Forced Governance Innovations for Managing the Economic, Financial and Auto Crashes

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ABSTRACT

This article analyzes how our pursuit of efficiency in both the public and the private sectors left us without viable corporate leadership and adequate public sector governance in the financial realm in the latter years of the first decade of the 21st century. Over investing in deregulation, reengineering and reinventing, we privatized and contracted our way into serious financial risk. Creative financial instruments without adequate regulation and enforcement for fiscal safety led to dangerous financial instruments and practices in the housing arena and on Wall Street that led to a buildup of toxic assets that eventually manifested as a freeze of financial credit. When banks and financial organizations could no longer do business normally and started to fail significantly, and when Detroit could no longer sell its cars regularly enough to stay in business, the federal government stepped in with the Troubled Asset Relief Program and the stimulus package, and outright bailouts and corporation reorganization assistance to unfreeze the financial system. This article analyzes how the government intervened to prevent a systemic collapse, and how it has struggled since to reform financial governance so we do not end up with a crisis gone to waste by not developing an acceptable set of guidelines, agencies and regulations to prevent such a serious situation from happening again in the future.

Key Words: Too Big to Fail, Financial Governance Failures, Financial and Auto Failures, Bank and Auto Bankruptcies, Government Bailouts, Governance Innovations.

Introduction

Productivity and quality became hallmark goals for both the public and the private sectors in the 1980s and 1990s (Halachmi, 1995; Holzer and Callahan, 2001; Johnston, 1990, 1995; Liou, 2001). Both at the policy level and in terms of management, theorists and practitioners were drawn to those defining aims. Often, it became clear however, that the common denominator came to be understood more in terms of efficiency. Economies, governments, companies, citizens and consumers tend to be more viable, and even to thrive, when they can optimize the balance of efficiency (output over input – like private sector production) and effectiveness (output over standards – like public sector safety and security). Maintaining this balance over time has generally improved the wealth, health and welfare of Americans, and their organizations and systems, significantly.

From time to time however, we move towards one extreme or the other, to excess. When this happens, the overall system gets out of balance and we experience a variety of suboptimal conditions, including crises and crashes (Johnston, 2008). In 2008 and 2009, the imbalances percolated to the surface significantly and manifested seriously in the economy (Krugman, 2009; Phillips, 2008; Soros, 2008), and especially in the finance and housing sectors, and in the auto industry. Underperforming government agencies failed to detect or remedy the increasingly failing situation. The condition became so extreme that the private sector was unable to keep its systems running, and it became necessary for the public sector to eventually step in to rebalance the overall system.

As conditions worsened, the financial system froze. Unemployment skyrocketed. We almost lost the auto industry. And public services, while suffering serious tax based financial problems themselves, were being counted on more and more to lead the way out of this quandary. We got into this condition to a significant extent by over investing in efficiency, not just in the private sector, but in the public sector as well.

After three decades of deregulation, reinventing government, and reengineering the private sector, all designed to provide more efficiency, America finds itself with an economic and governance collapse brought on in part by a virtual abdication of governance. Privatization and contracting out lured managers in both the public and the private sectors (Donahue, 1989; Johnston, 1999; Kettle, 1993; Seidenstat, 1999 a,b). After Jimmy Carter deregulated the airlines in 1978, Reaganomics ushered in the beginning of the presence of five conservative Bush related White House administrations through 2008, all designed to limit both government and governance (Johnston, 2008 a; Johnston 2008 b; Johnston 2008 c). The Clinton/Gore presidency also focused on efficiency, with its National Performance Review (Gore, 1993). States and local governments supported the efficiency in government crusade as well. California passed Proposition 13 in 1978, and Colorado followed with Amendment 1 later. Several other states passed similar legislation.

Reinventing Government, by whatever name it might be called, launched an era of increasing entrepreneurialism in government (Halachmi, 1996; Halachmi and Bouckaert, 1995; Holzer and Callahan, 2001; Johnston, 1996 a,b,c; Johnston, 2002; Johnston 2008; Johnston and Seidenstat, 2001; Osborne and Gaebler, 1992). Yet there were warnings that over investing in efficiency and entrepreneurialism in government could be highly risky (de Leon, 1996; Johnston, 1990; Johnston 1996 b). Johnston's "Caveat Emptor: Customers vs Citizens" is another example (Johnston, 1995). Contracting out and privatization remained primary concerns for those interested in management, accountability and governance into the 21st century (Johnston, 2007; Seidenstat, 2008).

Under investing in governance, appropriate regulation and professional public management caught up with us dramatically in 2008 and 2009 when Secretary of the Treasury Hank Paulson and Federal Reserve Chairman Ben Bernanke summoned Congressional leaders in

late 2008 and told them that if they did not receive $700B from Congress immediately, the entire financial system could collapse in a matter of days (Sorkin, 2009; PBS, 2009). With the national election campaigns in full contention, one candidate, more than any other, vowed to "change" the way the government would be managed. With the unfolding financial, economic, governance and management collapse, voters decided it was time to make a major change of direction. They elected Barack Obama as President.

President Obama has brought his version of leadership and professional public management to our nation. The values focused on here include the public interest, accountability and more effectiveness oriented government and governance. His directives for public managers, while still unfolding, emphasize these values in the wide variety of public programs and projects that we are witnessing as our national, state and local governments confront the economic, governance and management collapse. Among the prime priorities for Obama and public managers across the country are the following:

- transportation, infrastructure and public works including but not limited to roads, bridges, rail and highways;
- alternative energy, greening and climate change initiatives;
- dealing with the increasing unemployment crisis and the retraining that accompanies it;
- bailing out banks, AIG and the auto companies – Chrysler and GM;
- providing leadership for economic development with state and local governments;
- shifting the priorities towards more environmental protection;
- establishing public sector oversight for the Troubled Asset Relief Program;
- providing funds and accountability for the Stimulus Package funds;
- and, developing public–private collaboration efforts to optimize both effectiveness and efficiency.

Public Managers Confront the Financial and Economic Collapse

It started in the private sector, with inadequate regulation from government. Early indications began to surface in the housing industry. There were subprime loans and ARMS. These were later securitized and sold in large amounts by Wall Street. These virtually unregulated investments lacked adequate equity behind them and later became known as toxic

assets. These risky investment packages eventually became hazardous enough that banks and investment firms stopped buying them. They had become too risky. Without adequate government oversight and protections, the financial system began to freeze up.

The federal government took notice. It stepped in and assisted in the Bear Stearns acquisition by JP Morgan Chase, with government guarantees. It then nationalized Fannie Mae and Freddie Mac into a conservatorship when their value went down 60%. Secretary of the Treasury Hank Paulson balked at bailing Dick Fuld and Lehman Brothers out because he thought they were leaning far too closely towards moral hazard (privatized profit with socialized loss). In brief, Paulson thought they were taking on far too much risk while expecting the government would be there to bail them out. He warned them. When they ignored those caveats, then could not survive on their own any more, Paulson let them fail. The market dropped thousands of points. Other banks and investment firms found themselves in crisis as well. Merril Lynch went to Bank of America. Wachovia went to Wells Fargo by way of Citigroup. Two dozen banks failed in 2008. Over a hundred more have failed in 2009. Along the way AIG, the largest insurance company, was considered too big to fail as well. It received a $170B bailout, then gave $165M in bonuses to the very people who helped cause the crisis with their risky financial bets, causing outrage across the country (Sorkin, 2009; PBS, 2009).

Virtually unregulated in the private sector, finance and credit had frozen up in the fall of 2008. President Bush and his treasury Secretary Hank Paulson, along with Chairman of the Federal Reserve Ben Bernanke, sought an immediate emergency meeting with Congressional leaders. Upon being convinced of the gravity of the situation, Congress approved $700B for the Troubled Asset Relief Program. Bush would spend, through Hank Paulson, $350 immediately to relieve the credit pressure on the banks. This money, while originally targeted to unfreeze bank lending, was given to the banks almost without restrictions. The impact of this initial allocation was virtually insignificant. Obama's more governance, accountability and management focused efforts yielded a $350B outlay of TARP money that would be spent more effectively later.

As the financial freeze got worse, Wall Street collapsed as well. The DOW fell from 14,000 near the end of 2007 to 6,500 in March of 2009. Unlike defined benefit pensions that many public sector employees earn, the defined contribution or 401k pensions increasingly popular across the country for the last few decades reflected the market. Down about 40% with the financial and economic collapse, focus shifted towards the quasi governmental and significantly underfunded Pension Benefit Guarantee Corporation, and even to government provided social security, increasingly for at least some retirement peace of mind. With increasing unemployment witnessing over 500,000 per month for several months in a row, and reaching 10% by the end of 2009, citizens across the country were not surprised to learn that the country had been in a recession since about the beginning of 2008 (Sorkin, 2009).

So President Obama created a financial team to optimize his public sector oriented governance values, with strong emphasis on accountability and responsibility. The team is

comprised of leading financial managers and leaders from across the land, including: Treasury Secretary Tim Geithner, Federal Reserve Chair Ben Bernanke, Director of the National Economic Council Larry Summers, Director of the OMB Peter Orszog, FDIC Chair Shiela Bair, and Chair of the White House Council of Economic Advisors Christina Romer. They immediately changed the way the business of doing business with business is done. As they took charge, they started their work by requiring more accountability, responsibility, management and governance.

Mandating stress tests for banks gave notice that more regulation would be forthcoming in order to reduce risk for financial institutions, credit markets, investors and the economy. On the upside, these financial managers also helped formulate a stimulus package that with President Obama's leadership was finalized at $787B. In order to assist them with their significant work load, the financial team began the process of hiring several thousand new public management financial employees. As the stimulus package unfolds, there will also be several thousand more public management and private sector employees hired, perhaps especially in the public-private partnership projects. Saving jobs and creating new ones are among the primary targets of the stimulus package.

Detroit Requests a Government Bailout

Building and selling cars is the mission of Detroit's big three auto companies. In 1985 their market share was 85% of the autos sold in the United States. By 2009, it was just 43%. The economic collapse, coupled with fuel prices that soared to $4.00 per gallon, then dropped precipitously to just above $2.00 per gallon in a year, and a consumer confidence crisis…led to potential customers shying away from new car purchases. American auto sales declined 46% in 2008, while German and Japanese sales declined about 30% each. Consumers were shaken by: housing foreclosures, bankruptcies, the recession, fuel prices, unemployment increases, toxic assets, Wall Street crumbling, the credit crisis, evaporating pensions and more.

Public managers began looking seriously at the increasing costs of the downside of this unfolding catastrophic situation with Detroit and the financial sector, and the overall economy. Among the problems and issues they saw were: the increasing unemployment funds needed; health care increases for public hospital emergency rooms; taxes lost (sales of thousands per new vehicle, and income taxes for working employees, etc.); business licenses, permits, and fees; land use taxes; increasing old age, social security, and Pension Benefit Guarantee Corporation responsibilities; welfare demands, and more….

Detroit's top level management could no longer ignore the fact that their sales were not adequate enough to enable them to survive as a viable industry. They reorganized, had fire sales, executed layoffs, closed plants, renegotiated labor and management contracts, bargained down health care agreements, enacted furloughs, and downsized production lines. They renegotiated deals with those in their supply chains. They also worked with their over 10,000 dealers. When

all this proved to be insufficient to maintain adequate cash flows, they decided they had no other choice than to approach the government for financial assistance. Though Detroit's preferred approach to raising money is not through public management, which very well could lead to more public sector priorities like higher gas mileage, more pollution controls, and a different product mix, necessity demanded the auto companies ask for public management assistance.

Rebuffed by both Congress and the Bush White House after arriving in their corporate jets in Washington for their request for bailout money, the Detroit CEOs were more successful on their second attempt. With mandates to: rework union contracts, reorganize their corporations, and demonstrate long term viability, the bailout money was granted. Though nowhere near the hundreds of billions of dollars given to the chosen banks and AIG, the auto companies did receive an initial increment of government bailout money designed to hold them over for several months. GM got an initial $13.4B, Chrysler $4B, and Ford a line of credit for $9B which they have not used. GMAC was also certified as a bank, allowing it to qualify for an extra $5B in government aid. It would also be able to charge lower interest rates and be more competitive with its new status.

GM and Chrysler had to report in February 2009 that they were making substantial progress on their mandated charge to reorganize and prove their financial sustainability. Their request for substantial further government investment in their companies was disapproved by President Obama's Auto Task Force, essentially Obama's Financial Team, with Steve Rattner being the manager in charge. Chrysler was given until April 30 to make even further reorganization changes, or with the assistance of the Obama auto task force, be forced into a controlled or managed bankruptcy. GM was given longer, until June 1st of 2009, with essentially the same requirements. Among the major issues unresolved were the negotiations to rework the health care agreements with the union, how bondholders as secured creditors would be dealt with, how other debtors could be reasoned with, and how debt could be paid back to the government. In lieu of finding agreements, how could a reasonable ownership interest in the auto companies be given to the creditors, including the federal government. Failing to find adequate solutions to these and other issues, chapter 11 bankruptcies would follow.

The Auto Companies Requesting Government Bailout Money

General Motors

GM started 2009 with 252,000 employees, down from almost 400,00 a dozen years before. Fritz Henderson replaced Rick Wagoner as CEO. President Obama required the change after the February 2009 review. Among GM's initiatives for reorganization were divesting itself of the following brands: Saturn, Saab, Hummer, and Pontiac. It also promised to cut: plants, dealers, both labor and management employees, and benefits.

GM's hope for the future is the Chevy Volt. It is a 40mpg hybrid electric car. GM had some strong sellers in 2008. The Silverado truck was 2nd. The Impala was 7th. And the new Malibu was car of the year for 2008. GM also has a significant presence in China, where it plans to build small cars for the future. GM is also negotiating to sell its investment in the Opel brand.

Chrysler

With 55,000 employees in early 2009, Chrysler had the fewest of the Detroit Three. Bob Nardelli was its CEO. In order to conform to the Obama Auto Task Force requirements for its bailout money of $4B, it said it would divest itself of the Durango, PT Cruiser, and Aspen brands. Chrysler's top seller in 2008 was the Dodge pickup truck which came in at 8th place in sales. Its other hard asset has been the Jeep Brand. This company's hope for the future is the ENVI, a small electric vehicle. With sales down 55% in the last year, and Nissan and VW building Chrysler vehicles under contract, this company was looking for more viable alternatives for the future. Chrysler was clearly at risk. Having relied on power vs small economical autos over the years, Chrysler products were poorly placed to compete in an increasingly energy expensive future.

Chrysler has had a seriously difficult recent history. It required a bailout in the early 1980s. Lee Iacocca led them through that successfully, but has lately been critical of auto industry leadership and management (Iacocca, 2007). More recently Daimler partnered with Chrysler. That union ended poorly. Cerberus Capital Management bought 80% of Chrysler from Daimler a few years ago. Now, Chrysler has formed a new strategic alliance with Fiat of Italy. Fiat offers the possibility for smaller cars, new designs, and more efficient engines. Fiat's Sergio Marchionni has become the new CEO of the new corporation.

Ford

Ford is clearly in the best shape of the Detroit Three. Its F-Series pickup truck was 1st on the top ten best seller list in 2008 with 515,000 sold. With 87,000 employees in early 2009, it is larger than Chrysler but only a third the size of GM. Alan Mullaly is their CEO. He borrowed significantly a few years ago, before the credit markets tightened up, and has invested wisely in new technologies and safety that have kept Ford financially healthy enough that they haven't had to use their $9B line of credit from the federal government. Ford's small car for the future is a reengineered Fiesta, which is in use in Europe in its original design.

Ford also positioned itself nicely in the market by selling its Jaguar and Land Rover brands to TATA Motors of India recently. Among its research and development investments for the future are: fuel economy improvements, self parking vehicles, electric powered steering via batteries, carbon emission improvements, and more safety oriented features.

Cash for Clunkers

In the spring of 2009, with the auto companies and dealerships on the verge of collapse, Congress passed and then extended a "Cash for Clunkers" program. It helped sales in the short run, and got many older high polluting vehicles off the road. Once the program ended however, sales subsided again.

Chrysler Files for Chapter 11 Bankruptcy

President Obama's Auto Task Force decided in April 2009 that Chrysler would not be able to meet its bailout requirements. Chrysler was then forced to file for Chapter 11 of the Federal Bankruptcy Code. About 20 hedge fund and investment firms said they could not violate their fiduciary responsibilities to investors, and refused to cooperate. A number of these investors were retirement funds for police, firefighters, and teachers for instance. The President was not pleased. He wanted more cooperation and collaboration. At issue here was a conflict between contract law, dealer safeguard laws at the state level, and federal bankruptcy law. Public managers at various levels of government were involved in preparing the laws, passing the laws, and implementing the laws. Furthermore, they have also been involved in problem solving resulting from these conflicts.

The Auto Task Force did get cooperation from the Banks which were creditors. Having received hundreds of billions of dollars from the federally financed TARP program, this was not a surprise. Under the terms of the controlled bankruptcy, the United Auto Workers received 55% of the surviving organization. Fiat started with 20%. It can increase its ownership share to 35% in a couple of years if it meets certain requirements. And it can eventually get to @ 50% when the new company pays off the federal government loans. In the meantime, the United States federal government owns 8% of the new company. Canada owns 2%. To make this happen, the auto task force members used their negotiating skills to eliminate a lot of debt. The US Government forgave $4B (100%), Daimler and Cerberus $2B (100%), banks gave up $4.9B (71%), and the UAW forgave $6B (57%).

The Obama Auto Task Force plan was for a quick and surgical 30 to 60 day bankruptcy. With the hedge funds and investment firms deciding that law suits would be too expensive to pursue in public court, and with the leadership of the Obama team, it became possible to exit bankruptcy quickly; in 42 days from the initial bankruptcy filing on April 30, 2009. Among the significant issues here for citizens, companies and public managers is how the conflicts of the various public laws unfolded. There were issues involving: contract law, bankruptcy law, dealer protection laws, and constitutional protections against seizure of private property. Secured lenders, for instance, want bankruptcy law to prevail. As set up by the Obama team, the unsecured UAW workers won, with dealers and creditors taking a back seat. This debate effectively changed the way public laws in the United States have been enforced.

In early 2010, various websites reported on the progress of Chrysler's downsizing of its three designated brands. The Aspen brand is not found to have any 2010 vehicles available for sale. The Dodge Durango does have 2010 vehicles listed for sale. And the PT Cruiser has been redesigned and kept on in 2010, presumably at least to keep its small car market share until Fiat can begin manufacturing its new fleet of small cars.

General Motors Files for Chapter 11 Bankruptcy

Having many of the same types of problems, issues and concerns as Chrysler, yet being much larger and more complex, General Motors in the end found itself unable to sustain eight brands and thousands of dealerships, especially in an economy where credit was freezing up. GM vehicles were simply not selling enough to keep the organization afloat. So, a decision was made to file for Chapter 11 Bankruptcy on June 1, 2009. As with Chrysler, President Obama's Auto Task Force was significantly involved in crafting and supporting an innovative package designed for a swift passage through the process.

Emerging as the New GM on July 10, 2009, the corporation had changed dramatically. Before bankruptcy, GM brands included: Chevrolet, Buick, Cadillac, GMC, Saab, Saturn, Hummer, and Pontiac. Afterwards, the surviving brands are: Chevrolet, Buick, Cadillac and GMC. Not surviving the cut were: Saab, Saturn, Hummer and Pontiac. By the end of 2009, we found Pontiac scheduled to be terminated and closed. Hummer was sold to the Chinese company Sichuan Tengzhong, a heavy industrial machine company (marketwatch.com, February 9, 2010). The agreement collapsed when Chinese government regulators failed to approve it, leaving GM management with the task of winding down the business (nytimes.com, February 24, 2010). Saturn was almost purchased by Roger Penske in a deal with the French Company Renault, until the board voted it down at the last minute, apparently under pressure from major shareholder Nissan (Terlep and Stoll, 2009). And, after serious movement recently to put together a deal to purchase Saab by Norwegian investors, the Koenigsegg Group, with loan guarantees by the Swedish government, that option failed. In the end, Saab was bought by Spyker Cars with Swedish taxpayer money guaranteeing a loan from the European Investment Bank (TheLocal, January 27, 2010). After trying to sell its European Opel in 2009, GM finally decided to keep the brand.

The ownership stakes emerging from GM's chapter 11 process are as follows: U.S. Government 60.8%; Canadian Government 11.7%; UAW 17.5%; and bondholders 10%. Compared to U.S. Government ownership of 8% with Chrysler, U.S. taxpayers now own a significant majority of General Motors (aka Government Motors). President Obama has stated he does not want to be involved in running GM or Chrysler and he will get the government out of the business as soon as possible.

GM's organizational structure also changed dramatically under the government Auto Task Force's innovative guidance for processing through Chapter 11 bankruptcy. Entering the process on June 1, 2009, GM had: 91,000 employees; 47 plants; and 5,900 dealers for their eight brands. Exiting Chapter 11, 40 days later, GM emerged with: 68,500 employees; 34 plants; and 3,600 dealers for their four brands. This enormous transformation was designed to prepare GM to be able to compete and survive in a much harsher environment in the future (Stoll and King, July 10, 2009).

Perhaps Even More Government Intervention

Should Chrysler, and/or GM down the road, totally collapse, more governance and public management intervention would be required. We could reasonably look for more:

- unemployment assistance
- health care and emergency room assistance
- welfare
- job retraining
- retirement assistance and PBGC spending
- shrinking tax bases
- public sector furloughs, and
- inflation requiring more public management leadership.

We have a lot of good, strong experience and examples of innovative public-private partnerships and cooperative and collaborative joint ventures between public and private actors and stakeholders. Among the more complex and instructive are megaproject examples. One in particular, the Transportation Expansion Project (TREX) in Denver a few years ago stands out. Working with public managers at all levels of government and with private sector entrepreneurs and managers; collaborative, consistent and accountable efforts yielded substantial savings, improved time horizons, and extraordinary quality results in the TREX megaproject. The American Society for Public Administration had a special panel on this topic at its national conference in Denver in 2006 (Johnston, 2006).

Other good examples have emerged from our innovative responses to the 9/11 terrorist crises. The catastrophic events that occurred on September 11, let us know in no uncertain terms that relying primarily on privatization and contracting out for security for our airlines was seriously inadequate. The crisis proved we needed more government involvement and a

collaborative effort to develop, fund, and implement more viable public and private, governance and effectiveness based standards and practices (Haynes, 2004; Johnston, 2004; Plant,2004; Seidenstat, 2004; Waugh, 2004). It took years to more fully develop legislation that would allow us to implement more collaborative and governance based security in rail transportation, for instance. Yet, in 2007, with H.R. 1, titled "Implementing Regulations of the 9/11 Commission Act of 2007," as its base, Congress moved forward collaboratively to finalize rail security law that was eventually contained in Title XV, Subtitle B, sections 1511-1528. The crisis of 9/11 forced us to focus money, time, and energy to find a solution to the crisis created by too much efficiency and too little emphasis on governance and effectiveness; e.g., security and safety standards (Johnston and Plant, 2008).

Our public sector leaders and managers who are intervening in the financial and economic meltdown, and the auto crash are bringing their public priorities and values to the table. We are now witnessing the implementation of their public management and governance problem solving concerns for:

- the public interest
- sovereignty
- accountability
- public policy and business ethics
- quality
- transparency
- trust
- collaboration
- integrity
- effectiveness based standards, and
- transformed financial controls.

These are effectiveness and governance based values. Managers who focus primarily on efficiency, usually do not consider governance and management values as a priority. This often results in cynicism and lack of trust as well (E.M. Berman, 1997; Wicks, S.L. Berman, and Jones, 1999).

Preparing an Appropriate Innovative Governance Infrastructure

In order to provide optimal performance and productivity in both the private and public sectors, we need to have a reasonable understanding and trust based agreement regarding the ground rules. The governance and management infrastructure shifted in the late 1970s and early 1980s towards more efficiency and a business type model for implementing public policy. Privatization, contracting out, deregulation, total quality management, reengineering, and reinventing (de Leon, 1996; Donahue, 1989; Gore, 1993; Halachmi, 1996; Holzer and Callahan, 2001; Hyde and Olshfski, 2008; Johnston and Kurtz, 1985, 1986; Kettle, 1993) lured managers towards ever more efficient governance and management processes and standards.

Eventually, as can be seen in the financial and economic meltdown, and the auto crash analyzed in this article, the efficiency logic dominated so egregiously that credible and trustworthy effectiveness based governance, management and accountability disappeared. Left with the "ashes" of the financial and auto industry crashes, and the extreme impacts on the numerous significant actors and stakeholders, it has become imperative to innovatively create a new governance, management and accountability infrastructure to first of all deal with the crises, and then to build substantial and credible systems to enable them to function viably into the future.

At this point, as 2010 unfolds from 2009, and as the Dow hovers at 10,000 again after over a year of trauma, it appears the financial system is beginning to stabilize. We first reached 10,000 in 1999, for some perspective. Knowledgeable experts, however, warn that we have not had the genuinely significant changes in government regulation in the financial system necessary to insure that future crises do not occur (Sorkin, 2009). Some argue that such meaningful changes are no longer possible, given the political capital President Obama has had to expend towards getting his health care legislation enacted, only to be stifled at the end by a Republican Senatorial win in a special election in Massachusetts for Ted Kennedy's seat. Others target the serious overall military commitment required to deal with the Afghanistan and Iraq conflicts. Yet another analytical position is that Obama's financial team is too close to Wall Street. Treasury Secretary Tim Geithner is close to Director of the National Economic Council Larry Summers , and both have been close to former Treasury Secretary (under president Clinton) Robert Rubin, who went on to the very top levels of Citigroup, a significant problem organization in the financial meltdown. Also, Hank Paulson, Treasury Secretary under George W Bush, came from Goldman Sachs, which did as well as, or better than any of the other bailed out financial institutions emerging from the financial crisis.

Yet, we are making some moderate, incremental progress. TARP Pay Czar Ken Feinberg is seriously limiting pay for TARP executives whose companies have not paid back the government's investment in their firms. Current guidelines are that they should expect about half of their previous compensation (Soloman and Fitzpatrick, 2009). There has been considerable public outrage at the amount of pay and bonuses allocated to those very executives

who helped cause the disaster. As a result of this focus however, most of the TARP recipients paid their TARP money back to the government as quickly as possible.

There is also some progress beginning to emerge towards crafting legislation to establish a consumer financial protection agency to supervise the design, practices, terms and disclosures regarding financial products available to consumers. Barney Franks in the House of Representatives is a prime leader in these initial stages. Credit reform is also being worked on, but is not yet clear, let alone finalized. A financial services oversight council is being worked on. This would track and identify risks which could threaten the overall financial system. The Federal Reserve might also be given authority to supervise companies that could bring down the financial system. And, there has been mounting concern that we need more legislative control over hedge funds, derivatives, debt securitization markets, and private capital pools (Svaldi, 2009; Labaton, 2009).

The Struggle to Implement Adequate Governance Innovation

In order not to repeat the mistakes of the past which got us into this crisis, we need to change the way we have implemented governance in this arena. This energizes the forces of efficiency as well as those arguing for more effective governance. Two of the primary stakeholders who have responsibility for such change were interviewed recently. They are Treasury Secretary Tim Geithner, and the Director of the White House National Economic Council Larry Summers.

Geithner responded to his interviewer Maria Bartiromo on the state of the economy as follows. Regarding the access to capital, there is more credit available, but not across the board. Cash for clunkers helped, but has not been a total fix. Real recovery needs to be led by private demand. A second stimulus right now is not called for, though unemployment and other programs may be extended. When unemployment goes down and the economy begins to really recover, we will need to work on the deficits and inflation.

Emphasizing that we are not going to let the financial system go back to where it was before this crisis, Geithner made it clear that the administration's aim is to get away from "too big to fail" by crafting a system where firms can fail without taxpayers being on the hook. This is a primary goal of the administration's reform efforts. By establishing a consumer protection agency, the Treasury Secretary noted that there needs to be a balance between protection and financial innovation. Choice and innovation are important for consumers and investors. He also emphasized that a more productive economy, with lower unemployment and rising income, requires confidence on the part of both consumers and companies. To achieve that confidence, the President's financial team needs to help create an atmosphere where businesses become more willing to innovate, assume risk and actually invest more again (Bartiromo, 2009).

Larry Summers, Director of the President's National Economic Council, recently said that when he and Treasury Secretary Geithner were working on President Obama's transition they believed they were on the brink of Armageddon, that they were facing a real depression. Now the questions seem more like when the recession will be declared over and what level of satisfaction will be achieved. He also noted that the TARP money is yielding 17% in earnings for the taxpayers now, and that a supplemental injection will likely not be needed. This bodes well for a government exit strategy. Furthermore, the central governance in TARP organizations is now coming from the boards and not the government nearly as much any more. He also reported that GM and Chrysler are actually running ahead of projections.

Responding to a question about whether regulatory reform might limit GDP growth by demanding higher capital requirements, Summers noted the financial turmoil of the recent past. Over the last generation, he pointed to the pain of: the S&L crisis, the1987 stock market crash, the Latin American and Mexican financial crises, the bursting of the NASDAQ bubble, Enron, and now this crisis. He stated that he is confident that we will see legislation in the near future that will contain the most far reaching financial regulatory changes since the depression. Summers made it clear that appropriate financial system regulation is necessary for more economic growth. He also realizes there are those who don't want such reforms, and suggests they could try to divert the debate to jurisdictional and turf struggles (Easton, 2009).

One variation on what Summers alluded to is a debate Treasury Secretary Geithner has had with Shiela Bair, Chair of the Federal Deposit Insurance Corporation. The Treasury Secretary has noted that the rules in place have not provided the government with adequate tools and choices to be able to manage severe financial crises. He admonishes that we need to reinforce the system with a regulatory council accountable to the Treasury Department to avoid the "too big to fail" problem in the future. FDIC Chair Bair prefers to see the proposed council of regulators report and be accountable to an independent chair, as it expands its responsibility to include large troubled financial institutions that are not banks (Labaton, 2009).

In his just released book *Too Big to Fail: The inside story of how Wall Street and Washington fought to save the financial system – and themselves, The New York Times* financial reporter and author Andrew Sorkin is not nearly as optimistic about the prospects for regulatory reform as Geithner and Summers. He laments that we may indeed miss this once in a generation opportunity to use the lessons which have flowed from the crisis to strengthen and fix the financial system and the economy. If we don't change the regulations adequately in order to solve the pay structures that encourage irresponsible risks, deal with the manipulation of the stock and derivative markets, and rein in the rumor mongers who cause the markets to gyrate, then we will continue to have bubbles that burst and cause repeated crises.

Regulatory reform here, Sorkin notes, seems to be significantly less robust than what is called for to make a meaningful change in the direction of more viable, innovative and effective governance. As evidence, he notes that risk and ego are again escalating in the financial system.

And the goal, once again, seems to be focusing more on the opportunity to earn money for the financial insiders as opposed to their individual and organizational clients. Clearly making the case for more effective regulation, Sorkin also acknowledges that the struggle will not be easy. He uses a Theodore Roosevelt quote to make his case.

> It is not the critic who counts: not the man who points out how the strong man stumbles or whether the doer of deeds could have done better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood, who strives valiantly, who errs and comes up short again and again, because there is no effort without error or shortcoming, but who knows the great enthusiasms, the great devotions, who spends himself for a worthy cause; who, at the best, knows, in the end, the triumph of high achievement, and who, at the worst, if he fails, at least he fails while daring greatly, so that his place shall never be with those cold and timid souls who knew neither victory nor defeat (Roosevelt, 1910).

What is particularly interesting for this author, is that Sorkin on this topic, chose this particular quote to end his current book. In 2008, this author used this quote to start *Entrepreneurial Management and Public Policy.* In that book, the last chapter has this author's analysis of recent financial crises including the S&L bailout, and risky business (Enron, Andersen, WorldCom, Tyco, Global Crossing, Qwest, Adelphia, and more). It was clear at that time that the struggle among stakeholders for their values and their vested interests would not be easy, or even clear. It was also apparent that unless leaders in both the public and private sectors addressed the significant problems and issues adequately, that more financial problems would unfold. What Geithner, Summers, and the rest of the President's Financial Team believe is a solution, is cast as merely public relations by others with different vested interests. If this set of crises is not serious enough to create a new consensus, and a new coalition motivated enough to follow through with meaningful financial reform, then we will indeed experience more financial and economic crises. We would truly be wise not to let this crisis go to waste.

Forced Governance Innovations

We are experiencing a genuine paradigm shift (Kuhn, 1970) with our public leaders and managers assuming so much responsibility by intervening proactively in the financial and economic meltdown, and the auto crash. Without their innovative and creative governance and managerial contributions we could have sunk into a deep depression. Scholars have been providing innovative insights for theoretical and practical solutions for some time now, but increasingly on governance and managerial innovations more recently (Haynes and Wright, 2008; Johnston, 2008 c,d; Hyde and Olshfski, 2008; Press and Mazmanian, 2008; Waugh, 2008). In order to perform more optimally, we need to better prepare our leaders with public policy, business strategy and more innovative and collaborative conflict management skills. Our quality of life in the future may very well depend on how well we meet this challenge.

About the Author

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