

Despite Insourcing Trend, Pentagon Spending on Service Contracts To Remain High

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The Defense Department spent \$162 billion on professional services contracts in 2009. Although there are directives in place to bring in-house some of that outsourced work, it is still too early for the private sector to panic, according to a new study of the federal professional services industrial base.

"The U.S. government has a permanent and growing reliance on contracts with the private sector for a wide range of professional and support services," says a report released Nov. 15 by the Center for Strategic and International Studies, in Washington, D.C.

"Spending on professional services continues to grow despite efforts to reduce it," says David J. Berteau, a CSIS senior advisor and one of the authors of the study.

A surge in defense outsourcing over the past 15 years mirrors a similar trend in the federal government overall, which has seen professional services contracting climb to \$280 billion in 2009. Professional services accounted for 52 percent of total federal contract spending. Since 1995, the industry expanded at a compound annual growth rate of 5.2 percent per year, from \$137 billion in 1995 to \$280 billion in 2009, says the report.

The fastest-growing segments have been in the so-called PAMS sector (professional, administrative, and management services), followed by information and communications technology services.

PAMS accounted for \$93.6 billion worth of contracts in 2009, up from \$27.4 billion in 1995. "The PAMS market is likely to remain the largest in the industry," the study says. "It is also the segment that is drawing significant policy interest as the one with services most similar to those also provided by the federal government work force."

The Obama administration and Congress have mandated the insourcing of thousands of private-sector jobs, particularly those that involve management of contracts and technical analysis. The Pentagon recently announced plans to slash

spending on contract services by 10 percent a year. But there is no data yet available to be able to quantify how these policies may affect the industry in the foreseeable future. "The mid- to long-term analysis depends largely on developments in Iraq and Afghanistan," the study says. "There is nothing in the FPDS [Federal Procurement Data System] data analyzed in this report that suggests that things are going to change in the near future." The study notes that, since 1995, U.S. government spending on professional services has consistently represented about 20 percent of the total federal discretionary budget, reaching a record high of \$280 billion in 2009.

The study bespeaks the uncertainty about the scope and pace of insourcing efforts in the federal government. Far more analysis is needed on what the right balance should be between government in-house capacities and outsourcing of services, the report says. The exact definition of what jobs are "inherently governmental" has varied over time, depending on the urgency of the government's needs and its ability to fulfill its own requirements in house.

"The overall tendency toward insourcing combined with upcoming budgetary pressures could indicate that the professional services industry might be considerably affected," says the report. "The key question will be where the significant budget cuts will be made."

As the flush times slowly come to an end, anecdotal evidence shows that insourcing has become far more problematic than it was originally envisioned.

One of the early proponents of insourcing, Defense Secretary Robert Gates, has called for further study and cost-benefit analysis as it became clear that agencies were rushing to hire civil servants to meet quotas rather than based on what skills are urgently needed.

Within the Pentagon's largest civilian work force, the U.S. Army's, officials are still coming to grips with the new policies. "The intent of the secretary of defense is right on," says Army Undersecretary Joseph Westphal. "But now the issue is how we manage through this," he says during a recent news conference. "The secretary is deeply committed to moving governmental jobs to public sector and reduce the amount of contractors," he says, but it could take years to sort through the details.

One problem with today's federal work force, at least in the Defense Department, is that it is short of many sought-after skills that the government would like to have in-house, such as information technology expertise and detailed knowledge of how to maintain and update high-tech weapon systems.

More than half of the Army's 300,000-strong civilian work force is "not aligned in a career path," says Westphal. "We have too many people in generalist categories. ... We need to align their career paths with the appropriate needs that the Army has for the future."

Some industry executives have downplayed the impact of insourcing because they

see that many of the skills the government needs, such as advanced engineering, still reside mostly in the private sector.

Services such as maintenance of weapon systems and logistics support of deployed troops are not likely to be insourced, says George Allen, vice president of strategic development at VT Group's Technical Services Business Unit. "The Army is not going to assign more soldiers to do maintenance," he says in an interview. "They are going to contract out maintenance." The end of high-intensity conflict in Iraq and, eventually, Afghanistan, will create such a huge equipment repair workload that even if every government depot ramps up to full capacity, there will still be a significant share of work for the private sector, Allen says. In times of tight budgets, industry can help the government save money, he says. The Defense Department, for instance, would be smart to outsource services such as fuel delivery, because the alternative would be to have to hire people, buy trucks and build warehouses that industry can provide at lower costs, he contends.

One way for the government to trim the cost of service contracts is to encourage more industry competition, the CSIS study says. In the professional services sector, that should not be hard to do, considering that there are 118,000 firms in that segment of the market. The number of organizations in the professional services industrial base remained almost unchanged, at 45,000 contractors, between 1995 and 2001. But between 2001 and 2009, the number of contractors in the industry more than doubled.

With the abundance of competitors, it becomes more imperative for the government to figure out how to evaluate contractors' performance, Berteau says. One of the major unanswered questions in the CSIS study is whether the government is getting its \$280 billion's worth, he says. "We look forward to the day when the Federal Procurement Data System can answer that."