BTI 2020 | Global Uncertainty

Global Findings | Economic transformation

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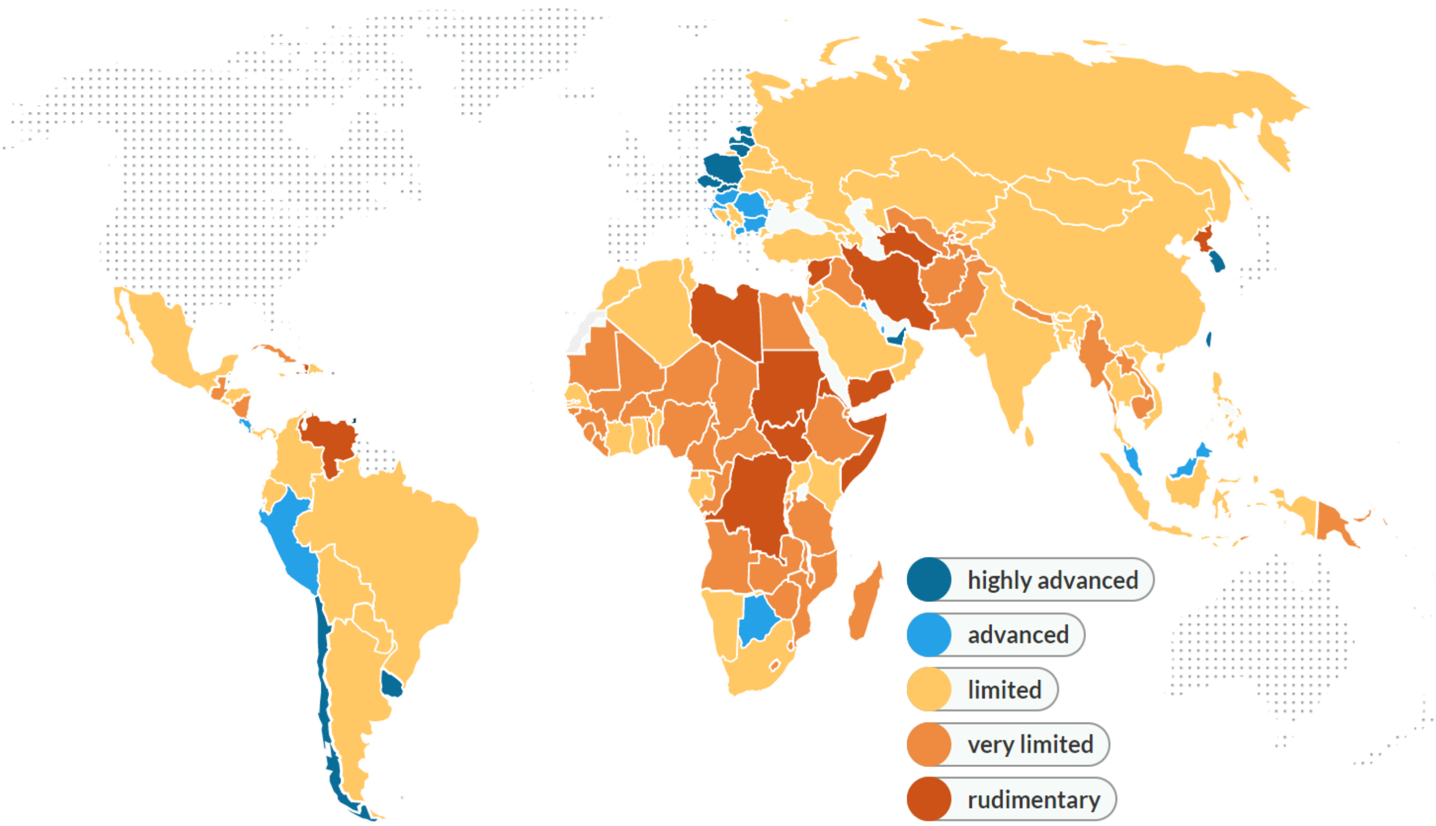
Overview of transformation processes in *137 developing countries and countries in transition*



This report analyzes the economic and social findings of the Bertelsmann Stiftung's Transformation Index (BTI) 2020, for the review period stretching from 1 February 2017 through 31 January 2019. For more information, see www.bti-project.org.

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Executive Summary

The current global economic situation is characterized by uncertainty. While the pace of economic growth has been subdued in many locations, this is due only in part to volatile commodity prices and external shocks in the form of trade wars, such as that between China and the United States, which have dampened economic activity. Many governments are pursuing unreliable, nationalistic or openly clientelistic economic policies aimed at substantially curtailing the free-market order and fair conditions of competition. Rapidly increasing debt levels in many developing countries have narrowed financial-policy flexibility and made it more difficult to achieve the Sustainable Development Goals (SDGs), particularly with regard to the fight against what remain the greatest problems of economic transformation: low socioeconomic-development levels and social exclusion due to poverty and inequality.

No positive turnaround

The global economy remains troubled. With only moderate growth of an average of 3% over the last 10 years, the global economy has gradually recovered since the worldwide economic and financial crisis of 2008, thanks to massive fiscal stimulus directly after the shock and an extremely expansive monetary policy conducted over the entire period. However, given the ongoing demographic pressure and great need for investment in most countries, this level of growth is far from sufficient to ensure solid economic development.

The assessment of economic performance rendered in the BTI 2020 is accordingly measured. On the one hand, over the course of the review period of the last two years, the most important macroeconomic indicators have improved in 33 countries, while deteriorating in just 22 countries. Thus, the economic-performance curve shows a slight upward trend as a global average for the first time this decade. The countries showing improvement have primarily been those at a comparatively low level of development, which, thanks to stabilizing political conditions, have been able to benefit from a peace dividend, especially viewed over the long term. Such countries include Côte d'Ivoire, Guinea, Kenya and Nepal.

On the other hand, well over half of the economies examined showed a largely unchanged level of economic performance. Behind these figures lie some definite successes in attaining stability after years of rapid catching-up growth, especially in leading economic nations such as China, India and South Korea, but also in smaller, innovative economies such as Estonia and Mauritius. Within the large emerging markets, in particular, it is now normal to see a multiplication of bottlenecks to growth, and a retreat of capital and labor productivity growth rates from their former pace of increase. For China, the trade war with the United States has also pushed back any hopes of a frictionless transition from an investment-driven, export-oriented development model to one driven by innovation and oriented toward domestic consumption. India, the second large emerging economy in Asia, has always been much more dependent on domestic demand for its development than has China. However, this demand has developed less dynamically than expected, leading to a significant correction to previously higher growth forecasts.

Overall, there is little evidence of a sustainable positive turnaround. For example, among the 74 states with macroeconomic indicator scores showing little change, numerous countries – from Afghanistan to Zimbabwe – are stagnating at a low level. In some cases, this is after having already experienced a serious, years-long decline due to civil war (Yemen, Sudan) or mismanagement (Angola, Nigeria, Venezuela). Among the countries showing a long-term negative trend are also the G-20 states of Argentina, Mexico and Russia, all of whose economic performance was significantly better at the beginning of the decade than is the case today. While domestic economic-policy failures have played a role here, these economies have in recent years also been impaired by highly volatile commodity prices and political burdens, such as clientelism, the drug war and sanctions.

Economic performance again weakened during the review period in the largely isolated Turkmenistan, sanction-encumbered Iran and a Nicaragua destabilized by unrest and repression. However, regional heavyweights, such as South Africa and Turkey, also saw declines. These latter countries' troubles are largely attributable to clientelistic economic policies. This means that policymakers are closely linked with or dependent upon economic elites; as a consequence, decision-makers provide the elites with preferential regulatory benefits, state funds or contracts, and promote selected companies or economic segments. In doing so, they purposefully restrict free market access and fair competitive conditions in favor of their clients. Viewed over the longer term, Brazil also numbers among the problematic G-20 countries. It has recently shown some sign of recovery, including an increase in foreign direct investment. However, its per capita GDP (on a purchasing-power-parity basis, PPP) has not yet returned to the level reached at the beginning of the decade. Brazil, South Africa and Turkey are each representative of problematic developments in their respective regions, each of which has been characterized by a persistent downward economic trend over the last decade.

Brazil has exemplified the inherent instability of resource-driven growth, which is subject to the volatility of world market prices and demand levels. As in the previous decade, many Latin American governments benefited during the first half of this decade from sharply increased commodity prices, which then remained at high levels for some time. Buoyed by higher revenues, many of these governments pursued increasingly expansionary budgetary policies. This often took place under a progressive aegis, as in Brazil under the Worker's Party, with a focus on funding newly created or expanded social programs. As world market prices for energy, metals and agricultural products fell rapidly beginning in late 2014, an economic model lacking in productivity gains, diversification or any substantial reduction in the informal sector became brittle, quickly running against limits to welfare-state policies and other developmental goals. Rapid changes in economic orientation, as took place in Argentina and Brazil, also reduce reliability and increase uncertainty among potential investors. Over the course of the decade, the BTI's average economic-performance score within Latin America and the Caribbean sank by 1.43 points on a 10-point scale – a quite significant tumble.

However, this negative record is exceeded by the plummeting economic performance shown by the countries of the Middle East and North Africa, where the average score has declined by 1.79 points since the BTI 2010. Within the region, economic and social development has been held back in part by civil wars and the massive marginalization experienced by broad swathes of the population, but also by economic policies primarily oriented toward keeping capricious rulers in power. In recent years, even the once-solid economic framework of the Turkish economy has morphed into a market order characterized by instability and legal uncertainty. This has entailed extensive expropriations targeting supposed regime opponents, along with rampant economic favoritism. The governing AKP awards state contracts to allied businesspeople on a preferential basis, and has thus forfeited much of its trust among international investors. A severe economic and currency crisis also contributed to the fact that the Turkish economy – previously high-placing in the BTI rankings – saw declines in eight of the 14 economic indicators as compared with the BTI 2018.

In South Africa, the inauguration of President Cyril Ramaphosa in February 2018 appeared to herald a new governing style clearly distinct from the nepotism and mismanagement of his predecessor, Jacob Zuma, who left office under suspicion of corruption. However, Ramaphosa has also been confronted with the clientelistic networks of the African National Congress. In addition, unproductive and highly indebted state-owned enterprises remain a drag on economic performance, which is exacerbated by restrained levels of international demand and the caution shown by international investors. As in Angola, Mozambique and Namibia, economic output in South Africa declined significantly over the last decade, a fact reflected in the decline in this BTI performance indicator by fully three points in all four countries. However, the unfavorable macroeconomic indicators cannot be ascribed solely to global economic difficulties, or even to the significant fall in commodity prices during the second half of the decade. Many African countries remain governed by parties with large parliamentary majorities that derive their legitimacy essentially from their fight against colonialism and apartheid. In such countries, economic difficulties have also stemmed from the destabilization of unconsolidated market-economic structures in favor of clientelistic policies. Today, protest against elite mismanagement is mounting within these countries' poor populations, which are proving receptive to populist arguments in the face of growing inequality and corruption. These are sometimes instrumentalized by governments, and directed against white minorities, as in the expropriation debates in Namibia and South Africa, or against interference by Western donors, as in Tanzania and Zambia. With the exception of Botswana at the highest level and Zimbabwe at the lowest, a negative trend was evident in all other countries in southern Africa, including Angola, Lesotho, Malawi, Mozambique, Namibia, South Africa and Zambia. As a consequence, the average economic performance of these nine economies sank by 1.78 points.

Unlike most African, Arab and Latin American countries, the majority of the Asian economies have shown solid or even dynamic development. Apart from crisis-tarnished exceptions such as Afghanistan and Pakistan, or the isolated North Korea, most of these economies have benefited from the fact that the traditional engines of regional economic growth (China, India and South Korea) remain relatively strong. Their demand, investments and international supply chains have helped boost growth in most of their neighboring countries. In the BTI 2020, two-thirds of all Asian economies are credited with good to outstanding economic performance (between 7 and 9 points). Only East-Central Europe achieves better scores, although most of the robustly growing economies there have only just returned to their pre-crisis levels or are nearing this point.

Despite this positive Asian and European countertrend, uncertainty remains the defining characteristic of the current global economy. This does not refer solely to the volatile commodity-price trends, to the unreliable, nationalistic or openly clientelistic economic policies of numerous governments, or to the recent weakness of the investment and trade stimulus provided by potential regional anchor states, such as Brazil, Nigeria, South Africa and Turkey. Today's environment is also heavily influenced by the trade and technology war between China and the United States, as well as by the effects of Brexit-related uncertainties, both of which endanger global economic growth and enhance unpredictability. Emerging and developing countries have been particularly strongly affected. Because trade between the United States, China and Europe constitutes about 40% of overall world trade, any major disruption in these relationships weakens global economic growth.

The looming debt crisis

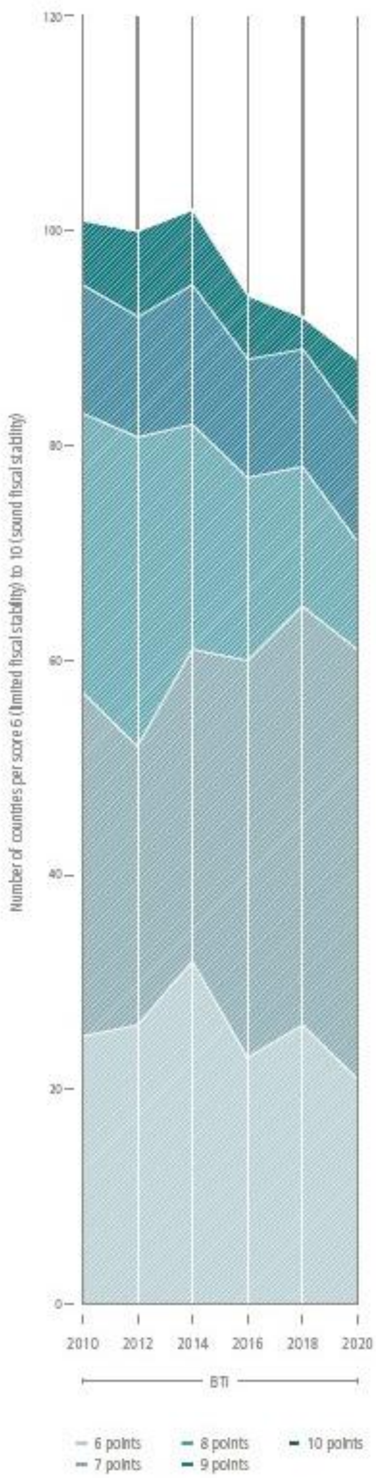
This global uncertainty is certainly being felt by developing countries and emerging markets, some of which have accumulated high levels of debt. Such countries are investment targets offering high yields for commercial and other lenders – especially today, due to the OECD countries' low-interest-rate policies – while conversely having a great need for investment. These countries' debt stocks have grown rapidly due to this combination of capital pressure and the willingness to absorb the influx of funds. According to the International Monetary Fund (IMF), debt levels within this group today average about 50% of national GDP, as compared to 15% in 2008, before the financial crisis. Moreover, a significant upward trend remains evident. Indebtedness of this scale was last seen in the 1980s.

Nevertheless, the bare fact of the debt-to-GDP ratios often cited in this context offers only limited insight into the drama of an acutely threatening debt crisis in developing countries. After all, debt-to-GDP ratios in the OECD states, most of which are deemed stable from a fiscal-policy perspective, are nearly twice as high, with the average ratio at around 100% with a slightly declining trend. In this respect, when assessing fiscal stability, the ratio of the interest payments paid on government debt to the country's total government revenues is a much more meaningful indicator. For example, governments in developed economies spend just over 5% of their tax revenues in servicing their interest payments, while emerging markets must expend nearly 15%, and low-income countries as much as 20%.

According to the World Bank, the share of state income devoted to interest payments is particularly high in the politically unstable countries of Lebanon (45.7%) and Sri Lanka (40.0%). This is in part due to unfavorable borrowing conditions, which in the case of Sri Lanka have already led to the forced 99-year lease to China of the strategically important port of Hambantota. The BTI's indicator addressing fiscal stability accordingly offers weak assessments for both countries, with scores of five and six points, respectively. The governments of Egypt and Brazil also saw their BTI assessments of fiscal stability decline significantly over the past decade (respectively dropping by two and three points). Each expends fully a third of its revenues on servicing interest payments. In Ghana (-2), India (-1), Jamaica (-1) and Zambia (-2), such payments still account for around a quarter of state revenues.

The Zambian case of overindebtedness illustrates the dangerous combination of a lack of economic diversification, poor governance and a dependence on external donors, a pattern that is particularly re-emerging in many countries of sub-Saharan Africa. Zambia was part of the partial debt-relief program provided to the group of heavily indebted poor countries (HIPCs), and it carried out sometimes-painful budget cuts agreed on with the IMF, such as in the area of education. As a result, its overall debt declined significantly, from $7 billion to $3 billion in 2005. This debt relief coincided with a rapid rise in the world market price for copper, Zambia's main export product. This price more than doubled within the course of a single year, and then stabilized at that high level for several years. However, as a consequence of this beneficial set of circumstances, budget discipline declined, with state expenditures for overpriced infrastructure projects nearly doubling over the last decade, for example. The incidence of office abuse and corruption also rose rapidly. With the help of bogus companies and falsified invoices, corrupt government employees apparently embezzled millions of dollars in development aid, prompting some donor countries to suspend their programs.

During the past ten years, the share of countries with robust fiscal stability nearly halved



Zambian governments' blatant economic mismanagement ultimately led to a sharp increase in foreign debt, to more than $16 billion. Despite the admonitions of the IMF and World Bank, inconsistent budgetary policies cannot be contained today solely through loan conditions set by the traditional Western lenders, as China and other non-Western funders now offer additional sources of credit. Granted, the Chinese government, now a creditor holding one-third of Zambia's external debt, also places sometimes-significant conditions on its loans. However, these are generally of an economic rather than an economic-policy nature. For example, Beijing is said to want to take over the state energy producer, Zambia Electricity Supply Company (ZESCO), as compensation for outstanding loan payments.

The situation in Zambia illustrates the only relative significance of fluctuating commodity prices to fiscal stability. To be sure, metal and energy prices did fall sharply in the middle of this decade, returning to their 2005 levels by the beginning of 2016, or even lower in the case of crude oil prices. However, the world market prices of numerous commodities have recovered in recent years, in some cases quite significantly. In the case of copper, the past decade's average price is significantly higher than that of the previous decade. Thus, commodity-exporting governments cannot escape any partial blame for the decline in fiscal stability, as unsustainable spending and mismanagement have made a substantial contribution to the debt crisis.

On the other hand, Zambia's example points to the increasingly strained fiscal-policy situation in a number of the HIPCs that were previously granted debt relief. Within this group, only Côte d'Ivoire (+4 points) and Guinea (+3) have been able to make significant improvements over the past decade with regard to the BTI's fiscal stability indicator. Haiti and Malawi, in particular (each -3), but also Ethiopia, Ghana, Mozambique, Nicaragua and Niger (each -2) now show significantly less sustainable fiscal policies than was previously the case. In the last two years, fiscal instability has increased in more than one-fifth of all the countries surveyed by the BTI. In only 10 countries was there a positive countertrend driven mainly by a temporary recovery in commodity prices, as in the Gulf states of Kuwait, Saudi Arabia and the United Arab Emirates (UAE).

In this respect, the average score for the fiscal stability indicator, with its average medium-term decline of 0.45 points, shows the second-greatest deterioration (after economic performance) of any of the economic and social indicators examined in the BTI in the past decade. Moreover, with a decline of 0.14 points over the last two years, it was the indicator showing the strongest negative trend in this period. The share of countries with robust fiscal-stability scores ranging from eight to 10 points nearly halved over the course of the decade, from 37% in the BTI 2010 to 20% in the BTI 2020. Low-income countries were hit particularly hard by this trend, with nearly half now showing acute difficulties in repaying their loans. This is in part due to the fact that the share of non-concessional loans in these countries has risen from just under 25% to 46% in the last 12 years.

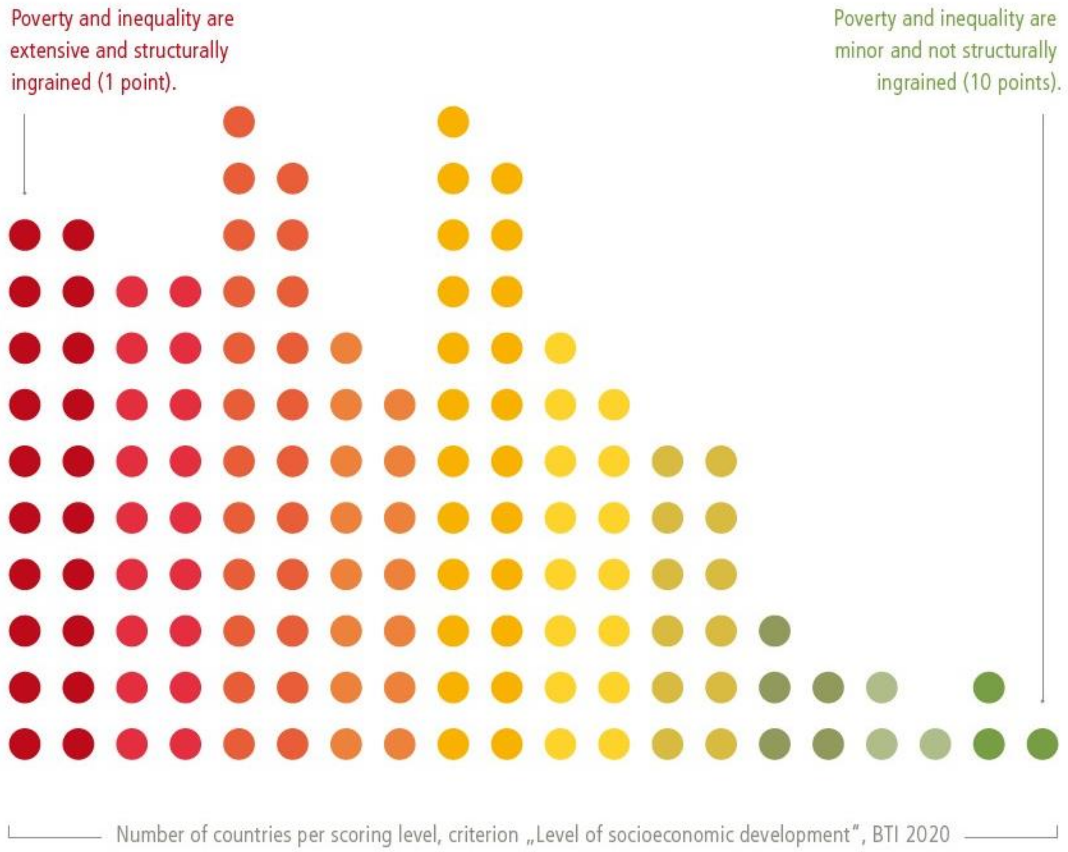
Donor countries bear a significant share of the responsibility for defusing the looming debt crisis. Possible measures include increased consideration of recipient countries' fiscal-policy sustainability when granting loans; greater transparency in financial flows; better donor coordination beyond the Paris Club; the development of a comprehensive, multilateral legal framework for debt relief – including China and India – under the auspices of the United Nations; and the promotion of better financial-management practices among borrowers. Many observers rightly warn that the rapid increase in debt ratios in many developing countries poses a massive danger to the achievement of the SDGs.

Growing inequality

Rapidly rising debt levels are also further restricting governments' fiscal leeway with regard to improving their social security systems or even constructing such systems for the first time. In this regard, the pressure to act has not diminished: 76 of the 137 countries show a very low level of socioeconomic development, a status assessed with four or fewer points in the BTI. Poverty and inequality are thus widespread in more than half of the countries surveyed by the BTI, indicating entrenched patterns of exclusion. Of the 50 African countries surveyed, only Algeria, Botswana and Tunisia (5 points), as well as Mauritius (6 points), do not fall into this category of strongly pronounced socioeconomic marginalization, and have been able to realize notable successes over the past 10 years, particularly in the field of poverty reduction. But even these positive exceptions in cross-continental comparison show significant shortcomings. Indeed, they serve to illustrate the overall limited significance of relatively low poverty rates when other factors are not taken into consideration.

According to the World Bank, the poverty rate in Algeria has been reduced by one-fifth over the last 20 years. However, fiscal-policy difficulties due to reductions in oil revenues have made it difficult to fund welfare-state measures to the same degree as before. As a consequence of rising unemployment rates, about 10% of the population is currently in acute danger of falling back into poverty. As in Algeria, there are pronounced regional disparities in Tunisia. The official Tunisian poverty rate of about 15% reflects a significant reduction in comparison to levels of around 20% at the beginning of the decade; however, poverty rates remain at around 30% in the country's northwestern and central regions. BTI country reports also note the continuing presence of systematic discrimination against women in the economic life of both countries.

Social exclusion is pronounced in more than half of all countries surveyed

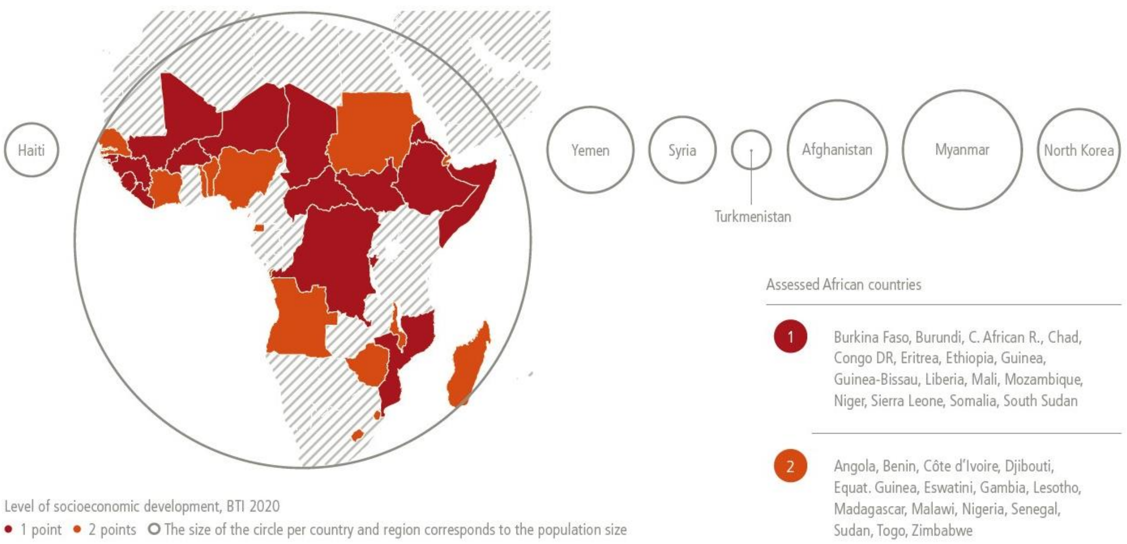


In Mauritius, the government has worked with the United Nations toward socially inclusive and sustainable development in the context of the SDGs, and has sought to counteract the low but rising poverty rate by increasing the minimum wage. However, the middle class has also been shrinking here for some years, and social inequality has been rising. Finally, in Botswana, resource wealth has been and is being deployed to support a long-term development strategy, which – among other successes – has resulted in a near-halving of the official poverty rate within the last 20 years, to 16%. Nevertheless, another third of the population lives just above this poverty line, and remains exposed to a high degree of social vulnerability. Depending on whether the share of the population being considered is that living on less than $1.90, $3.20 or $5.50 per day (on a PPP basis), different trends can be identified over the course of recent years. The fight against extreme poverty has been successful in the sense that the share of the population living on less than $1.90 per day has decreased. By contrast, efforts to increase living standards to the point of exceeding the higher thresholds ($3.20

and $5.50 per day) have not been as successful; the share of the population under these levels (but above the minimum threshold) is rising. The country's Gini index coefficient of income inequality, at a current level of 0.53, correspondingly indicates the continuing presence of extreme socioeconomic polarization, making Botswana one of the most unequal societies in the world.

Nevertheless, the situation in these four countries is far better than in the states receiving just one or two points in the BTI 2020 for their level of socioeconomic development. It is striking that the significant majority of these countries can be assigned to a fairly well-defined geographic region stretching from Senegal in West Africa across broad sections of Central Africa and, ultimately, to Somalia on the Horn of Africa. Apart from Afghanistan, Haiti, Myanmar, North Korea, Turkmenistan and the civil war-torn countries of Syria and Yemen, all of the other 31 countries with high poverty rates, extremely pronounced social inequality and structural socioeconomic marginalization affecting large sections of the population are located in the poverty belt of the South Sahel zone, Central Africa and Southeast Africa.

In countries assessed by the BTI, more than 80 percent of the population most affected by social exclusion is African



The oil-rich Equatorial Guinea proves that poverty does not necessarily have anything to do with a lack of resources. This county has the highest per capita income (on a PPP basis) in all of sub-Saharan Africa. However, the great majority of the population fails to benefit from this wealth. In the absence of reliable data, the World Bank estimates that the poverty rate here exceeds 75%. Half of the population in this resource-rich country lacks access to clean drinking water, and life expectancy is under 60 years, below the already-low regional average.

Overall, poverty has been reduced worldwide in recent years, in some cases significantly, while social inequality has increased significantly in many countries. Developments in Bulgaria and Mauritius illustrate this tendency. For the first time in this decade, both have fallen out of the group of (now only 23) countries that have achieved a satisfactory to high degree of social inclusion (7 points or more). In both cases, the absolute poverty rate has declined over the last decade, while relative poverty has risen, indicating that the upper income classes have been able to accrue significantly greater gains than the lower classes. The BTI country report for Bulgaria points to “a sharp increase in inequality” during the review period, while the BTI country report for Mauritius indicates that “prosperity is not equally shared, as growth dynamics are tilted toward the high-skilled services sectors and against the most vulnerable and the uneducated.”

Globalization appears to function as a driver of inequality alongside factors such as technology, corruption and unequal access to important resources, such as education and other public services. In the BTI 2010, the average level of socioeconomic development worldwide, at a score of 4.46 points, was already assessed as being very poor. However, in the last 10 years, this average has fallen still further, to its current low of 4.28 points. In this regard, it is striking that social exclusion is increasing even outside the war-torn or badly mismanaged states such as Burundi, Eritrea, Libya, Mozambique, North Korea, Syria, Turkmenistan, Venezuela and Yemen. Nor is it only the countries affected by significant setbacks in economic transformation over the last ten years that have been subject to increasing poverty and inequality, such as Ghana (-0.93 points in the overall economic transformation score) and South Africa (-0.57), or which have moderately curtailed their social expenditures due to reduced revenues, such as Kuwait and Qatar. Indeed, the social gap is also widening within countries showing strong economic-transformation gains, such as Indonesia (overall score +0.32), Latvia (+0.43) and even Mauritius (+0.50).

Even governments pursuing active social policies have found it difficult to arrest this trend toward greater social inequality. For example, Chile, Costa Rica and Uruguay may feature the most inclusive and least discriminatory welfare regimes in Latin America, but social inequality nonetheless remains a pressing problem for these countries, as Chile’s mass demonstrations in the winter of 2019 showed. These states’ Gini coefficients, which are still high in interregional comparison, have only slightly decreased (Chile, Uruguay) or even somewhat increased (Costa Rica). In Chile, recent social measures have included an expansion of programs related to health insurance, a basic pension and a basic family income. However, its example demonstrates that even structural measures of this kind can only with difficulty correct for conditions in which the role of the state in the social sphere has previously been drastically reduced, and in which inequality is amplified by weak tax policies and private privileges in the health and pension sectors. The closely watched Bolsa Famila and Fome Zero social programs in Brazil, implemented by the Workers’ Party (PT), contributed to lifting nearly 25 million Brazilians out of poverty. Yet despite these measures, income inequality grew considerably over the same period. Today, due to the successor government’s abandonment of the PT’s social policies, nearly 4 million people have once again fallen under the poverty line. Finally, Peru is one of only 23 countries in the BTI 2020 to have successfully achieved a qualitative improvement in its level of socioeconomic development over the course of the last decade. Paired with strong economic growth, well-crafted social programs aimed particularly at the disadvantaged highlands regions have contributed to a significant reduction in the share of the poor population to just over 20%. Aside from Peru, only Bolivia and Ecuador in Latin America – both also at a low level of initial development – were able to accomplish this, even if the structural disadvantages faced specifically by the indigenous populations in all three countries remain a massive problem.

Overall, the average welfare-regime score across all countries assessed by the BTI changed relatively little over the last decade. The indicators assessing social safety nets and the equality of opportunity each continued to receive average scores of five points. Put bluntly, this means that most governments have established little more than rudimentary social systems that fail to cover all risks and serve only a limited number of beneficiaries. In such cases, the majority of the population remains exposed to the risk of poverty, and there are patterns of structural discrimination against women and ethnic, religious or other minorities.

Less poverty, more inequality – few governments were ultimately willing or able to counter this trend. A major problem in this context is the comparatively small size of the formal sector in most countries. Even if the informal sector represents a safety valve for job seekers in economically difficult times, it is significantly less productive, and thus represents a forfeiture of developmental potential. According to the World Bank, wages paid there are also about 20% lower than in the formal sector. In addition, those working in the informal sector face significant barriers in accessing financial services, which in turn deprives the economy of important investment stimulus. Social-state interventions are also hampered by the presence of a large informal sector. Labor-law measures and support services have only a limited effect there, which means that protections and financial safety nets provided to the working population and their families in the informal sector are significantly weaker. In this respect, it is a significant barrier to development that – according to the World Bank – the informal sector still contributes an average of one-third of GDP in developing countries and emerging markets (although this trend is downward). Moreover, the sector accounts for more than 70 percent of the working population in these countries, half of whose members are self-employed.

Because the informal sector also accounts for a large share of agricultural employment for unskilled workers in low-income countries, increased education-sector efforts, in particular – alongside measures in the tax and regulatory sphere – are seen as a key means of enabling more people to transition into the formal sector. This makes it all the more problematic that little progress has been made in this area in the last 10 years. As previously, the three Asian countries of Singapore, South Korea and Taiwan lead the BTI's education ranking. China's education policy is also now focused increasingly on better school and vocational development in rural areas. By contrast, education policies particularly show distinct shortcomings in West and Central Africa, such as low education-related expenditures, poor infrastructures, high illiteracy rates and low numbers of average school years completed in almost all countries aside from Ghana. In Southern and Eastern Africa, positive exceptions are more common. Here, in addition to Botswana and Mauritius, Rwanda in particular stands out; the country's "Vision 2020" program, strongly supported by the international donor community, has shown notable successes in the school and vocational-education realms. However, education-system shortcomings overall represent one of the primary barriers to development in sub-Saharan Africa. The sector is also generally neglected on a global scale. Indeed, with the global average for this BTI indicator at just 4.67 points, education policy is the third-worst-rated aspect of economic transformation. This is a sign of serious education-policy shortcomings even in middle- and high-income countries, such as Hungary, Panama and Turkey.

Only environmental policy receives a worse assessment (after the level of socioeconomic development), with an average of 4.61 points. This, too, is an alarming sign in terms of achieving the SDGs.

With regard to sustainability, it is particularly worrying that environmental policies in Brazil and India have now deteriorated as well. This tendency threatens to intensify further in Brazil, given President Jair Bolsonaro's blatant contempt for environmental issues. For his part, Indian Prime Minister Narendra Modi has launched a series of positive-sounding initiatives, from the "Clean Ganges" project to a ban on single-use plastics by 2022. However, the BTI experts also point to India's considerably less attractive environmental record as well as to the continuing dilution of guidelines in the areas of plant and animal protection, waste management and air-pollution control. In this regard, Brazil and India are following the bad examples of falling environmental-policy standards in other G-20 emerging markets, such as Mexico and South Korea (which showed declines in the BTI 2016), as well as in Indonesia and Saudi Arabia (declines in the BTI 2018). Nonetheless, the spectrum of environmental-policy quality is also broad in this group, ranging from three points (Indonesia and Saudi Arabia) to seven points (South Africa and South Korea). The average BTI score for environmental policy in the G-20 countries is 4.82. This essentially means that environmental concerns are given only sporadic consideration, and are relatively often subordinated to growth efforts, with environmental regulations being accordingly weak and rarely enforced.

Free and fair competition?

Social policies and the ways in which markets are organized are closely related both empirically and functionally. With a Pearson correlation coefficient of 0.88 between the criterion scores for organization of the market and competition on the one hand, and welfare-regime scores on the other, the linear relationship between these systems of social and economic organization is very strong in the BTI 2020. Outliers, whose welfare-state and anti-discrimination policies are significantly more advanced than their rudimentary market-economic structures, such as Algeria, Belarus and, especially, Cuba, are rare. Moreover, their number has declined further in recent years. This is due in particular to the fact that welfare regimes in previous outliers, such as Libya, Syria and Venezuela, have deteriorated drastically. Cuba, too, has moved closer to the trend line, although it remains in the upper third of the BTI welfare-regime ranking. The country is pursuing a cautious liberalization of its economic order, while all aspects of the social state are deteriorating rapidly. Along with the general cessation of Venezuela's role as economic partner and oil supplier, Cuba's education, health and social systems – while still passable by international standards – are all declining in quality. At the same time, inequality in areas such as access to currencies is rising. Conversely, a number of economic-system outliers, whose welfare regimes were rated lower in the BTI 2010, such as El Salvador, Georgia, India and the previously mentioned positive case of Peru, have also drawn closer to the trend line thanks to investments in their social-security systems. Thus, the correlation coefficient has risen from 0.77 to 0.88 in the last 10 years.

With regard to the functional relationship between the two categories of regime, reference must be made to the inclusive institutions deemed essential by Daron Acemoğlu and James A. Robinson. These not only shape the interplay of political and economic developments, but are also relevant with regard to the interconnections between economic and social developments. For example, in a fair economic order that firmly prohibits discrimination against any market participants and, at the same time, seeks to prevent the emergence of dominant, competition-reducing monopolies in order to ensure fair competitive conditions, there is a higher probability that there will be less discriminatory marginalization of certain population groups within the labor market or with respect to educational opportunities. Likewise, such a system is apt to be paired with a legal framework that upholds the rule of law. A more participatory, freer economic order that prevents arbitrary barriers to access and resists the formation of structures intended to enrich exclusive circles of the privileged will generally be accompanied by social security systems that promote social inclusion to the greatest degree possible through the provision of sociopolitical support and safety nets. This also tends to be linked with greater opportunities for political participation. In this respect, market-economic structures that enable free and fair competition in the sense of inclusive economic development must be distinguished from state-dirigiste, market-distorting or clientelistic structures that only adopt certain aspects of the capitalist economy in order to realize efficiency gains in the service of a closed political system.

In order to capture the quality of economic systems in the free and fair sense described here, the BTI examines whether clear rules for market-economic competition exist and the degree to which provisions protecting against pricing collusion and the formation of monopolies are in place and are, in fact, implemented. On the other hand, it also analyses whether there is an adequate framework for a functional private sector with regard to the registration and protection of private-sector companies, the implementation of privatization processes in keeping with market principles, and the regulation and protection of property rights. By combining the four indicators addressing market organization, competition policy, property rights and private enterprise, it can initially be seen that only 15 of 137 governments work comprehensively and with few restrictions to ensure inclusive and legally secure market and competitive conditions. In addition to nine East-Central and Southeastern EU member states, this group includes Costa Rica, Chile, South Korea, Taiwan, Uruguay and, finally, Singapore, as the only autocracy. These countries score at least eight points in each of the four relevant indicators.

Another 14 countries can be included in an expanded top group of states that achieve at least seven points in one or more of these indicators; however, these countries thus already show more significant shortcomings. Such flaws may include discrimination in favor of certain population groups (Malaysia) or ruling families (Qatar), patronage systems (Hungary, South Africa) or insufficient protections against the formation of monopolies (Botswana, Mauritius), a large informal sector (Colombia, El Salvador, Peru), or institutional weaknesses with regard to private-sector liberalization (Croatia), or regulation that is transparent and in keeping with market principles (Montenegro, North Macedonia, Panama, Serbia). This list of major shortcomings in countries that are usually classified unquestioningly as market economies indicates the difficulty in clearly distinguishing them from economic systems that are characterized by cronyism and competitive distortion. If we refer to the expanded top group uniformly as “market economies” despite the shortcomings identified above, this still covers only one-fifth of all countries surveyed.

The gray area encompassing the transition to no longer sufficiently free and fair market and competitive conditions begins later, with the market-organization systems of Brazil and India, each of which receive six points. Both of these countries have protected economic segments in which widespread violations of market and competition principles are allowed, along with rampant corruption and very large informal sectors. For example, the recent corruption scandals in Brazil have demonstrated that informal practices have undermined formal institutional frameworks to a greater degree than previously thought, and that a variety of regulations have led to additional distortions and preferential treatment for special interests. On the other hand, countries that as yet lack sufficient rule-of-law protections, such as Albania, Georgia, Mongolia, Turkey, Ukraine and the UAE, show more severe shortcomings regarding the protection of private property – for which each state receives only a score of six points – and the guarantee of legal certainty. This significantly impairs market actors' freedom and the fairness of competition.

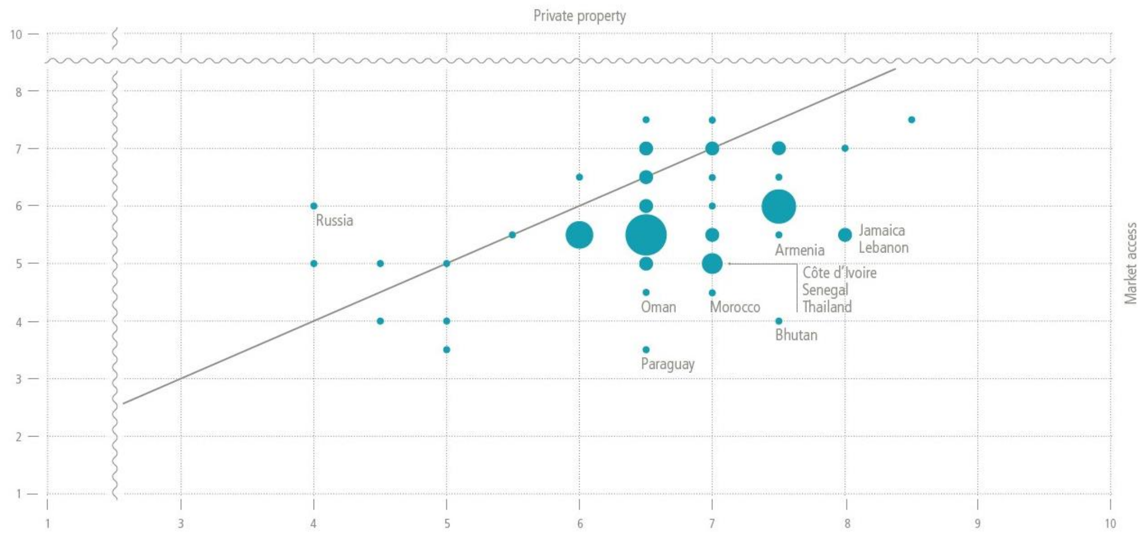
Among the 26 countries to which the BTI 2020 ascribes a highly advanced or advanced economic-transformation status, there is only one – the UAE – that, due to its weak protection of private property rights, falls into this gray zone between market-economy and clientelist-capitalist economic orders. Kuwait is located below this gray zone, in its case due to the presence of monopolistic structures. Among the large group of 55 countries that the BTI assesses as having only achieved limited economic transformation, ranging from Serbia (total score 6.93 points) to Gabon (5.07), two-thirds of the economic regimes are no longer positioned within this gray zone, as they are mainly characterized by dirigisme and patronage.

With regard to the framework conditions for a functional private sector, the trends appear to run in opposite directions. Thanks to the increasing recognition of the dynamic role of the private sector, along with numerous privatizations over the course of the last decade, the significance of private-sector companies in national economic structures has slightly increased as a world average (from 6.29 in the BTI 2010 to 6.39 today). Over the same period, however, the legal security provided to property rights declined (from 6.10 to 5.90). Current drivers of this contradictory development include Egypt, Ghana, Turkey and, to a lesser extent, Algeria, Bangladesh and India.

One-third of all countries surveyed provide less legal certainty in economic matters today than was the case in the BTI 2010. This can generally be seen as being linked to serious weaknesses in the area of the rule of law. Among the 44 countries with a negative record over the last 10 years with regard to the definition, regulation and protection of property rights, 34 have also seen their scores for the rule of law decline significantly. This phenomenon has been strongest in Turkey. Here, numerous politically motivated expropriations of organizations and businesses were carried out against supporters of the Gülen movement, particularly during the state of emergency that was imposed following the coup attempt and that lasted from July 2016 to July 2018. Moreover, after the end of the peace process with the PKK, thousands of Kurds were displaced and their possessions expropriated. The fact that such state attacks were bolstered by dramatic reductions in judicial independence – which ultimately resulted in the dismissal of more than one-fifth of all judges and public prosecutors – can also be seen in the fact that lawsuits against arbitrary expropriation have thus far been dismissed.

By contrast, other countries show good conditions for private-sector activity, for example with the effective protection afforded to property rights in Arab countries such as Bahrain, Jordan and Lebanon, or with the high value attributed to the private sector in Latin American countries such as Argentina, Brazil and Jamaica. However, they combine these strengths with serious shortcomings in the area of market organization and competition policy. This discrepancy between the protection accorded to the private sector and the regulation of the market and competition can overall be seen in 70% of all national economic systems assessed by the BTI. However, it applies particularly to the group of 55 countries with only limited economic transformation, in which there is nearly an entire point (on the 10-point scale) between the average score assessed for the conditions enabling a functional private sector (average of 6.59 in this group) and that for market organization and competition policy (average of 5.71). Thus, a market participant in Morocco, Paraguay, Senegal or Thailand tends to enjoy a certain degree of legal certainty; however, the question of whether he or she is allowed access to the market at all, or is able to appear there as a competitor with equal rights, is regulated insufficiently or in a manner favoring certain groups, and, thus, in a discriminatory way.

Adequate conditions to support a functional private sector exist, but market access is limited and discriminatory



In this graph, all 55 countries with „limited economic transformation" (overall score 5.00 to 6.99) in the BTI 2020 are evaluated
Private property: Criterion Score BTI 2020; Market access: average score of Market organization and Competition policy, BTI 2020

In this respect, the issue of economic freedom, which often seems to be foregrounded in such discussions, does not go far enough; rather, economic fairness must be made a considerably stronger focus of analysis. In many countries, there is not only a liberalization deficit, but also a pattern of discrimination, distortion and concentration of power that has been created by deficient or manipulative regulation of market access, property rights and competition.

Bleak conclusion

The BTI consolidates the diversity of economic and social indicators discussed here into an overall economic-transformation score. It thus sketches a comprehensive picture of the state of development that goes beyond current macroeconomic reference indicators. As a consequence, similar overall scores for economic-transformation status encompass what can be quite divergent regulatory-policy, social and performance profiles. For example, India, Indonesia, Russia, South Africa and Turkey, with total scores of between 6.11 and 6.14 points in the BTI 2020, are classified nearly identically around rank 50 in the economic-transformation ranking, while in fact demonstrating very different strengths and weaknesses. For instance, the Asian economies combine strong economic performance with a low level of socioeconomic development, while Russia acts in a more socially inclusive but economically exclusive way, with shortcomings in its market organization and insufficient protections for private property. These differences within the highly aggregated overall economic-transformation scores must be taken into account and broken down in order to be able to interpret a country's development classification.

The total economic-transformation score as an average across the 129 countries that were also included in the BTI 2018 has fallen only slightly, to 5.52 points. Nearly all of the 11 countries gaining more than 0.25 points on the state of economic transformation in the last two years were making up for losses experienced in previous years. This recovery came primarily in the form of gains in economic performance and fiscal stability in Azerbaijan, Cambodia, Kazakhstan, Nepal and Syria, but also and especially in Kuwait (+0.46), Ukraine (+0.54) and Vietnam (+0.61). Kuwait profited from higher oil prices and consequentially stronger domestic demand, which mainly benefited the construction sector. In Ukraine, past economic reforms began to take hold, while the strengthening of the private sector in Vietnam made a significant contribution to improved economic performance. In contrast, Belarus, Morocco and Slovenia (each +0.29) not only compensated for losses of previous years, but achieved their best overall economic-transformation status score of the decade. The Moroccan government reduced trade barriers and strengthened legal certainty for investors. Despite a high continuing degree of dependence on the agricultural sector, overall economic performance improved, contributing in turn to stronger fiscal stability. As it takes steps to define itself in distinction to Russia, Belarus has implemented low-threshold reforms to strengthen the private sector, and has emerged from recession. Finally, Slovenia has always ranked among the 10 best economies in the BTI and, in recent years, has successfully opened up further to foreign direct investment.

By contrast, the 12 countries that have lost more than 0.25 points on the economic-transformation scale in the last two years have all reached a new low. This applies to the repressive and isolated regimes in Burundi, Eritrea and Turkmenistan; to Cuba and Iran, both of which have been targeted by new U.S. sanctions; and to the crisis-torn countries of Nicaragua and Venezuela, all of which entered the review period at relatively low positions in the rankings. Even after the recent increase in oil prices, Oman continues to show a high budget deficit, sharply rising debt levels and thereby low overall fiscal stability, combined with only moderate economic growth. Like the previously described case of Zambia, which is also one of the economies showing the most significant deterioration, all the economies listed here are affected not only by unfavorable global economic or geopolitical factors, but also by poor economic policies. At a higher overall level of economic transformation, this is also true of Romania (-0.32 points), Hungary (-0.54) and Turkey (-0.68). The chronically unstable Romania, which has gone through 11 prime ministers in the last five years, was led during the review period by a nominally social-democratic government, which, despite mass protests, resisted the implementation of penalties for corruption and office abuse. Moreover, it paid little heed either to the Maastricht criteria for debt and inflation or to the independence of the central bank. The decline in the level of economic transformation was even more precipitous in Hungary, where a favoritism-driven economy similar to that of Turkey has been installed. The BTI country report concludes that in contrast to traditional state capture, in which economic interests dominate a weak executive, Hungary's strong government cooperates in non-transparent ways with economic circles that it has itself created. Like Turkey, Hungary saw declines in eight of the BTI's 14 economic indicators, with particularly serious deterioration in the area of the organization of the market and competition.

Thus, once again, the BTI's conclusion regarding economic transformation is bleak. Economic performance that is insufficient as a global average, paired with a looming debt crisis in many countries, is accompanied by only partially free and often unfair market and competitive conditions. This combination leaves little hope that the most urgent problems of economic development – the socioeconomic marginalization of large portions of the population due to poverty and inequality – can be overcome with any speed.