CHAPTER SIXTEEN

Managing Indirect Government

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On December 10, 1999, federal agents arrested Wen Ho Lee and capped their three-year investigation of leaked national nuclear secrets. Lee was a twenty-year employee at the Los Alamos nuclear laboratory and had been working at the secret "X Division." Somewhere along the way, intelligence analysts suspected that the Chinese government had captured the secrets of the W-88 warhead, America's most advanced nuclear device. The analysts believed that the Chinese had obtained the design from Los Alamos, and Lee was their chief suspect.

After Lee's arrest, the general impression was of a federal employee who had gone bad—or who, at the least, had been sloppy with matters of utmost national security. In fact, Lee was not a federal employee, even though he was working on the federal government's most sensitive nuclear secrets. He was an employee of the Los Alamos National Laboratory, which the University of California-Berkeley operated under contract to the U.S. Department of Energy (DOE). In short, Lee was part of indirect government and the case, even if just a matter of mishandling classified ultrasecret computer files, was a problem of managing indirect government.

It was also a case that demonstrates how tightly indirect government has become woven into government operations. Since its beginning, Los Alamos has been a "GOCO": a government-owned, contractor-operated facility. Indeed, the entire Manhattan Project, which developed the first nuclear bombs, and the fifty years of nuclear weapons production that followed, built on the same model. The government—first the Atomic Energy Commission, and then the DOE—ran few of these facilities itself. From the production of nuclear materials in Hanford, Washington, or Savannah, South Carolina, to the machining of plutonium warhead triggers at Rocky Flats, Colorado, GOCOs have been the keystone of the nation's nuclear strategy. Rather than produce the weapons itself, the federal government has always relied on private contractors.

So extensive is the government's nuclear contract network, in fact, that DOE is little more than a loose holding company for its contractors. Paul Light, for example, has estimated that there are thirty-five contractor employees for every DOE worker.[1] DOE does other things as well, including setting national energy policy and monitoring energy supplies. Its nuclear functions, however, dominate its budget as well as its workforce, both in government and in the contractors. It is no exaggeration to argue that the effectiveness of the nation's nuclear weapons program—and ultimately the nation's defense—depends on how well DOE manages the indirect government that produces and maintains the weapons.

I. THE HIERARCHY PROBLEM

As the other chapters in this book make clear, indirect government has proliferated, from subtle incentives contained in the tax code through the implementation of welfare

reform. Moreover, this is as true for state and local governments as it is for the federal government. Quite simply, the management of government is not one basic process but two: the production of government goods and services by government itself—a shrinking part of governmental activity; and the production of goods and services on behalf of government by others acting on its behalf, through one of the government's many indirect tools.

The spread of indirect government has been of both great and small importance to elected officials. Policymakers have often embraced it in a belief, often unsupported, that nongovernmental actors can deliver public services more efficiently than government agencies ever can. On the other hand, policymakers have often shown little interest in and less knowledge about the management implications of the indirect systems they have created. When Lee's case made national headlines, Congress's reaction was to restructure DOE's security apparatus, without charting how changes in DOE's headquarters would percolate out to the contractors.

Policymakers have often approached indirect government as a self-executing system. They frequently begin with a reverential view of market competition and an assumption that such competition is superior to government monopoly. They assume that leaving things to the market will produce superior services. And they assume that the management of government services through indirect mechanisms will happen spontaneously and with little need for government oversight. In fact, of course, no private-sector manager would assume that the company's contractors would deliver quality goods on time at a fair price. Private-sector experience teaches that outsourcing—the private corollary to indirect government—requires close management and careful oversight. The same is true of government.

Private-sector experience also teaches that managing such indirect strategies is different from managing goods and services produced by an organization's own bureaucracy. Even if the goods and services might be identical, the process that produces them is different and requires a different approach. Most complex organizations—public and private—are organized internally by hierarchy and controlled through authority. Decisions at the top trickle down the chain of command. Officials at each level have power because of the authority inherent in their positions. That does not necessarily mean that officials act most effectively by exercising that authority. However, the basic structure and process—as well as the ultimate fallback in case motivation-based approaches fail—are based on authority and hierarchy.

In indirect relationships, whether in government or the private sector, the basic approaches do not function on the basis of hierarchical authority. Top managers, for example, cannot order contractors to perform certain activities. They can negotiate, create incentives, or threaten nonrenewal of the contract, but they cannot command. The relationship within an organization traditionally builds on authority; the relationship between one organization and another organization, on the other hand, builds on market-based exchanges. The management and control systems follow. Bargaining and incentive systems replace command and control. The basic administrative problem of indirect government thus is developing effective management mechanisms to replace command and control. This holds as much for loose relationships, such as incentives in tax policy or loan programs, as it does for more formal ones, such as contracting out.

In most of these relationships, the centerpiece of the relationship is now a contract. That is, of course, the case for contracting out. However, the government uses written agreements, embodied in contracts and contract-like devices, in other policy tools as well. The federal government has increasingly negotiated written agreements with the states on issues ranging from waivers of welfare program requirements to environmental regulation. Direct and guaranteed loan programs rely on contracts as well:

borrowers promise to repay debts at specified rates, and they are liable in court should they fail to comply. Negotiated exchange relationships replace hierarchical authority.[2]

The management of indirect tools thus links with principal-agent theory. In that theory, relationships are exchanges: incentives and inducements in exchange for desired behavior. Elected officials create policy and establish relationships with agents—administrative agencies—to carry it out. Within bureaucracies, top-level officials likewise create relationships between themselves (as principals) and subordinates (as agents) who agree to carry out decisions in return for inducements (principally salary). Relationships between government agencies (as principals) and contractors (as agents) thus, in one sense, are simply variants of this basic pattern. However, differences in the basic relationship create different kinds of principal-agent relationships. Within an organization, agents not only agree to carry out a task. They also agree that, in doing so, they will subject themselves to the organization's basic rules and authority. Between organizations, the relationship is looser and more purely market based.

The point here is not that one system is inherently better than another. Rather, it is that they are different: managing authority-based relationships requires one approach; managing indirect relationships requires a different one. The dominant model, in both thinking and practice, is hierarchical authority. As government has increased its reliance on indirect tools, the thinking of policymakers has not adapted to the realities of indirect tools. Moreover, because government has frequently not developed instruments for managing indirect tools as fast as it has come to rely on them, managing indirect government is often harder than managing direct tools. In fact, government faces three major challenges in managing indirect government: using its hierarchical bureaucracy to manage nonhierarchical tools; dealing with multiple actors who often have widely different incentives and motivations; and reconciling government's bottom line—political accountability—with the diverse, sometimes conflicting, financial bottom lines of its partners. When, as is the case in Medicaid, the chain of implementation involves both intergovernmental and public-private-nonprofit partnerships, the challenges multiply.

Government's performance is only as good as its ability to manage its tools and to hold its tool users accountable. As the Lee case demonstrates, the federal government's programs are only as strong as its indirect partners. A weak link anywhere along the service chain, even if the weak link is far outside government's halls, undermines the effectiveness of public programs. Government thus must ensure that its service delivery partners have the capacity required to make shared service delivery work well. Moreover, government itself must develop the capacity to manage these indirect tools. If government (at all levels—federal, state, and local) retreats back to traditional hierarchical management strategies, it will not build the necessary leverage over its indirect partners. That can only undermine the effectiveness of public programs and diminish the government's ability to preserve important norms like responsiveness and equity.

The capacity problem spills over into the accountability problem that Paul L. Posner discusses in Chapter 18. Traditionally, accountability has been viewed as a problem of control. In nonhierarchical governmental programs, however, control is not an option. Accountability in indirect government hinges much more on obtaining good information. That, in turn, requires creating new mechanisms to generate, assess, and manage this information.

Networks and Public Management

How should we think about managing indirect government? *Network-based* approaches fit far better than traditional hierarchy-based approaches.[3] The fundamental relation-

ships among those managing indirect tools sometimes can be very formal (like contracts, grounded in civil law) or very fuzzy (like tax incentives, in which the government creates opportunities for anyone wishing to use them). The relationships, moreover, tend to be between individuals within a government bureaucracy and others (acting either as individuals or on behalf of a private or nonprofit organization) outside it.

In short, the relationships are more like webs than hierarchies. Because the relationships cross organizational boundaries, few government agencies can any longer fully encompass any important problems. Government managers cannot "control" indirect programs because they cannot exercise control over those who implement them. As more government programs rely on indirect tools, managers must shift their management techniques to gain leverage over the networks that produce the goods and services. Managers, in short, do not manage programs or agencies. Rather, they manage *networks.*

As Harvard Business School professor Nitin Nohira points out, every organization's environment is a network of other organizations. To do what they do, organizations interact with other organizations in their environment. Public policy implementation thus is a government agency's action embedded in a web of organizations, and a program imbedded in a web of other programs. The perspective of any one organization therefore misses important elements of the process. The actions of network participants can best be understood by understanding their place in these networks of relationships. Most organizational analysis—and the broader public understanding of government bureaucracies—begins by trying to understand where an official or program sits within the bureaucracy. Network theory argues that a manager's or program's place within broader networks is most important. It is one thing to look at how DOE sets energy policy. It is quite another to understand the connection between DOE and the University of California as its contractor, and between the university and the Los Alamos lab as subcontractor.[4]

Nohira argues that networks shape action—and actions shape networks. How things work depends on how networks' components fit together. This, of course, is a challenging job for government managers. They have to learn the points of leverage in networks, change their behavior to manage those points of leverage, develop the processes needed to make that work, and change the organizational culture from a traditional control perspective to one that accommodates indirect methods. It can be an even more challenging task for policymakers, who often worry little about program implementation. The fact that managers must work through networks limits their autonomy, increases their need to find cooperative strategies, and exposes them to greater political risk as they can exercise less control over what their nongovernmental partners do.

The Management Challenge

What does this mean for managing indirect government? Because indirect government is different from direct government, government managers relying on indirect government cannot control the front lines of service delivery by reaching down inside their own agencies. Indeed, they cannot control the front lines at all. Rather, they must find tools to influence the behavior of frontline service providers who work in other organizations. Sometimes they must shape incentives to influence the choices of individual consumers. To ensure accountability, policymakers hold managers responsible for these programs. The managers, in turn, must develop new tools to ensure the effectiveness of their programs. They are responsible for ensuring high-quality results in programs that they do not directly control.

Moreover, government managers face additional challenges. Compared with private-

sector managers, public-sector managers are responsible not only for what gets done but for how it gets done as well. Elected officials expect that public programs achieve their goals (effectiveness). They also expect that the programs achieve their goals at the lowest possible cost (efficiency). They expect that citizens will be treated fairly (equity) and that all citizens will have the same opportunity to receive services (equality). They expect that the process will be open and transparent, and they expect that those who manage the service-delivery system will listen carefully to citizens' views (responsiveness). In the end, they expect that policy results will match their programmatic desires (accountability).

This is a very tall order. Indeed, as economist Arthur M. Okun recognized, American government constantly wrestles with "the big tradeoff" among competing values. The institutional arrangements government creates to manage the tradeoff "represent uneasy compromises rather than fundamental inconsistencies."[5] It is always tempting to try to solve these problems by retreating to the hierarchical tradition. However, American government long since has made the decision to rely heavily on indirect government. Government has come to rely heavily on the flexibility and added capacity that indirect government brings. Moreover, indirect government is as much a political as an administrative strategy. It draws private and nonprofit organizations, as well as individual citizens, into the very fabric of governance. That spreads the benefits of public programs. It creates nongovernmental jobs in the government's partners. It turns the arguments about separating public and private functions on their heads—network-based partnerships blur the lines between the public and private roles.

The solution therefore lies in better equipping government to manage its indirect tools. Managing American government is a messy process at best. Managing indirect government is messier yet, precisely because indirect government incorporates more varied and complex social values into the process. Managing this system requires a three-part balance among process, people, and performance, and it requires building the capacity to do so.

II. PROCESS

The vending machine model of government services may be a caricature, but it nevertheless captures the way many people think about government management—and a lot about the way that managers actually manage and policymakers envision policy. It is easy to envision a government agency as a sophisticated mechanism that translates inputs (tax dollars) into outputs (goods and services). Policymakers put money in the top, expect agency managers to construct the machine's insides to produce the desired service, and then they wait for services to emerge. They do not worry much about what the insides of the machine look like any more than most consumers think about how a soft-drink machine actually takes coins and gives them cans. What matters is that inputs produce the desired outputs.

For policymakers, this approach works quite well. They do not really need to worry about the internal mechanisms by which government agencies work so long as they do work—that they produce the desired outputs in the desired way. That, in turn, reinforces hierarchy as the basic model. It defines the workings of the machine and line-item budgeting as the basic control mechanism. It also defines what resources go in the top and what activity ought to come out the bottom. This two-step process provides a valuable guide. It defines who is responsible for what, and it matches resources with their actions. Because indirect tools tend to operate through nonhierarchical networks, however, government managers must solve two problems. They must find effective

mechanisms for shaping policy implementation, and they must find ways to link these newer mechanisms to the more traditional ones on which policymakers rely.

Two mechanisms are of special help: managing contracts and tracking the flow of money. Contracts help structure the networks of policy implementation. Following the money provides a guide to who actually does what. It helps managers escape the often-fictional view of the vending machine to get a detailed view of how government programs are implemented. Controlling the flow of money, moreover, provides a way of enforcing accountability for the quality of program implementation. Together, these mechanisms provide the basic framework for managing indirect government.

Managing Programs by Structuring Contracts

Contract-based relationships apply formally to many forms of indirect government. Contracting out (including procurement of goods and purchase-of-service contracting) as well as many insurance and loan programs build on formal, written agreements. The shift from direct government to contract-based tools is not only a change in tactics. It is also a fundamental change in legal mechanisms: from the administrative law of delegated authority, which has been based since 1946 in the Administrative Procedure Act and its revisions, to the civil law of contracts, which grows out of English common law.[6]

Private-sector companies, of course, have long managed their suppliers. Governments likewise have successfully relied on contractors for everything from building highways and nuclear weapons to policy advice and external auditing. To operate effectively through contracts, government needs to be a "smart buyer" of the goods and services it is purchasing.[7] This, in turn, is a three-part process. First, government needs to identify the good or service it wants to buy. No auto company, for example, would contract with a supplier to deliver windshields without specifying their size, strength, and other characteristics. Specifying goals has always been problematic in government contracts. Indeed, problems of goal conflict lie at the core of many indirect government strategies, as Posner argues in his chapter. Public goods and services often are not off-the-shelf items for which generally accepted standards already exist. That often means that the government-as-buyer and contractor-as-supplier must negotiate what the finished product ought to look like. Kelman's study of government computer procurement has found that public managers believe that private suppliers are likely to overpromise on what they can deliver. Moreover, unanticipated problems often pop up in many government contracts. That requires the government and the contractor to renegotiate the deal. That, in turn, makes it harder to hold vendors strictly responsible for their performance or to control costs.[8] The further the procurement moves away from off-the-shelf items, the more likely these problems become.

Second, government needs to sustain a strong and competitive market for the goods and services it buys. An underlying argument for indirect tools is that market competition makes the private sector more efficient. However, if limited markets minimize competition, this assumption crumbles. Indeed, private monopolies are no more efficient than public ones. For much of what the government buys, this is no problem. The federal government, for example, has issued procurement credit cards to many of its managers, which allow them to buy items at discount-price office supply stores and similar facilities. The General Services Administration has created a massive online shopping facility for common items.

The more government's service system moves from buying off-the-shelf items or inducing people to do more of what they are already doing, the harder it is to apply the standard private-sector model. For example, when the government launched the

Manhattan Project during World War II, not only were there no existing suppliers—no one was even sure if the atomic bomb would work. When state and local governments began contracting out for the management and delivery of welfare reform in the 1990s, competition among potential service providers was limited. In fact, many of the markets in which the government arranges for goods and services are "monopsonies," in which the government is the sole buyer of the service. When the private market does not provide real competition—or if it does not naturally produce the goods and services government wants to buy or encourage—the case for private-sector efficiency erodes and the government's job multiplies. It must stimulate the market to produce goods and services that otherwise would not be produced. Then it must guard itself against market failures that can drive up costs, reduce efficiencies, and benefit some citizens more than others. Other indirect government tools, especially tax and loan programs, uncover more problems. Indirect government often depends on the assumption that government can use the private market for public purposes. The further the government's intended results move away from the existing state of the market, the more difficult the government's problems become.

The government's own management systems can also get in the way of achieving its goals. The procurement rules, for example, make it difficult for public procurement managers to use their discretion to strengthen competition. Government's typical requirement to accept the low bid, without taking into account vendors' performance record, makes it even harder to sustain quality services at the consistently lowest prices. The federal government's procurement reforms in the late 1990s began to change that by allowing manages to take past performance more into account. However, government's rule-bound procurement system, created to ensure uniform treatment and prevent favoritism in contract awards, makes it hard to establish and maintain strong and competitive markets. The rules embody important political norms but also complicate management.[9]

Finally, government needs to assess the quality of the goods it buys. Private-sector managers would never dream of paying invoices without first determining that what they thought they were buying was what they actually received. The government faces the same challenge. Government's job is often harder, however. The goals of public programs frequently shift along the implementation trail. In fact, many public programs seek to ensure that service recipients have some power over the way a program works. Moreover, in government programs, shifting goals make it that much harder to assess contractors' performance. In the government, moreover, there is no bottom line and performance measures are rudimentary at best. Complaints can arrive from many different sources, from congressional oversight to citizen protests. The chain of accountability, especially in indirect government, is much more complex than either in the private sector or in public direct service delivery. This combination makes it harder to measure results or assess responsibility for problems—and it separates government's indirect tools from the private-sector management model so often invoked.

Throughout indirect government, however, the legal skeleton is the nation's system of civil law. It is the basic relationships among parties to contracts as well as the procedures for handling disputes. Some indirect tools, like loan programs, require written agreements by lenders and borrowers. Government corporations live in a quasi-world between the public and private sectors, with the legal requirements of each sector typically applying. These agreements hinge on important elements of civil law, especially contracts and torts. Many indirect tools thus work through multiple legal layers: fundamental precepts of civil law; the government's own procedures and requirements, which multiply if several levels of government are involved; and a program's own goals and requirements. Simply asserting that the law provides the ultimate guide for ac-

countability of public programs does not help managers. They frequently face the challenge of discovering which legal frameworks apply and how to apply them. Indeed, as many former Soviet-bloc nations tried to sell off public industries and services, they discovered that the lack of a civil law tradition—what a contact is, how to structure it, how to resolve disputes in executing contracts—severely hampered the privatization effort.

Even in indirect tools not based on formal contracts, the legal structure shapes the tools' management. Regulatory tools flow directly out of the Administrative Procedure Act and its system of formal and informal rulemaking. The act fixes the procedures that federal managers must follow in issuing regulations and regulatory decisions. Tax expenditures sit in the rich—and huge—legal tradition surrounding the tax code. In short, even if contract law does not apply to all indirect tools, assessing the legal framework affecting each tool provides important clues to how it is managed and how disputes are resolved.

Managing Programs by Tracking Money

Indirect government, by breaking the chain of authority, disrupts the authority-driven approach to government management. The flow of funds, however, remains the basic tool for ensuring effectiveness and accountability. In indirect government, it is often deceptively hard to determine who actually is responsible for doing what. As John J. Lordan points out (see Chapter 17), financial accounting maps who spends how much money on which activities and provides a way to gauge accountability. Policymakers can thus shape outputs and outcomes by seeking leverage through the money flow. Moreover, by charting who actually does what, it promotes accountability by identifying who is responsible for which pieces of the system. It moves many of the key processes into civil court and mixes public and private mechanisms for responsibility.

Financial accounting in government has long been an analytical backwater. It has received little attention from mainstream scholars in public management and has been relegated instead to the "nuts-and-bolts" category. As indirect government has risen in importance, however, financial management and accountability have become more important as well. In a system that confounds traditional bureaucratic lines of authority and defies a clear mapping of responsibility, the money trail provides one of the few ways of determining just who is doing what to whom, when, and how. It is also one of the most powerful sources of leverage in a system where traditional authority-based tools frequently fall short.

St. Louis's "Job Link" program demonstrates the important role that good financial accounting plays in promoting high performance in indirect programs. Job Link focuses on helping public-assistance recipients make the transition from public assistance to work. It is a regional program that focuses on helping workers find jobs along an 18-mile light-rail line connecting East St. Louis with the airport. The local community college oversees the program and a local community organization, Better Family Life, carries it out. Better Family Life recruits workers, gives them training, places them in jobs, and then supports them for up to two years. As program director Carolyn D. Seward explains, "We tell clients, 'Success isn't just graduating from the program, it's also getting involved in your church, your children's school, the neighborhood crime watch. If you're living in the inner city, you're part of the solution or part of the problem.' "

In its first year, the program placed more than one hundred workers in jobs. Employers applaud their new workers and the training they receive. The concessions manager at the airport said, "Whatever they are doing at Better Family Life, they should

pass it on" to other programs training workers. To make the program work, the St. Louis Regional Jobs Initiative agreed in advance to pay Better Family Life $500,000 for training and placing two hundred workers—at the rate of $2,500 per trainee, but only for workers still on the job after a year. The program's managers set five milestones, with portions of the $2,500 fee paid at each step: after the first week's training; at placement in a job; after four months of employment; after seven months on the job; and then after a full year's employment. The community college official overseeing the contract said, "We don't get paid unless we produce the product."[10] This approach places heavy emphasis on tracking the performance of each trainee.

Following the money thus provides the basic foundation for assessing a program's performance. Determining who actually spends the money, and what they spend it on, is the first step to determining in the end what results the public money buys. That, in turn, demands a strong monitoring and accounting system. The Job Link program promoted "outcome-based funding." It demonstrates that there is no accountability without matching performance against the milestones, and it is impossible to do either without determining who spends the money for what.

Doing so, of course, is not a trivial problem. Job Link is a complex network involving both governmental and nongovernmental organizations: government money passes through a management contractor—the community college—to frontline, nongovernmental managers. Other public programs rely on partnerships that are even more complex. Medicaid, for example, is a federal program administered by fifty different states, each of which adds its own twist (and often its own money) to the program. Private and nonprofit partners actually deliver the health care, while other third-party companies process the claims. The same is true in many other federal grant programs. Regulatory partnerships, like the Environmental Protection Agency's (EPA's) emerging partnerships with the states, likewise raise staggering problems simply of charting the partnership, let alone following the money.

On the other hand, the money trail can help map the relationships and provide information on just who is doing what. It is, at once, a goal-defining system, telling a partner where to aim; a performance-tracking system, assessing the partner's success in meeting the goals; a financial control system, linking payments to results; and an accountability system, telling policymakers what results they get for their money. By following the money, managers, elected officials, and citizens can get basic information about who is doing what. That does not tell them how well the programs' managers are doing. To get that information requires far more detailed monitoring and evaluation systems. At their core, however, all of these systems begin with tracking the money. In the complicated government/nongovernmental networks that manage many government tools, the money trail is perhaps the one reliable guide to who actually does what.

III. PEOPLE

Just as the hierarchically organized, authority-driven model dominates theory and process, it also powerfully shapes the government's personnel system. A century-old tradition, dating from the early Progressive era, created a civil service system with clear rules. The system uses tests and other objective measures to select and promote people on the basis of what they know, instead of whom they know. This has helped insulate the system from political interference and secure a strong base of technical expertise in government at all levels of the intergovernmental system.

However, the old system has proved a poor match for the challenges of managing twenty-first century government—especially indirect governmental tools. The current system, created to manage direct tools, is now a jury-rigged patchwork that seeks to

bridge the gap between the system's original goals and the demands that public programs increasingly make on it. The strains and creaks in the personnel systems at all levels of government have made it increasingly difficult to get the right people with the right skills into the right jobs to manage government's growing reliance on indirect tools. It has proved poor in recruiting the managers needed for indirect government, training them in the requirements of managing indirect tools, and creating the incentives for high-performing governmental careers.

People Problems

Three problems, in particular, plague the government's people systems. First, the civil service tradition recruits and promotes individuals largely because of their substantive knowledge. Government seeks first-rate accountants, chemists, engineers, environmental policy analysts, clerks, and computer programmers. As their careers evolve, however, technical experts become supervisors and managers. The difficulty of this transformation is legendary. American government has notoriously had problems helping technicians make the transition into administration and management, especially because government invests so little money in training. People who are first-rate engineers do not always have the people skills to become first-rate managers.

Second, managing indirect government requires skills that the traditional civil service system tends to either undervalue or ignore. Managing indirect government requires great skill in managing networks, but the existing civil service system was created to manage hierarchies. Government managers might enter the EPA focused on a career in environmental policy and trained in engineering. They might well intend to spend their time developing new strategies for reducing pollution. However, EPA conducts most of its activity through intergovernmental partnerships (with states that do much of the frontline regulatory work) and contracts (with private companies doing most of the cleanup and remediation work). It is one thing to plan a career cleaning up the environment; it is another to end up with a career managing other people who actually do the work. That not only frequently causes motivation problems. It also creates challenges for the government in preparing managers for new tasks that the managers themselves did not anticipate.

Third, the traditional civil service system's very strength—its clear structure and rules—makes it hard for government to adapt to the fast-changing world of indirect government. Several federal agencies—the Internal Revenue Service, the Federal Aviation Administration, the Defense Department, and the National Weather Service—made multibillion-dollar mistakes because they failed to manage computer procurement contracts well.[11] In California, the attorney general probed the role of organized crime in a casino owned, but not managed well, by the U.S. Justice Department Marshals Service. In each case, the government lacked the capacity to specify what it wanted to buy, write good contracts, and monitor the contractors' performance.

Ad hoc efforts have been made to cope with these problems. In fact, the federal government's civil service system now covers just 56 percent of the federal government's workers. The merit-based testing-and-placement program provides the pipeline for only 15 percent of the federal government's new employees. More government agencies are hiring more employees through positions exempt from civil service recruiting, short-term positions, and other tactics to circumvent civil service requirements.[12] As a result, it has become a nonsystem that neither preserves the goals of nonpartisan competence for which it was originally created nor provides the skill set required to manage government's tools.

In a constant struggle to find—and keep—people with the skills to do government's

work, government managers have devised exceptions and new routes of entry to government service. Vice President Gore's "reinventing government" campaign led officials of the federal government's central personnel agency, the Office of Personnel Management (OPM), to dump the personnel rules into a dumpster and proclaim the death of the dreaded SF-171 standard resume form. OPM devolved authority down to the departments and agencies. Like rumors of Mark Twain's death, however, the end of these federal rules was greatly exaggerated. Many federal agencies simply readopted the old federal rules as their own, rather than try to create a whole new version. Some states have experimented with even more radical reforms, including Georgia's effort to virtually abolish the civil service system for new hires, but much more needs to be done.

The Indirect Government Skill Set

Managing indirect tools is fundamentally a people problem. The very complexity of networked relationships puts greater emphasis on the bridge-building, boundary-spanning skills of managers. The problems surrounding the Los Alamos labs are as much people based (given DOE's problems in getting the right people with the right skills to oversee the research program) as contracting based (given the complexity of the relationships). The fundamental irony of privatization and its other third-party variants is that they require very, very strong public management to make them work well. Moreover, they require a skill set—writing and negotiating good written agreements, tracking the money, auditing results, and assessing performance—on which governments often place relatively little emphasis.

The required skill set is not one that government actively nurtures, or, for that matter, is it a skill set that most of the nation's schools of public affairs develop. Most programs focus either on policy analysis (the microeconomics of decisions), public management (the leadership of top officials), or public administration (most typically, the running of traditional organizations and direct programs). All of these skills are useful in managing indirect government, but they are far from adequate.

The skill set for managing indirect government is different from the collection of tools that most government civil service systems emphasize, or most public policy or public administration programs teach. Effective managers of indirect programs need five skills in particular:

1. *Goal setting.* All government managers need to understand the goals of the programs they run. In indirect programs, this is even more important. Government managers need to craft contracts, tax incentives, regulations, or other tools to achieve the public purpose. Moreover, they need to understand how to communicate those goals effectively to government's partners so that they work to achieve that purpose. The ability to distill a measure of clarity from political ambiguity, build consensus for those goals, and fine-tune tools to achieve the goals are critical skills.

2. *Negotiation.* Government managers cannot display these skills by relying on the authority exercised through their agency's hierarchy. They must find the right collection of inducements to nudge their partners to common ground. Effective managers of indirect programs must become good negotiators able to find common ground with their partners, while ensuring that legislated goals remain paramount. In some tools, like contracts, government managers must be able to reduce this common ground to legally enforceable language.

3. *Communication.* Managing indirect government thus requires government managers to negotiate a two-way street: sending signals to partners about public goals,

and collecting feedback about partners' performance. Unlike pure market mechanisms, where the balance of supply and demand creates a self-regulating system, government-driven partnerships require more tending. The government has deployed indirect tools most often for fuzzy goals, ranging from tax expenditures encouraging investments to contracts for delivering social services. Feedback is important both for assessing the results of the tools and for fine-tuning goals. Managers must learn to manage these feedback systems to measure their programs' performance.

4. *Financial management.* Both tracking activity and measuring performance require careful accounting of financial activity. The money trail provides crucial information about who is doing what, when. Effective managers follow the money: financial management shapes partners' incentives and gives government managers leverage over partners' activities. It is also a central element to the feedback system.
5. *Bridge building.* Operating the tools of indirect government also requires government managers to gain a keen understanding of their partners' perspectives. Different organizations usually have different organizational cultures. Nonprofit social service organizations often have client-oriented perspectives. Private-sector contractors and regulatees have corporate missions and the goal of maximizing their profits. Effective government managers understand the cultures of their partners and seek to build bridges to find common ground.

Thus, effective management of indirect programs requires sensitive and effective government managers. Existing training programs, however, tend not to recognize the importance of indirect tools or the skills their managers need. American civil service systems, designed to recruit and promote technical specialists, frequently fail to cultivate the crosscutting skills that the effective managers of indirect tools need.

IV. PERFORMANCE

At its core, managing indirect government requires managing programs the government does not itself directly deliver through mechanisms it does not directly control. That translates into the central performance issue for indirect government: Ensuring high-quality government performance requires finding ways to manage public-private-nonprofit networks.

Reinventing Government and the Performance Puzzle

This dilemma sits squarely at the core of the Clinton administration's "reinventing government" efforts. In March 1993, the administration launched a major effort led by Vice President Al Gore and christened the "National Performance Review" (NPR). The administration pledged "a government that works better and costs less."[13] Its first round focused on downsizing the federal workforce, improving customer service, reforming the procurement process, and launching hundreds of lower-profile activities in individual agencies. The second round, begun after the Republicans took over Congress in 1995, focused more on deciding what government ought to do than on how it ought to do it. Clinton and the congressional Republicans, after bruising battles that shut down the government twice, fought to a standstill and never resolved the core question of government's role—except to conclude that Americans seemed fundamentally to like the government they had.

With Phase III in 1998, however, the administration changed course. In clear recognition of the network-based world of federal policy, Vice President Gore changed the NPR to the "National Partnership for Reinventing Government." To signal his reinvention of reinvention, Gore gave the NPR a new slogan, "America@Its Best." The NPR devised five new strategies: transform "high-impact agencies" into more productive government operations; use outcome measurement to improve federal management; build partnerships and develop strategies to prevent problems; give employees more freedom to do their jobs while holding them accountable for achieving outcomes; and develop one-stop information and service. The NPR promised a stronger focus on an information-age government and even better customer service. Meanwhile, it expanded its focus to far broader goals, such as building a "safe and healthy America," "safe communities," a "strong economy," and the "best-managed government ever."[14]

The reinventers recognized far more directly that the results Americans care most about—safer streets, healthier communities, a stronger economy—were goals that the federal government pursued only indirectly. The federal government's leverage over the economy, especially in the short term, is weak at best. Indeed, as the economy became more globalized and the budget more trapped in uncontrollable spending, the leverage of elected officials over policy has shrunk. Local governments police the streets. Civil society broadly shares responsibility for health and safety. Thus, in seeking a more politically relevant performance agenda, the NPR distanced itself from results it could control. The NPR struggled with a tough dilemma: early phases that produced administrative results but little political impact, or more ambitious goals with clear political stakes but indirect federal leverage.

Buried within the NPR's policy dilemma, however, was a potentially powerful performance tool. In 1993, Congress passed the Government Performance and Results Act (GPRA), which required all federal agencies to identify their goals and measure their success in achieving them. Starting in fiscal year 1999, agencies in addition began submitting to the Office of Management and Budget a strategic performance plan that identified the objectives of each program and which indicators the agency would use in measuring both outputs and outcomes. By 31 March 2000, agencies must present the president and Congress with a program performance report on how successfully they had met their performance goals. The emergence of GPRA thus offers the federal government a valuable tool for catching up with the demands of managing indirect government: It provides managers with a way of focusing on what goals they seek and how well their programs achieve them, regardless of who actually does the work.[15] GPRA was designed to strengthen the ex post oversight that stands at the core of the federal government's oversight of most tools, as Posner contends in his chapter.

In fact, other governments have pursued output-based management for fifteen years. New Zealand government ministers have, since the late 1980s, written contracts with chief executives in their agencies. These contracts specify how much output (inspections conducted or citizens served) the government is buying and how much the government will pay for the products. The performance of chief executives is measured by their ability to deliver outputs at cost and on time.[16] The New Zealand reforms, in fact, have turned indirect government on its head: They use contracting, typically applied to government's relations with external suppliers, to structure the government's internal relationships and expectations.

GPRA is at once more ambitious and more sweeping. As in New Zealand, it requires government managers to define strategic goals and set output measures. However, unlike New Zealand, government managers not only have to measure outputs—what they do—but also outcomes—what broader impacts the programs have. For example, it is one thing for the Occupational Safety and Health Administration to conduct safety

inspections of factories (outputs). It is another to ask how the inspections improve the safety of the workplace (outcomes). Output measurement is challenging; outcome measurement is even more difficult. Moreover, the New Zealand government manages most public programs directly, so that chief executives have a clearer line of authority to frontline service providers and an easier job tracking activity. GPRA is thus triply ambitious. It seeks to undertake a far more sweeping reform, in much less time, in a substantially more indirect system.[17] Not surprisingly, in its first five years few federal agencies fully rose to GPRA's challenges, and it remains to be seen whether GPRA will achieve the potential for which its advocates have planned. The objective, however, is quite laudable.

Many states likewise have established performance management systems. Virginia, Missouri, and Washington, for example, have integrated performance systems into their governance. In South Carolina, top officials use performance reports to hold agency heads accountable for their results. Benchmarks have proliferated throughout Oregon. Arizona has created program-based strategic plans. Kansas and California have established performance audits of individual agencies.[18]

These performance-based initiatives have surfaced three issues: redefining intergovernmental relationships through performance, creating strong financial accounting, and building effective personnel systems.

1. *Performance partnerships.* Some federal agencies have redesigned intergovernmental programs in performance terms. The EPA, for example, has encouraged the states to experiment with performance-based systems like the National Environmental Performance Partnership System (NEPPS). Developed in 1995, NEPPS allows states more flexibility in meeting national goals in exchange for closer state measurement of environmental results. NEPPS also encouraged states to create new partnerships: across different programs attacking similar problems; and across different "media-based" regulations—designed to reduce air, water, and soil pollution—dealing with related pollution sources. For example, the Delaware state government used the NEPPS flexibility to bring the state health and agriculture agencies into an environmental protection team because they share responsibility for drinking water, radon, and pesticide programs. New Jersey experimented with linking its state programs with EPA-funded programs, although some state officials worried that this connection might open the way to federal snooping into the way state officials managed the programs. Both states, moreover, used the NEPPS flexibility to improve their ability to focus on environmental justice as they framed their regulatory strategies.[19]

   Other states are following a well-worn slogan: "Don't litigate, mediate." Public officials are experimenting with alternative dispute resolution techniques to seek common ground among disputing parties. Government officials bring the parties face-to-face, arrange careful discussions of the issues, and seek a problem-solving consensus. Almost every state has experimented with one form or another of this technique. In Alabama, businesses can call anonymously to seek guidance on regulatory questions. Companies reporting their own noncompliance often receive a lower fine or, sometimes, no fine at all. On the other hand, companies that try to duck the process can have fines multiplied. In Wyoming, state law requires the Department of Environmental Quality to try to work with companies before launching litigation. As one exhaustive study concluded, "While EDR [environmental dispute resolution] is not a universal solution for all environmental conflicts, the experience of many states suggests that EDR is useful in bringing together

stakeholders with different interests to resolve complex, multi-issue, environmental disputes."[20]

2. *Visioning the partnership.* The dramatic change in the Federal Emergency Management Agency (FEMA) demonstrates how careful attention to financial accounting and information management can improve performance.[21] FEMA is the federal government's emergency response agency—when hurricanes, floods, and tornadoes hit, state and local officials call on FEMA for aid. FEMA sends out teams, but one Virginia county official said that the team's arrival in his area after a 1995 flood was itself a disaster. Indeed, its poor performance after Hurricane Andrew destroyed large parts of southeast Florida in 1992 cemented the agency's reputation as one of the federal government's worst-run agencies.

   James Lee Witt, however, took the reins in 1993 and launched a major redesign of FEMA's management systems. By 1997, Witt had turned FEMA around, getting checks into the hands of disaster victims within days. Witt turned FEMA around with a strong brand of personal leadership. He began his first day on the job by standing in Washington's headquarters lobby and shaking hands with employees as they came to work. He built a fast-track claim process and upgraded the information systems that process forms. Even Florida officials, enraged by FEMA's handling of Hurricane Andrew, had little but praise following storms in 1998. Senator Bob Graham (D-FL) hailed FEMA's response as "a 180-degree turnaround" from the Hurricane Andrew disaster.

   The kernel of Witt's success was his redefinition of FEMA's function. Instead of seeing its role as providing services when disaster occurs, FEMA officials recrafted their role as a partner in a far broader intergovernmental and public-private effort. FEMA sketched out a "life cycle" of disaster management that saw disasters and their costs as a product, in part, of preparation, planning, and mitigation that needed to begin far in advance of disasters and continue long after to prevent their recurrence.[22] Instead of waiting for a hurricane to hit and dealing with the aftermath, for example, FEMA officials worked closely with state and local officials to improve evacuation plans. They built partnerships with the construction industry to design and build houses that are more hurricane resistant. FEMA, in short, moved from a limited form of direct service delivery to a complex network-based approach that stretched from the federal government into state and local governments and the private sector.

3. *Effective people systems.* No matter how good the government's financial management system, however, results depend ultimately on the skill of managers—both inside government in managing the partnerships, and outside government in actually delivering services. The USDA's Food and Nutrition Service (FNS), for example, faces daunting problems. It is responsible for the government's food-assistance programs. Moreover, FNS does not itself provide food assistance; state and local governments perform that job. FNS must ensure that surplus food, food stamps, reduced-cost school lunches, and supplemental food grants reach eligible families. It must also ensure that no waste, fraud, or abuse occurs in the process, and in recent years it has had to do so with a 40 percent reduction in its workforce. Ellen Haas, USDA's undersecretary for the nutrition programs, has tackled these problems by focusing on partnerships. She has stretched her smaller federal workforce by building stronger links with state and local government partners and she has helped prepare federal employees for this new role. Observers have widely applauded the partnership approach she has constructed.[23]

Indirect government, at its core, represents the pragmatic solution to two puzzles. First, especially since World War II, the ambition of American public policy greatly exceeded Americans' eagerness for a larger government. The expansion of indirect government provided a way for government to deliver more programs without creating new government bureaucracies. Government's partners did what, in other times and many other nations, government itself would have done.

Second, many of the postwar programs sought complex goals that required matching broad national objectives to widely varying local conditions. It was one thing to declare war on poverty. It was another to fight it in campaigns diverging widely from the inner cities to small towns and rural areas. No single approach could possibly fit all problems. A remarkable range of innovative indirect strategies and tactics followed. If that made results harder to judge and processes harder to control, it also fundamentally transformed governance and made governmental tools almost infinitely adjustable.

Indirect government thus has manifest advantages. It also poses a tough challenge, however: Its administrative realities do not match the nation's administrative traditions and systems. The result is a performance deficit, a mismatch between government's expectations and capacity. Government's processes are designed to promote hierarchical control through authority-based systems. The traditional budgeting and personnel systems remain deeply rooted in this tradition. In budgeting, policymakers define goals and allocate resources, and then both goals and resources are broken down into smaller pieces as they move down the chain of command. The personnel system, on the other hand, works from the bottom up, with testing and promotion processes devised to direct workers toward progressively more challenging jobs. Neither process, however, develops the tools or skills needed to manage indirect government effectively, because both processes grow out of a basic framework that fits indirect government poorly.

Some parts of government have conquered this problem. FEMA redefined its mission from a hierarchically based, direct service delivery approach to a network-based, indirect tools approach. After the *Challenger* disaster, NASA downsized its core staff of governmental employees, turned over more responsibility to contractors in exchange for stronger performance reporting, and transformed its procurement system to its famous "faster, better, cheaper" approach. The failure of several Mars missions caused critics to question the strategy, but it reflected an important underlying reality: NASA could not hope to manage its operations without expanding and strengthening its indirect tools, especially contracting.

Lessons for Managing Indirect Government

The basic lesson, thus, is simple. Managing indirect government requires strong and sustained capacity. That capacity is fundamentally different from what is required to manage more traditional direct tools. It requires refining old tools and, more important, developing new ones. As managers reinvent their systems, it also requires preserving the enduring values of American democracy—concern for broad values such as equity, responsiveness to citizens, and accountability to elected officials. Experience in both the United States and around the world teaches that a strong system for managing indirect government builds on five basic principles.

1. *Government as a smart buyer.* The basic principle is that indirect government is different from directly administered governmental services—and that it requires different management strategies and tactics. If direct service delivery puts a

premium on control through authority, indirect service delivery puts a premium on leverage through market and voluntary mechanisms. In short, it increases government's need to find ways of aligning the goals and behaviors of its partners with its own policy goals. At its core, of course, this is no different from the basic management challenge facing many private-sector companies. Many private-sector organizations have flattened their hierarchies, contracted out all but their core functions, and developed just-in-time delivery systems for parts and supplies. They have become more "horizontal" than "vertical" to increase their flexibility and effectiveness.[24] That means, in turn, that government's success in managing indirect government depends on caring passionately about what its programs accomplish and much less about how it accomplishes its work.[25] This role of government as planner, arranger, and measurer is very different from its role in direct service delivery.

The case is easiest to make for programs contracted out, in which the government is in a direct fee-for-service relationship with its nongovernmental suppliers. In these, the government operates through a formal contract and thus creates a direct principal-agent relationship. The contract defines the output, structures the relationship, and shapes the government's oversight role. Other indirect tools, from grants and insurance to loan guarantees and tax incentives, raise distinctly different issues. All, however, frame the government's basic role as a relationship between its job in shaping services and others' role in providing them. Thus, its role is at its core that of a smart buyer: deciding what government wants to do and working through its partners to ensure that what needs to occur actually happens.

Nowhere have such partnerships proliferated more than in environmental protection.[26] Indeed, as one recent study has pointed out, "Many aspects of national policy are, in practice, becoming customized by state, locality, industry, or facility." Governments at all levels have sought to devise pragmatic strategies for tackling the special problems they each face. At the same time, they have struggled to build linkages among related programs—for example, air and water pollution control programs that are managed by different parts of the same agency (or different levels of government) but that nevertheless affect the same community. Tackling the problems of urban sprawl requires even more complex partnerships between the public and private sectors; among the levels of government; among different government agencies; and among various government programs.[27] The rise of interdependent programs and networked managers has led governments at all levels to seek pragmatic strategies for linking related programs—and to work to ensure that important problems do not fall between the many cracks of America's intergovernmental system.[28]

2. *Improving government's people processes.* Because the current civil service system at the federal level and in most of the states so poorly equips government to manage such strategies, restructuring the government's personnel system is thus a prime imperative. In fact, civil service reform has been a central part of the reform process in every nation that has launched major government reform except the United States. In the United States, opposition from both public employee unions (worried about protecting their members' jobs) and congressional committees (anxious to protect their jurisdictions) have made it difficult even to get started. In the states, only scattered and modest reforms have emerged.

   That has increased the gap between government's changing strategies and its people power to manage them. Indeed, the government's people problem is multilayered: retaining the right people to manage indirect programs, training people

for progressively more challenging positions, aligning the civil service system better with the jobs to be done, and building a more flexible workforce to help government adapt better to a rapidly changing job market and to constantly shifting policy and management strategies. These are huge challenges. There are few political incentives for tackling the job and strong opposition even to trying. That suggests that the management gap, between government's policy tools and its capacity to manage them, will not close any time soon.

3. *Strengthening training for present and future government managers.* Although that diagnosis might sound hopeless, the American experience also suggests two medium-term resolutions. First, the government could invest more in the training of its key officials. Many countries that launched major reinventions—notably Australia and New Zealand—also invested substantially in the training of government officials. The investment of American government in employee training is notoriously low, although there is little research to suggest just how low. Employees frequently need retraining throughout their careers to keep up to date with new technical issues and, especially, to manage the transition from technical specialist to group administrator and, ultimately, agency manager. Training, moreover, often provides mutual reinforcement (as managers discover others struggle with the same issues) and a signal that the manager's work is valued (as managers learn that top officials believe they are important enough to invest in). The more turbulent the environment and the more complex the partnerships, the more important training becomes.

   Second, public policy and public administration programs could adjust their curricula to meet the demands of managing indirect government. Few programs offer courses in negotiation or managing networks. Evaluation courses frequently focus on long-term studies rather than on action-oriented output and outcome assessment. Governmental accounting is rarely taught. And, in general, students frequently see these management issues as less sexy than policy analysis. In fact, of course, there are relatively few jobs for policy analysts and even fewer positions for recent graduates to make policy. Moreover, more graduates of these programs are taking positions with government's private and nonprofit partners. Aligning the curriculum with the management imperatives of the indirect government system would enhance the job prospects of the programs' graduates—and improve the management of all parts of the indirect service network.

4. *A commitment to public values.* With the rise of indirect government, more nongovernmental institutions are responsible for delivering public programs. An important but often overlooked fact is that this is not just a production function—delivering goods and services in exchange for a fee. It is also a value-transfer function. The what of government services as well as the how of their delivery are shaped by—and in turn define—basic social norms. The more government's indirect tools put nongovernmental partners in the important middle position between policymakers and citizens, the more the partners' behavior defines these values.

   Managing indirect government relies on building values as well as instrumental efficiency into the networks' central nervous systems. Contracts, for example, need to include standards for responsiveness to citizens, without at the same time becoming overprescriptive. Assessments of loan programs need to include judgments about equity as well as the impact these programs have on lending markets. That, of course, raises a broader question about how to induce private and nonprofit organizations to incorporate public-sector norms. In turn, that is a problem of

both organizational culture and management oversight. As nongovernmental organizations become more responsible for direct connections with citizens, however, the problem is inescapable.

One intriguing possibility, discussed more in the abstract than in practice, is rotation of government employees through nongovernmental partners. If government managers understand the nature of the partnership better, they are more likely to manage the partnership more effectively. By extension, if they spend some time during their careers working with government's partners, they might well spread public-service values.[29]

5. *Political leadership.* In the end, managing indirect government is much more than managing projects and tools. It is about creating public values, as Mark H. Moore has forcefully argued.[30] Indirect government arose in American governance not as a conscious embrace of a sweeping strategy but as a slow, incremental spread of disparate policy tools for pragmatic reasons. In the process, many agencies' administrative tools have been transformed radically, and many top managers and elected officials have little sense of the management systems over which they sit. How the systems are managed will create value; the only real question is which values they will create. That is why political leadership lies at the very core of the problem of managing indirect government. Indirect government is not so much a tactical toolbox as a strategic approach to governance. If it is to work effectively, it requires strategic leadership by top officials in addition to tactical administration by managers.[31]

VI. CONCLUSION

Indirect government has expanded faster than our thinking about how to make it work well—and much faster than our understanding of the administrative tools on which government relies for leverage. It is a truly revolutionary collection of strategies and tactics, and the odds that the American administrative system will unwind back to direct service delivery are slim. Building capacity to manage the indirect system therefore will become an even stronger imperative, from leadership by top government officials to a reinvention of management theory by academics. Government's performance hinges on cracking these nuts.

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