



## Strong institutions alleviate uncertainty

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The beginning of the year is the time where think-tanks and economists predict the trends, or forces, that will shape economic and social outcomes over the next twelve months.

The common ground of different studies suggests an extension of what we experienced last year: skepticism about globalization, inward looking governments, restrictions of movement of people and goods, changing demographic characteristics, as well as geopolitical tensions that bring forth concerns of war, trade or otherwise. The implied political and economic uncertainty affects competitiveness.

How do countries navigate this environment to secure sustainable value creation and ensure the prosperity of their people? Taking the 2019 IMD World Competitiveness Yearbook as a starting point we note that economies varied in their reaction to the challenges they faced. While we don't measure the range of specific responses, we are able to measure their perceived effectiveness through the [IMD Executive Opinion Survey](#). Despite a somewhat sluggish

performance in Western Europe and North America, they, together with Eastern Asia, mostly populate the top half of the competitiveness ranking. In this context, the data show that, strong institutions are an important component for addressing the given challenges.

Institutions play a fundamental role in smoothing the impact of political and economic uncertainty. They improve stability and, therefore, affect investments and innovation. Research shows that economies with high quality institutions tend to exhibit higher private investment rates and growth, inferring a higher quality of life for citizens.

**Table 1** presents the top and under performers in several aspects of institutional quality. Economies that rank in the top three in these indicators, place in the top quarter of the overall competitiveness ranking. Conversely, countries that rank in the bottom three in these institutional aspects, rank in the bottom quarter of the overall ranking. For example, Singapore, Hong Kong and the UAE top the legal and regulatory indicator, and rank in the top five of the overall ranking. The most underperforming economies in this indicator - Greece, Croatia and Venezuela – rank 58<sup>th</sup>, 60<sup>th</sup> and 63<sup>rd</sup> in competitiveness. Government policy transparency is topped by Finland, Denmark and Norway, which rank 15<sup>th</sup>, 8<sup>th</sup> and 11<sup>th</sup> in the overall ranking. The underperformers in transparency of government policy - Slovak Republic, Mongolia and Venezuela - rank 53<sup>rd</sup>, 62<sup>nd</sup> and 63<sup>rd</sup> in the competitiveness ranking.

**Table 1. Top and under performers in institutional framework, indicator level**

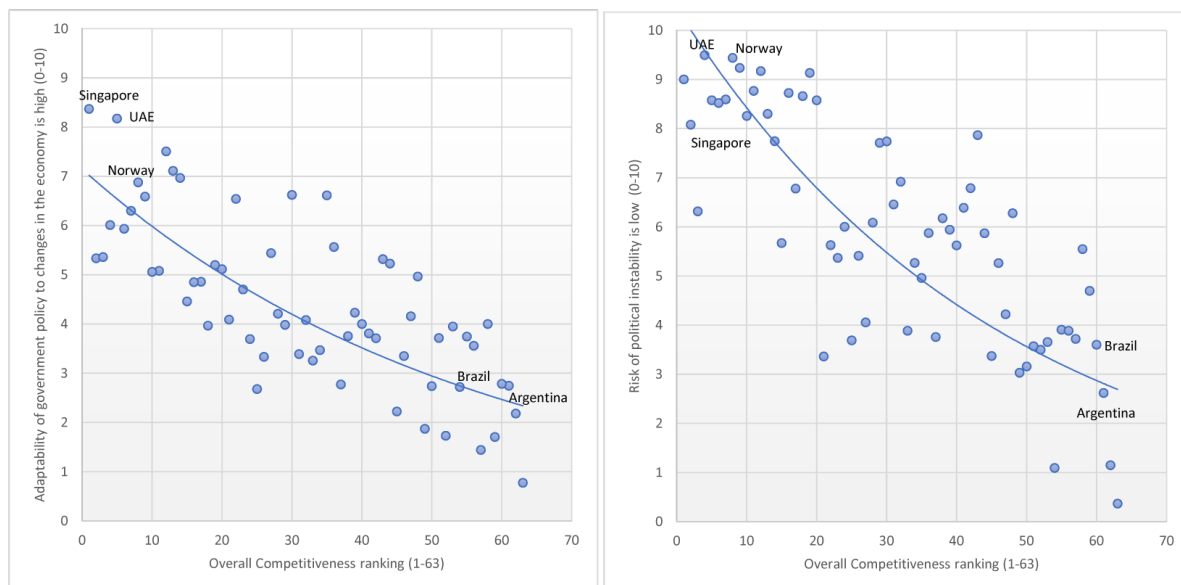
Selected indicators - Institutional Framework subfactor	Top performers			Under performers		
Adaptability of government policy to changes in the economy is high (survey)	Singapore	UAE	Luxembourg	Croatia	Greece	Venezuela
Bribery and corruption do not exist (survey)	Finland	Denmark	Singapore	Colombia	Peru	Venezuela
The legal and regulatory framework encourages the competitiveness of firms (survey)	Singapore	Hong Kong SAR	UAE	Greece	Croatia	Venezuela
Transparency of government policy is satisfactory (survey)	Finland	Denmark	Norway	Mongolia	Slovak Republic	Venezuela
Rule of law Index	Denmark	Norway	Finland	Mexico	Turkey	Venezuela

Source: 2019 IMD World Competitiveness Yearbook

**Figure 1** highlights the role of institutions through government policy adaptability and stability. In the Executive Opinion Survey high level managers are asked to evaluate the adaptability of government policy to changes in the economy as well as the risk of political instability in their country. The left chart shows that high scoring economies in policy adaptability, such as Singapore and Norway, are the same that are placed high in the competitiveness ranking, while countries that score low in policy adaptability, such as Argentina and Brazil, also have a low standing in the overall ranking. The (negative) relationship is strong with a correlation coefficient equal to -0.75.

The chart on the right in **Figure 1** exhibits the relationship between the risk of political instability (the higher the value the more stable the economy is) and the competitiveness ranking. Similarly, it shows that high levels of political stability are associated with higher competitiveness levels across all countries. This also has a strong (negative) relationship, with a correlation coefficient equal to -0.79.

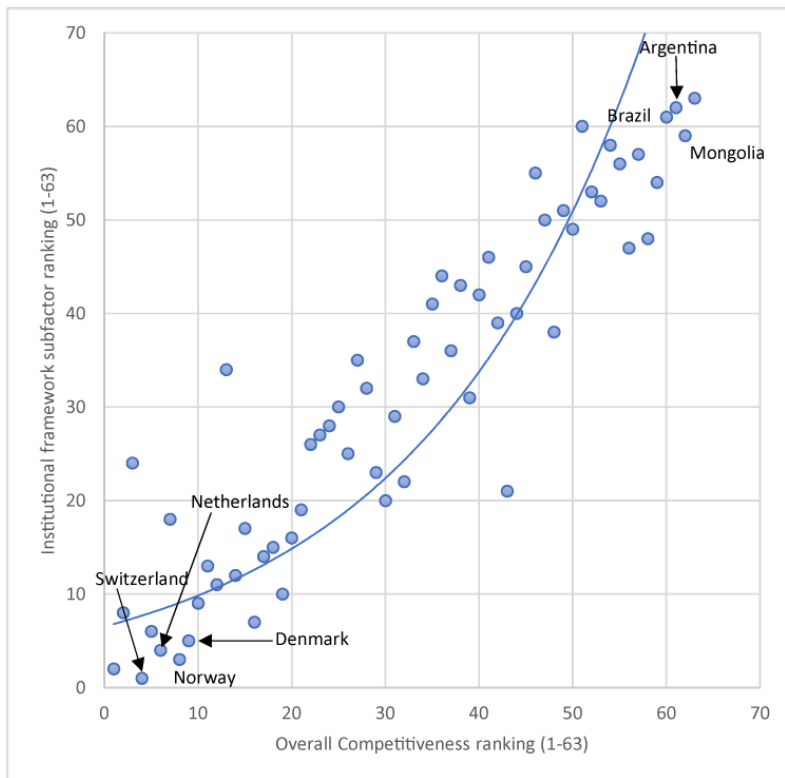
**Figure 1.** Adaptability of government policy, risk of political instability and competitiveness



Source: 2019 IMD World Competitiveness Yearbook

In fact, there is a strong positive association between the institutional framework sub-factor and the overall competitiveness ranking, which is presented in **Figure 2**. The institutional framework sub-factor (a component of Government Efficiency) can explain 86% of the variation of the overall competitiveness in 2019 (R-squared=0.86, observations=63). **Figure 2** shows this strong relationship which is characterized by a correlation coefficient equal to 0.93. This implies that the countries that rank high in the institutional framework sub-factor, are the countries that perform very well in the overall competitiveness ranking. For example, Switzerland, the Netherlands, Norway and Denmark rank in the top 10 in both dimensions. Argentina, Brazil and Mongolia are in the bottom 10 for both.

**Figure 2.** Institutional framework sub-factor and the overall competitiveness ranking



Source: 2019 IMD World Competitiveness Yearbook

Uncertainty is likely to continue to challenge countries in their drive toward competitiveness in 2020. What past data has shown is that economies with strong institutions tend to be more successful in mitigating this impact by providing a predictable context for investment, innovation, and value creation.

Many wishes for a happy and prosperous 2020 from all the members of the IMD World Competitiveness Center

Christos