

**STRATEGY
RESEARCH
PROJECT**

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PRIVATIZATION: ITS BENEFITS

BY

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USAWC STRATEGY RESEARCH PROJECT

Privatization: Its Benefits

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ABSTRACT

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The fall of the Berlin Wall, signaling the end of the Cold War is probably one of the most significant events in our lifetime. In the military, it has changed the way we maintain our force. No longer a race to be the world's superpower, we then cut our military budgets while maintaining high standards in the performance of our duties. From 1985-1997 the military budget was reduced by 38 percent, our force structure reduced by 33 percent, and our procurement programs reduced by 63 percent. In an effort to save money, the government, including the Department of Defense, has significantly downsized its workforce, eliminated many government jobs, and subsequently increased the number of contracts to civilian providers. This study discusses the positive impacts of various forms of privatization, outsourcing, and contracting-out. This study describes the essential differences among these options. No matter how we choose to privatize, the government is no longer providing either the goods or the services. This study assesses some of the benefits the government is realizing from these new ways of doing business. Privatization or outsourcing has changed the way we do business in the Army. These post-Cold War initiatives are all about value, competition, commitment, and focusing on what makes ours the greatest Army in the world.

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PRIVATIZATON: ITS BENEFITS

FOCUS OF STUDY:

The fall of the Berlin Wall, signaling the end of the Cold War, is probably one of the most significant events in our lifetime. In the military, it has changed the way we maintain our force. No longer in the race to be the world's superpower, we reduced military budgets by 38 percent, drew down the force structure by 33 percent, and reduced procurement programs by 63 percent.¹ In an effort to save money, the government, including the Department of Defense, has significantly downsized its workforce, eliminated many government jobs, and increased the number of contracts to civilian providers. Privatization or outsourcing has changed the way the Army does business. These changes and their consequences have created widespread disagreement about the costs and benefits of privatization.

This study examines the impacts on the military of various forms of privatization, outsourcing, and contracting of functions that were formerly performed by the military. This study seeks to answer the bottom-line question: What have been the benefits to the military from privatization?

The study briefly reviews the history of contracting/privatization. It defines key privatization concepts and analyzes how the Defense Strategy affects privatization decisions as part of the Army's current transformation efforts. It also reviews key reform initiatives that have prompted the government to expand and accelerate privatization over the past decade. The study concludes with an overview of benefits to the Army from recent privatization efforts and will conclude with recommendations for increasing these benefits.

HISTORY:

Employing civilians to support our Armed Forces is an age-old tradition, pre-dating the establishment of the United States Army. In 1775, we began employing civilians to assist the Revolutionary Army during war and peace. History is rich with examples of contractor-supported battles and lessons learned from their failures and successes. Contractors have provided a variety of support throughout the past two-plus centuries: food, clothing, shelter, ground and water transport, labor, fuel, weapons, equipment, petroleum, labor, construction, base support, maintenance, technical support, and general housekeeping. The failures of contractors have sometimes brought armies near to their knees. But on other occasions, such as during WWII, contractors made an outstanding contribution to support our armies in the field. We have been supported by contractors in every war from the Revolutionary War to the Gulf

War, and during numerous "operations other than war." Our traditional heavy reliance on our civilian counterparts is unlikely to change.²

A recent report accompanying the National Defense Authorization Act, shared with Congress, revealed an interesting fact: The number of contract workers outnumber the civilian ranks in the Department of Defense. This effort to privatize the workforce and reduce big government continues.³

KEY DEFINITIONS:

It is important to understand the key terms that pertain to this effort. The definitions listed below come directly from the General Accounting Office in a source document entitled Terms Related to Privatization Activities and Processes.⁴ These various contracting terms can be confusing, so this study employs the terms contracting out, outsourcing, and privatization interchangeably. This study does not attempt to delineate the fine details of defense contracting. Rather it seeks to discuss privatization broadly. Nonetheless, the following GAO definitions serve to illustrate the complexity of privatization initiatives:

COMMERCIAL ACTIVITIES: The term commercial activity is used in the governmental context to identify those activities that the government performs with its employees or resources but could obtain from private-sector sources. Commercial activities thus contrast with "inherently governmental" activities.

CONTRACTING OUT: Contracting out refers to hiring private-sector firms or nonprofit organizations to provide goods or services for the government. Under this approach, the government remains the financier and has management and policy control over the type and quality of goods or services to be provided. This enables the government to replace contractors that do not perform well.

INHERENTLY GOVERNMENTAL ACTIVITIES: An inherently governmental activity is one that is so intimately related to the public interest that federal employees must perform it. These functions include those activities that require either the exercise of discretion in applying governmental authority or the making of value judgments in making decisions for the government. Governmental functions normally fall into two categories: (1) the act of governing, i.e., the discretionary exercise of government authority, and (2) monetary transactions and entitlements.

MOST EFFICIENT ORGANIZATIONS (MEO): In certain circumstances set forth in OMB Circular A-76, agencies that are considering contracting out an activity must first conduct a cost benefit exercise to identify the MEO. The MEO designates the government's in-house

organization that would most efficiently perform a commercial activity after a managed competition under A-76. It may include a mix of federal employees and contract support. It is used as the basis for measuring all government costs (direct and indirect) and performance against competitive contractor or interservice support agreement (ISSA) offers. To determine the MEO, the in-house activity may reinvent, reorganize and restructure itself, including making capital investments in order to arrive at the agency's most efficient method of performing the commercial activity.

OMB CIRCULAR A-76: OMB Circular A-76 sets forth federal policy for determining whether federal employees or private contractors will perform commercial activities associated with conducting the government's business. Recent revisions to the A-76 Supplemental Handbook were designed to enhance federal performance through competition and choice, seek the most cost-effective means of obtaining commercial products and support services, and provide new administrative flexibility in agency decisions to convert to or from in-house, contract, or ISSA performance.

OUTSOURCING: Using outsourcing, a government entity remains fully responsible for the provision of affected services and maintains control over management decisions, while a contracted entity operates the function or performs the service. This approach includes contracting out, the granting of franchises to private firms, and the use of volunteers to deliver public services.

PRIVATIZATION: The term privatization has generally been defined as any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector.

PUBLIC-PRIVATE PARTNERSHIP: Under a public-private partnership, sometimes referred to as a joint venture, a contractual arrangement is formed between public- and private-sector partners that can include a variety of activities that involve the private sector in the development, financing, ownership, and operation of a public facility or service. It typically includes infrastructure projects and/or facilities. In such a partnership, public and private resources are pooled and responsibilities divided so that the partners' efforts complement one another. Typically, each partner shares in income resulting from the partnership in direct proportion to the partner's investment. Such a venture, while a contractual arrangement, differs from typical service contracting in that the private-sector partner usually makes substantial cash, at-risk, equity investment in the project, and the public sector gains access to new revenue or service delivery capacity without having to pay the private-sector partner. Leasing arrangements can be used to facilitate public-private partnerships.

SERVICE SHEDDING: Divestiture through service shedding occurs when the government reduces the level of service provided or stops providing a service altogether. Private-sector businesses or nonprofit organizations may then step in to provide the service if the market demand persists.

TRANSFORMATION:

Transformation of our war fighting forces requires us to make changes to the way we organize and employ our joint military forces. It is designed to eventually allow us to attain new levels of effectiveness across a wide range of conflict scenarios. The extent and pace of this transformation depends on the availability of resources to invest in research, development, testing and procurement. According to former Secretary of Defense William S. Cohen, "Reducing overhead and support structures by bringing the Revolution in Business Affairs to DOD will be critical to achieving the Revolution in Military Affairs."⁵ This Revolution in Military Affairs is essential to transformation. In many ways, we have been transforming for the past decade, first as a result of budget cuts and reduced force structure and then as a result of the 1997 Quadrennial Defense Review. Our force structure has been reduced to the lowest numbers of government civilians and armed forces members since World War II, leaving us with problems in recruiting and retention, along with an aging government workforce which is behind in hiring practices by a decade or two. We have also engaged in a record number of deployments involving humanitarian and peacekeeping efforts in the past years with end in sight. We must restructure to support our smaller size, to become more agile, lethal, mobile, force. We will have a higher level of technical support required to support the Army of the future. We must become more efficient in our core capabilities and shed the responsibilities that someone else can do for us, more efficiently and at a lower cost. Over the years, our infrastructure has grown dramatically. It is now time to divest us of those jobs or missions that are not inherently governmental, jobs that someone else can do for us. This is one of the reasons why privatization has increased so much in the past few years. These efforts will save money that can be used to fund the current transformation.

KEY REFORM INITIATIVES:

These key reform initiatives have fostered privatization of our armed forces. The first comes from the Office of Manpower and Budget Circular A-76, the second from the Defense Reform Initiative, and the third from the Federal Activities Inventory Reform Act. The last two were initiated in 1997 and 1998 respectively, outcomes of the QDR. All have led to key reform initiatives toward privatization within DoD.

OFFICE OF MANPOWER AND BUDGET (OMB) CIRCULAR A-76:

Federal policy states that the government shall not compete with its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is our primary source of national economic strength. In recognition of this principle, it has been the general policy of the government to rely on commercial sources to supply the products and services that the government needs. This national policy was established by the Bureau of the Budget in bulletins issued in 1955, 1957 and 1960.⁶

"In 1966, OMB issued Circular A-76, which established federal policy for the government's performance of commercial activities. Later, in 1979, OMB issued a supplemental handbook to the circular that included the procedures for competitively determining whether commercial activities should be performed in-house, by another federal agency through an inter-service support agreement, or by the private sector. OMB updated this handbook in 1983 and again in March 1996. The latest revision was intended to reduce the administrative burden of performing A-76 studies and to make cost comparisons between private sector proposals and government estimates more equitable. "⁷ To ensure fair competition, the Office of Management and Budget developed a formal process for this procedure. OMB Circular A-76 and its supplement provide the details for conducting cost comparisons or manpower efficiency studies, to determine whether commercial activities will be performed in-house or by the private sector. In conducting an A-76 cost study, an agency develops a performance work statement to identify the work to be done, prepares a government in-house cost estimate based on the "most efficient organization" (MEO) that can accomplish the work, and compares this estimate with the lowest cost or best value offer selected from the private sector. The most efficient organization generally refers to a more streamlined, smaller version of the government organization than is currently doing the work. The government activity can be converted to the private sector if the successful private sector offer is either lower by 10 percent of direct personnel costs of the most efficient organization or is \$10 million less over the length of the specified performance period than the in-house estimate. "⁸ OMB mandated that DoD evaluate the entire military and civilian workforce to identify which functions are commercial in nature and which could be opened up for competition under the A-76 process. "⁹

OMB A-76 competitions provide an important means for achieving efficiencies and cost savings. DoD data on cost comparisons completed between fiscal year 1978 and 1994 shows that these evaluations produced substantial savings--usually through a reduction in personnel--regardless of whether the government or a private company was awarded the work.¹⁰

These savings were achieved primarily by closely examining the work to be done and reengineering the activities required to do them with fewer personnel. This type of analysis has shown the potential for significant cost savings in activities where military manpower is not mission essential, and where civilian personnel can be substituted for military personnel in performing commercial-type functions. DoD's data showed the government won about half of the A-76 competitions, while private industry won the other half.¹¹

Despite the benefits of competition, the A-76 process has historically generated controversy. Government officials have been concerned about the cost and length of time required to complete the procurement process associated with A-76 studies, and employees have been concerned about the potential loss of jobs. On the other hand, private sector representatives believed that the A-76 process favors the government. They have contended that the government does not include all costs of operations in its A-76 competitions. In particular, they contend that the government excluded proportional shares of indirect and administrative costs such as facility maintenance and upkeep, payroll, and personnel services.¹²

As a result, OMB revised its A-76 supplemental handbook in 1996 to improve the administration of the A-76 process and the way government cost estimates is developed. Several standard cost factors were either changed or established. One of the areas, which the private sector felt was unfair, was the perception that the government did not incorporate any overhead costs into their estimates. The A-76 supplement required the government to calculate overhead based on a standard rate of 12 percent of direct labor costs. Because military personnel have higher benefits and support costs than their civilian equivalents, the revised handbook also directed DoD to develop a separate overhead rate for military personnel to be included in any work proposals. It also placed increased emphasis on consideration of the best overall value of each offer to the government, during the review of private sector offers.¹³

"Despite the requirement to develop a separate rate for military personnel included in government in-house estimates, DoD officials that manage commercial activity programs have no plans to develop such a rate. They explained that, by definition, commercial activities under the A-76 program should not include any military-essential functions. Therefore, when they prepare an in-house estimate under the A-76 program, they assume that all military personnel currently working in the activity will be reassigned and the activity will be staffed with civilians."¹⁴ Therefore, they do not include overhead costs for military personnel.

DEFENSE REFORM INITIATIVE:

Defense Reform Initiative (DRI) represents another major effort to modernize the Department's business processes and reduce its infrastructure costs. When the Secretary of Defense announced the program in November 1997, he said that his goal was to ignite a revolution in business affairs, similar to the revolution that had taken place in the private sector over the past several years. He also pointed out that the Department's fighting forces had become more agile and responsive, but that its business and support functions were mired in old inefficient processes and systems, many of which were based on 1950s and 1960s technology. By adopting the best business practices of the private sector, reducing and reorganizing headquarters elements, expanding the use of public- private competitions and eliminating unneeded infrastructure, the Secretary anticipated that the Department could save significant amounts of money, which would then be used to fund readiness and modernization priorities. For the most part, the reform initiatives that were first included in the DRI were not new. A few were outgrowths of the Packard Commission and Corporate Information Management programs and had been ongoing for several years. Nor did they represent all of the Department's ongoing reform initiatives. In explaining why some ongoing initiatives were included and others were not, a representative of the Defense Reform Task Force, which was responsible for developing the DRI Report, said the Task Force scrupulously selected initiatives where commercial practices might be successfully applied across a range of DoD organizations, functions, and activities.

"The Defense Reform Initiative (DRI) addressed the third element of the DoD vision: igniting a revolution in military business affairs within DoD that will bring to the Department management techniques and business practices that have restored American corporations to leadership in the marketplace."¹⁵ The goal was to bring competition and the best commercial practices into the business of government, especially defense activities. To implement defense strategy and to facilitate the transformation of our forces, the DRI stressed the importance of bringing competition and the best commercial practices into business of government.

To hasten the revolution in Military Affairs, by bringing the best commercial practices into the government, the Defense Reform Initiative applied the insights of numerous successful business leaders who had successfully downsized or restructured their corporations, which were then re-energized. The collective experience of these corporate executives guided DoD in shaping the DRI. DoD then took over initiatives to start the momentum of changing our business practices.¹⁶

- Reengineer: Adopt modern business practices to achieve world-class standards of performance.
- Consolidate: Streamline organizations to remove redundancy and maximize synergy.
- Compete: Apply market mechanisms to improve quality, reduce costs, and respond to customer needs.
- Eliminate: Reduce excess support structures to free resources and focus on core competencies.

The third initiative to reform our business practices required us to **compete**. Competition improves quality, reduces costs, and focuses on customer's needs. Both our bases and forces require support in many service-oriented areas; buildings and equipment must be maintained and administrative actions such as accounting must be accomplished. Currently, uniformed service members, civilian government employees, and private contractor support are performing these services. With the downsizing of military forces, we must look at ways to reduce overhead. By determining whether the job is inherently governmental, we can make some choices about how to streamline our support through healthy competition. Historically we have realized at least a 20 percent savings on the contract cost when we invite competition between the public sector and the private sector. Competition focuses both sectors to find ways to improve services and lower costs. This places government employees in competition with private sector companies.¹⁷

On 10 November 1997 Vice President Gore and Secretary of Defense, Cohen announced the Defense Reform Initiative which will aggressively business practices that would make the Department leaner, flexible and competitive. Gore endorsed the effort as part of the National Performance Review, one of his initiatives to downsize government.¹⁸ This represented an era of more DoD downsizing and contracting out. These cuts and reforms were spelled out in "Defense Reform Initiative: The Business Strategy for Defense in the 21st Century." Four familiar themes ran through this particular document based on astute civilian business leaders findings while engineering the DRI project: Downsizing, Base Closures, Contracting Out, and Reengineering, which supported the original initiatives of Consolidate, Eliminate, Compete and Reengineer.¹⁹ The DRID thus provided the impetus for the implementation of the OMB A-76 study that had been in place for over three decades. The Vice President and Secretary of Defense were telling us to implement and do it immediately. Before we knew it, we began to see shrinking budgets that forced us to act and then react.

In response to the Quadrennial Defense Review in 1997, DoD initiated competitions involving more than 34,000 positions in Fiscal Year 1997 and planned on pursuing competitions for 30,000 positions each year through 2002. This annual effort represents more than a tenfold increase over Fiscal Year 1996 and a threefold increase over any year in the previous two decades. DoD will further build on this experience by evaluating its entire military and civilian workforce by 1999 to identify functions to be competed. In particular, candidates for competition include the following functions; civilian and retiree payments, personnel services, surplus property disposal, national stockpile sales, leased property management and drug testing laboratories. DoD also plans to take advantage of its new authority to contract-out an additional \$1 billion in depot maintenance.²⁰

FEDERAL ACTIVITIES INVENTORY REFORM ACT:

Almost a year later, Congress enacted the Federal Activities Inventory Reform Act (FAIR) of 1998, Public Law 105-270, in October 1998. This replaced the Defense Reform Initiative Directive 20 (DRID20) that required an inventory of every DoD position to be classified as: "inherently governmental," as a commercial activity but exempt from competition, or a commercial activity that was eligible for competition. This law directed the head of each executive agency to submit an annual report of activities performed by federal government employees that are not inherently governmental functions. This list is called the "Commercial Activities Inventory." The Office of Manpower and Budget receives the FAIR inventories and then transmits it to Congress for future release to the public. The jobs that have been classified as not inherently governmental are subject to the OMB A-76 study²¹

The Secretary of Defense establishes criteria for determining when Government performance of a commercial activity is required for National Defense reasons. Only the Secretary of Defense or his designee has the authority to exempt commercial activities for National Defense reasons.²² Below are examples of the types of commercial activities that the government has shed. These services are considered commercial because they are performed generally by installation support. For example, health care in military hospitals is a commercial activity, but health care on the battlefield or at sea does not qualify as a commercial activity:

- Audiovisual Products and Services
- Automatic Data Processing
- Food Service
- Health Services
- Industrial Shops and Services

- Maintenance, Overhaul, Repair and Testing
- Management Support Services
- Manufacturing, Fabrication, Processing, Testing and Packaging
- Office and Administrative Services
- Other Services
- Printing and Reproduction
- Real Property
- Security
- Special Studies and Analyses
- Systems Engineering, Installation, Operations, Maintenance and Testing
- Transportation

DEFENSE STRATEGY, THE QUADRENNIAL DEFENSE REVIEW:

In May 1997, DoD completed a comprehensive review of defense posture, policy, and programs. "The Quadrennial Defense Review (QDR) examined the national security threats, risks, and opportunities facing the United States today, and projected out to 2015. Based on this analysis, DOD designed a defense strategy to implement the defense requirements of the President's National Security Strategy for a new century."²³ The QDR fostered privatization because it was the impetus for much of the change we see today in how we do business. The three central elements of current the defense strategy is: shape, respond and prepare.

Shape the international security environment in ways favorable to US interests by promoting regional stability, reducing threats, preventing conflicts, and deterring aggression and coercion on a day-to-day basis.

Respond to the full spectrum of crises that threaten US interests by deterring aggression and coercion in a crisis, conducting small-scale contingency operations, and fighting and winning major theater wars.

Prepare now for an uncertain future through a focused modernization effort, development of new operational concepts and organizations to fully exploit new technologies, and efforts to hedge against threats that are unlikely but which would have disproportionate security implications such as the emergence of a regional great power before 2015.

Executing this strategy requires a defense posture that balances the demands of meeting the present requirements around the world with the necessity to invest in our future. It requires us to transform our Army.²⁴

WHAT ARE THE BENEFITS OF PRIVATIZATION?

Although there are many positive and negative results of privatization, most analysts dwell on the negatives. This study summarizes what we have gained through privatization in terms of value, competition and commitment, and mission focus. GAO reports that a number of barriers have kept DoD from meeting its specific time frames and goals, the most notable of which is the difficulty in overcoming institutional resistance to change in an organization as large and complex as DoD, particularly in such areas as acquisition, financial management, and logistics. These areas arch over most of the Department's functional organizations and have aroused long-standing managerial concerns.²⁵

VALUE

Some of the many ways which we have gained value through privatization is with provision of better customer service, reduced costs, and better technical expertise. In the area of customer service, we have seen improvements in the way services are performed. Civilian businesses rely on good customer service for repeat business. In government work, there is little incentive for outstanding customer service. Over the years, the infrastructure grew too large and jobs were too secure, so many government workers did not fear learning from the workforce. There were few incentives for creative thinking or saving money; consequently many grew stagnant and lackadaisical. It is often said that if you have a bad experience, you will tell ten people about it; but if you have a good experience, you will only tell one person about it. This is why it is so important to have good customer service. When a company bids on a contract, they are normally ready and capable to perform the task for which the bid was placed. They have analyzed the scope of work in the Most Efficient Organization (MEO) document, analyzed how much it will cost to accomplish the work, and how much commission they want to make on performing the task. It is in the companies' best interest to meet the standards of the contract so that they can get repeat business with the government, just as they get repeat business in civilian life. Contracting out or privatizing prompts better responsiveness, reduces stagnation and allows for new ideas, creative thought, and for workers to be their best.

Reducing costs creates value. Savings may be captured by reducing expensive employee benefits, high overhead costs, research and development investments, and by getting better service for our money. In the long run, these cost savings will be passed on to American

taxpayers. "Over the past decade, force structure has declined by a third and military procurement funding has (after inflation) by two-thirds. Meanwhile, the cost of operations and maintenance—with includes most support functions—has fallen by 20%. As a result, operations and maintenance now is the biggest category of defense spending, far exceeding the combined cost of military construction, research, development and procurement. This disparity cannot continue without eventually undermining U. S. Military preparedness." For this reason, many senior civilian and military leaders of the defense department see outsourcing as the key to reduce the cost of military support functions. If support functions consume between \$120-160 billion of the Defense budget annually, and if we feel we can save 20% by outsourcing, then the annual savings would total between \$12-16 billion. Since some support functions cannot be outsourced, a more conservative estimate of potential savings from outsourcing is between 7-12 billion a year. "One reason why there is not more wholesale logistics is federal law that requires the military to preserve an organic "core" of support capabilities. Core in this context does not mean unique competency, but simply relevance to the war fight requirement." ²⁶

A-76 Competitions Available data indicated that DOD realized savings as a result of A-76 cost studies in at least seven of the nine cases, whether the in-house or private sector organization prevailed in the cost studies.²⁷ A recent Rand Study entitled "Personnel Savings in Competitively Sourced DoD Activities" noted that the annual personnel cost savings ranged from 34-59 percent of baseline costs. The cost for private contractors and government MEOs did not escalate above the expected levels unless the mission increased. Personnel cost savings were achieved primarily as a result of using fewer people and downgrading positions. Most of the personnel cost savings techniques were used by both contractors and in-house managers.²⁸

While the A-76 process has led to some gains, we are experiencing a delay in completing the studies. During the period from 1997 through 1999, 99,211 positions were planned for competition and only 11,768 were completed. The delay in completing these studies will have a negative affect on the overall savings. Instead of the expected savings of \$48 million for fiscal year 1999, the Army achieved an overall gross savings of \$22 million. However, this does not include transition costs, which amounted to \$31 million. This creates a shortfall of about \$9 million. Still, officials predicted that the A-76 program would generate significant savings for DoD. They expect to see net savings during fiscal years 2000 and 2001. They suggested that we look at the transition costs as an initial investment, which means overall net savings will increase over time. The table below depicts the A-76 positions planned, announced and

completed from 1997-1999, by service component. Most A-76 studies take an average of two years to complete.²⁹

	PLAN	ANN	COM	PLAN	ANN	COM	PLAN	ANN	COM
	1997	1997	1997	1998	1998	1998	1999	1999	1999
Army	14176	13739	32	11909	11909	235	11630	11334	987
Navy	7478	10663	94	5783	8980	200	11646	10807	1858
Air Force	3786	3906	1503	9203	8638	3675	9083	8732	2212
Marine Corps	0	0	0	0	0	0	2583	3722	0
Defense agencies	1938	365	357	3421	2152	299	6876	2264	316
Total A-76	27378	28673	1986	30316	31679	4409	41818	36859	5373

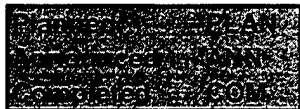


TABLE 1 PLANNED, ANNOUNCED AND COMPLETED A-76 STUDIES BY SERVICE

The DoD reported significant savings resulting from the A-76 Competitions based on a single point in time. The Department estimated that the 286 A-76 studies generated savings of \$290 million in fiscal year 1999. GAO studies show that "savings are being realized, however limitations in baseline cost data from which to calculate savings, study costs, and other factors make it difficult to estimate savings as precisely as suggested by the Department report."³⁰

A RAND research brief reveals some interesting information. It found that competitive sourcing generated personnel cost savings. As Table 2 shows, winners of competitive sourcing projected in every instance that they could operate with lower personnel costs. "For every personnel dollar DoD spent to obtain a given level of service before competitive sourcing, winning bidders promised to provide the same level of service for only 41 cents to 66 cents."³¹ Table 2 depicts the various types of missions, ranging from missile and aircraft maintenance, to telecommunications, maintenance, and operations, to base operating support.³²

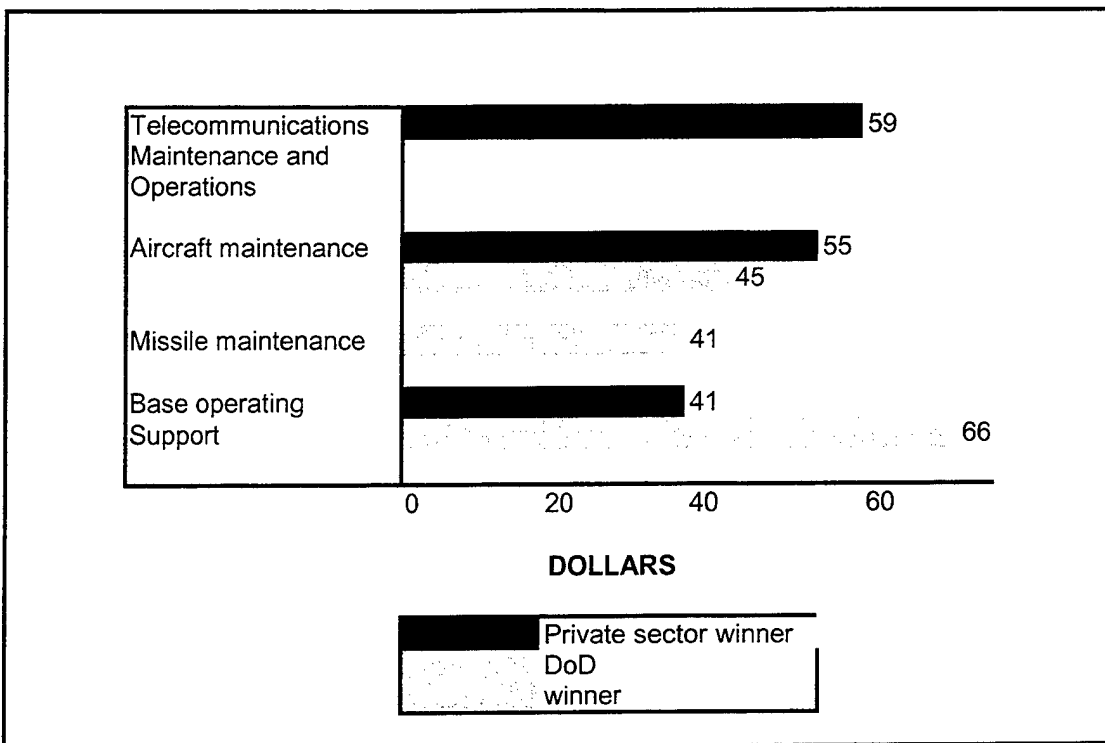


TABLE 2, WINNERS OF COMPETITIVE SOURCING

Cost savings came from reducing personnel.

Winning bidders were able to implement the personnel cost savings that they had projected during the competitive sourcing process. To achieve these savings, every private sector and DoD winner of competitive sourcing reduced its workforce, sometimes significantly. Winners of A-76 efforts were able to provide a specified level of services after competitive sourcing with workforces that were some 25 percent to 60 percent smaller. Many of these workforce reductions came from replacing uniformed military personnel with civilian workers. This substitution allowed A-76 winners to flatten their organizations, operate with fewer managers, and create more efficient operations by relying on fulltime workers rather than on personnel who at any moment could be called away to other military assignments. Workers at five of the six A-76 winners who held the same positions after competitive sourcing saw no reductions in their paychecks or benefits. However, most—but not all—of the competitive sourcing winners took a step that had a similar effect: they downgraded positions. Changing the classification structure of their workforces allowed them to reduce the average grade level of workers and pay lower wages. Personnel cost savings generated by competitive sourcing appear to be real and long lasting. At the time RAND analyzed the competitive sourcing winners, their cost savings measures had been in place one to ten years. Each achieved the personnel cost reductions that had been touted during the A-76 competitive bidding process. And each has been able to maintain those savings, with only minor fluctuations, in the years since.³³

The third way that privatization has created value and therefore benefited the government in the area of technical expertise in the area of information technology. Government regulations

have created cumbersome hiring regulations, antiquated pay schedules, and disincentives for acquisition of people with specialized high paid skills. Consequently, it has been difficult to hire and maintain skilled technicians in the information technology area. With the boom of the dot.com companies and the solid economy over the past few years, it has been very difficult to hire government workers in this field. When we did, these people were not always the most proficient on the latest technology, for the government did not have the latest technology. The high-speed computer operator was being hired in civilian industry for considerably more money, with more incentives. In this field, many people jump from job to job because there is always a demand. Thus, there is always someone who is willing to pay more for such expertise.³⁴ But, the government is not one of these people. Instead the government has spent an inordinate amount of money on computer systems such as RCAS, which took many years to develop and field. By the time it was fielded, the technology was obsolete because the computer craze was in full swing, with computers getting faster and smaller by the year. By outsourcing and purchasing the latest technology of off-the-shelf equipment and hiring those with current technical expertise, the Army has created value.

Through better customer service, cutting costs and better technical expertise and better information technology, the Army has benefited from better value through privatization. It is in our best interest to identify ways to continue this progress in terms of value.

COMPETITION AND COMMITMENT

Through competition and commitment in various forms, we can see many positive aspects of privatization. We can improve the quality of our work through the use of best business practices and standards. We can increase our efficiency through competition and commitment. Competition will create opportunities for the aging government infrastructure and for private industry.

The Commission on Roles and Missions of the Armed Forces reviewed critical changes that must take place in the Department of Defense. It gave recommendations on how to provide efficient and responsive support. It suggested that DOD could benefit from adopting more of the innovative business practices used in the private sector. It also suggested that the Department could benefit from these practices by relying more on the private sector for goods and services. These suggestions were in line with former Vice President Gore's National Policy Review *competition initiative*, but focused more on improving *responsiveness and innovation*. The Commission identified two major opportunities to take advantage of. One is to rely on the private sector for services that do not need to be performed by the government; the second was

to reengineer the remaining government support organizations.³⁵ We have responded to these initiatives through competition and reengineering the remaining government structure.

However, currently there are strong structural incentives in place that deter managers from making such changes if they are not involved in an A-76 competition. Competition or the threat of losing everything in the competitive process induces managers to make efficiency-enhancing changes that they might otherwise resist. RAND concludes that comprehensive reforms are needed to reduce the negative incentives and improve the positive incentives in order to encourage DoD managers to reduce personnel costs voluntarily.³⁶

The fact is that competition and commitment make everyone better at what they do. Whether it is playing basketball, fighting wars, or employing the best business practices, we all see our shortcomings measured against the success of others. From a loss on the basketball court, we realize we need to practice shooting outside shots or work on our defense more. From a loss on the battlefield, we realize we must get better air defense systems, or provide more timely logistics support. Where we fail, we should endeavor to build our strengths for the future. Commitment is simply our resolve to make needed changes in a particular area. Likewise, competition with the private sector also makes the government more effective. It does this by making the government review the parameters of the job when developing the MEO and determining exactly how many people are required to do the job. This may call for reducing people within the organization or for streamlining the processes by which we perform the job itself. Where a job may have evolved to using 10 workers before, with efficient planning, a manager might determine that the job can be done with only six workers. This will cause the budget to drop and a reduction in the number of workers within the section. But the government will still retain the function if its bid provides the best value and beats the bid of the private competitors. So no matter who wins the bid, the government has saved money through competition. This is but one example of how cost savings creates value in the privatization process.

Commitment is something that we all value in employees. Downsizing has given us a new view of life in the government workforce, since the government does not always offer the same job security that it once did. This often has a psychological impact of the employees in the government. They may see themselves as expendable, rather than committed to their jobs. When we have a contract with a private company, it will identify the scope and standards of the job. By law, the contractor is required to execute the terms of the contract in order to be in good standing with the government for further work. So it is in the best interest of all private

companies to be committed to their jobs, as was already discussed in the area of customer services.

Through applying best business practices and standards of measurement, we are able to perform our jobs in a more efficient manner. Generally, this enhances our effectiveness as well. When we engage in best business practices, we encourage our employees and managers to think creatively, to come up with ways to increase our performance.

Competition creates opportunity for both the government and private industry. Currently, the federal government has downsized so quickly that they failed to manage their human capital. Now they are in a difficult position: By the year 2004, nearly 30 percent of all Federal Employees will be eligible to retire, with an additional 19 percent eligible for early retirement.³⁷

Another interesting fact is that in the next five years, 60 percent of all Senior Executive Service members will be eligible to retire, with another 21 percent eligible for early retirement.³⁸ To further complicate things, one-third of the technically oriented workforce is within five years of retirement.³⁹ Although this may appear to be detrimental to our future force which will be more technically oriented, it will not be. Much of our technical expertise lies in the civilian workforce. This impending exodus of government workers offers an unprecedented opportunity to the private sector. If there is a shortage in the government and we successfully increase the pace of competing A-76 studies, we will be able to compete the job shortages and potentially give those jobs over to private industry. In the long run, this will reduce the shortage of personnel within the government and reduce our problem of human capital.

More competitions with private industry will create more money for the private sector and keep our economy moving in a positive direction. Currently our defense contractors are not realizing significant profits from working on defense contracts. The more we can do to increase their profit and to spread the wealth among our civilian counterparts, the better relations we will have with them. This is most critical to keeping competition alive, while competition keeps costs down. Further, we all know that the government is laden with rules and regulations. Private industry is often more responsive and flexible because they have fewer government restrictions to abide by.

Through competition and commitment, we have seen many positive results in the area of privatization. We see best business practices and standards being used to reach new levels of competence. We have become more effective and efficient, and we have had the opportunity to be creative. We have also seen new opportunities to resolve issues with the aging workforce and have developed more opportunities for private industry.

MISSION FOCUS

Through effective use of privatization, commanders will be able to focus on their core competencies. They can rely more on private industries to solve issues that plague family members, reduce morale, and have a negative impact on the readiness of his force. The Pentagon has received an overwhelming amount of pressure to manage resources, overhead, and other costs more effectively. Today, 60 Percent of DoD's annual obligation authority is spent on support infrastructure.⁴⁰ These are activities and facilities that are not directly part of DOD's core mission, but could be considered to be necessary to complete its mission. Half of this amount pays for personnel expenses.⁴¹ Privatization's focuses on having someone else to do the work who can do it better than us, thereby allowing us to save money and focus on performing our core mission.

During downsizing of the active duty force from 1988 until 1998, the force structure of 2,138,000 soldiers, sailors, airmen and Marines was reduced to 1,412,000. As a whole, the military lost 726,000 active duty members in this ten-year period, almost the number we had in the Army in 1988. In the Army, we decreased from 769,000 soldiers to 483,000 soldiers, a loss of over 286,000 soldiers. The share of losses among the services was fairly even for the Army, Navy, and Air Force, ranging from 34-37 percent. The Marines experienced a smaller loss of 13 percent.⁴² These radical changes in our force structure, along with the guidance from the QDR and the recent transformation guidance, have pointed the military in a new direction. We must focus and commit our efforts on our major war fighting duties if we are to successfully support and defend our great nation with this reduced structure.

One contribution to soldier readiness is to take care of soldier's families. Removing family issues as a distracter allows our commanders to better concentrate on core competencies. One magnificent change has come in the area of housing. Through privatization, housing standards have been raised considerably. On some installations, soldiers can now enjoy the quality of life that so many soldiers have been leaving the service to obtain as civilians. The goal is to revitalize, replace, or demolish all inadequate housing by 2010, using both MILCON and privatization. The Military Housing Privatization Initiative, enacted into law by Congress in 1996, has led to this vital improvement.⁴³

The Military Housing Privatization Initiative was designed to provide quality, affordable housing, primarily for junior enlisted service members and their families, using private sector expertise and capital. Military housing allowances are a critical ingredient in privatization projects, since they provide the income stream to support the initial and long-term financial

viability of a project. Recently, the Secretary of Defense announced a major DoD initiative to significantly increase service members' housing allowances.⁴⁴

Increased allowances will stimulate more and better quality privatization projects. By making the privatization deals more attractive economically to the private sector, DoD will get better projects through increased competition, and realize greater leveraging of housing appropriations. More importantly, service members and their families become the real winners by gaining access to better quality housing.

If our commanders can focus on their core competencies without distracters such as borrowed military manpower, unacceptable living standards, and families in crisis, we can avoid further recruiting and retention problems. Privatization is another tool to help leaders take care of soldiers by providing them a better quality of life, something they deserve for their many sacrifices.

CONCLUSION:

I initially undertook this study to determine what we in the Reserves have lost through Privatization. I found that there are issues with the process, with the estimate methods, with maintaining accurate records, and with the amount of time it takes to complete an A-76 study. But there were a few common and recurring themes: competition, the bottom line, and improvement. While the system today is imperfect, we need to focus on how to improve it and how to make it work. We need to figure out how to reduce our drastic backlog of A-76 studies. The sooner they are completed, the sooner the government will see cost savings to put toward modernization and transformation. While privatization may have some initial start up costs such as transition pay, the sooner we pass this hurdle, the sooner we will start realizing our net savings. We have seen marked improvements as a result of privatization in terms of value, competition and commitment. As a result, commanders are increasingly able to focus on our core competencies while private industry offers their soldiers ancillary assistance.

RECOMMENDATION:

In the short term, the military needs to hire more private research companies to conduct A-76 studies. This initiative would help DoD reduce its backlog of the A-76 studies and enable them to start competing these jobs. Once we compete them, whether the government or the private sector wins, we will save money. Having the government conduct these studies in their free time is not an acceptable procedure. With reduced manning and no reductions in responsibility, the burden to complete these studies is unmanageable, as indicated by the findings in this study.

A second recommendation is to provide incentives for commanders for saving the government money through the A-76 process. Incentive money will enable them to increase funding for programs that support soldiers.

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