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Managing the Crisis

A Comparative Analysis of Economic Governance
in 14 Countries

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Introduction: The Centrality of Governance

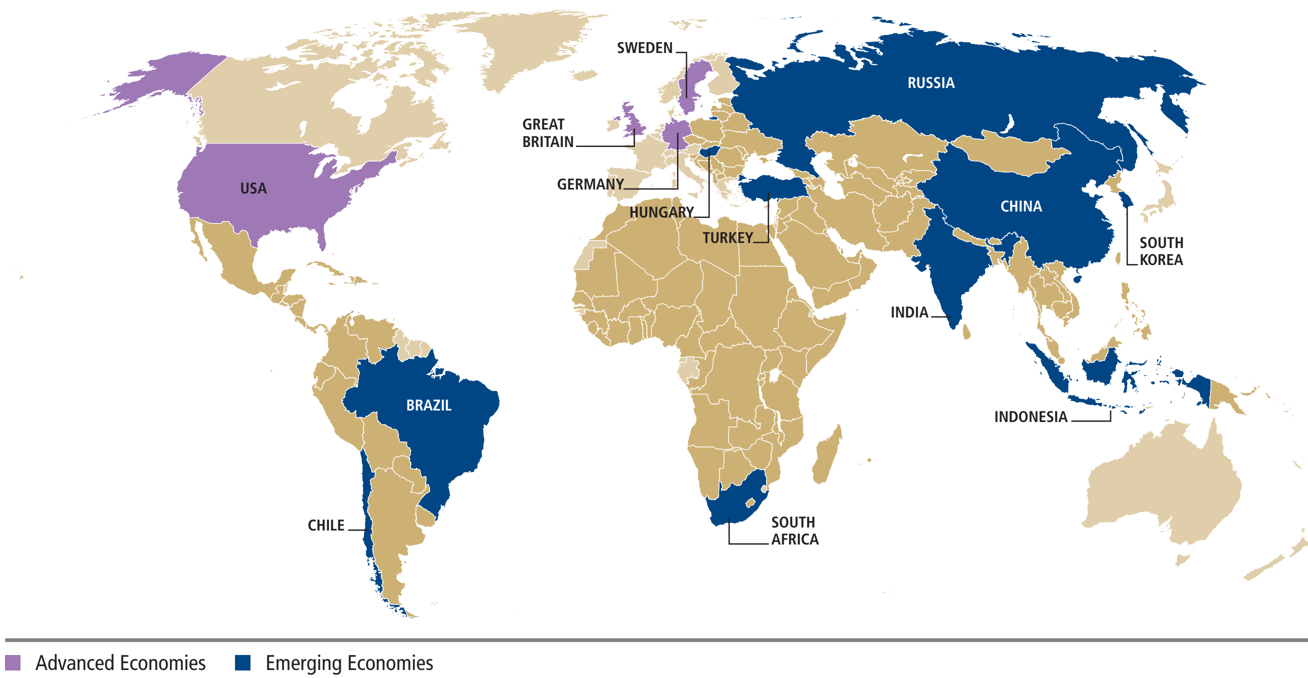
Sabine Donner, Hauke Hartmann, Andrea Kuhn

Political discourse in recent years has tended to discount the role of the state as a major engine in promoting economic growth and steering development processes. Mainstream economic thinking on the politics of reform has been more concerned with state efficiency, lean government, the prevention of over-regulation and the avoidance of populist interventions. However, the global financial and economic crisis has triggered a substantial shift in this perspective. Many free-market thinkers, including Deutsche Bank chief executive Josef Ackermann, have conceded that deregulation has reached or exceeded its practical limits. Ackermann himself has admitted that he no longer believes in "the market's self-healing power." There is broad acknowledgement that public spending contributed significantly to overcoming the recession, and the *New York Times*, reporting from the annual meeting of the American Economic Association in January 2009, even detected a "new enthusiasm for fiscal stimulus, and particularly government spending," among economists. At a time when the prospect of global financial governance remains no more than wishful thinking, the renaissance of the nation-state as crisis manager has proved indispensable—and all the more impressive given the previous skepticism about its efficacy.

The stimulus packages implemented by the world's major economic powers have already been ably assessed and compared. As of the time of writing, these measures seem to have averted an enduring recession, though some were hastily crafted, poorly implemented and even reinforced structural imbalances. But understanding the lessons of the turbulent months behind us will require a look beyond the quality and effectiveness of the various anti-crisis measures. We also need to know how governments' reactions were conceptualized, whether international experts and local stakeholders were consulted, how swiftly and transparently implementation took place, whether structural imbalances were addressed or influential lobbies had a disproportionate say, and whether policy learning took place. For all their pain, these months of economic turmoil constitute an opportunity to broaden our understanding of the successes and shortcomings of political steering processes in crisis situations, which will in turn provide us with valuable lessons for the next international crisis. The frequency of global shocks and imbalances appears to be on the rise, and in the absence of any resilient and convincing architecture for global governance, we simply need to know more about political management on the national level.

The Bertelsmann Stiftung has a long tradition of assessing the quality of governance and devising evidence-based policy strategies for decision-makers. Its Transformation Index (BTI) monitors political management around the world, encompassing all 128 developing nations and countries in transition that have a population of more than two million inhabitants and have not yet attained fully consolidated democracy and a developed market economy. The Stiftung's Sustainable Governance Indicators (SGI) offer a complementary focus on the OECD member states.

Our project teams, for whom the quality of governance is a key analytical focus, naturally observed various governments' responses to the financial and economic crisis with particular interest. From the outset, it appeared likely that governments' responses would exhibit elements of policy behavior not wholly captured by the BTI and SGI general assessments of political management capability and performance. The BTI criteria are designed to evaluate whether governments in developing countries and nations undergoing transformation are determined in pursuing their goals (steering capability), are prudent and effective (resource efficiency), combine mediation and conflict management (consensus-building), and cooperate reliably with international organizations and neighboring states (international cooperation). The SGI's Management Index turns to OECD countries to analyze executive capacity, that is a government's ability to plan and implement strategies in four central categories, as well as executive accountability, a concept assessing the degree to which non-executive actors (e.g., the parliament, political parties, associations and other civil society actors) inform, communicate with and monitor the government, thereby deepening its knowledge base and enhancing its level of normative reflection. The BTI and SGI do capture important aspects of crisis management with their criteria, but they do not cover the totality of a policy response that—if well conducted—rapidly and convincingly formulates effective concepts and measures, flexibly grasps the opportunity to tackle structural imbalances and invest in social and sustainable development, successfully resists the temptations of protectionism and understands the value of political communication as a psychological stabilization factor. With these dynamic measures in mind, the Stiftung's project teams have sought



Advanced Economies Emerging Economies

to expand their understanding of political management through a detailed study of various governments' modes of operation during the crisis.

We are highly grateful for the conceptual groundwork laid by Prof. Rolf J. Langhammer (Kiel Institute for the World Economy) and Prof. Sebastian Heilmann (University of Trier), both of whom advised and accompanied this study from its inception to its publication, and who summarize the results of our comparative assessment in the perceptive analysis that follows this introduction. In cooperation with these scholars, the Bertelsmann Stiftung developed a comprehensive set of criteria to assess the quality of crisis management in selected countries. Its 63 questions were focused on capturing the essence of governance as policymakers devised and implemented measures to cushion the blow of economic shocks. The following criteria were included:

- *Agenda-setting and policy formulation*, assessing the agility and credibility of policy responses and the extent to which external policy expertise and international cooperation were sought.
- *Policy contents*, referring not only to the time frame and size of stabilization and stimulus measures, but also to whether elements of social protection and strategic investment for developmental purposes were included and to whether protectionism played any role.
- *Implementation*, assessing governments' public communication, swiftness in execution and engagement in regional or international cooperation.
- *Funding, tax and monetary policies*, analyzing the financial character of stabilization and stimulus policies and the credibility of funding mechanisms.
- *Feedback and lesson-drawing*, analyzing public comments or criticism associated with anti-crisis measures, policymakers' subsequent responses and any institutional restructuring that took place in reaction to the crisis.

In devising a standardized questionnaire for country experts, the Stiftung's project team also included a set of introductory questions designed to assess risk exposure and initial crisis impact as well as concluding questions analyzing anti-crisis measures' tentative impact on the economy, with a particular focus on stimulus policies' potential to create structural distortions. In this way, the full cycle of policies aimed at coping with the recession was addressed, covering the time span between September 2008 and September 2009. The analytical criteria and associated questionnaire are documented in greater detail in the appendix of this book and on the attached CD-ROM.

Given the restraints of time and the associated impossibility of including in this project all 151 countries regu-

larly assessed by the BTI and SGI, the Stiftung teams decided to focus their attention on countries of special interest. Among these are eight developing countries and emerging markets whose considerable size makes them important to any future analysis of global economic developments: Brazil, China, India, Indonesia, Russia, South Africa, South Korea and Turkey. Chile, one of Latin America's most prominent economic success stories, and Hungary, a country hit hard and early by the financial crisis, were also added. When studying policy responses in developing nations, it soon becomes apparent that some of the measures taken, and certain aspects of crisis management policy, can be highly instructive for industrialized nations in Europe and North America. Realizing this, the project team decided to integrate established OECD members—Germany, Sweden, the United Kingdom and the United States—into the study so as to allow comparison between the governance styles of North and South as well as, of OECD members and emerging economies.

The comparative assessment "Managing the Crisis" by Sebastian Heilmann and Rolf Langhammer puts a special focus on precisely such a comparison. We hope it will help improve political learning and foster the exchange of best practices. These scholars' greatest accomplishment is their structured and systematic analysis of all the successive steps in the cycle of crisis management, which summarizes and interprets the sometimes strongly divergent steps taken by various governments, as described in the individual country reports. As this analysis is mainly topical, we have added country spotlights to offer an initial illustrative glance at the gist of the detailed country reports.

In creating a comparative assessment of the countries included in this study, the project teams decided to rely on qualitative analysis in the form of detailed country reports rather than devising a numerical comparison in the form of a ranking. The standardized set of 63 questions was deemed sufficient to elicit evaluations of governance that would be comparable by chapter, and even by individual paragraph. One of the early challenging tasks was to secure the support of additional scholars who were both experienced in the analysis of economic governance and acknowledged country experts. We are proud to have obtained the assistance of a number of outstanding academic specialists (introduced on pages 42 to 47) who have shared their country expertise with us and contributed to this study.

As the countries analyzed here recover from the recession, the groundwork for future crises seems already to have been laid. In some instances, structural imbalances have not been addressed properly. In others, stimulus packages have produced inflationary pressures and investment bubbles. In yet others, huge government spending has threatened to undermine macrostability. All of these issues should serve to warn us against complacency or confidence in easy fixes. It is our hope that this study will contribute to a transnational learning process and enable us to better address the next crisis. Many governments seem to have drawn valuable lessons from the Asian crisis of the late 1990s; indeed, several emerging economies with fresh memories of that difficult period—as the detailed country reports show—were better prepared for this crisis than some of the established OECD members. Trusting that such a learning experience will continue, we submit these analyses of crisis management policies in our 14 sample countries with the expectation that, at some stage, improvements in national political management will come to be complemented by an effective framework for global governance.

Managing the Crisis: A Comparative Assessment

Rolf J. Langhammer, Sebastian Heilmann

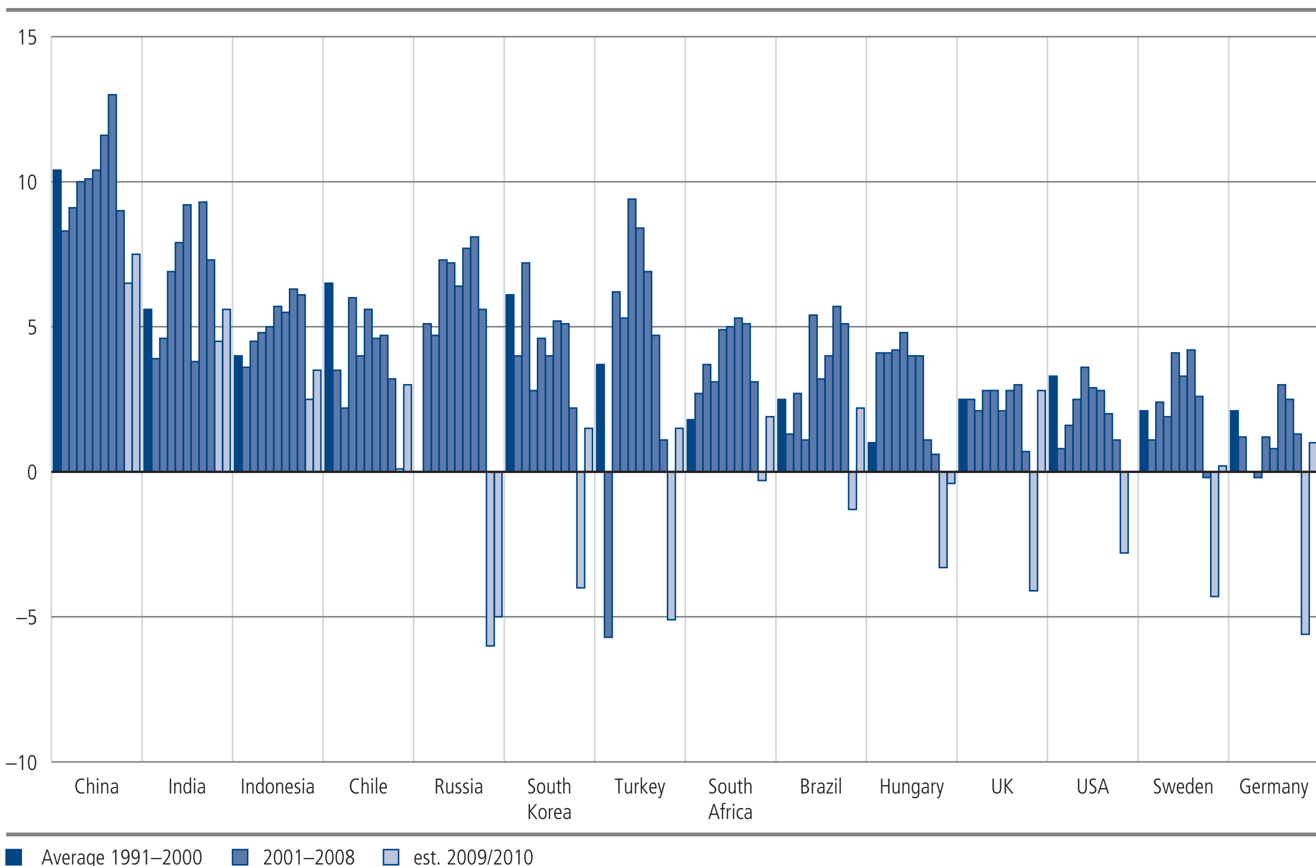
Situation at the time of crisis outbreak: Economic success stories and prudent policies in the emerging economies

The 2008 financial turmoil was unique from its beginnings: For the first time in post-war economic history, a major crisis had its source elsewhere than in emerging markets. Instead, it was faltering financial markets in the world's long-standing economic powerhouse, the United States—as well as in other advanced economies—that threatened to rattle the real sector of economies around the globe. Emerging on the heels of a period of record economic growth, the crisis utterly demolished the widespread belief that many emerging economies had decoupled their growth from that of the United States. Given the dazzling successes achieved in countries such as Brazil, China and South Korea by late 2008, the threat of abrupt economic contraction took many policymakers by surprise.

High growth rates in the pre-crisis period were accompanied by increasing openness, particularly in terms of trade flows and foreign direct investment. During the same period, technological progress in cutting trade costs and unilateral liberalization led to vertical cross-border value-added chains being increasingly sliced up. This, in turn, pushed trade in intermediate goods to record-high levels. As export-to-import ratios rose, an increasing number of countries became exposed to the risks of domino effects should the primary absorber of goods at the end of the pipeline—the United States—become the first to fall.

However, emerging economies were much better prepared to respond to this crisis than to the Asian crisis of 1997. By 2008, most of the countries analyzed in this study had rectified the extant shortcomings in their capital markets, instituted prudent regulations, consolidated their fiscal policies, made their monetary policies more flexible and improved the credibility of domestic institu-

Figure 1: Real GDP growth—impact of the crisis



All data = Annual percent change

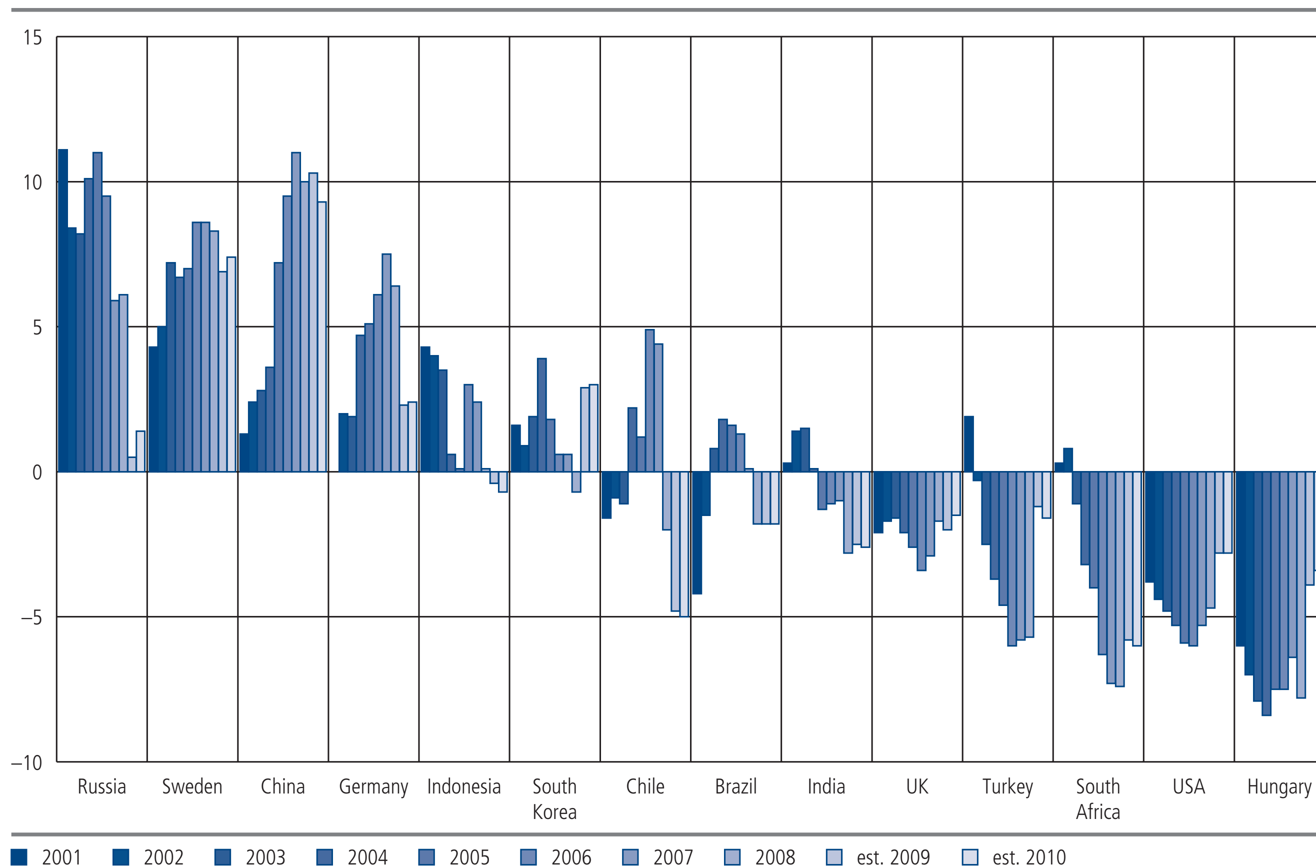
Source: IMF, World Economic Outlook April 2009, October 2009

tions, thereby bolstering the confidence of financial actors. In comparison to a number of advanced economies, most emerging economies had taken more cautious steps in deregulating financial markets than they had prior to 1997. Furthermore, in addition to having tightened fiscal and monetary discipline—so much so that many large economies of the South would have met the Maastricht debt-level target of 60 percent of GDP—most emerging economies simply did not have a large supply of toxic assets in their domestic financial systems. Perhaps most importantly, most of these countries' central banks had amassed a solid trove of foreign exchange reserves to help weather future storms.

As unprecedented as the economic and financial crisis was for emerging economies, some ingredients of previous crises were present. The "original sin" syndromes of the 1997 Asian crisis (the currency mismatch of borrowing in foreign currencies and investing in local currency projects, or the maturity mismatch of taking on short-term debt to make long-term investments) and overly rigid currency pegs again plagued some countries (e.g., Iceland and the Baltic states). The more tightly emerging economies tied their monetary policies to those of anchor currencies of advanced economies, thereby seeking to fight inflationary expectations, the fewer domestic monetary policy options they had available to combat the crisis.

However, many emerging economies, particularly those that had been severely hit by previous crises (e.g., Indonesia and Chile), had already abandoned fixed currency pegs, resorting instead to inflation targeting and more flexible exchange rates, in some cases even in the face of massive national opposition (Brazil). Moreover, efforts to reduce public debt had produced remarkable results in many emerging economies. Due to the global hikes in food and oil prices observed in mid-2008 and

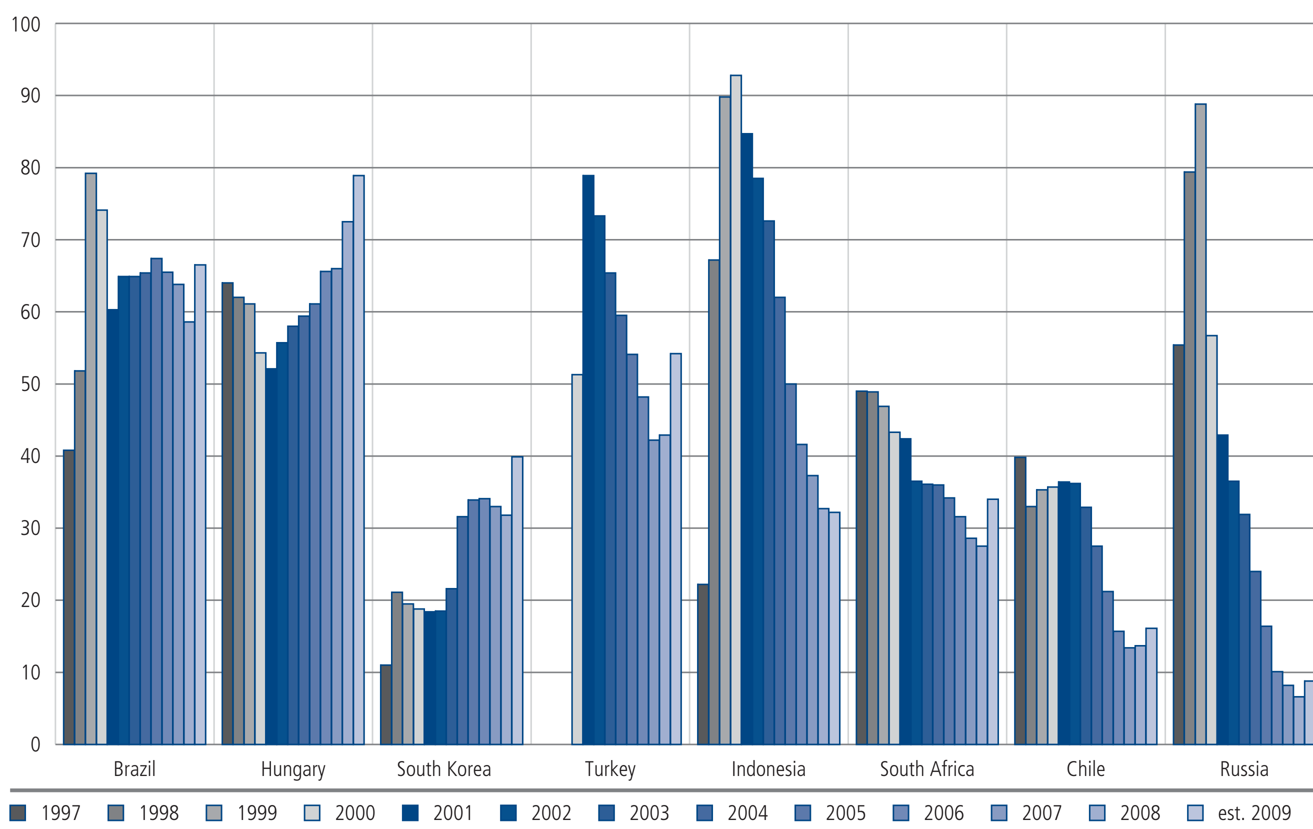
Figure 2: Global imbalances in current account balances



All data in percent of GDP

Source: IMF, World Economic Outlook April 2009, October 2009

Figure 3: The emerging economies' efforts at reducing public debt



All data in percent of GDP

Source: DB Research

the concomitant inflationary pressures, interest rates in most of these countries were at high and, in some cases, still increasing levels as the crisis began to unfold. These countries were generally better prepared to fight the crisis through monetary easing. This said, as the Hungarian example shows, flexible exchange rates proved ill-suited to crisis management in cases where interest rate gaps between borrowing in local currency and borrowing in international currencies had to be kept at very high levels in order to ensure the steady inflow of foreign liquidity needed to finance high budget deficits.

Coordination between governments and monetary authorities at both the international and regional levels had improved since the Asian crisis. During the crisis months of 2008 and 2009, coordination efforts among monetary authorities appear to have been more frequent and effective than those among governments. Nevertheless, the culture of coordination that developed in this period allowed leaders of leading developing countries to be incorporated into decision-making processes at the global and regional levels. As a result, major emerging economies contributed to G-20 talks on how to respond to the crisis, and other emerging economies engaged in swap arrangements, for instance, within the ASEAN+3 and the European Union. Thus, although there is no global governance scheme to handle crises of this nature, coordinated monetary easing among international actors—and, to some extent, the coordination of national fiscal stimulus programs—did serve as an imperfect substitute.

Previous crises separated more-affected and less-affected countries from each other, for instance, by income levels, monetary regimes, a country's status as a net energy importer or exporter, the degree of capital account openness and the extent to which a nation was a commodity or industrial goods exporter. By contrast, the ubiquity and pervasiveness (in both the financial and real sectors) of the current crisis did not allow transformation countries to separate themselves. This helped to put most

national policymakers on alert (even if, in several countries, the U.S. and U.K. were openly blamed for being the originators of the crisis).

Finally, the post-2000 economic boom experienced by many emerging economies—and particularly by those included in this sample—coincided with strong gains in the political reputations of their governments on the international stage. When the turbulence struck in the fall of 2008, economic policymakers in these countries demonstrated a more sophisticated understanding of the nature of the crisis and of how to address it than they had shown in previous situations of this type. More than ever before, the developing countries in this sample proved to be equipped with an extensive set of policy tools and the capacity to use them effectively.

Pre-crisis conditions among advanced economies were very different. Germany, Sweden, the United Kingdom and the United States had already experienced a sequence of bubbles in specific asset markets, such as stock exchanges, housing markets and commodity markets (with the United Kingdom and the United States being in the forefront of this trend). They had seen a number of financial institutions fail (IKB, Sachsen LB, Northern Rock, Bear Stearns, AIG) and were facing budgetary constraints after a longer period of fiscal expansion. Monetary policy had long been accommodating, and policymakers were considering a return to more restrictive monetary policies on the eve of the Lehman shock. While private households had benefited from stable or sometimes even falling prices for tradable goods (thanks to unprecedented rates of growth in international trade), they were soon fearing either loss of wealth (in all highly industrialized countries), an economic domino effect triggered by collapses in home equity and the housing finance market (U.S.) and/or job losses in the outsized financial sector (U.S., U.K.) as the crisis' various market shocks manifested themselves. However, the sudden and almost ubiquitous collapse in demand that took place after November 2008 was not yet evident to leaders of advanced economies at the time of the Lehman shock. This is why policymakers in Germany, the country which had the most to fear from such a collapse due to its strong export exposure, remained fairly calm.

On the whole, the general public perception in advanced economies was different from that in emerging economies as the crisis broke. While actors and markets in the former were generally more anxious than their counterparts in the latter, investors, consumers and public authorities in advanced economies were unaware of the impending collapse in demand and, thus, did not initially take precautionary actions.

Brazil—solid foundations, successful management

Brazil was one of the last major countries to feel the effects of the global economic crisis as well as one of the first to recover from it. The recipe for this success lies in its combination of: sound macroeconomic policies; tough regulations for the financial and the banking sector that pre-dated the crisis; the shrewd leadership of its charismatic president; and its timely resorting to countercyclical measures. Its stimulus package included an increase in public expenditures, an easing of credit conditions and generous adjustments to the minimum wage and salaries of civil servants. Nevertheless, one negative effect has been a deterioration in the performance of the treasury, which has been running monthly deficits since 2009.

Since Brazil's domestic banking system was already more controlled than those of most other countries, talks regarding regulation held at the international level during the crisis only had a limited degree of importance to Brazil. During the Cardoso years, a comprehensive restructuring of the domestic banking system had already been undertaken, which sanitized the sector and established strict controls and prudential rules, some of which are not to be found in any developed economy.

Brazil's domestic market carried it through the crisis. It has been fueled by an array of social programs that have turned a substantial segment of people who had previously been excluded from the economy into (basic) consumers. All factions of the government have supported Keynesian expenditures. However, while the majority in government tolerates "some inflation" and looser macroeconomic rules for developmental purposes, the minority holds that stability should be the main goal. Under these circumstances, President Luiz Inacio "Lula" da Silva has successfully employed his personal skills to maintain a fairly peaceful coexistence between both factions so as to ensure broad support.

Initial shock and response: Differing approaches, widespread agility

Given the history of recent financial crises, one might have expected that the retreat of short-term foreign capital from the emerging markets into safe havens would constitute the immediate shock of the present crisis, thus showing itself as the leading crisis indicator. This is what the experience of previous shocks in Latin America and Asia had taught us and, in the aggregate, this again proved true. In April 2009, the IMF forecasted a dramatic swing in net private capital inflows for developing and emerging economies, from $617 billion in 2007 to $109 billion in 2008 and, finally, to a net outflow of $190 billion in 2009.

However, the country reports point to a different aspect of the crisis as being the most salient for emerging economies. The sudden halt in global trade, terms of trade shocks or steep declines in net exports in the final quarter of 2008 were experienced in these countries as a more serious shock than were capital outflows or severe troubles in their financial markets. Due to generally minimal exposure to toxic assets, prudent regulation and strict supervision, only a few, and generally relatively small, financial institutions in these markets faced refinancing troubles severe enough to lead to insolvency. Thus, in contrast to advanced economies, such as the United States, the United Kingdom, Germany and Sweden, most emerging economies faced a crisis in the real economy caused by the slump in global demand and the fall in commodity and raw materials prices rather than a full-blown financial crisis.

Nevertheless, some developing countries also experienced troubles in the arena of corporate refinancing. The more deeply the countries had come to be integrated into global trade patterns in manufactured goods, the more keenly the shock was felt. Some country studies stress that the evaporation of foreign demand for their manufactures was the single most important crisis indicator (India, South Africa). The closely linked declines in industrial output (again, predominantly in the manufacturing sector) subsequently left their mark on the broader economy. Some governments (e.g., Russia, Turkey and Indonesia) did experience a twin shock, stemming both from the real sector and the capital account. Russia, Indonesia and Chile also faced steep reductions in state revenues, as all three were heavily reliant on returns from the export of raw materials.

A majority of governments (e.g., Brazil, India) initially interpreted the crisis as having a relatively small impact on their own economies, framing the turmoil primarily as

India—Crisis? What crisis?

Since India's policymakers were slow to grasp the full extent of the global economic crisis, the country's initial policy response differed from those of other major economies. For example, since what was to become a severe credit crunch was only gradually unfolding and there were ongoing fears about inflation, the Reserve Bank of India reduced interest rates in incremental tranches rather than drastically. At the same time, the country's fiscal response was even more delayed because, at first, there was some support for the idea of decoupling and some belief that the real sector would not be affected too seriously. Moreover, political decision-makers thought that public expenditures—in the form of the National Rural Employment Guarantee Scheme, debt relief to farmers, the 6th Pay Commission for government employees and higher procurement prices paid for rice and wheat—were already substantial. Eventually, between October 2008 and February 2009, a total of three fiscal packages were presented to Parliament, which included cuts in indirect taxes and some sector-specific measures.

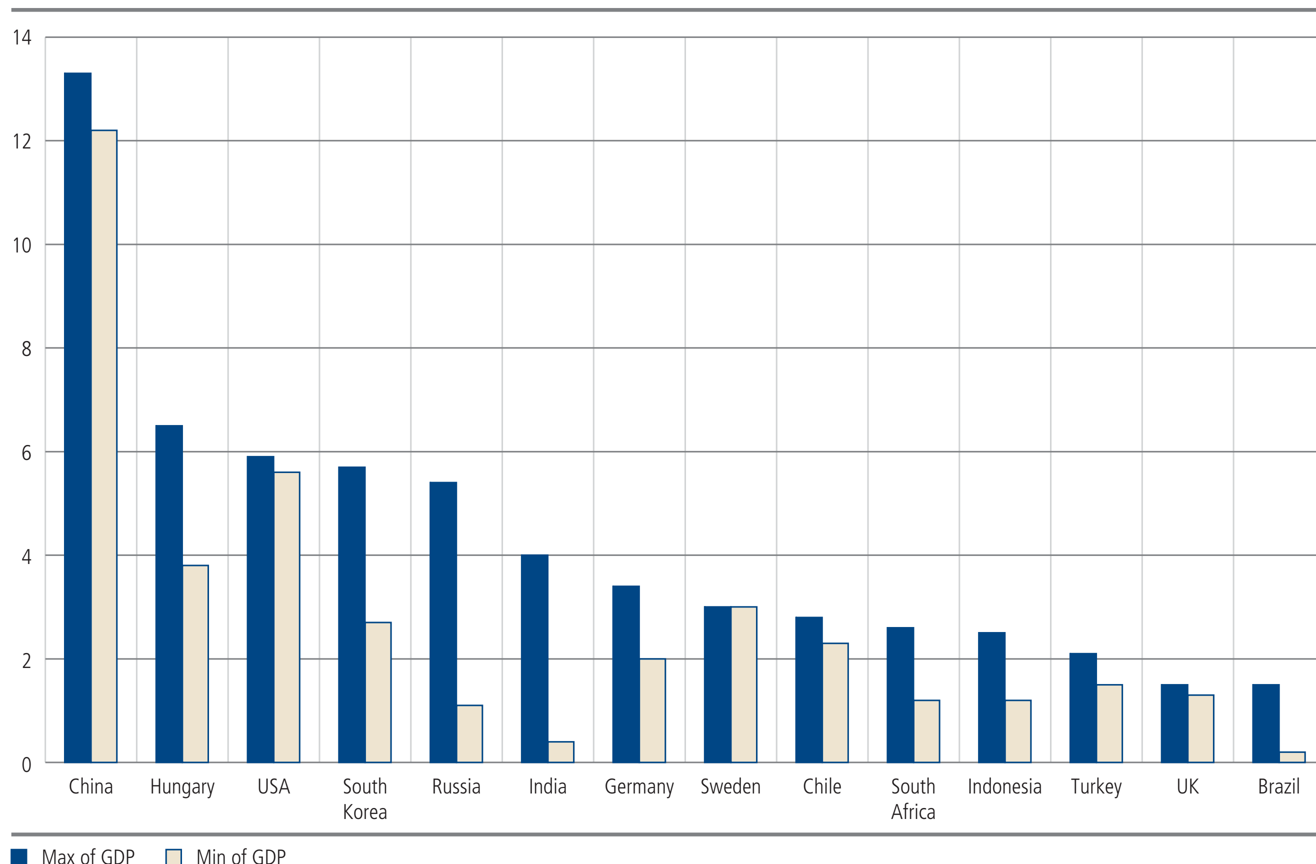
India's hesitant reaction also resulted from the fact that it was preoccupied with other urgent problems, such as the terrorist attacks in Mumbai in November 2008. Well into 2009, the major concern regarding economic management continued to be inflation, particularly food inflation, which had been accentuated by that year's drought. Finally, even before the crisis, India had experienced an economic slowdown and implemented countercyclical measures with a decidedly social focus on "inclusive growth." As a result, expansions of already existing social programs were viewed as being much more of a continuation of economic and social policies that had already been approved. Owing to its composition, there was little resistance in Parliament to the idea of increasing public expenditures and relaxing the guidelines set forth in the Fiscal Responsibility and Budget Management Act.

an “Anglo-Saxon” problem. Only China and Russia, for fear of potential risks to social stability, as well as Indonesia and South Korea, due to their traumatic experiences during the Asian financial crisis of 1997–1999, shifted into a state of alert as soon as they were hit by the first waves of financial turbulence. However, when the potentially devastating impact of the crisis for emerging markets' real economies became evident, governments and central banks in emerging economies demonstrated a much more comprehensive understanding of how to respond to the onslaught than had been seen in the past. National crisis management evolved into a period of extraordinary emergency politics, during which resistance to swift emergency measures and fiscal expansion was reduced for a certain period of time. As a consequence, we find strong and unusually uncontested executive leadership and largely compliant legislatures in most cases scrutinized in this project.

Yet, when looking into the details of the policy-making process, we find strikingly different approaches, ranging from personalized leadership (Brazil, Indonesia), corporatist/consociational policy deliberation (South Africa), technocratic dominance (South Korea) to government-big business collusion (Russia) and even command economy mechanisms (China). Such differences are reflected in all stages of the policy cycle, in formulating, communicating, implementing and, finally, assessing anti-crisis measures. While the devising of monetary stabilization mechanisms was in most cases relegated to central bank experts (often with a high degree of political leverage to ensure rapid response), stimulus packages were conceptualized in markedly different ways.

In the United States, the United Kingdom, Germany and, to some extent, Sweden, extensive state intervention into the economy conflicts with entrenched economic policy paradigms. By contrast, policy controversies in the

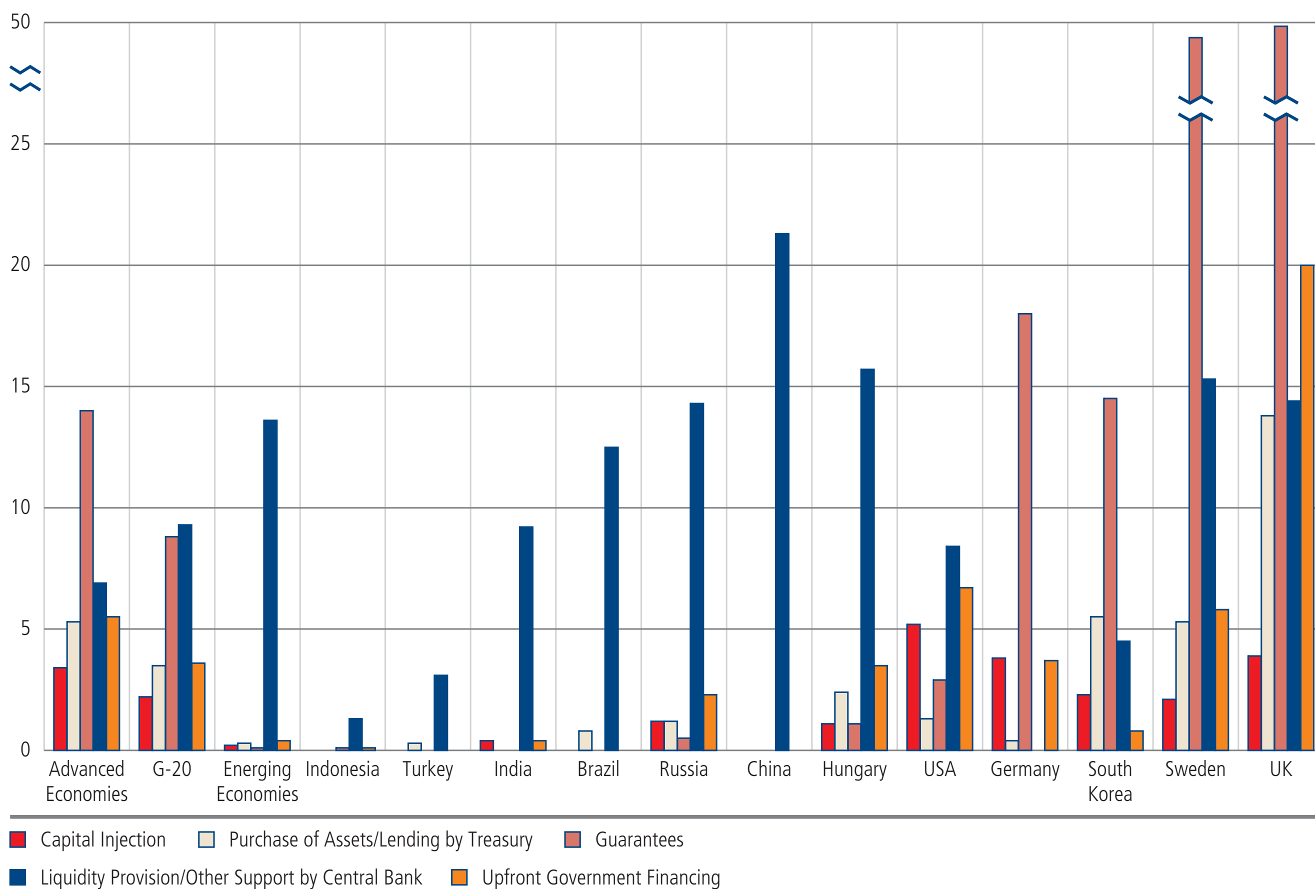
Figure 4: Differing information on the sizes of stimulus



All data in percent of GDP

Sources: IMF, OECD, IILS, news articles and country reports of this study

Figure 5: Support for financial and other sectors



All data in percent of GDP

Note: Chile and South Africa are not covered.

Source: IMF, Staff Position Note, The State of Public Finances: A Cross-Country Fiscal Monitor, July 2009

emerging economies were relatively minimal, as was lobbying by established economic interests (with South Korea and Hungary being minor exceptions). The unprecedented nature of the crisis disrupted conventional economic policy prescriptions; as a result, even pronouncedly market-oriented policy advisers were rapidly reconciled to—and even argued in favor of—substantive state intervention in emerging economies, such as Chile.

The countries analyzed here reveal substantial differences in the timing and composition of anti-crisis measures, but less so in sequencing (initial stabilization of the financial sector, followed by support for the real sector). In emerging economies, the first line of defense was typically monetary policy (i.e., monetary easing and bank guarantees). Central banks were able to act with little delay. Most countries joined the major central banks of advanced economies in concerted efforts to reduce interest rates and in drastic expansions of currency swap lines as the financial turmoil reached its peak in mid-October 2008. Indeed, previous conditions, including the hitherto restrictive monetary policies, more flexible exchange rate policies and declining inflationary pressures during the last two quarters of 2008, offered ample room for conventional policy steps. Monetary policy thus became a key policy tool for many emerging economies, as opposed to in past crises, when rigid exchange rate targets had rendered domestic monetary policy ineffective. Nevertheless, while they did react with swift monetary easing, implementing these policies ahead of stimulus measures like the advanced economies, it is evident that fighting the collapse

of the financial sector was a vastly more prominent policy goal in the industrialized than in the developing countries. This is natural since emerging economies' financial sectors had not experienced the same levels of pre-crisis growth as their counterparts in advanced economies.

With deep exposure to global financial sectors, the United States and the United Kingdom shared a common overarching target in setting an anti-crisis agenda: saving the financial sector from collapse. Sweden and Germany, the latter of whose financial markets were tightly integrated with those of the United States, rapidly joined the Anglo-Saxon countries in setting the agenda for rescuing the financial sector. In the European context, this translated into strong support for European Central Bank (ECB) decisions to lower interest rates and provide loans directly to troubled financial institutions. However, ECB regulations barred the direct purchase of toxic assets, a third measure taken by the U.S. Federal Reserve. Interaction and coordination between the Fed, the Bank of England and the ECB in the context of the G-7, the Bank for International Settlements (BIS) and the G-20 also helped integrate the central banks of emerging economies into the fight against financial-sector collapse.

With respect to timing, Germany has been accused of exhibiting a benign denial in the face of the disastrous effects of the global collapse in demand. In fact, the United Kingdom was the first among the advanced economies studied here to launch fiscal and tax-based anti-crisis measures, followed successively by the United States, Germany and Sweden. This sequence might be explained by the German and Swedish economies' reliance on automatic stabilizers, as manifested through social insurance schemes, which play a considerably smaller role in the United Kingdom and the United States. The presence of these programs may have persuaded governments in Germany and Sweden to wait for the stabilizing effects to manifest themselves before taking broader action. However, the delays may also have been due to policymakers' initial disbelief in the seriousness of the crisis.

Emerging countries showed an extreme short-termism and "expansionism" in drafting stimulus and stabilization policies, primarily concentrating on stabilizing domestic demand and preventing abrupt contraction in the export sector. In only a few cases was the crisis identified and used as an opportunity for a more forward-looking, purposive restructuring. Examples include South Korea's Green New Deal (in relative terms, the largest environmentally focused stimulus plan among major economies) and China's massive investment in health-care reform.

The record is equally mixed in advanced economies. In the United Kingdom, the government focused on stabilizing the financial sector, without implementing stimulus programs that took a long-term perspective. In Germany,

United States—breaking with boom and bust?

Toxic assets originating in unregulated U.S. mortgage markets spilled into the international financial system, triggering a global crisis. After acknowledging the scope and severity of the turmoil, the U.S. government swiftly spearheaded efforts to mount a global response. Nevertheless, because unemployment in the United States remains stubbornly high, communicating the stimulus plan nationally has presented a challenge.

Even after the unfolding of the crisis, the weakness of private balance sheets represents the greatest liability facing the U.S. economic system. By the close of 2009, policymakers had passed no sweeping overhaul of the country's financial regulation and oversight system that would adequately mitigate the risk of the next bubble. If the past decades' pattern of boom and bust is to be transformed into one of sustainable development, thereby lessening the impact of future crises, the U.S. economy will have to steer foundations of growth away from the increasingly dominant financial sector.

The Obama administration has focused on structural policy changes and long-term investments, particularly in the areas of energy, the environment, education and health care. However, the full impact of these expenditures will not be felt until 2011. Critics argue that the "developmental perspective" of the administration's recovery program came at the expense of stimulus spending that might have had a more immediate effect on unemployment, such as direct wage subsidies. Since the recovery package fell short of citizens' job creation expectations in 2009, the Obama administration and the Democratic Party have lost support that may be essential for the continuation of necessary reforms.

Sweden and the United States, early stimulus measures were focused almost exclusively on the short term. However, this changed somewhat over time, as the advanced economies and especially the United States ultimately added a focus on future-oriented investments, such as educational infrastructure and environmental technology. Still, these measures cannot be considered path-breaking and will not change the economic structure of the countries under review. Indeed, some anti-crisis packages in these countries included significant policies aimed at preserving industry sectors that, with respect to their leading role, are likely to be challenged by future structural change (e.g., the automotive industry). To date, there is no evidence regarding the measures' adequacy in addressing long-term structural deficits.

Political communication and policy transparency in a period of extraordinary politics

Governments in all emerging economies studied here, with the notable exception of Russia, did their best to be transparent in communicating their anti-crisis response packages to the public. They did so by relying heavily on Internet-based press releases, official documents and data archives run by the various government press offices or finance ministries. When the South Korean government was criticized for a perceived lack of sophistication in its crisis communication, it turned to a professional public relations company for help. Even in China, after some hesitation, Communist Party officials bowed to public pressure and allowed an unusual degree of public scrutiny and critical press coverage.

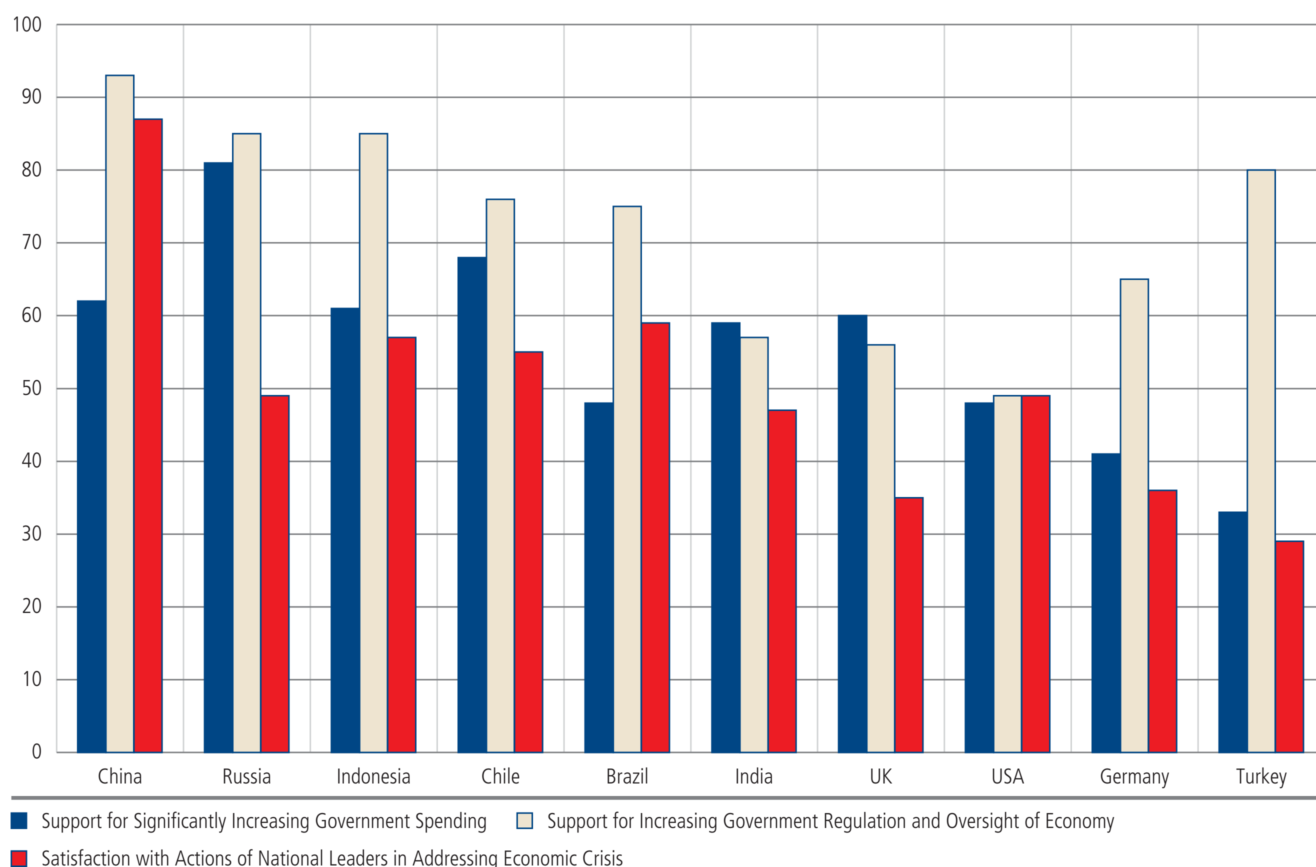
Those executive leaders who initially downplayed the dangers of the financial crisis (i.e., in Brazil, India and South Africa) did not face critical coverage in their domestic media when the situation turned out to be much more serious than anticipated. While the Swedish government was initially somewhat reluctant to discuss anti-crisis measures in public, the federal press office in Germany communicated an extensive range of materials to the general public, including arguments justifying the government's mix of policy measures. The U.K. and U.S. governments were also comparatively transparent in their approach to solving the financial markets crisis. However, in the advanced economies of Germany, the United Kingdom and the United States, the public and the media tended to be much more critical from the very beginning of the market turmoil. In Sweden, opinion polls showed a higher public acceptance of the stabilization measures not least because the government urged bank owners to absorb losses themselves rather than shifting the entire burden to taxpayers.

South Africa—a delayed but inclusive response

South Africa was one of the countries that considered itself to be well-equipped to weather the global economic storm owing to its strong regulatory framework, low levels of debt and banking system that hardly had any exposure to toxic assets. The government's optimistic tone in the early stages changed when it became obvious that the impact on the economy would be severe. Indeed, South Africa was pushed into its first recession in 17 years, as declining commodity prices and lower growth in major trading partners lowered demand for South African exports and employment decreased for the first time in almost four years.

Although South Africa was slower to implement decisive crisis management measures than other countries, its process of drafting an economic crisis response framework benefited greatly from the institutionalized and inclusive multi-stakeholder approach that is the procedural hallmark of the country. The deliberation process drew upon existing structures that had been set up in 1994 to ensure that social dialogue accompanies the development of economic policies. The National Economic Development and Labour Council (NEDLAC) convened a task force of government, labor, business and community representatives, which negotiated the final framework and retains responsibility for its monitoring and implementation. The framework has been praised at the international level for bringing together a broad range of social partners to jointly forge a common response to the crisis. Nevertheless, NEDLAC remains a quasi-governmental institution, and the government has been criticized for not consulting with civil society actors not included under the NEDLAC umbrella.

Figure 6: Public support for government action



All data in percent

Note: The sample countries Hungary, South Africa, South Korea and Sweden were not covered by the poll.

Source: WorldPublicOpinion.Org, BBC Poll, September 2009

Among the emerging economies, Hungary and South Korea stand out as the only countries studied here whose leaderships were confronted with harsh criticism, even when economic turnaround was already discernible. In Hungary, the most vehement discontent was sparked by the government's decision to call for help from the IMF, while the president of South Korea was attacked for allegedly being a "hard-hearted liberal" who relied too much on technocratic advice.

The extent to which scientific advice or consultation processes with intermediary organizations influenced agenda-setting and policy formulation varied among the countries studied here, depending on the character of their political systems and on the degree to which state-society consultations are institutionalized as a part of the political decision-making processes. In many countries, governments consulted existing bodies (including expert groups such as Germany's Council of Economic Experts or Sweden's Globalization Council, which consists of domestic social partners), with South Africa's inclusive, multi-stakeholder approach in drafting its crisis response standing out in this regard. But most regular processes were compressed due to time pressure and, more often than not, civil society groups were not actively involved in agenda-setting or policy formulation. Obviously, the agility of crisis responses trumped the participatory aspects of government legitimacy.

Given the huge sums of public money involved, it is surprising that concerns about corruption or government malfeasance featured prominently only in notoriously corruption-prone countries, such as Indonesia, Russia and China. The lack of public concern about corruption in

many of the countries surveyed here may have much to do with the good reputations for economic management earned by governments of major developing countries during the boom years between 2000 and 2007.

Since the efficacy of policy intervention was largely unpredictable in the early phases of crisis management, all governments surveyed here adopted an incrementalist strategy combined with a more or less explicitly signaled readiness to adapt to changing circumstances, if necessary. Since most emerging economies showed signs of economic turnaround by the summer of 2009 at the latest, the need for additional measures was primarily seen in the advanced economies.

International cooperation: An overstated component of crisis management?

Multilateral international cooperation has not been an essential component of crisis management. Most countries were unconstrained by international commitments (e.g., IMF programs). In effect, government leaders used the G-20 framework to reassure themselves as to the timing and extent of stimulus measures. But, otherwise, they contented themselves with providing fellow G-20 policymakers with information about their national programs, rather than jointly launching concerted, fine-tuned programs even with partners from regional integration schemes. One exception might be seen in the Chiang Mai Initiative, a regional swap arrangement created by the ASEAN+3 as a response to IMF policy prescriptions judged by many Asian policymakers to be unacceptably intrusive (especially during the 1997–1999 Asian financial crisis). The same pattern holds true for the advanced economies: An exchange of information took place within the frameworks of the EU, the G-7 and G-20 meetings, the IMF, the BIS and other bodies without, however, undermining the sovereignty of national governments to pursue stimulus packages strictly in line with their domestic objectives.

The most profound, continuous and effective coordination of policy steps took place between central banks and monetary authorities (partly within the framework of the BIS). This is, in part, why monetary easing and financial-sector support (including state guarantees of bank deposits) ranked high on the agenda for emerging and advanced economies alike and were among the first anti-crisis measures taken.

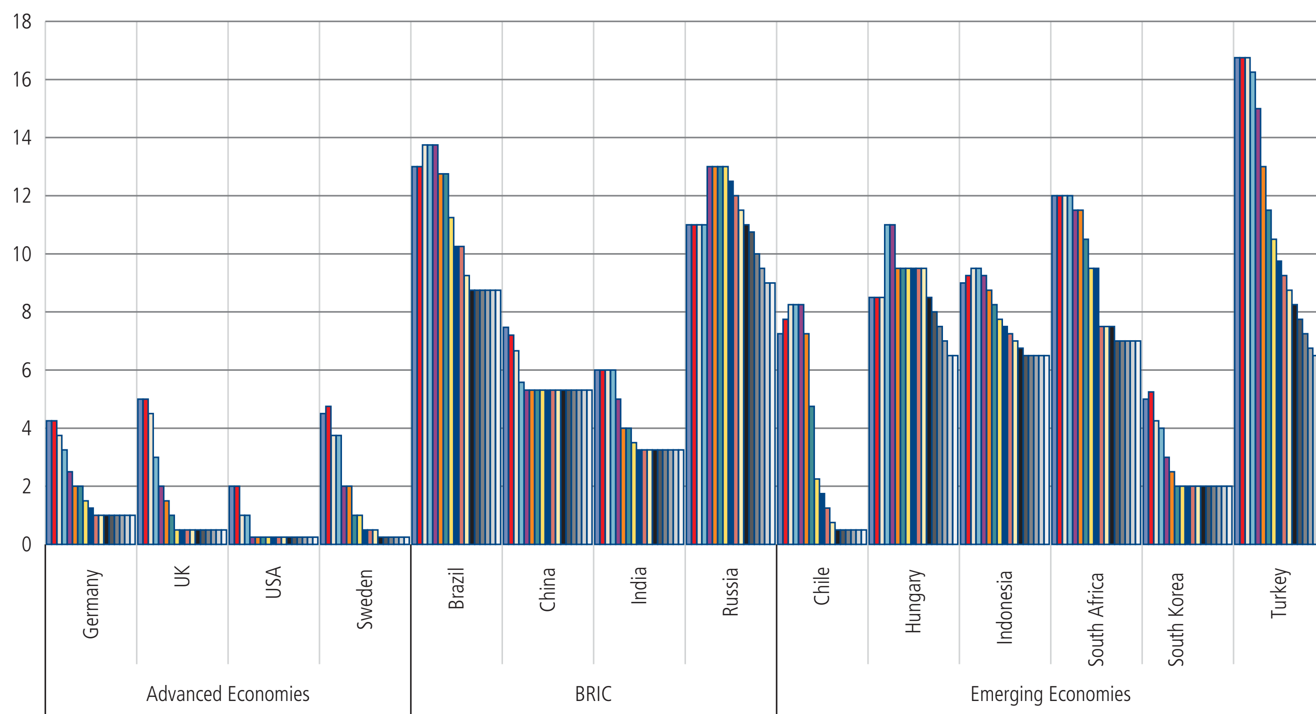
In those countries that maintained exchange rate targets, monetary policies could not be as effective as they were in the few cases where rates were allowed to float.

Hungary—bailed out at the brink of collapse

The global financial crisis severely affected Hungary in large part because of its openness to intra-European trade, the high budget deficits it ran in previous years and its extremely high level of external debt, which climbed to almost 100 percent of GDP by the end of 2008. The crisis found Hungary in an already precarious situation and made it susceptible to international speculation and, consequently, to potential economic and financial collapse. In order to increase investor confidence and ensure liquidity in domestic financial markets, in November 2008, Hungary was the first emerging economy to receive a $25 billion financial stabilization package from the IMF, the European Union and the World Bank. In return for this assistance, the Hungarian government committed itself to furthering fiscal consolidation, reforming its financial sector and enacting banking-sector support measures.

The Hungarian government had to concentrate on stabilization as a precondition for any stimulus policies. In April 2009, it enacted a more comprehensive set of anti-crisis measures, which contained both longer-term structural reforms and modest stimulus packages. A series of economic reforms have been enacted that aim to encourage employment, reduce the tax burden on labor, improve Hungary's economic competitiveness and introduce large spending cuts in public-sector salaries, pensions and other social expenditures. Given the country's highly polarized political situation and the rising tensions between the government and opposition, Hungary's immediate and decisive crisis management measures should be considered a success because they did, in fact, bring about the desired financial stabilization.

Figure 7: Interest rates—strong coordination among central banks



August 2008–December 2009 (in monthly intervals)

All data in percent

Source: National sources

Nevertheless, the signaling effect of central bank coordination was credible even in economies with exchange rate targets. With respect to foreign exchange markets, the ECB, the Bank of England and the U.S. Federal Reserve abstained from direct intervention. However, institutionalized communication between central bankers and markets can be understood as providing signals staving off dramatic, unwelcome movements in these currencies, essentially by warning currency traders that any speculative actions against or in favor of specific currencies could be easily nullified by concerted central bank action.

Though the subject of much discussion, the "buy national" clauses found in some stimulus packages (most prominently in Russia) are limited in scope and, thus, should not be interpreted as a general sign of rising protectionism in themselves. What can be observed is a kind of hidden protectionism, however: Some emerging-market countries raised individual tariffs that were not bound by formal WTO rules or subsidized some of their "national champion" corporations and sectors. Furthermore, anti-crisis packages relatively often included VAT reductions and credit programs for specific sectors, "buy national" preferences for public procurement or reductions in export quotas aimed at stabilizing export prices. The 2009 Global Trade Alert Report, coordinated by the Center for Economic Policy Research (CEPR), stated that, in the 300 days following the first G-20 Washington Summit, G-20 members (which include the most important emerging and advanced economies) on average broke the meeting's no-protectionism pledge every three days. While frequency is no equivalent to impact, in general, times of crisis have rarely offered prime opportunities for trade liberalization. Some "de-globalization," particularly the shortening of cross-border supply chains, may in fact have been driven by cost concerns as much as by any policy measures. In the advanced economies, domestic support programs contained no official "buy national" clauses beyond what was already allowed by normal public procurement regulations. Nevertheless, public infrastructure programs, in

particular, primarily benefited domestic suppliers, due to short tender slots and the familiarity of domestic suppliers with local conditions.

If multilateral coordination proved relatively limited in terms of fiscal and monetary measures, it has to date been outright ineffective in the re-regulation drive that has dominated headlines at various international meetings. Although there is a growing consensus that "macro-prudential regulation" should finally be put in place, the governments of the United States, the United Kingdom, Germany and Sweden still tend to treat the issue as if it could be handled solely at the national level. Many calls for enhanced regulation have been issued since the beginning of the crisis, but the amount of actual re-regulation implemented has been extremely limited. Three causes may be identified for this state of affairs:

- First, no majority stance on an appropriate "global" regulatory response has emerged, probably due to a lack of market-conforming or broadly acceptable policy recipes.
- Second, the financial industry's lobbying power reconstituted itself rather quickly, regaining influence as early as the first and second quarters of 2009.
- Third, re-regulation has often been presented by national policymakers as an issue transcending national reach, which must therefore be dealt with by means of multilateral coordination (which essentially shifts the blame to the supranational level).

The relative flimsiness of policymakers' justifications for inaction is easy to identify and explain. Political economy arguments support the view that financial oversight authorities seek to protect their local financial sectors. Moreover, due to their proximity to the sector they supervise, they are often subject to a kind of "Stockholm syndrome," showing a high level of understanding and sympathy toward the problems of the local financial sector.

Sweden—hailed for multilateral coordination and financial transparency

Sweden's open economy and reliance on trade rendered the country vulnerable to the global economic downturn. Exports and employment—particularly in manufacturing industries—plummeted in 2008. Despite reforms after the Swedish banking crisis of the early 1990s, the previous measures did not prevent the risk-taking activities of Swedish banks in the Baltic states, where Swedish financial exposure was at its greatest.

In its initial reaction, the Swedish government worked to stabilize the financial sector. As the Bank Support Authority forced bank owners to absorb losses rather than shifting the entire burden to taxpayers, public acceptance of the stabilization measures was relatively high. In a second step, the Swedish government implemented measures for the preservation of domestic car industries while simultaneously investing in research and development for reaching climate targets. Further crisis measures included tax reductions, active labor market policies and investments in public infrastructure and education. Beyond these measures, the Swedish welfare state provides automatic stabilizers through high public spending on social security schemes.

A peculiarity of the Swedish case lies in the transparency of decision-making in its central bank during the crisis and the great deal of public information made available for citizen participation and oversight purposes. The Central Bank (Riksbank) is required to present internal decision-making to the public, and all participants on the market can thereby follow up on and openly debate its decisions. Sweden also stood out among other EU countries for its emphasis on coordinating national stimulus with European responses and in line with EU crisis management.

Policy content: Social support measures emphasized, strategic investment lagging behind

The size and composition of stimulus programs have varied widely, ranging from double-digit shares of GDP (China) to minor programs in countries such as Brazil and India. This variance can be explained by individual national characteristics, such as: Brazil's fear of signaling a return to lax fiscal policies; India's confidence that it could weather the crisis without a big program due to relatively low exposure to international financial markets and trade

flows; or China's deliberate attempt to defend high growth rates despite strong exposure to foreign markets.

In countries undergoing transformation, particularly those with a relatively weak and narrow tax base and deficiencies in tax administration, tax cuts played a much smaller role than they did in advanced economies, such as the United Kingdom or the United States. In general, government spending—including infrastructure programs, increased salaries for civil servants and expenditures on social security and labor market development—accounted for the lion's share of stimulus programs in emerging economies, while the relationship between tax cuts and government spending was more balanced in advanced economies. With a relatively high emphasis on tax cuts, India and Brazil proved to be exceptions to this rule, but their stimulus packages were among the smallest of all countries surveyed in this project.

The contents of most emerging economies' anti-crisis measures were weighted toward social policies (e.g., help for the unemployed, direct or indirect transfers for the poor, expansions in health-care coverage, investments in the educational system) and infrastructure expenditure (especially in China and South Korea, less so in Russia and Turkey). With individual exceptions (South Korea, China), there was a lack of purposive efforts to engage in forward-looking economic restructuring. Help for small and medium-sized enterprises, as well as support for big "systemic" companies (especially in China, but also in Russia and South Korea), took the form of direct financial support through expanded and accelerated credit supplies, specific VAT reductions designed to stimulate sales and, in some cases, direct subsidies for specific sectors. In this way, a combination of industrial-cum-social policies took center stage (e.g., car-scrapping schemes, short-time work or training programs for laid-off workers).

Efforts to enhance "national innovation systems" were rare, whether through the deployment of new technology, investments in education or research, "green" policies or tackling structural bottlenecks in the economy. The infrequency of such policies is presumably due to the delayed effects of this form of investment. Positive exceptions to this rule are China and South Korea.

South Korea—green bubble?

Given South Korea's high level of foreign exchange reserves and the reasonably high capital-adequacy ratios of its major banks, the force with which the crisis hit the country came unexpectedly. On the one hand, investors withdrew funds from South Korea to mend problems elsewhere, which caused the stock market and won to significantly depreciate, and, for a certain period of time, new dollar funds seemed almost impossible to obtain. On the other hand, the widespread exposure of its market to the global market led to an extremely dramatic decline in exports. Although the government's initial reactions, particularly with respect to monetary and financial issues, were rather insecure, it still managed to stabilize the flow of funds by the end of 2008. Fiscal measures, including a major stimulus package, were prepared and implemented in a rather timely fashion.

The stimulus package's major measure aimed at boosting public infrastructure is known as the "Green New Deal." Of its total of $36 billion in funding, almost $6 billion are earmarked for improving energy conservation in villages and schools, $7 billion for mass transit and railroads, and almost $11 billion for river restoration. In relative terms, South Korea is implementing the most significant "green" stimulus measure of any major economy, with 81 percent of the total stimulus fund going to this measure. Moreover, 960,000 jobs are expected to be created within four years, most of which will be in manual labor. Major elements of this package had been contemplated already before the crisis—as well as criticized as being a way to subsidize the construction industry, in which the president has vested interests. Furthermore, many observers doubt the sincerity of the entire project, and some even talk of a "green bubble," even though the potential reduction of 7.37 million tons in CO_2 emissions would constitute a major achievement. Moreover, there are also ecological concerns about the physical repercussions of these massive projects.

Russia—lessons learned and opportunities missed?

Russia's initial response to the global financial crisis was both swift and massive. Having learned lessons from the 1998 financial crisis, political decision-makers took prompt actions as early as September 2008 to stabilize the country's banking and financial sector. However, at first, the government focused solely on the financial side of the crisis, and it was not until December 2008 that it officially recognized the wider impact of the crisis on the real economy, which manifest itself in a drastic decline in demand and reduced output in a number of industrial sectors.

Russia's strong fiscal position and the considerable reserves it had accumulated allowed it to finance an expensive and diversified fiscal stimulus package without additional borrowing. The package included cuts in taxes and duties, additional social spending and support for the labor market, the regions, the financial system and industry. Russian crisis management is mostly oriented toward returning to the high level of economic growth it enjoyed before the crisis as well as toward guaranteeing social and fiscal stability. Indeed, it tends to neglect the possibility of making changes on a more structural level, such as diversifying the economy, improving competitiveness or modernizing technologies.

Almost all of Russia's crisis management measures have been defined in a discretionary way without either any transparent mechanism of review or clear conditions related to terminating support. This holds especially true for the support of systemically important enterprises. Absent are transparent procedures for identifying potential recipients of state support and a comprehensible link between enhanced competitiveness and eligibility for support. However, between May and September 2009, eligibility criteria focusing on better performance, the use of advanced technologies, higher energy efficiency and more transparency in financial activities were added to the stimulus packages.

Once they accepted the serious nature of the crisis, the governments of advanced economies quickly put measures in place that were aimed, like the ongoing monetary easing, at stabilizing the financial sector. States offered guarantees for the survival of asset-troubled banks and launched fiscal stimulus packages. In contrast to expenditure-focused stimulus packages in developing countries, advanced economies' programs relied heavily on direct and indirect tax relief, even more so in Germany and Sweden than in the United States or United Kingdom. However, the size of these packages as a share of output differed substantially, with the United States in the lead (more than five percent of GDP), followed by Germany (about three percent), the United Kingdom and Sweden (less than two percent, irrespective of the automatic stabilizers, which are particularly high in Sweden). The stimulus programs of the advanced economies surveyed here also contained social support elements (mostly indirect, in the form of tax-relief measures benefiting lower income strata) and industrial policy measures designed to support sectors with excess capacity, most prominently the automotive industry. Industrial policies also included some forward-looking elements, such as funding for "green" technologies, but the share of stimulus measures with some "green" component has been estimated at only 10 percent in the United States and 13 percent in Europe, as compared to almost 30 percent in China. It seems safe to conclude that short-term anti-recessionary measures prevailed over programs designed to further longer-term innovation.

With regard to the funding of the stimulus policies, the countries surveyed here again show considerable diversity. Whereas most countries included the stimulus packages in their regular budgets, some relied on extra-budgetary revenues (Chile, Russia) or even on the state-controlled retail banking system (China).

The essential question for advanced economies is whether the funding of stimulus packages and tax relief by means of rising budget deficits will be understood by the public as an emergency measure to be necessarily followed by a credible exit strategy of fiscal consolidation. While Sweden entered the crisis in a sound fiscal situation and still benefits from these circumstances, the other three advanced economies surveyed here have driven their budget deficits to unprecedented levels, with Germany violating the Maastricht criteria (both in terms of its budget deficit above three percent in 2009 and its debt-GDP level), and it is feared that the United Kingdom and the United States will both post double-digit deficits

Germany—struggling to restore a skills-intensive trading economy

The economic downturn currently plaguing Germany is by far the most serious such episode in the country's 60-year history. As such, it signals a long-term structural crisis in the country's political economy rather than a simple cyclical downturn. Export dependency has rendered Germany's real economy particularly vulnerable to fluctuations in global trade and to global investment flows.

A mix of policy measures has managed to avert job losses, at least to some extent. These have included short-term employment support, parallel agreements between employers and trade unions, immediate support to financial institutions and the cash-for-clunkers scheme that paid consumers to scrap old cars and buy new ones. However, despite short-term successes in containing unemployment, support to the financial sector has placed a significant burden on public-sector finances. Moreover, stimulus policies have to date shown little sign of transforming the structural weaknesses—in particular the asymmetrical levels of demand—that characterized Germany's political economy before the crisis.

On the one hand, the German government has shown foresight in its strong focus on new investment in education. On the other hand, a grave danger remains that the legacy costs of salvaging Germany's financial sector could further weaken demand as state authorities seek to reduce chronic budget deficits through severe expenditure cuts and/or tax increases. Such de facto neutralization of the stimulus packages' effects could undermine the strong growth patterns that have historically supported the country's skills- and R&D-intensive economy.

in 2010. A Ricardian equivalence thinking would suggest that today's debts will translate into tomorrow's taxes and would thus encourage private households to save instead of consume in anticipation of rising taxes. If private households indeed viewed the economy in this way, it would seriously curtail the stimulus packages' ability to boost domestic demand. Given the decline in sovereign debt ratings in the United Kingdom, the downsizing of the financial sectors in the United Kingdom and the United States, and Germany's political resistance to cutting subsidies, it is likely that stimulus exit strategies and consolidation will in fact be further postponed. While Ricardian equivalence thinking is likely to be stronger in Germany than in the United Kingdom and the United States, these latter two economies are nevertheless in dire need of budgetary consolidation, in terms both of private and public balance sheets.

Monetary authorities are also in need of exit strategies. The ECB is likely to start reducing liquidity before the U.S. Fed in order to comply with its primary objective of price stability. However, providing the ECB with an additional goal of asset market stabilization (associated with financial-sector oversight authority) could create a difficult tradeoff for central banks: Stabilizing asset markets could clash with monetary exit strategies if banks and other financial institutions remain fragile.

Policy implementation: Variation, delays and a few early birds

Generalizing across national contexts, one cannot avoid the impression that domestic stimulus funds in emerging economies have been primarily channeled into infrastructure programs and, thus, to the construction sector. That raises the question of procyclicality and price effects, should disbursement of funds to infrastructure programs be constrained by capacity bottlenecks in the bureaucracy or the construction sector. This danger has been revealed in Indonesia in a striking way: By September 2009, not even a third of the infrastructure budget had been spent, and inflationary pressures have meanwhile been rising.

All countries under review planned to implement the majority of their stimulus measures in 2009–2010, with some early-bird countries beginning by the end of 2008 (China and South Korea, on a broad scale; the United Kingdom and the United States, in a limited number of sectors and policy areas). However, policy implementation varied widely between and even within countries. This is due to geographical variation (China, India), bureaucratic procedures (advanced economies) or a lack of bureaucratic capacities (Indonesia). Thus, South Korea (based on its centralized-technocratic administration) and

Chile—improved coordination

The impact of the global economic crisis on Chile was both swift to arrive and profound, partly because of the high degree of integration of its trade and capital markets. Nevertheless, the country implemented a series of fiscal and monetary policies that contributed to counteracting the adverse effects of the crisis. More importantly, the country benefited from an outstanding macroeconomic situation and an extremely sound domestic financial market. Owing to high prices for copper in recent years, the government had enjoyed significant budget surpluses, which allowed it to invest more than $20 billion in two sovereign funds that, in turn, permitted it to pursue expansionist fiscal policies in 2009. On January 5 of that year, the government launched a fiscal stimulus package involving approximately $4 billion (or 2.8 percent of GDP). The plan was complemented by federal legislation regarding the labor market, job protection and stimulating job training, which the National Congress approved by unanimous vote in May 2009. The government also launched an initiative known as Pro Crédito, which aimed at encouraging banks to extend more credit, particularly to very small companies.

One important difference between the current crisis and the Asian financial crisis of 1997 was improved coordination between fiscal and monetary authorities. Previously, several analysts had claimed that the central bank had played a role in worsening the situation during the Asian crisis by restricting credit as well as that the government had not pursued fiscal policies that were sufficiently active. This time around, the lesson had already been learned. Indeed, both monetary and fiscal authorities reacted promptly and in a coordinated fashion. The central bank began aggressively reducing its interest rate (from 8.25 percent in January 2009 to 0.5 percent in July 2009), while the government implemented large fiscal stimulus packages.

Indonesia—lessons learned

The global crisis did not hit Indonesia as hard as it did many other countries. Macroeconomic conditions had been relatively good in the country before the crisis because foreign debts had been significantly reduced, financial transactions were well-regulated and the banking sector had been solidified. Indeed, Indonesian decision-makers had clearly learned their lesson from the Asian crisis of 1997. A major feature of the country's response to the crisis was the harmonious cooperation between President Susilo Bambang Yudhoyono and Boediono, the head of the central bank, Bank Indonesia, which took swift and decisive actions at the outset of the crisis. By intervening in the foreign exchange market, the central bank prevented the national economy from sustaining major damage. Moreover, the sound foundation of Indonesia's domestic economy and its low exposure to the world economy contributed to its resilience in the face of the global economic downturn. In fact, Indonesia is one of only a handful of countries that managed to achieve robust growth in 2009.

Indonesia's government did not implement a stimulus package until February 2009. It was complemented by an expansion of income-tax relief for select industries, passed in December 2008, and an increase in subsidies aimed at softening the impact of the crisis on consumers and businesses. Parts of the business community complained about the slow disbursement of stimulus funds, noting that only 14.2 percent of the appropriated funds had been spent by September 2009. This slow disbursement can be attributed to delays in tendering mechanisms and a lack of preparedness on the part of public servants, particularly those at the local level. Since Indonesia suffers from rampant corruption and opaque patronage networks, it is also likely that some officials took advantage of their role in disbursing funds to line their own pockets. On the other hand, the government demonstrated its growing resilience to traditional patronage networks.

China (reverting to planning and implementation styles of a command economy) retained an implementation lead well into 2009.

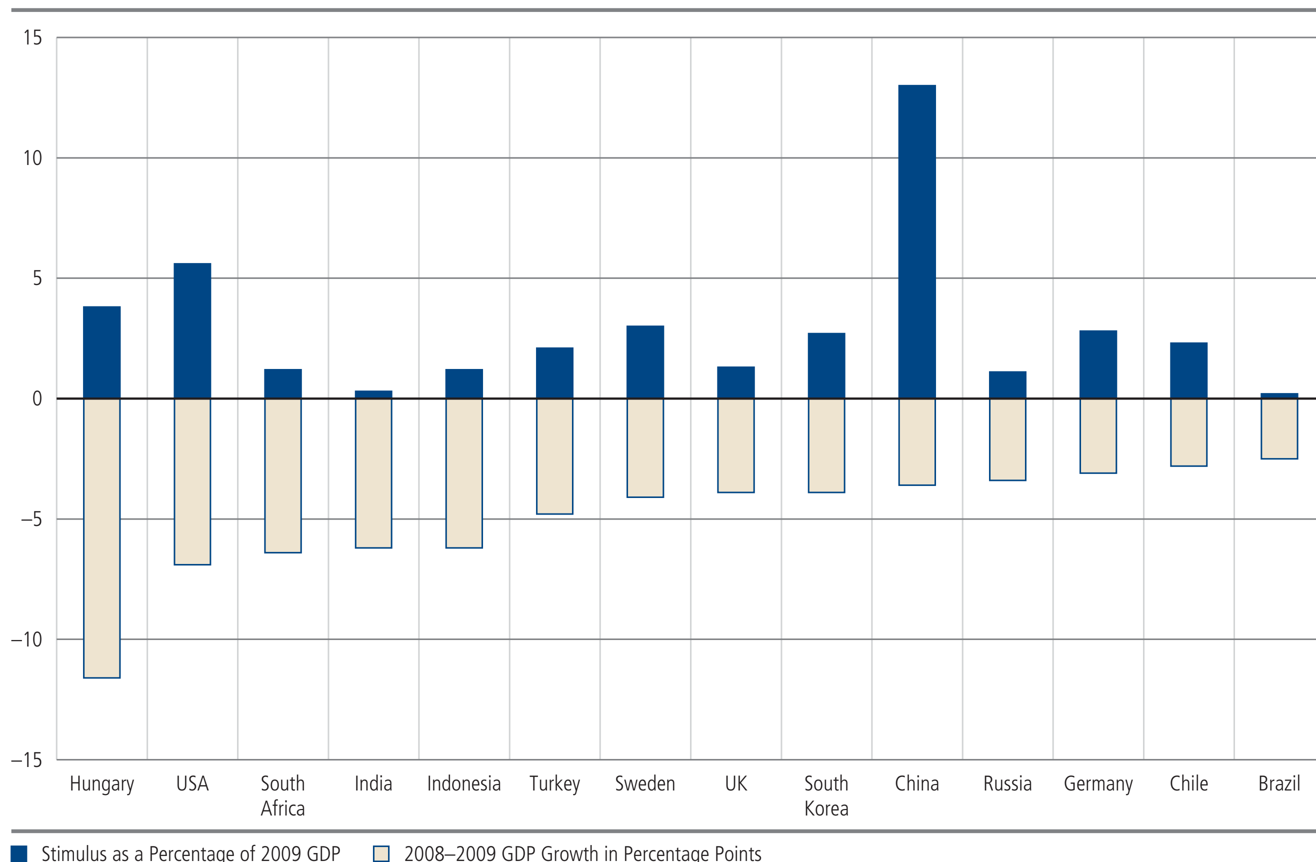
In all four advanced economies, public communication between the financial sector, central banks, public authorities and the media was intense and commensurate with the seriousness of the crisis. However, local variations certainly occurred. Germany's federal structure, and the co-competence of its 16 states on many issues (including infrastructure), rendered the development and implementation of anti-crisis measures more time-consuming than was the case with the United Kingdom's centralized political architecture, for example. The fact that German voters were initially unsatisfied with their policymakers' anti-crisis stance may be due to the complicated structure of political decision-making within Germany's three institutional layers. This feeling of inertia faded away as measures were implemented. By contrast, early movers, such as the U.S. administration, seem to have suffered a reverse swing in public opinion, from initial satisfaction to subsequent disenchantment.

Conclusion

The psychology of crisis management

If viewed from a short-term, present-focused perspective, the various measures aimed at calming financial market turbulence have evidently hit their target. This seems to hold true for advanced and emerging economies alike. Bank runs and other demonstrations of panic were averted. In addition, measures aimed at containing unemployment, preventing social upheaval and propping up consumer confidence seem to have worked. Some countries, including India and Brazil, even experienced an increase in employment during the crisis, although most of the newly created jobs are to be found in the informal sector,

Figure 8: Actual economic impact and stimulus size



Source: IMF, IILS, Staff Calculations

and actual reductions in poverty among the countries surveyed are rare. At least in the case of the emerging economies, these successes were helped by considerably better communication between policymakers and other economic actors than was seen in previous Latin American, Asian or Russian crises.

However, there is also reason to be cautious, since causal relationships between individual measures and concrete outcomes have yet to be analyzed in detail. For example, the multiplier effects of fiscal stimulus programs cannot yet be adequately quantified. There is hope that in major developing countries, where public debt levels are lower than they are in the United Kingdom or the United States, consumers and investors will avoid limiting current expenditures in fear of future tax increases. However, no good yardstick for assessing the size of emerging-economy multipliers exists. Given the dominance of public expenditures over tax cuts in the stimulus measures of emerging economies, the gestation period of expenditure is likely to extend into 2010 and 2011.

Two preliminary conclusions drawn from the 2008–2009 crisis management efforts are so far supported by evidence:

- The effect of stimulus packages rests on the ability of political management to take collective psychology into account and to generate confidence in the potential for recovery rather than on hard economic causalities and data points. Despite precarious situations in many national banking sectors in advanced economies and the persistence of longer-run excess capacity problems in some manufacturing industries, cyclical bottom points were soon reached, and confidence was injected into the system. Along with the concerted efforts in monetary policies and some early recoveries in equity and commodity markets, this has led to a more upbeat assessment of the potential for recovery. Notably, depression-like scenarios have been avoided.
- National governments have succeeded in pulling their societies out of the slump with very little help from outside demand. The main drivers of an early demand

Table 1: GDP growth forecast revision

	Forecast for				Revision in percentage points positive (+), negative (–)	
	2009		2010		for	
	Date of forecast		Date of forecast			
	April 2009	October 2009	April 2009	October 2009	2009	2010
Brazil	–1.3	–0.7	2.2	3.5	+0.6	+1.3
Chile	0.1	–1.7	3.0	4.0	–1.6	+1.0
China	6.5	8.5	7.5	9.0	+2.0	+1.5
Germany	–5.6	–5.3	–1.0	0.3	+0.3	+1.3
Hungary	–3.3	–6.7	–0.4	–0.9	–3.4	–0.5
India	4.5	5.4	5.6	6.4	+0.9	+0.8
Indonesia	2.5	4.0	3.5	4.8	+1.5	+1.3
Russia	–6.0	–7.5	0.5	1.5	–1.5	+1.0
South Africa	–0.3	–2.2	1.9	1.7	–1.9	–0.2
South Korea	–4.0	–1.0	1.5	3.6	+3.0	+2.1
Sweden	4.3	4.8	0.2	1.2	+0.5	+1.0
Turkey	–5.1	–6.5	1.5	3.7	–1.4	+2.2
UK	–4.1	–4.4	–0.4	0.9	–0.3	+1.3
USA	–2.8	–2.7	0	1.5	+0.1	+1.5

Source: IMF, World Economic Outlook April 2009, October 2009

stabilization have been national government spending and private demand. Exceptions may be seen in the cases of Brazil, Chile and South Africa, which clearly benefit from their reliance on commodity exports to China. However, the idea that China (or East Asia as a whole) is pulling the entire world out of recession does not appear justified across the other countries surveyed here.

Whereas the short-term effectiveness of stimulus measures is beyond doubt, there are numerous potentially detrimental longer-term effects. These include inflationary pressures that may hit many countries as early as 2010. The approach of monetary policymakers to this issue must be delicate: If central bankers seek to head off inflation too late, they may provoke new asset bubbles, while acting too early could trigger a new recession, as was the case in the United States in 1937, after the Great Depression.

One of the most important medium-term effects of the crisis might be a decisive alteration of the global power structure in favor of emerging markets. Their effective management of the crisis lends support to the conclusion that governments in major developing countries have become much more adept at preventing crises in their territories. This is primarily due to effective policy learning and the implementation of institutional changes (most importantly, in the fiscal and monetary domains) that constrain the systemic imbalances that triggered former crises. This situation will inevitably boost political and economic self-confidence in these countries. Exceptions to this success of emerging economies are represented by countries that remain strongly tied (institutionally, politically and economically) to mature OECD economies and whose domestic policies have proven inconsistent with sustaining these ties (e.g., in Hungary and the Baltic states).

However, it must be emphasized that the advanced economies also responded swiftly to the crisis with massive "neo-statist" programs and unanticipated pragmatism. Clearly, shock-driven policy learning has been taking place even in the most liberal market economies of the West. It would thus be premature to discount advanced economies' governmental achievements and economic models. Moreover, any structural rebalancing of the world economy that entails shifting the engine of growth from the United States' domestic absorption to

China—growth and graft

China was hit hard and fast by the unfolding of the global economic crisis, whose effects included a considerable rise in unemployment. This came as a shock to Chinese policymakers, whose initial reaction was to quickly announce a massive stimulus package valued at more than $580 billion (or 13 percent of GDP) in early November 2008. The sheer size of this package surpassed the efforts of any other government analyzed in this survey, though it should be noted that there is no real certainty as to how much of the package's funding was really "new"—or, in other words, whether they had already been appropriated for other measures, such as earthquake-related reconstruction. Four months later, the central government significantly modified its resource allocation. Although this included raising social expenditures related to housing and health care, both of which had immediate impacts on the livelihood of average citizens, it practically halved sustainable development expenditures related to energy and the environment. If measured in terms of the government's officially stated objectives, this huge investment was successful. In fact, it helped reach the short-term objectives of ensuring a growth rate of eight percent and curbing unemployment.

At the same time, though, these measures also entailed an impressive amount of waste. While helpful in terms of allowing an initial policy response that was rapid, the administrative mechanisms inherited from the command economy era contributed to an inefficient use of resources. For example, structural imbalances in the Chinese economy remain unresolved, and local and regional governments were more concerned with protecting income revenues derived from local industries than on the fact that their production processes were wasteful and harmful to the environment. Moreover, a massive amount of funds have been misused; instead of going toward attaining their designated aims, they went toward procuring assets in the stock and real estate markets since these offer much higher and faster returns on investment. Moreover, Communist Party cadres serving in various official capacities collaborated in mutually beneficially ways that led to insufficient supervision, which in turn resulted in distortions and corruption.

Asia's more inward-oriented trade regime will be difficult and time-consuming.

Nevertheless, the outcome of the crisis so far confirms the rapid rise of the major, diversified emerging economies and suggests a relative decline on the part of the major advanced economies (most prominently, the United States and the United Kingdom). Over the course of the crisis management process, the increasing importance and density of links between emerging markets and developing countries were powerfully evident. These links manifest themselves in the form of trade flows (manufactured goods and commodities) and foreign direct investment.

The intensification of South-South exchanges and cooperation might increasingly undermine the ability of policymakers from advanced economies to promote Western agendas in global conferences on issues such as climate change or trade and finance. Perhaps this will be one of the most lasting outcomes of the crisis.

Future challenges

The current crisis consists of four components, of which only the cyclical one, the recession, seems to have been mastered. Any assessment of crisis management to this point has to remain focused on the stabilization and stimulus measures that contributed to overcoming the recession. The other three challenges are institutional (restoring the financial sector), structural (enabling adjustment of the real sector to current levels of excess capacity) and budgetary (timing the exit strategies of governments and central banks) and remain high on the agenda.

The institutional component is primarily an issue for the advanced economies, which share the common goal of restoring the damaged institutional body of the financial sector. In the Asian crisis, private banks' non-performing loans were often parked in special public institutions (e.g., in Thailand). This time around, most emerging markets (with the notable exception of Hungary) are in a relatively more comfortable position, and it is the highly industrialized economies that must decide how to revitalize their financial sectors.

One key proposal in this regard has been the "bad bank" procedure, which would allow and even encourage financial institutions to "park" toxic assets off the balance sheets of their core businesses. Without going into a detailed discussion of adequate asset valuation models—a critical variable in order to avoid burdening taxpayers and implicitly subsidizing bank owners—it is enough to say that the essential problem remains unsolved: how to define a "good bank" in a situation where the real sector has not yet finished (or, in some cases, even begun) ad-

Turkey—a delayed and weak response

At the outset of the global financial crisis, political leaders in Turkey confidently stated that its economy was resilient enough to cope with the global turmoil and would not be at all affected. Consequently, the government did initially not work to establish a comprehensive recovery plan and, apart from acknowledging the need for financial stabilization, concluded that waiting for the recovery of the world economy would be a sufficient response. This self-confidence on the part of political decision-makers stemmed from the country's experiences related to the financial crisis of 2001 and the resulting reforms in the banking and financial sectors, which did indeed cushion the direct effects of the financial crisis.

The government's optimistic stance only changed once the Turkish economy was hit hard by a sharp contraction of exports and a sudden halt in capital flows. In March 2009, the government announced a series of measures aimed at stimulating domestic demand, but it was only in September of that year that it introduced a medium-term stimulus package, which included tax cuts in the housing and automotive sectors, financial support to small and medium-sized enterprises, export credits and increased subsidies to low-income groups in the form of additional funding for institutions related to health care and social security.

One of the highly debated and politicized issues in Turkey is the pending renewal of a stand-by agreement with the IMF. The government has been reluctant to sign the deal because it would prefer to maintain its expansionary fiscal policies. Critics of this stance have urged the government to conclude the agreement, arguing that a more realistic budget supported by a stand-by loan expected to amount to $20 billion could help improve Turkey's economic prospects.

justing to the crisis. The “good bank” business to be salvaged hinges on the recovery of the real sector, and such recovery is by no means certain in today’s advanced economies. Excess capacities remain, the core businesses of some banks will have to be downsized (e.g., in financing cyclically sensitive sectors, such as shipbuilding and automobile sales), and borrower risk aversion is likely to rise, thereby reducing bank profit margins. By contrast, the issues of shifting pecuniary incentives for bank managers toward medium-term company performance and binding salary payments to such performance have at least been addressed by policymakers.

Global governance in financial markets is still a *desideratum*. Governments of advanced economies have spoken in favor of more international coordination. But the G-20 meeting in Philadelphia, at least, gave rise to the suspicion that they are paying lip service to the idea and are not really prepared to surrender national sovereignties to supranational regulatory bodies in any decisive way. As previously mentioned, the “Stockholm syndrome” effect, in which regulators sympathize with their local financial sectors, seems to play a substantial part in this reluctance.

The structural component of the crisis concerns advanced and emerging economies alike. Almost all country reports produced in this project convincingly emphasize that the crisis has not been used as an opportunity to overhaul persistent industrial overcapacities in any substantial way. In fact, several stimulus packages even appear to have contributed to the perpetuation of structural deficiencies, including lack of economic diversification. Labor markets in many countries are unprepared to reallocate idle labor efficiently into new formal jobs.

The budgetary component of the crisis has been severely aggravated in recent months, especially by the substantial fiscal expansion or even skyrocketing levels of public debt in the advanced economies. In this regard, emerging economies (again, with the exception of Hungary) exhibit considerably higher levels of macrostability than do the United Kingdom and the United States. Sweden, with its relatively comfortable fiscal position, is also in better shape than its peers.

The danger is that the stimulus packages’ successes at overcoming the recession might eventually backfire. A massive loosening of fiscal (and, in some cases, monetary) discipline has taken place, even in political economies that had shown fairly strong discipline prior to the crisis. If unchecked, this will have an uncertain, yet potentially devastating mid- and long-term impact.

United Kingdom—finance sector domination

By 2008, the United Kingdom’s financial sector accounted for 8.8 percent of the country’s GDP, and high levels of consumer debt and mortgage exposure were the main drivers of domestic spending. The financial sector’s massive contribution to tax revenues in past years have compelled U.K. governments to protect and promote the sector’s interests. By the end of 2008, it became apparent that neither monetary policy nor rescue packages could prevent the real economy—which, since 2002, had run budget deficits of roughly three percent—from contracting sharply.

Established in 1997 as a single regulator of the financial sector, the Financial Services Authority (FSA) proved ineffective. In the years leading up to the crisis, the FSA, together with the Bank of England, allowed an unsustainable credit boom and asset price inflation to develop. At the same time, the FSA failed to address the problems associated with the widespread use of special investment vehicles. In response to both the crisis and the failings of the FSA, the U.K. government passed the Banking Act of 2009, which gave it the power to nationalize failing banks and undertake a major reorganization of the FSA so as to improve its ability to carry out its supervisory tasks.

Managing the Crisis: A BTI Perspective

Sabine Donner, Hauke Hartmann

The key innovation of the Transformation Index (BTI) is its focus on the steering and management of development and transformation processes. As one of the leading sources of information on how governments in developing and transition countries manage transformation, we are profoundly interested in understanding the extraordinary challenges posed to leaders by the global financial and economic crisis. Given the BTI's focus on leaders' capacity to manage change, taking a closer look at the orchestration of decision-makers' responses to the crisis and the results they have brought about was a logical and urgent next step. In fact, it was in December 2008 that the BTI Advisory Board first discussed the need to conduct an additional comparative study focusing specifically on how decision-makers manage the economic crisis. At that time, preparations for the BTI's 2010 edition were underway, and it was clear that the full effect of the crisis in most BTI countries would become apparent *after* the observation period had ended (January 2007 to January 2009). Indeed, our experts could discuss only initial responses to the looming crisis and precautionary measures taken by governments in the country reports, which are available at www.bertelsmann-transformation-index.de/en/bti/country-reports.

The BTI 2010 can and does offer some insight into the state of affairs of governments as they faced the crisis. Although many of the larger economies had been able to use the global economy's previous boom years to consolidate their budgets and pile up large currency reserves, the BTI 2010 registers only 47 countries out of 128 with good or excellent (8 to 10 points) macroeconomic stability. While this represents a sizeable number, nonetheless, economies in three-fifths of the countries assessed showed signs of instability as the crisis hit. A sound banking system with adequate supervision (8 to 10 points) was established in 40 countries, and economic performance in one-third of the 128 countries assessed was deemed good or excellent (8 to 10 points).

While the BTI's assessment of macroeconomic conditions in a country helps us to understand the robustness or vulnerability with which a country faced the crisis, the BTI's Management Index, which maps out capacities for good governance, helps us to identify a country's political strengths and weaknesses. Of the management criteria used in the Transformation Index, the following are of particular importance to managing crises: a government's steering capability to set strategic priorities, to implement decisions in an effective and timely manner, and to learn from mistakes made; its resource efficiency in managing available resources, in coordinating various interests in a coherent manner and in successfully combating corrupt practices; and acumen in conflict management and civil society participation.

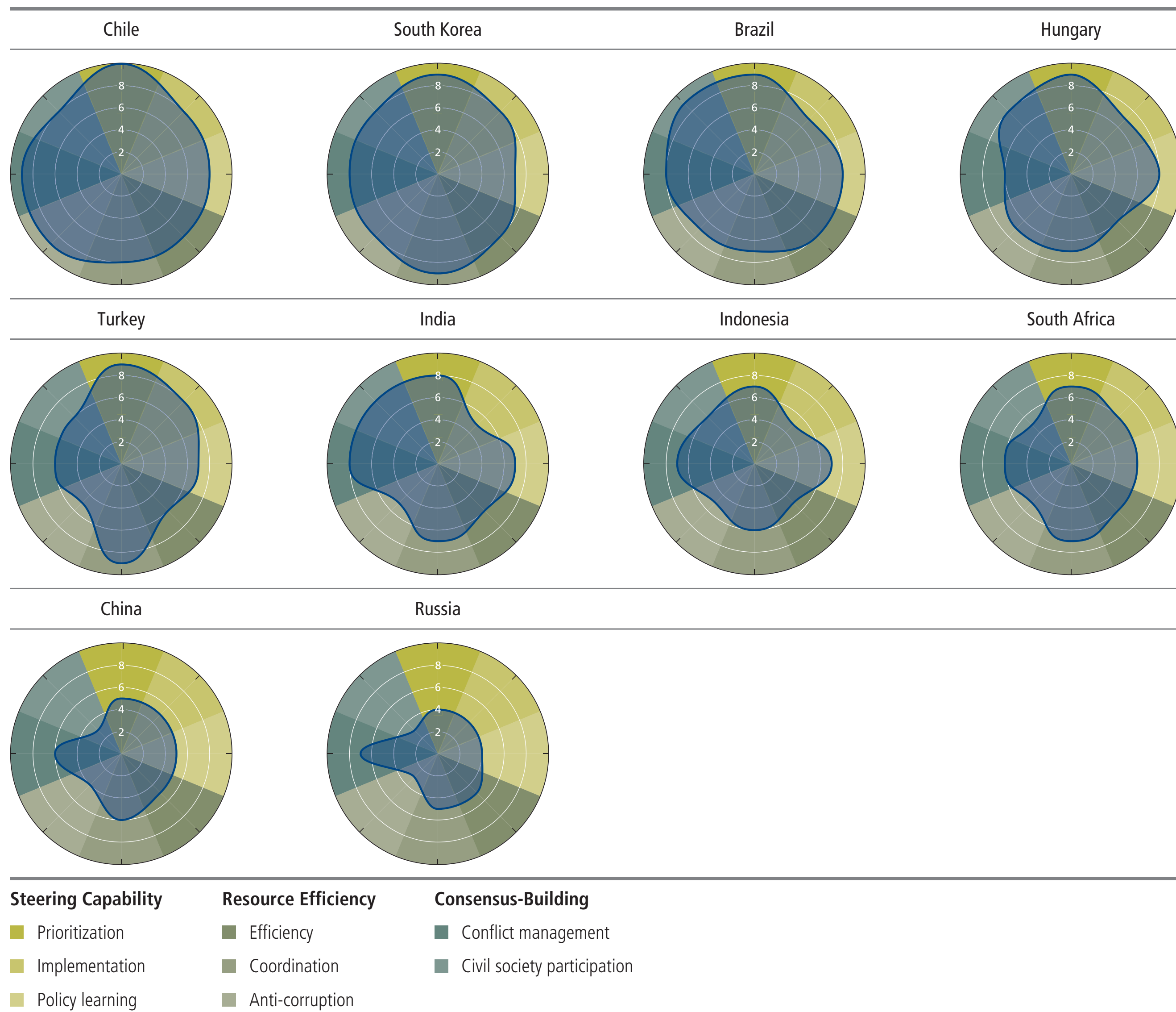
Overall, in all of the 128 countries surveyed, the scores for these select aspects of management are sobering. The average scores for specific indicators are staggeringly low, particularly those addressing achievements made in fighting corruption, the effective use of available resources and the engagement of civil society in the political decision-making process. However, if we focus solely on the 10 countries included in this study on crisis management, the picture of management capacities—as evaluated by the BTI 2010—brightens up considerably.

In almost all the criteria assessed, Chile and South Korea stand out, especially with regard to political leaders' ability in each to prioritize and organize policies according to strategic aims. Whereas Chile also received high scores for its anti-corruption policy and conflict management, South Korea was praised for its capacity to coordinate policies effectively and to act in a coherent manner. Political management in Brazil was also viewed positively, even though resource efficiency under Luiz Inacio "Lula" da Silva was scored markedly lower than its ability to identify political priorities, formulate policies and involve civil society actors in the political debate.

Hungary, India and Turkey also received scores ranging from respectable to good for their governments' respective management performances. Nonetheless, all three countries demonstrated only a moderately efficient use of available resources. In India and Turkey, this modest performance was coupled with an ineffective anti-corruption policy, while in Hungary, the government's weak conflict management has proved unable to overcome polarization and fragmentation, which has resulted in a considerable waste of resources.

Indonesia and South Africa, while still ranking relatively high in the BTI's Management Index, scored decidedly lower than the other six countries in terms of the aforementioned BTI criteria. Political management in both countries showed deficiencies in terms of the capability to effectively implement policy measures and to use available resources efficiently, especially regarding cor-

Figure 1: Management Index profiles



Source: www.bertelsmann-transformation-index.de/en/

ruption and red tape. In addition, both countries showed moderate levels of civil society participation. In Indonesia, this was due to the legal barriers potentially restricting NGO funding; in South Africa, this was due to the dominant position held by NGOs affiliated with the African National Congress (ANC). These deficits, however, pale in comparison to those identified in Russia and China's management performance. While both regimes in these countries scored low with regard to civil society participation—which is unsurprising for (semi-)authoritarian political systems—there were glaring problems registered in terms of resource efficiency. These included widespread corruption, a bloated and inefficient public sector, and the unreliable implementation of policy measures, the latter of which can be attributed to local opposition and/or deficient administrative capacities. It should be noted that because the BTI criterion for steering capability evaluates reforms targeting both democracy and a market economy, autocracies like China will receive lower scores on this issue. However, in terms of other "system-neutral" criteria, China's management performance still lags behind that observed in all other countries in this sample, except Russia.

We are well aware of the fact that assessing governments' capacities and successes in steering long-term transformation processes is quite a different matter than evaluating how well they manage a crisis situation. Among other criteria that the BTI would normally judge more critically, in times of crisis, successful management might entail: a decision-making process that allows more leeway for a strong executive center; sacrificing extended processes of expert consultation and policy formulation in order to swiftly implement stabilizing and stimulus measures; and the ability to recognize the need for quick wins that should eventually give way to long-term strategies targeting sustainable development.

With these considerations in mind, we have explored in this study whether the evaluations of political management in BTI terms correspond with those of economic crisis management. Do assessments of government performance under "normal" conditions help us to predict how well governments will fare in crisis situations? Is a government's response to the economic and financial crisis directly related to systemic or procedural characteristics of national governance or past experiences?

At first glance, there are striking differences in terms of how the countries examined here perceived the threat. Whereas governments in Brazil, India, South Africa and Turkey voiced self-confidence and trust in the resilience of their national economies as they downplayed the potential effects of the crisis, governments in the other countries responded immediately and forcefully, albeit for a variety of reasons. In both Russia and China, the crisis was quickly recognized as a major threat to high growth rates and social stability, prompting the government in each to react quickly and with a massive mobilization of resources. The need for these countries' regimes to respond in this manner, however, underscores their vulnerability. Indeed, compared with the other countries in the sample, the legitimacy of the ruling classes in China and Russia depends to a decidedly lesser extent on participatory consent and the rule of law than it does on stability, development and improving the living conditions of citizens. With their legitimacy at stake, the Chinese and Russian governments were prepared to invest heavily in social measures and perceived engines of growth, thereby generally perpetuating structural imbalances. This holds true for the Chinese bargaining process between central authorities, local governments and party organizations, in which Beijing was forced to give local decision-makers and their often wasteful pet projects considerable leeway in order to ensure a swift launch of the stimulus program. In Russia, the preferential treatment and massive support given to large, "systemically relevant" state-owned enterprises has only served to fortify structural flaws. Both responses are indicative of an insufficient level of resource efficiency, which is addressed thoroughly in the BTI reports and manifest in the low scores given to each country in this area.

Chile, Hungary, Indonesia and South Korea were also driven by their need to stabilize rapidly the banking and financial sector. While the shock of the financial crisis hit Hungary almost immediately, forcing the government to rely heavily on international support for stabilization, the governments of Chile, Indonesia and South Korea skillfully coordinated their policy responses with their central banks. Having learned their lessons from the financial crises from 1997 to 1999, these governments—much like the Russian government—were alert to the need for coherent action. This ability to implement improved policy responses derived from past experiences is also reflected in the above-average scores given to these three countries for policy learning in the BTI 2010. Even in South Korea, where, according to the BTI country report, highly partisan and even adversarial politics make any deviation from party orthodoxy "the equivalent of defeat," the government's management of the crisis served to unify a broad variety of interests. As the report in this volume states, "the almost ritualistic opposition by minority parties and the trade unions was less severe than in previous cases probably because anxiety over the financial crisis was so great that there was some sense of the need for national unity."

To be sure, the credibility of decision-makers and the quality of their management performance was on the line in all countries everywhere. Each government relied on its individual strengths in terms of governance style or architecture, be it the pragmatic moderation and personal leadership skills of powerful presidents like Lula in Brazil or Susilo Bambang Yudhoyono in Indonesia, the strong, top-down management style observed in Chile, South Korea and Turkey, the more corporatist and "inclusive" decision-making approach seen in India and South Africa, or the highly centralized administrative apparatus like that present in China. These distinct approaches can be identi-

fied in the “radars” above, which illustrate each country’s management performance as measured by the BTI 2010. Technocratic-style governance, such as that found in South Korea and especially Turkey, scored high on “prioritization” and “coordination,” producing an oval shape. Inclusive governance, such as that observed in Brazil, Hungary and India, fared better in “civil society participation” and “policy learning,” producing a fuller, broader shape. When comparing top-down management styles with more inclusive ones, we see that the swiftness in launching stimulus packages observed in the former is primarily attributable to technocratic approaches (Chile, South Korea). However, consensus seems to be broader and perhaps more sustainable in countries with corporatist approaches or in which the president has strong moderating powers, such as Brazil, India and Indonesia.

The role played by South Africa’s civil society in the government’s response to the crisis underscores a major difference between the BTI and the crisis management study in terms of focus. The crisis management report points to the inclusive multi-stakeholder structures that underpinned the drafting of South Africa’s Economic Crisis Response Framework, lauding the government’s consultative approach for its long-term sustainable effects. The BTI report, which focuses on the depth and reach of civil society in a country, is critical of the fact that NGOs organized outside the ANC can play only a marginal role. Indeed, the two reports describe two sides of the same coin. Whereas the “broad church” character of the ANC as the dominant political power accounts for the fact that many independent social movements “are largely ignored by the government and perceived as a threat to government policy” (BTI 2010), there is nonetheless an institutionalized framework of participation in place for the broad majority of intermediary organizations (crisis report). The government could therefore draw upon an established deliberation process to ensure that social dialogue accompanies the development of economic policies. In contrast to countries with less institutionalized mechanisms of participation and which introduced strict, top-down management when changing their gears into crisis mode, the South African government was ready and able to include major social partners in crafting its crisis response because it could rely on proven mechanisms already in place.

The case of Chile illustrates the importance of engaging civil society in successful political management, especially in terms of cultivating sustainable support for policies. As one of the top performers in the BTI for many years and being currently ranked second for governance, the Chilean government also excels with regard to crisis management. In a demonstration of effective coordination, the government worked closely with the central bank to quickly draft and implement highly successful stabilization and stimulus measures based on lessons learned from the Asian crisis of 1997–1999. In overcoming the crisis, the government benefited from the country’s solid macroeconomic fundamentals, which were already in place, and a sound domestic financial market. In addition, the government could pursue an expansionist fiscal policy in 2009 because state revenues from high copper prices in previous years had been invested as a strategic reserve in two sovereign funds. Unsurprisingly, as the crisis report notes, President Michelle Bachelet and her finance minister enjoyed record-high levels of popularity in 2009. While an outstanding performance should arguably be expected from such a model form of management, it is all the more surprising that Bachelet’s party—which had successfully weathered the storm—lost the presidential election in January 2010. On this point, both the BTI and crisis reports refer to growing popular disenchantment—not with outgoing President Bachelet, but with the center-left coalition that had been ruling Chile for the last 20 years. There has been a growing sense among the population that the center-left coalition had grown complacent over the years, neglecting to engage in dialogue and consultation. The BTI report points to a widening gap between citizens and politicians, emphasizing that the government lacks an institutional framework that would allow for real popular participation while, at the same time, Chilean civil society lacks the capacity to intervene in politics.

Although the styles of governance observed in the individual crisis responses have varied, the policy contents in each have not differed widely. All governments in the sample identified the need to stabilize domestic demand and prevent a sharp contraction in the export sector as main goals. Some governments focused more on the social side of the equation by expanding already existing social programs (India) or public works (Brazil) or by supporting poor households with cash transfers and subsidies (Chile, Indonesia). Others placed special emphasis on supporting the private sector with tax cuts, which included targeted

support for small and medium-sized enterprises (Turkey) or large state-owned companies (Russia), or they invested heavily in infrastructure projects (China, South Korea). In most cases, however, governments did not pursue astute long-term goals by restructuring the economy or using the crisis as an opportunity for strategic investment. This fact points to a salient difference between short-term crisis management and longer-term development strategies, as several of the countries examined in this study scored high in the BTI 2010 in terms of implementing their political priorities in a sustainable and far-sighted manner. While Brazil, Chile and South Korea received the highest score (10) with regard to the use of external support for a comprehensive development strategy, Hungary, Turkey and South Africa were also accorded high scores in this category (9, 9, 9, respectively). This corresponds with the scores given for the setting and maintaining of strategic priorities, with Chile again scoring best (10), followed by Brazil, Hungary, South Korea and Turkey (9 each).

South Korea represents the only potential exception to this issue of "short-termism" in times of crisis versus the pursuit of long-term sustainable development under "normal" conditions. In its response to the crisis, the South Korean government invested four-fifths of its stimulus package into a "Green New Deal" in order to improve energy conservation, mass transit and railroads, and to facilitate river restoration. This performance is in line with that described in the BTI report, which gives South Korea the highest scores in sustainability (i.e., environmental concerns, education policy and R&D) of all countries included in the crisis management study. In fact, among all 128 countries included in the BTI, South Korea ranks (together with Slovenia and Taiwan) second only to Singapore with regard to sustainable development and is among the top 15 countries concerning environmental policy.

In other countries explored in this sample, structural imbalances not only persisted, but were even reinforced by short-term policies. This became especially apparent in China, where powerful local governments were successful in "the stabilization of their income revenues by protecting the local industries, even if these industries rely on energy-inefficient, polluting production" (crisis report China). Even though some far-sighted investments (health care, R&D) were also part of the massive Chinese stimulus package, three-quarters of it were earmarked for construction (post-earthquake re-building, infrastructure, housing). Short-term thinking also dominated the Russian approach, where "crisis management as a whole was poorly related to such strategic goals as diversification of the economy, improvement of long-run competitiveness or technological modernization," leading to "the redistribution of resources in favor of traditional sectors, the preservation of an obsolete technological infrastructure and a distortion in regulations, and threatens to impede the recovery of high economic growth" (crisis report Russia). It must be noted, however, that the first learning effects became apparent in May 2009, when the Russian government decided that enterprises crucial to the system would continue to receive support only if they followed stricter performance, energy-efficiency and transparency guidelines.

In the BTI 2010 results, we find that implementation weaknesses correspond with inefficiency and corruption. In the country "radars" above, we see comparable shapes for India, Indonesia and, to a lesser extent, South Africa. These deficiencies in political management are also reflected in their respective policy response to the crisis. The crisis report on Indonesia states that "disbursements of funds for infrastructure projects experienced massive time lags. By September 2009, only 14.2 percent of the funds earmarked had been spent. This can be attributed to delays in the tendering mechanism and a lack of general preparedness on the part of public servants, particularly at the local level." India experienced similar problems. Indeed, according to the crisis report on India, "some estimates claim that no more than 10 percent of public expenditure reaches target beneficiaries. While leakage accounts for some of this loss, there are also very high administrative costs to consider. This arduous transmission mechanism also means that there are significant time lags in delivery." Corruption is common, as "there is a dearth of accountability mechanisms in administrative structures, and no apparent linkages can be established between expenditure and tangible improvements in outcomes."

Widespread corruption hindered the implementation of anti-crisis measures in several countries. In China, where investments in the stock and property markets yield much higher and faster returns, the massive misuse of funds effectively siphoned support from designated aims. The Russian government deliberately tried to avoid these problems by emphasizing social stability over tradi-

tionally corruption-prone infrastructure projects. In Indonesia, Finance Minister Sri Mulyani Indrawati defied classical patterns of patronage by refusing to bail out the Bakrie family conglomerate. Nonetheless, as the country report notes, the frequent misuse of funds is likely to be continued at the local level of administration.

Whereas BTI 2010 results regarding the quality of governance generally correspond to the findings of the crisis management study, we nonetheless see the top BTI Management Index performers pursuing more top-down, short-term approaches than expected. This suggests that crisis situations are not conducive to innovative thinking and institutional learning within governments. Quite to the contrary, perceived threats and time pressure are more likely to trigger atavistic behavior on the part of the leadership, which is reflected in tendencies to rely on authoritarian procedural modes (command economy), outdated industries (wasteful "systemic" companies) and quick fixes. That said, many examples in our country reports show—and this is one of the most encouraging signs—that policy learning had taken place as a result of previous crises. The lessons learned meant that many of the countries examined here—in contrast to several advanced economies—had already implemented reforms to establish a better-regulated financial sector, stronger fiscal discipline and sounder macroeconomic fundamentals by the time the 2008 crisis unfolded. The Asian crisis, in particular, apparently provided valuable lessons regarding regulation of the financial sector, monetary policy and cooperation between the executive and the central bank. Future BTI editions will show whether the current crisis provides for a comparable learning curve or not.

Managing the Crisis: An SGI Perspective

Andrea Kuhn

In assessing industrialized countries' management of the ongoing financial and economic crisis, the sister-index of the Transformation Index (BTI) provides invaluable historical and comparative insights. Published for the first time in the spring of 2009, the Sustainable Governance Indicators (SGI) project (www.sgi-network.org/) analyzes and compares the need for reform in OECD member countries, as well as their ability to respond effectively to current social, political and economic challenges, by drawing on a vast array of qualitative and quantitative data. Gunter Thielen, chairman of the Executive Board of the Bertelsmann Stiftung, has succinctly framed the project's design: "The crucial question is: To what extent are OECD governments capable of identifying and implementing reforms in order to ensure sustainable policy outcomes? And can we measure a country's political reform capacity?"

Although the survey period of the SGI 2009 concluded before the onset of the global crisis, the lessons drawn nevertheless illuminate industrialized countries' subsequent crisis-management efforts. Well-managed governments open to cooperation and expert advice proved relatively skillful at navigating the crisis, while institutional weaknesses already evident in boom times returned to haunt administrations when under pressure.

The SGI project is divided into two overarching sections. The first of these, the Status Index, is based on the conviction that the quality of a nation's democracy is a key factor in securing a high level of political, economic and social performance over the long term. The index thus analyzes the need for reform in terms of two fundamental dimensions: The first gauges the state of democracy according to criteria including "electoral process," "access to information," "civil rights" and "rule of law." The second dimension measures political, economic and social performance by looking at a range of quantitative socioeconomic data along with 13 specific policy areas grouped under the categories of "economy and employment," "social affairs," "security" and "sustainability."

The SGI's Management Index, the project's second top-level section, analyzes national capacities for reform according to the two dimensions of executive capacity and executive accountability. The former looks at governmental abilities to plan and implement strategies, assessing performance in four central categories. Of these, "steering capability" examines the degree to which governments rely on sustainable, long-term and knowledge-based planning in the formulation, implementation and communication of their policies. "Resource efficiency" assesses whether governments are effectively and efficiently able to translate programs into implemented policy. A third category, "international cooperation," looks at governments' readiness to cooperate with other states while adapting to new developments at home—this under the assumption that many reforms, from trade to environmental policy, are more effective if they incorporate international influences and are aligned with other states' actions. Finally, "institutional learning" assesses governments' abilities to cope with a permanently shifting environment. Governments with institutionalized structures and procedures of self-monitoring are demonstrably better able to adapt their policy strategies to new political circumstances and challenges.

Executive accountability, the Management Index's second dimension, examines the extent to which non-executive actors (e.g., parliament, political parties, associations and other civil society groups) inform, communicate with and monitor the government, thus deepening its knowledge base and enhancing its level of normative reflection.

The SGI 2009 sample set includes all 30 OECD member states, with an assessment period running from January 2005 to March 2007. Thus, the period under review does not include the shock of the financial and economic crisis and does not contain information about the various governments' reactions. Nevertheless, the report does highlight early indications of problematic financial and fiscal situations in a number of OECD member states that were evident even before the actual outbreak of the global crisis. Perhaps most relevant to the current study, the Management Index's rich assessments of executive capacities also expose institutional foundations that would prove vital as policymakers attempted to react to and manage the crisis. Specific aspects of the steering-capability and resource-efficiency categories played a particularly significant role.

In order to gain the clearest possible picture of behavior, the SGI breaks each of these categories into individual components. Steering capability's individual variables, for example, include strategic capacity, interministerial coordination, regulatory impact assessment, societal consultation and communication. Resource efficiency includes

Figure 1: Categories and criteria within executive capacity

Dimension	Category	Criteria and Indicators
Executive Capacity	Steering capability	Strategic capacity Interministerial coordination Regulatory impact assessments Societal consultation Policy communication
	Resource efficiency	Legislative efficiency Anticipation of veto players Effective implementation
	International cooperation	Domestic adaptability External adaptability
	Institutional learning	Organizational reform capacity

Source: Jann, Werner, and Markus Seyfried. "Does Executive Governance Matter? Executives and Policy Performance." In *Sustainable Governance Indicators 2009. Policy Performance and Executive Capacity in the OECD,* edited by Bertelsmann Stiftung. Gütersloh: Verlag Bertelsmann Stiftung, 2009. 168.

legislative efficiency, the anticipation of veto players and effective policy implementation.

The SGI 2009 found four of these aspects—societal consultation, capacity for strategic planning, policy implementation and interministerial coordination—to be particularly essential to good policy performance in general. It is logical to assume that these would also be relevant to successful management of the crisis. Societal consultation has a clearly positive impact on policy performance. By generating broad societal support while formulating and preparing policies, governments can significantly improve policy outcomes. However, the character of this behavior matters. States that consult societal actors (e.g., trade unions, employers' associations, churches or environmental interest organizations) only superficially or infrequently earn markedly lower performance scores in the SGI evaluations. The most successful countries by this measure, at least in the 2009 rankings, were Finland and Switzerland.

Strategic planning capacity also played a visible role in policy outcomes. The most successful SGI 2009 countries in terms of policy performance all possessed institutionalized scientific advisory boards or special planning units that relied on external academic experts for knowledge and data. Key factors in the project's evaluation was whether these bodies existed at anything more than a formal level, whether the core executive was actually open to external advice and whether experts were de facto able to influence governmental strategic-planning processes. Norway, Sweden, the Netherlands and Canada showed planning units and expert consultation processes that proved to be particularly successful in the phase of policy preparation and formulation.

Governments' ability to create effective procedures for policy implementation typically translated into a higher general performance level. Crucial elements of this task, as found by the SGI, included the ability to ensure ministerial compliance with government policy and the effective delegation of tasks from the core executive to all subordinate levels of administration. Australia, Canada, Sweden and the United States all showed themselves to be successful by this measure.

Finally, the organization of interministerial coordination plays an important role in political management processes. The rationale behind this series of SGI questions was to examine whether governments have institutionalized mechanisms allowing for early-stage and well-structured coordination between ministries, thereby ensuring that the cabinet itself can focus on strategic policy debates. Governments in France, Denmark, Finland, the Netherlands and Canada have institutionalized such procedures quite successfully.

Since not all 30 SGI countries could be included in the comparative study on crisis management, the project team decided to consider four countries of three different system types. While the United States and the United Kingdom represent capitalist, liberal welfare-state systems, Sweden offers a look at a social-democratic state and Germany at a conservative welfare state. The latter two countries also represent the coordinated market economy type.

Placing fourth in the SGI 2009's Management Index rankings, Sweden's management performance was comparatively good. This stemmed from the country's robust

levels of legislative oversight, well-informed public and the government's informative exchanges with interest groups, all of which facilitate a participatory political culture. Expert-advised strategic planning is a foundation of Swedish policy-making, and decisions are made collectively by the cabinet. The prime minister's office serves a coordinating role, particularly in coalition governments, and guarantees the efficient and effective implementation of public policies.

By contrast, centralized strategic planning is difficult in Germany, as it is hampered by coalition governments, ministerial autonomy and the federal-state divide. Though consultation does take place, links between social groups and political parties have weakened in recent years, and the Federal Chancellery is not well-equipped to monitor line ministries, thereby making it difficult to ensure effective ministerial coordination.

In the United Kingdom, effective strategic planning and communication has bolstered the leadership's steering capability, particularly as Prime Minister Tony Blair's administration centralized strategic, expert-advised planning capabilities. The Blair government put a high value on cohesive communication. However, though interest groups have taken a larger role in policy development, formal consultation channels are few. This SGI finding was mirrored in the country's crisis management efforts, in which interest groups again played a minor role.

In the United States, overall management performance is rated near the OECD average. On the one hand, policy-assessment processes are well-developed, and policy communication coherent. On the other, the country resists adaptation to international norms, a behavior that translated into a reluctance to cooperate and coordinate with other nations during the economic crisis. Strategic planning plays an important role in U.S. government decision-making, and the White House plays an active and powerful role in coordinating government activities. Additionally, consultation with societal groups is frequent, though informal.

In comparing the SGI 2009 results with the findings of the "Managing the Crisis" study, it is evident that the countries surveyed have generally maintained their accustomed modes of behavior. This has its pros and cons. On the one hand, existing institutional settings and processes did not prevent governments from mounting swift and generally well-prepared responses to the crisis. On the other hand, few sought solutions off the beaten track. It remains an open question as to how these countries will cope not only with the challenge of extremely high budget deficits, but also with a financially insecure environment for the foreseeable future. Aside from Sweden, which re-established long-term stability after a severe economic crisis in the 1990s, the countries under review here all have had difficulties achieving budget stability, largely due to structural issues. As all face serious pressure as a result of aging populations, the additional public debt taken on during the crisis will further decrease these countries' future viability.

Proposals for global regulation of the banking and financial sector were also influenced by national behaviors evident before the outbreak of the crisis. The SGI 2009 project found countries reluctant to constrain their national sovereignty through international agreements. Nonetheless, in the present circumstances, countries would be well-advised to find common solutions to prevent another financial-sector crisis.

The second edition of the Sustainable Governance Indicators project will be published in January 2011. Surveying the period from May 2008 to April 2010, it will encompass the whole of the current stage of the economic crisis and provide additional insight into the short- and long-term consequences of government action.

Criteria for Country Assessments

1. Risk Exposure at the Outset of the Crisis	
1.1 Economic structure and macroeconomy	• What was the structure of demand (e.g., share of private/state consumption, gross capital formation, exports and imports in GDP/GNI)? • To what extent was the economy exposed to macroeconomic imbalances (e.g., foreign debt, trade or fiscal imbalances)? • Was/is the financial system primarily bank- or market-based?
1.2 Policy priorities prior to crisis	• What was the government's economic record (e.g., growth, unemployment rate, inflation and fiscal position) prior to the crisis? • What was on the economic agenda prior to September 2008 (e.g., anti-inflation, efficiency-oriented, redistributive, supply vs. demand-side policies)?
1.3 Executive, fiscal & monetary capacities to respond to downturn	• How stable was the executive branch in the years/months prior to September 2008 (e.g., credibility/legitimacy of leaders/parties in government, cabinet stability/reshuffles, parliamentary/electoral support)? • How much room did fiscal conditions provide for a major stimulus (e.g., budget surpluses/deficits, conditions for issuing additional treasury bonds)? • How much room was there for monetary policy initiatives (e.g., pre-crisis level of interest rates, required reserve ratios, flexibility of foreign exchange rate regime)?
1.4 Exposure to specific market and trade risks	• To what extent has the country been exposed to global financial market risks, particularly contagious/toxic financial instruments (e.g., open capital account, floating or pegged/fixed currency)? • How important was/is the financial sector for the national economy? What was/is the extent of interdependence between the financial sector and real economy? • To what extent was the economy integrated into regional/global trade flows? How dependent was the economy on foreign demand for manufactures and commodities? • Did property, equity or other markets display excessive growth and a bubble-like situation prior to September 2008? • In what condition was the banking sector (e.g., size/structure of banking sector, non-performing loans, capital adequacy ratios of major banks, if available)?
1.5 Structural or policy advantages and disadvantages	• Did policymakers/executive agencies have any experience in handling financial crises? Did this experience play a role in the 2008–2009 policy response? • Were there independent regulatory institutions or prevention/response schemes in place to contain financial risks? • Were there internal veto players (e.g., federalist powers, courts) or international obligations that thwarted swift action on the part of the government? • Have executive powers been extended in times of crisis? Has this been based on formal or informal mechanisms?
1.6 Initial impact of economic downturn	• How strongly has the national economy been hit during the period under review? Where has it been hit most severely thus far (e.g., growth rate, production, trade, employment)?
2. Agenda-Setting and Policy Formulation	
2.1 Agility and credibility	• When did state organs (e.g., government, central bank) begin setting a crisis response agenda? How long did it take to adopt the first crisis measures? • Who were the driving forces (e.g., government, central bank, foreign actors, media, trade unions, employers' associations) in getting stabilization/stimulus policies started? • Were these measures launched as executive orders or parliamentary laws? How closely did constitutional bodies (e.g., executive, legislative, central bank) cooperate? • What kind of role did sectoral or regional lobbies play in policy formulation?
2.2 Consultation with external experts and openness to international collaboration	• Did policymakers actively consult domestic and/or foreign experts outside of government? • Did the government actively seek collaboration with other governments or international organizations? • Did the government participate in multilaterally coordinated rescue efforts? • Was the government curtailed in its response through IMF support programs?
3. Policy Content	
3.1 Scope of stabilization and stimulus policies	• How large is the stimulus package as expressed as a percentage of GDP (including compensations to those hit particularly hard by the crisis through social/labor policies)? • The stimulus is spread over a period of how many years?
3.2 Targeting and coverage of policy tools	• How is stimulus spending distributed across sectors? How and to what extent is the financial sector supported (e.g., through loans, guarantees, capital injections)? • Which industrial and structural policies (e.g. corporate tax cuts, subsidies, company bail-outs) can be observed? • What kinds of measures target the expansion of public spending on infrastructure? Which ones are designed to sustain business and consumer spending? • Are policies in support of businesses adequately targeted and delineated (e.g., at creating employment, supporting competitive firms)?

3.3 Development as an objective of stimulus policies	• Are stimulus measures influenced/limited by pre-crisis development strategies (e.g., industrial policies) or have novel/additional (e.g., environmental) policy objectives been inserted? • Is the response to the crisis grounded in a broader developmental perspective (i.e., crisis as development opportunity) or predominantly short-term political constituency logic? • Do stimulus policies address prevailing structural deficits and future growth potential?
3.4 National bias and protectionism	• Has the stimulus included "buy national" clauses? Have import-restricting mechanisms been newly established or re-established? • Has the country's executive/central bank manipulated the exchange rate or intervened in the foreign exchange market (if so, in which direction)? • Have there been measures to prop up export industries (e.g., tax rebates, direct export subsidies)?
3.5 Social protection	• Which labor market policies have been enacted (e.g., unemployment benefits, rise in public-sector employment)? • Which social policies have been included (e.g., expansion of support, additional investment in health and education system)? • Which measures have been taken to support purchasing power (e.g., consumer checks, tax cuts, cash transfers)?
4. Implementation	
4.1 Political communication	• Does the government actively communicate and justify the rationale/goals of its stimulus policies to the public? • Over time, how has the public responded to the government's management of the crisis (e.g., consumption/investment trends, public opinion polls)?
4.2 Modes and time frame of implementation	• How large has the time lag been between adoption and implementation of selected major stimulus components? • What are the reasons for delay in implementation (e.g., legal barriers, insufficient capacities, corruption)? • Have sectoral or regional interest groups influenced the workings of policy implementation in any way?
4.3 International or regional cooperation	• Beyond emergency stand-by programs with the IMF, has the government collaborated with other governments or international organizations in implementing its response to the crisis?
5. Funding, Tax and Monetary Policies	
5.1 Tax policies in support of stimulus/stabiliza-tion	• Has the government initiated tax reductions/incentive schemes? • Have these been aimed at the private and/or the corporate, domestic and/or the foreign sectors?
5.2 Monetary and currency policies in support of stimulus/ stabilization	• What kind of policies did the central bank contribute to the national crisis response? Which unconventional measures were used to fight the crisis? • If an independent national monetary policy is not feasible, were there substituting measures in the country's exchange rate policy?
5.3 Credibility of funding mechanisms	• Relative to conditions at the outset of the crisis, does stimulus funding have a solid foundation in monetary policy or in bond/credit markets? • Is the program part of the normal budget/integrated into the budgetary cycle, or is it financed primarily from sources outside of the formal budget? • Is there cross-level burden-sharing between center and regions (e.g., debt issuance, fund transfers)? • Is financial aid given to banks/companies/households in a discretionary way or based on well-defined formulas (e.g., conditionalities)? • Did the government make credible commitments to terminate its expansionary fiscal and monetary policies under (what kind of) post-crisis conditions?
6. Feedback and Lesson-Drawing	
6.1 Policy feedback and adaptation	• Have there been revisions or additions to the original policy packages or a sequence of distinct stimulus policies in response to unexpected new developments?
6.2 Institutional restructuring	• Has major institutional reorganization/capacity-building been undertaken in financial supervision? • Do we find new institutions that were not in place prior to the crisis (e.g., bad banks)?
7. Tentative Economic Impact	
7.1 Economic and political effectiveness of the crisis response	• What do major economic performance indicators tell us about the short-term effectiveness of the crisis response (e.g., growth rate, unemployment rate, industrial output, private consumption, consumer/producer confidence, inflation, exports, bank balance sheets, credit squeezes)? • How has the political logic of crisis management (i.e., crisis as an opportunity to broaden political support) worked out for the major decision-makers so far? How has the reputation of major government leaders at the center of the crisis response evolved (e.g., based on polls, election results, backing within their political party)?
7.2 Structural distortions	• Is there early evidence that the structure of the economy will change (e.g, greater role of the state, changes in sectoral shares in GDP)? • Could old structural imbalances be aggravated? Can we already identify new structural imbalances? Have previously existing imbalances been tackled?

Authors

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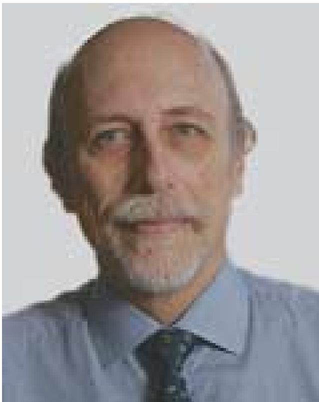

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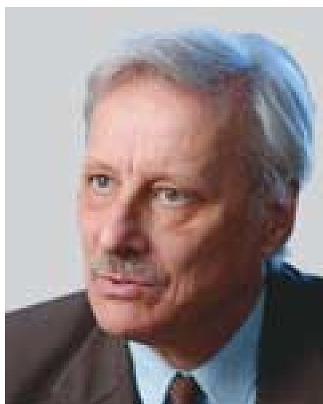

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