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DEFENSE DEPOT
MAINTENANCE

Privatization and the Debate
Over the Public-Private Mix

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss defense depot maintenance issues. As requested by the Committee, my testimony will focus on our preliminary analysis of the March 1996 Department of Defense (DOD) report responding to the congressional mandate for a comprehensive depot maintenance policy. It will also address issues related to the allocation of depot maintenance workload between the public and private sectors, such as ongoing privatization initiatives, including privatization-in-place.¹ Specific issues I will address are

- DOD's depot maintenance management model in the post cold war era,
- the extent to which DOD's proposed depot maintenance policy is consistent with congressional direction and guidance,
- the savings that DOD is anticipating from privatization of depot maintenance activities, and
- the cost-effectiveness of privatization-in-place as an alternative for closing depots.

Before I discuss specifics, I'd like to summarize the key observations from our ongoing work.

First, the new model for managing depot maintenance is evolving. DOD's proposed model continues to be a mix between the public and private sectors. However, DOD's policy report signals a clear intent to shift workloads to the private sector when readiness, sustainability, and technology risks can be overcome. Such a shift, if not effectively managed, including the downsizing of remaining depot infrastructure, could exacerbate existing excess capacity problems and the inefficiencies inherent in underutilization of depot maintenance infrastructure.

Second, we have several initial observations on the DOD policy report.

- It provides an overall framework for managing defense depot maintenance activities.
- It sets forth a clear preference for moving workload to the private sector that will likely result in a much smaller core capability than exists today.
- It is not consistent with congressional guidance in one key area—the use of public-private competitions for non-core workloads.

¹For purposes of this testimony, privatization means assigning or transferring work to private sector contractors whose employees perform the work in a facility that is usually not owned by the federal government, although depot plant equipment may be government owned. Privatization-in-place means the work will be performed at a former DOD facility.

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- It provides substantial flexibility on how the policy will be implemented. As a result, the precise effects of this policy on such factors as public-private mix, cost, and excess capacity remain uncertain.

Third, privatizing depot maintenance workloads in the current environment, is not likely to achieve the savings DOD expects and may even be more costly. Saving estimates of 20 percent were based on the May 1995 report of the Commission on Roles and Missions (CORM) of the Armed Services. This report relied primarily on results from public-private competitions for commercial activities under Office of Management and Budget (OMB) Circular A-76. Our analysis showed that the public sector won about half of these competitions and that the savings were therefore the result of competition rather than privatization. Further, these competitions involved activities that more readily lend themselves to private sector competition. These include family housing, real property and vehicle maintenance, civilian personnel administration, food service, security and law enforcement, and other support services. These activities—unlike depot maintenance—generally required low-skilled labor, uncomplicated and repetitious work tasks, small capital investment to enter the market, and were common to the private sector. Also, many offerors participated in the competitions.

Recognizing the influence of competition on potential savings from privatization initiatives, we examined results from the Department's public-private competition program for depot maintenance and reviewed contracting actions for depot maintenance work by 12 DOD buying activities to determine the competitiveness of the private sector market, and where possible, to make price comparisons. Our review of the depot maintenance public-private competition program revealed that 67 percent of the 95 non-ship competitions were won by DOD depots—with winning public sector bids averaging 40 percent less than their closest private sector competitor. For 23 percent of these public-private competitions there were no private sector offerors and for another 35 percent, only one private sector offeror. Additionally, we analyzed 240 active depot maintenance contracts, finding that 182—or 76 percent—were awarded sole-source. Further, about 86 percent of the full and open competitions had 4 or less offers. Finally, our analysis of a limited number of military systems or components that are dual-sourced—that is, repaired by both a DOD depot and a private sector firm—determined that DOD depot prices were lower for 62 percent of the items. Accordingly, privatizing without public-private competition and/or privatizing into a non-competitive

environment would not likely result in expected savings and may actually be more costly.

DOD has discontinued public-private competitions arguing that the depot accounting systems are inadequate to fully capture costs. We recognize that improvements must be made in this area, but implementation of improved internal controls, the use of the cost comparability handbook, and review and approval of the accounting systems and proposals by the Defense Contract Audit Agency should provide a reasonable basis for public-private comparability.

Fourth, based on our preliminary analysis, DOD's plans to privatize-in-place and delay closure and most workforce reductions until 2001 at the Sacramento and San Antonio Air Logistics Centers are not likely to be as cost-effective as closing the military facilities and reallocating depot maintenance work to other centers or private sector facilities having underutilized capacity. DOD states that its plan reflects concerns regarding the near-term costs of the closures and the potential effects on local communities and Air Force readiness. The Base Realignment and Closure (BRAC) Commission considered these factors and concluded that large potential savings and excess capacity of the Air Force depot system necessitated the difficult decision to close these activities and consolidate work at remaining depots.

Our analysis indicates that savings of about \$182 million annually can be achieved by transferring the centers' depot maintenance workloads to the remaining depots, which have about 45 percent excess capacity in fiscal year 1996 and are significantly underutilized. Further, our analysis of privatization-in-place at the Aerospace Guidance and Metrology Center at Newark Air Force Base, Ohio indicates that maintenance costs will likely increase rather than decrease as a result of this privatization initiative. Existing statutes concerning the performance of core workload and requirements for competition affect various privatization initiatives, including privatization-in-place, and it is not clear how DOD would proceed if these statutes are not repealed.

To conclude my summary, I think it is important to note that the future of the DOD depot system under the Department's new policy is uncertain. DOD depots would be used sparingly for public-private competitions since the depots could not compete for non-core workloads where "adequate private sector competition" exists even though they may offer the most cost-effective source of repair. If not effectively managed, over the long

term, DOD depots could become an economic liability rather than a cost-effective partner in the total DOD industrial base. Accordingly, as workloads are moved to the private sector, further downsizing—including additional closures—will be required. With these observations in mind, depot maintenance privatization should be approached carefully, allowing for the evaluation of economic, readiness, and statutory requirements that surround individual workloads. With that as a summary, let me turn to my detailed remarks.

Background

Depot maintenance is a key part of the total DOD logistics effort and is a vast undertaking, supporting millions of equipment items, 53,000 combat vehicles, 514,000 wheeled vehicles, 372 ships, and 17,300 aircraft of over 100 different models. Depot maintenance requires extensive shop facilities, specialized equipment, and highly skilled technical and engineering personnel to perform major overhaul of weapon systems and equipment, to completely rebuild parts and end items, to modify systems and equipment by applying new or improved components, or to manufacture parts unavailable from the private sector. DOD's depot maintenance facilities and equipment are valued at over \$50 billion. DOD annually spends about \$15 billion—or about 6 percent of its \$243 billion fiscal year 1996 budget—on depot maintenance activities. About \$2 billion of this amount includes contractor logistics support, interim contractor support, and funds for labor associated with the installation of some major modifications and parts of software maintenance, which are contracted to the private sector using procurement, rather than operation and maintenance funds.

The DOD depot system, which is actually comprised of four systems,² employs about 89,000 DOD civilian personnel, ranging from laborers to highly trained technicians to engineers and top-level managers. Our recent report on closing maintenance depots provides a history of each of the services' depot systems.³ While the number of depot personnel has been reduced by over 40 percent relative to when the DOD depot system was at its peak in 1987, depot facilities and equipment have not been similarly

²DOD Directive 5100.1, "Functions of the Department of Defense and Its Major Components," assigns the Army, Navy, Air Force, and Marine Corps, under their respective Secretaries, the responsibility for "providing logistics support for service forces, including procurement, distribution, supply, equipment, and maintenance, unless otherwise directed by the Secretary of Defense." To meet the responsibility to maintain its equipment, each service operates a depot maintenance system, with the Navy system including three different types of depots, excluding the Marine Corps.

³Closing Maintenance Depots: Savings, Workload, and Redistribution Issues (GAO/NSIAD-96-29, March 4, 1996).

downsized. At the time of the 1995 BRAC process, the DOD depot system had 40 percent excess capacity, based on an analysis of maximum potential capacity for a 5-day week, one 8-hour-per-day shift operation. The Air Force, which had not closed a U.S. depot since the 1960s, had 45 percent excess capacity. Currently, there are 29 major DOD depot maintenance facilities—Army depots, Air Force logistics centers, naval aviation depots, naval shipyards, naval warfare centers, and Marine Corps logistics bases—that perform depot maintenance work—of which 10 are in the process of being closed as DOD maintenance depots as a result of BRAC decisions.⁴ Additionally, DOD uses over 1,300 U.S. and foreign commercial firms to support its depot maintenance requirements.

Statutes and regulations influence the mix of maintenance work performed by the public and private sectors. For example, as early as 1974, legislation prescribed a specific dollar value mix for public and private sector performance of alteration, overhaul, and repair work for naval vessels. Since then, workload allocation decisions have been influenced by percentage goals found in DOD policy guidance and legislation.

DOD Directive 4151.1, “Use of Contractor and DOD Resources for Maintenance of Materiel,” directed the services to plan for not more than 70 percent of their depot maintenance to be conducted in DOD depots to maintain a private sector industrial base. The most basic of the legislative mandates governing the performance of depot-level workloads is 10 U.S.C. 2464, which provides for a “core” logistics capability to be identified by the Secretary of Defense and maintained by DOD unless the Secretary waives DOD performance as not required for national defense. Traditionally, core was defined as the capability, including personnel, equipment, and facilities, to ensure timely response to a mobilization, national contingency, or other emergency requirement. The composition and size of this core capability are at the heart of the depot maintenance public-private mix debate.

Other statutes affect the extent to which depot-level workloads can be converted to private sector performance. Two of the most significant are 10 U.S.C. 2466 and 10 U.S.C. 2469. The first prohibits the use of more than 40 percent of the funds made available in a fiscal year for depot-level maintenance or repair for private sector performance: the so-called “60/40” rule. The second provides that DOD-performed depot maintenance and repair workloads valued at not less than \$3 million cannot be changed to

⁴There are also 16 Army and 9 Navy facilities in the continental United States for weapons and munitions depot maintenance.

performance by another DOD activity without the use of “merit-based selection procedures for competitions” among all DOD depots and that such workloads cannot be changed to contractor performance without the use of “competitive procedures for competitions among private and public sector entities.” In recent years DOD has sought relief from both these two statutes.

DOD Depots Will Have a Future Role but It Will Be Smaller

DOD and the Congress are defining the role of DOD depots in the post cold war era, much in the same way the roles of U.S. war-fighting forces are being reshaped. The new model for managing depot maintenance has not yet emerged. However, given DOD’s depot maintenance policy report, the model apparently will be a mix between public and private sector capabilities, but with a clear shift toward greater reliance on the private sector. DOD’s March 1996 Depot-Level Maintenance and Repair Workload Report projected a significant increase in the depot work that will be privatized. Further, since the services periodically reevaluate their core workload requirements, it is unknown how much more of their current work will be determined to be non-core and privatized. Unless effectively managed, including downsizing of remaining depot infrastructure, a major shift in depot workloads to the private sector would exacerbate existing excess capacity in the DOD depot maintenance system.

Historically, depot maintenance on wartime critical DOD systems has been largely performed in DOD depots. Based on both cost and risk factors, the general DOD policy was to rely on DOD depots to provide a cost-effective and reliable source of support for wartime readiness and sustainability. With some exceptions, peacetime maintenance of weapon systems with wartime taskings was performed in DOD depots. This peacetime workload constituted depot maintenance core. Core was determined by quantifying the depot work that would be generated under war scenarios and then computing the amount of peacetime work needed to employ the number of people necessary to support the anticipated wartime surge. Peacetime workload was composed of a mix of high and low-surge items allowing employees to transfer from low surge workload to high surge workload during war. While there were always a number of potential war scenarios, the depots were sized to support a sustained global war.

During the cold war, there was not much pressure to move work from DOD depots to the private sector. Military leaders expressed a clear preference for retaining much of their work in DOD depots, which were highly flexible and responsive to changing military requirements and priorities. The

quality of the DOD depots was high and users were generally well-satisfied with the depots' work. Further, the threat of a global war and the resulting stress on the logistics system were constant reminders of the need to maintain the flexibility and responsiveness the depot system provided. Historically, DOD has reported that about 70 percent of its depot maintenance work was performed in DOD depots.

In our 1994 testimony before the Readiness Subcommittee of the House Armed Services Committee, we stated that the private sector more likely receives about 50 percent of the DOD depot maintenance budget. We noted that a portion of the funds expended on the maintenance workload assigned to the public sector ultimately was used for private sector contracts for parts and materiel, maintenance and engineering services, and other goods and services. Additionally, some types of depot maintenance activities, such as interim contractor support and contractor logistics support, were not included in previously reported statistics.⁵ Our review of data in DOD's March 1996 workload report indicates that by fiscal year 1997, the mix will be about 64 percent in the public sector and 36 percent in the private sector. Further analysis indicates that the data does not include funds reported by the services for interim contractor support, contractor logistics support, or goods and services that the DOD depots ultimately buy from the private sector. Including these funds would change the mix to about 53 percent in the public sector and 47 in the private sector. While the Department's projection for the public-private mix in 2001 is 50 percent in each sector, our analysis indicates that it is actually about 37 percent in the public sector and 63 in the private sector. Further, since the services are conducting risk analyses to further define their minimum core capability, the DOD depots' share of funding could be reduced even further.

With the end of the cold war and the subsequent declines in defense spending, there are increased pressures to privatize more depot maintenance work. Those declines affected force structure and the public and private activities supporting force structure. As acquisition programs began to decline, a growing concern arose over the impact on the defense industrial base. Particular concern focused on how that industrial base could be maintained without the large development and production programs of the past, and attention began to shift to DOD depot workloads as a potential source of work to keep the industrial base viable.

⁵Depot Maintenance: Issues in Allocating Workload Between the Public and Private Sectors,(GAO/T-NSIAD-94-161, Apr. 12, 1994).

Advocates of more private sector involvement argue that a shift toward the private sector would not only help keep the private sector production base healthy during a period of reduced weapon procurement but also could result in lower costs, since the private sector could provide depot maintenance at lower cost than the public sector. Proponents of the DOD depot system believe the DOD depots have provided a quality, responsive, and economical source of repair. They note that DOD maintenance policy for many years has supported the outsourcing of depot maintenance work when it was determined to be cost-effective to do so. Further, they contend there are substantial differences between developing and producing new systems and maintaining fielded ones and that the dollars spent on maintenance, while not small, cannot fill the void created by declining production dollars.

Section 311 of the National Defense Authorization Act for Fiscal Year 1996 is an indication of congressional intent regarding the continued need for DOD depots:

It is the sense of Congress that there is a compelling need for the Department of Defense to articulate known and anticipated core maintenance and repair requirements, to organize the resources of the Department of Defense to meet those requirements economically and efficiently, and to determine what work should be performed by the private sector and how such work should be managed.

Section 311 also directed the Secretary of Defense to develop a comprehensive policy on the performance of depot-level maintenance and repair for the Department of Defense that maintains the core capability described in 10 U.S.C. 2464 and report to the Senate Committee on Armed Services and House Committee on National Security. The section further directed that in developing the policy, the Secretary should include certain elements such as interservicing, environmental liability, and exchange of technical data.

The Congress supports preserving a DOD depot maintenance system to support core requirements. With no additional BRACS scheduled, the Department was charged with developing a depot maintenance policy that provides adequate workloads to ensure cost efficiency and technical proficiency in time of peace.

Preliminary Observations Regarding DOD's Depot Maintenance Policy Report

We are analyzing DOD's depot maintenance policy and workload analysis reports, as required by Section 311, and will be reporting our findings by May 18, 1996. However, as requested, I am providing our observations to date on the policy report. First, it provides an overall framework for managing DOD depot maintenance activities. Second, it sets forth a clear preference for moving workload to the private sector, which will likely result in a much smaller core capability than exists today. Third, it is not consistent with congressional guidance in one key area—the use of public-private competitions. Fourth, the policy provides substantial latitude in implementation. As a result, the precise affect of this policy on such factors as public-private mix, cost, and excess capacity remain uncertain.

Policy Report Provides Depot Maintenance Framework

In response to the congressional requirement for a comprehensive statement of depot maintenance policy, DOD provided an overall framework for managing DOD depot maintenance activities. The policy report reiterates some past policies and identifies some new initiatives for depot-level maintenance. It references other directives, publications, memorandums, and decisions and notes that DOD plans to develop an updated single publication with applicable maintenance policy guidance. Our assessment is based on observations to date about the policy report and other related documents.

Policy Report Sets Forth a Preference for Privatization

The policy report clearly states that the Department has a preference for privatizing maintenance support for new systems and for outsourcing non-core workload. It represents a fundamental shift in the historical policy of relying on DOD depots to provide for the readiness and sustainment of wartime tasked weapon systems.

Section 311 of the authorization act states that the DOD policy should provide that core depot-level maintenance and repair capabilities are performed in facilities owned and operated by the United States. It also states that core capabilities include sufficient skilled personnel, equipment, and facilities that are of the proper size to ensure a ready and controlled source of technical competence, and repair and maintenance capability necessary to meet the requirements of the National Military Strategy and other requirements, and to provide for rapid augmentation in time of emergency.

Core, as set forth in the policy and workload reports, no longer means that wartime work will be performed primarily by DOD depots. DOD's core concept is for its depots to perform maintenance requirements that the service secretaries identify as too risky for the private sector to perform. In determining core workloads, the DOD policy calls for maintaining only "minimum capability"—which does not necessarily mean an actual workload for a depot. What once was calculated as core is now called pre-risk core. For those mission essential workloads that historically would dictate retention of a core capability, the services will conduct a risk assessment⁶ to determine if the work should be made available for competition within the private sector. The policy guidance provides some limited criteria for performing a risk assessment, but DOD has not yet developed guidelines for making those assessments in a consistent manner. It is unclear the extent measured criteria or subjective judgement will be used for such assessments.

In a similar vein, DOD's policy on depot maintenance seeks to severely limit the use of DOD depots for new weapon systems. Section 311 provides for the performance of maintenance and repair for any new weapon systems defined as core in facilities owned and operated by the United States. On the other hand, the Department reported to the Congress in August 1995 that it intended to privatize depot maintenance for new systems and reported in its January 1996 depot maintenance privatization initiative that it intended to freeze the transition of new workloads to DOD depots. The policy report and other recently issued DOD guidance, such as DOD Instruction 5000.2, also show that DOD's maintenance concept for new and modified systems will minimize the use of DOD depots.

This preference, in combination with DOD's minimum core concept and limited public-private competitions, if not effectively managed—including reducing infrastructure and developing competitive markets—would likely result, over the long term, in DOD depots becoming an economic liability rather than a cost-effective partner in the total DOD industrial base. The DOD policy report states that the Department will provide for cost efficiency, sufficient workload, and technical proficiency in its depots. However, accomplishing this objective will be difficult given that the depots already are underutilized and the policy providing for additional outsourcing would exacerbate that situation, unless there are additional depot closures. Further, the report does not provide a clear indication,

⁶DOD's policy report requires three risks to be assessed: readiness, sustainability, and technology. It is unclear, however, what procedures should be used for making these assessments.

aside from recognizing ongoing BRAC actions, on how the Department intends to downsize to minimum core.

**Policy Report Is
Inconsistent With
Congressional Direction
Regarding the Use of
Public-Private Competition**

While we are in the process of reviewing the policy report for consistency with congressional direction and guidance, our observation to date is that the report is inconsistent in one key area—the use of public-private competitions for allocating non-core depot maintenance workloads.

Section 311(d)(5) of the act provides that in cases of workload in excess of the workload to be performed by DOD depots, DOD’s policy should provide for competition “between public and private entities when there is sufficient potential for realizing cost savings based upon adequate private-sector competition and technical capabilities.” DOD’s report provides a policy that is inconsistent with this instruction. According to DOD, it will engage in public-private competition for workloads in excess of core only when it determines “there is not adequate competition from private sector firms alone.” The report did not clarify what would constitute adequate competition. Under this policy, DOD depots would be used sparingly for public-private competitions and DOD depots cannot compete for all non-core workloads, where adequate private sector competition exists, even though the DOD depots could offer the most cost-effective source of repair.

We have reported that public-private depot maintenance competitions can be a beneficial tool for determining the most optimum cost-effective source of repair for non-core workloads. As noted in our recent reports on the Navy’s depot maintenance public-private competition programs for ships and aviation, we found that these competitions generally resulted in savings and benefits and provided incentives for DOD depot officials to reengineer maintenance processes and procedures, to develop more cost-effective in-house capability and to ensure that potential outsourcing to the private sector is more cost effective than performing the work in DOD depots.⁷

We recognize that DOD’s public-private depot maintenance competition program raised concerns about the reliability of DOD’s depot maintenance data and the adequacy of its depot maintenance management information systems. These deficiencies are not insurmountable. As we noted in prior reports, many of the problems were internal control deficiencies that can

⁷Navy Maintenance: Assessment of the Public-Private Competition Program for Aviation Maintenance (GAO/NSIAD-96-30, Jan. 22, 1996) and Navy Maintenance: Assessment of the Public and Private Shipyard Competition Program (GAO/NSIAD-94-184, May 25, 1994).

be addressed with adequate top-level management attention. We also noted that some corrective actions have already been undertaken and additional improvements can be made. Further, we recommended that the Defense Contract Audit Agency be used to certify internal controls and accounting policies and procedures of DOD depots to assure they are adequate for identifying, allocating, and tracking costs of depot maintenance programs and to ensure proper costs are identified and considered as part of the bids by DOD depots. DOD has stated that it plans to use the Defense Finance and Accounting Service to review and certify the accounting systems of DOD depots.

Policy Provides Wide Latitude for Implementation

The policy report provides wide implementation latitude in a number of key areas. For example, it provides for a DOD depot capability, but the ultimate extent of such capability, and hence DOD depot requirements, could be substantially reduced depending on future core workload assessments of privatization, readiness, sustainability, and technology risks.

Depending on implementation, the policy's preference for privatization and the lack of a clear and consistent methodology for determining risks will likely lead to significant amounts of workload previously designated as core being reclassified as non-core and privatized. For example, with respect to the Aerospace Guidance and Metrology Center, the Air Force is privatizing depot maintenance operations involving 627,000 direct labor hours of work—100 percent of which had been previously defined as core—stating that because the workload is being privatized-in-place, the risk is manageable. It is unclear how risky that privatization may turn out to be, particularly in light of the contractor's interest in divesting itself of its defense business. However, a similar rationale is being used to support other in-place privatizations. With this predilection, it is likely that future core will represent something far different than it did in the past. For example, DOD's March 1996 workload report noted that core would ensure "that the Air Force establishes and retains the capabilities needed to assure competence in overseeing depot maintenance production that has both public and private sector elements"—a significantly different mission than that historically envisioned for DOD's core capability. Further, DOD's March 1996 report to Congress, Improving the Edge Through Outsourcing, included intermediate maintenance of DOD weapons and equipment—another function traditionally considered core—as one which the Department will now consider privatizing.

The policy also provides wide latitude in several areas where the decision for determining public or private sector source of repair is based on an assessment of what is “economical” or “efficient.” For example, the policy states that non-core workloads be made available for only private sector competition when it is determined that the private sector can provide the required capability with acceptable risks, reliability, and efficiency. This efficiency requirement does not require the inclusion of the public sector to ensure that privatization is the most cost-effective option.

DOD’s Assumption That Depot Maintenance Privatization Will Achieve 20-Percent Savings Is Unsupported

The underlying assumption behind DOD’s depot maintenance privatization initiative is the expectation that savings of 20 percent will be achieved and these savings will be made available to support the services’ modernization programs. Our analysis indicates that this assumption is unsupported. The data cited by Department officials to support this savings assumption is the Report of the Commission on Roles and Missions of the Armed Forces.

In May 1995 the CORM concluded that 20 percent savings could be achieved by the privatization of various commercial activities and recommended that DOD transfer essentially all depot maintenance to the private sector. The Commission rejected the notion of core and recommended that DOD (1) outsource all new support requirements, particularly the depot-level logistics support of new and future weapon systems and (2) establish a time-phased plan to privatize essentially all existing depot-level maintenance. In its August 1995 response to the Congress on the CORM report, DOD noted that the Department agreed with the Commission’s recommendation to outsource a significant portion of its depot maintenance work, including depot maintenance activities for new systems. However, the DOD response noted that DOD must retain a limited core depot maintenance capability to meet essential wartime surge demands, promote competition, and sustain institutional expertise.

We found that the Commission’s assumptions on savings from privatization generally were based on reports of projected savings from public-private competitions for various commercial activities as part of the implementation of OMB Circular A-76. These commercial activities reviews included various base operating support functions, such as family housing, real property and vehicle maintenance, civilian personnel administration, food service, security and law enforcement, and other support services. While these activities were varied in nature, they had similarities in that they generally involved low-skilled labor; required little capital investment;

generally involved routine, repetitious tasks that could readily be identified in a statement-of-work; and had many private sector offerors who were interested and had the capability to perform the work.

Our review of A-76 competitions and public-private competitions for depot-level maintenance found that the conditions under which A-76 competitions resulted in lower private sector prices were often not present or applicable to depot maintenance. Specifically, we found that:

- Reengineered government activities won about half of the A-76 competitions because they could provide the work cheaper. Our work shows that for public-private competitions involving depot maintenance activities, a program authorized by the Congress and implemented independently from A-76, DOD depots won 67 percent of the non-ship competitions. Public-private competitions for ships provided a unique situation wherein private sector offerors could bid marginal or incremental costs while DOD depots were required to bid full costs—a condition which, in concert with the more competitive nature of the ship repair market, led to the public shipyards not being competitive.⁸
- When the private sector won A-76 competitions, savings were significantly higher than when the government function was performed by military personnel. The additional costs of military pay and benefits when coupled with productivity losses incurred for additional duties resulted in decreased competitiveness of the military personnel assigned to these duties. Depot maintenance, on the other hand, is performed almost exclusively with civilian personnel.
- The A-76 competitions did not involve activities comparable to depot maintenance—which is far more complex, less repetitious, and involves many unique systems not found in the private sector.
- Problems associated with statements of work in A-76 competitions resulted in cost increases for privatized work because of contract modifications to more explicitly define required work—a condition we also identified in our review of DOD's public-private program for depot maintenance. The impact of this cost growth for depot maintenance competitions can be illustrated by submarine repair competitions. While the average award amount for private shipyards was 16 percent less than that for competitions won by the public sector, greater cost growth in the private sector resulted in the average actual costs being about the same.
- While the A-76 commercial activity competitions resulted in savings, the savings were not readily quantifiable, did not consider the cost of the

⁸Navy Maintenance: Assessment of the Public and Private Shipyard Competition Program (GAO/NSIAD-94-184, May 25, 1994).

competition or the administration of the contracts, and for those competitions that were audited, savings were often less than projected. We had similar findings in our review of public-private competitions for depot maintenance. Additionally, we found that for the non-ship depot maintenance competitions won by a DOD depot, the DOD depots' bids averaged 40 percent less than the lowest private sector offeror. Where we observed cost growth in the limited number of depot competitions we analyzed, the growth was not sufficient to result in the DOD depots' costs exceeding the bid of the lowest private sector offeror.

- The A-76 competitions were conducted in a highly competitive private sector market—frequently involving 4 or more offerors, with 10 percent of the competitions involving 11 or more offerors. Savings were much higher for those A-76 competitions won by the private sector where there were 5 or more private sector offerors. Our review of DOD's 95 non-ship depot maintenance public-private competitions showed the private sector market to be significantly less competitive. Twenty-two of the competitions had no private offerors and 33 had only one. Only 28 of these competitions had three or more offerors, while the number of offerors averaged less than two per competition.

Current Depot Maintenance Market Is Not Highly Competitive

Recognizing the influence of competition on achieving savings from privatization, we analyzed the competitiveness of DOD's non-ship depot maintenance repair contracts. We asked 12 DOD buying commands to identify depot maintenance contracts that were open during 1995. They identified 8,452 contracts valued at \$7.3 billion and, based on high dollar value, we selected 240 contracts valued at \$4.3 billion to analyze the commands' use of competitive procedures for the contracted workloads.

The following table shows the results of our analysis.

Table 1: Procedures for Contract Award

Dollars in billions

| Command | Competition | | | | | | Total Awards | |
|--------------|---------------|----------------|----------------------|---------------|-------------|----------------|--------------|----------------|
| | Full and Open | | Limited ^a | | Sole Source | | Number | Value |
| | Number | Value | Number | Value | Number | Value | | |
| Army | 10 | \$.578 | 3 | \$.017 | 43 | \$.538 | 56 | \$1.133 |
| Air Force | 37 | 1.348 | 1 | .100 | 60 | .900 | 98 | 2.348 |
| Navy | 2 | .286 | 5 | .048 | 79 | .518 | 86 | .852 |
| Total | 49 | \$2.212 | 9 | \$.165 | 182 | \$1.956 | 240 | \$4.333 |

^aLimited competition refers to those which are conducted using other than full and open competition.

As shown, the 12 buying commands awarded (1) 182, or 76 percent, of the contracts through sole-source negotiation; (2) 49, or 20 percent, through full and open competition, and (3) 9, or 4 percent, by limited competition. The 49 fully competitive awards accounted for about 51 percent of the total dollar value while the 182 sole-source contracts accounted for about 45 percent of the dollar value.

In reviewing the number of offerors for the 49 contracts valued at \$2.2 billion that were awarded through full and open competition, we found that the commands averaged 3.6 offers for the 49 contracts—ranging from a low of only 2 offers to a high of 10. For 30 of the 49 contracts—about 86 percent of the \$2.2 billion—the number of offers was 4 or less. Five contracts valued at \$525.8 million had only two offers, while only 19 contracts valued at \$309.4 million had five or more offers.

We also found that a large portion of the dollar value of the contracts went to a relatively small number of contractors. Although the total number of contractors involved in the 240 contracts was 71, 13 of these contractors had most of the workload, about 76 percent of the \$4.3 billion. Three of these 13 contractors had workload valued at \$1.3 billion, about 30 percent of the \$4.3 billion.

Our analysis of depot maintenance contracts showed that the private sector market was more competitive for certain types of systems and equipment than for others. For example, awards for repair of ground vehicles, trucks, airframes, engines, and other items were more often competitive while sole-source contracts were prevalent for fire control systems, communications and radar equipment, electronic components,

and other components. We found that the buying commands sometimes used both DOD depots and private sector sources for repair of a limited number of items. To make price comparisons, we looked at 414 items that buying activities identified as being maintained in both sectors. For 62 percent of the items, the contract price was higher than the price for the same item repaired in a DOD depot.

We also analyzed the impact of other conditions relevant to creating a competitive environment. Regarding the ability to clearly define the service to be provided, the buying commands reported that depot maintenance activities present a difficult challenge. For much of the depot maintenance work, specific tasks that must be done, spare and repair parts that will be required, and the type and skill-level of the labor required cannot be identified until the equipment or component is inducted into the repair facility for inspection and repair. Our review of depot maintenance contracts showed the difficulty in constraining cost growth in this environment—particularly when cost-type contracts are used. It also showed the large costs normally associated with drafting statements of work, conducting the competitions, and administering the contracts. At one buying activity which obligates about \$180 million per year for depot maintenance contracts, we found sole-source contracts were used 100 percent of the time—many of which were also cost reimbursable. Officials said they did not have the manpower, technical data, technical manpower, or contracting skills to use competitive contracting. Additionally, officials noted that the process for qualifying repair sources is difficult and time-consuming.

Privatization-In-Place Plans Do Not Appear to Optimize Savings

There have been a number of recent initiatives to privatize depots recommended for closure or realignment by BRAC. The most prominent among these so-called “in-place” privatization initiatives involve the Aerospace Guidance and Metrology Center, a depot recommended for closure by the 1993 BRAC Commission and located on Newark Air Force Base, Ohio, and the Sacramento and San Antonio Air Logistics Centers, which were recommended for closure by the 1995 BRAC Commission and are located on McClellan Air Force Base, California, and Kelly Air Force Base, Texas, respectively.

We previously reported that, although it may be several years before the total cost of privatizing the Aerospace Guidance and Metrology Center’s depot maintenance workload can be identified, our preliminary analysis indicated that this privatization will likely increase, rather than decrease,

depot maintenance costs.⁹ In addition, our recent analysis of 254 contract items disclosed that (1) unit costs were higher after privatization for 201, or about 79 percent, of the items and (2) overall, there was a net cost increase of \$6.01 million for the 254 items.¹⁰ Further, although the Air Force is projecting annual savings of \$5 million for the last 4 years of the 5-year contract, we found that the Air Force did not include all relevant costs in its analysis. For example, our analysis showed that the Air Force's estimated prices for eight contract items did not include such items as material costs totalling \$15 million.

We also reported on the potential impact of privatizing the San Antonio Air Logistics Center's engine workload in place rather than transferring the work to the Oklahoma City Air Logistics Center.¹¹ Specifically, we reported that consolidating San Antonio's engine workload with Oklahoma City's engine workload would reduce Oklahoma City's overhead rate for engine work by as much as \$10 an hour and would result in an estimated annual savings of \$76 million. As requested by Chairman Spence, we are conducting a more thorough review of the Department's privatization-in-place initiatives, particularly those underway at San Antonio and Sacramento. Our preliminary observations on these initiatives follow.

Privatization-In-Place at Sacramento and San Antonio Will Be Costly

The BRAC Commission's July 1995 report to the President noted that the decision to close the Sacramento and San Antonio Air Logistics Centers was a difficult one to make, but was necessary given the Air Force's significant excess depot capacity and limited defense resources. The Commission report also concluded that these actions should save about \$151.3 million over the 6-year implementation period and \$3.5 billion over 20 years. Since this announcement, DOD has moved forward with its privatization efforts at these locations, including the announcement that contracts for five prototype workloads are to be awarded by the close of 1997.

When the President forwarded the BRAC Commission recommendations to the Congress, he stated that his intent was to privatize the work in place or in the local communities in order to (1) avoid the immediate costs and

⁹Aerospace Guidance and Metrology Center: Cost Growth and Other Factors Affect Closure and Privatization (GAO/NSIAD-95-60, December 9, 1994).

¹⁰This is a conservative estimate because it ignores contractor profits, lease costs, and other privatization costs that have not yet been determined.

¹¹Depot Maintenance: Opportunities to Privatize Repair of Military Engines, (GAO/NSIAD-96-33, March 5, 1996).

disruption in readiness that would result from the relocation of the centers' missions, (2) mitigate the impact on the local communities, and (3) preserve important defense work forces. The administration also decided to delay the centers' closures until the year 2001 to further mitigate the adverse impact on the local communities.

Our analysis indicates that delaying the centers' closures until 2001 could increase net costs during the 6-year BRAC implementation period by hundreds of millions of dollars, primarily because it would limit the Air Force's ability to achieve recurring savings to offset expected closure costs. Additionally, although the closures' potential impact on local communities and readiness is a valid concern, actions can be taken to limit the impact. For example, the Sacramento community's successful conversion of the Sacramento Army Depot to private use has demonstrated that this conversion, although difficult, can be accomplished. Further, according to Navy depot maintenance officials, on-going efforts to quickly close three aviation depots have had no significant impact on readiness.

Our preliminary analysis also indicates that privatizing the two centers' depot maintenance workloads in place is likely to be a more costly alternative than transferring the workloads to the three remaining centers. One reason for this is that there are substantial costs associated with privatization-in-place that do not apply to DOD maintenance depots. For example, our analysis indicates that unique requirements such as the cost of proprietary data rights, contractor profits, and contractor oversight could add 20 percent, or more, to the cost of performing the work. Further, the cost plus contract that will likely be used is not conducive to generating significant private sector economies, a situation already unfolding at the Aerospace Guidance and Metrology Center.

More significantly, our analysis indicates that privatization-in-place eliminates the opportunity to consolidate workloads at the remaining centers and to, thereby, achieve substantial "economy of scale" savings and other efficiencies. The Air Force's five air logistics centers currently have approximately 57.3 million direct labor hours of depot maintenance capacity to accomplish about 29.3 million hours of workload (projected fiscal year 1999)—leaving a projected excess capacity of 49 percent in 1999. The BRAC decision to close the San Antonio and Sacramento Air Logistics Centers provides the Air Force the opportunity to redistribute workload to the remaining three air logistics centers, thereby reducing excess capacity within its depot system to about 8 percent. Our analysis

indicates that redistributing 8.2 million hours of work from Sacramento and San Antonio to the remaining centers would allow the Air Force to achieve annual savings of as much as \$182 million.¹² According to financial management officials at the receiving air logistics centers, one-time workload transition costs of about \$475 million would be required to absorb the additional workloads, indicating that net savings would occur within 2-1/2 years of the transition completion.¹³ On the other hand, if the remaining centers do not receive additional workload, they will continue to operate with significant excess capacity, becoming more and more inefficient and more and more expensive as their workloads continue to dwindle due to downsizing and privatization initiatives.

Finally, various statutory restrictions may affect the extent to which depot-level workloads can be converted to private-sector performance—through privatization-in-place or otherwise—including 10 U.S.C. 2464, 10 U.S.C. 2466, and 10 U.S.C. 2469. While each of these statutes has some impact on the allocation of DOD's depot-level workload, 10 U.S.C. 2469 constitutes the primary impediment to privatization in the absence of a public-private competition. Competition requirements of 10 U.S.C. 2469 have broad application to all changes to the depot-level workload valued at \$3 million or more currently performed at DOD installations, including Kelly and McClellan. The statute does not provide any exemptions from its competition requirements and, unlike most of the other laws governing depot maintenance, does not contain a waiver provision. Further, there is nothing in the Defense Base Closure and Realignment Act of 1990—the authority for the BRAC recommendations—that, in our view, would permit the implementation of a recommendation involving privatization outside of the competition requirements of 10 U.S.C. 2469.

The determination of whether any single conversion to private-sector performance conforms to the requirements of 10 U.S.C. 2469 depends upon the facts applicable to the particular conversion. We do not have DOD's position regarding how it plans to comply with the statutory restrictions.¹⁴ While DOD has stated that it will structure these conversions

¹²Because of numerous uncertainties, it is impossible to precisely estimate the potential savings. For example, it is uncertain where some workloads would be transferred. Further, for systems such as the C5 aircraft at San Antonio, which could have relocation costs of about \$100 million, privatization—either in-place or at contractor facilities—may be the most cost-effective alternative.

¹³This amount includes \$318 million for relocating or separating center personnel, most of which would also be incurred under privatization-in-place.

¹⁴We have, by letter dated January 3, 1996, requested that DOD provide us with its plans for how it will comply with existing statutory restrictions in its privatization initiatives at various locations, including Kelly and McClellan. DOD has yet to respond to our request.

to comply with existing statutory restrictions, details of the Department's privatization plans for Kelly and McClellan are still evolving. Further, "in-place" privatizations at Newark, Kelly, and McClellan are now the subject of litigation. In March 1996, the American Federation of Government Employees filed a lawsuit challenging these privatization initiatives, contending that they violate the public-private competition requirements of 10 U.S.C. 2469 and other depot maintenance statutes.¹⁵

Conclusion

While our analysis of DOD's depot policy report continues, we believe there are several points the Congress needs to consider as it contemplates the repeal of 10 U.S.C. 2466 and 10 U.S.C. 2469—two statutes that influence the allocation of depot maintenance workload between the public and private sectors.

First, the policy does not provide for participation of DOD depots in depot maintenance competitions for non-core workload as directed by the Congress. Second, since the policy provides wide latitude during implementation, likely outcomes of the policy change are difficult to predict. Third, cost savings are likely achievable from some depot privatization, but not in the percentages and scope predicted by the CORM. Fourth, privatization-in-place does not appear to be cost-effective given the excess capacity in DOD's depot maintenance system.

Given these considerations, the Congress needs to assure itself that any new policy has the intended required features and that a process is in place to monitor readiness, sustainability, and cost considerations. Further, the effective implementation of the new policy will require a further downsizing of the Department's remaining depot maintenance infrastructure and the development of more competitive private sector markets.

Thank you Mr. Chairman that completes my statement. I would be happy to answer questions at this time.

¹⁵AFGE v. Clinton, No. C2 96-0283 (S.D. Ohio filed Mar. 18, 1996).

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