



ACCOUNTABILITY AND THE EXPERIENCE OF THE 2007 GLOBAL FINANCIAL CRISIS

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ABSTRACT

The ripples of the 2007 financial crisis are still felt in many economies. Taking advantage of hindsight, this paper examines the factors that facilitated the occurrence of the crisis and how the crisis was managed. It uses the concept of accountability in the private and public sectors of the economy as the yardstick for assessing the behaviour of errant financial actors and concludes that the crisis resulted from the cumulative lapses in corporate governance and operational procedures. It also concludes that profitability and accountability are not always positively related in a free enterprise system. An examination of the coping strategies used by the developed countries points to the effectiveness of planned government intervention in economic activities. For the developing countries, especially in Africa, the lesson is that a responsible government must at all times put the wellbeing of its citizens above any received doctrine.

Keywords: Financial crisis, Accountability, Profitability, Free enterprise system, Planned government intervention.

INTRODUCTION

Accountability, especially in business and politics, has remained topical. Essentially, accountability relates to the existence of a relationship involving at least two parties wherein one party is responsible to another in his/her actions. To that extent, it involves a commitment to some latent or expressed expectations. It involves trust as moderated by rules or guidelines governing the relationship. It also involves the existence of institutions for evaluating and monitoring behaviour. In the private sector, accountability is closely associated with, though not limited to, the accounting arm of management and the quality of professionalism therein. In this context, professionalism demands more than the ability to organise financial data in line with the Generally Accepted Accounting Principles. It goes further to demand strict compliance to ethical standards as specified by a recognised regulatory body.

The capacity to garner public confidence in the discharge of one's services to society is, indeed, one of the hallmarks of accountability. This requires the possession of such positive attributes as objectivity, due care and integrity. Thus, when an investor decides to buy the shares of a company based on the company's performance as reported in its audited accounts, the investor is in effect attesting to the confidence he/she reposes in the persons and processes that produced the accounts. In the private sector this confidence is expected to permeate the entire spectrum of economic activity, namely, investment, production, distribution and consumption. Every linkage in the process calls for accountability.

It is well appreciated by most business organisations that it is necessary to reckon with the needs, wants, and preferences of the consumer. Failure to be accountable in this regard could lead to poor business performance or even outright liquidation. But, there is a dimension of accountability in the private sector which is hardly captured in financial reports apart from a peripheral and rather cosmetic mention in the footnote. This aspect has to do with environmental issues including accountability for industrial effluent or for environmental degradation brought about by certain economic activities as in the case with oil and gas exploitation in the Niger Delta region of Nigeria (Tamunonimim and Ngerebo, 2013).

In the case of the Niger Delta, one wonders if the financial reports of the multinational oil companies give a true and fair reflection of their operations. If not, who bears the unreported costs, and for what compensating benefit? These and similar questions bug the mind as the issue of accountability is being examined. This paper does not set out to provide answers to the questions but rather seeks to draw attention to some concerns in the broad-based concept of accountability as they relate to economic development and stability.

Accountability: Definition and Issues

Accountability, by definition, involves being answerable to someone, group or institution for one's actions. (Bovens, 2006) acknowledged this position when he described accountability as "a relationship between an actor and a forum, in which the actor has an obligation to explain and to justify his or her conduct; the forum can pose questions and pass judgment, and the actor may face consequences"¹. The key components of that definition are (i) a relationship between an actor and a forum, (ii) an obligation to explain or justify conduct, (iii) the right of the forum to question and pass judgment and, finally (iv) the possibility of the actor having to face the consequences of his conduct (Akpakpan, 2010). Government, especially at the federal level, is increasingly calling for accountability from the private sector. In Nigeria, for example, the recent removal of the Chief Executive Officers of some financial institutions on grounds of alleged financial malfeasance is a manifestation of government's concern about accountability. Similarly, the on-going restructuring

in the financial sector underscores government resolve to instill discipline and accountability in the private sector.

The level of accountability in the public sector is, however, not so obvious. When measured against the accountability components earlier stated, there is no doubt that in Nigeria there is a relationship between the actor (government leaders and their representatives) and the forum (citizens). It is, however not clear that any government in the country has sufficiently demonstrated the obligation to explain or justify its conduct to the citizenry. For such an obligation to exist, the actor must see himself as being less powerful than, or in some ways dependent on, the forum. Where the reverse is the case, as in Nigeria, the obligation ceases to exist. Rather, those to whom the actor should account are busy struggling for whatever personal benefit they could extract from the relationship. This has arguably been the case for a long time. It is reported that the London based *Africa* magazine, over three decades ago, quoted Obafemi Awolowo as follows:

Since independence our governments have been a matter of [a] few holding the cow for the strongest and most cunning to milk. Under those circumstances everybody runs over everybody to make good at the expense of others (Wikipedia., 2010).

In the circumstance, much as the right of the citizen to ask questions and pass judgment exists, the inherent defect in the relationship between the actor and the forum limits the questions asked and blurs the judgment passed. It is, however, the desire of government that errant actors should face the consequences of their actions. This explains why institutions such as the Economic and Financial Crimes Commission (EFCC) and the Independent Corrupt Practices and other related offences Commission (ICPC) were established to instill the culture of accountability in actors. Also, given the interface between corruption and accountability, current government effort in fighting corruption could be regarded as a way of encouraging accountability and promoting economic development and stability. To take accountability for granted can prove disastrous as was the case during the 2007 financial crisis

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Financial institutions, worldwide, trade with other people's money. It is expected that in their intermediation role they would exercise due care so as to protect the interest of depositors and inspire their confidence. In other words, they are expected to show accountability in their decisions and in the way they conduct business generally. Somehow, that accountability was taken for granted until it was too late in 2007 when many banks in the United States ran into liquidity problems arising from the excesses associated with their high risk (subprime) lending. The interest paid on the high-risk loans was higher than what was paid for safe loans. That made subprime lending seemingly attractive to the banks. The expectation was that the high risk borrowers would

continue to service the loans and that the financial institutions would continue to reap from the high interest. For some time that was actually the case until the high risk took its toll and borrowers started to default. As more borrowers defaulted many financial institutions could no longer meet their obligations to depositors and other stakeholders – and so the crisis ensued. The crisis is also traced to abuses in the use of financial derivatives, especially securitization which [Akpakpan, \(2009\)](#) had described as “risky, and dangerous to the financial system, the economy, and the society as a whole”. He explained further as follows:

Securitization is the practice of raising funds by pooling various loans (that a lending institution has granted) into sellable assets and selling shares (securities) in the pool of loans to investors (i.e., shares in the pool of income-generating assets). Because by securitization banks are able to pass on the risk in the loans they make to other people, and they actually earn money by so doing, they are encouraged to make more loans even to high-risk borrowers in order to have more loans to pool and sell to make even more money (p.4).

The speculative use of this financial instrument led to overvaluation of assets which in turn brought about the ‘liquidity shortfall in the U.S. banking system’. The main concern of the banks was short-term profit making with little regard to accountability to depositors and the investing public. The meltdown was thus the result of an accumulated series of lapses in corporate governance and operational procedures. What started as a U.S. problem quickly grew into a crisis of global dimension with very severe consequences. Stock markets plummeted, some financial institutions collapsed while others were at the verge of doing so, and the housing market was replete with foreclosures and evictions. Faced with imminent economic collapse the government in many countries responded by injecting large sums of money into their ailing financial institutions so as to keep them afloat. The United States was the first to react in that manner, its free market ideology notwithstanding. In like manner, the affected European countries responded to the problem the way the Americans did. According to [\(Anderson et al., 2008\)](#), United States spent \$1.3 trillion while European countries spent \$2.8 trillion as at November 13, 2008 to bail out their ailing financial sectors. Apart from the financial sector, manufacturing also benefited from the bailout. As at January 2009 the auto industry in the United States, for instance, had received a total of \$24.9 billion from the \$700 billion which was set aside as bailout fund. And, in addition to the financial stimulus, the industry agreed to embark on some government induced reforms including:

- reduction in financial and non-financial benefits of Chief Executives,
- issuance of warrants to government for stocks in their organisations,
- speeding up the development of more efficient vehicles, and generally repositioning the industry for greater efficiency and competitiveness.

The regulatory and financial interventions made by the key proponents of the free market system have raised doubts about the integrity and accountability presumed to be embedded in that system (Essien, 2012). Some people have even wondered whether capitalism was, in fact, dead (Goodman, 2007; Reynolds, 2009). While not intending to engage in the debate, it would be instructive to note that there are lessons to learn from the crisis and the way it has been managed.

Lessons from the Financial Crisis and the Way Forward

One clear lesson from the crisis is that the confidence reposed in the probity and the efficiency of unfettered market fundamentalism might have been misplaced, after all. As it has turned out, accountability and profitability are not always positively related in the free enterprise system. For example, the financial institutions which engaged in subprime lending and securitization were conscious of the risk they were taking. That explains why they charged more for such transactions. They were also aware that the very funds they were risking belonged to others, the depositors. Yet the single-minded pursuit of profit made no room for accountability or due care in the way they conducted their businesses. The implication of this is that the market needs help; it needs to be regulated for greater accountability. The crisis has made a case for this position. That is, if government intervention with taxpayers' money is adjudged necessary for bailing out the free market in crisis, it would appear more prudent and instructive to intervene pro-actively in order to avert such crisis in the first place. That challenge confronts both the government and the regulatory institutions in the private sector.

Governments, especially in Africa, that had hitherto been led to believe that intervention would lead to suboptimal performance of their economies should now know that it need not be so. The United States and the European governments are aware of this fact. That is why they intervened in their economies with the "largest liquidity injection into the credit market and the largest monetary policy action in world history". The financial crisis that prompted the intervention had its collateral effects in the developing world. Indeed, research has actually shown that the growth rate of many developing countries reduced considerably due to the impact of the financial crisis on commodity prices, trade, remittances, and investment, and that the situation resulted in a sharp increase in the number of persons living below the poverty line in those countries (Velde, 2009). Yet intervention by African governments, where it took place at all, was less robust than was the case in the developed countries. In Nigeria, for example, the Central Bank injected a total of N620 billion (about \$4.2 billion) into the financial sector to salvage those banks considered to be in a 'grave situation' from imminent collapse. As a further action, the Chief Executive Officers of the worst affected banks lost their jobs. Those were modest interventions considering the enormity of the problem at the time. Nonetheless it still had a salutary effect on the economy. The Central Bank explained the position as follows:

In Nigeria, the economy faltered and the banking system experienced a crisis in 2009, triggered by global events. The stock market collapsed by 70% in 2008–2009 and many Nigerian banks had to be rescued. In order to stabilize the system and return confidence to the markets and investors, the CBN injected N620billion of liquidity into the banking sector and replaced the leadership at 8 Nigerian banks. Since then, the sector has considerably stabilised (Sanusi, 2010).

In addition to bailing out the ailing banks, the Nigerian government took other initiatives including the setting up of Asset Management Corporation (AMCON) with the prime function of buying toxic assets from banks, and the establishment of a N500 billion intervention fund for use in strengthening the real sector of the economy. As mentioned earlier, the organised private sector has a role to play in promoting confidence and a culture of accountability in the economy. Professional bodies now face a fresh challenge to look inward and update their standards and practices so as to cope with contemporary experiences. It would be necessary to examine, for instance, if the provisions of the Generally Accepted Accounting Principles (GAAP) and the Generally Accepted Accounting Standards (GAAS) are adequate for ensuring professional competence, and integrity given the prevailing challenges. In this regard, the recent adoption of international reporting standards under the aegis of the Financial Reporting Council of Nigeria seems to be a move in the right direction.

CONCLUSION

We have attempted to explain what accountability represents. We have argued that accountability and transparency are not inherent features of an unfettered free enterprise system. There is the need for planned intervention. And, if there was any lingering doubt about the necessity for government intervention in a free enterprise system, the role of government in successfully containing the 2007 financial crisis had put that to rest. The lesson for the developing nations, especially in Africa, is that they should be less gullible in accepting any advice to the contrary. Leaders in the United States and Europe have clearly demonstrated that a responsible government must at all times put the wellbeing of its citizens above any received doctrine. African governments must queue in.

End note

¹ For further discussion of the subject see Akpakpan, E.B. (2010). “Accountability as an Antidote to Corruption”. Uyo: A Paper presented at the ICPC Workshop on Accountability in Local Government Administration. August.

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