The impact of the global financial crisis: What does this tell us about state capacity and political incentives to respond to shocks and manage risks?

Literature review

Part 1: The effects of the global financial crisis on developing countries

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Developing countries were severely hit by the global financial crisis, which originated in developing countries in late 2007. Economic growth in emerging and developing economies dropped dramatically from 13.8% in 2007 to 6.1% in 2008, and it fell to 2.1% in 2009 (IMF, 2009a, and 2010). Some regions saw strong economic growth transformed into negative growth in 2009 (e.g. Central and Eastern Europe, and the Commonwealth Independent States), while others experienced significant slowdowns (e.g. sub-Saharan Africa and the Middle East). Looking at the country level, the recent country case studies coordinated by the Overseas Development Institute (ODI) point out to a general growth slowdown in all the analyzed developing countries throughout 2008 and 2009 (Te Velde et al., 2009a; 2010). Thanks to unprecedented public action at the national and international level, a slow recovery is expected in the next two years: growth in emerging and developing countries is projected to rise to 6% in 2010 and to accelerate further to 6.3% in 2011 (IMF, 2010). Nevertheless, these values are significantly below pre-crisis levels and there are still concerns regarding a double-dip recession.

There are four main financial and real channels through which the global financial crisis spread to developing countries: private capital flows, remittances, trade and aid (see, among others, Te Velde et al., 2008).

1.1.1 Private capital flows

The position for private capital flows to developing countries has deteriorated significantly due to the GFC. According to the World Bank (2009a), private capital inflows to developing countries dropped dramatically, to $707 billion in 2008 from their historical high of $1.2 trillion in 2007, and a further decline to just $363 billion is expected in 2009. The decline was particularly severe in the last two quarters of 2008 and early 2009.

Looking at private capital flows, there is a need for disaggregation. Portfolio investment flows to several developing countries (e.g. Indonesia, Uganda, Zambia, Bolivia) experienced a dramatic drop in late 2008 and over the first half of 2009, shifting sometimes to large net outflows (Bangladesh, Kenya) – (see Te Velde et al., 2009a, and 2010). Portfolio equity flows declined (e.g. in Nigeria, Zambia, India, Brazil) or even reversed (e.g. Philippines, Bangladesh, Kenya) alongside the sharp fall in equity prices (IDS, 2008; Te Velde et al., 2009a); and many bonds issuance plans were put on hold (e.g. in Ghana, Kenya, Tanzania, and Uganda - see Massa and Brambila, 2009). In some developing countries, portfolio investment flows have started to recover slightly since the second quarter of 2009, thanks to the improvement of global financial conditions. Anecdotal evidence shows that this recovery occurred, for example, in Bangladesh, Kenya, Zambia and Tanzania (Te Velde et al., 2010) as well as in several emerging economies especially in the Emerging Asian region (IIF, 2010).

Foreign direct investment (FDI) to developing countries continued to grow in 2008 –though at a much slower rate (7.2%) than in 2007 (20%). But it is expected to fall for the first time in a decade by 35% in 2009 (UNCTAD, 2009; 2010). In Africa, FDI inflows dropped by about 36% in 2009 compared to 2008 (UNCTAD, 2010), but the impact varied significantly across countries. The Democratic Republic of the Congo (DRC), Uganda, Ethiopia and Sudan experienced significant FDI drop in 2009, while in Kenya, Mozambique, Tanzania and Zambia FDI inflows continued to increase despite the global financial and economic crises (Te Velde et al., 2010). In Asia, FDI flows declined by 32% between 2008 and 2009 (UNCTAD, 2010) with Cambodia, for example, expecting FDI inflows to fall by 50% in 2009 (Te Velde et al., 2010). Latin America and the Caribbean appeared to be the hardest hit region experiencing a 41% decline in FDI flows. In Bolivia, for example, there is evidence that FDI flows reduced sharply in the first two quarters of 2009 (Te Velde et al., 2010).

With respect to international bank lending to developing countries, there is evidence of a significant decline since the last quarter of 2008, which is expected to continue over 2009 (World Bank, 2009a). The World Bank (2009a) reports that total foreign claims on developing countries held by banks reporting to the Bank for International Settlements (BIS) dropped by $500 billion in the second half of 2008, and the IIF (2009) highlights that cross-border bank lending to emerging market economies is likely to retrench in 2009/10. The country case studies coordinated by the ODI suggest that countries characterized by a high degree of foreign-owned banks (e.g. Kenya and Uganda) are likely to be more exposed than others to a drop in international bank lending (Te Velde et al., 2009a; 2010).

1.1.2 Remittances

One potentially important transmission mechanism of the crisis is represented by remittances. The decline in remittances has been much smaller than that for other private flows to developing countries, but it is significant. After a period of remarkable growth in 2007 and most of 2008, remittances slowed down from the last quarter of 2008 and this trend continued into the first three quarters of 2009. According to the latest data released by the World Bank (2009b), remittance flows to developing countries declined by 6.1% to $317 billion in 2009 from $338 billion in 2008.

Countries in Latin America and the Caribbean, Middle East, North Africa, Central Asia and Eastern Europe were strongly affected (World Bank, 2009b). In Mexico, for example, remittance flows declined by more than 13% in the first three quarters of 2009 on a year-on-year basis, and in Egypt they fell by 20% in the first half of the same year (World Bank, 2009b). Nevertheless, in 2009, remittance flows to some countries in South Asia, East Asia and the Pacific, and sub-Saharan Africa experienced the first signs of recovery (World Bank, 2009b). This evidence is in line with what reported by the 11 country case studies recently conducted by the ODI, (Te Velde et al. 2010), indeed, arguably the slowdown in remittance flows appeared to have mildly faded away in some of the sub-Saharan African and South Asian countries analysed by the second quarter of 2009. Remittance inflows to Uganda went up in the first quarter of 2009, in Kenya they have experienced an upward trend since February 2009, and substantial increases in remittances were also experienced by Zambia and Bangladesh (Te Velde et al., 2010).

The outlook for 2010-2011 is more encouraging. The World Bank (2009b) expects remittance flows to developing countries to increase by 1.4% in 2010 and by 3.9% in 2011, but three factors are still likely to put remittances at risk: a jobless global economic recovery, tighter immigration controls[1], and unpredictable exchange rate movements.

The patterns of remittances are underpinned by changing migration flows. The IOM (2009) identifies three main factors that affected migrants and migration over the crisis:

- *Restrictions on new admissions of migrant workers and non-renewal of work permits*: some countries stopped issuing visas for migrant workers (e.g. Korea, Malaysia, Thailand, and Kazakhstan); while others adopted more restrictive immigration policies (e.g. Australia, Italy, and UK).
- *Employment, working and living conditions*: job losses, reductions in wages or their non payment continued to occur (e.g. in Malaysia, and Singapore); newly arrived migrants or specific categories of migrants were not eligible for many social benefits; discrimination and xenophobia against migrants spread out (e.g. in the UK).
- *Return and reintegration*: a number of unemployed migrants returned to their countries of origin (e.g. migrants from the Gulf States to India or from Malaysia to Indonesia); rural-urban migration reversed in some countries (e.g. in China); some countries introduced financial incentives to encourage unemployed migrants to come back home (e.g. Czech Republic and Spain).
- *Irregular migration*: given the scarce job opportunities available for migrants in the destination countries, the flow of irregular migrants declined (e.g. in the United States).

1.1.3 Trade

The global financial crisis led to a lower demand for goods and services, the drying up of credit availability and rising protectionism. The combined effect of these three factors significantly affected trade prices and volumes in developing economies, especially in those countries with a high degree of trade openness and exports concentration, and highly dependent on crisis-hit markets.

Prices of many commodities declined dramatically from mid-2008. Copper, for example, lost almost 50% from 2008 to March 2009, negatively affecting countries such as Zambia (Te Velde et al, 2009a). Oil prices were down, affecting exports in oil-exporting countries such as Sudan, while the fall in diamonds and aluminium prices had a significant impact on countries such as Tanzania and Mozambique respectively (Te Velde et al., 2010). Prices for coffee, flowers and cotton declined as well and this contributed to the drop in the exports value of economies such as Uganda, Ethiopia and Kenya (Te Velde et al, 2009a, 2010). Te Velde et al. (2010) report that in Uganda coffee prices dropped by 20% in the third quarter of 2008/09 compared to the same period in 2007/08, while the prices of Ethiopian flowers imported by the Netherlands slumped by between 15-30% since last December. On November 2009, many commodity prices were up again compared to those of November 2008, but they were still below their pre-crisis levels.

On the other hand, lower demand for goods and services also led to export declines in countries such as Cambodia, where garment export values dropped from a monthly average of $250 million in 2008 to $100 million in January 2009 (Te Velde et al., 2009), and Kenya, where tourist arrivals declined by almost 34% in 2008 compared to 2007 (Te Velde et al., 2010). According to the latest data released by the IMF (2010), growth in emerging and developing economies'

[1] Te Velde et al. (2010) report that: 12,000 Bangladeshi workers were retrenched in Malaysia and 20,000 in Sudan; the Maldives halted hiring Bangladeshi workers; Thailand and Malaysia officially closed their doors to new inflows of Cambodian migrant workers.

exports volume, which had already slumped by more than a half between 2007 and 2008, fell to almost -12% in 2009.

1.1.4 Aid

So far, there is little to no evidence of an aid pullout from developing countries. According to Te Velde et al. (2009a), within a sample of 10 developing countries, only Uganda and Bangladesh reported a decline in aid in 2008, but it is not clear whether this should be mainly associated to the global financial crisis. IDS (2008) suggests that some private foundations scaled down their budget allocations especially in African countries.

A number of factors should be taken into account when assessing the likely effects of the crisis on developing countries through the aid channel. First, a persistent significant crisis in developed countries may lead to a contraction in official development assistance (ODA) - empirical evidence shows that aid is pro-cyclical with both donor and recipient incomes – and some countries have already cut their aid spending (e.g. Italy by 56% and Ireland by 24% - see Te Velde and Massa, 2009b). Second, due to the crisis some developed countries are changing the allocation of aid within and across developing economies. For example, the Netherlands implemented higher cuts of 25% in countries that are better off such as Vietnam and Indonesia, and plans to cut the budget by 12% for Tanzania, Zambia and Mali, while aid for fragile states such as Afghanistan and Burundi was not cut (Te Velde and Massa, 2009b). Finally, developing countries that are more aid dependent (e.g. Benin, Ghana and Cambodia) are likely to be more exposed than others (e.g. Kenya and Nigeria) to a contraction in aid (Te Velde et al., 2009a).

The implications of the crisis on poverty, employment and political stability are worrying.

1.1.5 Poverty reduction

The World Bank (2009) estimates that as a result of the crisis 89 million people will be living in extreme poverty (below $1.25 a day) by the end of 2010; in sub-Saharan Africa only, the number of infant deaths is expected to increase by 30 to 50 thousand (Friedman and Schandy, 2009).

Some of the factors that could contribute to impact on poverty in developing countries are the decline in workers' remittances and the collapse in global demand. The former could have significant implications on poverty in Latin America and the Caribbean, and in particular in Guatemala, Honduras and Tajikistan (World Bank, 2009). The latter, instead, is associated to work hour reductions, layoffs and job losses in export-oriented industries in many LICs (World Bank, 2009).

Te Velde et al. (2009a) argue that because of the crisis the number of poor might increase by 300,000 people in Bangladesh; 110,000 in Cambodia; and 233,000 in Uganda.

1.1.6 Employment

The global number of unemployed people is expected to significantly increase due to the crisis. The ILO (2010) estimates that it increased by 34 million in 2009 compared to 2007.

Central and South-East Europe as well as Latin America and the Caribbean were among the regions experiencing the largest jumps in unemployment rates. The ODI country case studies report that in Cambodia more than 38,000 workers were laid off in the first eleven months of

2009 and in DRC around 20,000 jobs were lost in the mining sector in Katanga province only between December 2008 and April 2009 (Te Velde et al., 2010).

Women were often the first to suffer the crisis impacts especially in certain export sectors, such as the cut-flower industry in Uganda and Kenya, or the garment sector in Cambodia where they represented 85%, 70% and 90% respectively of the total sectoral workforce (World Bank, 2009; Te Velde et al., 2009a).

Despite the projected increase in economic growth in 2010, the employment prospects are expected to remain still critical in the current year (ILO, 2010).

1.1.7 Political stability

There are two main mechanisms through which the crisis may affect political stability within developing countries: (i) citizen discontent, and (ii) consolidation of power by governments (CRS, 2009a).

The former may spread, for example, through people losing their jobs, experiencing declining prices for their products or losing their wealth in financial assets, and may result in public oppositions, social unrests, increased violence and criminal activities. This happened, for example, in Latvia, Thailand, China, Haiti, Guadalupe, Mexico, Kenya and Zambia (CRS, 2009a; Clegg, 2009; Bakrania and Lucas, 2009), and is likely to continue to spread particularly in post-conflict or fragile states, for example in sub-Saharan Africa (CRS, 2009b).

The latter, instead, means that authoritarian governments may use the crisis to arise nationalist sentiments among the citizens in order to take actions and exercise more power and control that would not be possible in normal circumstances. This was deemed to be the case of Venezuela and Russia (CRS, 2009a).

2.1 Political and governance challenges in the crisis response

The developing world has been severely hit by the global financial crisis through the four transmission mechanisms described above. However, the ability to respond to the crisis shocks has been different across countries depending on their governance mechanisms in the political, social, and economic spheres.

This has been recognised in several papers in the recent literature on the global financial crisis. The World Bank (2009c) suggests that the ability of developing countries to cope with the poverty effects of the crisis depends, among the others, on their fiscal capacity and institutional capacity. The IMF (2009b) argues that large adverse effects of the global financial crisis are likely to be felt by "[…] countries with entrenched policy weaknesses". The IMF (2009c) also emphasizes that developing countries' "[…] ability to undertake countercyclical policies given the resources available to them as well as their institutional and administrative capability to rapidly expand and adapt existing programs" are critical to cope with the adverse effects of the crisis. The IPCIG (2009) highlights that developing countries with sound macroeconomic indicators such as a large amount of international reserves are better placed to weather the impact of the financial crisis. Stiglitz (2010) claims that not only the lack of resources but also the lack of policy space hampers the ability of developing countries to experience a quick, robust and sustained recovery.

In what follows we will describe some of the main policy responses adopted by national governments in the developing world to manage the crisis shocks, and then we will move to an analysis of the economic, governance and political constraints to state capacity as reported in the literature and by a number of local experts the ODI has interviewed through a recent online consultation (see Appendix 1).

2.1.1 State responsiveness to the crisis

The key actors in identifying and responding to the crisis in several developing countries were mainly the Central Bank and the Ministry of Finance, while politicians were often blamed for not making serious efforts to manage the crisis, and instead adopting 'wait and see' strategies. This was the case in Zambia, Kenya, Uganda and Pakistan as reported by the country case studies coordinated by the IDS (2008) and the more recent on-line consultation conducted by the ODI (Appendix 1).

There is evidence that in a few developing countries governments were initially slow to respond to the crisis. Indeed, in countries such as Sudan, Kenya, Ethiopia, Tanzania, Brazil and Pakistan, authorities initially tried to sell the idea that the economy was unaffected by the crisis, delaying the implementation of effective policy measures (Te Velde et al., 2010; IDS, 2008; see also Appendix 1).

Nevertheless, some countries adopted specific ***institutional arrangements*** to promote the co-ordination and communication among key institutions in responding to the crisis. Coordination mechanisms between government departments and Central Banks were introduced, for example, in Ethiopia, Kenya, DRC, and Sudan (Te Velde et al., 2010). Broader consultative mechanisms or processes were also planned in Zambia (Te Velde et al., 2010) or put in place in Tanzania, where a national conference among several stakeholders was organized in March 2009 to discuss the impacts of the global financial crisis and suggest mitigation measures (Appendix 1). There is also evidence that social dialogue occurred across South-East Asia, for example in Cambodia, Indonesia, Malaysia, the Philippines, and Bangladesh (ILO, 2009; IDS, 2008).

A number of developing economies (e.g. Kenya, Ghana, Bangladesh, and Nigeria) also established a ***crisis task force*** to find ways to counter the crisis. In some countries the task force seems to have been effective. In Bangladesh, for example, it suggested a number of measures to support ready-made garments entrepreneurs such as the enhancement of cash incentives by 2.5% for three export-oriented items experiencing a fall in exports (Appendix 1). Conversely, in countries such as Kenya, it is not clear what kinds of activities (if any) the task force put in place (Appendix 1).

Besides these institutional arrangements, national governments implemented a number of policy interventions that can be categorized into two main areas: fiscal policy and monetary policy.

(i) Fiscal Policy

Between 2008 and late 2009, 59 countries worldwide adopted fiscal stimulus packages worth some 4.3 percent of the global GDP, which is equal to approximately $2.6 trillion (UN, 2009). The composition of each package varied from country to country, but in general they focused on increases in public consumption, various infrastructure investments, tax cuts and subsidies. In the developing world, there was a clear tendency towards expenditure measures with a focus on investing in infrastructure.

Several Asian developing countries endowed with large foreign reserves and significant surpluses were in a good position to undertake fiscal loosening policies to counter the crisis. China implemented the biggest and most aggressive stimulus package worth about 12-13% of its GDP, followed closely by Malaysia (9% of GDP), Vietnam (8.3% of GDP), Singapore (8% of GDP), and South Korea (6.2% of GDP). On a lower scale, stimulus packages were also adopted in the Philippines (3.1% of GDP), Thailand (3.4% of GDP) and India (1.8 % of GDP) (see Chhibber et al., 2009). There is evidence that Bangladesh also implemented three stimulus packages (Te Velde et al., 2010).

A few African countries with enough fiscal space were able to implement fiscal expansive policies while deepening their deficits. In sub-Saharan Africa, for example, many local governments decided to put in place stimulus packages by means of increasing public investment expenditures and reducing taxes. Tanzania adopted the biggest fiscal stimulus package equal to 6.4% of its GDP, which was designed mainly to compensate exporters for losses due to the global financial crisis (TanzaniaInvest, 2009; see also Appendix 1). Then, South-Africa announced a stimulus package of 1.5 percent of GDP, followed by Kenya (0.9% of GDP) and Nigeria (0.7% of GDP) (UN, 2009; see also Appendix 1). Conversely, Senegal, Cape Verde, Sudan and Uganda were forced to lower budgetary expenditure as well as priority expenditure (Committee of African Finance Ministers and Central Bank Governors, 2009).

Latin America, Mexico, Venezuela and some Caribbean economies had limited room for implementing countercyclical measures due to their high debts and reduced budget revenues (especially countries dependant on oil export revenues such as Mexico and Venezuela), while countries with surpluses and large stocks of foreign-exchange reserves such as Brazil, Chile, Panama and Peru were able to implement bigger fiscal stimulus packages and offer tax breaks. The stimulus package in Peru was about 2.6% of its GDP (i.e. about $3.3 billion), while in Chile, Mexico and Brazil it amounted to 2.4% of GDP, 2.1% of GDP and 0.2% of GDP respectively (UN, 2009).

(ii) Monetary Policy

As the crisis spread to the developing world, a major concern for national governments was to maintain domestic macroeconomic stability against declining food and fuel prices, depreciating exchange rates, increasing unemployment as well as deflationary or inflationary pressures.

In the Asian region, interest rates on average were cut five times more than in previous recessions (about 2.3 percent, see Chhibber et al., 2009), with the exception of Pakistan which was forced to keep its interest rates high in order to fight spiralling inflation. Besides cutting interest rates, in some countries cash reserve rules were changed in order to increase the level of liquidity into the economy. In Cambodia, for example, the Central Bank slashed the reserve requirement from 16% to 12% (Te Velde et al., 2010). In a few countries, the flow of credit to the private sector was also expanded such as in China where limits on credit growth were removed leading to a huge expansion of bank lending in early 2009 (Takagi, 2009).

In Africa, several Central Banks tried to stimulate borrowing and boosting consumption. In Botswana, the Central Bank cut its bank rate by 50 basis points to 15% by the end of 2008 (Committee of African Finance Ministers and Central Bank Governors, 2009). In a similar way, the Egyptian Central Bank cut its benchmark interest rate for the first time since April 2006, while the Namibia's and the South Africa's Reserve Banks reduced their repurchase rates (Committee of African Finance Ministers and Central Bank Governors, 2009). In Northern Africa, the Central Bank of Tunisia reduced its key interest rate by 75 basis points, going from 5.25 percent to 4.50 percent in early 2009 (Committee of African Finance Ministers and Central Bank Governors, 2009). In Kenya, the Central Bank lowered the cash ratio and the Central Bank rate in order to reduce interest rates and enhance credit supply in the economy (Te Velde et al. 2010; see also Appendix 1).

In the Latin America region, the dollarization of many economies limited the number of monetary policy options available to respond to the crisis. Indeed, some countries which used the US dollar as national currency could not use the exchange rate policy to cope with balance of payments problems. This was the case, for example, in Ecuador, which was forced to adopt protectionist measures towards imports from other Latin American countries that devalued their national currencies.

Moving to social policy, there is conflicting evidence on the implementation of ***social protection mechanisms*** during the crisis. ODI (2009) finds little evidence of adequate social protection responses in developing economies, even though these varied considerably across countries. Kenya and Uganda, for example, struggled to meet the pre-existing social protection commitments; Bangladesh and Kenya extended the coverage of social protection and Cambodia did the same even at the cost of a widening fiscal deficit; but Indonesia and Nigeria preferred to address macroeconomic stability and promote stimulus packages rather than focusing on social protection (ODI, 2009). Even more worrying is the fact that IDS (2008) finds no evidence on the implementation of social protection mechanisms to respond to the crisis in a study carried over 19 developing countries including, among the others, India, China Thailand, Pakistan, South Africa, Zambia, Brazil and the Philippines. Nevertheless, the evidence reported by the ILO (2009) appears to be more positive. Indeed, one of its surveys conducted between June 2008 and July 2009 in 54 countries reveals that low and middle-income countries have invested in expanding social protection to cope with the adverse social effects of the crisis especially on the most vulnerable such as disabled people, returning migrants and destitute women.

2.1.2 Constraints to state capacity

(i) Economic constraints

In the literature, there seems to be general agreement on the fact that *limited fiscal space* may constrain the ability of local governments to implement correcting measures to reduce the impact of the financial crisis on the economy (see, among the others, Blanchard et al., 2010; Horton and El-Ganainy, 2009; and Massa and Te Velde, 2008). In particular, three factors appear to be critical:

- Low reserves;
- High fiscal and current account deficits;
- High debt burdens.

Nevertheless, a recent paper by Blanchard et al. (2009) shows that there is no clear evidence that large reserves lowered output declines over the crisis period.

The World Bank (2009c) suggests that three quarters of the vulnerable countries to the global financial crisis have limited fiscal space to undertake countercyclical spending, including Bangladesh, Ethiopia, Haiti, India, Lao, Mozambique and Zambia. IDS (2008) highlights that countercyclical spending is key to cope with the crisis but is not always affordable in the developing world. The World Bank (2009d) claims that, while commodity exporters have scope to expand deficits given the significant surpluses they have accumulated during the period of high commodity prices, a number of LICs (including those in South Asia and many fragile states) have little fiscal space due to their high debt-to-GDP ratios. But the South Centre (2009) highlights that even those middle-income countries that before the crisis were able to build up relatively large reserves and strong payments positions are now experiencing a tighter balance-of-payments constraint due to the decline in export earnings and the reversal of private capital flows caused by the crisis. The IMF (2009d) states that several low-income countries are faced with financing constraints in implementing countercyclical macroeconomic policies, and one-third is likely to experience significant challenges in ensuring debt sustainability in the medium and long term. Because of this, fiscal easing have been greater in countries with low or moderate risk of debt distress before the crisis, while one-third of countries at high risk of debt distress or in debt distress are expected to tighten fiscal policy (IMF, 2009d).

From a regional perspective, Asia and Latin America appear overall to have enough fiscal space to adopt countercyclical macroeconomic policies (IDS, 2009b), while Africa does not have enough financing capacity to cope with the crisis effects (Committee of African Finance Ministers and Central Bank Governors, 2009) even though it is important to highlight that the continent has entered the crisis in a better fiscal position and with lower debts than in the past (IMF, 2009c).

However, within each region the level of fiscal space differs a lot across countries as shown by Table 1 and Table 2 (see also IDS, 2009a). While in Asia many countries such as Thailand and Malaysia have a high or moderate fiscal space (IDS, 2009b; Chhibber et al., 2009), in sub-Saharan Africa 22 out of 37 lowest income countries are characterized by a low or no fiscal space (UNESCO, 2010). For example, IDS (2009b) highlights that the levels of international reserves is very low in sub-Saharan African aid dependent countries.

Table 1. Fiscal space in selected Asian countries

Degree of Policy Space	Countries
High	Bhutan,China, Indonesia, South Korea, Lao PDR, Nepal, Papua New Guinea, Philippines, Singapore, Thailand.
Modest	Cambodia, Mongolia, Samoa, Solomon Islands, Tonga, Bangladesh, India, Iran, Malaysia.
Low	Maldives, Pakistan, Sri Lanka, Vietnam.

Source: Author's elaboration from Chhibber et al.., 2009. Note: Current account and fiscal deficit is defined as "high" if it exceeds 4% of GDP based on data of 2006-08.

Table 2. Fiscal space in selected low-income sub-Saharan African countries

Degree of Policy Space	Countries
High	Mali, Rwanda, Uganda, United Republic of Tanzania.
Modest	Benin, Burkina Faso, Cameroon, -central African Republic, Chad, Comoros, Lesotho, Madagascar, Mozambique, Niger, Nigeria.
Low	Congo, Cote d'Ivoire, Djibouti, Eritrea, Ethiopia, Gambia, Guinea, Guinea Bissau, Kenya, Malawi, Mauritania, Sao Tome and Principe, Senegal, Sierra Leone, Sudan, Togo, Zimbabwe.
None	Burundi, Democratic Republic of the Congo, Ghana, Liberia, Zambia.

Source: Author's elaboration from UNESCO, 2010.

In the Latin America and the Caribbean (LAC) region, Chile seems to be the best placed country to use counter-cyclical measures to respond to the crisis given its significant surplus and stabilization funds (Burton, 2009). On the other hand, Venezuela, Peru, Argentina, Nicaragua, Ecuador and Bolivia might be more constrained in doing this because other significant expenditures have been financed by the accumulated resources before the crisis, and they also have limited relations with foreign investors and a high dependence on commodity prices that have dropped sharply due to the crisis (Burton, 2009). Clegg (2009) suggests that many

Caribbean countries may be constrained in implementing measures and policies to cope with the crisis because of their high levels of debt-to-GDP.

ODI's on-line consultation reveals that economic constraints have been among the main capacity constraints to respond to the crisis in Sudan, Bangladesh and Kenya (see Appendix 1). In the latter, in particular, budgetary constraints were particularly tight since the country entered the financial crisis after having experienced two previous crises, namely the post-election violence and a drought in 2008 and 2009. Conversely, in Bolivia there appears to have been no economic constraints to undertake macroeconomic countercyclical policies, thanks to the large available resources accumulated before the crisis.

(ii) Governance constraints

The ability of developing countries to respond rapidly and effectively to crisis shocks depends not only on the existence of a reasonable fiscal space but also on a number of governance factors such as institutional, administrative and technical capacity. This is widely recognized by the IMF (2009c), World Bank (2009c; 2009e) and many other institutions and organizations worldwide.

According to the World Bank (2009c), one quarter of the developing countries exposed to the impacts of the crisis has weak institutional capacity to efficiently and effectively increase public expenditure, to protect vulnerable groups and to reduce poverty.

In the LAC region, some countries such as Chile, Costa Rica, El Salvador, Mexico and Uruguay are deemed to have high institutional capacity and so should be better able to design and implement effective and efficient policies to cushion the impacts of the crisis (World Bank, 2009c). Nevertheless, there are other smaller economies - especially in Central America and the Caribbean - that are likely to be much less resilient to the adverse effects of the crisis due to their weak institutional capacity. This is the case, for example, of Nicaragua where the effort of the government to reduce its 4% budget deficit had a slight impact on public finances as a whole but damaged significantly health and education spending. In Bolivia, the decision of the government to substantially increase public expenditures as a response to the crisis helped offset the adverse crisis effects in the short run, but its efficiency in contributing to growth, employment creation and poverty alleviation in the long-term is questioned (see Appendix 1).

In African countries, weak institutional and technical capacity is perceived as one of the main capacity constraints to respond to the crisis (see Appendix 1). In some economies such as Sudan, Tanzania, Kenya, Uganda, and Zambia, authorities (i.e. governments and to a lesser extent Central Banks) lacked the needed research and analytical capabilities to identify and quantify the effects of the crisis. In Tanzania, for example, there was no effective monitoring system to assess the crisis impacts on the real sector; in Uganda, the standard analytical tools (financial programming) available to the Ministry of Finance and Bank of Uganda were inadequate to understand the effects of the crisis; in Sudan, the staff of the Ministry of Finance and National Economy did not have the needed skills to cope with the crisis shocks, and there was no policy centre able to produce policy briefs and recommendations to support the decision-making process. As a result, the design of policies to respond to shocks has been initially slow. A lack of implementation capacity has also been identified in countries such as Sudan, Kenya and Uganda.

Inadequate technical and implementation capacities are also felt to be a significant constraint to state capacity to respond to the crisis in some Asian countries. In Bangladesh, for example, because of the lack of these two capabilities, the Ministry of Finance was slow in designing policy responses and the proposed policy to provide cash incentives for apparels exports to new markets took a quite long time before being implemented (see Appendix 1).

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Appendix 1

Prof. Medani M Ahmed, Sudan

1. *What were the key decision making processes and actors in identifying and responding to the crisis in your country? (E.g. role of central banks, President or Prime Minister's Office, etc.?). To what extent were these linked to formal institutional arrangements?*

The Central Bank of the Sudan [CBoS] is specialized on monetary policies and their implementation and often consults with commercial banks directors and private sectors representatives on new monetary and lending policies at the beginning of each year and also when it wants to deal with some urgent issues and crises. The CBoS does not have specialized centres or think tank institutions dealing with monetary crises and issues; e.g. exchange rate determination, inflation targeting or foreign exchange forecasting. It has a small research section which is not very will staffed and does have high calibre experts on relevant challenging monetary issues. The CBoS has tried recently to recruit some experts but the attempt has not produced adequate number of highly qualified staff.

The Ministry of Finance and National Economy [MFNE] addresses issues pertaining to fiscal and development policies, whereas the ministry of Industry and Foreign Trade tackle issues concerning industrial and trading issues , respectively. non-of these ministries has adequate technical, institutional and human capacities to deal with crisis situations, as they do not possess specialized centres or directorates to analyze and produce policies to solve fiscal , financial, economic crises.

On the other hand, the presidency doesn't have specialized centres or institutions to produce policy briefs, recommendations or research-based policies on economic ,financial, fiscal and monetary issues. It often resorts to and demands the technical support of relevant ministries [ministry of finance and national economy, foreign trade and industry, etc.] which themselves do not possess the highly needed technical and economic capacities for producing policy –related recommendations. On the other hand, there are some economic advisers to the presidency, who are not or do not possess the institutional, technical and expertise capacities to enhance the process of decision-making at the presidency level.

2. *What do you think were the main capacity constraints (political, economic and technical) to respond to the crisis? Do you have any examples of how in practice capacity issues constrained responses?*

The main capacities constraints are mainly technical and economic, and also -to some degree-political incapacities.. The technical side relates to the lack of technical know-how and do-how and the needed technical and human capacities to address and deal with the economic and financial crises. Presently, there is an urgent need to carry out and conduct research on the relevant economic and financial crises 'issues and also there is need to improve the capacity and expertise to produce policies from research findings and to use them in solving these crises. The Ministry of Finance and National Economy does not have adequate and relevant staff to address fiscal, financial and economic crises' situations and to produce policies to solve them.

There is lack of policy based planning, policy-based budgeting and decision-making capacities due to the fact that there are no policy centers that would be able to produce policy briefs and/or recommendations [to support the decision-making capacities at different administrative and institutional levels .

3. *In your view, how important are these capacity constraints for the long term recovery process (e.g. policy/administrative or fiscal reform)?*

The technical and human capacities constraints are important factors in retarding and slowing the adoption and implementation of sustained, sound and objective analysis of the crisis and in generating the required policies to solve them.

Dealing with fiscal, monetary, financial, economic and financial crises would require solid expertise and know-how to analyze the main causes, extent and impacts of the crises on different sectors and on groups, in order to undertake relevant solutions to lessen their costs and speed up economic and human recovery. The lack of these technical, institutional and human capacities has, and will in the future, prolong the problems and delay solutions and therefore magnify their economic and social cost .

4. *What are your reflections on the main political pressures and incentives which impacted on the response? (E.g. level of policy space/room for manoeuvre? Public demands?)*

The lack of institutionalization behaviour, deficiency in technical and human capacities, would tend to make political parties and politicians resort to inappropriate and unsound choices of tackling the crisis. They tend to hide the problems and resort to tactics and pressure to delay needed actions to deal with the crisis[wait and see approach is often used in these circumstances].. And also lack of commitment and adherence to principles and requirements of accountability and transparency , on one hand, and weak regulation and supervision from relevant oversight institutions, on the other, would tend to frustrate and lessen the use of sound economic, fiscal and monetary policies to solve crisis , mitigate its effects and speed up recovery.

Prof. Ndulo Manenga, Zambia

1. *What were the key decision making processes and actors in identifying and responding to the crisis in your country? (E.g. role of central banks, President or Prime Minister's Office, etc.?). To what extent were these linked to formal institutional arrangements?*

At the begining of the crisis the strong belief was that it would not affect the country. This view somewhat determined the quality of later responses. When the price of the major resource-copper, dropped, this had an immediate impact on all major decision making processes and actors. The Ministry of Finance and the central bank were the main actors. The politicians were concerned about the crisis but didnot act in a manner to be seen as a serious reaction to the crisis. So the meaningful reaction was through the formal structures such as the Ministry of Finance and Central Bank.

2. *What do you think were the main capacity constraints (political, economic and technical) to respond to the crisis? Do you have any examples of how in practice capacity issues constrained responses?*

There was a major political constraint in the sense that there was little and no serios understanding and appreciation of the crisis among politicians. The economic response was better in terms of short term policies of macroeconomic stabilization and not long term policies of diversification. There were serious technical constraints in terms of the capacity of the public service.

3. *In your view, how important are these capacity constraints for the long term recovery process (e.g. policy/administrative or fiscal reform)?*

Improving technical capacity in terms of the reform of the public service is the most important and can affect the long term recovery policies or any attempt at meaningful structural reform

4. *What are your reflections on the main political pressures and incentives which impacted on the response? (E.g. level of policy space/room for manoeuvre? Public demands?)*

The main political pressure is that the public service should not be reformed.On the other hand, public demands are high on performance and delivery. Policy space cannot be taken advantage of by an inefficient and unprofessional public service.

Dr. Lunogelo, Tanzania

1. *What were the key decision making processes and actors in identifying and responding to the crisis in your country? (E.g. role of central banks, President or Prime Minister's Office, etc.?). To what extent were these linked to formal institutional arrangements?*

As the crisis was unfolding, the immediate response from the Tanzanian government was not different from the generalized conclusions shared by leading financial sector experts globally; that the domestic banking sector was sparingly linked to the international financial and money markets such that there would be minimal contagious effects. The media, both print and electronic, took a different view, partly because most of some misunderstanding that banks with international names like Barclays, Citibank, Stanbic and Standard were under day to day control by their parent companies and could easily demand foreign exchange repatriation and therefore negatively affect their liquidity and consequently business operations in Tanzania. The Central Bank had to issue a special report for public awareness that the banks were locally registered as independent banks and were subject to regular supervision and that all the key indicators showed that they were on sound footing. However, as the crisis moved to a secondary level of effects—with the real economy feeling the heat through cancellation of export orders and tourism arrivals, it became obvious that the government and her institutions had to take urgent interventions to mitigate the effects. The Ministry of Finance and Economy in collaboration with the Bank of Tanzania, Tanzania Business Council, Confederation of Tanzania Industries (CTI), Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA, Tanzania Tourism Board, Association of Bankers, etc, convened a stakeholder national conference in March 2009 to take stock of the effects and impacts of the global financial crisis and suggest mitigation measures to be undertaken by all stakeholders under the leadership of government. The result of that meeting was a special economic rescue package that was incorporated in the government budget for FY 2009/10, mainly aimed at rescuing financially strapped companies, cooperatives and to protect commercial banks from defaulting borrowers.

So we can say that formal institutions initially performed the role of pacification, assuring the public not to panic, but as reality dawned as the secondary effects started to manifest, the same institutions had to take an active role of protecting the banking sector, the commercial sector and the public. On the other hand we can say the media consistently kept raising alarm on the dangers posed by the breakdown of the financial sector in the US and Europe, but also being pessimistic that the economic rescue package formulated by the government might fail if governance aspects are not well considered in the course of its implementation.

2. *What do you think were the main capacity constraints (political, economic and technical) to respond to the crisis? Do you have any examples of how in practice capacity issues constrained responses?*

I think the main technical constraints was to get well quantified assessment of how the real sector was being affected and isolating the effects of the crisis from other unrelated causes. Once identified, what would have been the most effect realistic way of dealing with the problem, and once the financial package how do you compensate for the losses without risking corrupt transactions, being in mind that the Central Bank was still recovering from a well planned financial rip off by the same private sector. Politically it was easier justifying to rescue cooperative union since by their very nature they are taken to belong to the common citizens. But when it comes to the private sector, I personally received phone calls protesting that it was not right to use tax payers money to help capitalists who have been exploiting our farmers by buying at very low prices all these year! They should bear their own cross as part of business risks, they argued. Those having such arguments were oblivious of the medium term implications if these companies closed business, namely the failure to continue servicing famers and exporting to earn the country foreign exchange. But perhaps the most challenge was how the government could obtain resources to finance the rescue plan, given that it has been struggling to reduce donor dependence in finance her annual budget. Luckily, the IMF and other donors offered timely interventions to assist the government in that endeavour. A long term strategy as part of economic recovery plan was to ensure that all economic operators work towards diversifying the markets: exporters to find markets regionally within Africa, in South East Asia, India and China, and also promote consumption of locally produced products. It also includes investing for more value addition and removing value chain constraints so that there are more economic activities within the country and also whatever is exported earns more income. As part of reducing transaction costs and increasing the competitiveness of the country's products, the question of enhanced investments in resolving supply-side constraints, especially transport and power supply infrastructure was to be given high priority. But then the government was by then hesitating to use its bonds for borrowing from the international market following the instability of the financial market. The government also tried in vain to streamline tax exemption procedure so as to plug tax revenue leakages. The civil society, led by religious bodies opposed the move.

3. *In your view, how important are these capacity constraints for the long term recovery process (e.g. policy/administrative or fiscal reform)?*

Lack of an effective monitoring system for gauging the performance of the real sector meant that the government has to rely on guessed estimates, which could have led to over or underestimation of the problem. For example, although the government came to realise that the diasporas could play a part in economic recovery through their remittances no institution had any reliable statistics of the geographical distribution of the diasporas and their level of remittances. Moreover shelving of some plans for infrastructure projects meant that some parts of the country would continue to be isolated and the costs of doing business high, thus reducing the competitiveness of Tanzanian products in the regional and international markets. Administratively one can say that the failure by government to convince the parliament to reform tax exemption procedures stems from public's perception that the government has failed to demonstrate or lead by example by streamlining its own expenditure whereby, for example, it was expected to have radically pruned its fleet of luxury range of utility vehicles and streamlined the duplication of workshops and seminars by its institutions.

4. *What are your reflections on the main political pressures and incentives which impacted on the response? (E.g. level of policy space/room for manoeuvre? Public demands?)*

In my view the government acted within the expected time in responding to growing public pressure, orchestrated by the media, in coming with an economic rescue plan such that there was a widespread appreciation of the intervention. Its however, somehow surprising that there has not been any high profile follow by the media and parliamentarians on how the economic rescue plan was progress, which is perhaps an indication that all was going on well.

Prof. Rahman Mustafizur, Bangladesh

1. *What were the key decision making processes and actors in identifying and responding to the crisis in your country? (E.g. role of central banks, President or Prime Minister's Office, etc.?). To what extent were these linked to formal institutional arrangements?*

The two major policy actors in Bangladesh were the Ministry of Finance (MoF) and the Central Bank (Bangladesh Bank).

In the context of the global financial crisis, Bangladesh Bank immediately took note of the emerging situation and put in place prudential measures to safeguard its own forex reserves with various foreign banks, and at the same time, it notified the commercial banks to bring bulk of the foreign currencies held in respective nostro accounts abroad. So there will was no immediate big loss with regard to its forex reserves. Bangladesh Bank had a monitoring cell, which worked on a continuing basis to review the signal from the global market and undertake necessary portfolio management of its and commercial banks' forex reserve. Bangladesh Bank also took appropriate decisions with regard to maintaining exchange rate (maintaining BDT's competitive exchange rate with USD to maintain export competitiveness of Bangladesh) and money supply (with an accommodative monetary policy stance).

In view of the global financial crisis, two committees were constituted by the MoF at first place at Bangladesh Bank and the Finance Division of the MoF. The MoF of Bangladesh indeed acted as the national focal point which is supposed take policy decisions in view of the emerging global situation with regard to fiscal policies, stimulating domestic demand and other incentives etc. The ministry set up a dedicated National Task Force on the Global Financial Crisis (on March 2009) to provide suggestions in view of the crisis. The task force comprised of 27 members including member of the parliament, government officials (e.g. Secretary, MoF), renowned academics, leaders of export-oriented chambers and representatives from a number of related Ministries other than the MoF (e.g. Ministry of Agriculture, Ministry of Textile and Jute, Ministry of Industry etc.). These bodies did suggest the enhancement of cash incentives by 2.5 per cent for three export oriented items whose exports were falling. However, the export oriented trade bodies were not satisfied. Particularly, the trade body of ready-made garments (RMG) entrepreneurs came out strongly. It was then that the Finance Minister took the initiative to constitute a *Working Group* of the Task Force to suggest additional measures. This group came up with some recommendations in support of export-oriented RMG and the emerging shipbuilding sector. So there was an institutional framework set up by the MoF in response to the crisis.

2. *What do you think were the main capacity constraints (political, economic and technical) to respond to the crisis? Do you have any examples of how in practice capacity issues constrained responses?*

There were two main capacity constraints: budgetary constraints and also technical constraints in view of the fast changing scenario. As is known, the analytical and research capacity of the MoF is rather weak. It was felt by many stakeholders that a number of decisions could have been taken earlier. There is also a criticism on the lack of speedy release of money under cash incentives as well (i.e. lack of implementing capacity). Although decision to provide cash incentives (5 per cent) for exports of apparels to new markets was taken on November 2009, it took a while to put this in practice. The policy measures were also constrained by availability of up-to-date data. By the time the policy responses were taken in view of the lagged data, scenarios had changed somewhat in a fast changing scenario.

3. *In your view, how important are these capacity constraints for the long term recovery process (e.g. policy/administrative or fiscal reform)?*

The GDP growth projection for FY2009-10 was reduced to 5.5 per cent in view of the crisis (GDP growth of 6.2 per cent and 5.9 per cent were achieved in FY2007-08 and FY2008-09). The MoF also went for some counter-cyclical measures in the budget for FY2009-10. Stimulating investment (in view of lower demand for export, lower industrial output, and lower disbursement of term loan) has been identified as a major policy focus. However, since implementation of government's development programmes (formally known as Annual Development Programme (ADP)) has been slow (29 per cent of the allocation for FY2009-10 has been spent in the first six months), investment has stalled. As a consequence, the crowding-in impact on private sector has also been adversely affected. Weak capacities of various ministries to implement ADP have been a continuing problem. So these will have some impact on the recovery process. However, these are administrative and implementation problems which have been regular feature in Bangladesh and not particularly associated with policies in the context of the recovery.

4. *What are your reflections on the main political pressures and incentives which impacted on the response? (E.g. level of policy space/room for manoeuvre? Public demands?)*

There was not much political pressure from the opposition to address the crisis. It was mainly the organized trade bodies such as Bangladesh Garments Manufacturers and Exporters Association (BGMEA), Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA) which had come out with their demands in view of the crisis (press briefing, meetings of entrepreneurs, submitting of demand to MoF etc). Because exports of apparels were registering positive growth during the early phase of the crisis (15.39 per cent in FY2008-09) their demands did not receive much attention at that time. On the other hand, although jute and leather associations weak, they were provided 2.5 per cent additional cash incentive because their export growth rate was negative. Now that the RMG export growth has gone into negative terrain [(-) 6.64 per cent during July to November FY2009-10] policies were put in their support in November 2009, one could argue with the hindsight that some forward looking policies should have been taken earlier.

Prof. Jemio Luis Carlos, Bolivia

1. *What were the key decision making processes and actors in identifying and responding to the crisis in your country? (E.g. role of central banks, President or Prime Minister's Office, etc.?). To what extent were these linked to formal institutional arrangements?*

The Global Financial Crisis found Bolivia in a relatively good position to undertake countercyclical policies in order to offset the negative effects of the crisis. Policymakers implemented countercyclical policies in order to gain in some cases, political support.
In the fiscal area, the key players were the Central Government and the regional governments (at the departmental and municipal levels). The Central Government was politically confronted with some of the regional governments, and thus they started a sort of expenditure competition between them in order to gain political support. The Central Government's most successful policy was the implementation of unconditional cash transfers to target groups, i.e. elder people, school children and pregnant women. Besides, public expenditures and investment was also significantly increased, without creating fiscal imbalances. Quite the contrary, the fiscal sector presented consistent surplus balances.
In the monetary area, the Central bank was the paramount player. Paradoxically, the crisis helped the Central Bank to restore monetary equilibriums. Previous to the crisis, the export commodity boom brought about an impressive increase of the monetary aggregates. Inflation was running at 17% year-to-year rate by October 2008. In order to offset inflationary pressures, the Central Bank sterilized excess money through open market operations, increasing the public domestic debt. Besides, the nominal exchange rate was appreciated, as a means to reduce inflation. With the GFC, the rate of growth of monetary aggregates reduced sharply, inflation was brought down, and the nominal exchange rate appreciation was stopped.
During this period a great deal of formal institutional arrangements were not observed by the Central Government. For instance, the Central Government decided to get control over a much larger share of the hydrocarbon rent, compared to what was established by law. The Hydrocarbon Law determined that these resources had to be transferred directly to regional government in predetermined amounts.
Besides, the Government did not complied with the Central Bank autonomy. The Central bank was required to lend significant resources to the public enterprises and to the newly created development bank, which was explicitly forbidden by the Central Bank Law.

2. *What do you think were the main capacity constraints (political, economic and technical) to respond to the crisis? Do you have any examples of how in practice capacity issues constrained responses?*

The government enjoyed a period of large availability of resources. At the moment of the outbreak of the crisis, the government had no economic constraints to undertake countercyclical policies. Public current and capital expenditures were increased substantially in order to offset the negative effects of the crisis. Public investment has increased from 6% of GDP in 2004 to 12% of GDP in 2009. However, there are questions about the efficiency of the increased government expenditures in terms of its contribution to the country's main developmental goals, such as growth, poverty alleviation, long term employment creation, etc. Some observers argue that there is a great deal of current government expenditures that have been recorded as capital expenditures. The government main capacity constraint is technical. Thus, increased government expenditures have helped to alleviate the negative effects of the crisis in the short run, but they will not contribute to a long term growth and permanent poverty alleviation.

3. *In your view, how important are these capacity constraints for the long term recovery process (e.g. policy/administrative or fiscal reform)?*

The government has changed a great deal of the previously existing institutional setting, through nationalizations, increased taxation, and eventually through a new constitution. These policies have produced positive short term results to the government in the form of increased fiscal revenues (i.e. basically an increased hydrocarbon rent). However, these policies have seriously undermined the long term growth and employment creation prospects of the Bolivian economy, by discouraging private investment.

4. *What are your reflections on the main political pressures and incentives which impacted on the response? (E.g. level of policy space/room for manoeuvre? Public demands?)*

The leftist government of Evo Morales had won the general elections by a landslide, promising that he would obtain a larger share of the hydrocarbons share for the Bolivians. With nationalization, increased taxation on hydrocarbon production and much higher prices for hydrocarbon exports (natural gas), he could easily deliver his promises without incurring in serious fiscal or macroeconomic imbalances. He had plenty of policy space and room maneuver to meet the public demands.

Prof. Mwega Francis, Kenya

1. *What were the key decision making processes and actors in identifying and responding to the crisis in your country? (E.g. role of central banks, President or Prime Minister's Office, etc.?). To what extent were these linked to formal institutional arrangements?*

As argued in my two reports, the first actors to comment on the GFC were the Central Bank of Kenya (CBK) and the Prime Minister (PM) who had different views about its impact. Given the above policy differences, the government did not initially articulate a strong view on how to handle the crisis. It was mainly left it to CBK to undertake a countercyclical monetary policy by lowering the Central Bank Rate and the cash ratio (done through its Monetary Policy Committee which meets quarterly) while using moral suasion to ask banks to lower lending rates. A task force was set up to look into ways of cushioning Kenya's economy from the adverse effects, comprising officials of the ministries of finance and planning as well as CBK, but it ended up being moribund. I am not aware of any of its activities (this is supported by Treasury officials).

Over time however a widespread consensus seems to have emerged that the GFC would have a major impact on the economy, and this is mainly articulated in the 2009/10 budget. This budget instituted a KSh 22 billion (US$ 0.3 billion) Economics Stimulus Package (ESP) that was to be spent by December 2009. Unfortunately, a large proportion of the ESP budget was not spent by that deadline due to delays in procurement processes and limited absorptive capacity in the implementing ministries, with the expenditures spilling into 2010. Treasury has said it will consider extending funding for ESP in the 2010/11 budget.

2. *What do you think were the main capacity constraints (political,economic and technical) to respond to the crisis? Do you have any examples of how in practice capacity issues constrained responses?*

The PM's Office, which was expected to coordinate government departments in response to GFC, is a recent creation (through an accord for a coalition government that was signed in February 2008) and therefore does not adequate capacity to analyse and articulate implementation plans.

There is also rivalry among the various actors from the two partners in the coalition government making it difficult to articulate a common position. The CBK and Treasury are for example dominated by actors from one partner while the PM's office is dominated by actors from the other partner. There were also budgetary constraints arising from the other crises that the government faced such as the post-election violence and a drought in the country in 2008 and 2009. It should also be noted that GFC caught the economics profession by surprise, and policymakers were not sure how to respond. They relied more on a demonstration effect from the more developed economies, and learning by doing, hence partially explaining the response delays.

3. *In your view, how important are these capacity constraints for the long term recovery process (e.g. policy/administrative or fiscal reform)?*

There is fairly good capacity at the CBK and Treasury, but there is much uncertainty about the PM's Office, which according to the accord expires with the next elections in 2012. The draft constitution under current debate has also eliminated the office. The policy institutions in Kenya are therefore in a flux, although the statutory independence of the CBK has helped it in providing some policy leadership.

4. What are your reflections on the main political pressures and incentives which impacted on the response? (E.g. level of policy space/room for manoeuvre? Public demands?)

These issuesa are discussed above: a post-conflict (divided) government; handling GFC alongside other crises especially the post-election violence, high oil and food prices as well as budgetary constraints limiting the options available to policymakers; etc.

Ssewanyana Sarah, Uganda

1. *What were the key decision making processes and actors in identifying and responding to the global financial crisis in Uganda? To what extent were these linked to formal institutional arrangements?*

The unfolding of the crisis took all institutions by surprise. There was pressure on the institutions including Bank of Uganda and Ministry of Finance to provide a coordinated response on the implications of the crisis to the economy. For a while there was some information vacuum where there was no formal response from government institutions on how the crisis would unravel. After pressure from largely civil society and politicians, the Central Bank made a statement that Uganda would largely be unaffected by the crisis given that it's financial system was not exposed to the mortgage-backed securities which sparked off the crisis in developed countries. This response never took into account the second round effects of the crisis which have affected the country. The second round effects included the impact of the crisis on ODA, commodity prices for our exports and reduction in remittances. After careful analysis and out-turn of actual developments, the Central Bank acknowledged that indeed Uganda would suffer from the second round effects of the Crisis. In addition, EPRC also played a role on the research front by working on two papers highlighting the impact of the GFC on the economy and channels of transmission. These papers were presented to policy makers both from the Ministry of Finance and Bank of Uganda which could have helped to acknowledge the fact that Uganda would indeed suffer from the second round effects of the GFC.

2. *What do you think were the main capacity constraints (political, economic, and technical) to respond to the crisis? Do you have any examples of how in practice capacity issues constrained responses?*

There were capacity constraints which could have led the Bank of Uganda to mislead the public that the Ugandan economy would not be affected at all. The standard analytical tools accessible to both the Ministry of Finance and Bank of Uganda were not adequate enough to understand the ramifications of the GFC on the domestic economy. To fully understand the effects of the crisis, this required a more comprehensive model that fully captures the channels through which the crisis affected Uganda. It's only recent that the Ministry of Finance is in the process of acquiring such a model which would have adequately provided answers to the public on the effects of the crisis.

3. *In your view, how important are these capacity constraints for the long-term recovery process (e.g. policy/administrative or fiscal reform)?*

Before the crisis unfolded, Uganda had already embarked on increasing spending for infrastructure particularly on roads and energy. While most countries where advocating for a fiscal stimulus, the Ministry of Finance was of the view that the fiscal stimulus was already inbuilt within the previous budget and there was no need for further widening of the fiscal deficit given the limited fiscal space. To an extent, by addressing the infrastructure problems this is expected to lower the cost of doing business in Uganda and sustain the high economic growth Uganda has realized in the past.

4. *What are your reflections on the main political pressures and incentives which impacted on the response (e.g. level of policy space/room for maneuver, public demands)?*

The official response (Uganda not being affected by the crisis) from Bank of Uganda was highly critiqued by the public and civil society. In the process, there were clear indications that the crisis was having an impact as the dollar continued to depreciate at a very first rate owing to reduced inflows in form of remittances and export receipts. Given all these signs, the President of Uganda tasked the Ministry of Finance to provide a well researched and coordinated response on the effects of the crisis on the domestic economy. Some parliamentarians and the opposition party members also demanded for a more coherent response from government. Only after that political pressure and the new data that was emerging showing the effects of the crisis did the Central Bank clarify that indeed Uganda would be affected by the crisis through the second round effects.