

DEFENSE INDUSTRIAL INITIATIVES CURRENT ISSUES

No. 8: The President's Government Contracting Review (03/30/2009)

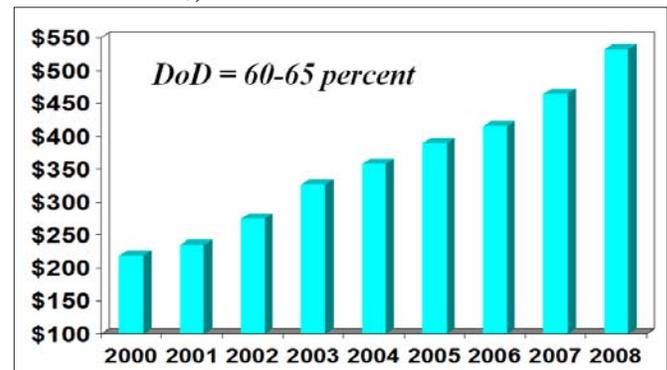
Sound companies always benefit from smarter customers. That is why the defense industry may feel some hope from President Obama's memo of March 4, the "Memorandum for The Heads of Executive Departments and Agencies" on "Government Contracting." Coupled with his words in the public announcement at the time, this memo offers the possibility that the Department of Defense (DoD) and the federal government will move toward a policy framework and a broad strategy for managing contractors. The question is, how can the Administration realize this potential from its announced contracting review? The political climate for the defense industry is complex and difficult, and this government review will help only if it is done right.

The time is long overdue for a government strategy for managing contracts. The growth in government contracting is well known, with more than \$500 billion in the last fiscal year (see Fig.1). This growth began well before 9-11 but has accelerated since 2001. Contract dollars for procuring goods have doubled, and services contract dollars have tripled since the mid-1990s (Fig. 2).

There are many legitimate reasons for this expansion in the use of contracts: wartime needs, advances in technology, ensuring surge capacity and flexibility, and gaining access to innovation and technical expertise. The government vitally relies on private sector support. But there is also an underlying set of challenges. Let's look specifically at defense.

DoD spends today more money on services contracts than it does on hardware, and those services are important and often critical. Arguably, DoD is more dependent on contractors than ever before. Yet there are no reliable figures on how many contractors support DoD or what DoD gets for the money in the aggregate. As a result, the federal government should proceed with care as it moves to implement the presidential memo.

Fig 1. Federal spending on contracts since 2000 (in billions of US\$)



Source: Federal Procurement Data System

<https://fpds.gov>

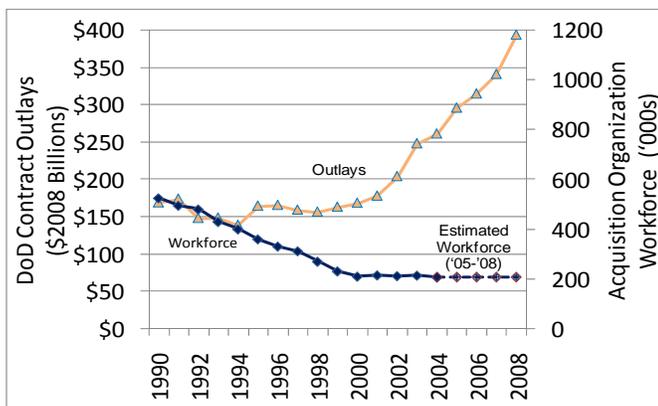
Why has it been so hard for DoD to array the benefits from services contracts? This is due in part to the decentralized nature of program execution in DoD, and that is altogether proper. Centralized control over decentralized programs will not be responsive or focused. However, adequate oversight does require that a policy framework be articulated in sufficient detail that adherence to the policy can be tracked and reported. No such policy has existed. The administration needs to use this opportunity to implement that policy framework.

That brings us back to the March 4 memo. It encourages increased competition and fewer cost-based contracts. Competition *will* save money, but we know that competition alone will not lead to fewer cost-based contracts. The only way to increase fixed-price contracts is for the government, including DoD, to do a *dramatically* better job defining its needs. Only clear and precise requirements can yield a good basis for industry to bid on a fixed-price basis and save the government money. Companies forced to bid fixed price on weakly-defined requirements will have to add risk to their price, and the risk goes up as the precision of the requirements goes down.

Even with better requirements, it will take more time and government expertise to negotiate fixed-price contracts than cost-based agreements. Too often, this will challenge the existing government workforce. The president’s memo recognizes this shortcoming in its statement that the “Federal Government must have sufficient capacity to manage and oversee the contracting process from start to finish.” As yet, however, there is no assignment of responsibility for action in this memo.

Fixed-price negotiations need to be based on requirements that are flexible enough to change, based on cost and schedule impact, prior to finalizing the contract. This could enable DoD to move toward Secretary Gates’ call to acquire the “75 percent solution.”¹ To do that, DoD (and the rest of the federal government) needs to rebuild the talent in its acquisition workforce. The growing gap between workload and workforce, shown in Fig. 2, needs to be addressed in this contracting review. Without that, the president’s initiative will fail.

Fig 2. DoD contract outlays and contracting personnel, FY1990-2008



Source: Federal Procurement Data System, DoD Human Capital Report

The study program under the Obama memo should endeavor to recognize these realities and therefore focus on developing that policy framework and broad strategy. The defense industry will clearly benefit from such a policy approach if it leads to a government that can:

- Define requirements better
- Run solicitations more effectively
- Negotiate tradeoffs between costs and requirements
- Set performance metrics and use those as evaluation criteria
- Provide proper funding for execution
- Reward high performance

If the government can do all that, industry will respond and deliver. Costs will go down, independent of contract type, because solicitations will be clean and focused. Too often today, the government says to industry “you probably know what we want; propose that to us.” DoD must do better than that, and the review called for by the president can either help or make matters worse. To succeed, the president’s review must be structured properly and focused on the proper outcomes. Done right, the best result of the president’s contracting study will be a government that’s a smarter buyer and a defense industrial base that is stronger and more resilient.

—David J. Berteau

© 2009 by the Center for Strategic and International Studies. All rights reserved.

¹ Statement before the US Senate Committee on Armed Services, 01/27/2009 <http://armedservices.senate.gov/Transcripts/2009/01%20January/A%20Full%20Committee/09-02%20-%201-27-09.pdf>