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CSIS Study Pounds Final Nail into Insourcing's Coffin

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For the past two years the Department of Defense (DoD) has been pursuing a mirage. This false vision is that the Pentagon can both save money and perform better by replacing a significant fraction of its private contractor workforce with government employees. The Secretary of Defense, Robert Gates, led the charge in 2009 by declaring that the department would reduce its number of service support contractors by about 33,000, replacing them over a five-year period with 39,000 new full-time government employees. This decision was based, in large part, on the notion that DoD had become excessively dependent on contractors -- some of whom, it was asserted, were performing functions that could be deemed inherently governmental in character. But in addition, Secretary Gates claimed that replacing contractors with government employees would produce an average savings of 40 percent (a number later reduced to 25 percent).

Within a relatively short time it became evident that the belief in the relative cost-effectiveness of public over private workers was indeed a mirage. In mid-2010, Secretary Gates planted the first nail in insourcing's coffin, declaring that "as we were reducing contractors, we weren't seeing the savings we had hoped from insourcing." DoD suffered from the mistaken belief that by simply swapping the fully burdened costs of private sector contractors with less than fully burdened personnel costs for government employees that it was saving money. But of course the government was paying those other costs, just from different accounts. Moreover, as studies by the CATO Institute and Heritage Foundation showed, the cost of federal employees, almost without exception, was higher than for private sector workers.

The Secretary added a second nail to the coffin when he halted his effort to hire tens of thousands of new federal employees in 2010 to find \$100 billion in cost savings in the defense budget. More nails have been added by Deputy Secretary Lynn and Under Secretary Carter in their efforts to make the department more efficient. These officials have rediscovered the profit motive and the sharing of cost savings as valuable incentives to greater efficiency. Of course, the profit motive doesn't apply when the work is performed by government workers.

The military services began to provide nails of their own. In February, 2011 Army Secretary McHugh sent out a memo that sharply curtailed his service's insourcing activity. McHugh reserves the right to personally approve any insourcing proposal across the Army. Any proposals for further insourcing had to include careful study of alternatives to insourcing, the number of civilian federal employees the proposal would require, proof that funds are available to support those permanent civilian functions and a comprehensive legal review. Similarly, a report of a meeting between defense officials and Pentagon reporters quoted one official as saying, "The insourcing that hasn't taken place by now probably will be held to the fiscal year 2010 level. At least in the Air Force, insourcing pretty much is going to be stopped."

Now it appears that the final nail has been provided by a new study from the Center for Strategic and International Studies. The study makes clear that DoD's approach to making comparisons between public and private sector work was fundamentally flawed. Ultimately, the study suggested that there was no basis for DoD's assertion that it could save money by insourcing. The study makes the point that the private sector had been asserting for almost two years, "If the true cost of the public performance of commercial services cannot be determined, any budget-driven insourcing decision becomes immediately suspect." It then goes on to ask the proverbial \$64,000 question: "How can DoD claim it is saving 40 percent, or 25 percent, or any amount via insourcing private sector positions when it does not know how much the newly insourced function will cost?"

There is still work to be done to repair the damage caused by more than two years of misplaced insourcing decisions. Beyond that, DoD needs to take a fresh look at how it manages a defense industrial base that insists on a variety of public and private sector entities with a wide range of capabilities. If efficiency is truly the name of the game, then for example, DoD needs to reconsider its policy of requiring that the overall sustainment workload be divided 50/50 between the two sectors. As part of the current comprehensive review, the department should also review the logic behind 50/50.