The Heritage Foundation Committee Brief

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A Special Report to the House Committee on Government Reform and Oversight

No. 15 7/6/95

THOUGHTS FROM BUSINESS ON DOWNSIZING GOVERNMENT

By Donald Rumsfeld[1]

Thank you, Mr. Chairman and members of the committee. I was pleased to accept your invitation to meet with you today to discuss the various corporate approaches and their relevance to the federal government. I believe I do have a somewhat unusual perspective on this issue, having spent a good deal of time in both the government and the corporate world.

Also, I am pleased to be back in these chambers. As a young member of the Congress during the 1960s, I had the opportunity to serve on this committee when it was known as the Government Operations Committee. At the beginning of my tenure, the government we oversaw was much smaller and simpler than the complex and overwhelming government that so many of you in this Congress have pledged to reform.

If my memory serves me correctly, one of the issues of my time in Congress was whether or not to close the Naval Academy Dairy. While this example is good for a laugh today, those who tried to end that practice were accused of not understanding the importance of a captive milk supply for the Midshipmen. Heaven forbid that the Naval Academy would have to buy milk from the private sector like everyone else.

While that may seem like a trivial example compared with the sacred cows that must be challenged if you are to balance the budget by 2002, the federal government is one of the few institutions that still thinks itself able to afford the luxury of sentimentality at taxpayers' expense. Businesses eventually cannot afford to hold on to activities, practices, divisions, or subsidiaries that have become outmoded, inefficient, and a financial drain on the rest of the company. Rather, they have to figure out what they should and should not be doing and then take decisive actions to get their financial affairs in order.

1 Donald Rumsfeld, a former U.S. Congressman and Secretary of Defense, now is in private business and serves on several corporate boards. Substantial portions of this were delivered in testimony to the House Committee on Government Reform and Oversight, Subcommittee on Government Management, Information and Technology, on June 6, 1995. Scott A. Hodge, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, assisted in the preparation of this testimony.

When taking over a troubled company, a good CEO checks his or her "teeth to tail" ratio as they say in the military. It requires undertaking a thorough review of the company's assets and resources and divesting those that are not central to the success of the institution. This forces the company to focus on its "core" business and to avoid wasting time and money on ventures that are secondary to what is most important to the long-term health of the company.

A good example of a corporation undergoing such a top-to-bottom restructuring is Sears Roebuck and Co. Sears in recent years decided to move from a highly diversified company back to its core businesses. During this restructuring it closed a hundred unprofitable stores, took Dean-Witter, Discover, and Allstate Corporation public, and even disposed of the famed Sears Tower in Chicago. Some of the cash raised from these sales was used to buy out thousands of middle managers, and the rest was plowed back to strengthen its basic businesses.

One of the most painful aspects of this restructuring was the decision to close Sears' catalog division —the business Sears was built on. The simple fact was that the catalog division was unprofitable and a drain on the company's main businesses. As difficult as it was, however, this break with the past told Sears stockholders that management was serious about fundamentally restructuring the company.

The experience at Sears, and the experiences of hundreds of other companies, including two I downsized—G.D. Searle & Co., a pharmaceutical company, and General Instrument Corporation, an electronics company—can provide Congress with valuable lessons on how to and how not to downsize and overhaul the federal government. There is no one formula for successfully reorganizing a major corporation beyond the fact that it requires making tough, serious decisions, and it is helpful that it be done by people from outside the institution and people who know how to do it.

DEFINE YOUR "CORE" BUSINESS

As the overseers of the federal government, an institution which by any reasonable measure is in Chapter XI, members of Congress must treat the job of restructuring it in the same tough-minded manner corporations around the country are now doing. The goal must be to earn back the confidence of the taxpayers, who are the real stockholders of the federal government. This does not mean simply "patching," as management guru Peter Drucker has characterized Vice President Gore and his associates as doing. The reason Gore's effort has received so little public attention, said Drucker, is that:

> In any institution other than the federal government, the changes being trumpeted as reinventions would not even be announced, except perhaps on the bulletin board in the hallway. They are the kinds of things that a hospital expects floor nurses to do on their own; that a bank expects branch managers to do on their own; that even a poorly run manufacturer expects supervisors to do on their own—without getting much praise, let alone any extra rewards.[2]

That is why techniques such as Total Quality Management, procurement reforms, or streamlining middle management will only affect the problems in government programs at the margins. Let's not forget that many well-intended corporations have used the same sorts of techniques and still failed to stay in business. It is vital that many of these things be done, but only after one has decided and dealt with the more central issue of what business to be in.

2 Peter F. Drucker, "Really Reinventing Government," *The Atlantic Monthly*, February 1995.

The first task is to decide what your core business is. Once this decision is made, then everything else in the enterprise is secondary. For the federal government, the four basic departments, State, Defense, Justice, and Treasury, have a solid basis for their existence. The other departments either were more narrowly based, or were an afterthought, or both. Some had utility when they were established but no longer do. Others, in my view, probably did not even have a vital role when they were established. Many were voted in less for organizational reasons and more as a favor to a particular interest group.

Once one has determined the core functions to be performed by the federal government, all other activities should be scrutinized for elimination, cuts, reorganization, or movement to state and local governments or to the private sector. I begin with the conviction that the first place activities should be undertaken is with individual citizens, second with private organizations, third with local governments, fourth with state governments, and only last with the federal government.

In the past, this was not always an easy principle to defend, even though in theory it was compelling and rational. It was not always valid because of the issue of civil rights. It was clear that if some activities were left up to local governments or individuals, then there would not be protection against discrimination. Given the many civil rights laws on the books and the progress that has been made, that argument is invalid today.

My view is that as overseers of the federal government, Congress ought to use federal solutions only as a last resort, not the first. I suggest that the question be asked whether a problem is truly a federal responsibility, or can it better be handled privately, by voluntary organizations, by local governments, or state governments. I understand how difficult this is in Washington, as all the institutional pressures run the other direction. But I am reminded of the sage warning of former Missouri Congressman Tom Curtis: "Public money drives out private money."

CUT SHARPLY AND RAPIDLY

Some useful advice on downsizing comes from Mr. Al Dunlap, who did a remarkable, and swift, job of restructuring Scott Paper Co. On downsizing, Dunlap says:

> Do it once, do it severe, and get it over with. When a company says it is going to restructure over the next three years it won't happen....Don't do it! You paralyze the company.[3]

This is sound advice for the Congress as it undertakes the massive task of balancing the federal budget by the year 2002. Cut severely and rapidly. Don't wait. Whatever it is you do, the odds are overwhelming that you should have done more rather than less and that you should have done it sooner rather than later. There are so many pressures in Washington for the status quo that the most frequent mistake is to cut too little. If in fact one cuts too much, which is very rare, it is easy to add it back. But once you make a cut, and then you find you have to go back and cut again, it is harmful to any organization to keep doing it time after time. Do it once, do it well, and don't underdo it. Don't try to cut the dog's tail off one inch at a time hoping it won't hurt as much.

Although the balanced budget plan drafted by the Budget Committee is remarkable in its specificity and scope, in my view it violates the principle of "cutting decisively and rapidly" in that it proposes phasing out programs and agencies over a period of three to five years. If a program or agency is outmoded and inefficient, phasing out its funding over a period of years will not make it less so. For instance, I agree with those who propose to eliminate taxpayer funding for Amtrak, the Corporation for

3 Al Dunlap, "If You're Going to be a Director...," *Directors and Boards*, Winter 1995.

Public Broadcasting, and dozens of other programs that are not, or are at least no longer, appropriate federal responsibilities. But why inflict on these programs the "death of a thousand cuts?"

If Amtrak, for example, should be give the challenge and the flexibility to compete in the private sector, then why can't it be done now, say over the next twelve months, rather than over the next five years? My advice is to sever public ties with much greater speed.

Likewise, the Small Business Administration continues to dodge reform. It was not even ten years old during my freshman term, yet in a 1963 article on pork barrel spending, *Life* magazine exposed the SBA as a new "device for soaking up money and getting rid of it." Based upon its early track record, we should have had the good judgment and courage to close down the SBA decades ago. I hope that this Congress will have the courage to act this year.

DOWNSIZE

I also recommend that Congress move swiftly to cut management and get labor costs under control. It is guaranteed that there are more managers and more staff than are needed. Mr. Dunlap reports that in less than seven months, Scott Paper eliminated 11,200 people, one-third of the total workforce. The company cut 71 percent of the headquarters staff, 50 percent of management, and 20 percent of the hourly employees. As CEO Dunlap said, "it was all excess."

Another example is G.D. Searle & Co., where I served from 1977 to 1985. There we reduced the centralized corporate activities down to about 20 percent of their prior size, divested some 30 to 35-plus businesses, sold a variety of assets, downsized the company to close to 50 percent of its employee base, with the not surprising result that investors and owners moved the stock from about $12 a share to $60 a share.

So, too, at General Instrument Corporation, where I served from 1990 to 1993. There we divested five or six businesses, sold a number of assets, downsized and focused on the core businesses, and dramatically reduced the size of corporate headquarters, with the result that the investors and owners of the company moved the stock from $15 a share to $50 a share.

There are hundreds of companies that are doing exactly this. Some do it after they should have; others do it ahead of the curve. Clearly, the U.S. government is behind the curve.

No doubt the federal government suffers even more waste throughout the bureaucracy. According to the Vice President's National Performance Review, the federal government has over 280,000 persons formally classified as "supervisors, managers, and executives all of whom perform control functions, costing billions of dollars." "At times," reports the NPR, "the federal government's management control system resembles a theater of the absurd."[4] If you take the Scott Paper model on downsizing as your guide, some 140,000 of these managers should be cut out immediately, saving taxpayers billions of dollars. For example, I see fewer and fewer companies where every manager has a special assistant. But in government, it seems even special assistants have special assistants.

REORDERING THE FLOW CHART

There are a variety of ways to merge federal agencies and departments, and certainly no one way is perfect. For example, over 20 years ago, Richard Nixon and the Ash Commission recommended that there be four basic areas: defense, foreign policy, the economy, and domestic. One can find powerful

4 The National Performance Review, "Streamlining Management Control," *Creating a Government That Works Better and Costs Less: Accompanying Report of the National Performance Review*, September 1993, p. 1.

reasons for either merging or terminating many of the newer departments. Some of their functions will, of course, need to continue, but certainly much of the overhead is not necessary.

I have no special insight as to which is the preferred way to reorganize our government, but I am persuaded that two-thirds of the non-basic departments are no longer needed in their current form. For example, the Republican proposal to close down the 93-year-old Department of Commerce seems reasonable to me. It does not have a clear sense of mission, and the fact that it duplicates the work of dozens of other departments and agencies is the surest sign that taxpayers could do without it. The same could likely be said for other, newer departments such as Energy, HUD, Education, Transportation, and Veterans Affairs.

Don't Micromanage

There is no one perfect organizational arrangement. The right people can make a poor organizational structure work well, and poor people will make the best possible organizational structure work miserably. People are the key. That is why the delays in the Presidential appointment process have been so damaging. In many cases, Cabinet and sub-Cabinet posts have not been filled until after a major portion of the entire term is over.

One of the more important rules for a board of overseers is to not try to micromanage the CEO or the company's managers. Boards should give management the direction, to be sure, but also the freedom to run the company in the most effective and profitable way they see fit, and hold them accountable if they don't. One of the problems in government is legislative micromanagement of the Executive Branch. Congress imposes so many restrictions, requirements, and requests on the Executive Branch, no one of which is debilitating, but in the aggregate it is like the threads the Lilliputians used to prevent Gulliver from moving. This was a problem at the Pentagon, and I suspect still is, where the Secretary of Defense has difficulty managing the Department because of the blizzard of studies, requests, directives, and rules generated by so many congressional committees and subcommittees.

Smaller government is an impossible goal if Congress continues to tell the Executive Branch when to turn right, turn left, speed up, or slow down. What Congress needs to do is tell the Executive Branch generally where to go, generally where the sides of the road are, and generally what the speed limit is. Then Congress should stand back and evaluate the Administration on how well they do it. Too many hands on the steering wheel will put the truck in the ditch.

Big Government, Big Business, and Big Labor

Anytime anyone proposes a change, there will be opposition and concern. Change is hard. It is not easy for people. However, the fact that there is opposition and concern does not mean the change is undesirable.

In Washington, D.C., this is a particular problem for several reasons. Any change in the Executive Branch tends to result in changes in people and organizational structure, and that makes life harder for the bureaucracy and those they deal with—Washington lawyers and lobbyists. These folks have invested many, many years in relationships and knowledge, which for them is the coin of the realm. Therefore, it should be no surprise that they became the earliest and most effective opponents of change, not because they think it is unwise, but because they would lose their investment in the structure and people the way they are currently arranged. This is a poor reason not to change.

Further, any change in the Executive Branch tends to result in difficulties for congressional committees. The jurisdictions of committees are affected. There are winners and losers. But the inevitable result of any proposed change tends to be that some members in the Congress oppose it for that reason. Here again, it is not a reason not to change.

Further, one must recognize that Washington, D.C., is arranged in a way that large companies are fully capable of hiring the lawyers, the lobbyists, and the representatives to effectively interact with the Executive Branch of the federal government and the legislative branch to their advantage. Indeed, that is one of the advantages large companies have—they have the resources and they have staying power. Big business and big labor have the institutional capability to interact with big government. They all fit together.

That is not true of small business. Dealing with the federal government drains the life out of small businesses that have to compete with big business in trying to see that government does things that are rational from their standpoint, rather than harmful to them. And small companies don't have the staying power. If a mistake is made by government with respect to a small company, it can be out of business in six to twelve months.

Back in 1965, I testified for the Joint Committee on the Organization of Congress. One of my recommendations concerned the policy of Members of the House and Senate announcing federal grants, contracts, and projects in their states and districts. I recommended that it be terminated. I said:

> If, in fact, a Member of Congress has successfully achieved Federal support for a legitimate problem in his state or district, this fact will surely become known. However, to encourage or assist Members in making initial announcements of Federal grants, projects, and particularly Federal contracts, leaves at least a shadow of a question as to whether or not the contract or project was awarded solely, as it should have been, on factors such as cost, performance, and national interest. I would think that a procurement officer or Corps of Engineers official, for example, who based his decisions on need, cost, and performance, would not be pleased to see Members' announcements of these contracts or projects leaving the impression that they may have influenced his decision.

In my view, implementing this recommendation would usefully contribute to the idea that all public activity need not reside in Washington, D.C. As long as this practice remains, the incentive will be wrong.

PRIVATIZATION INSURES ACCOUNTABILITY

"Corpocracy" is a term coined by Sir James Goldsmith relating to the private sector. Corpocracy means "bureaucrats running corporations for their own good and the shareholder be damned." Fortunately, the competitive marketplace punishes companies who become corpocracies. Indeed, the most valuable thing that exists in business and in the non-governmental sector is the opportunity to fail. The fear of failure focuses the mind. As long as government programs are insulated from the rigors of the marketplace and are denied the possibility of failure, no amount of corporate restructuring will make them well. The task is to find for government some substitutes for the "bottom line" in business. While not always appropriate, one essential way of bringing this level of accountability to delivering government services is privatization.

Thirty years ago, Nobel Prize economist Milton Friedman told me that the best way of curing the problems of waste and inefficiency at the U.S. Postal Service was to amend the law so it was no longer a monopoly, and thereby would be forced to compete. It was true then and it is even more true now. Similarly, I have questions about some of the so-called government-owned corporations. One effect of "corporatizing" these enterprises can be to insulate such an activity from being accountable to either the marketplace or to Congress, and everyone should be accountable to someone. The U.S. Postal Service and Amtrak are two examples. Still other so-called government corporations, such as the Legal Services Corporation, aren't really corporations. All the word "corporation" in their title does is befuddle and confuse.

Certainly a number of these activities should be cut loose from the taxpayers' purse and allowed the privilege of competing in the marketplace. Competition is what brings out the best in people and organizations. As the saying goes, it is your enemies who make you strong. I am attracted to the idea of divestiture, or privatization, of a number of government-owned enterprises such as the Air Traffic Control System, the Naval Petroleum Reserve, the Corporation for Public Broadcasting, and the Government Printing Office. I have no view as to whether it might make sense to make some of these activities "corporatized" government agencies as a temporary step toward full divestiture. Such a step might be useful in getting an enterprise's books in order, providing time to assess the assets, and in preparation for selling it off to people who know how to run such activities.

ASSET SALES

I have trouble understanding why the federal government should be borrowing over $200 billion per year to cover its deficit when it is sitting on billions worth of assets that could and should be sold to the private sector to raise cash and which would then be forced to operate on a more cost-effective basis. As Mr. Dunlap's article points out:

> Inside every corporation is the biggest bank one is ever going to find—its own assets. My philosophy is, before you go looking for outside funding, look inside first at what you don't need. We sold S.D. Warren, a paper subsidiary, for $1.6 billion. It was a fine company but I believe you can't be in two capital intensive businesses and do well at both. We sold other operations and have another $1 billion of assets on the block. We are on track to be debt-free in 1995. All this from a company that was heavily in debt, whose bonds weren't investment grade, when I arrived.

Unfortunately, for the past decade or so, asset sales have been seen somewhat as a gimmick here in Washington, D.C. It is not a gimmick in the business world and should not be seen as such in government. The goal of such sales is to use unneeded or underutilized assets to reduce liabilities. This is a businesslike strategy I believe Congress could usefully adopt. I understand that the majority's balanced budget plan does target a number of assets for sale to the private sector, such as the Power Marketing Administrations, the Helium Program, and the Uranium Enrichment Corporation.

This is a start, but there are billions of dollars in assets which could still be tapped to reduce the government's borrowing. Why not consider selling some government buildings, some land, and other commercial enterprises? The Heritage Foundation has suggested selling the government's $150 billion portfolio of direct loans to the secondary market. This is an idea that could generate as much as $100 billion in cash. Such steps could save taxpayers billions in future interest payments as well as have the advantage of moving such assets into the productive private sector.

CONCLUSION

As the Congress goes about the business of putting meat on the bones of the balanced budget plan passed two weeks ago, you will have to make some tough decisions. I can sympathize with these choices, having served here in the House. But I've learned that the decisions that are made every day in the corporate world are sometimes even more difficult because the very survival of the company is at stake. The choices you make affect real people with real careers, mortgages, and families to raise. But since you oversee an enterprise facing Chapter XI bankruptcy, you can have confidence that the decisions you make, however tough, will lead to the long-term health of the government, the economy, and the country.