

GOVERNMENTS CAN NAVIGATE UNCERTAINTY TO EMERGE STRONGER

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GOVERNMENTS ARE TRYING TO read the economic tea leaves, and they are finding that they have more questions than answers. The global economy is in the midst of a synchronized slowdown, and although there are signs of stabilization, the outlook is highly uncertain. The known risks include the increasing level of high-risk corporate debt in OECD countries and the unpredictable direction of trade policy. The events that are difficult to predict, such as natural disasters and health pandemics, can also change the trajectory of the global economy with little warning.

How, then, can governments ensure that they not only survive unexpected economic hits—but also thrive? The answer lies in seeing adversity as an opportunity. Governments must take action now to ensure that they are ready not only to move quickly in the face of an economic downturn or crisis but also to act in a way that builds advantage for the long term. Specifically, governments should take three steps. (See the exhibit.)

- **Prepare, don't predict.** Rather than spend more on the art of prediction, governments should invest in scenario planning and war-gaming to guide and test the robustness of their preparedness.
- **Respond, don't stall.** Governments should work more effectively across traditional bureaucratic boundaries. They should design whole-of-government responses to a crisis and foster connections among rank-and-file civil servants to make the government more pragmatic and nimbler. And governments should collaborate more effectively with other governments and multilateral organizations.
- **Regenerate, don't react.** Governments should use periods of economic difficulty to position their country for long-term success, and they should engage citizens in their efforts. Much as corporations must move beyond short-term, defensive responses to economic headwinds, governments can turn adversity to their advantage.

Governments Can Navigate Uncertainty to Emerge Stronger



Source: BCG analysis.

In the years ahead, governments must expect the unexpected. Those that embrace these three steps will position their country to withstand the inevitable economic shocks—and emerge from them stronger.

Prepare, Don't Predict

As both governments and private-sector companies know well, economic predictions can be maddeningly unreliable. Consider that although more than 25 subprime-lending firms in the US declared bankruptcy in February and March of 2007, it wasn't until August of that year that the Federal Reserve revised growth projections. Even the few economists and financiers who issued warnings about the housing market in the years leading up to the crash did not accurately predict the timing or consequential nature of the market collapse.

Given the difficulty of making accurate predictions, governments need to prepare for multiple possibilities—including low-probability events and unexpected ones. To this end, governments should adopt two critical, related tools: scenario planning and war-gaming.

Using scenario planning, governments can explore potential near- and long-term scenarios and develop plans for each. By thinking through potential standard operating procedures for crises, governments can bet-

ter prepare for emergencies. In particular, scenario planning can help governments spot potential bottlenecks that impede effective action—and set the stage for fast policy execution in time-critical situations. Australia, for example, recently conducted a planning exercise to explore four distinct future scenarios that could come about because of factors such as technological disruption and geopolitical developments.

One approach to scenario planning is to identify megatrends and prioritize those that have the highest potential for affecting a specific area of government responsibility and that cause the greatest levels of uncertainty. Examples of salient megatrends include the rise of resource scarcities (such as water and energy), the rise of cybersecurity risks, and the centrality of social media as a source of information for citizens. Using different combinations of these trends, governments can develop and analyze a set of potential scenarios to understand how well prepared they are for an unpredictable future.

War-gaming—a time-limited exercise that simulates challenging conditions and requires participants to map out a response—is a critical tool for honing a government's rapid response capabilities. Most often associated with defense, financial war games can help governments test the speed, resilience, and adaptability of their

response not only to an economic crisis but also to events such as massive hacks in government databases, a collapse in commodity prices, or a global pandemic.

War-gaming, of course, is not entirely new to governments. Financial regulators in the G7 have tested cyber-attack scenarios, and the Singaporean government has used policy-based simulations and games. And in 2009, in a top-secret weapons laboratory outside Washington, DC, the Pentagon conducted its first-ever financial war game, pitting the US against its major economic competitors. Along with Pentagon officials, this economic simulation also involved members of the US intelligence community, the US Department of the Treasury, the Federal Reserve, Wall Street, and various think tanks.

Conducting war games should become routine and incorporate exercises focused on economic cycles, including potential recessions and economic shocks. These games should be conducted not only at the central level but also at the departmental and subnational levels and include a wide variety of officials in order to understand the potential bottlenecks in a crisis. War-gaming should also include nonpublic-sector participants, such as companies, consumers, think tanks, and academics, to avoid groupthink, which is a risk when all players have the same background.

War-gaming will yield significant benefits. First, civil servants who are continuously challenged to react to various events will develop a more adaptive and agile mindset. Second, governments will have the opportunity to develop plans on the basis of key triggers under various scenarios—potentially accelerating the response to a downturn.

Respond, Don't Stall

Like most organizations, governments are often poor at anticipating or recognizing adverse events, and even when they do, cumbersome bureaucracy and rigid cultures often prevent them from reacting quickly. Governments need to engineer cooperation at the highest levels of ministries

and agencies and build better connections among rank-and-file civil servants in those organizations to foster natural collaboration. At the same time, given the global nature of many challenges today—and the extensive interdependence of economies around the world—governments must improve their abilities to collaborate on an international level.

Three Critical Obstacles to Effective Government Action. Governments face three challenges in mounting a quick and effective response to a crisis, such as an economic downturn.

The first challenge is the difficulty of spotting a crisis quickly owing to governmental organization structures. Governments typically have a ministry, agency, or department structure, which can prevent information sharing even in areas where these units have overlapping responsibility. These artificial barriers can hinder governments' abilities to spot economic signals.

The dangers of such silos were evident during the global financial crisis. In the UK, for example, the Bank of England and the Financial Services Authority (FSA), the country's financial regulator, missed signals that generally fell in each other's domains. So, when economists at the Bank of England were making decisions about monetary policy, they did not factor in issues such as the proliferation of collateralized debt obligations. The FSA, meanwhile, did not adequately consider larger systemic risks in its assessment of individual banks. As a result, the government was slow to recognize the magnitude of risk in the financial system.

The second challenge is a limited ability to execute a domestic rapid-response plan. Consider the practice of increasing government spending to stimulate a weakening economy. Ideally, government grants to subnational governments, such as states or provinces, would be countercyclical—rising when the economy is weakening and dropping when it is growing robustly. But a 2010 OECD study that analyzed the period from 1980 to 2010 found that grants from

central governments to subnational governments were more volatile and generally more cyclical than subnational tax revenue. The same study also found that the flow of funds lagged the cycle by one to two years in many countries. Such a lag likely reflects both slow decision making and slow disbursement.

Indonesia, for example, passed a stimulus package in February 2009, but only 14.2% of the funds had been spent by September of that year. This slow disbursement was due in part to delays in tendering mechanisms and a lack of preparedness on the part of public servants, particularly those at the local level. Even Germany, which reacted quickly to minimize the economic effects of unemployment caused by the global financial crisis, faced delays in 2009 at the local levels. Further compounding the challenges of a rapid response is the fact that multiple ministries and agencies are needed to address an economic downturn or crisis—but they often develop their responses in relative isolation.

The third challenge is the difficulty of developing a government response in coordination with the actions of other governments and multilateral organizations. Despite recent moves toward protectionism, global economies remain highly integrated. At the same time, many issues that pose a significant economic threat—including global pandemics, climate change, and large-scale migration—require a global response. But governments struggle to collaborate internationally to address both slow-building and sudden economic disruptions.

Four Actions to Improve Government Response. Governments can, in fact, reduce or eliminate delays. In the midst of the 2009 financial crisis, for example, the Singaporean government leveraged its small-business-lending programs and the country's network of financial institutions to launch new credit programs within just six weeks of announcing the effort.

Governments should take four actions to improve the speed and effectiveness of

their response to an economic downturn. First, they should make structural changes to promote collaboration among ministries, agencies, and departments. This is critical to ensuring an effective whole-of-government response.

Some governments have created a ministry or a ministry-level position to organize a cross-functional response to broad-based economic issues. Sweden, for example, has established the Ministry for the Future to assess how public policy should address the country's long-term strategic issues. Crucially, the prime minister designated the head of the ministry as a cabinet-level role, giving the unit significant status and authority. Singapore, meanwhile, has appointed senior leaders (who then have sufficient gravitas to push through policy) as coordinating ministers on cross-functional issues. So, although housing and infrastructure development are under different ministries, the newly created coordinating minister for infrastructure can ensure that when new housing developments are being built, the plans for nearby roadways, sanitation, and other requirements are also underway.

Second, governments should foster a nimble and naturally collaborative workforce. Governments that foster the development of strong personal ties among people working in different departments are likely to more quickly recognize danger signs—including those that indicate a downturn—and implement an effective response. Personal connections should be seen as an important complement to robust processes and systematic analyses of data.

A critical component of this effort is making ministries, agencies, and departments more permeable at all levels by fostering linkages that enable civil servants to interact easily with peers from different agencies. After all, in a crisis such as a downturn, people rely on informal networks to get around bureaucracy. Putting in a formal request to another department or ministry could take days or months—time that is simply not available in a crisis.

Governments should take steps now to encourage the development of personal networks. To help civil servants build connections, governments can offer cross-ministry leadership trainings or even greater secondment opportunities that let public-sector employees work temporarily in an outside organization. Governments can also encourage more employee rotations among agencies and ministries. The [cross-pollination of talent in the public sector](#) is relatively rare. In Australia in 2017, for example, only 2% of public servants moved among agencies.

Third, governments should try to remove barriers to data sharing among ministries and agencies. No doubt, there are signs that data is becoming more integrated as governments push to go digital. For example, vast amounts of US government data on topics such as finance, manufacturing, and climate are publicly available on the data.gov website. Still, in most countries, operational data remains walled off within various government units, and the adoption of tools for cross-functional project- and initiative-based collaboration is slow. Removing the barriers can advance both the shift toward a whole-of-government approach and an increase in pragmatism.

Fourth, governments should improve their abilities to collaborate internationally. This starts with embracing a mindset of shared costs and shared rewards. Too often, international collaborations fail because countries enter into them with a win-maximizing mindset, intending to give very little while gaining a lot. Instead, they should adopt a view that each country will shoulder a burden of costs commensurate with the benefits it derives.

With that mindset as the foundation, governments can move beyond an approach that spurs collaboration only when a crisis arises and, instead, build and constantly test operational readiness for a variety of regional or global risks. This can be done through mechanisms such as the war-gaming approach advocated above. For example, after the Asian financial crisis in the late 1990s, a group of Asian countries drew on the lessons learned and developed the Chiang Mai

Initiative, a multilateral currency-swap arrangement that would mitigate balance-of-payments risk and short-term liquidity challenges in a financial crisis. Rather than wait for a crisis to ensure the efficacy of the arrangement, these countries coordinate with the International Monetary Fund to routinely carry out test runs that simulate a financial crisis in member countries. Using the test results, they then improve the effectiveness of the initiative. Governments can use similar test runs to hone the operational readiness of international collaboration for a variety of potential risks.

Regenerate, Don't React

As the saying goes, in the midst of every crisis lies great opportunity. Governments should leverage the urgency created by an economic crisis—and the political capital it creates—to advance long-term goals and ambitions. In particular, governments can use periods of economic difficulty as a catalyst for transforming the economy.

Disruption has often created an opening for transformation. Finland, facing both the loss of a major trading partner (owing to the breakup of the Soviet Union) and the collapse of the financial sector in the early 1990s, took steps to transform national political and economic institutions.

Finland's influential new Science and Technology Policy Council (STPC)—a group of business leaders, university administrators, top policy makers, and union representatives—set the agenda for a national innovation system. Financial and trade policies were liberalized, and the telecommunications sector was deregulated. And despite the financial pressures created by the crisis, the STPC authorized substantial increases in funding for national R&D and higher-education institutions. The period was particularly severe for Nokia, which in 1992 began divesting businesses in order to focus on mobile communications. But by the end of the decade, Finland—with Nokia in the lead—emerged as the world's leading center for wireless communications equipment and handset manufacturing.

Sweden also has a track record of taking regenerative steps, rather than simply remedial measures, in the face of adverse events. Following the country's 1992 housing collapse, which forced the government to take over several major banks, the country took action to restore the economy's long-term health: it invested in improving education (developing a new national curriculum, for example), and it drove structural reforms (such as the deregulation of the telecommunications sector). Later, in the midst of the global financial crisis in 2009, Sweden steered additional funding into R&D: SEK 5 billion to universities and SEK 3 billion to public R&D institutions.

As governments think about how their response to an economic downturn can drive economic transformation, they should pay particular attention to implications from the rise of new industrial digital technologies that support Industry 4.0. Investments in reskilling programs, for instance, could help build the workforce needed to succeed in the future.

At the same time, governments should draw on the power of citizens to drive the transformation. Periods of economic difficulty often trigger rising citizen disenchantment with and declining trust in public institutions. Such developments can also spark increasing citizen activism, sometimes in opposition to government. Rather than trying to temper or quiet citizen involvement, governments should take action to harness that energy and build public support for the major economic transformation efforts. And they should focus on policies that ensure economic growth is inclusive and that support citizen well-being. Encouraging and building citizen engagement improves the legitimacy of the policies implemented by government, ultimately magnifying their positive impact.

Some governments and public institutions have already moved in this direction. The Bank of England, for example, has estab-

lished panels to gather input from citizens on issues such as pay levels, employment, and the cost of living.

Making Government Crisis-Ready

Certainly, economic signals are more encouraging than they were a year ago. But given the weakness in sectors such as manufacturing and the risks posed by a number of wildcards, governments should be sure they are ready to face a challenging economic environment.

To assess their readiness, government leaders should ask a few critical questions:

- Are we prepared for a variety of scenarios, even those that may seem relatively unlikely?
- Have we practiced responding to a crisis by conducting war games or other exercises—or are we waiting for “game day” to see how various ministries and agencies are able to work together?
- Are we encouraging our workforce to build connections across agencies and ministries?
- Are there structural changes that can be made today to ensure cooperation and data sharing at the highest levels of government?
- Do we have a vision for a transformed economy and society—an outlook that would inform and shape our plans to regenerate after a crisis?
- Are we actively drawing citizens into the policy development process to ensure public buy-in for major initiatives?

Governments that ask and answer these tough questions can begin to make changes that will help them not just survive—but thrive—in the face of adversity.

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