Outsourcing At DOD: All It's Cracking People Up To Be?

by J. Michael Brower

Outsourcing and its handmaiden privatization (O&P) are the twin stars of cost savings at the Department of Defense (DOD). Since Congress has indicated that it will not consider further Base Realignment and Closure (BRAC) rounds until the end of the Clinton administration, infrastructure costs will continue to demand an ample share of future budgets. Consequently, savings will be sought first by personnel cuts, second by O&P and, as a final resort, through program trimming. Both the Quadrennial Defense Review (QDR) and new congressional legislation call for further emphasis on O&P as a means to streamline, reengineer and, above all, save scarce DOD dollars. But exactly what makes O&P so financially attractive and managerially desirable? From whence comes the lion's share of the "savings" in most O&P projects? In the last analysis, both DOD personnel cuts and O&P gore the same cash cow-internal labor costs. While certainly not the only source for savings, reducing payroll is the most readily quantified O&P "benefit." And that is what makes it such a controversial-and potentially profitable tactic.

Outsourcing is the movement of work-but often not the transfer of accountability or oversight-to an outside provider. *Privatization* is outsourcing `writ large`-the government farms out the function and often the wherewithal to do it, getting out of a business more logically performed by the private sector. Privatization is essentially a reaction to the nationalization and government regulation of the late 1960s and 1970s and finds inspiration in the post-1979 conservative policies of Britain's former Prime Minister Margaret Thatcher, the modern privatization paradigm's architect.1 The concept of privatization though, is not new, and can be traced back to some of Adam Smith's writings in 1762.2 The "moniker" of contracting out may change, but the concept remains the same.

About 40 percent of the biggest companies in the United States have outsourced at least one major piece of their operation.3 American companies outsource more than $100 billion a year with average cost savings of 10 to 15 percent, while the federal government spent around $114 billion on outsourcing during 1995 but lacked the mechanisms such as activity-based costing (ABC) models for calculating actual savings.4

One of the principal feeding grounds for O&P recommended by the QDR and other studies concerns DOD information technology (IT). In a recent IT-related survey, the Outsourcing Institute found that controlling internal costs was the dominant motivation to outsource. Nevertheless, statistics from the Computer Economics 1997 report and consultants for Coopers & Lybrand found cost savings from outsourcing to be much lower than expected, usually only in the 10 to 20 percent range.5

In August 1996, Coopers & Lybrand consultants found that DOD would save $1.25 billion over 10 years by reducing its data centers from 16 to six and outsourcing more functions they perform internally.6 Substantial portions of estimated savings would come from reduced labor expenses. While there are other cost-saving techniques and strategies, including velocity management, process reengineering and use of tech-nology, none register cost reductions in the ledgers faster than payroll cuts.

While the Office of Management and Budget's Circular A-76, `A Performance of Commercial Activities`, calls for private versus public competitions and cost-benefit analyses before important computer functions are outsourced, barring legislation to the contrary, outsourcing IT and other "support" functions will continue apace at DOD. "Anything not involved in warfighting should be outsourced," intoned Emmett Paige, DOD's former assistant secretary of defense for Command, Control, Communications and Intelligence, in a recent interview. Paige warned those who do pursue outsourcing IT projects to "expect Congress to defend their constituencies."7

Despite the enthusiasm to outsource, the great fear remains that government computer functions will become hostage to the vicissitudes of the marketplace-for example, labor strikes and cost overruns. Also, the loss of in-house capability and loyalty is usually the price of O&P savings.

In some unfortunate cases, contractors bid low for outsourced work claiming substantial savings, government employees are surplused or "RIFed" (reduction in force), then the contractor runs up the bill once the indigenous labor source is shuffled off or absorbed. And soon, according to a recent article in the `Christian Science Monitor`, to afford "cutting-edge weapons systems," civilians must be dropped from DOD roles at a rate the likes of which we have never seen.8 Uncle Sam has nowhere else to go now that the "in-housers" have been benched in the name of savings and efficiencies. In another recent case, Texas Republican Governor George W. Bush announced he can save 40 percent of overall state government costs, reducing the state budget as much as $120 million, by outsourcing welfare information systems work.9 Much of the savings will be derived by reducing the labor force.

As writer Kathleen Melymuka reminds us in her article "KABOOM," the outsourcing "siren song" has run many companies aground, and one must be on guard during contract negotiations.10 In the most unfortunate cases, the outsourcer bids exceptionally low to be awarded the contract, obtains exclusive rights to control an entire IT department, then sticks the host organization with cost overruns after the indigenous labor force is absorbed or otherwise no longer available. Earlier this year, in a major outsourcing flop for IT giant Unisys Corporation, unanticipated "labor-intensiveness" caused early termination of a contract to manage the health-care program for Florida's 215,000 state employees. Worth $86 million over four years, the contract cited labor savings as the main financial motivation for this outsourcing venture. A Unisys spokesman admitted that the contract was "an aberration, an aggressive move" and one that proved a bridge too far.11

According to a Defense Science Board 1996 Summer Study "Achieving an Innovative Support Structure for 21st Century Military Superiority," of the 2.5 million military and civilian employees current receiving tax-base creating paychecks, more than 600,000 military personnel (40 percent of the active force) and almost 900,000 civilians are in support roles. Support and infrastructure costs consumed more than 55 percent of the Fiscal Year 1996 DOD budget. The primary cost driver is labor and the associated costs. Since O&P initiatives deliver most of their rather modest savings through reduced labor expenses, O&P can be *virtually equated* with personnel reductions. Given the postponement of BRAC cuts and sustainment of modernization plans, the overriding majority of savings must logically come from lowering personnel-related expenses through cuts, privatization or outsourcing. The human cost of these actions has yet to be assessed. ***MR***

---

1. John Vickers and George Yarrow, *Privatization: An Economic Analysis* (Cambridge, MA: MIT Press, 1988), 1.
2. Roger L. Kemp, (Ed.), *Privatization: The Provision of Public Services by the Private Sector* (Jefferson, NC: McFarland & Co., 1991), 7.
3. Thomas Hoffman, "Users Say Move Quickly When Outsourcing Your Personnel," *Computerworld* (17 March 1997), 77.
4. Tom Lowry, "Outsourcing Expected to Increase," USA Today (25 March 1996), B1.
5. Deborah Asbrand, "Outsourcing Your Maintenance Migraines," Datamation (June 1997), 50.
6. Government Computer News (31 March 1997), 42.
7. Kevin Power, "Feds, Get Used to Outsourcing," Government Computer News (16 June 1977), 70.
8. Christina Nifong, "Next Big Defense-Cut Target: Civilians," Christian Science Monitor (12 August 1997), 1.
9. Thomas Hoffman, "Texas May Outsource Welfare IS," Computerworld (17 March 1997), 14.
10. Computerworld (17 March 1997), 82.
11. Bruce Caldwell, "Outsourcing Buyer Beware," Information Week (16 June 1997), 144.