for the continuation of gradual monetary easing, which is likely to spur greater investment, putting the country's growth track within the 4%-4.5% range during 2007-08.

Nonetheless, despite progress on a number of vital issues, plenty will remain on the economic 'to do' list. Although public debt has been reduced from 58% of GDP in 2002 to slightly above 50% in 2006, the debt burden remains a source of vulnerability, while debt-servicing remains a significant drain on resources.

Meanwhile, government expenditure remains excessive; spending on social security continues to represent a major outlay, despite the partial reforms enacted by the Lula government in 2003. At 37% of GDP, the tax burden is equal to that of Germany or Sweden, but Brazil offers a fraction of the public services available in those countries.

Additionally, the tax system is in desperate need of simplification; under the present system, each state has its own taxes, while the main ICMS tax has no fewer than 55 different rates.

Investment in transport infrastructure is crucial if Brazil is to create a platform for sustained and more balanced development. More than half of the total interstate road network is in need of urgent repairs, at a cost of up to \$1.7bn; in practice, the word 'repair' is often a polite term for 'reconstruction'. Meanwhile, at the country's largest port, the Santos freight terminal in São Paulo, 30 containers can be loaded in one hour, compared with a rate of 100 per hour in Singapore. In addition, a much-touted series of public-private partnerships (PPPs) has failed to get off the ground; the bidding process for the first PPP project is expected to be concluded in early 2007, more than two years after Congress approved the initial PPP legislation.

Profligate – and more often than not misdirected – government spending, combined with an onerous tax system, must be addressed if Brazil is to overcome the stuttering growth phenomenon that Brazilians call the ‘chicken flight’ (*vôo de galinha*). However, with the presidential election resolved, the new administration’s ability to tackle these reforms and unlock Brazil’s growth potential will depend to a great extent on the political conditions that it will face over the next four years.

Politics – a dirty game

The government will face a highly challenging domestic political environment from 2007, and its ability to advance legislation will depend on its skill in coalition-building. The need to forge a workable legislative coalition that can maintain majority control in both the Senate (upper house) and Chamber of Deputies (lower house) will mean that political bargaining and ‘pork-barrel’ patronage will continue unabated, though perhaps with rather more subtlety following the exposure of the Lula administration’s cash-for-votes scheme in 2005.

Political manoeuvring will be more intense following the recent introduction of new threshold rules, which stipulate that parties will no longer be entitled to representation in Congress if they fail to secure at least 5% of the valid votes nationwide and 2% in at least nine states. The rules will create a host of

new ‘independent’ legislators whose loyalty will effectively be up for grabs, even if they attempt to circumvent the new rules by forming some kind of loose ‘confederation’.

With the largest contingent of governors and congressional representatives of any party, the amorphous and non-ideological Brazilian Democratic Movement Party (PMDB) is likely to play a crucial role in the formation of any legislative coalition. However, the PMDB will be an unreliable partner, requiring constant nurturing and political incentives. An unwieldy coalition will hamper the government’s ability to advance structural reforms, particularly given the profound divisions within the PMDB, and there is a danger that urgently needed initiatives will get bogged down in Brasília.

Conclusions

Before Lula’s 2002 election victory, there was considerable trepidation over what sort of government he would lead. Yet during the 2006 presidential electoral process, the markets remained steady and investor sentiment maintained buoyancy, reflecting the financial community’s confidence in the country’s adherence to economic orthodoxy. Although governability will remain a challenge, continuity in economic policy beyond 2006 will help Brazil to maintain its current path of stability, enabling the country to advance its claim to a role on the international stage.

China: Market liberalisation under threat?

Risk ratings

Political

Security

M

L

Guangzhou-Dongguan-Shenzhen corridor area (Guangdong province), border areas with Indo-China (far south-west), Russian far east (north-east), Central Asia (north-west)

H



North-East Asia analyst Andrew Gilholm assesses speculation that a key ruling party meeting could herald a policy shift that will harm foreign investors.

In late 2007, the ruling Chinese Communist Party (CCP) will hold its five-yearly national congress in the capital Beijing, at which key policies, plans, targets and appointments for the next five years will be announced. The staid ceremonies and formulaic pronouncements of the congress traditionally induce sleep rather than interest (including among the delegates), but those with a stake in China should be paying attention.

At the last congress, in 2002, President Hu Jintao and Premier Wen Jiabao were tentatively taking over leadership of the country amid speculation that former president Jiang Zemin would continue to run the show from behind the scenes. By the time the 2007 congress starts – the real action takes place during the 12 months leading up to the event – Hu will be firmly in control and ready to make his mark. In 2002, China had just entered the World Trade Organisation (WTO) and was embarking on a timetable of market-opening required under the terms of its accession. In 2007, that timetable will have just ended, and a major focus of debate will be the relative costs and benefits it has brought the nation. How will this debate, and Hu's ascendancy, shape policies towards foreign investment?

WTO backlash?

Events in 2006 raised many questions about whether progress on market liberalisation was grinding to a halt. In July, US Under-Secretary of Commerce for International Trade Franklin Lavin said that he feared a loss of momentum, or even retrogression, in the liberalisation process. Developments of concern included potentially restrictive new guidelines on foreign mergers and acquisitions, and a slowdown in approvals processes. The resistance faced by US private equity company Carlyle Group in its efforts to take control of Xugong, a maker of construction machinery, became symbolic of the trend. Meanwhile, leaked minutes from a meeting of a think-tank aligned with the State Council (cabinet) showed some influential

figures voicing dire warnings of the dangers of unrestrained foreign competition.

These may be signs of the growing influence of 'new left' and nationalist thinkers, who appear to have tapped into serious concerns about the inequality brought by capitalism and about foreign dominance of the economy. Some warn that by failing to control the level of foreign participation, China risks the destruction of domestic companies (which will be unable to compete), and will lose control of both its financial markets and its own destiny. This is often articulated in national security terms; some Chinese have drawn pointed parallels with the US' blocking of the state-owned China National Offshore Oil Corporation (CNOOC)'s attempt to buy US oil company Unocal.

To some extent, developments like these are part of a broader political trend, one that places greater emphasis on social and populist goals, and less on rapid economic growth. This is a trend closely associated with the leadership of Hu and Wen. Since coming to power, they have repeatedly stressed the need for a 'harmonious society', 'people-centred' development and balanced growth, with a focus on tackling inequality and creating economic growth that is sustainable and equitable, not simply rapid. This agenda was given greater prominence than ever at the CCP Central Committee's annual plenum in October 2006 (an important event on the road to the 2007 congress). To some observers, the populist overtones of such policies are bound up with the nationalist overtones of resistance to liberalisation, and they are therefore concerned by the increased political dominance of the leaders who promote them.

The 'Hu faction'

There is little doubt that in 2007, the president will complete consolidation of his position as the 'core' of the fourth-generation CCP leadership. In 2006, he reached an accommodation with Jiang to remove him from the active political scene. He followed up by ordering major corruption investigations around the country, including in Beijing and, most importantly, in Shanghai, where local party secretary Chen Liangyu

Keeping social unrest in perspective

China in the first half of 2006 saw 39,000 incidents of social unrest in cities, towns and villages nationwide, according to official figures. Some cases involved tens of thousands of people and pitched battles between protesters and security forces. These will continue to make headlines in 2007, and the press stories will at times paint a picture of a nation on the brink of revolt or collapse.

Clients investing and operating in China need not be unduly concerned by this misleading portrait of social chaos. Those involved in unrest are ordinary people seeking to protect their livelihoods in a time of extraordinary, wrenching socioeconomic change, not a new generation of political revolutionaries. Protesters are not seeking to overthrow the government and there is no wave of democracy headed for Chinese shores. Social tensions are of course a huge headache for the government, and it is not yet clear whether the current system can cope as the country's transformation continues at lightning speed. However, that question is more likely to be answered in 2027 than in 2007.

'Big-picture' political stability must feature in companies' strategic outlooks, but these should not obscure the emergence of more immediate potential threats. At present, foreign companies are very rarely affected by social unrest, but while risk levels remain low, taking China's benign security environment for granted could prove costly.

In 2006, a South Korean-invested manufacturing operation was among those ransacked during a violent demonstration against pollution, while reports emerged of protesters targeting businesses inadvertently caught up in a land-compensation dispute. As companies continue to move further from well established investment and development regions in search of reduced costs, the risk of such incidents will increase. Local partners and officials will invariably assure prospective investors that everything is rosy in their town, but smart investors will be armed not only with a brochure and a draft contract, but also with independent information and a full understanding of potential risks.

was removed from his post. This further undermined the influence of Jiang's 'Shanghai faction', strengthened the authority of the central government and increased Hu's ability to place supporters in key posts and shape policy plans to be issued at the 2007 congress.

Broadly speaking, members of the 'Hu faction' are characterised by backgrounds in poorer, inland provinces, and in the Communist Youth League (where many worked under Hu himself). This contrasts with the Jiang-era leadership, who were more closely associated with the richer, coastal provinces and with experience in dynamic sectors of the economy, such as foreign trade. These characteristics have added to the perception that the current leadership could begin to move away from economic reform.

No U-turn

Although the picture painted above is a worrying one for foreign investors, in reality there is no prospect of any serious departure from global economic engagement, and

foreign companies are not about to find liberalisation reversed. The impact of China's entry into the WTO in 2001, which many in the CCP fiercely opposed, was always certain to hurt particular domestic industries and interest groups, and to cause a backlash against opening the economy to foreign competition. This will continue to be manifested in resistance to opening, and periodic surges of pressure for greater protection from foreign competition.

There is clear evidence too that the government wants to ensure that strong Chinese companies emerge, with protection if necessary, to secure a leading position in their sectors and expand abroad. More generally, the idea that China has already conceded enough, or too much, to foreign business under its WTO commitments is resurgent. However, none of this should come as a surprise, and it does not mean abandoning the shift towards a market economy.

The CCP never saw opening up, free competition and liberal market economics as goals in themselves. They were always seen as means to achieve the party's real goal –

rapid development and economic growth to create a strong China and to ensure its own political survival. As such, there was never any question that the government would seek to maintain control over the pace and extent of liberalisation, both to protect specific interests and because the mentality of central planning and control lingers on in the CCP to some extent. There are many influential figures who see full transition to a market economy as the logical extent of the reform project, but those who see this as a short-term goal are very much in the minority.

Pragmatic party

Those worried about a U-turn on reform should remember that the fundamental logic that pushed the CCP to liberalise the economy in the first place remains strong and, though critics of China's transition have found a strong voice, no coherent alternative

is being articulated. Self-preservation remains the order of the day for CCP leaders faced with a rising tide of social unrest and ebbing legitimacy other than that based on economic performance. The party knows that it must continue to deliver material gains to the population and, as a result, has proved highly pragmatic in shelving ideological considerations and overcoming engrained fears in pursuing economic reform.

Progress will not be smooth, and will include backward steps in certain sectors at certain times (financial-sector opening will remain particularly sensitive), but will ultimately continue; most policymakers are aware that partial reform is dangerous. It will remain imperative that foreign companies are attuned to the shifting political influences affecting their area of operation, and seek to present their interests as compatible with those of the government. However, most have no reason to fear a backlash.

Congo (DRC): Consolidation or conflagration?

Risk ratings	Political	Security
	M	H
North-east		E

If the post-war transition is followed through to its logical conclusion, in 2007 Congo (DRC) can look forward to a year of democratic consolidation, gradual reform, and improving levels of economic growth and investment. However, as Africa analyst Chris Melville explains, this outcome is not inevitable and significant challenges remain.

Democratic opportunities

The lengthy 2006 election season provided some grounds for optimism. The electoral process was generally conducted freely and fairly, even if it clearly privileged those candidates with greater financial resources. President Joseph Kabila, who headed the widely criticised '1+4' transitional administration between 2003 and 2006, now has a democratic mandate and will preside over a government of his choosing. Despite Kabila's need to shore up important deals with his leading rivals – including Antoine Gizenga of the Unified Lumumbist Party (PALU) and Jean-Pierre Bemba of the Congolese Liberation Movement (MLC) – the existence of an elected and unified national government should reduce the risk of the policy deadlock that undermined the transitional administration. Equally as important, for the first time in 40 years the Congolese people enjoyed the freedom to choose legislative and provincial representatives. The latter, who should be locally accountable to an unprecedented degree, are in a prime position to address the problems facing local communities, particularly the absence of infrastructure and investment in remote rural areas.

The election process has revived popular aspirations for change, if not making it inevitable. More interestingly – given the electoral prominence of former warlords, ex-Mobutists and career opportunists – the polls appear to have inspired renewed confidence in the ability and willingness of the political class to manage the country's transformation. Of course, significant differences of opinion exist as to who is best placed to carry out the necessary measures. However, in many parts of the country there is a sense that, as long as the new government governs well enough and the victors do not punish the vanquished, the

Congolese people will be largely satisfied with the new democratic dispensation.

The powerful expectations of a dynamic and astute population offer a real opportunity to the new government to drive through post-conflict reforms and to consolidate its legitimacy by going some way to meeting popular demands for enhanced provision of social services and economic opportunities. The Mobutist strategy of managing expectations through song, spectacle and suppression should have no place in the new context, particularly in a situation where rivals for power compete – if still imperfectly – for popular affection, and where adherence to standards of fiscal probity and good governance is a crucial determinant of international legitimacy and continued financial aid. However, institutional weaknesses and the engrained behaviour of political elites may compromise the fulfilment of such popular ambitions.

Accountability deficits

The main problem, of course, is that social expectations only partially condition governments. In sub-Saharan Africa, the situation is particularly bad; party institutions are weak and the need for political leaders to maintain the support of elite constituencies frequently distracts from any developmental agenda. Campaign promises are often forgotten and the indigenous civil-society organisations that might serve as important mediators between elite and popular interests are frequently treated as a threat to the ruling power or are co-opted, becoming merely another implement for the imposition of 'legitimacy'.

Congo's experience in this regard is particularly grave. Although some parties have roots in the nationalist struggle of the 1950s and 1960s, or in the stalled democratisation of the early 1990s, many more have been established simply to exploit the political and economic resources made available by the post-conflict transition and the liberalisation of the political arena. Only rarely do they represent more than the personal ambitions of a single individual and his supporters. At a provincial or even legislative level, this may not pose a



significant risk to democratic consolidation – witness the high number of independent candidates elected on the basis of genuine standing within their communities.

However, at the national political level – where power is most removed from the country's problems – the absence of strong party structures and social bases undermines accountability and encourages political leaders to pursue personal agendas. In Congo, this situation is aggravated by deeply entrenched political behaviours, which seek to transform political office into an opportunity for self-enrichment and the exclusion or co-option of potential rivals.

It has been suggested in some quarters that Kabila's democratic mandate will enable him to sideline those of his personal counsellors most associated with the opaque wartime exploitation of natural resources, such as minister to the presidency Katumba Mwanke. While Katumba will lose his formal position in government, having been elected to a Lubumbashi parliamentary seat, he and other counsellors such as Kikaya Bin Karubi (elected as a Maniema province deputy) will remain significant influences over the president, in many instances enjoying greater power over policy than most ministers. Both from a political and personal standpoint, Kabila cannot afford to excise such elements.

Paradoxically, his ability to maintain the stability and peace that were the cornerstones of his electoral appeal depends on his capacity to incorporate such key powerbrokers. However, the importance of such individuals militates against the formalisation of politics and entrenches a culture of political patronage that thrives in the absence of strong formal institutions. It will also impede the development of systematic and far-reaching anti-corruption strategies.

Regional instability

Although Kabila's Alliance for a Presidential Majority (AMP) secured a majority in both the presidential and parliamentary polls, its control over the country is far from total; the first year of Kabila's government will give crucial indications of his ability to maintain stability and prevent the resurgence of chronic insecurity in key areas. Political and security risks in north-eastern Ituri district (Orientale province) will remain extreme. Joint operations between the Armed Forces of the Democratic Republic of Congo (FARDC) and the UN Mission in the

Democratic Republic of Congo (MONUC) are set to continue and the geographical scope of militia activity will recede further from its 2003 high. However, the situation will remain fluid and subject to reversals.

Most militias now appear willing to disarm in return for integration into the armed forces. However, the militias will largely dictate the terms of this process, with periodic raids and kidnaps serving as a reminder to the government that they will not go easily. Indeed, it is difficult to see a long-term solution to the Ituri problem that does not involve some level of transfer of civilian authority to the militias; individuals with militia links are already well entrenched at village-administration level, and they are unlikely to cede control over lucrative border crossings into Uganda without significant compensation.

A more aggressive military campaign by MONUC and the FARDC could, in theory, accelerate the decline of hardcore militias, but it is unclear whether sufficient resources would be made available for such a costly and risky enterprise. Moreover, until the deep social and ethnic cleavages entrenched by and underpinning militia activity are resolved, Ituri will remain a problem area and unresponsive to moves to encourage investment in its substantial natural resources.

Arguably, the situation in North and South Kivu provinces in the east poses a far greater challenge to government authority. Kabila's huge majority in the region paradoxically renders it more vulnerable to the spoiling tactics of renegade FARDC general Laurent Nkunda. The election process, and the country's gradual rapprochement with Rwanda, saw the decline of Nkunda's provincial and external support. In an effort to regain it, and to raise questions about Kabila's claim to be a peacemaker, Nkunda may well seek to provoke the FARDC into a heavy-handed counter-insurgency operation, in the hope that this would revive Rwandan and international concerns about Kinshasa's attitude towards the vulnerable Banyamulenge (Congolese Tutsi) population that Nkunda claims to represent. Interestingly, the much vilified leader of the Congolese Rally for Democracy (RCD), Azarias Ruberwa, may help to mitigate the risk of such a conflagration. Although taking little more than 1% of the popular vote in the presidential election, Nkunda has used the election process as an opportunity to transform his image and to position himself

as the key mediator between Kinshasa and the Banyamulenge population; he may come to enjoy enough influence over the government, and sufficient leverage over Rwanda, to perpetuate the marginalisation of the errant Nkunda.

Challenges will also present themselves in Kabila's home region, reflecting the shift in dynamics generated by the new democratic dispensation. In the key mining province of Katanga – generally regarded as Kabila's fiefdom and frequently viewed as being more homogeneous than other regions – electoral competition saw local powerbrokers increasingly exploit social cleavages. Key among these powerbrokers is former governor of Katanga Gabriel Kyungu wa Kumwanza of the Union of Congolese Nationalists and Federalists (UNAFEC), who orchestrated pogroms against ethnic Luba in the early 1990s at the instigation of then-president Mobutu Sese Seko (1965-97). Kyungu hopes to re-establish links with Kinshasa, but has been repeatedly overlooked and is appalled at the rise of Kabila's new agent in Katanga, Moïse Katumbi Chapwe. Having made great play of his 'partnership' with the AMP in the first round of the election, Kyungu revived his rivalry with Moïse in the second round, strongly challenging the latter's claims to

carry Katanga for the president. Although Kyungu's capacity to foment disorder has greatly diminished since the 1990s, unless Kabila and Moïse can find a place for the former governor in the new order, the risk of political instability in the province will increase.

Another key question is whether Kabila can effectively straddle the east-west divide reflected in the election results, which saw Jean-Pierre Bemba perform best in the west and north-west and Kabila perform most strongly in the east. The alliance with Gizenga, which afforded Kabila the conditional support of western Bandundu province, and the creation of a government of national unity based partly on maintaining a 'geopolitical' balance will mitigate the risks posed by regional divisions. However, the issue may be more acutely felt in Kinshasa, which voted heavily for Bemba – a westerner – in the first round of the presidential poll. Although Kabila improved his share of the vote in the second round, Bemba's campaign, which stressed Kabila's status as a non-westerner, has left a legacy of suspicion towards Kabila in the capital. This could create trouble for the new government if it is seen to have punished Bemba, and if Kabila's claim to be the one truly national candidate proves a hollow one.

EU: Eastward expansion, westward migration



The accession to the EU of eight former communist states in central and eastern Europe in 2004 was the first serious test of the union's commitment to the free movement of labour, one of the guiding principles of its single internal market. Europe analysts David Lea and Adam Strangfeld examine the impact of EU enlargement on labour markets and migration.

The accession of the 'EU8' – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia, Slovenia and Poland – widened the gap between the EU's wealthiest and poorest economies. Prior to 2004, EU economies had relatively equal status, limiting enthusiasm for migration. The number of nationals from poorer states seeking work in richer states was only slightly higher than pre-EU levels. Of the ten new joiners in 2004 (Cyprus and Malta also entered), eight were below average in terms of GDP per capita. In that year, only Slovenia was wealthier than any of the established EU states, at 78% of the 25-member average, compared with Portugal's 73%. Latvia was the poorest state, at 43% of the average. A number of EU states forecast that this would result in a large migration of workers from low-wage economies with high unemployment to the more stable economies among the established 'EU15'.

Labour market restrictions

Fearing that an oversupply of cheap labour would have a negative impact on their unemployment figures, most countries chose to exercise their right under the accession treaties to restrict the numbers permitted to migrate from new member states. EU15 countries are allowed to maintain limited derogation of the principle of free movement during a seven-year transitional period, which includes reviews of the labour market restrictions after two, five and seven years. After each review, the first of which was in April 2006, EU15 countries have the opportunity to relax the agreement. The final review in April 2011 will see the irrevocable abolition of all restrictions on the 2004 accession states.

In 2004, only Ireland, Sweden and the UK chose to open their labour markets fully to the eight new members. All three had above-average income and below-average unemployment at the time, and Ireland and the UK in particular were experiencing

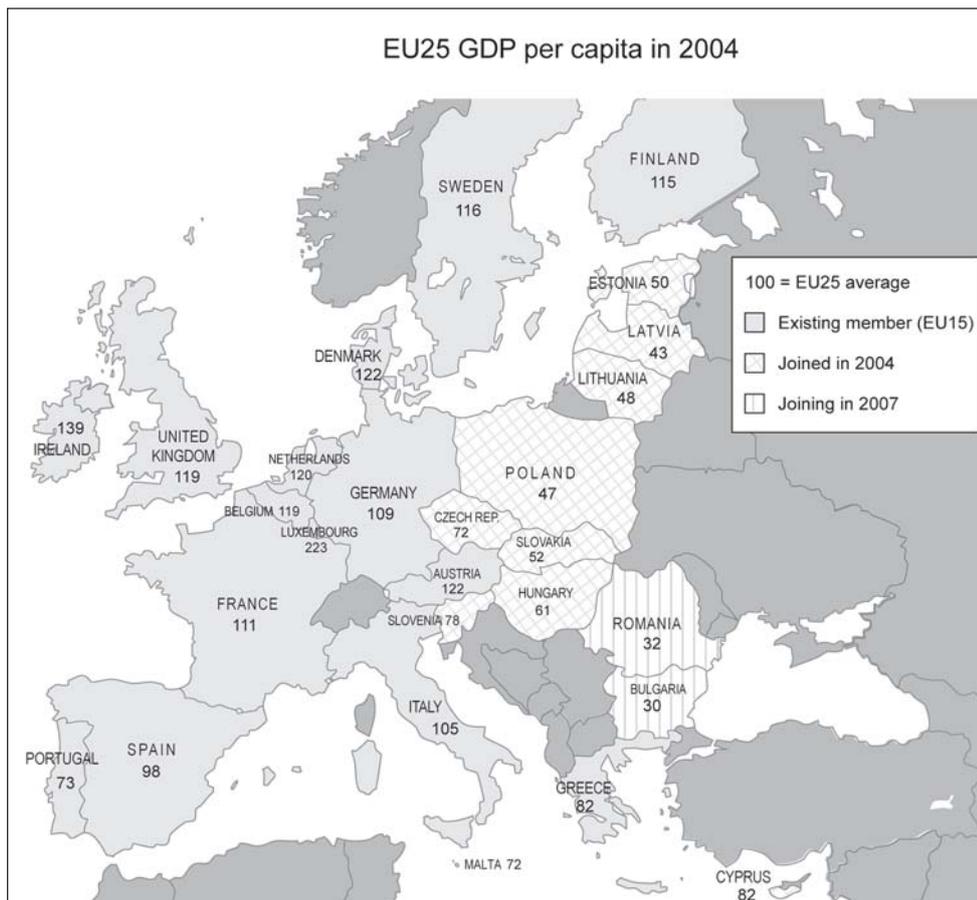
shortages of skilled and semi-skilled personnel. All three witnessed a greater-than-expected influx of migrant workers, particularly from Poland and Slovakia (though Latvia saw the greatest percentage of its population leave). Migrants from the EU8 constituted 3.8% of Ireland's active labour force in 2006; while their impact was also felt in Sweden and the UK, they constituted less than 1% of the workforce in those countries.

Political and social reactions

Despite significant media attention in the UK and Ireland, the issue of migration from the EU8 has remained largely peripheral to political debate. Even far-right British parties appear to have relatively little interest in the issue, preferring to concentrate on Muslim populations.

The right-wing media have attempted to generate anger at the extent of immigration, particularly over the British government's underestimate of the likely total (government forecasts in 2004 suggested a net inflow of 12,000, while figures released in late 2006 suggest that more than 600,000 have entered, though many may have returned to their countries of origin, with others making multiple visits). However, most British voters appreciate the improvement in service industries that has coincided with the advent of the 'Polish plumber', limiting their anger. Fears of 'benefit tourism' appear to have been unfounded, with nearly all immigrants seeking to work and few claiming from the more generous welfare systems in their destination countries.

In France, the influx of labour from the EU8 has met some resistance. Trade unions adopted a largely protectionist stance, fearing that the migrant workers would put downward pressure on wages and crowd out French workers. The issue was also linked to the more fundamental debate on the future socio-economic direction of the EU, with France defending its 'social model' against a more liberal, 'Anglo-Saxon' model favoured by the accession states. Moreover, the 'Polish plumber' was also regarded as a symptom of the European Commission's drive to further liberalise and deregulate the internal market. Such concerns, paired with unease over further EU enlargement, played a key role in the French 'no' vote in the referendum on the EU constitution in 2005.



Business reaction

Business reaction has been mainly positive, with employers' organisations looking favourably on the increased supply of labour, and no strong evidence of a general depression in wage rates or of increased unemployment among local populations. However, the Irish employers' organisation recently expressed concern that migration from the EU8 to Ireland may be a fashion and that, once the initial wave of migrant workers returns home or finds opportunities closer to home, the economy will struggle to source replacements at equivalent cost. Similarly, some fear that the use of migrant workers to plug the skills gap temporarily will only postpone much-needed structural reforms aimed at addressing problems linked to the ageing workforce in EU15 countries.

In relative terms, EU15 labour markets have hardly been flooded: in the first quarter of 2005, the proportion of the EU8 working-age population within the EU was limited, ranging from 0.1% in France and the Netherlands to 1.4% in Austria and 2% in Ireland. The percentage of non-EU nationals in the EU15 labour force remains significantly higher than that of EU8 nationals. While in part explained by historical reasons, it implies that immigration

from non-EU countries is a more important phenomenon than intra-EU mobility.

Positive effects in EU15

Migrant workers have generally played a key role in filling a skills gap and in alleviating problems caused by the EU15's ageing workforce. Rather than crowd out the existing workforce and increase unemployment, migrant workers from the EU8 have tended to complement the skills set of the labour force.

The employment rate of EU8 nationals tends to be comparable to that of nationals of the host country and of other EU15 countries – and generally higher than for non-EU nationals. This implies that EU8 workers, rather than burdening the welfare system, positively contribute to overall labour market performance, sustained economic growth and the state of public finances. Moreover, an increase in the employment rate of EU8 nationals in EU15 countries since 2004 indicates that enlargement may have contributed to bringing undeclared workers to the surface and reducing the 'grey' economy.

An expanded EU pauses to take stock

Romania and Bulgaria on 1 January 2007 will achieve their long-pursued goal of becoming full EU member states. However, concern remains over their ability to curb corruption and strengthen their judicial systems. The European Commission will continue to monitor the implementation of specific reforms in both countries for up to three years and may impose tough sanctions should reforms lag after accession.

Such penalties could include the suspension of structural funds worth billions of euros or, should their judiciaries remain corrupt, a refusal to recognise national court judgements at EU level. The main areas under scrutiny will be judicial independence and the fight against corruption and organised crime, as well as the administrative capacity to absorb EU funds.

While the accession of Romania and Bulgaria will only mark the end of the so-called fifth round of EU enlargement, it will also signal a temporary halt in the expansion process. With 27 member states, the EU will need time to reform its institutions and devise more effective decision-making mechanisms appropriate to its size. Moreover, the strict provisos imposed on Romania and Bulgaria will serve as a warning to future accession candidates, especially Croatia and Turkey, that they are likely to face tough conditions before being accepted into the EU club. The prospect of postponed entry and stricter requirements threaten to discourage political reformers in the Balkans and Turkey, who may lose ground in 2007 to radical nationalists and eurosceptics.

The effects of labour market restrictions

Contrary to the intention of the transitional agreements, there is no evidence suggesting a direct link between the extent of labour flow from EU8 member states and the labour market restrictions in a particular EU15 country. Labour migration into Sweden and the UK is comparable to that into countries with restrictions. The experience of the Nordic countries, which have similar labour markets and economic performance, seems to confirm this pattern: migration from EU8 countries into Norway (a non-EU country) is significantly higher than for all other Nordic countries combined, regardless of whether they have restrictions. This implies that labour mobility is primarily driven by factors related to market conditions of demand and supply. Arguably, not only will labour market restrictions simply delay labour market adjustments, they may promote illegal immigration and prompt workers and employers to resort to undeclared work.

Review of transitional agreements

Of the 12 countries that maintained restrictions, four – Finland, Greece, Portugal and Spain – abolished them completely in 2006, while only Austria and Germany, which border 'new' states, will maintain them fully until the next review. Nevertheless, Germany has issued more than 500,000 work permits, a figure roughly similar to the likely net migration into the UK. As restrictions are

relaxed and the larger economies of continental western Europe emerge from the sluggish growth that has afflicted them for much of the present decade, EU8 nationals are likely to seek work closer to home, and the effects seen in the UK, Sweden and Ireland will be diluted.

A mixed blessing for accession states

While the restrictions on migration are a temporary breach of the commitment to the free movement of labour across the EU, their practical implications are not limited to protectionism. Many officials in Bulgaria and Romania (scheduled to join the EU in January 2007) are concerned that a generation of young, skilled workers may choose to emigrate in search of improved employment prospects, creating a skills vacuum at home and stifling hopes of massive flows of inward investment that were a key factor in securing domestic support for accession. A number of companies with pre-accession investments in Poland and Slovakia are already reporting labour shortages in those countries; ironically, migration from the two incoming members is likely to help fill those gaps if more lucrative employment further west cannot be secured.

However, since acceding to the EU, labour market developments in the EU8 have been largely positive, with unemployment rates decreasing significantly in most countries.

With strong economic growth forecasts and increasing job opportunities, there is little to suggest increased pressure for labour migration from the EU8 in the future.

Immigration from outside the EU

The focus on internal migration from the EU8 has, in many countries, turned the spotlight away from immigration from outside the EU. However, the continent's southern fringes – the Canary Islands, Spain's Mediterranean coast and its exclaves in Morocco, Italy's southern coast and islands, and Malta – are experiencing significant inflows of migrants, chiefly from sub-Saharan Africa. Small islands such as Lanzarote, Fuerteventura, Lampedusa and Malta lack the infrastructure to manage large inflows of illegal immigrants and all have requested EU help to prevent such migration. However, traffickers will not give up easily. Tensions have already emerged in Malta as a result of the influx of immigrants, with a number of far-right groups emerging; clashes erupted on the island in June 2006 after an 'immigrants' rights' march.

The next enlargement round

The entry of Bulgaria and Romania into the EU will see the debate over labour market

restrictions resume. Domestic political pressure has led the British government to suggest that it will impose some restrictions on migrant workers from these two countries, though it has not yet formally stated its intentions. Ireland has suggested that it might follow the British lead, while Sweden is likely to impose restrictions. None of the 12 that imposed curbs on migration from the EU8 is likely to allow free movement from Romania and Bulgaria.

The introduction of such restrictions will arguably be based more on domestic political considerations than on economic realities, with politicians wary of lingering anxiety among the electorate over further immigration and, in some countries, of increasing voter support for right-wing parties. The EU labour markets' capacity to absorb migrant workers is not infinite and a continual influx could in the future tip the balance and begin to have adverse effects on economic growth, employment rates and public finances. However, the evidence from the 2004 enlargement round suggests that Bulgarian and Romanian EU accession will not be detrimental to existing labour markets and is more likely to contribute to sustained economic growth.

India: Time to hang up on outsourcing?

Risk ratings

Political

Security

L

L

Kashmir, Asom (Assam), Manipur, Tripura, Nagaland

H



South Asia analyst Maria Kuusisto explains why improving infrastructure will be the key test of India's ability to continue attracting service-sector and business processing operation (BPO) investment, maintain the interest of current investors and achieve high growth rates.

Investment in the service and BPO sectors has been India's biggest economic success story. However, in some ways India is becoming a victim of its own success as its rapidly growing cities fail to cope with investors' needs: large, modern operating spaces; a pool of cheap, educated labour; good transport infrastructure; reliable power and telecommunications; and good internal and external security. Many of the advantages that India has enjoyed over alternative locations are being eroded by high property prices, creaking infrastructure, natural disasters and concerns over terrorism and unrest.

The Congress-led United Progressive Alliance (UPA) central government has acknowledged these challenges and attempted to address them by approving modernisation projects, providing supervision and frameworks to improve emergency preparedness, and promoting special economic zones (SEZs). One impact will be a gradual shift of focus away from 'tier-one' cities, such as the capital Delhi, Mumbai and Bangalore, to tier-two cities, such as Kolkata and Chennai. These efforts will also encourage the emergence of satellite cities in the vicinity of current major investment hubs. Tier-two cities tend to have greater political willingness to accommodate the requirements of investors because they seek to attract them.

However, progress will be slow and infrastructure challenges will persist into the medium term. Investors must carefully weigh the costs and benefits of potential locations when planning their operations, though wider choice will allow companies to divide key operations between cities to limit the impact of disasters and improve flexibility.

Infrastructure challenges

Business costs are increasing as companies find themselves stepping into an

infrastructure vacuum. They invest in private security, transport services, energy generation, water supply, drainage and sewage systems and other basic services in and around their sites. This creates islands of infrastructural self-sufficiency, but triggers tough cost-benefit evaluations.

Infrastructural weakness is particularly apparent in sewage and drainage systems, which have not been modernised to accommodate the rapid growth of many key investment hubs. Natural waterways are badly silted and polluted, and often blocked by illegal structures and slums. Such silting contributed to the flooding of Mumbai's Mithi river in 2005. Lack of urban planning during the recent building boom means that buildings have been constructed on drained lakes and wetlands that traditionally played an important role in absorbing water, as with the Velachery area in Chennai, one of the worst-hit areas during the 2005 monsoon.

Weak infrastructure and poor response capacity mean that challenging natural conditions and hazards will continue to cause periodic problems. Monsoon rains have demonstrated the vulnerability of both Mumbai and Bangalore, which have seen flooding of low-lying areas, including some business districts, congestion and disruption of transport networks, and the collapse of other supporting infrastructure. While state governments recognise these weaknesses, they are struggling to overcome the problems because of inadequate finances and political delays.

Big plans run into big problems

The government has taken on ambitious modernisation projects, such as Mumbai and Bangalore airports, and allocated funds to state governments to develop infrastructure. It will take time for the impact of these projects to be felt, and their slow progress is a concern. Many high-profile projects become mired in political infighting and risk becoming outdated and overburdened before they are completed.

Rocketing land prices in major investment hubs politicise such projects and lead to political and bureaucratic obstruction. In Bangalore, for example, Chief Minister H D

Kumaraswamy criticised and obstructed the Bangalore-Mysore road and information technology (IT)-corridor project because of his own landholdings and interests in and around the city. When a project is finally implemented, its shape is often determined by political expediency, rather than necessity.

Development projects will continue to trigger resistance from labour unions, which fear job losses; local communities, which feel that they are being pushed away from their homes, not compensated adequately for their agricultural land and not provided with alternative livelihoods; and environmental non-governmental organisations (NGOs), which campaign against the negative impacts on flora and fauna. Political parties will capitalise on such criticism to strengthen their support base and make quick electoral gains. The Mumbai and Bangalore airport modernisation projects prompted campaigns by the Employees of the Airports Authority of India (AAI) and the Left Front in February 2006. Mumbai has also seen local tensions over issues such as the Bandra-Worli Sealink, which is urgently needed to relieve pressure on road and rail networks.

Security concerns

The Mumbai bombings in July 2006 reinforced fears over the impact of terrorism on business operations. The co-ordinated bombs targeted the strategic bottleneck along the Western Railway, used by commuters working in south Mumbai's business districts. They brought services to a halt, caused heavy congestion on roads and other railway lines, disrupted telecommunications services and led to heightened security at transport hubs, including airports. However, the system recovered remarkably rapidly – trains were running again within hours.

However, not all cities would have this capacity. There is an absence of emergency preparedness, response and communication mechanisms in major cities and there is a credible risk that cities other than Delhi and Mumbai, which are known to be potential targets, will see terrorist attacks. There is a clear trend towards attacks against crowded civilian locations, such as markets and transport networks, posing a direct risk to employees and causing significant disruption to transport, services and business operations in the vicinity.

There is a low but credible risk of attacks against business districts and company headquarters as the capabilities and

targeting choices of extremist groups evolve. Since 2005, there have been clear indications from Indian intelligence services that terrorist groups such as the Lashkar-e-Toiba (LeT) are interested in business targets. However, extremists are likely to view business districts as more difficult and less cost-effective targets than crowded civilian locations, though this should not lead to a relaxation of security.

On a less 'spectacular' level, the murder of a Bangalore-based female BPO employee by her company taxi driver in December 2005 triggered criticisms that companies were not providing adequate security to female employees working irregular hours. This too has added costs as companies introduce sophisticated transport networks to guarantee safe travel for employees. There is a trend towards pooling resources and the collectivisation of private security, as seen in Hyderabad's Cyberabad district.

The risk of social unrest adds to uncertainty, causing occasional disruption and security risks. Growing economic disparities (particularly affecting Muslims) and sensitive local issues have the potential to cause protests or trigger strikes. The death of popular actor Rajkumar in April 2006 led to a wave of unrest in Bangalore, with purported fans attacking shops, businesses, public buses and private vehicles. However, most BPO hubs draw educated Indians from all over the country who have a greater interest in individual advancement than in collective political, social and religious or communal agendas. Communal tensions are also mitigated by low unemployment and relatively high salaries in these areas.

Emergency response

Terrorist attacks and natural hazards are shedding harsh light on India's inadequate emergency response mechanisms. The central government has taken steps to improve this area, but the drafting and implementation of new plans is devolved to state level. There are thus wide differences from state to state over local ability to respond to emergencies. Delhi is considered to have the best emergency management mechanisms because of central government involvement; Mumbai has some of the worst, not least because of the challenges that infrastructure weaknesses pose to the emergency services.

Both terrorist attacks and monsoon-related incidents have demonstrated that all the key response services have a shortage of trained

personnel and modern equipment. Weak management and poor co-ordination between different levels (centre, state and local) and different agencies compound lack of training and resources. Lack of management and co-ordination is a particularly urgent problem in terms of ability to utilise scarce resources effectively in an emergency.

Unionisation

In recent years, India has witnessed a decline of labour activism, particularly in the service and high-tech sectors. However, major trade unions with a nationwide presence, particularly the Centre of Indian Trade Unions (CITU), have started to urge employees in the BPO sector to unionise. Bangalore has some 50,000 employees in BPO and their interests are protected by the Union for Information Technology Enabled Services. A unionisation drive in the sector has been gradually emerging around grievances related to 'hire-and-fire' policies, shift work and working conditions.

Companies in the sector have opposed unionisation because of fears of operational difficulties and impact on efficiency, in particular fearing strikes, walk outs and similar campaigns. Companies can attempt to counter the trend by responding to grievances and concerns with consultative mechanisms and by establishing clear codes of conduct. However, even if the unionisation drive moves forward, market regulations and labour market conditions are likely to limit the freedom of manoeuvre of any future BPO-sector unions.

SEZs

Another response to the challenge of attracting investors is the government's SEZ

policy. The key selling point of SEZs is not their fiscal and tax benefits – unlike in many countries – but their infrastructure. However, there are two key shortcomings: the policy promotes small, single-unit or sector-specific SEZs and it fails to lift the burden of infrastructure investment off companies.

The government has approved more than 160 SEZs, most of which are around 1,000 hectares in size and host a single unit. They are often based in rural areas and so require significant investment in supporting infrastructure in line with a company's operational requirements. Although employees are increasingly frustrated by the difficulties and costs of working in major cities, they are unlikely to be keen to move to remote rural locations without guarantees that the company will provide a wide range of benefits and services. These projects will remain hostage to political criticism and local unrest because of the sensitivities surrounding use of farmland and employment.

Still attractive...?

India will continue to be hugely attractive as an investment destination, not least because of its cheap and well educated workforce – 2.5m English-speaking graduates come on to the job market each year. However, its benefits must be considered in the context of rising costs and persistent infrastructural challenges. Years of underinvestment, neglect and poor planning have left many of its cities poorly equipped to cope with the levels of investor interest that they are experiencing. Investment in infrastructure will continue to be one of the principal costs of doing business in the country, but as the government's approach to the problem evolves, the choice of location will become an increasingly pivotal one.

Iran: Nuclear ambitions

Risk ratings

Political

Security



Middle East analyst Heinrich Matthee examines the impact of Iran's nuclear programme and the motives behind it.

Iran is unlikely to renege on its commitment to an independent nuclear capability during 2007. The dominant faction among the country's policy-makers will seek to continue negotiations with the international community without making concessions or responding to diplomatic pressure. The ruling regime will use this time to further develop the nuclear programme, while hoping that existing divisions within the UN Security Council over how to deal with Iran widen. International positions over the nuclear issue are too deeply entrenched to be resolved by negotiations in the near future and tensions, which could escalate into active intervention, will periodically emerge over the year.

Why Iran will maintain its approach

Iran's development of a nuclear programme reflects the domestic political and geopolitical factors that have shaped Iran's identity, including its regional and international standing:

- Iran is surrounded on virtually all sides by politically volatile countries (including Afghanistan, Iraq and Pakistan).
- Many of these countries either currently host US military bases or will do so in the foreseeable future.
- Iran views its Arab neighbours with a sense of both cultural superiority and mistrust.

Other, more subjective factors also determine the mindset of Iran's leaders. Iran considers itself to be a regional power with the right to an independent nuclear policy, and the legacy of the 1953 coup d'état, sponsored by the US and UK, that overthrew prime minister Mohammed Mossadegh after he nationalised the Anglo-Iranian Oil Company continues to fuel a conspiratorial mindset. Finally, the 1980-88 war with Iraq influences how Iran views its external relations and also its belief that it cannot rely on the international community for survival.

Military options

US decision-makers suspect that Iran's nuclear programme is not only or mainly aimed at developing a peaceful nuclear energy capability, but that it is intended to develop a nuclear weapons capability. The US does not want Iran to emerge as the dominant power in the Gulf region, especially one that possesses nuclear weapons that could threaten US interests or those of its regional ally Israel.

While military contingency plans, including air strikes against Iran's nuclear facilities, are being considered, a number of factors make this a difficult option to implement. These include a lack of evidence as to whether Iran possesses nuclear weapons; likely negative international, especially Muslim, reaction to an attack on Iran; the resistance of senior US military officials to the use of tactical nuclear weapons (an idea that some US hardliners have proffered); the difficulty of establishing whether all targets have been identified; and the technical challenge of hitting some underground nuclear facilities. Also militating against the military option is Iran's ability to retaliate against the US and Israel, through its allies in Iraq, Lebanon or the Gaza Strip and the West Bank; by interdicting oil shipping in the Gulf; or by sponsoring terrorist attacks in the Gulf Arab states or in the West.

Despite these drawbacks, the military option remains on the table and air strikes carried out by either the US or by Israel (with tacit US approval) remain possible over the coming months (though Israel's assessment of its own interests could mean that it opts for an alternative means of combating Iran). The prospect of imminent and overwhelming military action could encourage Iran's leaders to adopt a more conciliatory stance.

However, air strikes would delay rather than alter Iran's long-term nuclear programme and be unlikely to topple the ruling regime, an objective that is sought by more hawkish elements within the US administration.

Other options

While EU foreign ministers are exploring non-military means of pressuring Iran,



including ending export credits, extending controls on dual-use technology and a definitive end to trade negotiations, these will have only a limited impact on deterring Iran's nuclear development. Iran has already experienced ten years of US sanctions and has been preparing for additional punitive action. It has also been bolstered by a sustained period of high oil prices, which have boosted government revenues and given the country confidence that it can survive further 'punishment'.

Within the US administration, the influence exerted by a strongly pro-Israel neo-conservative faction has precluded consideration of a 'grand bargain' with Iran. Such a bargain would allow Iran to develop a limited nuclear energy capability, recognise Iran as a regional power alongside Israel, and provide assurances as to the future of the ruling Islamic regime. However, the extent of mistrust that currently exists between Iran and the US and Israel, in addition to President Mahmoud Ahmadinejad's provocative public statements, means that there is insufficient trust between the parties to reach such a deal. Consequently, US policy options will remain confined to pressuring the Iranian government and forceful intervention.

Strong sanctions are unlikely

Until recently, the US relied on European governments – in particular Germany, France and the UK (the 'EU3') – to maintain international pressure on Iran and to instigate a procedure under which the Iranian government would eventually be referred to the UN Security Council with a view to imposing strong sanctions. However, the opposition of Security Council members Russia and China to 'hard' measures against Iran has meant that this option has been quietly shelved.

Russia and China want a negotiated settlement to the dispute and are unlikely to support sanctions that would have a real impact on Iran's political and economic stability. They may support light, or even moderate sanctions, such as travel restrictions on Iranian leaders or a denial of credit facilities, but these would not curtail Iran's pursuit of an independent nuclear capability.

Outlook

Given that possible Security Council measures would be unlikely to prevent Iran from continuing to develop its nuclear programme, the US will persist with its strategy of pressuring Iran while weighing up the potential effectiveness of other options. Current measures include intelligence operations inside Iran; using extended media broadcasts to 'challenge' the views of the Iranian population; providing support to domestic opposition groups, including ethnic minorities; attempting to isolate Iran by obtaining the co-operation of Sunni Arab states such as Saudi Arabia, Egypt and the United Arab Emirates (UAE), where several senior Iranian officials have private bank accounts; and pressuring Western banks and financial institutions to isolate Iran in the international financial system.

For foreign companies, the impact of the dispute over Iran's nuclear programme over the coming months will be the prevalence of a sense of 'siege' among Iranian decision-makers in strategic sectors. This may translate into the cancellation or renegotiation of contracts; such action would be aimed at sending out a message of defiance in the face of Western pressure or at strengthening the government's financial position. Reputational risks, as well as the cost of trade finance, may also rise.

Japan: Sowing the seeds of a 'new cold war' in Asia?

Risk ratings

Political

Security



Japan's new Prime Minister Shinzo Abe is a charismatic leader with a vision for a more assertive Japan, but his critics accuse him of leaning towards the nationalist right, endangering ties with China and jeopardising regional stability. North-east Asia analyst Andrew Gilholm assesses speculation that resurgent nationalism and strategic competition are setting Asia's major powers on a dangerous collision course.

Abe succeeded Junichiro Koizumi in September. The latter's five-year tenure saw Japan's relations with the US reach new heights of co-operation, while those with China and South Korea sank to their lowest point in years. In the strengthening US-Japan alliance, Japan pushed ahead with joint development of ballistic-missile defence (BMD) systems and reinterpreted (some say violated) the country's pacifist constitution to facilitate its support of the US-led missions in Afghanistan and Iraq. Meanwhile, features of growing friction in North-east Asia included large, sometimes violent anti-Japanese protests in the South Korean capital Seoul and many Chinese cities, and tense episodes at sea such as a Chinese submarine incursion into Japanese waters. Bitter diplomatic clashes also occurred over Koizumi's annual visits to the Yasukuni shrine in the capital Tokyo (where Japan's war dead are honoured, including convicted 'Class A' war criminals), leading both Chinese President Hu Jintao and South Korean President Roh Moo-hyun to refuse summits with the Japanese leader.

Abe entered office with a reputation as a foreign policy hawk and nationalist, a record of controversial statements on sensitive historical issues, and a vision of a more assertive Japan with a new national pride and a normal military (the role of the Self-Defence Forces (SDF) is currently limited by the post-1949 constitution, which renounces war). Many observers therefore fear that under his premiership, Japan will move further and faster in directions that will bring it into conflict with its neighbours. An extension of this theory sees a 'new cold war' taking shape in Asia, involving mutual mistrust and resentment, and intensified Sino-Japanese competition for resources, influence and strategic dominance.

Rationality rules: why friction will not turn into aggression

Although recent troubles lend credence to this latter theory, there are important forces at work that greatly reduce the risk of it becoming reality. Most of these involve the rational interests of both China and Japan.

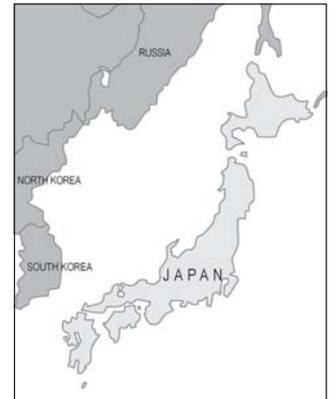
China

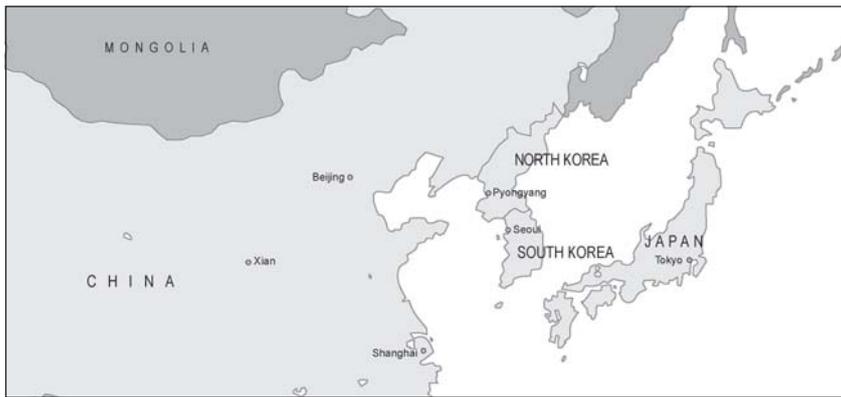
For at least the next two decades, Chinese leaders will be heavily preoccupied with enormous internal challenges. The most pressing concerns are not over how to dominate Asia, but how to sustain economic growth and head off social instability. China's overriding priority is to maintain a stable external environment within which to tackle internal problems, and stable ties with Japan – a vital market and source of investment for China – are important.

Longer-term strategic calculations also lead most Chinese leaders to realise that good relations with Japan are in China's interest. Beijing's main concern with regards to Japan is not instinctive and historical enmity, but rather the idea that it is becoming the lynchpin of a US containment strategy designed to 'encircle' China and prevent its re-emergence as a genuine global power. It is US – not Japanese – power in the region that primarily concerns China, and it seeks healthier ties with Tokyo to avoid making the US-Japan alliance even stronger. China's desire to preserve stable ties has been shown by several attempts in recent years (with limited enthusiasm and success) to move towards more constructive bilateral relations.

Japan

Like their Chinese counterparts, Japanese leaders repeatedly stress their desire for better relations with China. One reason in the current context is political expediency: although Abe enjoys high popularity ratings, Japanese voters have displayed nervousness about deteriorating ties with China and South Korea, and fear that he could exacerbate the situation. With elections to the upper house of parliament due in mid-2007, he is toning down his robust foreign policy rhetoric to allay these





Above all, US influence is crucial. At the same time as strengthening its alliance with Japan, and despite its misgivings over China's rise, the US will continue to see good relations with Beijing as an important objective and will continue to play the vital balancing role in the region for the foreseeable future. In particular, it is largely because of the US' role that speculation about a nuclear arms race in North-east Asia – in which Japan, South Korea and Taiwan go nuclear because of heightened insecurity – is not currently credible.

fears. While driven by strong beliefs and determination, Abe is also a populist politician who wants to stay in power and will feel compelled to tread carefully in pursuing the potentially provocative aspects of his agenda.

The comparison with his predecessor is instructive: like Koizumi, Abe appears committed to pushing through some bold and controversial reforms. However, Koizumi enjoyed a strong popular mandate and widespread consensus on the need for his reforms. He came to power amid deep popular concern about the decade-long economic slump that successive governments had failed to end, and he promised a crusade to reform the Liberal Democratic Party (LDP), government and economy to revitalise the nation and deliver it from stagnation.

Abe's circumstances are very different. His crusade is for a 'stronger' Japan, with a new sense of pride and a role on the international stage. While this certainly taps into the aspirations and frustrations of a substantial section of society, there is no consensus on the urgency or desirability of such reforms – most Japanese are more concerned about shoring up pensions and social security, tackling a perceived increase in social inequality and exclusion, and sustaining the economic recovery. In this latter regard, Japanese leaders are constrained, like their Chinese counterparts, by the importance of the bilateral economic relationship. This was a key supporting factor in Japan's economic recovery, and Abe will face strong pressure not to jeopardise it.

In addition, third-party actors in Asia generally exert a positive influence. Almost all Asian countries ultimately hope for, and help to underpin, balance and stability. They benefit economically from peaceful competition among the major powers, and would suffer from conflict or having to choose sides.

Fundamentals, fear and the future

The above are just some of the factors supporting continued stable, if not friendly, relations between the North-east Asian powers. Because of them, a new cold war is not a realistic scenario for Asia for at least the next decade. However, there are fundamental problems and trends that, if they persist, could create a more pessimistic outlook beyond that timeframe.

Problems in Sino-Japanese relations did not start under Koizumi and do not hinge on any single issue, such as Yasukuni shrine visits. Following the end of Japan's wartime occupation of China, it took roughly a quarter of a century for the two countries to normalise ties. When they did, it was largely on the basis of strategic imperatives (growing hostility between China and the Soviet Union gave Beijing a new-found willingness to repair relations with the US and Japan), not of any popular consensus and sense of reconciliation, nor any shared understanding of the past and focus on the future. A further 25 years on, these remain as elusive as ever. Without them as a foundation, there are limits to the positive progress that governments can make.

History matters

In this context, it is important to debunk a common misconception: that popular anti-Japanese sentiment in China is merely a product of CCP propaganda (if it were, the problem would be far simpler). Certainly, the party has, especially since 1989, turned to nationalism to bolster its political legitimacy. It has used 'patriotic education' and anti-Japanese rhetoric to achieve this aim, heightening nationalist sentiment and contributing to the demise in the 1990s of the era of 'friendship diplomacy' with Japan. However, independent of CCP policy there has long persisted a widespread, deep sensitivity among many Chinese to

perceived slights from Tokyo, sometimes leading to spontaneous outbursts of popular anger. The anti-Japanese demonstrations in several Chinese cities in April 2005 were widely interpreted as being staged or incited by the government, but in truth they stemmed primarily from the actions of independent nationalist activists. The government's main role in the saga was in regulating, and later suppressing, the protests.

There is little understanding outside China of the shift since around 1998 towards a more nuanced approach to Japan and to domestic nationalism, based on the realisation that the leadership had placed itself under unwelcome pressure from the strengthened nationalist forces unleashed by its earlier policies (which it has not entirely abandoned). The fact that this shift coincided with a shift in the opposite direction in Japan – that is, towards stronger nationalist influences and pressure for a tougher China policy – meant that the opportunity presented by this more conducive environment in Beijing was not taken.

The shift in Japan is particularly concerning – ‘patriotic’ education policies and an interest in reinterpreting history are things one might expect from a Communist government in a developing country, but not from the ruling elite of a developed, democratic country such as Japan. There is no doubt that much of the shift that has occurred in Japan over the past decade or so is natural and positive: it is natural that Japan has buried the long-outdated notion that because of wartime wrongs it should kow-tow, issue constant apologies and compromise its national interests in relations with its neighbours. It is positive that well over half a century on from the war, a Japan that has come so far and achieved so much should be a proud nation with a substantial role on the international stage. While China in particular harbours deep misgivings about Japanese military

normalisation, there is no reason why this inevitable and in many ways desirable re-emergence cannot be reconciled with stable regional relations.

These benign and noble goals are made more controversial than they need be because they are primarily promoted by, and closely identified with, conservative nationalists, many of whom – including the prime minister and Foreign Minister Taro Aso – have articulated some rather disturbing views (mainly involving apparent attempts to play down wartime aggression and atrocities, and stress what they see as positive aspects of the militarist period). Regardless of the rights and wrongs of the debate, as long as senior Japanese leaders and their policies are associated with such views, they will appear sinister and threatening to Chinese and many others, and otherwise acceptable Japanese aspirations will provoke fear and resistance. There is certainly some basis to Japanese conservatives’ charge that China uses the ‘history card’ to seek diplomatic leverage, but Beijing is also driven by real concerns and genuine domestic pressure.

These concerns and pressures are perpetuated and exacerbated by every event such as a Yasukuni visit, or Japanese government approval of nationalist-influenced school history texts. In turn, nationalist anger in China makes the country appear threatening and hostile in the eyes of Japanese, and the vicious cycle continues. If it is not broken, or at least weakened, popular antagonism will harden, mutual mistrust will enhance both the perception and the reality of mutual threat, and the notion of a new cold war in the region will become increasingly difficult to dismiss. Abe’s summit meetings with Hu and Roh in October 2006 show the scope and desire for a fresh start, but if fundamental problems are not addressed, this honeymoon period could be short-lived.

Kazakhstan: Pretenders to the throne

Risk ratings

Political

Security

L

M



Central Asia analyst Kate Mallinson examines the battle to succeed President Nursultan Nazarbayev in Kazakhstan.

For multinational energy companies operating in Kazakhstan, and especially for the handful that are tied into contracts for the next 40 years, the country's long-term political risk trajectory is a key business consideration. The government's significant leverage in business affairs reveals scant regard for human rights but provides stability and, therefore, a manageable business environment for investors. Nevertheless, this situation is unlikely to continue ad infinitum: the 2005 presidential election saw incumbent Nursultan Nazarbayev appointed for what is constitutionally his last term, and jostling for pole position in the post-Nazarbayev era has already begun. The nexus of business and politics in Kazakhstan is so tight that regime change could inexorably alter the operating arena.

The majority of the country's key assets are linked to Nazarbayev's family (known popularly as 'the Family'), and the president has hitherto been adept at balancing the powerful business elites that control these assets and dominate the Kazakh economy. However, although the next election is not expected until 2012, Nazarbayev is finding it increasingly difficult to manage competing government factions. The murders of two opposition figures in 2005-06 and the merger of Nazarbayev's party Fatherland (Otan) with his eldest daughter Dariga's Republican Party (Asar) in July 2006 signalled a phase of shifting allegiances and intense rivalry among the upper echelons of power, as the key political players grapple for influence.

Contenders for power

Debate over Nazarbayev's replacement is gathering pace; some have suggested that it will be an unknown, plucked from relative obscurity in the manner of the Yeltsin-Putin succession in neighbouring Russia in 1999, while others forecast a dynastic transfer of power similar to that in nearby Azerbaijan in 2003 (from Heydar Aliyev to his son Ilham).

The first scenario is unlikely because the population would be reluctant to accept a newcomer. Regardless of the machinations of the political system, the potential

successor would have to undergo due electoral procedure, which would see any newcomer stall. Nazarbayev is more likely to choose someone from his coterie, someone who will guarantee him and his family financial immunity. Nevertheless, a contender from the opposition cannot be ruled out; most opposition figures are former members of Nazarbayev's elite and are often co-opted into government.

The popularity of the various business elites waxes and wanes according to the public perception of their political ambitions and conduct. However, there are currently three apparent frontrunners for the succession.

Keeping it in the Family

Dariga Nazarbayeva is a likely candidate. Nazarbayev has no sons, and Dariga is the only one of his three daughters to harbour political ambitions. She has long enjoyed a high public profile as head of Khabar, the country's largest media group, which broadcasts propaganda in support of her political ideals. She founded the Republican Party in 2003 and remains an outspoken, ultra-loyal supporter of Nazarbayev, though she attempts to distinguish herself by promoting a socially liberal image aimed at attracting younger voters. She is married to Rakhat Aliyev, who has held senior positions in the national security service (KNB) and the customs service.

However, Aliyev has not always aided Dariga's cause. He has considerable business interests and has been accused of abusing his position to damage rival companies. Following embarrassing independent television footage that charged Aliyev with using his office to acquire personal assets, Nazarbayev 'exiled' him to Austria to serve as ambassador there. As soon as he was allowed to return in late 2005, Aliyev quickly reasserted his influence both politically and commercially. Aliyev and Dariga continue to control Khabar, but there are signs that Nazarbayev is trying to limit their power; in 2006, Information Minister Ermukhamet Ertysbayev oversaw government-backed plans to take over Khabar, and the merger of Fatherland and the Republican Party appears to have been forced on Dariga; indeed, the new party has kept the Fatherland name.

The president's right-hand man

Aliyev and Dariga are struggling for influence against Senate (upper house) chair Nurtai Abykayev. Abykayev has been Nazarbayev's closest confidant since 1989 and is regarded as unconditionally loyal to the president, as well as an important source of informal advice and influence on oil and gas policy. He was chief of Nazarbayev's staff until 1995, when he was appointed Kazakhstan's first ambassador to the UK. He subsequently worked in the presidential administration from 1996 to 1998, and was then appointed head of the KNB. However, Abykayev is also not immune to abusing his position for personal gain. He was demoted from KNB chief to deputy foreign minister in 1999 after clandestinely selling a batch of MiG-21 jets to North Korea. Furthermore, his domestic business interests in oil and zinc have occasionally seen him come into conflict with other oligarchs.

The Senate chairmanship is an important position with regard to the adoption and amendment of legislation. Although Abykayev does not deal formally with exploration and production matters with investors, he frequently represents the country on high-profile foreign trade missions. Should Nazarbayev be forced to step down because of ill health, Abykayev would become acting president until new elections could be called.

Rivalry between Abykayev and Aliyev has increased since the latter's return from exile. A major dispute surfaced between their respective factions in February 2006 when a well regarded opposition figure, Altynbek Sarsenbayev, was discovered murdered in the mountains outside Almaty. Sarsenbayev was a former government minister and ambassador to Russia, and was one of the leaders of moderate opposition party Ak-Zhol. Nazarbayev brought in the US FBI to track down the perpetrators and, within a week, five members of the KNB's elite Arystan force had been arrested. The detainees claimed that the killing had been contracted by the head of the Senate administration, Yerzhan Utembayev, who worked directly for Abykayev. Utembayev was found guilty at the end of August 2006, though few observers believe that he alone gave the order for the murder. Two theories have emerged: first, that Abykayev commissioned the killing to discredit Aliyev and Dariga, who had in 2005 sued Sarsenbayev over comments that he made about their influence; and secondly, that Aliyev (who retains links to the KNB)

ordered the murder, using Utembayev to discredit Abykayev.

Abykayev has so far come out of the Sarsenbayev controversy relatively unscathed and Nazarbayev has remained neutral over the affair. However, when various opposition newspapers (possibly encouraged by Abykayev) printed stories implicating Aliyev in the murder, Nazarbayev intervened and ordered a halt to the speculation, indicating either that he wished to draw a line under the scandal, or that he was siding with Aliyev.

The dark horse

The third frontrunner is Timur Kulibayev. He, too, is a son-in-law of the president (by marriage to Nazarbayev's second daughter Dinara) and a business magnate. Kulibayev is head of the state assets holding company, Samruk, and has little direct involvement in politics. He is also young, at 40, which would work in his favour in a battle for succession. Unlike Aliyev, he is not known to have major opponents and may therefore be successful in balancing the elites. As a member of the Family, he would also be able to guarantee immunity for Nazarbayev's assets while continuing to oversee major investment deals. He is believed to control the Family's money invested in Russia, and appears keen to strengthen ties with the Russian leadership. This attitude, as well as his control over the Kazakh energy sector, would afford him strong political backing from Russia, which is a necessity in a country where 30% of the population is Russian.

Kulibayev's good standing with Nazarbayev is in part a result of his distance from political circles. However, there are signs that he is quietly moving to carve out a political niche, including building a constructive relationship with the media and manoeuvring some of his allies into key government appointments. Nazarbayev's attack on Samruk's management in late 2006, in which he exposed what he considered to be the grossly inflated salaries of several of the company's bureaucrats, could be interpreted as a warning to Kulibayev to rein in his political ambitions, following rumours that he is setting up a new political party.

Backlash from business elites

Whoever prevails in the continuing power struggles will be strongly placed to determine the country's future political trajectory. If Nazarbayev steps down in 2012 or dies in office beforehand, either Dariga, Kulibayev

or Abykayev could be nominated to replace him. However, there is a risk that a handover of power to someone such as Dariga could provoke a strong, even violent, reaction from rival business elites. Oligarchal groups such as the Eurasia Group, led by Alexander Mashkevich, and the Korea Group, led by Abykayev, could form a tactical alliance and field their own presidential candidate. In this event, former prime minister (2002-03) and current mayor of Almaty Imangali Tasmagambetov would be a likely choice.

Nazarbayev now has the unenviable 'King Lear' task of choosing his successor. The election of any of the candidates discussed above would be unlikely to fundamentally

alter the country's policy course, but the transition may lead to temporary instability in the business sector. This would be of particular concern if the Dariga/Aliev faction were to seize power because it could attempt a move into the oil and gas sector, resulting in hostile takeovers or opaque changes to ownership of companies, unreasonable tax demands or interruptions to production. A Kulibayev or Tasmagambetov presidency would be more likely to ensure a stable, centrist course with macroeconomic stability and a relatively benign investment climate. However, the former could open the door to increased Russian influence and favouring of Russian businesses.

Lebanon: The post-conflict political order

Risk ratings

Political

Security



Lebanon has suffered two major crises over the past two years, but Middle East analyst Neil Quilliam argues that it remains stable and continues to provide a dynamic environment for business.

The inherent weakness of the Lebanese political system, which shares power disproportionately between the country's 18 separate religious confessions, has undermined successive governments, as well as efforts to promote national unity. However, the political order that emerged following the 1989 Taif agreement, which ended the long-running civil war and institutionalised the current political system, has managed to withstand the recent crises. Furthermore, the competition between the pro- and anti-Syrian political alliances and their respective international patrons is likely to benefit, rather than harm, Lebanon.

Since the assassination of former prime minister Rafiq Hariri in February 2005, politics have been shaped by competing forces:

- **The anti-Syrian alliance:** Otherwise known as the March 14 alliance, this includes the Future Movement (led by Saad Hariri, Rafiq's son); the mainly Druze Progressive Socialist party, led by Walid Jumblatt; and the mainly Christian Lebanese Forces party.
- **The pro-Syrian alliance:** This includes the Shia militant group Hizbullah, whose capture of two Israeli soldiers in July 2006 sparked off Israel's ground offensive in Lebanon; and the predominantly Christian Free Patriotic Movement, led by former armed forces commander Michel Aoun.

The fortunes of the pro- and anti-Syrian alliances have waxed and waned since 2005. In the immediate aftermath of Hariri's assassination, the anti-Syrian alliance – with significant international backing, notably from the US and France – acquired considerable domestic influence and support. The alliance led the so-called 'Cedar Revolution' (the series of demonstrations that followed Hariri's death) and with UN backing forced Syria to withdraw its forces in April 2005.

This marked what appeared to be a momentous victory for the anti-Syrian

alliance and gained Lebanon independence from Syria for the first time in 30 years. The alliance's strong performance in the 2005 parliamentary elections looked set to liberate the country not only from Syrian influence, but also from Hizbullah's Islamic ideology. Even the prospect that Hizbullah would be disarmed in accordance with UN Security Council Resolution 1559 appeared realistic.

However, the victory was short-lived and was superseded in mid-2006 by Hizbullah's 'divine victory' over Israel in a 34-day war. This provided not only Lebanon with a (qualified) first military success over its neighbour, but also – by extension – the wider Arab world. The victory earned popular support for Hizbullah in some sections of the Sunni, Christian and Druze communities. By contrast, the anti-Syrian alliance suffered through association with the US, which offered vocal and practical support for Israel.

Hizbullah's year

Hizbullah in 2007 will consolidate its position as a leading political party. Although many Lebanese fear its political ambitions, which include turning Lebanon into an Islamic republic, there is a growing sense among the population that it has become a pragmatic player that is increasingly integrated into the political system. The group gained widespread support because of its conflict with Israel. In the immediate aftermath, it demonstrated that it was prepared not only to compensate those who had been affected by the war but also to deliver social services and implement a sophisticated reconstruction programme. Moreover, Hizbullah planned, financed and implemented its programmes at a time when the government failed to realise essential reconstruction projects.

Hizbullah's ability to deliver on its promises has earned the party, and in particular its leader Sayyed Hassan Nasrallah, begrudging respect among many of Lebanon's religious communities. The group is likely to be able to capitalise on its newfound popularity by exercising increased political influence, though it will also be careful to retain its 'resistance' capability; Hizbullah is unlikely to trade in its military capabilities in the short term in exchange for greater political representation.



Disarming Hizbullah?

UN Security Council Resolutions 1559 and 1701 call for all Lebanese militias to be disarmed, but Hizbullah is unlikely to surrender its weapons. Its *raison d'être* remains the liberation of all Lebanese land, and Israel's continued occupation of Shebaa farms provides justification for possession of arms. A further, and equally salient, factor is that the Lebanese government has neither the capacity nor the will to disarm Hizbullah.

There is also little prospect of the UN peacekeeping force (Unifil II) that has been deployed in the south since 14 August attempting to disarm Hizbullah. The UN mandate for the force is deliberately vague and any attempt to disarm Hizbullah would risk engaging the group in a protracted conflict that the UN force would be likely to lose. Hizbullah has repeatedly shown a penchant for wilful resistance and continues to enjoy the backing of local communities, as well as the support of Syria and Iran.

The presidency

The selection of the next president, which is decided by parliament, will be a pivotal event in 2007. Syrian pressure to amend the constitution and extend pro-Syrian President Emile Lahoud's term in 2004 for a further three years precipitated the crisis that led to the withdrawal of Syrian forces in April 2005. As a result, the process in 2007 will represent Lebanon's independence from Syrian influence. The candidate that prevails will reflect the balance of power between the pro- and anti-Syrian political alliances.

While the March 14 alliance enjoys a parliamentary majority and will back Samir Geagea, the leader of the Lebanese Forces party, Aoun will draw on a broader support base that includes the anti-Syrian alliance and smaller secular and nationalist parties. The competition is likely to be intense and will lead to a series of large demonstrations, skirmishes and possible violence.

Control Risks believes that Aoun will prevail. He is a popular leader, whose secular approach to politics appeals to many Lebanese who want to see an end to the religion-based political system. In addition, while Aoun has drawn on Syrian support since his return from exile in Paris in 2005, he is unlikely to sanction the return of Syrian rule. Nevertheless, Aoun's appointment would frustrate the US and France, who have sought to prise Lebanon away from Syria's sphere of influence.

External powers, in particular Syria, Israel and Iran, will continue to exploit Lebanon's political and religious differences in pursuit of their own interests. Despite Syria's military withdrawal, it remains a significant player in Lebanese politics. Syrian President Bashar al-Assad's regime will seek to capitalise on Hizbullah's success against Israel to reassert its political and military reach into Lebanon, and despite the presence of the UN force in the south of the country is likely to re-arm, re-train and re-equip Hizbullah's military wing. However, neither Syria nor Hizbullah will want to precipitate a fresh conflict with Israel, which is unlikely for at least another five years.

Despite its success in forcing Syria's withdrawal from Lebanon in 2005, the anti-Syrian alliance's loss of moral authority following the conflict with Israel will hinder its efforts to prevent the gradual return of Syria to Lebanon in 2007. However, the current ascendancy of the pro-Syrian alliance is unlikely to translate into changes to Lebanon's foreign policy. The country has traditionally pursued a foreign policy that balances the interests of Western powers such as the US and France and eastern neighbours including Syria, Saudi Arabia and Iran, and is likely to continue to do so.

Outlook

The outlook for Lebanon going into 2007 is markedly different to that of the previous two years. The fortunes of the pro- and anti-Syrian alliances appear transformed, while the influence of the main external actors in the country's affairs, namely the US and Syria, has been inverted. While the March 14 alliance remains primarily concerned by the prospect of Syria's return to Lebanese politics, its constituent parties believe that the US is an unreliable and discredited partner. As a result, the balance of power between the two may come down on the side of the pro-Syrian alliance in 2007.

However, the political system has proven over the past few years that it is sufficiently flexible to withstand major shocks and that its threshold for accommodating change is substantial. This means that the waxing or waning of Syrian influence is unlikely to compromise the government's quest for greater sovereignty. In addition, Hizbullah is likely to place an increasing emphasis on its domestic agenda over the coming years and may distance itself from Syria and Iran. The reaching of a ceasefire between Hizbullah and Israel without Syrian participation is a likely precursor of future policies.

Mauritania: The challenges of democratisation

Risk ratings

Political

Security

M

L

The international community has praised Mauritania's efforts to embrace democracy, but problems remain. Middle East analyst Sarah Meyers assesses the political and economic challenges that the new government will face.

The transition to democracy following the Military Council for Justice and Democracy (CMJD)'s seizure of power in a bloodless military coup in August 2005 has been a remarkable process. Stability has been maintained – surprisingly effectively – and the coup caused only minor disruption to commercial operations. A national conference has set a timetable for polls, the freeing of political prisoners and the establishment of numerous political parties. However, while in 2006 the CMJD consistently demonstrated its commitment to introducing real reforms, its plans will be tested in 2007 when the democratic government takes over after local, parliamentary and presidential elections.

Democracy also poses challenges

A national referendum in June 2006 approved constitutional amendments that limited executive powers and paved the way for parliamentary and local elections on 19 November, followed in January and March by the Senate and presidential polls respectively. Coup leader Col Ely Ould Mohamed Vall's pledge that neither he nor his administration would participate in the elections was an exceptional move in a region where leaders have traditionally clung to power and there are few signs that he will renege on this promise.

However, challenges to democratisation could become increasingly acute as the process continues. The new government will need strength and unity of purpose to overcome the challenges that it will face. With some 30 political parties and a range of independent candidates planning to participate in the elections, a strong parliament is unlikely. The new government will also need to expend additional effort on containing corruption and addressing the lack of transparency in public tenders if it is to encourage further economic growth. Another coup could be undertaken if the new government is not effective or if the democratisation process begins to falter.

The democratisation process has also failed so far to provide tangible benefits to the country's majority black African population. While the CMJD has taken some steps, and even broached some previously taboo topics such as slavery, there are concerns that the elections could serve to reinforce the accumulation of wealth in the hands of a few oligarchic groups and continue the endemic discrimination against and economic marginalisation of the black population.

The curse of oil?

The coup was sparked off in part by growing concerns over the distribution of oil wealth ahead of the beginning of commercial oil production in February 2006, and the CMJD pledged to oversee a fairer distribution of this wealth.

Oil revenues are expected to have an immediate beneficial impact on the economy. The Organisation for Economic Co-operation and Development (OECD) forecast economic growth of 25.6% in 2006, but this rapid growth will contrast starkly with World Bank estimates that just under half of the population lives in poverty. Oil revenues will undoubtedly go some way towards addressing the serious problem of poverty. However, Mauritania also has a range of socio-economic issues that cannot be resolved by higher oil revenues alone. These include low literacy rates, endemic ethnic and tribal discrimination, and the continued existence of slavery.

In addition, unreasonably high expectations have been fuelled by statements from government officials, including Vall, that oil will 'resolve all problems'. This was illustrated in August 2006 when the joint venture operating the Chinguetti oilfield, which is currently the only source of commercial production in the country, said that it had halved its estimates of recoverable oil at the field because of technical difficulties surrounding extraction. While a number of other fields are likely to go into commercial production in the coming years, expectations of their production capabilities may also have to be revised downwards.

The CMJD's handling of corruption allegations and a dispute with Australian oil firm Woodside Petroleum, which was only



settled when the company paid the government a \$100m bonus, raised concerns among international oil companies over future operations in the country. However, the council has won international approval for its efforts to set up a plan to guarantee transparency and the good management of its rapidly growing oil revenues, including a National Hydrocarbon Revenue Fund. Given concerns that the coup's leaders, including Vall and Energy Minister Mohamed Ould Abdel Aziz, have close ties to the previous regime and the oligarchic groups that control much of the economy, efforts to reduce the influence of these groups could generate increased political tensions and result in economic and social instability.

An example to emulate?

Mauritania's pursuit of democratisation has been hailed by the international community as an example to other states in the region. The CMJD's actions have been generally positive and appear to be driving the country towards a more open, representative and transparent form of government. Strong international support and assistance, both from governments and international finance institutions, will be needed to keep the process on track, though the new government itself will have ultimate responsibility for continuing the process. Ultimately, the CMJD may discover that the overthrow of the Taya government was the easiest part of implementing democratic reform in Mauritania.

Nigeria: Fanning the flames of instability

Risk ratings	Political	Security
	<input type="checkbox"/> M <input type="checkbox"/>	<input type="checkbox"/> M <input type="checkbox"/>
Niger delta		<input type="checkbox"/> H <input type="checkbox"/>

West Africa analyst Rolake Akinola examines the combustible mix of looming elections, militancy in the Niger delta and oil.

Deep within 7,720 sq miles (20,000 sq km) of wetland primarily composed of thick mangrove swamps, waterways, muddy creeks and coastal islands is the hub of Nigeria's \$53bn-a-year oil and gas industry. Also around the thousands of miles of oil pipeline lie the roots of an armed struggle by self-styled militants seeking compensation from the government and oil companies for what they claim is the unjust exploitation of the Niger delta's resource-rich communities, which remain largely impoverished. Whatever the reasons for such a contradiction, it is clear that those affected are bent on drawing the world's attention to the region.

To some extent they have succeeded. Global media headlines speak of 'chaos', 'anarchy' and 'insurgency' in the delta; the US, strategically, assesses its options for providing security assistance to countries around the Gulf of Guinea and considers scenarios for the potential 'break up' of Nigeria; while China raids its coffers to fund the billion-dollar infrastructure and investment projects that are opening doors for it in Nigeria's oil industry. Meanwhile, international non-governmental organisations (NGOs) remind observers of the humanitarian, developmental and environmental concerns at the heart of the crisis. Despite the glare of the international spotlight and much conciliatory rhetoric, President Olusegun Obasanjo's government has failed to end the instability. In the worst-case scenario, it may never be able to.

An insurgency in the making?

Volatility in the Niger delta represents perhaps the greatest challenge to national stability ahead of the presidential, federal and state elections scheduled for April 2007. The region accounts for around 90% of Nigeria's oil export revenues, but some 26% of the country's oil production has been shut down because of the activities of militants and opportunistic criminal groups determined to capitalise on the insecurity. The difficult security environment fuels continued

apprehension on the part of foreign companies, some of which will scale down their operations in the delta ahead of the elections for fear of being caught in a political crossfire that could have an impact on both employees and assets. The situation has all the makings of an insurgency: underdevelopment; poverty; lack of economic opportunities for youth; unemployment; crime; corruption; ethnic disputes; widespread proliferation of arms and ammunition; and the swampy terrain that makes the area perfect for guerrilla-style operations.

Since the mid-1990s – considered to be a watershed for the deterioration of community relations with oil companies – several militant groups have used violence to articulate their grievances over the exploitation of local resources and perceived lack of benefit to their communities. Some, like the Niger Delta People's Volunteer Force (NDPVF), have become engaged in criminal activities and ostentatious displays of wealth that have undermined their credibility among ordinary delatans and further radicalised a new generation of youth and militant groups, which have adopted guerrilla-style tactics in their fight for the region.

The most prominent of these groups is the Movement for the Emancipation of the Niger Delta (MEND). Its attacks have targeted oil industry operations and interests, and its campaign demonstrates a level of sophistication that continues to challenge the government and its military Joint Task Force (JTF) in the region. One of the group's tactics has apparently been to operate an 'escalation ladder', staging targeted attacks in rapid succession followed by a short period of relative calm. A growing trend among the region's more sophisticated militant groups is a penchant for forming and articulating ideologies that fuel their armed resistance and attract much-needed community support. MEND is likely to adopt a more political agenda in the run-up to the elections. It will probably ally itself with a loose network of political figures who are positioning themselves for office at both state and local government levels and who share the group's grievances and its vision of local autonomy and resource control.



Although MEND positions itself as an umbrella organisation, its longevity appears to result from its decentralised, highly fluid structure, which will undermine efforts by security forces to infiltrate it. However, MEND is unlikely to escalate its campaign beyond a point where it can no longer dictate local security dynamics. Moreover, local politicians, who wield power over the various militant groups, would prevent an all-out war, which could undermine the status quo and consequently their personal and business interests. For now, MEND will be content to be seen as a threat to the future of oil operations, but not one of sufficient magnitude to warrant a full counter-insurgency operation by the armed forces. MEND and other militant groups will stop short of calling for independence for the Niger delta, and several moderate groups will remain willing to negotiate with the central government, despite the activities of hardline elements.

The implications of 'grand' politics

The presidential succession battle means that little effective political attention will be given to the Niger delta crisis before April 2007. Obasanjo's purported bid for a third term in office ended abruptly in May 2006, after legislators in the Senate (upper house) rejected a proposed constitutional amendment that would have extended presidential term limits, throwing the political stage wide open and creating space for various ethno-regional groupings to lay claims to the presidency.

Niger delta leaders and activists are fully immersed in this geopolitical battle. The northern political bloc's desire for a power shift to the north – after eight years of southern rule by Obasanjo, an ethnic Yoruba – faces a stiff challenge from the south-south oil-producing states of the delta. Political movement the South South People's Assembly (SSPA) leads the clamour, but apparent confusion over the legitimacy of the power-shift concept as a political framework portends a great deal of uncertainty ahead of the polls. Although Nigeria's ethno-regional balance of power suggests that the most likely outcome is a northern president, with the compromise of a south-south vice-president, this may not be sufficient to appease the delta's radicals.

While Nigeria's geopolitical complexities run much deeper than the north-south dichotomy, the possibility of new actors and dynamics disturbing the turbulent, yet enduring, north-south equilibrium could

plunge the country into greater instability. Indeed, Obasanjo's possible delay of the elections, or another heavily disputed election that completely alienates militant groups, could contribute to the radicalisation of moderate groups in the Niger delta.

Who gets what and how much?

Another political obstacle is Nigeria's lack of true federalism. The country's huge dependence on the oil sector exacerbates the situation; the struggle for power has largely hinged on attempts to control distribution of oil wealth. As a result of the tendency to centralise power under previous military regimes, local and state governments have remained in conflict with the central government. The struggle between oil communities, militants and the central government increasingly replicates this conflict, and calls for the devolution of federal powers will continue.

The 1995 constitution stipulates that the southern oil-producing states should receive a 13% share of oil revenues. The federal government's refusal to accept proposals to increase this to between 25% and 50% and to repeal the 1978 Land Use Act (vesting in the state the ownership of all land) and the Petroleum Act (vesting in the state all ownership and control of oil resources, including exploration and production licences) will continue to sour relations with the oil-producing states. It is unlikely that the majority of non-oil producing states, particularly northern states, will agree to an upward revision of the percentage for the foreseeable future. Without the prospect of an acceptable agreement on these issues, and with the increasing likelihood of strong northern political representation in the next administration, militancy will remain the preferred form of expressing regional grievances for the delta's radicals.

Pre-election troubles

Obasanjo's administration may well have exhausted its options for resolving the Niger delta issue before the elections, and there will be a myriad of considerations, not least economic reforms, demanding its attention in the final months of its last term in office. Therefore, it is likely that the government will continue to use the security forces to ease the path to the elections in the delta, rather than engaging in substantial dialogue with the region's stakeholders. The militants unsurprisingly viewed an April 2006 government development plan for the region as inadequate, highlighting their inherent

distrust of the government's commitment to finding a solution. The absence of dialogue on resource control could fuel the crisis and force an extended shutdown of oil operations in the region. There is a credible risk that militants will shift tactics and escalate attacks to reinforce their demands. In 2006, MEND was suspected of carrying out Nigeria's first car-bomb attacks against strategically important locations in Port Harcourt (Rivers state) and Warri (Delta state) – a military base and a state-owned oil refinery – marking a significant escalation in its campaign.

Crucial installations of strategic importance to the government, such as the oil export terminals and the liquefied natural gas project at Bonny (25 miles (40km) south of Port Harcourt) will increasingly come under threat of attack from militant groups. Ahead of the polls, militants will target individuals and public figures involved in the electoral process at state and local level, while attacks on foreign interests, particularly kidnaps,

may be less prevalent because of the scaling down of operations by companies. Insecurity in the delta will remain a source of instability during the transition period, amid the usual mix of ethnic and religious unrest, and political violence. While the 1999 transition to civilian rule has undoubtedly triggered a democratic momentum that increases the prospects of longer-term stability in Nigeria, volatility in the Niger delta in the short term threatens to set back those gains.

Divided or united?

Nigeria's first post-independence prime minister Abubakar Tafawa Balewa in 1948 remarked that 'Nigerian unity is only a British invention'. Maybe it was. In any case, the discovery of oil in the delta in the 1950s has for decades given Nigeria perhaps its only economic reason to stay united. As the delta continues to go up in flames, without genuine political negotiation and compromise Balewa's statement may once again ring true.

Russia: The dangers of resource nationalism

Risk ratings

Political

Security

M

M

North Caucasus

H

H



As President Vladimir Putin approaches the end of his presidency in March 2008, he will redouble his efforts to expand state control over the economy, and over natural resources in particular. Russia and Former Soviet Union analyst Carlo Gallo examines the implications.

Since coming to power in 2000, Putin has consistently worked to re-establish the state's authority following its erosion under former president Boris Yeltsin (1991-99). This policy has entailed the federal government's seizure of power from the regions, expansion of state control over the media and use of the prosecutor's office to neutralise political opponents. It has also seen increasing state intervention in the economy. Under the banner of redressing the injustices of the corrupt privatisations of the 1990s, the state has renationalised several major industrial assets, particularly in the energy sector, with more likely to follow in 2007. State energy giant Gazprom's monopoly on gas exports also facilitates the government's pursuit of its diplomatic and commercial goals abroad.

The drive to increase state control over natural resources and other key sectors is, to a large extent, a reaction to the perceived failures of Yeltsin's socio-economic model. Putin and other senior government figures view the large privatisations of the 1990s to have been little more than the plundering of state's most valued economic assets. Well connected oligarchs became exceedingly wealthy in a short space of time at the state's expense, paying minimal taxes and using their vast wealth to hold sway over Yeltsin.

Putin uses the assumption that private ownership equates to the self-enrichment of greedy individuals to validate his claim that the state must manage the economy to ensure that it serves the common good. The government will thus retain strategic control of key assets, even though it will continue to seek foreign capital and technological expertise. Furthermore, 2007 is likely to see an expansion of state control over the mining of precious metals, a sector hitherto largely unaffected by resource nationalism. This does not reflect a presidential whim; it is inherent to an overall programme for Russia's political and economic system and

is therefore likely to affect companies well beyond the end of Putin's tenure.

Economic control

The state generally seeks a controlling stake in companies that dominate lucrative sectors. Private investors, whether foreign or domestic, are permitted to buy the remaining shares. The means for acquiring control can include pressuring recalcitrant managers by conducting tax and other inspections, as well as investigations by the prosecutor's office. The government then uses companies already under its control to buy majority shares in the target business. Huge state holdings will continue to emerge in this way, enjoying dominant positions in their respective sectors. Their managers tend to be senior government officials, which creates clear conflicts of interest and, consequently, preferential regulatory treatment for the companies concerned.

Examples of such state holdings include the United Aircraft Construction Corporation, which resulted from the consolidation of the aircraft-manufacturing industry in February 2006. Rosoboronexport, an obscure 100% state-owned company created in 2000 to manage arms exports, is becoming a key vehicle through which the state expands its control over valuable industrial assets. Headed by Putin's close associate Sergei Chemezov, in December 2005 it took over the largest national car producer, AutoVaz, while in September 2006 it bought a blocking stake (41%) in VSMPO-Avisma, Russia's principal supplier of titanium to defence and civilian aircraft companies.

Resource nationalism

However, in no sector has this trend been more pronounced than in energy. This is not surprising, given that oil and gas represent the core of the Russian economy. The share of oil production under state control has risen from 10% in 2004 to about 30% in 2006, and is likely to surpass 50% in 2007. The government's aggressive stance towards energy companies began in July 2003 with its attack on the country's most successful private oil company, Yukos. The subsequent arrest of CEO (and political party

funder) Mikhail Khodorkovsky on tax evasion and other charges sent a message to other oligarchs that tax evasion and political interference would no longer be tolerated.

The crackdown on the oligarchs boosted Putin's popularity. He was re-elected in 2004, and proceeded to silence dissenting voices in government. Then-prime minister Mikhail Kasyanov (2000-04), who criticised the handling of the Yukos case, was dismissed in February of that year.

Oil sector

Since Putin's re-election, state oil company Rosneft has grown exponentially, mainly thanks to its controversial acquisition of Yukos' most valuable oil production asset, Yuganskneftegaz, in December 2005. Rosneft's London initial public offering (IPO) in summer 2006 was then limited to minority shares. In October 2005, Gazprom entered the oil sector with the acquisition of Sibneft, which included 50% of Slavneft's shares, with the other 50% held by Anglo-Russian joint venture TNK-BP.

Russia's Lukoil and TNK-BP remain the only major oil companies in private hands.

However, the state is highly likely to seek shares in both companies in 2007. The prosecutor's office in September 2006 threatened BP with revoking its licence for alleged breaches of environmental and other regulations. Even Shell and ExxonMobil, which are involved in three oil and gas production-sharing agreements (PSAs), will come under increasing pressure to sell shares to the state or renegotiate their tax breaks.

Natural Resources Minister Vladimir Trutnev is one of the many *siloviki* (state officials previously in the security or armed forces) to advocate a more assertive stance towards foreign investors in the energy sector. He has long threatened to revoke operating licences if foreign companies are deemed to breach licensing agreements. Communist and nationalist MPs are even more suspicious of foreign investors, whom they see as pillaging Russia's rich resources.

Gas sector

The gas sector is the least liberalised. Gazprom is the world's largest gas company, producing 94% of all Russian gas and controlling a quarter of the world's reserves. The state in June 2005 increased its share in Gazprom from 38% to 51%. Gazprom's long-held monopoly over the export pipeline

network, which it enjoyed even during the Yeltsin years, ensures that it can blackmail private producers, which are largely restricted to supplying the much less lucrative domestic market.

Mining

The mining sector has thus far remained comparatively untouched by government interference, mainly thanks to the loyalty of key oligarchs to Putin. Norilsk Nickel, the world's largest nickel producer, remains in private hands, as does aluminium giant Rusal.

Nevertheless, the tide is starting to turn. Legislative amendments in 2004 transferred authority for granting mining licences from regional administrations to the federal government. A new law on the exploitation of subsoil resources (to be implemented from 2007) is likely to stipulate that only companies with less than 50% foreign participation are allowed to bid for 'strategic' fields. These fields are yet to be defined by the government, but are likely to include deposits of diamonds, uranium and other rare metals.

State-owned mining company Alrosa, a global player in the diamonds sector, is likely to eye Norilsk Nickel for acquisition in 2007. Now that all hostile oligarchs have been eliminated, loyal oligarchs and foreign ventures that have maintained good relations with the government are likely to unwittingly provide attractive avenues for the further expansion of state control.

Political successes

The state's dominant position in the economy finds its political match in a tightly controlled political regime, where those in power can rule unchallenged and are exempt from independent anti-corruption investigations. If the ruling elite is acting in the general interest, as it claims, it follows that all opponents are enemies of the state and should be neutralised. The public is willing to accept this as long as it sees improvements in law and order, and living conditions. Putin's government has made noticeable advances on both counts.

Looking ahead, the expansion of state control over the economy and the reining in of private industrialists will remain popular policies during the 2007-08 electoral cycle and beyond. Large, successful, domestic private companies will continue to disappear as the state expands its reach, leaving only

Electoral machinations

The run-up to parliamentary and presidential polls scheduled for December 2007 and March 2008 respectively will bring a period of intense political manoeuvring to ensure that the Kremlin's preferred candidates are installed. Russia's federal authorities have long been suspected of pulling strings in an attempt to bring pro-government parties to power, but only under the rule of President Vladimir Putin have they started to see unqualified success. Putin has debilitated regional governors, brought media networks under state control and cracked down on disloyal oligarchs to ensure that his supporters and policies prevail.

The Kremlin's ability to engineer electoral outcomes was evident in the 2003-04 electoral cycle, with a parliamentary victory for the pro-presidential United Russia party and an easy re-election for Putin. The constitution bars Putin from running for a third term, but the political system revolves around him to such a degree that not only is there no viable opponent, but even his allies fail to command significant popular support. Possible candidates are Defence Minister and Deputy Prime Minister Sergei Ivanov, Emergency Situations Minister Sergei Shoigu and parliamentary speaker and United Russia leader Boris Gryzlov, though the Kremlin is likely to back a contender only in the last quarter of 2007. At that point, it will use the full force of its television monopoly to fashion a charismatic leader, while Putin's personal endorsement will do the rest.

In preparation for the parliamentary ballot, the Kremlin has been covertly orchestrating party mergers and dismissals of political leaders who are deemed unreliable. This stratagem will continue in 2007 but is hardly necessary, given that Putin's popularity rating is unlikely to fall below 70%. However, the numbing of civil society through media control and restrictions on non-governmental organisations (NGOs) has distanced the Kremlin from the populace, and the administration now finds itself in need of reassurance. Putin may even decide to advance the date of the presidential election to coincide with the parliamentary poll in the hope that the electorate, which will vote overwhelmingly for the endorsed presidential candidate, will also throw its weight behind United Russia.

foreign investors to challenge its economic supremacy. The government is then likely to step up pressure on the largest international companies operating in the country's strategic sectors. While it will continue to welcome foreign capital and technology, it will retain a controlling stake in all key assets. The growing power of officials – who are concerned with private gain – will see a gradual increase of corruption in line with the degree of state control over the economy.

Problems ahead

In three-to-four years, the government's ability to maintain the level of social spending presently supported by high oil prices will wane. Once oil prices decline, the consequences of the government's failure to introduce structural reforms – such as an overhaul of the pensions system, liberalisation of the energy and banking

sectors, and communal housing improvements – will become starkly apparent. Russia will then find itself unable to fund popular support for its semi-authoritarian political regime.

Given the absence of independent civil-society organisations and media, the authorities are becoming increasingly disconnected from the population. Discontent is already coming to the surface, as seen with the countrywide protests against the monetisation of social benefits in January 2005, and against rising utility bills in April 2006. Large state-controlled holdings and high oil prices sustain the dangerous illusion that Russia does not need structural reforms, but this misconception will not last. In this climate, resource nationalism and state control over the economy will contribute to increasing political instability in the next three-to-five years.

South Africa: The man who would be president

Risk ratings

Political

Security

L

M

Deprived urban areas

H

Southern Africa analyst Mike Davies examines the African National Congress (ANC) leadership battle.

When President Thabo Mbeki dismissed his deputy Jacob Zuma in June 2005, most observers assumed that Zuma's political career had ended. Few would have imagined, looking ahead to 2007, that Zuma would still be in the running for the highest post in the dominant ruling ANC. Few would also have forecast that the party would be so divided, with its splits – showing signs of tribal tensions – playing an incisive role across the spectrum of political debate: from the media to the civil service, from government to business.

The key political event in 2007 will almost certainly be the ANC party conference in December, at which the senior leadership and the 60-member national executive committee (NEC) will be elected. The conference has huge political significance because, given the ANC's current legislative majority, its leader is almost guaranteed to become state president in 2009. This is why Zuma's campaign for the ANC's highest post has created such a stir.

Zuma

Zuma is a controversial figure. Born in Nkandla (KwaZulu-Natal), he received little formal schooling and became involved in politics at an early age, joining the ANC in 1959 and its armed wing, Umkhonto We Sizwe, three years later. He has solid 'struggle credentials': in 1963, he was imprisoned for ten years on Robben Island for conspiring to overthrow the government and spent most of the 15 years following his release in exile. Elected ANC deputy president at the 1997 national conference, Zuma became state deputy president in 1999. However, by 2001, the National Prosecuting Authority (NPA) was investigating him for his role in an arms deal, but the NPA declined in 2003 to bring charges against him despite uncovering a prima facie case of corruption. The controversy continued with the trial of Zuma's friend and financial adviser Schabir Shaik and a May 2005 judgement that the two men had had a 'generally corrupt'

relationship prompted Mbeki to dismiss Zuma.

The reversal of Zuma's fortunes began in May 2006 when he was acquitted of rape charges that had been brought against him by the daughter of a late ANC colleague. Charges of fraud and corruption that were brought against Zuma after Shaik's conviction were dismissed in September 2006.

Zuma has gained large numbers of supporters within certain constituencies, generally on the left of the political spectrum. He has particularly attracted the attention of the poor who, despite significant advances in the delivery of social services in many areas, remain marginalised and unemployed. They believe that Zuma will address their concerns in a way that the ANC has failed to do since taking power in 1994.

No guarantees of success

Zuma's election to the ANC presidency is by no means guaranteed. Since 1994, when Nelson Mandela was elected, the presidential succession has been stage-managed. Mandela handed over many presidential duties halfway through his term and, in effect, became the figurehead that he remains today. Mbeki forced challengers out of the political running and secured the ANC presidency unopposed in 1997, leading to his election as state president for the first time in 1999. Many analysts believe that the ANC's ability to control internal dissent and build consensus is its defining characteristic. The party thus has good reason to fear the implications for unity if Zuma is elected as its president.

The election process for senior leadership positions could also thwart Zuma's efforts. According to the ANC constitution, at least 90% of voting delegates at the national conference must be from its branches. At the 2002 conference, there were 3,400 voting delegates, 3,060 (or 90%) of whom represented branches, while the NEC, the provincial executive committees, the ANC Youth League (ANCYL) and the ANC Women's League made up the balance. Branch delegates are elected in proportion to their paid-up membership; in 2002, for



example, 21% of branch delegates were from the ANC stronghold of the Eastern Cape, compared with 13% from KwaZulu-Natal. While Zuma has the groundswell of popular support that would provide the base for a nationwide vote, it is uncertain that it will align with the interests of the ANC conference delegates. Furthermore, while he might appeal to the left, the Congress of South African Trade Unions (COSATU) and other left-leaning organisations are also split over his candidacy.

Events in 2007

A combination of historical patterns of consensus-building and unease among the ANC elite is likely to conspire against Zuma's candidacy, though the course of events in 2007 could result in a different outcome than in previous ANC election years. First, unlike Mandela in 1997, Mbeki has not signalled his intention to stand down as ANC president. In contrast to the state presidency, there are no restrictions on the number of terms that the ANC president can serve. In fact, Mbeki could use this as a trump card to block Zuma's path until late 2008, when the party lists will be finalised ahead of the 2009 election. Under South Africa's proportional representation system, party lists are used to determine which candidates will become MPs, with the presidential candidate listed first. By putting himself up for re-election, Mbeki would effectively delay the succession race by a year, during which the NPA could bring new corruption charges against Zuma. Such a delay would also give the Mbeki camp more time to manoeuvre. However, it would be controversial and would fuel claims by Zuma's supporters of a conspiracy to keep him out of State House.

Secondly, in contrast to previous years, the ANC leadership will find it difficult to use its collective clout to influence the choice of candidates and, in particular, to discourage Zuma – who appears to believe that the presidency is his for the taking – from accepting a nomination made in the interests of the party. While the Zuma camp would not easily accept a candidate in Mbeki's mould, such as state Deputy President Phumzile Mlambo-Ngcuka, there are, as in previous leadership battles, a number of other candidates. Secretary-general Kgalema Motlanthe, for example, is seen as a more neutral candidate who, by virtue of his position in the party, is likely to receive significant levels of support from branch delegates. Other possible candidates include businessman Cyril Ramaphosa and Defence Minister Mosiua Lekota. The

precedent of negative campaigning that has characterised previous leadership battles means that alternative candidates will not emerge until closer to the conference. However, Zuma is unlikely to back away from his challenge for the presidency, leading to the unusual situation of a direct vote with an uncertain outcome.

Business implications

It is difficult to determine exactly what a Zuma state presidency might mean for international business because there is little in the public domain that provides much insight into Zuma's political stance or economic policy agenda. Only in September 2006 did any meaningful statements begin to emerge, but even these fell short of enunciating an articulate economic policy. His previous speeches merely committed him to ANC orthodoxy, which, his supporters argue, is a necessity given his position within the party.

While part of the labour movement – represented in the ruling alliance by COSATU – the South African Communist Party, and leftist elements of the ANC have adopted Zuma as their candidate of choice, there is little evidence to confirm that he is any more left-leaning than the centrist Mbeki. While this situation will obviously change during 2007, with aides providing further indications of policy direction, it is clear that expectations in some core constituencies are being raised. The COSATU secretary-general is on record as saying that, should Zuma become state president, there would be 'no free lunch', implying that COSATU would expect something in return for its support. The fact that these comments were made in the wake of the final resolutions adopted at the ninth COSATU national congress, which called for higher company tax, more labour rights and the 'nationalisation of mining and other commanding heights of the economy' will be of particular concern for business, despite Zuma's recent praise of the ANC's economic policies. Labour leaders have in the past been co-opted and given government positions in return for dropping demands over structural economic changes. Control Risks believes that Zuma is more likely to push for substantive changes in social policies, and only tinker with economic ones. However, major increases in social spending cannot be achieved in isolation.

There are also fears about Zuma's apparent populism. Presidents with close ties to trade unions have been elected in other countries

in recent years, raising similar fears concerning Zuma's potential presidency. However, once elected, presidents often find that checks and balances, elite interests, and structural issues combine to reduce the possibility of major shifts in policy. There was similar investor concern ahead of Brazil's 2002 presidential election when Luiz Inácio da Silva ('Lula') emerged as a frontrunner. However, Lula has managed to gain the confidence of the business community, despite his radical union background, by appointing key economic advisers and pursuing an orthodox economic programme. Zuma could take a similar course of action, though replacing Finance Minister Trevor Manuel after almost a decade will be difficult. There is little doubt that Zuma will face pressure from the emerging black middle classes not to rock the boat. However, faced with increasing pressures from an expectant labour movement and electorate, would he really be able to resist?

Certain uncertainty

Many commentators have raised the point that the succession battle reflects the robust nature of South African democracy. Some hope that it heralds a split in the ANC that will result in a credible opposition, which could act as a counter-balance to one-party dominance. However, while Zuma's ascendancy will almost certainly polarise the ANC, Control Risks does not believe that this will happen in 2007. Many will feel an incredulity over the prospect of a man who many perceive as corrupt and who – as patron of the Moral Rejuvenation Movement – showed a remarkable lack of judgement by having unprotected sex with an HIV-positive woman (as admitted during his rape trial), becoming president of South Africa; however, it remains a possibility. It is the uncertainty engendered by this possibility that will raise concerns. Many will hope that by December 2007 an alternative candidate will have emerged.

Thailand: After the coup

Risk ratings

Political

Security

Narathiwat, Pattani, Yala

M

M

H



Thailand on 19 September 2006 experienced its first coup d'état for 15 years, when army commander-in-chief Gen Sonthi Boonyaratglin deposed prime minister Thaksin Shinawatra. South-east Asia analyst Nicholas Owen examines the likely impact in 2007 and the possible course of the Muslim insurgency in the south.

In the aftermath of the coup, Sonthi carried out his pledge to hand power to a civilian prime minister. His choice, retired general Surayud Chulanont, will face mounting popular opposition as the year progresses because of disillusion with the coup. Criticism of his administration, as well as Sonthi's Council for National Security (CNS), will escalate as Thais grow frustrated with their appointed government. Within weeks of the coup, the same civil-society groups that had called for Thaksin's removal expressed concern at the composition of the National Assembly and the Constitution Drafting Assembly.

Prospects for resistance

King Bhumibol Adulyadej's endorsement of the coup has effectively ended the risk of a counter-coup by units still loyal to Thaksin. Army commanders who graduated with Thaksin from Pre-Cadet Class 10 of the army school would be seen to be directly contravening the revered king's will if they now tried to reverse the putsch. Palace endorsement was also key to pacifying Thaksin's mainly poor, rural supporters in the country's north and north-east who were the main beneficiaries of the ousted Thai Rak Thai (TRT) government's populist policies, including a moratorium on farmers' debt and the introduction of affordable health care and village loans.

However, pockets of resistance from Thaksin loyalists are still possible. Arsonists in September set fire to schools in the northern province of Kamphaeng Phet (200 miles (320km) north-west of the capital Bangkok) in what is widely suspected to have been the first act of violent opposition to the coup. The CNS revoked the operating licences of hundreds of local radio stations in the north and north-east in a sign of its concern over opposition from Thaksin supporters. Nonetheless, there is only a low risk of

protests becoming more frequent. In one of his first policy statements as prime minister, Surayud told northern community leaders that he would make health care freely available. The government's commitment to maintaining Thaksin's most popular policies has significantly reduced the chances of further unrest.

Appeasing Bangkok's civil-society groups will be far more difficult, and the risk of renewed civil unrest will increase the longer that a return to full democratic rule is postponed. A student-led group on 20 September protested peacefully against the coup at the capital's Siam Paragon shopping centre (mall) in the first significant challenge to a ban on demonstrations. Abhisit Vejjajiva, leader of the opposition Democrat party, has expressed concern at the postponement of elections for another year. Meanwhile, the People's Alliance for Democracy (PAD) protest movement has established its own Assembly for the People's Charter (APC) out of concern that the military-appointed Constitution Drafting Assembly will arrive at reforms that are less progressive than those of the 1997 constitution. Refusal to give more than a token hearing to the APC's recommendations could provide a trigger for renewed protests. So too could any sign that elections will be further postponed.

Coming elections

Sonthi appears to be sincere in his commitment to holding elections by October 2007. Nonetheless, his actions since 19 September expose a lack of confidence in civilian politicians that could potentially delay a return to full democracy. The appointment of a retired (albeit highly respected) general as prime minister, the provisions in the 1 October constitution that ensure that the CNS continues to play a more powerful political role than the civilian government, and reluctance to lift martial law could all be interpreted as signs that Sonthi may experience doubts when the time comes to relinquish power.

The election results will to a large extent be decided by the shifting allegiances of former TRT factions. While in power, the TRT expanded its parliamentary following through a series of 'mergers and acquisitions' that

led to the absorption of smaller parties, such as the New Aspiration and Seritham parties. Rather than simply moving across to one of the established parties, such as the Democrats, it is possible that these factions will create a new political force. However, Control Risks does not expect the TRT to re-emerge as an election-winning force without Thaksin at its head. The speed with which the party unravelled exposed its lack of coherence beyond the patronage and personality of its founder.

Economic considerations

Keeping the economy running smoothly during 2007 will be key to determining whether the government can retain public support. Surayud's brief statement following his swearing-in that he would seek to achieve 'people's happiness' rather than GDP growth did nothing to reassure the country's nervous financial markets. The belated appointment of respected central Bank of Thailand governor Pridiyathorn Devakula as finance minister only partially remedied this failure.

Foreign investors will continue to defer significant expansion plans as concerns over the operating environment mount. The Asset Examination Commission (AEC) will investigate contracts signed by the deposed TRT government. Its activities could call into question the validity of agreements signed with the previous administration. Sonthi and his fellow coup conspirators invoked corruption as a key reason for Thaksin's removal, and it is politically essential that the commission finds evidence of wrongdoing. Of greatest concern to investors so far has been the investigation into the sale of Thaksin's Shin Corp business empire to Singapore's Temasek Holdings.

Temasek acquired a 49% stake in Shin Corp in January 2006 in a transaction that was seized on by the PAD as evidence that Thaksin was using his premiership to advance his own commercial interests at the expense of the nation. Temasek's acquisition of a further 45% holding in Shin Corp through a tender three months later led to allegations that the company had relied on nominee companies to circumvent foreign-ownership rules. Regulators had previously been prepared to overlook the common practice of using Thai nominee companies to conceal foreign control of domestic businesses. The Shin Corp investigation appears to have challenged that practice. Foreign investors who reached similarly structured transactions will face greater

attention from regulators and could come under pressure to reduce their shareholdings.

Southern insurgency

Surayud's government will begin talks with separatists in the southern Muslim-majority provinces of Narathiwat, Pattani and Yala, where daily shootings and bombings have killed at least 1,700 people since January 2004. Thaksin's military approach to the conflict at the expense of reconciliation measures, such as those proposed by the National Reconciliation Commission (NRC), was responsible for a steady escalation of separatist violence. The coup came three days after six bomb attacks in Hat Yai, the main commercial city of Songkhla province, which borders Yala and Pattani. The explosions killed four people, including a Canadian, and represented a departure from attacks aimed at intimidating the authorities rather than inflicting mass casualties.

Sonthi, who is a Muslim, though not ethnically Malay, appears to favour a settlement based on the recommendations of the NRC. Among other measures, it called for the creation of civilian-led agencies to fulfil the role of the Southern Border Provinces Administrative Centre (SBPAC), which Thaksin dismantled in May 2002 in a move that is thought to have contributed to the upsurge in violence. The commission also recommended that the government establish a fund to rehabilitate the south and recognise Pattani-Malay as a working language. However, such measures are unlikely to satisfy the separatists' demands. Even if separatist leaders are willing to sign an agreement based on NRC-style recommendations, the fragmented nature of the conflict could yet derail a peace deal. Much of the violence appears to be perpetrated by village-based fighters over whom the leadership often exercises little operational control.

Separatist violence will continue to beset the southern border provinces during 2007. Although there is no sign of outside terrorist groups such as Jemaah Islamiyah (JI) infiltrating the conflict, the Hat Yai bombings were the separatists' most deliberate attack yet against venues popular with tourists. The risks of further such attacks will increase the longer the conflict persists. Moreover, separatists may consider expanding their campaign beyond the four southern provinces to more popular tourist destinations further north if the forthcoming peace talks fail to live up to expectations. Such an escalation would further add to the risk of delaying a return to democratic rule.

US: Political stalemate ahead

Risk ratings

Political

Security

L

L

Deprived urban areas

M



Problems both at home and abroad have eroded President George W Bush's support and undermined the credibility of the ruling Republican party. Americas analyst Emma Campos-Redman assesses the outlook for the final two years of the Bush administration and beyond.

Mid-term congressional elections are usually defined by local issues. However, during the build-up to the November 2006 elections, the vote threatened to become a referendum on the Bush administration. The president is fighting fire on a number of seemingly intractable domestic and international issues; a *Washington Post*-ABC News poll in early October showed Bush's approval rating at 39%, close to his lowest rating ever. Irrespective of the outcome of the November elections, Bush's final two years in the White House show every sign of becoming a 'lame duck' presidency. With the administration facing legislative stalemate, speculation will turn to the 2008 presidential election.

Sources of discontent

The Bush administration's stance on national security, based on its 'war on terror' policy, retains significant public support. However, the main foreign policy issue facing the government, the military involvement in Iraq, has been highly damaging. The number of US casualties continues to rise, while Iraq now appears to be on the brink of civil war, fuelling perceptions that the administration's policy has been a failure. Iraq has eroded the Republicans' traditional advantage over the opposition Democratic party on national security. Furthermore, it has weakened the ruling party's unity; a growing number of Republican legislators have voiced doubts about the continued involvement in Iraq.

On the domestic front, an increase in fuel prices since 2005 has eroded public support, particularly at a time when the oil industry has reported record profits. The government's widely criticised response to the devastation caused by Hurricane Katrina in August 2005 lingers in the public memory. Meanwhile, a series of corruption and sex scandals has implicated prominent Bush administration figures (particularly Bush's Deputy Chief of Staff Karl Rove and Lewis Libby, Vice-President Dick Cheney's former

chief of staff) and Republican legislators (including Tom DeLay, the former majority leader in the House of Representatives (lower house), and disgraced congressman Mark Foley).

A lame duck

The combined weight of these issues undermined the Republicans as the party prepared to defend its majorities in the House of Representatives and the Senate (upper house) on 7 November. Opinion polls published in the run-up the polls showed the Democrats enjoying an increasingly substantial lead over their opponents. However, the Republicans believed that they could still rely on votes from their core support base, the religious right. Meanwhile, divisions within the Democrats prevented them from capitalising on the fallout from the Republican scandals and Bush's poor approval ratings. Nonetheless, regardless of the result, the Bush administration will face significant challenges as political jockeying gathers pace ahead of 2008.

A Democrat-dominated Congress would present significant obstacles for the government's legislative agenda. It would also be likely to initiate damaging investigations into the administration, which would include scrutiny of its as-yet-unproven claims that Saddam Hussein's regime in Iraq had weapons of mass destruction.

Moreover, recent developments suggest that Bush cannot even rely on votes from legislators within his own party. Bush's key second-term domestic initiative, the overhaul of the social security system, was partly derailed because of opposition from Republican legislators. In July 2006, Bush used the presidential veto for the first time since taking office in 2001 to block a bill for further federal funding for controversial stem cell research that had the backing of moderate Republican congressmen; the episode highlighted a growing willingness among Republican legislators to distance themselves from the administration. Consequently, Bush is unlikely to be able to seek major legislative successes during the remaining two years of his government.

Foreign affairs

Bush has adopted a more multilateral approach to foreign policy during his second term, and his final two years in office are unlikely to see any major changes. A Democrat-dominated Congress would be likely to press for a reduction of troops in Iraq, but a full exit from the country under Bush is unlikely because the US presence there remains at the core of the 'war on terror' strategy. The administration will continue to argue that a premature exit from Iraq would fuel the terrorist threat. In addition, the Democrats' lack of a coherent alternative to the current involvement in Iraq means that only a limited withdrawal of forces would be likely to be pursued in the next two years. However, investigations into the administration's handling of the situation would be almost inevitable, along with calls for the resignation of controversial Defence Secretary Donald Rumsfeld, which some Republicans would be likely to join.

North Korea's apparently successful nuclear test will be used by the Republican party and the administration to regain some of the high ground on national security matters. However, the Democrats will portray the test as evidence of the Bush administration's failure to curb North Korea's continuation of its nuclear programme. Nonetheless, there will be little scope for the parties to differ greatly on how to deal with the threat; both multilateral and unilateral US sanctions will continue to form the basis of their response.

The administration will use the developments in North Korea to emphasise the need to prevent Iran from reaching a similar position. However, in contrast to North Korea, Iran has yet to demonstrate a nuclear military capability by detonating a bomb. Consequently, the US would struggle to step up international sanctions against Iran. The Bush government may consider unilateral military action, but this would be unpopular for the same reason that Iraq has become a source of public concern, and Congress would be unlikely to support it in those terms. Nevertheless, there is a credible chance that the Democrats might back the administration to avoid being seen as weak on national security matters ahead of the 2008 election.

Finally, Congress will continue to exert pressure on the administration to adopt tougher action against China, which is widely perceived as a military and economic threat. Under the current circumstances and given its security concerns involving the countries mentioned above, the Bush administration

will not alter its military policy towards China, but could give in to pressures in terms of trade. A Democrat-dominated Congress would be more likely to pursue harsh trade restrictions than a Republican-controlled legislature following the former's recent turn towards protectionism.

Domestic policy

The Democrats have frequently criticised the administration over the economy, particularly the growing budget deficit and trade policy. A Democrat-controlled Congress may curb some of the administration's spending plans. However, with the 2008 election in mind, it would be likely to act selectively, supporting some popular Republican initiatives that could have a negative effect on public finances, such as tax cuts, while championing an increased minimum wage, lower prices for prescription drugs and increased federal funds for stem cell research. On trade, the Democrats would resort to their increasingly protectionist position and attempt to block any further attempts towards liberalisation in an effort to maintain the support of labour groups.

Immigration will remain a key issue over the next two years. Stringent initiatives emphasising border security were approved by both houses between December 2005 and September 2006, even though a majority of Democrats favoured a more moderate reform. Ahead of the 2008 presidential race, Democrats will seek the support of immigrant groups – particularly Hispanic voters – which are disenchanted with the Republican party because of the new laws. However, they will avoid jeopardising the potential support of anti-immigration groups by reviving the highly controversial debate. Bush, who also favoured a similarly moderate reform, will not pursue any further changes.

Bush's failed social security initiative prompted the administration in January 2006 to acknowledge that any significant reform would require bipartisan support. However, the prospects of major changes to the pension and health-care systems would be poor under a Democratic Congress. Even if the Republicans retained control of the legislature, the chances of passing a major reform would be slim given their reduced number of seats.

The presidential race

For the first time since 1952, the incumbent White House will not provide a presidential

candidate for the 2008 election; the constitution prohibits the president from seeking a third term, and Cheney has repeatedly stated that he will retire alongside Bush.

Although potential candidates tend not to formally confirm that they will seek their parties' nomination more than a year before the election, several figures are already seen as likely contenders for 2008. Despite denying any interest in standing, Secretary of State Condoleezza Rice, the most popular member of the current administration, has been identified as Bush's mostly likely Republican successor. In addition, Senator John McCain and former New York City mayor Rudy Giuliani may pursue the Republican ticket. For the Democrats, public opinion has most frequently named Senator Hillary Clinton as the favoured candidate; also in the running are John Edwards, who stood for the vice-presidency in 2004, and former vice-president Al Gore (1993-2001).

Nonetheless, it is too early to ascertain who will be the most likely candidate to secure

the nomination in either party, let alone his or her chances of seizing the White House. Indeed, within the present context the emergence of a 'dark horse' candidate who steals the election cannot be ruled out. What is certain at this stage is that, given the likelihood of legislative stalemate over the next two years, the Bush government will be unable to boost the chances of a Republican victory in 2008 by securing any headline-grabbing legislative triumphs. However, this does not automatically mean that the Democrats will capitalise on the weaknesses of the outgoing administration and overcome the Republicans' formidable electoral machinery.

The 2008 presidential race is likely to be an open, uncertain, fiercely contested affair. Its outcome will largely be determined by the electorate's perceptions of the candidates' ability to tackle the problems that beset the current administration. Those challenges will continue to define US politics for the next few years.

The very long arm of US law

US extra-territorial legislation is having a growing impact on business. Whether targeting money-laundering, fraud, corruption or human rights, it has led to some high-profile and successful cases, with more likely to follow. Businesses will increasingly face being caught out or caught up in political sanctions and diplomatic disputes.

The US Treasury in October 2005 imposed sanctions against the Banco Delta Asia (BDA) in Macau (China) for what it claimed were lax money-laundering controls that allegedly helped North Korea to distribute counterfeit US currency. Its ruling prohibits US financial institutions from directly or indirectly establishing and maintaining correspondent accounts in the US on behalf of the BDA. International banking clients severed business ties with the BDA, while a swathe of banks in the region severed relationships with Pyongyang, exacerbating its financial isolation.

The legislative tool used was section 311 of the USA Patriot Act. Under this, US banks have a duty to conduct a review of correspondent banking transactions abroad and to monitor all transactions of third parties to check whether they could be linked to money-laundering or terrorism. Banks are required to file reports of suspicious financial transactions or risk fines and sanctions.

Another piece of US legislation, the Alien Tort Claims Act (ATCA), can be used to target companies over activities outside their country of operation, with a growing number of lawsuits filed over alleged labour and human-rights abuses. ATCA allows non-US citizens to seek legal recourse in US courts for violations of international law, such as forced labour. Companies may not be directly linked to the alleged abuses, but are still answerable for the actions of business partners in their supply chain.

While no ATCA case has so far gone to trial, all have generated significant negative publicity for the companies involved. Much more than the legal costs and management time, it is this publicity that has the biggest impact and gives greater momentum to other international campaigns and investigations.

Venezuela: The end of the Bolivarian Revolution

Risk ratings

Political

Security

H

M

Colombian border areas

H

How will history judge Venezuelan President Hugo Chávez? Madman or visionary? For now, the pressing question is how and when he will go. Americas analyst Daniel Linsker offers an alternative perspective on the end of Chávez' regime and his 'Bolivarian Revolution'.

Most analysts believe that a major drop in world oil prices would precipitate the Chávez regime's demise. The government and the Bolivarian Revolution are sustained by high levels of populist public spending that are only possible while international oil prices are at record highs. Any significant fall in prices would severely undermine the sustainability of such spending, leading inexorably to the regime's collapse. This logic is persuasive. However, it is an oversimplification that ignores trends and developments on the ground.

The fate of the Bolivarian Revolution is not inextricably intertwined with the oil price. More importantly, the end of the revolution will not bring about the collapse of the Chávez regime. Control Risks believes that Chávez will stay on in power beyond the expiry of his third presidential term in 2013, and that Venezuela will come to resemble a cross between Cuba and Saudi Arabia – an authoritarian state bolstered and protected by vast oil wealth.

The Bolivarian Revolution

Defining the Bolivarian Revolution is a complex exercise, largely because as an ideology it lacks clear foundations. In broad theoretical terms, the Bolivarian Revolution has international and domestic components, which often contradict each other.

Internationally, the revolution seeks to establish an anti-'imperialist' (essentially anti-US) bloc of nations and offer alternatives to the prevailing international order.

Domestically, the revolution aims to create a socialist utopia and eradicate poverty, which continues to affect 35% of the population. This would be achieved by radically redistributing resources and giving ordinary Venezuelans ownership of the means of production through workers' co-operatives.

However, the application of the revolution's principles has differed radically from their

theoretical origins. Venezuela has used its oil wealth to secure undue international influence, while attempting to undermine an order dominated by the US and Europe. Domestically, the revolution amounts to a series of measures to concentrate power in the hands of the president and his allies, tightening the regime's grip on the country. Overall, the Bolivarian Revolution represents an illiberal doctrine characterised by a strong centralised state, authoritarian command-and-control power structures and populist demagoguery.

The revolution falters

Chávez' bid to export his revolution will falter because his strategy for acquiring international support is fundamentally flawed. Venezuela has moved to secure alliances with countries around the world by offering cheap oil, promising financial assistance and signing a multitude of preferential trade deals. The sustainability of this largesse remains highly questionable; most of the deals do not make any economic sense.

More significantly, the deals will not cement any genuine alliances, except possibly with a handful of pariah states such as Belarus and Zimbabwe, because they are asymmetrical. The deals rely on Venezuela using its wealth without receiving anything in return, beyond headline-grabbing rhetorical pledges. Once Venezuela's new allies are tested, for example by having to choose between a free-trade agreement with the US or support for Chávez, these alliances would be forfeited. This was shown in the difficulties that Venezuela experienced in its bid to secure a seat on the UN Security Council, despite immense diplomatic effort.

Chávez' international ambitions are also restricted by other nations' interests, principles and democratic credentials. For example, Venezuela's recent attempt to introduce measures to regulate the media within the Southern Common Market (Mercosur) raised concerns that it would limit freedom of speech and was swiftly rejected by other members of the trading bloc. Chávez' fiery radicalism has already begun to alienate some nations, which have sought to distance themselves from his sphere of



influence so as not to damage their standing with the US and Europe.

The scope of Chávez' international influence will be further impeded as the recent flood of elections throughout Latin America passes, and a new wave of presidents take office. In 2006 Chávez sought to influence several elections in the region (including, allegedly, by financing campaigns), but his influence was limited. In some cases, such as the Peruvian and Mexican elections, his support proved to be an electoral liability and the candidates that he backed were defeated.

As Chávez' international ambitions are thwarted, he will shift attention to the domestic arena, where a growing number of problems have begun to raise questions over his administration's competence and concerns over his tightening grip on power. Despite the economy's continued growth, the results of the government's erratic economic policy are becoming clearer.

The introduction of price controls on basic goods has done little to contain inflation; the annual rate remains stubbornly above 15%. Although the government tries to contain inflationary pressures, it creates new ones by injecting ever more liquidity into the economy through increased spending, subsidies and public-sector salaries.

With high inflation, currency exchange controls and an uncertain business environment, there are few incentives to save or invest. As a result, most money is channelled back into the economy, where the price controls have acted as a strong deterrent for producers, leading to shortages in basic goods from powdered milk to sugar. This in turn continues to push inflation up. The government's incoherent policies will continue to steadily erode the foundations of Venezuela's economy.

Venezuela's economic problems are matched by the security challenges facing the country. A spiralling crime and insecurity problem has continued unchecked, exacerbated by a weakening of the country's security forces. Appointments, promotions and even dismissals are now based on political affiliations rather than on merit or competence. Personal alliances and internal politics have replaced effectiveness and efficiency as the foundations of the security forces' operations. Meanwhile, the removal of any checks and balances on state institutions has fostered an endemic corruption problem.

As Chávez fails to deliver on his promises and the economy begins to falter, discontent will begin to surface. Despite securing another six-year term in the December 2006 presidential election, Chávez will become increasingly reliant on the instruments of the state to maintain his regime as economic woes and public frustrations mount. Little by little, the failings of the Bolivarian Revolution will be exposed.

The end of the revolution

Domestic pressures will force the regime to become increasingly reliant on covert and overt forms of internal repression. Chávez' grip on power will tighten, backed by his closest allies, the army and the pro-Chávez civilian militias – the Bolivarian Circles and the 15,000-strong Francisco Miranda front. The country will lapse into corruption and cronyism as the state extends its control over all areas of public life.

As Chávez becomes too strong and deeply entrenched to be removed from power, Venezuela will begin its final transformation into an openly authoritarian state. A significant decline in world oil prices or the continuing decrease in domestic production levels may serve to accelerate this process, but it would not bring about the collapse of the regime. Nonetheless, the drift towards authoritarianism would signal the end to the Bolivarian Revolution as an ideology.

Implications

Following the demise of the Bolivarian Revolution, Chávez will emulate his friend and ally, Cuban President Fidel Castro; like Cuba, Venezuela will become an authoritarian state headed by a socialist dictator who openly challenges the world order. However, like Saudi Arabia, the government will be able to escape most international scrutiny because of the country's oil reserves.

Facing a closed political system in which it has no representation, the opposition will be forced to adopt alternative tactics, including protest actions and attempts to incite civil unrest. Some groups may engage in terrorism and sabotage, targeting the oil pipelines that are crucial to the economy in a bid to undermine the regime's stability. However, with Chávez commanding the loyalty of the armed forces and his armed militias, any widespread unrest or coup attempt would be swiftly repressed.

Interestingly, little will change in Venezuela's relationship with the US, with both countries remaining estranged bedfellows. Chávez will continue his verbal attacks on the US, but attempts to divert Venezuela's oil supplies to China will fail to bear fruit. As other sectors of the economy falter, the regime will become increasingly dependent on oil revenues from the US. The US will continue to regard Venezuela as a troublesome neighbour, occasionally pressing for democratic change and greater openness, but will generally tolerate the regime and refrain from any action that would threaten crucial oil supplies.

For the rest of the world, Venezuela's influence will dwindle. However, the country will remain an important player in regional politics, particularly regarding Cuba and Bolivia. Moreover, its stock of weapons and Chávez' political grandstanding will retain the potential to destabilise other countries, primarily by helping to equip insurgent guerrilla groups.

The Bolivarian Revolution will pass into the history books. However, its architect will outlive the ideology that he created. Chávez will continue to dominate Venezuela's political landscape for some time yet, even if the price of oil falls.

Losing the war on drugs

Drug-lords lounging by the pools of their sumptuous mansions, surrounded by beautiful women and heavily armed bodyguards, with US agents in dogged pursuit. This is how Hollywood depicts the war on drugs, but it is far from the violent reality.

The heaviest burden falls on producing countries: drug-trafficking fuels violence and corrupts political and social institutions. It also funds internal conflicts, most clearly in Colombia and Afghanistan. Contrary to popular belief, the drug trade also has a negative overall impact on the economy. In consuming countries, drugs exacerbate violent crime and the corruption of social institutions, including the family.

Billions of dollars have been spent on initiatives to curb production. The largest is Plan Colombia, to which the US has contributed \$3.7bn. It aims to eradicate coca cultivation in Colombia, the world's largest producer and supplier of roughly two-thirds of all cocaine consumed in the US. The Colombian government has spent \$10.6bn on the initiative, highlighting the high cost of such programmes for countries that can often ill afford them.

Initiatives of this kind may have a positive impact in improving governance and strengthening institutions in the worst-affected countries, but their long-term effectiveness remains questionable. In many areas, drug cultivation is often the only viable choice – the alternative is likely to be starvation or intimidation – while production can shift to new countries. An abundance of statistics, covering everything from areas under cultivation to street prices, confirms the ready availability of drugs in the streets.

Despite the massive human and financial cost, the narcotics trade is thriving across the world, posing considerable security, political, legal and reputational risks for governments and businesses alike. Drug production and consumption remain critical issues and raise significant challenges for international co-operation. However, as long as the war on drugs fails to recognise the economic realities behind production – and until it starts to tackle more effectively the ready availability of lucrative markets – it is a war doomed to fail.

Africa

Angola

Political risk: M

Security risk: M; H in interior of Cabinda exclave

Presidential and parliamentary elections are expected to take place in 2007, having been delayed from 2006, though they may not take place simultaneously. An announcement that voter registration will take place between November 2006 and June 2007 was the first real sign that the government might commit itself to elections. Any further delays would result in growing opposition criticism and could lead to increased electoral tensions. The elections are likely to raise voter expectations and, as memories of the civil conflict fade, various groups are likely to increase pressure on the government. This could lead to social protests, but these would be unlikely to destabilise the regime.

President José Eduardo dos Santos and the ruling Movement for the Liberation of Angola (MPLA) will benefit from incumbency and the significant degree of control that they have over state resources to secure victory at the elections. Their position will also be buoyed by double-digit economic growth; oil output is expected to exceed 2m barrels per day in 2007. This would further concentrate power around dos Santos and his close advisers, but dos Santos will need to continue to make deals with different groups within the MPLA to secure support. Periodic reshuffles and dismissals will be used to quell dissent and remove those who become too powerful. Corruption will remain a significant concern.

Political unrest is an increasing possibility as the new electoral cycle approaches, but a national security crisis is unlikely. The country is likely to progress through the election period without a regression to past levels of insecurity. High levels of inequality and unemployment will continue to fuel crime rates. Despite an August 2006 peace agreement between the government and a faction of the separatist Front for the Liberation of the Enclave of Cabinda (FLEC), security risks in the interior of Cabinda will remain HIGH because of the significant challenges of disarmament and demobilisation, and the factionalism that characterises the group.

Benin

Political risk: M

Security risk: L; M on Nigerian border

Prospects for a stable political and economic outlook will improve following the election of political newcomer and former economist President Yayi Boni in April 2006. A young cabinet of technocrats will drive major economic reforms after former president Mathieu Kérékou's 30-year rule ended in widespread public discontent. Nonetheless, Boni faces a considerable task in the face of a burgeoning macroeconomic crisis, high unemployment and inflation. He is also likely to face vested political interests that may hamper reforms. However, his strong showing at the polls will enable him to continue to win popular support for crucial reforms, including economic liberalisation, while his reputation and economics experience will encourage support from external donors that will help to mitigate the effects of unpopular policies.

The economy will remain largely dependent on regional trade, particularly with Nigeria. Government proposals announced in May 2006 to revive the cotton sector should help to boost growth. Security conditions will remain stable, though muggings and assaults will continue to be a problem in the main cities. The incidence of armed robbery, including carjacking, on the border with Nigeria will remain high.

Botswana

Political risk: L

Security risk: L

Political tensions over the presidential transition from President Festus Mogae to Vice-President Ian Khama, which is scheduled to take place around March 2008, will widen divisions in the ruling Botswana Democratic Party (BDP) through the course of 2007. The contest for leadership positions at the BDP congress in mid-2007 will have further significance because it will indicate who might become Khama's vice-president. Opposition parties will continue to struggle to find common ground. Economic policy will remain focused on diversification, while the privatisation of Air Botswana will increase pressure for further divestments. Illegal migrants from the crisis in Zimbabwe will continue to be blamed for rising crime levels.

Burkina Faso

Political risk: M

Security risk: M

A sense of popular disillusion continues following President Blaise Compaoré's controversial re-election in November 2005, but there is an increasingly widespread view that the present regime is best placed to maintain stability and continue to achieve limited progress on necessary structural reforms. However, Compaoré's control over the army is not absolute and a coup remains a possibility. Regional instability, particularly in Côte d'Ivoire, could also disrupt the status quo.

Student groups, which have ties to unions and human rights activists, are a significant source of organised protest; they will be at the forefront of unrest if the regime fails to deliver free and fair legislative elections in 2007. Economic growth prospects will remain strong, helped by the government's adherence to strict fiscal benchmarks and poverty-reduction targets. However, the predominantly agricultural economy will remain vulnerable to external shocks, particularly climatic conditions and – increasingly, as the mining sector takes off – fluctuations in prices for mineral commodities. Socio-economic unrest will result in a continuing risk of clashes with the security forces, while levels of armed crime will continue to rise, particularly in the south, where migrant workers are fleeing the conflict in Côte d'Ivoire.

Burundi

Political risk: H

Security risk: H; E in Cibitoke, Bubanza, Bujumbura Rural provinces

Rebel activity is set to diminish after the last remaining rebel group, the National Liberation Forces (FNL), finally reached an agreement with the government in September 2006, though security conditions in FNL-controlled areas will remain extreme. As the external threat to President Pierre Nkurunziza's position fades, challenges from within his National Council for the Defence of Democracy-Forces for the Defence of Democracy (CNND-FDD) will increase; he looks increasingly powerless in the face of the challenge posed to his authority by party chairman Hussein Rujabur, long regarded as the power behind the throne.

Rujabur may seek the presidency; he enjoys strong support within the National Assembly and intelligence services and is widely believed to have the capacity to unseat Nkurunziza should he so choose. If pro-Nkurunziza forces attempt to expel him from the party, he would be likely to act to guarantee his political position and commercial interests. Concern will persist over rising corruption within the administration and its increasing intolerance of opposition activities.

Cameroon

Political risk: M

Security risk: M; H in Douala, Yaoundé, Bamenda, Extreme North province, western areas of North province, border with north-western Central African Republic

Legislative elections scheduled for June 2007 will enhance the position of the ruling Democratic Rally of the Cameroonians (RDPC). Deepening divisions within the largest opposition party – the anglophone-dominated Social Democratic Front (SDF) – will result in a further decline in its parliamentary representation and the continuing contraction of support in its North-West province heartland. The stability of the regime will continue to depend on deals struck between President Paul Biya and key regional power-brokers, particularly those in the north. As ever, the greatest risk to political stability would emanate from a succession battle following Biya's departure from office, though he is unlikely to step down – or to announce a schedule for his resignation – much before the end of his term in 2011.

The economic and administrative reform programme initiated by the technocratic government appointed in 2004 is likely to continue, though vested interests – particularly among Biya's elite supporters in Centre and South provinces – will impede tentative efforts to combat high-level corruption. Such moves will satisfy both external partners and the reformist wing of the ruling party, thereby reducing calls for change. However, the government will continue to ignore key pressure points, including the marginalisation of the anglophone provinces in the west; the transition of the Bakassi peninsula from Nigerian to Cameroonian control; and worsening security conditions in key urban areas and along the border with the Central African Republic.

Transnational insecurity in the southern Sahel

Insecurity in the tri-border areas between Chad, the Central African Republic (CAR), Cameroon and Sudan is not a new phenomenon. The inability of these states to control such areas has contributed to political instability in all except Cameroon, which nevertheless suffers serious banditry problems in its northern provinces.

Weak state control, the influx of light arms and culturally engrained respect for 'rights through seizure' have engendered an environment where, increasingly, organised banditry can flourish. Ineffectively policed borders and divergent market conditions also enable transnational crime; the illegal trade in arms, cattle and contraband goods is frequently the most dynamic local economic sector. While implicitly challenging state authority, banditry also sustains more overtly political activities. During national political crises, tri-border bandit groups – frequently comprising demobilised soldiers – are available for political co-option, adopting monikers that appear to question not only state authority, but also the incumbent government's position. Rebel organisations that evolved from bandit groups in north-western CAR in 2005, such as the Patriotic Movement for the Restoration of CAR, are one example.

The activities of such groups will be most intense in the first and final quarters of 2007, when climatic conditions are better suited to rapid movement across poorly policed borders. In the CAR, these activities are unlikely to unseat the administration, but will increase international pressure for opposition political participation. In Chad, rebels from the CAR and Sudan may prove a greater threat to the government of President Idriss Déby and will render south-eastern Chad increasingly ungovernable. For oil and mining companies looking to eastern Chad and the CAR for new deposits, this nexus of sub-regional instability will represent a considerable risk and continue to retard the development of otherwise promising territories.

Cape Verde

Political risk: L

Security risk: L

Following the re-election of the ruling African Party for the Independence of Cape Verde (PAICV) in early 2006, Cape Verde will remain politically stable and no significant policy changes are expected. Recent increases in the level of foreign direct investment (FDI) are likely to continue in 2007 and GDP growth will remain above 5% for the third successive year. The government will persist in its policy of ever closer engagement with the EU, particularly over issues of maritime security; both the EU and the US are anxious to improve levels of surveillance and control in Cape Verdean waters, which have become an important trans-shipment point for trafficking of drugs, arms and people.

Central African Republic

Political risk: M

Security risk: M; H in northern areas of Ouham, Ouham Pendé, Vakaga prefectures

President François Bozizé faces few internal threats to his position and his government will continue to make slow progress in re-establishing relations with external partners and multilateral bodies. Security concerns will continue to dominate the political environment. The north-western prefectures, which have been subject to well organised banditry and repeated rebel incursions since mid-2005, will remain unstable despite greater French involvement in counter-insurgency operations. Security conditions in the north-east are unlikely to improve, with Chadian rebel groups continuing to take advantage of a security vacuum in the cross-border area. Rebel activity is unlikely to reach a level where it threatens Bozizé's regime, but a newly invigorated opposition – led by former prime minister Martin Ziguélé (2001-03) – will use insecurity as a pretext to demand greater participation in government.

Chad

Political risk: M

Security risk: M; H in northern, eastern areas

President Idriss Déby's election victory in May 2006, following a referendum removing presidential term limits, belies increasingly fragile political stability. Although Déby remains entrenched in power, coup attempts in 2005 and 2006 and a series of high-profile army defections will leave his government increasingly vulnerable to a coup. An attempted coup in April 2006 by eastern rebel groups, which have roots in the Darfur (Sudan) conflict, underlined the gradual shift of power away from the regime. Nonetheless, the opposition will remain weak, powerless and easily co-opted. The most likely challenge to the regime will come from within restive army ranks, though a strong French military presence will remain a countering force.

The deteriorating security environment and frequent clashes between the army and rebel groups will increasingly become an operational concern, and could have an impact on the southern oil-producing regions. Emerging regional insecurity could further undermine diplomatic relations with the Central African Republic and Sudan, despite a July 2006 accord with the latter to end its support for Chadian rebels in the east. However, there is little chance of an all-out conflict with Sudan despite bellicose rhetoric. Further banditry will pose a persistent risk in eastern regions.

Déby's government will continue to seek to reassert its national economic sovereignty, particularly in the oil sector, following a long dispute with the World Bank over the management of oil revenues. Further erratic policy changes are likely to undermine investor confidence, following moves to increase state participation in the sector; this will pose significant risks for oil operators doing, or seeking to do, business in the country.

Comoros

Political risk: M

Security risk: M

External and internal pressures prevented Azali Assoumani from seeking a third term in office at the May 2006 presidential polls. However, the election of Islamist preacher and businessman Ahmed Abdallah Sambi was regarded in some quarters as equally worrying, with some foreign governments and local politicians expressing concern about the possibility of an Islamist regime taking power. Developments in 2007 are unlikely to confirm such fears. Although a moderate form of sharia (Islamic law) is likely to be introduced, the new government is too dependent on external patronage – particularly from France and South Africa – to risk endangering its pro-Western stance. Indeed, the government's record is likely to improve, with progress on tackling corruption and impunity, and a re-engagement with social expectations.

Congo

Political risk: M

Security risk: L; M in Pool region

President Denis Sassou Nguesso faces a difficult year in 2007, though his supremacy is unlikely to be challenged. He is seeking enhanced domestic and international legitimacy, for which credible legislative elections in June are crucial, as is the reconfiguration of the northern-dominated ruling Congolese Labour Party (PCT). Sassou hopes to re-found the party, reducing the northern old guard's influence and reaching new deals with southern political elites. However, the old guard has refused to go quietly, threatening to split the party.

These challenges significantly reduce the likelihood of free and fair elections and will force Sassou to engage in high levels of electoral manipulation to guarantee a PCT majority. They will also undermine his attempts to bring an end to the Ninja insurgency in the Pool region. Sassou hopes to make a deal with former prime minister Bernard Kolélas (1997) to sideline Ninja leader Frédéric Bitsangou. However, the northern politico-military elite is opposed to any agreement and low-level militia activity will continue to disrupt transport between the capital Brazzaville and the coast. The opposition – from exile and in commercial hub Pointe Noire – will continue to highlight the regime's lack of popular support, while local and international non-governmental organisations (NGOs) will continue to criticise the government's handling of oil revenues.

Congo (DRC)

Political risk: M

Security risk: H; E in north-east

See also **Congo (DRC): Consolidation or conflagration** on p. 13.

The country should experience democratic consolidation, gradual reform and improving levels of economic growth and investment in 2007, if the post-election transition proceeds smoothly. The government's control over the country will remain far from total, though the stronger state will increasingly constrain chronic militia-driven insecurity in the east and north-east, limiting it to pockets of instability. Key mining areas in Katanga province will remain sufficiently stable for foreign operations to proceed, and the extension of the central government's authority from the capital Kinshasa in the west to Kindu in the east will also offer new investment opportunities. However, the effect of continuing economic reforms will not be felt for several years, and achieving macroeconomic stability will remain a key challenge for the new administration, which will continue to be dependent on external donors.

Côte d'Ivoire

Political risk: H

Security risk: H; E in west, rebel-held north

Following the UN's announcement that presidential elections scheduled for October 2006 would be postponed, the country will enter another period of stagnation. There is little prospect of a resolution to the continuing political stalemate following the failure of the government and the rebel New Forces to agree on the contentious issues of disarmament and voter identification. Although Prime Minister Charles Konan Banny is likely to be given increased powers within the interim government, he will continue to come up against the powerful vested interests of President Laurent Gbagbo and his ruling Ivorian Popular Front (FPI). Disarmament will continue to advance very slowly, while attempts to overcome nationality and voter-identification issues will continue to be undermined by opposition on all sides.

The security situation is unlikely to differ much from 2006. Although peacekeepers will not be withdrawn in the short term, political tensions are likely to rise following various indications by Gbagbo and the FPI that they wanted UN and French forces to leave the country ahead of the expiry on 31 October 2006 of Gbagbo's official mandate. All sides seem to be benefiting in some way from the continued political deadlock. Frequent security threats are likely as government loyalists, opposition supporters and rebels continue to seek to strengthen their positions in the midst of the crisis.

Djibouti

Political risk: M

Security risk: M

Equatorial Guinea

Political risk: M

Security risk: L

After a modest contraction in 2006, the economy will rebound significantly in 2007, powered by the start of liquefied natural gas (LNG) production. However, strong FDI and impressive infrastructural development on the island of Bioko and the second city Bata (on the mainland) will continue to obscure the extremely uneven distribution of wealth and political power. Concerns will mount over the risk of social and political disorder. The former will manifest itself in rising crime rates, including crimes against foreign companies and personnel; the latter in the repeated refrain of possible coup plots, repression and purges of opposition.

Eritrea

Political risk: M

Security risk: L; H on Ethiopian, Sudanese borders

The People's Front for Democracy and Justice (PFDJ) will continue to dominate the political environment. There is little prospect of political reform, particularly given rising regional tensions over interference in Somalia. The dispute with Ethiopia, which will remain unresolved despite efforts by the international community to commence border demarcation, will continue to undermine economic prospects. The introduction of compulsory permits for travel to all areas outside the capital Asmara underlines the challenges of doing business in the country. Despite improved political relations with Sudan, the security risk along the Sudanese border will remain high because of the presence of militant opposition groups. The repressive political environment will continue to limit other security risks, such as crime and social unrest, in other parts of the country.

Africa's brain drain

At least 70,000 graduates, mainly from Ethiopia, Nigeria and Ghana, leave Africa every year for Western countries; most never return. This loss of skills seriously affects crucial sectors, including health, technology and education, but exactly how much of a pain is this brain drain?

The worst-affected governments spend an estimated \$4bn annually attracting skilled expatriates. Meanwhile, declining birth rates force some Western governments to offer incentives such as permanent residency to highly qualified migrants. West Africa suffers most from the exodus, whereas the rest of sub-Saharan Africa experiences more intra-regional migration – 'brain circulation' – though this produces the same problem: national losses of skilled labour. While annual remittances from the diaspora of an estimated \$50bn may seem crucial to economic growth, they do not compensate for the drain's socio-economic costs.

State-funded repatriation programmes can only be effective if governments address the socio-economic causes of emigration. The diaspora has begun to contribute to African development through web-based training initiatives to facilitate skills transfer and capacity-building, and there are eight established virtual knowledge networks by African expatriates worldwide. However, the implications for business remain significant.

Ironically, while skilled Africans leave because of a lack of well paid jobs, countries such as Nigeria are increasing local content requirements. Foreign investors in Africa find it difficult to recruit suitable labour, training local staff only for them to accept better opportunities elsewhere. Recruitment programmes targeting Western-educated African graduates reinforce the perception that only these are worth employing. This is an implicit indictment of Africa's education system, but also a contributory factor to migration. In response to the problem, the New Partnership for Africa's Development (NEPAD) has called for the African diaspora to be recognised as the continent's 'sixth region'. Improving socio-economic conditions must be the focus of efforts in 2007 to bring the educated back to Africa.

Ethiopia

Political risk: M

Security risk: M; H in regions bordering Eritrea, Somalia, Kenya, southern Sudan

The presidential election scheduled for November 2007 will be of little consequence because the position is largely ceremonial. However, the repercussions of the government's response to the opposition's advances in the May 2005 parliamentary elections will continue to fuel tensions. Divisions have emerged between the opposition Coalition for Unity and Democracy (CUD) and United Ethiopian Democratic Front (UEDF) over the best approach to take.

A treason case against various CUD leaders, journalists and members of civil-society could see an increase in tensions, though the security forces will clamp down on any civil unrest. As a result, small-scale explosions targeting official buildings are likely to continue. Relations with Eritrea will remain hostile and, despite the efforts of the international community, the border issue will not be resolved. The rise of the Union of Islamic Courts (UIC) in Somalia will raise additional security concerns, particularly if the government is forced to act on its promise to defend the fledgling transitional federal government in that country.

Access to finance – given restrictions on foreign companies in the financial sector – and land ownership will remain key business concerns. There will be some progress in developing power infrastructure, but the monopoly in telecommunications will underline the challenges of doing business.

Gabon

Political risk: M

Security risk: L

After two successive election years – a presidential poll in 2005 and parliamentary elections in late 2006 – President Omar Bongo's government will look to consolidate relations with the IMF, which are likely to have taken a temporary battering following the inevitable electoral budgetary overspend. Bongo will hope that the 2006 elections are sufficiently credible to re-energise his regime and reduce unusually high levels of external scrutiny following the contested presidential election. Although he will enjoy some progress in this respect, Bongo will be unable to quash external and internal speculation about his intentions towards the succession; he is widely expected to step down at the end of his term in 2012, but has shown no signs of seeking to accelerate the transition process or aggravate the competition that would be unleashed between various rival factions within his Gabonese Democratic Party.

The drive to attract foreign investment for the development of mineral resources will continue; the government will strengthen relations with China and Chinese companies in particular. Such investment will not compensate for diminishing oil revenues over the medium term, and falling incomes in key urban areas will continue to provoke periodic social unrest in the capital Libreville and Port Gentil.

Gambia

Political risk: M

Security risk: L

President Yahya Jammeh's election for a third five-year term in September 2006 came as little surprise given the opposition's failure to present a single candidate to stand against him. Jammeh will look to consolidate his victory and entrench the de facto one-party state that his ruling Alliance for Patriotic Reorientation and Construction (APRC) has come to embody. The opposition will continue to push for political change, but Jammeh's increasingly autocratic tendencies will curtail its ambitions. In the long run, companies doing or seeking to do business in Gambia will be confronted by a range of reputational risks from association with the regime, which continues to thrive on corruption, firm control over the security and intelligence services, and the repression of opposition parties and the independent press. The absence of reform and stagnant democracy will continue to limit investor confidence and interest.

Ghana

Political risk: L

Security risk: L; M on south-eastern border with Togo, border with Côte d'Ivoire

President John Kufuor is likely to step down at the end of his current and final term in 2008, but will continue to consolidate democratic reforms while in office. Economic growth will remain a priority for his government, but corruption will remain a problem. The opposition may capitalise on the economic challenges facing the government and reform programmes will continue to cause tension. The government will face increasing pressure to meet socio-economic challenges, particularly following its inability to meet poverty reduction targets in its first term, but will come under heavy criticism in its pursuit of more populist policies. Power shortages in 2006 are likely to persist in 2007. The prospects for strong foreign exchange earnings from cocoa and gold exports are set to remain robust. The government will continue its drive to adopt investment policies favourable to foreign companies. External interest in the country's crucial mining and mineral sectors is also set to expand. Although the nationwide security environment will remain stable, continuing tensions in Côte d'Ivoire and, to a lesser extent, in Togo will increase the risk of cross-border banditry and smuggling.

Guinea

Political risk: H

Security risk: M

Political tensions will increase amid uncertainty over President Lansana Conté's health and the succession, with elite factions and opposition groups manoeuvring to obtain the best position ahead of his death or permanent incapacitation. The political environment will be dominated by a hardline faction that will seek to preserve its political and commercial interests in any transition. This includes certain key players within the ruling Unity and Progress Party (PUP) and the military, and politically well-connected businessmen. Opposition groups are largely excluded from the political arena, but increased labour union activism may cause a political stumbling block for Conté.

Rampant inflation, the lingering threat of further price rises and the withholding of donor aid are likely to exacerbate economic hardship for the majority of the population and erode Conté's hold on power. Political stability is unlikely to be threatened in the short term, but there is a credible risk of an escalation in social unrest as economic problems and popular discontent increase.

The armed forces are likely to play a significant role in the transition to ensure that their privileges remain unchallenged, but are most likely to exercise influence behind the scenes to avoid the international criticism that would result from an overt takeover. In the post-Conté transition, the current elite will largely retain its hold on power, but the uncertain political environment and deteriorating socio-economic situation will contribute to widespread security risks, including civil unrest.

Guinea-Bissau

Political risk: M

Security risk: L; M in Bissau, north-western area bordering Senegal

Improving levels of political stability and higher levels of public investment in 2006 should lead to increased FDI and stronger economic prospects in 2007. Since President João Bernardo 'Nino' Vieira's victory in the 2005 election, the risk of military intervention has somewhat diminished, not least because of the overriding influence of armed forces chief of staff Gen Baptista Tagmé Na Wai over Vieira and his government. However, the fragile coalition around the president will be strained by continuing disputes between Vieira and the opposition African Party for the Independence of Guinea-Bissau and Cape Verde (PAIGC), and Tagmé's effort to cut links between Bissau-Guinean politicians and the Senegalese separatist Movement of Democratic Forces of Casamance (MFDC).

Kenya

Political risk: M

Security risk: M; H in North-Eastern province, northern districts of Eastern province, Coast province, Rift Valley

Tensions and uncertainty will build ahead of the general elections, which are expected to take place in December 2007. Alliance-building between various political parties will characterise the political environment, with various leaders switching allegiance depending on whether or not they receive the party ticket as presidential candidate. Despite concerns over poor health and his defeat in the constitutional referendum in late 2005, President Mwai Kibaki will remain a leading electoral contender, most likely on the ticket of Narc-Kenya, a newly formed party believed to be a vehicle intended to secure his re-election. The electoral success of the opposition Orange Democratic Movement will depend on the ability of a range of ambitious politicians to unify behind a single candidate, which is unlikely. Despite election promises to undertake reforms and tackle corruption, voter, business and donor expectations of the government will be tempered, unlike in 2002. Corruption and violent crime will continue to be key business concerns, while instability in neighbouring Somalia will lead to a growing

influx of refugees and fuel fears of terrorism. There will be localised violence in the run-up to the elections.

Lesotho

Political risk: L
Security risk: M

The Lesotho Congress for Democracy (LCD), with Pakalitha Mosisili still at the helm, will benefit from a splintered and disorganised opposition and is likely to remain the ruling party following parliamentary elections scheduled for May 2007. Internal divisions, which led to the formation of the All Basotho Convention in October 2006, will continue to present a challenge to party unity in both the pre- and post-election environment. Social problems relating to high levels of unemployment and HIV/AIDS will continue to affect a significant portion of the population, while unemployment will also contribute to high levels of residential and petty crime, which will remain the most significant security risk.

Liberia

Political risk: H
Security risk: M; H on border with Côte d'Ivoire

The government of President Ellen Johnson-Sirleaf – elected in landmark transitional elections in October 2005 – will face an uphill struggle to address the legacy of civil war, and her position will remain fragile in the short-to-medium term. The government's ability to tackle corruption will depend on full and effective implementation of a donor-driven programme involving external oversight of government expenditure and revenue. Corruption investigations in February 2006 increased scrutiny of top government officials, highlighting willingness to tackle the issue. Reforms introduced to downsize the public service should gradually help to ease the bureaucratic burden for foreign business, but only in the medium-to-long term. Johnson-Sirleaf's international credibility and extensive governance experience will drive good relations with external donors.

Social unrest and a stagnant economy remain significant problems. Nevertheless, a full commitment to economic reform and tackling socio-economic problems will gradually increase investor and donor confidence, and limit social unrest and instability. Companies will continue to face reputational risks in the timber and mining (particularly diamond) sectors. The investment and security environments will remain fragile because of instability in neighbouring Côte d'Ivoire, and continued financial and logistical obstacles to restructuring the armed forces.

Madagascar

Political risk: M
Security risk: M

Despite tensions in the run-up to elections in December 2006, the first months of President Marc Ravalomanana's second term in office following his victory will be considerably more stable than the opening months of his first term, in which Madagascar came alarmingly close to civil war. Economic prospects will be much improved, with growth accelerating, and there will be further gains in combating the inflationary pressures that eroded Ravalomanana's popularity in 2005 and 2006. Investment in the nascent mining sector is set to grow and key exports – including minerals, gems, shrimps and agro-industrial products – will also rise. However, increasing authoritarianism and the suppression of political opposition will persist in 2007, generating social pressures in the medium term that will undermine political stability. The mysterious sporadic grenade attacks launched against government and military targets since 2004 will continue, compounding underlying anxiety about the sustainability of political stability under Ravalomanana.

Malawi

Political risk: M

Security risk: L; M in major urban centres

Malawi will remain mired in political crisis in 2007, with embattled President Bingu wa Mutharika unlikely to score a decisive victory against his rivals within the administration or against the opposition. The treason trial of Vice-President Cassim Chilumpha and the corruption trial of former president Bakili Muluzi (1994-2004) – both regarded as key tests of the president's authority – have lapsed into stalemate, much like wa Mutharika's relationship with the National Assembly, which will continue to obstruct key government business in the absence of a clear majority for the president. Political deadlock and the administration's failure to make genuine strides in tackling corruption will undermine its popular legitimacy and dent business confidence, which was showing signs of revival following the disruption that occurred during Muluzi's final years in office. Meanwhile, security conditions in major urban areas are expected to deteriorate in the face of growing poverty and low levels of formal-sector employment.

Mali

Political risk: L

Security risk: L; M in north-east, including Gao, Timbuktu

President Amadou Touré's stable government was mildly shaken in May 2006 when former Tuareg rebels fomented a rebellion in three northern provinces in the Kidal region. However, Touré's rapid resolution of the crisis through a negotiated peace agreement will help to prevent a renewed rebellion. As presidential and parliamentary elections scheduled for 2007 approach there will be political manoeuvring among potential candidates, but Touré will remain in control of government and his consensual style of politics will remain a source of political stability. The decentralised nature of national politics will continue to boost democratic consolidation.

Nonetheless, socio-economic problems may fuel social unrest in the short term. Prime Minister Ousmane Issoufi Maiga, who has a reputation for economic orthodoxy, will continue to demand discipline in the management of the economy. Despite the peace agreement with Tuareg rebels, security risks from bandits will persist in the northern regions, particularly near the north-eastern border with Algeria and Niger. Activities by Algerian Islamic extremist groups in the northern Mali desert may become an increasing security concern.

Mauritania

Political risk: M

Security risk: L

See also **Mauritania: The challenges of democratisation** on p. 33.

Mauritania will experience significant change in 2007. Wide-ranging constitutional amendments were adopted in 2006 and paved the way for municipal, parliamentary and presidential elections in which ruling military junta the Military Council for Justice and Democracy (CMJD) will keep its pledge not to participate. The elections, which follow the ousting of Maaouiya Ould Sid Ahmed Taya as president in August 2005, are aimed at strengthening democracy and pluralism in the political system. Economic growth will be solid rather than spectacular, despite the beginning of oil production in 2006.

Low-level security risks will persist in the remote desert region. Although the government has co-operated with the US in the war on terror and is participating in the Trans-Saharan Counter-Terrorism Initiative (TSCIT), Islamic extremist activity will represent a continuing threat over the year.

Mauritius

Political risk: L

Security risk: L

Political stability is guaranteed, though the government of Prime Minister Navin Ramgoolam will face a number of economic challenges in 2007, including halting the slide of key exports; managing the trade and budget deficits; and stalling the rise in unemployment. The government has still to adapt to the gradual loss of trade preferences and investment processes are relatively antiquated; some progress must be recorded in 2007 if the administration is to capitalise on its strong showing in the 2005 parliamentary elections and the weakness of the opposition Mauritian Militant Movement-Mauritian Socialist Movement (MMM-MSM) coalition.

Mozambique

Political risk: M

Security risk: M

The country's first provincial polls are scheduled to take place in 2007, commencing a cycle that will see municipal elections in 2008 and general elections in 2009. However, the polls are likely to be delayed to allow time to review electoral legislation; determine the role that provincial legislatures will play; examine the associated costs; and consider the impact of three consecutive, rather than simultaneous, elections. President Armando Guebuza is likely to be re-elected as party president at the next congress of the ruling Frelimo, which will take place in 2007. This will strengthen his mandate to push forward his reform agenda, which some suspect is being hampered by resistance within the party. Frelimo will dominate the provincial elections, if they take place, further consolidating its dominance of the political environment. Afonso Dhlakama, after leading the opposition Renamo through three failed elections, will face increasing challenges to his leadership, undermining the party's electoral prospects.

Corruption, bureaucracy and the poor state of infrastructure will remain the most significant challenges to business. The government will face strong resistance from unions over planned legislation expected in late 2006 or early 2007 that would make it easier to hire and dismiss workers. Crime will remain the most significant security risk.

Namibia

Political risk: L

Security risk: L

The next presidential and parliamentary elections will not take place until 2009, but the ruling South West African People's Organisation (SWAPO) congress, which will take place in the first quarter of 2007, will be crucial in determining who will lead the party at the polls. Former president Sam Nujoma (1990-2005) has promised to stand down, but it is credible that he could renege on his commitment and look to assert himself as party president for life. If he stands, Nujoma is likely to succeed in retaining the SWAPO presidency, but President Hifikepunye Pohamba will increasingly use allegations of corruption to sideline him and gain greater control over party functions. This will allow Pohamba to continue his efforts at reform. Future developments and business confidence are highly dependent on the outcome; should Pohamba fail, Nujoma will continue to exert an inordinate influence over the administration.

Niger

Political risk: M

Security risk: M; H in northern Agadez, Libyan border regions and along south-eastern border with Nigeria

Although President Mamadou Tandja – elected in 2004 for a second five-year term in relatively free and fair elections – has contributed to an emerging democratic ethos, socio-

economic unrest will emerge as a potential threat to long-term political stability. Demonstrations and strikes in 2006 highlight popular frustration with rising prices for key commodities and services, including fuel, health care, education and water. They also underline an increasing tendency for such concerns to be voiced through street protest. There is a latent threat of a military uprising, though this would be unlikely to pose a major threat to stability.

Continued instability elsewhere in West Africa will burden Niger's economy, which is dependent on Ivorian exports. The government will make further attempts to attract foreign investment in the extractive sectors, particularly mining. Tuareg activity along the borders with Algeria and Libya represents a significant challenge to security. There is a risk of kidnap by militants in these areas, but recent US military training initiatives in the region may help to contain any potential spread of terrorism from Algeria.

Nigeria

Political risk: M

Security risk: M; H in Niger delta

See also **Nigeria: Fanning the flames of instability** on p. 35.

President Olusegun Obasanjo's current term in office is likely to be his last, but the political environment will continue to be affected by lingering tensions between Obasanjo and Vice-President Atiku Abubakar, and by political manoeuvring ahead of the general elections scheduled for April 2007. These are likely to prompt an increase in social unrest and violence, particularly in the Niger delta, but to a lesser extent in other regions. Economic policy will continue to revolve around the National Economic Empowerment and Development Strategy (NEEDS), which is scheduled to be completed in 2007.

Rwanda

Political risk: M

Security risk: L; H on border with Congo (DRC); M on border with Burundi

Strengthening economic performance in 2007 will underline the astute stewardship of President Paul Kagame's technocratic regime. There will also be progress in stopping the slide of Kagame's international standing; levels of co-operation with the International Criminal Tribunal for Rwanda (ICTR) will be much improved, while relations with neighbouring Congo (DRC) will continue to thaw with Kagame's belated realisation that stability in Congo is necessary to Rwanda's security. Improving the government's international reputation is crucial, given that the administration's domestic legitimacy will continue to fall. Further defections and flights into exile among former regime insiders can be expected, with an increasingly substantial proportion of the Rwandan opposition mobilising overseas. Broad political stability will be maintained – underpinned by Kagame's guarantee of state security – but at the expense of press freedoms and restrictions on opposition activity. Moreover, with security conditions along the border with Burundi expected to stabilise following a peace agreement between the latter's government and its last remaining rebel group, the political weight of Kagame's security-driven agenda will diminish and alternative sources of legitimacy will need to be found.

São Tomé and Príncipe

Political risk: M

Security risk: M

After securing a decisive victory in the 2006 elections, President Fradique de Menezes and the ruling Movement of Forces for Democratic Change-Democratic Convergence Party (MDFM-PCD) will seek to drive through a number of key reforms in 2007, unshackled from the destabilising cohabitation with the opposition Movement for the Liberation of São Tomé and Príncipe-Social Democratic Party (MLSTP-PSD). Having reformed the tax regime in late

2006, the government will prioritise anti-inflationary policy and revive efforts to attract foreign investment in the non-oil sector. De Menezes may also revive efforts to modify the constitution to clarify the respective jurisdictions of the National Assembly and the presidency, and to reinforce the latter's supremacy.

With the political situation considerably more stable, the risk of a coup seems much reduced. However, there is a continuing risk of social disorder if the administration does not introduce reforms to boost the grassroots economy, increase employment and control the spiralling cost of living. As usual, vested interests will prevent de Menezes from pushing through key anti-corruption measures, and questions regarding the management of the oil sector will continue to be raised.

Senegal

Political risk: L
Security risk: L; M in Casamance region

The political environment is stable and democracy is entrenched; there is little risk of an unconstitutional change of government. President Abdoulaye Wade enjoys a high standing in the international community, but is increasingly unpopular at home and has a domineering style of government that has caused divisions in the ruling coalition. Wade will stand in the 2007 presidential election, despite his age, where his most credible challenger is former prime minister Idrissa Seck (2002-04). There is a risk that the government will use politically motivated corruption charges against Seck to derail his challenge. Since Wade's inauguration in 2000, there have been four prime ministers and six governments, underlining concerns about his creeping autocracy. An electricity crisis resulting in rolling blackouts in the capital Dakar has further undermined the government's reputation.

The Casamance insurgency appeared to have weakened following a peace agreement with the government in 2004, but a new wave of rebel attacks in the region since mid-August 2006 suggests a possible resurgence of the crisis. Occasional skirmishes will continue to underline the fragility of the peace process and do not bode well for security in the short term.

Seychelles

Political risk: L
Security risk: I

Stability and continuity is assured following President James Alix Michel's victory in presidential polls in July 2006, despite concerns before the election about rising tensions and unusual incidents of political violence. However, Michel's election win was hardly a ringing endorsement of the head of state. The ruling Seychelles People's Progressive Front (SPPF) will face another stern test at the November 2007 legislative elections; the opposition Seychelles National Party (SNP) performed well in the 2006 polls, while another year of economic contraction will belie the SPPF's efforts to liberalise markets and attract tourists.

Sierra Leone

Political risk: M
Security risk: M

President Ahmed Tejan Kabbah should step down in 2007 after serving two terms in office. The ruling Sierra Leone People's Party (SLPP) will remain a powerful force, but will find it difficult to gain ground in the north, where the opposition All People's Congress (APC) has a large following. The SLPP presidential candidate, Vice-President Solomon Berewa, will increasingly emerge as a popular figure and strong contender against opposition party candidates at the election.

Public investment in infrastructure and agriculture will continue in 2007, with the backing of external donors. Economic policy will centre on implementing wider IMF- and World Bank-

backed programmes on poverty alleviation and economic growth, but there is an increasing risk that donors may restrict funding if the implementation of reforms is haphazard. Revenue losses through smuggling – particularly diamonds – will mean that the country will continue to depend on donor support. Vested political interests wishing to maintain the status quo will interfere with the pace of economic reform.

The departure of the UN Peacekeeping Mission in Sierra Leone (UNAMSIL) and its replacement by the civilian UN Integrated Office for Sierra Leone (UNOSIL) in 2005 have seriously tested security conditions. Reported crime increases, particularly in the capital Freetown, are likely to continue until the security forces and police become more adequately equipped to combat them. While the newly trained security force will be adequate to maintain a level of stability, concerns over poor security along the border with Guinea and Côte d'Ivoire will linger.

Somalia

Political risk: E; H in Somaliland

Security risk: E; H in Somaliland

Somalia faces an uncertain year in 2007. Given the threat presented by the Islamic extremist group Al-Ittihad al-Islamiya (AIAI) in the late 1990s, Ethiopia will not take the increasing power of the Union of Islamic Courts (UIC) lightly. Any power-sharing agreement between the Ethiopia-backed transitional federal government and the UIC is likely to be precarious; the UIC will look to extend its control across the entire country, raising the prospect of clashes with the government. Fears that Somalia is becoming a base for Islamic extremism will force Western countries to become more engaged, to little effect. Conflict will have a regional impact, with refugees fleeing to more stable areas such as northern Kenya and Somaliland.

South Africa

Political risk: L

Security risk: M; H in deprived urban areas

See also **South Africa: The man who would be president** on p. 41.

High crime levels will continue to pose a major concern for business in 2007; initiatives between the government and business to combat the issue will only have a minor impact, while criticism of the government's approach to the problem will grow. Social protests over the slow pace of service delivery could also gain momentum, particularly if the African National Congress (ANC) leadership battle raises popular expectations of change. Large-scale infrastructure projects – such as stadiums for the 2010 FIFA World Cup football (soccer) tournament and the Gautrain rail link – will start to show signs of progress, though power supply constraints will remain a concern. Renewed efforts to address the crisis in Zimbabwe will have little effect, and will continue to undermine the country's foreign-policy agenda.

Swaziland

Political risk: M

Security risk: M

There will be little significant change in the political environment, which King Mswati III dominates, despite some minor protests by the banned opposition People's United Democratic Movement (PUDEMO) and the Swaziland Federation of Trade Unions (SFTU). The general climate of repression will continue to force the opponents of Africa's last absolute monarchy towards more drastic measures, such as firebombings. The EU's reform of sugar tariffs will undermine already limited economic prospects, while the introduction of value-added tax (VAT – sales tax) could face further delays.

Resource nationalism in sub-Saharan Africa

Since 2003, several Latin American countries have seen a startling rise in so-called 'resource nationalism'. Driven by high global commodity prices and a desire to extract maximum value from foreign-controlled extractive sectors, some leftist administrations have pushed through aggressive reforms – nationalising private companies, hiking royalties and introducing burdensome local content requirements. These represent a major risk to the business environment. Given the dependence of many African countries on extractive revenues, do similar processes threaten business activity on the continent?

Recent developments apparently bode ill; the Chadian government in 2006 took aggressive measures to strengthen its control of the oil sector, while in Zambia a populist opposition election campaign raised the possibility of a reversal of pro-business reforms. Elsewhere – for example, in Angola and Equatorial Guinea – new legislation has sought to guarantee closer involvement of local companies. Resource 'sub-nationalisms' have also emerged, with growing calls in the oil-producing region of Congo (Brazzaville) for greater derivation of oil revenues.

With commodity prices soaring, such trends are likely to continue in 2007. However, while promises of enhanced resource control may be a useful electoral campaigning strategy in Africa, the lack of accountability of most African governments (particularly those of countries dominated by extractive industries) means that they feel little compunction to satisfy the resulting popular expectations. The threat of resource nationalisation is more frequently a bargaining tool to increase the limited leverage of African governments in the face of continuing dependency. The influence of multilaterals and Western donors outstrips the ability of even well resourced African states to do without their support, while the restricted technical capabilities of African parastatals make resource nationalism not only economically illogical but politically unsound, given the sustenance that buoyant extractive industries provide to ruling elites.

Tanzania

Political risk: L; M in Zanzibar archipelago

Security risk: L; M in Zanzibar archipelago, north-western areas towards Rwanda, Burundi

The political environment will remain stable under the dominance of President Jakaya Kikwete and the ruling Chama Cha Mapinduzi (CCM), though Zanzibar will remain politically troublesome, particularly given increasing oil exploration activity in the region. The government will continue to make slow progress with economic reforms and tackling corruption, though senior CCM figures will not be targeted. Efforts to increase the royalties paid by mining companies will test the government's commitment to promoting foreign investment. Divisions in Kenya and difficulties in Uganda mean that donors and the international community will see Tanzania in an increasingly positive light, but power generation and bureaucracy will present major concerns. Increasing stability in neighbouring Burundi will result in improved security along the shared border.

Togo

Political risk: M

Security risk: M

Many hoped that a peace deal signed in August 2006 between the government and the opposition would help to end the damaging deadlock that has dominated politics since the April 2005 elections. President Faure Gnassingbé has sought to boost recent reconciliation efforts by appointing key opposition figure Yawovi Agboyibo as prime minister. Agboyibo will

have the difficult task of securing the full participation of the opposition and will come under pressure to demonstrate that he is not merely a stooge of Gnassingbé and his ruling Rally of Togolese People (RPT); the opposition Union of Forces for Change (UFC) will remain suspicious that the RPT will continue to dominate the government and will not allow genuine opposition participation. A crucial test of the peace deal will be the extent to which it overrides vested interests within the RPT that could threaten political and economic reform; the RPT is likely to make every effort to protect its interests. Continued political tensions and the heavy-handed tactics that the security forces often employ against opposition supporters, particularly in the north of the country, will remain the main sources of insecurity.

Uganda

Political risk: M

Security risk: M; H in northern, north-eastern areas, border areas with Congo (DRC)

President Yoweri Museveni will consolidate his political control, while Kizza Besigye and the Forum for Democratic Change (FDC) will fail to present a credible opposition. This could result in increased political tensions as Museveni's opponents look for alternative means to highlight the limits of democratic reforms – which saw the introduction of a multiparty system – ahead of the Commonwealth Heads of Government Meeting in November 2007. As in Tanzania, power generation problems will concern business. Donor relations will remain fraught. The discovery of oil in Lake Albert will generate increasing interest, but will have little real impact on economic growth.

Efforts to end almost 20 years of conflict with the rebel Lord's Resistance Army (LRA) in late 2006 will face significant challenges if there is to be an enduring peace agreement. Despite several extensions, a ceasefire agreement is likely to fail; International Criminal Court (ICC) arrest warrants for senior LRA leaders will not be rescinded. Difficulties over disarmament, demobilisation and provision of alternative economic opportunities will threaten to undermine any progress. As a result, security risks will remain high in areas where the LRA has a presence, as well as in north-eastern areas affected by Karamojong activity.

Zambia

Political risk: M

Security risk: L; M in Congo (DRC) border areas, Northern, Luapula provinces, Lusaka, parts of Copperbelt

President Levy Mwanawasa will consolidate his position in 2007 after his disputed victory in the September 2006 presidential election. However, the ruling Movement for Multiparty Democracy (MMD)'s narrow majority will encourage the opposition. Given his slim hold on power, Mwanawasa is unlikely to actively drive through the promised new constitution, a basic law that would substantially reduce the power of incumbent administrations at future elections. However, any further delays could compromise his hard-won, if somewhat exaggerated, reputation for good governance and lead to increased tensions and periodic demonstrations.

Mwanawasa will persist with pro-business and pro-donor policies. However, opposition leader Michael Sata's powerful, populist election campaign – which centred on closer regulation of the mining sector and greater state involvement in the extractive industry – will drive Mwanawasa to adopt similarly populist rhetoric. This will not result in a systematic reversal of pro-market reforms but could pressure the government to deal more aggressively with mining companies and may pose a risk to negotiations over a planned increase in mining royalties.

Zimbabwe

Political risk: H

Security risk: H

The failure of trade union and opposition protests in the winter months of mid-2006 to attract significant levels of support and threaten the stability of President Robert Mugabe's regime underlines the opposition's struggle to have any meaningful political impact. As a result, the economic and political crisis is likely to continue, while proposals to delay the presidential election scheduled for 2008 until 2010, when parliamentary elections will be held, suggest that Mugabe's presidency might continue for longer than many in the international community hope. Further economic decline remains the main threat to Mugabe's regime, but as long as dissent within the security forces is kept under control, the climate of repression will limit political and civil protests. Mugabe will also retain control of the ruling Zimbabwe African National Union-Patriotic Front (ZANU-PF), despite continuing wrangling for position to succeed him.

The business environment will remain extremely challenging, with further fuel, power and foreign-currency shortages. As the crisis continues, security risks will increase; crime rates will be driven by unemployment levels of more than 80%.

Americas

Argentina

Political risk: M

Security risk: L; M in Buenos Aires, tri-border area

Campaigning for the October 2007 presidential election will dominate the political environment. Either President Néstor Kirchner or his wife, Senator Cristina Kirchner, will run and win at the head of a coalition dominated by old-style Peronists and Kirchner allies. Former economy minister Roberto Lavagna, businessman Mauricio Macri and Neuquén province governor Jorge Sobisch will compete to lead the anti-Kirchner camp.

The legislative agenda will stagnate in 2007 as Kirchner devotes his energies to consolidating his support ahead of the elections. The president will continue to make full use of executive decrees and his considerable powers of patronage, relying on a coterie of advisors and allies. This will reinforce concerns over Kirchner's centralising tendencies and confrontational stance.

Economic growth will slow in 2007. Uncertainty over the government's economic policies will persist as it continues to rely on heterodox measures including export taxes and price controls to curb inflation. Venezuela will remain the country's principal credit supplier. Consequently, business confidence will remain subdued, deterring new investment and deepening concerns over capacity constraints. Companies will also be wary of the persistent lack of a clear regulatory framework, an absence of legal guarantees and Kirchner's combative style.

Crime rates will improve gradually as a result of sustained economic growth, with reductions in both violent and petty crime. However, opportunistic street crime and express kidnapping will remain credible risks, particularly in the capital Buenos Aires. Strike action by picket groups (*piqueteros*) will continue to cause sporadic disruption. Security risks are higher in the tri-border area, which remains a centre for smuggling and drug-trafficking.

Bolivia

Political risk: H

Security risk: M

Although government rhetoric will continue to focus on the nationalisation of key industries, policy changes during 2007 will be relatively limited. Extreme measures, such as the expropriation of companies' assets without compensation, will not occur. Radical elements within the government and the ruling Movement to Socialism (MAS) party will undermine President Evo Morales' credibility. Morales will face simultaneous pressures from the US to clamp down on coca production, and from coca growers (*cocaleros*) – his core constituency – who continue to oppose crop-eradication measures.

The main source of political instability will be regional tensions over the Constituent Assembly's drafting of a new constitution. The MAS will continue its attempts to manipulate the assembly to secure a constitution that would favour the traditionally marginalised indigenous population and strengthen the central government to the detriment of regional autonomy. However, opposition representatives for the eastern departments of Santa Cruz, Tarija, Beni and Pando will resist these efforts.

There remains a credible risk that demonstrations by various militant groups will degenerate into civil unrest, particularly in the capital La Paz. Crime is not expected to increase significantly and will remain relatively low by regional standards. However, poor socio-economic conditions, enduring political tensions, and corruption and deficiencies within the security forces will fuel both petty and violent crime.

Brazil

Political risk: M

Security risk: L; M in Rio de Janeiro, São Paulo, Salvador da Bahia, Recife, tri-border area

See also **Brazil: Growing pains** on p. 7.

Despite securing a second term, President Luiz Inácio 'Lula' da Silva faces the challenge of building a viable coalition after his Workers' Party (PT)'s losses in the elections. He will attempt to advance tax and political reforms. Continued adherence to an orthodox macroeconomic strategy and business-friendly policies will ensure sustained foreign investment, though failure to push through structural reforms will reinforce concerns over long-term competitiveness.

High levels of petty and street crime will persist, fuelled by economic disenfranchisement, while urban-based criminal gangs will retain the capability to undertake highly disruptive co-ordinated operations similar to the wave of attacks orchestrated by the First Command of the Capital (PCC) organised crime gang in São Paulo during 2006. The tri-border will remain a focal point for the smuggling of drugs, arms and counterfeit goods.

Canada

Political risk: L

Security risk: L

Prime Minister Steven Harper is unlikely to call a general election in 2007, though minority governments, such as the current administration, tend to be short-lived. The ruling Conservative Party must make significant inroads in French-majority Quebec province before Harper can be certain of securing a majority in a further poll. The opposition Liberal Party has lost significant support after a corruption scandal led to its defeat in the January 2006 general elections.

The country faces a credible threat of a terrorist attack by Islamic extremists, largely because of its continued involvement in Afghanistan and its support for other aspects of the US-led global war on terrorism. However, most terrorist activity in the country will continue to focus on fundraising and logistical support for attacks in the US or against US interests, as well as against Jewish targets in Canada. Crime levels will remain low.

Chile

Political risk: L

Security risk: L

President Michelle Bachelet will maintain the political and economic orientation of her predecessor Ricardo Lagos (2000-06), and the country will remain the most stable in the region. The most significant challenge facing Bachelet in 2007 will arise as a by-product of continued economic growth, with social sectors and interest groups putting pressure on the government to increase spending. Bachelet will seek to retain the political initiative, while preserving fiscal discipline, by undertaking pension reform, the success of which should be assured by the ruling *Concertación* coalition's legislative majority. However, Bachelet will seek cross-party consensus before attempting to eliminate the enduring institutional vestiges of the dictatorship of Gen Augusto Pinochet (1973-90).

Chile has an attractive foreign investment environment that offers strong regulatory structures, a transparent and independent judicial system, and low corruption levels by regional standards. Economic growth will remain robust. Even if the copper price falls, the economy can expect to benefit from the country's numerous free-trade agreements.

Public concerns over crime will persist, though the country will remain one of the safest in the region. Petty and street crime in urban areas will continue to represent the greatest security risk to foreign personnel.

Is kidnapping still a risk?

Kidnapping has long been a key security concern for business in many parts of the world, but in the last couple of years Control Risks – which has monitored worldwide kidnap trends for several years – has recorded an overall decline in the number of reported abductions.

The fall is almost entirely the result of a significant decrease in the number of kidnaps recorded in Colombia. Under President Álvaro Uribe, stringent security measures and sustained military offensives have weakened the guerrilla groups that traditionally carry out kidnaps. Mexico has now taken over as the world's kidnapping hotspot, but its figures do not compare with Colombia at its worst, which peaked at 2,469 cases in 1999 and remained above 1,000 per year until 2004.

Disregarding Colombia, the figures remain relatively steady. In the last couple of years Mexico, Brazil, Haiti, Trinidad and Tobago, Iraq and Venezuela have all recorded high levels of kidnapping. While Latin America remains by far the worst-affected region, events in the Middle East (Iraq and the Palestinian Territories) and Africa (Nigeria) have led to a sharp increase in kidnaps. Foreigners account for 25% of victims; Somalia, Iraq, Haiti, Sudan, Nigeria, the Palestinian Territories and Yemen recorded the most incidents involving foreigners. Business personnel and their dependants, both local and foreign, are the most common victim types worldwide.

While falling kidnap rates are good news, it is too soon to determine how long this downward trend will last. Levels will continue to fluctuate according to a country's individual circumstances; a security vacuum (as in Haiti) can bring an increase in abductions, while a security crackdown (Colombia) or an improved economy (Argentina) may reduce the problem. The nature of the crime is also shifting; in some countries, short-duration 'express' kidnaps are beginning to last longer, blurring the line with 'traditional' kidnap-for-ransom.

Given the unpredictable nature of kidnapping trends, it is important not to become complacent. Companies must continue to ensure that personnel in high-risk countries are properly briefed, have adequate protection and follow sensible security measures.

Colombia

Political risk: M

Security risk: M; H in rural areas

The political agenda in 2007 will focus on bolstering the peace process and consolidating improvements in the security situation. Continued gradual progress in tackling the country's security problems is likely, laying the foundations for further improvement in 2008. However, crime will remain a significant threat, fuelled by poverty, the presence of drug-trafficking gangs, widespread availability of firearms and social problems stemming from the country's armed conflict.

The demobilisation of right-wing paramilitaries linked to the United Self-Defence Forces of Colombia (AUC) will gather momentum, especially as the controversial Justice and Peace Law begins to take effect. However, the process will be marred by crises and impasses, especially as some of the AUC's worst atrocities are revealed. Progress will also be made in negotiations with the leftist National Liberation Army (ELN) guerrilla group. Exploratory talks will develop into a formal peace dialogue, resulting in a limited cessation of hostilities or even a formal ceasefire declaration. The larger Revolutionary Armed Forces of Colombia (FARC) will continue to stage attacks against government and military targets, particularly in rural areas. However, a peace process between the government and the FARC will be increasingly discussed towards the second half of 2007.

President Álvaro Uribe will push through most of his legislative agenda on pension, tax, education and health reforms. The government will also privatise several important state

assets, including part of the state oil company Ecopetrol. However, divisions will begin to emerge in the ruling coalition by the end of 2007, as several politicians with presidential aspirations move to differentiate themselves.

Costa Rica

Political risk: L
Security risk: L; M on the Nicaraguan border

President Oscar Arias will continue efforts to rebuild trust in the country's political institutions and will act swiftly against any alleged corruption. Growing social and economic pressures will occasionally prompt peaceful unrest but will not undermine the country's traditional political stability. The government's main challenge will come from demonstrations against the Central American Free-Trade Agreement (CAFTA), which will be ratified despite opposition from several political parties and some sectors of the population. Crime rates will remain low by regional standards, though security risks are higher in the northern border area, where both local and Nicaraguan armed criminal gangs are known to operate.

Cuba

Political risk: H
Security risk: L

Doubts over the regime's future without President Fidel Castro will persist after illness forced him to cede power in 2006 to his brother and designated successor, Defence Minister Raúl Castro. Raúl's leadership will not assuage concerns over the regime's long-term viability, which will depend on the armed forces and senior members of the Cuban Communist Party (PCC). The thrust of US policy towards Cuba will remain unchanged. The government will be boosted by the economy's continuing revival, spurred by Venezuelan aid. However, investor sentiment will remain cautious as doubts persist over the regime's future. Crime rates will remain low, though a poorly managed leadership transition could lead to unrest and a resultant increase in crime.

Dominican Republic

Political risk: L
Security risk: M

The legislative majorities won by the ruling Dominican Liberation Party (PLD) in the 2006 mid-term elections will boost President Leonel Fernández' efforts to consolidate macro-economic stability. The electoral gains will also allow for a renewed effort to tackle corruption, which remains a major operational risk. Problems with electricity provision will persist, though the Fernández government is likely to honour its pledge to phase out electricity subsidies totalling \$500m by December 2007. The subsidies' withdrawal is likely to be accompanied by electricity price hikes, eroding Fernández' popularity, while implementation of CAFTA will not bring a tangible pay-off in the short term. Drug-trafficking and other forms of organised crime, together with the proliferation of firearms, will continue to fuel crime rates, despite the use of military personnel in anti-crime operations.

Ecuador

Political risk: M
Security risk: L; M in Quito, Guayaquil, Manta; H in Colombian border areas

The chronic instability and lack of governability that has led in the past few years to the overthrow of several presidents will plague the government. A clear set of initial policies will mutate into an incoherent assortment of contradictory initiatives by the end of 2007, as the administration is forced to build uneasy political alliances to advance its legislative agenda.

Cuba after Castro

The question of how long President Fidel Castro can last in office has assumed added resonance since July 2006, when illness forced Castro to temporarily cede power to his brother Raúl. As a post-Castro era draws closer, what does the future hold for Cuba?

Castro's passing will have a profound political and psychological impact; around 70% of Cubans have never known another leader. Yet the calm that followed news of his illness indicates a notable degree of institutional and social stability, forged from decades of one-party rule. Social upheaval, while possible, will not be inevitable when Castro dies.

The lifespan of a post-Fidel regime would largely depend on Raúl's ability to hold the system together and retain the military's backing. Senior officers would certainly be unlikely to withdraw support for a system from which they benefit handsomely. Meanwhile, Raúl's call for an 'institutional succession' through the Cuban Communist Party (PCC) suggests that he realises that he will never match his brother's iconic status.

Raúl is 75 and there are few veterans of the revolution remaining. An institutional succession involving a younger generation of pragmatists offers the hope of a less doctrinaire approach on key issues. In this context, a slow political opening and gradual engagement with the US would be a possibility.

The US government's reaction to a post-Fidel era will be critical. US policy would not change towards a Raúl-led government, but the US may seek to quicken Raúl's demise. As ever, the exiled Cuban community in Florida will help to shape US policy. However, US military intervention remains unlikely.

Another factor will be Venezuelan President Hugo Chávez' burgeoning influence. However, Cuban public opinion is likely to support domestic solutions to future issues. History demonstrates that Cubans will resent heavy-handed meddling in the country's affairs by any foreign power, be it Venezuela or the US.

Critical initiatives, including structural reforms to the political system, will make way for piecemeal measures more notable for their symbolic value than for their content.

Disputes over a free-trade agreement with the US will resume, possibly leading to renewed, widespread civil unrest. Continuing political tensions, coupled with high-profile corruption scandals and a failure to address growing social concerns, will further undermine trust in political institutions and increase the pressure on the government. Although the president will survive into 2008, the government will be largely ineffectual and its stability questioned. Such an environment will remain a significant deterrent for foreign investment into the country.

Crime rates will continue their gradual rise but will remain low by regional standards. Petty crime will remain the main risk for foreign personnel, particularly in Quito, Guayaquil and Manta. Kidnapping will increase but will largely affect wealthy local individuals rather than foreigners. Security risks will remain considerably higher near the border with Colombia, despite government efforts to impose law and order; Colombian guerrilla groups regularly cross into Ecuador and engage in various criminal activities.

El Salvador

Political risk: M
Security risk: M

The ruling National Republican Alliance (ARENA)'s lack of a legislative majority will force President Tony Saca to rely on ad hoc alliances to advance his policy agenda. Nonetheless,

Caribbean

Anguilla

Political risk: I
Security risk: I

Antigua and Barbuda

Political risk: L
Security risk: L

Aruba

Political risk: L
Security risk: L

Bahamas

Political risk: I
Security risk: L

Barbados

Political risk: I
Security risk: L

Belize

Political risk: L
Security risk: L

Bermuda

Political risk: I
Security risk: L

British Virgin Islands

Political risk: I
Security risk: I

Cayman Islands

Political risk: I
Security risk: L

Dominica

Political risk: I
Security risk: I

French Guiana

Political risk: L
Security risk: L

the leftist opposition Farabundo Martí National Liberation Front (FMLN) will be able to veto major legislation that requires an absolute majority. Political tensions will persist over deep-rooted social inequalities, the perceived failure to fully implement judicial and social aspects of the 1992 peace accords, and the expanding debt burden. Significant improvements in the security environment are unlikely; high crime levels will persist, and gang-related violence will remain a major problem.

Guatemala

Political risk: M
Security risk: M; H in Guatemala City

Campaigning for the September general elections will dominate the political landscape in 2007. Public disillusionment with President Oscar Berger's government will benefit the opposition, particularly the leftist National Unity for Hope (UNE) party. Alvaro Colóm, the UNE's defeated candidate in the 2003 presidential contest, is likely to run again and has a good chance of securing the presidency.

Crime is the main security threat, and the situation will not significantly improve during 2007. Social unrest, particularly as a result of unfulfilled government promises regarding land reform, will remain latent. Corruption will continue unabated and remain the main operational risk in the country.

Guyana

Political risk: L
Security risk: M

Political risks will recede as controversy over the 2006 general elections subsides. President Bharrat Jagdeo's government will seek to engage more closely with the opposition People's National Congress/Reform (PNCR), reducing the scope for political and ethnic violence. Measures to combat crime and foster economic development will prove largely ineffective. Violent crime will remain the key security risk, particularly in low-income areas of Georgetown, the East Coast Demerara region and the villages of Buxton and Friendship. However, increased security for the 2007 Cricket World Cup in March and April will temporarily reduce crime rates. An arbitration ruling on a protracted territorial dispute with Suriname will not undermine bilateral relations and will improve the investment environment.

Haiti

Political risk: H
Security risk: H

Political stability, though fragile, will improve as President René Préal's government continues to benefit from international support in the form of the 8,000-strong UN Stabilisation Mission (Minustah) and significant donor assistance. The government will focus on restoring law and order, building a viable institutional framework and driving economic growth. However, the scale of the challenges facing the administration will mean that progress is slow; problematic issues will include gang violence, corruption within the police, the dysfunctional judiciary and the brittle state of the government coalition. The security situation will remain problematic, with kidnapping, carjacking, armed robbery and bouts of unrest posing persistent risks.

Honduras

Political risk: L

Security risk: M

President Manuel 'Mel' Zelaya's government will continue to focus on improving the country's fiscal position by following IMF recommendations to secure further debt relief. However, the economic situation is unlikely to improve significantly during 2007, resulting in sporadic protests by labour unions and other pressure groups. Although Zelaya favours foreign investment, his stance on environmental issues means that his government is likely to give in to pressure by community and environmental activists, particularly over projects in the extractive and energy sectors.

The security situation is not expected to significantly improve during the year, despite Zelaya's promises to tackle crime. Serious crimes including murder and kidnapping are likely to continue their growing trend.

Jamaica

Political risk: M

Security risk: M; H in Kingston, Spanish Town

General elections scheduled to take place by October will dominate politics in 2007. Prime Minister Portia Simpson-Miller of the People's National Party (PNP) will face opposition leader Bruce Golding of the Jamaica Labour Party (JLP). The PNP is likely to use its majority in parliament to enact populist policies aimed at boosting its electoral prospects. Such measures may overstretch public finances and create inflationary pressures that could fuel popular protests. Relations between the two main parties will become more strained as the elections approach, with a probable increase in political violence. Although the murder rate is likely to continue to fall, high levels of violent crime will remain the main security threat in 2007.

Mexico

Political risk: M

Security risk: M

Political polarisation and distrust in state institutions will endure throughout 2007. President Felipe Calderón's administration will adopt a moderate, consensual approach with the opposition to secure more widespread political support. However, the 'parallel government' created following the disputed presidential election of 2006 and headed by defeated candidate Andrés Manuel López Obrador of the leftist Party of the Democratic Revolution (PRD) will fuel political tensions and undermine Calderón's authority. Calderón is likely to pursue alliances in Congress and with opposition state governments to defuse this opposition movement. Despite his commitment to implementing structural reforms, including changes to tax, energy and labour regulation, Calderón will not pursue these initiatives during 2007.

Although the government will almost certainly attempt to tackle high crime levels, the security situation is unlikely to improve significantly during 2007, particularly in Mexico City. Violent crime will continue to represent the main security threat to businesses. Drug-related violence will continue unabated, particularly in coastal and northern states, but will only present indirect risks to legitimate businesses. An unresolved civil dispute in Oaxaca state will continue well into Calderón's term and has the potential to escalate into an open conflict.

Nicaragua

Political risk: M

Security risk: L; M in Managua, North Atlantic Autonomous Region (RAAN)

Former president Daniel Ortega (1985-90) of the leftist Sandinista National Liberation Front (FSLN) faces his best chance yet to return to power in the November 2006 presidential

Caribbean

Grenada

Political risk: L

Security risk: L

Guadeloupe

Political risk: I

Security risk: L

Martinique

Political risk: I

Security risk: L

Netherlands Antilles

Political risk: L

Security risk: L

Puerto Rico

Political risk: I

Security risk: L

St Kitts and Nevis

Political risk: I

Security risk: L

St Lucia

Political risk: I

Security risk: L

St Vincent and the Grenadines

Political risk: I

Security risk: L

Turks and Caicos Islands

Political risk: I

Security risk: I

US Virgin Islands

Political risk: I

Security risk: L

election, provided his political opponents remain divided. However, intense US pressure, combined with Ortega's high public-rejection rating, could hand victory to former finance minister Eduardo Montealegre of the National Liberal Alliance (ALN). Ortega may launch a legal challenge if he is defeated by a narrow margin. An Ortega victory would generate considerable investor concerns, particularly over his links to Venezuela's controversial President Hugo Chávez. Electoral uncertainty, the politicisation of the judiciary, continuing corruption and other significant operational risks will all deter foreign investment. Crime rates will remain low by regional standards, despite persistent law-enforcement deficiencies. Drug-trafficking and banditry will continue in Atlantic coastal areas.

Panama

Political risk: L
Security risk: M; H in Darién province

The government will enjoy considerable political capital after a difficult 2006, in which crucial reforms were approved and a referendum on a proposed expansion of the Panama Canal was won. However, high-profile corruption scandals will continue to erode public confidence in the political and judicial systems. The government's pursuit of a free-trade agreement with the US and its efforts to encourage mining and oil exploration in the *comarcas* (autonomous Amerindian reservations), along with the commencement of the canal expansion, will trigger isolated bouts of civil unrest, particularly in Panama City and Colón. Security risks posed by crime will remain unchanged; the Darién border area will remain a high-risk area because of the presence of Colombian guerrilla groups and criminals.

Paraguay

Political risk: M
Security risk: L; M in eastern border, tri-border areas

Intense political manoeuvring to alter the constitution to allow President Nicanor Duarte Frutos to seek re-election in 2008 will dominate the political landscape in 2007. The controversy will sideline efforts to improve the business environment, tackle rampant corruption and advance good governance. Corruption, particularly in the area of copyright and trademark protection, will continue to deter investment. Smuggling of arms, counterfeit consumer goods, stolen cars and narcotics across the porous borders will remain a problem; crime levels are higher in the eastern border town of Ciudad del Este than elsewhere in the country. Domestic and international intelligence agencies will continue to monitor the tri-border area because of credible evidence that trans-national criminal and extremist organisations are engaged in illicit activities there to generate funds.

Peru

Political risk: M
Security risk: M; H in Upper Huallaga, Apurímac, Ene, Perene valleys

President Alan García's pragmatic administration will continue to pursue foreign investment, while addressing key problems such as social exclusion and poverty. Attempts to redistribute wealth and rekindle economic growth in rural areas will begin to bear fruit. However, growing frustration over the slow pace of change will lead to civil unrest, particularly in urban centres like Lima and Arequipa. Several issues will also prompt demonstrations and protests, including the implementation of a free-trade agreement with the US and the future of coca cultivation. Bouts of unrest will largely remain isolated and will not threaten overall political stability.

The regime's stability will be underpinned by continuing economic growth, fuelled in part by high world prices for metals. García will continue to apply orthodox economic policies and maintain strict fiscal discipline. Slight fluctuations in prices will persist, with a small decrease expected towards the end of 2007, but this will not affect economic stability.

Crime is the principal security risk. Small rises in kidnapping and violent crime will not affect foreign personnel significantly. Sporadic localised anti-mining unrest will continue. Activities by the leftist Shining Path (SL) guerrilla group will remain limited to remote jungle areas, with occasional clashes with security forces and some high-profile arrests. The SL will not pose an increased risk for business operations or personnel outside its rural strongholds.

Suriname

Political risk: L
Security risk: L

President Ronald Venetiaan's government will continue to enjoy relative political stability. Periodic labour unrest will not threaten the prevailing atmosphere of relative calm. Slow progress will take place in the country's reform programme, including steps towards further liberalisation. Foreign investment will trickle in, particularly in the oil and mining sectors. Drug-trafficking, particularly near the border with Guyana, will fuel violent crime, though rates will remain low. Serious crime will mostly be limited to Paramaribo, Moengo and Albina, while petty crime will remain the principal threat for business personnel.

Trinidad and Tobago

Political risk: L
Security risk: M; L in Tobago

Prime Minister Patrick Manning's People's National Movement (PNM) is likely to win general elections scheduled for October 2007. Internal divisions within the main opposition United National Congress (UNC) party, led by controversial former prime minister Basdeo Panday (1995-2001), are unlikely to be bridged in time for the elections. The government will maintain its current positive stance towards foreign investment in the key energy sector. However, the security situation will continue to undermine the business environment. Violent crime is likely to continue its growing trend, particularly in Port-of-Spain.

United States

Political risk: L
Security risk: L; M in deprived urban areas

See also **US: Political stalemate ahead** on p. 46.

The November 2006 mid-term congressional elections are likely to reflect a significant fall in public support levels for President George W Bush's Republican party. The administration will struggle to pass its legislative agenda as political jockeying ahead of the 2008 presidential contest begins in earnest. An expected economic downturn is also likely to undermine the administration, while the situation in Iraq will remain the main source of public disapproval.

The US military involvement in Iraq will continue to fuel anti-US rhetoric by Islamic extremists, who remain the main terrorism threat in the US and against US interests abroad. High crime levels will remain confined to deprived urban areas.

Uruguay

Political risk: L
Security risk: L

Political and macroeconomic stability will not be threatened in 2007, and President Tabaré Vázquez will maintain his pragmatic centrist position. Vázquez' greatest challenge will be to contain the latent divisions within the ruling Progressive Encounter-Broad Front (EPFA) coalition. Moves towards a free-trade agreement with the US are likely to heighten those divisions. Investigations of military officers accused of human rights abuses during the military

dictatorship (1973-85) will continue but will not provoke political instability. The government will continue to observe an orthodox economic policy and honour its debt obligations. Crime levels will remain low by regional standards, though they will be higher in Montevideo than elsewhere.

Venezuela

Political risk: H

Security risk: M; H in Colombian border areas

See also **Venezuela: The end of the Bolivarian revolution?** on p. 49.

President Hugo Chávez will secure re-election in December 2006. This will allow him to strengthen his grip on power, effectively removing any remaining checks and balances on his authority while alienating the opposition and further polarising society. High oil prices will fuel steady economic growth. However, economic mismanagement and rising inflation will continue to expose the fragility of this growth and raise questions over its sustainability, and that of the regime. The business environment is hostile, with few genuine legal guarantees, contractual instability and an uncertain operating environment. The gradual deterioration in the security situation will continue apace, accompanied by a parallel erosion of the institutional foundations of the security forces.

Global warming and the North-West Passage

Climate change is already having a profound effect on the Arctic region, but as well as environmental consequences, there are geopolitical implications. If global warming results in longer ice-free periods each year, the North-West Passage – the sea route north of Canada connecting the Atlantic and Pacific Oceans – could become a commercially viable navigation channel within the next 20 years.

This could bring huge savings in shipping costs; routes between Europe and East Asia that currently transit the Panama Canal would be shortened by around 2,500 miles (4,000km). Opportunities for exploitation of natural resources, particularly fish, minerals and hydrocarbons, have also generated substantial international interest.

Canada claims sovereignty over the land and waters of the North-West Passage. Its land claim is widely recognised, but its control over the region's waters is not unanimously accepted. The US claims that these are international waters and has in the past entered them without Canada's permission, prompting formal complaints from the Canadian authorities. The issue is bound to generate tensions because of perceived threats from Russia, which also has commercial and strategic interests in the Arctic, and China. The US will undoubtedly ignore Canadian claims and prioritise its own economic and security concerns.

Access to natural resources will motivate other countries – such as Russia, Denmark and Norway – to seek some form of access or even control over the area. Denmark has sent navy ships to press its claim to Hans Island, a tiny and barren outcrop in the Nares Strait between Ellesmere Island and Greenland, which Canada also claims. Despite occasional shows of strength, such disputes will not only lead to hostilities among these nations. Nonetheless, they show that global warming will not only bring disputes over diminishing resources (such as water wars), but will also cause friction as nations compete over new opportunities.

Asia and the Pacific

Afghanistan

Political risk: H

Security risk: H; E in southern region, Pakistani border areas

There is little prospect of any significant improvement during 2007 in the security or operational environments, which will remain highly volatile and present significant barriers to business entry. Intense NATO-led counter-insurgency operations in the southern and south-eastern regions will continue to displace violence into urban centres, including the capital Kabul and provincial hubs. The extension of NATO operations to the east will provide further impetus for the urbanisation of the conflict. Thus, the security environment in Kabul and other urban centres will suffer continued decline, marked by an increase in large-scale and suicide bombings designed to cause mass casualties. NATO will have some success against a resurgent Taleban, but will not secure peace. Implementation of development and reconstruction programmes will face periodically difficult conditions in much of the country.

Counter-narcotic programmes will continue to prioritise crop eradication led by international security contractors and Afghan forces, which will destabilise poppy-growing regions, reinforce Taleban and criminal influence, and highlight the government's struggle to provide adequate alternative livelihoods. Illicit opium cultivation may decrease in 2007 because of downward price pressures following 2006's record harvest, but the narcotics industry will remain a challenge to government efforts to create a diverse legal economy and will threaten the development of effective and transparent financial and political institutions.

The burden of corruption and bureaucracy will grow as the legislative process struggles to mature. Legal, regulatory and financial structures will remain insufficient and opaque, and capricious policy-making reflecting anti-foreign sentiment will increase. The relatively well administered northern and western regions, particularly the western region of Herat, will present the most attractive destinations for foreign investment.

Australia

Political risk: I

Security risk: L

Prime Minister John Howard in 2007 will contest his fifth general election as leader of the Liberal Party, which heads the ruling Liberal-National coalition. The opposition Labor Party will find it difficult to challenge the government on the economy, which is enjoying strong growth. In the event of a likely fifth election win, speculation will soon resurface over when Howard will retire and who will succeed him. Treasurer Peter Costello remains the frontrunner.

Howard, who in August 2005 became the first prime minister in 25 years to control both houses of parliament, will face few opposition challenges to his legislative programme. His own MPs are likely to be more troublesome than the opposition's; in August 2006, Howard was forced to withdraw controversial immigration legislation after it became clear that it would be defeated by a revolt in the upper house, where the Liberal-National coalition has a single-seat majority. However, the election will serve to reinforce party discipline.

The risk of a terrorist attack will remain low but credible. Police in November 2005 detained 18 people in Sydney and Melbourne in a series of raids that New South Wales police commissioner Ken Moroney said had prevented a potentially 'catastrophic' attack. Nonetheless, police have yet to show how close the suspects were to carrying out bombings. Counter-terrorism laws have been strengthened and the government will continue to enhance the domestic security apparatus.

Australia will maintain an active policing role in the Pacific following its recent interventions in East Timor and the Solomon Islands. Accusations that Australia is interfering in others' domestic affairs will occasionally lead to diplomatic disputes with its neighbours, especially with Papua New Guinea and the Solomon Islands.

Bangladesh

Political risk: M

Security risk: M; H in Chittagong Hill Tracts

Elections in January 2007 and subsequent coalition-building will intensify the power struggle between the ruling Bangladesh National Party (BNP) and the Awami League (AL) in the first half of the year. The polls are likely to be closely fought, with the BNP the marginally stronger party. The contest will stall progress in addressing economic, infrastructural and security problems and trigger protest campaigns and violence. The losing party is likely to challenge the result and boycott parliament, undermining the legislature. An AL victory would be unlikely to prompt a major change in business policies, but individual contracts may be revised.

Law and order will continue to deteriorate in the absence of adequate police reform. The Islamic extremist Jagrata Muslim Janata Bangladesh (JMJB), Jamaat-ul-Mujaheedin Bangladesh (JMB) and Harkat-ul-Jehad-al-Islami (HuJI) are likely to slowly recover from the loss of their ideological and operational leaders and resume their anti-government campaign. Political marginalisation of Islamic parties in the aftermath of the elections could encourage this trend because extremists may feel that their political channels of influence are being blocked. However, extremist groups will focus on government targets and their activities will pose only limited direct threats to foreign companies and personnel.

India will continue to be concerned by the use of Bangladeshi territory by Indian ethnic separatist and leftist groups, as well as Islamic extremist groups. The growth of extremism and the use of Bangladesh as a transit route for narcotics, weapons and explosives will also lead to international pressure on the government to strengthen its anti-terrorism and anti-crime measures and border controls. Chittagong will remain one of the most lawless ports in the world, with frequent smuggling, piracy, theft and unrest, while instability in the Chittagong Hill Tracts will continue.

Bhutan

Political risk: I

Security risk: L

King Jigme Singye Wangchuck will continue his phased democratisation process to move from an absolute monarchy towards a two-party constitutional monarchy. A draft constitution will be adopted in 2007, paving the way for two-phase general elections and a transfer of power to his son, Crown Prince Jigme Khesar Namgyel Wangchuck, in 2008. The gradual democratisation is likely to be peaceful and the political and security environments will remain stable. The process will continue to proceed hand-in-hand with economic reforms and the opening up of the country to foreign investment.

Brunei

Political risk: L

Security risk: L

Sultan Hassanal Bolkiah, who has ruled the oil-rich country since 1968, will remain one of the world's only absolute rulers. Political reform aimed at introducing a modicum of democracy will move forward only slowly, if at all. The depletion of the country's proven oil reserves, which could happen within 15 years, poses the greatest risk to continued political stability. Hassanal used his 60th birthday celebrations in July to renew calls for economic diversification. Opportunities beyond the oil and gas sector, except for the thousands of people working in government-sector jobs, will remain extremely scarce.

Burma (Myanmar)

Political risk: M

Security risk: L; M on borders with Bangladesh, India, Thailand; H on Chinese border

Factional fighting within the ruling State Peace and Development Council (SPDC) is unlikely to weaken the military junta's hold on power. The SPDC's increasing paranoia over political opposition and both internal and external security threats will continue to render its policies unpredictable and irrational. The SPDC is unlikely to lift democracy campaigner Aung San Suu Kyi's house arrest. It could even try to ban her National League for Democracy (NLD) in a misguided effort to advance implementation of its opaque and implausible democratisation process. Further crackdowns on the opposition are likely to increase international criticism of the SPDC, which in turn would increase the reputational risks associated with conducting operations in Burma. Occasional bomb attacks will mostly reflect power struggles within the SPDC or form part of the junta's strategy of justifying its authoritarian rule and undermining the opposition. Insurgency and crime will continue to affect border areas.

Cambodia

Political risk: M

Security risk: M

Prime Minister Hun Sen will retain an authoritarian grip on power in 2007. The ousting of Prince Norodom Ranariddh as FUNCINPEC party leader in October 2006 is likely to see the party move towards Hun Sen's Cambodian People's Party (CPP). It will have little independent influence and there will be no link with the main opposition Sam Rainsy Party (SRP) ahead of a general election due by 2008. Land grabs by corrupt officials will remain a growing source of peasant discontent; all but the most reckless investors will continue to conduct thorough due diligence before leasing land. Cambodians will for the first time properly confront the atrocities of Pol Pot's rule in the 1970s with the start of the trials of Khmer Rouge leaders.

China

Political risk: M

Security risk: L; M in Guangzhou-Dongguan-Shenzhen corridor area (Guangdong province), border areas with Indo-China (far south-west), the Russian far east (north-east), Central Asia (north-west)

See also **China: Market liberalisation under threat?** on p. 10.

At the 2007 Chinese Communist Party (CCP)'s national congress (a key, five-yearly political event), President Hu Jintao will complete the consolidation of his power, strengthening his ability to implement his preferred policies. The leadership will continue to seek more sustainable and equitable growth, and promote governance reforms. This will be aimed, with limited success, at enhancing central oversight of local governments, boosting central macroeconomic control, reducing corruption and alleviating social tension.

Governance reforms should not be mistaken for liberal democratisation, which is not in prospect. Continued market liberalisation and opening to foreign companies will face further domestic criticism. This will complicate and slow the reform process, particularly in the financial sector, but will not derail it.

Economic growth will moderate, though will remain strong. High levels of investment will sustain speculation about overheating, and a slowdown in US demand could have a negative effect, but rapid Chinese growth is likely to prove relatively resilient to such problems. The huge bilateral trade surplus with the US will continue to rise (because of structural realities rather than sinister manipulation), sustaining trade frictions. These should prove manageable, particularly because the renminbi (currency) will continue to strengthen, incrementally but significantly, against the dollar.

In Hong Kong, the non-democratic process by which Chief Executive Donald Tsang will be 'elected' to continue in his post will reignite popular frustration at the central government's continuing unwillingness to implement political reforms, but protests will be limited and will not affect political stability.

East Timor

Political risk: M

Security risk: H

Security risks will continue to pose serious problems for business. Australian-led peacekeepers will struggle to prevent tensions between the country's westerners and easterners from escalating into further violence ahead of a general election that is due by May 2007. Prime Minister José Ramos-Horta, who took office in June 2006 following the resignation of Mari Alkatiri, will face renewed pressure to stand down if the Revolutionary Front for an Independent East Timor (Fretilin) does well at the polls. A continuing investigation into allegations that Alkatiri hired civilian 'hit squads' to eliminate Fretilin's opponents will also prove a source of tension. Successfully exploiting the natural gas resources of the Timor Sea and strengthening governance will remain essential if the country is to survive independently of foreign donor assistance.

Fiji

Political risk: M

Security risk: M

Prime Minister Laisenia Qarase's re-election in May 2006 averted the risk of an uprising by ethnic Fijian supremacists, who had refused to rule out a repeat of the 2000 coup in the event of a victory for Mahendra Chaudhry's Labour Party. Although the formation of a government that includes ministers from the country's two main parties has defused tensions, differences within the coalition will emerge as Qarase pushes forward controversial policies, especially a reconciliation bill that could lead to the release of the 2000 coup plotters. Divisions within the Labour Party over power-sharing with Qarase's Soqosoqo Duavatu ni Lewenivanua (SDL) are also set to widen. Mahendra could be challenged for leadership of the party, possibly by his deputy, Poseci Bune, who is one of nine Labour MPs to have taken up positions in the SDL-led government. Mahendra will continue to insist that Labour ministers follow official party policies rather than compromise with the SDL.

Any attempt to dismiss military chief Admiral Voreqe 'Frank' Bainimarama, who will continue to criticise Qarase for his 'racist' policies, would also heighten political risk. Bainimarama is looking more vulnerable after a public dispute in early 2006 with army chief Col Jone Baledrokadroka exposed divisions within the ranks.

Intercommunal tensions could lead to further political violence, though foreign interests are not usually targeted in such unrest. Crime continues to rise, particularly in urban areas, but from a low base.

India

Political risk: L

Security risk: L; H in Kashmir, Asom (Assam), Manipur, Tripura, Nagaland

See also **India: Time to hang up on outsourcing?** on p. 20.

The Congress-led United Progressive Alliance (UPA) government will remain stable, though minor political scandals could lead to ministerial changes. The Left Front alliance of left-wing parties will remain strong in several states, increasing its confidence to challenge the central government's economic and labour policies, and particularly its privatisation efforts, leading to minor policy adjustments but not major changes to the government's business-friendly approach. The Bharatiya Janata Party (BJP) will suffer from internal leadership and identity

struggles, which will weaken its support and draw its attention away from opposition politics. However, elections in seven states – Goa, Gujarat, Jammu and Kashmir, Manipur, Punjab, Uttar Pradesh and Uttaranchal – will see Congress and the BJP pitted against each other.

The peace process with Pakistan is likely to continue but progress will be harder to achieve. The principal reasons for this are political uncertainties related to Pakistan's 2007 assembly and presidential elections and India's lack of trust in Pakistani President Gen Pervez Musharraf's ability to deliver on his promises. In addition, occasional attacks against civilians by Kashmir-based Islamic extremist groups will persist. India will continue to accuse Pakistan of failing to crack down on the extremists and of using them to pressure India into concessions on Kashmir.

The government will stress the national security threat posed by extreme leftist groups (Naxalites) and allocate increased resources at both central and state levels to fight them. However, the weak social and development aspect of this drive will hinder these efforts. Naxalites are likely to spread their influence in rural areas and encourage communal tensions around development projects and economic issues. The government will also continue its efforts to draw north-eastern insurgent groups into a ceasefire. Although temporary ceasefires and negotiations are possible, they will come under threat from mutual lack of trust and the existence of breakaway elements, which will continue their extortion activities and attacks on government targets and infrastructure.

Failing states, failed interventions

The ending of the UN Mission of Support in East Timor (UNMISET) in May 2005 was widely taken as a sign that the newly independent state was capable of going it alone. However, almost a year to the day after the last UN peacekeepers withdrew, Australia was again leading an international force to restore law and order.

Prime Minister Mari Alkatiri's dismissal of more than half of the East Timor Defence Force (FDTL) in March following a month-long strike over alleged discrimination triggered widespread violence in the capital Dili. Rival gangs loosely aligned to eastern and western districts fought street battles and burnt buildings, killing at least 20 people and forcing more than 100,000 others to flee their homes. The speed with which one of the UN's most successful missions unravelled is a reminder of the risks involved in failing to fully address deep-rooted governance, economic and social problems.

Could similar disasters occur elsewhere? Australia in April was forced to lead a reinforcement of the Regional Assistance Mission to the Solomon Islands (RAMSI) after violence flared following the election of a controversial prime minister. The capital Honiara's Chinatown district was all but destroyed as rioters clashed with police, burnt buildings and looted property in two nights of violence. Again, RAMSI had been applauded internationally for restoring law and order following the inter-island conflict of 1998-2002, but the April violence exposed continuing governance problems besetting the country. Prime Minister Manesh Sogavare has failed to restore stability and there is an increasing risk of renewed violence.

Papua New Guinea and semi-autonomous Bougainville could experience similar problems. Prime Minister Michael Somare's announcement in August of emergency rule in Southern Highlands province was an admission that large parts of the country remain outside government control. Troubled islands in the Pacific will require sustained international engagement and support to prevent further outbreaks of instability.

Indonesia

Political risk: M

Security risk: M; H in Aceh, Papua, Central Sulawesi, Maluku

President Susilo Bambang Yudhoyono in 2007 will risk being further eclipsed by his deputy, Jusuf Kalla, who leads the powerful Golkar party and is expected to run for the presidency in 2009. Although Yudhoyono in October 2005 became the country's first directly elected leader after winning more than 60% of the popular vote, his Democrat Party controls only one-tenth of the seats in the House of Representatives. Rivalry between the two leaders will complicate policy-making.

Growth in South-east Asia's largest economy will fall below the rates required to create much-needed jobs. Widespread corruption, capricious courts and conflicting laws and regulations will continue to undermine investor confidence. The government in September announced that it was abandoning long-awaited reforms to labour laws following parliamentary opposition and violent protests by trade unions. There is a risk that other reforms will be similarly sidelined.

Accusations that the government is renegeing on its commitments under the August 2005 peace accord with the separatist Free Aceh Movement (GAM) will risk exacerbating tensions in the resource-rich province. Although the agreement will survive, criminal violence will increase as corruption undermines efforts to reintegrate former combatants into civil society. Separatist violence will continue periodically in Papua.

Piracy: Still making waves

The Seaborne Spirit cruise liner was 100 miles (160km) off the Somali coast in November 2005 when it was fired on by pirates using automatic weapons and rocket-propelled grenades. The liner, with its 600 passengers, moved away largely undamaged, but the incident briefly brought the modern-day problem of piracy into the public eye.

Piracy costs the shipping industry around \$16bn each year. With more than 90% of world trade – including most crude oil – conveyed by sea, piracy has serious implications for supply chains and the global economy as a whole, increasing costs through forced rerouting, additional security measures and higher insurance premiums.

Incidents are widely prevalent in several critical shipping lanes. The worst-affected areas are Indonesia (one-third of all incidents) and the Malacca Straits, but piracy is also a major problem off the Horn of Africa, Bangladesh and Nigeria. The past couple of years have also seen a notable rise in the use of violence; incidents increasingly result in the assault or kidnap of crews, with ransoms of up to \$700,000 demanded for the return of ship and personnel.

Despite the relative simplicity of their approach, pirate gangs have been allowed to operate with growing impunity. The lack of publicity surrounding the issue has resulted in an unfocused, under-funded international response. With many assaults occurring in international waters, jurisdiction and interdiction are problematic and, to date, official measures appear confused and inadequate. The problem is unlikely to ease; significant increases in commercial shipping are likely over the next few decades, while piracy remains closely linked to a shortage of onshore economic opportunities.

There is a lot that individual shipping operators can do to maintain vigilance and to mitigate the risk of being a target of pirate attack. However, without emphatic, concerted action by governments, including efforts to support prosecutions and share the costs of patrols, there will be no improvement.

The risk of terrorist attack will remain high despite the security forces' success in disrupting the capabilities of the faction of the regional Islamic extremist Jemaah Islamiyah (JI) network associated with Malaysia-born militant Noordin Top. An escalation of sectarian violence in religiously divided Central Sulawesi province could provide new recruits for JI attacks, which may include assassinations or abductions as well as mass-casualty bombings.

Japan

Political risk: L
Security risk: L

See also **Japan: Sowing the seeds of a 'new cold war' in Asia?** on p. 25.

New Prime Minister Shinzo Abe is popular but faces difficult early tests in 2007. Elections to the upper house of parliament are due in July and Abe's ruling Liberal Democratic Party (LDP) is nervous about losing its majority. The prime minister will survive this examination even if the party struggles, and may well even consolidate his position. However, signs of internal conflict are likely to emerge both within the LDP and between the administration and bureaucracy as Abe displays a preference for strong central direction. Nevertheless, he will be unable to establish the kind of authority and mandate that allowed his predecessor to implement bold reforms in the face of strong opposition. Progress on economic and structural reforms will be slower, particularly as populist pressures influence the new administration's fiscal policy. This loss of reform momentum will not derail the economy, which is relatively robust.

Abe will expend considerable energy on foreign policy, and particularly on relations with China. This will lead to a 'honeymoon' period of more constructive bilateral interaction and may well yield significant joint initiatives (existing mechanisms for dispute management have already proved reasonably effective, even during periods of strained ties). However, this thaw should be viewed cautiously: fundamental sources of friction have not been addressed and some disputes will remain intractable. These will continue to be carefully contained and no serious conflict is in prospect (China will oppose, but ultimately have to accept, constitutional reforms to facilitate military normalisation), but the longer-term outlook remains problematic. Japan will not move to acquire nuclear weapons in response to developments in North Korea, though the issue will be publicly debated.

Laos

Political risk: M
Security risk: M; H in Xaysomboune Special Zone, Xieng Khouang Province

The ruling Lao People's Revolutionary Party (LPRP) will continue the slow process of opening the country up to the outside world, but Laos will remain an authoritarian one-party state. There will be no bold policy changes under President Choummaly Sayason, who succeeded the retiring Khamtay Siphandone in June 2006. The 70-year-old Choummaly is a long-time protégé of Khamtay and has risen through the military ranks, having held the posts of chief of staff, army chief and defence minister. Prime Minister Bouasone Bouphavanh, also appointed in June, is similarly close to the former president. Small-scale bombings by exiled groups opposed to one-party rule will continue to represent the principal security risk.

Malaysia

Political risk: L
Security risk: L

Prime Minister Abdullah Ahmed Badawi must deliver on his election pledge to eliminate corruption if he is to counter future challenges to his leadership, such as that presented by his predecessor, Mahathir Mohamad (1981-2003). Although Mahathir's challenge effectively ended in September, when he lost an election in his home state of Kedah, Abdullah is more dependent than ever on the continued support of his senior colleagues, especially his deputy Najib Razak.

Corruption will remain a problem for investors. Despite some early success, Abdullah's failure to consistently prosecute those guilty of corruption was exposed in May 2006 by the refusal to discipline Mohamad Said Yusof, a lawmaker from the ruling Barisan Nasional (BN) coalition who confessed to instructing customs officials at Malacca port to 'close one eye' to illegal shipments of timber. The affair appeared to confirm the popular perception that the Abdullah administration is not serious about eliminating corruption. Mahathir will continue to exploit this view by accusing Abdullah of granting political and commercial favours to his son Kamaluddin and son-in-law Khairy Jamaluddin.

In a bid to revive his leadership ahead of elections in 2008, Abdullah will push ahead with the \$60bn-worth of spending programmes contained in the five-year economic plan. Although he remains committed to boosting GDP growth through deficit-financed spending, he has attempted to distance himself from the fiscal excesses of Mahathir's rule, chiefly by cutting fuel subsidies. These policies have not proved popular among all BN members, and Abdullah's economic policies risk becoming more populist as the 2008 elections approach.

Maldives

Political risk: M

Security risk: L

President Maumoon Abdul Gayoom will continue his democratisation process, which is driven by increasing pressure from the main opposition Maldivian Democratic Party (MDP) and the international community rather than by a genuine willingness to share power. Progress is likely to be slow and cosmetic, triggering protest campaigns in the capital Male. As the 2008 deadline for holding a presidential election approaches, political manoeuvring by Gayoom or reversals from his reform roadmap cannot be ruled out. However, the political and security environments will remain benign for foreign investors.

Mongolia

Political risk: M

Security risk: M

Mongolia in 2007 will continue to defy problems of poverty and political turbulence by remaining a surprisingly stable democracy. However, policy in the mining sector – the primary area of foreign-investor interest – will remain highly politicised ahead of parliamentary elections that are due in mid-2008. Civic movements demanding that a greater share of mining wealth be channelled to 'the people' established themselves as significant players in 2006. They will again seek to assert their position with protests and demonstrations in 2007, sustaining the risk of populist pressure shaping policy as the two main political parties vie for influence.

The central importance of the mining sector to the country's economic development will ultimately provide the imperative for broadly pro-investment policies, and legislation that threatens to retard mining-sector development will be reconsidered in parliament. However, the country remains far from reaching a consensus on how to meet the needs of both investors and the public. Therefore, doubts over the stability of the investment environment are unlikely to be resolved in 2007.

Crime continues to rise rapidly nationwide because of social deprivation. Petty crime is a problem for foreign nationals, but violent crime is also increasing, particularly in Ulaanbaatar.

Nepal

Political risk: H

Security risk: M

King Gyanendra is unlikely to stage a political comeback, but the emergence of multiple centres of influence and interest will continue to create uncertainty and instability. Political

power struggles and frustration over slow progress in the dual-track democratisation and peace processes will be the main drivers of this uncertainty. The ruling seven-party alliance (SPA) will struggle to maintain its political cohesion as democratisation moves on to more substantive issues such as the role of the king in the future constitution. The Maoists are likely to continue their engagement with the SPA, while using the threat of a return to violence to pressure the SPA into accommodating their political demands.

The SPA has set unrealistically short timeframes for the democratisation and peace processes. Conflicting political and ethnic interests are likely to mark elections to a constituent assembly – due to be held in April 2007 – and negotiations over the new constitution, making progress hard to achieve. An inability to meet popular expectations within the short timeframes could cause frustration, leading to protests. The uncertain political and security situation will continue to hinder economic reforms and foreign investment.

Although the Maoists have announced a temporary ceasefire and agreed to place their militants in camps under UN supervision, they have not agreed to disarm. Some elements will continue their quasi-militant/criminal activities in many parts of the country, carrying out extortion and levying illegal taxes. The elections to a constituent assembly are likely to pose a further challenge to security and law and order because Maoists and other political groups could try to use their influence over local populations to affect the results.

New Zealand

Political risk: I

Security risk: L

Relations between Prime Minister Helen Clark's Labour Party and the main opposition National Party will remain acrimonious during 2007. The country was beset by scandal in 2006 after it emerged that a secretive Christian sect with links to the National Party had hired investigators to uncover 'dirt' on senior Labour figures. With the next elections not due until September 2008, Clark will be more concerned with maintaining a working relationship with her smaller coalition partners. Labour controls 50 parliamentary seats, two more than the National Party but 11 seats short of an outright majority. Economic concerns will focus on the country's widening current-account deficit.

North Korea

Political risk: H

Security risk: L

Kim Jong-il's regime will enter 2007 under intensifying pressure from key states following the conduct of its first nuclear test in October 2006. Its vital relationship with China will remain badly strained; South Korea will be more wary and less supportive of unconditional engagement; and Japan's new prime minister will be keen to demonstrate his robust handling of Kim. These factors will boost US efforts to present a more unified front among these key countries, and within the UN. Nonetheless, Kim will not bow to international pressure to abandon nuclear weapons, which he sees as his country's only guarantee against perceived US hostility. North Korean behaviour will continue to alternate between the threatening (to raise the stakes) and the conciliatory (to extract concessions through negotiation).

Increased isolation and international pressure are likely to push the North back to negotiations before the end of 2007 (though these will not yield any genuine resolution of the nuclear issue). However, the year will also see further provocations, possibly including further nuclear tests. Either way, there is little risk of serious military conflict in 2007. Meanwhile, the economy will remain in a state of collapse and the regime will continue to maintain its grip on power through extreme repression. Foreign personnel travelling to the country through normal official channels will face few security risks, but the handful of companies attempting to deal or operate there will expose themselves to high levels of business risk, with virtually no security of investment.

Pakistan

Political risk: M

Security risk: H; M in Punjab, Sindh (excluding Karachi); E in tribal areas bordering Afghanistan

The political situation will remain tense in the run-up to national and presidential elections in late 2007, possibly weakening President Gen Pervez Musharraf's position among his military and political support base. Musharraf also faces the risk of assassination following three failed attempts in recent years. The Pakistan Muslim League-Q (PML-Q) is likely to win the elections, and subsequent alliance-building will be its greatest challenge. The six-party Muttahida-Majlis-Amal (MMA) religious alliance should also perform well thanks to its support base in North West Frontier Province (NWFP) and northern parts of Baluchistan. Despite its pre-election co-operation with the secular opposition parties, the MMA is likely to be keen to maintain political influence and will be susceptible to Musharraf's offers to form an alliance.

The security situation will be marked by multiple challenges. Internally, the September 2006 ceasefire with tribal militants in North and South Waziristan is likely to prove unsustainable, while unrest in Baluchistan is set to continue, with militant attacks spreading to new parts of the province. Meanwhile, Pakistan's cities – particularly Gilgit, Karachi and Quetta – will witness frequent sectarian tensions and attacks and occasional anti-Western violence, including bombings.

Regional relations will remain problematic. The peace process with India is likely to continue but progress will be difficult. Pakistan's perceived inability to control the movement of militants across the Afghan border and its alleged official or unofficial support for the Taliban are likely to stoke tensions with Afghanistan. Despite increasing international pressure to crack down on militants, Musharraf will struggle to implement stringent policies against extremism.

Business-friendly economic policies and gradual privatisations are likely to continue. However, weak infrastructure will undermine this pro-investment, pro-industry approach.

Papua New Guinea

Political risk: M

Security risk: H

Political violence will escalate as Prime Minister Michael Somare leads the ruling National Alliance (NA) coalition to a general election that is due by mid-2007. Armed criminal gangs (*raskols*) will continue to terrorise the towns, while tribal warfare will persist in parts of the countryside, particularly Southern Highlands province. Somare in August placed the province under direct rule from Port Moresby and dismissed governor Hami Yawari for allegedly pocketing state funds. Yawari responded by threatening to block a planned \$6m gas pipeline to Queensland (Australia), underlining that local politicians continue to hold commercial interests hostage for their own political ends.

Philippines

Political risk: M

Security risk: M; H in south-west Mindanao, Sulu archipelago

President Gloria Macapagal-Arroyo's political future will be decided by Congressional elections in May 2007. Arroyo, who in August 2006 survived the second impeachment vote against her in as many years, must retain the support of two-thirds of the House of Representatives if she is to prevent future impeachment motions from reaching the Senate. The ruling Lakas-led coalition will attain the required result. Arroyo's popularity is beginning to recover from allegations that she cheated her way back to office in the May 2004 elections. Furthermore, the president's chances of electoral success have been boosted by fiscal reforms that have allowed for greater spending on public services.

While opposition-led street protests are possible, a 'people power' uprising would be unlikely to succeed. The opposition has no popular figurehead and has so far failed to mobilise anything like the hundreds of thousands of people who took part in the successful uprisings against former presidents Ferdinand Marcos in 1986 and Joseph Estrada in 2001. Senior army figures remain loyal to their commander-in-chief and soldiers accused of involvement in coup conspiracies have either been arrested or dismissed.

Terrorism will remain a key concern and there is a credible risk of attacks in the capital Manila. An alliance with the Rajah Solaiman Movement (RSM) of Christian converts to Islam has increased the capabilities of southern-based groups such as the Abu Sayyaf to undertake operations in the capital. Abu Sayyaf leader Khaddafy Janjalani will continue to return the group to the jihadist ideologies of its founder, Abdurajak Abubakar Janjalani, while at the same time seeking to draw on the expertise of fugitive Jemaah Islamiyah (JI) bomb-makers in the south.

Singapore

Political risk: I
Security risk: L

The operating environment will remain attractive to foreign investors. Prime Minister Lee Hsien Loong will seek to stamp his authority on government policy after leading the People's Action Party (PAP) to victory in the May 2006 elections. Although the election result was never in doubt (the PAP has ruled since independence in 1965), Lee will find it difficult to establish his autonomy while former prime minister Goh Chok Tong (1990-2004) and Lee Kuan Yew continue to serve in the cabinet. He will also be privately aggrieved that the PAP's share of the popular vote fell to 66.6% from the 75.3% attained by Goh in the 2001 elections.

Solomon Islands

Political risk: M
Security risk: M

Prime Minister Manasseh Sogavare will continue to face criticism over allegations that his supporters incited rioting and looting in the capital Honiara following the April 2006 election. Honiara's Chinatown district was burnt to the ground in May after a secret ballot of MPs installed Snyder Rini as premier despite his high-profile position in the defeated People's Action Party (PAP)-led government. Rini was forced to resign after barely a week in office and was replaced by Sogavare. Relations with Australia will remain tense, with the practice of appointing foreign advisors to senior positions within government ministries likely to prove especially controversial. Sogavare's policies of devolving greater powers to the provinces will complicate the operating environment for foreign investors, but could defuse the inter-island tensions exposed by the violence of 1988-2003.

South Korea

Political risk: L
Security risk: L

The 2007 presidential election will herald an end to Roh Moo-hyun's tenure and return the main opposition Grand National Party (GNP) to power. The return of the GNP in one sense will be a blow for progressives and a victory for conservatives who have long resisted economic and political reforms. However, while Roh gained the presidency on a progressive platform, implementation of his reformist agenda stalled several years ago. Thus, in practical terms, 'progressive forces' were already blunted and a change of government will not imply any simple swing from pro- to anti-reform policies.

Should the new leadership secure a strong mandate and establish authority in parliament, it could launch much-needed initiatives to boost the economy. However, concerns will persist over a lack of political will for economic liberalisation, and the country's aim of becoming a

regional financial and economic hub will remain unrealistic. Signs of anti-foreign sentiment will continue to appear periodically in demonstrations against the US military presence, against proposed free-trade agreements and over disputes with Japan. Neither these, nor relatively frequent labour action, will entail serious security risks.

Bilateral relations with the US will improve under a GNP administration, and differences over key issues – North Korea policy and changing arrangements for military co-operation – will be better managed, though underlying tensions will remain. Amid growing criticism of the established policy of engagement with the North, the South will seek to push the North to deliver more in return for economic and other assistance, but will not abandon the basic policy or risk provoking a crisis.

Sri Lanka

Political risk: M

Security risk: M; E in north, north-east

The Sri Lanka Freedom Party (SLFP)-led government and President Mahinda Rajapakse's rule will remain stable. Rajapakse's increasing frustration with the disproportionate influence wielded over his policies by the ultra-Sinhalese nationalist Marxist Janatha Vimukthi Peramuna (JVP) and Buddhist Jathika Hela Urumaya (JHU) may see him call early elections, which would be likely to increase the SLFP's seats at the expense of these two parties. However, even if Rajapakse manages to weaken the influence of the JVP and JHU in parliament, hardline elements within the government and military would be likely to keep his policies in check and limit his freedom of manoeuvre.

The government will focus its attention on the de facto collapse of the ceasefire with the separatist guerrilla Liberation Tigers of Tamil Eelam (LTTE) and the escalation of violence in the north and east. Both sides may use occasional offers to negotiate, or actual talks, to accommodate the demands of the international community and create breathing space for regrouping and rearming. However, little genuine progress is expected. Both sides will make only limited and unsustainable territorial gains. The political and military deadlock could encourage the LTTE to extend attacks to districts bordering the north and east and to carry out assassinations in the central and southern regions to increase pressure on the government. Meanwhile, ethnic and religious tensions in the north and east will continue, but are unlikely to threaten other areas.

International donors are increasingly determined to pursue a policy of 'money for talks'. While the government might be forced into talks because of severe economic decline, the LTTE's pursuit of a military solution will continue to deter investment.

Taiwan

Political risk: L

Security risk: L

There will be no lasting respite from the political strife of 2006; if anything, the situation could deteriorate. Developments such as new corruption allegations may periodically reinvigorate the campaign to oust President Chen Shui-bian, and further street protests are likely. Meanwhile, with a legislative election due at the end of 2007 and a presidential election in 2008, politicians and parties will seek to score political points largely via confrontation and controversy, despite strong signs that voters are tired of both. Chen will remain determined to resist calls for his resignation, as long as he is not shown to have been personally involved in corrupt activity. There is only around a 20% chance of his removal in 2007; the risk of serious political instability (such as larger-scale civil disorder or the breakdown of democratic institutions) is less than 10%.

The risk of a crisis in relations with mainland China is similarly low. Chen and the government may resort to risky initiatives on cross-Strait relations to divert domestic attention and recover popularity, but parliament will reject these. Mainland leaders will issue stern warnings, but are unlikely to risk any real aggression because they expect elections to deliver a less 'difficult'

government in 2008. The political pantomime in the capital Taipei is thus unlikely to pose major political or security risks to foreign companies. Rather, its negative impact will be seen in continued political bickering, further undermining governance. Parliament will fail to pass important stalled bills, including those that would finance a crucial arms-purchase package, boost major state-owned enterprises and improve the environment for investment in the financial sector.

Thailand

Political risk: M

Security risk: M; H in Narathiwat, Pattani, Yala

See also **Thailand: After the coup** on p.44.

Army commander-in-chief Gen Sonthi Boonyaratglin and his prime minister, retired Gen Surayud Chulanont, will face mounting opposition during 2007 from the same people who led calls for the resignation of former prime minister Thaksin Shinawatra (2001-06). The reputation of the country's operational environment risks being weakened by the work of the asset-investigation commission, led by former Supreme Court chief justice Sawat Chotipanich, which has the power to probe all government-approved concessions and procurement contracts. Its activities could cast doubt on the sanctity of agreements signed with the former Thai Rak Thai (TRT) government. Sonthi will begin negotiations with separatist groups in the southern provinces of Narathiwat, Pattani and Yala, though this will not end the violence. The risk of a transnational terrorist attack will remain a concern.

Marching to political power?

Gen Sonthi Boonyaratglin on 19 September overthrew Thai prime minister Thaksin Shinawatra in the country's first coup d'état for 15 years. It led to speculation that generals in other South-east Asian countries, especially the Philippines and Indonesia, might feel sufficiently emboldened to consider their own power-grabs.

As in Thailand, the Philippines' armed forces have a history of intervening in civilian politics. Since taking power in a military-backed popular uprising in 2001, President Gloria Macapagal-Arroyo has faced a series of army coups and mutinies, most recently in February. However, the risk of a successful coup remains low. Whereas the successful Thai coup was led by the army chief, the Philippines' recent plots have involved junior or middle-ranking officers. Senior figures within the armed forces remain loyal to Arroyo. Although the army's intervention was key to the overthrow of former presidents Ferdinand Marcos in 1986 and Joseph Estrada in 2001, both interventions followed weeks of broad-based civil protests that demonstrated they had lost the support of the country's ruling elites. The opposition has failed to muster anything like the same breadth of opposition to Arroyo.

Indonesia does not have the same history of coups as either Thailand or the Philippines. The country has experienced only one successful putsch, that of 1965, when Gen Suharto toppled founding president Sukarno. Admittedly, the need for direct military rule was lessened by the principle of *dwi fungsi* – 'dual function' – which formalised the armed forces' role in politics and business. However, post-Suharto reforms have curtailed the political powers of the military. Unlike Thailand, where the revered figure of the king can provide de facto sanction to a coup, the constitution remains the sole source of legal authority in Indonesia. The armed forces' reputation is now so low that any coup attempt would provoke widespread opposition.

Tonga

Political risk: M

Security risk: M

Vanuatu

Political risk: L

Security risk: L

Vietnam

Political risk: L

Security risk: L

Vietnam will experience continuing rapid economic and social change following its expected accession to the World Trade Organisation (WTO) by December 2006. Membership of the WTO will attract renewed foreign investment and state-controlled enterprises will face increasing competition from their more efficient foreign rivals. Prime Minister Nguyen Tan Dung, who in June succeeded Phan Van Khai (1997-2006) in the country's generational handover, which also saw Nguyen Minh Triet confirmed as president and Nong Duc Manh as party secretary-general, will seek to make the process as painless as possible. Official corruption will continue to blight foreign investors' dealings in the country in the absence of far-reaching reforms aimed at separating party from state. Dung will seek to draw a line under the scandal at the transport ministry's road-building arm that attracted rare public debate for much of 2006. Land disputes will remain a source of peasant discontent, especially in the surroundings of the capital Hanoi and Ho Chi Minh, but also in the coffee-growing central highlands. However, the security risks of such unrest to business will remain low.

Europe and the former Soviet Union

Albania

Political risk: M
Security risk: L; M in north

The government is stable, but bickering with the opposition is likely to continue throughout 2007, reflecting the country's highly polarised political spectrum. The constant quarrelling is likely to distract attention from the government's key challenges, particularly the fight against rampant corruption and organised crime, both of which remain obstacles to Albania's EU accession. Under these circumstances, the presidential election in June 2007 may generate a renewed political crisis. Foreign businesses will continue to face serious shortcomings in the operating environment, including a poor legislative framework and excessive red tape. Security risks are higher in the north and east, where law enforcement and government control are particularly weak.

Armenia

Political risk: M
Security risk: L; H in Azerbaijani border areas

Parliamentary elections in May will dominate the political landscape and provide an insight into the likely outcome of the 2008 presidential contest. The elections will conform to the rigid constraints of Armenia's closed political system, with nominal opposition participation and a limited choice between members of the same political elite.

Although international mediators will continue to seek a settlement in the dispute with Azerbaijan over the status of the ethnic Armenian-dominated exclave of Nagorno-Karabakh, the elections will preclude a compromise by President Robert Kocharyan. Occasional confrontations will continue in violation of the 1994 ceasefire, but military conflict is unlikely.

The country will continue to keep Russia at the core of its foreign policy while maintaining good relations with the US and the West. The security situation will remain manageable, with a crime rate lower than in most western European countries.

Austria

Political risk: L
Security risk: L

The Social Democratic Party (SPÖ)'s unexpected victory in the October 2006 general election made a grand coalition with the country's other major political force, the centre-right People's Party (ÖVP), all but inevitable. The key challenge in 2007 will be to avoid the infighting and stagnation that affected similar 'Red-Black' coalitions between the SPÖ and the ÖVP in the 1980s and 1990s, especially given that the media are certain to exploit any hint of division. Chancellor Alfred Gusenbauer will aim for broad policy continuity, and any damage to investor confidence will be offset by the exclusion of the unpredictable far-right parties from government. Austria experiences less Islamic extremist activity than most nations in western Europe, and there are few domestic security threats.

Azerbaijan

Political risk: M
Security risk: M; H in Armenian border areas, Nagorno-Karabakh

The political environment is likely to remain relatively stable as President Ilham Aliyev consolidates his hold on power, sidelining potential rivals for the 2008 presidential election and ensuring that the opposition remains weak and ineffective.

Although the business climate for large oil companies will remain workable, other sectors will be undermined by increasing government interference, a lack of structural reforms and high inflation. Corruption and the absence of an independent judiciary or effective legal system will continue to thwart business operations. Despite a rise in hydrocarbons output, GDP growth will fall below 18% in 2007 (from 19.7% in 2005). Healthy tax revenues from the oil sector will result in an increase in wages, though high inflation and excessive, inefficient government-spending programmes could spark protests in 2007.

The terrorism risk will remain low and security risks for foreign business personnel will remain minimal. Given that parliamentary elections are taking place in Armenia in May, and presidential elections are scheduled in both countries for 2008, any breakthrough in negotiations over the conflict in Nagorno-Karabakh is unlikely. Periodic shootings and skirmishes will continue to occur but will be confined to the enclave and Armenian border areas and will not affect companies elsewhere. Azerbaijan will continue to balance foreign relations with Russia and the West, remaining neutral in the face of growing tensions between the US and Iran. This neutrality could pose problems for Azerbaijan should the UN impose sanctions on Iran. An agreement with Turkmenistan over the demarcation of the Caspian Sea is a remote prospect for 2007.

Belarus

Political risk: H

Security risk: L

President Alexander Lukashenko's authoritarian regime will remain stable. Opposition movements will continue to demonstrate, but the heavy-handed tactics of the security forces will preserve public order. The opposition's support base may increase as the economy deteriorates, but the downturn will be gradual, and mass dissatisfaction with the regime will not emerge before the end of 2007.

Should the government cede control of the country's gas pipeline network to Russian energy giant Gazprom, as expected, it will avert a sharp increase in the price of Russian gas. If the two administrations cannot agree on terms, higher gas prices will place a severe strain on the economy. Mutual distrust will continue to prompt the Belarusian and Russian governments to postpone their project of a political union.

The regime will take tentative steps to attract foreign investment. However, the business environment will remain marred by high political risks, including pervasive state intervention, regulatory unpredictability, an unreliable court system and persistent harassment of companies by government inspectorates.

Belgium

Political risk: L

Security risk: L

The governing coalition – bringing together the liberal and socialist parties from both major language groups – is likely to remain in office until the general election in June 2007. While it has overcome its first bout of the 'Belgian disease' – political tension between the Dutch-speaking and French-speaking regions and representatives – such disputes are never far from the political agenda and would undermine the incoming government. This is particularly likely given the strong prospect that an even broader coalition will be formed to keep the fast-growing populist-nationalist parties excluded from government. Conflicts between regional and national political structures will continue to raise occasional problems for business, as will the labour unions' reaction to a continuing economic austerity programme.

Belgium's location at the heart of western Europe, and the presence of international institutions such as the EU and NATO, make it a credible target for an Islamic extremist attack.

The return of the city state

The development of Europe's supra-national political entity the EU has led some national politicians to voice concern about the future of the nation state. In the 1990s, the 'Europe of the Regions' policy introduced the possibility of greater functional autonomy for certain regions and a further erosion of nation-state power. This has had some influence on developments in political structures – notably in the UK, with Scottish and Welsh devolution, and in Spain – but its overall impact has been limited.

In the 2000s, a smaller class of sub-national entity has increased its power and influence. Throughout western Europe, capital cities and some populous, financially significant regional capitals (notably Milan and Barcelona) are increasingly projecting themselves as key players in national and international debates. Many countries have long had strong executive mayors in their largest cities – French President Jacques Chirac maintained his national image by serving for 18 years as mayor of Paris, for the last two years combining the role with that of prime minister.

Elsewhere, the idea is relatively new; globalising economic and demographic changes have led to cities such as London, Madrid, Amsterdam and Rome presenting themselves as internationally significant political entities, with little reference to the nation-state that surrounds them. The increasing importance of international transport links and high-quality communications infrastructure has enhanced this trend.

While none appears likely to seek independence, there is a distinct move throughout the region towards a regeneration of the city state, with its own political structures, financial system and, most crucially, a sense of community identity among its often transient population. People of all nationalities can now be Londoners, Madrileños or Dubliners. The model of Brussels – where an increasingly international city is becoming distanced from Belgium's two other regions and to an extent from the Belgian state itself – may be more widely followed in the coming decades.

Bosnia and Herzegovina

Political risk: M
Security risk: L

General elections in October 2006 revealed persistent difficulties in inter-ethnic relations. The nationalist parties will continue to dominate the political scene at all levels and obstruct any significant measures aimed at building a viable state. Consequently, progress with reforms is likely to remain incremental at best. The Office of the High Representative, which was established under the 1995 Dayton peace accord to oversee the governing of the country, is likely to continue its mission, especially given the upsurge in nationalist sentiment and the radicalisation of political discourse during the elections. Nevertheless, the security situation is unlikely to deteriorate during 2007.

Economic recovery has begun, but unemployment remains high and the lack of a coherent, single economic space will continue to impair business activity. In the absence of effective central institutions, crime and corruption will continue to flourish, further hampering business operations and deterring investment.

Bulgaria

Political risk: L
Security risk: L

The country will join the EU on 1 January 2007 but will have to adhere to measures to guarantee the continuation of reforms. The European Commission will continue to monitor progress in specific areas, including judicial reform and the fight against corruption. However, concerns persist that the coalition government will be unable to maintain the pace of reform

because of political instability. The grand coalition that was formed in August 2005 has been propped up by the collective drive to secure EU accession, but it is likely to disintegrate once this incentive disappears. Government collapse could trigger early elections in 2007.

Economic growth is high and is likely to be boosted by the country's entry into the EU's common economic space. Investment is also expected to grow during 2007. Organised criminal groups remain active, and sporadic violence among rival organisations will persist, but foreign businesses operating in the country are unlikely to be affected.

Croatia

Political risk: L

Security risk: L

Croatia enjoys overall political stability and has stable institutions. The government is likely to continue efforts to improve the investment environment and implement the necessary reforms to further its bid for EU membership. The economy will continue to grow at a fast pace, but corruption, cronyism, red tape and, most importantly, a weak and inefficient judiciary, will continue to pose obstacles to foreign businesses.

Extortion is a problem but mainly affects local businesses. Organised criminal groups from Bosnia and Herzegovina use Croatia to launder money, but general crime levels remain lower than in most other European countries.

Cyprus

Political risk: L; M in Turkish Republic of Northern Cyprus (TRNC)

Security risk: L

The reunification issue is likely to return to pre-eminence in 2007, with domestic, Turkish and above all EU interests seeking to inject new impetus into the process. A referendum on reunification is unlikely until at least 2008, though any such vote would dominate the political landscape as soon as it is announced. Turkey is unlikely to abandon its refusal to recognise the Greek Cypriot Republic of Cyprus, and the issue will remain a pretext used by those EU states that seek to stall Turkish plans for accession. The general business environment will remain stable.

Cyprus' role as an international staging post between Europe and the Middle East was reinforced during the conflict in Lebanon in 2006; this presents another minor risk factor regarding a terrorist attack, in addition to the continued British military presence. The self-styled Turkish Republic of Northern Cyprus (TRNC) will remain isolated but politically stable, though its efforts to promote a rapprochement between Turkey and the Greek Cypriots will be hampered by its unofficial status.

Czech Republic

Political risk: L

Security risk: L

The political situation is likely to remain in flux as a result of the inconclusive general elections of June 2006, when the right-wing and left-wing coalitions won control of 100 seats each in the 200-seat lower house. Repeated failed attempts to form a government are likely to lead to early elections in late 2006 or early 2007. Continuing political instability will further postpone essential reforms of the health-care and pensions systems, which in turn may undermine the country's prospects of adopting the euro in the near future.

Despite a rising public deficit, the economy is healthy. The country is an attractive investment destination, though corruption and excessive red tape will continue to hamper foreign business. The security environment will remain generally safe, but organised criminal groups involved in money-laundering and racketeering will continue to operate.

Denmark

Political risk: I

Security risk: L; I in Greenland, Faroe Islands

Denmark is politically and economically stable and presents few operational obstacles. The right-of-centre minority government will continue to enjoy broad support until the end of its term in 2009. The economy remains robust and offers an attractive investment environment.

The controversy in early 2006 over a Danish newspaper's publication of cartoons deemed offensive to Muslims has raised the country's status as a credible target for Islamic extremist terrorist attacks. There is no precedent of such an attack in Denmark, but a number of arrests in 2006 underlined the presence of small Islamic extremist cells that have the motive, the will and the ability to launch attacks on Danish territory.

Estonia

Political risk: L

Security risk: L

The two main centre-left parties in the ruling coalition, the Centre Party and the People's Union, are likely to form the core of a new governing coalition after the March 2007 parliamentary elections. Social spending will increase in the run-up to the polls, leading to inflationary pressures that could jeopardise Estonia's prospects of joining the eurozone by January 2008. The new coalition, like the incumbent government, is likely to be unstable. However, the business climate will remain unaffected because all the main political actors share a fundamental commitment to a market economy and the adoption of the euro.

The government is likely to keep troops stationed in Iraq and expand its military presence in Afghanistan, but both military contingents will remain small and will not imply an increase in the terrorist threat to Estonia. The country's expected entry into the Schengen area (which allows free movement of people between European states and harmonises border controls) in October 2007 will boost tourism but increase pressure on the government to redraft the 1999 border treaty with Russia.

Finland

Political risk: I

Security risk: I

The year will begin with a curtailed election campaign, with the parties maintaining a truce until the end of the EU presidency in January. The general election in March will produce a coalition between two of the three main parties as usual, with a renewal of the existing arrangement between the Centre Party (Keskusta) and the centre-left Social Democratic Party (SDP) the most likely outcome. The new government will take advantage of favourable economic conditions to promote structural reforms that will prove unpopular with trade unions, and strikes in some industries are likely. The labour market is gradually liberalising and the business environment is otherwise strong. Finland faces an insignificant risk of terrorist attack, and the security environment is generally positive.

France

Political risk: L

Security risk: L; M in Corsica

The April-May presidential election will dominate the political landscape in the first half of 2007. Although neither is yet certain to win their party nominations, Nicolas Sarkozy of the governing Union for a Popular Movement (UMP) is likely to triumph over Ségolène Royal of the Socialist Party (PS) in the second round. Both are seen as highly individual, even maverick, figures within their parties; Sarkozy's reformist, Atlanticist outlook is unusual on the

French right, while Royal is willing to sacrifice many long-held PS tenets and edge towards economic liberalism and tougher social policy in search of centrist voters. The UMP is also likely to renew its majority at the June parliamentary elections.

Whatever the outcome of the elections, further strikes and protests against labour, pensions and public-service reform are almost certain, with a minority of protests escalating into violence. There is a low risk of renewed large-scale suburban rioting of the sort seen in late 2005.

Islamic extremist groups made explicit threats against France in 2006, reflecting the prevailing terrorism risk, and an attack remains possible in 2007. Corsican nationalists appear to have been frustrated in their attempts to re-escalate their campaign, though small-scale bombs at holiday homes and against symbols of French rule on the island are likely, particularly in the spring and early summer (April-June).

Georgia

Political risk: M

Security risk: M; H in Abkhazia, South Ossetia, Pankisi Gorge beyond Akhmeta

President Mikhail Saakashvili will continue to consolidate his power and attempt to control the more hardline elements in his administration. Frustration with generally poor living conditions and Saakashvili's failure to deliver on economic reform will persist. Protests are possible but would be unlikely to threaten business visitors.

The main domestic concern will be internal security. Relations with the unrecognised republics of South Ossetia and Abkhazia will continue to falter as the central government attempts to assert its control. Supported by Russia, the leadership of both regions will be reluctant to settle for anything short of total independence, and low-level clashes will continue. Violence in either region could incite an aggressive response from the Georgian military, which could reignite serious conflict. Relations with Russia are likely to remain strained, with provocative internecine rhetoric remaining the norm.

Georgia will begin to benefit from the completion of important hydrocarbons pipeline projects; GDP growth is expected to reach 8%. The government will push for a more active state role through fiscal policy. Corruption, smuggling and an inexperienced, partial judiciary will continue to thwart business operations, while crime levels will remain high.

Germany

Political risk: L

Security risk: L

The grand coalition between the centre-right Christian Democratic Union (CDU) and the centre-left Social Democratic Party of Germany (SPD) is likely to remain stable during 2007, but far-reaching reforms are unlikely because of lingering policy differences between the governing parties. However, the government is expected to cut corporate tax from 39% to around 30% and reduce social-security contributions from 6.5% to 4.5% of gross wages. These measures will be accompanied by an increase in value-added tax (VAT – sales tax) by three percentage points (to 19%) from January. This could adversely affect the economy despite steps towards recovery in 2006.

The security environment will remain generally safe for foreign businesses, though there is a credible risk of terrorist attack. The discovery of bombs on two trains in the west of the country in July highlighted that Islamic extremist cells remain active in Germany. The government is expected to step up security measures to mitigate the terrorist threat. Sporadic right-wing extremist violence, primarily targeting asylum-seekers and foreign residents, will remain a problem in eastern states.

Greece

Political risk: L

Security risk: L; M in Athens, Thessaloniki

Costas Karamanlis' government appears stable, despite a number of corruption scandals, and is likely to see out its full term. The appointment of Dora Bakoyannis, the high-profile former mayor of Athens, as foreign affairs minister has increased the country's international standing, and Greece can be expected to play a key role in the relationship between the EU and Turkey in 2007, particularly over Cyprus. Strikes and protests are likely in opposition to privatisations and welfare reform, though these should not result in prolonged disruption.

Greece does not appear to be an attractive target for international terrorists, though small domestic groups will continue to target state institutions, possibly including assassination attempts on ministers. Additionally, the risk of arson and small-scale bomb attacks by anarchist or ultra-leftist groups on commercial premises with strong US or British brands will remain.

Hungary

Political risk: L

Security risk: L

The social democratic government endured a significant loss of popular support in September 2006 following revelations that the ruling Hungarian Socialist Party (MSZP) had lied about the scale of its achievements to secure re-election in April 2006. However, Prime Minister Ferenc Gyurcsany's administration enjoys a majority in parliament and is expected to remain in power until the end of its mandate. The government is set to implement an austerity package aimed at curbing the 10% budget deficit and thereby safeguarding the country's prospects of joining the eurozone. The operating environment will remain favourable, though an inefficient judiciary and excessive red tape will continue to hamper business activities.

Organised criminal groups continue to operate in the country but remain unlikely to target legitimate foreign businesses. However, 'white-collar' crime, including fraud and money-laundering, poses a risk to foreign investors.

Iceland

Political risk: I

Security risk: I

Geir Haarde has had some success in stemming a deterioration of the country's financial position since becoming prime minister in June 2006, though the risk of a renewed crisis is credible with the country's banks and major companies seemingly undeterred by extremely high foreign debt. However, the governing coalition, formed by the centre-right Independence Party (ISF) and the centrist Progressive Party (FSP), is highly stable and is likely to be returned to office in the general election in May 2007. Haarde is likely to be less sympathetic towards the EU than his predecessor Halldur Asgrimsson. The business environment is generally good, though high interest rates and relatively wide currency fluctuations will continue to alarm many investors. There are no significant security risks.

Ireland

Political risk: L

Security risk: L

The first half of 2007 will be dominated by the extended campaign before the general election, which must be held by early July. A decline in support for the governing Fianna Fáil-Progressive Democrat coalition in the second half of 2006 is likely to result in a very close election, with the opposition Fine Gael-Labour-Green coalition challenging strongly. There is a credible risk of parliament being hung between the two coalitions, with the balance of power

falling to leftist nationalist Sinn Féin, which has links to former terrorist organisations; fresh elections would be likely in this scenario. The security situation is good, with paramilitary action in decline and now linked chiefly with organised crime rather than political grievances.

Italy

Political risk: L

Security risk: L; M in southern regions

The Union coalition government led by Romano Prodi holds paper-thin majorities in both houses of parliament, and consequently will be at risk of collapse in every controversial vote. The more left-wing elements are likely to tire of the reform measures necessary to improve the country's financial position, and their withdrawal of support is a significant risk on matters such as labour, welfare and pension reform. Should the government survive, gradual economic reforms are likely to continue, though the liberalisation necessary to improve international competitiveness will prove highly unpopular.

Islamic extremists continue to threaten Italy in public statements, and an attack in a major city is a credible risk; the withdrawal of Italian forces from Iraq, likely to be completed in January 2007, will be of little benefit in dissuading terrorists. Domestic terrorism appears to be in remission, though the direct action movement is becoming increasingly aggressive, chiefly with regard to environmental issues. Organised criminal groups remain active, particularly in southern regions, and their influence places businesses operating in those regions at greater risk of crime and corruption. In addition, petty crime is a more significant problem in the cities and tourist resorts of the south.

Kazakhstan

Political risk: L

Security risk: M

See also **Kazakhstan: Pretenders to the throne** on p. 28.

President Nursultan Nazarbayev will struggle to manage competing government factions as his expected retirement draws near. However, any instability is likely to be offset by political apathy among the population, who are appeased by rising incomes and the country's comparative stability in relation to neighbouring states. In support of its bid to chair the Organisation for Security and Co-operation in Europe (OSCE) in 2009, Kazakhstan will continue to pass political reforms in an apparent move towards democracy, but these will be unlikely to have a significant impact on governance.

The state will remain assertive in the hydrocarbons sector, insisting on a stake in all major projects. As a result of large-scale investment and high oil export volumes, GDP is expected to remain at 9%, while inflation will rise to around 8%. Russia's possible entry into the World Trade Organisation (WTO) at the end of 2007 could lead to Kazakhstan joining too, necessitating further reforms, but this remains unlikely. The government will attempt to improve communications, energy and transport networks throughout the year.

Kazakhstan will continue to prioritise relations with Russia, while an increasingly stable relationship with the US, following the decline of US political influence in Uzbekistan, could have a positive commercial impact. Kazakhstan will also step up energy co-operation with China. The government will continue to cement interregional security partnerships in the fight against terrorism, though the threat to Western companies will remain low. Crime poses a low but increasing risk to foreigners, particularly in the more remote western towns of Atyrau and Aktobe, because of the disparity in wealth and continuing poverty.

Kyrgyzstan

Political risk: M

Security risk: M; H in Fergana Valley

The government will come under attack because of popular resentment over entrenched official corruption, nepotism and economic hardship; there is growing disillusionment with the modest achievements of the March 2005 'Tulip' revolution, which brought President Kurmanbek Bakiyev to power. Friction will persist between Bakiyev and Prime Minister Felix Kulov as each attempts to strengthen his respective position. Regardless of whether or not the government acts on its promises of constitutional reform, tensions between the government and parliament are unlikely to jeopardise the regime's hold on power, because its mandate to rule does not legally depend on parliamentary support. There is little risk of widespread social unrest, but popular discontent could erupt into occasional protests. GDP growth will not exceed 4%, while continuing business disputes will deter foreign investment.

The security situation in southern areas will remain precarious. Religious tensions will remain high and support for radical Islamist groups such as Hizb ut-Tahrir will grow. Levels of street crime will remain higher than in other Central Asian countries. A US military withdrawal from Bishkek's Manas airport is unlikely, and Russia is likely to retain its troops at the Kant base.

Latvia

Political risk: L

Security risk: L

Parliamentary elections in October 2006 returned a fragmented assembly, with a centre-right coalition remaining in government. The business environment will remain favourable, with no major policy changes expected in 2007. Nevertheless, the coalition will be weakened by infighting and corruption allegations, which have become a hallmark of Latvian politics. The presidential election in June 2007, in which popular incumbent Vaira Vike-Freiberga must step down according to the constitution, will not significantly affect business because the president does not have a primary role in policy-making.

Corruption will continue to pose a problem, but less so than in other Commonwealth of Independent States (CIS) countries. The greatest risk for foreign personnel will remain petty crime. The government is likely to increase its military presence in Afghanistan, but not significantly; Latvia will not face an increased risk of Islamic extremist terrorist attack.

Lithuania

Political risk: L

Security risk: L

The centre-left government is likely to undergo a reshuffle in 2007 because of persistent infighting among parties. However, its commitment to liberal economic policies will remain unchanged and coalition instability will not significantly harm the business environment. Cuts in personal income tax are likely in 2007.

Relations with Russia will be strained until mid-year, when Russian oil deliveries to Lithuania's Mazeikiu Nafta refinery are expected to resume following a pipeline fault in 2006. The government is likely to have to agree to higher prices for Russian gas, which will keep inflation high and, in turn, prevent Lithuania from adopting the euro by 2008. Delays to improvements in border security are likely to prevent entry into the Schengen area (see Estonia) in 2007.

Luxembourg

Political risk: I

Security risk: L

Domestic politics will remain uncontentious by European standards, with Prime Minister Jean-Claude Juncker's coalition government stable and relatively popular. Unemployment will continue its gradual increase, but will not threaten the country's otherwise strong economic performance. Despite Luxembourg's status as a major financial centre, and the risk of terrorist attack in surrounding countries, the security risk will remain low.

Macedonia

Political risk: M

Security risk: M

Elections in July 2006 brought a new government, which is likely to remain stable and see out its full term. The two main coalition partners – the ethnic Slav Internal Macedonian Revolutionary Organisation-Democratic Party of Macedonian National Unity (VMRO-DPMNE) and the Democratic Party of Albanians (DPA) – had been seen as populist, nationalist parties while in office between 1998 and 2002, but they are likely to take a more moderate stance to safeguard the country's EU accession bid. Nevertheless, progress in key reform areas, such as anti-corruption and judicial independence, is likely to remain slow.

The government will continue to implement the provisions of the Ohrid peace agreement, which ended fighting between the guerrilla National Liberation Army (NLA) and government security forces in 2001. Inter-ethnic relations have improved significantly in recent years, but sporadic intra-ethnic low-level violence within the Albanian community is likely to continue.

Malta

Political risk: L

Security risk: L

The issue of illegal immigration into the EU via Malta is continuing to gain ground, with various right-wing pressure groups emerging and threatening to coalesce into a viable political movement. Marches by these groups will attract heavy police presence and could escalate into violence, as could any repeat of the 'detainees march' of June 2006. However, basic political stability is assured, with the Nationalist Party (PN) likely to remain in power at least until the next election in 2008. There are few risks to security.

Moldova

Political risk: M; H in Transdniestr

Security risk: M; H in Transdniestr

The conflict over the status of the breakaway region of Transdniestr will continue to threaten political stability. The prospect of a negotiated solution appears increasingly remote following an independence referendum in September 2006, which returned an overwhelming 'yes' vote but was not recognised by the central government or the EU. The security environment in Transdniestr is deteriorating; sporadic bomb attacks, a weak rule of law, widespread corruption and unreliable law enforcement will continue to adversely affect business operations in the region. Levels of street crime and organised crime are also likely to remain higher in Transdniestr than in the rest of the country, where the security environment is stable.

Moldova's relations with Russia will remain difficult because of the countries' divergent stance over Transdniestr. Russia's ban on selected Moldovan imports will continue to weaken the economy and Moldova will probably be forced to cede control of energy networks to Russian energy giant Gazprom in 2007 or face higher gas prices.

Montenegro

Political risk: M

Security risk: L

Montenegro split from Serbia in June 2006 following an independence referendum. The ruling pro-Western social democratic coalition won an absolute majority in the September 2006 general election, boding well for political stability over the next four years. The government is likely to sign a Stabilisation and Association Agreement – the first step towards eventual EU accession – in 2007. The country's bid to join the EU and become a financial and tourism centre may encourage progress with reforms, but the government will face serious challenges, especially with regard to corruption and organised crime. The administration's priority will be to build strong state institutions, at the expense of swift reforms.

Organised crime may increase as a result of Russian commercial investment, which many suspect is funded through money-laundering. Inter-ethnic or inter-state conflicts are unlikely because the transition to independence ran smoothly and the new country has swiftly gained international recognition.

Netherlands

Political risk: L

Security risk: L

The general election scheduled for 22 November 2006 is likely to result in a coalition government led by the Labour Party (PvdA). Its principal objective will be to maintain the strength of the country's economic recovery while meeting its commitments on spending increases in education, health-care and urban regeneration. The business environment will remain sound, with occasional strikes providing the most significant challenge.

Tensions between the Muslim community and the remainder of society have eased somewhat since their peak in 2003-05. However, immigration and integration remain a hot political issue, with a number of high-profile controversies inevitable no matter which parties win power. The tense atmosphere contributes to the increased risk of an attack by Islamic extremist terrorists in the country, a risk further exacerbated by the government's position on the conflict in Iraq and by the social exclusion experienced by many Muslim immigrants. The country's status as a hub for the distribution of goods, both legitimate and illicit, throughout Europe and beyond attracts organised criminal groups.

Norway

Political risk: I

Security risk: I

The centre-left coalition government has a comfortable majority in parliament. However, lingering policy differences between coalition members may lead to increasing instability, and discussions on the 2007 budget or the September 2007 local elections may even threaten to result in government collapse. Nevertheless, such an event would not significantly affect the business environment; Norway is one of the safest business destinations in the world, economic growth is good and companies face no serious operational obstacles. Security risks are insignificant.

Poland

Political risk: L

Security risk: L

Political instability may persist given the fragmented composition of parliament, which has prevented any workable coalition government since elections in 2005. Early elections are likely in 2007, but the survival prospects of any new government would not be significantly

greater than those of the incumbent administration, because both of the two main parties would struggle to secure a comfortable parliamentary majority. Despite political instability, the economy is relatively healthy and will continue to grow. The business environment is expected to remain attractive to investors, despite slight government intervention in the market economy.

Poland has one of the highest levels of crime in Europe. Petty crime, vehicle theft, and car and cargo hijacks are of particular concern. Organised criminal groups operate in the country but tend to engage in activities that do not pose a direct threat to legitimate businesses, such as car theft, smuggling and counterfeiting. The terrorism threat remains credible but low compared with many western European countries.

Portugal

Political risk: L

Security risk: L

The Socialist Party (PS) led by Prime Minister José Socrates has offered the country the stability that it had lacked in the 2000s and, though the economy has been slow to recover from the 2003 recession, progress is likely to accelerate in 2007. Socrates is likely to remain in office throughout the year, but his attempts to reduce the budget deficit will continue to prove unpopular with trade unions and left-wing elements within the PS. Strikes can be expected to recur on a regular basis in 2007, particularly in the public sector. There is a low risk of an attack by international terrorists, and there are no significant domestic terrorist groups.

Romania

Political risk: L

Security risk: L

Romania will join the EU on 1 January 2007. The drive towards EU accession has sustained the centre-right governing coalition, led by the Truth and Justice Alliance (DA) and the Democratic Party (PD), despite constant infighting. However, EU membership could prompt early elections in 2007, which would be likely to reinstate the same two parties but in a looser coalition; neither would be keen on a partnership with either the former communist Social Democratic Party (PSD) or the far-right Greater Romania Party (PRM). In any event, the government can be expected to continue reforms in accordance with EU membership requirements. The economy will continue to grow, while foreign investment is expected to increase as a result not only of EU accession but also of the country's low corporate taxes and a general improvement in the operating climate. Nevertheless, corruption and red tape remain a concern.

The security environment will remain largely safe for businesses; organised criminal groups are mainly involved in smuggling and people-trafficking, and are therefore unlikely to pose any significant threat to legitimate foreign companies.

Russia

Political risk: M; H in North Caucasus

Security risk: M; H in North Caucasus

See also **Russia: The dangers of resource nationalism** on p. 38.

Political stability is assured and economic growth will remain robust, though marginally weaker than in 2006. Despite the state's determination to exert control over the economy, particularly in the energy and mining sectors, the country's rich natural resources and expanding consumer market will continue to attract multinationals. Corruption and an unpredictable regulatory environment will remain businesses' primary concerns. Social spending will increase substantially to boost support for the government ahead of parliamentary elections in December 2007; consequently, inflation will exceed the 8.5%

Chechen terrorism after Basayev

The fight against Chechen terrorism achieved significant successes in 2006, not least with the elimination of rebel leaders Abdul Khalim Saidullayev and Shamil Basayev, the latter having been on the government's most-wanted list for more than a decade. Saidullayev's successor, Doku Umarov, has adopted a more moderate stance, apparently keen to avoid the virulent domestic and international criticism that followed civilian atrocities such as the 2004 Beslan massacre.

The threat of bomb attacks against Chechen civilians is currently low and is likely to remain so in 2007. However, kidnaps by armed groups affiliated to Chechen Prime Minister Ramzan Kadyrov will continue to terrorise the local population. The Russian government may well seek to replace Kadyrov with a more compliant leader in 2007, which would provoke violence among Chechen warlords.

Rebel attacks against military and law-enforcement units and government officials in Chechnya and throughout the North Caucasus will remain frequent in 2007. As usual, rebels will step up attacks in the summer because they face logistical difficulties in the winter months while hiding in the freezing Caucasus mountains. President Vladimir Putin's plan for military withdrawal from the region, scheduled to begin in 2007, is unlikely to lead to a significant reduction in troops in the short term.

The federal forces' success in restoring a semblance of peace in the North Caucasus may prompt radical rebels to stage a 'last-stand' attack on civilian targets in Moscow and St Petersburg in 2007 or 2008. Although these cities have not experienced a terrorist attack for two years, the threat will increase gradually from the summer until the end of the year and remain high into 2008, because radical militants may wish to pressurise the government in the run-up to parliamentary and presidential elections, scheduled for December 2007 and March 2008 respectively.

target. The elections will bring few surprises, with pro-government party United Russia likely to dominate the next parliament. Russia's negotiations with the US on joining the WTO will progress slowly; there is only a small chance of membership by the end of 2007.

The security climate will remain stable, with the principal threat to foreign personnel remaining petty crime. Any opposition demonstrations during the electoral period will not threaten public order. Nevertheless, the risk of an attack by Chechen rebels in Moscow or St Petersburg will increase in the run-up to the polls.

Serbia

Political risk: M, H in Kosovo

Security risk: L, M in Kosovo

The minority government is unstable and early elections are expected in late 2006 or early 2007. It remains to be seen whether the centre-right parties will be able to overcome lingering animosity to form a coalition and prevent the nationalist radicals from taking power. In any event, a reversal of reforms to cement democratic governance and a market economy is unlikely. Economic growth is strong and low corporate taxes will attract investors. A new and more stable centre-right government would be likely to push for the capture of war-crimes suspect Gen Ratko Mladic, facilitating the resumption of talks with the EU on a Stabilisation and Association Agreement. Organised criminal groups will continue to operate but are unlikely to affect the interests of foreign business.

Continuing international talks on the status of Kosovo are likely to conclude in early 2007. The international community will probably have to impose a UN Security Council resolution granting 'conditional independence', as a precursor to eventual independence. This would see Kosovo formally secede from Serbia, but it would remain a de facto international protectorate for years to come because of persistent political instability and insecurity, with continued but isolated violence among rival ethnic groups or against the international administration. Kosovar independence could lead to sporadic unrest in southern Serbia.

Slovakia

Political risk: L

Security risk: L

The centre-right coalition enjoys a majority in parliament and is likely to see out its term in office. Radical changes to the positive business environment are unlikely and growth forecasts are encouraging. While the administration will continue to implement some populist measures to meet its pre-election promises, these are unlikely to affect overall growth or the government's aim of joining the eurozone by 2009. Although the cancellation in October 2006 of an important privatisation deal raised fears that the government would adopt an increasingly interventionist stance, a nationalisation programme remains unlikely. The operating environment is benign, though corruption and an ineffective judiciary will continue to obstruct business.

Organised criminal groups operate in the country, but their activities are unlikely to affect legitimate foreign investors. Ethnic tensions will persist between Slovaks and the Hungarian minority, but unrest will remain isolated and pose no risk to foreign companies or personnel.

Slovenia

Political risk: L

Security risk: L

The country is likely to remain politically stable. The government will retain its pro-reform, business-friendly stance, and the country will be the first new EU member state to adopt the euro, on 1 January 2007. Membership of the eurozone is likely to spur economic growth and investment. Levels of crime, including organised crime, remain lower than in other European countries and are unlikely to affect foreign business operations.

Spain

Political risk: L

Security risk: L; M in Basque Country

The ceasefire maintained by Basque separatist group ETA since March 2006 will come under increasing pressure from the movement's more hardline elements in 2007. Nevertheless, while sporadic incidents of street violence may occur, these will pose little risk to the public and a complete breakdown in security is unlikely. The socialist government is likely to remain in office until the next parliamentary elections in 2008, with its key policies (engagement with Basque separatists, negotiated regional devolution, even the more liberal elements of its social policy) having proven unexpectedly popular, and the economy remaining strong.

The year is likely to see progress in the trials of those accused of involvement in the March 2004 train bombings in Madrid, ensuring that the Islamic extremist terrorist threat remains a major issue. Terrorist networks are known to be established in the country (though diminished by repeated law-enforcement successes) and a future attack is a credible risk. Similarly, trials of those accused in a number of major money-laundering scandals are scheduled to begin in 2007, focusing media attention on the issue, particularly in property development near the Mediterranean coast.

Sweden

Political risk: I

Security risk: L

The centre-right government, which ended the ten-year tenure of the Social Democrats in the September 2006 general election, is likely to remain stable over its four-year term. The new cabinet is expected to enact pro-business reforms, including deregulation of some state-owned industries and relaxation of the rigid labour market. Further reform of the traditional

welfare system is also expected, though changes will not be radical. Economic growth will remain strong. The security environment presents few risks to businesses, though direct action and organised criminal groups may continue to pose a risk to some companies.

Crawling towards a federation of unequals?

The approval in June 2006 of a new statute governing the relationship between the central government and the region of Catalonia opened a debate on the future of the Spanish state as a whole. Prime Minister José Luis Rodríguez Zapatero hopes that it marks the beginning of a transition to a federal system of government, with all 17 regions having broadly similar degrees of autonomy. However, the practicalities of reaching an accommodation that will prove politically and fiscally acceptable to the centre and each of the emerging regional power bases will ensure that, while the process is probably inexorable, it is likely to last decades rather than years.

The wide differences between regions and peoples in contemporary Spain suggest that federalisation might be a useful route forward. However, it is likely to create as many problems as it solves: there would be little common cause between regions, even on matters as fundamental as what they want from the arrangement. Catalonia's position illustrates the problem. By far the country's wealthiest region, its cultural and linguistic differences, and memories of its repression under the rule of Gen Francisco Franco (1939-75), contribute to a nationalist – and occasionally separatist – mood, exacerbated by the impression that Catalans' tax revenues fund the poorer regions. The spectrum of nationalist opinion ensures that no constitutional change is likely to satisfy a majority within Catalonia – or in the other wealthy, nationalist region, the Basque Country – even if they gain almost complete control over domestic affairs.

On the other side of the coin, poorer, less developed regions such as Extremadura have a weaker regional identity and no separatist ambitions, and have little to gain either politically or financially from increased autonomy under a federal system. Without the geographical and communications advantages enjoyed by the richer regions (the aforementioned Catalonia and the Basque Country, and the capital Madrid, fast emerging as one of Europe's new 'city states'), and with tax rates almost certain to be higher, regions such as Extremadura would struggle to attract investment and the disparity in wealth could only increase. The current round of statute revisions, which should be completed by 2009, is likely to frame the debate and confirm the federalising trend, but the road to Zapatero's goal is a much longer one.

Switzerland

Political risk: L
Security risk: I; L in Geneva, Zürich, Berne

The governing coalition will experience some tension as the far-right Swiss People's Party (SVP) gains in influence following its success in tightening immigration legislation in 2006. The SVP and the other coalition parties will tacitly oppose many of each other's official initiatives, though major disruption is unlikely and basic stability is assured. Organised criminal groups from the former Soviet Union and eastern Europe remain present, attracted by the nature of the country's financial system. There is a low risk of an attack by international terrorists.

Tajikistan

Political risk: H
Security risk: M; H on Afghan border

President Imomali Rakhmonov is likely to win a further seven-year term, virtually unchallenged, at the end of 2006. The security environment will remain tense after the vote

because of popular frustration over rising economic hardship, including higher energy prices, and persistent corruption. Disaffected radicals or Islamic extremists may repeat the assassination attempt on Rakhmonov during the 1999 election campaign. The country remains highly militarised after the 1992-97 civil war and, in the absence of a pluralistic political system, settlement of business quarrels by force is a first resort.

The popularity of radical Islamic movements, particularly in Uzbek-dominated areas in and around Khujand, will continue to rise unless the government can provide gainful employment opportunities to young men. Travel will remain difficult in central districts such as the Karategin valley and Garm, where the government's authority is weak. However, security in the major cities is likely to continue to improve in 2007, and petty crime will remain much lower than in western Europe.

Turkmenistan

Political risk: H

Security risk: M

The political situation will remain unchanged in 2007 unless President Saparmurat Niyazov dies unexpectedly. Economic performance will remain difficult to gauge, given the unreliability of statistics, but unemployment and inflation are likely to continue to rise and living standards will remain low. Continuing hardship could prompt protests and labour disputes. There is unlikely to be any fundamental restructuring or privatisation of the agricultural or industrial sectors as long as Niyazov remains in power, and opportunities for foreign investment will remain extremely limited and challenging. In the event of Niyazov's death, the lack of transparent institutional structures and the concentration of political and economic power in his hands could result in a violent transition period.

The risk of terrorist attack will remain low because of the country's neutral status. However, this situation could change if Niyazov dies or steps down. Drug-trafficking (with the complicity of the government) will continue to rise in 2007 following 2006's record opium harvest in Afghanistan. Levels of street crime will remain low compared with those in western Europe.

Ukraine

Political risk: M

Security risk: M

Prime Minister Viktor Yanukovich's ruling coalition is likely to remain in power throughout 2007. However, the Communist Party may be eased out of government if pro-presidential party Our Ukraine, as expected, makes a renewed attempt to join the coalition. The government will continue to build ties with the EU while keeping Russia as a close political and commercial partner; Yanukovich is unlikely to pursue NATO entry in 2007 so as not to antagonise Russia. The economy will remain dependent on Russian gas; expected price rises will fuel inflation and further debilitate the energy-hungry steel industry. However, improved relations with Russia will prevent prices from reaching EU levels and enable the government to avoid any interruption in supplies.

Despite slow implementation of legislation necessary to secure entry into the WTO, the country is likely to become a member in 2007. These new laws will also increase Ukraine's chances of signing a free-trade agreement with the EU in 2007. Further integration into EU and Western trade organisations will benefit the investment climate, but operating conditions for foreign businesses will remain hampered by an inefficient and corrupt judicial system and by changeable tax regulations.

Organised criminal groups, currently based largely in the east, will progressively extend their activities across the country in 2007. However, violence perpetrated by such groups will continue to target local businessmen and is unlikely to affect foreign companies directly.

United Kingdom

Political risk: L

Security risk: L

With Prime Minister Tony Blair having already announced that he will step aside by mid-year, the succession will dominate British politics in 2007. Chancellor of the Exchequer (finance minister) Gordon Brown remains likely to secure the Labour Party leadership and can be expected to provide broad continuity, with some minor leftward policy shifts to satisfy the party base and some centrist moves to boost his appeal to the wider electorate. The economy will remain resilient, and the business environment as a whole will retain its strength and flexibility.

Further arrests in connection with Islamic extremist terrorist plots are likely, and there is a credible risk of a further attack. After the progress in the political process in Northern Ireland in late 2006, any further stagnation would produce frustration among the political parties, though a return to widespread paramilitary political violence is unlikely.

Uzbekistan

Political risk: M

Security risk: M; H in Tajik border areas, Fergana Valley

A presidential election is expected in 2007, and President Islam Karimov is likely to attempt to stay in power by amending the constitution. The opposition will not be strong enough to orchestrate any effective challenge or protest movement; nor is there an obvious contender within the government. In the run-up to the elections, the government will continue to stifle independent media, both domestic and international non-governmental organisations (NGOs) and opposition groups. Relations with the US and Europe are unlikely to improve substantially, while relations with Russia, China and other Asian countries will continue to gain strength, particularly in the commercial sphere.

High commodity prices will continue to boost government coffers, while economic indicators such as unemployment and GDP are likely to remain at about 6%. The government is expected to make changes to the tax system in favour of businesses and private individuals. However, political influence over Western companies will remain strong, deterring new investment. The long-awaited privatisation of key energy companies may begin in 2007, but the state will retain a controlling share in all such companies.

Street crime is likely to worsen, fuelled by a decline in living standards and a lack of police reforms, particularly in the capital Tashkent. The risk of small-scale attacks against government and foreign interests by unsophisticated domestic terrorist groups will remain.

The high costs of transnational bribery

Bribery by competitors remains a major problem for international business. Control Risks' latest report on *International Business Attitudes to Corruption*, which was co-sponsored by international law firm Simmons & Simmons, surveyed international business development directors from 350 companies in the UK, the US, France, Germany, the Netherlands, Hong Kong and Brazil. Overall, 43% of respondents believed that they had failed to win business in the last five years because a competitor had paid a bribe, and one-third had lost business to bribery in the past year. Hong Kong was by far the worst affected, with 76% of companies believing that they had lost business in the last five years.

Host countries lose out as well. More than 35% of companies had been deterred from an otherwise attractive investment because of the host country's reputation for corruption. British companies were most likely to be put off an investment. Hong Kong and Brazilian companies were least likely to be deterred, perhaps in part because they have a narrower range of choices in their geographical regions.

Companies based in countries with high levels of corruption lose out in several ways. It can be harder to find international partners or to raise finance from foreign banks. And as one Brazilian respondent observed: 'We have something called the "Brazil Cost", the amount we have to pay in bribes to the various parties to win any contract. This is our biggest risk because even when we pay, we do not know if we still win.'

Concerted action is needed to tackle the corruption problem. Companies need to back up anti-corruption codes with effective compliance procedures. National and international industry associations should work together to pool experience of anti-corruption strategies and develop common standards. Governments should raise awareness of their own anti-corruption laws, and ensure that they are enforced.

Full details of the survey are available on Control Risks' website: www.control-risks.com

Middle East and North Africa

Algeria

Political risk: M
Security risk: M; H in northern rural areas

Political tensions will increase ahead of parliamentary elections in May 2007 as the ruling National Liberation Front (FLN) seeks to consolidate its support. The government is also likely to call a national referendum on key constitutional amendments that would allow presidents to serve three consecutive terms and create the post of vice-president. Although the proposed measures are viewed as a less than subtle attempt to extend President Abdelaziz Bouteflika's time in office, the referendum will pass easily. However, questions remain over Bouteflika's health.

Following the completion of a second national amnesty programme in 2006, the threat from Islamic extremist violence will continue to decline. Further violence is likely in remote, mountainous areas, particularly in the north-east, but the security environment in main towns and cities will improve. Crime and unrest will replace terrorism as the country's primary security concerns. Issues such as a lack of access to basic infrastructure, high unemployment and a severe housing shortage represent significant additional challenges for the government that will take some time to resolve.

Bahrain

Political risk: L
Security risk: L

The Sunni Muslim elite will continue to dominate legislative proceedings through the appointed upper house of parliament. Meanwhile, King Hamad bin Issa al-Khalifa's refusal to amend the constitution will further frustrate the Shia Muslim community's efforts to address its political and socio-economic grievances. More radical elements of the Shia opposition will sponsor a more robust form of opposition, including social unrest that, in addition to competition from Qatar and Dubai, may compromise the government's efforts to establish Bahrain as a regional commercial and banking hub.

A large-scale terrorist attack in 2007 remains possible. The emirate provides a 'target-rich' environment for transnational Islamic extremist groups, including a large Western expatriate population, and serves as the base for the US Fifth Fleet in the Gulf region. However, small-scale, opportunistic attacks will continue to pose the most immediate risk to foreign personnel.

Egypt

Political risk: L
Security risk: M

President Hosni Mubarak's ruling National Democratic Party (NDP) will maintain its hold on power, while the security forces will quell dissent and ensure political stability. The security forces will continue to benefit from the absence of a completely independent judiciary and the extension of the country's 25-year-old emergency laws. Internal NDP power struggles will revolve around the presidential succession and economic reforms. The government will implement cosmetic political reforms while continuing efforts to co-opt the military, professional and business elites and ensure international economic and political support.

The leading opposition Muslim Brotherhood, which controls 20% of seats in parliament, will benefit from popular resentment of the government's selective patronage and corruption. Limited employment opportunities for middle-class youth and a rise in moderate conservative religious sentiment will bolster its support. The government will persist with attempts to marginalise the movement with a campaign of harassment and detention of activists.

Terrorism and tourism

A number of terrorist attacks in recent years have directly targeted tourists, most notably in Bali (Indonesia), Egyptian Red Sea resorts, Jordan and Turkey. They are effective because, while creating fear and mistrust, they also have an economic impact that reverberates far more widely.

Attacks against tourism are not a new phenomenon: Egyptian Islamic extremists killed 58 foreign tourists at Luxor in 1997. Nor is it restricted to Islamic extremists. Basque separatist group ETA targeted Spanish coastal resorts in the 1980s and 1990s in an effort to disrupt the country's economy, while the Kurdistan Workers' Party (PKK) in the mid-1990s led a campaign targeting visitors to Istanbul. Its urban splinter, the Kurdistan Freedom Falcons (TAK), staged attacks in Turkey's southern coastal resorts in 2005-06.

Tourist resorts are an attractive target, with large numbers of people and generally weaker security. For Islamic extremists in some countries, such as Egypt and Indonesia, tourists offer concentrations of vulnerable Westerners. There is also symbolic value for Islamic extremists; beach resorts may be perceived as emblematic of Western 'moral degeneracy' or the cultural domination and imperialism against which they are fighting.

Successful attacks can have a huge economic impact. Egypt's tourism industry was worth \$6.4bn in 2005. Tourism has virtually dried up in Dahab since an attack in April 2006 killed 24 people. Terrorism can also affect the industry globally. After the first Bali bombing in October 2002, many US tourists cancelled holiday plans for destinations across Asia. The second Bali attack in October 2005 affected the island's economy; Indonesia's flagship carrier, Garuda; and foreign investment in Indonesia generally.

Scenarios drawn up for a tourism-dependent city such as Las Vegas suggest that insured losses alone could reach tens of billions of dollars, with added costs from suspended business activity, travel disruption, loss of consumer confidence and decreased tourism. As long as tourism retains its symbolic and economic significance, it will remain a highly desirable target.

Further Islamic extremist attacks are likely against tourist resorts and sites in the Sinai peninsula region. Attacks on political leaders or the security forces may also occur in areas south of the capital Cairo or in the city itself. However, security forces will be able to prevent the emergence of a sustained campaign of violence that would significantly affect businesses operating in the country.

Tensions between the minority Coptic and majority Muslim populations will be fuelled by an Islamic revival in broad sectors of the Muslim community and by the popular association of Copts with foreign powers. These tensions are likely to take the form of attacks on churchgoers, interference in the building of churches and clashes in areas with Coptic populations.

Iran

Political risk: M

Security risk: M

See also **Iran: Nuclear ambitions** on p. 23.

President Mahmoud Ahmadinejad and his supporters within the traditionalist 'conservative' political faction will seek to establish a key minimum of support in 2007 by holding elections under restricted conditions, redistributing state assets to preferred private networks and commissioning public projects that appeal to Muslim and Iranian identity and provide patronage. Attempts by the reformist political faction, which advocates a democratic, pluralist state, to regain some of its lost influence will prove largely unsuccessful.

The security forces will contain popular protests and ethnic unrest within the Azeri, Arab, Kurdish and Baluchi populations. Any unrest will generally represent only an incidental risk to business.

The international dispute over Iran's nuclear programme will continue into 2007, with potential implications for foreign business. These include the cancellation or renegotiation of contracts in strategic economic sectors, increased reputational risks and rising trade finance premiums.

Iraq

Political risk: H; M in Kurdistan

Security risk: E; H in south; M in Kurdish region

The central government will continue to comprise competing groups who are unable to establish their authority nationwide. In the event that it falls, it would be replaced by a 'caretaker' administration with similarly limited powers. The political bloc headed by the rebel Shia cleric Moqtada al-Sadr will become increasingly influential in the capital Baghdad and in the south. Assassinations of political and religious leaders will continue at the local level and may target central government figures.

Real authority in many areas will fragment into ethnic and sectarian power zones. Shia Arab militias, both official and unofficial, will represent the dominant local authority in Baghdad and in the south. In Baghdad and areas north of the city, sectarian cleansing of neighbourhoods will continue as the conflict between Shia and Sunni Arabs escalates. The conflict will be most intense in Baghdad, while other areas of the country will be less seriously affected. In most of the country, with the exception of the north-eastern Kurdish region, sudden incident-driven deteriorations in the local security environment are likely.

Kurdistan: The other Iraq

Iraq's 5m Kurds, who make up 20% of the population, have been one of the key beneficiaries of the US-led overthrow of former president Saddam Hussein in 2003. Amid escalating sectarian and insurgent violence elsewhere in Iraq, most Kurds see their semi-autonomous Kurdish region as a separate entity capable of becoming an oasis of socio-economic stability. The region has considerable oil resources and agricultural potential and is currently experiencing a construction boom and increased interest from foreign investors.

The Kurdish regional government is based on a relatively stable balance of power between the two main Kurdish political factions, the Kurdistan Democratic Party (KDP), led by Massoud Barzani, and Iraqi President Jalal Talabani's Patriotic Union of Kurdistan (PUK). Their common interest in maximising the autonomy of the Kurdish region has proved more durable than any lingering divisions between them.

More than 6,000 significant incidents of insurgent violence have been recorded in Iraq since 2003, but only ten took place in the Kurdish region. The security services enjoy wide support among the semi-militarised population and, while successful one-off attacks remain possible, a sustained insurgent campaign comparable to that elsewhere in the country is unlikely.

The key issue that could impact on the stability of the region is whether the oil-rich and ethnically mixed city of Kirkuk will be absorbed into territory controlled by the Kurdish government. Political tensions and violence between the city's Kurdish, Arab and Turkomen residents are likely to result in increased political turbulence. This will be compounded by tensions between the Kurdish regional government and the national government and Turkey over Kurdish authority expanding to the oilfields of Kirkuk, which would bolster the region's autonomy. However, the issue of Kirkuk is unlikely to affect the day-to-day security environment in the Kurdish region, which is set to remain an unsung success story in an otherwise troubled country.

While some Sunni Arab leaders may turn against insurgents and operations by US and Iraqi forces may meet with some success, insurgents will act as the source of real political power in the predominantly Sunni province of Anbar. In the quasi-autonomous Kurdish region, tensions between the regional Kurdish and central governments will increase over issues including who controls the region's oil resources. Tensions between Kurdish and Arab residents of the disputed city of Kirkuk are also likely to escalate.

In the south, competition between Shia political groups and militias for status, power and access to resources will continue and occasionally spill over into violence. This could lead to the fragmentation of local police forces into competing militias. The operations of criminal gangs will add to the general climate of insecurity.

Israel and Gaza/West Bank

Political risk: L; H in Palestinian Authority (PA) areas

Security risk: M; H in PA areas

Prime Minister Ehud Olmert's administration will come under increasing pressure in 2007 as the fragile coalition begins to fall apart over issues such as social welfare and Israel's policy towards the Palestinians. Elections are likely to be called before the end of the year, despite the lack of a realistic challenger to Olmert's Kadima party.

Israel's security paradigm underwent a major shift in 2006 during the month-long offensive in southern Lebanon against the Shia militant group Hizbullah; the group fired hundreds of rockets into northern Israel, threatening major Israeli population centres such as Haifa, Nazareth and Tiberias for the first time. While another major confrontation with Hizbullah is unlikely in 2007, tit-for-tat skirmishes along the border with Lebanon may occur. Inside Israel, further attacks by Palestinian militants remain likely in main towns and cities.

In the Palestinian territories, the main Islamist movement Hamas will be forced to form a government of national unity with its rival Fatah or face early elections. However, while a national unity government would allow for the resumption of international aid to the PA, it would have only a limited ability to address many of the outstanding issues facing the West Bank and the Gaza Strip. Social unrest will persist and pose a threat to political stability. Peace negotiations with Israel are unlikely.

The security situation in the West Bank and Gaza will remain highly unstable. Efforts by the PA to take control of Palestinian militant groups are likely to lead to clashes, while militants in the Gaza Strip will continue to fire rockets into Israel. This will prompt further Israeli military incursions into the territory, as well as targeted killings of militant leaders.

Jordan

Political risk: L

Security risk: L

The government will continue with efforts to liberalise the economy but will hold back from political reforms. King Abdullah bin Hussein will seek to marginalise the more radical elements of the Islamic opposition while re-affirming the unwritten contract between main opposition movement the Islamic Action Front (IAF) and the state.

Transnational terrorism will continue to pose a threat to the kingdom's security environment in 2007, when the continuing civil conflict in Iraq may inspire extremists to carry out further attacks against Western targets. Although the security forces have deployed forcibly around key installations in the capital Amman, low-profile venues will remain vulnerable to attack.

Kuwait

Political risk: L

Security risk: L

The process that accompanied Emir Sheikh Sabah al-Ahmed al-Sabah's accession in 2006 underlined the position of the emirate's parliament as the most influential elected political institution in the region. The opposition has also been emboldened by its success in reducing the number of political constituencies from 25 to five in the next parliamentary elections. As a result, parliament will continue to challenge the government over the slow pace of political and economic reforms in 2007. This is likely to be accompanied by government attempts to exploit the fragile alliance between reformists and Islamists to further its own political agenda and constrain the reform process.

Transnational Islamic extremism will continue to pose a threat to the emirate's security environment, in particular from across the border with Iraq. While the authorities have reinforced security along that border, extremists will continue to enter the country and pose a threat to Western targets. A large-scale attack remains possible, though small-scale attacks will pose the most immediate risk to foreign personnel.

Lebanon

Political risk: M

Security risk: M

See also **Lebanon: The post-conflict political order** on p. 31.

The ceasefire between Israel and Hizbullah, which came into effect on 14 August 2006, will hold throughout 2007. Hizbullah agreed to the deployment of UN peacekeepers and the Lebanese army along the 'Blue Line' between Lebanon and Israel so that it could recover its military capabilities and rebuild its social infrastructure in Shia-dominated areas of the south, the capital Beirut and the eastern city of Baalbek. Throughout 2007, the pro-Syrian alliance, which comprises Hizbullah and Michel Aoun's mainly Christian Free Patriotic Movement, will call for a national unity government to replace the pro-US administration of Prime Minister Fouad Siniora. Siniora is likely to succumb to popular pressure, paving the way for a more pro-Syrian government. The populist Aoun is likely to replace President Emile Lahoud towards the end of 2007.

Libya

Political risk: M

Security risk: L

The country's political direction will remain erratic and unpredictable in 2007 despite the country's evolving rapprochement with the West. This will largely be the result of leader Col. Muammar Gadhafi's attempts to balance his return to the international community with increasing domestic social pressures. Public expectations of tangible improvements in living standards have been raised, and a failure to address issues such as unemployment and access to basic infrastructure could lead to increased dissent, and in rare instances, social unrest. However, large-scale unrest is highly unlikely and the country will remain politically stable for as long as Gadhafi remains in power. While uncertainty remains over the political system once Gadhafi is gone, he will not name a successor in 2007.

Although the growing presence of foreign investors makes the country a more likely target for transnational terrorism, the robust intelligence and security forces will counter this risk. Crime levels will remain low. Any demonstrations or protests will be swiftly suppressed.

Morocco

Political risk: L; M in Western Sahara

Security risk: M

With parliamentary elections scheduled for 2007, the government remains concerned by the growing popularity of Islamist parties, particularly the Party for Justice and Development (PJD). While a PJD election victory could prompt King Mohammed VI to halt his programme of gradual democratic reforms, the party has proved pragmatic in the past and may opt to limit its participation to avoid losing its status as a legitimate political party. Regardless of the elections' outcome, the kingdom will remain fundamentally politically stable and Mohammed will face no challenges to his authority. The dispute over sovereignty for Western Sahara will continue, with little likelihood of a resolution.

While the security forces have responded robustly to Islamic extremist activity since a series of suicide-bomb attacks in Casablanca in 2003 that killed 43 people, the risk of further attacks persists. Poor urban slums have provided a fertile recruiting ground for domestic and transnational extremist groups and the country has an abundance of symbolic targets.

Oman

Political risk: L

Security risk: L

Political stability will be supported by relatively benign economic conditions and efforts by ruler Sultan Qaboos bin Said al-Bu Saidi to ensure co-operation between the important merchant families and the continued goodwill of the population. If Qaboos dies in office in 2007, the succession process will proceed smoothly but take some time to resolve.

Significant increases in revenues from oil and natural gas, customs duties and income tax are likely in 2007 and will be combined with continued fiscal discipline. Economic stability will allow the government to proceed with its programme of 'Omanisation', which aims to replace expatriate workers with Omani nationals, though the programme will remain less successful than in the private sector.

The security forces have successfully prevented any attacks in the sultanate to date. However, Islamic extremist groups still have the intention, capability and initiative to attack targets in Oman. The sultanate's borders with the UAE, Saudi Arabia and Yemen are porous and criss-crossed by smuggling routes that could be exploited by terrorists; weapons are also available on the black market. While one-off attacks are possible, a sustained Islamic extremist campaign is unlikely.

Qatar

Political risk: L

Security risk: L

Qatar will hold its first elections to the 45-seat Consultative Council (*Majlis al-Shura*) in 2007. However, the council will be only partially elected, with 15 of its 45 members appointed by Emir Sheikh Hamad bin Khalifa al-Thani. The ruling al-Thani family will continue to occupy key positions within the government while driving the emirate's successful development model.

Qatar will continue to carve out a unique regional role by sponsoring development projects in southern Lebanon, supporting the peace process between Israel and the Palestinian Authority, maintaining low-level relations with Israel and competing for influence with Saudi Arabia. Hamad's nuanced approach to balancing competing interests, such as maintaining diplomatic relations with Israel while hosting prominent exiled Islamic clerics, is likely to raise the emirate's regional profile. However, it may also increase Qatar's attractiveness as a target for transnational Islamic extremist groups.

Saudi Arabia

Political risk: L

Security risk: H

A significant change in the security environment is unlikely in 2007. Islamic extremists will continue to plan large-scale operations against government and Western business and diplomatic targets, and a major attack remains likely. Small-scale attacks will continue to pose a threat to Western personnel, though extremists will remain focused on large-scale operations.

King Abdullah bin Abdul Aziz will consolidate his position within the ruling al-Saud family while continuing with a programme of piecemeal political reforms. While these are unlikely to satisfy domestic reformists, the buoyant economy will further enrich the ruling family, allowing it to co-opt its opponents. Economic growth will outpace the poorly conceived and executed 'Saudisation' programme that seeks to replace foreign labour with Saudi personnel, and the kingdom will remain dependent on its expatriate workforce.

Sudan

Political risk: M

Security risk: L; H in south, west, Eritrean border area

Government stability will remain fragile in 2007. Although the comprehensive peace agreement (CPA) signed in January 2005 between the government and the southern rebel Sudan People's Liberation Movement (SPLM) continues to hold, the national unity government that the CPA created has struggled to implement the accord. While it is unlikely to collapse in 2007, the peace process is unlikely to proceed smoothly until a referendum on whether the country should remain unified is held in 2012.

Divestment campaigns against Sudan

Sudan's government in January 2005 signed a comprehensive peace agreement with the SPLM, bringing an end to the long-running civil war. However, international opprobrium related to its actions in the south during the war has shifted to focus on the conflict in the western Darfur region. This condemnation remains driven by the US government and NGOs.

Unilateral sanctions prevent all non-humanitarian US investment in the country. However, international NGOs have mounted regular campaigns against investment by non-US companies, particularly in Sudan's oil industry. Several US universities and three state governments passed legislation in 2005 to divest from companies doing business in Sudan.

Only a comparatively small number of shares have so far been sold, but the divestment campaign could become a source of growing concern over coming years, with a further 19 universities and 12 state legislatures expected to consider similar measures. According to campaigners, more than \$91bn is invested by the top 100 US state pension funds in 83 companies that operate in Sudan.

Perhaps of greater concern than the financial impact of such moves are the reputational risks attached to these campaigns. Companies vary in their approach to safeguarding their reputation according to size, strategy, nationality and whether they are listed on major stock exchanges. In Sudan's case, the key determinant is nationality. Pressure groups are most influential in northern Europe and the US; US companies are banned from investing in Sudan and most major north European companies have so far stayed away. As a result, Chinese, Malaysian and Middle Eastern countries – which are all less concerned with reputation and less vulnerable to divestment pressures – have taken advantage and are now among the largest investors in Sudan.

The government has come under intense international pressure over the conflict and humanitarian crisis in the western state of Darfur. While the UN, with strong US support, has called for deployment of a 20,000-strong UN force in the region, the government has strongly resisted this. With the UN reluctant to deploy peacekeepers to the region without the government's consent, the diplomatic stand-off will persist. However, the conflict will have only a limited impact on domestic political stability because it is contained within the Darfur region.

The security environment in the capital Khartoum will remain relatively stable, though social unrest will represent an intermittent risk. However, serious security concerns will persist in the south, where tribal and militia clashes occur regularly. Heightened tensions will also continue between the government and rebel groups along the eastern border with Eritrea, though the situation is unlikely to deteriorate into armed conflict. The security situation in Darfur will not improve in 2007, when clashes and attacks on civilians and aid convoys will continue unabated.

Syria

Political risk: M

Security risk: L

President Bashar al-Assad's regime will face a number of domestic and international challenges during 2007. These include the UN investigation into the assassination of former Lebanese prime minister Rafiq Hariri, which is likely to implicate senior Syrian officials. Assad will come under international pressure to submit these officials to an international inquiry, which will be held in either Lebanon or a European capital.

The US and EU will continue to isolate Syria unless it agrees to co-operate with the UN inquiry, restrains its allies in Lebanon (namely Hizbullah), and downgrades its relationship with the Iranian leadership. However, Assad will not assent to the third condition because Syria's relationship with Iran has deepened and acquired a strategic dimension. However, a US attack on Iran's nuclear facilities would compel Syria to reach a 'grand bargain' with the US that could bring about a loose resolution of the Arab-Israeli conflict.

While the regime has been able to capitalise on Hizbullah's political and military successes in Lebanon, its secular brand of politics has become increasingly unpopular. Public attitudes towards political Islam, in addition to events in Iraq and Gaza and the West Bank have compounded the belief that Islam offers a viable solution to the country's domestic and international problems.

International pressure on the ruling regime could also provide Islamic extremists with an additional pretext with which to attack Western symbolic targets and key regime figures. Assad's regime has the capacity to confront the extremist threat, but it will lose public support if it responds disproportionately and clamps down on moderate Islamists.

Tunisia

Political risk: L

Security risk: L

Tunisia is a stable country and little change is expected over the coming year. President Zine al-Abidine Ben Ali and his ruling Democratic Constitutional Rally (RCD) party will continue to dominate the political scene, though Ben Ali may reshuffle his government, replacing Prime Minister Mohamed Ghannouchi, if economic growth remains sluggish. While Tunisians have accepted stability and prosperity at the expense of greater political freedoms, a further slowing of economic growth could increase pressure for reforms. Nevertheless, Ben Ali will continue to suppress political opponents, particularly Islamists. The threat of terrorism will remain low, though in common with many Middle Eastern and North African countries, there is an underlying risk of a major terrorist attack.

Turkey

Political risk: M

Security risk: M; H in south-east

The political environment will undergo considerable change in 2007. A presidential election will be held in May 2007 and will be followed by parliamentary elections later in the year. Prime Minister Recep Tayyip Erdogan has made no secret of his desire to become president and the post appears within his grasp; his ruling Justice and Development Party (AKP) holds a convincing majority in parliament, which will vote for the new president.

The election of an Islamist-leaning president would be anathema to the secular establishment, which includes the military and judiciary and has long viewed the presidency as the vanguard of Turkish secularism. As a result, a compromise candidate may be put forward to avoid a confrontation between the secular establishment and Erdogan. Parliamentary elections are likely to be less controversial; although the AKP is likely to emerge victorious, a number of other parties are expected to perform strongly and a coalition government is likely.

Following the series of bomb attacks carried out by militant Kurdish separatists in southern resort areas in 2006, security will remain a key concern in 2007. Kurdish separatists are likely to attempt further attacks against tourist and Turkish civilian targets, though their capabilities will remain limited and a large-scale attack is unlikely.

The Kurdistan Workers' Party (PKK) and the Kurdistan Freedom Falcons (TAK), which is thought to be the PKK's urban combat wing, are both believed to receive training and weapons from the quasi-autonomous Kurdish region of northern Iraq. Although Turkey has called on the Iraqi government and US-led coalition forces in Iraq to crack down on the PKK's activity in the region, neither is in a position to take effective action. However, while the government has regularly threatened to conduct cross-border incursions into northern Iraq, these are unlikely in 2007, not least because they would harm Turkey's relations with the US.

United Arab Emirates (UAE)

Political risk: L

Security risk: L

The UAE will experience a series of labour protests throughout 2007 when the Asian expatriate community in Dubai, the federation's economic hub, is likely to protest vociferously over working practices. The government will come under external pressure to ensure that local businesses implement best practices in accordance with the International Labour Organisation (ILO).

The seven emirates that comprise the UAE will continue to develop their financial services and tourist sectors. This will lead to a further influx of expatriate personnel into the federation, presenting transnational extremists with an expanded range of 'soft' or lightly defended targets. While transnational extremists have yet to target the UAE, an attack remains likely.

Yemen

Political risk: M

Security risk: H

President Ali Abdullah Saleh will remain in power as long as he retains the support of the security forces. However, declining oil output, corruption, mismanagement of oil revenues and high population growth will weaken the government's control. While the ruling elite will maintain its hold on power, some Western institutions may consider suspending support or investment until the quality of governance improves.

Tensions will persist between the government and tribes in areas east of the capital Sanaa, along with tribal discontent in the south; these will periodically erupt into clashes and kidnaps.

Blood or honour killings stemming from disputes over access to land and water, revenge killings and tribal conflicts are also likely. The rebel Believing Youth movement will continue to launch periodic attacks on government and military facilities in the northern provinces of Saada and Amran. One-off attacks in Sanaa are also possible, though these are unlikely to be aimed at foreign businesses.

Islamic extremist cells, some linked to the al-Qaida extremist network and containing returning fighters from the Iraq insurgency, may seek to carry out attacks on Western personnel or businesses or places frequented by Westerners. The government's counter-terrorism strategy will seek to balance foreign pressure for strong action and the government's need to appear independent and focused on tribal and local demands.

Among the general population, neutral or hostile attitudes to Western businesses and personnel will remain strong.

Labour activism in the Gulf Arab states

Worker unrest is not an issue commonly associated with the Gulf Arab states, but a series of labour disputes in 2006 have focused attention on the pay and treatment of migrant construction workers in the region. International human rights bodies are also starting to pay increasing attention to the issue.

There were an increasing number of protests recorded over 2006. In March, expatriate labourers in Dubai working for a local business took industrial action over poor pay and medical care, while in April, more than 2,000 construction workers protested against poor working conditions. During the protests, company cars and office property were damaged and company staff were assaulted. Human rights groups, meanwhile, have blamed poor working conditions for a rise in suicide rates among foreign workers (67 in the UAE during 2004 and 80 during 2005).

The protests are symptomatic of the poor conditions that continue to affect expatriate workers in the region. In the past, the Gulf Arab states could rely on the ultimate sanction of deporting 'troublemakers' to deter widespread labour action. However, Gulf governments have been forced to reappraise their approach to expatriate labour because of increasing economic sophistication; the presence of high-profile Western businesses; a dependence on white-collar Asian workers; and a developing tourist economy.

At the same time, expatriate blue- and white-collar workers, who tend to live and work in discrete communities, have come to appreciate the significance of the emerging business environment and understand the value of their contribution. They may be more inclined to organise labour action and seek international support for better conditions. Nevertheless, the impact on investors will be limited; action will be directed against local companies primarily engaged in the construction sector. Gulf states are likely to respond with a series of new labour laws that may assuage some international criticism, such as permitting unions. They are unlikely to be fully implemented, and further protests – some of which may turn violent – are likely in 2007.

Control Risks

Control Risks is an independent, specialist risk consultancy with 18 offices on five continents. We provide advice and services that enable companies, governments and international organisations to accelerate opportunities and manage strategic and operational risks.

Since 1975, Control Risks has helped hundreds of clients to manage risk and deliver opportunity. In an interconnected world where regulation, risk and complexity may appear to present a daunting impediment to success, we help clients look after their people, their interests and their reputation. They regularly call on us to help them resolve some of their most sensitive issues, and this is when they appreciate our independence, honesty and a commitment to act ethically at all times. It is also then that they most value our discretion.

Control Risks' people will always work to the highest professional standards, bring a depth of expertise and experience and be informed about what is happening in the world. Our staff are drawn from a range of backgrounds and professions, whether it be government service, the law, journalism, commerce or academia.

We offer a diverse range of risk consultancy services to assist with finding the solution to a multitude of issues for a wide variety of clients in every region of the world. We provide insight, talent and a practical focus to break down complexity and deliver clarity. Our clients rely on our resolve, dedication and integrity to deal with uncertainty and to take the right decisions.

Political and security risk analysis

Supported by a worldwide network of retained correspondents, Control Risks' analysts provide tailored assessments, briefings and workshops on political, business or security risk issues that could affect investments or operations in a country.

Business intelligence and investigations

Control Risks' business intelligence consultants work with mergers and acquisitions teams to carry out detailed due diligence into the personalities, backgrounds and reputations of target companies. Our anti-fraud team carries out fraud vulnerability studies, investigate fraud and trace and recover assets. Where the problem is

intricate, multi-jurisdictional or just sensitive, Control Risks can draw together an international, multi-disciplinary team to help senior management solve it.

Forensics

Control Risks Network Forensics is the largest private, technical forensic laboratory in Europe and provides a range of supporting forensics services for both law-enforcement and corporate clients, including audio/visual, computer, fingerprinting and handwriting analysis. We also have a specialist IT security and investigations team.

Security consultancy

Control Risks develops comprehensive security strategies for clients and manages their implementation. In particular, we advise clients on reducing risks to their people, information and physical assets. When the threat to business is particularly acute, Control Risks provides specialist security co-ordinators to operations. Services we provide in this area include consultancy and behavioural threat investigations, customised security awareness and travel security training, executive protection, special event security and high-risk environment asset protection. We review existing security arrangements and, for new projects, our engineers work with architects to include security measures at the design stage.

Crisis management planning and training

Our consultants provide customised crisis management planning and training, which enable our clients to anticipate events and retain the initiative in handling crises, such as extortion, kidnap, product contamination and emergencies requiring evacuation.

Crisis response

Control Risks provides incident management consulting for clients facing kidnaps, extortions, short-term hostage situations and illegal detention of employees, product tampering, and other unique business crises. If a client falls victim to such an incident Control Risks will deploy a consultant to advise on negotiation strategies and liaise with law enforcement, families and the media. Control Risks has handled more than 1,100 such crises.

Travel security

We offer a broad range of services to assist clients with designing, implementing, reviewing and enhancing a travel security programme. Our online services provide updated information vital for travellers, and detailed security briefings and learning programmes are also available. We have a dedicated team of consultants providing retained clients with immediate support and security, crisis management and related advice on demand – 24 hours a day, 365 days a year – from our state-of-the-art operations centre (CR24). Control Risks' travel-tracking service (CRTravelTracker) automatically collates all employees' travel details into a single, user-friendly interface, allowing clients to control where employees can travel and locate them at a moment's notice.

Screening services

Control Risks Screening's skilled research staff provide a variety of screening services

to support a comprehensive risk management programme. Our flexible and cost-effective screening packages can be tailored to varying requirements across a range of industries and countries, and include pre-employment screening to suit different levels of appointments, vendor screening and drugs and alcohol screening.

Governance and development

Control Risks' dedicated specialist team provides governments, donors, NGOs and the private sector with a range of consultancy services to assist with the design and implementation of stabilisation programmes, national threat and risk assessment strategies, and defence and emergency response reviews. We also provide advice on protecting against reputational issues such as human rights abuses, corruption and fraud.

Political and security risk analysis

Wherever in the world you operate you need to understand the political, security and commercial environment: how it affects your business, your travellers and expatriate employees; how it affects your suppliers and partners; and, most importantly, how it affects your customers.

In understanding these risks and putting procedures in place to mitigate them, you can gain competitive advantage by

- ensuring that you are better placed to take advantage of opportunities;
- reducing the potential for the unexpected;
- making informed decisions in bidding for contracts;
- identifying where you need training, contingency planning and insurance;
- opening doors to wider financing options;
- showing dedication to employee welfare, so helping recruitment; and
- ensuring the safety of your staff, contracts and assets, including reputation.

How we can help

We have a number of services and tools to help you analyse the risks that you face, continue to monitor them and reduce them. We provide tailored research analysis and consultancy for your specific company, project or business trip. We also provide a comprehensive online service with constantly updated objective analysis and forecasts of political, operational, security and travel developments and their implications for business and employees across a range of sectors.

Political risk consultancy

Managers need to understand legal and regulatory intricacies and the impact of politics or political instability on company interests. They need to analyse how their operations can affect host governments and local communities. They also need to consider how new legislation, means of communication and pressure groups are combining to demand higher standards of accountability.

Understanding and preparing for these risks can provide real competitive advantage.

Conducting structured risk assessments for new investments can help you avoid costly mistakes and increase your profitability. Developing mitigation strategies at an early stage can help keep projects on track and on budget since many risks only become apparent once you have committed significant financial resources. Assessments of ongoing projects and supply chains can identify existing risks and vulnerabilities before they become a problem.

We can help at every level

We can help you assess and analyse these risks at every stage of a project's life. We actively monitor political and security trends around the world. We have a wealth of experience in helping clients address complex issues, from security threats to political stability, and business culture risks to engaging with pressure groups.

We provide customised research and consulting specific to your needs, having carefully scoped your requirements. Our approach focuses on the risks that you could face, analyses the likely impact and recommends practical mitigating measures. The scope of these projects varies widely, from brief risk summaries through project assessments to comprehensive pre-entry risk assessments. We can provide you with written reports and assist you in leading workshops and scenario planning exercises. We can also give presentations to focus your attention on the areas you need to address.

Online services

Country Risk Forecast, CityBrief and World Risk Summary are our web-based information tools providing daily analysis on the latest developments in 200 countries and more than 320 cities around the world.

Country Risk Forecast

Country Risk Forecast gives you up-to-date analysis of the latest political, operational, security, terrorism and travel developments in 200 countries worldwide. We analyse and forecast the effects of these developments on business environments and how they can affect your operations, assets, travellers and supply chain. The service features a political, security, terrorism and travel risk rating system, including an interactive map

showing you the different risk ratings between and within countries.

Our analysis is independent, unbiased and business focused. It is an invaluable tool for managers throughout your organisation including senior, operations, risk, business development, human resources, and security managers. With the added focus on security and travel information, it is also invaluable for travellers to ensure their own safety and for travel managers to look after the security of employees. The service helps raise your awareness of current and upcoming issues so that you can reduce the risks that your operations and staff face.

CityBrief

CityBrief constantly monitors the security and travel environment for business travellers in more than 320 cities worldwide. The service is aimed at business travellers and at security and travel managers, analysing developments and giving practical advice on how to deal with the problems that they may face. It provides daily updates on what is happening that may disrupt travel for your staff, from transport strikes and demonstrations to security alerts, crime problems and extreme weather.

This service is aimed at helping you prepare for a trip, anticipate possible problems, and enjoy and get around your destination safely. It provides you and your travelling staff with

information on upcoming events that may cause problems as well as giving background information on travelling to and around these cities, the trouble spots to avoid, details of crime and security, who to go to for help, special advice for women travellers and much more.

World Risk Summary

World Risk Summary is a Japanese-language service covering key political, security and travel information of interest to Japanese business and personnel, together with analysis of the risks that crime and kidnapping pose in 200 countries.

How to use our online services

Single and multiple licences are available for these services, so that an individual, a small group or your whole organisation can have direct access to our analysis. You can also receive the latest information by email to stay informed wherever you are.

Our online services are available separately, though they complement each other and work seamlessly together. If you are interested in managing the risks to your employees, these services are used to their best advantage when combined with CR24™, our 24-hour incident support service, and CRTravelTracker to create a comprehensive travel security package.

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