

Plans to 'In-Source' Contractor Jobs Collide With Fiscal Reality

September 2010

By Sandra I. Erwin



As he unveiled a new wave of austerity measures at the Defense Department, Secretary Robert Gates made a striking acknowledgment: Replacing contractors with government employees does not really save money.

In theory, in-sourcing jobs was supposed to reduce costs. But in the "money-is-no-object" atmosphere that has pervaded the Pentagon during the past decade, the theory was proven wrong. Agencies have been hiring workers, but they weren't necessarily eliminating contractors.

So much for efficiency.

It was only a year ago that the Pentagon was promoting its in-sourcing initiative to eliminate 33,000 support contractors by 2015 and replace them with full-time government employees. Gates had been flabbergasted by the vast presence of contractors in the building, who grew from 26 percent of the total Defense Department work force cost in 2000 to 39 percent a year ago — not counting battlefield contractors working in Iraq and Afghanistan.

One year into the in-sourcing effort, however, Gates saw that it was not achieving the desired results. Not only are there still too many contractors, he said, but agencies are indiscriminately bulking up the payroll without carefully evaluating what jobs are really needed.

It is not surprising that in-sourcing has been a disappointment. Gates blamed it on the absence of a "culture of savings and restraint" in the department.

If people can't be trusted to make common-sense decisions, Gates concluded, then choices have to be made for them.

He mandated a 10 percent budget cut for service support contractors for each of the next three years. For good measure, he instituted a three-year hiring freeze for government workers. "We will no longer automatically replace departing contractors with full-time personnel," he said. "The department must start setting priorities, making real trade-offs, and separating appetites from real requirements."

Gates' actions reflect his frustration about bureaucratic inertia and lack of fiscal discipline. In the weeks before he announced the new measures, he had warned his staff in private meetings at the Pentagon that changing the culture of the building after a decade of easy money was going to be tougher than anyone realized. Gates feared that the efficiencies drill was going to degenerate into the usual "salami-slicing" exercise that Pentagon bureaucracies favor because it avoids tough choices and ensures survival. They cut a little from each program without setting priorities.

"The boss really hates 'salami slicing,'" said a senior official from the office of the secretary of defense. "That's what everybody wants to do, but that's not what he wants to do."

Efficiency is an alien concept inside the building, the official lamented. "How do you change the way people think and act normally, and what incentives do people have to save money? That's a really tough one and I'm not sure we're going to figure that out."

Gates' own office is contributing to the inefficiency by being notoriously top-heavy. At the controllers' office alone, less than 10 percent of its government employees are ranked lower than GS-15.

On the industry side, there is obviously much angst about shrinking budgets for service contracts. But contractors give Gates credit for also imposing hiring freezes on the government side and conceding that in-sourcing was not a panacea.

Industry executives for months had been fuming over the inconsistent enforcement of in-sourcing policies. Gates said the priority would be to in-source "inherently governmental" management and procurement-oversight jobs that should not be held by contractors. Contrary to the spirit of what Gates wanted to do, agencies began hiring government workers without necessarily cutting the equivalent contractor jobs.

The politics of in-sourcing have become so polarizing that many contractors who initially believed the Pentagon was in good faith trying to save money began to scream hypocrisy. Pentagon officials originally said that in-sourcing reduces costs because contractors are paid substantially more than government workers. But the same was said of "outsourcing" when it became in vogue in the late 1990s. Also inflaming the debate is that when the Pentagon computes the cost of hiring civilian workers, it does not include retirement expenses because they are not carried in the Pentagon's budget. In many contractors' minds, that alone undermines any assertions that government workers are cheaper than contractors.

Pro-industry analyst Loren B. Thompson, of the Lexington Institute, has argued that in-sourcing actually promotes inefficiency because it saddles the government with more manpower that it can't easily fire during downturns, whereas contractors can be terminated relatively trouble-free.

Defense contractors have been reluctant to speak out because they don't want to risk losing business with their only customer, but many believe that the Defense Department is punishing them for the government's own lack of fiscal discipline. They see that the "last thing likely to be cut is the bureaucracy itself, even though that is where much of the waste occurs," Thompson noted.

Gates' newest cost-cutting plans, to the surprise of many observers, inflict pain on both the public and private sectors. Unlike what experts had predicted, this efficiencies drive is not one of those barking dogs that never bite.