The Grace Commission: How much waste in government?

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There are few beliefs more deeply embedded in the popular consciousness than that government wastes a lot of money. Seymour Martin Lipset and William Schneider, in their book *The Confidence Gap*, report that in surveys asking people how much of each tax dollar they think the federal government wastes, the median response is 48¢. Lipset and Schneider argue that the paradox of simultaneous public support for tax cuts, and for maintaining or increasing spending in all major categories of government programs, is explained by the perception that waste in government is so rampant that there can be big spending reductions without service rollbacks.

Last January the President's Private Sector Survey on Cost Control (generally known as the "Grace Commission" after its head, J. Peter Grace, Chief Executive Officer of W.R. Grace & Co.), delivered its final reports. The Grace Commission recruited over 2,000 corporate executives to scrutinize the government. Announcing the report, Peter Grace told the press that President Reagan had asked him to look at government agencies as if considering a merger or takeover. "The President's private sector survey would not acquire the government" was the conclusion, he stated. No wonder. He found that, over a three-year period, a total of $424 billion in sav-
ings could be obtained from controlling waste, "without weakening America's needed defense build-up and without in any way harming necessary social welfare programs." These were stupendous numbers, almost enough to eliminate federal deficits.

But they were not uncontroversial. With the perspective of someone interested in how government can be managed better, I spent time examining some specific allegations of waste the Grace Commission made in areas where, first, there is general agreement—public and governmental—that the activity being undertaken is worthwhile, and second, there are examples of the private sector producing the same output, so that the relative costs to government and to the private sector can be compared. The Grace Commission issued 48 reports and made a now-notorious 2,478 recommendations, so it was obviously impossible to examine any significant percentage. But in the press packet accompanying the Grace Commission report, there was a chart entitled "Ten Random Examples of Bureaucratic Absurdity" (which was picked up in the New York Times story on the Commission), and I examined those ten. Also, I examined recommendations the Commission made involving the General Services Administration (GSA) and the Veterans Administration (VA), because the responsibilities of both agencies include tasks very similar to ones private firms undertake.

The case of the $91 screw

(1) "The Pentagon has been buying screws, available in any hardware store for 3 cents, for $91 each."

There have been many widely publicized examples of the apparently outrageous prices paid for spare parts for weapons—$110 for a 4¢ diode, $9,609 for a 12¢ Allen wrench, and $1,118 for a plastic cap for a navigator's seat.

One has reason to doubt these stories, even before further investigation, on strictly logical grounds. To suggest that defense contractors could routinely charge the government $110 for something they got for a few pennies is to suggest that the defense contracting business is the easiest avenue to unearned fortune since the invention of plunder. In fact, it turns out that the Defense Department has not negligently allowed itself to be hoodwinked. Most of these

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1 Of these, four proved not to be "bureaucratic absurdity" after all, but rather poli- cies enacted by Congress. So only six cases were investigated. In addition, I examined the issue of Defense Department spare parts prices (which appeared in the press packet under another listing) because the issue had received so much media attention and because it had the horror-story sound of the other examples of "bureaucratic absurdity."
cases have a common explanation, which involves an accounting
quirk in pricing material purchased from contractors.

Any time anybody buys something, the price includes not only
the direct cost of the materials, machines, and labor to produce it,
but also a share of the company's overhead expenses—ranging from
running the legal department to renting corporate headquarters.
Defense Department acquisition rules prescribe that a defense con-
tractor's overhead expenses be allocated to each shipment at some
fixed proportion of the value of the procurement. Thus, if the direct
cost of a weapon is $5 million, a company might be authorized to
tack on, illustratively, 20 percent or $1 million, for overhead ex-
penses. The same percentage may also be added to the direct costs
of other items procured, such as spare parts. Thus $1 million would
be added to a spare parts order for $5 million, just as it would be to
a fighter plane order.

The Pentagon orders many different spare parts at one time.
Often in the past, contractors have, simply as a matter of account-
ing convenience, allocated the overhead to the individual parts
on an “item” basis rather than a “value” basis. Say that the $20 mil-
lion order is for 10,000 parts, some of which have a direct cost of
$25,000 each and others of 4¢ each. Instead of apportioning the
$1 million total overhead such that the $25,000 part gets a lot and
the 4¢ part a little, the computer printout will allocate $100 to each
part. This produces a charge to the government of $25,100 for the
expensive part and $100.04 for the cheap one.

Although this produces horror stories, nothing horrible has oc-
curred. The total overhead represents real resources legitimately
charged to the government. If the $100 doesn't get allocated to the
4¢ diode, the diode no longer appears to be so outrageously expen-
sive. But the $100 doesn't disappear, nor should it. The overhead is
just allocated elsewhere.

There is one mildly distressing aspect of this practice. The spread-
ing of overhead costs over a contractor's entire production appears
to reduce the up-front costs of new weapons systems, since research
and development for the weapon is charged to spare parts as well.
This, in turn, makes new weapons systems appear less expensive
than they really are, and distorts political discussions of a system's
costs and benefits. But that has nothing to do with "not minding the
store."

Other horror stories have a different explanation. Many parts
the Defense Department procures are "common use items," the same
as commercially produced parts that might be used in a car as well
as a tank. Other items need to be custom designed, which often pro-
duces an extremely high price per unit, because, unlike Chevrolets, much military equipment is produced in very small quantities and thus requires only a few of the same spare parts. The initial cost to design the part, and make the machine die or molding to produce it, must then be spread out over only a few units. (If it costs $3,000 to design and tool up a plastic cap, that will add only 1¢ to the cost of the cap if 300,000 are produced, but $1,000 if three are produced.)

The economics of tooling-up do suggest that common-use parts be used when possible, and the Defense Department does make efforts to get common-use items. Spare parts are frequently procured on a sole-source basis from the contractors for the original weapon. When the contractor submits designs for spare parts, he must designate those which are common-use. This list is reviewed by a Defense Department contracting officer, who makes suggestions for expanding common-use procurement when appropriate. After the contractor proposes prices, the contracting officer requests an independent evaluation of the offer by Defense Department value engineers, who may question whether a newly designed part is sufficiently different from common-use items to justify special tooling-up. But special design is sometimes necessary.

Contractors have something of an incentive to propose custom-designed parts, since a contractor is allowed to take a standard percentage profit, which in dollar terms is of course far greater for a $1,000 item than a $1 item. Cheating is presumably discouraged by the negative impact repeated discovery would have on the contractor’s relations with the Defense Department. But the Department has an enormous review task—there are about 300,000 parts in an airplane—and sometimes an item that should have been classified as common-use ends up getting designed to order. This is what happened in the case of the $1,118 plastic cap. In the widely publicized case of the $9,609 Allen wrench, however, the system did work. General Dynamics proposed a custom-designed wrench, but the Pentagon’s value review engineer found that the function could be performed equally well by an ordinary wrench. The Defense Department never ordered the custom-designed version, and is now increasing its scrutiny for common-use items. The additional scrutiny may cost more than it saves, but the issue to the Defense Department at this point is the credibility of the defense buildup.

The outrageous case of building management

(2) “In comparison to a private sector company, managing comparable building space, the General Services Administration employs
17 times as many people and spends almost 14 times as much on total management costs.”

This contention is so wildly inaccurate that it is hard to know where to begin. The best place to start is with two whopping errors in the numbers the Grace Commission provided on the private sector firm being compared with GSA. The chart the Commission provided stated that the property management division of a large life insurance firm was managing 10,000 buildings, “comparable building space” to GSA. In fact, no insurance company has a portfolio anywhere near that large. The correct number for the insurance company is not 10,000 buildings, but 1,000, which is not comparable to GSA at all. Furthermore, the Grace Commission states that the insurance company employs a total of 300 professionals, 100 in central administration, and 200 under contract. It turns out, however, that the company in question does not employ 200 individuals under contract, but rather hires 200 property management firms actually to manage its buildings. Each of these firms in turn has many professionals working for it.

The figure the Commission chart provided for GSA professionals—5,000—is also exaggerated. About one-third of these are clerical and other non-professional employees (the Grace Commission simply looked at total white-collar employment at the Public Buildings Service). And about 800 of this number manage GSA design and construction, overseeing the contract process for construction of new buildings as well as repairs and alterations of existing buildings; the people who do this for the insurance company work in a different division, and thus aren’t included in the employment figures the Grace Commission provided. So the number of professionals working on building management at GSA is really around 2,700, rather than 5,000.

Although all this indicates that the Grace Commission is monumentally mistaken, a precise comparison is difficult to make. One would need to know how many professionals the building management contractors employ, and the insurance company itself doesn’t know that. Beyond that, the nature of the GSA portfolio and the insurance company’s portfolio is different. Over two-thirds of the GSA buildings are leased space rather than owned space; this requires people to work on initial lease bids and on lease renewals (neither of which applies to the insurance company), but does not require government-provided building management services. Over 1,000 of the GSA buildings are (owned or leased) local social security offices, which are considerably smaller than the properties an
insurance company owns. GSA officials would themselves concede that they probably have a larger staff for comparable functions than a private sector counterpart, because GSA requires more levels of review on contracting and leasing decisions to assure due process and to minimize corruption. But the difference is nothing like 17 to 1.

The $61,250 nursing home bed

(3) "The VA spends $61,250 per bed to construct nursing homes—almost four times the $16,000 per bed cost of a major private sector nursing home operator."

The Grace Commission averaged the cost of six VA nursing homes, and the average was raised dramatically by the reported $113,500 per-bed cost of construction of a home in Martinsburg, West Virginia. This nursing home was being built simultaneously with a VA hospital adjacent to it, and the cost the Grace Commission reported included construction costs for a domiciliary that was part of the whole medical center, as well as site preparation and utilities for the entire complex. The actual cost for the nursing home at that site was $29,000 per bed, bringing the average cost per bed for the six facilities down from $61,000 to $47,000. Furthermore, the cost of three of the VA homes was significantly higher than usual because of unfavorable site conditions (such as confined space for construction, thus requiring off-site warehousing of building materials). Site conditions were unfavorable because the nursing homes were being built next to already-existing VA hospitals, pursuant to VA policy. The average cost of the remaining three homes, built under normal site conditions, was $39,000 a bed. So while the Commission exaggerates, there remains a substantial difference compared with the private sector, even if one considers only the homes constructed on normal site conditions.

Why these differences? Whatever the answer, one can be relatively confident that it is not the result of lazy government construction workers or bloated construction material prices paid by government. In fact, the VA does not construct nursing homes itself. It takes its nursing home specifications and puts them out to bid by building contractors. The low bid wins.

The truth is that what the VA calls a nursing home is in many ways of much higher quality than what private-sector chains produce. These quality differences increase the cost of a VA nursing home relative to a private one.

The most obvious differences involve the physical designs. VA facilities have been top-of-the-line. Homes have routinely included
balconies in each room, occupational therapy areas, quiet rooms, extensive recreation space, and on-premises artwork. The VA policy of building homes contiguous to VA hospitals rather than freestanding, as the private company Beverly does, is also quality-driven; it provides nursing home residents quick access to hospital services and allows more rapid treatment of medical emergencies. That policy drives up costs in a number of ways, however. The VA got into the nursing home business relatively recently, and most homes are built on existing hospital sites. Often, however, these sites are too small to be ideal for new construction. That can raise costs by requiring construction in cramped or otherwise difficult situations. And frequently there is not enough land to build single-story homes, which are marginally cheaper to construct than the two-story homes the VA often must build. Is it worthwhile to produce this level of quality? That is a matter of debate. But it is not an issue of "waste," as the term is typically used.

The cost of constructing VA nursing homes can be reduced by decreasing quality. In 1981 the VA established a task force on nursing home construction cost reduction, after private nursing home chains had called cost differences to the attention of congressional oversight committees. The task force proposed a number of design changes that will reduce the cost of new VA nursing homes by about $12,000 per bed. They include eliminating balconies, making ceilings eight rather than nine feet high, reducing recreation room and dining room space by 35 percent, and reducing landscaping by half.

Another part of higher VA construction costs stems from the special requirements of government procurement. The most obvious are ones such as Davis-Bacon, and the preference given to American-made products and to minority and small-business enterprises. When the government builds a nursing home, it has decided not just to build a home but also to aid small business and American-made products. Again, this is not "waste," but rather government policy.

The entire mode of procurement in government is a less obvious, but very important, source of additional costs. Private sector nursing home chains generally establish ongoing relationships with construction firms in an area (often two firms, each to serve as a competitive check on the other), to whom they turn again and again. This allows them to avoid the costs of gearing up for new bidding procedures for each job. By contracting for several jobs at the same time, it allows the general contractor to obtain lower prices from subcontractors and suppliers, who give quantity discounts for the larger volume of work. It allows the contractors to become familiar
with the details of how the firm wants the home built and to look for ways to build more economically, since investments in such efforts can be capitalized over a number of projects. The VA, by contrast, must gear up for a de novo bidding procedure, open to all, for each construction contract, with detailed functional specifications (rather than brand-specific ones) so that nobody is excluded from bidding. There are many layers of review within the VA to ensure that specifications inhibit no one, and to clear any deviations by the procurement or project staff from the rule that the lowest bid must be accepted. These procurement methods entail extensive additional costs, both because any individual act of procurement is more complicated (developing functional specifications, layers of review) and personnel-intensive, and because there are far more separate procurement decisions to be made (the de novo bidding process). Although the monetary costs of these procedures outweigh their monetary benefits (or else private firms would follow similar procedures) none of them, again, constitutes a clear example of waste. At worst, they reflect mistaken policies. They produce outputs with "quality" features not found in private home construction such as equal opportunity for all businesses to compete and a minimization of kickbacks.

Where does all this leave the VA/private sector comparison? I start with a $39,000 per bed average figure for the nursing homes built on normal site conditions, and I subtract $6,000 per bed in savings from the cost-control task force. This brings the VA cost down to $33,000 a bed, compared with $16,000 in the private sector: about twice as much, rather than four times as much. The costs of Davis-Bacon and various statutory procurement preferences, of complex procurement procedures that must be repeated each time a home is built, of any remaining quality difference compared with private sector homes, and of any extra costs from two-story construction, reduce the differences further. Since no study exists of the accumulated effect of those factors, it is impossible to say how much of the VA/private sector difference that does remain is simple waste. My suspicion is that something does remain, but that the differences are not dramatic.

2 I subtract $6,000 rather than the estimated $12,000 in savings because some of the changes the VA is making bring VA nursing homes below Beverly's standards—for example, the ceilings in VA homes will now be lower than those in Beverly homes. Lacking time, or expertise in architecture, to allow an exact estimate of "the cost-reduction steps that bring the VA homes to the same level as Beverly's", I have taken a figure of one-half, the arbitrary nature of which the reader should be aware of.
The freight-charges boondoggle

(4) "The government spends almost $5 billion annually on freight charges but doesn't bother to negotiate volume discounts with suppliers."

The Grace Commission's own backup material regarding this claim turns out not even to make the contention that the government "doesn't bother to negotiate volume discounts." In fact, it turns out that virtually all government freight is moved at rates discounted for volume.

The problem is a more subtle one. Before trucking deregulation, freight tariffs were fixed. Deregulation in 1980 produced an avalanche of different rates (similar to the situation for airline travelers). Suddenly, there were differences in fares charged for a given route and many lower tariffs for full-load shipments.

Deregulation opened up opportunities for savings on freight expenses, but the proliferation of rates increased the information-processing requirements for taking advantage of those possibilities. Very quickly, computer software companies began offering packages that allow a shipper to determine the cheapest available rate, and also to determine what shipments from several sources within the organization might be going to the same place at the same time, so that full-load discounts can be obtained. These systems have spread quickly in the private sector since 1980.

In 1981 the General Services Administration, which administers shipping for most of the government, began to look at these new computer systems, but decided they were still too new to try. In the summer of 1983 they decided to procure one, and the system they selected went on-line in March 1984.

The mailing list fiasco

(5) "Government mailing lists erroneously repeat the same addresses as many as 29 times."

This statement, though ambiguous, seems to suggest that somewhere there is a government mailing list that has the same address on it 29 times, causing 29 copies of the same publication to be sent to one location. The implication is that government officials simply never bothered to check the list for such wasteful duplication.

This example of 29 repetitions comes from a 1980 effort by the Office of Human Development Services in HHS to improve its management of mailing lists. The Office was formed in the mid-1970s as an umbrella organization for a large number of already existing
agencies, such as the Administration on Aging and the Administration for Children, Youth and Families. Each of these separate organizations, quite naturally, maintained its own mailing lists—usually, in fact, a number of different mailing lists, such as lists of subscribers to an agency magazine, media contacts, libraries, or recipients of grant award information. There were about 300 different mailing lists in all.

In 1979, a newly appointed manager of the Office of Public Affairs at Human Development Services persuaded his boss to authorize a project to centralize and modernize the organization's mailing lists. The 300 lists were combined into one master list. A "positive purge" was conducted, whereby every person on any of the lists had to return a card in order to stay on. The Public Affairs Office also began to rent commercially available lists—of libraries, professors of social work, etc.—as an alternative to maintaining and updating its own lists.

In the course of this project, it was discovered that one address (a social service agency) appeared 29 times. But this was 29 times on 300 different lists, and these 300 lists generally received different publications. In other words, the addressee might have been on one list to receive the Mental Disability Law Reporter, on another for press releases from the Administration on Aging, and on a third for information about grant availability from the Office of Handicapped Individuals. The addressee wasn't receiving 29 copies of any one publication. At worst, as the person in charge of the reform effort told me, an addressee appearing 29 times might receive five copies of a single publication—but only in the rare cases when a mailing went to several of the agency's different lists. There were certainly some examples of duplications on the same list: Although federal law requires annual canvassing of individual agency lists for duplication, compliance is mixed.

Although the quality of mailing list management within the government varies, there is no doubt that significant improvements could be made. There have been major changes in the mailing list business during the last decade, with the increased use of computers for list generation and management. Simple software now exists to purge lists of duplication, and with the growth of list brokers there is no longer any need for an organization to attempt to maintain its own lists of nursing home administrators, libraries, or public health professors. The government is now beginning to adapt to these changes.
The scandal of seized assets

(6) "The Justice Department just sits on the cash seized from criminals, not bothering to deposit the money in interest bearing accounts while cases are being adjudicated."

Traditionally, cash seized from criminals was indeed not deposited in interest-bearing accounts. "Not bothering," however, was not the reason. Prosecuting attorneys wanted the actual bills in hand, to impress juries with wads of ill-gotten lucre. Depositing the money would have meant losing the ability to show it to juries: The only thing available would have been a statement in a government bank account! Furthermore, some jurisdictions require that actual bills be submitted as evidence.

Until quite recently, very little cash was seized from criminal suspects. In the late 1970s, however, the Justice Department began actively to seize cash and physical assets (such as cars and boats) —and to seek their forfeiture—as a tactic against organized crime.

Soon thereafter, the Department realized that this vast quantity of physical assets had created a management problem. The Justice Department's policy was not to question legitimate third-party liens on seized assets, so that if there was a $110,000 loan outstanding on a $150,000 boat, the government would not contest the bank's right to collect $110,000 from the sale of the boat. The frequent problem is that the hypothetical boat might deteriorate badly while in the government's possession. When sold after being forfeited, less than $110,000 might be realized; the government would have to make up the difference. The local U.S. Attorney offices had no capability to manage seized assets while they awaited disposition (lawyers are experts at trying cases, not managing property), and no centralized management system had ever been developed because there were so few seized assets.

In 1981, the Justice Department appointed a task force to examine the management of seized assets. It issued a report in 1982, recommending that the Department establish a central organizational capability, through the U.S. Marshal Service, to manage seized assets for local U.S. Attorney offices. Agreement having been obtained within the Department (including from the U.S. Attorney offices), this new capability is now being established.

The shocking sloth of loan collectors

(7) "HUD makes only 3 attempts to collect loans versus 24 to 36 tries in the private sector."
This refers to loan collection procedures for two programs—a Housing and Urban Development credit insurance program for regular property improvement loans (Title I), and HUD’s direct, subsidized loan program for property-improvement loans in disadvantaged areas (Section 312). Title I is an old program (enacted in 1934) that does not have income restrictions; Section 312 is a War on Poverty-era program that is targeted to poorer neighborhoods.

Again, the comparison the Grace Commission presents is exaggerated. First, the Grace Commission’s own backup material refers to two or three loan collection tries per month in the private sector (compared to a total of three in HUD), but collection activity, in both the private sector and HUD, proceeds for only four months before legal action is commenced or the loan abandoned. The press packet figure of “24 to 36 tries in the private sector” comes from incorrectly assuming that collection activity at private banks goes on for an entire year. Even accepting the Grace Commission comparison at face value, the proper number is thus eight to 12 tries in the private sector, not 24 to 36. Second, HUD loan collection officers generally do not make a written record of telephone calls they make to delinquents, so Grace Commission investigators looking only at the written record underestimated the number of collection tries HUD made. Finally, and crucially, there has been collection activity on these loans before they are sent to HUD. Title I loans are made by regular banks, and Title I regulations mandate that the banks pursue their own normal debt-collection efforts before passing the loans on to HUD; for the Section 312 loans that HUD makes directly, Fannie Mae (the Federal National Mortgage Association), which services the loans, engages in some mild collection activity (dunning letters but no phone calls or contacts with an employer) before passing the loans on. HUD isn’t starting from scratch on collections, as the Grace Commission’s comparison suggests.

None of this is to suggest that there have been no problems with debt-collection at HUD. Although the regulations call for banks to pursue normal debt-collection efforts first, HUD officials concede that compliance is mixed. Also, when their own collection efforts fail, private banks give potentially collectible loans to private collection agencies, and HUD gives them to the Department of Justice for prosecution. Attorneys there have regarded these as low-priority cases and have not prosecuted them in a timely way—something that debt-collection experts regard as crucial to any chance of recovery. Finally, at least for Section 312 loans, management at HUD has probably always regarded these loans as a sort of disguised social
assistance program, and has seen the idea of banging on the doors of poor people to get them to pay as distasteful. Loan collection efforts for the 312 program traditionally received little attention from top management. (The Title I program, by contrast, turns a profit for the government.)

The organization of debt collection at HUD has also failed to reflect changes in private debt collection practices. HUD standard operating procedures continued to call for personal dunning visits to delinquents, although banks had concluded over a decade ago that such efforts (earlier traditional in the industry) were generally not cost-effective. And HUD was very slow to computerize debt information, which resulted both in a great deal of clerical work for loan collectors (reducing the time available for collection activities) and in poor control over the status of files. The Section 312 program began to move toward computerization (and now to contracting out its debt collection to a private firm) after a critical report by the General Accounting Office in 1979; Title I has only recently computerized its collection activities, after a decision to do so was made by the assistant secretary appointed by President Reagan.

Fat City at the VA

Beyond the issue of nursing home beds, the Grace Commission made a number of specific contentions about Veterans Administration activities that are similar to private sector activities, but allegedly cost much more.

Perhaps the most dramatic was that it costs the VA $140 to process a claim for hospital coverage, compared to $3 to $6 for private sector insurance companies. This is wildly inaccurate. The Grace Commission listed the General Accounting Office as its source, but the GAO denies ever having made such a calculation. Dividing the total dollars spent by the total number of claims the VA processes yields a cost of $5-$7 per claim. This figure is still slightly higher than the private sector average, but the VA's claim-processing procedure is necessarily more complicated. In processing a claim, an insurance company often must determine only the amounts for which a beneficiary is covered. Statutes determining eligibility for VA medical care, by contrast, often restrict coverage to health problems related to service injuries, to emergency treatment, and so forth. This frequently requires extensive investigation. Whether VA claims-processing is still somewhat more costly even after these differences have been taken into account is hard to say.
Also in the area of claims processing, the Grace Commission stated that it takes the VA 25 to 40 days of internal processing time (that is, after all the appropriate documentation had come in) to process a veteran's pension or compensation claim, compared to an average of four days in the private sector for processing similar long-term disability claims.

The Grace Commission contention is correct. The main reason for the difference is that the VA's procedure requires more layers of review. In the private sector, the entire process would typically be handled by a single person. The claim reviewer would request any information needed, review it, and authorize payment. The VA procedure, by contrast, involves four separate reviews. First, a medical rating board makes a medical judgment about the extent of disability. At this point local representatives of service organizations such as the American Legion examine and comment on the file, as authorized by statute. Then an adjudicator determines how much money the claimant will receive. And finally an authorizer reviews the case from scratch. This procedure is designed to provide safeguards for veterans.

The Commission also made two criticisms of the way the VA purchases drugs and supplies for its hospitals. The first was that the VA does not make sufficient use of bulk discounts. Proprietary hospital chains, the report stated, obtain 75 to 85 percent of their supplies through bulk purchases, the VA only 60 percent.

The Grace Commission figures are correct. Why the difference? Essentially, the explanation involves the fast pace of change in medical technology. New medical products come on the market constantly. They are typically used first at scattered local hospitals, where some doctor, one way or another, has found out about them. If the innovation is a good one, use will gradually spread, but in the early stages there is insufficient national demand to warrant national (i.e., bulk discounted) purchasing. Gradually, though, successful new products are bought in sufficient quantity to warrant this move. It is the slowness of the VA, compared with the private sector, in moving its purchases of new products from local to national contracts that accounts for the greater proportion of local purchases. This is because the VA's system for purchasing supplies is not computerized; other uses of the VA's computer budget have hitherto been regarded as higher priorities.

The other Commission criticism involved the method of storage for supplies procured through national contracts. Since the 1940s, the VA has operated central warehouses to supply individual hospi-
tals. Products are delivered directly to warehouses and transported to individual hospitals as they are ordered. Advances in distribution technology, the Commission stated, have made warehouses uneconomic; proprietary hospital chains, the report said, have rejected warehousing.

The VA presents different figures. It claims that running a warehouse system adds only 15 percent to costs, not the 30 percent that the Grace Commission claimed. The VA claims that this 15 percent is more than offset by the lower prices that suppliers charge for single-point delivery to warehouses, as against multiple-point delivery to individual hospitals. They point to several studies by the General Accounting Office and the VA Inspector-General supporting the cost-effectiveness of the depots.

It is hard to know whom to believe. On the one hand, the VA provides specific dollar breakdowns of its costs for running the warehouses, while the Grace Commission merely cites “experts in materials management.” What is clear, however, is that the VA does worry about the cost-effectiveness of running central warehouses. The VA generates computer data on each item procured to the warehouses, terminating those that do not meet its criteria for warehousing: When the warehouses were first established, all nationally-procured products went through them; now, only about half do. On the other hand, if private hospital chains have indeed considered and rejected a warehousing system, and if their situation is comparable, that is strong evidence on the other side. Top management at the VA, itself unsure, has now commissioned an outside consultant to study the warehouses.

**Torpor at the GSA**

Two of the specific Grace Commission claims about the GSA involve maintenance management and energy conservation.

The Commission claimed that “maintenance productivity,” defined as the proportion of maintenance workers on the job at any given moment, was 60 to 65 percent in well-managed private firms but only 40 to 45 percent in the government. It is difficult to determine whether these claims are accurate. The “survey” of government performance to which the report referred turns out to have been, to put it generously, far more impressionistic than the report implies. A Commission member simply made casual observations at government locations he was visiting in connection with his other Commission responsibilities. That the evidence is impressionistic does not, of course, mean it is incorrect. The GSA itself doesn’t gen-
erally measure maintenance productivity the way the Grace Commission does (and differences in how to measure it are apparently quite common), so there is no hard evidence to contradict the report. But what one can say is that traditionally, in both the private and public sectors, maintenance was scheduled manually. Over the last five years or so, though, the private sector has come more and more to rely on computerized maintenance management systems. These decrease the non-productive time of maintenance workers by allowing them to perform several activities on each trip to a given building. The computerized systems also make it easy to compare the amount of time actually spent on a task with the standard amount of time for such a task.

In 1982 GSA began to investigate acquisition of such a computerized maintenance management system: Maintenance managers had seen these systems on exhibit at trade shows and read about them in the trade press. They wanted to keep up with the "state of the art." After examination of prototypes and delays for budget approval, a system has now been leased and has begun to operate.

On another subject, the Grace Commission stated that "although GSA has reduced annual energy costs significantly by daytime cleaning and other measures, little has been done to implement an Energy Management Control System, which has proved highly successful in the private sector." Such systems monitor data on building temperature and "enable heating and cooling units to be turned on and off —remotely and automatically—according to predetermined conditions."

But the "other measures" GSA has already taken accomplish much of what energy management control systems do. Government buildings already have timers and other devices to turn heating and cooling off and on. Buildings constructed since 1974 have centralized computer systems for this purpose. Consumption since 1973 in GSA buildings is down 30 percent even in the face of the rising demands owing to office automation. The Commission states that an energy management control system reduces consumption by 5 to 10 percent. GSA believes that the marginal benefit of adding such systems to the measures already undertaken rarely outweighs the marginal cost.

Waste in government?

There are a number of conclusions one can draw from all of this. First, the horror stories one hears are almost always gross exaggerations. What we have seen suggests that those responsible for the
activities in question generally pay attention to costs, and have a fairly good sense of ways to keep them down. People are too quick to conclude that programs are wasteful when they think the programs are not worthwhile. But if the government efficiently delivers a worthless product, the criticism should be directed at the decision to deliver the product, not vented in charges of incompetence and venality against those making the deliveries.

Second, some differences between relative costs to government and to the private sector occur because the government, superficial similarities notwithstanding, is in fact producing something very different. This is most obviously the case when, for instance, the VA puts balconies outside its nursing home rooms. But it is also the case when agencies follow cumbersome procurement procedures designed not solely to procure certain goods, but also to ensure due-process for vendors and special aid for disadvantaged businesses. There may indeed be incentives in some government programs, such as those administered by the VA, to overproduce quality. And it may be that we are spending too much for due process. But the extra money entailed has not simply disappeared down a black hole.

Third, even after taking account of quality differences, it is probably true that government generally produces a given output less efficiently than the private sector. If I had to hazard a guess, I would say that the government might typically use, not four times or 17 times as many resources as the private sector to produce a given output, but perhaps 1.2 times. That is less dramatic, but it does add up. Even if it adds up only to several billion dollars, rather than to the Grace Commission’s fantasy figures, such a sum is negligible only to those who, to paraphrase Everett Dirksen, have gotten so used to spending a billion here and a billion there that they forget it eventually adds up to real money.

Fourth, government is not very good at turning on a dime. As we have seen, there are many situations in which the environment changed—computer programs becoming available, for example—and it took more time for government to adapt than for the private sector. But, as we have also seen, the government does in fact adapt. But if the Grace Commission exaggerates badly, waste is nonetheless a problem. We should, with modest expectations, still look to see what changes are possible that might, at the margin, improve things.

First, public managers should aggressively look for quantifiable measures of performance. How many complainants does an employee of a local Social Security office see each hour, how many
complainants must return with the same problem, how satisfied are complainants with their treatment? Private sector experience suggests that such results-oriented measures can work well. In a number of the Grace Commission examples, managers did have good performance measures available, and performance in fact turned out to be competent. Sociologists and political scientists writing about organizations are remarkably sensitive to the difficulty of developing such measures for government, and to their possible perverse effects. (The literature is filled with observations along these lines: Judging the performance of an inspector by the number of inspections encourages cursory inspections, of small establishments only.)

But the private-sector doesn't seem to be as gloomy. Andrew Grove, president of the highly successful Silicon Valley firm Intel, notes the problem of the perverse consequences of performance indicators, but suggests that this can frequently be handled by developing pairs of measures. For example, companies keep inventories to avoid shortages, but carrying inventory costs money. If only shortages are measured, this will encourage overaccumulation of inventory. Therefore, he suggests, pair a measure of shortages with one of inventory carrying costs.

Second, government functions, particularly non-core functions, should be contracted out to private organizations if the same output can be produced more cheaply that way. The issue of contracting out services occasions enormous controversy, mostly of an ideological nature. Yet contracting out occurs all the time within the private sector itself, without ideological overtones. To take some traditional examples, large corporations hire advertising agencies and law firms, rather than keeping everything in-house. More recently there have emerged rapidly growing firms that provide laundry, food, and maintenance services for hospitals and businesses. Private sector firms frequently discover that specialized service providers are more efficient than in-house provision, because of various economies of scale. It shouldn't be surprising if this is frequently the case for government as well. If top management in government agencies prefers to devote its attention to grand issues of public policy, this is all the more reason to let other services be performed by those willing to toil in less glamorous vineyards.

Third, one spur to competent performance is a desire to live up to the standards of one's profession. The decision to adopt a computerized maintenance management system in GSA is a good example; the GSA officials regard themselves as professional building
managers. More broadly, government officials may perform well because they are proud to be in the public service. They believe they are helping people who might not otherwise be helped. The very fact that the organization for which they work is not trying to “make a buck” can be a source of motivation. Whether or not businessmen believe that only the bottom line can motivate, GSA officials I spoke with made it clear that during the energy crisis they believed it was their patriotic duty to reduce energy consumption in government buildings.

Since living up to professional standards and keeping up with the profession are important substitutes for a missing marketplace environment, the development of a sense of identification with a larger professional community should usually be encouraged (though there are cases where professional identification can have a negative impact: If government lawyers can’t conceive of any way to accomplish governmental purposes besides bringing lawsuits, we will have a problem). Since pay scales for top government managers will never be high enough to allow the public sector to motivate by appealing to the prospect of great personal wealth, this alternative will have to do.

More generally, we need desperately to foster within government the sense that public managers are indeed managers. At the end of his Managing the Public’s Business, Laurence E. Lynn, Jr., who has had extensive experience in government, stated that improvements in governmental competence require that public managers “take the time to manage.” This statement is noteworthy for what it suggests about current practice. One would think it superfluous, and certainly it would be if directed at most private sector managers. Yet many career government managers, promoted because they were good at lower-level jobs calling for individual accomplishment, are never told that being a good manager is not the same as being a good individual achiever; and many politically appointed executives have had no previous management experience. The increased use of management training for newly appointed career managers, as well as (if I may be permitted a bit of institutional chauvinism) the growth of professional schools in public policy and management, can contribute to the growth of this necessary culture of public management.

Finally, a number of institutional changes, some moderately difficult and others excruciatingly so, would help. Some changes in the budget process could address the problem of waste specifically. Annual appropriations cycles often waste money, since weapons
systems and spare parts, for instance, may have to be ordered in uneconomical quantities in order to stay within the year’s budget. There are cautious signs of willingness in Congress to accept multi-year procurements, as well as so-called “zero year appropriations,” wherein an agency can spend a certain sum for capital equipment, but the year is not specified.

Furthermore, unlike a typical private firm, the federal government does not have a capital budget separate from its operating budget. In private firms, capital expenditures, such as plant and equipment, are not regarded only as current outlays, but also as sources of future revenues (or savings). If a manager wishes to invest $10 million in some new equipment, he needs to justify that the stream of future revenue (or savings) as a result of the investment is likely to be greater than the cost of capital for the investment. Normally, any investments that meet this test are approved, independent of how much or how little money that means spending during a given year.

The federal budget discourages this. The emphasis is, instead, on an overall level of expenditure, using the previous year’s level as a baseline. It is often difficult to get “blips,” in the form of lumpy single-year investments, approved, even if spending a chunk of money now will save lots more in the future. The government thus tends to underinvest in capital equipment, such as computers.

Larger, and much more difficult, institutional changes would address not just waste but the broader questions of government performance. One of the greatest differences between the public and the private sectors is the generally greater rule-boundedness in government. Procurement is a typical example: The resources spent on development of detailed functional product specifications to assure access to bidding by many competitors, the strict rules for accepting the lowest bids, the extensive clearances through which all procurement decisions must go to minimize corruption—these not only probably cost more money than they save (or else the private sector would generally use government-style procurement systems, which it doesn’t), they also turn government officials into clerks. Rules and clearances also explain the frequent slowness of government’s reactions to new situations. Public managers need to be freer to make decisions, to take initiatives, and to innovate; then they must be held responsible for the results.

Having said that, I am unable to present a proposal for making it happen. It is all too easy to understand the incentives that produce fixation, among elected officials and in the media, on wrong-
doing, scandal, and horror stories—and hence on rules on clearances to prevent them from taking place. I have only two thoughts. One is that those concerned with public-sector performance need to think seriously about how to make marginal improvements that do not run afoul of these constraints: Are there ways, for example, to structure the procurement system to minimize kickbacks without forcing everything through multiple layers of review? The second thought is that when all else fails, a resort to the merits of the argument may be in order. There are certainly at least some journalists and elected officials who might emphasize a broader view of governmental accountability, if they can be persuaded that attention solely to wrongdoing hurts rather than helps the performance of government, not to speak of public confidence in our institutions.

Good performance by government consists of more than just controlling costs. It requires that elected officials and managers select worthwhile things for government to produce in the first place. And it requires that attention be paid to quality as well, since the cheapest way to produce something may not be the best way. The suggestions outlined here would, I believe, improve the overall quality of government performance, not just reduce waste. By contrast, efforts to "combat waste" by introducing additional rules and additional layers of control are likely to hinder good performance—and may, as the example of the procurement system suggests, not even reduce costs. Yet it is exactly the headline-grabbing horror stories, such as the ones in which the Grace Commission specialized, that lead more than anything to the development of ever-newer rules and clearance points. In this sense, the Grace Commission may have betrayed the "war on waste" it set out to wage.