



**Economic Theory**

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**QUALITY OF INSTITUTIONS  
AND DEVIATION OF THE EXCHANGE RATES  
FROM THE PURCHASING POWER PARITY:  
IMPACT ON ECONOMIC GROWTH**

**Abstract**

It is stressed, that the global monetary relations are distorting the global competitiveness. Economic growth maintaining under the middle and low income countries competitive pressure is possible with the deviating down of the nominal exchange rate from PPP or with high graded institutions developing that can encourage innovations, business opportunities, and capital inflows. Basing on the data of 82 countries it is empirically confirmed direct and statistically meaningful relations between quality of institutions and exchange rate deviations from PPP. It is found that five clusters of the countries joined by the principle of quality of institutions and exchange rate deviations from PPP. The highest economic growth is observed in the countries with strong institutions and little undervalued exchange rates. The countries with low graded institutions may maintain economic growth only under the strong undervaluation of currency. Developed countries may deal with the competitive pressure due to the institutions of high quality. Quality of institutions and institutional competition are expected to be the most important forms of the global economy fragmentation.

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**Key words:**

Quality of institutions, purchasing power parity, exchange rate, global competitiveness, real convergence, global monetary relations.

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Emergence of the tendencies of the unprecedented growth of the currency reserves volumes in the countries with emerging markets caused the range of the issues and discussions concerning the adequateness of the traditional models of the international monetary economics in the interpretation of the mechanisms of interaction among the payment balances, economic growth and financial stability. So called «Asian syndrome», as an impulse to the accumulation of the enormous sovereign external assets exceeded the scopes of the issues, connected with the functioning of the global financial architecture. The global monetary relationships, based on the ability of the continuous support of the financial imbalances, cause the range of challenging problems, which change the basic modality of ability to support the global competitiveness in the world, where the monetary mechanisms of the payment positions improvement are almost obsolete and the external demand on the assets of the certain country can contradict to its ability to support the effective export.

According to the dilemmas of the world monetary models dysfunction, the issues concerning the emergence of the asymmetrical manipulation capabilities of support the rapid economic growth based on the global competitiveness, expressed by the undervaluation of the exchange rates concerning the purchasing power parity (PPP) are raised.

The abstention from the exchange rate upward movement began to perform a specific role: it created the absolute benefits and promote the export-oriented growth in conjunction with the accumulation of reserves to maintain the macrofinancial stability. As a result of the Asian countries' policy escalation into the systemic phenomenon the global economy is faced with the problem of adaptation to the new challenges in the sphere of competitiveness and survival support under conditions where the individual countries are able to underevaluate

the rate and avoid its movement towards the PPP even in the process of the real convergence while the others are limited in this choice.

Under conditions of the global competition and growing of share of countries with the low labor costs in the global GDP, the macroeconomic leverages of creating of the incentives for the economic growth appear quite limited. It was proved by the rapid post-crisis exhaustion of the demand stimulation programs to stimulate demand. However, one of the criteria of the world heterogeneity intensification is the quality of institutes which synergistically reflect the current and localized benefits of the business placement, likewise developments and innovations, dissemination of creative solutions in the field of economic life, the rising cost of the human capital. Possibilities of transfer of the institutional capacity to compete into the institutional plane are still poorly examined, especially in the case of institutions as opposed to politics acceleration of export growth based on undervalued rates, which makes this study currently important.

Thus, the identification of the basic monetary points in the global economy transformation under the influence of the prolonged accumulation policy of sovereign external assets (Aizenman and Lee, 2005; Aizenman, 2007) sufficiently points out on the preconditions for the transformation of the principles and possibilities of the external balance and competitiveness maintaining in the countries which are targeting the payments surplus, and in the countries which find themselves under the influence of the effects of unilateral actions of the first mentioned (Blanchard, 2011; Blachard and Milesi-Ferretti, 2009). However, some researchers suggest indirectly that the policy of reserves accumulating is the result of preventing of the upward movement rate in order to maintain the competitiveness. Moreover, a special emphasis on the fact that the undervalued exchange rate is a part of the mechanism of stimulation of the export-oriented growth is not only in the context of the Asian crisis, but considering the significant changes in the policies of the 1980s, when the association with the «Dutch disease» precondition was consolidated by the actual appreciation. The abstention from the exchange rate upward movement, in spite the expected benefits and advantages for the paying capacity increase and economic agents welfare, provides the essential advantages for the export growth and support of its competitiveness in the long term (Magud and Sosa, 2011). Another aspect concerning the mentioned advantages of abstention from the actual appreciation is well theorized issue concerning the constructing of the system of early indicators of the exchange crisis impending. The experience of the permanent currency disruptions in 1970-1990 laid the clear understanding of the fact that the rapid actual appreciation indicates the worsening of the payments balance, throwing the doubt upon the country's ability to maintain the current exchange rate, which is associated with the nominal anchor of the macroeconomic stability (Sachs et al., 1996; Popov, 1999; IMF, 2001). However, the most significant here is that the countries with the low and middle-income should take into account the specificity of their equilibrium undervalued rate in relation to PPP, which should be risen in the process

of the actual convergence (Balas – Samuelson effect) and avoidance of crises is possible only due to the productivity growth in the export sector based on the investments into the improving of the technological level of production. That is the deterioration of the balance of payments and vulnerability to the monetary and financial destabilization is risen exactly where there is no actual appreciation but an approximation to PPP rate.

Increase in the value of the capital flows into the countries with emerging markets, and the corresponding response in the form of abstention from the actual appreciation by accumulating of the reserves to some extent reduced the tension in the discussions that the undervaluation of rate is a means of the export promotion. Maintaining of the macrofinancial stability based on the ownership of the large reserves and compensation in accordance with such a way of impossibility of flexible exchange to restore their competitiveness without losses in the financial sector began to be seen as a key factor of reproduction of the differences between the developed countries and the rest of the world (Aghion et al., 2006; Aizenman and Riera-Crichton, 2006).

However, the policy of reserves accumulating on the basis of the undervalued rates has a tradition of the alternative analysis. Institutional reasons are the basis of the policy of reserves undervaluation and accumulation. The impossibility to ensure the effective collection of taxes, or the significant institutional costs from the taxation leads to the selection of the tax rates, lower than the equilibrium and higher foreign debt, where the reserves act as the insurance against the default (Aizenman and Marion, 2004). Analogically, the undervaluation and accumulation of reserves becomes a rather simple way to avoid the structural reforms which could be focused on the economic growth, increase of the economic flexibility, its adaptability to the global competitive pressure (Rato, 2006).

Although the discussions about the role of the actual exchange rate as an indicator of the economy competitiveness are far from complete, the emphasis on the fact that it is not endogenous, so it can become an instrument of the economic policy, it is made to explain the success of many Asian countries, in particular China. In view of the growing wave concerning the discussion about the role of institutions in generating of productivity, innovation and incentives for growth, exogeneity of the undervalued actual exchange rates is presented as a counterbalance to the endogenous formal and informal barriers of the economic development in the countries with the medium and low incomes (Bhalla, 2012).

The intensification of interest towards the institutional factors of the global competitiveness took place on the basis of the discussions about the development of the economy after the global financial crisis. On the one hand, the quality of institutions is currently considered as an integral part of an innovative economic growth within the framework of the economic flexibility and adaptability support. As a rule, the leading role of the quality of institutions in generating of the preconditions for the «high-quality» growth is confirmed by a huge number of

the literary sources (World Development Report, 2002; Zhuang et al., 2010). On the other hand, the fragmentation of the developed countries and their distinct asymmetrical global competitiveness as of today is not limited only by the issue of the real convergence. Failures in the structural policy, institutional rigidity, and incentives to innovations are more understood by the gap drivers between the innovative «Protestant North» and «traditional South» than in fact, the gap at the initial income level, although the most studies tend to the abstract interpretation of these problems in terms of analysis of the labor markets centralization degree (Pelagidis, 2009). The unique institutional characteristics of Scandinavian countries are shown from the perspective of the quality of institutions' formation of the global competitiveness even under conditions of the significant tax burden (Eklund, 2011; Berggren and Tragardh, 2011).

Hence the following issue arises: even if the developed countries lose their homogeneity on grounds of the institutions quality and maintaining of competitiveness on its basis, is not a manifestation of a more general trend, when the policy of the undervalued rates in the same group of countries changes the pattern of the global competitiveness in the world and requires the institutional adaptation. In economics there is the lack of studies aimed at identifying of the correspondence between the quality of institutions and the real exchange rate. Hence, the main objective of the paper is to show the fragmentation of the global economy on these criteria and to identify the clusters of the countries where the economic growth rates reflect a combination of the quality institutions with degree of deviations from PPP.

The basic PPP doctrine provides the fact that the countries with the higher per capita income should always have the deviations of the nominal exchange rate from PPP upwards, thus reflecting the higher cost of goods which are not the subject of the international trade. In its turn, in the countries with the lower incomes the opposite ratio between the nominal exchange rate and purchasing power parity is observed. Also the basic theory predicts that such deviation is equilibrium, but on the limited time horizons. It should be noted, at the time when in the world the relatively tight relationships between the domestic inflation and the nominal exchange rate was observed, the real exchange rate actually looked endogenous, as the consequence of which the degree of development of the country produced a significant impact on its level.

Under conditions of the payment surpluses targeting by the group of countries with the low PPP and increasing of the trend to the disconnection between the domestic inflation and the nominal exchange rate, the standard macroeconomic model of the multilateral balance of payments adjustment does not reflect the situation which has developed. Possibilities of the long-term payment surpluses maintaining without the significant changes of the real exchange rate, which in the traditional macro-models of the open economy are not realistic, change the configuration of not only the mechanisms of the balance of payments adjustment but also the conditions of the global competitiveness maintaining,

within the framework of which one or another country can be in a state of no external balance for a long period of time under the simultaneous maintaining of the acceptable rates of economic growth. Due to the fact that under conditions of the global competitive pressure intensification the possibilities of economic increase support more and more depends on innovation, productivity and creativization of economy, the role of quality of institutions increases sharply.

The quality of institutions in the global competitiveness maintaining comes to the fore is that for the countries which do not conduct the policy of payments surpluses targeting, especially since the all countries at the same time can not conduct it, they faced with the problem of the exchange rate exogenous preconception. The situation is even more dramatic in light of the fact that the currencies of most developed countries are increasingly seen as the variants of diversifying of the large reserves of the world's leading exporting countries with the average incomes and undervalued rates concerning PPP. If the external demand for the country's currency exchange rate neutralizes the ability to perform as an elastic mechanism competitiveness recovery, equalization of payments and, consequently, achievement of the inner equilibrium and maintaining of the competitiveness and the inner balance should be ensured by the increasing of the factor productivity and the creation of the unique benefits, which is impossible without the creativization of economy and permanent innovation.

In light of the fact that the achievement of the permanently high levels of creativity and innovation depends on a set of formal and informal controls of the social and economic behavior, the possibilities to compete in the world begin to shift in the institutional plane. It defines the motivation for investment into the human and social capital and its application in the innovative sectors. It also determines the easiness with the help of which the radically new ideas are converted into the business projects. Not less important is the fact that the quality of institutions is associated with the ability to compete for the capital attracting and minimization of the transaction costs, property rights protection, regulation and transparency and fulfillment of contracts are converted into the cumulative advantage within the framework of the competition between the different types of economic systems.

Taking into account the above noted, we can make a conclusion that that the rate overvaluation concerning the PPP, which is regarded as equilibrium on a certain length of time, in a format of the global competition changes create such a competitive pressure which should generate the compensatory reactions. Creating and maintaining of the quality of institutions should be considered as one of the reactions. For the countries with the undervalued concerning PPP, depending on the level of the development and institutional maturity and they can go by two ways. Creating of the high-quality institutions within the framework of which the coexistence of the policy avoidance of approach to PPP exchange rate would act as an additional leverage of the economic growth acceleration. Another way will provide the fact that the unwillingness or inability to create and sustain the high-

quality institutions should correspond to the same undervalued exchange rate in relation to PPP in order to carry out the minimum requirements for the economic growth. The undervalued rate will compensate the lack of the quality institutions, so that for a long time period the economy can be developed by the algorithm of the «exploitation» of traditional country's comparative advantages.

In the light of this theoretical position it can be assumed that in the countries with a deviation from the nominal rate upwards PPP the quality institutions should take place, while in the countries with a rate deviation downwards PPP the weak institutions may exist. In this case, «may» means that the certain countries may combine the quality of institutions with the undervalued rate, but after that the high rate of economic growth should be observed in them. From an empirical point of view this assumption means that it should be the direct link between the quality of institutions and deviation rate from the PPP.

For an empirical test of this hypothesis the nominal exchange rate deviations from PPP are elected as the ratio of PPP conversion factor to the nominal rate, which is calculated by the World Bank, and three indicators by means of which the quality of institutions is evaluated, especially those which determine the degree of the loyalty environment for the business doing and innovation development. These indicators are the following: Legatum sub-index of opportunities for the entrepreneurship and business doing; Legatum sub-index as governance<sup>1</sup>, sub-index of the quality of institutions the Global Competitiveness Index of the World Economic Forum. The first indicator somewhat biased towards the assessing of the ability of the country to combine the business opportunities with the innovative potential of the country. The second indicator shows the quality of the government policy in the sphere of the ownership rights, sectoral regulation, judicial system effectiveness provision etc.

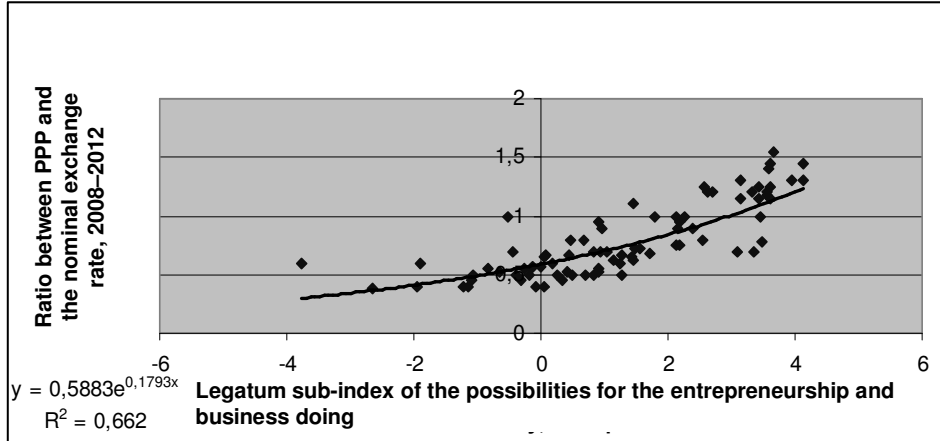
The sub- index of the quality of Davos Forum institutions is a more general indicator. To some extent, the three indexes duplicate each other, but are used for the additional confirmation of the initial assumption concerning the direct relationship between the institutions and the deviation rate from PPP. That is, if at the empirical level the theoretically predicted relationship is confirmed in one case, it should be confirmed in all three cases. Figures 1-3. show that at the example of 82 (all developed countries, all post- communist countries, the biggest countries in Asia, Africa and Latin America) countries we can see the entire adequacy of the initial hypothesis.

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<sup>1</sup> Legatum index is calculated by the Legatum Institute within the framework of the examination of the quality of institutions influence on the well-being of the nation.

Figure 1

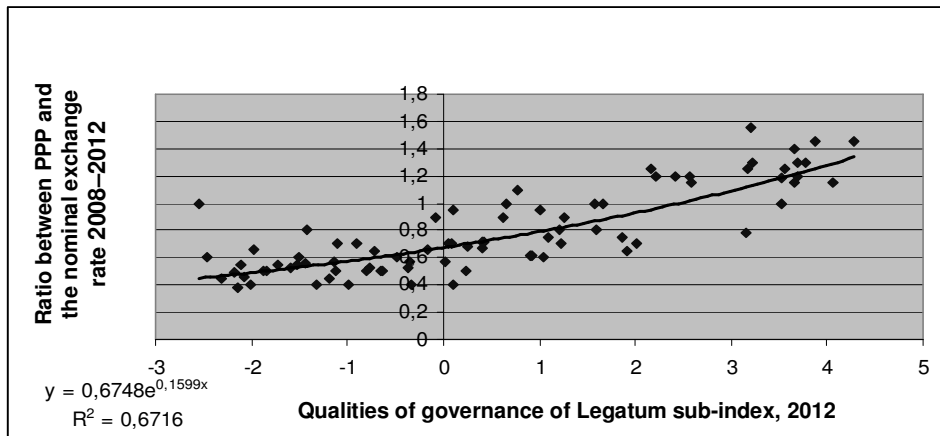
The ratio of the exchange rate to PPP and quality of institutions,  
exchange rate to PPP and



Note 1. Based on the data of Legatum Institute Index, 2012 ([www.li.com](http://www.li.com)) and World Development Indicators of the World Bank statistical basis ([www.world.bank.org](http://www.world.bank.org)).

Figure 2

The ratio of the exchange rate to PPP and quality of institutions,  
82 countries of the world

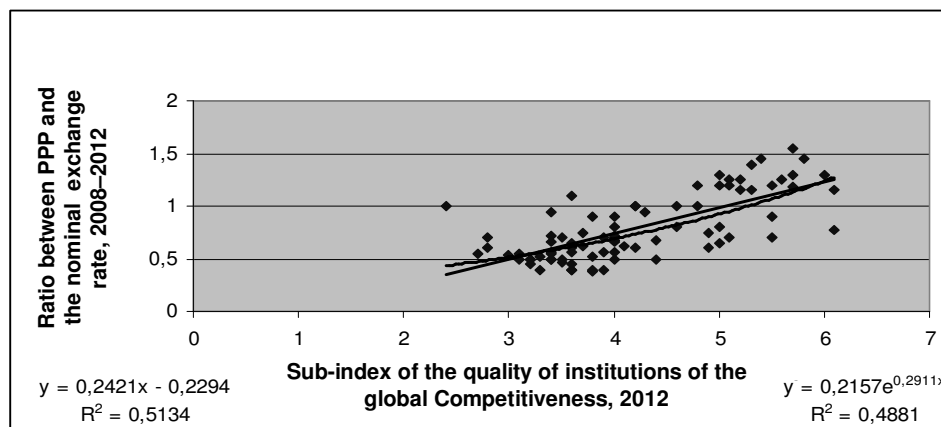


Note1. Based on the data of Legatum Institute Index, 2012 ([www.li.com](http://www.li.com)) and World Development Indicators of the World Bank statistical basis ([www.world.bank.org](http://www.world.bank.org)).



Figure 3

The ratio of the exchange rate to PPP and quality of institutions, 82 countries of the world



Note 1. On the basis of the World Economic Forum Global Competitiveness Report, 2012 and World Development Indicators of the World Bank statistical basis ([www.world.bank.org](http://www.world.bank.org)).

Figures 1–2 show that between the deviation of the rate from PPP and the corresponding sub-indexes not only linear, but exponential dependence is observed, which has a high level of accuracy of approximation. The exponential nature of the dependence indicates that maintaining of the overvalued exchange rate needs much better institutions than in comparison with their quality in cases where the rate is undervalued. The competitive pressure by means of institutions is much more compensated whereon there is already a lack of competitiveness associated with the overvalued exchange rate.

Figure 3 also fully confirms the stated theoretical hypothesis. The nature of the relationship between the exchange rate deviation from PPP and sub- index of the quality of institutions of the global competitiveness index follows the cases of the relevant sub-index Legatum. However, the density of connection in the approximation by means of the exponential function is somewhat lower. In the linear approximation, the R2 value increases, reaching a statistically significant level. You can see that in the case of the sub -index indicator of the quality of institutions of the global competitiveness index the dispersion of is clearly higher and the degree of dispersion of values within the entire sample below. That is to

say, that indicator in the Fig. 3 is less variable in the whole sample, which should be explained from the perspective of the index methodological features.

Taking into account that countries with the emerging markets, are at the different stages of the economic development, they have an excellent vision of the policy of the institutions quality provision, and that even the developed countries are not a homogeneous group and may be essentially different from the point of view of the quality of institution and the degree of comprehension by the process of the real convergence, the simple division on the principle of «the developed countries and the rest» does not give the desired result while the assessing of the economic substance of the correspondence between the institutions and the rate of deviation from PPP. To define the clusters which bring together these countries, the data from Fig. 3 is selected. It is for the third case, the lowest density of connection is observed. This will enable avoiding the revaluation of the results of the cluster division when applying the data, between which the density of connection is higher.

According to the variation of the quality of institutions under of Davos Forum sub-index and the degree of deviation of exchange rate from the PPP five clusters are identified.

The first cluster involves the group of the developed countries with the most overvalued rate (the ratio of PPP to the value of the nominal exchange rate exceeds 1.3), (Australia, Austria, Denmark, Finland, Sweden, Switzerland and Norway). The average value of deviation from the PPP is 1.39 with an average sub-index index of the global competitiveness – 5.56.

The second cluster represents the countries with the moderate overvaluation (respectively 1-1,29). These countries are: Belgium, Canada, France, Germany, Iceland, Ireland, Italy, Spain, Israel, Japan, New Zealand, Netherlands, United Kingdom, USA, and Luxembourg. The corresponding average values are 1.2 and 5.1.

The third cluster involves the developed countries with the undervalued rate concerning PPP, likewise the countries – new EU members of the first wave. The specificity of this group of countries is that they all are about at the same level of GDP per capita and the within the last period of time they are strongly influenced by the process of the real convergence. The average values of the relevant indicators are 0.8 and 3.95.

The fourth cluster connects the countries with the emerging markets in which the undervalued exchange rate concerning PPP is observed, but which are characterized by the relatively strong institutions whose quality exceeds the similar characteristics of the developed countries like Italy and Greece. This group includes the traditional Asian and Latin American leaders on the implementation of the high standards of the institutional economics organization, as well as the range of countries which actively introduce the structural reforms. This group in-

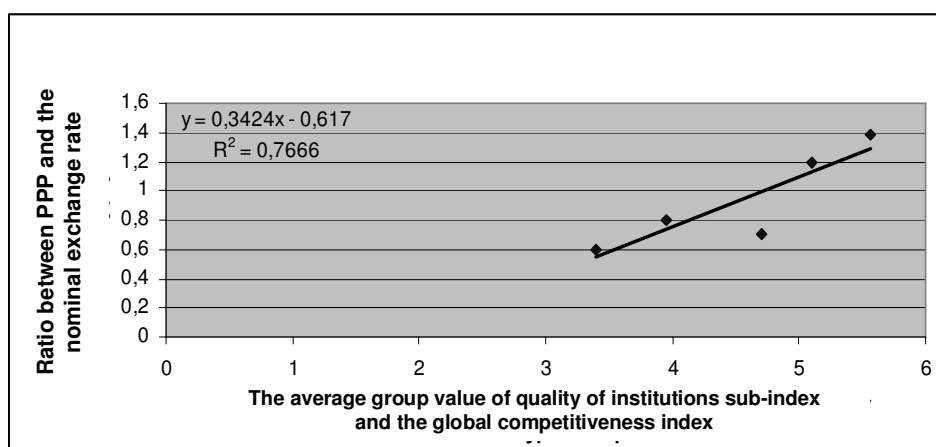
cludes Singapore, Hong Kong, Taiwan, Malaysia, Korea, Turkey, South Africa, Chile, China, Uruguay, Montenegro, Georgia, Azerbaijan, Kuwait, UAE, and Saudi Arabia. The average values of the indicators are 0.7 and 4.7.

The fifth cluster shows the similarity between the rests of the 82 countries, which includes countries with the different GDP level per capita. They are: Romania, Bulgaria, Serbia, Macedonia, Croatia, Ukraine, Belarus, Russia, Kazakhstan, Uzbekistan, Armenia, Moldova, Mexico, Peru, Argentina, Colombia, Brazil, Ecuador, Paraguay, Venezuela, Thailand, Indonesia, Philippines, Vietnam, India, Algeria, Tunisia, Egypt, Ethiopia, Central African Republic, Kenya, Tanzania, Senegal, Pakistan. This group is the most homogeneous in economic, social or political positions. These countries are combined by the most undervalued rate concerning PPP and by the lowest institutional quality, which is reflected in the average group values of the relevant indicators: 0.6 and 3.4.

Introduction of the average group values into the regression model speaks about the direct and close connection between the quality of institutions and the degree of the exchange rate deviation from PPP (Fig. 4).

Figure 4

**Quality of institutions and the ratio between PPP and exchange rate, Average data for the group of countries**



Note1. On the basis of the Figures 1–3.

As it is evident from the nature of the data dispersion (Fig. 4), only the countries of the fourth cluster fall beyond the borders of the explicit dependence, which can be summarized as follows: the higher quality of the institutions is, the more countries are able to maintain the overvalued exchange rate concerning PPP, reaching the high standards of living; the lower the quality of institutions is, the more countries are ready to compensate the undervalued exchange rate concerning PPP, limiting the possibilities of the progress in the sphere of social standards by means of considerations concerning the global competitiveness maintaining.

The comparison of the previously analyzed indicators with the average rates of the economic growth in 1995–2004 and 2012 within the framework of each cluster (such a time period excludes the distortion of the results, potentially provided by the influence of the pre-crisis overheating of the global economy and after the crisis and rapid recovery in response to the stimulating action) also points to the conclusion that the impact of the quality of institutions and the exchange rate deviation from PPP on the GDP growth dynamics can be considered the same according to the direction but different in nature. Data in the Table 1 confirm this fact.

Table 1

**The average value of the quality of institutions sub-index of global competitiveness, deviation from PPP and economic growth in term of 5 cluster's**

	GDP growth, %		Indicator of the quality of institutions	Indicator of exchange rate deviation from PPP
	1995–2004	2012		
First cluster	2,8	1,3	5,56	1,39
Second cluster	3,3	0,7	5,1	1,2
Third cluster	4,3	0,2	3,95	0,8
Fourth cluster	4,6	3,6	4,7	0,7
Fifth cluster	3,5	3,2	3,4	0,6

Note 1. On the basis of: quality of institutions sub-index and the global competitiveness index – World Economic Forum Global Competitiveness Report, 2012; ratio between PPP and the nominal exchange rate – World Development Indicators of the World Bank statistical basis ([www.world.bank.org](http://www.world.bank.org)); GDP growth – IMF World Economic Outlook for the corresponding period ([www.imf.org](http://www.imf.org)).

Analyzing the data from the Table 1 you can identify the following regularities. First. The highest rates of the economic growth both in 1995–2004 and in the year marked by the emergence of the features of the global recession, is observed in the group of countries with emerging markets (4 cluster), which are the most advanced in the area of the structural reforms and the formation of the high-quality institutions. For the noted group of countries the institutional quality is specific, it is higher than in the countries covered by the process of the real convergence within the integration process in the EU. For the fourth cluster countries the most undervalued nominal exchange rate concerning PPP is not observed. So it is for the countries of the fifth cluster. This confirms the assumption that maintaining of the high rates of economic growth in the new global environment can not be based only on the manipulation of the exchange rate. The monetary incentives of growth might be enough vulnerable to the endogeneity of the real exchange rate behavior. In contrast, the institutional quality is an inherent component of strengthening of the competitiveness on the permanent but not transitive basis.

Second. The countries combined by the fifth cluster show clearly stable growth rates than before the crisis, even under the lowest institutional quality. To some extent, this reflects the standard assumption of the neoclassical models that countries with the lower GDP per capita should increase faster. However, to achieve the above mentioned it should be attributed to the most undervalued rate concerning PPP. Despite the fact that the group average growth rates of these countries is somewhat higher than in the developed countries, they are inferior to those that occur in the countries with high quality institutions. This means that the failure to achieve the economic growth, supported by the leaders in economic development is associated with the lack of institutional quality. Similarly, a diminished rate leads to the development of the traditional sectors with the comparative advantage, which makes exports vulnerable to the fluctuations in the global market conditions, restraining the development of the internal market due to the lack of demand, limiting the investment into the human capital and weakening the incentives to innovations. The combination of the weak institutions with the low income per capita is cemented by the incentives for the economic growth sideways the undervalued rate that slows the economic development even under the GDP growth.

Third. Group of countries covered by the third cluster showed relatively high rates of economic growth in the pre-crisis period. The average value of GDP growth for 1995–2004 ceded only the countries with emerging markets with high-quality institutions. However, after the crisis, the growth rate slowed rapidly and this group shows the worst result, despite the fact that the level of the institutional development on the average exceeds that one which occurs in middle and low income (fifth cluster) countries. Such regularity is possible to explain on the problem of the combination of the real convergence process with the loss of competitiveness. Even under the slight underevaluation rate concerning PPP, the rapid

convergence of income promoted the economic growth in an environment of the rapidly growing global economy. But as soon after the crisis, the global GDP rate slowed down, the real convergence of the preliminary stage began to push aside the loss of the competitiveness. Quite limited possibilities of the exchange rates reduction (Portugal, Greece, Slovenia, Slovakia, Estonia – Euro zone members, the EU countries of the first wave face with the continued flow of capital (the specifics of this fact, compared with the other countries of the similar levels of development is presented in (Abiad et al., 2007)) does not compensate for the loss of competitiveness caused by the growth of real income at the stage of the rapid development. At the same time, the structural reforms in this group of countries, inspired by the aspirations for the deeper integration with the EU economies and flexibility increase in order to improve the effectiveness of membership in the euro area, show that the restoration and permanent maintenance of the global competitiveness is found not so much in the underevaluation of the exchange rate concerning PPP, as in the development of the appropriate institutions that would guarantee a high propensity to innovation, human capital and minimize the cumulative transaction costs in the economy.

Fourth. The most developed countries (cluster 1–2), as predicted by the neoclassical theory of increase, during the analyzed periods showed the slower rates of GDP growth. This is hardly a surprise, despite the high quality of institutions. But given the fact that the majority of them has a certain preconceived exchange rate (the payment surpluses are targeted by many countries with the emerging markets that directs capital on the financial markets of the developed countries) the overvalued exchange rate concerning PPP did not stop growth. The quality of institutions was the fundamental basis of the innovative development, which compensates the pressure on the global competitiveness by the overvalued exchange rate concerning PPP. This is especially peculiar to those countries where there is the greatest deviation upside of purchasing power parity.

Despite of the significant rate overvaluation the growth rates prior to the crisis in the first cluster are not significantly worse than in the developed countries of the second cluster, and after the crisis – tended to be higher. This regularity can be explained by the fact that perhaps the quality institutions restrained the procyclicality, being an additional factor of flexibility and investment involvement into the innovative sectors after the crisis. The analysis of the structural reforms in the Nordic countries (Eklund, 2011; Berggren et al., 2011) argues that the creation of the high-quality institutions oriented on the incentives for innovation development, human capital, economy's flexibility and adaptability to shocks fully offset the overvaluation of the rate concerning PPP and a high level per capita income, the monetary impacts on the global competitiveness head for back.

Fifth. The grouping of the world countries concerning the quality of institutions demonstrates the lack of the regional homogeneity. The established view on the combination of the globalization and regionalization is rather a continuation line of the analysis of the integration processes political economics when the

geographically close communities demonstrate the formal commitments to deepen the multilateral cooperation. However, the significant intraregional differences are increasingly inspired by the fact how the institutional quality becomes an incentive for economic development and the attraction of the global capital. The advantages and benefits of the regional integration, in spite of their equal distribution between the participants, will be made actual where will take place not only where the price competitive advantage occurs, supported by an undervalued exchange rate concerning PPP but also where there will be a benefit on the side of the quality of institutions. That means that the strengthening of the asymmetries within the frames of the formalized integration associations is not limited only to the centrifugal forces within the axis of the «center-periphery» and evolves towards the institutional competition. In terms of the global economy it means that in the world the fragmentation not on the geographically but by an institutional basis will not prevail. The leaders in the institutional competition will form the new centers surrounded by the geographically close periphery of the institutional outsiders.

**Conclusions.** The global monetary relations within the frames of which some countries target the payment surpluses while others adapt to the external demand for their assets transformed the system of the global competition. The limited capacity of the balance of payments adjustment based on the monetary approaches require the creation of a new model of the global competitiveness maintaining. The traditional division of countries into the developed countries with the over evaluated or close to PPP rates, and countries with the low and middle-income with the low rates does not account the striking differences in the degree of the deviation and that endogeneity of the real exchange rate is not always confirmed. The quality of institutions as an expression of the capital attracting, incentives for innovation, growth in the value of the human capital and minimization of the cumulative transaction costs should offset the competitive pressure generated by the countries with the low and middle incomes which conduct the monetary policy of mercantilism. At the empirical level it is revealed that the quality of institutions is in the directly exponential / linear dependence of the degree of deviation from PPP rate.

Differences in the quality of institutions in the context of the similar levels of economic development has revealed five clusters which bring together countries concerning the quality of institutions and the degree of deviation from PPP rates. The undervalued rate corresponds to the low quality of institutions, compensating for the lack of the latter to stimulate the economic growth, while the excessive rates correspond to the high quality institutions that compensate for the competitive pressure and help to sustain the global competitiveness based on innovation. The highest rates of the economic growth are observed in the countries with quality of institutions, but with somewhat undervalued rates. The countries covered by the strong real convergence, are faced with the challenge of competitiveness maintaining, and therefore undertake the reforms aimed at

improving of the quality of institutions. The developed countries are able to sustain the growth even in the unfavorable global monetary surrounding by means of capital attracting in the innovative sectors sensitive to the institutional quality. The significant intraregional differences are formed by means of the gaps in the quality of institutions. This means that the fragmentation of the global economy will be under the institutional principle. The institutional competition will become the basis for the formation of a new «center-periphery».

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