

# The 2008-2009 Global Crisis and Governance

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**Abstract** *In this study, we examine the impact of the 2008-2009 Global Crisis on Governance. We focus on the World Bank's Worldwide Governance Indicators (i.e. WGI) which includes six dimensions of governance. These six dimensions are "Voice and Accountability", "Political Stability and Absence of Violence", "Government Effectiveness", "Regulatory Quality", "Rule of Law", and "Control of Corruption". We find that, due to the crisis, the world suffered in terms of "Voice and Accountability" and "Political Stability and Absence of Violence" scores. On the other hand, we are seeing that the governments around the world reacted fast and improved "Government Effectiveness", "Regulatory Quality", and "Rule of Law" after the crisis. This process continued through year 2011 and beyond. In terms of "Control of Corruption", there have been ups and downs, but the overall trend is down, which indicates that the governments, on average, have not been willing to or effective in controlling corruption.*

**Key words** Governance, WGI, economic crises

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## 1. Introduction

The recent global crisis has had a big impact on governance around the world. Some countries have weathered the crisis better than the others. There have been quite a few studies that examine why we had different responses to the crisis from different countries. In this study, we take a holistic approach and focus on what happened in governance globally, rather than focusing on a specific country or a group of countries. For this purpose, we use the World Bank's Worldwide Governance Indicators (i.e. WGI) dataset. This dataset covers governance data for 215 countries. The WGI dataset covers six indicators of governance. These are "Voice and Accountability", "Political Stability and Absence of Violence", "Government Effectiveness", "Regulatory Quality", "Rule of Law", and "Control of Corruption".

By looking at a more comprehensive dataset compared to the previous studies that only focus on a group of countries; we are hoping to draw more generalized conclusions. We focus on two issues: (1) how governments overall react to the crisis, and (2) the timing of these reactions. We believe that the findings in this study will shed a new light on the impact of crises on governance. More specifically, we will see how different governance indicators changed over our sample period (i.e. which includes the three-year periods before and after the crisis).

## 2. Literature review

One of the earlier studies that examine the impact of a crisis on governance is Haggard (1999). In this study, the author focuses on the East Asian financial crisis of 1997-98. The author examines three possible factors that may have a negative impact. These are the role of political regime type, the structure of business-government relations, and the design of government agencies. Haggard (1999) contends that institutional weaknesses contributed to the onset of the Asian financial crisis.

Higgott (1998) also examine the Asian crisis. The author lays out those aspects of the crisis that are common to all the countries affected by the crisis. According to Higgott (1998), Japan had a significant role as a "long-term" and "ever-present" factor in the crisis. The author also talks about the resistance of the Asian countries' economic development models to conform to the Western economic system. The author also discusses the role of the IMF after the crisis.

Fleischer and Parrado (2010) examine the impact of the 2008-2009 crisis on executive decision-making in Germany and Spain. The authors argue that, during this period, while both countries experienced a centralization of executive decision making, this was less pronounced in Germany due to its institutional setting. Fleischer and Parrado (2010) explains that this was due to the Chancellor's authority being more limited compared to the Spanish Prime Minister's in cabinet.

Jung (2010) argues that the global financial crisis that began in 2008 has had a significant impact on public administration in most countries in the world. The author examines "path dependence (adhering to existing policies or changing course), centralization or decentralization, politicization (reliance on political appointees or the permanent bureaucracy), coordination and coherence or retention of power by individual ministries or agencies, and time perspective (the search for quick relief or long-term solutions)". According to Jung (2010), "the crisis disrupted the stability of public administration in many countries. At the same time, it has facilitated policy and institutional changes that otherwise might not have been possible to implement. Different countries, experiencing the current economic crisis in different ways, have chosen different options within these dichotomies, with varying levels of success".

Another study that examines the impact of this recent global crisis is Gieve and Provost (2012). The authors argue that policymakers' objective of keeping inflation low and stable while employing some regulation to financial markets caused a lack of coordination between monetary and regulatory policy in the subprime mortgage market. The authors recommend better coordination between monetary and regulatory policymakers in the future.

Kahler (2013) argues that international cooperation was better after the 2008-2009 crisis compared to the two previous big crises (i.e. the Great Depression of 1929-33 and the global recession of 1981-82). According to Kahler (2013), this departure from previous responses to economic crisis is due to several different factors. The character of economic globalization was different this time (i.e. economic nationalism was less attractive this time due to global economic integration). Also this time, there were combined international constraints imposed by international economic cooperation. Another important factor this time was the major developing and transitional economies being more successful during the crisis. Kahler (2013) recommends that national policies should be scrutinized more closely in the future. He also recommends the international constraints to be stricter. He warns us about the role of key emerging economies, such as China, India, and Brazil on global governance.

Kickert (2012) analyzes how the UK, Germany and the Netherlands responded to the crisis. According to the author, the crisis "resulted in the centralization of decision making in the hands of prime-minister and Finance ministers across the three nations, though the extent of prime-ministerial power differed between the countries. The subsequent stages of the crisis involved many more ministries, parliaments, politicians, parties, and social partners in deliberation and decision making". Kickert (2012) contends that economic recovery requires more politicized decision-making.

Levine (2012) argues that "there was a systemic failure of financial regulation and those senior policymakers repeatedly enacted and implemented policies that destabilized the global financial system". The author recommends a new independent institution with informed, expert staff which will evaluate financial regulation from the public's viewpoint.

Li (2003) establishes a theory of relation-based governance to explain both the "East Asian miracle" and the Asian crisis. According to the author, "economic development is fundamentally a process of establishing relation-based governance and subsequently making a transition to rule-based governance". Li (2003) argues that "there is little difference between East and West or between North and South other than they are at different stages of development".

Peters, Pierre, and Randma-Liiv (2011) argue that the crisis has been perceived differently in different countries. The authors argue that, in fact, the crisis was different in countries such as Germany or Sweden when compared to the United States. Also, according to the authors, these countries were at different starting points in their governance regimes when the crisis hits; therefore the policy and governance options available to them were very different. The authors point out to the fact that there have been no common ideas globally about how best to govern.

Posner and Blöndal (2012) contend that "politics is far less predictable and decision making far more open than ever before. The magnitude of the fiscal challenges has heightened the importance of early action and foresight in fiscal policymaking". According to the author, "the best chance of effectively

dealing with the fiscal forces building up is to make timely decisions that have the broad support of as many interests and actors as possible". Remmer (1990) discusses about a study that examines the relation between democracy and economic crisis. If the magnitude of the debt burden at the outbreak of the crisis is controlled, there is no statistically significant difference between democratic and authoritarian regimes, or between new democracies and more established regimes in terms of the impact of the crisis.

Woods (2010) examines IMF's role after the crises. Woods (2010) argues that the IMF's dependence on loans from its wealthiest members restrains the institution from serious reform. The author recommends IMF to get more resources, especially from emerging economies. Desta (2012) examines African countries' development issues. The author argues that the development experts and policy makers suggest the application of East Asian developmental state model to African countries. The author asks why Africa is used as testing ground for a number of development models forged mainly to satisfy western donors. Mgonja and Tundui (2012) examine Tanzanian government's ambitious and far-reaching reform programs to improve the socioeconomic condition of the country since 1990s. The authors contend that unless someone addresses "institutional shortfalls" within the greater system of governance, any policy or reform initiative aimed at improving good governance will ultimately fail to deliver.

### 3. Methodology of research

As measures of governance, we use the World Bank's Worldwide Governance Indicators (i.e. WGI) dataset. The World Bank describes the dataset as follows: "The Worldwide Governance Indicators project constructs aggregate indicators of six broad dimensions of governance:

*Voice and Accountability*

*Political Stability and Absence of Violence*

*Government Effectiveness*

*Regulatory Quality*

*Rule of Law*

*Control of Corruption*

The six aggregate indicators are based on 30 underlying data sources reporting the perceptions of governance of a large number of survey respondents and expert assessments worldwide. Details on the underlying data sources, the aggregation method, and the interpretation of the indicators, can be found in the WGI methodology paper.

Kaufmann *et al.* (2010). "The Worldwide Governance Indicators: A Summary of Methodology, Data and Analytical Issues". World Bank Policy Research Working Paper No. 5430 ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1682130](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1682130)).

The World Bank also adds the following explanation for the dataset: "The Worldwide Governance Indicators (WGI) are a research dataset summarizing the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources".

Below are the definitions of the six dimensions of governance as explained by the World Bank:

*Voice and Accountability:*

Reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

*Political Stability and Absence of Violence:*

Reflects perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism.

*Government Effectiveness:*

Reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

**Regulatory Quality:**

Reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

**Rule of Law:**

Reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

**Control of Corruption:**

Reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. For all six dimensions of governance, the estimate of governance (i.e. the score) ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance. There are 215 countries in the dataset. The governance data are annual data and they are posted on the website [www.govindicators.org](http://www.govindicators.org). We examine the period from 2005 through 2011.

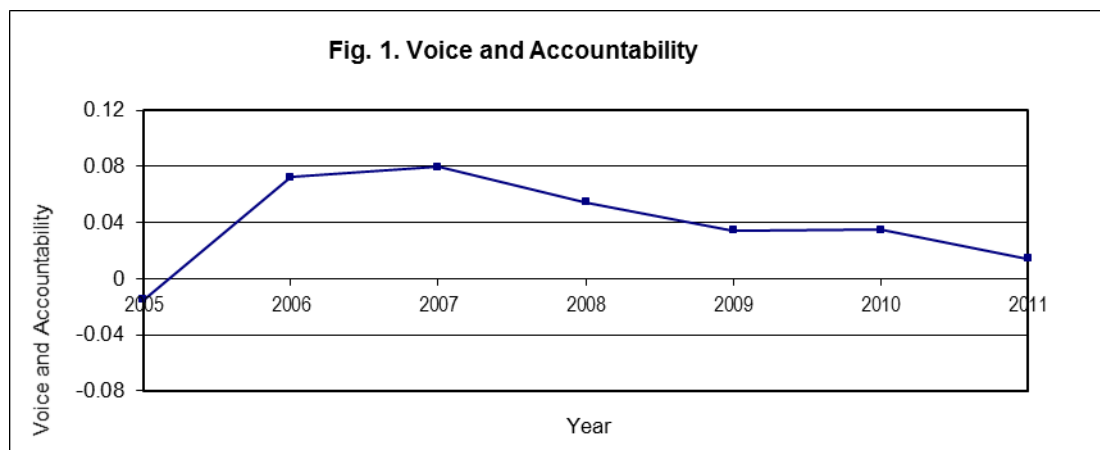
**4. Governance scores before and after the 2008-2009 global crisis**

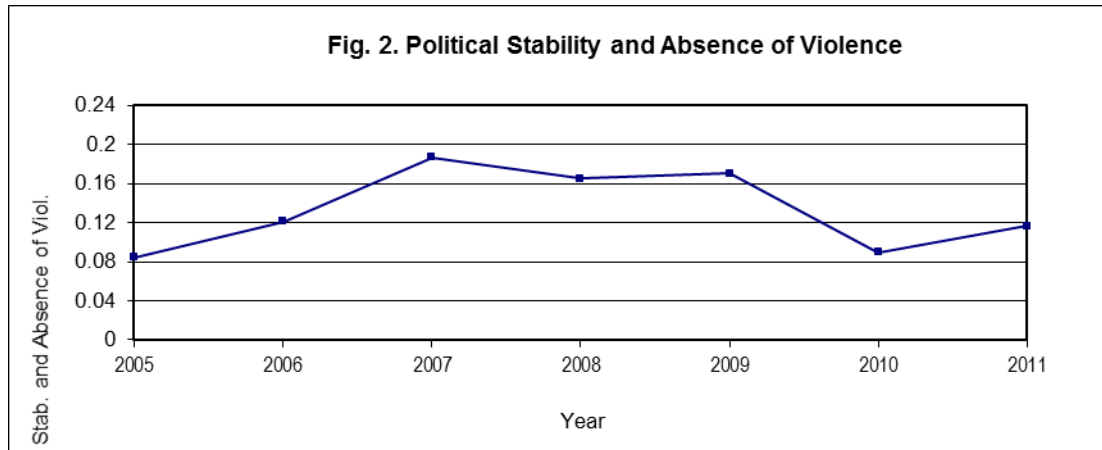
The governance indicator scores for the whole sample (i.e. 215 countries) over the 2005-2011 period are as shown below.

Table 1. Governance scores over time

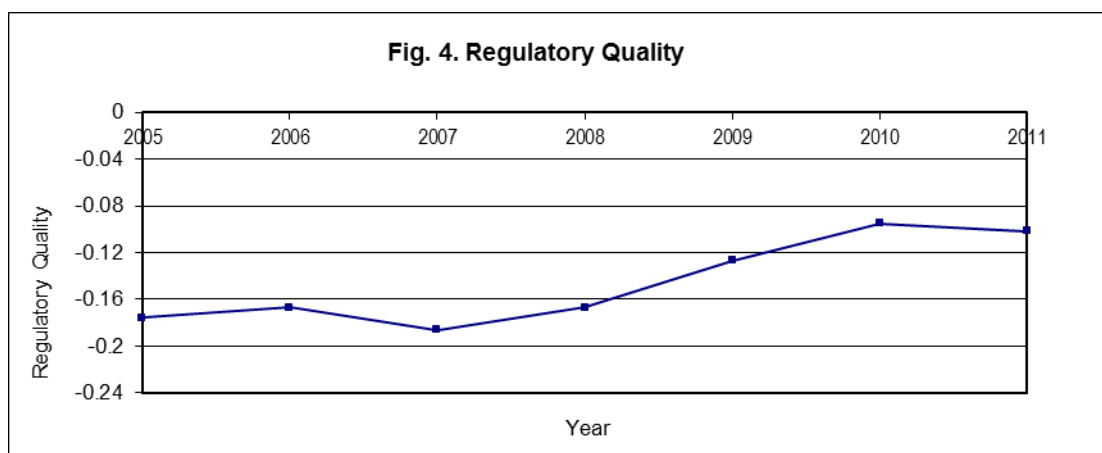
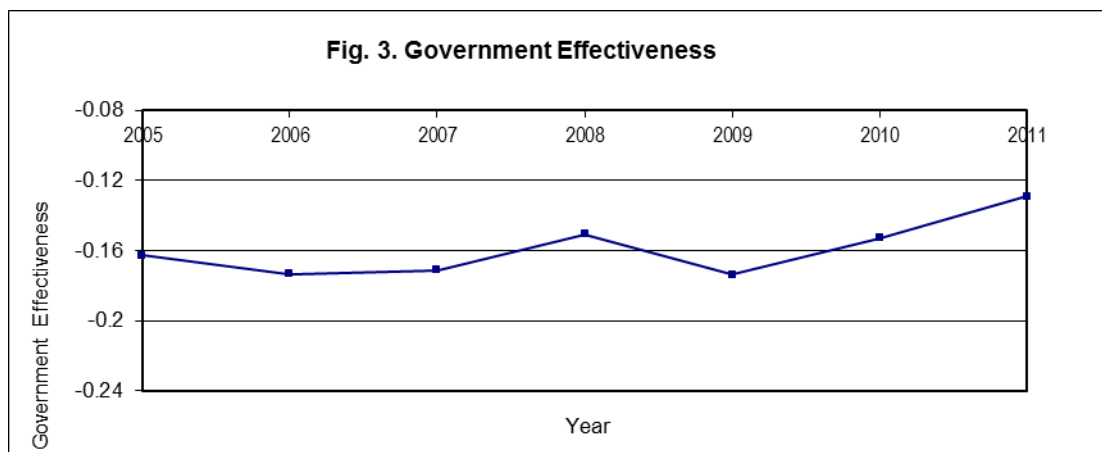
Year	Voice and Acc.	Political Stab.	Govt. Effective.	Reg. Quality	Rule of Law	Control of Cor.
2005	-0.0148	0.0842	-0.1628	-0.1757	-0.1305	-0.2090
2006	0.0723	0.1210	-0.1733	-0.1667	-0.1999	-0.2337
2007	0.0799	0.1865	-0.1713	-0.1861	-0.1985	-0.2598
2008	0.0545	0.1652	-0.1508	-0.1669	-0.2161	-0.2324
2009	0.0346	0.1701	-0.1738	-0.1271	-0.2050	-0.2767
2010	0.0349	0.0896	-0.1529	-0.0949	-0.1959	-0.2378
2011	0.0145	0.1162	-0.1290	-0.1017	-0.1915	-0.2669

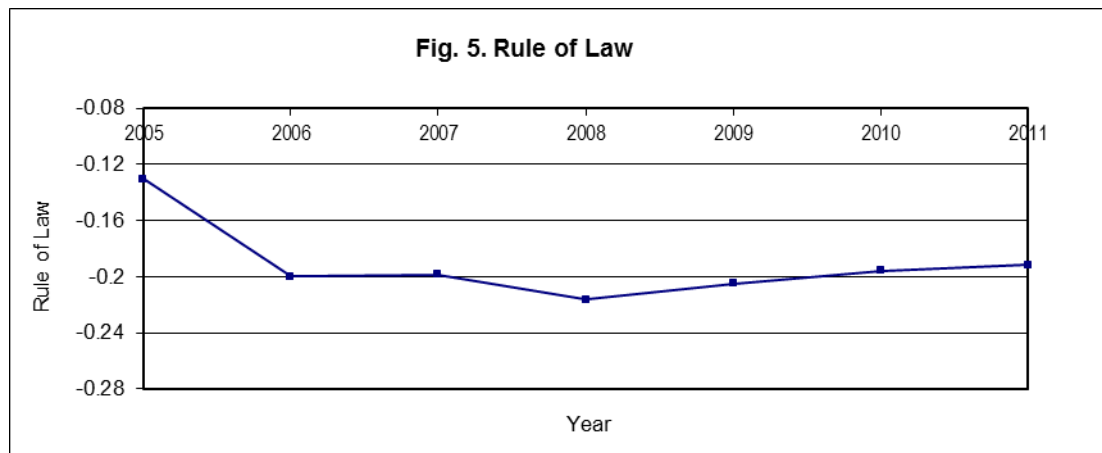
First, we look at the “Voice and Accountability” and the “Political Stability and Absence of Violence” scores. In figures 1 and 2, we are seeing that both scores started to deteriorate before the crisis started (i.e. after year 2007). These two scores continued to go down until year 2010 or 2011. These are long-term effects. In other words, we can conclude that the global crisis has had long-run implications on political stability, violence, and lack of voice and accountability across the globe. Another important point here is this: there was an immediate deterioration in these two governance indicators, namely “Voice and Accountability” and the “Political Stability and Absence of Violence” in 2008. The crisis immediately affected political stability, violence, and accountability.



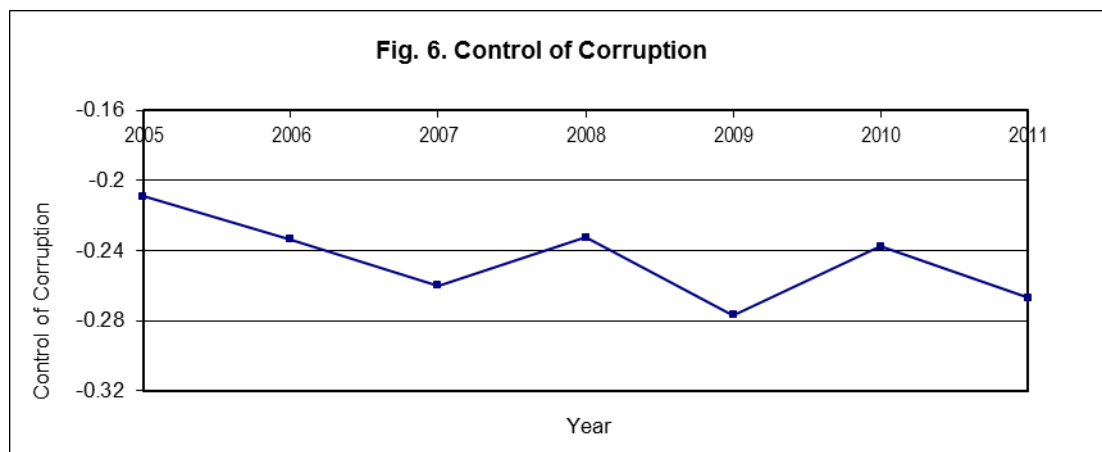


Figures 3, 4, and 5 show how the “Government Effectiveness”, the “Regulatory Quality”, and the “Rule of Law” scores have changed during that period. From these graphs, we are seeing that all three indicators improved after the crisis. “Government Effectiveness” started improving after year 2009, “Regulatory Quality” started improving in year 2008, and “Rule of Law” started improving after 2008. We interpret these findings as the governments around the world reacting swiftly and taking precautions just after the crisis, thereby improving rules and regulations and government effectiveness.





We cannot say the same for “Control of Corruption”. Figure 6 for “Control of corruption” shows that the governments, on average, have not been willing to or effective in controlling corruption before or after the crisis. So, in terms of “Control of Corruption”, there have been ups and downs, but the overall trend is down.



## 5. Conclusions

In this study, we examine the impact of the 2008-2009 Global Crisis on governance. As measures of governance, we focus on the World Bank’s WGI dataset. This dataset covers six dimensions of governance and these dimensions are “Voice and Accountability”, “Political Stability and Absence of Violence”, “Government Effectiveness”, “Regulatory Quality”, “Rule of Law”, and “Control of Corruption”.

In total, there are 215 countries in the dataset, and we examine the 2005-2011 period which approximately covers the three years before and the three years after the crisis.

First, we look at the “Voice and Accountability” and the “Political Stability and Absence of Violence” scores. We find that both scores started to deteriorate in 2008. These two scores continued to go down until year 2010 or 2011. Therefore, we conclude that the global crisis has had long-run implications on political stability, violence, and lack of voice and accountability across the globe.

Then, we look at how the governments around the world reacted after the crisis. Did they improve rules and regulations, government effectiveness, and corruption? We find that, after the crisis, on average, there was an improvement in the “Government Effectiveness”, the “Regulatory Quality”, and the “Rule of Law” scores, but not in the “Control of Corruption” scores. These findings indicate that the governments around the world reacted swiftly, took precautions after the crisis, and improved rules and regulations and government effectiveness. However, our finding for “Control of corruption” shows that the governments, on average, have not been willing to or effective in controlling corruption before or after the crisis.

An interesting finding in this study is the timing of the declines in the “Voice and Accountability” and the “Political Stability and Absence of Violence” scores. Both measures started to deteriorate before the

crisis (i.e. in 2007). This is very important because any decline in these measures may be used as a signal of a coming crisis by policy makers, companies, and investors.

Another interesting finding in this study is the timing of the improvements in the “Government Effectiveness”, the “Regulatory Quality”, and the “Rule of Law” scores. We find that “Government Effectiveness” improved after year 2009, “Regulatory Quality” improved after year 2007, and “Rule of Law” improved after 2008. These findings indicate that the governments first acted to improve the regulations, then to improve the laws, and finally one year after the crisis, they improved government effectiveness. This implies that there is an order in which the governments react to crises. They tend to focus on regulations first, then laws, and as a last resort, they try to improve their own effectiveness. This shows that they are unwilling to clean up their own yards. In fact, the continuous deterioration in “corruption” supports this idea.

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