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## Pentagon Insourcing Binge Begins To Unravel

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Barack Obama won the presidency by running against an unpopular war. Voters knew he was less experienced than Hillary Clinton, his main rival for the Democratic Party's nomination, and John McCain, his opponent in the general election. But many of them hated the war in Iraq so much that they were willing to take a chance on the relatively untested junior senator from Illinois. One of the things they hated most was the persistent drumbeat of news stories about well-connected contractors who seemed to be profiting handsomely from supporting U.S. and allied forces in the war zone.

Many of the stories were exaggerated. The biggest battlefield contractor was Kellogg Brown & Root (KBR), which began the war as a subsidiary of Halliburton — Vice President Dick Cheney's former place of employment. KBR booked billions of dollars in sales from its work in Iraq, but profit margins were slim, seldom exceeding two percent of contract value (Halliburton eventually decided to spin off the unit). Nonetheless, when the war effort went bad administration critics began to allege all sorts of contractor abuses, and there were just enough Blackwaters in-theater to make the charges seem plausible. The fact that warfighters rated KBR's performance highly never seemed to make it into the news accounts.

Beyond issues of malfeasance and misfeasance, the U.S. military campaigns in Afghanistan and Iraq were unique in the degree to which the government chose to rely on contractors rather than utilizing federal employees. On the day that George W. Bush left office, there were 30 percent more contractors on the ground in Afghanistan than U.S. military personnel — 68,000 versus 52,000 — and the number of contractors in Iraq nearly matched the troop count of 141,000. Although many of these private-sector workers were locals hired to assist in tasks such as base support and translating, the heavy use of contractors played into a political narrative among Democrats at home who alleged that the Bush Administration was trying to “privatize” functions that should only be performed by federal personnel.

This concern had big implications for candidates seeking the Democratic Party's presidential nomination, because by 2008 public-sector employee unions had become the biggest component of organized labor, making them a crucial part of the Democratic electoral base. For many on the Left, the fact that the Bush Administration was outsourcing federal jobs at home and relying on KBR in Iraq was all the same issue. They argued federal jobs often involved "inherently governmental" functions that should never be performed by private workers, and that the Bush Administration was on an ideological crusade to shrink the ranks of civil servants regardless of cost or competency.

This charge was not baseless. Bush had made the use of public-private competitions to determine who should perform commercial functions for the government one of his key management initiatives. And the surge in military activity after the 9-11 attacks had led to rapid increases in outlays for contracted services, with some big contracts awarded on a non-competitive basis. Since the Department of Defense was by far the biggest purchaser of such contracted services and had conducted the most public-private competitions, it was inevitable when Democrats won control of the White House that they would try to rein in the outsourcing "excesses" of the Pentagon. Within days after the inauguration, the Obama Administration posted a policy agenda at the White House web-site stating the Pentagon and State Department would be required "to develop a strategy for determining when contracting makes sense, rather than continually handing off governmental jobs to well-connected companies."

On March 4, 2009 the President issued an executive order directing the government "must ensure that those functions that are inherently governmental in nature are performed by executive agencies and are not outsourced." This direction began a government-wide campaign to "insource" many of the services that had been contracted out by President Obama's predecessor. Defense Secretary Robert Gates complied with the direction a month later in releasing his revised fiscal 2010 budget request, stating, "we will reduce the number of support service contractors from our current 39 percent of the workforce to the pre-2001 level of 26 percent and replace them with full-time government employees." Gates predicted the defense department would hire up to 30,000 new civil servants over the following five years. In a related move, he announced that the number of civil servants in the acquisition workforce — the part of the military bureaucracy responsible for contracting — would grow by 20,000 through creation of new positions and conversion of contract jobs to federal employment.

This was a big change. At the time the acquisition corps consisted of 127,000 workers, of which 52,000 were contract personnel. Defense managers stated in congressional testimony that they had been forced to rely increasingly on contract employees during the Bush years because the

ranks of civil servants had thinned even as workloads grew due to overseas contingencies. They portrayed the changes Gates proposed as necessary steps in restoring discipline to the acquisition process. However, the implementation guidance for pulling contracted services back into the government that Deputy Defense Secretary William Lynn issued in late May of 2009 made the changes sound like something more than a workforce adjustment. The guidance stated that defense organizations “should review all contracted services for possible in-sourcing as part of a Total Force Management strategy.” It went on to say that “In-sourcing is a high priority of the Secretary of Defense.”

Secretary Gates thus signed on to a White House-led ideological crusade that was the mirror-image opposite of the Bush Administration’s outsourcing initiatives. He did so in part because he agreed that his department had become overly reliant on contractors, and in part because he needed White House support for other goals he wished to pursue. Having spent most of his first two years on the job absorbed in the task of stabilizing Iraq, he was now ready to actually manage the Pentagon, so it was natural to align himself with the management principles of the new administration. And since he shared White House concern that the military was wasting billions of dollars each year on goods and services that either weren’t needed at all or weren’t being procured efficiently, it was also natural that much of his insourcing activity would focus on the part of the bureaucracy where contracting took place. But like the White House, Secretary Gates over-estimated how much money could be saved by converting contract positions to in-house jobs, and under-estimated how difficult such conversions would be.

The biggest defect in Obama Administration thinking about sourcing of federal work concerns the divergent expectations of public and private workers. Once engaged in a suitable structure of incentives, workers with identical qualifications will tend to perform at parity whether they are publicly or privately employed. However, federal workers are accustomed to higher levels of compensation and job security, which come at a cost to the government. Numerous studies have shown that federal pay and benefit packages substantially exceed their private-sector equivalents in most job categories, which is one reason why federal workers are much less likely to leave jobs than their private-sector counterparts are. If they do not voluntarily depart then they are nearly impossible to get rid of due to civil-service rules, regardless of whether they are productive or the work they do is still required.

What this means in practical terms for the government is that it must pay more for workers if they are federal employees than if they are contract personnel. Not only will federal workers cost more to sustain each year, but as career employees their positions will require a long-term commitment to health and retirement benefits that contractors do not demand. When

contractors fail to perform or the job they are doing is completed, the government can simply stop using them. Civil servants will continue to be a burden to the government for decades to come, first as employees and then as retirees. So replacing contract personnel with full-time government workers will tend to raise costs unless the government workers are substantially more productive. Higher productivity is a possibility given the federal worker's commitment to a career in public service, but there is scant research demonstrating such a linkage. In any event, the government loses much of its management flexibility in the bargain.

These challenges are exacerbated at the Pentagon, where the Defense Business Board estimates over 300,000 uniform military personnel are engaged in performing "commercial activities" — in other words, activities that cannot reasonably be defined as inherent functions of government. Military personnel cost the government an average of \$160,000 per year, far above the compensation received by civilian workers in either the public or the private sectors. This potentially makes the Pentagon's workers less cost-effective than those of civil agencies. The defense department traditionally has taken the position that cost is less important than readiness and reliability in determining what sorts of personnel should fill jobs, but with budget deficits beginning to bite the high cost of manning non-combat positions in this manner will undoubtedly become subject to greater scrutiny.

None of this was really thought through before Secretary Gates began his insourcing binge in 2009, so it didn't take long for policymakers to notice they weren't saving any money by pulling work in-house. On August 9, 2010, Gates acknowledged at the public kickoff to a new round of efficiency initiatives that "we weren't seeing the savings we had hoped from insourcing." However, he was still determined to cut the ranks of contractors so he directed that funding for contract service providers be cut ten percent in each of the next three years. The twist was that he now proposed not to replace departing contractors with civil servants unless the jobs being done were mission-critical. The new approach seemed likely to save money in the near term, but implied that a large portion of the department's contract workforce was performing functions that didn't really need to be done. If that assumption proves faulty, the military could end up wasting whatever money it saves on contractors by executing necessary activities ineptly.

The military services are beginning to show signs that they too aren't happy with how insourcing has gone. The Secretary of the Army suspended his service's insourcing initiatives last month and threatened to reverse decisions that had already been made if there was inadequate analytic foundation for the moves. The Air Force discovered it couldn't fill key technical positions with new federal employees due to a shortage of available talent. And all of the services are finding themselves in bidding wars with the private sector for certain types of specialists such as cyber-

security experts. So the Pentagon's big insourcing campaign seems to be slowly grinding to a halt, a victim of bad planning and disappointing results. As memory of the Bush Administration's outsourcing efforts fade, the Obama Administration increasingly is making sourcing decisions for defense and civil agencies alike on the basis of merit, and it's finding that much of the time relying on contractors to perform commercial services isn't so bad after all.

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