

Pentagon buries evidence of \$125 billion in bureaucratic waste

By **Craig Whitlock** and **Bob Woodward** December 5, 2016

The Pentagon has buried an internal study that exposed \$125 billion in administrative waste in its business operations amid fears Congress would use the findings as an excuse to slash the defense budget, according to interviews and confidential memos obtained by The Washington Post.

Pentagon leaders had requested the study to help make their enormous back-office bureaucracy more efficient and reinvest any savings in combat power. But after the project documented far more wasteful spending than expected, senior defense officials moved swiftly to kill it by discrediting and suppressing the results.

The report, issued in January 2015, identified “a clear path” for the Defense Department to save \$125 billion over five years. The plan would not have required layoffs of civil servants or reductions in military personnel. Instead, it would have streamlined the bureaucracy through attrition and early retirements, curtailed high-priced contractors and made better use of information technology.

The study was produced last year by the Defense Business Board, a federal advisory panel of corporate executives, and consultants from McKinsey and Company. Based on reams of personnel and cost data, their report revealed for the first time that the Pentagon was spending almost a quarter of its \$580 billion budget on overhead and core business operations such as accounting, human resources, logistics and property management.

The data showed that the Defense Department was paying a staggering number of people — 1,014,000 contractors, civilians and uniformed personnel — to fill back-office jobs far from the front lines. That workforce supports 1.3 million troops on active duty, the fewest since 1940.

The cost-cutting study could find a receptive audience with President-elect Donald Trump. He has promised a major military buildup and said he would pay for it by “eliminating government waste and budget gimmicks.”

For the military, the major allure of the study was that it called for reallocating the \$125 billion for troops and weapons. Among other options, the savings could have paid a large portion of the bill to rebuild the nation's aging nuclear arsenal, or the operating expenses for 50 Army brigades.

But some Pentagon leaders said they fretted that by spotlighting so much waste, the study would undermine their repeated public assertions that years of budget austerity had left the armed forces starved of funds. Instead of providing more money, they said, they worried Congress and the White House might decide to cut deeper.

So the plan was killed. The Pentagon imposed secrecy restrictions on the data making up the study, which ensured no one could replicate the findings. A 77-page summary report that had been made public was removed from a Pentagon website.

"They're all complaining that they don't have any money. We proposed a way to save a ton of money," said Robert "Bobby" L. Stein, a private-equity investor from Jacksonville, Fla., who served as chairman of the Defense Business Board.

Stein, a campaign bundler for President Obama, said the study's data were "indisputable" and that it was "a travesty" for the Pentagon to suppress the results.

"We're going to be in peril because we're spending dollars like it doesn't matter," he added.

The missed opportunity to streamline the military bureaucracy could soon have large ramifications. Under the 2011 Budget Control Act, the Pentagon will be forced to stomach \$113 billion in automatic cuts over four years unless Congress and Trump can agree on a long-term spending deal by October. Playing a key role in negotiations will probably be Trump's choice for defense secretary, retired Marine Gen. James Mattis.

The Defense Business Board was ordered to conduct the study by Deputy Defense Secretary Robert O. Work, the Pentagon's second-highest-ranking official. At first, Work publicly touted the efficiency drive as a top priority and boasted about his idea to recruit corporate experts to lead the way.

After the board finished its analysis, however, Work changed his position. In an interview with The Post, he did not dispute the board's findings about the size or scope of the bureaucracy. But he dismissed the \$125 billion savings proposal as "unrealistic" and said the business executives had failed to grasp basic obstacles to restructuring the public sector.

"There is this meme that we're some bloated, giant organization," he said. "Although there is a little bit of truth in that . . . I think it vastly overstates what's really going on."

Work said the board fundamentally misunderstood how difficult it is to eliminate federal civil service jobs — members of Congress, he added, love having them in their districts — or to renegotiate defense contracts.

He said the Pentagon is adopting some of the study's recommendations on a smaller scale and estimated it will save \$30 billion by 2020. Many of the programs he cited, however, have been on the drawing board for years or were unrelated to

the Defense Business Board's research.

Work acknowledged that the push to improve business operations lost steam after then-Defense Secretary Chuck Hagel was replaced by Ashton B. Carter in February 2015. Carter has emphasized other goals, such as strengthening the Pentagon's partnerships with high-tech firms.

"We will never be as efficient as a commercial organization," Work said. "We're the largest bureaucracy in the world. There's going to be some inherent inefficiencies in that."

'Dark matter'

Work, a retired Marine officer, became deputy defense secretary in May 2014. With the military budget under the most pressure since the end of the Cold War, he sought help from the Defense Business Board, an advisory panel known for producing management studies that usually gathered dust.

Work told the board that the outcome of this assignment would be different. In a memo, he directed the board to collect sensitive cost data from the military services and defense agencies that would reveal how much they spent on business operations.

Pentagon officials knew their back-office bureaucracy was overstaffed and overfunded. But nobody had ever gathered and analyzed such a comprehensive set of data before.

Some Defense Business Board members warned that exposing the extent of the problem could have unforeseen consequences.

"You are about to turn on the light in a very dark room," Kenneth Klepper, the former chief executive of Medco Health Solutions, told Work in the summer of 2014, according to two people familiar with the exchange. "All the crap is going to float to the surface and stink the place up."

"Do it," Work replied.

To turn on the light, the Pentagon needed more outside expertise. A team of consultants from McKinsey was hired.

In a confidential August 2014 memo, McKinsey noted that while the Defense Department was "the world's largest corporate enterprise," it had never "rigorously measured" the "cost-effectiveness, speed, agility or quality" of its business operations.

Nor did the Pentagon have even a remotely accurate idea of what it was paying for those operations, which McKinsey divided into five categories: human resources; health-care management; supply chain and logistics; acquisition and procurement; and financial-flow management.

McKinsey hazarded a guess: anywhere between \$75 billion and \$100 billion a year, or between 15 and 20 percent of the Pentagon's annual expenses. "No one REALLY knows," the memo added.

The mission would be to analyze, for the first time, dozens of databases that tracked civilian and military personnel, and labor costs for defense contractors. The problem was that the databases were in the grip of the armed forces and a multitude of defense agencies. Many had fought to hide the data from outsiders and bureaucratic rivals, according to documents and interviews.

Information on contractor labor, in particular, was so cloaked in mystery that McKinsey described it as "dark matter."

Prying it loose would require direct orders from Work. Even then, McKinsey consultants predicted the bureaucracy would resist.

"This is a sensitive exercise conducted with audiences both 'weary' and 'wary' of efficiency, cost, sequestration and budget drills," the confidential memo stated. "Elements of the culture are masterful at 'waiting out studies and sponsors,' with a 'this too shall pass' mindset."

Overstaffed chow hall

From the outset, access to the data was limited to a handful of people. A \$2.9 million consulting contract signed by the Pentagon stipulated that none of the data or analysis could be released to the news media or the public.

Moreover, the contract required McKinsey to report to David Tillotson III, the Pentagon's acting deputy chief management officer. Anytime the Defense Business Board wanted the consultants to carry out a task, Tillotson would have to approve. His office — not the board — would maintain custody of the data.

"Good news!" Work emailed Tillotson once the contract was signed. "Time to cook."

In an Oct. 15, 2014, memo, Work ordered the board to move quickly, giving it three months to produce "specific and actionable recommendations."

In a speech the next month, Work lauded the board for its private-sector expertise. He said he had turned it into "an operational arm" of the Pentagon leadership and predicted the study would deliver transformational results.

In an aside, he revealed that early findings had determined the average administrative job at the Pentagon was costing taxpayers more than \$200,000, including salary and benefits.

"And you say, hmmm, we could probably do better than that," he said.

The initial results did not come as a surprise.

Former defense secretaries William S. Cohen, Robert M. Gates and Chuck Hagel had launched similar efficiency drives in 1997, 2010 and 2013, respectively. But each of the leaders left the Pentagon before their revisions could take root.

“Because we turn over our secretaries and deputy secretaries so often, the bureaucracy just waits things out,” said Dov Zakheim, who served as Pentagon comptroller under President George W. Bush. “You can’t do it at the tail end of an administration. It’s not going to work. Either you leave the starting block with a very clear program, or you’re not going to get it done.”

Arnold Punaro, a retired Marine general and former staff director for the Senate Armed Services Committee, said lawmakers block even modest attempts to downsize the Pentagon’s workforce because they do not want to lose jobs in their districts.

Without backing from Congress, “you can’t even get rid of the guy serving butter in the chow hall in a local district, much less tens of thousands of jobs,” he said.

‘Time to hunt!’

The Defense Business Board assigned five members to conduct the study alongside consultants from McKinsey. Scott Rutherford, senior partner at McKinsey’s Washington office, declined to comment.

The team ran into resistance as several Pentagon offices delayed requests for data, according to emails and memos. Work and Tillotson had to intervene to get the data flowing. At one point, more than 100 people were feeding data from different sectors of the bureaucracy.

Laboring under its tight deadline, the team hashed out an agreement with Pentagon officials over which job classifications to count in their survey. The board added a sixth category of business operations — real property management. That alone covered 192,000 jobs and annual expenses of \$22.6 billion.

On Christmas Eve, Klepper emailed Work and Tillotson to thank them for putting their muscle behind the project. Without it, he said, “this would all have been DOA and the naysayers would all have been right.”

He hinted the board would make some eye-catching recommendations and expressed relief its work had not been torpedoed.

“I have to admit, with all the caution, negative reaction and pushback,” Klepper said, “I had a bit of concern at the end of the analysis some form of censorship would stop us from showing the true opportunity.”

Work replied that he could not be happier.

“Time to hunt!” he said in an email, adding that he was “very excited about 2015” and ready to make “some bold moves.”

The year kicked off with promise. On Jan. 21, 2015, the Pentagon announced Stein, the private-equity investor, had been reappointed as the board's chairman and praised him for his "outstanding service."

The next day, the full board held its quarterly public meeting to review the results of the study. The report had a dry title, "Transforming DoD's Core Business Processes for Revolutionary Change," and was packed with charts and jargon. But it began plainly enough.

"We are spending a lot more money than we thought," the report stated. It then broke down how the Defense Department was spending \$134 billion a year on business operations — about 50 percent more than McKinsey had guessed at the outset.

Almost half of the Pentagon's back-office personnel — 457,000 full-time employees — were assigned to logistics or supply-chain jobs. That alone exceeded the size of United Parcel Service's global workforce.

The Pentagon's purchasing bureaucracy counted 207,000 full-time workers. By itself, that would rank among the top 30 private employers in the United States.

More than 192,000 people worked in property management. About 84,000 people held human-resources jobs.

The study laid out a range of options. At the low end, just by renegotiating service contracts and hiring less-expensive workers, the Pentagon could save \$75 billion over five years. At the high end, by adopting more aggressive productivity targets, it could save twice as much.

After a discussion, the full board voted to recommend a middle option: to save \$125 billion over five years.

Hordes of contractors

Afterward, board members briefed Work. They were expecting an enthusiastic response, but the deputy defense secretary looked uneasy, according to two people who were present.

He singled out a page in the report. Titled "Warfighter Currency," it showed how saving \$125 billion could be redirected to boost combat power. The money could cover the operational costs for 50 Army brigades, or 3,000 F-35 Joint Strike Fighters for the Air Force, or 10 aircraft-carrier strike groups for the Navy.

"This is what scares me," he said, according to the two people present. Work explained he was worried Congress might see it as an invitation to strip \$125 billion from the defense budget and spend it somewhere else.

A few weeks later, Carter replaced Hagel as defense secretary. Carter sounded as though he would welcome the kind of revolutionary change the board was urging.

“To win support from our fellow citizens for the resources we need, we must show that we can make better use of every taxpayer dollar,” Carter said in an inaugural message in February 2015. “That means a leaner organization, less overhead, and reforming our business and acquisition practices.”

In briefings that month, uniformed military leaders were receptive at first. They had long groused that the Pentagon wasted money on a layer of defense bureaucracies — known as the Fourth Estate — that were outside the control of the Army, Air Force and Navy. Military officials often felt those agencies performed duplicative services and oversight.

But the McKinsey consultants had also collected data that exposed how the military services themselves were spending princely sums to hire hordes of defense contractors.

For example, the Army employed 199,661 full-time contractors, according to a confidential McKinsey report obtained by The Post. That alone exceeded the combined civil workforce for the Departments of State, Agriculture, Commerce, Education, Energy, and Housing and Urban Development.

The average cost to the Army for each contractor that year: \$189,188, including salary, benefits and other expenses.

The Navy was not much better. It had 197,093 contractors on its payroll. On average, each cost \$170,865.

In comparison, the Air Force had 122,470 contractors. Each cost, on average, \$186,142.

Taking fire

Meantime, the backlash to the \$125 billion savings plan intensified.

On Feb. 6, 2015, board members briefed Frank Kendall III, the Pentagon’s chief weapons-buyer. Kendall’s operations were a major target of the study; he oversaw an empire of purchasing agents and contractors that were constantly under attack from Congress for cost overruns and delays.

Kendall put up a stiff fight. He challenged the board’s data and strenuously objected to the conclusion that his offices were overstaffed.

“Are you trying to tell me we don’t know how to do our job?” he said, according to two participants in the meeting. He said he needed to hire 1,000 more people to work directly under him, not fewer.

“If you don’t believe me, call in an auditor,” replied Klepper, the board’s restructuring expert. “They’ll tell you it’s even worse than this.”

In an interview, Kendall acknowledged he was “very disappointed” by the board’s work, which he criticized as “shallow” and “very low on content.” He said the study had ignored efforts by his agencies to become more efficient, and he accused the

board of plucking the \$125 billion figure out of thin air.

“It was essentially a ballpark, made-up number,” he said.

Still, Kendall knew that lawmakers might view the study as credible. Alarmed, he said, he went to Work and warned that the findings could “be used as a weapon” against the Pentagon.

“If the impression that’s created is that we’ve got a bunch of money lying around and we’re being lazy and we’re not doing anything to save money, then it’s harder to justify getting budgets that we need,” Kendall said.

More ominously, board members said they started to get the silent treatment from the Pentagon’s highest ranks.

Briefings that had been scheduled for military leaders in the Tank — the secure conference room for the Joint Chiefs of Staff — were canceled. Worse, the board was unable to secure an audience with Carter, the new defense secretary.

Stein, the board chairman, accused Carter of deliberately derailing the plan through inaction. “Unfortunately, Ash — for reasons of his own — stopped this,” he said in an interview.

Peter Cook, a spokesman for Carter, said the Pentagon chief was busy dealing with “a long list of national security challenges.” He added that Work and other senior officials had already “concluded that the report, while well-intentioned, had limited value.”

The fatal blow was struck in April. Just three months after Stein had been reappointed as board chairman, Carter replaced him with Michael Bayer, a business consultant who had previously served on the panel and clashed with Stein. Bayer declined to comment.

A few weeks later, Klepper resigned from the board. The \$125 billion savings plan was dead.

In an interview, Tillotson, the Pentagon’s acting deputy chief management officer, called the board’s recommendations too ambitious and aggressive. “They, perhaps, underestimated the degree of difficulty we have in doing something that in the commercial sector would seem to be very easy to do.”

Yet he acknowledged that its overall strategy for scaling back the bureaucracy was sound and that, given more time, it would be possible to realize huge savings.

“If we had a longer timeline, yes, it would be a reasonable approach,” he said. “You might get there eventually.”

Ending the debate

Frustration, however, persisted in some corners over the Pentagon's unwillingness to tackle the inefficiency and waste documented by the study.

On June 2, 2015, Navy Secretary Ray Mabus delivered a speech at the American Enterprise Institute, a conservative think tank. He complained that 20 percent of the defense budget went to the Fourth Estate — the defense agencies that provide support to the armed forces — and called it “pure overhead.”

He singled out the Defense Finance and Accounting Service and the Defense Logistics Agency, which together employ about 40,000 people, as egregious examples.

When a reporter in the audience asked whether he thought the agencies should be abolished, Mabus resisted the temptation to say yes.

“Nice try on getting me into deep trouble,” he replied.

But trouble arrived in Mabus's email the next day.

“Ray, before you publicly trash one of the agencies that reports through me I'd really appreciate a chance to discuss it with you,” wrote Kendall, the Pentagon's chief weapons-buyer, whose management portfolio included the Defense Logistics Agency.

He said that if Mabus had a complaint, he should raise it directly with their mutual bosses, Carter and Work, and copied the email to both.

In his interview with The Post, Kendall said he was “completely blindsided” by the Navy secretary's criticism, “so I sent him what I thought under the circumstances was a pretty polite note.”

Mabus did not back down. In an emailed retort to Kendall, he referred to the ill-fated Defense Business Board study.

“I did not say anything yesterday that I have not said both publicly . . . and privately inside this building,” he said. “There have been numerous studies, which I am sure you are aware of, pointing out excessive overhead.”

That prompted a stern intervention from Work.

“Ray, please refrain from taking any more public pot shots,” Work said in an email. “I do not want this spilling over into further public discourse.”

Evelyn Duffy contributed to this report.