

Strategies to Cut Costs and Improve Performance

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The federal government faces an estimated annual structural budget deficit of \$500 billion–700 billion. Deficits of this magnitude represent a major threat to the economic health of the nation. A plan to reduce and eliminate this structural deficit is urgently needed.

Observers believe the President’s National Commission on Fiscal Responsibility and Reform (The Debt Commission), which is charged with developing such a plan, may set a target of reducing the deficit by about \$7 trillion over a 10-year period. If such a deficit-reduction plan is to be credible, the federal government must adopt an aggressive spending reduction program that includes reforming entitlement programs, eliminating low-priority programs, and adopting commercial best practices in government operations.

We estimate that through a combination of spending reforms of entitlement programs, eliminating low-priority programs, and adopting commercial best practices in government operations, the federal government can save \$1–1.5 trillion over five years and up to \$2–3 trillion over ten years. Approximately \$1 trillion of those savings can be generated by adopting commercial best practices in government operations. In real terms, government organizations at all levels are being asked not only to do more with less, but to adjust their missions to today’s demands and expectations. Many commercial best practices have been adopted to help commercial organizations save money while becoming more competitive—essentially, doing more with less.

We propose pursuing new strategies that will improve performance while reducing cost and enhancing mission value provided by departments to citizens, state and local governments, and businesses.

Here is a simple way of expressing value in terms that we may intuitively understand:

$$\text{Mission Value} = \frac{\text{Quality} * \text{Service}}{\text{Cost} * \text{Time}}$$



Quality could describe more accurate refunds/payments, getting the right commodity to the right place at the right time, or intercepting bad guys before they create damage.

Service could mean organizations that can regard you as an individual across transactions over time, that anticipate your questions, and that provide service channels that are convenient and accessible.

Cost could mean cost per transaction for government, cost per citizen, or reduced operations and maintenance (O&M) costs.



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Time could mean shorter elapsed or active time processing applications, or a decrease in wait time.

Adjusting any of these components will improve the value provided to citizens, leaders, and other stakeholders. Using this practical approach and applying proven best practices to major aspects of the way government does business would remove costs and improve mission outcomes.

The Nature of the Challenge

According to budget projections produced by the Congressional Budget Office in January 2010, the federal government will accumulate more than \$7 trillion in new debt between 2010 and 2019. These estimates suggest the government is running a structural deficit of between \$500–700 billion each year. The International Monetary Fund estimates the annual structural deficit in the U.S. may even reach \$1 trillion by 2015 under current policies. The scale of this fiscal challenge is unprecedented.

Such a fiscal imbalance poses a severe risk to the country. Over time, the accumulation of debt at this scale will crowd out private investment and could lead to inflationary pressures and currency instability. Under those macroeconomic conditions, the private economy will struggle to grow and create jobs. For that reason, it is imperative that the federal government adopt an aggressive plan to reduce and ultimately eliminate its structural deficit.

Any credible approach to restoring the country's fiscal condition will likely include both a reduction in spending, including entitlement reform and elimination or reduction of low-priority programs, and an increase in revenues, most importantly, through the return of a robust economy. The Office of Management and Budget (OMB) has already directed all department heads to identify program reductions or eliminations that can reduce their discretionary budget proposals by 5 percent. Secretary of Defense Robert Gates has separately directed cuts of \$100 billion over the next five years. OMB has also directed agencies to identify their lowest priority programs. The strategies that follow reach beyond these directives.

Adoption of Commercial Best Practices in Government Operations

While entitlement reform and the elimination of low priority programs will be critical components of any deficit reduction strategy, without question the federal government can generate significant savings by elevating its operational performance. In 2009, McKinsey & Company published "The Case for Government Reform," which suggested that a 5–15 percent improvement in the efficiency of federal government operations could generate \$450 billion–\$1.3 trillion in savings over the next 10 years. In a recent *Wall Street Journal* opinion piece, New York University Professor Paul Light made a similar assertion, claiming that \$1 trillion in savings over 10 years could be generated primarily through aggressive workforce reductions, particularly in the management ranks.





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While these estimates are directionally useful, they lack the specificity necessary to persuade the public that a serious performance improvement effort can yield material savings. Through a private-public partnership, we can identify specific operational functions that can be improved significantly through the adoption of commercial best practices. By aggressively implementing these strategies, sustainable cost savings can be realized while, in many cases, improving operational performance at the same time. Below is a short summary of the opportunities that could constitute a “starter list” of initiatives of this type.

Cost-Saving Initiatives

Initiative 1: Consolidate Information Technology (IT) Infrastructure

The government’s costs of operating its IT infrastructure are higher than they need to be—in some cases by more than a factor of two. Significant savings can be realized if departments and agencies employ proven methods to reduce overall costs of IT ownership.

The federal government currently spends approximately \$78 billion in fiscal year 2010 to support its widely-dispersed IT assets. At least 20–30 percent of that spending could be eliminated by reducing IT overhead, consolidating data centers, eliminating redundant networks, and standardizing applications.

IBM has dramatically reduced its data center operations and saved up to 40 percent in operating expenses. IBM has cut its IT expenses in half over the past five years through consolidation and standardization. Gartner Group reports that these types of efforts generally deliver a 20–30 percent reduction in costs. If the federal government could achieve similar improvements in performance, it could save \$150–200 billion over the next 10 years.

Initiative 2: Streamline Government Supply Chains

The federal government procures approximately \$550 billion worth of goods and services each year. These goods and services are procured largely within agencies and departments with independent procurement processes. In 2005, OMB announced a “strategic sourcing initiative” with the intent of reducing procurement costs by leveraging the purchasing scale of the government and pooling the purchases of commodity items. The anticipated benefits have not been realized primarily due to failures to reform budget and procurement processes. The effort also focused too intensively on commodity purchasing and not enough on supplier management.

Over the past decade, IBM internally consolidated 30 different supply chains and restructured its supplier network.





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The company eliminated \$25 billion in costs and improved supplier performance. Given the company's scale and complexity—33,000 suppliers, 45,000 business partners, and 78,000 products with 3 million possible configurations—IBM can serve as a reasonable point of comparison to size the opportunity for savings available to the federal government.

We also know that these savings can be achieved in public sector settings. The U.S. Postal Service realized \$2.5 billion in cost reductions and cost avoidance through transformation of its supply chain process. The Department of Defense is applying processes such as Lean Six Sigma to extract costs from their supply chain. In our experience, process improvements alone can improve efficiencies by 10–20 percent. If the federal government could achieve similar improvements in supply chain performance, it could save more than \$500 billion over the next 10 years.

Initiative 3: Reduce Energy Use

In October 2009, the president issued Executive Order 13514, mandating federal agencies cut greenhouse gas

emissions and energy/water use. One of the most effective means for reducing energy use is through facilities rationalization. IBM's experience in call center consolidation suggests that organizations can reduce IT-related energy costs by 25 percent. The aggressive adoption of voice, video, document sharing, and collaboration tools can reduce travel-related expenses by 10–20 percent. The implementation of new building management technologies can reduce energy consumption for the 3.1 billion square feet of space currently occupied by federal agencies. Advanced fleet management systems can reduce the size of the fleet and reduce energy consumption by 10–20 percent. The combination of these initiatives could generate \$20 billion in savings over 10 years.

Initiative 4: Move to Shared Services for Mission-Support Activities

Every dollar spent on support activities and overhead within federal agencies is a dollar that could be spent on programming or returned to the taxpayer. Why should every agency have its own IT, finance, legal, human resources, or procurement operations? When the federal government consolidated 26 payroll systems to four, the Environmental Protection Agency reduced payroll costs from \$270 to \$90 per employee, saving \$3.2 million a year; and the Department of Health and Human Services reduced costs from \$259 to \$90 per employee, saving \$11 million a year. Likewise, when the government consolidated travel systems, the Department of Labor reduced its costs from \$60 to \$20 per travel voucher and reduced processing time from about 7 to about 3 days.

Four government cases studies from the British government suggest that 20–30 percent savings are achievable by moving to a shared services platform. If that savings rate were applied to the federal government's support services spending, \$50 billion in savings could be generated over 10 years.





Initiative 5: Apply Advanced Business Analytics to Reduce Improper Payments

The administration already recognizes the magnitude of this issue. Upon signing Executive Order 13520 on reducing improper payments in November 2009, the president stated that “my administration is expanding the use of ‘Payment Recapture Audits,’ which have proven to be effective mechanisms for detecting and recapturing payment errors.... One approach that has worked effectively is using professional and specialized auditors on a contingency basis, with their compensation tied to the identification of misspent funds.” The president followed this with an April 2010 memorandum to agencies directing them to reduce improper payments by \$20 billion a year. His authority to act was reinforced when he signed the Improper Payments Elimination and Recovery Act in July 2010.

The federal government annually issues nearly \$3 trillion in payments in one form or another (e.g., grants, food stamps, Medicare payments, tax refunds). The Government Accountability Office estimates that \$72 billion was lost to improper payments in fiscal year 2008. OMB estimates losses approached \$98 billion in 2009 (\$54 billion in Medicaid and Medicare alone).

OMB issued guidance this spring to departments asking that they develop plans to reduce these improper payments by \$20 billion. Industry regularly conducts recovery audits of large-scale transactions; these could be due to fraud or mistakes, or an unanticipated shift in demand. New

analytical techniques can increase the identification rate to 40 percent, which would double the current anticipated savings rate and generate an incremental \$200 billion over 10 years.

Initiative 6: Reduce Field Operations Footprint and Move to Electronic Self-Service

Most departments have citizen-facing operations that rely on manual, paper-based business processes. By moving as many touch points to electronic platforms as possible, and at the same time rationalizing the government’s field operations footprint, the government can reduce costs and improve the citizen’s experience.

Australia’s CentreLink initiative provides online benefit determination and payments to individuals on behalf of 27 different government agencies. The estimated annual savings total \$86 million. Similarly, the Service Canada initiative provides 70 services on behalf of 13 federal agencies through online, phone, and in-person service delivery channels. The estimated annual savings in the first year totalled \$292 million.

In the U.S., there are more than 10,000 federal government forms in 173 different agencies that could be automated to allow citizens and businesses to conduct their business with government online. Reducing the citizen-related field



Implementation

How to Get Started

The White House should establish specific savings targets for each priority cost reduction initiative. We suggest that the OMB Director appoint a steering team comprised of the OMB Deputy Director for Management and a subset of departmental secretaries. A central support team would operate out of OMB (or under the direction of the President’s Management Council) and would function as a program management office charged with coordinating the effort.

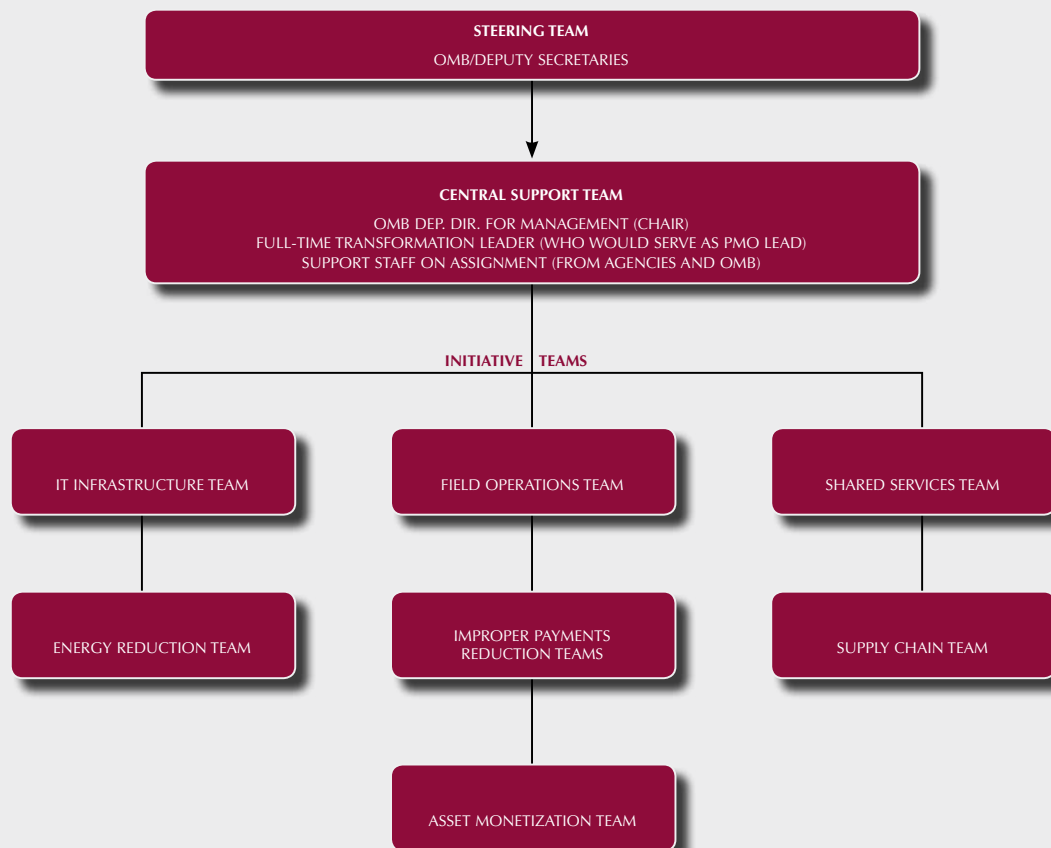
Each participating department would establish its own initiative teams in each of the seven areas. These teams would be responsible for delivering the target results in their respective departments. These teams would also work together across departments to identify government-wide savings opportunities. Each cross-cutting initiative team would work under direction of a deputy secretary.

The Time is Now and It Can be Done

The imbalance in the federal budget must be addressed. While reasonable people may disagree concerning the speed with which that imbalance is eliminated, all agree that there is an urgent need to adopt a credible plan for doing so. The business and economic risk associated with inaction is no longer tolerable.

It is possible to achieve the level of savings we have outlined here. These savings can be realized while at the same time improving service. We’ve seen it in industry after industry, and we’ve seen it in our own companies’ transformations. The federal government must adopt a long-term spending strategy that is structurally sustainable, and a combination of innovative, technology-fueled efficiency and commercial best practices should be at the center of such a strategy.

OMB Steering Team



operations of the federal government and automating the government's form processing could generate \$30 billion in savings over 10 years.

Initiative 7: Monetize the Government's Assets

The federal government has a large inventory of assets that could be producing revenue. "Mining" the balance sheet by examining concessions agreements and other opportunities may generate significant revenues. This could include selling surplus facilities, and selling and leasing back others. For example, OMB has found 14,000 excess buildings and 55,000 underutilized buildings in the federal inventory. The federal government has other assets—such as rights-of-way for energy transmission—that could be auctioned off.

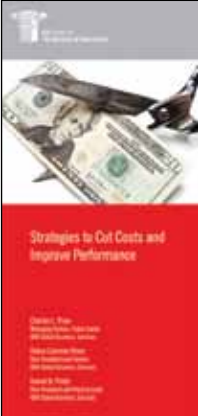
The federal government also has an array of fee-generating programs that do not recover their costs. Oftentimes, fee structures and levels are dictated by issues other than cost recovery. We suggest the federal government identify agencies that can be statutorily dependent on the fee income they generate (i.e., no longer subject to the appropriation of general revenues). For example, a number of countries have corporatized their air traffic control operations. By mining the balance sheet aggressively and corporatizing certain federal operations, the federal government could save \$150 billion over 10 years.

When taken together, these initiatives could generate billions in savings in coming years. These savings would be in addition to the approximately \$240 billion in savings we estimate the Department of Defense could generate over the next 10 years as a consequence of the operational improvement effort recently launched by Secretary Gates. ■



TO LEARN MORE

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The report can be obtained:

- In .pdf (Acrobat) format at the Center website, www.businessofgovernment.org
- By e-mailing the Center at businessofgovernment@us.ibm.com
- By calling the Center at (202) 551-9342