

# THE TWO-FRONT WAR ON

WASTE

AND

FRAUD



**On one front,**  
the Obama administration  
is pushing for open  
competition and  
fixed-price  
contracts.

**By**  
**Harold**  
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**On the other front,**  
Congress is searching  
the frontlines for  
waste and fraud.

**ON MARCH 4, 2009,**

**THE OBAMA ADMINISTRATION RELEASED A PRESIDENTIAL MEMORANDUM AIMED TO STOP CONTRACTS THAT “LINE THE POCKETS OF CONTRACTORS.”<sup>1</sup> THE TOP TWO PRIORITIES OUTLINED IN THE TWO-AND-A-HALF PAGE MEMORANDUM WERE (1) CREATING FULL AND OPEN COMPETITION FOR ALL CONTRACTS (AS OPPOSED TO SOLE-SOURCE FUNDING); AND (2) THE USE OF FIXED-PRICE CONTRACTS (AS OPPOSED TO COST-REIMBURSEMENT).<sup>2</sup>**

In addition, the administration is requesting new guidelines for outsourcing in order to have inherently governmental activities performed by employees within government agencies. The new memorandum is part of an increased push to decrease contracting costs throughout the federal government with the specific goal of decreasing contract costs for the wars in Iraq and Afghanistan and throughout the Department of Defense (DOD).

### **Controlling Costs on the Frontlines**

DOD easily spends the largest share of the federal government’s contract money with \$390 billion of the total \$500 billion allotted in 2008. When Gordon Heddell, the Pentagon’s acting inspector general, went before the House Appropriations Defense Subcommittee on February 20, 2009, he had a different message on how to decrease contract costs than the Obama administration. Heddell advocated an increase in the government acquisition workforce in order to control contractor waste and fraud.<sup>3</sup> The

examples of waste he brought before the committee were appalling, including a nearly \$1 million cost to ship two 19-cent washers to Iraq. Last year, in response to wastes like the ones Mr. Heddell testified about, and with the cost of the contracting support of Operation Iraqi Freedom topping \$435 billion, Congress established the Commission on Wartime Contracting to investigate waste and corruption in Iraq and Afghanistan.

The commission is modeled after the Truman Commission, which was assembled nine months before the attack on Pearl Harbor and was credited with saving \$15 billion during World War II (an estimated \$178 billion by today’s standards).<sup>4</sup> The commission met for the first time on February 2, 2009, when it heard testimony from Stuart Bowen, the inspector general for Iraq. His 456-page report, titled “Hard Lessons: The Iraq Reconstruction Experience,” focused on the lack of contractor oversight in Iraq. In the report, Bowen estimated that \$3 billion of the \$20 billion allocated for big-ticket reconstruction projects in Iraq had been wasted. One

example of the obvious lack of competence is that the Development Fund for Iraq, initially given \$20 billion, was kept track of on a single Excel spreadsheet. In addition, the report talked about the lack of leadership in Iraq, including the much publicized conversation between Condoleezza Rice and Donald Rumsfeld in which they argued over who the top official on the ground in Iraq answered to in Washington. The report also quotes former Secretary of State Colin Powell in an interview stating that there were large communication disconnects between the U.S. Central Command, the Joint Chiefs, and the White House.<sup>5</sup>

In addition to the Commission on Wartime Contracting, other inquiries into contractor fraud in Iraq are currently being investigated by the Special Inspector General for Iraq Reconstruction, the Justice Department, the Army’s Criminal Investigation Command, and other federal agencies. As of February 2009, the number of convictions had reached 35.<sup>6</sup>

One such activity that is currently under serious investigation is the taking of bribes. Many of the charges against private and federal contracting officials include bribes that may have reached as high as \$10 million.<sup>7</sup> In January 2009, federal authorities focused on high-level officials, including the colonel in charge of reconstruction contracting in Iraq in 2003 and 2004, and a senior contracting officer in the U.S. Air Force. Both men had their bank records subpoenaed and were suspected of taking bribes.

Another reported area of abuse is the use of offshore tax havens by government contractors. In an August 6, 2008, opinion article in the *Wall Street Journal*, then-Senator Hillary Rodham Clinton (D-NY) accused government contractor KBR, a former Halliburton subsidiary, of moving its business to the Cayman Islands in order to avoid paying hundreds of millions of dollars in federal taxes.<sup>8</sup> Subsequent to this move, KBR has been awarded a ten-year, \$150 billion government contract for the war in Iraq. According to Ms. Clinton, offshore tax havens have become common for government contractors to use and putting a stop to them would save the taxpayers hundreds of millions of dollars.

## The Obama Administration's Priorities

The Presidential Memorandum's statistics reveal that the percentage of cost-reimbursement contracts has remained unchanged over the last decade. However, the cost of such contracts is too large to be ignored. The dollar amount of cost-reimbursement contracts has nearly doubled from \$71 billion in 2000 to \$135 billion in 2008, but so has the total dollar amount of all government contracts, reaching over \$500 billion in 2008. It is currently the policy of the government to prefer fixed-price contracts to cost-reimbursement, except when the government agency cannot "define its requirements sufficiently to allow for a fixed-price type contract." President Obama's plan is to strengthen this definition and thereby facilitate more open competition, saving taxpayers billions of dollars every year.

Sole-source contracting is a trend the administration plans to decrease as well, but only if it can leave in place the flexibility for agencies to tailor contracts to accomplish their missions. If full and open competition will compromise a mission and sole-source is required, there must be adequate measures to minimize the risk of value loss to the taxpayer.

In addition to competition and the type of contracts awarded, the Obama administration is concerned about private contractors performing activities that are governmental in nature and that should therefore be performed by government employees. Currently, contractors sit next to federal employees at nearly every agency and the number of private contractors greatly outnumbers federal employees. In fact, the government's system for keeping track of government contracts is operated by a private contractor.

The Memorandum's new guidelines have the potential to change the makeup of the federal government workforce. The Office of Management and Budget Circular A-76, first issued in 1966, requires that government employees perform work that is "inherently governmental."<sup>9</sup> A-76 defines inherently governmental functions as those that are intimately related to the public interest, such



as applying government authority or making decisions for the government. If an activity is inherently governmental, a government employee must perform it. If the activity is not considered inherently governmental, then competition is used to determine if it is more or less expensive to have a private contractor perform the activity. If it is more expensive for a government employee to perform the task, then and only then should a private contractor be awarded the work.

The Obama administration believes that the distinction between "inherently governmental activities" and those that are not is misunderstood and misapplied because the distinction is not clearly defined in A-76. As a result, contractors are currently performing tasks that A-76 prohibits them from performing. The administration's first action on A-76 was the cancellation of the collection of overdue tax debts by private contractors on March 11, 2009. If the administration succeeds in its goals, many jobs currently performed in the private sector may be moved back to the government workforce.

## Plans for Change

Peter Orszag, director of the Office of Management and Budget (OMB), as well as the secretary of defense, NASA administrator, and numerous other agency heads, are charged with the task of taking the instructions from the Presidential Memorandum regarding fixed-price contracts, open competition, and inherently governmental activities, and creating governmentwide guidance for the review of such contracts by July 1, 2009. The Memorandum bluntly states that any contracts identified as "wasteful," "inefficient," or "not serving the correct purposes" under the new guidelines will be subject to modification or even cancellation.

Additionally, by September 30, 2009, the same officials are to create governmentwide guidance on the use and oversight of noncompetitive contracts and cost-reimbursement contracts. Regarding A-76, the Memorandum requires the clarification of the distinction between "inherently governmental activities" and those that are not, as well as guidance for



federal agencies on assessing their capabilities to oversee the acquisition process.

There is substantial evidence to prove that misuse, waste, and fraud on the frontlines is rampant. Further, taxpayers could save unknown (and most likely substantial) amounts if fixed-price contracts were awarded competitively. In response, Congress is investigating and the Obama administration is making changes in how government contracts are awarded and how they are overseen. The two together could substantially change what types of contracts are awarded and to whom. **CM**

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#### ABOUT THE AUTHOR

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#### ENDNOTES

1. Presidential Memorandum, "Priorities—Not Lining the Pockets of Contractors" (March 2009), available at [www.whitehouse.gov/blog](http://www.whitehouse.gov/blog).
2. "Memorandum for the Heads of Executive Departments and Agencies," Office of the Press Secretary, The White House.
3. Gordon Heddell, "Commission on Wartime Contractors Discovers...Afghanistan" (February 2009), available at [www.propublica.org](http://www.propublica.org).

4. See, e.g., "Contractors on the Defense" (October 2008), available at [www.dcbbar.org](http://www.dcbbar.org).
5. Stuart Bowen, "Hard Lessons: The Iraq Reconstruction Experience" (February 2008), available at [www.sigir.mil/hardlessons](http://www.sigir.mil/hardlessons).
6. James Glanz, C.J. Chivers, and William Rashbaum, "Inquiry on Graft in Iraq Focuses on U.S. Officers" (February 14, 2009), available at [www.nytimes.com](http://www.nytimes.com).
7. Ibid.
8. Senator Hillary R. Clinton, "No Crisis is Immune from Exploitation Under Bush" (August 2008), available at [www.wsj.com](http://www.wsj.com).
9. O.M.B. Circular A-76, available at [www.whitehouse.gov](http://www.whitehouse.gov).