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Defense Acquisition Reform: Status and Current Issues

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Valerie Bailey Grasso
Foreign Affairs, Defense, and Trade Division

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SUMMARY

The end of the Cold War and its impact on defense spending has created a strong need to reform Department of Defense's (DOD) acquisition system. With procurement spending down, DOD expects to depend on savings from acquisition reform to help finance future force modernization. Policymakers believe that DOD should use more commercial products because, in many instances, they cost less and their quality is comparable to products built according to DOD military specifications. Many such reform proposals are based on recognition that DOD regulatory barriers and a Cold War acquisition "culture" have inhibited the introduction of commercial products.

The need to encourage greater interaction between the defense and commercial industries is considered vital to keeping U.S. military technology the best in the world — a major objective of U.S. defense policy. Many high-technology commercial products (e.g., electronics) are state-of-the-art and changing so fast that DOD's milspec system cannot keep pace. Congress has passed several important reforms, among them the Federal Acquisition Streamlining Act of 1994, Federal Acquisition Reform Act of 1996, Defense Reform Act of 1997, and the Federal Activities Inventory Reform Act of 1998. DOD has lowered or abolished regulatory barriers; experts agree, however, that more work is required to make the system responsive to U.S. defense needs.

Restructuring DOD's acquisition organization: Enacted reforms will mean greater freedom to innovate, make quicker decisions, and improve DOD program development — running DOD more like a private sector operation. At issue is just how to change DOD personnel management policies, and introduce DOD's acquisition reform initiatives to the private sector.

Privatizing DOD's functions through outsourcing: Although DOD had begun outsourcing some functions, expanding its use has been a major goal. Success stories and studies estimated that outsourcing could reduce costs and increase efficiency. Basic questions include (1) how much can be saved over the long-term and how will savings be measured; (2) can DOD's structure effectively manage the new outsourcing proposals; (3) do outsourcing proposals go beyond the "proper" limits of DOD's mission to protect U.S. national security; and (4) can outsourcing harm DOD's military readiness or war-fighting capability?

Oversight of reform initiatives: Congress will continue to exercise a strong oversight role because of its longtime interest in streamlining DOD's acquisition processes. Its attention will be directed at several congressionally mandated DOD reports on acquisition reform issued in 1996. Important topics will include how DOD is streamlining and restructuring its acquisition processes, practices and infrastructure; increasing efficiencies in acquiring defense maintenance and repair services; and, outsourcing DOD support functions that are considered commercial in nature. Congress will rely on the recommendations of several reports, including the Task Force on Defense Reform, Defense Science Board Task Force on Procurement Reform, and the Section 912 (c) report on streamlining acquisition processes, workforce and infrastructure.

MOST RECENT DEVELOPMENTS

The *President has signed the FY2001 Defense Appropriations Bill, P.L. 106-259. The bill prohibits 1) the conversion of DOD functions from government to contractor performance unless a "Most Efficient Organization" analysis is completed and certified to House and Senate Defense Appropriations Committees; and 2) the purchase of welded shipboard anchor and certain mooring chain unless both are manufactured in the United States from components that are substantially manufactured in the United States. The bill authorizes public-private competitions for depot maintenance and repair work, provided that DOD certify that all successful bids include comparable estimates of all direct and indirect costs and exempts such competitions from the requirements of OMB Circular A-76. H.R. 4205, the proposed FY2001 defense authorization bill, is now in conference.*

H.R. 4722, known as the "Department of Defense Privatization and Outsourcing Moratorium Act," was introduced on June 22 and referred to the House Committee on Armed Services. The bill would impose a 5-year moratorium on conversions to the private sector of work performed by federal employees and suspend both OMB Circular A-76 cost comparison studies and studies conducted under Section 2461 of Title 10, Chapter 146. (For further discussion of OMB Circular A-76 and the FAIR Act, see CRS Report RL30392, Defense Outsourcing: The OMB Circular A-76 Policy, *and CRS Report RL30574,* Defense Outsourcing: The OMB Circular A-76 Policy and Options for Congress - Proceedings of a CRS Seminar, *both by Valerie Bailey Grasso.)*

BACKGROUND AND ANALYSIS

Since the late 1980s, a number of important factors have converged to create a strong need to reform DOD's acquisition system, a system that has been periodically studied, and altered, over the last 50 years. First, defense procurement spending has declined every year since 1987. This decline has forced policymakers to examine how DOD buys military equipment, and look for ways to reduce costs in DOD's acquisition system. Second, there has been a realization that more commercial products should be used by DOD. These products, in many cases, are now cheaper and of comparable quality to similar products produced according to DOD's military specifications, or "milspecs." Indeed, many high-technology commercial products, particularly in the electronics industry, are state-of-the-art, and they are changing so fast that DOD's milspec system cannot keep pace with private sector advancements. Third, it has become common knowledge that DOD's regulatory barriers and its acquisition culture have not only resulted in higher costs, but also kept commercial products from being used in the defense sector. As a result, policymakers are now seeking to make DOD's acquisition system more (1) cost effective; (2) interactive with commercial industries; and (3) committed to procuring state-of-the-art technology for DOD weapon systems on a timely basis.

Policymakers have faced difficulty revamping a DOD acquisition system; however, the budgetary need to do so has become more and more apparent. Former Secretary of Defense Perry had stated that DOD was depending on substantial savings from acquisition reform to finance a significant portion of future force modernization. In this regard, he had expressed

the importance of achieving greater integration of defense and commercial industries, as this was the only way the United States can maintain its technological leadership — a major element of U.S. defense policy.

Over the last 7 years, Congress has enacted a number of important reforms in the acquisition process. DOD has taken steps of its own to reduce or eliminate regulatory barriers, as well as to encourage use of commercial products in military systems. In the view of many experts, however, a great deal more work will be needed in the future to achieve the efficiency and responsiveness required of DOD's acquisition process.

DOD Acquisition Strategy for the New Era

The end of the Cold War produced a significant decline in U.S. defense spending, particularly in the acquisition of weapon systems. Procurement spending has declined 59% in real terms from fiscal year FY1987 to FY1997. The decline in DOD procurement spending during the Bush Administration resulted in termination of some major weapon programs. It also prompted development of a new acquisition policy, refined by the Clinton Administration, that emphasized upgrading existing systems rather than initiating new ones. The new policy also supported more spending for defense research and development (R&D) and less for weapons production. The logic of the decision was that, although there would be a reduction in the quantity of new weapons produced, the need to maintain technological superiority, (a key combat multiplier), required increased efforts to develop new and innovative technology. DOD also began altering the way it did business with the defense industry, looking for ways to reduce costs. U.S. companies embarked on a variety of strategies to adjust to the new spending environment and the inevitable consolidation of the defense industry.

Table 1 lists national defense budget outlays, FY1962-2002. The outlay deflators represent the inflation factor; the "CY$" are current year dollars and are based on the cost of goods and services in terms of prices current at the time of purchase; constant dollars in the third column refer to the cost of goods or services adjusted to eliminate the effect of inflation.

Another change in DOD procurement policy included increased interaction between the defense industry and commercial, non-defense industries. Due to the plight of the defense industry (increasingly affected by cutbacks), the 102nd Congress initiated a defense economic adjustment program which included funding for commercializing military technology. This program was designed to help U.S. defense companies diversify their operations; the firms were encouraged to produce so-called "dual-use" products that could also be sold in the commercial sector. It also included incentives for DOD to form partnerships with industry to develop cutting edge, dual-use technology that would be mutually beneficial. In 1993, the Clinton Administration proposed additional initiatives; the 103rd Congress supported and expanded them to help with the defense transition. These initiatives promoted highly-skilled jobs in non-defense and dual-use technology areas, commercial-military interaction, and conversion opportunities to invest in new civilian technology.

Table 1. DOD Procurement, FY1962 - FY2002*

Year	Outlays, Deflators FY1998 Base	Outlays (CY$ in millions)		Outlays (FY1998 $ in millions)	
		Proc.	RDT&E	Proc.	RDT&E
1962	0.1601	14,532	6,319	90,768	39,469
1963	0.1612	16,632	6,376	103,176	39,553
1964	0.1671	15,351	7,021	91,867	42,017
1965	0.1700	11,839	6,236	69,641	36,682
1966	0.1816	14,339	6,259	78,959	34,466
1967	0.1921	19,012	7,160	98,969	37,272
1968	0.2016	23,283	7,747	115,491	38,428
1969	0.2088	23,988	7,457	114,885	35,714
1970	0.2239	21,584	7,166	96,400	32,005
1971	0.2376	18,858	7,303	79,369	30,737
1972	0.2575	17,131	7,881	66,528	30,606
1973	0.2744	15,654	8,157	57,048	29,727
1974	0.2964	15,241	8,582	51,420	28,954
1975	0.3308	16,042	8,866	48,495	26,802
1976	0.3546	15,964	8,923	45,020	25,164
1977	0.3810	18,178	9,795	47,711	25,709
1978	0.4089	19,976	10,508	48,853	25,698
1979	0.4404	25,404	11,152	57,684	25,322
1980	0.4938	29,021	13,127	58,771	26,584
1981	0.5532	35,191	15,278	63,614	27,617
1982	0.6069	43,271	17,729	71,298	29,212
1983	0.6343	53,624	20,554	84,540	32,404
1984	0.6592	61,879	23,117	93,870	35,068
1985	0.6852	70,381	27,103	102,716	39,555
1986	0.7026	76,517	32,283	108,905	45,948
1987	0.7227	80,744	33,596	111,725	46,487
1988	0.7463	77,166	34,792	103,398	46,619
1989	0.7774	81,620	37,002	104,991	47,597
1990	0.8019	80,971	37,453	100,974	46,705
1991	0.8442	82,180	34,549	97,347	40,925
1992	0.8647	72,727	34,556	84,107	39,963
1993	0.8920	67,317	36,923	75,467	41,393
1994	0.9133	60,400	34,751	66,134	38,050
1995	0.9306	54,253	34,590	58,299	37,170
1996	0.9511	48,535	36,493	51,030	38,369
1997	0.9746	45,531	36,034	46,718	36,973
1998	1.0000	43,125	34,645	43,125	34,645
1999	1.0220	44,647	35,152	43,686	34,395
2000	1.0456	47,616	33,960	45,539	32,479
2001	1.0699	51,641	33,158	48,267	30,992
2002	1.0948	55,399	33,552	50,602	30,647

Source: CRS, based on DOD data; excludes Desert Shield/Desert Storm costs and receipts.

Path to Reform

As defense spending continued to decline and defense acquisition strategy evolved, congressional policymakers directed DOD to undertake a comprehensive review and study of its acquisition system, and present reform recommendations. Called the "Section 800" report (after the pertinent section in the Defense Authorization Act of 1991, P.L. 101-510), its purpose was not to replicate the work of previous studies, like the Packard Commission Study (1986) and Defense Management Review (1989), but to take their findings and prepare a workable set of recommended changes to acquisition laws. The study, once completed, would serve as a major resource for the National Performance Review and the Clinton Administration's efforts to reinvent government, including the acquisition system.

The first package of congressional reforms, many of which were noncontroversial recommendations of the "Section 800" report, was passed in the Federal Acquisition Streamlining Act, or FASA, P.L. 103-355. The legislation revised more than 225 statutory rules, encouraged federal agencies to buy commercial, off-the-shelf products, and simplified government procedures for procuring those products. Key provisions included the following: (1) raising from $25,000 to $100,000 the threshold for waiving many statutes governing defense procurement; (2) streamlining the bid-protest process to prevent costly delays that could result when contractors protest procurement contract awards; (3) raising to $500,000 the cap that would allow bidding defense contractors to bypass special accounting systems requirements, and avoid providing lengthy cost and pricing data to the government; (4) raising from $25,000 to $100,000 the value of contracts that could be reserved for small business; and, (5) creating unified federal procurement statutes for executive branch agencies.

This legislation promoted performance-based contracting in DOD, as well as the use of acquisition reform "pilot" programs to test the effectiveness of some reform initiatives; one such example is mission-oriented program management. Performance-based contracting defines work to be performed in measurable, mission-related terms — in contrast to the heretofore procedure of defining the work in broad, imprecise terms through a "statement of work". This approach was intended to reduce government costs and improve contractor performance by encouraging more innovative and efficient approaches to government contracts. Examples of such programs include joint direct-attack munitions (JDAM), commercially-derived aircraft and engines, and a fire-support tactical trainer (see **Oversight of Reform Initiatives**.)

A second package of reforms, called the Federal Acquisition Reform Act (FARA) of 1996, was passed as part of the FY1996 Defense Authorization Act. FARA made changes in the acquisition process in the areas of competition, commercial items, certification requirements and the Federal Acquisition Computer Network (FACNET). FASA II (called FARA) was passed during the first session of the 104th Congress. It built upon the earlier FASA legislation, and was included in the FY1996 DOD Authorization Act (P.L. 104-106). The newest reform provisions sought to (1) simplify procedures to procure commercial products and services, and at the same time preserve the concept of full and open competition; (2) reduce barriers to acquiring commercial products by eliminating the requirement for certified cost and pricing data for commercial products; and, (3) streamline the bid protest process by providing for all bid protests to be adjudicated by the General Accounting Office (GAO). To reflect the projected efficiencies of acquisition reform and the broader manpower reductions occurring at DOD, FASA directed DOD to reduce its

acquisition workforce by 15,000 personnel during FY1996, and to report to Congress on how to implement an overall 25% reduction during the next 5 years (from October 1, 1995). In addition, the "procurement integrity" provision consolidates and clarifies the standards of conduct for federal officials in the acquisition process, to ensure consistent treatment of such personnel on a government-wide basis.

The FY1996 Defense Authorization Act changed federal procurement of information technology through the establishment of the Information Technology Management Reform Act of 1995 (ITMRA). First, it eliminated the central procurement authority of GSA, making each federal agency responsible for its own information technology procurement and investment. Second, it directed agencies to appoint a chief information officer whose responsibilities would include ensuring that information technology expenditures conform to budget and program management decisions. Third, it combined both protest processes for information technology and federal procurement under GAO's authority. (For a discussion of current federal policies on information technology, see CRS Report 98-845, *Federal Government Information Technology Policy: Selected Issues*, updated January 5, 1999.)

The FY2000 Defense Authorization Act, S. 1059, was signed by the President on October 5, 1999. Known as P.L. 106-65, the bill totaled $288.8 billion in budget authority; key provisions included 1) reductions in the size of the acquisition workforce; 2) phased-in reductions to the personnel count of major DOD headquarter activities; and 3) changes in procedures for the applicability of cost accounting standards and the purchase of commercial items. The bill required DOD to submit reports on the status of personnel reductions in the defense acquisition workforce and personnel reductions in DOD headquarters.

DOD Promotes Reform

Former Secretary of Defense Perry and his deputies were active in introducing acquisition reforms to foster greater efficiency, cost effectiveness, and military-civilian industrial interaction. In 1994, DOD leadership began introducing and promoting a number of new concepts, among them: 1) the single process initiative (SPI); 2) integrated product teams (IPT) to develop and build weapons systems; and, 3) "cost as an independent variable," a concept that would increase the priority of cost considerations in weapon system decisions. Each of the military services had also introduced reforms to service-specific parts of DOD's acquisition system. DOD and the services are now in various stages of implementing these concepts.

In June 1994, Secretary Perry introduced a major acquisition reform directive reversing the traditional DOD preference for milspecs in favor of performance specifications and commercial standards. The directive required preference changes in purchasing new systems as well as modifications of existing systems. As a result, special waivers are now needed to use milspecs and will be granted in special cases only — a rule that used to apply to performance specifications and commercial standards. The plan to implement this policy directive was the SPI, which required U.S. companies to establish a common plant-wide process and performance standard for new and existing defense contracts. It forced contractors to consolidate, or eliminate, multiple processes, specifications, and standards for a particular product whether it be for commercial or defense use within different services.

Over the next 12 to 18 months, DOD would modify all contracts at a given facility at the same time, instead of on a contract-by-contract basis.

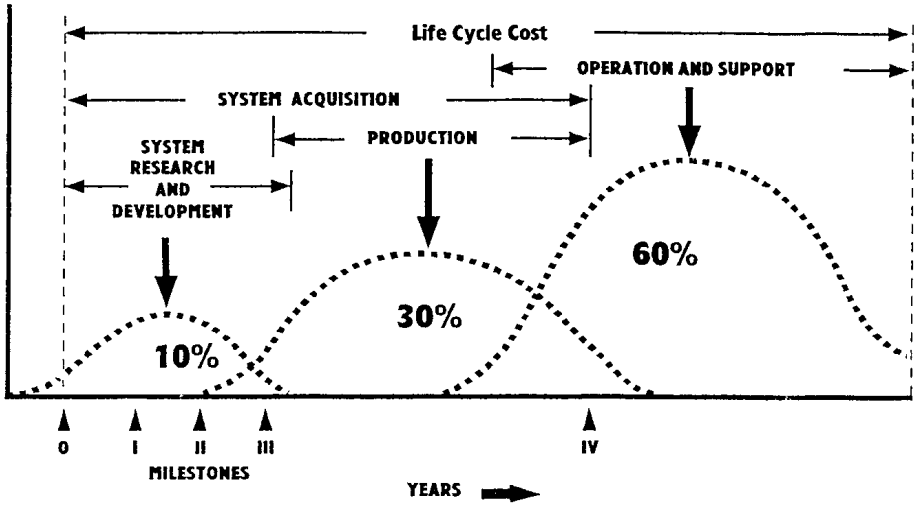
In another important policy decision, DOD decided in May 1995 that the IPT approach would be used to develop and build weapon systems. The IPT concept, an increasingly common practice in the commercial world, would link representatives of the weapon maker, the military service purchaser, and the office of the defense secretary. Members of the team stay in constant communication, addressing problems and negotiating changes to the program's development as they arise, rather than working at arm's length through a formal process (such as through the Defense Acquisition Board). The IPT concept was intended to transform historically adversarial relationships, such as between headquarters staff organizations and program office teams, into productive partnerships, and place renewed emphasis on the importance of working as a cross functional team to maximize overall performance. Success has been achieved by the IPT approach in a few new programs; one example is the JDAM program (see next section). Encouraged by its results, DOD has begun widening the IPT concept to many other programs, both new and existing; one such effort, to review past performance in the source selection process, has resulted in policy and procedural changes in federal acquisition policy (see "Issues in the 105th Congress.)

In one of the latest, potentially far-reaching decisions, DOD has begun a policy of increasing the importance of "cost" as a factor in deciding on the acceptable performance level of a weapon system. It is likely to force decision-makers to consider trading away some system performance to achieve greater cost savings. The policy, called CAIV, would attempt to move away from a major tenet in the Cold War culture of trying to achieve the best level of weapon performance at almost any cost. With the goal of lower costs and shorter schedules, the policy would require DOD program managers to examine the weapon system's entire life-cycle — including research and development, production, operation and support — and its cost patterns and objectives (see **Figure 1**).

The program manager would have to think about cost-related factors such as budgetary resources, unit costs of comparable or fielded systems, mission effectiveness, technology trends, innovative manufacturing techniques, and commercial business practices. DOD intends to give its program managers and contractors more freedom to make the trade-offs and meet cost targets; however, a significant challenge to implementing CAIV will be to persuade DOD and industry managers to become more innovative, accepting larger risks to achieve breakthroughs in cost and performance. The objective is to not penalize failures that might occur, despite management's best efforts (see the section on restructuring DOD's acquisition organization).

One of the most controversial of the acquisition reform initiatives is called "best value." Best Value is a process used in competitive contracting to select the most advantageous offer by evaluating and comparing several factors, including 1) technical competence; 2) proven past performance; 3) management capability; 4) life cycle costs, not just the initial price; and, 5) quality. The "best value" may not be the lowest bid offered; in fact, a Navy contract award based on "best value" resulted in the awarding of a $1.5 billion dollar contract (to build three LPD-17 amphibious assault ships) to a bidder that was $100 million more expensive than the lowest bidder. (For additional information, see CRS Report 96-346, *Navy San Antonio (LPD-17) Class Amphibious Shipbuilding Program: Background Information*).

Figure 1. **Typical Life-Cycle Cost Distribution**



Source: Defense Systems Management College

Potential Impact of Reform Actions

Perhaps the most often-asked question about acquisition reform is how much DOD will save from the ongoing initiatives. Although many are hopeful, history shows that many past DOD efforts have resulted in only minimal savings. Past disappointments included the projected, but unrealized, savings associated with the 1989 Defense Management Review. A chief obstacle has been a residual inertia on the part of the U.S. government, particularly in DOD — a clinging to the culture of the Cold War. Some experts argue, however, that this time will be different because the defense procurement budget has declined so dramatically (see Table 1, DOD Procurement), and there is little hope of the budget increasing enough in the foreseeable future to finance projected U.S. needs for modernizing its force structure. Former Secretary Perry had made it clear that DOD was depending on "substantial" savings from acquisition reform, as well as from base closings and privatization of some of DOD's functions, to help finance "critical" defense modernization.

It is difficult, at this point, to predict what DOD will achieve in the way of savings from its acquisition reform effort. More time is needed to complete implementation of the new initiatives, and to establish a system that accurately measures the savings. Fairly reliable estimates, however, exist for a few of the ongoing individual efforts. For example, the SPI could result in significant cost reductions. In 1995, a study by Coopers & Lybrand found that 1.7% of the cost of DOD acquisitions resulted from milspecs and standards, and that government-imposed material management and accounting systems added another 0.6% to costs. DOD estimates that about half of those costs, or $400 million, could be saved through reform. Experts also believe that by applying the IPT approach to program development and

the CAIV concept to spending on weapons performance, potential costs savings could be in the billions of dollars — a preliminary estimate at this point.

The most definitive estimate of cost savings, when SPI, IPT, CAIV, and other such acquisition initiatives are applied to DOD programs, was offered by Secretary Perry. In introducing DOD's budget request for FY1997, he cited three DOD programs. The first of these was the "Smart T" program — the Army's tactical communication terminal for MILSTAR. After reexamining the costs of certain levels of performance and streamlining the specification and data requirements, the original programs' cost estimates were reduced from $800 million to $250 million, for a net saving of $550 million. The second estimate of costs savings cited was for the Air Force and Navy JDAM program. The Air Force has reported that using the IPT approach has shortened the JDAM acquisition cycle by 4 years, eliminated numerous complexities, and significantly reduced the program's original cost projections. Using the accelerated acquisition plan, as well as off-the-shelf components and other commercial practices, the original cost estimate would drop from $42,000 per unit to $14,000, a 67% savings estimated at $2.9 billion. The third estimate of costs savings cited by Secretary Perry was for the C-17 program. After instituting the IPT approach, rethinking some performance requirements using CAIV, reducing reporting requirements some 3 years ago, and reaching an agreement to a multi- year procurement plan, DOD has estimated that it will save $5.3 billion over the life of the program. Furthermore, the Air Force has identified $13 billion in potential savings, or cost "avoidances," for 24 programs that include the C-17 and JDAM programs.

Issues in the 104th Congress

Three focus areas evolved during the 104th Congress: (1) restructuring DOD's acquisition organizations and workforce; (2) grappling with the outsourcing of defense acquisition-related functions to private sector companies; and, (3) overseeing the progress of the many ongoing initiatives, including those contained in FASA and FARA.

Restructuring DOD's Acquisition Organization

Many of the acquisition reforms initiated by Congress and DOD over the last 3 years have required changes in DOD's acquisition organization and operations. The objective of these reforms has been to achieve breakthroughs in cost and performance, even if it entails a greater degree of risk. Acquisition managers have been given more freedom to make decisions; these decisions will have to be made faster. In short, the organization is now expected to run more like a private sector operation. DOD has already designated a handful of pilot programs, such as the JDAM, for incorporating some new innovations. As an example, the Air Force is investigating a plan to financially reward the entire JDAM program team, as a result of its success in saving $3 billion and meeting acquisition milestones. DOD and the Air Force are continuing to work together on a pay-for-performance plan that would acknowledge the entire team — including DOD civilians, military, and contractor support personnel.

Organizational reform efforts have included major changes in the infrastructure. In the May 1995 study released by DOD's Commission on Roles and Mission, it was noted that while private sector contractors had undertaken large-scale reorganization to adjust to the

sharply reduced level of defense spending, no corresponding reduction had been made in the number of DOD acquisition organizations, or personnel.

In the FY1996 DOD Authorization Act, Congress moved to downsize DOD's acquisition organization and workforce to keep pace with broader civilian and military personnel reductions; it directed DOD to reduce the acquisition workforce by 15,000 in FY1996. The Act also required the Secretary of Defense to issue a report addressing such issues as eliminating duplication of functions among acquisition departments or agencies, as well as reporting a plan to reduce the acquisition workforce by 25% over 5 years, beginning October 1, 1995. Before the report (outlining the elimination of duplication of functioning among acquisition department agencies) was issued, the House passed the FY1997 DOD Authorization bill, H.R. 3230, which would require DOD to reduce its defense acquisition workforce by 25,000 in FY1997. The conference report amended this requirement to 15,000 in FY1997, bringing the total acquisition workforce reduction for FY1996 and FY1997 to 30,000 less than the baseline number on October 1, 1995.

Another issue, outside the scope of the congressionally mandated 1996 DOD report, involved the acquisition workforce. Congress had expressed its concerns about the workforce's ability to adapt to the new thinking and demands of proposed reforms. A provision was added to the FY1996 DOD Authorization Act (section 4308) that established a demonstration program to test various proposals for improving the management of acquisition personnel. The Quadrennial Defense Review (QDR) recommended that DOD reduce by 109,000 civilian and military personnel associated with infrastructure, achieving reductions planned beyond the 9% reduction planned in the current Future Years Defense Plan (FYDP), over the period FY1997-2003. In addition, the QDR recommended that a variety of defense-wide activities be competed, outsourced, re-engineered or consolidated, and requested authority for two additional rounds of base closures, one in 1999 and the second in 2001.

The defense acquisition workforce continued as a source of congressional oversight during the 105th Congress. The FY1998 Defense Authorization (P.L. 105-85) required a 25% reduction in the number of personnel assigned to DOD management headquarters and headquarters support activities over five years; it specifically directed a 5% reduction during FY1998, as well as a 5% reduction in staff at the United States Transportation Command during FY1998. The compromise reached on the downsizing of the defense acquisition workforce (previously, the FY1998 House authorization bill contained a provision that would have mandated a reduction of 124,000 personnel by October 1, 2001, but the Senate bill omitted any provisions) was to require a reduction of 25,000 defense acquisition workforce personnel in FY1998; included in this bill are provisions that grant authority to the Secretary of Defense to waive up to 15,000 of the 25,000, based on his assessment that a greater reduction would "be inconsistent with cost-effective management of the defense acquisition workforce system to obtain best value equipment and would adversely affect military readiness."

The FY1999 Defense Authorization Act directed the Administration to reduce the workforce by 25,000 acquisition personnel by October 1, 1999, lowering it to 12,500 personnel if the Secretary of Defense certifies that such a reduction would cause an adverse effect on military readiness or management of the acquisition system. Sections 921-22 of the FY2000 Defense Authorization Act directed DOD to submit reports on the status of

personnel reductions in the defense acquisition workforce (report is due by May 2000) and personnel reductions at headquarters (the report is due by October 2000.) (For additional information, see CRS Report 98-938, *Defense Acquisition Workforce: Issues for Congress*.)

Privatizing DOD Functions through Outsourcing

For a long time, DOD has privatized some of its functions through outsourcing to the private sector. Recently, however, DOD's interest in outsourcing and privatization has increased, largely due to federal efforts to reinvent government and other like initiatives. The move toward increased outsourcing had been boosted by success stories in the private sector, and by studies that estimated DOD could reduce costs and substantially increase efficiency. The Commission on Roles and Missions study, for example, concluded that DOD could achieve a 20% cost saving and greater efficiency by relying on the private sector to perform "commercial" activities, such as data processing, equipment maintenance, base maintenance, and installation services.

Congress had already taken steps to encourage DOD to privatize some specific operations and to explore the potential for other privatization opportunities. In the FY1996 DOD Authorization Act, Congress directed DOD to begin a process of outsourcing certain types of support services that are considered commercial in nature, but are not critical to DOD's war-fighting mission. The Act's provisions directed DOD to (1) privatize most printing and duplication services during FY1996; (2) begin to privatize payroll and travel administration; (3) adopt private industry inventory management practices, and rely on private sector vendors to manage inventory and deliver supplies, as needed; and, (4) submit a plan on opportunities for increased use of the private sector to provide commercial products or services, including specific justifications in cases where DOD recommended that a function continue to be performed by the government. Most of these directives required that DOD issue reports on its plans and progress to Congress during the current year.

U.S. policymakers will confront a number of questions, the answers to which will help determine the success or failure of outsourcing initiatives. First, does the initiative really reduce DOD costs over the long-term, and how will DOD measure those savings? It is known that DOD has experienced problems with its cost accounting and billing systems, important components in tracking cost savings. Second, will DOD's management structure be able to "manage" the initiative to make sure its operation becomes more efficient? Experts point out that some private sector companies have run into outsourcing problems because they failed to make necessary changes in their management structure. Third, does the initiative fit into the current policy of encouraging the closer integration of the U.S. defense and commercial industrial bases? Finally, does the initiative go beyond the "proper" limits of privatization at DOD, whose first and foremost mission is to protect U.S. national security, not to maximize savings? In other words, does the initiative adversely impact DOD's war-fighting capability?

Oversight of Reform Initiatives

Congress has faced important oversight responsibilities because of changes taking place in defense acquisition policy. The success or failure of these changes will be determined by how quickly and effectively DOD acts to implement them. On March 15, 1996, DOD gave final approval to a major revision of DOD Directive 5000.1 and DOD Regulation 5000.2-R,

both of which contained new policy changes and procedures based on FASA and FARA legislation. The former 900-page set of regulations has been reduced to a 160- page volume and is available via an on-line database. FASA has required the Comptroller General to evaluate the effectiveness of implementing the final FASA regulations, and submit a report to the Congress within eighteen months; FARA further broadened the scope.

The various congressionally-mandated acquisition reform reports issued, and those to be issued later, require attention and, perhaps, subsequent action. For example, and in addition to the reports previously cited, the FY1996 DOD Authorization Act required another report that would enable DOD to improve the performance of depot maintenance and repair of U.S. weapon systems. On April 4, 1996, DOD issued its report, "Policy Regarding Performance of Depot-Level Maintenance and Repair Workload." It advocated reforming the laws regulating how DOD allocates its maintenance workload between the public and private sectors. It stated that such legal requirements prevented DOD from (1) taking full advantage of lower cost opportunities through outsourcing to the private sector, and (2) restructuring its public depots to provide the military only necessary "core" capabilities. The report drew mixed congressional reactions, and the allocation of DOD's maintenance workload has become a subject of debate.

When the House passed the FY1997 DOD authorization bill (H.R. 3230), it voted to maintain current DOD depot maintenance and repair policy (60% government, 40% private). The Senate voted to increase the "private" share, from 40% to 50%. In the 1997 DOD conference report, the House and Senate both receded; the conference report does not contain any of these provisions. The conferees agreed not to take any action regarding these issues that year; thus, the DOD depot maintenance and repair policy remained unchanged. The FY1998 Defense Authorization Conference Report (P.L. 105-85) establishes a new definition of what constitutes "depot maintenance and repair;" it will require that DOD, in the course of conducting such competitions, clearly satisfy a number of congressional requirements during the source selection process, and requires that the Secretary of Defense provide an annual report to the Congress, detailing the public/private percentages of depot maintenance and repair workloads. This report would be reviewed by the Comptroller General to determine whether DOD had complied with requirements of Section 2466 of the U.S. Code.

The Senate Armed Services Committee's Subcommittee on Readiness recommended a revision of the laws relating to the performance of DOD depot maintenance, including 1) an increase in the private share to 50%; 2) adjusting the law so that work performed by private companies at public depots will be counted as public sector depot maintenance, rather than private sector depot maintenance; 3) requiring the efficient operations of the remaining public Air Logistics Centers (ALC) prior to the implementation of any "privatization in place" at former ALC locations; and 4) requiring DOD to preserve a core depot capability that could maintain the types of weapons systems that have been identified as "mission essential." The effect of these provisions would have been to prohibit privatizing Air Force maintenance work at McClellan ALC, Sacramento, California and Kelly ALC, San Antonio, Texas. By November 6, the House and Senate had both reached a compromise on the FY1998 Defense Authorization Conference Report, adjusting the public/private depot maintenance and repair workload from 60/40 to 50/50; however, a number of new provisions were included, such as directing DOD to begin integrating public depot work. (See P.L. 106-259, the FY2001 Defense Appropriations Bill.)

On March 2, 1999, in a hearing before the Subcommittee on Military Readiness, Deputy Undersecretary of Defense (for Acquisition Reform) Stan Z. Soloway reported that DOD acquisition reform initiatives had experienced measurable success within the Joint Air-to-Surface Standoff Missile Program (JASSM), Joint Direct Attack Munition (JDAM) Program, Fire Support Combined Arms Tactical Trainer (FSCATT) Program, Joint Primary Aircraft Training System (JPATS), and the F-117 Tactical Air Program. Here are excerpts of his March 2, 1999 testimony before the House Subcommittee on Military Readiness.

> The Joint Air-to-Surface Standoff Missile, or JASSM, a next-generation air launched cruise missile that will provide the Air Force and Navy a standoff capability greater than currently exists, has made major gains from acquisition streamlining. Estimated program costs have been reduced 44%. JASSM will also have a complete "bumper-to-bumper" 15-20 year warranty.
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> The Joint Direct Attack Munition, or JDAM, a strap-on guidance kit to enhance the delivery accuracy of 1000 and 2000 pound bombs, employed acquisition reform to achieve lower development and production costs, faster schedules, and lower unit costs. The JDAM team reduced unit cost by approximately 60% below the estimated requirement costs. Overall, cycle time for JDAM was reduced 35% with a 30% reduction in program staffing. JDAM reduced projected O&M (Operation and Maintenance) Costs by $49.4 million (86.8%) through the use of a 20-year warranty.
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> The Fire Support Combined Arms Tactical Trainer (FSCATT) program has achieved a 33% reduction in cycle time with a 13.5% reduction in estimated contract cost and 27% reduction in program staffing.

Issues in the 105th Congress

Issues in the 105th Congress included 1) reviewing congressionally mandated reports, the findings of which will aid Congress in identifying further cost cutting strategies for reducing infrastructure costs savings in the Department of Defense; 2) integrating the assessments and recommendations of various defense panels charged with assisting the Secretary of Defense in changing the business culture within the Defense Department; and 3) assisting DOD in its implementation of acquisition workforce reductions as well as refinements and other changes to federal acquisition regulations.

Review of Congressionally Mandated Reports

The continuing acquisition reform debate in the 105th Congress focused on a number of congressionally mandated reports, the findings of past and current reports of the Defense Science Board, and the changes that Secretary Cohen has announced as part of his Defense Reform Initiatives. The first was a study of major defense acquisitions programs, called the "Report of the Defense Science Board's Task Force on Defense Acquisition Reform." Phase II of the report was issued August, 1994; Phase III was published in August 1996. Under the requirements of FASA, DOD was asked to reduce the average time that it took to field "emerging technologies," starting from the baseline of October 13, 1994. At that time, it would take over 16 years to field the next generation's weapon system; one of the study's objectives was to reduce this by upwards of 50%. In the Secretary of Defense's Annual Report for FY1996, the average time was reduced to about 9 ½ years.

The second study was chartered to develop recommendations for DOD on how to effectively use outsourcing to create a funding mechanism for future force modernization needs. The Task Force issued a lengthy final report, stating:

> ...The Task Force believes that all DOD support functions would be contracted out to private vendors except those functions which are inherently governmental, are directly involved in war fighting, or for which no adequate private sector capability exists or can be expected to be established...

The third study was chartered to develop ways to improve the organization of acquisition processes and personnel. The goal of the panel is to help DOD define a new acquisition system that can reduce weapons procurement, both costs and cycle time.

Assessments and Recommendations of Defense Panels

In keeping with his desire to change the way that the Pentagon conducts business, often characterized in the press as a "revolution in business affairs," Secretary Cohen announced a number of Pentagon management and organizational reforms. These reforms were recommended by the Task Force on Defense Reform, a public/private partnership which studied ways to improve business practices within DOD. The "Tail-to-Tooth" Commission and the Task Force on Defense Reform operated in parallel, and a number of their recommendations were used by the Secretary to develop his Defense Reform Initiatives. They include 1) reducing the size of the Office of the Secretary of Defense, the Joint Staff and defense agencies, from 141,000 to 111,000 staff members; 2) realigning functions within the Department of Defense, consolidating and eliminating duplicative functions; 3) increasing public-private competitions to outsource non-core maintenance and support work; and, 4) establishment of a senior-level Defense Management Council to monitor compliance. Cohen has also proposed base realignment and closure (BRAC) rounds for the years 2001 and 2005 to further reduce defense infrastructure.

Changes in Federal Acquisition Legislation

Another significant policy change that evolved in the 105th Congress was the interpretation of the use of past performance in the source selection process. Dr. Paul Kaminski, Dr. Gansler's predecessor, instituted the Past Performance Integrated Product Team (IPT) to take a look at the evaluation of the use of past performance within the defense contract industry. As a result of the IPT's recommendations, Dr. Gansler issued a new set of guidelines on past performance in the source selection process, to become effective on February 1, 1998. These guidelines changed federal acquisition regulations and the Defense Acquisition Regulation (DAR) Supplement; all defense agencies are required to adopt them. The purpose of the new guidelines was to establish consistency and standardization in how DOD contracting officials define and collect information about defense contractors. Among defense contractors, the lack of consistency in the use of past performance information had been an ongoing source of criticism; the new policy will help defense contractors to understand the kind of information that will be evaluated, rather than be evaluated on factors known only to DOD. The new policy guidelines are to spell out a common management policy among the services (previously Army, Navy and the Air Force each had unique approaches for collecting and evaluating contractor past performance information), and the unified policy will make it easier to evaluate and compare contractor performance. Past

performance information (PPI) will be automated and, along with other efficiencies, will make the information more accessible. The information will be made available to the general public, at some future time. DOD has implemented a pilot study; a status report is expected.

Issues in the 106th Congress

The 106th Congress will have an important oversight role in defense acquisition reform, especially in monitoring DOD reports to Congress on many of its acquisition reform initiatives (such as progress in reducing the size of the acquisition workforce) or in defining governmental activities subject to managed competition and outsourcing alternatives.

OMB has published the proposed rules to implement the Federal Activities Inventory Reform (FAIR) Act of 1998 (P.L. 105-270) through the use of OMB Circular A-76. The OMB Circular A-76 policy was first issued in 1966. The policy, supplemental handbook, and accompanying policy memoranda were revised and re-issued on June 14, 1999. Authority for the OMB Circular A-76 originated in the Budgeting and Accounting Act of 1921 (31 U.S.C. 1 et seq.) and the Office of Federal Procurement Policy Act Amendments of 1979 (41 U.S.C. 401 et seq.) Legal or procedural challenges to the policy or procedures are provided for in the Supplemental Handbook. Copies of updated versions can be found on the Internet, at [http://www.whitehouse.gov/OMB/circulars/index-procure.html].

FAIR outlines a way for federal agencies to decide who is best to perform work activities — whether the work should be performed in-house or contracted out (called outsourcing) to another public or private group. FAIR includes a definition of what is generally considered an inherently governmental function, although agencies can argue for inclusions/exclusions to the lists. The lists may be challenged by "interested parties," as defined in the legislation. Activities or functions not inherently governmental in nature shall be considered "commercial" and may be subject to a managed, competitive outsourcing process; however, the legislation does not require agencies to contract out commercial activities.

P.L. 105-270, the Federal Activities Inventory Report (FAIR) Act of 1998, requires federal executive agencies to submit annual inventory lists of government activities "not inherently governmental" in nature; ultimately, the lists are to be made available to Congress and the general public. Federal executive agencies (which include the Department of Defense) must submit their lists to OMB by June 30, 1999. It appears that federal agencies are meeting the legislative requirements. On September 30, 1999, some fifty-two federal agencies released their annual inventory lists of positions deemed non-inherently governmental.[1] The lists covered approximately 320,000 federal employees. Approximately one-third of the federal positions listed are functions that the agencies believe are non-inherently governmental.[2] On December 30, 1999, DOD reported that approximately 504,000 civilian jobs could be performed in the private sector, of which approximately 308,000 were

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[1] Friel, Brian. "Contractors Eye Job Lists; Agencies Try To Retain Work." *Government Executive*, October 4, 1999.

[2] Friel, Brian. "Agencies Say 100,000 Jobs Could Be Contracted Out." *Government Executive*, September 30, 1999.

potential candidates for outsourcing. On July 18, 2000, a senior DOD official announced that DOD may use the annual inventory lists required by the FAIR Act to decide which jobs should be opened to public-private competition.

106th Congress: Key Public Laws

P.L. 106-259 (S.2593, H.R. 4576). A bill making appropriations for FY2001 for the Department of Defense and for other purposes. Approved by the House Defense Appropriations Subcommittee, May 10, 2000. Approved and ordered reported by the House Appropriations Committee (H.Rept. 106-644), May 25, 2000. Approved by the House (367-58), June 7, 2000. Senate took up H.R. 4576, deleted all after the enacting clause and substituted the text of S. 2593 as reported by the Senate Appropriations Committee, June 8, 2000. Considered by the Senate June, 2000. Approved by the Senate (95-3), June 13, 2000. House agreed to close portions of the conference (407-7), July 12, 2000. Conference Report (H.Rept. 106-754) filed, July 17, 2000. House agreed to conference report (367-58), July 19, 2000. Senate agreed to conference report (91-9), July 27, 2000. Signed into law (P.L. 106-259), August 8, 2000.

P.L. 106-65 (S. 1059, H.R. 1401). Authorizes appropriations for FY2000 for military activities of Department of Defense, for military construction, for defense activities of Department of Energy, and for other purposes. Ordered reported by Senate Armed Services Committee, May 13, 1999. Report filed (S.Rept. 106-50), May 17, 1999. Considered by Senate, May 24, 25, 26, and 27, 1999. Passed Senate, with amendments (92-3), May 27, 1999. Conference agreement ordered reported (H.Rept. 106-301), August 5, 1999. House approved the conference report (375-45), September 15, 1999. Senate approved the conference report (93-5), September 22, 1999. Signed into law October 5, 1999.

P.L. 106-79 (H.R. 2561, S. 1122). A bill making appropriations for FY2000 for Department of Defense and for other purposes. Ordered reported by House Appropriations Committee (H.Rept. 106-244), July 16, 1999. Considered by House, amended and passed as amended (379-45), July 22, 1999. Called up in Senate, amended with the text of S. 1122, and passed Senate by unanimous consent, July 28. Conference report filed (H.Rept.106-371), October 8, 1999; passed by House (372-55), October 13, 1999; and passed by the Senate (87-11), October 14, 1999. Signed into law (P.L. 106-79), October 25, 1999.

105th Congress: Key Public Laws

P.L. 105-261 (H.R. 3616, S. 1812). Defense Authorization Act for Fiscal Year 1999. Introduced in House, April 1, 1998; referred to Committee on National Security. Passed House May 21, 1998 (357-60). Passed Senate, with an amendment and an amendment to Title, by unanimous consent, June 25, 1998. Conference report passed House, September 24, 1998 (373-50); passed Senate, October 1, 1998 (96-2). Signed into law October 17, 1998.

P.L. 105-262 (H.R. 4103, S. 2132). Defense Appropriations Act for Fiscal Year 1999. Introduced in House, June 22, 1998. Passed House, June 24, 1998 (358-61). Received in Senate, June 25, 1998. Passed Senate, in lieu of S. 2132, July 30, 1998 (97-2). Conference report passed House, September 28, 1998 (369-43); passed Senate, September 29, 1998 (94-2). Signed into law October 17, 1998.

P.L. 105-270 (H.R. 716, S. 314). Federal Activities Inventory Reform (FAIR)Act of 1998. A bill to require that federal government procure from private sector the goods and services necessary for operation and management of certain government agencies. Introduced in House, February 12, 1997. Passed Senate, with amendments, July 30, 1998. Signed into law October 19, 1998.

FOR ADDITIONAL READING

Business Executives For National Security, Tail to Tooth Commission. *Issue Paper: Office of Management and Budget Circular A*-76. February 1998.

Government Executive. "Congress Sends Privatization Bill To Clinton." October 9, 1998.

—— "DOD May Put More Jobs Up For Outsourcing," January 5, 2000.

New Labor Forum. "Beyond The $600 Toilet Seat: How Federal Employees Can Save Taxpayers Billions," by Wiley H. Pearson, Spring/Summer 1999.

U.S. Department of Defense. *Commission on Roles and Missions of the Armed Forces. Directions for Defense.* May 1995.

—— *Depot Level Maintenance and Repair Workload*. April 1996.

—— *Improving the Combat Edge Through Outsourcing*. April 1996.

—— *Policy Regarding Performance of Depot Level Maintenance and Repair*. April 1996.

U.S. Department of Defense. *Task Force on Outsourcing and Privatization Report,* Defense Science Board. August 1996.

U.S. Department of Defense. Section *912(c) Report of the Secretary of Defense to Congress. Actions to Accelerate the Movement to the New Workforce Vision.* William S. Cohen, Secretary of Defense. April 1998.

CRS Reports

CRS Report RL30392. *Defense Outsourcing: The OMB Circular A-76 Policy*, by Valerie Bailey Grasso.

CRS Report 98-938. *Defense Acquisition Workforce: Issues for Congress*, by Valerie Bailey Grasso.

CRS Report 96-373. *Federal Acquisition Reform Act of 1996*, by Michael V. Seitzinger.

CRS Report 95-522. *Privatization: Meanings, Rationale, and Limits*, by Ronald C. Moe.