

**INSTITUTE FOR DEFENSE ANALYSIS
DEFENSE ECONOMICS CONFERENCE - 2/14/02
TAPE NO. 1 - DR. DAVID CHU**

DEFENSE AGENCIES: PUBLIC PROVISIONS OF COMMERCIAL
GOODS AND SERVICES

INTRODUCTION

I'm very pleased to be able to address this particular subject, not only for the reasons Dave McNicol outlined, which derive from having been a critic.

Now I'm an owner of defense agencies. Of course, I believe all of ours in P&R are well run and brilliantly managed and should be held up as an example to the rest of you!

I see many representatives here from defense agencies this morning. As many of you know, the term defense agency has almost become an epithet within the Department of Defense. It is the source of the generalized suggestion, whenever budget reductions or budget offsets need to be discussed, that somehow there is a large pot of efficiencies available in the defense agency world. That if we were only a little bit more clever or perhaps a little bit more ruthless, we'd be able to secure resources in order to finance higher priorities.

Therefore, I want to congratulate Dr. McNicol for having arranged to have this 17th conference on Valentine's Day. Because I think it's the only time that defense agencies can hope to receive something other than brickbats from their colleagues in the department!

WHY ARE DEFENSE AGENCIES IMPORTANT?

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I think it's useful to start with the question of why it's important to talk about the defense agencies. Dave McNicol has outlined one reason, the need for the department to be more attentive to the business functions for which it is responsible. But I think that there is a quite elementary second reason we need to be interested. As all of you know, the defense agencies as a collectivity now account for about one-quarter of the defense budget. As a collection, they are in bureaucratic size and budgetary scope equal to one of the military departments. And so they can no longer be seen as a minor appendage of the Department of Defense, a small part of the portfolio. They are now a significant part of what the Defense Department undertakes. Or more accurately, they, as an organization or several organizations, represent a significant part of the business of defense.

The third reason I think they're important is if you look at the responsibilities that they have, they are the designated producers of a number of the key products of our cabinet department. Those range, as you know well, all the way from the straight-forward, such as the provision of commissary services to our troops, through the provision of health care as Dave McNicol has noted, to such functions as the provision of intelligence, not only to the Department of Defense, but to all agencies, U.S. government, and the President of the United States.

I'd like to come back to that thought as I outline how I think we might approach the substance that you're going to debate in this conference.

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WHAT IS A COMMERCIAL SERVICE?

First, however, I'd like to beg your indulgence and digress briefly to talk about the material after the colon in the title or theme of this conference. And that material, of course, is provision of commercial services. And I think I would like to challenge all of us to consider what indeed is a commercial service? And how does the government across the board - not just the Department of Defense - intertwine with the provision of these services in our economy at large?

Because, of course, as we can all immediately conclude, some of the largest commercial or commercial-like services in the portfolio of the United States government are provided outside the Department of Defense. Perhaps the best single example of that is the post office. Indeed, the post office, I think, illustrates one of the difficulties in deciding what a commercial service is in the first place. If you look back 100 years or so, there's no doubt that postal services were considered a governmental function (although the pony express is a bit of an early counter example to that generalization; indeed, the telegraph as a substitute product is another early alternative to the services for which the United States government had made itself responsible).

As we come down to the present day and you look at the important role that entities like United Parcel Service and FedEx play, to say nothing of the inroads that e-mail is making on what would normally be viewed as a government service, the delivery of mail, you can see,

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I think, how our definition of what is a commercial service has evolved over time. There are voices, as many of you know, in the debate over what to do with the postal system, raising the question of whether we ought to privatize this more significantly than we have already done.

Within the Department of Defense, one of the interesting historical developments you can look at in this regard is the evolution of the arsenal system. Perhaps back in the 18th century it was appropriate for the United States government to be the producer of cannons as we did and still do at Watervliet Arsenal in upstate New York. And in fact, over the decades, the United States government built a number of facilities, including importantly naval shipyards, as the places where weapon systems were produced because there wasn't a commercial market for these items. That situation changed significantly during the Second World War when, as we all know, commercial manufacturers were invited to produce military articles, if only because of the necessity of turning out a volume that was far larger than any government plant could sustain. And the country never went back after the Second World War. Still, it has taken the better part of 50 years to close the last of the government manufacturing plants. And we do still have Watervliet Arsenal as a portion of our portfolio! You can read with great amusement the arguments of its supporters as to why that continues to be something the United States government should undertake.

More important, of course, in the current debate is whether we should continue to maintain our own repair facilities. This is the whole

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issue of what the depots should be or whether we should have government depots at all, that is, government logistics agencies.

I'd also like to emphasize that some of the services produced by the defense agencies are, at least for the moment, still viewed as non-commercial in character. An example of that, of course, is the intelligence product. Even there, I think if we look across the Atlantic to the activities of Her Majesty's government, as Ellen Pint has done, we could start asking some questions about whether some of those services could be or should be considered commercial or eligible for commercialization.

As some of you here are aware, Her Majesty's government took a very different approach to the renovation of its headquarters than we took in the Pentagon renovation. Whitehall was sold to a private developer on a lease back basis with the idea obviously of largely evading the capital constraints, but also with the hope of producing a somewhat better product than might otherwise be the case.

Her Majesty's government is exploring questions of whether tanking services - that's air refueling services - could be supplied by a private producer. The Parliament has given the government authority to confer on the personnel involved in producing that service some kind of military status in time of war, to deal with the questions of control, and status as a combatant. Using these powers, the British Minister of Defense has already undertaken some commercialization of military services in more mundane fields such as trucking.

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HOW DID WE GET TO WHERE WE ARE TODAY?

To return to our main subject, as we think about the substance of this conference, I believe it's useful to ask ourselves how we got the set of defense agencies and defense-agency-like enterprises that we have today. Many here are much more competent in that history than I am. But I am struck by the degree to which it is not solely a function of the McNamara revolution in the department, which was my original assumption. In fact, if you look at the history of department agencies, I believe you can go back to the Eisenhower Administration and a concern by the then president and his lieutenants about duplication of services, particularly in the communications area, leading to a desire to put several things together in one place.

I think that is a consistent theme over the decades regarding the creation of defense agencies. Certainly that theme was present in the first Bush administration; Don Shykoff here was a leading exponent of that perspective, that we could gain some efficiencies and eliminate duplication by consolidating activities in a single place. That's certainly a worthwhile objective. The department is always interested in ways to save money. The budget constraint is always there however large the budget might be.

But I do think it's useful to ask if there's anything wrong with this picture. In thinking about these agencies, should we emphasize as much as we have historically the importance of efficiency as a guidepost? I would argue, and that's my main contention here this

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morning, that it would be at least equally useful, indeed perhaps more useful, to take a leaf from the Government Performance and Results Act, and emphasize that our ultimate interest here is in the outcomes we produce, the results that these organizations achieve, not the inputs that they consume. I don't want in any way to minimize the importance of being efficient, but I do think that a focus on outputs as opposed to input, and a focus on benefits, not just on costs, would be a very constructive way to think about these organizations going forward. I'll come back to that point in just a moment.

OUR ASSUMPTIONS ABOUT COSTS

I would like to digress a second time, if I may very briefly, on the cost issue. The classic concern with these enterprises as to whether they're efficient or not remain the concern of many in the department, and the source of the brickbats that are hurled in their direction. In my judgment, there are a series of implicit assumptions that we make about the cost of these enterprises that, at least as we apply our organizational templates, we ought to keep in mind and test whether or not these assumptions truly are applicable.

First, and often the factor driving those who would like to eliminate duplication in the department, or in any activity of the federal government, is the assumption that economies of scale are available. If I put things together, I can have back-office savings. It will be possible to run the bigger organization for far fewer resources than the sum of smaller organizations.

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That may often be true.

Of course, the economists will remind us that there can just as easily be diseconomies of scale. And indeed, if you look at the literature on where new ideas come from, the standard view is they don't come from large centralized organizations, but that they come from the classic entrepreneur in his or her garage. They come from small organizations. Smaller organizations are nimbler, more agile, are more easily able to respond to the changes of the time.

For the Department of Defense, given its large size and given its scale of its operations, one of the interesting questions is whether consolidating things doesn't bring a very serious price in terms of how quickly we can respond. That certainly is one of the concerns of the present Secretary of Defense. His constant lament is the department is too ponderous. It takes us too long to decide to come to grips with an issue, to act in a way that is effective in the military sphere.

A second assumption worth reviewing when one deals with the cost or input side of the defense agency or public agency equation is the belief that some kind of price can be put on the various resources consumed that is indicative of their scarcity, their value. In particular, there is the further corollary assumption that that price is in some way closely related to actual market values and therefore serves as a good guidepost to our decisions.

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A wonderful test, a nice case study of whether we can do this, resides right there on Waikiki with the lovely resort facility that the Army maintains for the uniformed and civil personnel of the military. What's the value of the land underneath that facility? Well, if it's truly a market in land and I could sell that piece of property, probably a billion dollars. Would that be the best use of the department's resources if I in fact could cash it in for a billion dollars? Perhaps even the operators of the facility would acknowledge that maybe you ought to sell it. Whether you use it to buy a Crusader or not is another issue, but the Army might well be tempted to cash the property in if that were indeed feasible.

However, is it possible to sell it and retain the money so gained for the Department of Defense? In fact, as many people know in this conference, the city of Honolulu has long made clear that should the Department of Defense ever, ever think about closing the facility, Fort DeRussy would become one of the most important park development opportunities in the state of Hawaii. And that it will move aggressively to realize same.

That's an easy example. But there are other examples where it's not always clear what the right price is to mark the resources that we're going to put into our cost efficiency calculations. I'm reminded in that regard of what Richard Ruggles liked to do in teaching his basic national income accounts class.

Ruggles, as many of you know, was the grand old man of national income accounts design, post World War II. He liked to get up in

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front of the class at the start of the semester and rattle a bottle of aspirin. He'd say, "Okay, what's the price of the aspirin in this bottle? If I buy it at Safeway, I can get 100 aspirin for a dollar. If I put Bayer on the front, recommended by 9 out of 10 doctors, it costs me three bucks. Ladies and gentlemen, what's the price of these aspirin?" That problem affects more of our calculations here in defense than we would like to admit.

The third assumption that bears some debate each time we try to look at cost or efficiency issues, whether in the defense agency context or other business activities of the Department of Defense, is that our organizational arrangements, particularly the pricing structures that we adopt will be neutral in their incentive effects. Indeed, the proponents of any particular move typically make the even stronger assumption that the incentive effects associated with the prices we select will be positive, helpful relative to the goals that we have in mind for that particular agency.

The core assumption is that we understand in advance what the incentive effects of our pricing decisions will be. I'll tell a little story on myself that illustrates the actual incentive effects may turn out to be somewhat different from those that you contemplate, however well intentioned and however shrewd--if not brilliant!--you think your decision is.

In the early 1980s, as some of you recall, we had a constant problem each year with what was then the Defense Mapping Agency, now part of NIMA. It would come in every program review period and lament the

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many new requirements that had been placed on it by the other elements of the department, for mapping services, with the result that, of course, it could not live within the fiscal guidance. These were always compelling requirements. You wouldn't want the B-2 to be without its necessary maps, et cetera. So we'd always weep a little bit, but ultimately we'd dig into our pocket and find some way to finance the mapping.

One of Mr. Major's staff came up with the idea that maybe we should say, as a regulatory matter, programs should pay for their maps. It was seen as a little too dramatic just to say they had to pay. So it was decided they had to pay if they were presenting a "unique" mapping requirement to DMA. We were pleased the next couple of cycles: DMA didn't come in asking for a lot of extra money.

I finally did ask someone, "what is actually happening?" out there. I had this vision everyone was converging on a single set of standards. They were using the same map. No. We had a Noah's ark result: There were a lot of two-user map solutions, because then you were no longer "unique"! This little story illustrates that it is critical to think carefully about the language that's used in writing regulations.

A more recent example of that problem occurred as Mr. Shykoff tried to bring the department to a strategy in which people paid for their major repair parts. The price of these repair parts, of course, is a critical part of that strategy. As people here know well, while there were some important savings achieved by that decision, one of

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the unintended consequences has been that various entities in the department have started their own parts repair services.

This is not surprising, of course, because the pricing decisions about what you get when you turn in a part, or what you pay when you buy a new one, are not always carefully tuned to the actual behaviors that are incentivized by the pricing structure adopted. So while at a global level we have made some progress with this notion, at the local level it's not at all clear that we've got quite the result that we would like to have.

Indeed, the difficulties created by incentives go beyond the obvious Soviet central planning examples that these stories illustrate. You know that example: If you emphasize the weight of nails as the output of the nail factory, you'll get a lot of large heavy nails. If you emphasize the number of nails produced, you get a larger number of tacks. The problem is the person trying to buy a nail in the marketplace doesn't get what he or she would really like to have.

The further problem that arises is the opportunity for misuse. Much as I believed at the time that the notion of working capital funds was a perfect idea, one of the unfortunate things that occurred over the years is their misuse to solve other financial problems. So other kinds of expenditures the department could not get funded, or the proponent could not get financed in the normal way, were loaded into the prices that were charged in the working capital fund.

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So, for example, in the '90s, because of the department's unwillingness to fight with the Congress over financing for U.S. activities in the Balkans, costs associated with the Balkans were loaded into the working capital funds, yielding an incentive to evade using the usual Department of Defense supplier.

WE NEED A RESULTS-ORIENTED APPROACH

That all said, what might be the implications of taking the alternative focus that I would recommend? That alternative focus, as I suggested earlier, is that our primary interest ought to be on the results, on the outcomes, that we produce with these organizations, or the products they produce, not simply on whether we think it is going to be slightly more efficient to do it through these organizations.

If one takes that perspective, I think it's useful to remind ourselves that many of the "commercial products", whatever that term may be defined to include, are actually produced not by the defense agency group, but by the military departments.

Indeed, I think that's an interesting question of semantics in and of itself. The phrase "defense agency" is uttered with pejorative quality in the Department of Defense, whereas the term "military department" is seen as a subject worthy of praise.

Why is that? They're both agencies. They're both organizations. Why do we have this difference? They both produce various goods and

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services. One set's much older than the other. But it's not clear to me that there ought to be this pejorative distinction between the two.

Indeed, some of the most important commercial-like services in the Department of Defense are produced by the military departments. The example that I would offer is the training or educational establishment that we run.

Dr. McNicol mentioned the Department of Defense Educational Activity. It's actually the smallest educational activity in the Department of Defense, compared to the entry and advanced training establishments that the military services run. Her Majesty's government is already privatizing the war college effectively. How much of this service really ought to be produced inside the government, and how much might usefully be produced by agents outside of the government's limits?

If we take a product or results focus for our guiding principle in this debate, I do think we immediately get to questions that involve provision of services by more than the defense agencies. As you debate the issues of the conference, I urge that we widen the field. In terms of the business issues that Dr. McNicol is challenging us to confront, we should not restrict our scope to the defense agencies, but include the military departments in our ambit.

Second, if we take this product- or results-oriented perspective, I believe that we are much more likely to see competition as a valuable

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tool in producing the kinds of results that we want--certainly in terms of product quality, perhaps also in terms of cost.

Let me take intelligence as my case in point. The creation of the so-called Central Intelligence Agency was supposed to supplant the allegedly duplicative intelligence services of the individual military departments and other elements of the federal government.

Is it useful to have all intelligence come through a single central intelligence agency?

One product of the intelligence community is the so-called national intelligence estimate. The most useful element of that product, in my judgment, is the set of footnotes that indicate where there has been a quarrel among the various intelligence agencies as to what the proper conclusion ought to be. That tells a lot more about what's really going on and how you might weigh the distribution of potential results that you could reach from the evidence at hand, giving a hint of the richness beyond the point estimate that it is bureaucratically convenient for a centralized agency to reach as its consensus conclusion.

In other words, perhaps the most important thing we can do to improve the quality of American intelligence is to think about competitive sources. That might include competitive sources outside the federal government, including the academic establishment as well as other potential players. Businesses, for example, maintain important

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intelligence operations. They may not call it that, but they often have insights into what's going on around the world.

The third result of taking a product-oriented approach is that we could more usefully and more promptly adjust our definitions over time as to what is a commercial service. What's a commercial service that we could consider securing from other than an in-house source?

Let me point to a very interesting problem we have right now in terms of United States public policy, and that is airport security. We have gone through a fascinating evolution in which we have decided we lack confidence in the private sector's provision of this service to a decision that it should be a federal force. And then we've had a fascinating development, in which many have argued that the federal government should hire some of the people now conducting those security checks! What exactly was the problem that federalization was supposed to solve?

As you move towards the new standard of inspecting luggage, there is the question who is most competent to do this? Do we want a single technical solution? Do we want to encourage some degree of competition in terms of how we might provide this particular service? As you think about the underlying question here, which is what should the government do versus what should non-government entities do, the best answer may turn out to be a mixed solution. One size does not fit all--it's not either/or.

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I am fascinated by the kinds of results that are being produced by the various public/private partnerships, in the housing arena. We offer the land for long-term lease. The contractor builds a set of houses and, in some fashion, we "guarantee" that there will be renters for the houses.

The incentives we select may be important to what kind of result we get. At Fort Carson specifically, one of the interesting decisions is that we haven't quite guaranteed that there will be anybody in those houses. We've guaranteed that the developer can rent them to military personnel, but they must be willing to rent them to others if there are not enough military personnel to fill them up.

That has already produced a fascinating set of incentives for the developer, replacing the usual sort of military view that "here's your house." Take it--you're going to love it whether you like it or not. The developer has a very strong interest in making this an attractive community for military people to rent the houses on a long-term basis. It's in his interest to make this a premiere place to live in the greater Colorado Springs area.

That, of course, in turn triggers various amusing legal problems with the Department of Defense. For example, in the local marketplace, it is the style to present a small gift to the renter, a fruit basket or something like that, when the family moves in. Under the government rules under which we must live, that's a gratuity from a government contractor. And you must not eat this fruit. (It reminds you of the Garden of Eden!)

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More seriously, the contractor, faced with a softening local market where other purveyors of housing services are offering the first month's rent free, has been told by his lawyers this would not be allowed. Instead, what he's angling to provide are superior services in the community, i.e., a better community center. And he and the lawyers are now negotiating whether the government can accept those services if he were to proffer them.

The larger point is that because the incentives were thoughtfully designed, we're getting the kind of result that you would like to have, in which the contractor has interest in the long-term result.

The result is not that the house is X thousand square feet or is painted to Y standard or has this particular light fixture in the ceiling. All those answers will change over time in terms of what's a marketplace result. The result that's of interest is whether the good military family is happy. That's the outcome that we want to achieve; all other decisions are essentially producing intermediate products.

An interesting aspect of this mixed solution is that the government owns part of the asset, the underlying land. By specifying various rules about what the contractor can or cannot do and by designing incentives with some degree of thoughtfulness, we are in the process of producing a useful result.

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I am looking forward to the kinds of conclusions you come to in this conference. As Dr. McNicol outlined at the very start, I do now have the privilege of being responsible for several defense agencies. I know that we will be able to benefit from the wisdom that you will produce. And I look forward to the debate that you are about to have. Thank you, very much.

Q: Do you want to take any questions?

A: If you like. You're welcome to ask questions. I'm also happy if you don't ask questions.

Q: Can you talk a little bit about [determining how to use the] private sector to best support the defense agencies? In the case of housing, a success story, it was a lot of work to understand how to think about the outcomes.

A: Well, I'll give you an example that comes from my area of present responsibility, where I'd like to encourage DoD to take a more outcome-oriented approach, and that is schools for dependants in the United States.

We have all sorts of mixed solutions at the moment. We operate a certain number of schools ourselves, largely for historic regions in the southeastern part of the United States. We offer free government land in a variety of places to schools. Fort Belvoir has a school on it. Fort Gordon, Georgia, has a new school being built. You might ask what the incentive is. What the local systems get out of this is they save on busing costs. What we get out of it is more control of the school system or the schoolhouse.

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But our ultimate interest here ... and that is what's frequently driving local posts to offer the land to the local school system ... is in how good the education that the children of our people receive. That's really our interest. It's not in having the school on our property per se, which in the post September 11th security situation is a bit of a problem. It's not in running the school itself, although there are good reasons for doing that. It's in the quality of the educational opportunity that these children receive.

Going forward, I hope we can define what's our responsibility in this regard. It's in the outcome. This does raise all sorts of sticky issues, because educational services are classically seen in the United States as a local government service. And yet, we have an interest as a major employer, just as I think other major employers do, in what the school is system like.

But I fully agree with you. My plea would be that we define the outcome at the highest possible level, at least as a starting point, lest we wind up with sub optimization, which is I think, classically, what we have quite understandably done in the Department of Defense.

Q: David, as you say, you've got the authority to oversee three of these agencies. What kinds of resources or capabilities or additional authorities would you like to have in this area?

A: There are serious impediments to more business-like management. The fact that the personnel structure is enshrined in statute is one of the central challenges the department faces. This is something the

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department is trying to address for the whole civil service system, not just the agencies for which I am responsible.

That's one of the interesting issues that the Congress has before it. There are good reasons, historic reasons, for why we operate the government this way. I am struck, having recently had the privilege of starting to read some of this literature, how much of those reasons go back to the mid 19th century.

The personnel structures of the federal government are very much informed by one result in a long-running battle. Jefferson's view was that government should be staffed with people responsive to those who are elected. And President Jackson took that, as I understand history, a very significant step further. By the late 19th century, this became such a problem that you had the Civil Service Reform Act, which basically gives us the principles which we're living with still today.

Some elements of that act are several decades older than the act itself. The rule of three, for example, I've discovered ... or as I read the professors on this subject ... this rule goes back to roughly the mid-19th century!

One of the most improvements we can make is to give the federal government a more flexible approach to hiring, appointing, promoting, managing people than is true of the civil workforce. In many ways, we have much more flexibility and much more latitude in how we manage

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military personnel. This lack of flexibility is one of the most significant problems.

The other most significant impediment is that we operate on the basis of something very close to a cash budget. In other words, we mix operating and capital costs in the federal government. So there is a constant problem with how you finance capital expenditures. At the same time, how do you make those proposing capital projects think about the efficient solution?

So it's either feast or famine. Either we don't have enough money for the capital item or we have in some sense an open-ended bank account. We build something too big, too grandiose, not efficient. And we remain stuck with what we've built for a long period of time and can't get out of it, which I think is an underlying part of the problem.

In my judgment, if we could get a more flexible set of personnel authorities from the Congress and if we could separate the operating budget from the capital budget and allow the business entities to borrow, but also be disciplined by the requirements to pay the borrowings back, I think we'd get much better solutions over time.

Q: If we replace the fixation on cost with more attention to outcomes, are we going to get ourselves involved in a politically very awkward debate of all the various constituencies involved of how much is enough? To go back to your school example, my sense is that the DOD schools, in terms of their outcomes, compare favorably, demographically adjusted, with the best school systems in the United

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States. And yet, year after year, we're pressed for putting these resources into it.

A: I'm not sure it's an awkward debate. I think it's a debate we ought to have. And in the case of the schools, I think the issue really ought to be how important is schooling as part of our total compensation package for our people? I'm really arguing we need to see it as part package.

I grant that debate will be harder to conduct than the debate over costs, but it will be much more profitable. This department ought not be shy in taking credit for its ability to debate those issues. Over the long run, it's done pretty well.

If you look at the success of American military forces over the last five or six decades, particularly comparing recent conflicts with those earlier in the 20th century, I think there is a real benefit of this kind of planning. Thanks to people like Debby Christie, who kept beating on people to get their scenarios ready, and to show what the military forces are really going to do when they get there, we have the results that we've seen in places like Afghanistan. It's not accidental.

It's a result of having a debate over product, not just what it costs to do something.

Let me offer a contemporary example where we could profitably apply this approach! The President has emphasized an interest in greater collaboration between VA and DOD. We had a set of sessions this last

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fall to exchange construction plans so that we could coordinate our activities. We were recently told by the most senior leaders of VA that they wish they had a process DOD's for construction planning. It turns out VA construction planning is, as a first approximation, mostly deciding what the amount of money is the next fiscal year to be spent. Then once it's obtained, they decide what projects to finance and what they're going to look like.

They're envious of a system, whatever its imperfections, that tries to look out five or six years. We in DoD actually have to have a design partially completed before we send the budget to the Congress. So we have some control over the cost of the project that will result. And we've had some debate about why this project is important. Why do we want to do this project? Not why did someone for reasons of political distributional tell us that the project had to be pursued.

I recognize the debate will be messier, that you will be subject to inflation of expectations as to how much is enough. But in the end it will be a much more productive debate for the country to have.

Q: Well, David, great admirer, a friend of yours. I'm going to throw you a real softball and give you an opportunity for a home run again. I want to ask you about the propriety or the desirability of having a principle staff assistant manage defense agencies. There are a couple of things I might ask in that context.

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One is does it weaken the ability of the comptroller and PA&E to do a thorough review of defense agencies when they're up against Secretary of Defense-managed agencies?

Is there a problem of principal staff assistants on the agencies circumventing the budget process and going to the Secretary or using staff connections to weaken the controller or the financial managers in the budget process?

But there's another one too which has to do with your role as principal staff assistant. Does it weaken your role relative to the Secretary? Is there a conflict of interest when you are both managing an agency and providing advice to the Secretary about the agency? So that's an easy question.

A: Well, first of all, let me say for the record the controller has not looked so beneficial from my new perspective as he did when I was in PA&E. It's a pretty hard-hearted approach the office uses!

All joking aside, I think that there's ultimately a problem here. But we have, on a larger scale, the same problem with the military departments. To the extent you hope the secretaries are the Secretary of Defenses' line managers, there is a conflict with their other role, as the proponent for the Army, Navy, or Air Force.

That kind of conflict runs throughout the department. The real question is what would be the alternative to the present arrangements? And would that alternative in the end produce better results than the present arrangement?

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As a practical matter ... and again I think one size will not fit all ... as a practical matter, only if you're willing to aggregate certain agencies into a larger collectivity that could then indeed report directly to the Deputy Secretary or Secretary of Defense, do I believe you can get any major change?

In doing that, one has to be very careful, once again, about what kind of incentives you create, and to be sure that there really is an ability to control the enterprise that you have founded. The reason I say that is that I have had the privilege now of seeing the challenges presented by the management of the intelligence agencies from both sides of the fence, both from the DOD side and from the intelligence community side.

To speak quite candidly, what you have is agencies that really answer to neither side very well. I know in Defense that the constant challenge presented to us when we raised questions about the intelligence agencies functions, budgets, outcomes, et cetera, was "that's the DCI's responsibility." I had the privilege in my most recent prior incarnation to see the issue from DCI's side, and found that the DCI's complaint is every time he raises the same questions, the response is "The Secretary of Defense will be offended."

A similar issue arises with nuclear power in the Defense Department, as you know, between the Department of Energy and the Department of Defense.

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What you get from these arrangements are agencies that really are self-regulating, as opposed to responding to political authority.

While it is quite conceivable you'll improve the management of the department by different organizational arrangements, in designing them, I would want to be very careful about what behaviors will result.

On that optimistic note, I think I should give you a break. Thanks very much, Dave, for inviting me.