

# Timely insights from portfolio managers and industry experts on key financial, economic and political issues.

*The views expressed in these posts are those of the authors and are current only through the date stated. These views are subject to change at any time based upon market or other conditions, and Eaton Vance disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions for Eaton Vance are based on many factors, may not be relied upon as an indication of trading intent on behalf of any Eaton Vance strategy. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness.*

DECEMBER 2, 2020

[Emerging Markets Debt | Markets and Economy](#)

## Democracy's positive impact on developing countries and their sovereign bonds

**London** - Economic policy has an empirically documented relationship to asset prices. For example, sovereign bonds of economically "free" countries typically have higher credit ratings and much tighter yield spreads than those of countries where economic policy is much less liberal.<sup>1</sup>

So what are the determinants, the precedent conditions, to economic policy change? To find out, we researched the relationship between a country's political institutions and its future economic policy changes. This entailed regressing various political institution variables against data from the Fraser Institute's Economic Freedom of the World (EFW) Index, which ranks more than 150 countries on a standardised economic freedom measure, ranging from 0 (least free, i.e. very illiberal economic policy) to 10 (most free, i.e., "ideal" economic policy). These scores can be understood as the ability, in a particular country, to produce, trade and consume any goods and services acquired without the use of force, fraud or theft.

We found that a country's political institutions do explain how likely a country is to increase its level of economic freedom or to reverse an already high level of economic freedom. Specifically, we found that:

- Prior to the turn of the 21st century, high levels of democracy correlated to increases in economic freedom across all countries.
- Since then (2000-2017), democracy has continued to play a positive role in low economic freedom countries such as emerging markets, correlating to future increases in economic freedom.
- However, in the period 2000-2017, in countries that have already achieved a high level of economic freedom, the role of democracy is either indifferent or antagonistic (e.g., democracy facilitating illiberal economic policy).
- Civil liberties (freedom for the individual) appear to be consistently related to improvements in economic freedom among both higher and lower economic freedom countries.

In our view, it may be the case that economic freedom, a liberty for the individual, eventually conflicts with democracy, the rule of the simple majority, while civil liberty applies to every individual. Further research that describes democracy as distinct from individual liberty may provide insights.

**Bottom line:** Democracy typically helps poorer economies improve their economic institutions, which in turn, fosters beneficial socio-economic changes and (all else equal) asset price gains. However, among countries that already have relatively sound economic institutions, democracy can facilitate the loss of economic liberalism; intensifying the redistribution of resources and extracting economic rents from various groups.



**Marshall L. Stocker, Ph.D., CFA**  
Director of Country Research and Portfolio Manager  
Eaton Vance Management

"A country's political institutions do explain how likely a country is to increase its level of economic freedom or to reverse an already high level of economic freedom."

<sup>1</sup> Stocker, M. "Emerging markets debt: Determinants of sovereign bond quality and returns", September 2019. This paper published findings of a regression model showing a strong correlation between the orientation of economic policy, as measured by the Fraser Institute's Economic Freedom of the World Index dataset, and Moody's ratings. It found economic freedom to be the most important determinant of sovereign bond quality and yield spreads.

---

## RELATED CONTENT

[Democracy's dichotomous role in economic policy changes and investment outcomes](#)

[Accessibility](#) | [Privacy & Security](#) | [Terms & Conditions](#) | [Form CRS](#) | [Contact](#)

Eaton Vance is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley

The information on this Web site is for U.S. residents only. The information on this Web site does not constitute an offer to sell, or a solicitation of an offer to purchase, securities in any jurisdiction to any person to whom it is not lawful to make such an offer.

There are no guarantees regarding the achievement of investment objectives, target returns, portfolio construction, allocations or measurements such as alpha, tracking error, stock weightings and other information ratios. The views and strategies described may not be suitable for all investors. Not all of Eaton Vance's recommendations have been or will be profitable. Eaton Vance does not provide tax or legal advice. Investing entails risks and there can be no assurance that Eaton Vance (and its brands) will achieve profits or avoid incurring losses. Prospective investors should consult with a tax or legal advisor before making any investment decision.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT

© Eaton Vance Management. All rights reserved. Two International Place, Boston, MA 02110