OUTLAND: THE VOGUE OF DOD OUTSOURCING AND PRIVATIZATION

J. Michael Brower

The twin silver bullets of outsourcing and privatization are purported to be the saviors of future defense budgets, as private contractors tout their ability to produce goods that retain quality while cutting costs. But this ammunition should be examined carefully before use, for its effects are likely to be devastating to the defense industry's labor force, and estimated savings may evaporate once large segments of the industry are turned over to the private sector.

...Pharaoh commanded the same day the taskmasters of the people, and their officers, saying, Ye shall no more give the people straw to make brick...Go ye, get you straw where you can find it: yet not ought of your work shall be diminished.

Exodus 5:6-7, 11

The *Quadrennial Defense Review (QDR)* is history—and so too are the hopes of many defense workers for relief from the strains of post-Cold War downsizing. For many, the time of troubles is just beginning. The QDR's report, issued May 19, 1997, called for reductions in infrastructure, support functions, and personnel to fund weapons modernization. But while the study wisely attempts to build more muscle out of the defense budget, in the process it makes some recommendations that have potentially bone-breaking consequences—while leaving some fatty deposits of pork quite untouched. In a well-meaning attempt to put mission first, the QDR forgets that a healthy national defense puts people first always. The QDR's call for unbridled outsourcing and privatization to supplant modernization accounts introduces a sinister game of musical chairs that will put many defense workers off, behind, down, and out.

It will soon be argued that programs receiving the planned financial infusion

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will be in a position to employ the tens of thousands of workers to be turned out into the streets under the QDR and concomitant Congressional legislation. But the civilian defense industries are themselves largely saturated and have a general interest only in those with advanced technical skills. Nevertheless, there will be cheap, unionless, competent workers coming soon to an unemployment line near you. The defense workers that remain— uniformed and civil service—will be required to make bricks without straw, to do even more with noticeably less, and they will receive a firsthand education in two rapidly maturing concepts, known as outsourcing and its handmaiden privatization.

HIDDEN ECONOMIC BACKHAND

Outsourcing is the movement of work to an outside provider that has been or might be performed in-house. Privatization is outsourcing writ large—the government farms out the function and often the wherewithal to do it, getting out of a business more logically performed by the private sector. Privatization, in its essentials, is a reaction to the nationalization and government regulation of the late 1960s and 1970s and finds inspiration in the post-1979 conservative policies of British Prime Minister Margaret Thatcher's government, where the modern privatization mold was cast (Vickers & Yarrow, 1988). But the concept of privatization is not new, and can be traced back to some of Adam Smith's writings in 1762 (Kemp, 1991). To meet the ambitious goals of the QDR, outsourcing and privatization must be relied upon as never before to generate cost savings and cost avoidance to accommodate the proposed modernization schedule (Donnelly, 1996).

With a sort of weary, dull surprise, many who have overseen some outsourcing and to a lesser degree, privatization projects, are discovering that these "new ways of doing business" amount only to old wine in new bottles. Contractors bid for outsourced work claiming substantial savings, government employees are surplused or RIFed, then (once the indigenous labor source is shuffled off or absorbed) the contractors run up the bill. Uncle Sam then has nowhere else to go, since the in-housers have been benched in the name of savings and efficiencies. It is the charge and duty of the government employee to ensure that taxpayers don't

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get fleeced—but the contractor's first duty is just to charge. For the latter, it is the stockholder, not the taxpayer, that ultimately controls the purse strings. And while many taxpayers are stockholders, as professional Wall Street watchers will tell you, some stockholders are more equal than others.

Privatization and outsourcing are management paradigms that exist because even during downsizing, to paraphrase Calvin Coolidge, the business of America remains business. What Eisenhower called the "military-industrial complex" is an integral part of the U.S. economy and the government. After the Great Depression, World War II, and curative doses of Keynesianism, the government became industry's biggest customer and the two have remained joined at the hip ever since. The Cold War continued and deepened the relationship. Consequently, in the QDR, and in the laws that are passed in legislative reaction, tens of thousands of workers for America's largest employer, the Department of Defense (DoD), will find their fates have been sealed first in American and foreign boardrooms, and only as an afterthought in the halls of Congress and the Pentagon.

Indeed, the reason that the QDR can afford to be so modest in its cuts is more a reflection of a healthy corporate economy that can afford to underwrite $250 billion Defense budgets for the "foreseeable future" than outright threats to national security. This is why the phrase "security" doesn't receive the emphasis that the phrase "national interests" enjoys in the Pentagon's QDR study—and "national interests," as was the case during the Gulf War, are generally pecuniary in nature. The determination, then, is that the damage done to the economy with the reduced spending power of displaced defense workers and those in their train is more than offset by positive economic effects of industries sanctioned *ipso facto* by the QDR. Cuts in infrastructure (i.e., military installations), personnel, and support functions will be required to ensure the health of large and small corporations alike. Privatization and outsourcing will be the purest expression of the sentiment to support those industries by slashing, among other stakeholders, DoD's indigenous workforce.

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McEmployee

According to the National Association of Temporary and Staffing Services (NATSS) in Alexandria, VA, outsourcing trends have helped explain increases in the ranks of the nation's temporary employees. Temporary work of all descriptions has doubled in the last five years and in 1995, there were 2.7 million temporary workers in that category.

Additionally, about 40 percent of the biggest companies in the United States have outsourced at least one major piece of their operations, according to *Computer World* (Hoffman, 1997a). DoD is emulating industry and will be outsourcing and privatizing more than ever.

The Navy, for example, is attempting to save more than $3 billion over the next six years by designating 50,000 civilian and 30,000 military positions as outsourcing candidates. Fiscal year (FY) 1997 will see the final preparations for outsourcing competitions with the intent of applying the savings toward procurement accounts. In a January 8, 1997, message from Chief of Naval Operations Adm. Jay Johnson, we understand that the "Navy's program objectives memorandum for fiscal year 1998 included...3 billion in savings from outsourcing," which Johnson terms an "ambitious, but achievable goal" (*Inside the Navy*, 1997). The Navy is continuing to study outsourcing and is countenancing Office of Management and Budget (OMB) Circular 76 ("Performance of Commercial Activities"), which contains competition guidelines updated in early 1996, in anticipation of contracting out more than 10,000 jobs (about 8,400 civilian and 2,300 military) during FY97. The Navy, as of April 1997, had about 408,000 military and 218,000 civilians on its payroll. As the Navy outsources more work it expects to take its $3 billion in savings and plow it back into modernization programs (*Computer World*, 1997). The problem, of course, is the time delay between banking those savings, and meeting program and operations and maintenance bills.

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The principal problem with the zealous privatizer and outsourcer (a.k.a. "government reformer") is that they are notoriously short-term thinkers. They forget or never bother to calculate the stimulation that government paychecks have in the economy. In the private sector, a firm can hire more workers when demand is high, lay them off during a lull in demand—but this is not so in government. The axiom that layoffs boost profits in the short term is verifiable (and is in part accountable for the historic rise of the U.S. stock market), but long-term effects may be less desirable

A related development, which is gaining momentum and adherents, is the "franchising" or hiring of temporary government workers, who are then terminated at project completion. Headlines in recent months about "payoffs for layoffs," an issue championed by independent Vermont Rep. Bernie Sanders, and the introduction of legislation such as the "freedom from government competition" bill, all center on the continuing destruction of good, tax-base creating jobs in the public and private sector. Today's "government reformer" is in many cases using privatization and outsourcing as cudgels to beat down concepts that working Americans did not always associate with sloth: steady employment, good fringe benefits, security, decent working hours and conditions, paid vacation and sick time, health care, a well-funded retirement. But to be progressive today, one cannot support these notions. The popular belief in this country (unlike in Japan and Germany) seems to be that those working in government today must by definition be deficient—they obviously couldn't make it in private industry. Ridiculous as the prejudice is, these concepts are spreading according to critically acclaimed books such as Jeremy Rifkin's *The End of Work* (1995) and William Greider's *One World Ready or Not:*

The Manic Logic of Global Capitalism (1997). Both authors assert that privatization and outsourcing will continue apace, no matter the economic or social cost.

NEW STRAINS OF OUTSOURCING

A review of outsourcing and privatization literature reveals fewer references to fixed costs, rates of rent or taxes, or the price of capital and materials than to the cost of labor. In the main, the cost cuts that outsourcing achieves are accomplished by reducing the price of the employee. By capitalizing on the specialization of techniques, specific functions done at low cost can trim a company's on-site workforce. Two new genres of outsourcing highlight this interest in reducing people-generated expenses.

PURE OUTSOURCING

Here we find a new social contract at work—but Locke didn't have this one in mind. Private industry is permitted to purchase, at a discount, publicly underwritten facilities and acquire trained employees with the understanding the taxpayer will end up with a better deal. This is the same pretext rationalizing the privatization of the U.S. uranium enrichment business (Moses, 1997). In an ode to outsourcing, *National Defense*'s December 1996 issue states the case plainly enough. Sandra I. Meadows introduces "pure outsourcing" (and it does have a pleasant, almost religious ring to it). The new addition to the lexicon of privatizers and outsourcers is a scheme to transfer all government workers and all government assets in a given field into the waiting hands of a company. Addressing the popular inclination to outsource information systems, "a government data center would transfer its assets and employees to a private firm, which would be running the operation—becoming an agency partner rather than just a supplier." Later she writes, "there is mounting pressure on corporations, both in the public and private sector, to be more efficient, to perform new functions with fewer employees" (Meadows, 1996).

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With "pure outsourcing" the public underwrites the private sector by virtually or literally giving away taxpayer-purchased facilities and assets, cuts government's employee costs by transferring workers to industry, and saturates the labor pool. As wages fall, the regular paychecks on which workers depend to underwrite their bills become more exception than rule.

DOUBLE OUTSOURCING

Also known as "mad cow contracting-out," double outsourcing is one of the most hazardous breeds of the outsourcing animal. Simply put, it means subcontracting to the *nth* power—triple or even quadruple outsourcing—and it is daily becoming more the rule than the exception. For instance, the EDS Company supplied information technology requirements for General Motors Corporation for more than 12 years. Then GM negotiated a $3.6 billion deal to co-negotiate with EDS ("double outsource") with EDS's subcontractors (*Information Week*, 1997). Economies of scale are realized by pooling resources and labor costs are driven to lower levels. For example, Microsoft has a rather modest employee base compared to its revenue, due in part to an aggressive outsourcing strategy, which can involve double-outsourcing, particularly in the code writing arena. But outsourcing can lead to severe labor problems: the machinist strike at McDonnell Douglas, which started in June 1996, was largely fought over the question of outsourcing to nonunion subcontracts.

Other forms of outsourcing run the gamut between the straight GOGO (government-owned, government-operated) model and the COCO (contractor-owned, contractor-operated) model. These forms include co-sourcing (partnering equipment and expertise with an outsider), and outsourcing partnerships (generally, only the technical staff is outsourced).

Outsourcing also finds many labor cost savings in the area of information technology, and QDR's suggestion that DoD largely remove itself from that line of work has many precedents in private industry and in other parts of government. The Internal Revenue Service is outsourcing returns processing, while the Academy of Motion Picture Arts and Sciences is relying on outsourcing services rather than "overburden[ing] its small Management Information Systems (MIS) department." Brian Riggs reports in his piece "Web Outsourcing Hits Big Time," that installing and operating a Web server can cost above $60,000 a year—and two full-time computer jockeys added on boost the price to $221,000 (Riggs, 1997). But outsourcing such a project lowers costs to about $40,000. But according to *Computer World*, the outsourcing Siren song has run many companies into the ground (Melymuka, 1997). Typically, the outsourcer bids low, gets exclusive rights to control an entire information technology department, then reams the outsourcee with cost overruns.

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WHO REALLY WANTS OUTSOURCING AND PRIVATIZATION?

At the Pentagon, one notices that those above the rank of colonel and GS–14 and political appointees are almost wholly in favor of outsourcing and privatization. For the political appointee with a limited future in government, job security is job none anyway, so why worry about the fate of middle and lower income taxpayers working for DoD? For the high grades, there is no danger of them becoming victims of privatization, outsourcing or "reinvention" in general—quite the reverse! Mike Causey's popular federal column in the *Washington Post* (1997) featured a Dickensian commentary on the haves having and the have-nots having nothing. Causey estimates that between 1989 and March 1995, the number of GS–14s and –15s soared during downsizing (14s went from 69,000 to 83,000; more than 7,000 new 15s were created). In the same moment, those in grades below GS–7 have found themselves in a free-you're-fired zone. Since "government reinvention," began, GS–1s have been virtually eliminated, GS–2s lost nearly 6,000 positions, GS–4s were cut in half, and GS–7s were reduced by 30,000 positions.

On both the military and civilian side of DoD, we see a pattern common with most downsizing, the Personnel Centripetal Effect: headquarter staffs swell while the field shrivels. To preserve the upper grades, work done by the lower tier is contracted out (hence the worship of outsourcing, economical or not) and numbers of employees are shown to decline. The problem is that those who can least afford to go—the young, the low grades, the "temps"—are forced out, while those who can easily afford departure remain. Voluntary retirements and incentives have helped, but the QDR demands more cuts and Congress is asking for still deeper position reductions.

The military remains hopelessly top heavy. A few years ago, the Air Force actually had to eliminate the basic rank of "sergeant" and RIF many junior officers, mainly to preserve positions in the service's stratosphere. In the QDR, forces were cut, but force structure was preserved. Truly, as the African proverb has it, when elephants fight, the grass suffers.

In a sinister twist, there is now a big push to get people "off welfare" by putting many of them into the government in the same low-grade categories that were sacrificed on the alter of reinvention. Private industry only employs up to the point of diminishing returns: when employees cost more than they return to the company in profits, they become economic liabilities; their utility is at an end. The unthinkable but perfectly practical solution would have been to simply lower the grades of the upper-level military and civil servants to better reflect a post-Cold War world, and use the savings to avoid cutting jobs. Yet no economic analysis of this possibility was conducted, because of the anticipated conduct of the fox when stationed at the hen house. In this ironic form of social leveling, many of those RIFed might now be reemployed by the government that released them from service (and don't forget about veteran's preference and reinstatement rules).

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Take another example of who gets what from the outsourcing phenomenon. The Defense Science Board's (DSB's) estimates of outsourcing and privatization savings to DoD of $30 billion per year by 2002 were disputed by officials in the Office of the Secretary of Defense's (OSD) program analysis and evaluation (PA&E) shop. In early April, PA&E's examination of the much-heralded DSB summer study, "Achieving an Innovative Support Structure for 21st Century Military Superiority," indicated that even after aggressive contracting out, there could be less than $14.8 billion in savings opportunities. Even that figure would depend on repeal of restrictive legislation, higher than anticipated personnel cuts, and more base realignment and closure (BRAC) proceedings. Why are the estimates so different by so many billions?

There are (at least) two possible explanations for the discrepancies. The OSD PA&E may estimate conservatively because it has vested interests in doing so—just as the members of the DSB have vested interests in liberal estimates in the amount to be saved through outsourcing and privatization. OSD PA&E would see more substantial savings estimates gobbled up to fund other programs (the higher the estimate of savings, the greater the cuts somewhere else). Another reason for the disparity could be that the DSB generally consists of a membership that can be less than objective. In the course of examining the PA&E analysis, "most reviews are performed by people who have a stake in the process" (*Inside the Air Force*, 1997).

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Paying the Price, Not Counting the Cost

To be sure, there have been economical privatizations and outsourcings. State and local governments have in many instances reported success, especially when results were measured using an activity-based costing (ABC) approach. In a March 1997 privatization study conducted by the General Accounting Office (GAO), an interesting discovery was made about the role played by the price of labor in privatization projects. When laws were enacted that required private firms to "compensate [former government employees] at a rate comparable to their government pay and benefits," privatizations dramatically declined.

In the last analysis, the relative and socially necessary labor price makes or breaks most privatization and outsourcing initiatives. Each case, therefore, must be handled individually, since privatization and outsourcing have experienced some profound failures and false starts, and usually entail traumatic work force transition (GAO, 1997, p. 4). For instance, in a major outsourcing flop for Unisys Corporation, unanticipated "labor-intensiveness" caused an early termination of a contract to manage the health-care program for the state of Florida's 215,000 employees. The contract was worth $86 million over four years and, with labor savings being again the financial incentive for the outsourcing venture ("we can do it better, cheaper"), a Unisys spokesman admitted that the contract was "an aberration, an aggressive move" and one that proved a bridge too far (Caldwell, 1997).

In the case of unregulated privatization, the long-term problems of destroying government as a steward of a nation's resources can be best illustrated in Russia. As Gary Bertsch and Igor Khripunov pointed out in their article "Privatization Carries Cost" (1996), the "largest proliferation of weapons and weapon-related technology in human history" is beginning to take place because the recently privatized high-tech Russian companies have no "nonproliferation culture." Nor has there been time or opportunity to build such a culture (which would have had to overcome the impetus of history), given that Russia's private sector is "locked in a merciless struggle for survival"(Bertsch & Khripunov, 1996). Privatization has driven the former Soviet Union and its former East European comrades into a new competition with America for the title of leading arms seller and producer. The ideological struggle may have subsided, but the economic struggle continues.

Start the Revolution in Business Affairs Without Me!

Outsourcing and privatization, if considered on a case-by-case basis and taken in moderation, can be beneficial. It is definitely here to stay, or, if we forget our duty to our fellow workers, here to slay. American companies out-source more than $100 billion a year, with average cost savings of 10–15 percent; the federal government spent about $114 billion on outsourcing during 1995 but lacked the mechanisms (e.g., activity-based costing models) for calculating savings (Lowry, 1996). But optimism springs eternal: Texas Gov. George W. Bush, son of the former president, believes he can save the state 40 percent of current computer costs (as much as $120 million) by outsourcing welfare information systems work (Hoffman, 1997b). But massive job slashings that give people no place to turn, dispensed willy-nilly, can create economic and social chaos.

The so-called Revolution in Business Affairs (which is the complement of the technology-based Revolution in Military Affairs) was initially launched to help Defense workers conduct the Department's affairs more economically and effectively—not give them the business. Defense workers are just regular people: they carry debt, pay their rents and mortgages, support children through school. If DoD workers are something other than "economically viable," then we need to explore ways to make them so. But neither national security nor "national interests" are served by arbitrarily putting huge numbers of them on the cold side of the employer's door where there are no jobs commensurate with their old paychecks and abilities. The problem with out-of-work Russian nuclear specialists and frustrated, unemployed Eastern European mathematicians who can earn more as authors of computer viruses than of textbooks should not be lessons lost on us.

The noted conservative commentator Henry Hazlitt reminded us in his classic work *Economics In One Lesson* (1946), that "in studying the effects of any given economic proposal we must trace not merely the immediate results but the results in the long run, not merely the primary consequences but the secondary consequences, and not merely the effects on some special group but the effects on everyone." Not so readily examined by the "reformers" seeking the Red Badge of Downsizing is the aftermath of transforming reasonably paid Defense workers (motto: "Together, we can build it") into pauperized McEmployees (motto: "Would there be fries with that?"). If DoD is about people always, privatization and outsourcing must be outfitted with a human face, or a higher economic and social price will be paid by all, not far enough down the line.

"If DoD workers are something other than "economically viable," then we need to explore ways to make them so."

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