

# Country Governance Research Commentary

## November 2017

### Country Ranking Trends

Magni upgraded Indonesia following a review of the country's insurance supervision. Action taken by the country to implement previously-stated intentions resulted in a modest upgrade. The upgrade was enough to move Indonesia ahead of Turkey, while keeping Indonesia close to the middle of the countries in the emerging markets.

### Need to Head Them Off at the Deutsche Impasse

In Germany, the discussions to form a coalition government have collapsed, bringing about a period of unprecedented political uncertainty. Given the disparate views of the parties involved, the results aren't completely surprising, but the traditional consensus-oriented nature of German politics led most observers to believe an agreement would be cobbled together. Germany now finds itself at an impasse and more time will be required. One possibility would be the formation of a minority government, but Angela Merkel has said she would prefer new elections over the inherent instability of governing in the minority. All indications are that new elections would produce similar results, though the far-right Alternative for Germany (AfD) party may strengthen its position. A third option would be forming another "grand coalition" with the Social Democrats (SPD), which has been the ruling coalition since 2013. Despite the SPD's vow to stay in opposition, the two parties have begun talks though many obstacles remain to reach a deal.

**Implications:** While the impasse may cause some temporary issues within the country, the more significant implications involve the EU as an institution and the ever-present threat of an unwinding of the union. Germany has provided strength to the EU. A protracted impasse could energize opposition to the EU elsewhere and Brexit could become contagious. Should the EU start unwinding, there would be different impacts across the countries. Germany and much of northern Europe have strong governance so the primary impact would be the disruption of business activity. For example, Magni ranks Germany's strong governance as 4<sup>th</sup> best in the world. The countries in the EU with weaker governance, particularly in southern Europe, would face more significant issues, especially over the long term. Greece is among the countries that would experience the greatest potential impact. The EU-level impasse on resolving Greek issues would fade away and hard realities about an unsupportable sovereign debt and a dysfunctional economy would need to be addressed.

### Disrespecting Mandela's Legacy

The previously discussed broad corruption scandal in South Africa continues without resolution. The scandal is having spillover effects on the economy, with slowing growth and declining business confidence. Two credit rating agencies recently downgraded South African debt below investment grade and into junk status. With Moody's only considering a downgrade, South Africa has for now avoided expulsion from widely followed bond indexes. However, Moody's has said the country's rating may be cut soon if the upcoming budget fails to address the country's fiscal challenges and structural impediments to growth. Rooting out corruption will be a prerequisite for reinvigorating the economy. So far, despite the evidence of high-level corruption, no individual has been charged in South Africa.

**Implications:** The late Nelson Mandela deserves credit and respect for ending apartheid without destroying much of the positive legacy from the country's time as part of the British Commonwealth, particularly the strengths in governance. Now, those strengths are

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eroding. Instead of being a leader among the countries of the emerging markets, South Africa may erode its governance down to the average of these countries.

### *Un Populista Distaido por Otro Populista*

The fifth round of talks on renegotiating NAFTA (North American Free Trade Agreement) recently concluded in Mexico City with some progress on technical issues but with little headway made on the more controversial issues. The original goal of completing talks by the end of the year will not be met. Aside from the United States' call for a sunset clause in the agreement, other difficult topics relate to automotive rules of origin, government procurement, and dispute settlement. The United States has pressed for counterproposals to its idea for rules of origin, but instead, Mexico and Canada presented data showing the harm the proposition would inflict on the auto sector and pressed the United States to explain its reasoning. The ongoing talks will now overlap with the next Mexican presidential campaign. The current frontrunner is the populist former mayor of Mexico City, Lopez Obrador, who has been an outspoken opponent of NAFTA. The longer the talks carry on without resolution, the greater the risk grows that the agreement collapses.

**Implications:** Independent of the various views of NAFTA as a trade agreement, the election of a populist leader in Mexico raises new issues. Populist leaders tend to have an "ends justify the means" approach to governance and such an approach is inconsistent with good governance. Mexico's relatively high governance scores for a country in the emerging markets would be at risk. Further, a populist leader in Mexico would raise challenges for the United States and could become a meaningful distraction for President Trump. Previous U.S. presidents have had such distractions and these distractions have often led to unfortunate results.

### *Brazil: Como Voce diz Corrupcao Sistematica?*

Twice in recent months, President Temer's opponents have failed to secure the two-thirds votes necessary in the lower House of Congress to refer corruption cases against the President to the country's top court. This has effectively blocked any corruption investigations, and make it likely that he will serve out the rest of his term. However, he has consumed tremendous political capital in the process, and he is deeply unpopular. It is against this backdrop that his government is attempting to pass critical pension reform. The current unsustainable system consumes nearly half of the national budget. In the face of resistance to the government's initial proposal, Temer has introduced a scaled-down plan with partial reforms. Brazil's lower house Speaker Rodrigo Maia has said he will try to pass the pension reform bill this year, but there is limited time to secure the three-fifths super-majority needed for passage.

**Implications:** Unsustainable pensions are an important topic and germane to many governments, including all countries in the developed markets; many countries in the emerging markets; and most states/local governments across the United States. Should unsustainable pension issues go unaddressed, the rising debt levels will inevitably undermine sovereignty. That said, making pensions sustainable will not improve weak governance. This commentary has contained several discussions about the corruption in Brazil. So far, none of the proposed actions address the underlying governance issues that enable systemic corruption.