Insourcing Is Bad For America's Economy & Security

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Near as I can tell, the only people paying close attention to the insourcing controversy are those whose careers and income depend on how it turns out.

The rest of America barely knows the subject is being discussed, which is par for the course in most policy debates.

Even among the pundits who usually comment on policy matters, insourcing seems too arcane to merit much attention.

So what I'd like to do here today is direct your attention to the larger consequences of how we resolve the insourcing issue.

It turns out those consequences are pretty profound, and extend far beyond the question of who gets to do the work.

Although today's controversy *sounds* similar to a debate we had when the Cold War ended, it really isn't because our nation is weaker now than it was back then.

To put it bluntly, America has been in decline for the last ten years, and we therefore need to think more clearly about how seemingly arcane policy choices play into our larger troubles.

With that in mind, I'd like to briefly describe how much ground the United States has lost over the last decade, and then explain why the outcome of the insourcing debate could make our problems better, or worse.

When George W. Bush was inaugurated president at the beginning of the new millennium ten years ago, America was by far the greatest economic power in the world -- in fact, in the history of the world.

In 2001, the five percent of human beings who call themselves Americans generated 32 percent of world output (in other words, nearly a third of all global wealth).

Our economy was three times the size of China's, even though China had four times as many people.

In the decade before Mr. Bush was elected, the number of workers employed in the U.S. economy had grown by 20 percent.

Rapid growth produced robust tax receipts, so the new president inherited a $230 billion budget surplus, and the Congressional Budget Office was projecting additional surpluses of $5.6 trillion in the decade ahead.

Defense spending had fallen to a mere three percent of the economy, but the U.S. economy was so big that still represented a third of all global military outlays.

So it seemed America had entered a golden age of prosperity, and that 2001 would be the beginning of a second "American Century."

Now, fast forward ten years to into what is beginning to look like the "Chinese Century," and consider where America stands today.

The U.S. economy has produced no net new jobs in a decade.

Our share of global output has fallen from 32 percent to 23 percent, and would fall much further if the federal government stopped borrowing.

A faltering economy and some poor policy choices have saddled the government with record deficits -- deficits so huge that during the three hours we are meeting here today, Washington will need to borrow another half billion dollars to keep operating at its current pace.

Much of that money will be borrowed from China, the country whose economy was only a third the size of ours a decade ago.

Last month, the International Monetary Fund predicted the purchasing power of China's economy would surpass that of America in only five years.

Not surprisingly, the intelligence community has warned President Bush's successor that the ongoing transfer of wealth from America to Asia is "without precedent in modern times."

To summarize, then, the United States is rapidly destroying the economic foundations that have made it the most successful country in the world for the last hundred years.

If Washington continues behaving as it has over the past decade, America's future will unfold like the closing scenes from a Greek tragedy.

You know how Greek tragedies go -- the outcome is foreshadowed early on, but the characters are powerless to change their natures.

Which, oddly enough, brings me back to the topic of today's meeting -- insourcing.

We have debates in this town about pulling contracted work back into the government every time a war ends.

If the current debate plays out the way past debates have, the public sector will fare better than the private sector for the simple reason that federal workers have more political clout than contractors do.

But because today's debate unfolds against a backdrop of American decline, insourcing initiatives have the potential to do more damage to the nation's economy than in the past.

If we focus on the various proposals to strip contractors of responsibility for providing industrial services in support of military systems, several undesirable consequences of insourcing are apparent...

-- First, the government's fixed costs are increased at a time when it is already borrowing four billion dollars per day.

-- Second, the product life-cycle of military systems is disrupted, undermining the potential for technological progress.

-- Third, maintenance and repair workloads are broken up in a manner that diminishes the potential for economies of scale.

-- Fourth, the competitiveness of some of the nation's biggest exporters is diminished during a period of massive trade deficits.

-- Finally, performance of sustainment services is isolated from the mainstream of global innovation occurring in commercial markets.

Let's briefly consider each of these consequences to understand why today's insourcing debate is about more than who gets to do the work.

The reason insourcing raises the government's fixed costs is that federal workers are employed full-time by the government and usually perform their duties in facilities where the government is liable for all costs.

In addition, government employees who work for the civil service or the military typically make careers there and thus qualify for benefits extending far into the future.

The government's fixed costs therefore are considerably higher when work is insourced than when it is sent to a private facility such as a commercial maintenance center where workers can be furloughed if their services are no longer required.

In other words, insourcing reduces the government's flexibility to cope with financial pressures by locking it into long-term commitments that could be avoided by sticking with private contractors.

The second problem, fracturing the product life-cycle of weapons systems, is a bit more esoteric.

Every product, whether it is a toothbrush or a TOW missile, passes through a life cycle that begins with development, progresses to production, and then moves through operational deployment to retirement.

Industrial management experts are unanimous in stating that the most efficient way to generate and sustain products is by planning for an integrated life cycle in which experience at each step informs how the product is supported and improved.

In the defense business though, the product life-cycle is *dis*-integrated by yanking fielded systems away from the companies that designed and built them so they can be maintained in public-sector organizations.

That means there is much less opportunity from cross-fertilization between manufacturers and maintainers, leading to fewer product and process improvements that take longer to introduce.

Warfighters and taxpayers alike benefit when the same organization manages a product from birth to death, because each stage in the life-cycle teaches lessons about how the other stages might be improved.

The third drawback of insourcing, diminished economies of scale, refers simply to the fact that if big workloads are split up into smaller jobs and parceled out to different organizations, there will be fewer opportunities for efficiency.

Said differently, the smaller the amount of work sent to any particular provider, public or private, the more likely it is that the government will overpay for a given increment of service because inputs are used less efficiently.

Unfortunately, this is precisely what happens when a portion of military maintenance is reserved for federal facilities.

A fourth consequence of insourcing is weakening the competitiveness of key U.S. exporters such as Boeing and Lockheed Martin.

When maintenance and modification work for which exporters are well suited is removed from their business mix for performance in public-sector facilities, it reduces the opportunities the companies have for spreading overhead and other costs across a robust revenue base.

This has the effect of driving up the costs of whatever products or services remain in the business mix, making them less competitive in foreign markets.

Thus, Boeing transports, Lockheed fighters, Raytheon missiles and the like are less likely to prevail in competitions with overseas sources, worsening the U.S. trade deficit in manufactured goods -- which already exceeds a billion dollars per day.

Finally, insourcing isolates the provision of technical services and support from the mainstream of global innovation, which occurs in the commercial marketplace.

The reason why is that once work in placed in a government facility, it is performed according to rules and regulations that impede the application of new technologies and processes.

These rules slow the installation of modern equipment, limit the ways in which skills can be applied, and impose performance standards that have little to do with productivity.

The simple truth is that innovation and efficiency are more likely in the private sector because organizations there that fail to improve eventually are forced out of business.

So the bottom line on insourcing is that it raises government costs, undercuts competitiveness, and impedes warfighter access to the best technology.

Those concerns have seldom stopped the political system from insourcing in the past, but against the backdrop of today's problems, it makes proponents look like they are indifferent to national needs.

This is no time to be raising federal costs and further burdening a weak economy.

We need to pay more attention to the long-term consequences of making poor policy choices, because failure to do so is what delivered us into our current predicament in the first place.