

The Economic Instrument of National Power

INTRODUCTION

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LUNCHEON SPEAKER

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PFALTZGRAFF

Ladies and gentlemen, may I have your attention, please? I know that everyone has been enjoying a very good lunch and a very good conversation. I know at our table that has been the case and I’m sure elsewhere as well. But now we must get back to even more serious work and discussion and turn to our luncheon speaker. I have great pleasure in introducing Sean O’Keefe whom I have known for many years. His present position of course is that of Deputy Director of the Office of Management and Budget and he has just been nominated I should add just this morning to be administrator of NASA. In his present position, he oversees the preparation, management, and administration of the federal budget and government-wide management initiatives across the executive branch. He brings some very special qualifications to the discussion of the economic instruments of national power, which is the area that we asked him to focus upon in his remarks at lunch today.

Sean O’Keefe has had a long and very strong interest in national security and specifically in defense policy. In 1992-1993 for example, he served as Secretary of the Navy. He served as Comptroller and Chief Financial Officer of the Department of Defense from 1989 until 1992. He also has been a staff member of the Senate Appropriations Committee dealing with defense issues. Just before assuming his present position, Sean was a Professor of Business at Syracuse University. I should say he holds a degree from that school as well. He was director of National Security Studies overseeing executive education programs for senior military and civilian department of defense managers. Last but not least, Sean O’Keefe is the author of numerous publications on defense and public policy issues. Therefore it is with very great pleasure, personal and professional, that I welcome Sean O’Keefe as our speaker here today. (Applause.)

Thank you, Bob, for a very thoughtful, warm introduction. It is reminiscent -- I believe it was the Lyndon Johnson line that my father would have been impressed and my mother would have actually believed it. I think as he walked resume items to include this morning's announcement it dawns on me that most folks who would consider such a checkered set of experiences would lead to the conclusion that I have a difficult time holding a job. My wife reminds me of that with regularity. I am always trying to determine what it is I want to do when I finally find the opportunity to settle into something. But nonetheless it has been a varying set of experiences and I appreciate spending the time with some friends here who I have known over the course of lots of years of professional experience in the national security field and certainly in the resource management business as well. The topic of an economic instrument of national power is a daunting challenge. The assumption would be you have some extensive or 12 thoughtful treatise on what the economic prowess globally could be or in the United States very specifically to bring to bear on the question of national security in international affairs issues or a range of different applications. I am not so qualified to give you an economic treatise of that variety. As a matter of fact, all of my colleagues and friends at Syracuse University would be aghast if they thought I was impersonating an economist, in this particular situation. But I remind them that economists are merely those who aspired to be accountants but didn't have the personality. So as a consequence let me focus a slightly different bent on this.

And speak to the economic instrument of national power that we possess, that we bring to bear that has changed so dramatically in the course of the last two months. And how that will bear on the overall kinds of issues and problems that we have to sort with. First and foremost it is important to kind of reach back just a little bit of time, not more than about ten years, and consider and think in terms of what the burning national debate was not more than ten years ago. It was a working assumption that there would be no prospect at all of anything short of a continued sustained persistent structural deficit. The commonly held view among politicians, statesman, policy makers, economists and the like was that it was simply a fact of life that we were stuck in a grind of persistent annual deficit spending, and that would be our condition we would have to sort with year in and year out. Which always required therefore some sense of concern of exactly how you deficit finance as well as how you would service that debt that was accruing during of course of that time. Spirited debate at the time also, albeit a minority view, was that in time given the right circumstances of economic performance, that we would grow our way out of that problem. Well that minority view proved to be more the truth or more the reality than any other forecast at that time.

It isn't too long ago to recall the nature of the debate was consistently to debate annually the question of a constitutional amendment to require a balanced budget. We've achieved that without that very extensive action on the part of the Congress, but nonetheless, it was that debate that brought around that particular view. And were it not for the extraordinary expansion we experienced in the 1990s arguably we would have remained in that deficit spending condition for some period. Just by way of statistics, it was a position in which we annually spent on the order of magnitude of \$200 to \$250 billion more than what we took in as revenue. That was again an accepted condition by some, by others it was to be argued and worked out of and

statutorily dealt with if need be. As it proved the no statute is ever going to have quite the effect that the economic performance could have. Nonetheless, in the course of the last few years we have been in an interesting debate. One I frankly don't recognize at all having spent time in Washington in the deficit debate days, of an argument over exactly what size should the surplus be.

On September the 10th the debate that was brewing mightily and the arguments that we were engaged in with tremendous amounts of enthusiasm with our friends on capital hill was whether the size of the surplus should be enormous or merely just immense. There was a term that was used with absolute regularity, every newspaper, every single day, typically on the front page somewhere referring to a lock box, I haven't heard that term since September 11th. For the argument was and the debate was that we should set aside a percentage of what we bring in as revenue each year for social security revenue, as if somehow it went into some separate special account for that purpose. Indeed, in I think as most know, the condition is that all proceeds given the unified budget were used for the purpose of paying down the national debt, including social security revenues in excess of payments to individuals. So the nature of the debate and the argument was a political argument. Not an economic one. Indeed, I would suggest that the nature of the debate and argument ten years ago and the argument of balanced budget amendments and everything else were also on the order of a political debate as well.

The conditions have changed dramatically since September the 11th, and as a consequence of that there is now a new set of imperatives to be sure. Some of which are real, some of which have a very profound effect on our economic capacity, our capacity to produce, and to afford and the wherewithal to deal with a range of national policy questions. And some of it is much like the nature of the debate 10 to 15 years ago over the issue of balanced budget amendments, or lock boxes, a very political argument. And again, that is not a derogatory term. It is the nature of policy, debate among individuals over the question of what political arguments will be. So as a consequence I think we're experiencing an entirely different circumstance. One that is very much not like the deficit days, certainly not like the surplus experiences of arguing over how much should be reserved for some other set of purposes optimally when indeed it is reserved for the same purposes we've always used them for.

But instead now it is an argument and debate, a spirited one, a very earnest one, over exactly what should be the nature of our priorities and what is our economic capacity to afford. The President has been very specific in arguing that his intention would be to maintain a balanced budget unless we encountered war, recession, or an emergency. Well shortly after September 11th unfortunately we have hit the trifecta. We've encountered all three of those conditions in the course of this span of time. And our greatest challenge I think can be summarized in three areas and I'll leave this for food for thought and I'll open it for questions, comments, dialogue but I hope we provoke some thought on how we sort through these three items in specific in terms of the kind of imperatives we need to deal with.

The first issue, I think, is very much a question of how to respond to the immediate challenges that emerged since September 11th. There is no question our economic capacity to afford and to provide for inasmuch as we are to be sure in a position dramatically different than that we experienced on September 11th. We're now looking at two successive quarters of negative gross domestic product expansion as a result,

that's a double negative, an actual contraction of the economy as it were of slightly less than .1%. As a result of that we are clearly on our way towards what is defined by classical economists as a recessionary period. Not a big surprise, but nonetheless has an enormous effect on what the overall revenue would be and what the projections will be for the foreseeable future. Nonetheless we are still dealing with a \$10 trillion economy. One that, while you see a contraction which doesn't portend the continued expansion that we've experienced over the course of the last ten years, it nonetheless is a very robust, very resilient, extremely resourceful economy in that regard. . Ok, three imperatives, I think, can be narrowed to [inaudible]. It is how to sort through the immediate aftermath of disasters of September 11th.

The Congress in a historic expeditious manner enacted a supplemental appropriations measure for emergency response within days of the event and provided the most broad-based sweeping authority that any President in the United States that I have ever heard of or anyone else I have been associated with had ever considered possible. What it did was provide the authority to the president for 20 of that 40 billion to respond with virtually no notification to all the things that are happening at that time. For debris removal in New York City, the repair of Pentagon, immediate assistance for the victims involved. A range of different circumstances that required immediate response. It was quite remarkable and quite unprecedented in terms of the authority granted by the Congress to the chief executive of the United States. But in doing so there was a range of expectations and aspirations that grew beyond that. Forty billion was considered to be an absolutely preposterously large number, more than adequate to cover anything imaginable.

Not so fast. Within a matter of about ten days the federal agencies and departments of the federal government generated requests sufficient to absorb about 125 billion. Well, it doesn't take a high math expert to realize there is no way you are going to stretch that to a factor of three. So the expectations and the demands are well beyond what anybody would reasonably expect, and for largely issues, problems, and concerns that are immediate consequences of the aftermath of September 11th. As in immediate remediation that's required, but also a range of different objectives that are recovery oriented. Intended to be more long term in their permanency. Think of it in terms of security measures. You can either establish some temporary security measures that are labor or personnel intensive, or you can erect a more comprehensive force protection if you will kind of regime that will take more in terms of resources, as well as time, effort, and energy. But all of that is accomplished in a larger set of expectations. This is not restrictive of the federal department and agencies.

The Congress of the United States in an effort to respond to a range of things have considering actively a range of proposals that based on our last count total easily \$200 billion dollars, all of which have some direct consequence or linkage or in some cases are very indirect consequence or linkage depending on your circumstances to the immediate events in the aftermath of September 11th. So that is one set of concerns is the immediacy of the kinds of problems what is it we really require what do we want to do? Quite frankly the response from the president has been let's press on, move on with the initial supplemental funding and do what we need to do to deal with the immediate problems and then let's sort through this and determine what those requirements are down the road. And as in nowadays, down the road means

weeks, not months or years. It is a continuing process that develops on a real-time basis.

The second challenge I would suspect and it is going to be a real refinement of the kinds of challenges that will place great pressure on our economic instrument of national power is how we define what the requirements are for homeland security. This is something that there have been lots of commissions, every one in this room is well aware of panels, commissions, blue ribbon groups, all kinds of folks who have talked about what the consequences of homeland security should be and how it should be defined. More broadly in terms of an organizational context or in terms of very specific programs and resources. That to be sure is going to be the focus and the concentration of attention over the course of the next several months and the next few years in terms of how we redefine what we've talked about in an academic or, if you will, theoretical context. We now see the graphic consequences of the challenges of something as basic as intragovernmental coordination between federal, state, local law enforcement, first responders. That's a term that's now rolling off the lips of those journalists.

If you had said that two months ago, they wouldn't have had a clue what a first responder was. Now it is part of the lingo. And that is part of the challenge of sorting through what level and activism does the government want to be involved in. The federal government specifically in these sets of challenges. You are seeing it played out in the context of right now debates on the aviation security bill for example. Very spirited difference of view over how extensive that regime needs to be and exactly what component should be consumed in that. There are those who would believe in you make that as complex and as in depth as some would like the aviation security provisions to be, you would guarantee that one passenger will board each aircraft. It will be a very efficient way to do it, but it will be restricted to one. Because while everybody else will be left in line as the plane takes off getting through the security regime.

Those are the kinds of problems we'll dealing with in addition to what is the range of requirements that are necessary, numbers of people required, whether screeners will be federal work force officials, all kinds of different implications like that. And those have enormous consequences in terms of the overall cost as well as a strain on our economic capacity at a very time when our economic capacity is being challenged. So how this becomes defined in a more broad-based construct than what has typically been viewed by many as a counter-terrorism response. This now becomes a much more expansive kind of debate. It includes and encompasses a wide range of capabilities. Yet to be defined. And could be very consequential in terms of its organizational implications as well as to be sure of the resource implications that will flow from it.

The third and final piece I think has been a continuing debate, certainly in the course of this administration, is what ultimately will portend as a consequence and revisions to the strategy review which may necessitated as a result of the events of September 11th. The concern over what transformation should look like, what constitutes transformation, definitionally, and in turn how rapidly you should go about doing that and can you afford to abandon legacy procedures and approaches and force structure and programs in your pursuit of some transformation is a continuing raging debate. But one that translates into if you maintain both, it will be more expensive

than it is today to be sure. Therefore again putting a greater and greater strain on what the overall consequence and economic impact will be in this fragile period in which we're trying to respond to that.

And again with these three pressures coming to bear, the immediacy, redefinitions of home land security, and a refinement, a thinking through of exactly what the national security strategy may portend or import as a consequence of these dramatic revisions in turn will all place enormous resource requirements on what is right now our fragile economic condition and how we provide for this. Again, a great point to take heart in is again we're dealing with a very resilient capacity of a \$10 trillion economy, for which the congress of the United States right now, and which the debate is brewing over whether a \$100 billion dollar stimulus package will be sufficient to jump start a \$10 trillion economy again. You do the math.

It is one that is very much an issue of how do you provide impetus stimulus capability that will at least move or prod along some elements of what may be sluggish in this economy, but the very notion that somehow we can do something along the lines of what we experienced as classical or more traditional definitions a economist would view as Keynesian economics by either spending or specific tax provisions that will have a dramatic impact on what the economy will do, this is comparatively a spit in the bucket. But it is nonetheless one that has some.

[inaudible]...thought and debate where we can engage in more of a dialogue where we are not talking at you. I want to thank you for the opportunity to be hear, it is a great pleasure to be here with the Fletcher School.

PFALTZGRAFF It is a great pleasure to have you Sean with us, why don't you have some ice tea or water and we can offer you, we have some cold soup here too. In any event we have a few moments for discussion or comments. Who would like to ask the first question? Please raise your hand.

FROM AUDIENCE I am an analyst with Credit Suisse First Boston in light of, sir, the comment that you made regarding expanding the expectations, we have heard all kinds of numbers of where the defense budget could be going as a trajectory could be going as a result of the next 5 or 6 years, can you limit our expectations, or sort of lay a ground work at least for what the expectations should or can be?

SEAN OKEEFE The short answer is no. I think it is yet to be determined. The more central question that is going to drive a set of answers to the question of how big this is going to be or how attractive whatever else, depends largely but not exclusively, on the proposition I laid out earlier which is to the extent that you decide is that there is a consensus, that's quite a leap of faith in itself, that we could actually define what would constitute transformation, identify programs, initiatives, specific policies, there are lots of ideas on that front but exactly how that is going to gel in a very specific way is still at the formative stage. There is still a lot more debate and discussion going on that is certainly beginning to coalesce around a number of different ideas or initiatives. But if you pursue those, concurrent with the maintenance of a legacy type of position, it is going to translate into substantially more resource requirements. The alternative is you pursue both and do both poorly. And that's part of the challenge to pursue this kind of agenda or strategy concurrently but none the less is an imperative brought

home and made more clear to us by the September 11th events. That said, I think that we are looking at again the difference between how I began this discussion of how we once viewed the question of surplus whether it is enormous or just merely immense.

FROM AUDIENCE I'm Suzanne Carlton, Department of the Army.

O'KEEFE Hi, Suzanne.

FROM AUDIENCE Recently I saw a group of CEOs in corporate America offering to come to the aid of the military and the government in whatever way their corporations could assist this new transformation, so to speak, we are trying to achieve. Is anything being done to channel that sector and overcome some of the procurement legislation all the things that does to a very slow process to help quick start companies that are hurting to channel their energy to help the country move along here.

O'KEEFE Absolutely, I think that is a very good point and frankly I have been stunned in the course of the last couple of months by the speed and agility with which this federal process can move when properly focused in this regard but it takes specifics, that's the catch. And I'll give you two points. I think they are really worth driving home. First one is there is a specific set of cases, I'll give you one really right off the bat, it came up just the other day kind of example, in which the Federal Bureau of Investigation has been for some time working on an effort to substantially upgrade its information technology systems for information that I think you could use any amount of your imagination to determine what it is that they would use that capacity for.

I'll leave it at that.

But the purpose is to speed up that process and move along. Every single effort from a contractual standpoint with every corporation, with every contracting official, whatever who have identified specific circumstances in which they need to move that particular contract action along accelerated to meet a very ambitious timetable that the FBI director I think appropriately laid down for its initiation and initial action, all of which are well within the parameters of existing law. And all it takes is identifying what those limitations are, and then moving on expeditiously to move all of the impediments and the usual challenges that would otherwise occupy our time out of the way because we now have an objective that is so clearly understood that you can use existing law. And indeed, the concern initially was raised, we have to get a law to waive the following requirements on a very cursory examination ascertained as how there is absolutely no legal statutory impediment whatsoever to do what they want to do. It is all within the parameters of existing law. It is all a question of focus. It is astounding to see how well that can be deployed.

Second one is, there is a very specific provision of law that the President has proposed which establishes a procedure for the elimination of specific statutory impediments to efficiency. To doing what it is we think managerially as managers within the federal establishment are necessary in order to do this. And he named it himself, the Freedom to Manage Act. What it sets up a very simple, no frills way, is a process by which each year if there is identified a specific set of provisions of law that get in the way of doing the work much like your question poses as a context,

that we can put that under an expedited procedure for immediate Congressional consideration for which they will be required within a very within a very specified period of time to vote to sustain that particular requirement or statute or repeal it. Very rapid process for that consideration. That kind of discussion would never even be enjoined as a serious debate or serious question of public administration were it not for the events of September 11th I would suggest. Now it is focused the mind and attention in a way that says we don't want to have something that is an impediment that serves a very narrow set of purposes, it statutorily is in place, it would otherwise impede a response for the protection of the citizens of the United States.

Here is the rub. What I found fascinating in a cursory request and review from departments and agencies is among the things that are perceived to be statutorily impeding much like this FBI analogy, most of it melts away as soon as you say I have a process to get rid of it. Suddenly you've come to find out that it really isn't a statute at all. It may be some interpretation of some report language long ago forgotten as to why it got there that suddenly has crept into in the way we do business, simply because that is the way we've always done business. As so a result, no one is even left alive who can remember what the genesis of it was, but that's the way we are doing it. In which you come to find out like the old Pogo cartoon would suggest, we have met the enemy and it is us. More often than not the impediments to this kind of circumstances are not statutory, they are not regulatory, they are typically because we've interpreted for a set of reasons legitimately with good faith, rarely in malice, that ultimately has us in a process for which that has served that purpose.

This particular provision, I think, the President really hit on something hereby proposing this freedom to manage act provision is going to be useful for the purpose of specifically repealing a set of provisions of law that are impediments, but more importantly, it is going to work in those 99% of the cases in which those impediments don't exist at all, but it now gives you a means, a way to answer that particular process and assertion each time it is raised that we can't do efficiently because the law says we can't. Now you have a rhetoric that says show me the law. And if you can't show me the law, then do it. And that's a very different mindset, interesting cultural managerial mind set change of how I think we are going to be doing business in the future.

Thank you for the question.

PFALTZGRAFF

Thank you very much, Sean, for this outstanding presentation. We should end on this upbeat note, if there's not a law, let's do it. We thank you for being with us and understand that there are many more questions, but the art of good public speaking is to stimulate so many questions that you cannot possibly answer them in the time available. And you've done that brilliantly. So we thank you very much for being with us today. May I suggest also that we should move rapidly back into the theater where the afternoon session will begin in approximately ten minutes. In fact at exactly 1:30.

(Applause.)