

Shifting Boundaries between Public and Private Sectors: Implications from the Economic Crisis

Prepared for the
Public Management Research Association Conference
October, 2009

WORKING DRAFT

Charles Wise
Professor and Director
John Glenn School of Public Affairs
The Ohio State University
wise.983@osu.edu

Stephanie Moulton
Assistant Professor
John Glenn School of Public Affairs
The Ohio State University
moulton.23@osu.edu

“Between financial rescue missions and the economic stimulus program, government spending accounts for a bigger share of the nation’s economy – 26 percent- than at any time since World War II. The government is financing 9 out of 10 new mortgages in the United States. If you buy a car from General Motors, you are buying from a company that is 60 percent owned by the government. If you take out a car loan or run up your credit card, the chances are good that the government is financing both your debt and that of your bank.”- Edmund Andrews and David Sanger, *New York Times* 2009

Introduction

While understanding the interrelatedness of public and private sectors has been perhaps one of the most essential and enduring challenges for Public Administration throughout history (Dewey 1927; Dahl and Lindblom 1953; Lindblom 1977; Wamsley and Zald 1973; Bozeman 1987; Bozeman 2007), recent events in the nation’s economy have elevated a fundamental questioning and reordering of the relationships between public and private. In the current economic crisis, lines between public and private are being redrawn rapidly through new organizations, policies, programs and regulations. It is unclear what systemic effects, intended and unintended, will ultimately result from these initiatives.

In the height of the “privatization era”, Wise pointed out that the question at hand was not which was better, public or private, but rather “what configuration of organizations, public and private, is needed and what arrangements between them provide the most effective relationships to perform the needed function” (Wise, 1990, 142). Too often policymakers have restructured public organizations and public service programs without adequate conceptualization and understanding of the “configuration of organizations impacting public services, and also without considering the modes of interaction that the public organizations will have with significant officials and organizations” (Wise, 1990, 142). Now, the “object” has been turned around – it is not public services but private goods and services that are the central focus. However, the question is quite analogous: What is the most effective configuration of public-private organizations to bring about particular outcomes in the private economy while still observing the requisites of democratic government?

As PA scholars, it is critical that we evaluate the public-private configurations that are employed, not only for the problem at hand, but for the longer term reconfiguration of the public management

system. *Essentially, what are key considerations that should guide the emerging reconfiguration of the public and private sectors? Further, how do we integrate these considerations into public management?*

This paper proceeds as follows. First, we briefly review the history of public-private interrelatedness, across dimensions of time and culture. Then, we present the public interest, economic and management dimensions as analytical frames by which to evaluate public-private configurations. Next, we employ the dimensions to evaluate three case studies of initiatives in the Troubled Assets Relief Program (TARP) that implicate public-private configurations. Finally, we conclude with implications for research and practice moving forward.

Background: Historical Survey

The differences and similarities between public and private administration have preoccupied research and study of public administration since almost the beginning of formal study in the field, particularly in American public administration. However, focus on the relationships between public and private spheres predate discussions in the field of public administration and have been debated and defined since Roman times (Goldhammer 1983, 45). For most of human history, the distinction between government (public) and non-governmental (private) enterprises meant little. In the centuries dominated by aristocratic and/or religious rule most organizational activities were dominated by those in power whether kings, lords, or clergy. In Europe, new political and administrative structures in government evolved from the twelfth century gradually creating a role for civil servants, but it was not until the late-eighteenth century that civil servants became *public servants*. During the period 1780-1820 the dichotomy between public and private came to meaningfully influence the structure and functioning of administration (Raadschelders 1998, 151-152).

Before industrialization, everything was public and private at the same time. Up through the 1800s, trade was organized in guilds and regulated by government. In a mercantilist economy private management had little meaning and public and private were intertwined, financially, organizationally, and in terms of people who pulled the strings. The Lockean notion of property being either public or private

laid the foundation for business administration as a separate form of activity, and it developed as government retracted their mercantilist policies between 1810 and 1870 (Raadschelders 1998, 248-249).

Of course in various countries, the types of activities dominated by public or private organizations have varied during different time periods. In Britain, the industrial revolution was based on private property, private enterprise and free trade. However, from the late nineteenth century, state enterprises increased and state regulation expanded. In particular, municipal ownership of water, gas, electricity, transport systems proceeded from 1845 through the First World War, along with state regulation of the private sector operators of public services. Then, a series of private companies were taken over by the state pursuant to a nationalization policy including those involved in telephone services, oil production, electricity, radio, and airlines so that by the late 70s the nationalized industries dominated strategic sectors of the economy. In contrast, the United States did not have a nationalization policy, and companies owned by the national government in the interwar years constituted the exception, but some were notable including the Emergency Housing Corporation, the Electric Home and Farm Authority, the Inland Waterways Corporation and the Tennessee Valley Authority (Parker 2009). In terms of the continuum of relationships between government and business organizations including regulation, support, business involvement in government services (eg. contracting), and ownership, in the United States, governments have tended toward emphases on regulation, support, and business involvement in government services. Even within those categories, the relationships have varied, with the federal government fostering a spurt of new regulatory agencies and initiatives in the 20s and 30s and again in the 70s, followed by a period of emphasis on deregulation.

Some countries have tried to rationalize the relationships between government and business by means of adopting government industrial policies. While such proposals were made for adoption of a national industrial policy for the United States (Rosenblatt 1974; Genovese 1988), federal policy makers have shied away from this approach, with the notable exception of the establishment of the Appalachian Regional Commission, which Congress established to support economic development in only one region of the country. While proponents of an industrial policy argued that the Federal government should have a

comprehensive –integrated approach with respect to its myriad relationships with business, opponents have argued that the government lacks the capacity and foresight to do that and adoption of such a policy would lead to increased and undesirable intrusion in business with government policy makers trying to pick winners and losers among various business sectors and even among business firms. This, opponents have argued, would be ensnarled in special interest and regional politics and which would result in favoritism, cronyism, and distortions in both government and business operations.

Most recently, an emphasis in numerous countries has been on what is widely called privatization, which actually refers to a variety of phenomena in the arrangement of government-business relationships from contracting to load shedding (Wise 1990). The emphasis in this movement has been premised on the superiority of business operations and bringing businesses more into operation of government to a greater extent or to turn over areas of responsibility to private businesses. The Grace Commission Report presented to Congress during the Reagan Administration and the National Performance Review conducted by the Clinton Administration both promised greater efficiencies by the greater adoption of modern business methods. The Bush Administration adopted rules for putting federal jobs up for competition with private firms (OMB Circular A-76 revised, May 29, 2003).

Recent policies adopted since the onset of the economic crisis have tended to be based on a quite different premise- that business organizations have failed and government organizations must be involved in various business operations to curb their excesses, to improve them, to prevent further failures and harm to the public, and to foster greater economic development for the nation as a whole. Various other countries such as Great Britain have adopted similar stances. Similar to the privatization of public organizations, the increasing influence of the public sector on the private sector is not one easily identified strategy. Rather, it is comprised of diverse instruments or tools of government (Salamon 2002), ranging from direct ownership or “takeover” of privately held firms (such as in the auto industry), to an

infusion of public funds (as with the Capital Purchase Program), to regulation of private sector economic activity or management practices (such as executive compensation).¹

While this represents a shift from the previous focus on the privatization of public services, many of the same considerations are applicable. "Three analytic dimensions are derived-public interest, economic, and management-which policy makers are encouraged to consider in order to increase the likelihood that a public organization can effectively play its intended role in interacting with key organizations in its environment to produce public outputs and advance democratic government" (Wise 1990, 142). This is not to deny that a significant debate exists about the proper role of government in private enterprise. That debate is on-going and perhaps intensified by recent governmental actions. Nonetheless, rather than engage that issue, our point of departure is to consider what the altered configuration of public-private organizations is likely to mean for the behavior of the organizations and the resultant effects of that behavior on public interest, economic and management dimensions. It is to these dimensions that we now turn.

Public-Private Configurations: Dimensions for Analysis

Public Interest

The public interest dimension reflects the underlying (often elusive) public objective in public-private configurations. In dissecting the differences between public and private organizations, both in the literature and practice of public administration, a point of departure often noted is that public servants and public organizations should work in the public interest (Appleby 1952; Flathman 1966; Goodin 1996; Bozeman 2002; 2007). Private businesses that have historically had rather limited contact with government may occupy one end of the public interest continuum and other businesses that have extensive and intimate contact with government, such as defense contractors and heavily regulated

¹Organizations may be considered more or less public to the extent that they are enabled or constrained by political authority (Bozeman 1987). Indeed, all organizations are constrained or enabled by varying sources of political authority to some degree. Research on organizational publicness focuses on the degree to which an organization is constrained or enabled by political authority, and how such influences affect organizational behavior (management functions, decisionmaking, red-tape) and/or outcomes. In publicness research, the focal organization is typically the unit of analysis. The purpose of this manuscript departs from this, in that configurations of political authority are the primary focus.

utilities occupy the other (Bozeman 1987). However, private actions and public policy can alter the position of private organizations and their relationships with public organizations and public interest considerations can rise in priority in how private organizations operate and how they interact with public organizations.

Determination of the precise meaning of the public interest has long been considered problematic (Dewey 1927; Shubert 1961; Pesch 2008), but as Bozeman points out, it continues to carry significant meaning “because legislators continue to make laws citing the ‘public interest,’ regulators continue to regulate in the ‘public interest,’ and courts continue to rule in the ‘public interest’ (Bozeman 2002, 148). Rather than a clearly defined objective, the public interest is normative ideal that includes both substantive and procedural aspects (Dewey 1927; Bozeman 2007; Wise, 2002).

First, the public interest includes identifiable substantive components, or public values, that are often context specific. “A society’s public values are those providing normative consensus about (a) the rights, benefits and prerogatives to which citizens should (and should not) be entitled; (b) the obligations of citizens to society, the state, and one another; and (c) the principles on which governments and policies should be based” (Bozeman 2007, 13). Substantive values may be derived from a nation’s founding documents, or “fundamental laws” (Jorgensen and Bozeman 2002; Bozeman 2002; 2007.) In the U.S., substantive values include, but are not limited to, such things as civil rights, liberty, limited government and equal treatment (Jorgensen and Bozeman 2002; Wise 2002). Rather than identifying one “core” public value to guide the appropriate public-private configuration, public values often conflict, resulting in public-private configurations that are designed through an incremental “mutual adjustment” process (Lindblom 1959).

Second, in a democracy, the public interest includes important procedural components such as rule by consent of the governed, accountability of public officials to the governed, and the appropriate use of sovereign power. The U.S. governmental system emphasizes the three branches of government and the system of checks and balances to ensure popular participation and accountability. As Wise pointed out, when determining public-private configurations, whether by means of legislation, executive order, or

regulation, policymakers need to be cognizant of the linkages to the three branches and ask the hard questions of how democratic direction and political accountability will be “preserved and enhanced” (Wise, 1990, 149). Accountability serves several important functions: enabling democratic control by providing needed information (Prezworski, Stokes, and Manin 1999); enhancing the integrity and legitimacy of government (Rose-Ackerman 1999); improving performance by fostering individual or institutional learning (Aucoin and Heintzman 2000, 52-54); and providing for public catharsis (Bovens 2005, 192-193).

Providing arrangements to preserve adequate democratic control and accountability, while avoiding damage to important program goals and other public objectives is challenging, even when confined to public organizations (Wise and Freitag 2002). However, the introduction of new in-depth linkages to private organizations brings a whole new level of complexity to the task. As Bovens discusses with respect to public agencies, too rigorous democratic control will squeeze entrepreneurship out of public managers and turn agencies into rule obsessed bureaucracies (Bovens 2005, 194). Relatedly, positive risk taking behavior can be significantly impacted (Wise and Freitag 2002, 501). In addition, in institutions where resources are scarce, a large measure of accountability can lead to an inefficient distribution of those resources (Adelberg and Batson 1978). Too much emphasis on accountability can lead to suboptimal and inefficient decisions instead of improved performance (Adelberg and Batson, 1978; McLaughlin and Riesman 1986; Bovens 2005). If the dampening of entrepreneurship by poorly designed or understood accountability measures among public managers is a concern in public management, the concern is most likely heightened when accountability measures are imposed on private managers operating private businesses. On the other hand, accountability measures that are weak, incomplete, missing or ill-formed risk sacrificing important public interest values. Balancing these concerns is important.

Economic

Broadly speaking, the economic dimension refers to the coordination system for producing outputs, or the task environment (Wamsley and Zald 1973; Scott 2003). Private businesses, through the

market system, coordinate many of the essential functions of social organization in our society, enabled, subsidized and limited by government (Dahl and Lindblom 1953; Lindblom 1977). While many focus on market failures as the ultimate signal for “government intervention”, the market failure approach overlooks the embedded nature of markets within the political environment (Granovetter 1985; 2005; Swedberg and Granovetter 2001). Indeed, the public sector has an important role in setting the stage for a functioning economy, whether or not there has been a confirmed “market failure” (Dahl and Lindblom 1953; Lindblom 1977; Nelson 1987; Wise 1990; Bozeman 2002; 2007). The question is not whether or not government should intervene in markets, but what configuration between government and the private sector is appropriate to achieve the desired coordinated outcomes. Two important considerations help guide this configuration: (1) economic assumptions, or hypothesized relationships between means and ends; and (2) the “institutions” to be included in the configuration and the effects on the broader economic system.

When considering the hypothesized relationship between the means and ends, it is important to keep in mind that the market and “tools” of the market (like wages, price structures, competition, etc.) are means to desired ends, not ends in and of themselves. The “ends” often lead back to the public interest dimension discussed previously. Market mechanisms are viewed as a means by which to achieve those publicly desired ends (Dahl and Lindblom 1953; Lindblom 1977). The appropriate configuration to bring about desired ends, and subsequently the level and type of government intervention that is appropriate, varies depending on the nature of the desired outcome (measurability, complexity, specificity, salience, etc.). Further, the clarity of the hypothesized link between the means and ends varies greatly from “task” to “task” (DiMaggio and Powell 1977; Scott 2003). In some task environments, there is a very clear relationship between inputs and outputs. In other more complex task environments, there may be several, sometimes conflicting hypothesized relationships between the appropriate means to accomplish desired ends. Identifying the operational assumptions between means and ends thus becomes an important component of the economic dimension of public-private configurations.

Second, it is important to not only identify the institutions to be implicated, both directly and indirectly, in the proposed public-private configuration, but also the subsequent effects on the broader economy outside of the targeted institutions. While specific measures may be targeted at a specific “set” of firms, such as organizations who participate-voluntarily or involuntarily- in a particular government initiative, all firms are part of a larger institutional environment (Scott 2003). The success of public-private configurations depends in part on the institutions that exist in an environment at any given point in time and on government’s ability to design new and reform existing institutions (Przerworksi 1997; Olsen 2006). However, we are more “institutional gardeners” than “institutional engineers” (Olsen 2006). Indeed, institutional change is often incremental, path dependent and conflict invoking (North 1990; Ostrom 1990). Thus, understanding (and predicting) the broader “field” level impacts of configurations are an important facet of the economic dimension.

Management

Whereas the economic dimension focuses on the coordination *system* for public-private configurations, the (public) management dimension refers to the coordination *ability* of public administration. The inclusion of market-based strategies does not reduce the role for public management, rather, it changes the skill-set needed to coordinate the public-private configurations (Wise 1990; Salamon 2002). Public-private configurations are more complex than traditionally conceptualized government entities responsive to hierarchical market controls or market driven firms responsive to customers and ultimately shareholders (Mosher 1980; Salamon 2002; Moe 2001). However, rather than the exception, mixed configurations are the norm for most economic activity operating in politically embedded, complex institutional environments.² To attempt to shape public-private configurations, it is critical to take into account the government’s organizational capacity to affect the public-private configuration, and the potential strategic behavior of private firms in response.

²Quasi-governmental entities, such as government sponsored entities (GSEs) may be viewed as an extreme case of managing mixed configurations (Mosher 1980; Koppel 1999; Moe 2001; Koppel 2001).

Public-private configurations require uniquely equipped public management capacity that includes knowledge of and skill with the appropriate management tools (Mosher 1980; Salamon 2002), an “energetic executive” equipped to carry out ongoing management responsibilities (Light 2008), and the authority (and credibility) to provide direction and shape outcomes (Moe and Stanton 1989; Moe 2001; Koppell 2001; Stanton 2007). Nearly three decades ago, Frederick Mosher (1980) commented on the need for public administrators to be better equipped to understand and implement alternative management tools frequently incorporated in public-private configurations: “We need to know more about the direction, management, and effects of devices to utilize and to modify the private society and other governments: regulations, taxes and tax expenditures, loans and loan guarantees, contracts for goods and services, including procurement, quasi-govern- mental enterprises, and others. Most of these fall beyond the limits of the traditional controls, budget and personnel, we have inherited from our forebears” (547). Today, the same concerns are echoed by Lester Salamon (2002), who stresses the importance of understanding the diverse “tools of government” that fall outside of traditionally designed institutions.

Further, implementing these tools effectively requires “energetic executive” capacity, including not only physical capacity and human resources, but also a publicly motivated and mission driven civil service (Light 2008). Finally, public management capacity includes the authority and credibility to provide direction and shape outcomes. The authority challenges of public-private configurations are perhaps best typified in the case of quasi-governmental entities, or “instrumentalities” of government that achieve public purposes, but fall outside of the traditional hierarchical government agency purview (Moe and Stanton 1989; Seidman 1998; Moe 2001; Koppell 2001). “The federal government uses an instrumentality to carry out governmental purposes in addition to usual private purposes such as profit making for its private owners” (Moe and Stanton 1989, 324). Not unlike public-private configurations, the challenge with these instrumentalities is that they may not only be subject to both market and political authority, but that they may have the “upper hand” with both authority sources

by playing one against the other to meet their objectives, leading to the infamous concern of “privatizing profits” and “socializing losses” (Seidman 1998)³.

This “upper hand” relates directly to the potential strategic responses of private firms in public-private configurations. Organizations are not passively determined by their environments, but rather respond strategically to their environments and environmental constraints (Pfeffer and Salancik 1978; Scott 2003). Indeed, the political environment has long been viewed a potential source of competitive advantage for firms, to the extent that an organization can benefit from political or bureaucratic institutions, while competitors are constrained by such institutions (Mitnick 1993; Shaffer 1995). “In general, corporate political behavior is an attempt to use the power of government to advance private ends” (Mitnick 1993). Lindblom refers to this as the “privileged position of business,” that because society is so dependent on the business sector for many of our core function of social coordination, business interests are given an important seat at the policy table- unique from any other interest groups (1977).

That businesses respond strategically to their environments is not inherently “conspiratorial”; it is simply a fact of organizational life (Shaffer 1995). An entire subfield of strategic management focuses on corporate political behavior (Leone 1981; 1986; Shaffer 1995; Oliver 2008; Agarwal et. al 2009). According to Christine Oliver, “Strategic political management refers to the set of strategic actions that firms plan and enact for the purpose of maximizing economic returns from the political environment” (2008, 496). For public-private configurations, the challenge for public management is to appropriately account for (and respond to) strategic behavior. For example, more than two decades ago, Leone (1981) noted: “The indirect and unintended competitive consequences of regulation are an important and poorly understood part of the regulatory process” (1981, p. 117). Thus, when designing public institutions, it is

³ In commenting on quasi-governmental entities, Harold Seidman remarked: "Intermingling of public and private purposes in a profit making corporation almost inevitably means subordination of public responsibilities to corporate goals. We run the danger of creating a system in which we privatize profits and socialize losses" (Seidman 1998, 213).

critical to anticipate potential strategic and competitive responses from the entire organizational field (including, but not limited to the focal entities).

Case Study: Troubled Asset Relief Program (TARP)

The public responses to the current economic crisis afford a plethora of case studies to examine shifting configurations of political authority constraining or enabling organizations. Perhaps one of the best known public initiatives that encompasses many of the complexities of the new configurations is the Troubled Asset Relief Program (TARP). TARP was first initiated in October of 2008 under the Emergency Economic Stabilization Act (EESA), to purchase, sell and manage “toxic” assets. It was quickly refocused to include a much broader purview. A quarterly report from the Special Inspector General for TARP in April of 2009 comments on the magnitude of its coverage. “From programs involving large capital infusions into hundreds of banks and other financial institutions, to a mortgage modification program designed to modify millions of mortgages, to public/private partnerships purchasing ‘toxic’ assets from banks using tremendous leverage provided by Government loans or guarantees, TARP has evolved into a program of unprecedented scope, scale, and complexity” (SIGTARP April, 2009).

Table 1 provides a summary of the \$361.3 billion in TARP funds spent on various programs as of July 10, 2009, reported by the Government Accountability Office (GAO July, 2009). The largest portion of funds (57 percent) was spent on the Capital Purchase Program (CPP), which invests in qualified financial institutions (QFIs), such as banks and bank holding companies, viewed as important to stabilizing and growing the U.S. Economy. Four QFIs comprise nearly ½ of the allocations under the CPP to date, including Bank of America, JP Morgan Chase, Wells Fargo and Citigroup, although more than 600 institutions have received some amount of funding under the CPP (SIGTARP July, 2009). Although previously firms had to wait three years to repay CPP funds, revisions to the legislation now

permit repayment if the firm can demonstrate its financial sustainability⁴. Repaid funds can be redistributed for other uses under TARP, and do not require further congressional appropriation for expenditure.

(Insert Table 1 Here)

The second largest investment of TARP funds, comprising more than 20 percent of the total invested to date, is through the Automotive Industry Financing Program, namely to Chrysler and GM. The purpose of the investment is to prevent a shock to the U.S. financial markets and economy broadly that would result from a failure of these large private firms. The third largest investment of TARP funds, totaling \$41.2 billion as of July 2009, is for the “Systematically Significant Failing Institutions” program which was essentially set up to prevent the failure of the private company American International Group, Inc (AIG). In addition to financial investment, the government intervention in AIG will result in a complete restructuring of many of the company’s financial activities and increase the exposure of particular activities to government oversight (SIGTARP July, 2009). Following closely behind, the fourth largest investment of TARP funds, totaling \$40 billion as of July 2009, has been allocated under the “Targeted Investment Program.” The purpose of the program is to further support firms on a “case by case basis” deemed to be critical to American jobs and financial security. Only two firms are recipients of this program to date, each receiving \$20 billion under this program (in addition to funds that they received under the CPP): Citigroup and Bank of America.

While the primary objective of TARP is rather straightforward-- to serve as stimulus and stabilizer to the recipient organizations and the economy at large, the configurations of political authority that result from TARP interventions are multiplex and messy. Indeed, as indicated on Table 2, the sheer

⁴Further, the largest firms (18 large bank holding companies) were evaluated under the Capital Assistance Program to determine if they had sufficient capital to weather upcoming economic events (referred to as “stress tests”. From this evaluation, 10 firms were identified that need an additional \$75 billion in capital to bring them to financial health. This additional capital may come through private or public funding under the Capital Assistance Program. As of July, 2009, 6 of the 10 firms had already raised the additional needed capital through private channels. Other firms have until November, 2009 to raise additional capital.

number of “government authorities” involved in TARP and dispensing political authority, demonstrates the complexity.

(Insert Table 2 Here)

Attempting to realign the public-private configuration in order to maximize positive impacts within the public interest, economic and management dimensions is a formidable challenge. Below, we evaluate three specific cases within the TARP along the three dimensions. We begin with the least intrusive in terms of depth of government involvement (the regulation of executive compensation), then proceed to the more intrusive Capital Purchase Program (the “infusion” of public funds into private financial institutions), and conclude with the most intrusive (the government purchase of GM and Chrysler). Through a review of documents related to each of these cases, we highlight the complexities and tradeoffs inherent in each dimension. This information is then used to derive implications for future research and practice of public-private configurations.

Executive Compensation

Executive compensation practices of private firms have been of heightened public interest since the Enron fiasco and the adoption of the Sarbanes Oxley provisions for corporate governance (Thatcher 2009). Even before that, however, public scrutiny of executive pay has been an important consideration for private firms, and the potential for “outrage” has been a critical factor in structuring compensation (Bebchuk and Fried 2003; Anderson et al 2009). It is no surprise, then, that most all iterations of the TARP have included provisions related to executive compensation, including the “Interim Final Rule on TARP Standards for Compensation and Corporate Governance” issued by Treasury June 10, 2009, the prevailing guidance as of the date of this manuscript. It is critical for PA scholars and practitioners to consider, however, the substantial public interest, economic and managerial dimensions of public regulation of executive compensation.

Public Interest

Most all rationales for public regulation of executive pay include the public interest- through deference to public values (such as equity), democratic processes (including shareholder “say on pay”), and/or accountability and disclosure (accurately reflecting executive compensation). One of the primary rallying cries for reform of executive pay taps into public value notions of fairness and equal treatment. However, what is meant by “fairness” of compensation is a subjective matter. For some, it may imply a specific unreasonable *amount* of pay or an unfair gap between the lowest and highest paid within a company (Anderson et al 2009). For others, fairness may simply imply a *process* that is judged to be transparent and appropriate. Whether “fairness” is justified based on the amount or the process, the public has generally expressed an uneasiness with liberal and/or opaque executive compensation packages for firms receiving taxpayer dollars through TARP.

President Obama tapped into public sentiment following the outrage over the \$165 million in AIG retention bonuses: “All across the country, there are people who work hard and meet their responsibilities every day, without the benefit of government bailouts or multimillion-dollar bonuses” (Cooper 2009). He vowed that Treasury would “pursue every single legal avenue to block these bonuses and make the American taxpayers whole,” contradicting earlier statements by his chief economic advisor that the administration lacked the power to stop the bonus payments that were contractually obligated (Cooper 2009). Nonetheless, public outrage over AIG bonuses led the House to pass legislation imposing a 90 percent tax on bonuses paid to executives earning more than \$250,000 per year in companies receiving more than \$5 million in assistance through TARP (H.R. 1586). In response to the public outrage, 15 of the 20 top recipients returned their bonuses, and a handful of senior AIG executives resigned (Rapport and Plevin 2009).

In addition to concerns of the public at large, much of the discussion on executive compensation includes reference to the interests of the shareholders of publicly traded companies. As the legal owners of the firm, some argue that shareholders should have a degree of control over the compensation packages of firms. As a shareholder with 80 percent ownership over AIG, this was one of the arguments employed recently by House Financial Services Committee chairman Barney Frank in challenging the bonus

payments of the firm. However, as noted by financial expert Carl Icahn, “the ownership rights that the government, as a shareholder, is now demanding are the same ones that activist shareholders have been demanding for years” (Icahn 2009).

The EESA guidelines include provisions to provide a forum for shareholder interests. While earlier versions of Treasury guidelines *permitted* a TARP recipient to “opt out” of annual salary limits by publicly disclosing information regarding its compensation program and agreeing to a nonbinding “say on pay” shareholder vote, the most recent “Interim Rule” *entitles* shareholders to an annual non-binding vote on the compensation packages of firms (Treasury June, 2009). Even though the vote is non-binding, it is likely to lead to restrictions on executive compensation (Bebchuk and Fried 2003). The question is whether or not shareholder interests are sufficient to ensure adequately designed compensation structures in line with the public interests; some challenge that shareholder interests introduce another set of biases into the equation that may also distort firm behavior (Verret 2009).

Beyond accountability to shareholders, recent outrage over executive compensation has led to demands for accountability to the public, generally. Two formal mechanisms are currently incorporated into the EESA to increase accountability to the public at large: (1) a “special master” appointed by Treasury Secretary Geithner, Kenneth Feinberg, to formally review compensation packages at TARP assisted firms (Treasury June, 2009); and (2) requirements for review and approval of compensation packages by a firm’s internal “compensation committee”, independent of management and the board. While these mechanisms may increase perceived accountability, the challenges lie in the meat of what the accountability intends to accomplish when interests diverge: accountability to whom (shareholders or taxpayers) for what (repayment of tax dollars or performance of the firm). This is related directly to the economic dimension of executive compensation.

Economic Dimension

It is generally understood that there is a link between executive compensation structures and the economic performance of a firm (Bebchuk and Fried 2003; Bebchuk and Spamann 2009). Thus, when firm performance is brought into question, as with the recent economic crisis, questions arise about the

compensation strategies of the respective firms and how they may have contributed to firm performance. For example, leading up to the crisis, firms have been charged with engaging in excessive risk taking that predominately focused on high short term returns rather than the long term financial performance of the firm and the economy (Reuters September, 2009).

Accordingly, beginning with the October, 2008 EESA, the link between excessive risk taking and compensation packages has been an underlying rationale for public regulation of executive compensation for TARP recipients. According to Section 111 of the EESA, “TARP Recipients not have pay packages that promote excessive risk” (P.L. 110-343 Division A, codified as 12 U.S.C. 5221). Since 2008, the EESA and revised regulations have included a risk assessment requirement for senior executive official compensation, reviewed and certified by a (independent) compensation committee.

The revised Treasury Guidelines in 2009, culminating in the June “Interim Final Rule”, also include an annual compensation limit of \$500,000 and limit any bonus or incentive compensation to be in the form of restricted stock that does not vest until TARP funds are repaid to the Treasury (and cannot exceed 1/3 of the executive’s annual compensation). Tying incentive payments to restricted stock is partially intended to realign executive interests with long term economic performance of the firm. However, some question the rationale of tying the restriction to repayment of TARP, rather than a period after an employee leaves a firm, if the intent is truly to realign executives with long term firm performance (Bhagat and Romano 2009).

The critical component of curbing excessive risk taking becomes the definition of excessive risk, and its tradeoffs with other important considerations. Whose interests- the firm, the shareholder or the taxpayer- are ultimately to be aligned with compensation structures? While some have suggested aligning compensation packages with shareholder interests will correct excessive risk taking, others challenge that shareholder interests may diverge from government or the general taxpayer’s interests (Bebchuk and Spamann 2009). The propensity for conflicting economic actors and goals is portrayed in Treasury’s most recent (June 2009) “Interim Final Rule” that among other things, establishes “clear principles” for

the “special master” to follow when evaluating compensation packages of TARP recipients⁵. While designed to provide clear guidance, the principles themselves likely conflict (Lebaton and Dash 2009).

A recent case with Citigroup highlights the dilemma. Citigroup has received \$45 billion in assistance under TARP to prevent the failure of the firm and systemic risk to the economy; resulting in government holding a 34 percent ownership interest in the bank (Lebaton and Dash 2009). The special master for compensation (Kenneth Feinberg) recently received from Citigroup information on the compensation packages for the 25 highest paid employees and senior executives (as requested), including \$98 million due to one employee (energy trader) with the firm. However, Citigroup asserts that the energy trader is exempt from federal review because his contract was executed before the new federal restrictions were put in place. Even if his contract is legally exempt from review, however, the political attention and outrage is likely to pressure changes in his compensation package.

Any punitive or restrictive action (formal or informal) may lead to the exodus of high performing employees, like the energy trader, from regulated firms to less regulated firms who could pay more. This would violate one of the special master’s principles of ensuring comparable pay for TARP recipients, to avoid distorting the competitive balance of the marketplace (Lebaton and Dash 2009). Further, the loss of talented individuals could reduce the economic performance of the firm, thereby reducing returns to shareholders and repayment of federal tax dollars- two of the primary objectives of the special master’s oversight of executive compensation. It is thus important to consider the economic ramifications for the

⁵ As written in the summary of the Interim Final Rule, the special master should be guided by the following: “(1) *Risk*: Compensation should avoid incentives that reward employees for short-term or temporary increases in value that may not ultimately result in an increase in the long-term value of the TARP recipient; (2) *Taxpayer Return*: Compensation should reflect the need for the TARP recipient to remain a competitive enterprise and ultimately repay TARP obligations; (3) *Appropriate Allocation*: Compensation should be appropriately allocated among each element of pay (e.g. salary, short- and long-term incentive pay, and current and deferred compensation or retirement pay); (4) *Performance-Based Compensation*: Compensation should be performance-based, and determined through tailored metrics that encompass individual performance and/or the performance of the TARP recipient or relevant business unit; (5) *Comparable Payments*: Compensation should be consistent with, and not excessive in comparison to, pay for those in similar roles at similar entities; and (6) *Employee Contribution*: Compensation should reflect the current or prospective contributions of the employee to the value of the TARP recipient.

entire market environment, not just the environment of regulated firms, when establishing compensation regulations for TARP. This is complicated further by the fact that the market environment is not restricted to domestic borders, but extends globally.

Management Dimension

While much of the focus has been placed on passing legislation and developing policies to regulate executive compensation for TARP recipients, the effectiveness of the interventions depend in large part on how they are implemented and managed. Per the most recent guidance on executive compensation under TARP (Treasury June, 2009), the newly appointed Special Master is in charge of (1) interpreting the application of the restrictions on executive compensation for TARP recipients, (2) administering the Secretary's duties to review bonus, retention and compensation paid before February 17, 2009; (3) approving compensation packages for TARP firms receiving "exceptional assistance" (not firms participating in the CPP); (4) providing advisory opinions for other TARP recipients related to compliance with executive compensation rules (including CPP participants); and (5) providing other duties as delegated by the Secretary.

In addition to the oversight provided by the Special Master, all TARP recipients are required to establish an independent "compensation committee", whose responsibilities include reviewing compensation plans every six months to evaluate the potential for excessive risks and providing a report annually that includes a narrative description of how the compensation packages do not encourage excessive risk (Treasury June, 2009). Finally, under the new Interim Final Rule, all TARP recipients are to provide shareholders with the opportunity to vote (non-binding) annually on the compensation packages of the firm. While each of these mechanisms: the Special Master, the compensation committee, and the shareholder say on pay, may increase the perceived accountability of the firm, they severely complicate the management and implementation of executive compensation policies, not only for the firm, but also for the Treasury. It is not likely that all of the institutional actors will agree in all (or perhaps even most) circumstances. For example, what happens when the decisions of the special master and compensation committee diverge? If the compensation committee recommends compensation that

diverges from the firms previous compensation practices but nonetheless are substantially different than the decisions of the special master, where does the public interest lie? How will executive compensation be determined with differing interpretations and competing public and private interests?

In addition to organizational issues, the potential for strategic behavior of firms in response to federal executive compensation regulations is paramount. There is a growing research suggesting firm strategies to “camouflage” excess executive compensation to prevent and/or reduce public scrutiny. “To avoid or minimize the outrage that results from outsiders’ recognition of rent extraction, managers have a substantial incentive to obscure and try to legitimize—or, more generally, to camouflage—their extraction of rents. The strong desire to camouflage might lead to the adoption of inefficient compensation structures that hurt managerial incentives and firm performance” (Bebchuk and Fried 2003, 76).

Thus, an “unintended consequence” of public regulation may be strategic manipulation of observable (and regulated) compensation structures. This type of manipulation is typified in strategic responses previous regulations. Following the implementation of the Sarbanes Oxley Act of 2002, one researcher noted: “Even if the Act is ineffective, as this Article suggests may be the case, the Act could cause harm simply by misleading the market that regulation can solve its problems. In fact, as history has often shown...defrauders manage to stay one step ahead of the regulators” (Ribstein 2002, 68).

Capital Purchase Program

The primary vehicle under TARP for stabilization of financial markets is the Capital Purchase Program (CPP). The purpose of the CPP is to provide additional capital to healthy financial institutions by purchasing preferred shares of the financial institutions, in exchange for dividends and warrants. By increasing the capital base of the healthy institutions, the institutions should have increased capacity to lend to businesses and consumers, thereby stimulating the economy. The CPP will invest up to \$250 billion in viable financial institutions (recommended by their federal regulator), that would benefit from

additional capital for lending activity or stability. As of June, 2009, preferred shares and subordinated debentures of 623 financial institutions were purchased for about \$200 billion.

Public Interest Dimension

Popular consent and accountability are significant issues with respect to the Capital Purchase Program. Originally, when TARP was proposed (and sold by the Administration to Congress), the major modality of assistance to the banks was to be the purchase by the Treasury of distressed mortgage related or so-called “toxic assets.” However, shortly after passage, the Treasury Department announced it would inject capital by more direct means. Thus, high interest among congressional committees and the public exists about which financial institutions are getting Federal money and what they are doing with it.

In order to address the crisis, the Treasury department constituted a committee within the Department aided by a small staff of 40 to sort through the thousands of applications for money from banks, savings and loans, insurers and other institutions to select institutions for funding (Lander, Nov. 4, 2009). The applying financial institutions were assigned a ranking of eligibility by the federal agency that regulates them (S.E.C., F.D.I.C., etc.), but the Committee made the decision. Treasury officials did not disclose the criteria for deciding which institutions were sufficiently healthy to warrant assistance and which were not, leading members of Congress to question the program’s legitimacy. The Treasury Department stressed that the process had to be confidential so that rejected banks did not suffer damage in the markets, further harming the financial system (Lander, Nov. 4, 2009).

Congress imbued multiple organizations with accountability mandates for TARP. Responsibility for accountability is undertaken by four Federal organizations: the Special Inspector General of the TARP (SIGTARP); The Government Accountability Office (GAO); The Congressional Oversight Panel (COP); and the Financial Stability Oversight Board (FINSOB). While the Treasury Department has issued several reports and includes some data on its website, the SIGTARP and the Congressional Oversight Panel have continually recommended that the Treasury Department collect additional data from TARP recipients on the actual use of funds. The SIGTARP stated that doing so is essential to meet Treasury’s stated goal of

bringing transparency to the TARP program and informing the American people and their representatives in Congress about what is being done with their money (SIGTARP July, 2009,8).

This speaks directly to the procedural public interest function of democratic control. The Treasury Department has rejected the recommendation and claimed that the exact use of federal aid cannot be tracked because “money in a bank is like water poured into an ocean” (Applebaum, July 20,2009). The SIGTARP’s accountability partner GAO cannot assist in obtaining the information, because GAO does not have direct access to the companies that receive TARP funds (Dodaro, March 31, 2009). The General Accountability Office also has continually found that Treasury had not developed “a means of regularly and routinely communicating its activities to relevant congressional committees, members of the public, and other critical stakeholders” (GAO March, 2009). GAO stated that “Until the plans for regular outreach to Congress on TARP matters are implemented, Treasury risks that some congressional committees or staff may not be receiving consistent or timely information, increasing the likelihood of misunderstanding by Congress and according to Treasury officials will continue to be inundated with ad hoc TARP-related inquiries” (GAO June, 2009).

Inadequate information on agency activities clearly risks the perception of legitimacy of the programs being managed. Communication difficulties are more likely to be experienced with crash programs where activities are rapidly evolving and being changed, where organizations to run them are newly established, and where programs are dependent on many new employees and are understaffed. All of these conditions existed in the establishment and initiation of TARP activities.

With respect to the integrity of government, the potential challenges in TARP are significant. As the SIGTARP declared:

“We stand on the precipice of the largest infusion of Government funds over the shortest period of time in our Nation’s history. History teaches us that outlay of so much money in such a short period of time will inevitably attract those seeking to profit criminally. If, by percentage terms, some of the estimates of fraud in recent government programs apply to the TARP programs, we are looking at potential exposure of hundreds of billions of dollars in taxpayer money lost to fraud” (Barofsky, March 31, 2009, 8).

At this writing, it is still early in the administration of the programs and it will take some time to discover if the estimates of large amounts of fraud are on target.

The challenge in getting the accountability balance right in the Capital Purchase program lies in the tradeoffs between investing the accountability agents (SIGTARP, GAO, COP, FINSOB) with sufficient powers to obtain information but not overly intrusive powers that disincent financial institutions from participating, thereby decreasing the chances of restoring financial stability.

Economic Dimension

Since the passage of the Full Employment Act of 1946 (15 U.S. C. sec.1021) the Federal Government has assumed the responsibility for economic stability of the country. The Act encourages the Federal government to promote maximum employment, production, and purchasing power. Its mandates were reinforced by the Full Employment and Balanced Growth Act of 1978. The imperatives of these acts no doubt infused the perceived need for the government to act when the financial crisis ensued. A primary rationale for the Capital Purchase Program was to head off the systemic failure of the credit markets and collapse of the financial system which was projected to lead to a serious price deflation and resultant depression in the economy. The President, the Secretary of the Treasury, and the head of the Federal Reserve all claimed that capital support to private financial institutions was mandatory to prevent these results and to restore growth to the capital markets.

Under the CPP, political authority is utilized as an “economic stabilizer,” whereby the government intent is to restore financial activity in the market by directly investing money (in the form of capital) into financial institutions. “The program is designed to generate a positive return to the taxpayer while strengthening the backbone of and providing confidence in our nation’s financial system” (Treasury March 2009). Before exiting the program and repaying government, financial institutions have to demonstrate that they are well capitalized through non-governmental sources. The success of the federal government use of political authority in the CPP is dependent on at least three economic assumptions: that selecting financial institutions for capital infusions will indeed increase lending activity and signal legitimacy/stability to private market participants, that the taxpayer funds will be paid back with a return

on the investment, and that financial institutions will remain in the program until they are healthy enough to generate and sustain private capital and lending activity. If any of these three assumptions is miscalculated, the CPP may be an ineffective tool.

When considering the economic dimension of political authority in this situation, it is apparent that the success depends in large part on dynamic factors outside of direct government control. For example, the market may respond in unexpected ways to the capital infusions by government into financial institutions. “While government intervention has the potential to stabilize the system by shoring up bank capital, it can also risk further scaring away private capital by creating new forms of risk and uncertainty” (COP June, 2009, 7). This risk is large part due to the propensity for government to pay below market prices for assets. Indeed, while the government is being repaid and earning a decent return on its investment (estimates at the end of August total \$4 billion repaid at an equivalent of 15 percent annually), some financial experts say that the Treasury paid too much for the assets, and could have earned three times the amount of return (COP February, 2009, 2; Kouwe August 30 2009).

In addition to considering the dynamic environment, it is necessary to consider the numerous other institutions- independent of the CPP- that also drive the success (or failure) of the market. As the General Accountability Office has noted, isolating and estimating the effect of the CPP (and other TARP programs) includes discerning the influence of s other very large capital infusions programs initiated separately by the Federal Reserve, and the dynamics of world markets and money flows. In June 2009 GAO noted that indicators of risk in credit markets had improved since March although the cost of credit had risen in some markets, (GAO January 2009; GAO June 2009, 68). However, determining the role that the CPP played in this, as one of several interdependent institutional influences, is extremely difficult.

Management Dimension

A noteworthy issue in any new government initiative, including the CPP, is whether or not the focal government agency has the management capacity to achieve the desired impact. The first decision for policymakers is whether to assign the “new responsibility” to an existing organization or to create a new organization. Legislators often have a bias toward creating new organizations under the supposition

that the new organization will pursue the stated program objectives with greater vigor than would an existing organization. Often, however hopes for new agencies are soon eclipsed by the realities of organizational life in governments. Start -up times and costs are very often greater than proponents foresee, and the lack of experience, expertise, and learning leads to a struggle rather than aggressive pursuit of policy priorities (Johnson, 1990, Wise, 2002).

In the case of the CPP, Congress and the Administration chose a hybrid between the old and new by mandating the establishment of a new agency within the existing Treasury Department. The Emergency Economic Stabilization Act (of 2008) mandated that an Office of Financial Stability be established within the Treasury Department to administer the funds appropriated under the Act. In effect, the Treasury Department had to create a new organization which immediately had to distribute hundreds of billions of dollars, somewhat like building an airplane while flying it. The effort has faced management capacity issues since its inception. It is important to remember that the financial stability effort was put into place by appointing an Interim Assistant Secretary for Financial Stability and other interim officials. Coming in the last days of an outgoing Administration, appointment of permanent officials who would bear continuing responsibility for the program was not realistic. The slowness of the political appointments and confirmation processes further constrained the capacity of the Treasury Department to provide political and policy leadership for the program at the Departmental level. By the middle of March 2009, every key political appointee position with the exception of Secretary Geithner was either vacant or the appointee awaited confirmation. By September, 2009, almost a full year since the program's inception, only 13 of 33 Treasury appointees had been sent to the Senate for confirmation, and only 7 had been confirmed (Washington Transition Project).

With respect to the impact on Treasury's capacity, Sheila Baird, Chairman of the Federal Deposit Insurance Corporation observed, "There are a couple of go-to people trying to do five different jobs. I do think that's a real issue... I think being unable to get their own people has hampered their ability" (Cho, 2009). As a result, the major policy decisions involved in the Capital Purchase Program as well as the numerous other programs were made by the Secretary and a group of unofficial senior advisors who had

not been appointed by the President nor confirmed by the Senate (Andrews and Labaton, March 9, 2009). The Assistant Secretary for Financial Stability was not confirmed by the Senate until June 19, 2009, and while Treasury had identified the Chief Investment and Chief Home Ownership Preservation Officers, they were still not in place.

Professional staff capacity within the Office has also been an issue. The program had a staff of 48 (only 5 of which were permanent staff) as of Nov. 21, 2008 which grew to 90 (38 permanent staff) as of January 26, 2009, and 166 (137 permanent staff) as of June 2009 (GAO January 2009; GAO June 2009). Treasury estimated that it would need 225 full time employees to operate OFS at full capacity (GAO June 2009). Treasury faced a number of challenges in hiring to quickly staff the program. Conflict of interest considerations increased the time needed to recruit and hire personnel for OFS and in some cases caused qualified individuals to withdraw from consideration.

Also, candidates that had the right skills often worked for a financial regulator that could offer a more competitive salary than OFS (GAO January 2009; GAO June 2009). Professional staff for oversight is also potentially an issue. The SIGTARP whose offices employs 30 employees observed that his operation would need an agency the size of the FBI—which has 30,000 employees—“truly cover this by ourselves’ (Goldfarb, April 7, 2009, A_17).

To supplement the efforts of professional staff Treasury turned to contractors, and by June 1, 2009 had concluded 40 TARP financial agency agreements, contracts, and blanket purchase agreements (GAO January 2009; GAO June 2009). Of course employing private sector contractors to be involved with activities providing funding for and regulating other private sector organizations poses issues of potential conflicts of interest. The General Accountability Office recommended that Treasury issue guidance requiring that key communications and decisions concerning vendor-related conflicts of interest be documented but as of June 2009, Treasury had not completed that task (GAO January 2009; GAO June 2009).

The ultimate impacts of the management of the program will not be known for some time as it is still on-going, and determining impacts is very complex. Staffing, working out the relationships with

other units of Treasury, the management of contractors and establishing performance metrics are all in flux.

Auto Industry Assistance

Beginning in late 2008, the US Treasury launched the Automotive Industry Financing Program (AIFP) to prevent a catastrophic failure of two of the largest US automakers⁶. Such a failure was expected to cause “systemic risk” to market stability and the economy at large (Treasury September 4, 2009). Specifically, Treasury has provided \$76 billion in loans and equity investments to GM (and its lending arm GMAC), and Chrysler (and its lending arm Chrysler Financial), resulting in government ownership of 61 percent of GM and 10 percent of Chrysler (Associated Press, September 2009). As a result of their participation in the AIFP, both companies have taken on a government advised restructuring program, and adhere to “rigorous standards” to protect taxpayer interests (Treasury September 4, 2009).

Public Interest Dimension

One issue relevant to the public interest and popular control is whether the expenditure of TARP funds is being done pursuant to the statute as passed. The ESSA does not explicitly state that TARP is available to provide assistance to the automotive industry or to any specific industry except the financial and banking industry. ESSA states:

The Secretary is authorized to...purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act, and the policies and procedures developed and published by the Secretary (EESA sec . 101 (a)(1)).

A financial institution is defined as:

[a]ny institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, insurance company...(EESA Sec.3 (5)).

When asked before the House Financial Services Committee about auto companies after TARP passed, Secretary of the Treasury Paulson testified, “I don’t see [preventing the failure of one or more auto

⁶In addition to the AIFP, TARP also includes allocations to support auto suppliers (the Auto Supplier Support Program) and automobile warranties (Auto Warranty Commitment Program). These additional allocations total less than \$6 billion. The primary focus of this case study is on the AIFP.

companies] as the purpose of TARP. Congress passed legislation that dealt with the financial system's stability" (Paulson 2008, 18-19).

In fact, the House of Representatives passed a specific bill to appropriate \$14 billion for the auto companies but the bill was defeated in the Senate. At that point the Administration reversed its position and claimed that EESA's definition of "financial institution" was broad enough to include automotive companies, whose failures "would pose a systemic risk to financial market stability and have a negative effect on the economy of the United States" (U.S. Dept. of Treasury, Jan. 6, 2009). Both Constitutional and statutory issues potentially arise from the use of TARP funds. The Congressional Oversight Panel concluded that, "While Treasury (and President Bush) have made various statements regarding their interpretations of the statute and the authority to use TARP in this way, it is not clear that any of these statements is sufficient to qualify as speaking with the force of law, especially since there has not been one coherent statement but a mix of court filings, oral argument, and statements by Treasury officials" (COP September 2009, 77). The Panel recommended that "Treasury provide a legal opinion justifying the use of TARP funds for the automotive bailouts" (COP September 2009,115).

Another issue relevant to popular control and accountability lies in the question of what are the objectives of the government in investing in these two companies? The Congressional Oversight Panel found that Treasury's public statements cited different objectives at various times and had not clarified them. (COP September 2009). The Panel recommended that Treasury should clarify its policy objectives, reasonable expectations, and the implications of these policy decisions in the automotive bailouts, and that if the objectives include more than the rescue of the two companies but also other aims such as environmental improvement, support for pension obligations, or continued employment, Treasury should make that clear and also provide transparency on the costs of such objectives (COP September 2009 112). "The Panel is particularly concerned with the lack of publically disclosed information regarding Treasury's evaluation of the viability of the automotive companies and its exit strategy with respect to the substantial investments it has made in those companies in order to ensure that 'these companies-and this industry – must ultimately stand on their own, not as wards of the state (quoting Presidential Remarks,

March 30) (COP September 2009, 112). The Panel observed that in the absence of a clear consensus of Treasury's objectives, it is difficult to assess their success (COP September 2009). In summary, the Panel stated, "Treasury must be clearer, more transparent, and more accountable in its TARP dealings, providing the American people with the information needed to determine the effectiveness of Treasury's efforts" (COP September 2009, 5).

Another issue is the potential for conflicts of interest by virtue of the government's dual ownership and regulator roles in the two companies. Can the government safeguard the public interests as a regulator, and ensure the viability of the firm as an owner? The Congressional Oversight Panel pointed out that most courts have found that the controlling shareholder owes a fiduciary duty to the corporation, but that the pursuit of public policy objectives using an investee corporation could violate these duties. Even under the best of intentions, the potential for conflict exists, and the longer the government plays the role of regulator and regulated, the greater the opportunity a conflict has to occur (COP September 2009). The Panel pointed out that a further complicating factor is the risk of political interference in government-owned entities. It stated that thus far, Congress has not directly become involved in the management of Chrysler and GM but that the possibility exists. In fact, congressional hearings were held over the decisions by Chrysler and GM management to eliminate dealer franchises and the criteria for those decisions.

Economic Dimension

The public-private configurations in the AIFP have critical economic dimensions that will in large part determine the success (or failure) of the entire intervention. In December of 2008, Treasury issued "bridge loans" to GM and Chrysler totaling \$22.9 billion dollars, with the caveat that the auto companies would present restructuring plans to Treasury in February. After reviewing the plans, Treasury deemed that the companies needed to undergo serious restructuring (eventually initiated through bankruptcy) before they could be on a financially viable path and thereby receive additional federal dollars (GAO March 2009). A series of economic assumptions underlie the probability of AIFP success, including: that the challenges for achieving "financial viability" can be appropriately identified, that these

challenges can be overcome through restructuring and federal investment, and that the actions taken by the government to help restructure GM and Chrysler-if successful- will have a positive net effect on the auto industry as a whole and the economy at large.

In a report last April on the AIFP prior to the restructuring, the GAO noted several challenges that face GM and Chrysler, that while perhaps beyond their control, will impede the effort to achieve financial viability. These include weak economic conditions, frozen credit markets, solvency of suppliers, cost of developing advanced technology vehicles, reducing the number of dealerships to align with sales volumes, uncertainty over future fuel economy standards and reducing debt (GAO March 2009). Any one of the factors might be considered a formidable challenge. Developing the appropriate restructuring package to meet these challenges (and others not anticipated) through “planned interventions” rather than market processes is daunting.

Further, assuming that GM and Chrysler emerge (which is questionable), what is the intended objective with regard to the larger economy? The objective of political authority should not be firm specific, but rather, to benefit the public at large. The overall market for autos decreased from 16.1 million in 2007 to 10.6 million for 2009. However, the domestic companies’ market share has been declining for several years. For example, GM’s market share fell from 27.2 per cent in 2004 to 22.1 per cent in 2008 (GAO April 2009). In essence the market share trend line for domestic automakers is steadily down. By buying shares in only GM and Chrysler, it would appear that the government is trying to turn the domestic automaker sales trend-line up – essentially reshaping the market by realigning sales market share. Thus, a successful GM and Chrysler that emerge from this crisis would indicate a re-allocation of market share from auto companies not receiving federal intervention towards the reconfigured GM and Chrysler. Several questions are raised by this attempt. Is it within the capacity of government to reshape such a large market by making selective investments? What are the criteria for making such investments, other than the firms are on the verge of failing? Should other domestic producers (Ford?) receive compensation if they lose market share as a result of government action? This

broader industry perspective must be taken into account when configuring and evaluating the political authority interventions.

Management Dimension

In order to manage the Federal Government's decision to invest in GM and Chrysler, the President created an interagency structure, the Presidential Task Force on the Auto Industry (Task Force) co-chaired by the Secretary of the Treasury and the Director of the National Economic Council and includes four other Cabinet Secretaries, as well as directors of OMB, EPA, and the White House Office of Energy and Climate Change, and ten other staff of various White House and departmental entities. In addition, he named two advisors (Ron Bloom, a former investment banker and advisor to the President of the United Steelworkers and Steven Ratner, the co-founder of a private equity firm) to lead the Treasury Department auto team which had the responsibility for evaluating the companies' viability plans and negotiating terms of assistance. The auto team was to report to the Task Force and its co-chairs, who then report to the President. The Treasury auto team, which was actively involved in recruiting many of the new directors who now sit on the new boards of Chrysler and GM and articulated the goals, objectives and management strategy of the Government's involvement with the two companies, was disbanded during the summer of 2009. Given that these were temporary (and unconfirmed) officials, it is unclear what staying power attaches to their articulated positions. Nonetheless, the statements of the leaders of this team constitute the government's statements about strategy.

President Obama provided the Task Force with dual roles: (1) First to avoid intervening in day-to-day corporate management and refrain from becoming involved in specific business decisions, since its role was not to manage but to serve as a "potential investor of taxpayer resources" with the goal of promoting "strong and viable companies," (Bloom July 27, 2009); and (2) Second to "behave in a commercial manner" (Bloom June, 10, 2009). A significant management issue is determining the government's strategy for managing its relationship with the auto companies through its execution of these "dual roles".

The Treasury auto team made conflicting statements about how Treasury will fulfill the first role – avoiding intervening in day-to-day management. On one hand, Treasury states that it will manage its shares in a “hands-off manner,” voting only on core governance issues including the selection of directors and other major corporate actions and transactions (Bloom July 27, 2009, 9). On the other hand, however, the team stated that in order to create conditions most likely to lead to sustained viability for Chrysler and GM, it is necessary to change the culture within the companies (Maynard 2009). The Congressional Oversight panel questioned this more involved management strategy, “The lingering issue is whether the government can really change the culture of these companies and help improve their profitability while it remains a (supposedly) disinterested shareholder with a ‘hands-off’ approach to managing its investment” (COP September 2009, 83). The Panel opined that if the government intends to be a silent partner then it remains to be seen how it intends to protect the interests of the taxpayer as a shareholder (COP September 2009, 83).

In examining Treasury’s role to “behave in a commercial manner,” the Congressional Oversight Panel found that the Department’s performance in protecting the interests of taxpayers in the support of auto companies is somewhat mixed. On one hand, the Department negotiated aggressively in the transactions, demanded significant concessions from the other stakeholders, and protected taxpayers as if it were a private sector investor. On the other hand, the Panel found that the decisions to enter into the transactions in the first place suffered from a lack of transparency (COP September 2009, 111). The Congressional Oversight Panel called for Treasury to formally adopt one of two alternative courses of action. The first alternative is to clearly articulate the duration of its investment and the conditions for disinvestment, to develop a mission and strategy for the companies that is transparent to management, the boards, and the taxpayers, to set up a system for reporting and disclosures, and to leave the business in the charge of the management. The second alternative is to hold Treasury’s interest in a trust, like the 77.9 percent share that the Government holds of AIG (COP September 2009). The Panel observed that the longer Treasury lingers in the decisions of management, the greater the opportunity that such decisions could become politicized (COP September 2009).

The logic model underlying Treasury's approach appears to be confusing. The meaning of the two major articulated dual roles (and the relationships between them), the primary objectives and the strategy for pursuing them are not clearly stated, making it difficult to evaluate "success" (COP September 2009). The most clearly communicated objective was perhaps expressed by the leader of the now defunct auto team, who stated that the primary metric that the public and policymakers could use to assess the success of TARP investments (in Chrysler and GM) is whether or not taxpayers see a return of their money (Bloom July 27, 2009). However, the Congressional Oversight Panel's finding was "...there are significant obstacles to the two companies' ever achieving the level of profitability that would permit the return of all the taxpayer funds expended, and Treasury's best estimates are that some significant portion of those funds will never be recovered" (COP September 2009, 110). Thus, while measurable, a return of taxpayer money was clearly not the primary objective for the AIFP initially.

The loan agreements that Treasury executed with the companies stated that the funding should be used to enable the automakers to develop a viable and competitive business and develop the capacity to produce energy-efficient advanced technology vehicles among other things. However, the General Accountability Office found that the goals stated in the loan agreements include concepts that are not defined, such as rationalized manufacturing capacity and competitive product mix. GAO also found that in addition to lacking clear definitions, some of Treasury's goals may work at cross purposes and will require an assessment of the relevant trade-offs among the goals. Mirroring the findings of the Congressional Oversight Panel, GAO concluded that it will be important for Treasury to clearly articulate what it intends to achieve with this assistance (GAO April 2009).

The General Accountability Office has previously identified three fundamental principles to serve as a framework for considering federal government financial assistance to large firms:(1)Identify and define the problem(2) determine the national interests and set clear goals and objectives that address the problem (3) protect the government's interests (GAO April 2009). By these principles it is not clear that Treasury's strategy fulfills any one of the principles. With regard to the first, a considerable list of problems affecting the conditions of the companies exists, but there has been no comprehensive analysis

presented by the Department that calibrates the various problems and their susceptibility to specific management actions and how specific federal assistance will facilitate successful execution of those actions. With respect to the second, both the Congressional Oversight Panel and GAO have cited a lack of clear goals and objectives as a fundamental issue (the lack of a logic model). With regard to number three, there is evidence that some steps were taken to protect the government's interest by achieving concessions from management, labor suppliers and creditors, but the extent to which the government will be in a position to safeguard public interest as the companies' restructuring proceeds is very unclear. Similarly, the oversight agencies have noted that accountability measures, necessary for the Congress and the public to have confidence that the assistance is used in a manner consistent with identified objectives, are missing.

In sum, major management challenges including clarifying the goals of the program, the strategies for pursuing those goals, the objectives of the strategies and the metrics for assessing progress still remain before the implementing agency.

Conclusions: Implications for Practice and Research

It has become commonplace to refer to the "blurring" of the public and private sectors. Indeed, private actors are frequently relied upon to provide public services, and as demonstrated by the recent economic crisis, public actors are relied upon to ensure functioning private markets. However, rather than "blurring" into a homogenous, autonomous entity, these public-private configurations have critical dimensions that require continuous monitoring and shaping.

First, these configurations, endowed with varying degrees of "political authority" through formal institutions of government, have a responsibility to act within the public interest, both substantively serving public values and procedurally being democratically accountable to the public. In the case of the TARP, the challenges in fulfilling this public interest responsibility are significant. Many of the initiatives under TARP have been broadly defined, with even broader executive discretion to implement the initiatives. Typically, the notion of "popular control" implies that programs are executed by agencies

based on authority granted by Congress. However, in large part, Treasury has been responsible for not only defining but also redefining its own authority to intervene on behalf of the “public interest”.

This is further complicated by lack of transparency, reducing the accountability of both the public agencies and the private participants. And perhaps more perplexing, even if there is some degree of accountability (through reporting on observable indicators), the bigger question is accountable to whom for what? Whose interests, (shareholders, taxpayers, businesses), is the government responsible to protect, when all are so tightly interrelated? What defines a successful outcome in the public interest, when there are competing “publics” and competing interests?

Second, public-private configurations are based on a set of economic assumptions about how government action will affect market dynamics. These assumptions must be made explicit and open to continuous review and evaluation to ensure that the intended consequences are maximized and the unintended consequences are minimized. In the case of TARP, the three cases demonstrate substantial variation in the explicability and accessibility of the underlying assumptions. For executive compensation, there is a logic linking compensation practices to excessive risk, and communicated assumptions that government regulation may intervene in this link by limiting and exposing practices, thereby reducing excessive risk. Whether or not one agrees with the logic and its assumptions, they are relatively explicit, and thus open to evaluation. In the case of the auto industry on the other hand, the underlying logic might be that intervention is necessary to prevent systemic failure; however, this logic does not lend itself to evaluation. What is success and what is failure? Is success based on the lack of “failure” of the two firms targeted for the intervention, or the success of the auto industry as a whole, including the competitors of the two assisted agencies?

Indeed, in public-private configurations, it is critical to monitor the impact not only on the targeted firm engaged in the configuration, but in the larger economy that will be impacted by the intervention. Organizations operate as part of a larger organizational field, and respond to incentives and disincentives created by other participants in the field. To the extent that government extends its authority

to shape the direction of a particular firm's success (or failure), it reshapes the success (or failure) of other market participants and the economy as a whole.

Finally, public-private configurations require the requisite capacity of government, both organizational and human resource capacity, to not only initiate but to implement and monitor the configuration towards the intended impact. As demonstrated through the TARP cases, this requires clear identification of agencies with specific responsibilities, to be executed in line with clearly defined objectives and strategies. In each of the cases, a reoccurring challenge is the multiplicity of implementation "actors" with varying degrees of capacity and authority. From carrying out executive compensation regulations, to injecting capital into financial institutions, to taking on the ownership and risk of large auto companies, a first and essential task is to ensure that the team on the ground is equipped with skilled players and the game plan. Both seem to be lacking in varying degrees across the TARP initiatives.

A further challenge is matching the strategies and capacities of government with the capacities and strategies of the private participants. Private corporations are skilled at harnessing the "tools" of government to create new private strategies and competitive advantage in the market. The capacity of government must therefore be "nimble" enough to predict and respond to strategic behavior, while still operating under clear lines of accountability to the public.

The implications of the changing boundaries between the public and private sectors are both retrospective and prospective. Retrospectively, policy makers, public managers and analysts need to monitor and adjust programs like those in TARP that are already being implemented to ensure realignment with public interest, economic and management dimensions. Prospectively, policy managers, public managers and analysts need to evaluate the new programs and organizations being proposed that further alter public-private configurations that affect major sectors of the economy. Careful analysis of the public interest, economic, and management dimensions will need to be conducted to guide those deliberations. It is hoped that lessons from the first stage of attempts to change the boundaries through programs like TARP will inform these future decisions.

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Table 1: TARP Disbursements as of July 10, 2009

Dollars in Billions

Program	Disbursement
Capital Purchase Program	\$204.2
Targeted Investment Program	40.0
Capital Assistance Program	TBD
Systematically Significant Failing Institutions	41.2
Asset Guarantee Program	0.0
Automotive Industry Financing Program	75.9
Making Home Affordable Program	0.0
Consumer and Business Lending Initiative	0.1
Public Private Investment Program	0.0
Total	\$361.3

Source: Treasury OFS, as reported in the GAO report, July 22, 2009

Table 2: TARP Participants with Political Authority

Direct

U.S. Department of the Treasury

Office of Financial Stabilization

Congressional Oversight Panel

Government Accountability Office

Office of the Special Master for TARP Executive Compensation

Indirect

Federal Reserve Bank

Federal Deposit Insurance Corporation

Securities and Exchange Commission
