
**SPINNING OFF ARMY ACTIVITIES INTO
FEDERAL GOVERNMENT CORPORATIONS**

Experience indicates that the corporation form of government is peculiarly adapted to the administration of governmental programs which are predominately of a commercial nature, are at least potentially self-sustaining, and involve a large number of business-type transactions with the public.

—Harry S. Truman
Budget Message to Congress, 1948

CONTEXT

Mergers, acquisitions, subsidiaries, and asset sale are standard tools for the implementation of corporate strategy. In the decade of the 1980s when the corporate strategy of General Motors (GM) involved pulling critical business functions as close as possible under the corporate umbrella, Electronic Data Systems (EDS) was acquired because it was providing all the information, computer, and data services for GM. Moreover, GM was the biggest single customer of EDS. More recently, in 1996, under a new corporate strategy involving a focus on core businesses, EDS was divested in an asset sale with GM retaining some of the stock ownership through a GM pension plan. During each of these eras the GM leadership felt the key to competitive advantage was aligned in directions indicated by the acquisitions and divestments of the time.

The United States has a similar instrument for the implementation of national policy: the Federal Government Corporation (FGC) (U.S.

GAO, 1995; Froomkin, 1995). The first Government Corporation predates the Constitution. The Continental Congress decided in 1781 that a bank owned by our country rather than the only other choice at the time, the Bank of Britain, would better handle the finances of the new nation. The Bank of North America was chartered as a result (Lewis, 1882). The first Federal Government Corporation was the Bank of the United States, chartered in 1791. During the 20th century the FGC has become a common instrument of national policy. Since World War II the Congress has created about one FGC per year, resulting in about 60 in existence today.

A good example of the formation of an FGC is in the area of uranium enrichment. When nuclear testing ceased, the Strategic Arms Limitation Talks (START) were continuing, and a Comprehensive Test Ban Treaty was anticipated, the strategic position that the U.S. government played as a customer in the market for enriched uranium changed. Hynes, Kirby, and Sloan (2000) have traced the various developments leading up to the final decision to spin off the uranium enrichment activity. After several years of consideration, Congress passed the Energy Policy Act of 1992. As part of this act, the United States Enrichment Corporation (USEC) was formed as a wholly owned government corporation. Eventually, the USEC, operating as a government corporation, proved to be successful, and in 1998 it was privatized and its stock began to be traded on the New York Stock Exchange. The initial public offering agreement contained provisions that allowed the government to benefit from any windfalls in profits from the new private corporation.

During the first half of the 20th century, FGCs were a common instrument of national military strategy to capture the manufacturing efficiencies of the U.S. economy for both the execution of and preparations for the two world wars (Lilienthal and Marquis, 1941). In the current era the FGC can be an instrument of national military strategy. In an era of decreasing federal budgets, increased constraints on personnel, and growing emphasis on achieving greater efficiency and productivity, the Federal Government Corporation structure can be used to realize a renewed focus on core responsibilities for the Army as well as the other services. Just as GM used its acquisition and divestment of EDS as an expression of corporate strategy, so too can the Army use the FGC as an instrument of national military strategy.

FEDERAL GOVERNMENT CORPORATIONS

The basis for Congress's ability to create government corporations is derived from the Necessary and Proper clause of the Constitution, Article I, Section 8, Paragraph 18, which states:

To make all laws which shall be necessary and proper for carrying into execution the foregoing powers and all other powers vested by this Constitution in the Government of the United States or in any Department or Officer thereof.

There is a long history of Supreme Court rulings and case law using this paragraph as the foundation of the ability of Congress to create corporations.¹

There are three basic groups of organizations that are considered FGCs. The first group is the Government Sponsored Enterprises (GSEs), which are very large financial organizations such as Federal Home Loan Banks, Fannie Mae, Freddie Mac, FICO, REFCORP, and six other specialized lending organizations. These organizations have special financial privileges and were created to facilitate the creation of credit for specific economic groups or for a specific financial purpose such as recapitalizing insolvent savings and loans. Congress usually categorizes GSEs as mixed-ownership FGCs. In reality the amount of private ownership varies from 0 to 100 percent. The second group has only one member, the United States Postal Service (USPS). This organization is officially categorized as an Independent Establishment of the Executive Branch of the U.S. Government. The special category is drawn in part from the specific constitutional citation which empowers the Congress to create "Post Offices and post roads."² In the same way, the constitutional provision for Army arsenals ("the erection of forts, magazines, arsenals, dock-yards and other needful buildings.") could form the basis for a new Independent Establishment.³ The third group comprises about 50 government corporations that are chartered by Congress to

¹See, for example, *Osborn v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 859-60 (1824); *Federal Land Bank v. Bismark Lumber*, 314 U.S. 95, 102-103 (1941); and *Pittman v. Home Owners' Loan Corp.*, 308 U.S. 21, 33 (1939).

²United States Constitution, Article 1, Section 8, Paragraph 6.

³United States Constitution, Article 1, Section 8, Paragraph 17.

achieve specific national policy goals. For example, in the first Clinton Administration, when it was felt that a domestic “Peace Corps” might solve some of the problems of the inner city, the Congress at the behest of the administration created the Corporation for National and Community Service (AmeriCorps) in 1993.⁴ The most recent FGC is the Valles Caldera National Preserve and Trust, which authorizes the acquisition and independent management of the Valles Grande, an enormously beautiful and undeveloped area of land in northwestern New Mexico.⁵ These organizations include such familiar entities as the Tennessee Valley Authority (TVA), the National Railroad Passenger Corporation (AMTRAK), and the Smithsonian Institution. Others may not be so familiar, such as Federal Prison Industries, Inc., the Saint Lawrence Seaway Development Corporation, and the Pennsylvania Avenue Development Corporation. In this list we do not include the national banks that have a federal charter but no government-appointed board of directors members or ownership, or the more than 80 patriotic or charitable organizations that have a federal charter but receive no federal funds and are responsible for their own business affairs.^{6,7} In addition, the federal government has directed the establishment of some corporations not directly chartered by Congress but nevertheless owned, funded, or directed by the government, such as the Corporation for Public Broadcasting and the American Institute in Taiwan.^{8,9} We do not consider these in our analysis of the FGC option for the Army, but we observe that the government corporation form can assume a wide variety of identities.

Since World War II, Federal Government Corporations have been used as instruments of national policy because of their efficiencies arising from commercial market forces, their flexibilities with regard to encumbering regulations, and their ability to access financial alternatives. The usual process for creating an FGC starts with

⁴National and Community Service Trust Act of 1993, P.L. No. 103-82.

⁵The Valles Caldera Preservation Act of 2000, P.L. No. 106-248.

⁶12 U.S.C. 21, 35, 40, 41, 215c, 1817, 3102.

⁷36 U.S.C. 1-9, 13.

⁸47 U.S.C. 396-399.

⁹22 U.S.C. 3301-3310.

Congress drafting a charter that sets forth the entity's goals, obligations, special powers and exemptions, and organizational structure including the composition of the board of directors. The enabling legislation can specify a federal charter or incorporation under the laws of the District of Columbia. All FGCs are created as separate and permanent legal entities. Generally, in the congressional charter the right to sue and to be sued is a provision and is considered a waiver of sovereign immunity that clearly distinguishes the FGC from other government organizations.¹⁰ Additionally, the FGC can settle cases against it independent of Department of Justice representation.¹¹ These rights and privileges obtain in regard to issues associated with the conduct of normal business. For issues regarding constitutional rights the courts consider an FGC a state actor.¹²

Efficiency. Free market forces generally create low-cost products and services. As echoed in the Truman quote that opened this chapter, when products and services provided by the government as part of a national policy goal are inherently commercial in nature, the option of choice is most likely the government corporation. Because of these efficiencies, the FGC option appeals to a broad base of support. Fiscal conservatives can agree that the low-cost option for a national policy goal can be created using free-market forces. Adherents of small government can agree that the FGC could be a first step to the privatization of commercial government activities. Even democratic socialists can see the FGC as a method to redistribute the wealth created by public works activities or those arising from natural monopolies. Beyond the economic efficiencies, the FGC option creates a highly focused organization with a well-defined national policy goal. FGCs are allowed to focus on a single product or service and on a limited customer base or constituency. This is in contrast to the usual multimission span of a traditional government agency.

Flexibility. FGCs are granted much flexibility with regard to the otherwise encumbering regulations that would obtain for a traditional

¹⁰*United States v. Nordic Village*, 503 U.S. 30, 34 (1992); *Federal Housing Administration v. Burr*, 309 U.S. 242, 245 (1940).

¹¹28 U.S.C. 516 (1993); 5 U.S.C. 3106 (1988).

¹²*Lebron v. National R.R. Passenger Service Corp.*, 115 S. Ct. 961 (1995).

government agency. FGCs can enter contracts for goods and services independent of the FAR. They can buy and sell assets independent of the Federal Property and Administrative Services Act of 1949.¹³ Most FGCs are exempted from Civil Service regulations on pay and employee tenure (Lilienthal and Marquis, 1941) and from government personnel ceilings. Some FGCs are even exempted from the Government Corporation Control Act (GCCA), which was created to better regulate the mix of powers and privileges granted to FGCs in their congressional charters.¹⁴

Finance. FGCs benefit from financial freedoms beyond the restrictions on federal agencies. FGCs have the right to borrow funds from commercial and private sources, to issue debt in the form of bonds, and to own, to acquire, and to dispose of real property plant and equipment.¹⁵ Generally an FGC is not subject to the year-end budget pressures forcing expenditures within a given fiscal year. They can enter into multiyear commitments based on funding that will be available in their budgets regardless of yearly expenditures. Mixed and private ownership FGCs are usually financed “off the balance sheet” (Collender, 1997) which, in effect, excludes them from the national accounts. With such a status, the debts of such organizations do not count against the national debt and are not subject to deficit reduction goals or spending caps when Congress is operating under budget reduction measures such as the Gramm-Rudman-Hollings budget reduction process. Some FGCs are exempted from local, state, and federal taxes, and their executives are excluded from Security and Exchange Commission regulations.

Federal Government Corporations can be analyzed along three basic dimensions: control, cash, and customers. FGCs are categorized for legal and regulatory purposes as government-owned, mixed-ownership, and private-ownership (U.S. GAO, 1995). However, these categories are not useful in determining, for example, how to deal with an FGC as a customer or how to think about FGCs as an instrument of strategic policy for an organization.

¹³Federal Property and Administrative Services Act of 1949 (41 U.S.C. 251–260).

¹⁴Government Corporation Control Act (GCCA), 31 U.S.C. 9101–10 (1988 and Supp. Vol. 1993).

¹⁵Ibid.

The strategic control of an FGC flows from the level of ownership by the federal government, the level of ownership by private parties, and by the composition of the board of directors (BOD). Operationally, the control of the FGC is in the hands of the leadership brought in to run it. These individuals report to the BOD. For a government-owned FGC, the President of the United States appoints the majority or the entire BOD, whereas for a privately owned FGC, the President appoints a minority of BOD positions. The mixed-ownership FGCs are in the middle. In the control dimension, FGCs are spread from mixed control to total private control, as illustrated in Figure 4.1.

The locations along the control dimension for a government department or agency, a GOCO, an FFRDC, and a GSE are displayed for comparison in the figure. The department or agency is totally under government control with both line and program management reporting directly to government officials. The GOCO is similar, although the distance from total government control is increased

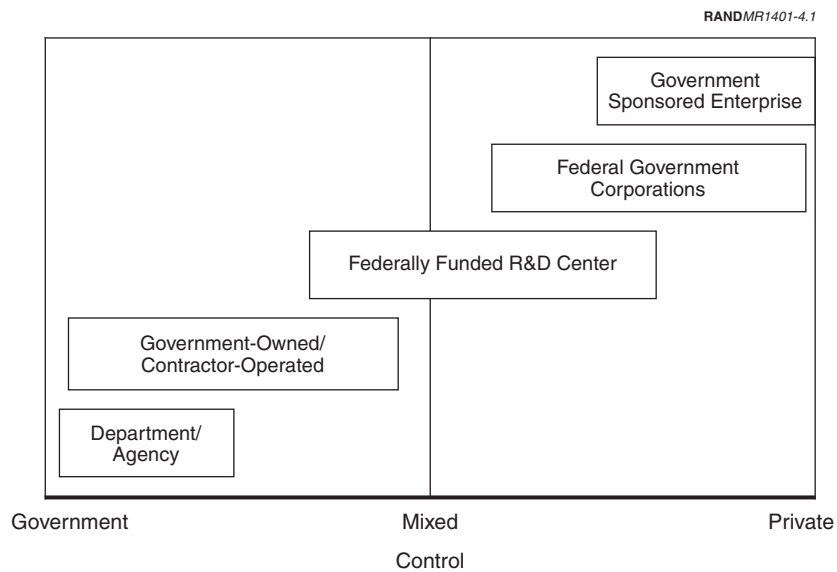


Figure 4.1—Comparison of Organizations Along the Control Dimension

because a contractor now operates a government-owned facility. An FFRDC is similarly more distant from complete government control. An FFRDC is created to give an exclusively government customer an unbiased research opinion on critical issues. FGCs are spread from mixed to totally private whereas GSEs are almost entirely under private control.

Along the cash dimension, the basic organizational characteristic is source of revenue. Figure 4.2 shows where the FGC and other organizations fall in this dimension. The figure illustrates that FGCs span the spectrum from mostly governmentally funded to mostly privately funded. Generally, FGCs that are mostly government funded tend to be mostly government controlled, such as Federal Prison Industries, Inc., or the Saint Lawrence Seaway Development Corporation, whereas the opposite is true for FGCs funded mostly from private sources, like the Tennessee Valley Authority and AMTRAK. In contrast a department or agency is totally funded from government sources. This is true also for a GOCO and for an FFRDC.

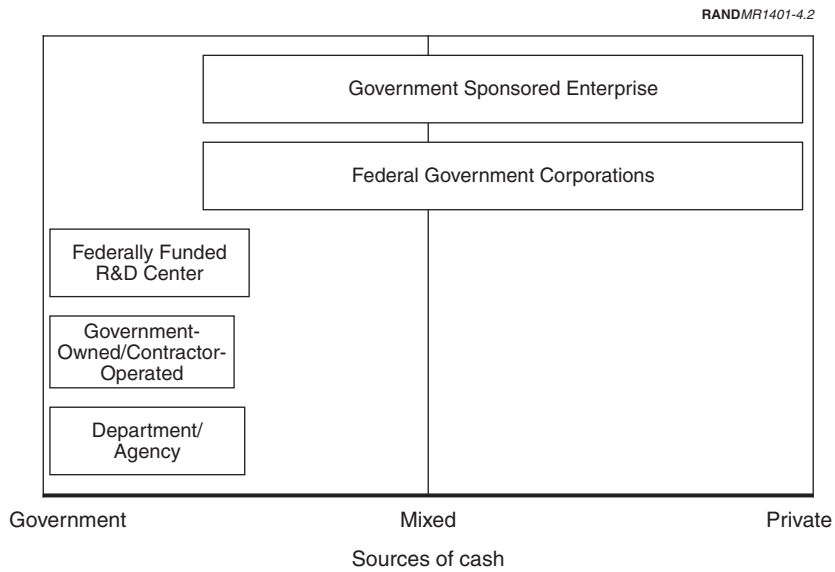


Figure 4.2—Comparison of Organizations Along the Cash Dimension

Along the dimensions of control and cash, FGCs are roughly in the mixed category, although some are on either end of the spectrum. As the Truman quote that opened this chapter suggested, the important distinction of FGCs is that they have or could potentially have a customer base that is mixed or mostly from the private sector, as indicated in Figure 4.3. GSEs have a customer base that is entirely in the private sector, whereas GOCOs and FFRDCs have only government customers.

FGC customers are almost always the commercial sector or the general public. Some FGCs have government customers as well. The basic theme for all FGCs is that corporations can be more efficient than governmental structures when it comes to market transactions. If this product or service can be offered to the government as well as the private sector, so much the better. Under those circumstances the government can extract for its own use the efficiencies embodied in the product or service arising from the commercial market pressures.

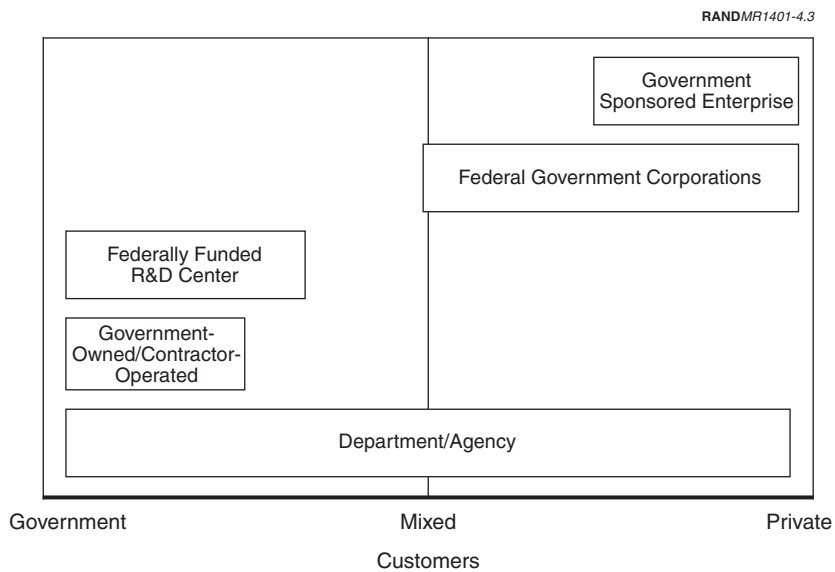


Figure 4.3—Comparison of Organizations Along the Customer Dimension

Whereas FGCs have existed for more than 200 years, there are significant differences in how they are structured and controlled. There is essentially no uniform legal definition of an FGC. Because Congress individually charters each FGC, the range of applicable statutes may vary widely. In 1945, the Congress established the Government Corporation Control Act, which tried to better define FGCs in terms of corporations either owned or controlled by the U.S. government. However, specifics have not been standardized, and many FGCs are exempted from the GCCA (Moe, 1983; U.S. GAO, 1983).

THE ARMY AND FGCs

The FGC presents the Army with a very flexible instrument to implement policy and strategic initiatives. For example, it has long been an Army policy that core logistics capabilities will be sustained in peacetime so that they can be available in times of war. This policy has resulted in a general understanding of what is core in the Army and what is peripheral to the core. For many of the peripheral functions, outsourcing of certain services and products has proved to be a good mechanism for increasing efficiency and reducing costs. For other activities that are on the boundary of these two domains, simple outsourcing is far too trivial a solution. For example, the Army depots and arsenals have many Army-unique capabilities that are significantly underutilized in peacetime yet may be needed in future times of war. If these organizations were converted to FGCs, then their underutilized workforces and physical plant could be applied to creating economic value in the private sector. Partnering with industry could take the form of a strategic partnership with a company that otherwise would be the FGC's competitor, or a mixed-ownership FGC with some BOD members drawn from the industrial stockholders. As an FGC matures and our understanding of the warfare of the future evolves, some of the capabilities of yesterday may migrate from the core to the peripheral domain. Then the FGC can outsource this capability or divest it. As new needed capabilities become apparent, they can be acquired from the private sector. These divestments and acquisitions can be done in a flexible and expeditious manner because, like most corporations, the FGC can maximize best long-term value rather than being driven to lowest cost.

The FGC option can provide the Army leadership with a flexible and agile instrument for policy initiatives. These organizations are controlled by their congressional charter and by their board membership. Thus, the Army leadership can extract itself from day-to-day operations and assume a more strategic perspective.

FGC AREAS OF CONCERN

A central premise in our constitutional form of government is that organizations that implement public policy should be held accountable for their actions. Moreover, public organizations supported by public funds should not benefit private organizations. All benefits from public funds should flow to the public. The FGC sits atop this divide between federal and private roles and responsibilities. Let us suppose that an FGC called United States Ordinance Corporation (USOC) is created from the arsenals, depots, and ammunition plants. Consider the case of a machinist at USOC who posts a notice about a meeting for a political action group on the company bulletin board. The vice president for human resources has the notice removed and admonishes the employee. The employee insists that it be posted as a matter of First Amendment rights. USOC has a policy on posting notices, allowing the vice president to decide. Is USOC acting as a part of the federal government that must be bound by the Constitution, or is it acting as a private company within its rights? Consider the case of a commercial client who sues USOC for nonperformance on a contract. Can USOC claim sovereign immunity and escape any legal remedy? If USOC makes an enormous profit one year, should those profits be returned to the U.S. Treasury? General Electric proposes a strategic alliance with USOC for heavy industrial machining using existing and new USOC staff. In return for stock and a board seat, General Electric will build two new facilities, populate them with the most advanced equipment, and provide the workforce with the needed training. How should USOC respond? Just as the economic efficiencies of the free market can create low-cost products and services, so too do these economic forces drive corporations to maximize profits. When profit maximization is at odds with a part of the formative national policy, where should USOC's loyalties lie? These questions are but a few of the manifold of possible issues that can and will arise in the life of USOC.

To be prepared for these possibilities with a clear path of action, USOC needs a well-crafted congressional charter making clear the roles and responsibilities of the corporation itself, the executive management, and the board of directors. However, Congress has not crafted a clear FGC charter for many decades, despite creating about one FGC per year since World War II. Although these FGCs have served the government well as instruments of federal policy, this service has been executed with some difficulty. Many of the difficulties derive from an unclear path of accountability, to the President, to the Congress, and to the American people.

Crafting good FGC charters has been the subject of considerable effort in the public administration arena (Froomkin, 1995; U.S. GAO, 1983; Leazes, 1987). Several sample charters along with the examples of the types of considerations that should be raised in drafting these documents are available (NAPA, 1981). All issues and concerns can be addressed in a well-crafted corporate charter and a well-designed BOD. The lessons learned from the present set of FGCs can provide considerable insights into the proper course. Clarity is the key to a successful Federal Government Corporation.

POTENTIAL ARMY CANDIDATES FOR FGCs

At least three Army candidates for FGCs have been proposed: (1) Army chemical demilitarization, (2) Army R&D laboratories, and (3) Army depots. As part of the 1998 AMC Redesign OIPT, the Army considered turning the Army chemical demilitarization operations into an FGC. While the assessment was positive, no action was subsequently taken (Gonczy, 1998). At this stage in the demilitarization process, it may now be too late to consider making this organizational change. However, the other two FGC candidates are still timely and relevant, and the Army has not seriously studied them. In this section, we indicate that both should be considered as possible candidates for establishing FGCs.

Army R&D Laboratories

Context. The Army R&D laboratories include AMC laboratories, the Corps of Engineers (COE) laboratories, and the Army medical laboratories. The AMC laboratories include both the Army Research Labo-

ratory (ARL) and the Research, Development, and Engineering Centers (RDECs) associated with the various AMC commodity commands. In this discussion, we will limit our comments to the AMC laboratories, although the observations most likely apply to the COE and medical laboratories as well.

Over the past few years, the AMC laboratories have been criticized for not initiating and broadening exchanges with industry (NRC, 1998), for not working more closely with the RDECs in avoiding duplication and competition for research funds (NRC, 1998), for working too much in isolation from other research laboratories (Crawford, 1998), and for not attracting competent engineers and scientists to DoD laboratories and S&T management (DSB, 1998). While much of the criticism has been directed at the ARL, the RDECs (as well as other DoD laboratories) have not gone unscathed. While many of these concerns have been addressed by the AMC, the laboratories still remain under the microscope of various government and industry critics.

Analysis approach. At the Army's request, the Arroyo Center has looked into the pros and cons of candidate alternative organizational models for the AMC laboratories.¹⁶ The broad aim of the studies was to provide the Army with an independent analysis to help guide the long-term evolution of the laboratories. In each case, hypothetical candidate models were assessed in terms of evaluation criteria that attempt to represent the generic functions of the laboratories. The high-level generic functions were synthesized from available information on laboratory functions.

The alternative laboratory organizational models that have been considered are shown in Table 4.1, along with the defining feature of each concept. The models are listed in alphabetical order. A more complete description of each is given in Appendix A.

¹⁶Over the past few years, RAND has performed several studies that have investigated laboratory alternatives. Because of the potential sensitivities involved, the findings have not been released as public-domain documents, and are only discussed in general terms here.

Table 4.1
Organization Laboratory Models Considered

Organizational Models	Defining Feature
Defense Research Institute	• Is like a graduate school doing hands-on R&D
Defense Working Capital Fund	• Only does work that is paid for
Federal Government Corporation	• Is owned/controlled by the public sector
Federally Funded Research and Development Center	• Is modeled after MIT Lincoln Laboratory
Government-Owned/ Contractor-Operated	• Is modeled after Sandia/LLNL/Los Alamos
Government as a Subcontractor	• Has labs compete with private industry
International Laboratory	• Performs R&D of mutual interest
Joint Service Laboratory	• Jointly works with combined funds
Outsource Laboratory	• Is modeled like DARPA, with 95 percent outsource
Private Laboratory	• Has no ownership stake or control
Reserve S&E Corps	• Has S&Es on call for service
Technology Incubator	• Provides basic service support
Venture Capital	• Operates like commercial VC fund
Virtual Laboratory	• Performs R&D at multi-lab sites

The various candidates were assessed in terms of the following criteria. Can they

- Understand and influence the Army's long-term visions to maintain technological superiority?
- Plan and direct a research program to implement the Army vision?
- Influence and leverage commercial technology/system developments?
- Conduct high-quality, revolutionary, government-funded research?
- Perform the "smart buyer" function for current and future materiel acquisitions?

- Plan and direct the integration of technologies into current and future weapon systems?
- Evolve as necessary to effectively and efficiently achieve mission goals?

The models were qualitatively assessed against the assessment criteria by RAND staff members who possessed some general familiarity with military, civil, and civilian R&D laboratories as a result of their past work experience in military, FFRDC, and industrial R&D centers.

Analysis results. Based on the subjective assessment performed by the RAND staff members, the FGC model emerged as one of the more promising organizational models. Its strength lies in its ability to achieve flexibility and efficiency, characteristics desirable to the Army in adapting to changing research needs.

Clearly, the Army needs to look more closely at the FGC model before considering it as a viable option. Other factors must be considered, including ease of implementation, cost of implementation, approval authorization, public support, etc. However, it is not insignificant that the FGC looked so promising in the preliminary exercise.

Army Depots

Context. We will use the term “Army depot system” to refer to the Depot Maintenance—Army (DMA) activities in the AMC, whose operating expenses (i.e., wages, salaries, and benefits; materiel costs; and all other operating expenses) are financed and paid for by the Army Working Capital Fund (AWCF).

In physical terms, the Army depot system consists of the following five heavy maintenance depots:

- Anniston Army Depot, Anniston, Alabama;
- Corpus Christi Army Depot, Corpus Christi, Texas;
- Red River Army Depot, Texarkana, Texas;
- Letterkenny Army Depot, Chambersburg, Pennsylvania;
- Tobyhanna Army Depot, Tobyhanna, Pennsylvania.

These five depots, with a civilian workforce of more than 9,500 people, are in the business of repairing, overhauling, and upgrading weapon systems and equipment. They do this mainly for the Army, but they have other customers as well. In addition to their maintenance work, the depots provide tenant support to other AMC, Army, and DoD activities at the five locations. In financial terms, the system expected to collect about \$1.2 billion in revenues from its customers in FY00.¹⁷

The Army depot system is an overwhelmingly civilian activity. The Army's FY01 President's budget submission indicates it will have 9,502 civilians on the payroll in FY00, but only 21 military personnel. That makes the Army depot system not only the largest civilian employer in the AWCF (accounting for just over half the total number of civilians in the four AWCF business areas of depot maintenance, supply, ordnance, and information services), but also the largest single employer of civilians in AMC. (After the Army depot system, the next-largest civilian employers at AMC, which employ roughly 50,000 civilians in total, are the commodity commands Tank-automotive and Armaments Command (TACOM), Communications-Electronics Command (CECOM), and Aviation and Missile Command (AMCOM), with 7,000 to 8,000 civilians each.) Overall, about 40 percent of the total civilian positions at AMC are funded by the AWCF, about 20 percent are funded by other, smaller reimbursable-type activities that the command performs, and the remaining 37 percent are funded by direct Army appropriations allocated to AMC.

Like all Working Capital Fund (WCF) activities, the Army depot system is already required (by DoD and Army policy) to operate in many respects "like a business." In particular, the system relies on customers to come in the door with work and the money to pay for it. However, Army customers are not required to buy from the Army depot system. In fact, many routinely use alternative providers to get depot-level work done. WCF policies also establish a financial "bottom line" under which the Army depot system must try to keep its share of the AWCF in balance by seeking to achieve an "Accumulated Operating Result" (AOR) of zero over time. Most

¹⁷Based on the Fund 14 "Revenue and Expenses" exhibit for Depot Maintenance in the FY01 AWCF President's Budget (February 2000), p. 39.

important, given the Army's military mission, the Army depot system has a key responsibility to do its part in making sure Army customers have the quality products and services they need to do their jobs.

Unlike a normal business, however, the Army depot system (like all DoD WCF activities) must operate in the "planned economy" of the DoD, in which the annual programming, budgeting, and appropriations process places highly non-market-like constraints on such things as the total amounts available to be spent, where investments can and cannot be made, and the prices that can be charged for goods and services provided. As a result of these and other special political and legal constraints on what managers inside the depot system can do, operating-cost reductions in the Army depot system have not kept pace with reductions in force structure and workload.¹⁸

Analysis approach. In a way similar to how we looked at organizational alternatives for Army laboratories, we have assessed alternative candidates for the Army depot system against assessment criteria using an in-house RAND evaluation team. In this case, however, the assessment was not performed as in the laboratory evaluation case. Rather than using a formal Delphi approach with four rounds of evaluations, we used a traditional consensus-forming approach with the evaluators ranking the various alternatives after discussing them in an open forum.

The alternative depot organizational models that we considered are shown in alphabetical order in Table 4.2, along with their defining feature. The "Baseline Plus" model refers to a restructured and improved depot system operating under full organic control by the Army. This model is assumed to be redesigned according to current and evolving Army plans to pursue optimal efficiency and capacity consistent with maintaining an in-house government system. Each organizational model is described in more detail in Appendix B. The FGC model has a form of ownership different from the other models.

¹⁸For example, W. N. Washington in the *Acquisition Review Quarterly* (Summer 1999) cites data provided by the AMC Deputy Chief of Staff for Resource Management (B. Leiby, November 30, 1998) indicating that from FY92 to FY98 operating costs in the Army depot system fell by just under 30 percent, while incoming workload fell by almost 50 percent.

Table 4.2
Organizational Depot Models Considered

Organization Model	Defining Feature
Baseline Plus	Achieves optimal efficiency/capacity within constraints of current system
FGC	Has flexibility in control, financial operations, and customers
GOCO	Has depot facilities/equipment owned by the government but has depot operated by contractors with mostly contractor staffing
Prime Vendor Support	Performs all wholesale logistics functions under a system contract
Privatization in Place	Has a private contractor assume ownership of a depot at its current location
Public-Private Partnership	Has private sector contribute property, plant, equipment to achieve end goal of the public-private partnership

It is chartered by Congress, which sets forth goals, obligations, special powers, exemptions, and composition of the board of directors. As mentioned earlier, the FGC benefits from financial freedom beyond the restrictions on federal agencies. It also offers workforce management options unavailable to government agencies. The unique characteristics of FGCs make this approach a promising candidate for application in the Army depot system.

To test that hypothesis, we used various assessment criteria in the evaluation, which are shown in Table 4.3 listed under five generic categories covering mission fulfillment, institutional issues, statutory requirements, financial issues, and congressional support.

Analysis results. The results of the assessment indicate that the FGC, as a candidate approach dealing with issues in the current Army depot system, ranked with the highest among all the approaches.¹⁹

¹⁹Michael Hynes, "Organizational Alternatives for the Army Depot System," private communications, May 2000.

Table 4.3
Depot Assessment Criteria

Generic Category	Assessment Criterion
Mission fulfillment	<ul style="list-style-type: none"> • Improves repair/maintenance capability • Improves system renewal (recapitalization/modernization) • Improves surge/reconstitution capability
Institutional issues	<ul style="list-style-type: none"> • Improves workforce management • Improves process management • Offers entrepreneurial (agility to respond to business opportunities)
Financial issues	<ul style="list-style-type: none"> • Creates competitive environment • Reduces costs • Provides access to capital to finance expansion/innovation
Congressional support	<ul style="list-style-type: none"> • Lessens concern over jobs • Improves local economic help • Addresses core competency concerns
Statutory requirements	<ul style="list-style-type: none"> • Satisfies requirement for competition (10 U.S.C. 2469) • Satisfies limitations on contracting (10 U.S.C. 2466) • Satisfies core logistics capability (10 U.S.C. 2464)

Other models also achieved high rankings, in particular, Baseline Plus and Public-Private Partnership. As in the case of the emergence of the FGC as a candidate for the AMC laboratory organization, the Army needs to look more closely at the FGC model and address a series of significant issues.

Two aspects of the Army depot system explain why caution is necessary before applying the FGC idea. First, the FGC concept works best when external commercial opportunities exist, and it is not clear which, if any, of the five Army depots meet that criterion. Second, the Army depot system relies upon Program Offices and Item Managers in the AMC Major Subordinate Commands (MSCs) for guidance, direction, and workload assignments. Thus, any FGC ar-

rangements would necessarily entail establishing special working arrangements and relationships with the MSCs. With those caveats, we believe that the methodology we have developed is a useful way for the Army to further evaluate the FGC approach.

Notwithstanding the cautionary notes above, there are three additional reasons why the FGC model is appealing for Army depot maintenance. The first reason has to do with the uncertain nature of the depot maintenance business itself. The DoD's traditional Planning, Programming, Budgeting, and Execution System (PPBES), under which the Army and all the services must operate, works best when "requirements" can be clearly defined, programs and workloads can be established with certainty ahead of time, and management actions can be taken to control how money is spent in execution. In the depot maintenance business, however, it is virtually impossible to predict demands, workloads, and sales with the degree of accuracy required to ensure "break-even" performance.

The Army depot system's financial performance provides evidence that this is true. In FY98, for example, the system reported losses of \$133.7 million on revenues of roughly \$1.5 billion.²⁰ The problem is very much entwined with the PPBES system and the way DoD must operate as part of the executive branch within the government. In particular, because authority to spend AWCF dollars is controlled for the DMA system in essentially the same way it is for appropriated dollars, the Army depot system (despite the fact that it is a WCF activity) does not really enjoy any more "business flexibility" than it would if it were simply an appropriated function.²¹ Therefore, a key

²⁰AWCF FY00/01 Budget Estimation Submission, September 1999, reports the FY98 DMA Net Operating Result (NOR) was negative: \$133.7 million. The "recoverable" portion of the Accumulated Operating Result (reflecting the net effect of annual NORs going back to FY92, adjusted and reduced by write-offs) was reported to be negative \$36.1 million.

²¹As an example of this, the HQDA Program Analysis and Evaluation Directorate stated to the DWCF Reform Task Force in September 1998: "Frustrations with the current structure boil down to an inability to accurately forecast customer demands and restrictions against sizing workforce and facilities appropriately. Imbalances cause cash problems or operating losses which manifest themselves as bills to the services." Although it is true that depot operations have been "industrially funded" for many years, it was only in FY92, with the creation of the Defense Business Operations Fund and its establishment of "full cost recovery" pricing combined with the "stock funding" of DLRs in the Army, that these problems began to surface.

structural reason for considering FGC-type arrangements is to remove the activity in question from the rigidity of the annual budgeting and appropriations process, when that rigidity conflicts with the basic nature of the business.

The second reason for considering FGC approaches for the Army depot system has to do with the mandate facing the Army from the 1997 Quadrennial Defense Review (QDR) to eliminate 17,366 civilian positions by FY04, 8,530 of which are supposed to come from AMC. As the largest single employer of civilians in AMC, the Army depot system is a natural candidate to be a significant contributor to the AMC effort, but, in fact, it is not. Army and AMC plans as of 1999²² indicate that only 400 of the total 8,530 positions to be eliminated from AMC will come from the Army depot system, and those reductions are attributed entirely to the decentralization and transfer of depot management from the Industrial Operations Command (IOC) to the individual commodity commands. By way of comparison, 1,567 positions are to come by restructuring AMC RDECs (which employ far fewer civilians than the depot system), and another 730 positions are to come by competing functions and reducing test requirements in the Test and Evaluation Command (TECOM), which employs less than half as many civilians as the depot system.²³

By applying the FGC concept to its depot system, the Army could make reductions to its *government* civilian workforce, without having to eliminate jobs. Indeed, one of the significant advantages of the FGC approach, if applied at a particular depot, is that it would allow the employees at that depot to keep their jobs at that location provided they would be willing to give up their status as *government* employees. To be sure, a key advantage of the FGC approach is that it affords much greater latitude and incentives for managers and employees to reform internal processes, and that almost always entails changing some jobs and eliminating others. However, it also

²²As described in the March 1999 GAO Report, *Status of Efforts to Implement Personnel Reductions in the Army Materiel Command*.

²³Salaries, wages, and benefits for civilian personnel are the largest single element of expense in the Army depot system. In FY00, salaries, wages, and benefits for the system's 10,409 civilians will be \$534.5 million (an average of \$51,350 per person), with the next-largest element of expense being the cost of materials and supplies used in repair operations—\$404.1 million in FY00.

means that new jobs could be created if the new FGC takes advantage of the opportunities to seek new customers and markets, compete, and grow. Because FGCs can compete for new work, partner with industry,²⁴ and reward employees in ways that internal government activities cannot, there is every reason to believe that depot employees who are willing to commit to the idea have more to gain from being in an FGC than they have to lose.

The third reason for looking at the FGC idea for the Army depot system is that senior Army leadership has already considered the concept and indicated its willingness to pursue it further—an important prerequisite for possible success. In particular, a consensus has been reached in the senior programming, budgeting, and logistics communities at HQDA that the FGC concept is not an unreasonable one to explore for the AWCF activities. Indeed, that consensus has existed for some time. In September 1998, as part of its contribution to a joint DWCF Reform Task Force under the Defense Reform Initiative, the Army itself proposed that the Task Force consider (as one possible reform alternative) converting some or all the DoD's DWCF activities to FGCs.²⁵

The upshot of the Army proposal, after a year of Task Force study that included a high-level review by the Task Force's Executive Steering Group with the Assistant Vice Chief of Staff representing the Army, is that the Task Force and its Steering Group recommended to the Deputy Secretary of Defense and the Defense Management Council (DMC) that they:

²⁴“Strategic partnering” with industry and other options for “commercializing” the Army depot system are beginning to receive increased attention inside the Army as a way to help reform and improve the system. See, for example, Washington (1999).

²⁵In a presentation to the DWCF Reform Task Force, September 3, 1998, prepared by the Program Analysis and Evaluation Directorate (PAED), Office of the Director of the Army Staff, the Army told the Task Force: “Prior attempts to address infrastructure limitations have focused on complete commercialization or privatization of DWCF activities. This proposal offers a way to maintain control over inherently governmental functions (i.e., mobilization capability) while improving ability to operate ‘like a business.’”

Support proposals through the DMC for alternative organizational structures [for DWCF activities], such as a Federal Government Corporation.²⁶

To ensure that the Army and other services were still on board with the FGC idea before issuing the above recommendation, the Task Force leadership individually briefed flag-level representatives from the programming, budgeting, and logistics communities in the Army and other services in June 1999 on all the Task Force recommendations.²⁷ The HQDA representatives from all three communities gave a “green light” to the Task Force recommendation that a “detailed feasibility analysis” should be done on adopting an FGC structure for a “pilot” WCF activity, thus indicating their concurrence with the Task Force statement that

Of the alternatives (status quo, Federal Government Corporation, privatization, employee stock ownership, mutual benefit corporation performance-based organization), the Federal Government Corporation provides the most gains in operational and financial flexibility while continuing to address the Department issues of industrial preparedness and mobilization.²⁸

²⁶DWCF Reform Task Force Decision Briefing (showing decisions by the ESG made on August 18, 1999).

²⁷DWCF Reform Task Force Information Briefing to the DWCF Policy Board and the Deputy Secretary of Defense, July 1999.

²⁸By June 1999, the Task Force had in hand the results of a study it had commissioned on the FGC concept. See Vivar and Reay (1999).