Managing the Crisis |

United Kingdom Country Report

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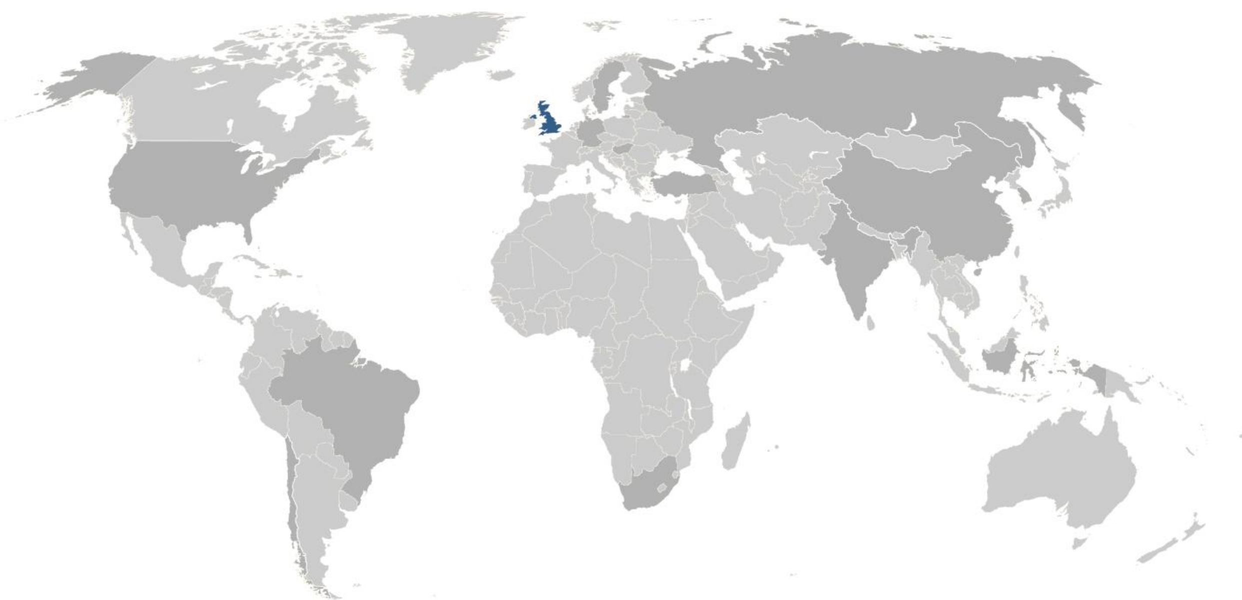

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1. Risk Exposure at the Outset of the Crisis

- 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?

Economic structure and macroeconomy

In the 10 years leading up to the financial markets crisis, the United Kingdom enjoyed a period of very positive macroeconomic development. Until the crisis broke, the Labour government had boasted that the country was enjoying a period of economic expansion of a length unparalleled since economic records began. Both economically and politically, however, this claim should come back to haunt the government and the prime minister, who was previously chancellor of the exchequer.

Standard indicators of macroeconomic performance indeed show a positive picture in the years before the crisis. The rate of inflation remained close to target and stable, while GDP growth was robust and amounted to 2.75 percent in 2006; the rate of unemployment fell to 5.4 percent in 2007, its lowest level since the 1970s. Chief among the drivers of this trend were domestic consumption and pronounced private leverage. These were achieved by the low savings ratios and high debt positions of private households, in turn made possible by low interest rates and cheap interbank lending. A relentlessly rising housing market contributed to consumers' positive sentiment, while credit expansion was heavily financed by capital imports from overseas investors (particularly U.S. banks) and underpinned by a persistently large current account deficit.

A substantially eased fiscal stance after 2001, when the new Labour government won its first re-election, resulted in a deficit of around three percent of GDP. Spending increased particularly in areas such as the health service, and the deficit at the time has to be rated as high, given the United Kingdom's position in the economic cycle. When the economic crisis hit, room for maneuver in terms of expansionary fiscal policy was restricted.

The credit boom and asset price inflation prior to the crisis drove a boom in debt-financed consumer expenditure. In conjunction with low interest rates, this debt-financed consumption led to high house prices. The increase in total system leverage (driven by the credit boom and the housing price explosion) in turn created vulnerabilities. The United Kingdom experienced a credit and property price cycle similar to that in the United States. The ratio

of total mortgage debt-to-GDP rose from 50 percent to 80 percent between 1997 and 2007.

In retrospect, economic development in the United Kingdom must be seen as having been highly dependent on financial sector growth, which played an ever-increasing role as a component of national GDP, eventually accounting for 8.8 percent of GDP in 2008. It also contributed to rising private consumption through the credit expansion, and to the expansion of public expenditure through its high contribution to the state's tax income. The positive economic evaluation by standard macroeconomic indicators therefore has to be put into perspective, as it was heavily reliant on the momentum of a financial services sector growth that eventually proved unsustainable.

- 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)?

Policy priorities prior to crisis

The economic record of the Labour government prior to the crisis was a positive one. The Blair government spent years building up a reputation for economic competence, which had been its main electoral advantage over the Conservative party since the mid-1990s. Chancellor of the Exchequer Gordon Brown had for a long time stressed the importance of fiscal prudence, and had been very successful in erasing the memories of previous allegedly fiscally irresponsible Labour Party governments. By granting operational independence in monetary policy to the Bank of England (BoE), he had paved the way for a low rate of inflation, and although the government's fiscal policy achieved a substantial amount of redistribution toward low-income citizens, it did so mainly through hidden tax-system mechanisms rather than through loud announcements. Anxious to please rather than to scare the markets, the Labour government was fully aware of the power and economic importance of the City of London to the United Kingdom's economy.

Along with New York, London is one of the world's leading financial centers. It is a major cluster of banking, insurance, capital market, fund and private wealth management operations. In the last two decades, it has seen unprecedented growth and innovation. The sector employs more than one million people and is highly internationalized. It also contributes massively to the government's tax revenues – to the tune of £250bn over the last nine years through corporation tax, income tax and national insurance contributions. To protect and further its interests has therefore been a particular concern for various UK governments for a long time.

- 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)?

Executive, fiscal & monetary capacities to respond to downturn

The United Kingdom's political system is characterized by a strongly centralized unitary state and traditional one-party government. Having enjoyed a historically unparalleled third consecutive general election victory in 2005, Prime Minister Tony Blair's government was still comparatively strong in the run-up to the crisis, even if its previously almost absolute hold on power had been diminished through criticisms of its involvement in the Iraq war and by debates about Blair being replaced by then-Chancellor of the Exchequer Gordon Brown.

The handover from Blair to Brown took place in the summer of 2007. When the initial crisis in the financial markets started later in the year, Brown seemed the perfect person to guide the country through the vicissitudes of that crisis. Although the Labour Party no longer enjoyed the lavish majorities of its first two terms in office, the prime minister enjoyed a largely disciplined parliamentary party, which saw its minds concentrated by the fact that the Conservative Party had elected a new popular leader who strove to remold many of their old policies, and by the general difficulty of winning a fourth consecutive general election victory.

During 2008, however, the Brown government's initial honeymoon period quickly came to an end. After rumors of an early general election were first floated, but then decided against, Brown increasingly seemed to lack a vision of where he wanted to take the United Kingdom. Yet the growing political unease within his own party did not translate into diminishing political discipline or open rebellion. If anything, the mood can perhaps be best described as one of quiet desperation at seeing prospects of a fourth term in office diminish.

As the fiscal situation deteriorated sharply, it was clear that the room for added fiscal stimulus was limited. After having run balanced budgets or even surpluses from1997 through 2001, budget deficits had been around three percent since 2002. In monetary policy, the government had voluntarily given up its influence in 1997 by granting operational independence to the Bank of England. Given Britain's dismal inflation record over the last decades, the central bank was particularly interested in building up an anti-inflationary

reputation, and therefore could not be counted upon to act quickly and decisively in relaxing monetary conditions.

- 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)?

Exposure to specific market and trade risks

The United Kingdom has a tradition of openness toward foreign investment and ownership, which enhances links with global and regional financial centers. Because of the nation's historical role in financing and insuring global trade, the scope of financial services available in the United Kingdom is unparalleled. Consequently, United Kingdom markets and institutions were deeply involved in the prolonged global credit and asset-price cycle that developed into the financial crisis. But modernity also increased risks. Banks such as (most prominently) Northern Rock, but also others including Bradford & Bingley, Alliance & Leicester, and HBO, initially increased profitability by relying less on customer deposits and more on direct funding through large-scale interbank markets, as well as their continuous ability to securitize and sell rapidly accumulating credit assets. Thus, they were hard hit when these markets collapsed at the outset of the crisis. To sum up, the United Kingdom's very open financial system and economy were heavily integrated into and influenced by developments in global financial markets, investment and trade, and were therefore particularly vulnerable to the money market turmoil.

By the mid-1990s, British policymakers and executive agencies had already gained experience in handling financial crises, or more specifically in handling banking crises. The collapses of banks such as BCCI and Barings led the authorities to question the effectiveness of banking supervision mechanisms in the United Kingdom. As a result of these bank failures, fundamental reforms and institutional changes in the area of banking regulation were implemented. In 1997 the newly elected Labour government established the Financial Services Authority (FSA) as the pivotal new oversight authority for the prudential and conduct-of-business supervision of all main sectors – banking, securities and insurance – as a single regulator.

The Bank of England, in addition to its monetary remits, remained responsible for maintaining the stability of the financial system as a whole.

This new supervisory framework was put to a first test in the years leading to the crisis, and in retrospect it is difficult to give it an unambiguously positive assessment. Between them, the two supervisory agencies allowed an unsustainable credit boom and asset price inflation to develop, and presided over a substantial increase in total system leverage that ultimately proved unsustainable. While the leverage ratios of UK banks were not extraordinarily high – indeed, these were around the mean in international comparison – this changed once special investment vehicles (SIVs) were taken into account. These mechanisms, which played an important role in the development of the crisis, were heavily used by banks in the United Kingdom, and the supervisory agencies failed to identify the underlying problems. While other countries have suffered similar oversights, this does not speak well for British agencies that had conceived of themselves as being at the forefront of market sophistication.

- Did policymakers/executive agencies have any experience in handling financial crises? Did this experience play a role in the 2008-09 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?

Structural or policy advantages and disadvantages

The United Kingdom has had experience with managing banking troubles already in the 1980s and 1990s. Since the previously existing system of oversight and supervision had been judged to be inadequate, a new system was put in place by the incoming Labour government after 1997. However, this system was untested by crisis.

Initially, the new supervisory framework, in which all banking oversight was concentrated in one agency, was hailed as befitting a modern financial system of the complexity of the United Kingdom's. It was pointed out that the new FSA as a single regulator would be in a position to assess the risks accumulating in modern financial conglomerates regardless of the specific subfield (bond trading, insurance, money markets, etc.) in which they were occurring. The central bank, whose main remit was monetary policy and the safeguarding of the stability of the currency, was to have very little influence in financial markets supervision, in hopes of avoiding a conflict of interest in aiming both at banking system stability and low inflation. In hindsight, however, it has become clear that decisions about the bankruptcy status of major

banks have a deep impact on the viability of the overall payment system, and should therefore be made with the central bank's involvement.

In terms of the overall political decision-making system, the United Kingdom is characterized by a majoritarian democracy that has no discernible veto players. A British government neither has to deal with a federal chamber in the legislature nor has to face a constitutional court with the power to limit the range of its decision options. As a rule (and certainly in the present situation) it is a one-party government, and can therefore avoid even the squabbles present in coalition governments. With the political system resting on a set of established conventions rather than a written constitution, there are hardly any formal limitations to what government can do in times of crisis. Executive power is highly centralized and supremely flexible in the United Kingdom, probably much to the envy of governments in other countries.

- 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)?

Initial impact of economic downturn

In terms of the financial crisis, the United Kingdom is clearly one of the hardest hit countries in the Western world as its economy is undergoing a severe downturn. According to recent IMF World Economic Outlook and Eurostat data, the country's GDP growth rate shrunk from 2.6 percent in 2007 to about 0.7 percent in 2008. For 2009, the IMF projects a decline in GDP by -4.4 percent, with a slight recovery in 2010 to 0.8 percent growth. The unemployment rate rose steeply from 5.4 percent in 2007 and 5.5 percent in 2008 to 7.6 percent in 2009 (projection) and 9.3 percent in 2010 (projection). In addition, the financial crisis led to a rapid decline in housing prices – by 16 percent in 2008 alone. During the course of the crisis, small businesses and people with low or middle incomes found it difficult to get access to financial services such as real estate mortgages or essential working capital. The banking crisis has also impaired the ability to extend credit to the real economy, and the corresponding liquidity crisis for households and firms played a major role in exacerbating the economic downturn. Consumer behavior also changed significantly. Confronted with falling property prices (a main source of perceived wealth over the last decade) spending was cut dramatically – the saving ratio climbed from near zero percent in 2007 to about 10 percent in 2010 (projection) – resulting in a massive decline in aggregate macroeconomic demand. With state spending rocketing, both as a result of bank recapitalization and stimulus programs, and tax revenues falling, the United Kingdom's budget deficit is projected by the Treasury to

hit double digits (12.6% and 12.5%) in the next two fiscal years before falling back into single-digit territory.

Overall, the state of affairs seems particularly dire in the United Kingdom, with little relief forecasted in the near future for the labor market, the government budget situation, and growth. These developments are sure to have a negative effect on the country's bond ratings and currency.

2. Agenda-Setting and Policy Formulation

- 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?

Agility and credibility

The UK government reacted quickly to the crisis unfolding in September 2008 after the collapse of the Lehman Brothers bank in the United States. It should be noted that this report covers only the period between September 2008 and September 2009. The financial market crisis, however, had already started by summer 2007. If that were to be taken as the starting point of the analysis, the assessment would be somewhat different, because both the government and the central bank took some time to react to the crisis unfolding around Northern Rock in those earlier months.

Given the importance of the financial sector for the UK economy and the experience of the preceding 12 months, the government reacted swiftly to support and stabilize the financial system. This quick reaction can be ascribed mainly to two aspects of the system, namely the traditional executive dominance of the government vis-à-vis Parliament (and the absence of veto players), and the informal, well-established network of financial-sector governance.

Parliamentary life in Great Britain is dominated by the plenum, and the role of Parliament must be described as comparatively weak. There are no specialized, permanent committees, a situation that allows the government to seek advice from ad hoc committees and independent commissions. Fast and relatively easy implementation of fundamental reforms is typical for the British

governmental system, though this sometimes comes at the expense of thorough debate.

In the case of the crisis, the government's reactions were led by the Treasury, which is responsible for the overall architecture of the financial system. Informal relationships between firms on the one hand, and regulators and central bankers in the city on the other are typical for the British financial system. Agenda-setting and policy formulation can be characterized as being dominated by the executive in the shape of the Treasury, the Bank of England, and the FSA. During the crisis these institutions intensified their cooperation. They had to work together when dealing with failing banks, the recapitalization of the banking system and other measures to support the supply of credit.

Thanks to the extensive informality of the British political system and the absence of written constitutional rules, much of this was possible without legislation. However, even the need for legislation presented little obstacle in cases when the pressing need for its introduction could be successfully communicated, as became clear with passage of the Banking Act of 2009.

- 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?

Consultation with external experts and openness to international collaboration

Before Lehman Brothers crashed, policymakers in the United Kingdom – like their counterparts in other OECD countries – did not look extensively beyond their borders for policy input. Indeed, the world's major central banks generally did not coordinate their actions; they instead pursued their individual (and different) strategies. It was the Lehman debacle that prompted governmental and monetary authorities around the world to consider the need for intensified global cooperation efforts.

In September 2008, major central banks (the Bank of England, the European Central Bank (ECB) and the United States' Federal Reserve) undertook a coordinated round of interest rate cuts. Interest rate policies are not usually coordinated, so this was an unprecedented step of jointly announcing interest rate cuts. Efforts to implement additional, broad-based policy measures continued in the following weeks: The central banks increased existing swap lines to accommodate unlimited quantities of U.S. dollar funds; Euro-area member countries announced guarantees and equity injections to stabilize

the banking sector; and the U.S. Treasury recapitalized major banks with $250 bn.

In the course of the crisis, the position of the UK government toward global cooperation in regulating the financial sector changed somewhat, becoming more positive. The pledge for joint efforts to enhance global cooperation, restore global growth and reform the world's financial system at the G20 summit in November 2008 was actively supported by the British government. However, since that time the position of Gordon Brown and Chancellor of the Exchequer Alistair Darling can be described, at best, as ambiguous: Whereas efforts to construct coordinated G-20 stimulus packages were actively supported, a global accord for financial market regulation enjoyed less support. The interests of the strong financial sector seem to have had rebalancing effects on the government's ambition to improve financial oversight.

As of this writing (November 2009), it seems difficult to reach a conclusive assessment of the UK government's strategy concerning global cooperation. While the UK government was in the vanguard in terms of suggesting plans for re-regulation of global financial markets, it then wavered in trying to find international support for this idea. An example would be Prime Minister Brown's support for the introduction of a global tax on financial transactions, which he offered in early November 2009, only to withdraw it a day later when support from the United States was not forthcoming.

3. Policy Content

- 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?

Scope of stabilization and stimulus policies

Beginning in October 2008, the British government devised and implemented measures in three broad areas, including banking sector stabilization measures, economic stimulus, and institutional/regulatory restructuring. The allocation of funds to stimulus programs was relatively small by international comparison, whereas the amount of funds devoted to the stabilization of the financial services sector was substantially higher than in almost every other G-20 country. A specific characteristic of the British reaction was the early and far-reaching proposals for financial regulation reform.

Broad and far-reaching improvement approaches include measures drawn from most categories of crisis management, with a focus on stabilizing the financial system, optimizing financial market regulation through strengthening the FSA and the BoE, providing stimulus measures and extended consumer protection. The stimulus is spread over a period of three years between 2008 and 2010, but focuses largely on 2009 where it reaches 1.4 percent of GDP and consists of a temporary value-added tax (VAT) cut as well as bringing forward planned capital spending.

Simultaneously, an aggressive monetary policy was implemented by cutting interest rates for a sum of 2.5 percentage points – from 4.5 percent to 2 percent – in the pace of just four weeks in late 2008. Under normal circumstances, such an aggressive cut alone would have been sufficient to provide a massive stimulus. In this case, an additional fiscal stimulus package was launched in January 2009.

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)?

In the area of financial regulation, the UK government's key response was to pass the Banking Act 2009. It served several purposes, although its main focus was to provide the government with powers enabling it to deal with failing banks in order to protect depositors and limit the risks to financial stability. To that end, the act gives government emergency powers a permanent statutory footing. Thus, the authorities have the legal power to intervene when the failure of a bank or another deposit-taking institution threatens the stability of the financial system, the protection of depositors' money, or the interests of the taxpayer. The act also contains as secondary law a new insolvency regime for investment banks.

The three central objectives of regulation and supervision of the banking system are: the prevention of systemic risk through maintaining the stability of and confidence in the financial system; the protection of consumers and investors from excessive risk of loss or financial harm arising from failure, fraud, manipulation or other forms of financial misconduct; and regulations concerning the conduct of business, by ensuring effective, efficient, and reliably functioning financial markets in a competitive environment.

The Banking Act provides the Bank of England with a clear statutory objective to protect the stability of the financial system and improve its own governance structures; in addition, the FSA is reorganized with a new operational structure designed to enable it to better identify and mitigate risk and to carry out its supervisory tasks, while the number of FSA supervisory staff is increased.

In the field of economic stimulus and social policy, support is targeted at keeping the economy running and getting it back on track. The entire economic stimulus constitutes 1.5 percent of GDP. These supporting measures are targeted toward the provision of liquidity to firms rather than to specific direct investments or subsidies. Moreover, future consumption possibilities were brought forward, with programs such as offering tax allowances to be taken earlier than initially planned. A temporary VAT cut from December 1, 2008 to December 31, 2009, from 17.5 percent to 15 percent, was included in the stimulus package. To offset the effects of the temporary VAT reduction, alcohol and tobacco duties were increased. In addition, the government brought forward £3 bn of capital spending related to housing, education and transport infrastructure from 2010 – 2011 to 2008 – 2009 and 2009 – 2010.

The stimulus measures can be divided into four basic categories: support for private households, support for real estate mortgage lenders and borrowers, help for the unemployed in finding new jobs, and support for struggling businesses in the form of tax relief and liquidity provision, particularly for small and medium-sized enterprises. The details of each category are as follows.

Support for private households included:

- a £600 increase in the income tax personal allowance, originally announced in May 2008, was made permanent with a further increase of £130;
- the April 2009 increase in child benefit payments was brought forward to January;
- child tax credits were increased; and
- all pensioners gained a payment of £60 that was equivalent to bringing forward the April 2009 increase in the basic state pension to January.

Support for real estate mortgage lenders and borrowers included:

- help for eligible homeowners in difficulty through mortgage rescue and support for mortgage interest schemes; and
- a commitment by major mortgage lenders not to initiate repossession action within at least three months of an owner-occupier going into arrears.

Support for unemployed to find new jobs included:

- an additional £1.3 bn earmarked to help the unemployed find new jobs.

Support for small and medium-sized businesses facing credit constraints included:

- a Small Business Finance Scheme, aimed at supporting bank lending to small and medium-sized businesses;
- the HMRC Business Payment Support Service, aimed at allowing businesses in temporary financial difficulty to pay their HMRC tax bills on a timetable they can afford;
- generous tax relief for businesses now making losses; and
- modifications of already planned tax reforms, such as the vehicle excise duty, the air passenger duty and a deferral of the increase in small companies' corporation tax rate.

To finance the stimulus program, and in order to assist in fiscal consolidation, increases in alcohol and tobacco duties will be maintained after December 2009. In addition, fuel duties increased about 2 pence per liter beginning December 1, 2008, following the fall in pump prices of over 20 pence per liter from that year's summer peaks. In April 2011, national insurance contribution rates for employees, employers and the self-employed will be increased by 0.5 percent. Moreover, the income tax personal allowance for those with incomes over £100,000 will be restricted beginning in April 2010. From April 2011 onward, a new additional higher income tax rate of 45 percent for those with incomes above £150,000 will be introduced.

The extent of the British stimulus program (2008 – 2010) lies below the G-20 average. In 2008, stimulus constituted 0.2 percent of GDP compared to a G-20 average of 0.5 percent; the 2009 UK stimulus amounted to 1.4 percent of GDP, compared with a G-20 average of 2.0 percent. The 2010 figures are -0.1 percent for Britain and a G-20 average of 1.5 percent.

- 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?

Measures stabilizing the banking system

In order to stabilize the banking system, the UK government launched a program worth more than £500 bn. It consists of bank recapitalization, credit guarantees, (partial) state ownership of endangered banks such as RBS and Lloyds, deposit guarantees and swaps of illiquid assets with the Bank of England.

The government's responses were targeted at three areas: addressing system-wide instability, tackling problems in individual institutions and getting credit flowing through the economy.

The following support measures were aimed at enhancing the liquidity, solvency and funding of financial institutions:

- a governmental intervention was necessary to protect depositors in United Kingdom banks and building societies, to enable banks to continue to lend to the economy during the recession and to restore financial stability. Capital injections were intended to strengthen banks' capital base;
- explicit guarantees covering liabilities were aimed at helping banks retain access to wholesale funding; and
- purchases or guarantees of impaired legacy assets were aimed at helping reduce banks' exposure to large losses.

In international comparison, the United Kingdom has spent the greatest amount on banking sector stabilization (only Iceland spent relatively more), amounting to more than 50 percent of its 2008 GDP.[1] According to the International Monetary Fund, in 2008 the United Kingdom spent about 81.8 percent of GDP to support the financial sector.[2]

Specifically, the government has established a £50 bn Bank Recapitalization Fund to make capital available to eligible banks and building societies to strengthen their capital ratios, as well as a Credit Guarantee Scheme

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[1] Bank for International Settlements, "An Assessment of Financial Sector Rescue Programmes," BIS Papers, No. 48, Basel: 2009, 12.

[2] IMF, *Update on Fiscal Stimulus and Financial Sector Measures*, April 26 (2009): 4 http://www.imf.org/external/np/fad/2009/042609.htm (accessed November 20, 2009).

(up to £250 bn) aimed at unblocking the interbank money market, and thus providing banks with a guaranteed source of funding and improving the flow of credit to the economy. The government also made £200 bn available under the Bank of England's Special Liquidity Scheme, which allows institutions to swap preexisting illiquid assets for Treasury bills over a three-year period, thus providing financial institutions with short-term liquidity. Lastly, capital protection for banks through the Asset Protection Scheme was offered. This plan offers banks protection against future losses on certain assets in exchange for a fee, with the intention of allowing the institutions to continue making loans to creditworthy businesses and households.

- 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)?

National bias and protectionism

Only a small number of implemented measures in Britain can be described as having a protectionist nature. In this regard, most actions were not direct violations of trade, but rather direct measures strengthening national sectors at the potential expense of foreign competitors. According to Global Trade Alert Report, 11 measures implemented in the United Kingdom harm foreign commercial interests. Six of these are bailouts or state aid measures, two are trade defense measures, two are export subsidies and one deals with the issue of migration.

- 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)?

Social protection

The area of social and consumer protection was another field in which the government sought to implement improvements. The main thrust of measures here was aimed at reducing the information asymmetries that characterize many areas of financial investment, to the detriment of consumers. Specific measures include consumer education and the regulation of credit products.

A "Money Guidance Service" offers people help in gaining control of their finances before they accumulate unmanageable levels of debt, as well as offering specific support in cases of job loss. In addition, the promotion of

public understanding of the financial system has been added to the FSA's statutory objectives. In practice, this means active consumer education and the delivery of consumer information (the FSA has a "Treating Customers Fairly" (TCF) agenda). In addition, a governmental white paper tackles consumer protection issues, in particular aspects of the consumer credit market. This paper announces the government's commitment to raising decision-making standards across all regulated consumer credit products, and to making the regulatory regime for consumer credit effective for all consumers.

4. Implementation

- 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)?

Political communication

The UK government has been comparatively transparent in its approach to solving the financial market crisis. This was at least the case for the period under investigation here, September 2008 to September 2009. During the previous year, at the very beginning of the crisis, any such assessment would likely reach a different conclusion. In particular, the hesitant handling of the Northern Rock bank crisis, which featured the first full-scale run on a British bank in more than 140 years, must be mentioned here. At that point, the distribution of competences between the Bank of England, the FSA, and the Treasury was unclear.

But a year later, when the second round of the crisis broke, lessons had been learned. The perceived (and real) competence of Prime Minister Brown as a long-time chancellor of the exchequer was certainly helpful, as was his successor's preparedness not to steal the limelight from him. Brown and Darling could therefore serve as an effective team in reassuring the British public and the financial markets that the government was willing to help in the crisis and was up to its job.

The fact that so many British citizens were directly affected by the crisis (through high levels of debt and/or mortgage exposure) certainly helped concentrate leaders' minds, and there was very little fundamental criticism of the government's approach to solving the crisis – not least due to the fact that no credible left-wing opposition exists in the United Kingdom.

- 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?

Modes and time frame of implementation

The United Kingdom's political system is highly centralized and faces very few if any veto players. Such a majoritarian democracy allows for quick policy responses. In addition, the close ties between financial firms on the one hand and the regulators of the FSA and the Bank of England on the other are stable and allow for quick coordination between the relevant parties. If (as was the case in the current situation) the interests of the government and the financial sector pull in the same direction, solutions can quickly be found and implemented. If, however, the UK government were to attempt a serious round of re-regulation with the aim of reining in the financial sector, substantial resistance would probably be the result. Implementation capacity therefore depends on the direction of and degree of consensus associated with the measures to be taken.

- 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?

International or regional cooperation

The UK government, from an early point in the crisis, was publicly very supportive of international cooperation aimed at finding a global solution for the regulatory problems. Indeed, it was influential in drawing up elements of an international agenda in that direction. However, no such solution has to date been found; the elements of such a strategy are not readily visible, and no part of one has yet been implemented.

Both within the G-20 and the European Union, the UK government has put forward proposals for reform of global banking operations and cooperation by regulators. The Brown government used the United Kingdom's chairmanship of the G-20 summit and membership in international bodies such as the International Monetary Fund to push forward its ideas for reforms of global financial regulation and supervision standards. However, it remains unclear to what extent concerns held by the City of London have ultimately held back the UK government in international negotiations, and to what extent blockage has come from other countries. It is a well-known fact, seen often over the last three decades, that actually agreeing on global rules for financial investment oversight is a massively contentious and time-consuming process.

Without access to negotiators and their records, no firm assessments can be made as to the cause of the present non-agreement.

The FSA, led by its Chairman Lord Turner, has also aimed at strengthening standards of financial supervision via an international approach, emphasizing the role of the Basel Committee and International Organization of Securities Commissions (IOSCO) in its Business Plan 2009/10. The strong correlation between the contents of the Basel Committee's recommendations on improving Basel II and Lord Turner's recommendations on the causes of the financial crisis, as contained in his report, support this assessment. However, since the acute effects of the crisis have receded somewhat, and markets have begun to function more normally again, profits have returned and bonus payments for bankers have apparently begun reaching pre-crisis levels once again. As a result, the City of London has mounted opposition to a comprehensive re-regulation of global financial markets. As stated above, it is possible that such opposition has had a major impact on the UK government's policy stance.

5. Funding, Tax and Monetary Policies

- Has the government initiated tax reductions/incentive schemes?
- Have these been aimed at the private and/or the corporate, domestic or the foreign sectors?

Tax policies in support of stimulus/ stabilization

As described in the respective section above, some main parts of the economic stimulus package used tax policy instruments, in particular changes in allowances and VAT cuts. This approach was chosen to give consumers more freedom in making their consumption choices, rather than deciding which consumption sectors should be strengthened.

- 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?

Monetary and currency policies in support of stimulus/ stabilization

The Bank of England pursued a highly aggressive expansionary monetary policy, after the second round of the financial market crisis began in September 2008. In particular, the bank slashed its interest rate from five percent in October 2008 to a mere 0.5 percent in March 2009. The bank also pursued an explicit strategy of quantitative easing designed to provide funds to the economy. Quantitative easing means that the central bank buys up

government bonds and private sector bonds, thus literally injecting fresh money into the economy. This is a highly unusual policy for a central bank to pursue, and its use is a measure of the seriousness of the situation.

With its Asset Purchase Facility, the Bank of England has the means to acquire bond issues up to a total value of £175 bn, of which up to £50 bn can be private bond issues. These assets are acquired through a subcompany of the Bank of England, the Bank of England Asset Purchase Facility Fund Limited. The volume of the acquired government bonds constitutes 10 percent of GDP since March 2009. Thus, factually, the whole of new public debt over this period was financed by the Bank of England.

The Bank of England, like most other central banks, has drawn lessons from the monetary policy mistakes committed during the Great Depression of the 1930s. At that time, tight monetary policy and an unwillingness to ease it further deepened economic problems and contributed to the depth of the depression, and thus also exacerbating economic misery for millions of people.

Having learned history's lessons, the new challenge for the Bank of England is to find a credible and well-timed exit strategy that will neither choke off a coming economic upswing nor allow inflation to emerge. Given the scale of the United Kingdom's expansionary monetary policy, concerns about this problem have already been raised by international institutions such as the IMF.

- 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?

Credibility of funding mechanisms

The United Kingdom, as was pointed out previously, is among the world's top countries in terms of its spending on the economic crisis, if one includes both outlays for stabilization of the banking system and stimulus spending for the general economy. As a result, the United Kingdom's budget deficit will reach unprecedented levels: starting with 12.6 percent for the fiscal year 2009 – 2010, the deficit will remain in the double digits for several years, reaching 10.5 percent in 2011 – 2012, and will, according to estimates

published by the Treasury, drop back into single digit territory only in 2012 – 2013.

The fact that the United Kingdom's public debt is on a trajectory that can probably be best described as an explosion has raised worries about the sustainability of the situation. Compared to other, similar countries, the United Kingdom's sovereign credit rating is most at risk of being downgraded, according to rating agency Fitch. If the country were to lose the AAA-rating for its sovereign debt, this would significantly increase its cost of borrowing.

6. Feedback and Lesson-Drawing

- Have there been revisions or additions to the original policy packages or a sequence of distinct stimulus policies in response to unexpected new developments?

Policy feedback and adaptation

In the last quarter of 2008, the first wave of banking rescue packages turned out to be insufficient to stabilize the financial system. It became clear by the end of 2008 that neither monetary policy nor rescue packages were sufficient to prevent a sharp contraction of the real economy. Therefore, the government responded by introducing a sizeable fiscal stimulus to support aggregate demand. These extraordinary policy actions started in early 2009. In support of the government's stimulus measures, the BoE brought interest rates close to zero by the end of May 2009.

- 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)?

Institutional restructuring

The institutional restructuring of banking regulation can be divided into the measures already implemented mainly through the Banking Act 2009 (implemented in February 2009), and future reform approaches currently being debated and detailed.

The Banking Act 2009 and further already implemented measures

While the reforms to date have not led to a major institutional reorganization, significant reforms and reorganizations were made to preexisting structures. The BoE and FSA both were strengthened by adjustments in their mandates: The FSA was assigned even more responsibility for prudential and conduct of business regulation, and the BoE gained statutory responsibility for systemic overview as well as remits to secure financial

stability.[3] The FSA in particular was strengthened in terms of resources in order to fulfill more detailed supervisory tasks. Both institutions have since restructured their organizations.[4]

As the most far-reaching regulatory work already implemented, the Banking Act has its origins in emergency legislation of October 2008 that came in response to the Northern Rock insolvency. These measures, initially restricted to one year, were adapted for permanent application to prudential banking problems and passed into law in February 2009. The act enables the executive to deal with failing banks, to protect depositors and to limit risks to financial stability. In addition to clarifying and strengthening the roles of the BoE and FSA in systemic, respectively prudential and business regulation, it created a framework for how to handle banks in times of insolvency, by establishing rules – the so-called Special Resolution Regime – for three subsequent steps:

- Financial stabilization: The FSA has a prudential mandate to identify banks that pose a threat to financial stability, and after consultation with the BoE and the Treasury, these latter two can engage in actions to stabilize the bank by selling it to a commercial purchaser or a bridge bank, or by taking public ownership.
- Bank insolvency arrangements: A clear-cut insolvency regime for banks, initiated either by BoE or FSA and executed by courts.
- Bank administration arrangements: These detail rules under which stabilized insolvent banks can be run by an administrator

The effects of the financial crisis have led to intensified cooperation between the so-called Tripartite Authorities – the Treasury, the FSA and the BoE. In fact, the Banking Act makes it mandatory that all three cooperate when dealing with failing banks, recapitalization of the banking system and other measures to support the credit supply.[5]

The strengthening of the FSA's role in prudential supervision, especially with regard to so-called High Impact Firms (HIF), is projected in the organization's budgetary expansion between 2008 – 2009 and 2009 - 2010, which amounts to an overall budget increase of 22 percent (from £362m to £441m).

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[3] The central bank received a clear statutory objective to protect the stability of the financial system.

[4] The Supervisory Enhancement Program, which is included in the Banking Act 2009, strengthened the FSA by increasing resources and deepening the organization's skills base, as well as leading to a major reorganization. The new operational structure tries to optimise internal operations, allowing the FSA to identify and mitigate risks. In addition, an increase in the number of supervisory staff is intended and the rule-making power of the FSA has been extended.

[5] The abovementioned three steps are characterized by extensive consultation between the Treasury, the BoE and the FSA

In its internal audit report on Northern Rock, the FSA identified weaknesses in its own supervisory approach. In response, the organization designed and launched a Supervisory Enhancement Program which entails important changes in internal processes, a significant intensification in the supervision of large, systemically important firms, and major investment in the number and skills of staff devoted to that supervision. In total, about 280 additional staff members will be recruited (going from a total below 2,800 to more than 3,000), of which around two-thirds are already in place.

Another proposed future shift is to back away from FSA adherence to a strict principles-based framework. Future reforms are being discussed that would shift to outcomes-focused regulation.[6] In the future, the evaluation of financial firms will be based on outcomes rather than compliance, and the enforcement approach will be tougher than that seen to date. The staff and supervision procedures have been and remain under overhaul within the FSA.

Overall, the measures taken so far have led to a refocusing and strengthening of the roles and remits of the leading regulatory institutions, the BoE and the FSA. The legal attempt to create clear-cut rules for winding up an insolvent bank can be seen as a reaction to the pronounced banking system problems of the UK beginning with the events associated with Northern Rock. The Banking Act is quite far-reaching, and was applied for the first time to resolve the Dunfermline Building Society in March 2009.

Further reform approaches

Further regulatory adjustments can be expected, and while widespread agreement on a wide variety on safeguard measures for the future exists, the precise architecture remains unclear at the moment.

First, a clear-cut agreement on improved regulation in all three fields – systemic, prudential, and conduct of business regulation – has been discussed with reference to proposed improvements by the Basel Committee. Once again, this is mirrored in the Turner Review.[7]

Based on this work by FSA Chairman Lord Turner, and approved by the Treasury, the Financial Services Authority is currently at work on the improvement of two aspects of regulation, namely bank regulation and corporate governance regulation. The reform of bank regulation aims to strengthen capital and liquidity requirements. Both the quality and quantity

[6] Financial Services Authority, "The Turner Review. A Regulatory Response to the Global Banking Crisis," (London: FSA, 2009), 9.
[7] For a detailed discussion of these aspects, see Maximilian J.B. Hall, "The Reform of UK Financial Regulation," (Loughborough University Dept. of Economics Discussion Paper Series, WP 2009), 16.

of capital held by banks need to be increased. Furthermore, the capital requirements for riskier trading activities must be increased. Another point is the improvement of the effectiveness and intensity of bank supervision. Business and risk monitoring need to be improved to ensure that financial institutions remain stable and secure. Therefore, the Financial Services Authorities' regulatory resources need to be extended. At the least, the reduction of incentives for excessive risk taking by banks needs to be addressed by tackling the problem of bankers' pay and bonuses. Long-term and sustainable growth should be rewarded rather than short-term or paper profits.

The reform of corporate governance holds the potential for major changes in the way bank boards function. Improved risk management at the board level, changes in the balance of skills, experience and independence and a better approach to audit, risk and remuneration are likely to be aspects of any reform. Moreover, institutional shareholders need to be more actively engaged in monitoring bank boards.

In terms of architecture, one can see disagreement between the political parties, with the Labour Party currently dividing the remits between the BoE and the FSA, and the Conservatives pushing a model that would strengthen the BoE by returning prudential regulation of banks to it, dissolving the FSA and creating a new consumer protection agency. Judging by public opinion polls in the UK at the time of writing (November 2009), the Conservatives' priorities seem more likely to be given a chance of being put into reality.

It remains unclear how financial stability supervision will ultimately be coordinated. The government has proposed the creation of a new institution, the Council for Financial Stability, consisting of members from the Tripartite Authorities (Treasury, FSA, BoE). The operation of the Council will be formalized on a statutory basis, thus providing it with clear responsibilities. The institution is aimed at increasing public accountability and decision-making transparency in financial market regulation. Meetings of the Council are to be held when particular risks to financial stability arise, and when action to intervene or resolve these threats needs to be considered. The main task of this new institution is to coordinate the activities of the various authorities. It is planned as a forum for discussion and coordination of the activities of the authorities in attempting to ensure financial stability. However, the Conservatives prefer another option and at the time of writing, no conclusion seems possible. In addition, the government intends to bring forward primary legislation requiring the Financial Services Authority to establish an independent consumer education and information authority (see "social protection").

In addition to the abovementioned reform efforts, the Treasury expects that key parts of the new global financial framework will be agreed upon at the EU level. Therefore, Europe's ability to identify and manage system-wide prudential risks needs to be enhanced. The European Union needs to develop the quality and scope of rules applying to firms and ensure their proper enforcement.

7. Tentative Economic Impact

- 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)?

Economic and political effectiveness of the crisis response

The effectiveness of measures taken by the UK government must be considered individually. As pointed out above, many of the standard macroeconomic indicators such as the rate of economic growth, the rate of unemployment, the rate of inflation, and the size of the budget deficit developed in a rather negative manner. While the United Kingdom seems about average in terms of the contraction of economic activity, it must probably be rated below average on the three other indicators: the rate of unemployment has climbed particularly steeply if compared to continental European countries (although not if compared to the United States), and the rate of inflation (at least as of November 2009) is back at about one percent, sufficiently high for the Bank of England to have to worry more than the European Central Bank about reining in inflation by means of an interest rate hike. But as pointed out above, it is probably the budget deficit that the United Kingdom has to worry most about. Whether the government will succeed in developing and communicating a credible strategy for the future development of the state's finances will to a large degree determine the viability and eventual success of its anti-crisis strategy.

On the housing market, crisis measures have managed to limit the rapid decline in the price level. Credit easing measures have smoothed the credit crunch, and the quick and firm response has led to improved investor sentiments. The measures also helped the financial markets to relax, and trading has regained momentum. The recovery of major equity markets is also a sign

that economic conditions have left their steep downward trajectory and are beginning to stabilize. Interbank markets have also shown signs of gradually improving conditions.

Taken together, the effects of government measures to prop up the real economy have been modest – at best. However, compared to other countries like the United States of America, Spain or Ireland that suffered from the financial and economic crisis and the collapse of the housing bubble, the United Kingdom still scores favorably.

With regard to the government debt burden, a large budget adjustment is needed. Whether the government will indeed bring forward a broad fiscal consolidation program in 2010 is still to some degree uncertain, as the general election will have to be held by May 2010. It is far from a foregone conclusion that a government capable of conclusive action will be in office by the summer of next year. A hung parliament (i.e., one in which no party has a majority) is a distinct possibility, and might well stop the process of fiscal consolidation in its tracks. Such a political situation, given the country's lack of experience with coalition government, might well develop into a protracted crisis that would have an impact on the country's standing in the financial markets. The United Kingdom's sovereign credit rating would likely be negatively affected, resulting in higher spending for future government debt, thus resulting in a deepening rather than an improvement of crisis conditions.

Looking at the political logic of crisis management, the Labour government under Gordon Brown could have been interpreted as the perfect actor to cope with the crisis while at the same time winning public support for its measures. Given the prime minister's competence in the field, achieved through a decade of duty as chancellor of the exchequer, and his reputation as a politician who likes to get involved in policy detail, this could have been a success story of a beleaguered third-term Labour government rising like a phoenix from the ashes. In practice, events unfolded rather differently. A less-than-perfect communication strategy, as well as the interference of one of the biggest political scandals in recent years (over parliamentary members' expenses), have resulted in a situation in which political survival of the Brown government beyond next year's general election seems highly unlikely.

- 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?

Structural distortions

Regarding the economic structure of the United Kingdom, a public debate about the size of the financial sector has been going on for some time, triggered by remarks in Lord Turner's report. But questions as to whether the financial sector has outgrown its social usefulness have understandably been met with little enthusiasm in the City of London.

It remains to be seen whether the United Kingdom's particular profile with respect to crisis consequences – in particular, a high requirement for funds to stabilize the financial sector, and high losses in terms of tax revenue (because of the financial sector's comparatively large size as a component of GDP) – will translate into medium- to long-term consequences. While the United Kingdom could theoretically profit from a certain rebalancing, which would see the size of the financial sector shrink in favor of other sectors such as manufacturing and non-financial services, both economic and political considerations speak against this. Economically, it is difficult to see which mechanisms could produce decline in an area in which the United Kingdom enjoys a competitive advantage, and how other sectors could benefit from such a shift. Politically, it seems most unlikely that a sector so capable of influencing political actors and political agendas could let a move against its own central interests happen.

It thus seems unlikely that structural imbalances in the British economy – if one assumes them to exist according to the aforementioned analysis – can be corrected in the future. In that sense, government spending programs linked to the present crisis can be interpreted as prolonging such an imbalance rather than correcting it.

8. Concluding Remarks

The United Kingdom entered the financial crisis that started in 2007 (and turned into a global economic downturn in 2008) with a good economic profile. It had enjoyed almost a decade of very good economic development, of which its government had been very proud, and publicly so. However, the benefit of hindsight indicates that several of the factors that contributed to the positive economic assessment several years ago can now be identified as having sown the seeds of economic problems to come. A number of

economic vulnerabilities had existed which policymakers evidently chose to ignore: a substantial budget deficit maintained even in times of continuous economic growth; a high level of debt, particularly among private households; and the dependence of private consumption on an ever-rising housing market.

The United Kingdom is home to some of the most sophisticated financial markets in the world. It is therefore no surprise that the United Kingdom was particularly hard hit by the crisis, and at an early point. Evidence for the latter was provided by the crisis surrounding Northern Rock, which featured the first bank run in an advanced market economy for many years, and the first in the United Kingdom in 140 years. This early crisis was followed by several bank rescues that demanded enormous financial sums, such as the one for RBS.

The consequences of the financial market crisis in the United Kingdom demanded swift and decisive government reactions, which can clearly be said to have been forthcoming. The institutional mechanisms of the British political system, which is characterized by strong, perhaps even excessive centralization of power, the absence of relevant veto players, a weak parliament, and one-party government, allow for swift decision making, even if perhaps sometimes at the expense of rigorous debate.

These mechanisms were used, and given the scale of the problems in Britain an assessment of their use has to be on balance positive. There are no evident areas where hindsight would indicate that the decisions made were clearly wrong. However, while the government emphasized a transparent decision-making process, details such as secret loans to banks like RBS are now emerging, retrospectively starting to undermine the legitimacy of government actions.

For several decades, the United Kingdom has been at the forefront of promoting the liberalization of markets, in particular financial markets. Given its present problems, it is likely that some observers will quote the old saying that pride comes before the fall, since the United Kingdom seems to be suffering particularly hard from the fallout of the crisis in areas such as labor market performance, inflation and budget deficits. While the United Kingdom will likely remain an influential player in the area of global financial market regulation, it will probably suffer from a somewhat diminished stature in years to come.

The high probability of a change in government in 2010 leaves substantial uncertainty as to the policies likely to be pursued by the UK government in the future. Will the new government honor the pledge of cooperating in the development of new global financial regulation rules? Or will it take its new-found political mandate as a trigger for a policy shift and pursue a different policy agenda? These are central questions, but at present they simply cannot be answered with a substantial degree of confidence.

Study Context

The Bertelsmann Stiftung has a long tradition of assessing the quality of governance and devising evidence-based policy strategies for decision makers.

The **Transformation Index (BTI)** monitors political management, democratic quality and economic development around the world. The BTI encompasses 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 **Sustainable Governance Indicators (SGI)** offer a complementary focus on the OECD member states. The SGI evaluate the sustainability of political action in 15 different policy fields (from economy, labor, and education to environment, research and development), the quality of democracy and questions of strategic management capability in each of the 31 OECD countries.

The study *Managing the Crisis* is a joint initiative of the two projects.

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