



NATIONAL SECURITY RESEARCH DIVISION

THE ARTS
CHILD POLICY
CIVIL JUSTICE
EDUCATION
ENERGY AND ENVIRONMENT
HEALTH AND HEALTH CARE
INTERNATIONAL AFFAIRS
NATIONAL SECURITY
POPULATION AND AGING
PUBLIC SAFETY
SCIENCE AND TECHNOLOGY
SUBSTANCE ABUSE
TERRORISM AND
HOMELAND SECURITY
TRANSPORTATION AND
INFRASTRUCTURE
WORKFORCE AND WORKPLACE

This PDF document was made available from www.rand.org as a public service of the RAND Corporation.

[Jump down to document](#) ▼

The RAND Corporation is a nonprofit research organization providing objective analysis and effective solutions that address the challenges facing the public and private sectors around the world.

Support RAND

[Browse Books & Publications](#)

[Make a charitable contribution](#)

For More Information

Visit RAND at www.rand.org

Explore [RAND National Security Research Division](#)

View [document details](#)

Limited Electronic Distribution Rights

This document and trademark(s) contained herein are protected by law as indicated in a notice appearing later in this work. This electronic representation of RAND intellectual property is provided for non-commercial use only. Unauthorized posting of RAND PDFs to a non-RAND Web site is prohibited. RAND PDFs are protected under copyright law. Permission is required from RAND to reproduce, or reuse in another form, any of our research documents for commercial use. For information on reprint and linking permissions, please see [RAND Permissions](#).

This product is part of the RAND Corporation occasional paper series. RAND occasional papers may include an informed perspective on a timely policy issue, a discussion of new research methodologies, essays, a paper presented at a conference, a conference summary, or a summary of work in progress. All RAND occasional papers undergo rigorous peer review to ensure that they meet high standards for research quality and objectivity.

OCCASIONAL
P A P E R



A Call to Revitalize the Engines of Government

Bernard D. Rostker



NATIONAL SECURITY RESEARCH DIVISION

The research described in this report was prepared for the Office of the Secretary of Defense (OSD). The research was conducted in the RAND National Defense Research Institute, a federally funded research and development center sponsored by the OSD, the Joint Staff, the Unified Combatant Commands, the Department of the Navy, the Marine Corps, the defense agencies, and the defense Intelligence Community under Contract W74V8H-06-C-0002.

The RAND Corporation is a nonprofit research organization providing objective analysis and effective solutions that address the challenges facing the public and private sectors around the world. RAND's publications do not necessarily reflect the opinions of its research clients and sponsors.

RAND® is a registered trademark.

© Copyright 2008 RAND Corporation

All rights reserved. No part of this book may be reproduced in any form by any electronic or mechanical means (including photocopying, recording, or information storage and retrieval) without permission in writing from RAND.

Published 2008 by the RAND Corporation
1776 Main Street, P.O. Box 2138, Santa Monica, CA 90407-2138
1200 South Hayes Street, Arlington, VA 22202-5050
4570 Fifth Avenue, Suite 600, Pittsburgh, PA 15213-2665
RAND URL: <http://www.rand.org>
To order RAND documents or to obtain additional information, contact
Distribution Services: Telephone: (310) 451-7002;
Fax: (310) 451-6915; Email: order@rand.org

Preface

The increased role that contractors play in support of the federal government has become the subject of numerous reports by the U.S. Government Accountability Office (GAO), and Congress has taken note. Section 324 of Public Law 110-181, the National Defense Authorization Act for Fiscal Year 2008, promulgates “Guidelines on In-Sourcing New and Contracted Out Functions” that would start to rectify the current situation. This paper provides a comprehensive review of the issues raised by the GAO and Congress and suggests corrective action. It incorporates data presented by the Under Secretary of Defense for Personnel and Readiness at the annual meeting of the Western Economics Association in July 2008.

This research was conducted within the Forces and Resources Policy Center of the RAND National Defense Research Institute, a federally funded research and development center sponsored by the Office of the Secretary of Defense, the Joint Staff, the Unified Combatant Commands, the Department of the Navy, the Marine Corps, the defense agencies, and the defense Intelligence Community.

For questions about this document, please contact the author, Bernard Rostker, at rostker@rand.org.

For more information on RAND’s Forces and Resources Center, contact the Director, James Hosek. He can be reached by e-mail at James_Hosek@rand.org; by phone at 310-393-0411, extension 7183; or by mail at the RAND Corporation, 1776 Main Street, P.O. Box 2138, Santa Monica, California 90407-2138. More information about RAND is available at www.rand.org.

Contents

Preface	iii
Figures	vii
A Call to Revitalize the Engines of Government	1
Factors Contributing to the Current Crisis	1
A Reduced Federal Workforce	2
Preference for Contracting.....	3
Defining “Inherently Governmental” Work.....	4
Ease of Contracting.....	5
But Contractors Can Actually Cost More	6
Faulty Rational for a “Blended Workforce”.....	7
Managing the Increased Workload After 9/11	7
Pending Retirements Will Deprive the Government of Needed Talent	10
Lack of Appropriate Supervision Has Led to Abuses	12
Needed Action.....	12
Recent Congressional Action.....	13
Additional Action Is Required to Revitalize the Civil Service	13
Recommendations	15
Bibliography	17

Figures

1. DoD and Non-DoD Employment Trends: 1982–2007	2
2. DoD Total Budget and Personnel Costs, Then-Year Dollars	8
3. DoD Total Budget and Personnel Costs, 2007 Constant Dollars	8
4. Defense Spending as a Percentage of DoD’s Total Budget	9
5. Overall Procurement Trends	10
6. The Federal Workforce Is Getting Older, with Many Eligible to Retire	11
7. Percentage of DoD Employees Remaining Employed in Years Following Retirement Eligibility	11

A Call to Revitalize the Engines of Government

by Bernard Rostker¹

We face an unparalleled crisis in the federal government's ability to do the nation's business. Decades of neglect and outright hostility toward the federal civil service by both political parties, together with the coming loss of experienced people due to an unprecedented number of retirements, will exacerbate problems that the U.S. Government Accountability Office (GAO) has been highlighting for years. While former GAO Comptroller General David Walker called on the U.S. Department of Defense (DoD)² to "reexamine its extensive reliance on contractors" (Walker, 2008), the fact is that the government's ability to provide appropriate oversight of contracts has already reached an alarmingly low level, one that will diminish even further with an unprecedented number of retirements over the next few years. Headlines in the *Washington Post* such as "Pentagon Auditors Pressured to Favor Contractors" (Hedgpeth, 2008) highlight both the political pressure that favors privatization of government functions and the poor state of government supervision of contractors. In reporting on the conviction of the Science Applications International Corporation, a multibillion-dollar provider of services to the federal government, for "making dozens of false and fraudulent claims for payments relating to the Nuclear Regulatory Commission (NRC) work," the *Post* noted that "organizational conflicts of interest are a disease that a decade ago were rare and now in Washington are an epidemic" (O'Harrow, 2008).

The current situation is the result of a number of factors. Although each of these factors is by itself benign, together they have resulted in a most unfortunate and dangerous situation. This paper reviews these factors and the current situation, and outlines actions that can be taken to revitalize the government's ability to do the nation's business.

Factors Contributing to the Current Crisis

Since the 1970s, partly as a result of the loss of confidence in government after the Watergate scandal, antigovernment sentiments have been in vogue. Once seen as the grantor of a level playing field, the last quarter century has seen a steady increase in the role that the free market plays in our national life. President Ronald Reagan summed up the tenor of the times when, in his first inaugural address, he said, "government is not the solution to our problem; government is the problem" (Reagan, 1981). Starting with the Carter administration and its exten-

¹ The views expressed in this paper are the author's and do not necessarily reflect those of the RAND Corporation or its research sponsors.

² This paper focus mainly on the experience of the Department of Defense, but the story is consistent throughout the federal government.

sive deregulation of the oil, airline, and trucking industries, those that favor the “free market” became the dominant force in American economic and political thinking. In many ways, the Clinton administration of the 1990s reflected more the thinking of Reagan Republicans than the traditional policies of the Democratic Party (Krugman, 1994).

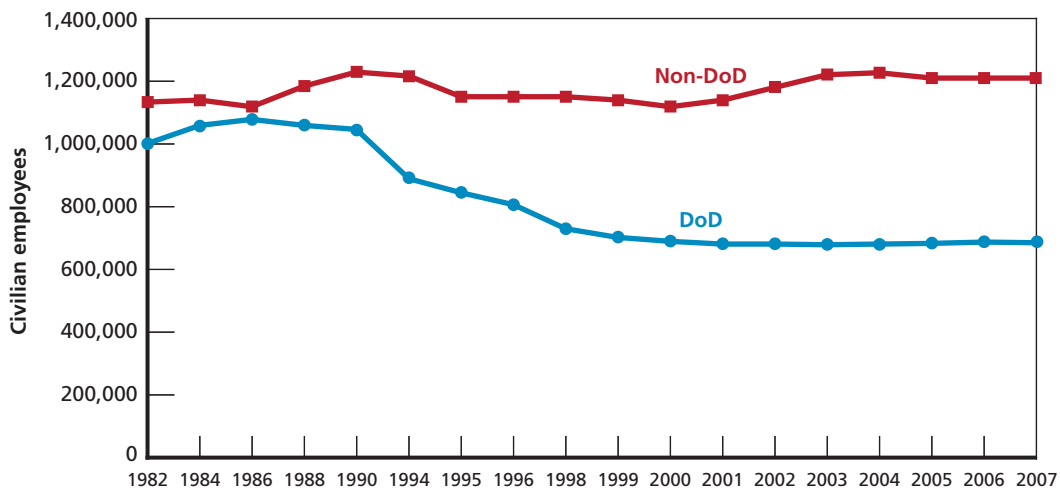
The “attack” on government has taken a number of paths, including extensive deregulation of the financial services industry, calls for a less progressive tax system and even a flat tax, and increased demands to privatize the provision of services traditionally provided by government. Reduction in the number of federal government employees became a measure of merit for both political parties’ administrations; to this end, federal administrators increasingly substituted contract personnel for government personnel, not only in the production of services, but in the very administration of the government itself.

This paper reviews these trends and suggests a course of action to correct the excesses that have resulted in the current situation. As a new administration prepares to take over in Washington, the issue discussed in this paper will have to be faced squarely. The old canard of reporting a reduction in the federal payroll while ignoring the increase in contractors and the cost of doing business must be addressed. The next president must be honest with the American people that it is not the number of government employees, but rather the efficiency and effectiveness of government that really matters.

A Reduced Federal Workforce

Efforts to reduce the size of the government, as shown in Figure 1, have unbalanced the workforce. The post–Cold War re-sizing of the Defense Department, for example, not only reduced the number of military personnel, but also had a profound effect on the size of the civilian workforce. The drawdown after the fall of the Soviet Union led to a sharp curtailment of hiring new DoD civilian employees. As a result, the number of new hires in the early 1990s was quite small, and the average age of incumbent DoD civilians became older. The small number of new hires meant that, from an overall organizational level, new cadres of DoD civil servants

Figure 1
DoD and Non-DoD Employment Trends: 1982–2007



SOURCE: U.S. Office of Personnel Management, *The Fact Book: Federal Civilian Workforce Statistic*, 1998.

RAND OP240-1

were not being developed. Since 1999, the number of civilians employed at the Department of Defense has been relatively stable, but the demands on that workforce have increased as a result of the Global War on Terror and two active military conflicts in Iraq and Afghanistan. Contractors have largely filled this gap.

Preference for Contracting

Since the Carter administration, it has been fashionable to expound the virtues of contracting, because many saw the government bureaucracy as inflexible and unresponsive. Cost was the easiest metric by which to rationalize a move to competition and contracting, but it was by no means the only motivation. Policies developed during the Reagan administration (e.g., the 1983 rewrite of OMB [Office of Management and Budget] Circular A-76)³ and during the administration of George W. Bush (e.g., the President's Management Agenda [OMB, 2002]) codified a preference for contracting over in-house activities.⁴

The Bush administration's President's Management Agenda identifies "competitive sourcing"⁵ as one of its five "government-wide initiatives" (OMB, 2002, p. 17). It is the policy of the Bush administration to "achieve efficient and effective competition between public and private sources . . . to better publicize the activities subject to competition and to ensure senior level agency attention to the promotion of competition" (OMB, 2002, p. 17). To accomplish this, the administration developed "specific performance plans to meet . . . goals of completing public-private or direct conversion competition on not less than five percent of the full-time equivalent employees" (OMB, 2002, p. 18). The President's Management Agenda for competitive sourcing, places a new emphasis on selection of the best service provider, public or private,

³ The roots of Circular A-76 can be traced to the former Bureau of the Budget's Bulletin 55-4 (issued January 15, 1955), which stated that the federal government would "not start or carry on any commercial activity" that the private sector could do. Revisions have been made periodically ever since. The policy first appeared in its current "A-76" form on March 3, 1966. It has been changed four times: in 1967, 1979, 1983, and 2003. In 1979, a "Supplemental Handbook," which spells out the complex details on conducting competitions, was issued. The handbook also has been revised three times (first in 1983, then in 1996, and again in 1999), and has been abandoned with the current OMB Circular A-76, which was published May 29, 2003.

⁴ The congressionally mandated Acquisition Advisory Panel described this change in their recent report (Acquisition Advisory Panel, 2007, p. 414):

The past fifty years [under both political parties there has been] . . . a global transformation in public administration from government to governance, whereby our federal government has increasingly come to rely on non-governmental actors to perform core "governmental" activities, and the achievement of public goals has been accomplished by a mix of state, market and civil society actors. This development has presented a challenge to the ability of federal government officials to retain the capacity to supervise and evaluate the work of the government, whether such work is performed by contractors or federal employees. During the same period, civil service personnel ceilings have been imposed, which has ensured that as the government has grown, reliance on contractors has also increased. To compound the challenge, many agencies have been unable to recruit and retain an adequate number of skilled professionals to be able to do the complex types of work that are now part of their missions.

⁵ While many reviews (such as the numerous GAO reports) use the term "outsourcing" generically, strictly speaking, there is a distinction between "outsourcing" and "competitive sourcing." Outsourcing refers to a decision to contract without the A-76 process, while competitive sourcing complies with OMB Circular A-76. Public-private competitions under the Circular can only be conducted on activities performed by government personnel. Before Section 324 of the FY 2008 National Defense Authorization Act went into effect, new commercial activities could be contracted without conducting a public-private competition so long as the activity was not "inherently governmental" or commercial but exempted from private-sector performance. Policy that implements Section 324 now requires DoD Components to conduct a cost comparison to determine whether commercial activities that are *not* otherwise exempted from private-sector performance should be performed by DoD civilians or contractors.

as determined through competition (U.S. Army IMCOM Installation Management Command, 2008).

Defining “Inherently Governmental” Work

However, the competitive sourcing initiative makes no reference to a central feature of the A-76 process, namely its long-standing prohibition that contractors should not perform work that is “inherently governmental.” Prior to the Bush administration’s May 2003 revision, A-76 had defined “inherently governmental” work as follows:

An inherently governmental activity is an activity that is so intimately related to the public interest as to mandate performance by government personnel. These activities require the exercise of discretion in applying government authority and/or in making decisions for the government. (Daniels, 2003)

The May 2003 modification added the word “substantial” before discretion. A-76 now reads, “An inherently governmental activity is an activity that is so intimately related to the public interest as to mandate performance by government personnel. These activities require the exercise of substantial discretion in applying government authority and/or in making decisions for the government” (Daniels, 2003). This change, which was opposed by the American Federation of Government Employees, AFL-CIO (see Simon, 2005), reduced the impact of the provision by allowing outsourcing of many activities that were previously considered “inherently governmental.” The key to the 2003 changes was to be “agency oversight,” which the Acquisition Advisory Panel and the GAO found was lacking.⁶

The administration’s actions were based on the presumption that “increased competition consistently generates significant savings and noticeable performance improvements” (OMB, 2002, p. 18). The GAO found, however, that early studies that showed the benefits of outsourcing select government jobs have been extrapolated way beyond the original studied contracts. Projected savings have never materialized, as lessons from these early studies have been extended inappropriately into new areas, especially into the area of support services, with unexpected results. For example, the GAO notes, “while the 1995 Commission on Roles and Missions projected savings of 20 percent from outsourcing,” such savings have not materialized (Walker, 2008, p. 27). In fact, when public activities were allowed to compete under A-76, they won about half the competitions. (The GAO also questioned the Defense Science Board’s projections of \$30 billion in annual savings from privatizing [Walker 2008, p. 29]).

⁶ In reviewing activities at the Department of Homeland Security, the GAO found that

DHS management and oversight of contracts for selected services did not provide assurance that DHS had adequately mitigated the related risk. Federal acquisition policy requires enhanced oversight of contractors providing professional and management support services that can affect government decision making, support or influence policy development, or affect program management. However, most contracting officers and program officials we spoke with were unaware of this requirement and, in general, did not see a need for enhanced oversight of their professional and management support services contracts—even though they acknowledged these contracts closely supported inherently governmental functions. According to some officials, their contracting experience and training enabled them to determine if enhanced oversight was needed. However, we found the level of oversight provided did not always ensure accountability for decisions or the ability to judge whether the contractor was performing as required. In addition, training was not targeted to provide the necessary skills to determine whether enhanced oversight was needed. Failure to ensure appropriate oversight increases the potential for a loss of management control and ability to ensure intended outcomes are achieved. (GAO, 2007, p. 4)

The importance of the A-76 competition is not, as some have contended, that the private sector can do things more efficiently than the government, but that the competition itself often frees government employees from rigid ways of doing business and opens new avenues for innovation. Transferring work to the private sector without regard to the outcome of the A-76 competition is antithetical to the very purpose of the competition. Rather than saving money, which was the original basis for outsourcing and competitive sourcing, it appears that, at least in the area of support services, the current course is costing the taxpayers more money.

Ease of Contracting

Hiring a civilian employee into the federal government often frustrates managers. The U.S. Merit Systems Protection Board (MSPB) has identified four challenges for the federal government in hiring civilians: “the length and complexity of the hiring process, the Government’s ability to market its jobs to attract high-quality applicants, the ability of Government assessments to distinguish the most qualified candidates, and the capacity of human resource (HR) staffs and supervisors to adequately carry out Federal hiring programs” (Crum, 2008). The MSPB found that hiring commonly can take as long as five months, with the decentralized system adding to the complexity rather than simplifying the process. Limitations placed by Congress and OMB—largely in the form of “personnel ceilings,” i.e., restrictions on the number of employees that may make up an agency’s headquarters staff—push managers to take the path of least resistance. Hiring contractors is much easier, especially when it can be done on a sole-source basis. With money and a contract in hand, managers are able to give new tasks to an existing contractor without competition. The contractor, unencumbered by having to compete for the task or to meet employment standards, can supply a qualified worker in short order, sometimes within hours—though usually at a substantial premium, by some accounts as large as 50 percent. The resulting so-called “blended workforce”—comprising both government and private employees—is problematic.

In recent years, outsourcing has become easier, with agencies skirting the provisions of A-76, as “most of the growth in service contracting has occurred outside of the A-76 process” (Walker, 2008, p. 5). The lack of competition of current practices has not been lost on the Congress. The Senate Government Affairs Committee found that through the use of task order contracts,⁷ with their “broad categories of ill-defined services,” competition has “unnecessarily diminished” (Acquisition Advisory Panel, 2007, p. 29).

In the world of support services, the problem is not the definitions used in the A-76 process. While the A-76 competition process provides a certain rigor, the fact is that in fiscal year 2004 nearly one-third of the government’s contracting dollars obligated was awarded without competition.⁸ The problem of contracting for support services, however, is not new. As early as 1991 the GAO noted that the U.S. Department of Energy (DOE) had increased the money it spent on support services by 56 percent, and the GAO told Congress that “guidance does not call for cost comparisons when contracting for services needed to fulfill new agency requirements or when federal performance is not considered feasible” (Peach, 1991, p. 1). DOE offi-

⁷ A task order contract, also known as an indefinite quantity contract, allows the government to add a new task to an existing contract. The government uses task order contracts when it cannot predetermine the precise quantities of supplies or services it will require during the contract period.

⁸ The Acquisition Advisory Panel reported that the amount of noncompetitive awards is underreported (2007, p. 9).

cials told the GAO that “they did not compare costs since they could not get additional staff to perform the work in-house because of personnel ceilings ” (Peach, 1991, p. 6).

But Contractors Can Actually Cost More

The GAO found that contracting outside of A-76 can actually cost the government more than doing the work in-house. In 1991, the GAO compared the costs of contractors and government employees of 12 contracts at DOE and found that 11 of the 12 contractors were, on average, 25 percent more costly (Peach, 1991, p. 2). In 2007, the House Select Committee on Intelligence made a similar cost comparison for the intelligence community and found that, on average, a contractor costs almost twice as much as a government employee (House Select Committee on Intelligence, 2007, p. 28). In 2008, the Office of the Director of National Intelligence reported that the cost of “salary, benefits, as well as full lifecycle costs; . . . [including] pension costs and health benefits” (Sanders, 2008, p. 8) for government employees was \$125,000. It also found that “per-capita cost per contractor was \$207,000 [for] direct labor, [this] does not include overhead” (Sanders, 2008, p. 8).

Understanding why contract labor costs more is key to correcting the current situation. Often the difference in the cost of a government employee and a contract worker is *not* reflected in the pay the workers actually receive. Typically, support contracts are not “cost plus fixed fee contracts,” but are MOBIS contracts.⁹ Under this type of contract, when the government replaces a government employee with a contract worker, it has no assurance that it is getting a qualified person or that it is not overpaying for the services of the worker the contractor assigns. Contractors establish labor rates for broad categories that carry ambiguous titles, such as “Principal Management Consultant.”¹⁰ The standards for the “Principal Management Consultant III,” for example, are so general (e.g., “Generally requires a business-related masters degree and 6 years of relevant experience”) that a very wide range of people can be assigned to that category. The payment the contractor will receive is very specific, however; according to one contractor on the GSA MOBIS schedule, it would be \$373,000 per year. Moreover, the government is charged the labor rate regardless of the actual pay a worker receives. The government does not compare the actual pay of the assigned contract worker with the labor rate it is being charged. As a result, contractors have an incentive to assign workers who actually earn less than the rate they charge the government.

Contractors also charge the government for the supervision of contract workers and overhead for the operations of the contractor’s organization, even when the contract workers do their jobs in government facilities and sometimes have little direct contact with the firm that employs them. All too frequently, the contract workers work behind the desk once occupied by a government employee, taking direction from a government supervisor. Anecdotally, some contract workers have never even been to their firm’s facilities. At the Naval Air Weapons Sta-

⁹ The MOBIS [Mission Oriented Business Integrated Services] schedule enables the government to award contracts to companies to help improve management and organizational effectiveness of government agencies. Today, the MOBIS contracts are increasingly how the federal government responds to a continuous stream of new mandates. MOBIS contractors provide support services to agencies, to include “Contract administration support services, including assistance with reviewing [other] contractor performance, developing contract modifications, and investigating reports of [other] contract discrepancies” (U.S. General Services Administration, 2008).

¹⁰ The category, qualifications, and the associated labored rate in the example given here were taken from a firm’s MOBIS listing on the MOBIS schedule approved by the U.S. General Services Administration and posted on the Internet on November 6, 2008.

tion China Lake, the base even charges contractors a fee for all the costs it incurs from housing contractors. While this allows the base to generate the funds needed to maintain its facilities, since basing it on the population of government employees would undercount the number of people actually working on the base, it is just another cost that is added to the contract. One has to ask: What is it that the government really gets from the contractor that justifies the cost differences between government employees and contract workers?

Faulty Rational for a “Blended Workforce”

While some exalt the benefits of the blended workforce (Thompson and Mastracci, 2005), others are concerned about the loss of in-house expertise (Senate Appropriations Committee, 2008, p. 14), lack of ethical standards for contractors, and the “pirating” of government employees by contractors (Negroponte, 2006). In a blended workforce, the lines of authority are often confused, with contractors not only supervising other contractors but contractors even supervising government employees. Today, many conflict-of-interest requirements apply only to federal employees. The *Washington Post* reports there are “more than 900 cases alleging that government contractors and drug makers have defrauded taxpayers out of billions of dollars” (Johnson, 2008) pending at the Justice Department.

The blended workforce undermines the very fabric of the federal workforce. Although the congressionally mandated Commercial Activities Panel recommended that federal sourcing policies and practices “be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performing federal workforce” (Walker, 2002, p. 46), this has not happened. There is an inherent conflict between the Bush administration’s human capital goals and its competitive sourcing policies. Opportunity for professional challenge and career advancement within the federal civilian workforce has been diminished by the large increase in contracted work. This may be demotivating to civilians and discouraging to potential civilian new hires.

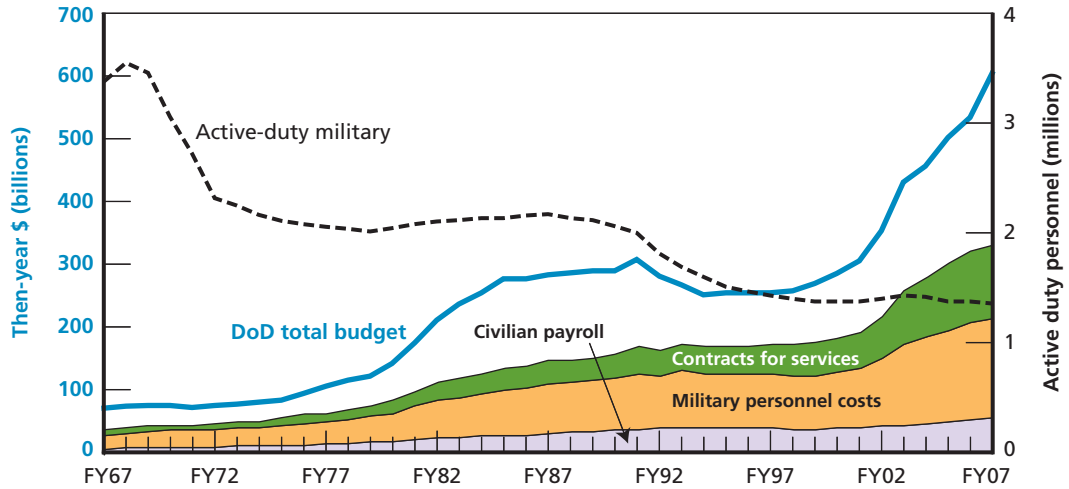
Competition in the private sector is supposed to produce incentives for efficient production, technological innovation resulting in new and improved products, and the reallocation of resources to their most productive use. Using contract workers simply to overcome limits placed by arbitrary personnel ceilings does none of these things.

Managing the Increased Workload After 9/11

The increased demands placed on the government after 9/11 have almost entirely been met by contracting, not only for the needed goods and services, but also to perform inherently governmental functions. For example, the former Director of National Intelligence recently complained,

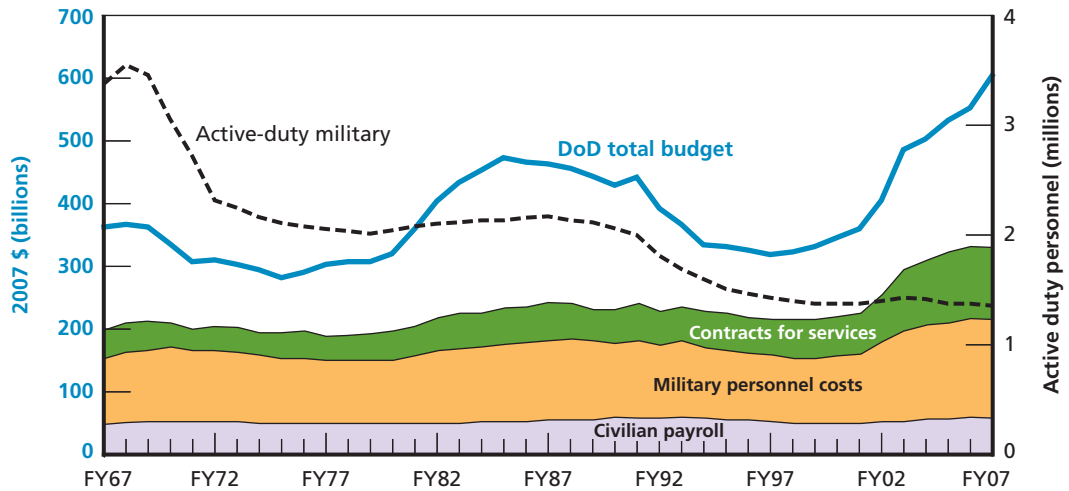
increasingly, the Intelligence Community finds itself in competition with its contractors for our own employees. Confronted by arbitrary staffing ceilings and uncertain funding, components are left with no choice but to use contractors for work that may be borderline ‘inherently governmental’—only to find that to do that work, those same contractors recruit our own employees, already cleared and trained at government expense, and then ‘lease’ them back to us at considerably greater expense. (Negroponte, 2006, p. 6)

Figure 2
DoD Total Budget and Personnel Costs, Then-Year Dollars



SOURCE: Chu and Eanes, 2008.
RAND OP240-2

Figure 3
DoD Total Budget and Personnel Costs, 2007 Constant Dollars

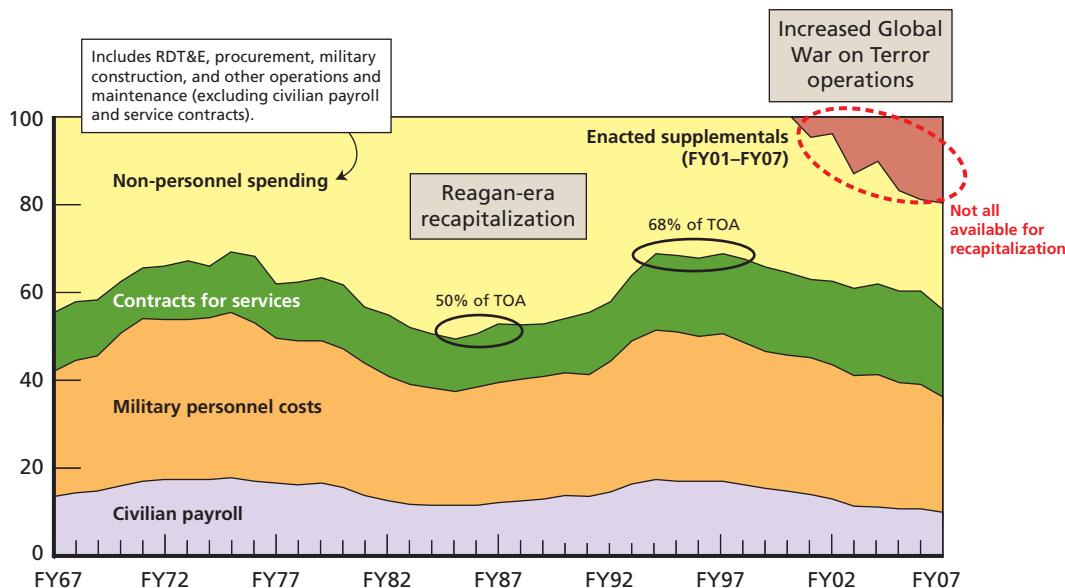


SOURCE: Chu and Eanes, 2008.
RAND OP240-3

The increase in workload, especially at the Department of Defense, is reflected in the following charts prepared by the Office of the Under Secretary of Defense for Personnel and Readiness.

Figure 2 shows the sharp upturn in expenses that started at the end of the Clinton administration and accelerated after military operations started in Afghanistan and Iraq. The increase in the cost of military personnel reflects higher wages, health costs, enlistment and reenlistment

Figure 4
Defense Spending as a Percentage of DoD's Total Budget



SOURCE: Chu and Eanes, 2008.

NOTE: RDT&E = research, development, testing, and evaluation; TOA = Total Obligation Authority.

RAND OP240-4

bonuses, and active-duty pay for reserve personnel. In contrast, the chart shows the decrease in the size of the active-duty military. The largest increases are in the cost of contractor services.

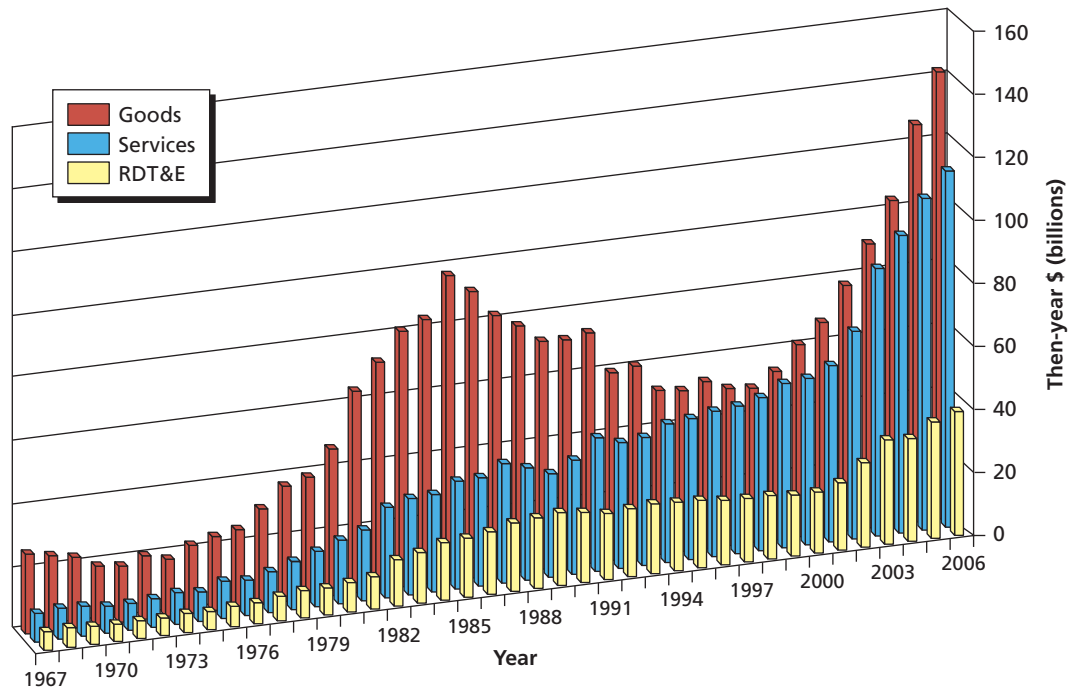
Figure 3 shows this same picture in constant 2007 dollars. Here again, the largest increases are in contractor services. Viewed this way, the largest increases have been for military personnel and contractors. The cost of DoD civilians has been relatively constant since the late 1960s, even though the increasingly white-collar nature of the workforce alone should have resulted in higher costs.

Figure 4 shows that, while the share of personnel costs of the DoD total budget have grown over time—from a low of 50 percent during the Reagan buildup (i.e., significant extraordinary capital expenses) to over 68 percent during the post-Cold War drawdown (i.e., reduced capital investment)—today it is about where it was in 1967, before the transition to an all-volunteer force. However, in contrast to 1967, the biggest difference is the growth in the cost of support contractors. The shares spent on civilian personnel and military personnel have dropped, but the proportion spent on support contractors has increased.

The Department of Defense estimates that in 1967 contractors made up 11 percent of the total force. In 2007 they made up 23 percent of the total force, even though the absolute number of the total force has held relatively constant. In 2007, contractors accounted for 35 percent of personnel costs, as compared with 24 percent in 1967. The proportion of costs for Reserves is the only other manpower segment that saw an increase over 1967, from 3 percent to 6 percent (Chu and Eanes, 2008, p. 13).

Over the last decade, government contracting for services has grown sharply, such that, in 2006, “procurement spending on services accounted for more than 60 percent of total

Figure 5
Overall Procurement Trends



SOURCE: Chu and Eanes, 2008.

NOTE: RDT&E = research, development, testing, and evaluation.

RAND OP240-5

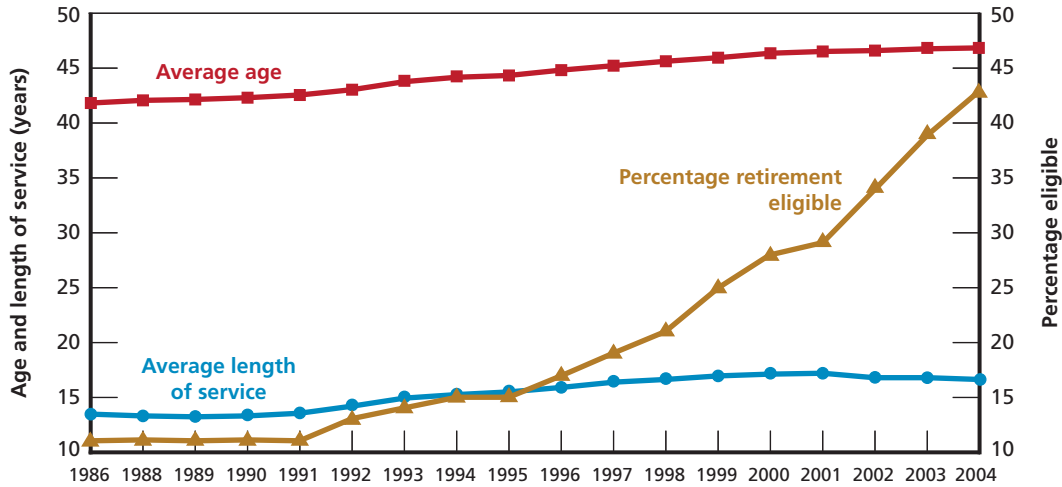
procurement dollars in the federal government. In FY 2005, DoD obligated more than \$141 billion on service contracts, a 72 percent increase since FY 1999” (Acquisition Advisory Panel, 2007, p. 3). The largest service contract category is “professional, administrative and support services.” In FY 2006, the Department of Defense spent over \$32 billion in this category alone (Chu and Eanes, 2008, p. 14).

The growth in the services category relative to other contracts over time is shown in Figure 5. This growth has been largely outside the A-76 process, using task order contracts that are extremely broad in their scope of work. According to the Acquisition Advisory Panel, use of task order contracts “fails to produce meaningful competition” (Acquisition Advisory Panel, 2007, p. 102).

Pending Retirements Will Deprive the Government of Needed Talent

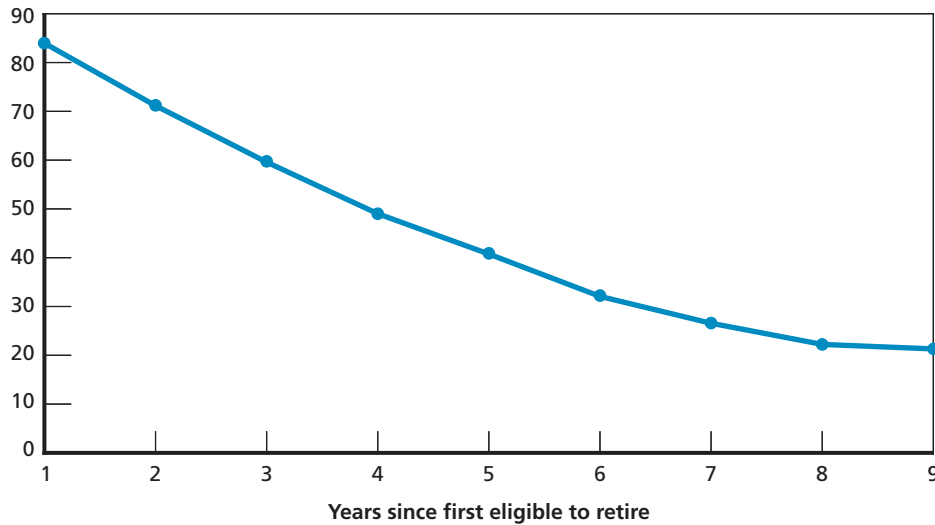
As the federal workforce was first reduced in size, and then just maintained with relatively small yearly losses barely replaced, another dynamic was taking place. What appeared to be stability covered an insidious creeping reality that the number of employees eligible to retire was sharply increasing, resulting in what the U.S. Merit Systems Protection Board has called “a ‘brain drain’ as the result of an aging workforce and high retirement eligibility rates” (McPhie, 2008a). Figure 6 shows how the existing workforce has grown older over time and the sharp increase in the number of civil servants who are eligible to retire. However, not everyone leaves when they are eligible to retire.

Figure 6
The Federal Workforce Is Getting Older, with Many Eligible to Retire



SOURCE: U.S. Office of Personnel Management, *The Fact Book: Federal Civilian Workforce Statistics*, 1998.
 RAND OP240-6

Figure 7
Percentage of DoD Employees Remaining Employed in Years Following Retirement Eligibility



SOURCE: U.S. Office of Personnel Management, Division of Strategic Human Resources Policy, 2008, p. 9.
 RAND OP240-7

Historically, although not all employees retire when they are first eligible to do so, 50 percent of them do retire within the next four years (U.S. Office of Personnel Management, Division of Strategic Human Resources Policy, 2008). Because the number of civilian employees reaching retirement eligibility has increased sharply in recent years, even the historic rates of retirement will mean that large numbers of experienced federal employees will be leaving.

While the government loses less than 20 percent of its retirement-eligible workforce per year, the cumulative effect reduces the number of experienced workers over time. Figure 7 shows that, nine years after reaching retirement eligibility, almost 80 percent of these workers have retired. While, for some agencies, having 45 percent of the workforce eligible to retire has not been an immediate problem because of historic retirement patterns, the sharp increase in the numbers who are eligible to retire will present new challenges for federal managers. Although in the short term the government can rehire retirees as “re-employed annuitants,” which can facilitate the transfer of knowledge to new employees, by the end of the decade an unprecedented number of experienced federal employees will be gone.

Contractors who aggressively recruit can reverse the historic retirement pattern if those who are eligible to retire decide to avail themselves of the very attractive financial opportunities to be both a retiree and a contract worker. For example, in the area of military intelligence, where there are many opportunities for former government personnel to join a contractor, we find lower retention rates, with relatively more intelligence retirees going to work for contractors than do their colleagues who do not have an intelligence background. To counter this, some have proposed that the government aggressively recruit older workers from the private sector and former military personnel to ensure that a broad range of experiences is available (McPhie, 2008b; Gates et al., 2008, pp. 48–49).

Lack of Appropriate Supervision Has Led to Abuses

Over time, as the size of the contract workforce has increased, government oversight has waned. For example, the GAO found numerous cases at the U.S. Department of Homeland Security (DHS) in which “components lacked the capacity to oversee contractor performance due to limited expertise and workload demands. These deficiencies may have resulted in a lack of control over and accountability for decisions” (GAO, 2007, p. 22). The Washington Post recently reported that “more than 900 cases alleging that government contractors and drug makers have defrauded taxpayers out of billions of dollars are languishing in a backlog that has built up over the past decade because the Justice Department cannot keep pace with the surge in charges brought by whistleblowers, according to lawyers involved in the disputes” (Johnson, 2008).

Needed Action

Remedial action has been the subject of a number of GAO reports and special congressional commissions. Their recommendations have tended to be conservative and do not address either the fundamental causes or the needed changes.¹¹ Arguments over the provisions of A-76

¹¹ See, for example, the recent statement by David Walker before the House Committee on Armed Services. Walker said,

I believe that we must engage in a fundamental reexamination of when and under what circumstances we should use contractors versus civil servants or military personnel. This is a major and growing concern that needs immediate attention. In general, I believe there is a need to focus greater attention on what type of functions and activities should be contracted out and which ones should not. Inherently governmental functions are required to be performed by government personnel, not private contractors. Government officials, in making decisions about whether to use contractors for services closely supporting inherently governmental functions, should assess risk and consider the need for enhanced management and oversight controls. Once the decision to contract has been made, we must address challenges we have observed in ensuring

are increasingly irrelevant, as most of the growth in service contracting has occurred outside of the A-76 process. While it has not been fashionable to argue that increasing the size of the in-house workforce is the only way to provide appropriate government oversight and to ensure that inherently governmental work is done by federal civilian employees, the recent action by the Congress did just that (Section 324 of the National Defense Authorization Act for Fiscal Year 2008 [P. L. 110-181]).

Recent Congressional Action

The Senate Appropriations Committee told the Department of Homeland Security to “establish an aggressive plan to convert contract functions to in-house functions where appropriate. The Department should also consider projected savings or costs of replacing contractor positions with full-time Government employees” (Senate Appropriations Committee, 2008, p. 14).

Section 324 of the National Defense Authorization Act for Fiscal Year 2008 provides “Guidelines on In-Sourcing New and Contracted Out Functions” that require the Defense Department to “devise and implement guidelines and procedures to ensure that consideration is given to using, on a regular basis, DoD civilian employees to perform new functions and functions that are performed by contractors and could be performed by Department of Defense civilian employees.” This provision challenges the 2003 rewrite of A-76 with its insertion of the word “substantial” before the words “inherently governmental.” It directs

special consideration . . . be given to using Department of Defense civilian employees to perform any function that—

(1) is performed by a contractor and—

(A) has been performed by Department of Defense civilian employees at any time during the previous 10 years; (B) is a function closely associated with the performance of an inherently governmental function; (C) has been performed pursuant to a contract awarded on a non-competitive basis; or (D) has been performed poorly, as determined by a contracting officer during the 5-year period preceding the date of such determination, because of excessive costs or inferior quality; or

(2) is a new requirement, with particular emphasis given to a new requirement that is similar to a function previously performed by Department of Defense civilian employees or is a function closely associated with the performance of an inherently governmental function. (U.S. Department of Defense Inspector General, 2008, pp. 1–2.)

Additional Action Is Required to Revitalize the Civil Service

If, as a result of Section 324, the government were to start to bring jobs that have been contracted out back in-house, a number of things must happen. The government must eliminate the politically set personnel ceilings, determine the proper mix and appropriate roles of contractors and government employees, and ensure that it can recruit, train, develop, and retain a

proper oversight of these arrangements—especially considering the evolving and enlarging role of contractors in federal acquisitions. (Walker, 2008, p. 29)

skilled and qualified workforce. *Let's be clear: The government will not be able to effectively control the use of contractors if it continues to impose arbitrary manpower ceilings at any level.*

There needs to be a clear understanding of what should and should not be contracted out. Much has been written about the provisions of A-76 in terms of “inherently governmental,” but more is needed. The historic prohibition of not contracting for personal services,¹² which has recently been interpreted in the most lenient way, needs to be tightened up and strictly adhered to. There needs to be a clear understanding that the government does not contract out jobs, but rather functions—functions that can be measured and for which the government can assess the quality of the work performed by a contractor. This fits into the realm of the classic A-76 competition, but does not fit well with support service contracts under which contractors supply workers to do the work traditionally done by government employees.

Even with the end to ceilings, bringing essential government work in-house and providing oversight for appropriately contracted-out work will not be easy. The U.S. Merit Systems Protection Board in a recent study suggested a number of ways to improve the hiring process by treating hiring as a critical business process and not just an administrative process (Crum, 2008). Actions include the following:

- Eliminate the use of personnel ceilings at any organizational level as a means to control cost. The contracting for support services must be on a cost-effectiveness basis, with due regard to the restrictions on both “inherently governmental” work and personal services contracting.
- Implement “Manage to Payroll”¹³ with appropriate incentive structures for managers to ensure adherence to human capital principles as outlined by the 2002 Commercial Activities Panel (Walker, 2002).
- Improve the attractiveness of government jobs for new entrants to the labor market.
- Adequately resource a streamlined and effective government hiring process.
- Sustain commitments and funding for the training and career development of civilian personnel analogous to that provided to military personnel.
- Train and hold federal managers responsible to manage and use the flexibilities provided by the various federal personnel systems.
- Develop a transition program to ensure the continuity of work during “in-sourcing.”
- Eliminate the blended workforce. Prohibit support contracts that simply put contractor personnel at desks previously occupied by government workers, or at new desks because of arbitrary personnel ceilings.
- Implement strategic sourcing (as opposed to competitive sourcing) that fully implements the provisions of A-76 that restrict outsourcing to functions that are not “inherently governmental.”

¹² According to Federal Acquisition Regulations (FAR), personal services contracts are characterized by the employer-employee relationship they create between the government and contracted personnel. Agencies of the federal government are not allowed to award personal services contracts unless specifically authorized by statute.

¹³ “Manage to Payroll” is a managerial approach developed by the Department of the Navy in 1986. It gives managers maximum flexibility in selecting the mix of people to employee, regardless of arbitrary ceilings or grade restrictions.

Recommendations

At this point in U.S. history, it is particularly important that the government address the use of contractors to accomplish the nation's business. Current practices are costing the taxpayers billions of dollars, as suggested by the comparisons of costs of government employees and contract workers, as well as the number of firms that the government is taking legal action against. There needs to be a clear understanding of when it is appropriate to contract functions (never individual jobs) and the oversight that the government must provide. The government should strictly adhere to the concept of "inherently governmental" and the prohibition on personal services contracting. Contract personnel must never be put in a position where there is any semblance of a conflict of interest. The interests of a contractor are ultimately private gain, and do not necessarily align with the interests of the government. To think otherwise is to invite problems.

As envisioned in Section 324, converting positions from contracting back to the government will not be easy and will run counter to the canard that measures the efficiency of government by the number of people it employs. The new administration should not try to fool the American people, perpetuating the myth of smaller government by not counting the hordes of service contractors it engages. Clearly, there are things that should be contracted and that the government need not and should not undertake, but the unfettered use of contractors has skyrocketed and must be brought under control.

Bibliography

Acquisition Advisory Panel, *Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the United States Congress*, Washington, D.C.: Office of Federal Procurement Policy, 2007.

Chu, David, and Jeffrey Eanes, *The Trajectory of Personnel Costs in the Department of Defense*, Washington, D.C.: Office of the Under Secretary of Defense for Personnel and Readiness, 2008.

Crum, John, "Taking Aim at Federal Hiring," *Issues of Merit*, July 2008.

Daniels, Mitchell E., Jr., "Circular A-76 Revised," Washington, D.C.: U.S. Office of Management and Budget, May 29, 2003. As of November 13, 2008:
http://www.whitehouse.gov/omb/circulars/a076/a76_rev2003.pdf

GAO—See U.S. Government Accountability Office.

Gates, Susan M., Edward G. Keating, Adria D. Jewell, Lindsay Daugherty, Bryan Tysinger, Albert A. Robbert, and Ralph Masi, *The Defense Acquisition Workforce: An Analysis of Personnel Trends Relevant to Policy, 1993–2006*, Santa Monica, Calif.: RAND Corporation, TR-507-OSD, 2008. As of November 13, 2008:
http://www.rand.org/pubs/technical_reports/TR572/

Hedgpeth, Dana, "Pentagon Auditors Pressured to Favor Contractors, GAO Says," *Washington Post*, July 24, 2008.

House Select Committee on Intelligence, "Intelligence Authorization Act for Fiscal Year 2008," Washington, D.C.: U.S. House of Representatives, 2007.

Johnson, Carrie, "A Backlog of Cases Alleging Fraud: Whistle-Blower Suits Languish at Justice," *Washington Post*, July 2, 2008.

Krugman, Paul, *Peddling Prosperity*, New York: W.W. Norton & Company, Inc., 1994.

McPhie, Neil A. G., *Attracting the Next Generation: A Look at Federal Entry-Level New Hires*, Washington, D.C.: U.S. Merit Systems Protection Board, 2008a.

———, *In Search of Highly Skilled Workers: A Study on the Hiring of Upper Level Employees from Outside the Federal Government*, Washington, D.C.: U.S. Merit Systems Protection Board, 2008b.

Negroponete, John D., *Five Year Strategic Human Capital Plan*, Washington, D.C.: Office of the Director of National Intelligence, 2006.

O'Harrow, Robert, Jr., "Potential for Conflict Grows with Government's Use of Contractors," *Washington Post*, August 18, 2008.

Office of Management and Budget, "The President's Management Agenda," Washington, D.C.: Executive Office of the President, 2002.

Peach, J. Dexter, *Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services*, Washington, D.C.: U.S. General Accounting Office, GAO/RCED-91-186, 1991.

Public Law 110-181, National Defense Authorization Act for Fiscal Year 2008, January 28, 2008.

Reagan, Ronald, "First Inaugural Address," Washington, D.C., January 20, 1981.

Sanders, Ronald, "ODNI Transcript: Conference Call on the Results of the Fiscal Year 2007 U.S. Intelligence Community Inventory of Core Contractor Personnel," Washington, D.C.: Office of the Director of National Intelligence, 2008.

Senate Appropriations Committee, "Department of Homeland Security Appropriations Bill, 2009," Washington, D.C.: United States Senate, 2008.

Simon, Jacqueline, "Statement by Jacqueline Simon, Public Policy Director American Federation of Government Employees, AFL-CIO, Before the Acquisition Advisory Panel/Section 1423 Panel," Washington, D.C., December 19, 2005.

Thompson, James R., and Sharon H. Mastracci, "The Blended Workforce: Maximizing Agility Through Nonstandard Work Arrangements," in *Human Capital Management*, Washington, D.C.: IBM Center for the Business of Government, 2005.

U.S. Army IMCOM Installation Management Command, *Brief History and Overview of Competitive Sourcing and the Circular A-76*, Washington, D.C.: U.S. Army, 2008.

U.S. Department of Defense Inspector General, *DoD IG Report to Congress on Section 324 of the National Defense Authorization Act for Fiscal Year 2008: Review of DoD Guidelines on Considering Civilians for New and Contracted Functions*, Washington, D.C.: U.S. Department of Defense, 2008.

U.S. General Services Administration, "Mission Oriented Business Integrated Services (MOBIS)," Web page, 2008. As of November 13, 2008:
http://www.gsa.gov/Portal/gsa/ep/contentView.do?contentId=9944&contentType=GSA_OVERVIEW

U.S. Government Accountability Office, "Department of Homeland Security: Improved Assessment and Oversight Needed to Manage Risk of Contracting for Selected Services," in *Report to Congressional Requesters*, Washington, D.C.: U.S. Government Accountability Office, 2007.

U.S. Office of Personnel Management, *The Fact Book: Federal Civilian Workforce Statistics*, 1986–2004 editions, Washington, D.C.: United States Office of Personnel Management, 1987–2005.

U.S. Office of Personnel Management, Division of Strategic Human Resources Policy, *An Analysis of Federal Employee Retirement Data: Predicting Future Retirements and Examining Factors Relevant to Retiring from the Federal Service*, Washington, D.C., 2008.

Walker, David M., "Commercial Activities Panel: Improving the Sourcing Decisions of the Federal Government," in Testimony Before the Subcommittee on Military Readiness, Committee on Armed Services, House of Representatives, Washington, D.C.: U.S. Government Accountability Office, 2002.

———, *Defense Management: DOD Needs to Reexamine Its Extensive Reliance on Contactors and Continue to Improve Management and Oversight*, Washington, D.C.: U.S. Government Accountability Office, Report 08-572T, 2008.