

## THE ADVANTAGES AND THE LIMITS OF COUNTRY RISK

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*The risk represents a permanence of human activity in general.*

*In the economic activity, the prognosis factors and the degree of risk allow the adaptation of action strategy in a timely manner so that business profitability is not affected.*

*Regarding the risks for the international business, the country risk is one that reflects the overall situation and the cumulative effects of other risks associated. Although the utility of country risk seen as a prospective indicator regarding the chances toward a successful international business have been proven in practice, there are also constraints, shortcomings regarding its use.*

*Key words: country risk, international affaires, facilities, constraints.*

*Paper JEL code: F0*

It is widely accepted the idea that risk is a permanent human activity in general.

Regarding the economic activity, the experts considered that, for success in business, a significant role is represented by the ability to adapt to the environment so much easier to achieve when the risks to which the business can be exposed are known. The prognosis of the factors and of the risk degree allows the modification of action strategy in a timely manner so that business profitability is not affected.

In this context, given the trajectory that has entered irreversibly in the economic environment and the fact that the results of the economic activity have a direct impact on the social and political environment, the analysts, and also the directly involved subjects in the international economic flows, confer a great importance to the concept of country risk.

Country risk is the one that gives in a general manner the international business risks, reflecting the overall situation and the cumulative effects of other associated risks. This is why it is considered to be a diagnosis of the socio-economic potential of the country that receives international economic flows.

The usefulness of country risk as a "label", as a prospective indicator of the chances of a successful international business has proven in practice, that however, it presents drawbacks.

Both issues could be summarized as follows:

- **informing the economical agents**, interested in the internalization of their activity, regarding the opportunities available, but mostly regarding the assumed risks, in real terms.

Thus their **flexibility** will **increase**, considering that they can develop strategies pre and post internationalization, for situations where the risk materializes, so that they can adapt in a timely manner and they are able defend their interests. Thus it becomes a **shield against** the vicious effects of globalization.

Of course, all of these have as a result the **increase of the effectiveness of the international economic activities**.

However a set of indicators on which a **complete and accurate** commensuration can be made regarding the country risk **does not exist**. For example, when quantifying, a series of indicators could be overlooked by analysis, and later proven to be essential.

Suggestive in this case is that geopolitical risk assessment, although it was used previously, to which a great importance has been assigned after the terrorist attempt on 11 September 2001, in the United States.

- provides a broader investment universe and ensures the selectivity.

Unitary criteria used by rating agencies in awarding the grades allow the investors to draw up a "risk map".

**Based on grouped classes** of risk the potential investors can make comparisons between the countries and between different default internationalization opportunities that have arisen.

But the **evaluation companies use the same assessment shares for the country risk components, without customizing them, according to the specificity of each country.**

For example, in countries in transition a greater importance should be given to the institutional and legal risk.

Or, because emerging markets have a political and economical risk greater than mature markets, the analysis should focus on these types of risks.

**- The introduction of "thresholds" of risk**

Country risk is a useful criterion for the foreign affairs when establishing the optimal level of the investment, for the credit or for purchase of financial products, but the main disadvantage is represented by the relativity of the score assigned to quantitative factors and particularly to the political environment.

This is because future developments are expected and the anticipation accuracy depends on access to information sources, relevance of data used and the level of training of those involved.

**- Rating is used in setting prices for external loans and for speculative spreads titles.**<sup>197</sup>

Because it **acts as a ceiling on the corporate rating**, indirectly it influences the ability of financing by external loans and implicitly, their profitability.

Thus, access to international financial markets is granted only to good rated entities (national governments or firms), whereas for others, the cost of indebtedness is very high<sup>198</sup>.

Although metaphorical, highly suggestive seems in this sense the words "bankers give you the umbrella when the sun comes out and they take it back when it rains"<sup>199</sup>.

**Therefore, the rating is for the entities a real "passport" in obtaining loans.**

- When the rating is favorable, due to the credibility of this indicator, the confidence of investors and creditors is maintained, even in the periods when on the receiving market failures occur.

But rankings are relative because they may indirectly reflect the interests of the evaluating institution or the position on the international scene of the country from which it originates.

For example, given that Africa receives aid from the government of France, a French assessor can interpret the risk of African countries as being less than a neutral evaluator would appreciate.

Moreover, government intervention, some indicators may seem better than they actually are.

Thus, imposing severe restrictions on imports and controlling the exchange rate may improve, but only on a short-term basis the trade balance situation. Facilitates the reduction of the costs by direct monitoring, and specialized agencies record high costs for evaluation. As a synthetic indicator, provides in a single symbol, generally recognized by the international business environment, information regarding the quality of governance and allows in-depth knowledge of the analyzed country.

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197 Spreads are risk premium, that is to say they are amounts given to the investors additional speculative securities in order to compensate the potential assumed losses.

198 In this respect, a relevant example is the correlation between the interest rate paid by Romania in 2000 on capital markets and risk rankings by country. See Chapter IV, subheading 4.4.2.

199 Ionut Balan "risk country risk", Financial Week newspaper, no.28, 12.september 2005.

But because it is evaluated on the basis of some macroeconomic indicators, the situation analysis in the host country must be completed with aspects from the sectorial level, (the study of the market which covers the internationalization) and major risk assessment.

In short, we can say that is a "barometer" in terms of stability (safety) of business environment within the receiving country.

Although it shows some shortcomings, the usefulness of knowing the rankings of country risk cannot be disputable, evaluating agencies could be considered "a crucial global order nervous system"<sup>200</sup>.

In the globalization era, the rating has become a necessity. Everywhere in the world rating agencies appear and reveal new possibilities for use and cover the gaps in the market.

For example, in China, the first rating agency was set up in 1988, and currently there are over 50 companies.

An additional proof regarding the importance increase of risk ratings by country is given also by the large number of news appearing in the press on this subject, thousands of Internet pages devoted to rating and rating agencies. To summarize and reinforce the above information, I consider that the following statement illustrates in a very suggestively the role of rating agencies in the open economies context. "I can treat myself reading the works of medicine, but better go to the doctor."

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200 Timothy Sinclair,"The new Masters of Capital".American Bond Rating Agencies and the Politics of Creditorworthiness, Cornell University Press, London,2005,pag.18.