

Michel-Henry Bouchet & Alexandre Landi* - 3 September 2024

Towards a Global Governance Barometer (GloGovGamut)

Good governance is key to a country's attractiveness

Today, with mounting global economic and geopolitical turbulences, measuring and anticipating the evolution of governance and institutional stability have never been more challenging. Academic research confirms that institutional strength is a key ingredient of socio-economic growth¹. Sociopolitical instability impedes sustainable and inclusive development. Higher degrees of political instability are associated with lower growth rates of GDP per capita. Regarding the channels of transmission, political turmoil adversely affects growth by lowering the rates of productivity and, to a smaller degree, physical and human capital accumulation². Inversely, income per capita, institutional stability and democracy are correlated because economic and socio-political institutions transform growth into comprehensive development.

Should a country's socio-economic environment be negatively affected by political turmoil, it's not surprising that the economic climate also suffers, and that economic agents, whether national or foreign, wish to protect themselves from instability and therefore anticipate it. The latest WTW Political Risk Survey Report³ documents a sea change in how companies perceive political risk, given that political risk losses of all kinds soared over the last few years: "The heyday of the global rules-based order appears to be over. Geopolitics is now more volatile and less kind to globalized business". Geostrategic competition, economic nationalism, democratic backsliding, and populism increase in both developed and developing countries. Likewise, the 2024 Marsh Political Risk report⁴ concludes that businesses face a world made more volatile and riskier by systemic macroeconomic and geopolitical disruptions. International governance norms are losing legitimacy, contributing to a surge in unpredictable and longer-lasting conflicts.

Failed states and autocratic governments still qualify for official international lending

The IMF and the World Bank turned a blind eye for a long time to issues of governance and corruption, while lending billions of dollars to kleptocratic and autocratic governments. Abruptly recognising that poor governance is detrimental to inclusive development, the IMF promoted a Framework for Enhanced Engagement on Governance in 2018. In parallel, the IMF has provided technical assistance to help foster good governance, such as promoting public sector transparency and accountability. Still, the ten countries most indebted to the IMF are by no means impressive examples of good governance, transparency, and institutional quality.⁵ They include Argentina, Egypt, Pakistan, Ukraine, Ecuador, Colombia, Angola, Kenya, Ghana, and Ivory Coast. Overall, 70% of the IMF's loan portfolio is currently concentrated on poor governance countries with little scope for improvement. Moreover, the IMF's recent enhanced debt reduction scheme lists as eligible countries a catalog of bad governance⁶. One of the latest recipients of a massive 64% debt relief, equivalent to a US\$4.5 billion debt reduction, was Somalia at end-2023⁷, one of the worst corrupt countries by all standards. As recently as June 2024, the IMF boasted that the Common Framework for debt reduction aimed at accelerating the process to bring debt reduction to indebted countries, giving the examples of Ghana, Chad, Zambia, and Ethiopia⁸. Debt relief in these four notorious examples of bad governance is unlikely to alleviate poverty and to promote government effectiveness and accountability.

Private investors cannot afford such short-sightedness regarding good governance. They are concerned by the quality of local institutions where they will invest capital as well as human resources and technology. They need to be reassured by a minimum of

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transparency and regulatory quality (except in mining and hydrocarbon-producing countries where bad governance does not seem an obstacle)⁹. In 2024, the 25 countries that boast the best FDI attractiveness scores are also those that show economic openness, low corruption and transparency¹⁰. Regarding developing countries, the empirical results confirm that institutional quality has a positive impact on foreign direct investment (FDI).¹¹ In the specific case of Africa, political stability, curb of corruption and ease of doing business are considered by most investors as the key variables to boost Africa's attractiveness¹². Creating favorable business environments remains the top priority to attract and retain investment.

The challenge of assessing and measuring governance

Though good governance is a key ingredient to feed inclusive socio-economic growth, its definition and measure remain a challenge. Does governance boil down to low corruption? Is bureaucracy quality and good infrastructure components of governance? Is democracy a prerequisite for sustained development? Overall, governance covers all aspects of how a country is governed, including its economic policies, regulatory framework, and adherence to the rule of law. We define governance as the robustness of institutions which help transform economic growth into sustained and inclusive development¹³. We define institutions as formal and informal norms and enforcements of socio-economic and political interactions. Governance, therefore, comprises such variables as accountability, government effectiveness, transparency and regulatory quality, as well as control of corruption. What is detrimental to comprehensive development is unabated corruption, income gaps, over-indebtedness, commodity-driven growth, limited socio-economic freedom as well as declining democratisation.

Although governance and socio-political risk indices are supposed to shed light on countries' institutional environment, hence reducing opacity, they often turn out to be "black boxes". Consanguinity is an element of great caution before drawing strategic conclusions. Indeed, many risk indices incorporate other meters. This is the case of the Corruption Perception Index that is based on several assessment sources, including ICRG. The World Bank governance indicators include the Corruption Perception Index as well

as indices from Heritage Foundation and Freedom House. Likewise, Euromoney's country risk rating gives a 10% weight to Moody's risk index. Risk indices are most often a mix of hard statistical data coupled with subjective assessment. Qualitative assessment is supposed to help mitigating any potential positive or negative biases that may emerge from noisy content analysis data. This is the case of the World Competitiveness Ranking (IMD) based on more than 250 indicators, with a large weight of the perception input of thousands of global executives. The professional status of these observers is rarely made explicit. Do they work in the very field where they are going to assess corruption? The Fragile State index also includes "content analysis" that aims at drawing meaningfully inputs from hundreds of Boolean search phrases coming from 45-50 million global media data, including articles and research reports. We might wonder whether the newspapers and research publications of many countries are a reliable reflection of socio-political stability. All this numerical and sometimes algorithmic artillery gives an impression of scientific rigor, which is an illusion.

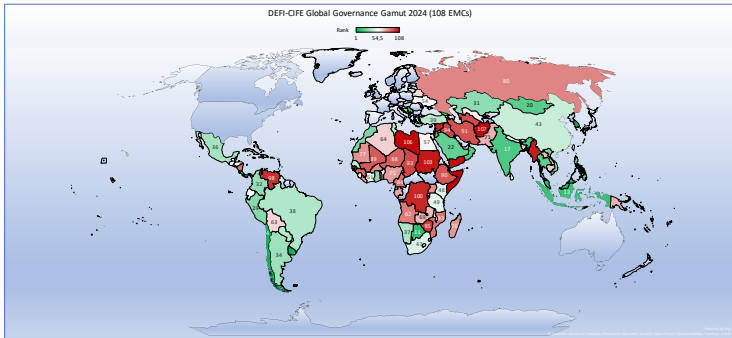
Overall, country risk analysts, policymakers, and field practitioners have no shortage of governance indicators, as their production increased at a dizzying pace over the last twenty years. One can rely on roughly forty indicators of governance and socio-economic development stability, mainly in developing countries, as shown in the table in annex which may not be totally exhaustive

Towards a new composite indicator backed up by a global network of seasoned analysts

To measure the level of governance, broadly defined, a new composite indicator has been built, based on a dozen specific sub-indices of institutional quality, government efficiency, and corruption (see map below). Overall, the indicator covers more than one hundred developing countries, and it includes roughly 3000 data points. Its added value stems from an "expert assessment" that is based on seasoned country risk analysts, including professors and trained alumni from the CIFE's Joint Master in Global Economic Governance and Public Affairs¹⁴, currently roughly 200. In the future, this composite indicator could draw on the growing CIFE alumni community, by gearing the governance assessment to the added value of the students, i.e. their professional expertise and their

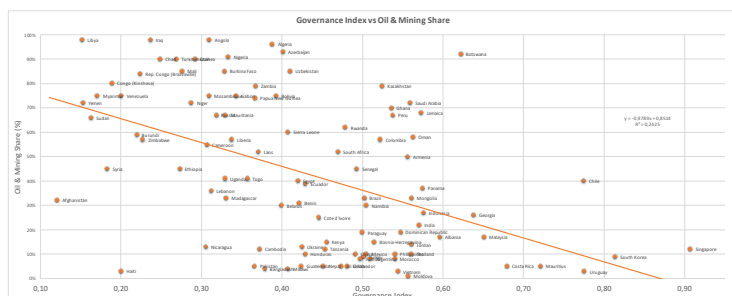
geographic specialisation. Each of these students has followed an intensive academic country risk programme that is focused on socio-political stability, institutional strengths and weaknesses, and early warning signals of state failure. The Master programme concludes with the renowned “Failed States Seminar¹⁵” that draws on the expertise of seasoned keynote speakers and risk analysts.¹⁶

DEFI-CIFE Global Governance Gamut 2024 (108 EMCs)



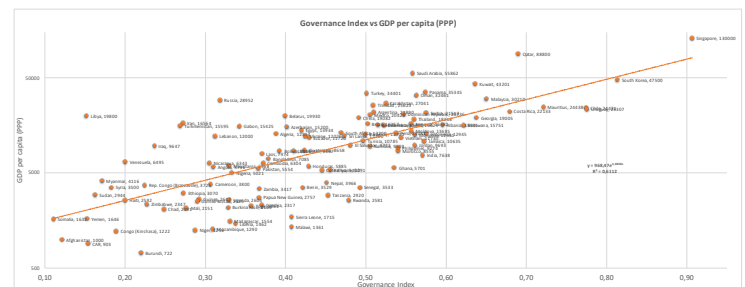
The Global Governance Gamut’s perspective

Though the indicator remains “work in progress”, it has been tested in three convincing ways. First, in most developing countries where economic growth is raw materials-driven, based on mining and hydro-carbon resources, one observes a twofold power concentration, both economic and political. Indeed, at the global level, the only countries that escaped from the rent trap (and the resource curse) are Norway, Chile and Canada, all OECD members. The following chart shows the relationships between the Global Governance Gamut and the share of oil and mining resources in total export revenues. Clearly, in an environment of state capture, rent-seeking and kleptocratic regimes, the larger the share of oil and mining revenues, the worse the governance.



Second, bad governance tends to discourage domestic savings and investment, hence triggering capital flight and brain drain. Corruption and opacity lead to institutional weakness, including in the domestic banking system. One can observe the pull and push forces of capital flight in relation with governance¹⁷. The lower the governance, the larger the share of private deposits in international banks compared to total loans. Bad governance leads to large expatriated private savings in foreign banks¹⁸.

Third, the analysis of the relationship between the governance index and GDP per capita PPP reveals a clear positive correlation. As the governance gamut increases, the GDP per capita PPP also increases, and this relationship is best described by an exponential function. It suggests that improvements in governance can lead to substantial increases in GDP per capita PPP. Small enhancements in governance index scores can result in disproportionately large gains in economic prosperity. A few mining-based countries can boost GDP per capita while maintaining unabated bad governance thanks to high market prices and on-going capital inflows, particularly FDI, though clearly at the expense of sustainable and inclusive development prospects! This insight should have important policy implications for international donors and creditors in developing countries, including the IMF, the EU and the Paris Club. Conditional lending coupled with close monitoring of the socio-economic impact of foreign loans and grants could encourage governance practices, hence driving economic growth and improving the standard of living. Too often, international institutions are not sufficiently demanding in providing loans and grants to rich countries with poor people.



Annex II - Data Standardisation using Min-Max Scaling

To ensure comparability across different indicators, the raw data for each variable was standardised using min-max scaling. This method scales each variable to a range of 0 to 1, where the minimum value of the variable becomes 0 (indicating the worst performance) and the maximum value becomes 1 (indicating the best performance). The formula for min-max scaling is:

$$\text{Standardised Score} = ((\text{Value} - \text{Min Value}) / ((\text{Max Value} - \text{Min Value})))$$

For most indicators, a higher value represents better performance. For these indicators, the minimum value corresponds to the worst performance (scaled to 0) and the maximum value corresponds to the best performance (scaled to 1).

However, for some indicators, higher values represent worse performance (e.g., higher corruption scores indicate worse corruption). To maintain coherence in the index where 0 always represents the worst and 1 represents the best, the scores for these indicators were inverted by subtracting each standardised value from 1.

$$\text{Inverted Score} = 1 - \text{Standardised Score}$$

The indicators for which we used the inverted score are:

- **Civil Liberties:** Freedom House, Freedom in the World Report
- **Political Rights:** Freedom House, Freedom in the World Report
- **Civil Liberties:** Freedom House, Freedom in the World Report
- **Political Rights:** Freedom House, Freedom in the World Report
- **GINI:** UNDP, FRED
- **Country Risk:** OECD, Country Risk Rating

Min-max scaling was applied to all the indicators across the categories to ensure consistency.

Composite Index Calculation

The standardised scores for each indicator were combined to form a composite index. Each category's scores were weighted according to their assigned importance and then aggregated to form the final index. The steps for calculating the composite index are as follows:

1. **Aggregation of Standardised Scores:** The standardised scores for each indicator within a category were aggregated.
2. **Weighting of Categories:** The aggregated scores for each category were then weighted according to their respective importance:
 - Corruption: 20%
 - Institutional Development: 15%
 - Government Effectiveness: 15%
 - Development Sustainability: 15%
 - Business Conditions: 15%
 - Expert Assessments: 20%

Justification for Weighting

- **Corruption (20%):** Corruption is given a higher weight because it fundamentally undermines governance and development. It creates opacity and is an obstacle for a level playing field in the domestic socio-economic system. High levels of corruption can distort markets, deter investment, and erode the effectiveness of public institutions. Corruption is directly linked to lower economic performance, reduced public trust, and increased inequality. By giving corruption a higher weight, the index acknowledges the pervasive and detrimental impact that corruption has on overall governance quality.
- **Expert Assessments (20%):** Expert assessments are given a higher weight to incorporate qualitative insights and professional judgments that may not be captured by quantitative data alone. Experts can provide nuanced evaluations of governance quality, taking into account contextual factors and recent developments that standardised indicators may miss. This ensures that the index is comprehensive and reflects on-the-ground realities and expert insights, adding depth and reliability to the final governance assessment.

Overall, the resulting index provides a comprehensive measure of governance quality, reflecting both quantitative data and qualitative assessments. It thus represents a balanced measure of governance quality, based on a robust methodology of data standardisation using min-max scaling, aggregation, and expert assessment integration, with appropriate weighting for each indicator category.

Annex III - Relationship Between Governance Index and GDP per Capita PPP

The analysis of the relationship between the governance index and GDP per capita PPP reveals a clear positive correlation. As the governance index increases, the GDP per capita PPP also increases, and this relationship is best described by an exponential function. The regression analysis yielded the following exponential model:

$$y=968.47*\exp(4.8828x)$$

where y represents the GDP per capita PPP and x represents the governance index. This model demonstrates a strong fit with an R-squared value of 0.6112, indicating that approximately 61.12% of the variability in GDP per capita PPP can be explained by the governance index.

A notable observation in the data visualisation is that the plot appears to show a linear relationship between the governance index and GDP per capita PPP. However, this apparent linearity is due to the logarithmic scale used on the y-axis (GDP per capita PPP). The logarithmic scale compresses the exponential growth, making it appear as a straight line. In reality, the underlying relationship is exponential, as indicated by the regression function. The exponential nature of this relationship highlights the potential for significant economic benefits through targeted governance reforms. Countries with lower governance index scores have the opportunity to achieve rapid economic progress by adopting policies that improve governance, thereby unlocking exponential growth in GDP per capita PPP.

Relationship Between Governance Index and Oil and Mining Share of GDP

The analysis of the relationship between the governance index and the oil and mining share of GDP reveals a negative correlation. As the share of oil and mining in GDP increases, the governance index tends to decrease. This inverse relationship is best described by a linear function. The regression analysis yielded the following linear model:

$$y=-0.9789x+0.8514$$

where y represents the governance index and x represents the oil and mining share of GDP. This model indicates that for every unit increase in the oil and mining share of GDP, the governance index decreases by approximately 0.9789 units. The R-squared value for this regression is 0.2425, suggesting that about 24.25% of the variability in the governance index can be explained by the oil and mining share of GDP.

This relationship implies that economies with a higher dependence on oil and mining tend to have lower governance index scores. The negative slope of the regression line signifies a trade-off between reliance on extractive industries and governance quality. Countries with a larger share of GDP derived from oil and mining often face challenges such as resource dependency, rent-seeking behaviors, and governance issues, which can detract from overall governance quality.

The relatively low R-squared value indicates that while the oil and mining share of GDP appears to be a significant predictor of the governance index, there are other factors at play that also influence governance quality. This underscores the complexity of governance and the multitude of elements that contribute to its measurement.

In summary, the analysis highlights a critical insight: an increased share of oil and mining in GDP is associated with lower governance index scores. Policymakers in resource-rich countries need to be aware of this dynamic and consider implementing measures that mitigate the negative impacts of resource dependency on governance. Diversifying the economy and strengthening institutional frameworks can help improve governance outcomes, even in the context of substantial natural resource endowments.

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