

Think Tank: Defense Insourcing Decisions Based on Flimsy Analysis

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May 17, 2011

A new study pours cold water on the notion that insourcing saves the government money, and calls for the Pentagon to conduct a more careful analysis of how much it costs to bring in-house jobs that have been performed by contractors.

The study, titled, "DoD Workforce Cost Realism Assessment," was released May 17 by the nonpartisan Center for Strategic and International Studies. The authors do not take sides in the insourcing vs. outsourcing debate, but do fault the Obama administration for lacking reliable cost data and for making hiring decisions that could end up wasting billions of taxpayer dollars.

Since 2009, the administration has directed federal agencies to shift work that had been performed by contractors to government employees. With billions of federal dollars and thousands of jobs at stake, insourcing policies have caused widespread anxiety in the contractor community. Defense Department contractors, particularly, have stood to lose the most, as the Pentagon is the government's biggest buyer of contracted-out services. In 2010, the Pentagon added 17,000 employees to its payroll as a result of insourcing efforts.

Administration officials, including Defense Secretary Robert Gates, have strongly backed insourcing policies as necessary in order to rebalance the work force after a decade of rampant outsourcing.

Since 9/11, federal spending on service contracts more than doubled — from \$164 billion in 2000 to \$343 billion in 2010. The Defense Department in 2010 awarded \$161 billion worth of service contracts, up from \$67 billion in 2000.

The potential value of insourcing is clear for "inherently governmental functions," such as contract management and for areas where the Defense Department needs to strengthen its managerial or technical capability, the CSIS study says. "However, it is not clear that insourcing can provide large budgetary savings," states the report. "In fact, an extensive empirical literature review indicates that increasing in-house support functions such as building maintenance, printing, laundry, and food service would result in a cost increase of between 20 to 40 percent."

The study highlights inconsistencies in how public-sector costs are measured vis-à-vis contractor costs. "Given differences in accounting systems between public and private service providers, as well as the problems inherent in allocating joint overhead costs and estimating the cost of risk, it may often be impossible for even the most expert and

objective observer to compare in-house and contractor costs with any useful degree of accuracy," says the report.

CSIS proposes an alternative methodology — based on competition — for conducting better sourcing decisions between private and public providers. The Office of Management and Budget circular A-76 process allows for public-private competition to determine whether jobs should be kept in house or outsourced. Congress in 2009 suspended A-76 competitions in an effort to bolster insourcing. CSIS says the A-76 rule offers a more suitable, although still insufficient, approach to cost comparisons in public-private competitions as a foundation for in- and outsourcing decisions.

"The challenge of conducting accurate cost estimating has importance beyond the issue of insourcing," the study says. "In a time of budgetary strain, the U.S. government must have repeatable, verifiable, and data-driven mechanisms for making decisions and understanding their resource implications, including associated costs."

The Defense Department's insourcing strategy calls for replacing more than 30,000 contractors with government civilian workers by 2015. Gates defended the plan as key to "restore balance" to the work force by returning the ratio of contractors to civilians to its 2001 level. The plan was also based on an assumption that federal civilians would be significantly less costly than the contractors they replaced, the study notes. "As a result, DoD planned to achieve budgetary savings equal to 40 percent of the cost of the contractors being replaced." More recent statements claimed savings of 25 percent, says the report. "Though neither figure appears justifiable, research has shown that about 65 percent any savings achieved through public-private competitions derive from the competition itself, not from any intrinsic advantage" in insourcing.

There are legitimate reasons for the Pentagon to increase its in-house acquisition work force and reduce the role of contractors in order to control conflicts of interest and fraud, the study says. Other positions might be insourced to provide career progression for federal employees with scientific, engineering, and technical skills. "Without an adequate base in these areas, DoD cannot be a good manager or a smart buyer," the study says.

But when cost control is the priority, only competition works, says CSIS. "History is clear: the absence of potential competition leads inexorably to cost growth."

On March 4, 2009, President Obama signed a memorandum that emphasized the importance of competition in controlling costs for the entire federal government. Yet the Defense Department's April 2010 guidance on insourcing "does not cite the degree of competition as a factor in determining which contracts to insource," the study says.

Insourcing efforts are well under way, CSIS notes, and while "cost is reportedly the rationale for half of the insourcing decisions, there is not enough public information to estimate even the likely range of overall real, achieved savings. ... Anecdotal evidence regarding savings is unsatisfactory."

CSIS also warns that sourcing decisions — whether outsourcing or insourcing — based exclusively on anticipated short-term cost savings can have unintended consequences. "In discussions with CSIS, representatives of several small firms that provide temporary staffing services indicated that DoD is not merely shifting positions in-house," says the study. "Instead, DoD managers are targeting individual employees from those firms for the newly insourced positions. ... Many of these firms are small businesses that have made a significant investment in recruiting and supplying high-quality personnel with valuable skills

to DoD. They were able to bid for one-year contracts with option years in the expectation that, if their performance was good, the options would be exercised. Although converting these workers to temporary or permanent DoD employees may yield short-term savings, it is something that can only be done once. In the future, there will be fewer firms willing to recruit on DoD's behalf, and those that do will require a stronger commitment on the part of their employees not to take DoD positions. Consequently, DoD will pay a higher price for such services due to the perceived business risk."

According to the Defense Department, half of the positions being insourced are for reasons other than cost: 8 percent because they are inherently governmental and another 42 percent for reasons of institutional capabilities (readiness) or work force management.

CSIS calls for a slowdown in insourcing and for tackling this effort as a "good-government initiative, rather than a budget drill [so it] might give managers a better chance to identify and recruit for those specific functions and positions that should be moved in-house."

A budget crunch at the Pentagon, meanwhile, already has put a damper on insourcing. The military services have been directed to maintain their civilian work forces at the same size they were in fiscal year 2010. Some agencies that had been on hiring sprees will either have to halt insourcing or eliminate other jobs to fund new hires. "The insourcing that hasn't taken place by now probably will be held to the fiscal year 2010," said a senior Air Force official.

Air Force Undersecretary Erin Conaton told a recent industry gathering that the service's original objective of hiring 20,000 government workers has been slashed to 4,000.