

Why Not Outsource? Let Us Count the Ways

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I have often noted over the years that the claims by private military and security contractor advocates regarding the cost effectiveness of operations should be regarded with skepticism. That is because there is so little academically rigorous, methodologically sound evidence to back up their claims. Advocates claim there is "oodles of evidence" but when you ask them to point you to just a single peer reviewed journal article, one gets blank stares and hemming and hawing.

Does this mean all their claims are invalid? Not necessarily. It just means that nobody has yet, for a variety of reasons produced such a study. If and when it happens I will be among the first to acknowledge it.

But to be fair about it, since I question the accuracy of advocates claims I should, in the interest of fairness, offer some reasons why outsourcing might not be all it can be, to paraphrase the old recruiting slogan.

In that regard let's look at an article published last year. I mentioned this in a post last August It is *Uncontracting: The Move Back to Performing In-House* by Maj Kevin P. Stiens and Lt. Col. (Ret.) Susan L. Turley. Naj Stiens is the Staff Judge Advocate, Air Force Research Laboratory Information Directorate, Rome, New York and Lieutenant Colonel (retired) Turley is an acquisition attorney in the Legal Information Services directorate of the Air Force Legal Operations Agency, Maxwell Air Force Base, Alabama.

The authors start the article by noting that both supporters and critics of outsourcing have one thing in common; their unwillingness to say it depends. Either private military and security contractors are the best thing since sliced bread or the worst thing since Attila the Hun with nothing in between. As the authors note, "Outsourcing -- or contracting out, or commercial sourcing, or whatever moniker one uses -- is the acquisition world's Jekyll and Hyde, either embraced as a miraculous cost-saving tool or pilloried as the embodiment of all that is wrong with government contracting."

Their article argues:

Overestimated cost savings and global changes negatively impacted the outsourcing process. Not only did the cost savings fail to materialize, outsourcing caused other tangible losses. The government lost personnel experience and continuity, along with operational control, by moving to contractors. Although insourcing will not be a miracle cost-saving tool, performing more functions with federal employees instead of contractors will better equip the government to operate in current global conditions.

It is important to remember that the authors do not ridicule the notion that outsourcing might produce savings. Indeed, they trace the idea that the government should not do things that the private sector can do just as well.

But the authors write that "competitive sourcing" -- the process whereby a federal agency compares the performance by government employees against a commercial entity to determine which can provide a specified level of service at the lowest cost -- ultimately fails for a number of reasons.

The biggest drawbacks roughly correspond to benefits offered by insourcing. The anticipated cost savings turned out to be inflated at best and non-existent at worst. In some cases, outsourcing has actually cost the government more, in part because of an inability to properly manage the contracts and contractor personnel, and the recurring recompetition requirement. Insourcing, on the other hand, would not only reverse the financial roller-coaster but would allow the government to better control personnel while retaining in-house expertise.

In what can only be called ironic the authors note that the same rationale offered in support of outsourcing is also cited in support of insourcing.

With estimates ranging from \$3 billion to \$30 billion in savings, outsourcing sounded like a good deal during the past decades. Ironically, the same basic justification used to support outsourcing - - lower cost -- was recently touted as the reason for returning to in-house performance. After passage of the 2008 NDAA, defense officials stated, "This new legislation should improve our ability to reduce costs and manage the Defense workforce." They issued implementing guidance to "help ensure that when DOD Components make decisions to use DOD civilian employees, the decisions are fiscally informed and analytically based. Similarly, when advocating insourcing, OMB echoed the rationale originally supporting outsourcing: "to ensure that commercial activities are performed by the best source at the lowest possible cost."

The authors argue that outsourcing does not deliver because, "inherent difficulties in calculating the costs and resulting savings, to a failure to track the actual expenses, to short-term savings that led to long-term increases in cost."

It is difficult to compare private to public sector costs in an apple to apple fashion when one does not know what the public sector apples costs to begin with.

The primary problem with the competitive process has been calculating the true cost of a DOD employee. A computer program, COMPARE, considers everything from current pay and medical benefits to retirement and likely temporary duty costs when determining the government in-house estimate. The calculation formulas can take into account a number of factors, but including or removing certain factors can manipulate the ultimate results.

The ability to modify the calculations allows critics on both sides to complain about the system. "To compare the cost of in-house performance to private sector performance, detailed estimates of the full cost of government performance to the taxpayer have to be calculated. The development of these estimates has devolved into a contentious and rigid exercise in precision."

Furthermore, the fact that the government uses a detailed process to determine costs does not guarantee that the private competitor will conduct such an exacting pricing evaluation. Contractors' bids should reflect their overhead costs, such as training personnel and providing medical and retirement benefits; their more direct costs, such as wages; and what they plan to charge the government to achieve a reasonable profit. However, contractors have an economic incentive to overestimate their savings and efficiencies: award of the contract.

In a fixed-price contract, the contractor bears the risk of underbidding, but if the government commits to reimbursing the contractor's costs, the government may realize no savings.

No matter how the results are calculated, they are simply estimates, which may or may not play out as expected.

Most outsourcing savings estimates failed to account for typical growth in contract costs. Admittedly, the government can obtain some simple goods and services more cheaply through contracting out. However, frequently "the short-term savings that [outsourcing] promises evaporate quickly once competitors drop out; contractors who underbid to win a contract are free to raise rates later or in follow on contracts, often leaving government representatives with little choice but to accept."

While the GAO recognized that outsourcing can be cost-effective, in a report to Congress it questioned some of the savings projections. The GAO reported doubts that the services would ever achieve the projected 20 to 30 percent savings. In fact, the "GAO found that contracting outside of A-76 can actually cost the government more than doing the work in-house." According to GAO, both DOD and OMB lacked "reliable data" at every stage of the outsourcing effort. Neither agency had the right information at the start "to assess the soundness of savings estimates," and DOD then failed to consistently track and analyze cost data to determine whether the contract achieved the savings. The process takes into account anticipated costs; it does not look at what a contract costs the government in the end.

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Overall, GAO summarized the problem with anticipated savings as follows: (1) savings estimates represent projected, rather than realized savings; (2) the costs of the competitions were not included; (3) baseline cost estimates are lost over time; (4) actual savings have not been tracked; (5) where audited, projected savings have not been achieved; and (6) in some cases, work contracted out was more expensive than estimated before privatization.

The authors point out that these conclusions are not new.

As early as 1991, various studies showed that contracts are more expensive than government employees. For example, the GAO concluded that 11 out of 12 contractors in their study were about 25 percent more costly. Studies after years of outsourcing confirmed this early data. In 2007, a Congressional study found that contracts for intelligence support cost, on average, almost twice as much as in-house performance. In 2008, the Office of the Director of National Intelligence reported that the cost of a federal employee -- including not just salary but all benefits such as retirement and healthcare -- was \$125,000, while the direct cost (excluding overhead) for each contractor employee was \$207,000.

If you think contracting in the spook world is a bit esoteric let's turn to military logistics which is the bread and butter of the private military contracting industry.

Prolonged military operations requiring services in more isolated and less technically developed locations such as Iraq and Afghanistan have overcome any potential savings achieved by paying a higher cost for short durations. A prime example is the Army's Logistics Civil Augmentation Program, or LOGCAP, the subject of a 1997 GAO report. While the Army centrally managed the single, worldwide LOGCAP contract, each operational commander defined his organization's requirements, paid for the services, and integrated contract employees into mission performance. Responding to Congressional concerns about LOGCAP usage in Bosnia, GAO found that in just a year contract costs jumped 32 percent, from \$350.2 million to \$461.5 million. GAO attributed the increased costs mainly to changes in requirements, stemming from factors such as unfamiliarity with the operating environment. However, other causes included lack of guidance on using the contract and insufficient monitoring and tracking systems.

There is more, but the bottom line is that context is everything. The authors conclude, "In today's fluid environment, the decision to outsource must consider a number of factors rather than cost alone. Although insourcing has its own difficulties, using government employees, whether military or civilian, involves fairly well understood and expected costs, as well as the resources and control necessary to accomplish the mission."

Private military contractor advocates would better serve their industry if they acknowledged this reality, instead of just giving it pro forma lip service