



What a Waste

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Last week, the *Washington Post* published a **doozy of a story on waste at the Department of Defense**. According to the report by Craig Whitlock and Bob Woodward—the latter of Watergate fame—Pentagon officials suppressed a 2015 report outlining \$125 billion in wasteful spending that could be eliminated over five years. The report, produced by McKinsey & Co for the Defense Business Board, suggests a “clear path” to savings through administrative changes. However, the path is not as clear as *Post* story suggests.

The report itself—titled “**Transforming DoD’s Business Processes for Revolutionary Change**”—has a number of issues that cast doubt on the potential savings estimates from the “back office” reforms it recommends. It includes a great deal of business school jargon but not a whole lot of concrete recommendations. The \$125 billion—which is the high estimate, with \$75 billion represented lower bound—in savings comes from a number of efficiency measures the consultants at McKinsey believe the Pentagon should implement. Shortly after the story broke, Benjamin Friedman of the Cato Institute explained why it is **unclear the recommendations would actually produce savings**:

But the Defense Business Board Report isn’t much help. It says that the Pentagon could save \$46–89 billion by “optimizing” contracts, without explaining why they are suboptimal now. It sees another \$5–9 billion in savings from information-technology efficiencies, though IT reform efforts at big U.S. agencies have a **poor track record**. Another \$23–53 billion in savings comes from business-process reforms, like “hybrid business process innovation and agility centers,” as

if the problem was a deficiency in trendy adjectives. The most concrete recommendation is “labor force optimization”—reducing civilian and contractor personnel. That’s **not a bad idea**, but the report doesn’t tell us who the wasteful personnel are. It settles for banalities, like “review organizational structure to identify and reduce areas of complexity and redundancy.”

The major basis for the report’s estimated savings is its claim that DoD should be able to replicate private-sector “productivity gains” of 4–8 percent annually. But that assumption shows fundamental confusion about government. The Pentagon is not beholden to profit, but it efficiently serves competing bosses in the executive and legislative branches. It doesn’t have “business processes,” really, and cannot easily make the “productivity gains” that McKinsey thinks are easy. Doing so would offend some of those purposes and masters.

Friedman’s explanation touches on something I discussed in an **op-ed for *RealClearPolicy* back in October**: government agencies, and the Department of Defense is no exception, are not businesses. They run according to a different logic and respond to different incentives.

Bureaucracies lack either a profit motive or market feedback and are **constrained by their political environment**. For example, the Pentagon has in fact been trying to reduce overhead for years by closing unnecessary military bases. **Congress continues to stonewall** because those bases are politically beneficial for some legislators even if they are inefficient from a managerial standpoint.

There is no doubt that bureaucracies could improve their efficiency. But as Friedman notes, suggesting that a bureaucracy needs to “optimize” something it is doing requires an explanation of what it is doing that is suboptimal, or why it is doing it. While the word “bureaucrat” is easy to use as a pejorative, it is unlikely many are avoiding optimal practices purposely. Sometimes bureaucratic inertia keeps a practice in place longer than it should, while other times **agencies are legally prohibited** from adopting more efficient administrative techniques.

There is also a problem of what type of waste the failure to optimize contracts represents. The report is not listing line items that can be cut from a budget. It is referring to savings that would stem from adopting more efficient administrative practices. **Scholars of public administration refer to this type of waste as “x-inefficiency”** waste (also known as “doing the wrong thing”). Boiled down to its essence, it refers to the adoption of suboptimal administrative practices. X-inefficiency, according to William Stanbury and Fred Thompson, stems from either a lack of competition between organizations or a lack of information.

Unfortunately, lack of information is inherent to bureaucracies. As Nobel Prize winner Herbert Simon argued decades ago, **bureaucracies “satisfice” instead of optimize**. This means that organizations seek satisfactory—as opposed to optimal—amounts of information when making decisions because their rationality is bounded. Bounded rationality means that administrative practices are likely to be chosen from a narrow range of options that might not include the optimal one.

Problems with the report go beyond its lack of an explanation, or solution, for x-inefficiency waste. For instance, the suggestion that savings from reductions in back office and support personnel could have been shifted to purchase additional combat power is somewhat dubious. As **Tobin Harshaw notes in a *Bloomberg View* piece on the report**, the increased combat forces that these savings could buy would require additional logistical and support personnel. "An army," as Napoleon famously said, "marches on its stomach." And Harshaw rightly notes that supply chains are integral to warfighting not tangential to it. Support functions can only be reduced so far before rendering combat functions ineffective.

The real scandal according to the *Post*, however, is not so much about the report itself, but that Pentagon officials—specifically, Deputy Secretary of Defense Robert Work and Under Secretary of Defense for Acquisition, Logistics, and Technology Frank Kendall—suppressed its findings. Work and Kendall were worried, according to the story, that instead of highlighting a path to savings in light of the Budget Control Act, the report would be used to justify further cuts to the defense budget. If true, this aspect of the story rightly paints Work and Kendall in an unfavorable light.

But there is another way to interpret this aspect of the story. Suppose Work and Kendall saw the report less as a "clear path" to savings, but the string of MBA buzzwords that it is. They might have rightly believed that if legislators used the report to cut the Pentagon's budget, and the proposed savings failed to materialize, it would be damaging to the military. There is something to be said for the idea that budget constraints might force the Pentagon adopt more efficient practices—**with austererity forcing it to reform its back office**—because otherwise they would have to sacrifice combat power. However, it is also reasonable that Pentagon officials worried that Congress would force them down an illusory path to efficiency divorced from the **realities of defense politics**.

In no way do the flaws in this report suggest that the Pentagon should be let off the hook for wasteful spending. But addressing that issue means acknowledging that these are political, as opposed to managerial, problems. As I noted in my *RealClearPolicy* op-ed, private sector managerial techniques have been part of defense management for five decades. These efforts fail to provide greater efficiency because government bureaucracies are not businesses. They operate according to a different set of logic, and respond to different incentives. All the business school jargon in the world does not change that.