Chapter 2

Administrative Management & Administrative Law

MPA Comprehensive Exam Study Guide

2.1 Keynesian Economics

Keynesian economics, also Keynesianism and Keynesian Theory, is an economic theory based on the ideas of twentieth-century British economist John Maynard Keynes. Keynesian economics promotes a mixed economy where both the state and the private sector have important roles. Keynesian economics seeks to provide solutions to the failures of laissez-faire economic liberalism, which advocates that markets and the private sector operate best without state intervention.

In Keynes' theory, macroeconomic trends can overwhelm the micro-level behavior of individuals. Instead of the economic process being based on continuous improvement in potential output, as most classical economists had believed from the late 1700s on, Keynes asserted the importance of aggregate demand for goods as the driving factor of the economy, especially in periods of downturn. From this he argued that government policies could be used to promote demand at a macro level, to fight high unemployment and deflation of the sort seen during the 1930s. Keynes argued that the solution to depression was to stimulate the economy ("inducement to invest") through some combination of two approaches:

a reduction in interest rates.

Government investment in infrastructure - the injection of income results in more spending in the general economy, which in turn stimulates more production and investment involving still more income and spending and so forth. The initial stimulation starts a cascade of events, whose total increase in economic activity is a multiple of the original investment.

A central conclusion of Keynesian economics is that there is no strong automatic tendency for output and employment to move toward full employment levels. This conclusion conflicts with the tenets of classical economics, and those schools, such as supply-side economics or the Austrian School, which assume a general tendency towards a welcome equilibrium in a restrained money-creating economy. In the 'neoclassical synthesis', which combines Keynesian macro concepts with a micro foundation, the conditions of General equilibrium allow for price adjustment to achieve this goal.

More broadly, Keynes saw his as a general theory, in which utilization of resources could be high or low, whereas previous economics focused on the particular case of full utilization.

Keynesian economics by Alan S. Blinder[1]

Keynesian economics is a theory of total spending in the economy (called aggregate demand) and of its effects on output and inflation. Although the term is used (and abused) to describe many things, six principal tenets seem central to Keynesianism. The first three describe how the economy works.

1. A Keynesian believes that aggregate demand is influenced by a host of economic decisions—both public and private—and sometimes behaves erratically. The public decisions include, most prominently, those on monetary and fiscal (i.e., spending and tax) policy. Some decades ago, economists heatedly debated the relative strengths of monetary and fiscal policy, with some Keynesians arguing that monetary policy is powerless, and some monetarists arguing that fiscal policy is powerless. Both of these are essentially dead issues today. Nearly all Keynesians and monetarists now believe that both fiscal and monetary policy affect aggregate demand. A few economists, however, believe in what is called debt neutrality—the doctrine that substitutions of government borrowing for taxes have no effects on total demand (more on this below).

2. According to Keynesian theory, changes in aggregate demand, whether anticipated or unanticipated, have their greatest short-run impact on real output and employment, not on prices. This idea is portrayed, for example, in Phillips curves that show inflation changing only slowly when unemployment changes. Keynesians believe the short run lasts long enough to matter. They

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often quote Keynes's famous statement "In the long run, we are all dead" to make the point.

Anticipated monetary policy (that is, policies that people expect in advance) can produce real effects on output and employment only if some prices are rigid—if nominal wages (wages in dollars, not in real purchasing power), for example, do not adjust instantly. Otherwise, an injection of new money would change all prices by the same percentage. So Keynesian models generally either assume or try to explain rigid prices or wages. Rationalizing rigid prices is hard to do because, according to standard microeconomic theory, real supplies and demands do not change if all nominal prices rise or fall proportionally.

But Keynesians believe that, because prices are somewhat rigid, fluctuations in any component of spending—consumption, investment, or government expenditures—cause output to fluctuate. If government spending increases, for example, and all other components of spending remain constant, then output will increase. Keynesian models of economic activity also include a so-called multiplier effect. That is, output increases by a multiple of the original change in spending that caused it. Thus, a $10 billion increase in government spending could cause total output to rise by $15 billion (a multiplier of 1.5) or by $5 billion (a multiplier of 0.5). Contrary to what many people believe, Keynesian analysis does not require that the multiplier exceed 1.0. For Keynesian economics to work, however, the multiplier must be greater than zero.

3. Keynesians believe that prices and, especially, wages respond slowly to changes in supply and demand, resulting in shortages and surpluses, especially of labor. Even though monetarists are more confident than Keynesians in the ability of markets to adjust to changes in supply and demand, many monetarists accept the Keynesian position on this matter. Milton Friedman, for example, the most prominent monetarist, has written: "Under any conceivable institutional arrangements, and certainly under those that now prevail in the United States, there is only a limited amount of

flexibility in prices and wages." In current parlance, that would certainly be called a Keynesian position.

No policy prescriptions follow from these three beliefs alone. And many economists who do not call themselves Keynesian—including most monetarists—would, nevertheless, accept the entire list. What distinguishes Keynesians from other economists is their belief in the following three tenets about economic policy.

Keynesians do not think that the typical level of unemployment is ideal—partly because unemployment is subject to the caprice of aggregate demand, and partly because they believe that prices adjust only gradually. In fact, Keynesians typically see unemployment as both too high on average and too variable, although they know that rigorous theoretical justification for these positions is hard to come by. Keynesians also feel certain that periods of recession or depression are economic maladies, not efficient market responses to unattractive opportunities. (Monetarists, as already noted, have a deeper belief in the invisible hand.)

Many, but not all, Keynesians advocate activist stabilization policy to reduce the amplitude of the business cycle, which they rank among the most important of all economic problems. Here Keynesians and monetarists (and even some conservative Keynesians) part company by doubting either the efficacy of stabilization policy or the wisdom of attempting it.

This does not mean that Keynesians advocate what used to be called fine-tuning—adjusting government spending, taxes, and the money supply every few months to keep the economy at full employment. Almost all economists, including most Keynesians, now believe that the government simply cannot know enough soon enough to fine-tune successfully. Three lags make it unlikely that fine-tuning will work. First, there is a lag between the time that a change in policy is required and the time that the government recognizes this. Second, there is a lag between when the government recognizes that a change in policy is required and when it takes action. In the United States, this lag is often very long for fiscal policy because Congress and the administration must first agree on most changes in spending and taxes. The third lag comes between the time that policy is changed and when the changes affect the economy. This, too, can be many months. Yet many Keynesians still believe that more modest goals for stabilization policy—coarse-tuning, if you will—are not only defensible, but sensible. For example, an economist need not have detailed quantitative knowledge of lags to prescribe a dose of expansionary monetary policy when the unemployment rate is 10 percent or more—as it was in many leading industrial countries in the eighties.

Finally, and even less unanimously, many Keynesians are more concerned about combating unemployment than about conquering inflation. They have concluded from the evidence that the costs of low inflation are small. However, there are plenty of anti-inflation Keynesians. Most of the world's current and past central bankers, for example, merit this title whether they like it or not. Needless to say, views on the relative importance of unemployment and inflation heavily influence the policy advice that economists give and that policymakers accept. Keynesians typically advocate more aggressively expansionist policies than non-Keynesians.

Keynesians' belief in aggressive government action to stabilize the economy is based on value judgments and on the beliefs that (a) macroeconomic fluctuations significantly reduce economic well-being, (b) the government is knowledgeable and capable enough to improve upon the free market, and (c) unemployment is a more important problem than inflation.

The long, and to some extent, continuing battle between Keynesians and monetarists has been fought primarily over (b) and (c).

In contrast, the briefer and more recent debate between Keynesians and new classical economists has been fought primarily over (a) and over the first three tenets of Keynesianism—tenets that the monetarists had accepted. New classicals believe that anticipated changes in the money supply do not affect real output; that markets, even the labor market, adjust quickly to eliminate shortages and surpluses; and that business cycles may be efficient. For reasons that will be made clear below, I believe that the "objective" scientific evidence on these matters points strongly in the Keynesian direction.

Before leaving the realm of definition, however, I must underscore several glaring and intentional omissions.

First, I have said nothing about the rational expectations school of thought (see Rational Expectations). Like Keynes himself, many Keynesians doubt that school's view that people use all available information to form their expectations about economic policy. Other Keynesians accept the view. But when it comes to the large issues with which I have concerned myself, nothing much rides on whether or not expectations are rational. Rational expectations do not, for example, preclude rigid prices. Stanford's John Taylor and MIT's Stanley Fischer have constructed rational expectations models with sticky prices that are thoroughly Keynesian by my definition. I should note, though, that some new classicals see rational expectations as much more fundamental to the debate.

The second omission is the hypothesis that there is a "natural rate" of unemployment in the long run. Prior to 1970, Keynesians believed that the long-run level of unemployment depended on government policy, and that the government could achieve a low unemployment rate by accepting a high but steady rate of inflation. In the late sixties Milton Friedman, a monetarist, and Columbia's Edmund Phelps, a Keynesian, rejected the idea of such a long-run trade-off on theoretical grounds. They argued that the only way the government could keep unemployment below what they called the "natural rate" was with macroeconomic policies that would continuously drive inflation higher and higher. In the long run, they argued, the unemployment rate could not be below the natural rate. Shortly thereafter, Keynesians like Northwestern's Robert Gordon presented empirical evidence for Friedman's and Phelps's view. Since about 1972 Keynesians have integrated the "natural rate" of unemployment into their thinking. So the natural rate hypothesis played essentially no role in the intellectual ferment of the 1975-85 period.

Third, I have ignored the choice between monetary and fiscal policy as the preferred instrument of stabilization policy. Economists differ about this and occasionally change sides. By my definition, however, it is perfectly possible to be a Keynesian and still believe either that responsibility for stabilization policy should, in principle, be ceded to the monetary authority or that it is, in practice, so ceded.

Keynesian theory was much denigrated in academic circles from the mid-seventies until the mid-eighties. It has staged a strong comeback since then, however. The main reason appears to be that Keynesian economics was better able to explain the economic events of the seventies and eighties than its principal intellectual competitor, new classical economics.

True to its classical roots, new classical theory emphasizes the ability of a market economy to cure recessions by downward adjustments in wages and prices. The new classical economists of the mid-seventies attributed economic downturns to people's misperceptions about what was happening to relative prices (such as real wages). Misperceptions would arise, they argued, if people did not know the current price level or inflation rate. But such misperceptions should be fleeting and surely cannot be large in societies in which price indexes are published monthly and the typical monthly inflation rate is under 1 percent. Therefore, economic downturns, by the new classical view, should be mild and brief. Yet during the eighties most of the world's industrial economies endured deep and long recessions. Keynesian economics may be theoretically untidy, but it certainly is a theory that predicts periods of persistent, involuntary unemployment.

According to new classical theory, a correctly perceived decrease in the growth of the money supply should have only small effects, if any, on real output. Yet when the Federal Reserve and the Bank of England announced that monetary policy would be tightened to fight inflation, and then made good on their promises, severe recessions followed in each country. New classicals might claim that the tightening was unanticipated (because people did not believe what the monetary authorities said). Perhaps it was in part. But surely the broad contours of the restrictive policies were anticipated, or at least correctly perceived as they unfolded. Old-fashioned Keynesian theory, which says that any monetary restriction is contractionary because firms and individuals are locked into fixed-price contracts, not inflation-adjusted ones, seems more consistent with actual events.

An offshoot of new classical theory formulated by Harvard's Robert Barro is the idea of debt neutrality. Barro argues that inflation, unemployment, real GNP, and real national saving should not be affected by whether the government finances its spending with high taxes and low deficits or with low taxes and high deficits. Because people are rational, he argues, they will correctly perceive that low taxes and high deficits today must mean higher future taxes for them and their heirs. They will, Barro argues, cut consumption and increase their saving by one dollar for each dollar increase in future tax liabilities. Thus, a rise in private saving should offset any increase in the government's deficit. Naïve Keynesian analysis, by contrast, sees an increased deficit, with government spending held constant, as an increase in aggregate demand. If, as happened in the United States, the stimulus to demand is nullified by contractionary monetary policy, real interest rates should rise strongly. There is no reason, in the Keynesian view, to expect the private saving rate to rise.

The massive U.S. tax cuts between 1981 and 1984 provided something approximating a laboratory test of these alternative views. What happened? The private saving rate did not rise. Real interest rates soared, even though a surprisingly large part of the shock was absorbed by exchange rates rather than by interest rates. With fiscal stimulus offset by monetary contraction, real GNP growth was approximately unaffected; it grew at about the same rate as it had in the recent past. Again, this all seems more consistent with Keynesian than with new classical theory.

Finally, there was the European depression of the eighties, which was the worst since the depression of the thirties. The Keynesian explanation is straightforward. Governments, led by the British and German central banks, decided to fight inflation with highly restrictive monetary and fiscal policies. The anti-inflation crusade was strengthened by the European Monetary System, which, in effect, spread the stern German monetary policy all over Europe. The new classical school has no comparable explanation. New classicals, and conservative economists in general, argue that European governments interfere more heavily in labor markets (with high unemployment benefits, for example, and restrictions on firing workers). But most of these interferences were in place in the early seventies, when unemployment was extremely low.

Further Reading

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2.2 Risk Management as a Strategic Posture: Public vs. Private Approaches

Since the events of September 11, 2001, the way governments manage risk (especially in the United States) is changing significantly. In addition to unforeseen events such as terrorist attacks, risk events of all types seem to be occurring at an unprecedented pace during the infancy of our 21st century. The risks we face range and affect the entire span of human activity - from natural disasters such as Hurricane Katrina and earthquakes/tsunamis in Indonesia - to deaths resulting from unregulated imports of tainted food and poisonous products from China. As a result of this increased risk environment, important questions are being asked about the proper role of government in mitigating and responding to risks of all types. This paper reviews the recent literature detailing past and present approaches for risk management in both the private and public sectors, outlines several suggested strategies for managing risk in the future, and concludes with an analysis of recommendations for changes in the way that governments manage risk.

The traditional ways in which governments and businesses managed risk centered on either purchasing various types of insurance or simply bearing the risk without any sort of protection. For those organizations exposed to risks that preclude the availability of commercially-available insurance coverage, such as emergency management, taxpayers inevitably end up footing the bill for any given response. When disasters and other risk events occur, local, state and sometimes federal budgets have to be adjusted in order to "find" the fiscal resources needed for a proper response. This necessarily means that various previously-authorized programs are cut or have their appropriations reduced.

While the need for improved risk management methods has increased, the availability of sound, rational models for managing risk has also increased. As supported by Werner Pfenningstorf (1977), it seems that the tools we require have always been there, but implementation and standardization are problematic. "The available information shows that many governments, especially small municipalities, still have haphazard, fragmented, and inconsistent risk management policies; many rely exclusively on the advice and the services of local insurance agents, who may not be equipped or inclined to select the best available coverage." (Pfenningstorf, 1977).

Although commercially-available insurance is an important piece to any risk management strategy, it can be argued that the risk environment has changed significantly over the past 50 years, and that a new comprehensive and more flexible approach is needed to address the risks inherent to governments and to populations.

Risk Culture:

Bozeman and Kingsley (1998) feel that the risk management approach of any given organization is directly related to the "risk culture" that pervades that particular organization and its management philosophy. Bozeman and Kingsley performed a survey of public and private organizations to measure "risk culture". The concept pertains to managers' perceptions regarding their co-workers and superiors willingness to take risks and promote risk-taking. Their findings:

> *"A riskier culture is positively related to the willingness of top managers to trust employees and to the clarity of organizations' missions. Organizations with more red tape, weak links between promotion and performance, and high involvement with elected officials tend to have a less risky culture." (Bozeman and Kingsley, 1998)*

Review of Risk Management Approaches:

A literature review of risk management approaches reveals a wide array of public and private methods that span the range from scientific-management-style programs to community and relationship-based networks. Over the past 20 years or so, many new approaches to managing organizational risk have been employed in both the U.S. and abroad, with varying degrees of success. Outlined below are arguments based on some of the most common methods found in the literature.

Budgeting as a Strategic Tool for Risk Management:

One major risk facing state and local governments involves the economic variability associated with the business cycle. Dealing successfully with cyclic variability is important for government officials and political leaders. Economic downturns place greater demands on local governments, who are far less equipped to handle the effects than agencies and officials operating at the federal level. How do budget officials attempt to manage this source of risk? According to Michael Wolkoff (1999), four different generic strategies are available to budget officials: they can budget pessimistically for the period (the most conservative approach presuming the least favorable economic circumstances for the budget period), they can make use of savings devices (rainy day funds), they can practice financial ledgerdemain (short-run accounting tricks that shift expenditures to later periods), or they can implement contingency plans (pre-agreed upon actions that are triggered by economic events, i.e. taxation and spending policies that depend on defined funding levels).

In attempting to adapt to unexpected budgetary shocks, Wolkoff notes: "The types of actions budget officials may take will depend on the timing and magnitude of the unexpected shock, the political environment at that time, and the tools available." (Wolkoff, 1999)

Risk Management in the European Union: The "Precautionary Principle".

The United States and the European Union countries differ substantially in their perceptions and tolerance for risks of all types. Americans seem far more willing to employ innovations that pose serious environmental or health risks, such as engineering genetically modified crops and organisms or infusing meats with carbon dioxide and dangerous preservatives so they appear "fresh" longer. "The French and many other Europeans tend to be more prudent, evaluating new technologies based on the 'precautionary principle', which echoes the old adage of medicine: First, do no harm." (Tama, 2003) Since the U.S. has a "window dressing only" policy of regulation and enforcement, foods and products that are refused entry into the EU are routinely re-routed for easy sale to the United States. Recent examples include mercury-filled shrimp from Vietnam, toys from China with poisonous plastics and lead-based paints, cough syrup from China found to contain anti-freeze, and toothpaste from China found to contain several poisonous substances. Thanks to the "precautionary principle", which is encoded into EU law through the Maastricht Treaty, and which forms the basis for all European environmental policies, the EU seems to be far ahead of the United States when it comes to risk management and protecting their citizens from unscrupulous corporations whose main concern is profit, and not the public interest.

Risk Analysis: Rational, Scientific Approaches to Risk Management

The Case of British Rail:

Computer-based simulations are established and effective aids to decision-making and are widely used in all types of business. The risk analysis procedures used by British Rail (BRB) involve the use of fractile analysis and Monte Carlo simulation. They were first used in the BRB's 1983 Corporate Plan, and because of its perceived success, is now incorporated as a permanent feature of its corporate planning process. (Harris and Williams, 1985) The planning process used by BRB incorporates both bottom-up and top-down budget estimates, and incorporates several alternative scenarios and contingency plans which can be triggered as deemed necessary. The massive amounts of data from these plans are aggregated and risk profiles are associated with each alternative estimate (representing the "best" and "worst" results), then the data is fed into a simulation model. The method is known as the Continuous Distribution Fractile Method, to give its full title, and its purpose is to establish key points for a distribution that includes the range, median and quartiles. These are established first for a cumulative probability curve which can then be transcribed into a probability density curve." (Harris and Williams, 1985) In attempting to use the simulation to evaluate possible future financial outcomes, we then take selected data from the fractile analysis and apply it into a Monte Carlo Simulation. "This method involves taking a sample from each of the distribution curves and combines them to create a set of possible financial outcomes, which represents what might happen in certain circumstances." (Harris and Williams, 1985) The major benefit of using this type of process, is that when and if "shocks" occur, management can readily see the range of financial outcomes are likely to result given a certain action, and can be proactive in applying contingent actions to keep the organization financially on-track with regard to the longer term.

Rethinking Risk Management in the Federal Government:

Robin Cantor (1996) is another proponent calling for a more rational, scientific standard for managing risk at the federal level. Cantor notes that there is much discontent with the current methods being employed in risk management, and that there is need for radical reform. He suggests also that there needs to be an intellectual shift in the way that managers think about risk and respond to risks. Agencies such as the Department of Energy (DOE) and the Environmental Protection Agency (EPA) are already using sophisticated risk analysis and risk management systems, and Cantor feels that this will help in the push toward a uniform adoption of risk analysis and rational processes for risk management across the federal landscape. Cantor describes the origins of this shift in risk policy:

> *"The Clinton administration's efforts on risk management have tended to emphasize the role of risk analysis both in setting agency priorities and in rule making. The Executive Order on Regulatory Planning and Review (No. 12866) reinforced attention to risk-based priority setting and the balancing of risk reduction and costs in the broader context of regulatory decision making. This order also established a Regulatory Working Group, which launched a concerted effort across federal agencies to develop principles for risk assessment, risk management and risk communication." (Cantor, 1996)*

Legal Issues related to Risk Management Approaches:

There is no disagreement on the fact that controlling the costs associated with government operations is a challenging exercise. Strategic planning and budgeting efforts should incorporate the risks associated with court judgments and exposure to lawsuits brought by parties in the organization's operating environment. It can be argued that the more decentralized the particular government or agency is with regard to its particular service delivery systems, the more exposed they are to potential legal actions. Additionally, the nature of the business of an organization is related to its degree of exposure to legal challenges and the risks associated with them. As noted by Pfenningstorf, the federal government has always had a policy of non-insurance (Pfenningstorf, 1977). As such, when unexpected court rulings force agencies or local government units to pay damages, or when courts issue remedial orders that require significant outlays, these government units must re-analyze their current plans and re-work their budgets to accommodate these costs. There are a number of ways in which court decisions force public managers to consider financial risk and exposure. These unexpected costs can cause already-authorized programs to be curtailed or even cancelled.

Risk Management and the Public-Private Issue:

In recent years, one hot topic that has generated heated debate in government circles is the question of privatization. According to Phillip Cooper (1999), "In the contemporary environment, issues of risk are often intertwined with other complex problems, particularly privatization and intergovernmental relations." What is usually meant by privatization is the contracting-out or wholesale transference of government service delivery in certain areas to private or non-profit firms operating under contracts with the government. The key problems associated with privatization are oversight and accountability.

One contentious example of the risks involved in privatization of government services is that of correctional facilities operated by for-profit private corporations. In his 1999 article, "Courts and Fiscal Decision Making", Phillip Cooper reviews a Tennessee case involving the Corrections Corporation of America. In *Richardson v. McNight*, 1997, a prisoner in a facility operated by the corrections Corporation of America (CCA) sued the state, charging two guards with physical abuse that violated his constitutional rights. Cooper notes that in normal state-run prisons, guards are protected under immunity. CCA used this fact to claim immunity for its guards. However, as this case proceeded to the Supreme Court, Justice Breyer argued that private sector employees work under a different system of accountability and incentives, and they are required to have sufficient insurance coverage to address potential liabilities such as this one. It is clear from this case that the costs of legal services and potential remedies make up an important part of the risk calculations used by public administrators (Cooper, 1999).

Terrorism, Homeland Security and Emergency Management:

Managing the risks associated with terrorism, homeland security and emergency management are arguably the most challenging of the risks attempting to be managed by U.S. government and international officials. Unfortunately, in the name of attempting to manage these risks, our current U.S. government (G.W. Bush administration) has viewed it as necessary to take severe and outwardly-aggressive actions that negate the rights of individual citizens as well as those of sovereign foreign governments in order to succeed in their current "war on terrorism".

In addition to suspending the civil rights of individual citizens, large-scale surveillance of the domestic population is currently taking place, involving agencies at the federal, state and local levels. This unprecedented attack on individual freedoms domestically, along with the incredible offenses that have been leveled against other sovereign nations, is arguably causing the *opposite* effect of the one originally intended (reducing risk) by those in charge of authorizing these operations. In addition to conducting overtly illegal operations, the federal government has also adopted quasi-legal methods of attempting to reduce the risks associated with terrorism and homeland security. Consider the case of InfraGard, an FBI-led organization started in 1996, which is now a 23,000 member-strong domestic surveillance network in the United States. This rapidly growing group enlists business owners, banking executives, non-profit organizations, neighborhood watch groups and other hand-selected citizens as "deputized FBI agents with limited powers" (Rothschild, 2008).

InfraGard is essentially a partnership between the FBI and private-sector business and citizen-members that is overseen by local FBI offices as the first line of defense against terrorist attacks to vital infrastructure.

> "Members receive secret warnings of terrorist threats before the public does – and at least on one documented occasion, before elected officials. In return, they provide information to the government, which understandably alarms the ACLU. One business executive, who showed me his InfraGard card, told me that they have permission to "shoot to kill" in the event of martial law." (Rothschild, 2008). InfraGard members are told to contact the FBI if they "note suspicious activity or an unusual event." (Rothschild, 2008)

Another highly-questionable practice used by the current administration is the illegal "data-mining" and surveillance of domestic and foreign telephone calls, emails and internet surfing habits of private citizens. This also is done in the name of risk management, and has been challenged in the courts, though unsuccessfully – arguably because of the current administration's vast judicial *political* appointments, resulting in "ideological ownership" of judges strategically positioned in the same courts where these cases are arranged to be heard.

Emergency Management:

The demand for more effective and efficient government service delivery during and after disasters has increased, especially in the wake of botched federal responses to emergencies in the recent past. In terms of preparedness and risk management practices, the emergency management communities at the state and local levels are far ahead of their federal counterparts. After the creation of the Department of Homeland Security (DHS) in November, 2002, billions of dollars were sent out to cities and counties to make capital purchases that could enhance local responses to emergency events in the future.

However, as Vicki Wilson notes, "Deciding what to fund and what not to fund before a disaster occurs is a fine line that finance officers and elected officials must walk." (Wilson, 2007) Partly due to the experiences of September 11th and Hurricane Katrina, local governments and first responders realized that they needed to coordinate and establish relationships with organizations that may be needed in the response efforts to various emergencies. Unlike the grass-roots efforts of InfraGard, emergency management officials at the state and local level have now established *legitimate*, and efficient networks of organizations and individuals that may be called upon in times of emergency. Efforts such as mutual-aid agreements between states and localities; agreements with private sector companies that could support emergency operations; agreements with national suppliers such as Grainger, Home Depot, and Wal-Mart; and liaison relationships with support agencies like the Salvation Army and Red Cross, all form a cohesive network of professionals who can increase the success of state and federal responses to emergencies. Another popular risk management practice used the emergency management field is the establishment of “private sector consortium groups. Building managers and owners, utility and other infrastructure companies, healthcare organizations, hotels, as well as universities and colleges, can play an important role in disaster management. Having previously established relationships, contacts and agreements with these industry segments can make life a lot easier during a disaster.” (Wilson, 2007) In addition to these efforts, internal procurement policies can be streamlined, so that during an emergency, public safety departments can acquire the items they need immediately, bypassing the time-consuming regular purchasing procedures. These new approaches to managing risks lead us directly into a discussion of the possibilities for managing risk in the future.

A More Comprehensive and Flexible Risk Management Approach:

In his 2005 article, “Governance and risk management: challenges and public productivity”, Arie Halachmi calls for a shift from “governing to governance”, in which governments engage private industry and the multitudes of civil society based organizations to help elected officials address accountability issues, improve productivity, and provide monitoring of their environments to improve government response and risk management. Halachmi’s suggested approach to risk management is in line with the emergency management methods outlined above by Wilson. Halachmi’s 2005 paper recounted a recent case in which extreme management challenges resulted from government network oversight failures during the Great Blackout of August, 14, 2003, occurring in the Northeastern United States. Oversight definitely becomes a complicated issue when government “devolves” responsibility and distributes power to networks of nongovernmental entities. It can be argued that extreme events like this cannot be guarded against because there are too many areas under different commands, making oversight and risk management impossible. However, according to Halachmi, increasing decentralization and devolution is a very effective way of managing risk. It involves a paradigm shift from “governing to governance”.

> *“…’governance’ is now used to depict an effort to meet the welfare needs of citizens in a better way through partnerships with other elements of the ‘civil*

> *society' for the purpose of overcoming limits on action due to governmental structures, legal issues, or administrative procedures. While some of these partnerships are explicit (official designation of authority delegated to a nongovernmental organization), others are implicit (examples in the U.S. include church-based programs for adoption and placement of children or the sponsorship and settlement of refugees).* (Halachmi, 2005)

Halachmi argues that by enlisting the help of civil based society organizations and private-sector companies, threat and risk information is more effectively and efficiently gathered and transmitted to authorities. By incorporating street-level organizations and companies into the management chain of government service delivery, government can take best advantage of local-level knowledge and ideas for addressing risks. The network of small and large organizations is far more efficient in monitoring the environment, which translates into improved government response and overall risk management.

Conclusion:

Bozeman and Kingsley feel that the risk management approach of any given organization is directly related to the "risk culture" that pervades that particular organization and its management philosophy. They argue that when the environment is characterized by red tape, a weak relationship between promotion and performance, and a high level of involvement with elected officials, this translates into a "less risky" culture. Wolkoff supports the use of budgetary devices as vital risk management tools for the public administrator. Tama argues that risks can be avoided by adopting similar policies as the European Union's "precautionary principle", which is applied universally (as a result of codification in the Maastricht Treaty) to all policies being considered in the EU. Harris and Williams, along with Robin Cantor, are proponents for the adoption of rational scientific approaches to risk management such as the Risk Analysis simulation methods used by British Rail and several executive agencies within the U.S. federal government, including DOE and EPA. Phillip Cooper finds that legal issues in the form of court judgments and exposure to lawsuits represent significant risks and are often intertwined with other complex problems, particularly privatization and intergovernmental relations. As such, Cooper recommends that public administrators consider these risks in any strategic planning they perform. Rothschild believes that U.S. initiatives such as InfraGard and illegal wire-tapping (domestically) and the "war on terror" (internationally), are actually *increasing* risks to the country and its people, instead of successfully reducing risks. Finally, Wilson and Halachmi are staunch proponents for a comprehensive and flexible network system of relationships between governments, businesses and civil-based society organizations. These arrangements are viewed as improving public productivity, helping governments accomplish their goals, and helping in monitoring the environment for risks, while improving communication and enhancing government responses to crises, effectively reducing risks throughout the system.

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2.3 Accounting Methods and Strategic Planning / Management Issues

This paper analyzes the recent change in several government accounting systems from cash-based to accrual-based. In the United States, the impetus for this change started in the 1980s and resulted in the 1990s of the government beginning procedures to adopt the generally accepted accounting principles (GAAP). Changes to accrual-based accounting in New Zealand, Australia, Canada, United Kingdom, and in the U.S. are reviewed and their impact on government oversight and management. Several current costing methods used by the private and public sectors are described and how accrual-based could work with these. Finally, whether accrual-based accounting is beneficially impacting the efforts of the U.S. government to improve transparency and performance measures is considered.

Introduction

This review of the literature covers current trends in public accounting methods and focuses on the change from cash basis to accrual basis accounting in the public sector and how that impacts management initiatives such as activity-based costing (ABC), cost-volume profit (CVP), and value for money (VFM). This impetus for change from cash to accrual in the public sector began in the United States in the 1980s and by the end of that decade it was recognized that much of the government's financial systems had become obsolete and did not meet generally accepted accounting standards (Bowsher, 1990). The National Commission on the State and Local Public Service (1993), sponsored by the Nelson A. Rockefeller Institute of Government at the State University of New York, recommended among other things, that state and local budgets be less line-itemed thus allowing for carry over of unused funds to meet changing or unforeseen needs and budgets should better account for depreciation of capital assets thus allowing managers to plan more effectively. Additionally, The Committee on Governmental Affairs concluded that the absence of timely, relevant, and comprehensive financial information added to the difficulty of controlling government operations and costs (Jones & McCaffery, 1998).

It was consequently suggested that the U.S. government adopt the same accounting principles employed by businesses and many foreign governments, namely generally accepted accounting principles or GAAP (Mautz, 1991). GAAP recognizes liabilities as they are incurred and associates costs of assets with the period during which they are used, which is accrual rather than cash basis accounting (DioGuardi, 1989). The foregoing provided a basis for audited financial statements of agencies and departments. The Social Security Administration published its 1988 report using the accrual basis accounting method using full disclosure of assets and liabilities and the statement attested to the soundness of the Social Security system. Contrastingly, when the Government Accounting Office (GAO) audited the Federal Savings and Loan Insurance Corporation using the accrual-based accounting, it found a $13.7 billion deficit, whereas a cash-based audit for the same period reported a substantial surplus (Craig, 1989).

Questions for this paper include: Has this change in accounting methods beneficially impacted strategic management issues in the public sector in the United States and other countries? Additionally, are program and service performance measures being captured more efficiently and effectively with accrual-based accounting procedures in public entities? Finally, how do experts in the field of public administration see the future prospects for the advantage of these changes in the gathering of usable financial information?

Accrual Accounting and management issues in other countries

New Zealand had a rapid transition from the Public Finance Act of 1989 and the setting up of the first milestones of accrual-based accounting (Marty, Trosa & Voisin, 2006). This did not happen without forethought and planning. One year before the Public Finance Act of 1989, the State Sector Act took stock of the responsibilities that were to fall on public managers with the change in financial reporting proposed. To offset the added responsibilities, managers were given greater freedom in terms of the management of their teams, such as flexible staffing and performance-based rewards. Therefore, this preplanning stage resulted in a more rapid and smoother transition than that in other countries.

In 1996, the Australian government introduced an accrual-based outputs and outcomes budgeting and reporting system (Sterck, 2007). One consequence of this change is that amounts appropriated to governmental agencies are now based on the full cost of delivering outputs and outcomes rather than the expected cash outflow for the year. While Parliament is receiving more information than it formerly had at its disposal, its control has been weakened due to authorization now taking place on a more aggregated level (i.e., outcome level) and the complexity of the budget and accounts increasing. Parliament complains that the output information in the annual agency reports is too aggregated and thus more difficult to get a clear view of the agencies' contributions to the outputs. With agencies adapting their outcome and output structures, this instability has led to less transparency of the financial system and has weakened Parliamentary control.

Since the late 1990s the <u>Canadian</u> government has attempted to institute a modified accrual accounting system in concert with the new structure under which the departments and agencies have to manage and report to Parliament, namely the Program Activity Architecture [PAA] (Sterck, 2007). Under this new structure, costs are allocated to program activities, subactivities, and subsubactivities. However, even though this has led to the Canadian Parliament having more information on program achievements and costs, members of Parliament have not been using this information in any consistent fashion to influence their budget decisions to date.

The implementation of the new public accounting system in the <u>United Kingdom</u> (UK) was spread over seven years between the approval of the White Paper on accounting and budgetary policies in 1995, the Government Resources and Accounts Act in 2000, and finally the publication on public accounts on the basis of Accrual Based Accounting in 2002 (Marty et al., 2006). Currently, the UK Treasury has shifted its accounting policy away from the traditional appropriations to 'resource accounting' involving accrual basis accounting (Wilks, 2007). This along with other reform initiatives has led to the current emphasis on 'corporate governance' and the institution of 'board of directors' to oversee government agencies and municipalities.

Wilkes points to both advantages and disadvantages of this development in the UK. Advantages include: 1) location of responsibility; 2) ethical expectations; 3) transparency; 4) consistency; 5) performance measurement; and 6) accountability.

Potential pathologies include: 1) formalistic compliance; 2) failure of mechanisms of control; 3) creation of biased or inadequate boards; 4) lack of coordination; or 5) crude managerialism emerging from a preoccupation with a simplified bottom line. This last possible problem is the most concerning when the public interest should be involved in what good performance of government entities really means.

Use of performance measures

Halachmi (2005) cautions first about the cost-benefit analysis of performance score cards, stating the cost is always significant while the benefits in many instances may only be tentative. Secondly, Halachmi enumerates the differences of measurements for accountability ('Was it done right') as opposed to productivity ('Was the right thing done') as follow:

- "Accountability is living up to performance standards that existed when the use of resource/authority was authorized."
- "Accountability is primarily about relationships: Who is superior to whom? Who is answerable to whom? What must be reported and who decides it?"
- "Productivity is more than keeping with past trends or marginally improving on them."
- "Productivity relates to progress, innovation, and change, preferably moving to a higher curve rather than moving to a higher point on the same productivity curve."
- "Productivity is about management, adaptation, creativity, and breaking away from the past or from the group, while accountability is about staying within the four corners of the contract."
- "Productivity has to do with a continuous free-form process of self-examination and an internal search for new insight, whereas accountability involves external scrutiny and a relatively rigid use of pre-established legal or professional standards."

Why bring this out when writing on accounting methods relating to strategic management issues? The above dichotomy seen by Halachmi between accountability and productivity performance measures relate to the limitations of financial reporting (accountability) to enable public sector managers to manage strategically to improve performance (productivity). Strategic management needs greater insights and adaptation than the financial bottom line can accommodate. Can any of the current management costing systems used in conjunction with accrual accounting facilitate a link to performance measures that will enable real progress in the use of outcome information in government planning and budgeting?

Linking performance measures to accurate costing information

The Office of Management and Budget (OMB) has been in the process of encouraging the development of definitive performance measures linked to accurate cost accounting that would conform to the National Performance Review (NPR) goals (Jones & McCaffery, 1998). In 1996 Congress passed the Federal Financial Management Improvement Act (FFMIA), which in conjunction with the Government Performance and Reporting Act (GPRA) of 1993 attempts to integrate financial and performance data in a way that relates to budget accounts.

Brimson & Williams (2007) analyzed the U.S. federal government's financial and performance reporting models. While the current financial reporting model is single dimensional with an accounting regulator creating a set of principles as to how financial effects of transaction and events are to be measured, recorded and reported. These authors also analyze the proposed process-based accounting, which is a multidimensional approach that bridges both financial reporting and cost management as is the intent of the FFMIA.

Can costing methods currently used by the public and private sector such as activity-based costing (ABC), cost-volume-profit (CVP), or value for money (VFM) effectively capture the true costs needed to link performance to cost management? First, According to Martin (2006) designing an ABC model system requires:

1) Identifying the main activities;

2) Determining the primary and secondary drivers of these activities;

3) Aggregating activities into homogenous cost pools; and

4) Selecting activity measures to represent each pool or cost driver.

Therefore the activities are the sum of the resources that are needed to develop the productive process and that add value to the product or service (Gonzalez-Gomez & Morini, 2006).

Conclusions reached by Akkyol, Tuncel & Bayhan (2005), after doing a case study of ABC implementation in a manufacturing company, were that ABC is capable of monitoring hidden losses and profits of the traditional costing methods. Pricing decisions can be done under the scope of these hidden losses and profits with the company increasing or decreasing product costs to gain a more competitive advantage. This study also found that the existence of the ABC database was an advantage to the Balanced Score Card implementations as further performance analysis is undertaken.

Can cost-volume-profit analysis capture sufficient liability information? Kee (2007) found it necessary to expand on traditional CVP analysis to incorporate the cost of capital. This cost of capital is traced to products like the cost of overhead-related resources using the principles of ABC costing. The opportunity cost of invested funds is deducted from the product's operating income after taxes and measures it economic income. This CVP model based on the discounted economic income of a product enables managers to compute a product's breakeven sales quantity, to measure a product's profitability over the range of it sales and to determine the rate of change in its profitability. The CVP also facilitates measuring the tradeoffs in alternative investment and cost upon a product's profitability from a program of process improvement.

Value for money, simply put, is the price minus the cost of producing a product or delivering a service (Shannon, 2006). To maximize the value for money, the gap between the price and cost must be increased. Whether public or private entities, the main emphasis to attain more value for money is to decrease the costs. The difference is that in the public sector the price charged for services and products or the monies from taxes cannot always be increased to account for the increased costs.

Differences in the public and private sector cost management objectives

For government contractors in a cost reimbursement contract, costs drive a contractor's revenues and profits (Mackie, 2006). Any decrease in cost results in immediate profit loss. Therefore, government contractors believe a change in the way costs are reported usually means lower revenues and decreased profits. In the private sector, any cost savings leads to increased profits and potential increase in the market share. Currently, a contractor has to refund any savings from lower costs to produce a product or deliver a service for the government. Adoption of ABC management may provide more accurate cost data with which to price items, but it may reduce contractors' operating margins and profits, increase the efforts of providing cost data, and lengthen the approval process of final annual indirect cost allocations.

The cost management objectives of the public sector are not typical of those of the private sector (Mackie, 2006). First, government contractors are primarily interested in obtaining a fair recovery of all costs and currently believe it is fair to attach general and administrative costs to direct labor hours using an overhead rate even though it is not the best way to manage costs. Not every contract uses all the activities grouped into the administrative pool, however these are still charged costs based upon their percentage of the total cost base. Secondly, the government seeks uniformity and consistency in cost accounting practices, whereas private sector manufacturing methods are diverse and dynamic. In addition, government contract regulations ensure that all contracts use the same set of cost recovery rules regardless of their manufacturing methods and not all of these methods have the same costs. Even with the foregoing, the government encourages the use of advanced cost management systems, such as ABCM.

Will accrual accounting methods benefit management and planning?

Accrual-based accounting is one of the decisive stages of the attempts to comprehensively reform public management (Marty, et al., 2006). The first objective in the U.S. federal government's move to accrual-based accounting was to better management the government's assets evident from the concomitant implementation of policies to improve management of government real estate. This accounting valuation of public assets can lead to further incentives for long-term management of the natural and cultural heritage.

Secondly, the move to accrual accounting offers the possibility of defining a complete cost. This definition of complete cost on the same accounting foundations as private firms is essential if the public and private offers are to be compared to each other within the framework of partnership contracts. Further, the financial impact of commitments relating to pensions or social services will help to clarify public decision by supplying an honest and fair picture of the financial situation and performance of public entities.

While the benefits of accrual-based accounting for government agencies are many, it is not without risks and potential impediments to NPM or NPR initiatives. First, the costs of set up and training involved in switching to accrual are necessary but considerable (Marty, et al., 2006). Second, the years of time invested to reach compliance of accounts and reports. Third and perhaps most important, the investment relating to the explanation of the reform to involve the staff in the process is daunting but vital to its success.

Conclusions

The above considerations, particularly the financial cost of the transition, are among the reasons that the Netherlands, while a ground-breaker in evaluating the cost of the service delivered by its public administrations, has rejected the adoption of the accrual-based accounting system for the government (Marty, et al. 2006). Has the United States government made a wise choice in the changeover to accrual-based accounting? If it gives managers more of the tools they need to plan for program costs and to evaluate the returns in outcomes realized by these outlays, then it will be advantageous. However, in analyzing the Central Banks' move to accrual-based accounting, Mendezela (2007) cautioned Banks to accept inherent imperfections of accounting and reporting systems and reminded to use real-world info to improve real world service performance and management. The next few years will bring further insight into whether the United States' move to accrual-based accounting in its government institutions enhances strategic planning and management initiatives or is an impediment to real progress.

Summary of Accounting Methods and Strategic Planning and Management Issues

Introduction

- Review of literature to cover current trend of change from cash-based to accrual-based accounting in the public sector and how this impacts planning and management issues
- Impetus for change with the "Winter Commission Report" (1993) on state and local governmental reform needs and
- Committee on Governmental Affairs that called for timely, relevant and comprehensive financial information to aid in controlling government operations & cost (Jones & McCaffrey, 1998).
- These reports were in concert with the earlier examples of how accrual-based accounting could give a more accurate picture of an institution or agency's fiscal soundness.
- Social Security Admin 1988 annual report used accrual-based accounting using full disclosure of assets and liabilities, which attested to fiscal stability of the system.
- In contrast, the GAO's audit of the Fed Sav & Loan Ins. Corp using accrual-based accounting found a $13.7 billion deficit.

Questions covered

- Has this change to accrual-based accounting beneficially impacted planning & management issues in the US and other countries?
- Are performance measures being captured more efficiently and effectively using accrual-based accounting procedures?
- What are the future prospects for obtaining useful financial information using accrual accounting for public administration?

Accrual Accounting & Management Issues in Other Countries: New Zealand

- Public Finance Act - 1989 - Preplanning lead to rapid and effective transition to accrual.
- In 1988 assessed what greater responsibilities fall on mangers
- To offset above, managers given greater freedom in terms of management of teams with flexible staffing and performance-based rewards.

Accrual Accounting & Management Issues in Other Countries: Australia

- 1996 - government went to accrual-based outputs and outcomes budgeting & reporting systems
- Appropriations now based on full cost of delivering outputs & outcomes rather than expected cash flow for the year
- Parliament complained that output info too aggregated and thus more difficult to assess agency's contributions to outputs.
- Above has led to less transparency of financial system and weakened Parliamentary control and planning.

Accrual Accounting & Management Issues in Other Countries: Canada

- Late 1990s instituted modified-accrual accounting in concert with the Program Activity Architecture structure for agencies reporting to Parliament
- The costs were allocated to program activities, sub-activities, etc.
- To date, this has not led to Parliament using this info consistently to influence budgeting decisions.

Accrual Accounting & Management Issues in Other Countries:United Kingdom

- Implementation of new accrual accounting system spread over 7 yrs starting with the White Paper on accounting & budgetary decisions in 1995 to publication on public accounts in 2002 (Marty, et al., 2006).

- UK Treasury has shifted accounting policy from traditional appropriations to resource accounting and has led to emphasis on corp. governance & to institution of boards of directors for oversight of municipalities (Wilks, 2007).
- Advantages of transparency & accountability
- Potential problems - biased or inadequate boards that make decisions on the simplified bottom-line instead of pub interest (Wilks, 2007).

Use of Performance Measures

- Halachmi (2005) cautions against confusing accountability (financial bottom-line - Was it done right?) with productivity (strategic planning for better service to the public interest - Was the right thing done?)
- Strategic management needs greater insights and adaptation than the financial bottom line can accommodate
- Can any of current costing systems be used with new accounting method to facilitate meaningful link to performance measures?

Linking Performance Measures to Accurate Costing Information

- OMB has encouraged development of definitive performance measures linked to accurate cost accounting that would conform to the NPR goals (Jones & McCaffrey, 1998).
- In 1996 Congress passed the Federal Financial Management Improvement Act (FFMIA) in support of the GPRA of 1993 - attempting to integrate financial and performance data in a way that relates to budget accounts.
- Brimson & Williams (2007) analyzed US government's financial & performance reporting models
- Analyzed proposed process-based accounting, which is multi-dimensional approach that bridges both financial reporting and cost management as is intended under FFMIA.

Current costing methods: ABC

- Activity-based costing requires:
  - Id the main activities
  - Determine primary & secondary drivers of activities
  - Aggregate activities into homogenous cost pools
  - Select activity measures to represent each pool or cost driver (Martin, 2006).
- Activities are the sum of the resources needed to develop the productive process and add value to the product or service (Morini, 2006).
- ABC capable of monitoring hidden losses and profits of traditional costing methods
- Pricing decisions based on the above can help gain competitive advantage
- ABC database is an advantage to the Balanced Score Card implementations

Current costing methods: CVP

- A modified Cost-Volume-Profit (CVP) adding the cost of capital that is traced to products or services like the cost of overhead-related resources
- This CVP model based on the economic income enables manager to compute a product's breakeven sales quantity, its profitability over range of its sales and determine rate of change in profitability
- Facilitates measuring tradeoffs in alternative investment and cost on a product's profitability from a process improvement perspective (Kee, 2007).

Current costing methods: VFM

- Value for money (VFM) simply is cost of producing a product or delivering a service minus the price charged

- To maximize VFM gap between price & cost must be increased
- Main emphasis in VFM is decreasing cost
- In public sector - value should not just be financial return for service -

Public versus Private Cost Management Objectives

- Government contractors primarily interested in obtaining fair recovery of costs and even though contract may not use all activities grouped into admin pool - still charged based on % of total cost base
- Government seeks uniformity and consistency in cost accounting practices while private sector accounting methods are diverse and dynamic
- Public contract regulations ensure all contracts use same set of cost recovery rules regardless of manufacturing methods and not all methods the same

Accrual accounting benefits planning & management

- Accrual-based accounting one of decisive stages of the attempts to comprehensively reform public mgmt
- First objective of US government in moving to accrual - to better manage assets - leading to long-term management of natural & cultural heritage
- Move to accrual offers definition of complete costs on same accounting foundation as private firms - essential with public & private partnerships
- Financial impact of commitments relating to pensions or social services help clarify decision-making

Risks & Problems of Accrual Accounting

- Costs of set up training considerable
- Years of time invested to reach compliance of accounts & reporting
- Explanation of reform to staff

- Netherlands - ground-breaker in evaluating costs of services - rejected accrual change - above reasons
- Basing decisions & planning on accounts receivables that may not occur - example - taxes not able to collect

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2.4 The Sarbanes-Oxley Act of 2002; Audit and Governance of Not for Profit Organizations

Section I: Summary of the key provisions the Sarbanes-Oxley Act of 2002 and their impact in the nonprofit sector

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, which he characterized as "the most far reaching reforms of American business practices since the time of Franklin Delano Roosevelt." The Act mandated a number of reforms to enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud, and created the "Public Company Accounting Oversight Board," also known as the PCAOB, to oversee the activities of the auditing profession (U.S. Securities and Exchange Commission). The Sarbanes-Oxley Act (SOX) is arranged into eleven titles. As far as compliance is concerned, the most important sections within these eleven titles are usually considered to be 302, 401, 404, 409, 802 and 906. The Act can be divided into three parts: internal controls (exercised by management), external checks (performed by the board or external auditors), and investigations (triggered by whistleblowers or others). Only two provisions directly apply to nonprofit organizations: whistle-blower protection and document preservation. These provisions require employees or volunteers of a nonprofit to be shielded from retaliations for whistle-blowing or making reports of waste, fraud, or abuse. Nonprofits are expected to comply with the document requirement by having a fully functioning policy in place for the preservation, archiving, and disposal of agency documents.

SOX creates parameters to ensure the independence of auditors from their clients by requiring that auditors report directly to an audit committee, reporting all critical accounting, policies, and practices used, as well an accounting of alternative treatments of financial information shared with management. Disclosure must also include a discussion of how the ramifications of alternate treatments might impact stakeholders. Chief Executive or Financial Officers are required to certify the propriety and accuracy of financial statements and periodic reports. The law requires organizations to conduct and publish annual reviews of internal controls and process, financial reporting procedures, and year-end results, including disclosure of recent material changes in financial condition or operation. The law established criminal penalties for any person who knowingly alters, destroys, or conceals documents with the intent to obstruct justice or influence an official investigation.

In her report *Responding to the Sarbanes-Oxley Act of 2002; The Financial Reporting Practices of Nonprofits,* Heinz (2003) rightly states that not for profit agencies should be held to the highest standards as they often accept private money on behalf of people in need. Their finances should be held open to the tightest scrutiny. Jackson (2005) in *Nonprofit Strategic Planning* suggests that the spillover of SOX into the public sector can be tied to the close alignment between business models of private sector firms and current trends in nonprofit management. Just as a business must prove compliance with SOX legislation before launching an Initial Public Offering (IPO), non for profit organizations must assuage the apprehensions of potential donors or partners by assuring that accountability standards are high and impregnable. Oxholm (2005) suggests that, in large measure, non-profits enjoy the special benefits they receive— exemption from tax being chief among them—because they do the public's business. The substantial financial assistance they receive indirectly from all levels of governments, even without regard to grants, arguably makes them more deserving of governmental oversight and control than publicly-traded companies, because it is the public's tax money, not that of private investors, that is being spent.

Whether Sarbanes-Oxley should be applied to non-profits is still being debated, particularly in consideration of the potentially substantial costs involved that may be burdensome to small organizations. By taking this proactive stance, however, Jackson (2007) suggests that nonprofits will earn a competitive advantage that will inspire confidence among stakeholders, ensuring that directing boards and executives understand the operational importance of SOX mandates. Boude (2006) reaffirms that when the Sarbanes-Oxley Act was adopted, the Congressional record indicated that it was not intended to apply to any organization other than public companies. At that time, many commentators predicted that regardless of the intent of Congress, the guidelines would

ultimately filter down to all businesses under the guise of "best practices." Boude's (2006) report found that The Sarbanes-Oxley Act continues to have a significant impact on private organizations, with 86% of his survey respondents indicating that SOX and other corporate governance reform requirements had impacted their organizations.

A majority (70%) of the private organizations surveyed implement self-imposed corporate governance reforms.

Section II: How non-profit organizations are reacting to the opportunity/threat of greater accountability

Jackson (2007) views the SOX requirements as an opportunity for nonprofits to improve their operational systems, procedures and methods for doing business via better control mechanisms. Ancillary benefits are also accrued to the organization via streamlined standard operating procedures, record keeping, and policy adoption as a result of engaging in SOX compliance activity. Jackson finds that engaging in the strategic planning process forces a nonprofit to evaluate how it is perceived by its donors and the public at large as it engages external and internal stakeholders in the development of goals and objectives that are commonly held.

Boude's research (2006) reveals that more nonprofit survey participants cited implementation or planned implementation of more aspects of corporate governance reforms than for-profit organizations. In comparing the data, Boude cited three groups consistently influencing the decision to adopt corporate governance standards: the organizations themselves, their board members and their auditors. The influence of these three groups fuels the continued adoption of standards as perceived "best practices." The research also contends that auditors generally perceive they have more risk on audits they perform for large organizations and therefore exert more pressure on these organizations to adopt SOX standards. The voluntary corporate governance measures private organizations have implemented continue to come at a cost to those organizations. Private organizations estimated an average annual price tag of $105,000 for corporate governance procedures, representing an estimated increase of approximately 26% over their estimated costs prior to the enactment of the Sarbanes-Oxley Act.

Section III: How other countries are impacted by the SOX Act; Focus on EU and China

Sound corporate governance is good for maximizing the shareholder value and productivity of companies. In countries outside the United States, powerful mimetic forces in international business practice drives isomorphic tendencies that create pressure (and incentive) for organizations to adopt Sarbanes-Oxley requirements (Lucci, Dewing & Russell, Lin). It is important to note that the Act applies *only* to foreign corporations that *elect* to avail themselves of the benefits of American capital markets. Lucci (2003) From its inception, Sarbanes-Oxley “caused headaches” for the more than 1,300 foreign firms, such as British Airways and GlaxoSmithKline, that trade on an American exchange, and left many foreign officials uncertain as to which provisions of the Act applied to them. Lucci reports that these officials criticized the Act for regulating foreign accounting services and corporations. Contraindications for adoption of SOX standards cited by Lucci conclude that exempting foreign corporations from the Act’s coverage would create economic disparities between American and overseas firms, as one group would be required to incur compliance costs and the other would not. Furthermore, if corporations outside the United States are exempt from Sarbanes-Oxley’s more stringent requirements, this could provide a perverse incentive for corporations to leave the United States to seek refuge in countries with less stringent accounting and corporate governance standards. (p.219) As a basis for exemption from the Acts provisions, many European executives argue that firms are already highly regulated in their respective countries and that Sarbanes-Oxley adds another layer of unnecessary regulation. Lucci offers as an example why it is necessary for French companies to follow the regulations of Sarbanes-Oxley when the country already has *two* of its own oversight boards.

Dewing and Russell (2004) provide an overview of EU policy developments in accounting, auditing and corporate governance before and after the collapse of Enron. For EU policy-makers the article identifies areas for both encouragement and concern. It concludes that considerable progress has been made towards the harmonization of accounting, auditing and corporate governance within the context of the Financial Services Action Plan. However, the authors argue that to achieve this balance, the EU “has given too much ground to US hegemony, whether by embracing US practice masquerading as international best practice.”

Lin (2004) cites China’s securities market as well as corporate governance structure and rules as important factors in its economic reforms. Since 1992, China has made substantial progress in specifying rights and since entering into the World Trade Organization (WTO) in late 2001, the Chinese government has continued to improve its corporate governance policies. Lin’s work provides specific examples and recommendations of how following rules form the Sarbanes-Oxley Act can be modified and used to improve the quality of China’s company corporate governance. (Lucci, 2003) quotes Wang Xiaochu, CEO of blue-chip company China Mobile in Hong Kong, which does business in the United States following SOX regulations: “‘Our accounts are very transparent and accurate, we will be happy to sign the document and bear the legal responsibility.”

By applying one set of standards to all corporations—regardless of whether they are located in the United States or abroad—investors will be assured that each and every corporation deriving a direct benefit from American capital markets will be subject to the stringent protections in Sarbanes-Oxley. Corporate migration to avoid Sarbanes-Oxley will lead to further instability in markets if companies seek refuge in jurisdictions offering less accountability for corporate wrongdoing.

Section IV: Implications for the future – What will motivate non-profits to ensure compliance?

Oxholm (2005) maintains that Sarbanes-Oxley is not designed to rid businesses of corruption as it does not punish anyone for embezzling, wasting corporate assets, excessive compensation, or anything else. Those rules, and punishments, lie elsewhere. Instead, its goal is to encourage the earlier discovery and disclosure of corruption. Its method is to require businesses to have enough incentives and mechanisms in place to persuade persons who are generally lower in the organizational chart to disclose problems and possible wrongdoing to someone with greater authority.

Heinz (2002) finds that accounting professionals and regulators will initiate driving forces to motivate change in the financial practices and auditing process of nonprofits. Regulatory control of non-profits from states will as they intensify oversight of activities through detailed reporting requirements and prosecution of illegal practices. Heinz proposes that this effort will constitute a "collective watch dog group" that oversees nonprofits. State initiatives mirroring SOX include the California Nonprofit Integrity Act (SB1262), which applies to any nonprofit with a budget in excess of $2 million that solicits donations within the state.

Ostrower &Bobowick (2005) include among these driving forces IRS requirements for posting financial statements (which are public, but the authors suggest should be made available electronically for stakeholder viewing). Their research found that only 11% of organizations were posting their IRS returns on the agency's site. Additional measures to ensure compliance would be collaboration with Certified Public Accounting protocols, real-time distribution of material, and use of plain language documents. Non-profit boards will be called on to re-examine their composition and possibly alter them to include ad hoc committees that represent interests vested in the stakeholder constituency. Executives will need to provide adequate training for management in understanding accounting and reporting measures, not only for employees but for board members as well. Relying on board members for specific guidance in financial and planning matters will be integral in ensuring compliance and transparency.

Section V: Emerging best practice and strategies for governance and auditing

In 2004-2005 Senate Finance Committee Hearings, Mark W. Everson, Commissioner of the Internal Revenue Service (IRS), testified on a more aggressive oversight and enforcement stances for uses related to nonprofit organizations (Jackson 2004, pp. 14-15) Addressing the concern that almost 3 million agencies qualify as tax-exempt entities, employing about one if every four workers in the U.S. If abuses in accounting are left unchecked by these agencies, there is a risk that Americans will lose faith in and reduce support for charitable organizations, potentially compromising the integrity of the national tax systems. Calls for increased transparency in the tax exempt sector include compliance with IRS regulations, five-year reviews of tax-exempt status based on data collected by the IRS, adoption of policies that comply with SOX requirements, and potential agency accreditation from professional bodies that outline industry specific standards of best practice. Jackson (2005) recommends that nonprofits ensure that their operations are consistent with stated mission, in their words, "that they are who they say they are and do what they say they are doing."

Oxholm (2005) describes a process undertaken in higher education that parallels initiatives from strategic planning and governance. "Toward ensuring that adequate controls are in place, consultants will analyze each process to see what kinds of controls the system already has ("analysis") and what is missing ("gap analysis"). Then they will determine what new controls are required ("diagnostics"), designing and installing what it lacks ("remediation"). Finally, consultants will test them ("validation") and then audit them on an annual basis, comparing them to those of our peers ("benchmarking")."

Broude (2006) provides the most common aspects of corporate governance reform that some private organizations have implemented or plan to implement in response to the regulations on public companies. These are: audited financial statements, establishing independent directors, establishment of a corporate ethical code and audit committee oversight of auditors. Research results show that 95% of nonprofits implement or plan to implement these reforms, compared to only 78% of for profits Among not for profit organizations, Broude (2006) reports that more large organizations (with annual revenue or budgets in excess of $300M) have implemented or plan to implement more aspects of governance reform when compared to smaller organizations. Smaller organizations typically answer to a smaller number of constituencies that may be less concerned about corporate governance reform. Broude sees this trend is logical because large organizations are more able to easily absorb the costs associated with adopting aspects of governance reform.

Webb (2008) found several differences between compliance groups in terms of equity ownership, board structure, and executive compensation schemes. However, the strongest determinant of Section 404 compliance is firm size. This result supported anecdotal evidence that compliance with SOX is achieved primarily by firms that can afford it. Webb's work suggests that firms found to be in violation of SOX are not systematically worse when it comes to common measures of corporate governance. The financial structure and soundness of the groups of firms are very similar to groups in compliance. This work raises an important policy issue: Is SOX really differentiating firms in terms of corporate governance or in terms of size?

The U.S. General Accounting Office (GAO) issued its own Auditor Independence Standard in 2002, establishing standards for auditor services and behavior that are similar to those passed in Sarbanes-Oxley. The GAO standard applies to federal agencies, state and local governments, any nonprofit agency directly receiving federal grants, and many nonprofits receiving federal funds from pass-through grants or through purchase of service contracts with their local and state jurisdictions. As models of governance evolve to include public-private partnerships that seek to achieve the greatest public good with high levels of efficiency and with limited risk, Halachmi (2005) would suggest use of market forces and non-governmental entities to replace government agencies and regulations that are expensive and cumbersome to implement. Sarbanes-Oxley was conceived as a rebuttal and remedy to scandal and corruption, yet is itself subject to revision as the political tides of reform wash away memories of past wrongdoing in the face of current economic pressures. Alternative approaches to governance would promote managing risks to the public good by relying less on government regulation and more on market forces that can exert safeguarding measures through effective administrative management.

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2.5 Etzioni & Lorcsh - Attempts to Combine

Etzioni

- Structuralist model
  - Combine Weber, a little Marx and natural systems
  - Weber and Marx on alienation
  - But why no conflict?

Authority and Power

- Source of Conflict—Marx
- Separation from the means of production-Marx
- Separation from the means of administration—Weber
- Therefore there should be conflict

Addition of Natural

- Acceptance of power by the powerless-Bernard
- Informal relations
- Limit the conflict and alienation

Lawrence and Lorsch

- Extension of contingency model
- Rational or natural dependent on the environment
- Lets talk about restaurants
  - Compare the hotel with McD's
    - Hotel natural
    - McD rational

Thompson's Levels

- Technical level—production—rational
- Managerial level—controlling the production system and personal—natural

- Institutional level—relates to the larger environment—open

2.6 Admin Management – Strategic Management

STRATEGIC PLANNING – 2 BASIC APPROACHES:

1) Start with a MISSION: Given the mission, what can you do in order to carry it out successfully? Because environment changes, we constantly adjust "what we can do".

2) Start with an IDEA: Start by identifying STRENGTHS & WEAKNESSES, thus the evolving strategy (or evolving structure) will support the idea that you can maximize your strengths, If cannot change structure, then you can concentrate on STRATEGY.

STRATEGY IN THE PUBLIC SECTOR STARTS WITH THE <u>MISSION</u>!

Halachmi – "The notion of a stable environment doesn't exist anymore".

- With strategic planning, you don't need to succumb to the typical life cycle of organizations.

Several professors said to KNOW: POLITICAL ECONOMY – OSTROM, NISKANEN, WAMSLEY & ZALD

Know these Org Theory authors for Comps: Cyert & March, Merton, Gouldner, Parsons, Etzioni, Porter, Ronald Coase (Transaction Cost Econ).

CHANDLER – The structure of modern organization emerges from the strategy that business pursues as it defines and capitalizes on opportunities.

MINTZBERG (1978) – *Patterns in Strategy Formation.*

1. Orgs experience cycles of strategy formation. The frequency of planning and strategy formation depends on the environment and what pressures for change exist.
2. Mintzberg asks: "Why do orgs undergo distinct periods of change & continuity?"
3. Argues that "gestalt strategies" exist at the founding of orgs.

4. **CHANDLER – Well-known edict of STRUCTURE FOLLOWS STRATEGY**:

   - "Changes in strategy lead to changes in org structure. Structure should be designed to facilitate the strategic pursuit of a firm, therefore, STRUCTURE FOLLOWS STRATEGY.
   - **MINTZBERG'S CRITICISM OF CHANDLER** – Structure follows Strategy must be called into question because of the influence of bureaucratic momentum on strategy formation. "Every strategy maker faces an impossible overload of information; as a result he can have no optimal process to follow."
   - **MILLER – "Public orgs can be characterized as low on deliberate strategy and high on emergent strategy." "Any manager who is unable to relinquish *intended* strategies in order to pursue *emergent* strategies is likely to fail."**

5. **STRATEGY SHOULD FOLLOW STRUCTURE**:

   - The org first chooses what services/products they will provide to the market. Based on that choice, there may exist an already-researched optimal structure for your org.
   - Sometimes facets of structure are mandated by the state (safety officer, IG).
   - At the beginning of any org you start with an idea that is shared among a group. The group who decides to stay and entertain this idea further is considered the initial structure. Now they interact and develop PLANS to proceed. STRATEGY is then dictated from higher in the structure or developed thru group and team processes. The results of these processes may necessitate a change in structure as a result of new strategies.
   - **PUBLIC SECTOR ARGUMENTS FOR "STRATEGY SHOULD FOLLOW STRUCTURE"** (See Gerard Miller article):
     - Applying Chandler's argument that structure follows strategy, we see that some agencies begin with a basic structure that

may change very little over time (Emergency Management – structure is dictated by State and strategies are formulated as program initiatives and work is handed down to the States). However, in the case of Emergency Management, when the Fed structure changed (Dept. of Homeland Security), the missions of State and local agencies changed in response. STRUCTURES then changed to accommodate new programs and mandates from above.

    - To Summarize: In the public sector, normally strategy follows structure. Agency structure is relatively stable over time. In the case of Homeland Security, it was all new, so it was a rare case where structure followed strategy.

- **MINTZBERG** – EQUAL FOOTING -
    - "Structure follows strategy as the left foot follows the right in walking. NONE TAKES PRECEDENCE; EACH ALWAYS PRECEDES THE OTHER, AND FOLLOWS IT, EXCEPT WHEN THEY MOVE TOGETHER, AS WHEN AN ORG JUMPS TO A NEW POSITION."

MINTZBERG – Strategy Formation:

- Strategy formation is not a regular, nicely sequenced process. An org may find itself in a stable environment for years without ever needing to reassess strategy. Then suddenly, the environment can become so turbulent that even the very best planning techniques are of no use because of the impossibility of predicting the kind of stability that will eventually emerge.
- In response to this kind of environment, patterns of strategic change are never steady, but irregular and AD HOC.
- GESTALT STRATEGIES – most frequently developed at the time when the org is founded.
- DELIBERATE, EMERGENT AND REALIZED STRATEGIES.

- EVERY STRATEGY MAKER FACES AN IMPOSSIBLE OVERLOAD OF INFORMATION (MUCH OF IT SOFT); AS A RESULT HE CAN HAVE NO OPTIMAL PROCESS TO FOLLOW.

Gerald MILLER – Strategy should follow structure.

- "A manager that is unable to relinquish intended strategies in order to pursue emergent strategies is likely to fail."
- IN THE PUBLIC SECTOR: SOME BUT NOT ALL STRATEGIES WILL WORK IN PUBLIC ORGS.
    - Strategies often emerge only after the fact.
    - Strategies are constrained by forces beyond the control of those pursuing them.
    - Classic Sub-Optimization – Often occurs because the details of a strategy call for precise evaluation measures. We may end up OPTIMIZING the measure and fail to achieve the strategy behind the measure.
- ADHOCRACY - Miller argues that in the public sector, there tends to be more ADHOCRACY going on, and long-range strategic planning may not be applicable in most areas of public management.

THIS IDEA (ADHOCRACY) WAS SUPPORTED IN 1986 BY HALACHMI – in his paper "Strategic Planning and Management? Not Necessarily", in which he identified a history of problems related to adopting private-sector management tools in the public sector.

- HALACHMI – Emergent strategies are most compatible with the adhocracy configuration, in which many people at all levels are potentially involved in the establishment of strategies.
- HALACHMI argued that the application of strategic planning to the public sector is problematic:
    - "In government, higher levels may set strategic goals for lower levels in certain areas, but not in others."

        - Reserved powers of the states.
        - "Home rule" provisions.
    - In the public sector, the basic mission of the org is always determined externally, by legislative bodies, and it is expressed through laws and regulation.
    - Since legislation is often vague in policy making, strategy often follows structure in the public sector.
    - Halachmi argues that managers in the public sector tend to follow the "MUDDLING THROUGH" style of management, rather than investing valuable time and energy into more proactive approaches such as strategic management.
- Goals are more difficult to measure in public sector – not tied to any single criterion like bottom-line profits.
- Halachmi adds that many public sector decisions must be made with limited information, and for reasons of political "capital", must produce short-term results. This means that developing long-term plans or strategies is often a useless exercise in the public sector, except in cases where the primary work is technological in nature, in which case strategic planning holds promise.

CYERT & MARCH – *BEHAVIORAL THEORY OF THE FIRM.*

- Individuals do NOT always engage in self-interested maximizing behavior.
- STRATEGY FORMULATION IN THE PRIVATE SECTOR:
    - ADAPTIVE MODE:
        - Many decision makers with conflicting goals bargain amongst themselves to produce a stream of incremental, disjointed decisions. Some of the literature describes this as "entrepreneurial mode".

Philip SELZNICK – "Strategies take on value only as committed people infuse them with energy."

- COOPTATION – TVA AND THE GRASS ROOTS.

FUTURE MANAGEMENT CHALLENGES IN PA:

KETTL (2000) on FUTURE MANAGEMENT CHALLENGES IN PA:

- Kettl: "Americans have always been distrustful of governmental power, and especially administrative power. They have long believed that public administration is more inefficient and corrupt than private administration.
- In The Transformation of Governance, Kettl identifies 3 management challenges for PA:
    1. GLOBALIZATION – Instantaneous communication is accelerating govt transformation.
    2. DEVOLUTION – Increased PRIVATIZATION & CONTRACTING-OUT.
    3. DEFINING THE NEW ROLE OF GOVERNMENT – In a globalized world, what capacity does the federal govt need to play?

DENHARDT & DENHARDT (2000) – In *The New Public Service: Serving rather than Steering*.

- Argues for a "New Public Service" in which public managers focus on responsibility to serve and empower citizens while performing their work in managing public organizations and implementing public policy.
- Denhardt feels that we desperately NEED A RENEWED SENSE OF COMMUNITY, and the way to do this involves building a new active set of institutions that serve the public interest.

HALACHMI (2005) – In *Governance and Risk Management: Challenges and Public Productivity*.

- CALLS FOR A SHIFT FROM "GOVERNING" TO "GOVERNANCE".
- Engage private industry and civil society organizations to help address accountability issues, improve productivity and provide monitoring of environments.
- Results: improve government response and risk management.

Conclusion to "the FUTURE CHALLENGES FACING PA":

- Increasing regulation is not effective in increasing public productivity or correcting problems with oversight.
- The best way to approach these problems is to develop a more responsive and flexible system of GOVERNANCE in which the work of government is accomplished through partnerships with private industry, civil based society organizations and individual citizens.

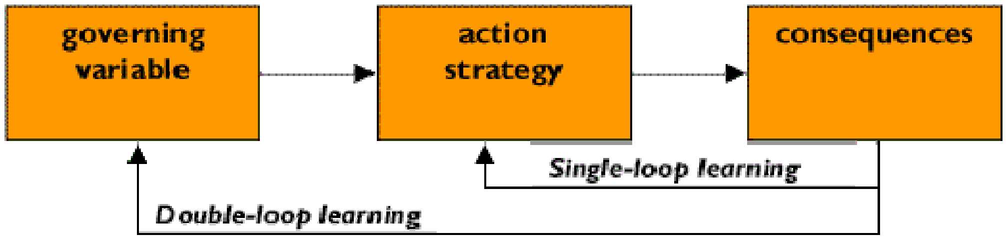
Chris ARGYRIS – SINGLE AND DOUBLE-LOOP LEARNING.

Single-loop and double-loop learning

For Argyris and Schön (1978: 2) learning involves the detection and correction of error. Where something goes wrong, it is suggested, an initial port of call for many people is to look for another strategy that will address and work within the governing variables. In other words, given or chosen goals, values, plans and rules are operationalized rather than questioned. According to Argyris and Schön (1974), this is *single-loop learning*. An alternative response is to question to governing variables themselves, to subject them to critical scrutiny. This they describe as *double-loop learning*. Such learning may then lead to an alteration in the governing variables and, thus, a shift in the way in which strategies and consequences are framed. Thus, they came to explore the nature of organizational learning. This is how Argyris and Schön (1978: 2-3) described the process in the context of organizational learning:

When the error detected and corrected permits the organization to carry on its present policies or achieve its presents objectives, then that error-and-correction process is *single-loop* learning. Single-loop learning is like a thermostat that learns when it is too hot or too cold and turns the heat on or off. The thermostat can perform this task because it can receive information (the temperature of the room) and take corrective action. *Double-loop* learning occurs when error is detected and corrected in ways that involve the modification of an organization's underlying norms, policies and objectives.

This process can be represented quite easily by a simple amendment of our initial representation of theory-in-use.



Single-loop learning seems to be present when goals, values, frameworks and, to a significant extent, strategies are taken for granted. The emphasis is on 'techniques and making techniques more efficient' (Usher and Bryant: 1989: 87) Any reflection is directed toward making the strategy more effective. Double-loop learning, in contrast, 'involves questioning the role of the framing and learning systems which underlie actual goals and strategies (*op. cit.)*. In many respects the distinction at work here is the one used by Aristotle, when exploring technical and practical thought. The former involves following routines and some sort of preset plan – and is both less risky for the individual and the organization, and affords greater control. The latter is more creative and reflexive, and involves consideration notions of the good. Reflection here is more fundamental: the basic assumptions behind ideas or policies are confronted… hypotheses are publicly tested… processes are disconfirmable not self-seeking (Argyris 1982: 103-4).

The focus of much of Chris Argyris' intervention research has been to explore how organizations may increase their capacity for double-loop learning. He argues that double-loop learning is necessary if practitioners and organizations are to make informed decisions in rapidly changing and often uncertain contexts (Argyris 1974; 1982; 1990). As Edmondson and Moingeon (1999:160) put it:

The underlying theory, supported by years of empirical research, is that the reasoning processes employed by individuals in organizations inhibit the exchange of relevant information in ways that make double-loop learning difficult – and all but impossible in situations in which much is at stake. This creates a dilemma as these are the very organizational situations in which double-loop learning is most needed.

Peter SENGE – (1990) The Fifth Discipline. The LEARNING ORGANIZATION.

The learning organization

According to Peter Senge (1990: 3) **learning organizations** are:

…organizations where people continually expand their capacity to create the results they truly desire, where new and expansive patterns of thinking are nurtured, where collective aspiration is set free, and where people are continually learning to see the whole together.

The basic rationale for such organizations is that in situations of rapid change only those that are flexible, adaptive and productive will excel. For this to happen, it is argued, organizations need to 'discover how to tap people's commitment and capacity to learn at *all* levels' (*ibid.*: 4).

While all people have the capacity to learn, the structures in which they have to function are often not conducive to reflection and engagement. Furthermore, people may lack the tools and guiding ideas to make sense of the situations they face. Organizations that are continually expanding their capacity to create their future require a fundamental shift of mind among their members.

When you ask people about what it is like being part of a great team, what is most striking is the meaningfulness of the experience. People talk about being part of something larger than themselves, of being connected, of being generative. It become quite clear that, for many, their experiences as part of truly great teams stand out as singular periods of life lived to the fullest. Some spend the rest of their lives looking for ways to recapture that spirit. (Senge 1990: 13)

For Peter Senge, real learning gets to the heart of what it is to be human. We become able to re-create ourselves. This applies to both individuals and organizations. Thus, for a 'learning organization it is not enough to survive. '"Survival learning" or what is more often termed "adaptive learning" is important – indeed it is necessary. But for a learning organization, “adaptive learning” must be joined by “generative learning”, learning that enhances our capacity to create’ (Senge 1990:14).

The dimension that distinguishes learning from more traditional organizations is the mastery of certain basic disciplines or ‘component technologies’. The five that Peter Senge identifies are said to be converging to innovate learning organizations. They are:

Systems thinking

Personal mastery

Mental models

Building shared vision

Team learning

He adds to this recognition that people are agents, able to act upon the structures and systems of which they are a part. All the disciplines are, in this way, ‘concerned with a shift of mind from seeing parts to seeing wholes, from seeing people as helpless reactors to seeing them as active participants in shaping their reality, from reacting to the present to creating the future’ (Senge 1990: 69). It is to the disciplines that we will now turn.

Systems thinking – the cornerstone of the learning organization

A great virtue of Peter Senge’s work is the way in which he puts systems theory to work. *The Fifth Discipline* provides a good introduction to the basics and uses of such theory – and the way in which it can be brought together with other theoretical devices in order to make sense of organizational questions and issues. Systemic thinking is the conceptual cornerstone (‘The Fifth Discipline’) of his approach. It is the discipline that integrates the others, fusing them into a coherent body of theory and practice (*ibid.*: 12). Systems theory’s ability to comprehend and address the whole, and to examine the interrelationship between the parts provides, for Peter Senge, both the incentive and the means to integrate the disciplines.

NEO-CLASSICAL vs. INSTITUTIONAL ECONOMICS:

- In NeoClassical, the INDIVIDUAL is the primary unit of analysis.
- In Institutional Econ, individuals operate within socially constructed frameworks that influence their economic decision making.
- In Neo-Classical, individual is self-interested and makes rational economic choices.
- Institutional Econ focuses on transactions and behavior between individuals in the context of collective action.
- In Neo-Classical, individuals shape economic outcomes
- In Institutional Econ, individuals are limited by institutional constraints (govt, legal, etc.) in their economic decision making.

TRANSACTION COST ECONOMICS:

- RONALD COASE (1937) – first asked "Why do organizations exist?" and answered that "Sometimes the cost of managing economic exchanges across markets is greater than the cost of managing economic exchanges WITHIN THE BOUNDARIES OF AN ORGANIZATION."
- WILLIAMSON (1975) – Suggests that an internal hierarchical structure may serve as an effective arena of exchange to reduce transaction costs.
- ASSUMPTIONS OF TCE:
    - Bounded Rationality (actor has limited info, cannot predict future – departure from classical and neo-classical econ theories which assume actor is "rational".
    - Opportunism (Self-Interested, Cheating or lying, Withholding information)

AGENCY THEORY – aka PRINCIPAL-AGENT THEORY:

- Addresses how actors manage their respective risks in an exchange.
- Problems with Agency Theory – Moral Hazard (agent does not complete task-shirking), Adverse Selection

MOE (1984) – LACK OF ECONOMIC ANALYSIS IN PUBLIC ORGANIZATIONS

- MOE argues that economic analysis of public organizations has received little attention in the literature and suggests three primary areas in which economic analysis could be applied:
    - A contractual perspective on organizational relationships
    - A focus on hierarchical control
    - Formal analysis via principal-agent models

MOE (1987) – *Exploring the Limits of Privatization.*

- Need for mutual coexistence and links between public and private sectors.
- Moe views limits to privatization from a legal context (vs. economic or managerial)
- PA should be based on a legal foundation and the concept of sovereignty.

STRATEGIC MANAGEMENT DEFINED – The ART & SCIENCE of formulating, implementing and evaluating cross-functional decisions that enable an org to achieve its objectives.

STRATEGIC PLANNING & PRINCIPAL-AGENT THEORY:

- To assume that when you have a strategic plan, you have a roadmap, is wrong. Principal-Agent relationships and people working for their own interests can change how strategic plans work out.

LINDBLOM - STRATEGY FORMULATION IN THE PRIVATE SECTOR:

- ADAPTIVE MODE:
    - Many decision makers with conflicting goals bargain amongst themselves to produce a stream of incremental, disjointed decisions. Some of the literature describes this as “entrepreneurial mode”.

WALDO

- Waldo criticizes both the emphasis on supposed principles or commonalities among organizations and the rationalist bias of Classical organization theory.

Organizations should be defined and structured to meet purposes, not general principles, and the organizational form and process actually adopted should be suited to the specific situation confronting the organization.

Graham ALLISON – 3 MODELS OF DECISION MAKING. (Know for Comps – get article)

- Allison is best known as a political scientist for his book *Essence of Decision: Explaining the Cuban Missile Crisis* (1971), in which he developed two new theoretical paradigms - an organizational process model and a bureaucratic politics model - to compete with then-prevalent approach of understanding foreign policy decision making using a rational actor model. *Essence of Decision* swiftly revolutionized the study of decision making in political science and beyond.
- ***Essence of Decision: Explaining the Cuban Missile Crisis*** is an analysis, by political scientist Graham T. Allison, of the Cuban Missile Crisis. Allison used the crisis as a case study for future studies into governmental decision-making. The book became the founding study of the John F. Kennedy School of Government, and in doing so revolutionized the field of international relations.

When he first wrote the book, Allison contended that political science and the study of international relations were saturated with rational expectations theories inherited from the field of economics. Under such a view, the actions of states are analyzed by assuming that nations consider all options and act rationally to maximize their utility.

Allison attributes such viewpoints to the dominance of economists such as Milton Friedman, statesmen such as Robert McNamara and Henry Kissinger, disciplines such as game theory, and organizations such as the RAND Corporation. However, as he puts it:

> *It must be noted, however, that an imaginative analyst can construct an account of value-maximizing choice for any action or set of actions performed by a government.*

Or, to put it bluntly, this approach (which Allison terms the "Rational Actor Model") violates the law of falsifiability. Also, Allison notes that "rational" analysts must ignore a lot of facts in order to make their analysis fit their models.

In response, Allison constructed three different ways (or "lenses") through which analysts can examine events: the "Rational Actor" model, the "Organizational Behavior" model, and the "Governmental Politics" model.

To illustrate the models, Allison poses the following three questions in each section:

1. *Why did the Soviet Union decide to place offensive missiles in Cuba?*
2. *Why did the United States respond to the missile deployment with a blockade?*
3. *Why did the Soviet Union withdraw the missiles?*

The "Rational Actor" Model

The origin of Allison's first model is explained above. Basically, under this theory:

- Governments are treated as the primary actor.
- The government examines a set of goals, evaluates them according to their utility, then picks the one that has the highest "payoff."

Under this theory, Allison explains the crisis like this:

1. John F. Kennedy, in 1961, revealed that the Soviet Union, despite rhetoric, had far fewer ICBMs than it claimed. In response, Nikita Khrushchev ordered nuclear missiles with shorter ranges installed in Cuba. In one move, the Soviets bridged the "missile gap" while scoring points in the Cold War. Based on Kennedy's failure to back up the Bay of Pigs invasion, they believed the U.S. wouldn't respond harshly.
2. Kennedy and his advisors (EXCOMM) evaluated a number of options, ranging from doing nothing to a full invasion of Cuba. A blockade of Cuba was chosen because it wouldn't necessarily escalate into war, and because it forced the Soviets to make the next move.

3. Because of mutually assured destruction by a nuclear war, the Soviets had no choice but to bow to U.S. demands and remove the weapons.

The **Organizational** Process Model

Allison noted there were many facts that the rational model had to ignore, such as why the Soviets failed to camouflage the nuclear sites during construction, but did so only after U-2 flights pinpointed their locations.

He cited work by James G. March and Herbert Simon, which argue that existing governmental bureaucracy places limits on a nation's actions, and often dictates the final outcome. He then proposed the following "organizational process" model propositions:

- When faced with a crisis, government leaders don't look at it as a whole, but break it down and assign it according to pre-established organizational lines.
- Because of time and resource limitations, rather than evaluating all possible courses of action to see which one is most likely to work, leaders settle on the first proposal that adequately addresses the issue, which Simon termed "satisficing."
- Leaders gravitate towards solutions that limit short-term uncertainty (emphasis on "short-term").
- Organizations follow set "repertoires" and procedures when taking actions.
- Because of the large resources and time required to fully plan and mobilize actions within a large organization (or government), leaders are effectively limited to pre-existing plans.

Under this theory, the crisis is explained thus:

1. Because the Soviets never established nuclear missile bases outside of their country at the time, they assigned the tasks to established departments, which in turn followed their own set procedures. However, their procedures were not

adapted to Cuban conditions, and as a result, mistakes were made that allowed the U.S. to quite easily learn of the program's existence. Such mistakes included such gaffes as supposedly undercover Soviet troops decorating their barracks with Red Army Stars viewable from above.

2. Kennedy and his advisors never really considered any other options besides a blockade or air strikes, and initially, were almost unanimously in favor of the air strikes. However, such attacks created massive uncertainty because the U.S. Air Force couldn't guarantee it would disable all the nuclear missiles. Additionally, although Kennedy wanted a "surgical" air strike that would destroy the missiles without inflicting extensive damage, the existing Air Force plan required extensive bombing that would have created more collateral damage than Kennedy desired. Because the U.S. Navy already had considerable strength in the field, because there was a pre-existing plan in place for a blockade, and because Kennedy was able to communicate directly with the fleet's captains, members fell back on the blockade as the only safe option.
3. The Soviets simply did not have a plan to follow if the U.S. took decisive action against their missiles. Khrushchev's communications indicated a high degree of desperation. Without any back-up plan, the Soviets had to withdraw.

The "Governmental Politics" Model

After reading works by Richard Neustadt and Samuel P. Huntington, among others, Allison proposed a third model, which takes account of court politics (or "palace politics"). While statesmen don't like to admit they play politics to get things done, especially in high-stakes situations such as the Cuban missile crisis, they nonetheless do.

Allison proposed the following propositions for this model:

- A nation's actions are best understood as the result of politicking and negotiation by its top leaders.
- Even if they share a goal, leaders differ in how to achieve it because of such factors as personal interests and background.

- Even if a leader holds absolute power (i.e., the President of the United States is technically the commander-in-chief), the leader must gain a consensus with his underlings or risk having his order misunderstood or, in some cases, ignored.
- Related to the above proposition, the make-up of a leader's entourage will have a large effect on the final decision (i.e., an entourage of "yes men" will create a different outcome than a group of advisors who are willing to voice disagreement).
- Leaders have different levels of power based on charisma, personality, skills of persuasion, and personal ties to decision-makers.
- If a leader is certain enough, they will not seek input from their advisors, but rather, approval. Likewise, if a leader has already implicitly decided on a particular course of action, an advisor wishing to have influence must work within the framework of the decision the leader has already made.
- If a leader fails to reach a consensus with his inner circle (or, at least, the appearance of a consensus), opponents may take advantage of these disagreements. Therefore, effective leaders must create a consensus.
- Because of the possibilities of miscommunication, misunderstandings, and downright disagreements, different leaders may take actions that the group as a whole would not approve of.

Allison had to admit that, because the Soviets were not as open with their internal affairs as the Americans, he simply didn't have enough data to fully interpret the crisis with this model. Nonetheless, he made the following attempt:

1. Khrushchev came under increasing fire from the Presidium because of Kennedy's revelation of the Soviet lack of ICBMs, as well as American successes in the Berlin Airlift. Also, the Soviet economy was being stretched, and military leaders were unhappy with Khrushchev's decision to cut the size of the Red Army. Placing missiles in Cuba was a cheap and quick way for him to secure his political base.

2. Because of the failure of the Bay of Pigs invasion, Republicans in the Congress made Cuban policy into a major issue for the upcoming congressional elections later in 1962. Therefore, Kennedy immediately decided on a strong response rather than a diplomatic one. Although a majority of EXCOMM initially favored air strikes, those closest to the president - such as his brother and Attorney General, Robert Kennedy, and special counsel Theodore Sorensen - favored the blockade. At the same time, Kennedy got into arguments with proponents of the air strikes, such as Air Force General Curtis LeMay. After the Bay of Pigs fiasco, Kennedy also distrusted the CIA and its advice. This combination of push and pull led to the implication of a blockade.
3. With his plans thwarted, Khrushchev tried to save face by pointing to American missiles in Turkey, a position similar to the Cuban missiles. While Kennedy refused to move these missiles "under duress," he allowed Robert Kennedy to reach a deal with Soviet ambassador Anatoly Dobrynin, in which the Turkish missiles (which Kennedy ordered removed prior to the crisis) would be quietly removed several months later. Publicly, Kennedy also agreed never to invade Cuba.

Implications

When the book was first published, Allison's primary message was that the concept of mutually assured destruction as a barrier to nuclear war was unfounded. By looking at organizational and political models, such an outcome was quite possible - nations, against what was predicted by the rational viewpoint, could indeed "commit suicide."

He pointed to several incidents in history that seemed to back this assertion. His most salient point: prior to the attack at Pearl Harbor, Japanese military and civilian leaders, including those responsible for making the decision, were fully aware that they lacked the industrial capacity and military might to win a war against the U.S. They went ahead and attacked anyway.

He also believed that the organizational model explained otherwise inexplicable gaffes in military history. To return to 1941, he noted that the U.S. intercepted enough evidence to indicate that Japan was about to attack Pearl Harbor, yet the commander did not prepare. The answer, Allison revealed, was not some conspiracy, but that what the intelligence community viewed as a "threat of attack," the commander interpreted as a "threat of sabotage." This miscommunication, due to different viewpoints, allowed the attack to be pulled off successfully - as Allison sarcastically noted, having U.S. planes lined up wing-to-wing and surrounded by armed guards was a good plan for preventing sabotage, but not for surviving an aerial attack.

Likewise, the political process model explained otherwise confusing affairs. Allison pointed to the decision by General Douglas MacArthur to defy his orders during the Korean War and march too far north. The reason was not a "rational" change in U.S. intentions, but rather, MacArthur's disagreements with Harry Truman and other policymakers, and how officials allowed MacArthur to make what they considered unwise moves because of concerns over political backlash due to the general's public popularity.

Above all, he described using rational actor models as dangerous. By using such models (and modes of thinking), people made unreliable assumptions about reality, which could have disastrous consequences. Part of what allowed the attack on Pearl Harbor to be pulled off was the *assumption* that, since Japan would lose such a war, they would never dare attack. The *assumption* under MAD is that nobody will ever start a nuclear war because of its consequences. However, humans are not inextricably bound to act in a rational manner, which history has proven time and time again.

While Allison did not claim that any of his additional two models could fully explain anything, he noted that policymakers and analysts alike would benefit from stepping away from the traditional model and exploring alternate viewpoints (although this last remark could be viewed as facetious on Allison's part).

Difference between: Classical Economics & Institutional Economics.

KORTEN (1984) – Developed the concept of STRATEGIC ORGANIZATION.

Traditional models of organization are not well-suited for the future and STRATEGIC MANAGEMENT represents a positive alternative, one that carries with it a "proactive commitment to the ideal that the purpose of organization is to serve the needs of people, while facilitating the human growth of all participants.

MOE (1987) – *Exploring the Limits of Privatization.*

- Need for mutual coexistence and links between public and private sectors.
- Moe views limits to privatization from a legal context (vs. economic or managerial)
- PA should be based on a legal foundation and the concept of sovereignty.

HISTORY OF FINANCIAL MANAGEMENT REFORMS: See Jones, R.L. and McCaffrey 1999 – "Financial Management Reform in the Federal Government" In Roy T. Meyers ed. (1999) *Handbook of Government Budgeting*. San Francisco, Jossey-Bass Inc. Publishers, 53-81.j

- The DOCKERY ACT OF 1894 – Established and strengthened centralized accounting function, creating a single comptroller in the Treasury Dept.
- BUDGET AND ACCOUNTING ACT OF 1921 – Created a centralized executive budget, requiring the president to submit unified budget annually to Congress. The effect was to separate budgeting, accounting and auditing and establish an independent auditing arm of Congress.
- The ECONOMY ACT OF 1932 – Installed accounting systems, forms and procedures.
- The REORGANIZATON ACT OF 1939 – Moved BOB from Treasury to the Executive Office of the President (EOP) to assist in the preparation and execution of the budget. BOB changed to OMB.

- BUDGET AND ACCOUNTING PROCEDURES ACT OF 1950 – Established mandate for an adequate system of accounting and internal controls on head of each executive agency. Amended in 1956 after 2nd Hoover Commission – called for cost-based budgeting for federal govt.
- BUDGET AND IMPOUNDMENT ACT OF 1974 – Moved federal fiscal year to begin October 1, created the CBO, added budget committees to both houses.
- INSPECTOR GENERAL ACT OF 1978 – Established IG offices in departments and federal agencies. In charge of conducting audits and investigations of executive offices and major independent agencies.
- DEBT COLLECTION ACT OF 1982 - strengthened fed govt's ability to collect monies owed it. Prompt Payment Act required fed govt to pay bills within 30 days.

AUDITS, IG ACTIONS AND INCREASED REPORTING ADDRESSED WEAKNESSES IN FEDERAL SYSTEMS. HOWEVER, DEPARTMENTS FAILED TO TAKE CORRECTIVE ACTIONS AND SCANDALS CONTINUED.

- CHIEF FINANCIAL OFFICERS ACT OF 1990 – Intended to bring the budget and accounting functions together and to centralize financial management functions at dept and agency levels with a CFO. OFFM – Office of Federal Financial Management was created to assist with CFO task.
- GOVERNMENT PERFORMANCE RESULTS ACT (GPRA) 1993 – A product of Gore's NATIONAL PERFORMANCE REVIEW. Idea came from OSBORNE & GAEBLER's 1992 REINVENTING GOVERNMENT. Called for agency STRATEGIC PLANNING and FOCUSED ON RELATIONSHIPS BETWEEN MISSION AND OUTCOMES.

PORTER – 5 Forces

MAZLOW - Hierarchy

DRUCKER – MBO

Friedrich Hayek – ("Old Econ=Keynsian, New Econ=Hayek – Will Be On Comps)

The economic calculation problem

Hayek was one of the leading academic critics of collectivism in the 20th century. Hayek believed that all forms of collectivism (even those theoretically based on voluntary cooperation) could only be maintained by a central authority of some kind. In his popular book, *The Road to Serfdom* (1944) and in subsequent works, Hayek claimed that socialism required central economic planning and that such planning in turn had a risk of leading towards totalitarianism, because the central authority would have to be endowed with powers that would have an impact on social life as well, and because the knowledge required for central planning is inherently decentralized.

Building on the earlier work of Mises and others, Hayek also argued that while, in centrally planned economies, an individual or a select group of individuals must determine the distribution of resources, these planners will never have enough information to carry out this allocation reliably. The efficient exchange and use of resources, Hayek claimed, can be maintained only through the price mechanism in free markets (see economic calculation problem). In *The Use of Knowledge in Society* (1945), Hayek argued that the price mechanism serves to share and synchronize local and personal knowledge, allowing society's members to achieve diverse, complicated ends through a principle of spontaneous self-organization. He used the term catallaxy to describe a "self-organizing system of voluntary co-operation."

In Hayek's view, the central role of the state should be to maintain the rule of law, with as little arbitrary intervention as possible.

Spontaneous order

Hayek viewed the free price system, not as a conscious invention (that which is intentionally designed by man), but as spontaneous order, or what is referred to as "that which is the result of human action but not of human design". Thus, Hayek put the *price mechanism* on the same level as, for example, language. Such thinking led him to speculate on how the human brain could accommodate this evolved behavior. In *The Sensory Order* (1952), he proposed, independently of Donald Hebb, the connectionist hypothesis that forms the basis of the technology of neural networks and of much of modern neurophysiology.

Hayek attributed the birth of civilization to private property in his book *The Fatal Conceit* (1988). He explained that price signals are the only means of enabling each economic decision maker to communicate tacit knowledge or dispersed knowledge to each other, in order to solve the economic calculation problem.

Investment and choice

Perhaps more fully than any other economist, Hayek investigated the choice theory of investment involving the inter-relations between non-permanent production goods and "latent" or potentially economic permanent resources, building on the choice theoretical insight that, "processes that take more time will evidently not be adopted unless they yield a greater return than those that take less time." Hayek's work on the microeconomics of the choice theoretics of investment, non-permanent goods, potential permanent resources, and economically adapted permanent resources mark a central dividing point between Hayek's work on central planning, trade cycle theory, the division of knowledge, and entrepreneurial adaptation and that of most all other economists, most especially that of the macroeconomic "Marshallian" economists in the tradition of John Maynard Keynes and the microeconomic "Walrasian" economists in the tradition of Abba Lerner.

The business cycle

Capital, money, and the business cycle are prominent topics in Hayek's early contributions to economics. Mises had earlier explained monetary and banking theory in his *Theory of Money and Credit* (1912), applying the marginal utility principle to the value of money and then proposing a new theory of industrial fluctuations based on the concepts of the British Currency School and the ideas of the Swedish economist Knut Wicksell. Hayek used this body of work as a starting point for his own interpretation of the business cycle, which defended what later became known as the "Austrian Theory of the Business Cycle". In his *Prices and Production* (1931) and *The Pure Theory of Capital* (1941), he explained the origin of the business cycle in terms of central bank credit expansion and its transmission over time in terms of capital misallocation caused by artificially low interest rates.

Social and political philosophy

In the latter half of his career Hayek made a number of contributions to social and political philosophy, which he based on his views on the limits of human knowledge, and the idea of *spontaneous order* in social institutions. He argues in favor of a society organized around a market order, in which the apparatus of state is employed almost (though not entirely) exclusively to enforce the legal order (consisting of abstract rules, and not particular commands) necessary for a market of free individuals to function. These ideas were informed by a moral philosophy derived from epistemological concerns regarding the inherent limits of human knowledge.

In his philosophy of science, which has much in common with that of his good friend Karl Popper, Hayek was highly critical of what he termed *scientism*: a false understanding of the methods of science that has been mistakenly forced upon the social sciences, but that is contrary to the practices of genuine science. Usually scientism involves combining the philosophers' ancient demand for demonstrative justification with the associationists' false view that all scientific explanations are simple two-variable linear relationships. Hayek points out that much of science involves the explanation of complex multi-variable and non-linear phenomena, and that the social science of economics and undesigned order compares favorably with such complex sciences as Darwinian biology. These ideas were developed in *The Counter-Revolution of Science: Studies in the Abuse of Reason*, 1952 and in some of Hayek's later essays in the philosophy of science such as "Degrees of Explanation" and "The Theory of Complex Phenomena".

2.7 Important Comps Questions and Student Answers

Administrative Management

What are the major approaches to measuring service quality? How applicable are they to the case of public agencies?

There are a number of approaches to measure service quality and many are appropriate for public organizations. While there are great similarities between public and private organizations, there are several methods to measure service quality used by the private sector that are clearly not compatible with public organizations.

"Early work on municipal service quality assessment recommended multiple measures of performance from both providers and users. Citizen satisfaction surveys have rivaled their more quantitative counterpart, administrative performance measures, in adoption, but the implication of survey results for action is not well understood by managers or scholars. To achieve meaningful integrated multiple measures of service quality, we need to explore the dimensions of citizen satisfaction and review patterns of satisfaction across localities. We also need to understand the relationship between administrative performance measures and citizen perceptions. This cross sectional analysis of municipal citizen satisfaction and performance benchmark data suggests that citizen satisfaction survey results are useful to managers in conjunction with performance-measurement programs as part of a multiple-indicator approach to evaluating municipal service quality. However, understanding citizen perceptions requires a different perspective than that applied to administrative service performance measurement."

(Kelly, J.M., Swindell, D. (2002). A multiple-indicator approach to municipal service evaluation: correlating performance measurement and citizen satisfaction across jurisdictions. *Public Administration Review*, 62, 5, 610-621.)

Other approaches to measuring service quality are:

- Customer Interaction – works for the public sector
- Self Assessments – works for the public sector
- Mystery Shopping (now here's an idea for a public service!)

- Organizational Report Cards

  Fred David (p.317-320) introduces us to a number of useful methods to measure service/performance. For example, comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives. These are viable measures for private and public agencies. Other procedures commonly used for measuring service quality include: 1) comparing the agency's performance over different time periods, 2) comparing the agency's performance to competitors' (this seems particularly useful with contracting out or privatization, that is, government comparing their performance with a private entity), 3) comparing the agency's performance to industry averages. These are all good measures and can be analyzed with both quantitative and qualitative methods.

Robert K. Yin reminds us that the case study method is best used when seeking the "how" or "why" questions asked about a contemporary set of events, over which the investigator has little or no control. Actually, Yin recommends the use of the dual approaches of case study and survey methods. Therefore, the case study is a superlative method of measuring service quality. Yin (p.8) relates that one particular method, the randomized field trial, was designed for evaluation research and is commonly used. While this method works well for both public and private organizations, Yin points out that randomized field trials do not work well in a number of situations.

A related article that is excellent for this and other public administration topics to describe the differences between public and private organizations is:

Rainey, H.G., Backoff, R. W., Levine, C.H. (1976). Comparing public and private oganziations. *Public administration Review*, March/April, 233-244.

Of importance, is page 240, section III, 3. Performance Characteristics. This short section discusses the observations of Dahl, Lindblom, Golembieski, and Downs concerning the performance of government organizations and administrators, usually in comparison to business.

Performance assessment is often implemented as a series of specific performance measures associated with certain service functions or as indicators of progress toward a mission, as in the case of service efforts and accomplishments. These may be thought of as internal measures of service quality because they come from a definition of effectiveness derived and monitors by administrators. In contrast, external measures of service effectiveness come from citizens, usually through satisfaction surveys. Results from these kinds of measures are problematic for administrators because it is unclear what criteria the citizens are using to evaluate effectiveness. Also questionable is how much accurate information citizens have on which to base their evaluations.

Administrative performance measures are widely accepted as reliable indicators of service quality though there is considerable variation in the types of measures employed and how local governments use them. There is not so much consensus on the utility of citizen satisfaction surveys as a reliable indictor of government performance, which makes this topic a bit more interesting.

Describe no less than five (5) approaches/definitions/models of strategic planning and highlight their possible advantages and limitations in general and when applied to the public sector.

Mintzberg, Henry and Quinn, James Bryan *Readings in the Strategy Process*

1. The Entrepreneurial Organization---p. 244 (Mintzberg)

    * simple structure
    * one flamboyant leader
    * little staff
    * the leader creates the strategy and can adapt it as he/she deems necessary

2. The Machine Organization---p. 265 (Mintzberg)

* more complex structure

* routine work (i.e., the postal service)

* highly standardized work processes

* very regulated, bureaucratic structure

3. The Professional Organization---p. 288 (Mintzberg)

* complex work (i.e., a university; a hospital)

* work must be carried out by professionals

* but stability is important

* standard operating procedures are used

4. The Innovative Organization---p. 309 (Mintzberg)

* must be capable of sophisticated innovation (i.e., a research firm)

* adhocracies---matrix organizations (move people around a lot)

* highly organic structure

* flexibility is the key

* experts are grouped in functional units and then deployed to teams as needed

5. The Diversified Organization---p. 335 (Mintzberg)

* the most complex structure

* a set of semi-autonomous units called divisions

* very common in the private sector

* each unit is relatively free form headquarters control

The Model Approach --- the structure is most important

Chafee, Ellen Earle presents three models of strategy:

* Linear---rational, logical / closed system
* Adaptive---monitor the environment / open system
* Interpretive---social contracts based on free will / open system

Dutton, Jane

Categorization theory---merely labeling an event as an opportunity or a threat affects

information processing and motivation

Ginter, Robert

Social learning theory---behavior results from interactions of persons and Situations

Hart, Stuart

Integrative framework---focuses on integrating the 5 roles played by top managers: command, symbolic, rational, transactive, and generative

The Process Approach---the process is most important

Mintzberg, David----strategic thinking (synthesis, creativity, intuition) is as important as strategic planning. We need both. Mintzberg notes 3 fallacies of planning: prediction, detachment, and formalization.

Comps Question from Syracuse University:

Pine Mountain State University

On the basis of your readings and class discussions offer an analysis of the following case and assess the President's approach for dealing with the unfolding situation.

The administrative staff at Pine Mountain State developed a comprehensive reorganization plan to combat specific issues of concern to the President of the university. However, it is evident that there was no formal systematic approach to the analysis or their strategy formulation. In addition, they neglected to include the major stakeholders in the strategy planning and development process. This may explain why the legislature, trustees, faculty and students are complaining about severe problems that did not exist prior to the reorganization.

It can be argued that strategy follows structure in the typical public university scenario. Since federal and state funding for public universities comes with requirements, the underlying structure of a public university tends to follow a relatively standard organizational model that serves the requirements dictated in part by the funding authorities. In the case of Pine Mountain State, it appears that the administration's top levels agreed upon a new strategy, and then designed a structure around these objectives. Instead of keeping the initial structure, which successfully fueled the growth of the university for the last 30 years, the administration chose to abandon it to focus mainly on external threats from the environment.

As we know from the SWOT Matrix, there are more than just external threats to be analyzed in formulating strategy. The reading says that "after extensive study, the top administrative staff of Pine Mountain developed a comprehensive reorganization plan…" However, we are not told what type of analysis was employed, or if any consideration was given to the university's strengths, weaknesses or opportunities. By focusing only on external threats, the administration is risking the loss of the synergies and efficiencies enjoyed by various existing internal organizational components.

We see from the case reading that the strategy adopted by the administration resulted in several detrimental effects to the university (as witnessed by a freeze in additional funding allocations from the legislature based on criticism of the new "heavy admin" structure, and complaints from trustees, students and faculty concerning deteriorating service levels university-wide). These problems may have arisen because of the manner in which the reorganization was planned and managed. A comprehensive reorganization is bound to have a disruptive effect on operations throughout the university, as well as having detrimental effects on everyone in the organization. However, these detrimental effects can be buffered by proper planning that involves all interested parties.

The case noted that "the role of most of the units was redefined". If the roles were redefined specifically to address the external threats and no attempt was made to keep successful structures in place, then problems will naturally arise as a result of poor planning. Role ambiguity, combined with unexpected changes in departmental processes may explain some of the service complaints reported by students and faculty. New and unexpected reporting relationships can also cause stress and reduce the positive effects of a reorganization plan.

Stakeholders

The main criticism of the President's approach for dealing with the unfolding situation is that he did not include the major stakeholders in the reorganization planning process.

It is evident that the top administration was only thinking of themselves and the problems that they face on a day-to-day basis, rather than adopting a university-wide vision for the reorganization.

The legislature and trustees would have informed the administration that there is too much spending in the administrative category, and that the proposed structure is not appropriate and not in line with the structures of other similar institutions. The faculty would have lobbied to reduce the levels of administration, thus ensuring that access to the President and administration is not too problematic. Students and faculty would have argued against the administration's plans to cut funding for new professors and parking in favor of enhancing the funding at the top administrative levels.

Organizational Development Committee

The committee was established to monitor and receive feedback on the implementation of the new structure. The committee was formed at the time of reorganization but has only met three times in the past 18 months. It appears that this committee was the "window dressing" for the reorganization effort. It sounds like an effective piece of the new structure, but will have no effect unless the committee is run with a standard set of rules and expectations. This would include a regular meeting schedule and enforced reporting requirements for the committee (monthly, quarterly, etc.).

Vision/Mission Statements

The objectives which fed-into the creation of the Pine Mountain reorganization plan were simply the issues currently being faced by the top administrative level of the organization. In a "true" reorganization plan, there ideally will be a refinement or reworking of the organization's vision and mission statements. This drives the rest of the process, as structure and strategy tie directly into the mission of the organization. In the case of Pine Mountain State, the mission being pursued is simply that of the top administration, neglecting the mission of the overall university and the other parts of the organization.

Finance, Accounting and Technology

Since the reorganization was aimed at addressing the problems of declining allocations, improving financial responsibility and accountability, and improving internal operations of the university, the administration should have started by instituting a new accounting/budgeting system. Since the state in which Pine Mountain State resides is also being affected severely by an on-going national recession, this is another reason for instituting a new university-wide accounting and budgeting system. The President should be focusing on running the organization in a more "lean" manner than that evidenced by the latest university organization chart, which is heavy in the administrative layers ("Pine Mountain State spends for administration twice the amount spent by the other major state university and four times the amount spent by a teacher's college"). The case for adoption of a new accounting system is strengthened by the fact that the reorganization plan established several new units and redefined the roles of most other units. With the adoption of a new accounting/budgeting system, people can more easily manage the transitions to new budgeting and reporting relationships. New technology can also make restructuring and reform efforts more bearable for all by buffering the disruptive effects with the positives associated with improved information resources.

Conclusion

Pine Mountain State University used no formal systematic approach to analyze their organization's current problems or their strategy formulation. The administration neglected to include the major stakeholders in the strategy planning and development process. There was no attempt to develop new vision/mission statements to accompany the reorganization effort, and with the backdrop of severe financial pressures, the administration should have started the reorganization process by instituting a new accounting/budgeting system. This case is a perfect example of what can happen when organizations undertake reorganization efforts without performing the necessary work involved to ensure the success of the efforts. By short-changing the strategy formulation process, they ended up short-changing the organization, all of its stakeholders and its future prospects for success.