GOOD GOVERNANCE:
LEARN FROM THE MISSING COUNTRIES

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Framing the Issue

Consider a different and unheralded "group-of-eight," comprised by these countries: Botswana, Chile, Mauritius, Uruguay, New Zealand, Norway, Singapore and Switzerland. Do they have any relevance for the G-20? Hardly, at first. None of them are invited to the G-20 heads of state London Summit on April 2. They are not G-20 members, since neither their economic size nor their population are large enough, and they lack the global "systemic significance" of most G-20 members. None of them belongs to the EU, so none in this group of eight can be represented by proxy in the G-20. And they do not really exist as a formal body.

But to argue for this particular group-of-eight small nations to be invited to the G-20 summit in order to represent their people (or their GDP) is to miss the point. Instead, in today's turbulent times, there is a forgotten rationale for the G-20 summit leaders to pay attention to this particular set of uninvited countries. Like the G-20, they comprise a rather diverse group of countries from different regions of the world, and are also at various stages of industrialization. But, unlike most of the G-20, this group of eight countries has exhibited high quality of national *governance*.

Let us review comparative performance of this good-governance-group-of-eight (ggg-8) by focusing on three of the relevant dimensions of governance, namely the extent of: 1) government effectiveness, 2) the quality of the application of rule of law, and 3) the effectiveness in controlling corruption.

The governance performance in each one of these dimensions is high in the ggg-8. As we can see in Chart 1, governance levels among this ggg-8 not only far surpass the G-20, but are even a bit above the rich G-8 club, even though the ggg-8 includes four developing countries (Botswana, Mauritius, Chile and Uruguay).

Further, over the past decade, governance has improved on average somewhat in the ggg-8, in contrast with the G-20 (Chart 2).

This significant difference in the quality of governance between the G-20 and the ggg-8 does not mean that each country member in the G-20 exhibits subpar governance, or that each country in the ggg-8 has already attained exemplary governance in all dimensions. Canada, a member of the traditional G-8, and of the G-20, stands out for its high level of governance in all dimensions, and not surprisingly, it is the only member of the G-8 that has had fiscal surpluses and whose financial house has been relatively in order. Conversely, one member of the ggg-8, Singapore, which does have exemplary governance ratings in political stability, regulatory quality, government effectiveness, judiciary and control of corruption, has subpar ratings in the "voice and democratic accountability" dimension (although even on that component it does rate above some G-20 members, such as Russia, China and Saudi Arabia). But in general, the countries in the ggg-8 do stand out in their governance performance, towering over and above the G-20.

One specific area of governance weakness for the United States in particular, but also for the G-8 and the G-20 generally, is the extent of "legal corruption," which also encompasses the distortive role of money in politics, as well as regulatory capture. As shown in Chart 3 already five years ago—well before the financial system imploded—evidence was already available about the glaring weaknesses in the US and across the G-8 in terms of legal corruption and capture, which are relevant for understanding some of the antecedents of the financial crisis, as well as drawing the lessons for public policy. Consequently, sheer power, country size, and systemic imperatives drive the particular constituency of the G-20, yet these have not been synonymous with world-class country-level governance in recent times.

Policy Considerations

Therefore, for the G-8 and the G-20 to claim a higher moral ground for appropriately representing the priority global concerns, and for appropriately acting on the crisis and beyond, it will need to be uncharacteristically candid in acknowledging and understanding their own lessons of recent governance failure. And it would also benefit by drawing from the positive lessons that emerge from countries outside the G-20. The ggg-8 demonstrates that good governance is attainable, with each country offering valuable case studies in particular dimensions of governance relevant for today's challenges. It is precisely some of those good governance lessons that need to be "represented" and put into practice among the G-20.

An important set of lessons to be considered by the G-20 can be gleaned from Chile's experience with a financial crisis almost 30 years ago, in the early 1980s. As in the US in recent years, prior to its own major crisis Chile underwent an ideologically-driven financial deregulation in finance, mismanaged its macro-economic policies; had ballooning corporate debt, and vested private corporate interests unduly influenced regulations and policy.

Yet the serious financial crisis in 1982 did trigger concerted and decisive action in Chile, including: 1) sound macro-economic management, with fiscal, exchange rate and monetary policies that nowadays are regarded as world-class; 2) effective Central Bank initiatives in loan restructuring and in a temporary and conditional purchase of non-performing loans from viable banks, as well as in the intervention of troubled banks and sale or liquidation of insolvent banks, and, 3) a revamp of the prudential supervision and regulatory framework, including the institution of an effective Securities and Exchange Commission, and the overhaul in oversight, disclosure and prudential regulations.

The case of Chile exemplifies the paramount importance of decisive and comprehensive public policy action to tackle a major financial crisis (minimizing the short-term direct cost to the taxpayer was not the major objective). Today, the Chilean economy is on sound footing and does not require a bailout. A countercyclical fiscal stimulus plan is now in motion to counter the effects on the (very open) real economy. This stimulus is funded from Chile's large stabilization fund, the result of years of budgetary surpluses, and it has a very effective and balanced composition between social and infrastructure expenditures—devoid of "pork" and unproductive special interests projects. Further, over the years Chile has grappled with campaign funding reforms, which are still ongoing, so as to mitigate the perverse impact of money in politics and regulatory capture.

Not every detail of the Chilean experience is applicable to G-20 countries today, and it is far from the only case deserving in-depth study. But the Chilean case has not received sufficient attention, in contrast to the focus on the Swedish lessons from their 1992 financial crisis (e.g. Richardson and Roubini recently wrote "we are all Swedes now").

Other countries in the well governed group of the ggg-8 have also exhibited sound macro-economic management. In recent years, Botswana, Singapore, Norway and Switzerland (alongside Chile) have each had significant budgetary surpluses, averaging an impressive 7 percent of GDP. In fact, the ggg-8 as a whole had an average fiscal surplus of about 5 percent of GDP during 2005-2008, in sharp contrast to both the US and the UK which run high fiscal deficits, amounting to 3 percent of GDP (among the G-7 only Japan managed to fare worse).

Action Items for Global Coordination

Unsound *macroeconomic policies* were also a determinant of the financial crisis, suggesting that particular attention by G-20 leaders during their summit needs to be paid to present and future fiscal and monetary policies, as well as to regulation. The U.S. and other economic giants in the G-20 will need to implement decisive policies, including an *effective financial bailout plan*, which is not overly generous to the traditional large bankers and poses future moral hazard (yet it does include banking triage), as well as carrying out a productive fiscal stimulus package. Yet these urgent measures need to be balanced against the paramount objective of a fiscally responsible medium-term program that restores and institutionalizes macro-economic stability.

Further, the *financial regulatory system* needs to be revamped in earnest, making history of the ineffective and captured regulatory institutions, as well as ceasing the national and cross-border regulatory "races to the bottom" (financial institutions 'shopping' for the most lenient treatment among competing regulatory institutions, both within the U.S., and also between the New York and London financial centers). And the nefarious impact of *money in politics on the resulting performance and capture of financial regulations and policies* can no longer be ignored. Countries like Norway have fared better on many of these issues, and the lessons ought to be reviewed by G-20 leaders.

A focus on governance and anti-corruption by the major world powers is a particular priority now also because of the major ongoing shift in the role of government, which in the most prominent countries is already becoming a major provider of: 1) infrastructure and other large investments; 2) massive bailout funds to selected financial institutions; 3) ownership of major financial and other (previously private) assets and institutions, and 4) special social safety and housing programs. And the government role as a regulator is about to be transformed as well. These require specialized initiatives on governance, transparency and integrity.

Another consideration for G-20 leaders is how Norway, Chile and Botswana have also effectively *managed their oil and mineral wealth*, in contrast with most every other resource-rich country. Further, each one of the ggg-8 countries provide case studies for *controlling corruption*, a pending challenge in most countries in the world, including within the G-20 constituency.

And each country among the ggg-8 have also exhibited *open trade policies*, shying away from protectionist tendencies that plague some in the G-20, where right now the specter of further protectionism, including in finance, looms large. Further, it is not countries in the G-20, but Switzerland and Norway from the ggg-8 instead that lead the world in terms of *environmental performance.* Costa Rica, New Zealand and Colombia are also among the top 10 environmental performers, while France, ranked 10th, is the only individual member of the G-20 among the top 10. This is noteworthy, since the G-20 is expected to seriously address global climate change, and therefore it may want to draw on the good experiences outside of their own members.

Last, but not least, the G-20 needs to concretely offer initiatives to help address the enormous plight of the poor in many *developing countries* in crisis, which need urgent assistance. Again, Norway has shown to be a model for donor countries, a rare example in a world where *"aid effectiveness"* has been elusive. Norway balances a generous commitment to fund development with a clear focus on selectivity and on governance in their aid programs and in recipient governments.

Being aware of the serious recent failings in the U.S. economy and polity, President Barack Obama has mentioned the need to address some of these broader governance challenges, including special interest politics. A few other G-20 leaders also recognize the need for major reforms.

In times of such deep crisis, there is both an opportunity and a responsibility to transcend local politics and implement far-reaching changes. This could enable a major leap forward in governance, and in regaining trust and credibility around the world, and in the major markets.

Some individual countries in the G-20, like Canada, and some within the EU, like Finland, Sweden, Denmark and the Netherlands, also offer some relevant examples in good governance. But as important is to draw from the experience of some other countries which have performed well, even if they are far from the table at the G-20 Summit in London.