

# Bloomberg

## Obama's 'Insourcing' May Hit United Technology, Defense Contractors Profit

*By Gopal Ratnam and Danielle Ivory - Jan 20, 2011*

Ever since the U.S. Air Force began flying C-17 transport jets nearly 20 years ago, Pratt & Whitney has been tasked with repairing the engines, about 200 each year, at its plants. Pratt, a unit of Hartford-based United Technologies, developed the C-17 engine from the version it supplies to Boeing's 757 airliner.

Pratt has "millions of hours" of experience performing maintenance on both, says William J. Begert, a vice-president for business development in the company's military engines unit.

Now an Obama Administration plan to stop outsourcing jobs that can be done by federal employees has Pratt worried that the government may take that work away. Servicing military engines was worth \$400 million in 2009 for Pratt. Losing that income would "have a very large financial impact on us" and put several hundred jobs at risk, Begert says.

U.S. law already stipulates that no more than 50 percent of military repair work can be outsourced to private contractors. Early in his Administration, President Barack Obama said government would take back more of the tasks that have been outsourced. In a 2009 memo, Obama called for "clear rules prescribing when outsourcing is and is not appropriate." Those rules are now being drafted.

Obama wants to hasten the move away from the use of private contractors for government work, including military equipment maintenance, a practice that had been increasing for 30 years.

From 1985 to 2003, the Defense Dept.'s civilian payroll dropped 43 percent, to 636,000, according to the U.S. Office of Personnel Management. Since then the number has rebounded 15 percent, to 737,000 in 2009, an increase driven by budget cuts at the Pentagon.

Daniel I. Gordon, administrator for federal procurement policy at the White House Office of Management and Budget, is drafting new outsourcing regulations. The rules will define functions that only federal employees may perform. Critical tasks still may be outsourced, as long as agencies are able to maintain control, he says.

Contractors want to see how the Administration defines critical functions, according to Robert A. Burton, a partner at the Washington law firm Venable and a former federal procurement policy official. Agencies may argue that even landscaping should be reserved for government workers, he says.

"In all seriousness, you could make the argument that trash removal is critical," Gordon says the White House's goal is not "massive hiring or 'in-sourcing'" but to "correct imbalances that developed over the past few years."

The outsourcing rules are just one of the battles that defense contractors, including Lockheed Martin, Boeing, and Northrop Grumman, are fighting that may affect their profits, says Richard Sylvester, vice-president for the Aerospace Industries Assn. in Arlington, Va.

For example, Defense Secretary Robert M. Gates' plan to save \$100 billion over five years could affect contractors' profit margins if they are prohibited from passing on to the government some costs that are now allowed, Sylvester says.