



Five Factors Plaguing Pentagon Procurement

By William C. Greenwalt

The Pentagon has been undergoing major procurement reform since 1984, but hoped-for results have not been achieved. Bipartisan acquisition reform legislation was passed in the 1990s, but these positive changes did not hold. At the heart of the current procurement dilemma is too much faith in central planning and too little faith in the free market. Policymakers must first remedy the incentives underlying reform, and five overarching categories are driving the misplaced incentives: trust in central planning leading to increased bureaucracy, preference for defense-unique versus commercial solutions, distrust of the defense industry and profit motives, fear that the workforce is incapable of exercising discretion, and finally, preoccupation with cost certainty and maintaining low prices over achieving results and value. By reaching out to and incentivizing the private sector, the Pentagon can help reform the procurement system by lowering costs, restoring competition, and delivering taxpayers the best value for their money.

Since the Competition in Contracting Act of 1984 and the landmark 1986 Goldwater-Nichols Act, the Pentagon has been in a near constant state of acquisition reform. Despite numerous changes to Pentagon procurement practices, however, almost no one is satisfied with the current system. According to retired Marine Corps major general and former Senate Armed Services Committee staff director Arnold Punaro, the current acquisition process can be summed up in seven words: “spend more, take longer and get less.”¹

This state of affairs did not arrive overnight. It is the result of a longer-than-50-year process that, oftentimes under the banner of reform, has increased bureaucracy, decreased competitiveness, and restrained creative ideas from nontraditional sources. Indeed, many of the problems that plague the current system stem from too much faith in central planning and too little faith in the free market.

There was one glimmer of hope in the 1990s when commercial-market incentives were used to drive down Pentagon costs and increase defense

innovation. This reform effort resulted in the passage of bipartisan acquisition reform legislation and changes in the Pentagon’s procurement practices. Many positive benefits accrued from these changes, but even these positive reforms were not institutionalized during the Bill Clinton and George W. Bush years and have been considerably rolled back in the last five years of the Obama administration. The next stage of acquisition reform will need to

Key points in this *Outlook*:

- Three decades of almost constant procurement reform at the Pentagon has disappointingly resulted in increased bureaucracy, decreased competitiveness, and less innovation.
- Five overarching tendencies are contributing to poor outcomes: trust in central planning, preference for defense-unique solutions, distrust in the defense-unique industry, fear of the workforce exercising judgment and discretion, and valuing cost certainty and low prices over results.
- By reaching out to and incentivizing the private sector, the Pentagon can help put the free market to work for America’s armed forces, driving down costs, restoring competition, and delivering taxpayers the best value for their money.

William C. Greenwalt (bill.greenwalt@aei.org) is a visiting fellow in the Marilyn Ware Center for Security Studies at AEI.

be much more comprehensive if the US military is to retain its technological superiority into the future.

During the Cold War, the Pentagon's bureaucracy and acquisition system began to look more like the Soviet Union's.

While the challenges facing Pentagon procurements are as complex as they are numerous, this Outlook attempts to boil them down into five key baskets that outline some of the overarching beliefs driving misplaced incentives applicable to all procurements. These beliefs are at the core of the acquisition practices witnessed in the last five years. They are contributing to poor acquisition outcomes and exacerbate the effects of one another. These views include a trust in central planning that has led to excessive rules, regulations, and bureaucracy; a preference for defense-unique options that reinvent the wheel versus commercial solutions; a distrust of industry and the profit motive; a fear that the acquisition workforce is incapable of exercising judgment and discretion; and finally, a focus on obtaining cost certainty and low prices versus achieving results and value.

These beliefs, however, did not begin with the Obama administration. In fact, they were for the most part the same assumptions and worldviews that former secretary of defense William Perry, the Clinton administration, and a bipartisan Congress tried to overcome in the 1990s acquisition reforms. That they are back and have triumphed is a testament to their ideological and bureaucratic staying power.

Thus, today's procurement problem is that we have come full circle in the last decade. The current system is now coalesced around policies that would return the Pentagon to an acquisition system from around the mid-1980s. Unfortunately, the US industrial base and global economic and security conditions have changed radically since those halcyon days of bipolar competition. Acquisition reform is now even more of a critical national security issue than it was in the early 1990s, and one that needs to be addressed; otherwise, more will be lost than wasted taxpayer dollars.

First, we must fix the incentive structure. The underlying beliefs of government leaders in both the Congress and executive branch drive the incentive structure of the key actors in the system: the bureaucracy and industrial base. By distilling this complex problem into digestible

portions, this *Outlook* aims to introduce these five underlying beliefs as the most egregious reasons the Pentagon acquisition system is in such dire shape. The next step will be to begin charting a better path forward to aligning incentives in a way that allows the Pentagon to obtain the best procurement solutions rather than compliance with a process.

ISSUE 1

Trust in Central Planning: Rules, Regulations, Process, and Bureaucracy

Trust in central planning is at the heart of much of the Pentagon's acquisition problems. Bureaucratic one-size-fits-all solutions have continued to be inflicted on the system in order to address ad hoc, nonsystemic challenges as they arise. These new solutions rarely replace old structure; rather, they are bolted onto the existing system, adding additional levels of complexity and cost.

The 2010 Quadrennial Defense Review Independent Panel—a bipartisan blue-ribbon commission established by the Congress to stress test the Pentagon's 2010 Quadrennial Defense Review (QDR)—stated this problem bluntly, observing that acquisition “reform” initiatives of the recent past had “produced more structure and more process but have not produced notable improvement in delivering required capabilities when needed at the expected cost.”²

In 1986, another blue-ribbon commission, headed by Hewlett-Packard cofounder and former deputy secretary of defense David Packard, issued a report on defense procurement that rings almost as true today as it did the day it was written. As the Packard Commission found, acquisition team members report that they often operate under the burden of “inefficient, confusing regulations that are often inconsistent with sound business practices.”³ Unfortunately, the problem has only gotten worse since 1986.

These unsound business practices frequently lead to extremely high transaction costs incurred to comply with increasing regulations and reporting requirements. The regulatory burden is so high, for example, that the Defense Business Board recently proposed “zero-basing” all Pentagon acquisition regulations, throwing out the entire book and putting the burden of proof on regulations to stay on the books. This guilty-until-proven-innocent approach is designed to bring market-oriented flexibility and life back to a moribund acquisition process.

Many layers of organizations, structure, laws, rules, and regulations have been directed at the one constant over the last 50 years of US Department of Defense (DOD) procurement: cost overruns, schedule slippages, and performance issues. J. Ronald Fox of Harvard Business School concludes that despite decades of reform efforts, “Fifty years later, acquisition reforms continue to seek remedies to the same problems.”⁴

One of the sources of this conundrum is the way the acquisition system was established and structured. During the Cold War, the Pentagon’s bureaucracy and acquisition system began to look more like the Soviet Union’s, and it has never quite been able to escape this history. The wrong lessons were drawn from successful 1950s procurement programs that rapidly developed advanced nuclear weapons, the means to deliver these weapons—intercontinental ballistic missiles, ballistic missile submarines, and long-range bombers—reconnaissance aircraft, satellites, and strategic command-and-control systems.

At the time, the predominant takeaway from these efforts was the significant role of government planning as the key to success. The concerns over Sputnik in 1957 and fears that the Soviet Union’s rise was inevitable only reinforced the view that history was on the side of central planners.⁵ The private sector’s contribution was subsequently viewed as a negative and as the cause of cost overruns, profiteering, and missed deadlines.

It was under this environment in the early 1960s that the foundation of the centrally planned acquisition system was formalized. In the beginning, concerns about cost overruns on newly developed and newly produced military programs ushered in this new scientific management and oversight approach for acquisition. This included the Planning, Programming, and Budgeting System (PPBS) remarkably reminiscent of Soviet Five Year Plans, formal systems acquisition and requirements processes, and the Truth in Negotiations Act of 1962 (TINA) designed to regulate contractor costs. It is from these basic four systems—budget, procurement, requirements, and cost accounting—that the centrally planned acquisition system has grown over the last 50 years.

Thus began a continuing cycle of procurement scandal (either real or perceived) followed by new laws, regulation, rules, and czars to address those scandals followed by new scandals and more laws, regulations, and bureaucracy. It became dogma that each eventuality could be planned for, and better “management and oversight” would lead to acquisition perfection. One-size-fits-all

solutions were continuously adapted based on narrow cases and anecdotes.

By the time of the Ronald Reagan military buildup, the defense-unique acquisition system was firmly entrenched.⁶ The rate of US defense innovation slowed as research and development (R&D) efforts were focused on making incremental design improvements to those systems originally developed in the 1950s. It should be noted that the most innovative and game-changing technologies of the 1970s and 1980s (advanced intelligence-gathering satellites and stealth aircraft) were developed, produced, and deployed for the most part outside of the traditional acquisition system’s bureaucratic morass.

Since the end of the Cold War, DOD’s acquisition process has only become more engrained in bureaucracy, rules, regulations, and process. The predominance of procurement successes (if one is focused on speed to deployment and innovation) in the last several decades has been the byproduct of using legislative authorities or management approaches where acquisition rules are waived or bypassed. While capability can be achieved through traditional procurement rules, it often takes 10 to 20 years and an extraordinary amount of money to deploy. As the budget comes under increasing pressure and future threats mount, current trust in the old centrally planned system needs to be overturned. This will be extremely difficult, as all participants in the process believe in the inherent value they think they provide. The reality is that these actors are working at cross purposes from each other, and each requirement, rule, and regulation has its own unique cost to the system—some measurable and some not.

To be fair, some degree of defense-unique management structure and process will be required to manage the monopsony defense market. The issue is the magnitude of this structure. But anything defense-unique—be it a rule, process, or practice—is going to be expensive and should meet a strict cost-benefit test. Are these measures worth the cost, and are there any negative incentives being created that drive unproductive behavior in the government workforce and industrial base?

ISSUE 2

Preference for Defense-Unique Solutions

The Pentagon has long preferred defense-unique solutions and an industrial base over which it has greater control. A government-knows-best mentality and rigid defense-

unique requirements have dominated Pentagon procurement since the 1960s. Not surprisingly, a defense-unique industrial base has grown up to meet these needs while commercial companies have traditionally shunned DOD.

The defense-unique industry's primary advantage in government contracting compared with the rest of the private sector is its ability to comply with acquisition rules, regulations, and requirements. This is not surprising as this is what the industry was being held accountable for by the government. The problem with the government's regulatory approach to acquisition is that top engineers, innovators, and firms do not want to focus their time on rules-based compliance and have other places to work beyond the defense market.

The first example of this occurred in the 1960s. The commercial companies and individuals behind the miniaturization of electronics and the development of the air defense and command-and-control systems of the 1950s escaped from this path to pseudo-nationalization and control by first working with NASA, which was more reminiscent of the early Pentagon programs. These companies formed the basis of Silicon Valley and the Massachusetts Route 128 commercial computer and electronics industries chasing and eventually capturing the higher returns to be found in those sectors.

The aftermath of the Vietnam War era saw the further bifurcation of the civilian and military industry bases. DOD continued to develop and refine defense-unique procurement and oversight requirements, military-unique specifications, greater government control of intellectual property that is anathema to commercial companies, and security-unique requirements and export controls. In large part because of these trends, doing business with DOD became more difficult than ever before. This resulted in the fundamental reorganization of the defense industry and the emergence of an industrial base that exclusively focuses on providing goods and services to the Pentagon—but with little exposure to the commercial market. Dual-use companies created divisions that specialized in the arcane acquisition process of the DOD, walled off from the more dynamic commercial portions of the firm.⁷

The Pentagon central planners of the 1960s and 1970s did not see a problem with this bifurcation of the market because those nascent Silicon Valley firms and other commercial providers were still technologically years behind the Pentagon. For example, in 1964, the federal government provided 67 percent of R&D funding and served as the driver of innovation in the economy.⁸ The command-and-control economic model seemed to be working.

That situation began to change by 1980 when aggregate, commercially funded R&D in the United States overtook government-funded R&D.⁹ As this trend intensified in the 1980s, some defense policymakers began to focus on ways to access this emerging source of innovation, especially as commercial products began to prove cheaper and more reliable than their military counterparts. Still, commercial-item incorporation was stymied at every turn and the preference for defense-unique solutions resident in the requirements, technology, engineering, test, contracting, and oversight communities posed (and continues to pose) severe challenges for the incorporation of commercial items.

The 1986 Packard Commission called for the adoption of commercial processes and practices as a primary tool that DOD could leverage to broaden access to cutting-edge commercial products, services, and solutions. Commercial-item acquisition reforms, however, did not begin in earnest until the early 1990s when post-Cold War budget pressures became a reality. Adopting commercial products, services, and business practices became one way to free up money to maintain military capabilities. Without that budgetary pressure, it is doubtful that the Pentagon's preference for defense-unique solutions and processes would have been overcome. Even with these pressures, it was critical for senior leadership in both the Pentagon and the Congress to lead and advocate for these commercial buying reforms.

In the 1991 National Defense Authorization Act, the Congress chartered the so-called Section 800 Panel to review and assess the efficacy of existing laws impacting the government's procurement system. The Section 800 report, published in January 2003, recommended a different acquisition approach to commercial-items acquisitions by explicitly stating a preference for acquiring commercial items and waiving acquisition laws, regulations, and rules for the purchase of these items. In the 1994 Federal Acquisition Streamlining Act and the 1996 Clinger-Cohen Act, the Congress implemented these recommendations.

Secretary of Defense Perry began his own acquisition reform efforts by attempting to move DOD away from its dependence on military specifications and by adopting commercial specifications wherever possible. The Perry memo repudiated the use of inflexible military specifications that limited competition, stifled innovation, increased costs, and delayed the fielding of new systems. The future importance of commercial items to US military strategy was outlined when then-undersecretary of

defense Paul Kaminski stated in a testimony before the Committee on Armed Services Subcommittee on Defense Technology, Acquisition and Industrial Base: “The military advantage goes to the nation who has the best cycle time to capture technologies that are commercially available; incorporate them in weapon systems; and get them fielded first.”¹⁰

Adversarial relations with industry begin with government employees’ and political leaders’ views toward industry.

These reforms led to radical changes at the Pentagon that continued for about a decade in the traditional procurement system and longer in the rapid acquisition process designed to meet urgent warfighter needs in Iraq and Afghanistan. Commercial companies began to wade into the defense market, and barriers between the defense and commercial portions of firms began to evaporate. While the reforms did not go far enough for some commercial firms, they did open the door for enough firms to make a difference.

The benefits to the DOD included access to the latest technology, faster delivery, lower prices, integration of the defense and commercial industrial bases, access to commercial support services, and elimination of the need to fund the development and support of unique items. The use of commercial contracting practices allowed commercial companies to enter the government marketplace and provide products to both commercial and military customers using common product lines and workforces. Internal investments to develop commercial products benefitted both commercial and military customers and created a larger production base with lower prices because of economies of scale. The R&D for these products was paid for by these commercial companies, which freed up funding for DOD to pursue other priorities.

In recent years, however, the process by which the government acquires goods and services from the commercial market has been destabilized and suboptimized. Much of this rollback can be attributed to the lack of budget pressures and the reemergence of the command-and-control mentality in the Pentagon and Congress. A steady stream of legislative and regulatory changes, some initiated in the annual defense authorization process and others driven by internal Pentagon audit findings and policy changes, have undermined commercial buying reforms by

imposing new defense-unique acquisition oversight requirements that are inconsistent with commercial practices and threaten the commercial procurement model.¹¹ This steady erosion of the government’s use of the streamlined approach to commercial acquisition incurs both monetary and innovation costs.

ISSUE 3

Distrust of Industry and “Excessive Profits”

Given the history of the acquisition system, perhaps it is not surprising that Pentagon bureaucracy is deeply distrustful of the private sector and what seems a lack of understanding of how profits motivate industry. While there is a distrust of the traditional defense-unique industry that translates into an almost pathological desire to eliminate allegedly excessive profits, the animosity is even higher for those companies who make even greater profits in the true commercial marketplace outside of defense.¹²

1990s-era acquisition reform measures focused on harnessing the profit motive, improving government-industry communications, and developing public-private partnerships to better incentivize the private sector to deliver best-value solutions to the government at lower cost. However, in the last five years, DOD has seen the return of a culture of adversarial business relations with industry. The environment for anyone contracting with DOD is now more confrontational and risk averse. One former undersecretary of defense for acquisition, technology, and logistics summarized the current acquisition environment as a “Global War on Contractors.”¹³

The Section 800 Panel observed changes taking place in the industrial base in the early 1990s that are remarkably similar to those occurring today: “Firms, particularly subcontractors and suppliers of system components, are moving from defense to the commercial market, where the profits are better and where business is conducted in a more stable, less adversarial manner.”¹⁴

There is a similar refrain from today’s industrial base as companies debate whether the defense market is worth the risks for such limited gains. From the defense industry’s perspective, the breakdown in industry-government communications, adversarial relations, low profitability, and doubt that the government will do the right thing are the worst seen since the advent of acquisition reforms in the 1990s.

Adversarial relations with industry begin with government employees’ and political leaders’ views toward industry. Do these employees believe industry is a potential

partner to help solve problems the government cannot, or do they believe industry is trying to rip the government off any chance it can get? The latter view has prevailed since President Obama's speech on federal procurement in March 2009, which is referred to by some in the defense industry as the "culture of corruption" speech.

While it is not clear that the president was targeting more than a small subset of acquisition issues related to wartime contracting abuses and poor cost estimating on major defense programs, the application of his concerns has been much wider than these concerns. For better or worse, this speech was the catalyst for an atmosphere of distrust in the procurement community that has resulted in adversarial relations with industry, a return to defense-unique oversight mechanisms that are not applicable to commercial contractors, a reinstatement of defense-unique requirements, and a prevalent culture of risk aversion.

The current belief in the government seems to be that contractors are making obscene profits and thus need to be reined in. As a result, DOD is seeking ways to drive profit margins down in the regulated defense-unique market. The higher profit margins that commercial companies make are even more objectionable. This obsession with profits led one long-time observer of the defense acquisition system to remark that DOD would rather have a 5 percent profit margin on a \$1 billion contract than a 20 percent margin on a \$500 million contract to do the same thing.¹⁵

The war on profits at DOD is another example of the Pentagon bureaucracy's lack of understanding of how the private sector works and how to use profit incentives to reward good performance. It also completely misunderstands the profound difference between the profit margins in the regulated defense-unique industrial base and those in the commercial marketplace. Profit margins are significantly higher in the information-technology (IT) industry than they are in the defense industry.¹⁶ This impacts the level of innovation in the industry and the kind of technical, engineering, and management talent that each industry can access. By all measures, the commercial market is crushing the defense industry in this competition. This has national security implications, particularly if DOD continues to distance itself from the commercial industry and is not able to access this innovation in the future.

The defense-unique industrial base has developed into a highly regulated utility with similar lower returns to investors. But regulated utilities are not normally incentivized to be very innovative, and services and warfighters should want this innovation from the defense industry.

DOD, however, does not seem to want to pay for this innovation and the tension between requirements and incentives will continue to result in technological overreach, disappointment, and cost overruns.

While DOD continues to try and limit defense-unique returns, it is likely going to have to pay a higher level to gain, or maintain, commercial contractors' interest. If DOD is not willing to accept double-digit profit margins in some industry sectors, then it will likely not get the benefits of those firm's technologies, products, or expertise. DOD's recent concerns about profit margins of commercial-of-a-type items do not bode well for the continued participation of these commercial firms in the defense marketplace. The defense industry's perception that the government has embarked on a war on profits, even if it is only against traditional defense contractors, will have a cost. Expanding it to commercial of a type will have an even greater cost. These widespread perceptions contribute to the financial community's perception that the defense market is not a good market in which new entrants should invest. Addressing this perception is necessary to avoid rapidly limiting DOD's available supplier pool and altering to some measurable degree the quality of the products it will be able to buy.

ISSUE 4

The Fear of Discretion in the Acquisition Workforce

According to Steve Kelman, Harvard University professor and head of the Office of Federal Procurement Policy during the Clinton administration, "It is the fear of allowing public officials to use good sense and good judgment in procurement works against both the selection of the best contractor and the quality of performance of those that are selected."¹⁷

This fear of discretion or of the exercise of sound business judgment has led to the development of cookie-cutter approaches to procurement. This allows bureaucracy to have a step-by-step approach for all contingencies, and if the acquisition goes wrong they have the best defense: "I was just following the rules." The change in culture necessary to disable these traits would require that federal leaders provide the encouragement and political support for the procurement community to exercise the necessary discretion and sound business judgment to get the best deal for DOD.

An attempt was made in the 1990s to do just that, but the change was never fully achieved. As soon as the

opportunity arose, advocates for more prescriptive policies were able to reaffirm and reinstate many of the older policies and practices. One-size-fits-all solutions and the elimination of discretionary authority on behalf of the acquisition community now dominate Pentagon acquisition bureaucracy. Considering the values that the current acquisition workforce is facing (compliance with rules, distrust of industry, and preference for defense-unique solutions) there may be some truth that the exercise of discretion at this time may only make the system worse.

Still, successful procurement requires the use of discretion and involves some calculated risk. It simply cannot survive in a risk-adverse environment. However, risk takers are not rewarded in government contracting. If they succeed there is very little fanfare, but if they fail they are punished for their actions. Given this risk-reward scenario, it is no surprise the acquisition workforce has hunkered down and cloaked itself in procedure and rules. With leadership not having their back, acquisition officials are incentivized to be risk averse. Until that risk-reward scenario changes, DOD and federal acquisition will be mired in poor business decisions that conform to process but do not achieve results.

To break this cycle, DOD has to not only change the culture but also attract the types of procurement personnel who can exercise sound business judgment and discretion. This, rather than adherence to rules, should be the ultimate criterion for the quality of the workforce. Quality is more important than quantity in acquisition personnel, but the never-ending requirement to comply with rules and regulations drives the need for increasingly higher numbers. The 2010 QDR Independent Panel cautioned that adding more people to address workforce shortcomings would not necessarily make things better—rather, an emphasis should be placed on ensuring that staff have the requisite expertise to competently perform their functions.¹⁸

Unfortunately, finding and training quality personnel is easier said than done. The Pentagon's recent Better Buying Power 2.0 initiative notes that the current certification process for the acquisition workforce does not adequately ensure that workforce members are qualified for their positions, and proposes several measures including increased emphasis on on-the-job training to address the problem. These efforts may be a step in the right direction as long as DOD's and senior leadership's definition of quality conforms to the ability to exercise sound business judgment. If these reforms are an exercise in box

checking, compliance, and expanding training class sizes, then the situation will only get worse on the ground.

Complicating the picture is the increased age of the procurement workforce. A 2009 study found the average age to be 45, with a plurality of its members in the senior stages of their careers.¹⁹ These individuals have witnessed the pendulum swings in defense acquisition reform. How they impart their knowledge of this experience to the next generation will be critical. Still, the challenges facing the workforce will only grow in the future as these experienced career professionals leave and are replaced with comparatively young civil servants.

Ultimately, improving the acquisition workforce will take both an increased effort from within the Pentagon to "grow" the workforce and an influx of outside talent. The simple reality is that the Pentagon is in desperate need of private-sector experience, whether it comes from federally funded R&D centers, nonconflicted portions of the defense industry, or nontraditional sources such as the IT sector. Private-sector experience will help bring in fresh blood and new ways of thinking to keep increasing the quality of the Pentagon's acquisition workforce.

ISSUE 5 Prioritizing Cost and Price Over Results and Value

DOD values cost certainty and low price more than obtaining results and value for taxpayers. These values result in two of the most problematic cookie-cutter approaches in the DOD acquisition toolkit: obsessive focus on knowing contractor costs and on obtaining the lowest price. If used in moderation, these are reasonable approaches. But the lengths DOD has gone to obtain these goals extends well beyond achieving diminishing returns. The obsession with obtaining cost data inherent in TINA, which mandated that contractors provide the government with all costing data used to establish a given price, has created requirements for Rube Goldberg accounting systems at defense-unique contractors that are themselves significant drivers of cost in the industry. DOD efforts to apply TINA-like cost accounting to some commercial items are driving these contractors away from DOD. The current trend of lowest price technically acceptable (LPTA) contracts awarded to the lowest bidder comes at the expense of obtaining results and the best-value solutions.

Requiring cost data from contractors and LPTA is currently the bane of the procurement system, but these are default options because they are easier for the bureaucracy to implement. The alternative methods—competition, commercial price analysis, market research, and best value— and solutions-based contracting—are difficult to implement, require the workforce to justify their analysis, and may require more upfront costs.

By reaching out to and incentivizing the private sector, the Pentagon can help put the free market to work for America's men and women in uniform.

Because of its historical desire for defense-unique solutions, DOD defaulted to awarding noncompetitive cost contracts to defense-unique contractors. This created a quandary for the government about how to know if it was getting a fair and reasonable price from these sole-source contractors. There are several tools to address this issue. The first is competition. Competition and the maintenance of alternative sources serve as a check on contractors inflating their prices. However, planning for competition, conducting good negotiations based on market trends and prices, and maintaining sources is hard and expensive in the near term, so the default is regulation.

TINA was designed to regulate contractors' costs and eventually led to the establishment of nonmarket-unique accounting systems [regulated by the Cost Accounting Standards (CAS)] at defense firms. Also created was a system of embedded auditor apparatchiks and overseers (such as the Defense Contract Audit Agency) that enforces these nonmarket rules and behaviors within the defense-unique contracting community.

The basis of cost accounting is essentially that contractors will identify and justify costs of implementing a contract to a very rigid standard, and the auditors tell the contractor when those costs are acceptable and allowable for reimbursement. There are no incentives to actually reduce costs on these contracts beyond justifying that identified costs comply with regulation.

Unfortunately, unless an alternative can be found, this system will likely need to continue to operate for sole-source, cost-type contracts at defense-unique facilities producing aircraft carriers and military-unique planes and ground vehicles. The problem arises when DOD oversight officials want to obtain the same level of cost transparency

for commercial items that are either standalone or incorporated into defense-unique systems. Commercial companies do not have the same approach to tracking costs as has developed in the government bureaucracy over the last 50 years of TINA implementation. For this reason, commercial items were exempted by law from the requirements of CAS and TINA, and commercial accounting systems that are in place to meet commercial needs were determined to be adequate. While commercial contractors were given this exemption in law, the auditors have never accepted the wisdom of this action.

There appears to be a deep-rooted desire within the government oversight community to rely solely on the production of cost data, and a growing belief that any company selling to the government should generate this data even if it is a commercial firm that sells a disproportionately small share of its products to the government. As a result, commercial companies are seeing greater demands for underlying cost data that do not exist. Because of this pressure from auditors, programs and contractors are under greater pressure to spec out commercial items.

Today, instead of being rewarded for getting a better deal on price, a contracting official may be questioned if a commercial item is being purchased. It does not take long for a DOD acquisition official to understand that the auditors will not question him or her if that individual is working with a TINA- and CAS-covered military-unique contractor versus a commercial one, even if comparable prices are higher for the military-unique item. Thus, the entire rationale for commercial contracting is under threat from within DOD, ironically by those who are supposed to be charged with ensuring that DOD gets more for its money.

The auditing community is seemingly pushing DOD back to the time when companies were forced to separate their defense and commercial business. The civil-military integration of production (resulting from commercial-item exemptions that allow commercial products to be modified for military purposes without triggering defense-unique oversight measures like TINA) has been replicated for engines, avionics, aircraft, helicopters, IT, and other components in a number of firms. A return to the old way of doing business—modifying commercial products in separate facilities—would make these programs uneconomical in today's budget environment.

The other tool of modern contracting that keeps DOD from achieving the best value for taxpayers' money is LPTA or low-bid contracting. For commodities and easily

comparable services where you only need a minimum quality level, this is probably an appropriate approach. The application of LPTA to highly complex acquisitions is not appropriate, however, and could be one of the government's biggest contracting mistakes in years, likely causing many future contracting scandals. While DOD leadership has recognized problems with LPTA contracts, there does not seem to be a reduction in their use.

Why are LPTAs in favor? Because they are easy and because they reduce near-term costs and guard against bid protests. The alternative is a best-value procurement where you might pay more for higher quality. An LPTA is the equivalent of paying for the lowest bidder to fix your roof—a quick result, but your roof may be leaking again much sooner than you would like. Still, it is easier to evaluate price than contractor quality. Measuring quality implies some level of discretion will be used by the acquisition workforce. In the current procurement environment, discretion is risky and requires justification.

Prospects for Genuine Reform

Although the challenges are many, there is some hope for reforming the way the Pentagon purchases goods and services. The country has gotten reform right in the past, especially in the 1950s and mid-1990s, when rapidly changing technologies and common-sense approaches converged as the Pentagon emphasized nontraditional contractors and brought commercial and technological innovation into the building.

While there are no one-size-fits-all solutions to the problems plaguing the Pentagon's acquisition system, they do share many overlapping themes and guiding principles for reform. Enhanced competition, best-value and results-oriented contracting, the streamlining of outdated rules, regulations, laws and organizations, government-industry partnerships, cost-benefit analysis, market research, commercial-pricing analysis, and limitations on bid protests are all tools that can be better used to improve procurement. By reaching out to and incentivizing the private sector—for lessons learned, innovative commercial products and services that work, and talented personnel—the Pentagon can help put the free market to work for America's men and women in uniform, driving down costs, restoring competition, and delivering taxpayers the best value for their money.

Finally, regarding the acquisition workforce, as the Packard Commission put it nearly three decades ago, "Capable people must be given the responsibility and

authority to do their job. Lines of communication must be kept as short as possible. People on the job must be held accountable for the results."²⁰

It is hard to imagine a more succinct, sensible, or effective approach to reforming Pentagon acquisitions.

Notes

1. Gordon Lubold, "Resolution on U.S.-Japanese Stalemate; Is There Another Sequester in the Works?; An Army Two-Star, Relieved; Carter Malkasian Advising Dunford; @zbig Makes a Debut; And a Little More," Situation Report, April 5, 2013, www.foreignpolicy.com/articles/2013/04/05/resolution_on_us_japanese_stalemate_is_there_another_sequester_in_the_works_an_a.

2. Stephen J. Hadley and William J. Perry, *The QDR in Perspective: Meeting America's National Security Needs in the 21st Century: The Final Report of the Quadrennial Defense Review Independent Panel* (Washington, DC: United States Institute of Peace, 2010).

3. David Packard, *A Quest for Excellence: Final Report to the President by the President's Blue Ribbon Commission on Defense Management* (Washington, DC, June 30, 1986), http://usacac.army.mil/cac2/CSI/docs/Gorman/06_Retired/01_Retired_1985_90/07_86_PackardCommission_FinalReport/01_PackardCommission_FinalReport.pdf.

4. J. Ronald Fox et. al, *Defense Acquisition Reform, 1960–2009: An Elusive Goal* (Washington, DC: Center of Military History, US Army, 2011).

5. Josef Joffe in his new book outlines the US elite view of the superiority of Soviet central planning of the time and the fear that the Soviet Union's superior economic and military progress would soon overtake the United States. It should not be too much of a stretch that these considerations had some impact on the development of the managerial framework and processes that were developed and institutionalized, which would guide the Pentagon for the next 50 years. See Josef Joffe, *The Myth of America's Decline: Politics, Economics, and a Half Century of False Prophecies* (New York: Liveright, 2013).

6. By this time, the Soviet and US defense-unique acquisition establishments began to look remarkably similar. A January 1988 Central Intelligence Agency research report's observation of the Soviet acquisition process is illustrative. Substitute US for Soviet and the same observations can be made about a new US weapons systems acquisition getting programmed in the PPBS process. "The forecasting and planning process for Soviet weapons operates in the fairly inflexible schedule of the five-year planning process. Normally, major weapons development projects are forecasted and planned two to three years before the start of the five-year plan if they are to be implemented within that five-year plan. The long Soviet lead time (7 to 15 years) for responding to Western threats (systems) requires

the Soviets to forecast threats far in advance so they can field a timely response when the threats are deployed.” See Central Intelligence Agency Directorate of Intelligence, *USSR: Forecasting and Planning Weapons Acquisition* (Langley, VA, January 1988), www.foia.cia.gov/sites/default/files/document_conversions/89801/DOC_0000500618.pdf.

7. Many of these defense-unique divisions were sold off after the end of the Cold War as a result of the “Last Supper,” which heralded the consolidation of the defense-unique industry into five major companies.

8. National Science Foundation, “Science and Engineering Indicators 2012,” January 2012, www.nsf.gov/statistics/seind12/c4/c4s1.htm.

9. Roles are now reversed with private-sector R&D funding at 68 percent of US R&D funding in 2012. An even more ominous trend for DOD is the percentage of US R&D relative to global R&D. This implies not only a greater need for international cooperation with US allies but also a need to stay ahead of the proliferation of technology and capability around the globe.

10. Paul Kaminski, “Statement of the Under Secretary of Defense for Acquisition and Technology on Dual Use Technology” (statement before the Subcommittee on Defense Technology, Acquisition and Industrial Base, Committee on Armed Services, US Senate, Washington, DC, May 17, 1995), www.fas.org/spp/starwars/congress/1997_h/h970515k.htm.

11. Some of these changes include new audit requirements, defense-unique contract clauses, requirements for defense-unique cost data and pricing data, a more stringent intellectual property and technical-data regime, and the return of additional military-unique requirements, specifications, and standards.

12. There is a statutory limit on profits on cost contracts of 10 percent of allowable costs. For some experimental R&D contracts, the limit is 15 percent of allowable costs. Defense contractors do not achieve those margins on their contracts as 1) these are maximum

limits and not reflective of current rates that are lower and 2) contractor costs are higher than “allowable” costs for reimbursement, so their profit margins are lower when allocated over a larger cost base than the government recognizes. Defense contractor margins can be higher (but not necessarily so) on fixed-price and foreign contracts than for cost-reimbursable contracts. Defense services contracts usually have lower profit margins than hardware contracts.

13. Lisa Singh, “Jacques Gansler: ‘Global War’ on Contractors Must Stop,” *ExecutiveBiz*, Jan 15, 2010, <http://blog.executivebiz.com/2010/01/jacques-gansler-global-war-on-contractors-must-stop/>.

14. *Streamlining Defense Acquisition Laws: Report of the Advisory Panel to the United States Congress* (Washington, DC: Committee on Armed Services, US Senate, March 1993).

15. Pierre Chao, “Twenty-Five Years of Acquisition Reform: Where Do We Go From Here?” (statement before the Committee on Armed Services, House of Representatives, Washington, DC, October 29, 2013), 5, <http://docs.house.gov/meetings/AS/AS00/20131029/101414/HHRG-113-AS00-Wstate-ChaoP-20131029.pdf>.

16. According to figures provided by Capital Alpha Partners and Bloomberg, average profit margins in the defense industry were 8.8 percent in 2012 compared with commercial capital goods producers whose average profit margins were 14.4 percent. Comparable 2012 numbers for representative major IT firms were Intel (27.1 percent), Microsoft (37.8 percent), Apple (35.4 percent), IBM (21.1 percent), and Cisco (26.8 percent).

17. Steve Kelman, *Procurement and Public Management: The Fear of Discretion and the Quality of Government Performance* (Washington: AEI Press, 1990).

18. Hadley and Perry, *The QDR in Perspective*.

19. “Section 2 Defense Acquisition Workforce Analytics,” Defense Acquisition University, April 28, 2010, <https://acc.dau.mil/CommunityBrowser.aspx?id=340821>.

20. Packard, *A Quest for Excellence*, 2.