

**Predicting Overseas Political Instability:
Perspectives of the Government Intelligence and
Multinational Business Communities**

by
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INTRODUCTION

Ever since the emergence of the modern nation-state, political stability at home and abroad has been one of the foremost concerns of foreign policy elites. In the 1980s headlines about instability in South Africa, the Philippines, and Haiti vividly illustrate the continued prominence of this topic. In the context of the diffused sources of instability which have occurred for centuries, the special tensions associated with the Cold War have sometimes seemed to transform international relations into a contest between the United States and the Soviet Union over who can simultaneously stabilize its own allies and destabilize its opponent's allies. For both government foreign policy-makers and multinational business executives, overseas political instability has the potential to wreak havoc in existing relationships, agreements, spheres of influence, and—perhaps most importantly—success in foreign operations. While such instability may have no lasting effect or may even improve conditions abroad, both parties are still determined to prepare themselves to cope with the threats or to seize the opportunities presented by major or minor upheavals of this kind. In order to deal effectively with political instability, which today is especially prevalent in the Third World,¹ early warning of its onset through a variety of forecasting strategies is essential.

While the American government intelligence community (since its formal emergence after World War II) has continually been interested in predicting political instability, intensive concern among American multinational corporations has been confined largely to the last decade. The two sets of institutions have operated in parallel ways for similar purposes but without much cross-fertilization between them, at least partially due to the understandable secrecy and sensitivity associated with political instability analyses. Although there have been substantial efforts² to integrate academic theories on political instability, violence, and conflict, no systematic comparison has emerged of these two sets of applied perspectives on this topic.

This study investigates the differences between the perspectives of the American government intelligence community and those of the American multinational business community about predicting overseas political instability. While neither community is monolithic or homogeneous in its approach to this instability forecasting, the attempt here is to identify the central characteristics pervasive within each community. The differences examined include the purpose, focus, and

methodology of prediction. The intent is not to compare outcomes—forecasts about specific countries' instability—but rather to compare the predictive processes responsible for such outcomes. Findings derive from interviews with government officials and business analysts dealing with political instability (including some with experience in both the public and private sectors), as well as from a comprehensive review of the literature dealing with general international relations forecasting, crisis early warning indicators, political risks overseas faced by American business, and foreign instability concerns of the American government. This study concludes with policy prescriptions designed to help improve instability predictions by both sets of institutions.

DEFINITION OF POLITICAL INSTABILITY

Like most social science concepts, political instability has been defined in a variety of ways. All of the interpretations involve some breakdown in the established pattern of political authority in a nation,³ but there is little agreement about whether this breakdown must be violent or surprising in order to be classified as instability. In the context of predictions by the government intelligence and multinational business communities, this analysis utilizes a three-stage process for identifying political instability and its implications:

(1) the probability of a significant political event or change in the political environment occurring within a nation;

(2) if such an event or change occurs, the probability of it having a major direct or indirect impact on American governmental or corporate interests within the nation; and

(3) if such an impact occurs, the probability that it has positive or negative implications—gain/loss in profits/influence within a nation—for government or business.

This definition indicates that two key aspects of overseas political instability are its significance, whether or not it is sufficiently important to generate new threats or opportunities in a nation,⁴ and its probability, whether or not a clear outcome with an explicit level of certainty/uncertainty, which may be partially a function of the level of information about the instability and the level of experience of the forecaster, can be associated with a particular event or change.⁵

Political risk from a governmental or corporate perspective is a frequent but by no means an invariable consequence of political instability, occurring when such instability involves a high probability of threat rather than of opportunity. The threshold for assigning political risk, and indeed, political instability, varies by nation and time period, and neither government nor business usually identifies these thresholds explicitly or precisely.⁶

Political stability and risk encompass numerous dimensions. The distinction between macro-risks and micro-risks separates either (1) risks affecting the full scope of American government or business activities from risks affecting a narrower range of such activities⁷ or (2) major

forms of political instability such as war or revolution from less flagrant changes in government policies affecting the American government/business communities.⁸ Analysts frequently distinguish between: long-term and short-term warning of political instability;⁹ continuous and discontinuous change involved in this instability;¹⁰ instability evidence among a nation's elites or its government and instability manifested among the masses;¹¹ and instability resulting from domestic (internal) sources and that resulting from international (external) sources.¹² These categories illuminate further subtleties in the notion of political instability and seem critical to the exploration of government-business differences.

COMPARATIVE ANALYSIS OF GOVERNMENT/BUSINESS PERSPECTIVES

In analyzing the purpose, focus, and method of political instability prediction by government intelligence officials and multinational business executives, this study emphasizes differences rather than similarities in perspective because many of the commonalities deal with rather broad and obvious basic assumptions. The underlying expectation is that significant differences exist despite the absence of huge disparities due to the shared basic values of American government and business.¹³ While no studies have specifically contrasted government and business perspectives on overseas political instability, the more general literature on public-private differences and governmental-corporate attitudes provides useful background for this analysis. It seems widely accepted that "business and government increasingly must act as partners to deal with the monumental problems that confront contemporary society,"¹⁴ but this relationship has more than occasionally exhibited strains,¹⁵ despite the strong interest each group of elites has in the other and the recognition of some interdependence¹⁴ especially overseas. A debate continues to flourish about whether multinational corporations do or should maintain an "arms-length" (distant) relationship with the government,¹⁷ use it as their "sales representative",¹⁸ or act as a "conduit" for its foreign policy.¹⁹ Overall, government appears to operate more on the basis of politics and business more on the basis of profits,²⁰ and government appears to have a wider scope of interest than does business,²¹ with greater emphasis on broad equity notions contrasted to corporations' stress on narrower efficiency notions.²²

PURPOSE/RATIONALE FOR PREDICTING POLITICAL INSTABILITY

Government

In the government intelligence community a broad consensus exists that forecasting is one of the chief purposes of intelligence,²³ and in particular that monitoring, assessing, and predicting political instability are crucial. Consequently there has been little need for explicit discussion of the purpose of these efforts. Belden²⁴ asserts that "the primary objective of state-conducted intelligence is to contribute to warning." This warning appears necessary "to ward off threat or seize the opportunity," and

provides the necessary lead time for formulating and implementing policies and actions.²⁵ More specifically, warning frequently has a sequence of objectives: trying to "head off" a potential crisis situation, then trying to manage a crisis to satisfy foreign policy needs without resorting to force, and finally sometimes using conventional military force and diplomatic and economic efforts to avoid prolonged or severe turmoil.²⁶

Unlike academic scholars, who are interested in discovering hypothetical relationships and broad regularities, government bureaucrats are interested more exclusively in forecasts clarifying which practical action to choose—the consequences of realistic developments under probable circumstances, such as when and how conditions of political instability might arise that could affect American interests.²⁷ Phillips and Rimkunas²⁸ controversially note that the Central Intelligence Agency (as compared with the State and Defense Departments): is particularly sensitive in its prediction to forces that potentially endanger the status quo and which demand urgent preventive action; is particularly likely to believe that crisis-linked countries are likely to become battlegrounds between the superpowers and the anti-American forces will take over; and usually equates political instability with threat. However, government officials²⁹ retort that they do not equate instability with threat. Often advanced warning of a positive regime change, in which a foreign government becomes more pro-American, can be just as important as negative change in provoking attentiveness and in generating changes in American foreign policy.

Business

The motivation by multinational corporations to forecast overseas political instability, or, more specifically, political risks, needs more elaborate discussion because this effort has never had the acceptance, continuity, and legitimacy in the eyes of the foreign policy-making community. At the beginning of the 1980s, multinational companies were just recovering from "debacles" in Iran, Nicaragua, and El Salvador, and the *Wall Street Journal*³⁰ reported that more than sixty percent of American multinationals had suffered political damage in the previous five years, usually in the form of delayed payments or restrictions on bringing profits home. Increasingly corporations began to recognize that politics played a more important role than ever before in affecting business objectives.³¹

LaPalombara³² enumerates many reasons for the "exponential" growth in corporate political risk analysis: (1) post-colonialism, in which the home state governments of multinational business could no longer provide the protection once afforded; (2) patterns of trade and profits, in which companies make an increasingly large proportion of their profits from overseas activity but at the same time are more closely scrutinized by both host and home governments; (3) burgeoning public sectors, in which foreign government officials are increasingly involved in managing their economies; (4) sophisticated regulations and regulators, in which host governments have found ways to enhance their bargaining

positions and improve their control; (5) declining profit margins; (6) increased international competition from other multinationals; (7) host government-administered prices; (8) frequent political upheavals; (9) sophisticated corporate managers who are capable of appreciating the value of studying political risks; and (10) an increasing recognition by these managers of the importance of normal everyday processes of politics and administration—routine policy-making and implementation in host states—in affecting the success of overseas operations. Rayfield³³ adds that the recognition of the saturation of the mature industrialized economies of Europe and North America, as well as the major foreign corporation intrusion into the American market, helped to fuel this business concern with political risks.

American firms have seemed particularly vulnerable to political risks, in comparison to their developed nation competitors, because:³⁴ (1) the United States government provides less support for their multinational firms than do these other governments; (2) American firms may, due to overcentralization, be less sensitive than other nations' firms to local conditions; and (3) American firms' initial advantage overseas—deriving from their expertise in expanding and operating efficiently on a large scale in their domestic market—taught them little about overseas political risk. American multinationals continue³⁵ to be accused of having a status quo orientation and of supporting pro-business host state governments regardless of repressiveness, but Kahan³⁴ contends that while these firms do want a predictable environment they are reluctant to associate with host governments of which Americans disapprove, particularly if the companies do considerable business in the United States.

Almost as soon as the field of political risk analysis began to develop, however, skepticism emerged from within the corporate community. Some³⁷ equated this field with "peddling snake oil," asserting that political risk estimates had little predictive value and misled corporations by overstating the wrong kinds of risks. To put it in the words of one critical company executive, "you're right about 50% of the time," and even when political risk analysis was booming many firms viewed it as an "unnecessary luxury."³⁸

By the mid-1980s, the political risk profession was already in trouble—"in a few short years, political risk analysis went from being a hot topic to a dead issue at business luncheons."³⁹ A political risk analyst at General Motors⁴⁰ explains the reasons for this change, helping to isolate further the purposes of political instability prediction by the business community: (1) the global recession of the early 1980s helped to trigger the Third World debt crisis and caused stagnation in many of the most promising nations; (2) after the United States recovered, the continued strength of the American dollar priced American goods out of overseas markets while making foreign goods cheaper here, a trend which forced some companies to have to focus their efforts on protecting their domestic market rather than penetrating foreign markets; (3) corporate executives mistakenly equated political risk exclusively with the

kind of spectacular and massive political instability evidence by the fall of the Shah (macro-risks), and were reluctant to consider the equally if not more important risks emanating from the day-to-day impact of local host state politics, economic decisions, and treatment of foreign firms; and (4) many American multinationals reacted to political risks not by increasing their capacity to analyze these risks but rather by seeking "to avoid them entirely." Coplin⁴¹ contends that private firms now care as much as ever about overseas political risks, but that there has become less of a need for separate political risk analysts. Of course, many of the precipitants of the current trend in the field are themselves subject to rapid change, and so business concern with political risk may continue to fluctuate and perhaps even be cyclical.

The primary purpose of corporate political risk assessment has moved away from judging the soundness of initial investment decisions and moved toward analyzing security and threat concerns for ongoing investments.⁴² Multinational corporations seem to utilize political risk consulting firms as "objective second opinions" about the political and economic environments in host states.⁴³ Many private firms have felt,⁴⁴ particularly under the Reagan administration, that their expectation of American government protection overseas had become unrealistic because the government has been cutting ties with business and not using them so much as extensions of policy. American corporations have consequently felt the need to "build their own bridges" solidifying relationships with host state governments.

Comparison

Some key government-business differences emerge from this analysis. Perhaps most critically the government seems more concerned with confronting political risk—determining whether it should intervene or what it should do to reduce risk—while business wants to know more whether or not it should be in a particular country in the first place.⁴⁵ This distinction may be linked to the tendency of government to view political instability itself as a threatening risk because of potential changes in policy toward the United States, while business sees such instability in a less fearful manner simply as a frequent or even just occasional precipitant of key risks through potential changes in the business climate.⁴⁶ This difference in turn may account for the more stable and legitimate role of political instability prediction in government as contrasted to business.

FOCAL POINTS IN PREDICTING POLITICAL INSTABILITY

Government

Despite its comparatively massive efforts, the government intelligence community's resources for predicting overseas political instability are inescapably limited and insufficient to provide detailed coverage of every emerging risk in every part of the world.⁴⁷ This limitation necessitates a narrowing of concern in instability prediction and an identification of focal points. This narrowing applies to all intelligence collection and analysis issues, but with particular reference to forecasting boils down⁴⁸ to questions of: (1) target selection—which countries are

covered; (2) objectives—what threats or opportunities are likely to erupt in these targets; and (3) ordering—which targets, threats, and opportunities are most important. Some observers question spending resources on “arcane” subjects,⁴⁹ slowly-developing trends, or remote possibilities, and in any case officials disagree about who should control decisions about intelligence focal points—collectors, analysts, or policy-makers.⁵⁰

The most frequently suggested geographical focal points for the government intelligence community are⁵¹ long-recognized hot spots, communist nations, dictatorial regimes, areas where circumstances are the most manipulable, or situations posing the greatest immediate danger to, or having the most significant influence on, American interests. Government officials⁵² focus more on the East-West split than on the North-South split and pay extensive attention to sources of instability outside of a country as well as inside. They deny that they concentrate their efforts on manipulable situations, and instead indicate that the emphasis is on unstable situations which exhibit a high likelihood of change and of impact on American interests, while de-emphasizing situations in which these probabilities are low. The difficulty with this focus is that downplayed low-probability situations may sometimes be of great significance.⁵³

A long-standing debate continues over whether to focus forecasting on capabilities or intentions, although there has been agreement that collecting information on intentions is more difficult.⁵⁴ Mandel⁵⁵ suggests that it might be useful to assess various balances—aggressive intentions with restraints, technological capabilities with defenses against them, and *insurgent groups with incumbent groups*—but government officials⁵⁴ indicate that forecasting and assessing such balances may not be productive because there is often a low correlation between the ratio of opposition/support and the occurrence of significant political instability within a nation.

Regarding the time focus for political instability forecasting, most foreign affairs customers do prefer short-range estimates in the “tomorrow-to-six-month” time period.⁵⁷ Government officials perform up to two-year projections of political instability, but they feel that the evidence base for this longer range forecast is somewhat shaky.⁵⁸ The amount of decision time available to policy-makers is a critical influence on the selection of the time frame for prediction.⁵⁹

In terms of the emphasis within political instability, government officials⁶⁰ tend to concentrate on regime change, on elite rather than mass behavior, and on political and military changes which are seen as rapid and short-term triggers rather than on social and economic changes which are seen more as slowly-developing long-term influences. Social changes, in particular, seem downplayed and political changes most emphasized.⁶¹

Business

In comparison to the government intelligence community, the multinational business community appears to display more internal

agreement about focal points in political instability prediction. It goes almost without saying that developing nations which are the site of existing or potential investment opportunities are the geographical focus of this effort. One reason that communist nations (and the East-West split) are not a focus of business political risk predictions is the lack of relevant data available to the corporate world in this regard.⁶² This omission seems increasingly controversial as American foreign investment in communist bloc nations continues to escalate. Multinational managers have traditionally been concerned with predicting macro-risks, and aggregate political instability has indeed had a major influence on foreign investment decisions.⁶³ However more recently corporations have paid some attention to micro-level changes in government policy⁶⁴ which Kobrin⁶⁵ asserts produce the greatest risks for firms: the effects of conflict and political instability "are more likely to be felt through the medium of changes in government policy than directly as plant bombings, assassinations of executives, the impact of turmoil and disorder on inputs or outputs, or even mass expropriation." Thus, for example, minor fluctuations in taxation, performance requirements, or joint ventures have been of increasing concern to the multinational business community.

In their examination of political instability, corporations may emphasize governmental over extra-governmental instability (such as riots or strikes) because firms perceive little direct influence of these extra-governmental upheavals on host government controls on business activities⁶⁶ and are interested more in governmental responses to internal turmoil.⁶⁷ However, Coplin⁶⁸ disagrees and argues that multinational corporations are quite concerned about domestic turmoil and the possibility of direct mass disruption of business facilities. Regardless, business seems most concerned with predicting irregular discontinuous change, because it affects not only the magnitude of expected returns but also the risk associated with them;⁶⁹ Its concern centres primarily in marginal nations—borderline cases which are neither highly stable nor highly unstable.⁷⁰ The risks of greatest concern to business in its political instability prediction include repatriation of profits, access to raw materials, changes in the import regulatory environment, and the ability to move executives in and out of a host country.⁷¹ Even though international firms seem to emphasize the general political environment rather than the specific project impact,⁷² the greatest project-oriented concerns⁷³ reflect the industry sectors facing the greatest vulnerability to political risks—public utilities (especially transportation and communication), natural resources extraction, and banking—and, more generally, businesses which engage in activities affecting host states' security and economic control, which are poorly integrated into the local economy or wholly owned by the parent company, and which dominate a host industry or have mature widely-diffused technology.

The time frame for corporate prediction of political instability abroad appears to be relatively short-term and largely reactive. Rayfield⁷⁴ contends that American multinational managers focus on the short run—"this quarter and next"—because the incentive system

rewards them for short-term performance and not for risking their capital and careers on long-term growth. While this tendency is consistent with the desire to avoid risks, he points out that many foreign business executives have been increasingly successful, often at the expense of American firms, at taking risks in order to develop long-term global markets. However, prominent political risk firms such as Multinational Strategies and Frost & Sullivan⁷⁵ include five-year projections of political instability in their country studies and indicate corporate interest in this longer range view. Political risk scanning does tend to be reactive and crisis-oriented rather than stable and continuous,⁷⁶ especially among smaller multinationals, and is rarely independent of pending proposals.

Comparison

Some clear contrasts in focus concerns are apparent between government and business. Government seems to have a broader range of instability concerns than does business,⁷⁷ including a greater emphasis on the external precipitants of political instability than the more "parochial" multinational corporations.⁷⁸ This breadth of concern, when combined with the larger geographical scope of government scanning, helps to explain why government instability assessment is more continuous and less reactive than that of corporations. Government foreign policy makers seem to take a keener interest in military/security risks resulting from instability,⁷⁹ while business emphasizes more the resulting economic risks. In a related manner, even though both focus to some degree on the Third World, the government appears to concentrate more on East-West tensions while business stresses North-South tensions. Business is quite concerned about how instability affects changes in government policies, while government is less concerned with these micro-risks and more worried about macro-risks. American business seems much more interested than is the American government in examining bureaucratic roadblocks which affect the operating climate in host states, such as red tape, corruption, and ineffective government apparatus.⁸⁰ Finally, although both sets of institutions have a relatively short-term perspective in their political instability prediction, business seems likely to place a greater emphasis on long-term trends because "acceptable financial return on direct investment in fixed facilities is usually dependent on a relatively long period of operation."⁸¹

METHODOLOGY FOR PREDICTING POLITICAL INSTABILITY

Government

From the vantage point of the government intelligence community, developing an effective methodology for predicting political instability overseas faces a number of critical obstacles. First, the types of questions asked to aid in this prediction are quite demanding methodologically, involving multiple discrete variables, non-linear relationships, and significant time lags.⁸² Second, any investigation takes place in an atmosphere of ambiguity, with incomplete definition of goals, inadequate determination of operating conditions, and a large number of alternative interpretations of evidence.⁸³ As a result, it is especially difficult to separate

ordinary events and changes from those related to threat and opportunity—to separate signals from noise and meaningful early warning indicators from signals.⁸⁴ Third, these warning indicators do not come neatly packaged into categories such as political, military, and economic. Any organizational scheme for data collection and analysis is virtually certain to have the problem of “hardening of categories,” in which an overly rigid structure causes vital information to “fall between the cracks.”⁸⁵ Finally, the bureaucratic setting impedes sound prediction: (1) the multiplicity of intelligence organizations within the American government, combined with the internal compartmentalization of these organizations based on the “need-to-know” principle, inhibits bringing together all of the relevant information concerning a given issue;⁸⁶ (2) the incremental nature of the policy-making process tends to make predictions foreshortened, parochial, and conservative;⁸⁷ and (3) changes in the structure of intelligence organizations have tended to atrophy, created disruption and disorientation, generally not succeeded in their objectives, and instead replaced one weakness with another.⁸⁸

Taking these obstacles into account, government officials find⁸⁹ that political instability is most difficult to predict in extremely personalistic and totalitarian regimes rather than in democratic regimes with multiple identifiable factions. These officials find prediction easier if they are examining gradual and continuous changes, but they recognize that getting bogged down tracking continuous change can be misleading because frequently a case-specific trigger—such as fraudulent elections—may be essential to translate long-term degeneration into significant political instability. A retired intelligence official⁹⁰ believes that determining when a foreign government will undertake military options poses the trickiest prediction dilemma.

One significant methodological controversy about ways to overcome these obstacles concerns the role of theory. Many academic critics of government forecasting argue that explanatory theory, involving explicit interrelated assumptions and an interest in root causes, is essential to prediction. Choucri⁹¹ contends that “without theory, forecasting becomes crude prophecy,” while Rothstein⁹² argues that “the proof of the pudding may be in predicting—we want to know who predicts well even if we cannot explain why—but we cannot be satisfied knowing so little.” While it is generally accepted that government officials are less interested in the search for explanation than they are with prediction⁹³ due to the urgency and concreteness of forecasting needs, government intelligence officials⁹⁴ respond that they are just as concerned with theory as are academic scholars, but admit that their theory may not be explicit enough to be tested and critiqued by others. Furthermore, some observers⁹⁵ claim that one cannot wait for well-developed general theory because its development is too slow to meet the pressing need for early warning indicators. Often intelligence analysts have to develop intelligence forecasts based on incomplete or contradictory information under the pressures of limited time and rapidly changing circumstances, inhibiting the development of general theory. Government officials often view academic theories and models as irrelevant to their policy-making

prediction needs⁹⁶ due to the "scientific hubris, methodological constipation, and linguistic incomprehension" of these theories and models,⁹⁷ but these officials have recently made concerted efforts to take a "middle position" between abstract theory and historical case analysis and to incorporate explicit theoretical assumptions in their analysis of political instability.⁹⁸ In a discriminating manner, Betts⁹⁹ points out that theory is much more important when trying to predict a state's objectives, capabilities, and proneness to risk in the long-run than when guessing the state's short-run behavior regarding a specific issue, a situation he views as "almost atheoretical." In any case, Ofri¹⁰⁰ explains that the intelligence analyst continually faces a choice between induction and deduction as the basis for prediction: using post-mortems of historical case studies to determine observables which were noticeably present or absent before past crises (induction); or using a broad global understanding of the structure and trends in the international system as the basis for pattern recognition (deduction), a method which is inherently more theoretical and seems particularly well-suited to new threats and opportunities for which there is no close analogy in the past.

A related debate concerns the quantitative or qualitative nature of the forecasting procedures. Several academic scholars advocate quantitative approaches for the government's forecasting methodology: Singer and Wallace¹⁰¹ claim that many of the government's current international relations forecasting procedures "represent little improvement over the superstitions of the prescientific era" and recommend quantitative empirical methods as the solution; and O'Leary and Coplin¹⁰² contend that quantification is preferable for government forecasting because the technique avoids the ambiguity of qualitative verbal prediction, encourages identification of a greater variety of causes, and promotes clearer articulation of the basis for forecast. But others see problems with scientific quantitative prediction by the government: Chapman¹⁰³ views international relations as an art which cannot be analyzed scientifically because world politics is too complex and fluid to be characterized by general regularities; Jervis¹⁰⁴ indicates that the frequent appearance of international deception in world politics inhibits the use of scientific methodology in intelligence analysis; and Belden¹⁰⁵ points out that predictive probabilities are lowered (1) the more precise the prediction, (2) the greater the number of "informational elements" within the probability statement, and (3) the greater the time span of the prediction. Across the intelligence community, many relevant government officials would: support the critics of quantification and would use subjective probability estimates rather than statistical procedures;¹⁰⁶ not apply explicit quantitative weightings to the various indicators of political instability;¹⁰⁷ take a traditional case-by-case rather than comparative approach concerned mainly with current events rather than general trends;¹⁰⁸ and question whether overseas political instability can be consistently predicted with high accuracy.¹⁰⁹ However, there has at least been sporadic recent interest among these officials¹¹⁰ in the application for predictive purposes of sophisticated quantitative techniques which emphasize more comparative analysis, including Bayesian analysis, the

Delphi technique, cross-impact analysis, content analysis, a computerized events data base, and multidimensional scaling. There is also growing recognition of the need to mix different objective and subjective methodologies depending on the type of threat or opportunity considered.¹¹¹

This discussion of the qualitative/quantitative split links the concerns about theory with another key dimension of prediction methodology—the nature of the information sources. The primary source for the government intelligence community is¹¹² expert-generated data rather than events data, survey data, or aggregate data based on national attributes. The emphasis here is on the intuition and judgment of these experts, incorporating their past experience and “feel” for the issue at hand.¹¹³ However, relying on experts as one’s primary information source can have major drawbacks. Singer and Wallace¹¹⁴ argue that the efficacy of expert-based prediction has not been rigorously tested and that its track record when used by policy makers is “far from impressive.” Rothstein¹¹⁵ implies that two specific problems could result from this kind of source: (1) since many of the experts used are connected with the American government and have some vested interest in the topic of prediction, the data presented may be biased because of the evidence that such involvement reduces objectivity; and (2) the tendency of government officials to have no feelings of inadequacy about their performance—to attribute failed predictions to bad luck, inaccurate information, or the impossibility of forecasting certain kinds of events—may inject overconfidence into data generated. Indeed, such overconfidence, when combined with wishful thinking and bureaucratic inertia, can create an inability to forecast surprise.¹¹⁶ Intelligence experts may project Western rationality onto intelligence targets and not have adequate “cultural empathy” with a given country,¹¹⁷ although government officials¹¹⁸ correctly point out that too much emphasis on cultural peculiarities can prevent rigorous assessment of warning.

In general, government officials do not systematically weight sources involved in political instability prediction according to their credibility, knowledge, or past success.¹¹⁹ While government bureaucrats do subscribe to corporate political risk analyses and circulate them among country specialists, it is difficult to determine to what extent these private sector sources have a significant impact on government predictions of political instability abroad.¹²⁰ A former intelligence official¹²¹ suggests that government officials pay most attention to business risk assessments when dealing with economic issues such as oil.

Of all the methodological facets of forecasting, the means of evaluating effectiveness is the thorniest. A variety of approaches are in use for evaluating the extent to which predicting political instability is successful. Bobrow¹²² proposes that the general considerations for effective forecasting are importance, utility, timeliness, reduction of uncertainty, relevance, and durability. For the government intelligence community in particular, Ofri¹²³ defines success as a high ratio of “hits,” where a warning is issued and an event occurred, and “correct

rejections," where no warning is issued and no event occurred, to cases where there is no association between warnings being issued and events occurring. Heuer¹²⁴ asserts that the best test of success in the intelligence context is the extent to which predictive reports serve as a catalyst to change in the attitudes or behavior of other analysts and policy-makers. Finally, Lowenthal¹²⁵ judges intelligence failure as the inability of the intelligence process "to produce timely, accurate intelligence on an issue or event of importance to national interests."

Yet, the problems endemic to any system for evaluating forecasts are many. Using "batting averages" or judging the "accuracy" of intelligence predictions is difficult because the predictions may be vague, heavily conditionalized, or on target only through pure chance.¹²⁶ Furthermore, erring in the direction of warning and being overly alarmist may be desirable in prediction.¹²⁷ Using quantity of intelligence evidence collected as a basis for evaluating predictions seems undesirable¹²⁸ because of the increased chances of noise and confused signals obfuscating the truth (such as in Pearl Harbor). A major complication in evaluating prediction, particularly experienced by government officials, is posed by "interaction effects": what the American government does may render a prediction inaccurate by changing the forecasted response of an affected state.¹²⁹ Even awareness of the forecasts may change foreign behavior, as "a state's behavior is determined in part by its leaders' predictions of how other states will behave."¹³⁰ Rothstein¹³¹ sums up some possible negative implications of the problem—"the more we can control events, the more we produce and determine changes, the less important prediction becomes . . . rather than predicting non-falsifiable events, we manipulate events so that the prediction is non-falsifiable." Lastly, Betts¹³² shows that the ultimate complexity in evaluating intelligence predictions may be not knowing what success rate to expect or to consider adequate; he feels that forecasting failures are inevitable and that there needs to be a "tolerance for disaster."

Clearly, as government officials themselves contend,¹³³ there is "more than one bottom line" involved in evaluating political instability prediction. Thus government forecasts of political instability¹³⁴ tend to be in the form of contingent warnings about levels of vulnerability rather than direct probability statements about the likelihood of certain events occurring in the future.

Business

Turning to the viewpoint of multinational business, major methodological roadblocks again emerge which need to be overcome for sound political risk forecasting. Corporations generally find the notion of political instability to be vague and consider it difficult to determine when instability is important to them.¹³⁵ Kobrin¹³⁶ notes that, "compared to most types of business or economic forecasting, political forecasting remains a very underdeveloped art" due to: (1) the ignorance of the relationship between political environments and corporate effectiveness; (2) the relatively recent evolution of genuine internationalization by American firms; and (3) the lack of documentation on the

managerial experience dealing with overseas political predicaments. Furthermore, the effects of political instability on American business seem to resist generalization and depend on such specifics as a firm's nationality, size, and industry.¹³⁷ Finally, multinational firms face the structural problem that political risk forecasts are rarely well-integrated into the corporations' central decision-making systems: business executives are often "drowning" in political data which they ignore;¹³⁸ the process is typically "bottom-up", lacking strategic direction from top management;¹³⁹ and most multinational firms have no established procedures for feeding political data into the decision-making process.¹⁴⁰ However, Coplin¹⁴² claims that recently significant progress has occurred in the integration of political variables into business decision-making.

As a result of these obstacles, business faces some particularly difficult tasks in its political risk prediction. It is quite tricky to attempt to determine the minimum acceptable return for a given level of risk or the maximum risk tolerable for a given level of return, particularly with the risk changing over the course of the investment, and thus it is not surprising that such risk-return calculations are rarely performed.¹⁴² The previously-discussed business emphasis on discontinuous change in borderline situations presents an almost insuperable challenge to effective forecasting. Furthermore, it may be even more difficult to predict the impact of changes in the environment than to predict these changes themselves.¹⁴²

Discussions in the business literature about the necessity of theory for political instability prediction are quite sparse. Kobrin¹⁴⁴ classifies political risk assessment systems according to whether or not they are structured (having an explicit conceptual model or theory of the relationship between political events and managerial contingencies) or systematic (having explicit assessment and/or forecasting procedures). He finds that unstructured and unsystematic political risk assessment characterized by implicit and intuitive models and methodologies is the most common among American multinationals. Being relative novices in the study of the political environment, multinational executives seem to have found it difficult enough simply to incorporate political trends into their decision-making, let alone to select explicit theoretical frameworks or to search for the underlying roots of these developments. Kahan¹⁴⁵ more bluntly states that business does not care about the theory or methodology behind political instability projections due to firms' pragmatic orientation.

As to the choice between qualitative and quantitative methods, there is an ongoing debate. LaPalombara¹⁴⁶ feels that many business executives "believe that a good 'political risk index', however simplistically derived, should be quantified" because "numbers have a mesmerizing effect on the corporate community;" certainly a variety of quantitative political risk forecasting models have emerged for corporate use. At the same time skepticism has persisted about the appropriateness of these quantitative approaches¹⁴⁷ and a continuing interest expressed in more qualitative analysis. Indeed, less than one-fifth of all business political risk analysis relies on quantitative methods,¹⁴⁸ and many multinational

businesses still depend heavily on intuition and experience as the basis for their political risk predictions.¹⁴⁹ Rummel and Heenan¹⁵⁰ compare four popular methodologies—using “grand tours” by business executives to foreign markets, “old hands” such as seasoned diplomats, Delphi techniques, and quantitative multivariate analysis—and they conclude that the best approach to political risk forecasting might integrate all four of these subjective and objective methods. Some current political risk assessment systems used by business do combine quantitative and qualitative indicators,¹⁵¹ as well as using different methodologies for different cases and mixing case-by-case and comparative approaches.¹⁵²

Regarding source selection for political instability prediction, there is general agreement that the dominant data source for such forecasts is internal—subsidiary managers, regional managers, and headquarters personnel.¹⁵³ Still, several problems result from this heavy reliance on corporate managers as a political risk assessment source: (1) often there is an “overdose of selective information,” through which business executives are exposed to first impressions and dramatic current events and are insulated from the political and economic realities of the country in question;¹⁵⁴ (2) this selective information may reflect the predictable bias of these internal sources, since they have a vested interest in the outcome, have an influential relationship with host state elites, and may even be host nationals themselves;¹⁵⁵ and (3) traces of ethnocentrism frequently appear in the determination of instability, such as requiring that a government have a legitimate constitutional order to be considered stable,¹⁵⁶ and so the basis for rejecting investment sites can be “incomplete, outdated, or in some cases even erroneous.”¹⁵⁷ Shackley¹⁵⁸ explains that because the private sector has far fewer resources than the public sector for political instability prediction, business has to be more “imaginative” in its use of sources and can take greater advantage of information obtained from top officials in host state governments.

American government officials are not a major source of corporate political risk information because of: (1) the adversarial relationship “which many managers in the private sector consider endemic;”¹⁵⁹ (2) private firms’ complaints that government country desk officers have limited knowledge due to rotating assignments and that these officers may lie to them;¹⁶⁰ and (3) the widespread business view that government foreign policy makers lack commercially-oriented information and understanding of important business considerations.¹⁶¹ However, more sophisticated private sector analysts may use the government as a source,¹⁶² but they use it mostly for raw data rather than for interpretation of trends.¹⁶³

The lack of consideration within the corporate community about how to judge the success or failure of political risk forecasts appears at least partially due to the prevailing assumption that the resulting change in profitability for a given business would provide the acid test. The newness of the corporate political risk field may also have inhibited more penetrating consideration of evaluation concerns. Moreover, the tendency of many business analysts of political risks to describe likely future

scenarios without assigning probabilities makes determination of success difficult.¹⁶⁴ However, one crucial evaluation issue is whether or not political risk assessments help managers make better decisions and/or understand their environment better.¹⁶⁵ Furthermore, interaction effects need to be considered when judging the effectiveness of political risk prediction:

A . . . relevant issue is the role of political and business-risk prediction as self-fulfilling prophecy. Consider, for example, a large firm which expects adverse changes in political stability and attempts to protect possible losses by withdrawing investment. Such action may promote the very instability it was designed to anticipate and can undermine the firm's position in that country. The possibility that companies themselves may be unwitting agents in promoting political risk is unrecognized by current analyses.¹⁶⁶

Kahan¹⁶⁷ notes that such interaction effects may be particularly obvious with international energy companies. Political risk consulting firms sometimes judge their success simply by whether client multinational corporations continue to hire them; a single major predictive blunder can be sufficient to terminate either this business relationship or the employment of the responsible political risk analyst.¹⁶⁸ Because this concern about unsuccessful analysts using outmoded or biased data permeates the business political risk community,¹⁶⁹ and because of the peripheral position of political risk analysts in the business world, there seems to be at least the potential for accountability here despite the absence of rigorously-defined evaluation systems.

Comparison

Several differences in perspective emerge from juxtaposing government and business forecasting methodologies. Although both sets of institutions face similar bureaucratic problems when they use political risk assessment in decision-making, business seems to face a tougher task of effectively predicting political instability¹⁷⁰ because of: (1) the greater number of variables incorporated in the business community's forecasts; (2) the fewer resources available to business; and (3) the ambiguity, complexity, and indirectness of the link between the instability and business risk. As Coplin¹⁷¹ explains, the government is mainly concerned with policy shifts by foreign governments, while business has a double-layer'' problem of needing warning of both these shifts and the economic consequences resulting from them. Neither group has a particular affinity for theory, but government agencies appear to have greater concern than do multinational corporations about incorporating abstract theoretical frameworks into their political instability predictions.¹⁷² Though both prefer qualitative predictions, the business community emphasizes quantification more than the intelligence community. Given the bias in both sets of sources, business sources appear to possess a more damaging slant because of their greater vested interest in the outcomes. While both public and private sectors experience the complexities of interaction

effects, this problem seems greater for the government¹⁷³ because of its superior ability to influence directly overseas political environments. Finally, while both government and business may have a low tolerance for fundamental forecasting errors,¹⁷⁴ there seems to be a greater tolerance for low-level predictive failure by government than business¹⁷⁵ because of (1) a fuzzier definition of success by government and (2) greater acceptance by government of inherent unpredictabilities in political instability. However, the real-world consequences suffered from predictive failure seem to be more severe for government than for business; faulty business forecasts hurt profits, but faulty intelligence forecasts can lead to war.

PRESCRIPTIONS

This study indicates that, although political instability prediction by government and business is quite similar in many ways,¹⁷⁶ some significant differences exist in purpose, focus, and methodology. Both sets of institutions have a mixed track record in their overseas forecasts; while it seems impossible to perform an exact comparison of success, at least one analyst¹⁷⁷ contends that multinational corporations have done as well as government intelligence agencies in this regard. Regarding political instability, the intelligence community seems to view the corporate community and its efforts with respect, while business views government and its efforts with apprehension.

What can be done to improve political instability prediction? One logical starting point is to enhance sharing of insights between government and business, far beyond the cosmetic exchange of sanitized reports. Government intelligence agencies could benefit more than they have from the increasingly sophisticated corporate identification of economic variables and trends and their linkages to the political environment, as well as from private-sector methodology for making long-term (five year) forecasts which would be quite useful to the public sector despite the intrinsically low confidence/precision of such predictions. Multinational businesses could benefit from government data/forecasts dealing with macro-level political change (so that business could focus its attention on micro-risks), as well as from government help with strategies for confronting risks and negotiating their reduction when firms are unable to extricate themselves from an unstable situation. Such sharing could help each by further diversifying sources, by expanding and intensifying overall coverage, and even by testing predictive effectiveness through a cross-check on findings.

This increased voluntary cooperation between government and business in political instability prediction would no doubt be tricky to implement. Kobrin¹⁷⁸ feels that the initiative needs to come from the government for educating business and for providing information and assessment in this regard, because government has a direct interest in fostering American private investment overseas. While the American government is already engaged to some degree in this kind of activity, through organizations like the Overseas Private Investment Corporation,

the intelligence community needs to be more willing to open itself up to flexible and meaningful exchanges with business while at the same time not compromising secrets. Shackley¹⁷⁹ astutely points out that a key difficulty in the government providing risk assessments to corporations is that the government would feel that it would need to dispense the information equally so that no one American firm would receive a competitive advantage from the assessments. Kahan¹⁸⁰ asserts that if multinational corporations were reluctant (for a variety of previously-discussed reasons) to have much direct contact with government, private political risk firms could provide an interactive bridge between the two. This kind of "middleman" could only work, of course, if it were trusted and viewed as critical by both parties.

Beyond government-business cooperation, methodological improvements appear essential for better prediction of political instability. The initial steps which have occurred in the direction of mixing quantitative and qualitative, objective and subjective, and case-specific and comparative analyses need to progress even further in order to increase the validity and reliability of predictions and ultimately their credibility in the eyes of an increasingly sophisticated target audience. The need for better policy-relevant theory to help interpret events and environmental changes seems to be greater than the need for more data on political instability. Both government and business need to develop and test better ways of evaluating their performance in political instability prediction, despite the obstacles involved, not for purposes of public display of success rates but rather for internal accountability and awareness of when to change forecasting systems or personnel. There should be a re-assessment of the dimensions of political instability of greatest relevance to the public and private sectors, so that predictive efforts can be more focused and co-ordinated within organizations. Finally, special attention needs to be paid to interaction effects experienced by both sets of institutions: research should occur on developing applied methodologies for handling such effects, including forecasts of one's own government's/corporation's behavior in predicting overseas political instability.

While these policy recommendations involve major attitude and behavior modification by both government and business, the increasingly competitive global struggle for political sphere of influence and economic market share seem to require dramatically enhanced receptivity to such change. For, if predicting overseas political instability is seriously undertaken by institutions with the vast resources and ingenuity of the American government intelligence and multinational business communities, then this complex task can be done a bit better.

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