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Reforming the Department of Defense: The Revolution in Business Affairs

**by John P. White, Steven J. Kelman
and Michael J. Lippitz**

Preventive Defense Project

A research collaboration of
Stanford University and
Harvard University

Co-Directors

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Foreword: Preventive Defense

Through more than four decades of Cold War, American national security strategy was difficult to implement but easy to understand. America was set on a clear course to contain Soviet expansionism anywhere in the world, all the while building a formidable arsenal of nuclear weapons to deter the Soviet Union from using military force against it or its allies. Now, with the end of the Cold War, the underlying rationale for that strategy—the threat from the Soviet Union—has disappeared. What strategy should replace it? Much depends on finding the correct answer to this question.

The world survived three global wars this century. The first two resulted in tens of millions of deaths, but the third—the Cold War—would have been even more horrible than the others had deterrence failed. These three wars trace a path that leads to the strategy needed for the post-Cold War era.

At the end of the First World War, the victorious European allies sought revenge and reparations; what they got was a massive depression and another world war. The United States sought “normalcy” and isolation; what it got was total war and leadership in winning it. Because it failed to *prevent* and then to *deter* Germany’s aggression, America was forced to mobilize a second time to *defeat* it.

At the end of the Second World War, America initially chose a strategy based on prevention. Vowing not to repeat the mistakes made after World War I, the Truman administration created the Marshall Plan, which sought to assist the devastated nations of Europe, friends and foes alike, to rebuild. The Marshall Plan and other examples of the preventive defense strategy, aimed at preventing the conditions that would lead to a future world war, were an outstanding success in Western Europe and in Japan.

But the Soviet Union turned down the Marshall Plan and, instead, persisted in a program of expansion, trying to take advantage of the weakened condition of most of the countries of Europe. The resulting security problem was clearly articulated by George Kennan, who forecast that the wartime cooperation with the Soviet Union would be replaced with a struggle for the heart of Europe and that the United States should prepare for a protracted period of confrontation. Kennan's analysis was accepted by the Truman administration, which then formulated a strategy that would get us through the Cold War: deterring another global war while containing the Soviet Union's demonstrated expansionist ambitions. Deterrence supplanted prevention: there was no other choice.

Even deterrence was a departure from earlier American military strategy. The United States had twice previously risen to defeat aggression, but it had not maintained the peacetime military establishment or the engagement in the world to deter World Wars I or II. Marshall and other defense leaders around Truman created the peacetime posture and new security institutions required. In time, as George Kennan had forecast, the Soviet Union disintegrated because of the limitations of its political and economic systems. Deterrence worked.

The result is a world today seemingly without a major threat to the United States, and the U.S. is now enjoying a period of peace and influence as never before. But while this situation is to be savored by the public, foreign policy and defense leaders should not be complacent. This period of an absence of threat challenges these leaders to find the vision and foresight to act strategically, even when events and imminent threats do not compel them to do so.

To understand the dangers and opportunities that will define our nation's strategy in the new era, we must see the post-Cold War world the way George Marshall looked upon Europe after World War II, and return to prevention. In essence, we now have another chance to realize Marshall's vision: a world not of threats to be deterred, but a world united in peace, freedom, and prosperity. To realize this vision, we should return to Marshall's strategy of preventive defense.

Preventive Defense is a concept of defense strategy for the United States in the post-Cold War Era. It stresses the need to anticipate security dangers which, if mismanaged, have the potential to re-create Cold War-scale threats to U.S. interests and survival. The foci of Preventive Defense are: proliferation of weapons of mass destruction,

catastrophic terrorism, “loose nukes” and other military technology from the former Soviet Union, Russia’s post-Cold War security identity, and the peaceful rise of China.

Preventive Defense is the most important mission of national security leaders and of the defense establishment. They must dedicate themselves to Preventive Defense while they deter lesser but existing threats—in Iraq and North Korea—and conduct peacekeeping and humanitarian missions—in Bosnia, Haiti, Rwanda, and so on—where aggression occurs but where American vital interests are not directly threatened.

This report is the fourth in a series of Preventive Defense Project reports on key applications of Preventive Defense. We are grateful to the participants of the conference “The Revolution in Business Affairs: Department of Defense Reform” for their collaboration.

Ashton B. Carter
William J. Perry
Co-Directors
Preventive Defense Project

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The Stanford-Harvard Preventive Defense Project brought together approximately fifty former and current government officials, university faculty, and business executives at Harvard University on April 30 and May 1, 1998, for the conference “The Revolution in Business Affairs: Department of Defense Reform.”

That conference and this report benefited from the participation of some of the most capable and experienced people now thinking about reforming the Department of Defense and the revolution in business affairs. We would like to thank all of the participants for their contributions and their participation:

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This report seeks to consolidate and organize the various ideas presented at the conference—both formally and during discussions—

as interpreted by the authors. The views expressed here do not necessarily represent those of any individual participant or the organizations they represent.

We owe a special note of gratitude to Michael Lippitz for his outstanding work as the rapporteur of the conference and as a co-author of this report.

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Ashton B. Carter
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Conference Co-Chairs

Introduction

The Revolution in Business Affairs (RBA) is an effort to improve the overall effectiveness of the Department of Defense (DOD) by increasing the efficiency of its support operations. Waste and inefficiency within the DOD represent a major internal threat—an “enemy within”—that, by drawing money away from needed modernization, could steadily erode our ability to meet the challenges of the post-Cold War era. The RBA seeks to change the way DOD does business.

Secretary of Defense William S. Cohen articulated the challenge in the 1997 Quadrennial Defense Review (QDR):

Over the past decade, the American commercial sector has reorganized, restructured, and adopted revolutionary new business practices in order to ensure its competitive edge in the rapidly changing global marketplace. It has worked. Now the Department must adopt and adapt the lessons of the private sector if our Armed Forces are to maintain their competitive edge in the rapidly changing global arena.¹

Deputy Secretary of Defense John Hamre elaborated on this point as follows:

One main element of the QDR is to prepare now for an uncertain future through a focused modernization effort, development of new operational concepts and organizations to fully exploit new technologies, and efforts to hedge against threats that are unlikely but which would have disproportionate security implications. To meet these demands of the strategy, we need a transformation of our forces—a “Revolution in Military Affairs.”

The extent and pace of the transformation of our forces will depend critically on the availability of resources to invest in necessary research, development, testing, experimentation and procurement. In this regard,

*the Secretary envisions the “Revolution in Military Affairs” interlocking with a “Revolution in Business Affairs.”*²

In order to develop and articulate the RBA, formal presentations at the conference covered (1) lessons learned from governmental reform efforts in the U.S. and abroad and from private sector business re-engineering; (2) recent reform achievements and current challenges in DOD; and (3) civil service reform. The conference concluded with Under Secretary Gansler outlining his priorities for defense reform, after which participants offered suggestions for moving the RBA forward.

This report is a consolidation of the ideas presented at the conference. The first three sections set the stage for the RBA, covering its rationale, scope, and accomplishments to date. The remainder of the report looks to the future, covering principles, enablers, challenges, and implementation measures.

Reforming the Department of Defense: The Revolution in Business Affairs

Rationale for the RBA

The U.S. is enjoying an era of relative international peace without major external security threats. U.S. armed forces are strong and have made significant progress in meeting the challenges of the post-Cold War era. However, flat or declining future defense budgets mean that DOD must reduce waste and inefficiency in order to maintain current readiness as well as invest in modernization. DOD must also become more flexible and adaptable in order to keep pace with changing threats and to maintain the confidence of the U.S. public. The bottom line, as stressed in the two recent outside commissions established by Congress³ and reports by the Administration,⁴ is that it will be necessary to shift between \$12 and \$18 billion each year from accounts that support current activities to those that support investments in the future. Failure to spend adequately on modernization could render U.S. forces ill suited to future threats.

The RBA is enabled by the marked increase in technological capability of U.S. industry over the last two decades. The private sector has achieved this capability by focusing on core competencies while outsourcing other functions; flattening organizations, stressing innovation, and emphasizing measured performance. These same practices are directly relevant to the DOD, and their adoption is necessary for effective force modernization.

Although the DOD civilian workforce has been reduced substantially in recent years and many facilities have been closed or consolidated, the DOD still employs more civilians than it needs and maintains too large an infrastructure of military bases and support activities. Since fiscal year (FY) 1987, the overall DOD budget has fallen by one-third, in real terms. Active duty military forces have been reduced

by approximately 35% and current operations by roughly 25%. The largest cuts have been in modernization programs, which by FY 1999 will be only 55% of their FY 1987 levels. A recent Defense Science Board (DSB) study on support structure determined that DOD currently spends approximately \$140 billion on operations and support versus \$110 billion on acquisition and technology development.

It is also expected that the U.S. will have less time to respond to emerging threats than in the past. The new, uncertain era in which we live places a premium on being able to deal with new, unanticipated threats. The National Defense Panel expects that these threats will be asymmetric, will involve transnational and substate actors, and will require operations in difficult venues (e.g., urban locations). Hence, the system must encourage innovation, adaptability and experimentation among various approaches, operational concepts, structures, and technologies. Such adaptability is needed not only for operating forces but also for the structures that support them.

Finally, the RBA can play an important role in restoring citizens' general confidence in government. DOD has the opportunity to demonstrate that large, government institutions can achieve world class performance.

Funding modernization programs requires DOD to move resources from accounts that support current activities to those that support investments in the future. It has three options for shifting resources from current to future accounts: (1) reduce expenditures on operations and maintenance, i.e., readiness; (2) reduce the number of active military personnel, i.e., force structure; or (3) reduce the cost of support services and infrastructure. There was strong consensus among seminar participants that the third—the RBA—is clearly the preferred choice. But it is also the most difficult because it requires fundamental changes in the way the DOD does business.

Scope of RBA Activities

One view of the RBA limits it to the operational, “yellow pages” activities of the DOD: food, clothing, business travel, etc. Participants at this conference adopted a broader view. The RBA must encompass a fundamental reexamination of a larger array of support functions such as logistics, medical support, management information systems, housing, and training. DOD's goal is to improve the efficiency of all functions that support military operations, not just

eliminate useless or outdated appendages. As such, “tooth-to-muscle” would be a better metaphor than the traditional “tooth-to-tail” conception of this problem.

It is important to keep in mind that efficiency is the ratio of effectiveness divided by cost. In seeking to improve DOD efficiency, one should concentrate on the goals of particular activities. In many cases, efficiency can be improved by re-engineering an entire activity rather than just making its component processes faster or cheaper. Detailed consideration of process should follow consensus on the desired outcome. The overall goals are better products, more flexible processes, faster service, and lower costs.

Accomplishments of DOD Reform to Date

In discussing Acquisition Reform, former Secretary of Defense William Perry is fond of quoting Victor Hugo:

“More powerful than the tread of mighty armies is an idea whose time has come.”

Many of the ideas embodied in the RBA have been around for some time (e.g., the Rockefeller-Fitzhugh Act in the 1950s) but the time is ripe for major change. Reforms underlying the RBA are well underway. They need to be expanded to the entire support structure. The RBA is part of the wider National Performance Review (NPR) effort of the Clinton Administration. NPR began with performance audits in 1993 and 1995. These audits identified government wide problems of organization and process. NPR then focussed on training government employees in customer service concepts and publicizing best practices through Hammer Awards, some 800 of which have been given. This publicity is critical to convincing the federal workforce that change is possible. Government is no longer to be seen as a condition to be endured but as an array of critical functions to be effectively and efficiently performed. NPR has recently changed its name to National Partnership for Reinventing Government, reflecting a new focus on making government a performance-based organization.

DOD has made progress on many aspects of the RBA. The civilian work force of the DOD has been reduced substantially, 45% through elimination of billets.⁵ Other efficiency initiatives are also beginning to pay off. For example, 75% of DOD’s 10 million annual acquisition transactions under \$2,500 are being carried out using the

new IMPAC credit card, which greatly reduces paperwork. More broadly, acquisition reform pilot programs have achieved up to 50% acquisition savings and demonstrated the ability to leverage commercial technology developments. Industry consolidation has proceeded apace and is widely viewed as being beneficial.⁶ Senior DOD leadership has endorsed the RBA in the Quadrennial Defense Review and the Defense Reform Initiative.

Principles for Implementation of the RBA

The presentations and discussions covered several aspects of the RBA, and participants offered many constructive suggestions. The topics can be categorized into four areas, representing the key principles of the RBA:

1. Incentives for contractors and suppliers. DOD's reform efforts are based on the proposition that private business can often do a better job than government in finding creative, cost-effective solutions to DOD needs. Acquisition reform has eliminated the legal barriers to leveraging commercial technology and practices. The key challenges are for DOD to manage fairly public/private competitions and to implement contracting mechanisms that create incentives for product suppliers and service-providers to improve DOD effectiveness. Specific tasks include (1) gaining support from the DOD Inspector General and the General Accounting Office; (2) countering negative publicity over the inevitable mistakes and apparent abuses; and (3) overcoming "color of money" problems in the DOD budget.

2. Accountability of program managers and government employees. People make changes, not "departments" or "offices." People are more motivated to make changes if they are held accountable for the results. In order to have accountability, people must (1) have visibility into their processes; (2) control the needed resources; (3) stay in their positions long enough to see the changes through; and (4) have measurable results that are used to determine performance. Greater accountability can be achieved by employing activity-based accounting, giving greater scope to policy managers, increasing program management tenure, developing appropriate management performance metrics, and rewarding employees based on those metrics. Key challenges include revising current military and civil service career development practices, paying the initial costs of changing accounting systems, and devising appropriate metrics.

3. Focus on performance for the customer. A focus on the quality of outcomes as viewed by the customer—i.e., the regional and functional commanders-in-chief who conduct joint military operations—has the potential to change how the entire DOD organization thinks about its tasks. In fact, it will change the very way that people talk about their activities and responsibilities. The use of performance specifications, for instance, draws attention to goals for which a product or service is being acquired. Acquisition reform pilot programs have demonstrated the dramatic savings achievable when contractors are given the flexibility to optimize their processes to meet system performance goals. The key challenges include retraining the work force to focus on performance, defining outcomes and improving training for federal managers in supplier and workforce management.

4. Development of core competencies. Organizations that stay focused on their core competencies experience more efficient operations, improved management practices and retention of talented people. People are attracted to and stay with organizations whose core competencies match their skills. For DOD, this will mean (1) more outsourcing of non-core activities—i.e., those not directly involved with joint military operations, policy development, management & oversight; (2) developing a new employee skill mix suited to modern information technology and supplier management; and (3) empowering the acquisition workforce. Key challenges include streamlining outsourcing processes, attracting and retaining technical talent, retraining workers and managers, and building congressional support.

Taken together, the ultimate mission statement for the RBA might be summarized as: *An accountable government and contractor workforce with the incentives, skills, tools and flexibility to achieve cost-effectively the performance necessary to support the warfighter.*

The section that follows summarizes the discussion of enablers toward this goal.

Enablers for Implementation of the RBA

Leadership

Effective leadership is a *sine qua non* for the RBA. Good leadership can, in the words of one participant, “get ordinary people to do extraordinary things.” Leaders can provide “forcing functions” for change, create and manage new incentives, conquer procedural problems, keep the workforce focused on the customer, hold the workforce

accountable for their results, and develop a consensus around DOD core competencies. None of the challenges to the RBA is insurmountable.

Publicity

Managing communication needs to be a top leadership priority. It will be critical to convince Congress to support the RBA and to shape media understanding of the importance of the reform process and what it is trying to achieve. Mistakes are inevitable in an organization the size of DOD. This will be particularly true as it changes the way it does business. The resultant bad publicity can undermine good work if it is not seen in the context of the larger goals. So DOD needs to anticipate such problems and get out in front with its broad story of fundamental reform.

DOD must also use internal publicity to create understanding and incentives for reform. In such a large organization it will take enormous energy to shift from the status quo. Highlighting both good and bad management outcomes focuses the workforce's attention on performance. A focus on performance will shift the debate to outcomes that are the true measures of success. One participant suggested that the term "*Revolution* in Business Affairs" is the wrong framework for DOD change. What DOD should learn from the private sector is that *continuous* process improvement is the key to success. RBA should focus on setting up the process of change. This is the secret of those business leaders who have made their companies successful.

Competition

Competition can provide a powerful incentive for continuous improvement in government and contractor performance. It can encourage a customer orientation, promote increased flexibility, and help overcome organizational tendencies toward the "not invented here" syndrome. Consider the U.S. Post Office, whose performance and profitability improved when they began to face competition from overnight shipping companies. In competitions between public and private organizations, experience to date is that costs go down no matter which organization wins.

But competition in and of itself is not always beneficial. If the metrics by which competitors are evaluated weight near-term factors

too heavily, competition can inhibit sound strategic initiatives. For instance, too much focus on initial acquisition cost could lead programs to underinvest in technologies that could lead to long-term strategic advantage or life cycle cost savings.

One of the great challenges for DOD will be to manage competition by value and price rather than by cost. Consider how much would be saved if the interests of contractors and the government were aligned and if there were not almost automatic protests on every contract award. The contracting mechanism must embody certain properties and be supported by all stakeholders. Specifically,

- Contractors must be able to
 - ⇒ profit from finding solutions that meet defense needs
 - ⇒ have the flexibility to develop new types of supplier relationships that encourage innovation
 - ⇒ be rewarded for taking sensible risks.
- Program offices must be able to
 - ⇒ define system value in terms of system performance, price and schedule
 - ⇒ benefit from making sensible performance-price-schedule tradeoffs
 - ⇒ have the authority and flexibility to make such tradeoffs (i.e., to manage by value)
 - ⇒ evaluate a contractor's technical response against system value.
- DOD leadership must
 - ⇒ gain support with Congress, the General Accounting Office, the DOD Inspector General, and other affected agencies for the new types of public-private business relationships and contractor teaming contemplated under the RBA
 - ⇒ clarify policy on value/price-based management, international participation, sole source production, incremental R&D funding, and the nature of competition in a consolidated industrial base
 - ⇒ address internal barriers such as "color of money" disincentives for saving money
 - ⇒ counter negative publicity that is certain to arise among those interests who consider themselves hurt by the RBA.

Managing by value and price can create incentives for contractors to manage system design in ways that improve the outcome for both the government and the contractor. For instance, suppose the government awarded contracts that specified the price it would be willing to pay for different levels of performance. Under this approach, the government would specify the various combinations of price and performance among which it is indifferent and allow the producer to select the best outcome. Specific prices would be based on existing analysis of the value of different levels of performance for accomplishing DOD missions. The supplying organization, public or private, could then use the relationship between value and price not only to determine a solution that best matched their technical capabilities, but also to guide the detailed design process toward good value vs. price tradeoffs. The government would obtain the most efficient solution to its ultimate mission performance goal.

In this respect, value/price-based contracting is the next step in DOD's progression from cost-based contracting, to cost plus incentive contracts, to fixed price contracts, to fixed price contracts with warranties. Value-based pricing improves upon fixed price contracts by encouraging sensible performance-price tradeoffs. Contractors improve their profits by including only those features whose value to the government exceeds their cost. The government obtains the most efficient solution to its ultimate mission performance goal. Furthermore, all tiers in the supply chain are strongly motivated to find commercial technologies that provide improved performance for lower cost. In this way, best value contracting embodies the true spirit of "cost as an independent variable."

Outsourcing

One of the principal lessons from reengineering in the private sector is the concept of focusing organizations on their core missions. This is accomplished by outsourcing non-core operations to partners, who are given incentives to innovate for mutual benefit and who, by focusing on their own core mission, are better able to develop and retain qualified people.

Success in outsourcing depends on reengineering the entire value chain; i.e. working on comprehensive processes for continuous improvement. If well designed, partnering arrangements can progress from simple contract based interactions to fully networked "virtual

organizations” that think synergistically and create value across a broad spectrum of opportunities. The private sector experience is that partnership objectives are unique to each engagement. Consider global information technology (IT) outsourcing, a \$87.5 billion industry in 1997, which one participant predicted would grow to \$197.6 billion in 2001. Lower cost is not the principal driver for IT outsourcing. Rather, in a competitive environment the partners will emphasize technology renewal, a skilled work force and innovation.

For DOD to apply lessons learned by the private sector, it must develop better knowledge of outside processes and the contexts in which they are successful. Such monitoring will help DOD avoid adopting business practices that the private sector has found to be unworkable (e.g., excessive or poorly targeted downsizing). For instance, DOD needs better trained middle managers who are able to be leaders for continuous change. This being said, most participants seemed to believe that very little of what DOD does in its support functions is “inherently governmental,” so most of what has been learned in the private sector applies.

The participants were in general agreement that the OMB circular A76, which specifies the process for government outsourcing, is cumbersome and flawed, but the political reality in Washington is that it is unlikely to be changed. The A76 methodology is claimed to give unfair advantage to government offices by allowing them to provide projections of future efficiency, while contractors must provide hard numbers. In addition, existing government accounting systems often fail to account for overhead costs realistically.⁷ Finally, the A76 process forces assessments of small, narrow mission organizations while the largest savings can often be realized by changing processes that cross existing organizational boundaries. On the other hand, several of the current and former senior government leaders present were of the view that A76 is not an insurmountable barrier but rather a stumbling block that is used by obstructionists who wish to resist outsourcing. There was broad agreement that most of the barriers to change are inside the DOD.

Personnel Reform

One of the barriers to outsourcing is the desire to protect jobs. The entire rationale for the RBA is to improve efficiency to enable modernization. It is something of an oxymoron to try to increase

efficiency and protect jobs at the same time. Unproductive jobs are a burden. More importantly, DOD faces a demographic bubble. The workforce is aging, fewer young people are joining, and qualified people in their 30's and early 40's are leaving for better jobs outside. DOD faces the twin dangers of having a civilian work force that is not up to the challenges of the future and being unable to attract a new generation of knowledge workers.

But there is also opportunity here. DOD needs to recreate itself into an exciting, challenging work environment. To do so, it will be necessary to restructure the civil service rules, retrain middle managers in contract management, increase discretion in order to encourage leadership, and develop new approaches to promotion and compensation. One presenter put it succinctly: "People trump process."

The business changes that must be made also require civil servants with new and enhanced skills. The current civil service structure emphasizes preventing mistakes, low job mobility among workers, and limiting mid-career professional development. To be successful in the RBA, DOD must change many personnel policies and practices. This means investing more in civil servants. Training and development are particularly important as technologies and procedures change. DOD needs to hire, train, and retain more technically trained people.

In addition to training and employee development, participants offered several other suggestions for improving the DOD workforce:

- Rework the promotion and compensation system so that DOD can reward good performance. This is central to workforce accountability, as discussed above.

- Increase program management tenure in order to increase accountability. Instability pollutes relationships with suppliers. In the military, it's "up or out." This is good in the sense that it creates a focus on training and development. But this system conflicts with the need for longer program management tenure. Some suggested that a single tour of duty as a program manager should be viewed negatively.

- Allow people to move in and out of government more easily.

The bottom line is that DOD needs a more innovative, educated, flexible work force. This means civil service reform.

Cost Visibility

Improving cost visibility is a key component of "having the right knowledge." One of DOD's most important tasks is to implement

accounting systems that empower managers. Activity-based accounting would provide appropriate cost metrics. The barriers to its implementation are making the initial investments and overcoming bureaucratic inertia.

Improving cost visibility must be complemented with new performance metrics. Performance metrics enable managers to make the business case for changed processes and for taking prudent risks. Initial NPR metrics are a 25% cycle time reduction of key activities and 95% visibility into assets. At present, DOD has poor information on how the system is working. But, as the private sector has learned, while devising appropriate internal management metrics can be very hard, it is central to success.

Challenges to Implementation of the RBA

One of the most important challenges facing DOD in implementing RBA is developing congressional support. Congressional support was critical to the success of early acquisition reforms, including allowing DOD to lead the government in the areas of procurement reform and budget authority experiments. DOD now needs to lead on other aspects of the RBA (accounting systems and sale of assets are two promising initial targets). To do so, the same type of congressional support needs to be generated for implementation of the Defense Reform Initiative.

The movement or elimination of DOD activities is always sensitive because it affects people's jobs. DOD must get the message out better that failure to reduce support facilities threatens its ability to acquire the modern systems needed in the future. It can not afford excess and inefficiency if it is to modernize the force for the future. In the case of both acquisition reform and military housing reform the Congress has been supportive once the DOD developed a compelling case. The same must be done with RBA. It will be harder because it is so broad and fundamental but congressional support is necessary for success.

At the same time, DOD must improve the public/private competitive process to assure fairness. The evidence is clear that savings occur regardless of who wins, if the process is well managed.

The same type of convincing needs to be done with other government agencies. DOD has worked effectively with the White House, the Environmental Protective Agency (EPA) and the Office of Per-

sonnel Management (OPM) during the base closure process to expedite base conversions. In the same vein, DOD needs to work with the Small Business Administration to address small business concerns with new contracting and purchasing practices. DOD also needs to make the case with the DOD Inspector General and the General Accounting Office for the new types of public-private business relationships contemplated under the RBA. Particular issues in which policy must be clarified include value/price-based contracting, international participation, sole source production, incremental R&D funding, and retention of competition with further industrial base consolidation and contractor teaming.

The government budget process is often raised as a barrier to making change. Because of the current budget rules, it is hard to move funds among organizations or accounts and across time periods for the purpose of optimizing a program. For instance, upgrading legacy systems is inhibited because the logistics community gets the operations and maintenance dollars for maintenance, while the acquisition community gets the dollars for development. Program managers need to be able to make trades between the two. This is the so-called “color of money” problem which earmarks discrete funds for specific functions and greatly limits management flexibility.

Near-Term Implementation of the RBA

DOD must “stay the course” in its reform efforts, giving them the necessary leadership attention while encouraging change throughout the organization.

At the end of the conference, participants were asked to suggest some concrete, actionable items. A selection of these comments is presented below:

- To succeed in the RBA, DOD should implement it in functional chunks that take about 9-12 months a piece. Two or three focus areas should be selected for the development of world class best practice, with a view toward building momentum for RBA one success at a time; i.e., show the payoffs first, then deal with parochial concerns. The process could begin with a summit meeting for the purpose of achieving widespread leadership buy-in for the medium-term vision for the RBA and selection of the focus areas. For example, logistics would be a good place to start because decent metrics already exist. DOD should then designate centers of excellence for the specific

activities chosen and give them a lot of attention. Additionally, DOD should consider creating a special project office to manage the overall process.

- There are several concrete steps DOD can take to reward good program management. Program goals can be made explicit and widely visible. Good and poor management can be highlighted. DOD should work with the unions and OPM to (1) devise a compensation system tied more directly to job performance; (2) change career development processes to create incentives for good program managers to serve multiple tours of duty; (3) develop compensation systems consistent with attracting and retaining technical program management talent (e.g., professionals in operations research, information technology, and systems engineering); and (4) improve civil service executive training, especially in areas of personnel management, labor-management relations, and supervision of technology suppliers.

- Implement value/price-based acquisition practices. Don't let the "exceptions" hold up the general goal.

- Put more emphasis on the development and specification of requirements. For example, give the regional and functional commanders-in-chief more control of price-performance tradeoffs and establish joint funding for them to maintain their own in-theater logistics.

- Implement activity-based costing for DOD programs; i.e., track cost and resources to purpose.

- Work harder within the current system to achieve efficiencies through public/private competitions. Give offices some set number of years to get as efficient as they can; then base competition on their real performance against the real performance of outside contractors.

- Publicize the scope of reforms contemplated under the RBA, to reach people beyond the acquisition community.

- Change the budget rules to allow programs to maintain control over the proceeds of asset sales. Consider using a Resolution Trust type organization to overcome the perception that assets are being sold too cheaply.

- Develop improved policies and guidance on (1) interoperability, international cooperation, and defense industry consolidation; (2) the relationship sought between DOD and the commercial market; and (3) intellectual property created in partnership with industry.

In conclusion, participants thought that the seminar was very useful and that it addressed many of the issues critical to realizing a RBA. But all agreed that, given the complexity of the issues, significant follow-up activities would be required. The seminar organizers are assessing next steps.

Notes

1. William S. Cohen, in *The Report of the Quadrennial Defense Review*, May 1997.

2. "Improved Business Practices Will Improve Military Effectiveness," Statement of Deputy Defense Secretary John J. Hamre to the House National Security Committee, Washington, March 11, 1998.

3. The Commission on Roles and Missions of the Armed Forces and the National Defense Panel.

4. The Quadrennial Defense Review and Defense Reform Initiative.

5. Overall, the U.S. government is the smallest since the Kennedy administration. Government personnel as a percentage of the U.S. workforce is at its smallest since 1973.

6. Concerns have been raised about competition among subtier suppliers for critical defense technologies. A May 1997 Defense Science Board Task Force report entitled *Vertical Integration and Supplier Decisions* suggested that DOD needs to monitor the industry consolidation with a view toward maintaining innovation and competition. Greater use of commercial components in defense systems should help.

7. One participant offered an example in which a Navy hotel claimed a cost of \$21 per night. When the cost of their externally provided power plant was included, the cost rose to \$1,200 per night!

Conference Agenda

Thursday, April 30, 1998

- 8:30-9:00 **Registration and Breakfast**
- 9:00-9:45 **Welcome and Conference Overview**
 Ashton Carter, Harvard University
 Steven Kelman, Harvard University
 John White, RAND Corporation
- 9:45-11:30 **DOD Reform Lessons to Date**
 Robert Murray, Center for Naval Analyses
- DOD Reform (I)—An Outside Perspective**
 Josh Weston, Automatic Data Processing and Business Executives for National Security
- 11:30-11:45 **Break**
- 11:45-1:15 **Keynote (lunch) Address**
 John Hamre, Deputy Secretary of Defense
- 1:15-2:45 **Lessons From the National Performance Review**
 Elaine Kamarck, Harvard University
- 2:45-3:00 **Break**
- 3:00-4:30 **Public Sector Experience**
 Don Kettl, University of Wisconsin-Madison
- 4:30-5:45 **Re-engineering in the Private Sector—Lessons Learned**
 Milton Cooper, Computer Sciences Corporation
- 6:00-6:30 **Cocktails**
- 6:30-8:00 **Dinner**
- 8:00 **Forum Event: Can Government Perform?**
 Franklin Raines, Director, Office of Management and Budget

Friday, May 1, 1998

8:30-9:00 **Breakfast**

9:00-10:15 **DOD Reform (II)—An Outside Perspective**
Philip Odeen, BDM Corporation and National Defense Panel

10:15-10:30 **Break**

10:30-11:45 **Civil Service Reform**
Representative Steny Hoyer, U.S. Congress
Bobby Harnage, American Federation of Government Employees
Rudy de Leon, Under Secretary of Defense for Personnel and Readiness

11:45-1:30 **Working Lunch**
William Perry, Stanford University

1:30-3:00 **DOD Goals and Expectations**
Jacques Gansler, Undersecretary of Defense for Acquisition and Technology

3:00-3:30 **Wrap-up and Conclusions**
Steve Kelman, Harvard University

About the Authors

Steven J. Kelman

Dr. Kelman is the Weatherhead Professor of Public Management at Harvard University's John F. Kennedy School of Government. A *summa cum laude* graduate of Harvard College, with a Ph.D. in government from Harvard University, he is the author of many books and articles on the policymaking process and on improving the management of government organizations. His most recently published books are a study on how to improve the government computer procurement process, entitled *Procurement and Public Management: The Fear of Discretion and the Quality of Government Performance* (AEI Press, 1990), and *Making Public Policy: A Hopeful View of American Government* (Basic Books, 1987). He has also received number of academic honors throughout the years. In 1996 he was elected a Fellow of the National Academy of Public Administration.

From 1993 through 1997, Dr. Kelman served as Administrator of the Office of Federal Procurement Policy in the Office of Management and Budget. During his tenure as Administrator, he played a lead role in the Administration's "reinventing government" effort. He led Administration efforts in support of the Federal Acquisition Streamlining Act of 1994 and the Federal Acquisition Reform Act of 1995.

Michael J. Lippitz

Mr. Lippitz is a consultant to the U.S. Department of Defense (DOD), Office of the Director of Defense Research and Engineering, specializing in dual use technology policy. He served from 1994-1997 as Special Assistant for Strategic Technology Planning in the

DOD Office of International and Commercial Programs. While there, he wrote the DOD strategy paper on merging military with commercial production to achieve affordable, leading edge, dual use technologies (1995) and led research teams in the publication of reports that articulate and expand that policy in the areas of microelectronics (1996) and satellite communications (1998).

Prior to joining the Department of Defense, Mr. Lippitz worked at Lawrence Livermore National Labs on verification provision for the Biological Weapons Convention, Strategic Arms Reduction Treaty and Threshold Test Ban Treaty. At Rockwell International, he applied decision theory, artificial intelligence, and psychology to problems in command and control. At Hewlett-Packard, he coordinated and provided strategic direction for engineers in research and development, production, and sales in support of a \$30-million microwave test equipment product line.

Mr. Lippitz received a bachelor's degree in Electrical Engineering, *Magna Cum Laude*, from Brown University in 1984 and a master's degree in Engineering-Economic Systems from Stanford in 1987. He is presently pursuing a Ph.D. in Engineering-Economic Systems under former U.S. Secretary of Defense William J. Perry.

John P. White

Dr. White is on the faculty of the John F. Kennedy School of Government, Harvard University.

Dr. White has held several senior federal government positions during his career, including U.S. Deputy Secretary of Defense from 1995 to 1997, Deputy Director of the Office of Management and Budget from 1978 to 1981, and Assistant Secretary of Defense, Manpower, Reserve Affairs and Logistics from 1977 to 1978. Prior to his most recent government service, Dr. White was the Director of the Center for Business and Government at Harvard University and the chairman of the Commission on Roles and Missions of the Armed Forces.

Dr. White also has extensive private sector experience, having served as Chairman and CEO of Interactive Systems Corporation from 1981 to 1988 and, following its sale to the Eastman Kodak Company in 1988, as General Manager of the Integration and Systems Products Division and a Vice President of Kodak until 1992. Dr. White also spent nine years with The RAND Corporation where he was the

Senior Vice President for National Security Research Programs and a member of the Board of Trustees.

Dr. White is currently a Senior Partner of Global Technology Partners, LLC, which, in partnership with DLJ Merchant Banking Partners, specializes in private equity investments in technology, defense, aerospace and related businesses worldwide.

He also is a Senior Fellow at The RAND Corporation and a member of the Council on Foreign Relations. He serves as a director of Wang Laboratories, and Mitsubishi Electric America as well as the Concord Coalition and Center for Excellence in Government. Dr. White received his BS from Cornell University and earned his MA and Ph.D. in economics from the Maxwell Graduate School, Syracuse University.

About the Stanford-Harvard Preventive Defense Project

The Preventive Defense Project is a joint venture between Stanford University and Harvard University. Preventive Defense is a concept of defense strategy for America in the post-Cold War era. The premise of Preventive Defense is that the absence of an imminent, major, traditional military threat to American security presents today's national security leaders with an unaccustomed challenge and opportunity: to prevent new Cold War-scale threats to U.S. security from emerging in the future. While the United States defense establishment must continue to deter regional conflicts in the Persian Gulf and the Korean Peninsula, as well as keep the peace and provide humanitarian relief in selected instances, its highest priority is to contribute to forestalling developments that could directly threaten the survival and vital interests of American citizens.

The Preventive Defense Project will initially concentrate on forging productive security partnerships with Russia and its neighbors, dealing with the lethal legacy of Cold War weapons of mass destruction, engaging an awakening China, and countering proliferation of weapons of mass destruction and catastrophic terrorism. The Project seeks to contribute to these objectives through the invention of new policy approaches reflecting Preventive Defense, intensive personal interaction with defense and military leaders around the world, and through the establishment of highly informed, non-governmental track two initiatives that explore new possibilities for international agreement.

Current Preventive Defense Project initiatives include:

- **Describing Preventive Defense.** In a forthcoming book, the Project's leaders will explain the concept to a wider audience, draw-

- **Organizing to combat catastrophic terrorism.** The Project convened the Catastrophic Terrorism Study Group, which is a collaboration of faculty from Harvard University, the Massachusetts Institute of Technology, Stanford University, and the University of Virginia and is co-chaired by Ashton B. Carter and John M. Deutch. The Study Group is identifying appropriate responses by the United States government to the dangers of catastrophic terrorism.

The Preventive Defense Project is a multi-year effort supported by the Carnegie Corporation of New York, the John D. and Catherine T. MacArthur Foundation, and private sources. The Project's Co-Directors are former Secretary of Defense William J. Perry and former Assistant Secretary of Defense for International Security Policy Ashton B. Carter. Former Chairman of the Joint Chiefs of Staff General (ret.) John M. Shalikashvili and former Deputy Assistant Secretary of Defense for Russia, Ukraine and Eurasia Elizabeth Sherwood-Randall serve as Senior Advisors. Additional contributors to the Project include: member of President Clinton's Foreign Intelligence Advisory Board Robert J. Hermann and former Deputy Secretary of Defense John P. White.

Institute for International Studies

Stanford University

The Institute for International Studies (IIS) seeks solutions to real-world, international problems that affect international security, the global environment, and international political economy. IIS creates a dynamic environment in which to address these critical issues by bringing experts from a variety of disciplines within Stanford University together with long- and short-term visitors from other academic, government, and corporate institutions. At any given time, over 150 scholars are engaged in policy studies within the Institute's federation of research centers.

Center for International Security and Cooperation

Stanford University

The Center for International Security and Cooperation (CISAC), part of Stanford University's Institute for International Studies, is a multidisciplinary community dedicated to research and training in the

field of international security. The center brings together scholars, policymakers, scientists, area specialists, members of the business community and other experts to examine a wide range of international security issues.

Belfer Center for Science and International Affairs

Harvard University

The Belfer Center for Science and International Affairs (BCSIA) is the hub of the John F. Kennedy School of Government's research, teaching, and training in international security affairs, environmental and resource issues, and science and technology policy. The center's mission is to provide leadership in advancing policy-relevant knowledge about the most important challenges of international security and other critical issues where science, technology, and international affairs intersect. BCSIA's leadership begins with the recognition of science and technology as driving forces transforming threats and opportunities in international affairs. The center integrates insights of social scientists, natural scientists, technologists, and practitioners with experience in government, diplomacy, the military, and business to address critical issues.

**Preventive Defense—
the central strategic imperative for
the U.S. in the post-Cold War era.**

The absence of an imminent, major, traditional military threat to American security presents today's national security leaders with an unaccustomed challenge and opportunity: to prevent new threats from emerging. While day-to-day crisis management preoccupies policymakers, Preventive Defense concentrates on identifying and forestalling developments that could pose major new threats to U.S. vital interests. The Preventive Defense Project seeks to contribute through thorough research of such threats, invention of new policy approaches reflecting a preventive defense approach, intensive personal interaction with defense and military leaders around the world and through the establishment of highly informed but non-governmental "Track Two" initiatives that explore new possibilities for international agreement.

A research collaboration of

Center for International Security and Cooperation,
Institute for International Studies, Stanford University

The Belfer Center for Science and International Affairs,
Harvard University