

**A DEFENCE OF CONTRACTORS:
OUTSOURCING CAPACITY TO WAGE WAR**

Dr Graham Pratt
School of Management, University of Technology, Sydney
Email: Graham.Pratt@uts.edu.au

And

Dr Neil Barnwell
School of Management, University of Technology, Sydney
Email: Neil.Barnwell@uts.edu.au

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Profile: Dr Graham Pratt is a former Associate professor in the School of Management at UTS. Although retired from full time work, he maintains an active teaching and research association with the School.

Dr Neil Barnwell is a senior lecturer in the School of Management His teaching and research interests are in organisation theory, international business and business history.

A DEFENCE OF CONTRACTORS: OUTSOURCING CAPACITY TO WAGE WAR

Governments have greatly expanded their outsourcing activities over the last twenty years. A review of the various types of outsourcing is presented, along with the political implications associated with each. The paper then concentrates on the expansion of outsourcing associated with the Iraq war. A significant amount of the expenditure for that war is allocated to contractors to the US military for work to be undertaken in Iraq. This pushes the boundaries of what has normally been considered solely a government responsibility. Drawing upon the literature of US defence outsourcing, a model, termed the 'iron triangle' has been developed to assist in analysis of US defence spending on private provision of goods and services.

Keywords: Social and political strategies; stakeholder theory; social perspectives; new public management; policy (development/reform)

No two wars are identical. Yet the Iraq War is quite different from any other in the modern era in that the US Administration has pursued a strategy of privatising a significant proportion of its contribution through outsourcing. Up to April 2007, the conflict was estimated to have cost USA US\$423 billion, devouring approximately US\$9 billion per month (Rogers 2007, A.6). It is has been claimed that there are around 125,000 civilian contractors in Iraq, with private contractors responsible for over 30% of essential military support services. In Iraq, contractors have been engaged to provide services well beyond "back room" support, including allegations of involvement as interrogators at Abu Grhaib prison and Balacf Air Base (Bowden 2007, 54). KBR, a subsidiary of Halliburton, is claimed to have been awarded about half of reconstruction work (Marshall 2006) and KBR alone has about 50,000 workers in Iraq, leading to claims that the firm "has become indispensable to the global projection of American military might" (Bianco, Forest, Crock & Armistead 2003, 68). The fact that the US Vice-President, Dick Cheney, was formerly Chairman & CEO of Halliburton has been noted as possibly accounting for KBR's heavy involvement.

This paper will analyse developments in outsourcing by the public sector, with a particular focus on US defence outsourcing. This is primarily because of the US military's size and global influence arising from its involvement in international conflicts and its impact on defence spending of other nations, both friend and foe. The complexities of the situation are also of interest as the case of the US military in Iraq introduces outsourcing to new activities, particularly those which had previously been the preserve of government.

The outsourcing of such quasi military functions provides a new dimension to international management. The emphasis in most international management studies has been on the adaptation of businesses to diverse environments. This paper examines that area of international management which sees formerly government functions being undertaken by the private sector in a foreign environment. It thus invites students of international management to expand the way in which they view their discipline.

TRENDS IN OUTSOURCING FUNCTIONS OF GOVERNMENT

Outsourcing has been defined as passing functions previously performed in-house to outside contractors (Aulich & Hein, 2005, 36). Its practice is by no means limited to the public sector. Indeed a fundamental justification for outsourcing was made centuries ago. "It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than buy." (Adam Smith, 1776, cited in Taylor, 2005 367). Over more than the past decade, outsourcing by private firms in much of the developed world has been expanding, with technological developments providing increasing opportunities for firms to outsource a greater variety of functions. Managers and employees with critical expertise are urged to focus their time and energy on their "core business". For reasons of greater efficiency and cost reduction, non-core activities should be contracted out (outsourced) to other firms that have high level

competencies in these less critical activities. It is argued that the firm wouldn't choose buying over making unless it saved money (Taylor 2005, 368).

Public Sector Catalysts

While issues of efficiency and cost reduction are also relevant in public sector agencies, reasons for outsourcing are often more varied and complex. A major catalyst was a push for smaller government, delivering “more for less” in a number of Western countries. This was in part a reaction against the large-scale welfare state of the 1960s and 1970s. Modern globalisation, with increasing integration of economies, combined with voter discontent over perceived high levels of taxation combined to force changes of national governments in the UK in 1979 and USA in 1980. It has been noted, “Politicians such as Reagan and Thatcher rode this wave of discontent to power --- This tide was the tide of market-based, less organised capitalism” (Wilson 2003, 169). By the mid 1990s governments, particularly in English-speaking Western countries, were “steering more and rowing less” (Osborne & Gaebler, cited in Bishop & Wanna 2002, 107). What traditionally had been regarded as “core” functions of the public services were progressively being outsourced. Reasons given for decisions to outsource functions were varied, including needs for external expertise and technology, value for money, improved quality and service, benchmarking, minimising risk, stimulating private markets and, more generally, globalisation and the information revolution (Bishop & Wanna 2002, 109; Aulich & Hein 2005, 36; Sturges 1996, 70-71).

Conceptualising Outsourcing

The nature of outsourcing options available to government may be identified in four categories. **Government provision** refers to activities which have by law or convention been mandated to government, such as the raising of military forces. However this study illustrates that outsourcing of activities in this category is often facilitated by government. As government is the only or main purchaser of services in this area, eg defence, it can increase the capacity of the market by acting as a purchaser. This paper

identifies the competing pressures and rationale acting upon governments in such decisions. The devolvement of core public sector activities to private contractors however raises fundamental issues of influences in political decisions, accountability, controls over public expenditure, and the proper role of government vis-à-vis the private sector.

Specialist outsourcing refers to those areas which are an accepted government responsibility but which may be broken down into clearly defined parcels which many suppliers have the capacity to perform. Examples are IT outsourcing for the defence department or police, coastal surveillance and even private prisons. The outsourcing of these activities by governments generally has become less politically contentious with practice. Over the last few years there has been a significant increase in the number of firms which specialise in this form of outsourcing, thus increasing the capacity of the market. This capacity in turn provides incentive for governments to outsource activities that it had previously not considered feasible.

Selective outsourcing refers to those areas where governments do exert authority, but where market capacity is low because markets do not operate efficiently. Areas such as health provision, compulsory education and water resource allocation are examples. Some activities in these areas may be provided profitably and effectively by private providers. If however government were to withdraw completely from provision in these areas in favour of the private sector, it is probable that the market would deliver allocations perceived by the public as suboptimal and unjust. Examples would be education or the provision of medical services only for those who could afford the price charged. In other words the market capacity to deliver a comprehensive service for the

relevant members of the community is limited. For most societies this would be an unacceptable situation so governments provide some services themselves and selectively outsource others.

Government choice refers to those areas which the private sector is capable of providing but which for reasons linked to local political circumstances, are still undertaken by government. The provision of electricity in New South Wales is an example. Many activities formerly undertaken by governments but now privatised fall into this category; airlines, shipping lines and telecommunications being examples. Essentially in this category, governments have significant choices as to outsourcing with political considerations being the prime concern as to their decision whether to or not.

A further theoretical categorisation is provided by Feigenbaum, Henig & Hamnett (1999) to help explain the rationale for outsourcing public sector activities. *Tactical Outsourcing* covers the situation where governments are pursuing broader political agendas through outsourcing, such as promoting scarce technologies or assisting in the development of selected industries. *Systemic Outsourcing* promotes the privatisation of public sector services and aims to introduce long-term changes in the political relations in society. *Pragmatic Outsourcing* has a narrower, business decision application, covering the “make-or-buy” decisions so common in the private sector. Aulich & Hein (2005) used this framework to conduct an extensive study of the outsourcing of information technology services in the Australian public sector.

Limits to Public Sector Outsourcing ?

In the UK, as in Australia, outsourcing intensified during the 1980s and 1990s in mainly blue collar jobs. In the latter years of the twentieth century however outsourcing impacted more heavily in white collar jobs. As noted by the CEO of a rapidly growing private firm receiving a wide range of government outsourcing contracts, “nothing is off limits now, and the potential

for the private sector is massive” (Timmins 2005, 2). In Australia, commentators acknowledged, “there is little agreement on where the boundary between the private and public sectors should be drawn” (Bishop & Wanna 2002, 114). Sturgess listed many activities of the public sector that are performed in whole or part by the private sector in a range of nations. Emergency Services were an exception, where Denmark appears to be alone in having long significant private sector involvement. He also noted that defence was constrained by certain international conventions from outsourcing front-line combat activities (Sturgess 1996, 66).

In USA, the Office of Management and Budget (OMB) precluded inherently governmental functions being outsourced by the federal government. “Inherently governmental” referred to activities that required the exercise of substantial discretion in matters intimately related to the public interest (OMB 2003). “Substantial discretion” however was severely limited to those situations that were not already constrained by existing policies, procedures, directions and orders. Based on these guidelines, the federal government activities that are off-limits for further potential outsourcing are quite limited, prompting commentators to state, “there is nothing inherently governmental about launching space shuttles, building data bases for military recruiters, and probably, interrogating prisoners held in Abu Ghraib and in similar circumstances elsewhere” (Rosenbloom & Piotrowski 2005, 184).

Problems with Public Sector Outsourcing

Given the scale and scope of public sector outsourcing over the past few years, it is little surprise that there have been claims that public sector agencies in the US are experiencing the problem that they don’t have enough sufficiently competent staff to administer and oversee the private contractors (Clark 2007, 6).

Drawbacks of outsourcing and other public sector market-based reforms include - increased opportunities for corruption and collusion; governments can become “price takers” (depending

upon whether suppliers quote fair prices); and potential difficulties for government to change supplier if the latter has expertise and detailed knowledge in a market with a small number of participants (Bishop & Wanna 2002, 112-3). There is also the problem of diminished accountability for goods and services provided by a private contractor. Ministers and senior government officials are simply not as accountable as they would be if the services were provided by their own departments (Mulgan 2006, 55). Based upon a detailed study of the Jobs Network in Australia, the researcher concluded, inter alia, that the government cannot direct private contractors as they do their own departments, other agencies of government (eg parliamentary committees and Ombudsman) do not have direct access, public rights of legal accountability are curtailed, and commercial confidentiality often places the outsourcing arrangement beyond the range of public enquiry (Mulgan 2006, 50).

DEFENCE – A SPECIAL MARKET

The defence market in USA is distinctive in a number of respects. The US Department of Defense (DOD) is the world's largest enterprise, its GDP ranking it equal to the eighteenth largest country. (Farley 2007, 52). Its annual budget has been running at more than US\$450 billion (Boxell (a) 2007, 25). In February 2007, the White House proposed an increase to US\$481 billion for DOD's regular operations, with an additional US\$235 billion for Iraq and Afghanistan, making a total of US\$716.5 billion for the year (Kopecki & Holmes 2007, 70; Anselmo 2007, 10). The market is monopsonistic, subject to the changing needs of one purchaser. DOD controls entry and exit to the market via its allocation of contracts. Contracts are awarded for expensive military weapons that often are not yet in production, being merely a defence planner's dream of the future for which technology may not yet be available. DOD and individual contractors establish an alliance under which they will share risks and management responsibilities. Key personnel from DOD may be located within the premises of a private supplier during the currency of contracts, including during the lengthy research and development phase. Hence technical requirements and superior quality frequently often are

accorded a higher priority in the contract than price, on the basis that “the second fastest fighter aircraft may be no bargain.” (Weidenbaum 2004, 268). Although most of the US military outsourcing is undertaken by firms based in the US, a large amount of work is undertaken overseas, as can be seen in the case of Iraq. This leads to the unusual situation of firms being involved in delivering services in foreign countries but having limited management responsibilities to the citizens of the host country.

Outsourcing defence

Presumably many executives in DOD, motivated by responsible and accountable management principles, were attempting to achieve “more with more” in the short-term and in the medium term “more with a bit less” after Iraq. The Pentagon conducts a strategic review each four years (the most recent in 2005) that, inter alia, can lead to a reordering of military priorities (Karp 2005, C.1). For much of the war in Iraq, a strategy has been pursued to contain the size of the permanent military forces by mobilising the national guard, the Reserve force, and increasing the use of private contractors by outsourcing and privatising a wide range of functions. The DOD’s contractor workforce collectively costs more than the equivalent (military and civilian) workforce (Farley 2007, 49-50). The DOD thus has been relying on non-traditional business partners to meet less predictable threats while sustaining its infrastructure. Several years ago this was revealed in the following terms, “A US\$200 billion market has appeared on your business horizon, but you may not have noticed it.” (Apgar & Keane 2004, 45).

Defence contractors ranging from clothing manufacturers, providers of food services, health services, logistics, security, to designers of supersonic fighter bombers benefit from the largesse of US defence budgets. Since 2001, the spade defence index, recording data for large and mid-size firms in the defence industry, has increased by 150%, compared with a 40% increase for the S & P 500 (Kopecki & Holmes 2007, 70). In January 2007, shares in Lockheed Martin and Northrop Grumman hit record highs

(Boxell (a) 2007, 25). By May 2007, shares had increased by about 18% in Northrop, obviously a beneficiary of record spending. Further increases were forecast if the firm won a contract to build an aerial-refuelling tanker (Martin 2007, 20).

Balancing Stakeholder Demands

The term “Iron Triangle” has been coined to refer to the coalition of the US Defense Department, Congress, and the private defence industry, all of which benefit from a sustainable defence program (Farley 2007, 46). This symbiotic relationship is viewed by some members of Congress as altogether too cosy. Indeed, representatives of the defence industry have extremely close, if sometimes unwelcome, associations with politicians, the former being described as “fearsome lobbyists” (Boxell (b) 2007, 11). While there are no doubt many members of Congress anxious to promote other priorities apart from defence, especially in times of peace, politicians are always keen to protect local jobs and hence resist the winding back of defence establishments and spending within their own electorates. In June 2004, a Pentagon plan for US\$30 billion in cuts through to 2011 was partially rolled back by Congress (Karp 2005, C.1). A representation of key elements of the ‘iron triangle’ is shown in Figure 1.

With the expectation of continuing bi-partisan support during war for US defence spending to support the troops, it is enormously difficult to cut the defence budget. The rationalisation of US defence spending also is a complex task in times of relative peace, made more difficult by the “mutuality of interest” of members of the “iron triangle” (Farley 2007, 46). An aerospace and defence analyst from JP Morgan Securities was quoted as saying recently, “If our presence in Iraq abates, there is some risk to defence spending dropping off” (Kopecki & Holmes 2007, 70). Yet the military incursions into Iraq and Afghanistan have been portrayed as part of the global “war on terror”, a different type of conflict with a shadowy enemy and a likely protracted term. This provides some solace, even optimism, to defence industry leaders who

would expect on the basis of historical trends to witness a sharp decline in DOD contracts following US withdrawal from Iraq and Afghanistan.

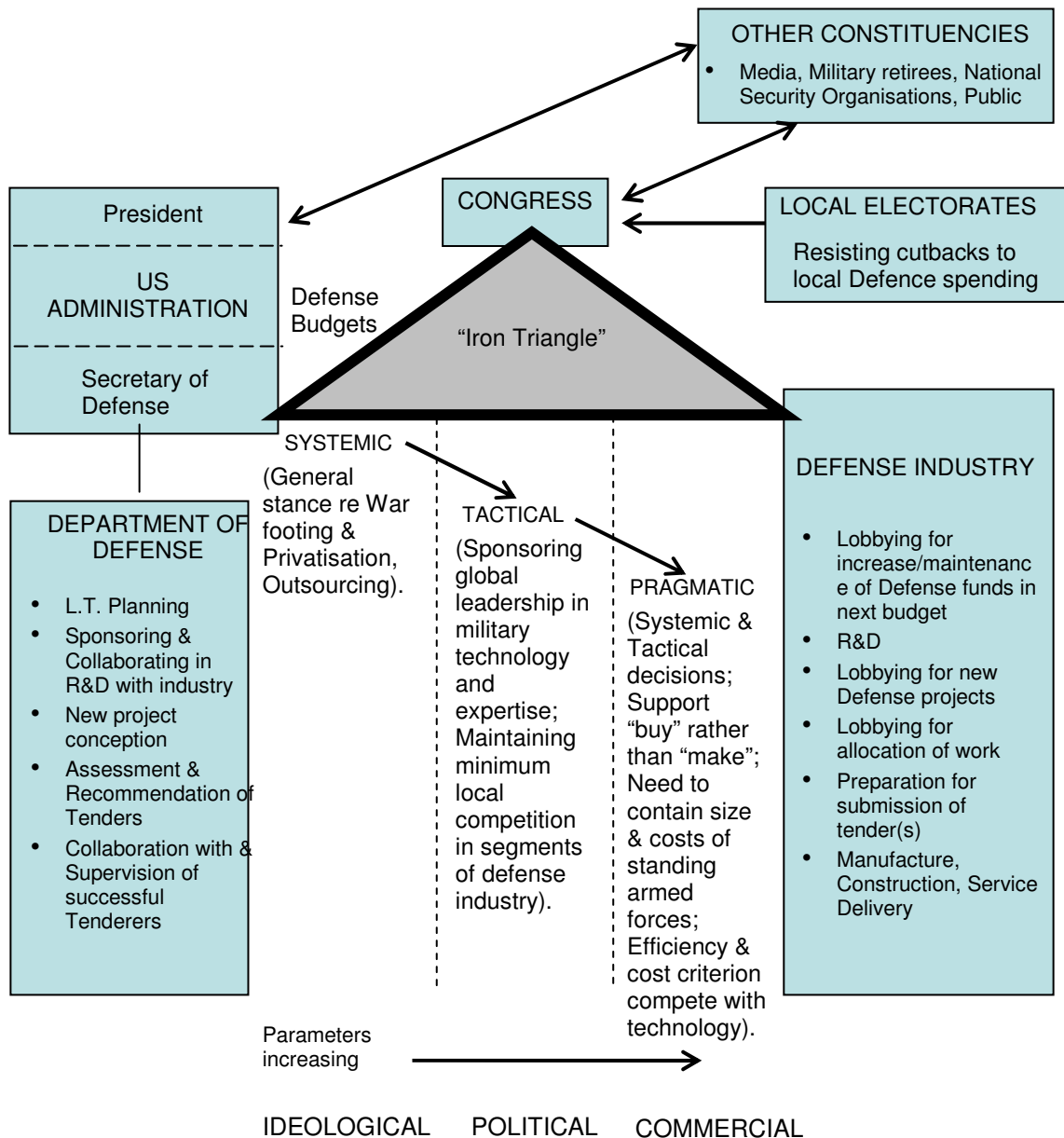
Already industry leaders are publicly attempting to influence a post-Iraq environment. Boeing's Head of Defense Business warned ominously that a slow down in the Pentagon budget "would leave the country relying on old and worn-out weapons after recent conflicts" (Boxell © 2007, 21). In a similar vein, the Chief Executive of Lockheed Martin stated in early 2007, "There is the global war on terrorism. There are obviously the circumstances in Iraq and Afghanistan. There are discussions about the intent of the Iranian government and maybe even interest in the behaviour of China and other countries around the globe. So our long-term view is that there will likely be more rather than less funding." (Boxell (b) 2007, 11)

The difficulties of containing US defence expenditure in such an environment are not new. A former Secretary of Defense in the Carter Administration explained that the acceptability of defence budgets depended on the attitudes of multiple constituencies including the public, Congress, the media, associations of retired military people, and the various national security-related associations. These created a whole set of conflicting forces, often legitimate, whose pressures were neither toward efficiency nor combat capability. He concluded that the US Department of Defense could not be managed like a business as "the intensity of the pressures (of external political pulls) and the importance of the stakes --- are so quantitatively different as to produce a qualitative difference. Mistaken defense policies can kill us all!" (Brown 1981, 14).

CONCLUSION

The US has enormous financial capacity to wage war. Because of trends in outsourcing, DOD is increasingly reliant upon the defence industry which stands to make significantly enhanced gains in both profits and share values with increases in defence spending. Defence industry leaders are strong lobbyists. Local politicians tend to resist cuts to defence spending in their electorates. There is a mutuality of interests among parties to the “iron triangle” that makes it is extremely difficult for the political head of DOD to manage the Department and cut its budget. The US has warned the world that the “war of terror” will be long and drawn-out. With the reluctance in Congress to cut defence budgets during a conflict, there appears to be little optimism for a lessening of USA’s military posture in the foreseeable future. The privatisation trends of outsourcing defence in the US are likely to continue.

Fig 1. Influences on Decisions to Outsource US Defence Activities
 (Note. US spelling has been used when referring to US institutions)



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