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Report to the Chairman, Subcommittee on Military Readiness, Committee on Armed Services, House of Representatives

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MILITARY BASE CLOSURES

Lack of Data Inhibits Cost-Effectiveness Analyses of Privatization-in-Place Initiatives

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Abbreviations

BRAC	base realignment and closure
DOD	Department of Defense

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National Security and
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The Honorable Herbert H. Bateman
Chairman, Subcommittee on Military Readiness
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

This report responds to your request concerning the privatization-in-place of select Department of Defense industrial facilities that were closed as a result of base realignment and closure decisions made in 1993 and 1995. Privatization-in-place is a concept in which a private sector entity takes over the operations of a facility that was once operated by the government. To date, privatization-in-place has been associated with the base closure process and used by the Department for transferring industrial work to the private sector. With legislative constraints affecting the Department's ability to close military facilities, privatization-in-place is not likely to be used outside the base realignment and closure process.[1]

The privatization of the former government-run operations at the Air Force Aerospace Guidance and Metrology Center in Newark, Ohio; the Naval Surface Warfare Center in Louisville, Kentucky; and the Naval Air Warfare Center in Indianapolis, Indiana, have been the only privatization-in-place actions resulting from the base closure process. These facilities primarily provide industrial support services for the Department. The Newark, Ohio, facility—operated by Boeing North American, Inc., and Wyle Laboratories, Inc.—performs maintenance on guidance systems for Air Force aircraft

[1] Specifically, in 1977, Congress enacted legislation, reflected in 10 U.S.C. 2687, which essentially halted Department of Defense initiated base closures. Under section 2687, the closure of any military installation in the United States with at least 300 authorized civilian positions or the realignment of any installation involving a reduction of more than 1,000 civilian employees or more than 50 percent of the installation's authorized civilian workforce could not take place until the Secretary of Defense had evaluated the "fiscal, local economic, budgetary, environmental, strategic, and operational consequences of such closure or realignment." These requirements would make it difficult to close a large industrial facility such as a depot outside the base closure and realignment process. Subsequently, special legislative authorities were enacted in 1988 and 1990 to overcome impediments to base closure. These authorities provided the basis for four rounds of base realignments and closures between 1988 and 1995.

and intercontinental ballistic missiles and provides metrology and calibration services. The Louisville facility—operated by Raytheon Systems Company and United Defense Limited Partnership—provides maintenance and other services for Navy shipboard air defense systems and guns. The Indianapolis facility—operated by Raytheon—designs and develops advanced electronics and other products for aviation, space, and other defense applications.[2] Appendix I provides additional background information on these privatization-in-place initiatives.

Our overall focus was to assess the status, cost, and effectiveness of the Department's three privatization-in-place actions. Specifically, our objectives were to (1) determine how contractors are responding to decreasing workloads at these privatized facilities, (2) compare the cost-effectiveness of the privatization-in-place operations to the former government-run operations, and (3) identify the impact of privatization on excess capacity in the Department's industrial infrastructure.

Results in Brief

In general, the contractors at the privatization sites are facing decreasing defense workloads and have either initiated or planned efforts, such as bringing in new work and reengineering business processes, to reduce operating costs and improve efficiencies. Contractors at these facilities have experienced difficulties in attracting new customers and are uncertain about future workload levels. Contractors at the Navy privatization sites in Kentucky and Indiana are optimistic about efforts under way to increase workloads.

Due primarily to data limitations, we were able to compare the cost-effectiveness of privatization-in-place with the former government-run operation for only one of the three facilities in question. Our analysis of a recent Air Force cost comparison study indicates that costs to the government for fiscal year 1997 for work performed at the privatized facility in Newark, Ohio, were about 16 percent higher than the estimated cost had the Air Force continued to operate the facility. Similar cost comparison studies of the Navy privatizations have not been done and were not possible to construct due to (1) the absence of sufficient, detailed

[2] At both Louisville and Indianapolis, Navy contracts were initially awarded to subsidiaries of Hughes Aircraft Company. Subsequently, Raytheon Company merged with Hughes Aircraft in December 1997 and took over Hughes' s operations at Louisville and Indianapolis.

historical baseline cost data for the closed Navy facilities and (2) changes to workload volume and mix. However, contractors at each of the privatized sites have initiated business improvements that appear to be increasing operating efficiencies and reducing costs to the government. The military customers were generally pleased with the timeliness and quality of the products produced by the privatized facilities.

As a general rule, privatization-in-place has not optimized reductions in excess capacity and operating costs in the infrastructure owned and operated by the Department of Defense—a major base realignment and closure objective. Rather than closing facilities and transferring defense work to other underutilized defense facilities in the public or private sector to reduce excess capacity, privatization-in-place allows work to remain at the original sites to be performed by the private sector. While the Department no longer owns the infrastructure, it continues to support it through payments for contract work performed at these facilities. Indirectly, the Department continues to pay for excess capacity, and as a result, the goal of eliminating excess capacity may be realized more in form than in substance. Consequently, the cost reductions anticipated under the base closure process may not be fully realized. At the same time, privatization-in-place actions can produce some reduction in excess capacity and operating costs, where privatized facilities are also used to consolidate defense related work from other contractor facilities, such as at the former Naval Surface Warfare Center in Louisville. In such instances, contractors' efforts to improve business practices and reduce their own defense business infrastructure may create efficiencies in overall public-private defense infrastructure.

Should the Department of Defense consider privatization-in-place in the future, we are recommending that the Secretary of Defense require the services to (1) consider the overall cost-effectiveness of this approach in reducing operating costs and excess capacity in the combined public and private sectors supported by the defense budget; (2) retain an adequate baseline of historical government costs, preferably on a per-unit basis, to assess the cost-effectiveness of privatization-in-place; and (3) periodically reassess the cost-effectiveness of prior privatization-in-place initiatives, in light of excess capacity in other private sector and DOD facilities and continuing declines in military workloads.

Background

Three facilities have been privatized-in-place as a result of the 1993 and 1995 base realignment and closure (BRAC) processes—an Air Force

facility in Newark, Ohio, and Navy facilities in Louisville, Kentucky, and Indianapolis, Indiana. The facility at Newark is owned by an Ohio-chartered local redevelopment authority, which was formed to accept the transfer of the property from the Air Force.[3] The Louisville and Indianapolis facilities are still owned by the government, which established leases between the Navy and selected local redevelopment authorities for facility use. At both privatization sites, the Navy plans to eventually transfer the property to the local redevelopment authorities.

Recommending closure of the military facilities, the BRAC commissions provided the Department of Defense (DOD) with the flexibility to move work to other DOD facilities or to the private sector.[4] Closure actions at two Air Force facilities as a result of the 1995 BRAC process (the Air Logistics Centers at Kelly Air Force Base, San Antonio, Texas, and McClellan Air Force Base, Sacramento, California) at one point focused on privatizing work in place. However, the Air Force subsequently shifted to an emphasis on public-private competition to determine where the work would best be done.[5] Nevertheless, efforts to privatize-in-place the work at these latter facilities have stimulated significant debate over the benefits of such privatization initiatives and have figured prominently in subsequent congressional debates over whether to authorize additional BRAC rounds. Consequently, the three privatization-in-place initiatives have created much interest in the costs and benefits of these privatized operations compared with prior government operations.

Prior studies have questioned the privatization-in-place concept. An August 1996 Defense Science Board study team concluded that privatization-in-place should be avoided, since it tends to preserve excess capacity. In 1996, a privatization task force comprised of executives from

[3] A local redevelopment authority is a community organization officially recognized by DOD as having sole responsibility for planning reuse of the property and serving as the community's point of contact for all matters relating to the closure.

[4] The 1993 BRAC Commission recommended closure of the Air Force facility as a DOD operation, while the 1995 BRAC Commission recommended closure of the Navy facilities.

[5] To the extent privatization-in-place involves a potential transfer of DOD in-house depot maintenance and repair work valued at $3 million or more to a contractor, 10 U.S.C. 2469 requires that a competition among public and private sector entities be held for the work. In addition, the San Antonio and Sacramento workloads were the subject of special restrictions contained in 10 U.S.C. 2469a.

the aerospace industry that was formed by the governor of California concluded that privatization-in-place

> "inhibits the realization of cost savings intended from base closures and the performance goal improvements that privatization is intended to achieve. Privatization-In-Place, therefore, does nothing to solve the excess capacity problem within either the public or private sector of the industrial base."[6]

Our prior report on the Air Force privatization of the Newark aerospace facility showed that as of July 1997, and based on several months of contractor operations, the Air Force estimated that contractor costs were about 17 percent higher than historical costs for similar work at the former government facility.[7] The Air Force attributed this increase primarily to increased material costs, contract oversight and administration costs, and estimated contractor award fees. Neither DOD nor we have previously performed similar cost comparisons for the Navy privatizations. However, our July 1997 report on the Louisville privatization questioned the Navy's workload relocation analysis and concluded that privatization-in-place was not likely to be as cost-effective as relocating the work to other DOD facilities.[8]

Privatization Contractors' Efforts to Combat Decreasing Workloads

Defense workloads at the privatized facilities are less than those before privatization. However, workloads at the former Air Force facility in Newark, Ohio, have remained relatively stable during the 3 years of privatized operations. Even so, in the near future, the aircraft and missile repair contractor is expecting workload decreases as military system requirements decline. Workloads at the former Navy facilities in Louisville, Kentucky, and Indianapolis, Indiana, have decreased more significantly. As a result, the contractors at these locations are reducing their infrastructure and reengineering business processes to contain costs. Moreover, the Navy contractors have moved other defense work into the privatized facilities to supplement the existing workload and consolidate certain operations.

[6] *Report of the California Chief Executive Officers' Defense Privatization Task Force to Governor Pete Wilson: Pathway to Privatization—An Industry Perspective,* California Trade and Commerce Agency (Sacramento, Cal.: Mar. 1996), p. xix.

[7] *Air Force Privatization-in-Place: Analysis of Aircraft and Missile Guidance System Depot Repair Costs* (GAO/NSIAD-98-35, Dec. 22, 1997).

[8] *Navy Depot Maintenance: Privatizing Louisville Operations in Place Is Not Cost-Effective* (GAO/NSIAD-97-52, July 31, 1997).

Workload at Air Force Privatization-in-Place Site

Less maintenance work is performed at the privatized facility at Newark than had been performed under the Air Force's operation. However, during the years of privatized operations the overall workload has remained relatively stable. Aircraft repairs performed by the primary contractor, Boeing North American, Inc., have decreased somewhat, while missile repairs have stayed about the same. The facility's other contractor, Wyle Laboratories, has experienced a small workload increase. However, both contractors expressed uncertainty about their future workload projections, with Boeing officials expecting sizable workload decreases. For example, aircraft repair requirements are expected to decrease by about 6 percent in 2000, with further decreases expected through year 2014. Boeing officials attribute these expected decreases to normal system retirements and attrition, increasing reliability of newer and future weapon systems, and greater reliance on the original equipment manufacturers for logistics support.

The outlook for combating these anticipated workload reductions is not very optimistic because of difficulties in attracting new work. Although Boeing has been actively pursuing the acquisition of work from other in-house operations, manufacturing partners, other DOD programs, and commercial sources to offset its declining Air Force workload, its efforts have been largely unsuccessful to date. Wyle Laboratories has been encountering similar problems in acquiring additional work. It now performs very little commercial work and has few prospects for any major new business.

Workload at Navy Privatization-in-Place Sites

Since privatization-in-place was implemented at the Navy facilities in Louisville and Indianapolis, the defense workload has declined, primarily due to reduced Navy operational requirements and lower weapon systems maintenance budgets. In some cases, the workload reduction has been significant. According to contractor officials, work now performed by United Defense Limited Partnership in Louisville has declined almost 80 percent, from 1.3 million direct labor hours in 1994 to about 277,000 hours in 1998. Moreover, Raytheon's maintenance workload in Louisville has declined about 50 percent, and its workload in Indianapolis has decreased about 30 percent since privatization.

In response to declining workloads, the Navy's privatization contractors have instituted several business improvements to contain costs. In Louisville, for example, United Defense reduced the former Navy workforce by over two-thirds and its facility infrastructure by about

40 percent. This was accomplished primarily through organizational restructuring initiatives and work process efficiencies. Raytheon in Indianapolis has similarly reduced its workforce by 330 employees, or 17 percent, mostly in response to declining workloads. By reengineering its workstations and improving inventory storage, Raytheon has also modernized its facility in Louisville to provide for a more cost-effective maintenance work flow and to accommodate new production work.

In addition to infrastructure reductions and improved business practices, the contractors at the former Navy facilities have brought in additional defense business work from their other facilities to supplement the declining workload. For example, Raytheon in Louisville has transferred its Phalanx and Rolling Airframe Missile launcher production work from its Tucson, Arizona, facility. Moreover, United Defense is moving some naval gun production work from a Navy-owned plant in Fridley, Minnesota, to Louisville. As a result, Navy and United Defense officials believe that the workload will stabilize at its current level over the next 2 years, if the Congress provides additional funds for gun repair work at Louisville beyond DOD's budget requests as it has for the last 2 years. While United Defense continues to use the Fridley facility, officials told us they plan to downsize it further. They said that by the end of the year 2000 the Fridley workforce will be reduced by 285 employees, or 17 percent, and its facility infrastructure by about 1 million square feet, or 50 percent.

Raytheon has also been able to consolidate work from its plant in Long Beach, California, with that in Indianapolis, thereby reducing the company's internal infrastructure. Raytheon officials told us that it had transferred its entire Long Beach facility depot-level repairs and spares manufacturing to Indianapolis. This restructuring initiative equated to consolidating about 120,000 square feet from its Long Beach facility to Indianapolis. Raytheon has also brought additional work to Indianapolis from foreign government sales.

Cost-Effectiveness of Privatization-in-Place Is Difficult to Determine

Although military customers were generally pleased with the quality and timeliness of products produced by the privatized activities, data limitations precluded us from determining for two of the facilities in question whether privatization-in-place offers a more cost-effective approach for DOD to accomplish its workloads than the former

government-run operations.[9] A recent Air Force study on the Newark, Ohio, facility indicated that privatized operations were costing more than former Air Force operations, but no similar cost studies have been performed for the Navy privatizations at Louisville and Indianapolis. Moreover, we were unable to independently conduct such cost comparisons primarily because of (1) the absence of sufficient historical baseline data for operations at the former government-run facilities and (2) Navy-directed revisions in maintenance practices for certain key weapon systems and changes in workload mix. While the two Navy privatization contractors have initiated business improvements that appear to be improving operating efficiencies and reducing costs, the cost-effectiveness relative to the former government operations is unknown.

Air Force Studies Show Privatization Costs at Newark Exceed Costs of Former Government Operations

In our prior work in January 1997, we asked the Air Force to compare the costs of missile repair at Newark, Ohio, under privatization to the facility's costs to perform this same work under government control, based on about 3 months of contractor data. The Air Force also initiated similar cost analyses of its two other workload components—aircraft repair and metrology operations. Estimated privatization-in-place costs for fiscal year 1997 (the first full year of privatization) were projected based on limited actual work data for the contractors' operations and included some other privatization costs attributable to the government (e.g., costs for contract administration and oversight). Estimated government costs were based on actual production data from fiscal year 1995, escalated for inflation and adjusted for fiscal year 1997 requirements. These costs also included comparability adjustments for such items as estimated base operating support costs (cost comparability adjustments represent factors that need to be added to the government's actual production costs in order to obtain a total government cost for the operation). The Air Force study, released in July 1997, estimated that the fiscal year 1997 work performed at the privatized facility would likely cost the government about $14.1 million, or about 17 percent more than if the facility had continued to operate as a government activity. Contract award fees, government costs for contract administration and oversight, and higher material costs were the primary causes for the cost differential. Table 1 shows the results of this study.

[9] An alternative to privatization-in-place was closure of the facilities, with transfers of the workloads to other DOD facilities. According to BRAC commissions, the closure option was estimated to provide annual savings to DOD of $3.8 million, $28.6 million, and $39.2 million for Newark, Louisville, and Indianapolis, respectively, after one-time closure costs have been recouped.

Table 1: Initial Cost Comparison Between Projected Government and Actual Privatization Operations at Newark, Ohio (July 1997)

Dollars in millions

Work category	Government	Privatization	Difference	Percentage change
Aircraft	$34.4	$42.4	$8.0	+23
Missile	41.2	45.5	4.3	+11
Metrology	8.7	10.5	1.8	+21
Total	**$84.2**	**$98.3**	**$14.1**	**+17**

Note: Numbers may not add due to rounding.

Source: Air Force cost comparison study dated July 1997.

In our December 1997 report,[10] we concluded that the Air Force's cost study methodology was analytically sound, appeared reasonable, used the best available data, and was consistent with DOD guidance on public-private depot competitions.[11] While we reported that the study provided a reasonable interim cost estimate at that time, we also reported that it was premature to reach a final conclusion on costs until a full year of actual data was available.

Subsequently, the Air Force conducted follow-on workload cost analyses based on reported fiscal year 1997 costs and production results. In its November 1998 study, the Air Force concluded that the privatization costs were again greater than the projected government costs to perform the same work. Privatized costs were $16.8 million, or about 21 percent higher than historical Air Force costs. Table 2 shows the results of this updated

[10] *Air Force Privatization-in-Place: Analysis of Aircraft and Missile Guidance System Depot Repair Costs* (GAO/NSIAD-98-35, Dec. 22, 1997).

[11] We did not verify the accuracy of the Air Force historical cost data used for the study. Our prior work has identified unreliable cost data as one of several key weaknesses in DOD's financial management systems. These long-standing weaknesses led us to designate DOD financial management as a high-risk area vulnerable to waste, fraud, abuse, and mismanagement. DOD has started to devote additional resources to correct these problems. Our recent work includes *Department of Defense: Status of Financial Management Weaknesses and Actions Needed to Correct Continuing Challenges* (GAO/T-AIMD/NSIAD-99-171, May 4, 1999), *High-Risk Series: An Update* (GAO/HR-99-1, Jan. 1999), *Major Management Challenges and Program Risks: Department of Defense* (GAO/OCG-99-4, Jan. 1999), and *Defense Outsourcing: Better Data Needed to Support Overhead Rates for A-76 Studies* (GAO/NSIAD-98-62, Feb. 1998).

study. Our review of this cost analysis identified some overstated contract costs for leasing and capital improvement projects and the omission of estimated government revenue received from corporate federal income tax payments. We subsequently made adjustments to the analysis that resulted in decreasing the cost differential to about 16 percent in favor of the former government operation.

Table 2: Updated Cost Comparison Between Projected Government and Actual Privatization Operations at Newark, Ohio (November 1998)

Dollars in millions

Work category	Government	Privatization	Difference	Percentage change
Aircraft	$37.5	$45.2	$7.7	+21
Missile	33.9	41.0	7.2	+21
Metrology	8.8	10.7	1.9	+21
Total	**$80.2**	**$97.0**	**$16.8**	**+21**

Note: Numbers may not add due to rounding.

Source: Air Force cost comparison study dated November 1998.

The updated study followed the same general approach and methodology used in the interim study. Contractor costs represented a full year of privatization operations and, as previously described, included other associated privatization costs. The government cost estimates were largely based on fiscal year 1995 data that were adjusted for inflation and applied to actual repair quantities accomplished by the contractors during fiscal year 1997. After resolving some concerns raised by Boeing, the Air Force added some additional cost to the government estimate for comparability reporting purposes. This had the effect of reducing the cost differential from about 24 percent to 21 percent. These additional costs were attributable to detailing each workload's allocated share of accounting, information services, and dispensary costs. We agree with these comparability adjustments.

As noted previously, the Air Force's interim study initially identified three factors contributing to the increased costs of privatization at Newark, namely (1) contract award fees, (2) government costs for contract administration and oversight, and (3) material costs. Although the first two causes—award fees and contract monitoring—are continuing contributors

to increased privatization costs at Newark, the material cost issue has since been resolved. As a result of a 1998 Air Force Audit Agency study recommendation to improve visibility over materials and to control contractor access to material in the DOD supply system at Newark, the contractors and DOD have performed a detailed inventory of material on-hand and instituted new record keeping procedures and controls. As a result, neither the Air Force nor the Defense Contract Management Command view the material cost issue as an ongoing factor in terms of increased privatization costs. The November 1998 updated cost study assumed that material costs were the same for both the contractor and the government.

While the Air Force cost studies indicate operations are more costly at the privatized facility, the contractors have been incorporating business improvements to obtain cost efficiencies in order to reduce their operating costs. For example, in October 1997—after the data had been collected for the updated Air Force study—Boeing reduced its staffing by 77 to better size the workforce for the workload, thereby reducing costs. Moreover, Boeing has introduced new work flow and work processes intended to reduce turnaround times and costs for some work. A Wyle official cited reduced turnaround times for repairs and the elimination of repair backlogs. The Air Force, however, does not plan to revise its cost comparison for future years beyond fiscal year 1997 because of concerns about the usefulness of the historical baseline costs as the data get older.

Air Force customers and Defense Contract Management Command officials were satisfied with the timeliness and quality of the work performed by both Boeing and Wyle to date. Although citing some initial start-up problems experienced with Wyle Laboratories, they said that both contractors now exhibit positive performance measurements in such areas as scheduling, repair process improvements, and quality assurance. For example, ongoing Boeing program management reviews report missile and aircraft repairs meeting or falling below target pricing expectations, with related repair performance results meeting or exceeding most workload goals. According to Air Force managers, they would prefer not to relocate the current workload to any other facility, government or private sector, given the present quality of work and the expertise developed over the years in Newark.

Similar Comparative Cost Analyses of Navy's Privatizations at Louisville and Indianapolis Cannot Be Made

The Navy has not performed any similar cost analyses on the privatization-in-place sites at Louisville and Indianapolis. Moreover, the absence of sufficient historical data for former Navy operations at these sites precluded us from performing cost comparisons similar to that of the Air Force's study at Newark. Thus, the cost-effectiveness of these particular initiatives, in relation to former government operations, is unknown. However, contractors at these privatization facilities have taken steps to improve cost efficiency and program results. While the Navy has not performed cost analyses similar to the Air Force study of Newark, it continuously monitors the costs for work performed at Louisville and Indianapolis as part of its ongoing contract oversight and administration.

Our discussions with Navy officials showed that detailed operational and financial data, such as per unit costs, needed for an equitable cost comparison were not available. Some macro-level data, including total work years expended and reported overall costs, were available at higher-level headquarters units (such as the Naval Air Systems Command at Patuxent River, Maryland, for the Indianapolis site), but were not useful for the overall purpose of comparing costs. Moreover, Navy-directed revisions to maintenance practices on select weapon systems and changes to product mix occurred after the privatizations were under way, thereby precluding equitable cost comparisons even if detailed historical data were available. For example, Raytheon has modified its maintenance practices for overhauling Phalanx systems at Louisville by making only necessary repairs, referred to as condition-based maintenance, rather than performing complete overhauls. This change in practice has reportedly resulted in fewer component replacements, reduced labor hours, and reduced costs for each unit overhauled. United Defense in Louisville has made similar changes to its overhaul process for the Navy's 5-inch MK-45 gun.

Although the overall cost-effectiveness of the Navy privatizations could not be determined, there are indications of at least potential short-term cost savings to the government resulting from contract provisions restricting labor rate charges and the contractors' efforts to improve business practices. In Indianapolis, for example, a city-imposed covenant placed on Raytheon at the time of contract negotiations requires it to offer labor rates for most Navy work that are 15 percent lower than Navy-operated facility rates over the 5-year contract period. However, after that time, the rates will not be restricted and will be renegotiated, thus raising uncertainty about future rates. A Defense Contract Management Command analysis confirmed that Raytheon was performing work under the primary Navy

contract in 1997 at labor hour rates that were, on the average, 15 percent less than the prevailing Navy rates at the time.

Facing decreasing workloads and increased costs, United Defense in Louisville reduced its workforce and facility space by returning unneeded buildings to the local base redevelopment authority and reengineering maintenance processes. United Defense officials now believe their labor hour rates are comparable to rates used by the Navy when it operated the facility; however, without a baseline of historical government costs, we could not independently validate this assertion. Raytheon in Louisville has reengineered its facility layout and manufacturing and maintenance practices to improve cost efficiencies, and Navy contractors at Louisville and Indianapolis have consolidated some workload operations at the privatized facilities by bringing in work from their other facilities to reduce overall contractor infrastructure and costs. For example, United Defense has relocated assembly work from its Fridley, Minnesota, site to Louisville, thereby reducing space requirements at Fridley by over 50 percent and reducing hourly labor rates by as much as $14. However, we did not assess the impact of the transfers on the cost of the work remaining at Fridley. Raytheon in Louisville has brought in production work for the Phalanx and Rolling Airframe Missile launcher from its plant in Tucson, Arizona, thereby allowing it to close its Lewisville, Texas, facility. Raytheon has also transferred its Long Beach facility depot-level repairs and spares manufacturing to Indianapolis. This restructuring contributed, along with other transfers, to closing Raytheon's Long Beach facility.

Navy customers of the Louisville and Indianapolis privatizations-in-place told us they were satisfied with the timeliness, quality, and cost of the work performed to date. Customers said, for example, that United Defense and Raytheon in Louisville have either maintained or improved quality and timeliness since privatization through changes made to the older Navy work processes and better customer service. They also said that work performed by Raytheon at Indianapolis was as good as that provided by the Navy before privatization. None of the customers we spoke with planned to transfer work to other locations. In Louisville, for example, Navy officials told us they would prefer not to relocate the current workload to any other facility, government or private sector, given the quality of work and the expertise developed over the years. In fact, the Navy gun work customers of United Defense see no reasonable alternative for overhauling their naval guns outside the Louisville facility. As such, they plan to continue sending work to Louisville in the future, as do the Raytheon customers.

Privatization-in-Place Does Not Optimize Excess Capacity Reductions in DOD's Own Infrastructure

Privatization-in-place has not optimized reductions in excess capacity in DOD's own infrastructure, but it can allow for some cost savings in the overall public-private defense infrastructure supported by the defense budget. Reducing DOD's infrastructure was a major BRAC objective, but information provided by DOD, as well as our prior reports, shows that excess capacity still exists in the industrial infrastructure, despite four rounds of BRAC. Rather than closing facilities and transferring defense work to other underutilized DOD facilities to reduce excess capacity, privatization-in-place causes workload to remain at those sites. As a result, DOD continues to support the costs associated with maintaining that facility infrastructure through the rates charged by the contractors for the workload performed. If, instead of privatization, these facility workloads had been relocated to other underutilized DOD facilities, DOD's excess capacity and infrastructure costs would have been more optimally reduced. In effect, by increasing the workload and utilizing capacity at underutilized government facilities, facility overhead costs can be spread over a larger workload base and, as a result, overall costs for repairs on specific units could be reduced and customer prices lowered.

Although privatization-in-place has not addressed DOD's excess capacity problem, contractors at the privatized facilities we visited told us they have either reduced or are trying to reduce their costs, as noted previously, through improved operating efficiencies and reductions in their corporate infrastructure. However, to the extent that DOD maintains underutilized facilities in its industrial infrastructure, it is difficult to assess whether privatization-in-place offers a cost-effective alternative to relocating workload to other underutilized DOD locations. Privatization-in-place would only be a more cost-effective alternative if the contractors can achieve savings that are significant enough to offset the savings lost by not relocating workloads to DOD's underutilized facilities.

Conclusions

Latest estimates of costs at one privatized facility were about 16 percent higher than costs of the same activities when operated as an Air Force facility. However, without an adequate historical baseline and accounting of government operating costs, the Department of Defense lacks the means to compare current costs of operations with the former government-run operations. Faced with decreasing workloads, it will be increasingly difficult to hold down costs of workloads performed at the Department's three privatized facilities. Contractors performing work at these facilities are taking steps to reduce costs and improve efficiencies. The Department

needs to examine these initiatives in the context of the entire defense industrial infrastructure rather than in isolation as individualized operations. As a general rule, privatization-in-place does not optimize reductions in excess capacity in government-owned facilities, and it reduces the potential to achieve greater economies in overhead costs. The Department's efforts to eliminate facilities it owns by transferring them to the private sector does not appear to be cost-effective at one facility, but insufficient data were available to fully assess the cost-effectiveness of the other two locations relative to former government operations. Moreover, since the Department is continuing to pay for the use of these facilities through contractual arrangements, they have not optimized reductions in excess capacity but rather have shifted it to the private sector. Thus, through privatization-in-place actions, the goal of eliminating excess capacity may be realized more in form than in substance.

Recommendations

Should DOD consider privatization-in-place in the future, we recommend that the Secretary of Defense require the services to (1) consider the overall cost-effectiveness of this approach in reducing operating costs and excess capacity in the combined public and private sectors supported by the defense budget; (2) retain an adequate baseline of historical government costs, preferably on a per-unit basis, to assess the cost-effectiveness of privatization-in-place; and (3) periodically reassess the cost-effectiveness of prior privatization-in-place initiatives, in light of excess capacity in other private sector and DOD facilities and continuing declines in military workloads.

Agency Comments and Our Evaluation

DOD provided written comments on a draft of this report. These comments are included in their entirety in appendix II. DOD disagreed with our recommendations, stating that they were unreasonable to implement. In light of DOD's comments, we made changes to the report to clarify our position and have revised our recommendations to reflect these changes. We continue to believe that our recommended actions can be accomplished and that they are essential to assessing the cost-effectiveness of privatization-in-place.

DOD disagreed with our recommendation regarding the assessment of the cost impact of future privatization-in-place actions on DOD and private-sector defense-supported infrastructure, stating that it would be unreasonable to estimate operating cost reductions for both the public and

private sectors. DOD also stated that such an assessment would be sensitive to many factors outside the control of DOD. While we agree that such an assessment would be difficult to complete, especially for the private sector portion, some assessment needs to be made, even if it includes rough order of magnitude estimates, for DOD to be in a position to assess the cost-effectiveness of any such proposal. Such an assessment should, for example, consider the effects of consolidating complimentary workloads at potential privatized locations from other facilities (and thereby reducing or eliminating infrastructure associated with those facilities), either in DOD or in the private sector, to achieve the best possible efficiencies. We continue to believe that such an assessment, completed prior to implementing privatization-in-place, is essential if DOD is to assure itself that privatization-in-place is a cost-effective option to take to reduce DOD infrastructure and costs.

DOD also disagreed with our recommendation regarding the retention of historical baseline government cost data for subsequent use in analyzing the cost-effectiveness of privatization-in-place actions. In disagreeing, DOD stated that it was unreasonable to retain such historical cost data because it would necessitate a change in accounting procedures at most DOD activities and place an unnecessary burden on these activities. While we agree that some financial reporting changes may be necessary and additional record keeping may be required, we do not believe implementation of this recommendation need be unnecessarily burdensome or unreasonable given the Air Force's ability to collect such cost data for its cost analyses of the Newark facility.

We further believe it is important to develop and retain such a performance baseline of costs, to the extent practical, to be able to conduct future cost comparison analyses, as well as effectively manage costs of current operations. In fact, such accumulation of historical cost information is already required by financial accounting standards. Specifically, Statement of Federal Financial Accounting Standards No. 4 requires agencies to accumulate and report the costs of its activities on a regular basis for management information purposes. The standard also states that measuring cost is an integral part of measuring performance in terms of improving efficiency and cost-effectiveness. Without an adequate baseline of historical operating costs, DOD is not in a position to judge the cost-effectiveness of any potential privatization-in-place actions, including anticipated infrastructure efficiencies achieved by these actions. Therefore, any changes in accounting procedures necessary to improve

DOD's ability to identify costs associated with work performed at its individual activities should be considered.

Finally, we have added a recommendation to provide for a reassessment of prior privatization-in-place actions, in light of declining workloads in those facilities and continued excess capacity in both the public and private sectors.

In addition to comments regarding our recommendations, DOD provided technical comments regarding specific findings presented in our draft report. Our evaluation of these comments is provided below.

DOD disagreed with our statement that privatization-in-place does not reduce excess capacity. We have modified our report and recommendations to better reflect our view of the impact of privatization-in-place on the total defense industrial infrastructure, including that in both the public and private sector. We believe that privatization-in-place may reduce excess capacity in DOD's infrastructure to a certain extent. However, we continue to believe that it does not maximize potential efficiencies that could be gained because the workload remains at the privatized facility instead of being transferred to other DOD facilities to further reduce excess capacity. Furthermore, the privatization sites may subsequently acquire additional workloads that could have gone to other underutilized DOD facilities, thus missing an opportunity to further reduce excess capacity. At the same time, some efficiencies may be gained when privatization-in-place options are used to consolidate work from other contractor-operated locations.

DOD stated that privatization-in-place is a BRAC implementation issue, not a BRAC selection issue. We agree that privatization-in-place is a matter of implementation and that initial base closure decisions are made on the basis of excess infrastructure and military value considerations. However, costs to close and return on investment are also factors considered by DOD in its BRAC decision making. An expected outcome of closure decisions is reduced infrastructure operating costs. Before implementing any potential future privatizations-in-place, we continue to believe it would be prudent for DOD to assure that this option is cost-effective and consistent with the overall base closure concept of reducing costly excess infrastructure capacity.

Scope and Methodology

To determine how contractors are responding to decreased workloads at the former DOD facilities in Newark, Ohio; Indianapolis, Indiana; and Louisville, Kentucky, we reviewed documents and interviewed officials from both the government and private sectors. Our DOD contacts included those organizations responsible for overseeing the privatization initiatives and program managers who programmed defense workloads for the facilities. Through those contacts, we sought to gain a sense of the progress being made by the privatization contractors and their satisfaction level with the cost, timeliness, and quality of the work being performed. We also visited the privatization-in-place sites, toured the facilities, and discussed operational status and future plans with cognizant contractor officials. We contacted city and local redevelopment authority officials at the various privatization locations to obtain their perspective on the privatized operations.

To examine the cost-effectiveness of the privatization-in-place actions and their impact on DOD's industrial infrastructure, we reviewed prior work on the Louisville, Kentucky, and Newark, Ohio, operations as well as available DOD workload relocation analyses related to the closures of the military facilities at the three locations. We did not examine the cost-effectiveness of the privatizations as compared to the option of closing the facilities and transferring the workloads to other locations, as envisioned under one BRAC option. Further, we did not examine other issues associated with privatization-in-place such as preservation of jobs in the local communities and retention of technological skills needed to provide services, such as depot maintenance, to DOD. Rather, we limited our review to comparisons between costs of the privatizations-in-place and those of the former government-run operations. In that regard, we reviewed July 1997 and November 1998 Air Force cost analyses that compared privatized operational costs with those of former Air Force operations at Newark, Ohio. The latter study was an update to the July 1997 study that we had reviewed in our prior report of the Air Force privatization initiative.[12] In analyzing the most recent cost study, we compared study results with that of the previous work and used DOD's guide for making cost comparisons between public depots and private contractors to ensure that the Air Force study included all applicable cost elements and included any adjustments. We discussed the study results with cognizant Air Force and contractor

[12] *Air Force Privatization-in-Place: Analysis of Aircraft and Missile Guidance System Depot Repair Costs* (GAO/NSIAD-98-35, Dec. 22, 1997).

officials. We also discussed factors that affect the cost-effectiveness of privatization-in-place with Air Force and contractor officials.

For the Navy privatizations at Indianapolis, Indiana, and Louisville, Kentucky, we attempted to identify comparable DOD cost comparison analyses of government versus privatized operations, but found none. We also collected cost data from contractor and Navy sources to make such comparisons. However, we were unable to conduct these analyses because of (1) the absence of sufficient, detailed historical Navy baseline data for operations at the closing military facilities at those sites and (2) Navy-directed revisions in maintenance practices for certain key weapon systems and changes in product mix. While rigorous cost comparisons were not possible, we reviewed selected contractors' costs and discussed business improvements and restructuring initiatives to bring in additional work to the privatization sites with Navy and contractor officials. We did not attempt to identify the impact on other government contracts as a result of workload transfers from other contractor facilities. In addition, we contacted Defense Contract Management Command officials at these sites to obtain contractor-related cost information and their views about contractors' performance.

In conducting our work, we contacted officials from the following organizations:

- Office of the Secretary of Defense in Washington, D.C.;
- Air Force Materiel Command, Dayton, Ohio;
- Air Force Metrology and Calibration Program Office, Newark, Ohio;
- Naval Sea Systems Command and Naval Surface Warfare Center Headquarters, Arlington, Virginia;
- Naval Air Systems Command and Naval Air Warfare Center Headquarters, Patuxent River, Maryland;
- Defense Contract Management Command offices at Newark, Ohio; Louisville, Kentucky; and Indianapolis, Indiana;
- Raytheon Systems Company, Indianapolis, Indiana;
- Raytheon Systems Company and United Defense Limited Partnership, Louisville, Kentucky;
- Boeing North American, Inc., and Wyle Laboratories, Inc., Boeing Guidance Repair Center, Newark, Ohio;
- Louisville/Jefferson County Redevelopment Authority, Louisville, Kentucky;

- Indianapolis Economic Development Corporation, Indianapolis, Indiana; and
- Heath-Newark-Licking County Port Authority, Newark, Ohio.

We conducted our review from October 1998 through September 1999 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Honorable Jacob Lew, Director, Office of Management and Budget; the Honorable William S. Cohen, Secretary of Defense; the Honorable F. Whitten Peters, Secretary of the Air Force; the Honorable Richard Danzig, Secretary of the Navy; the Honorable Louis Caldera, Secretary of the Army; General James L. Jones, Commandant of the Marine Corps; and other interested parties. We will make copies available to others upon request.

GAO points of contact concerning this report and other key contributors are listed in appendix III.

Sincerely yours,

David R. Warren, Director
Defense Management Issues

Privatization-in-Place Initiatives

The following sections provide additional information on DOD privatization-in-place initiatives at Newark, Ohio; Louisville, Kentucky; and Indianapolis, Indiana.

Newark, Ohio

The announcement to close the Newark, Ohio, facility as an Air Force managed operation was made in 1993, with workload turnover in October 1996 to two contractors—Rockwell International and Wyle Laboratories. While the Air Force retained most of its existing workload at the privatized facility, the Navy moved most and the Army moved all of their Newark workloads to other sites. For the work remaining at Newark, Rockwell International was awarded a contract for depot repairs of aircraft inertial navigation systems and missile guidance systems and Wyle Laboratories was awarded a contract for operating the primary standards laboratory and providing calibration services. Boeing North American, Inc., has since taken over the Rockwell division responsible for work at Newark. The facility, now called the Boeing Guidance Repair Center, has been turned over by the Air Force to the Heath-Newark-Licking County Port Authority, which leases it to Boeing.

The Port Authority is the Ohio-chartered local redevelopment authority formed to accept the conveyance of the property from the Air Force. It is responsible for managing the property and for economic redevelopment. The lease represents about 88 percent of the old Newark facility space occupied by the contractors. The lease provides that Boeing pay the Port Authority for appropriate administrative operations and staffing, buildings and ground maintenance, and reimbursable charges attributable to on-site fire protection services, some utilities, insurance, and taxes. A portion of the lease is retained in a capital equipment reserve fund to pay for future major facility and equipment repairs or replacements. Wyle Laboratories, in turn, subleases about 17 percent of the facility space from Boeing. It pays a pro rata share of the lease and for other Boeing provided services, including electricity charges, protective services, and building maintenance, based on the square footage it and the co-located offices of the Air Force Metrology and Calibration program[1] occupy.

[1] The Air Force only privatized the standards lab operations, technical order management, and certain calibration workloads. The Air Force Metrology and Calibration office retained responsibilities for program management, contract oversight, certification of Air Force Primary Measurement Equipment Labs, and standards procurement.

Until recently, Boeing has been operating under an indefinite delivery/indefinite quantity, cost plus award fee contract that was originally valued at $264 million. The performance term consisted of the base year (9-month transition period) and four 1-year options. In October 1999, the Air Force renegotiated and awarded a sole-source 15-year contract (5-year basic term and two 5-year options) with Boeing. As a cost plus award fee contract, it features incentive provisions for reducing costs and developing new business. Also, Boeing is in the early stages of implementing several management changes to promote manufacturing efficiencies to include improved process monitoring.

Boeing and government officials believe that future workload requirements at its facility will decline for repairing aircraft and missile items, thus increasing the overhead rate. Aircraft repair requirements are expected to decline by about 6 percent in 2000 with further declines expected through year 2014. Officials attribute these expected declines to normal system retirements and attrition, increasing reliability of newer and future weapon systems, and increasing reliance on original equipment manufacturers for logistics support. Although missile repair requirements were similarly expected to decline with strategic missiles retirements, the life expectancy for those missiles has actually increased, with the resulting missile workload remaining about the same.

To replace declining workloads, retain employment levels, and maintain operating efficiencies, Boeing is actively pursuing future work from other Boeing operations, manufacturing partners, DOD programs, and commercial sources to offset its declining workload. However, it has not been very successful to date. Moreover, Boeing expects very little commercial work—its future nondefense workload is not expected to exceed 5 percent of its total work requirements within the new contract period. If new work is not added to replace declining requirements, repair prices could increase due to overhead.

Wyle Laboratories workload with the Air Force has increased somewhat since contract inception, but the company has had similar difficulties in acquiring new commercial customers. The Wyle Laboratories' contract is similar to the Boeing contract. It is an indefinite delivery/indefinite quantity, cost plus award fee contract consisting of a base year and four 1-year options, ending in September 2000. The contract was originally valued at $19 million and the current estimate at completion is $49 million. A Wyle Laboratories' official attributed the cost increase to increased calibration workloads and higher than expected leasing and overhead

costs. Regarding potential nondefense work, Wyle Laboratories currently performs very little commercial work, and it has no immediate prospects for any major new business.

Prior to privatization, the Newark facility employed about 2,500 personnel. When closure was announced in 1993, the total workforce declined to about 1,500; and, by the official closure date in October 1996, the workforce had declined further, to about 1,350. At start-up, Boeing employed about 800 and Wyle about 100; most workers were former government employees at the Newark facility. About 130 government civilian and military remained in the Air Force Metrology and Calibration Program Office.

Since privatization, Boeing's workforce has decreased, with better matches between personnel and workload requirements and associated small reductions in workload. In October 1997, for example, 77 employees were "reduced-in-force" due to reduced workload requirements forecasted for fiscal year 1998. However, most workforce-related reductions have occurred incrementally over time as a result of Boeing-instituted production and personnel efficiencies. Thus, the Boeing workforce currently numbers about 640.

In contrast, since privatization, Wyle Laboratories' workforce and workload, as well as that pertaining to the co-located Air Force Metrology and Calibration Program Office, have increased and are expected to further increase next year. At time of closure, about 80 government lab technicians were hired by Wyle Laboratories to augment its staff working on primary standards lab operations. The Wyle workforce has since grown to about 125, with added workloads attributable to increased demands for repairing calibration equipment and revising technical orders. It is expected to further increase its workforce to about 140 next year. Likewise, the Air Force Metrology and Calibration Office expects to grow by 20 to 40 employees to accommodate the increased contract management and standard measurement responsibilities associated with the increased Wyle-related workload.

Louisville, Kentucky

The decision to close the Louisville facility was announced in 1995, with workload turnover to two contractors (United Defense Limited Partnership and Hughes Missile Systems Company) occurring in August 1996. Raytheon, the current contractor, subsequently merged with Hughes and took over its operations at Louisville. To implement the privatization, the Navy set up a lease with the Louisville local redevelopment authority,

known as the Louisville/Jefferson County Redevelopment Authority, for use of the facility until title of the property can be transferred to the redevelopment authority. The lease requires no payments to the Navy and provides for an initial 1-year term with four 1-year renewal options. Under the agreement, the redevelopment authority assumes responsibility for routine protection, repair, and maintenance at the site. The Navy assumes all liability for environmental conditions existing at the time of turnover. An application has been submitted to the Navy by the redevelopment authority for acquisition of the property through an economic development conveyance; it is currently pending.[2]

The redevelopment authority, in turn, leases out the property to the contractors at a rate, which, according to community officials, is below market value. However, the contractors are responsible for operations and maintenance costs for the portion of the facility that they occupy. Any part of the property not leased to the Navy's two contractors or occupied by Navy personnel can be leased to other commercial activities by the redevelopment authority. In fact, 70,000 square feet, or 14 percent, of this available space has been leased to three local commercial enterprises.

Work performed for the Navy at Louisville is done under cost reimbursable type contracts by the two contractors—United Defense and Raytheon. The contracts cover an initial base period from August 1996 through September 1996 with five 1-year options, taking them through fiscal year 2001. There are also agreements that were put into place between the Navy contractors and the local redevelopment authority as a part of their competitive selection by the city of Louisville. These agreements include promises by the contractors to use best efforts to expand their businesses, to hire former government workers at wages equal to what they had earned with the government, and to guarantee employment levels.

The Navy workload has been taken over by United Defense and Raytheon, with some engineering support still being provided by a Navy detachment and its support contractor remaining in place at the Louisville facility.[3] This detachment is working out of buildings still owned and maintained by the

[2] An economic development conveyance is a means by which a local redevelopment authority may obtain property from DOD at no cost provided the property is to be used for economic development and job creation purposes.

[3] A contractor, CACI Field Services, Inc., which employs about 60 employees at the Louisville facility, provides technical support services to the Navy engineering detachment.

Navy. Once the Navy has turned over the facility to the local redevelopment authority, the detachment will lease its space at no cost to the government. United Defense is responsible primarily for production, overhaul and maintenance support of naval guns. Raytheon mainly performs production, overhauls, and component repair for the Phalanx close-in-air defense system and the Rolling Airframe Missile launcher. United Defense and Raytheon annual sales are about $35 million and $21 million, respectively.

The workload at Louisville has declined significantly from that prior to privatization. Although workload had begun declining prior to privatization, the workload after privatization was even lower than initially estimated. According to United Defense officials, its share of the total Louisville defense work had declined from about 1.3 million direct labor hours in 1994 to 277,000 in 1998, a drop of almost 80 percent. Because of the ongoing decline in work, United Defense only hired a total of 354 employees at the onset of privatization, a reduction of about 60 percent from the prior level of 866 Navy employees. However, according to United Defense officials, it initially expected the workload to be about 449,000 direct labor hours based on prior Navy projections. In response to the lower workload, United Defense further reduced its workforce to 256 employees. Moreover, United Defense returned several buildings to the local redevelopment authority, thereby reducing its facility infrastructure by 40 percent, from about 1 million square feet to about 600,000 square feet. United Defense also redesigned its existing space to allow for a more efficient work process.

Beginning in fiscal year 1999, United Defense has transferred gun production work from its Fridley, Minnesota, plant to Louisville. United Defense projects that, as a result, its total workload at Louisville will stabilize for the next few years. However, this assumes that a significant amount of funding will continue to be provided over the next 2 years from congressionally-designated increases to the Navy's budget. For example, MK-45 gun mount overhaul work, which comprises about 30 percent of United Defense's workload, has been funded in fiscal years 1998 and 1999 primarily through congressionally-designated additions to the Navy's budget. Further, Navy officials maintain that there is little, if any, funding available for this work in the Navy's budget for fiscal years 2000 and beyond without additional funding from the Congress.

In addition to adding work to Louisville, the transfer from Fridley will assist United Defense in reducing its infrastructure. Specifically, United Defense officials assert that after transferring work from Fridley, United

Defense will reduce its Fridley space by over 1 million square feet, or 50 percent, and reduce its Fridley workforce by 285 people, or 17 percent.

Raytheon similarly has seen a 50-percent decrease in its maintenance workload, going from about 250,000 thousand direct labor hours in 1994 to about 128,000 thousand hours in 1998. However, the company has transferred in its Phalanx and Rolling Airframe Missile launcher production work from its facility in Tucson, Arizona. As a result of this added work, Navy and Raytheon officials expect a net increase in Raytheon's Louisville workload. The consolidation of Phalanx and Rolling Airframe Missile launcher work at Louisville has also allowed Raytheon to close its plant in Lewisville, Texas, because of the space made available in Tucson.

While Raytheon has not reduced its on-site facility infrastructure, it has updated its entire facility to accommodate the workload changes associated with the new production work. Under Navy direction Raytheon has also made improvements to the process for overhauling Phalanx systems by adopting "condition-based maintenance." Under this approach, only parts that are not working are repaired or replaced as opposed to the prior Navy process of replacing all parts whether working or not. Conditioned-based maintenance has reportedly allowed Raytheon to keep its overhaul costs down.

Indianapolis, Indiana

In 1995 the closure of the Indianapolis facility was announced, and on January 6, 1997, the workload was transferred to the Navy's contractor, Hughes Technical Services Company. As is the case in Louisville, Raytheon became the contractor after it merged with Hughes in December 1997. The facility is currently under lease from the Navy to the city of Indianapolis for $1 per year over a 10-year term with two 5-year renewal options. An application for acquisition of the facility through economic development conveyance has been submitted by the city and is currently pending before the Navy. The redevelopment authority is subleasing the facility to Raytheon for $1 per year with a lease term of 20 years. Under this lease, Raytheon is responsible for the operation and maintenance costs for the property.

Similar to the situation in Louisville, there are also agreements in place between the city of Indianapolis and Raytheon for such things as hiring former government workers at wages equal to those before privatization and guaranteeing employment levels. Indianapolis also was able to obtain other commitments from Hughes (now Raytheon), including such promises

as reducing product costs to Navy customers, transferring related lines of work into Indianapolis from other locations, and expanding commercial revenues. However, according to Raytheon officials, the agreement to expand commercial revenues related to a specific product line managed by Hughes that was not acquired by Raytheon after the merger. As such, Raytheon officials at Indianapolis do not anticipate being able to fulfill this promise made by Hughes, and this agreement provision has since been removed by the city of Indianapolis.

Work performed by Raytheon is done for the Navy through a 1-year indefinite delivery contract with four 1-year renewal options. The 5-year contract period runs through December 2001, at which time Raytheon will compete with other private companies for the Navy's business. Raytheon's annual sales at Indianapolis are about $180 to $200 million.

The volume of work at Indianapolis, as measured by direct labor hours, has dropped 30 percent since privatization, prompting Raytheon to lay off about 330 employees in mid-1998. According to Navy and Raytheon officials, the reductions in workload occurred primarily because of decreased Navy requirements and the transfer of certain inherently governmental functions to other Navy facilities. However, Raytheon has added new work to Indianapolis, primarily for foreign customers. For example, it has brought in armored tank modification work for Portugal, accounting for about $31 million in sales. Additionally, Raytheon transferred other DOD work for depot repairs and spares manufacture to Indianapolis from its plant in Long Beach, California. This internal restructuring initiative equated to consolidating about 120,000 square feet from its Long Beach facility at Indianapolis. Raytheon has since closed the Long Beach facility. As a result of Raytheon's efforts to bring in new work to Indianapolis, the older Navy work that existed prior to privatization now only makes up about 65 percent of Raytheon's total business at Indianapolis.

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Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

OFFICE OF THE UNDER SECRETARY OF DEFENSE

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ACQUISITION AND TECHNOLOGY

3 NOV 1999

Mr. David R. Warren
Director, Defense Management Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Warren:

See comment 1.

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report "MILITARY BASE CLOSURE: Cost-Effectiveness of Privatization-in-Place Is Uncertain" dated September 24, 1999 (GAO Code 709342/OSD Case 1900).

The Department non-concurs with both recommendations contained in the GAO report. An explanation of the DoD position and technical comments are enclosed.

Sincerely,

for Roger W. Kallock
Deputy Under Secretary
of Defense (Logistics)

Enclosure:
As stated

GAO DRAFT REPORT DATED SEPTEMBER 24, 1999
(GAO CODE 709342) OSD CASE 1900

See comment 1.

"MILITARY BASE CLOSURES : COST-EFFECTIVENESS OF PRIVATIZATION-IN-PLACE IS UNCERTAIN"

DEPARTMENT OF DEFENSE COMMENTS TO THE GAO RECOMMENDATIONS

Now on p. 17.

Recommendation 1: Should the Congress authorize additional base realignment and closure rounds and should it consider privatization-in-place as an option, the GAO recommended that the Secretary of Defense assess to what extent privatization-in-place would reduce the DoD's cost of operations related to defense infrastructure principally in the public sector, but also in the private sector defense-supported infrastructure. (p. 14/GAO Draft Report)

DoD Response: Non-concur

It is unreasonable to require the DoD to estimate the reduction in operating costs for ***both*** the public and private sector resulting from privatization-in-place. Specifically, requiring the DoD to determine the reduction in operating costs relative to the private sector defense-supported infrastructure is prohibitive, not to mention out of the scope of BRAC. Moreover, much of this requirement would be sensitive to many factors outside the control of the DoD.

Now on p. 17.

Recommendation 2: As the Department improves the reliability of its financial data, the GAO recommended that the Secretary of Defense require the Services to retain an adequate baseline of historical government costs, preferably on a per unit basis, to assess the cost-effectiveness of initiatives such as privatization-in-place. (p. 14/GAO Draft Report)

DoD Response: Non-concur

It is unreasonable to expect the DoD require the Services to retain a detailed baseline of historical government costs to assess the cost-effectiveness of initiatives such as privatization-in-place. This requirement would necessitate a change in accounting procedures at most DoD activities. Requiring DoD activities, in the anticipation of future BRAC rounds, to maintain such records for cost comparisons under the privatization-in-place option places each DoD activity under an unnecessary burden.

See comment 1.

TECHNICAL COMMENTS

General Accounting Office (GAO) Draft Report "MILITARY BASE CLOSURE: Cost-Effectiveness of Privatization-in-Place is Uncertain," Dated September 24, 1999 (GAO Code 709342/OSD Case 1900)

The report makes the statement that "privatization in place does not reduce excess capacity in DoD's own infrastructure." This is false because DoD no longer operates or maintains these properties, and no longer retains the capacity. The GAO report, itself, states that Boeing is leasing the Newark facility from the local Port Authority (who received the property from the Air Force). Similarly, the GAO report also states that in Louisville and Indianapolis, the Navy has leased the properties to local authorities pending final disposal. Further, in all of these cases, it is the contractors, not DoD, that have adjusted their workforce and facilities in response to workload received from DoD and the private sector. For instance, at Louisville, United Defense has reduced its workforce and returned several buildings to the local redevelopment authority for reuse. This is contractor, not DoD capacity.

Second, the report's recommendations regarding estimates of operating costs for both the public and private sector resulting from privatization in place initiatives and historical public cost baselines misses the important point that we have argued that privatization in place is a BRAC implementation issue, not a BRAC selection issue. BRAC closure/realignment decisions are based on excess capacity and military value considerations. Implementation of these decisions through privatization in place or other means is an implementation issue subject to an evaluation of the current, not historical, workload mix. Additionally, historical costs do not reflect the infrastructure efficiencies gained by the BRAC action.

The following is GAO's comment on the Department of Defense's letter dated November 3, 1999.

GAO Comment

1. We have revised the report title to more accurately reflect the report's primary point that we could not perform cost-effectiveness analyses of all privatization-in-place initiatives due to the lack of data.

GAO Contacts and Staff Acknowledgments

GAO Contacts

Barry Holman (202) 512-8412
Julia Denman (202) 512-8412

Acknowledgments

In addition to those named above, James Reifsynder, Bruce Fairbairn, Joe Faley, and Cary Russell made key contribitions to this report.

Related GAO Products

Defense Depot Maintenance: Use of Public-Private Partnering Arrangements (GAO/NSIAD-98-91, May 7, 1998).

Inventory Management: DOD Can Build on Progress by Using Best Practices for Reparable Parts (GAO/NSIAD-98-97, Feb. 27, 1998).

Air Force Privatization-in-Place: Analysis of Aircraft and Missile Guidance System Depot Repair Costs (GAO/NSIAD-98-35, Dec. 22, 1997).

Navy Depot Maintenance: Privatizing Louisville Operations in Place Is Not Cost-Effective (GAO/NSIAD-97-52, July 31, 1997).

Defense Depot Maintenance: Uncertainties and Challenges DOD Faces in Restructuring Its Depot Maintenance Program (GAO/T-NSIAD-97-111, Mar. 18, 1997) and (GAO/T-NSIAD-97-112, Apr. 10, 1997).

Privatization: Lessons Learned by State and Local Governments (GAO/GGD-97-48, Mar. 14, 1997).

Defense Outsourcing: Challenges Facing DOD as It Attempts to Save Billions in Infrastructure Costs (GAO/T-NSIAD-97-110, Mar.12, 1997).

High Risk Series: Defense Infrastructure (GAO/HR-97-7, Feb. 1997).

Air Force Depot Maintenance: Privatization-in-Place Plans Are Costly While Excess Capacity Exists (GAO/NSIAD-97-13, Dec. 31, 1996).

Army Depot Maintenance: Privatization Without Further Downsizing Increases Costly Excess Capacity (GAO/NSIAD-96-201, Sept. 18, 1996).

Navy Depot Maintenance: Cost And Savings Issues Related to Privatization-in-Place at the Louisville, Kentucky, Depot (GAO/NSIAD-96-202, Sept. 18, 1996).

Defense Depot Maintenance: Privatization and the Debate Over the Public-Private Mix (GAO/T-NSIAD-96-146, Apr. 16, 1996) and (GAO/NSIAD-96-148, Apr. 17, 1996).

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

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

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