A FIVE-STEP AGENDA FOR SMARTER GOVERNMENT SPENDING

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After a year of managing the COVID-19 pandemic, every level of government faces a profound financial strain. Costs continue to escalate, and the need to provide more public assistance—especially fiscal stimulus and medical services—will only climb during the remaining months of crisis. At the same time, revenues and taxes have been sharply constrained. Across developed countries, the 2020 GDP is expected to have declined by 5% to 10% since 2019. And though the economy may recover to some extent in 2021, it's not yet certain how or when the pressure on government expenses will be reduced.

Every public-sector leader is grappling with the same questions: How can we drive costs down while maintaining a high level of impact? How can we do more with less? How can we address today's challenges with more proactive, responsive policies and services? There are many ways to reduce spending, and some are much more effective than others—indeed, some can make an organization stronger. Even so, it can be challenging to create and implement a comprehensive cost management agenda, especially after several pre-pandemic years of steady economic growth and against the backdrop of entrenched bureaucratic structures.

Many experts and commentators suggest that, to deal with this crisis, governments should adopt best practices or lessons from the private sector. In other words, they should cut costs the way businesses do. But governmental agencies have a different set of missions, responsibilities, and constraints; they can't just suddenly apply business principles directly as could, for instance, a private equity fund. But they can derive some cost-cutting lessons from world-class companies, marrying commercial best practices with a deep understanding of governmental organizations and the requisite tradeoffs.

Our experience in the public and private sectors suggests that there are five key principles for managing a government spending agenda. While they may feel unfamiliar to some agencies and departments, they reflect the urgency of the current fiscal moment. These principles are all designed to position governmental organizations to be more effective, more focused on their mission, and potentially even stronger than they were before the pandemic.

1. Emphasize and Practice Transparency

In many governmental agencies, data is poorly assembled and delivered, so that decision makers may not have all the information they need to make the best spending choices. This is a particularly critical issue in managing costs, where many cutbacks involve tradeoffs. Transparency will also help department or organization heads successfully communicate the rationale for cuts to all employees and to any oversight group.

One pragmatic approach is to use KPIs in a diagnostic role. If these are set up to link the drivers of spending to outcomes, budgets can be structured to surgically tackle the cost structure of operations. The goal is not to seek a comprehensive, complex IT installation, but a simple view that illuminates the 20% of activity that may be responsible for 80% of the unnecessary costs. Once those figures are in hand, cuts can be prioritized.

The same financial KPIs can be adopted to set aggressive but achievable targets for cost reduction. These targets should be clear, specific, and credible. Public- and private-sector benchmarks based on similar activity make a good starting point.

One large, multi-component US government department developed a cost transparency approach that used some business post-merger integration principles. For example, it set consistent, comparable, and universal spending categories. Now, for each agency within the department, costs are organized in the same format and can be easily tracked and compared on readily accessible dashboards. Decision makers can use this information to continually improve effectiveness and efficiency.

Rather than focusing solely on incremental funding, department and organization heads should review the overall cost base. All activities, no matter how well-regarded they were in the past, should be on the table for review and consideration. Many private-sector businesses use zero-based budgeting (ZBB) to do this. ZBB starts each year without carrying over expenses from the past, requiring each item to be justified in terms of future needs and strategies. Artificial intelligence–based tools, such as BCG's Spend.AI, can be deployed in only a few weeks to accurately consolidate and meaningfully categorize all expenditure in support of such efforts. While public-sector organizations have not always embraced zero-based approaches, the actual experience with them is generally positive. They give agencies a way to look across the baseline budget as a whole, which presents the largest potential value for cost savings. Transparency and linkages to outcomes mean that the tradeoffs needed to meet service goals and financial necessity can be weighed.

2. Create a Central Structure for Coordinated Governance

When there is an urgent need for rapid cost reduction, government entities cannot rely on decentralized decision making, with decisions pushed down to local and operational levels. Decentralized cost reduction does not take advantage of the agency's scale benefits or accommodate some strategic approaches. A single leadership team, with representatives from each part of the organization, can conceive, articulate, align, and drive a coordinated set of cost-cutting measures.

Only a central leadership team can make the tough decisions that produce the best outcomes. This team should be thought of as playing the part of a project management office and central to managing the cost program. It will manage internal communications, regularly meeting with top leadership and others in the agency to regularly review progress and resolve issues. This internal forum drives a lot of traction, aligning the workforce to strategic goals and providing the organizational fortitude for difficult tradeoffs. Review meetings are important to ensure accountability to outcomes, which is particularly important in public-sector organizations.

The leadership team will also oversee the change management processes needed to implement these modifications successfully and sustainably, demonstrating the criticality of the effort through their own active involvement. But this does not mean operating in an ivory tower—key messages must be reinforced with the entire organization to support change management, and frontline worker realities and sentiments must be incorporated into the thinking to ensure that cost programs are designed for success.

Rather than relying on gradual, incremental measures, the team should aim for implementing the first phase of cuts within weeks or months. Establishing the necessary sponsorship and oversight will allow decision makers to set bold goals with specific targets and timelines for stepwise improvement.

3. Optimize for High-Priority Outcomes

When faced with urgent demands for slashing costs, many governmental organizations are oriented toward making across-the-board cuts—asking each part of the organization to reduce its spending by the same percentage. Experience in both business and government has found this to be counterproductive. The greatest opportunities for savings do not always correspond to the size of the agency or function. And they do not result in sustained efficiency gains because underlying operations are rarely improved in these exercises.

Instead, decision makers should identify the department's most critical outputs and outcomes, judging them in the same way that a company's most important stakeholders and respected outside observers would. Costs can then be mapped to one or more of these outcomes, with the analysis used as a basis for setting a proactive cost-reduction agenda. Zero-based budgeting is a useful tool for this activity.

Proactive cost management is different in government than it would be in the private sector, where there are common metrics for profitability and return on investment. Here, decision makers have to consider a variety of relevant measures of importance, often based on a mix of economic, public safety, and social elements. Once these factors have been articulated, it will be possible to identify which cost levers would have the highest impact. Some of these will be ongoing day-to-day expenses that minimize potential disruption; others may be longer-term investments. Reductions can be focused on the lower-impact expenses that remain—where the links to outcomes are weaker, even if they have been funded in the past.

This exercise provides a learning opportunity for administrators to gain insight into their real impact and sharpen their abilities to respond to future crises.

4. Reimagine Operations Within and Across Silos

To cut costs with minimal reduction of services or outcomes, it's necessary to rethink and redesign operations with a movement toward productivity and operational excellence. In many agencies, functions like facilities, information technology, oversight functions, workforce management, and procurement can be reimagined and made more effective with relatively less transitional cost than core operational functions, taking advantage of digital platforms and support that were prohibitively expensive several years ago.

Depending on an agency's starting point or level of coordination across similar types of expenditure, it may choose to carry out either "programmatic change" or "functional change." Programmatic change is improving operational or service delivery processes within agencies or functions. Examples include deploying artificial intelligence–based maintenance or streamlining the spans and layers of the hierarchy within a specific organization's operations. Functional change comprises improvements that span beyond internal boundaries, bringing together processes and activities that were previously managed by separate departments or agencies. (Exhibit 1 compares across-the-board cuts with programmatic and functional change approaches.)

Private-sector organizations have largely come to rely on central shared services organizations to support functional capabilities. But public-sector organizations tend to have less experience with them, in part because of the way budgets and payments for internal services are organized. One potential opportunity to reduce costs may be for several agencies in a larger organization to consolidate their management of real estate, gaining economies of scale, bargaining power, and better use of assets. In the past, this may have been difficult because of diverse missions and legacy technologies; but it may be easier now, particularly under the pressures that agencies currently face, with right people to design and streamline a common approach.

One central focus should be upgrading technology, taking advantage of advances in digital platforms, analytics, and interoperability—which, if managed well, can bring down expenses and raise productivity considerably, while keeping cybersecurity and other necessary protections in place. In addition, many back-office tasks can now be carried out through robotic process automation, driving greater efficiency and reducing time and cost.

Another key area is procurement: developing more productive supplier relationships, renegotiating supplier contracts using a deep understanding of value chain economics for better outcome/cost tradeoffs, and redesigning the workflow to gain productivity and higher quality.

A final area to consider is adjusting the employee base—through accelerated attrition, shifting to remote work and more flexible jobs, or possibly personnel reductions. A dedicated workforce management group can be formed to retain top talent, provide support for reskilling and upskilling (training staff in the new skills needed for a more technologically enabled environment), and rebalance teams appropriately vis-à-vis changing talent needs.

Exhibit 1 | Comparing Three Approaches to Governmental Expense Reduction

	Stopgap short-term approach	Recommended combined approach	
	Across the Board	**Programmatic**	**Functional**
Description	Apply comparable budget percentage targets to all agencies (e.g., 5% reduction to all agency budgets)	Perform agency-level reviews to determine priorities for process improvements and reductions	Deploy function-wide and cross-boundary lenses (e.g., procurement, IT) to drive savings for the larger system
When to Use	• Urgent need for cost reduction • Acceptance of inefficiencies • Lack of operational data • Lack of trust	• Rapid need for cost reductions • Agencies oriented to savings • Detailed operational data • Trust among agency stakeholders	• Opportunity for fundamental reductions • Cross-agency teams are feasible • Broad-based operational data • Widespread determination to improve
Considerations	• Does not reflect mission or priority • Avoids fundamental but needed change • May lead to internal pushback	• Requires core team to oversee • Requires consensus within agency • Draws insight from operational data	• Requires cross-agency coordination • Will reconcile agency-specific views • Draws insight from systemwide data

Source: BCG analysis.

(Exhibit 2 shows potential cost reductions in each of these areas.)

5. Reset Incentives

Currently, many governmental agencies send mixed signals with their annual budgeting process. They may champion small reductions or execute larger cost cuts, but both are done independent of outcomes or the organizational culture. Combined with the difficulties of laying off civil servants and the lack of incentives for managing the spending down on large contracts, the most critical priorities are underfunded.

To remedy this, decision makers may need to shift the agency or department's operational incentives. Unlike a private-sector company, government entities cannot use financial incentives for staff as primary levers to motivate change. But they can deploy non-financial incentives: for example, commendations as "heroes," access to training, exposure to leadership, or opportunities to give talks elsewhere in the department.

Rigorous, holistic metrics based on outcomes that clearly demonstrate success in cost reduction can help; for example, in speeding up the delivery of services, managing the number of complaints, and promoting efficiency and productivity as beneficial outcomes. By tracking related metrics as they play out during this cost-reduction period, decision makers can ensure the metrics are nested so that, in aggregate, they build up to the agency's overall cost management goals. This should help pinpoint the most difficult challenges.

Driving successful change for government frequently requires not just operational improvements, but changes in the scope and scale of service levels. These redesigns might require a pause or permanent halt in some activities. This is a difficult task for any organization—but one that many leaders find necessary from time to time.

Any initiatives to influence the organizational culture to adopt new, more productive behaviors and attitudes will typically require the support of superiors. As in private-sector firms, leaders within the agency should focus on a few bold aspirations, challenging it to achieve the same or better results with a smaller organization. Senior leaders should set incentives, including opportunities for career growth, that reward innovative improvements.

Momentum and Leadership

Following these five principles can help government agencies systematically reduce

EXHIBIT 2 | Four Levers for Cost Reduction in Government Operations

Domain of functional activity	Organizational	Procurement	IT	Property & Facilities
Examples of possible changes	Optimize span of control Eliminate redundant support functions Institute shared services model	Develop in-depth price transparency Deploy negotiation best practices Reduce usage volatility Increase order volumes for scale	Manage down unnecessary demand Use digital platforms to improve legacy systems Consolidate contracts to drive scale Centrally negotiate with suppliers	Right-size portfolio of facilities and assets Consolidate contracts Improve maintenance staff schedule Renegotiate leases
Potential cost savings range on addressable spend	5% to 10%	10% to 20%	15% to 20%	20% to 30%

Source: BCG analysis.

expenses. Efforts like these are most effective when they're comprehensive: for example, when a single group pulls together the strategic goals, the broad agreement about which goals will be used, and the means of implementation. Decision makers within government bodies will have to orient their purpose to strategic goals and be agile and responsive as opportunities and roadblocks arise.

Those who bring their organizations through this kind of process are often surprised by the positive response. At first, many employees are reluctant to participate, concerned about possible loss of services or other cuts. But they often come to appreciate an atmosphere with higher levels of productivity, more effective use of resources, and more streamlined processes and oversight mechanisms. People find they are able to get more capability from their allocated funds than they previously imagined. It can feel very energizing to spend smarter—to raise the quality of government services while reducing the cost.

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