



Different paradigms for dealing with economic, financial, and physical risk

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Remarks to the Panel “*Political Risks and Opportunities
in a Shifting Geopolitical Context*”

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EFP risks

Economic

(output, employment, prices)

Financial

(asset prices and balance sheet)

Physical

(climate change and environmental degradation)

Political risk analysis is about...

events that (negatively) affect current and expected profitability

Unilateral changes in rules, regulation, laws, confiscation, expropriations, inability or refusal to service debt, disputes, sanctions, social unrest, terrorism, war events, ...

Political risk analysis is about...

events that (negatively) affect current and expected profitability

political decisions

*social and political
instability*

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EFP risks

THREE PARADIGMS

❑ **GENERAL EQUILIBRIUM MODELS**

(Risk described by random processes)

- Exogenous, random shocks
- No detection of pre-2008 vulnerability
- Justified innovations that fed systemic risks

THREE PARADIGMS

❑ **BLACK SWAN MODELS**

(Risk described by epistemic uncertainty)

- No sufficient data to calculate such small probabilities
- Public policy should let the fragile go
- Sacrifice efficiency for more redundancy

THREE PARADIGMS

❑ **EVOLUTIONARY MODELS**

(Risk described by ontological uncertainty)

- Capitalism's economic process is cumulative instead of equilibrating
- Stability engenders a progression toward more risky structures
- What's uncertain is not the occurrence of events. What's uncertain is the theory explaining the occurrence of events

Concluding question

If economic shocks that feed into social and political instability are differently understood by competing economics paradigms, what's the best way to calibrate political risk analysis?

THE RETURN OF POLITICS

Celebrating the first year of the Franklin
Political Risk and Opportunity Index



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