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Government Contracts and Contractor Behavior

Ruben Berrios

ABSTRACT. The U.S. government embraces the concepts of privatization and market competition, but the realm of contracting shows that it has not always been able to put its principles into practice. Although the contracting system is supposed to be open and competitive, in recent years the government has often awarded contracts with little or no competitive bidding, has chosen to award mostly cost-plus type contracts that force the government to assume more of the risk, and lacked efficiency in monitoring and overseeing private contractors. While the number and value of contracts have increased, the workforce to oversee these contracts has been reduced, preventing the government from adequately enforcing compliance with the contractors, and the government has not made use of past performance evaluations in its contracting system. Private contractors that do business with the U.S. government are for the most part well-established firms with ample resources and inside contacts; many contracts are still being awarded on preferential treatment and to the larger and well-established contractors.

KEY WORDS: contracting, contractor behavior, cost-overruns, government procurement, past performance

Introduction

Over the past two decades privatization has become the cornerstone of almost all government economic reform packages. Policy-makers have sought cost reductions, increased efficiency, and more effective implementation of programs through privatization.

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In its broadest meaning, privatization refers to contracting out and outsourcing. The government purchases the expertise of private firms to provide services. The goal is to create a more effective and efficient delivery of services through a system that fosters and creates competition, provides better management, and helps reduce the size of government. This study reviews the procurement practices of the U.S. government, the types of contracts it awards, and the behavior of private contractors.

Research questions

The research questions in this study are whether the U.S. government's contracting process is competitive and whether the government is getting the best value for the contracts it awards. The research questions are aimed at getting a comprehensive picture of current government contracts and contractor behavior. Much of the information is based on government documents and reports and audits by governmental and non-governmental agencies.

Some specific questions addressed are: What types of contracts in terms of cost, timeliness, and performance are best for the government? What types of contracts does the government use most frequently? How has the bidding process changed over the past 10–15 years? Which contractors are most likely to win government contracts? How has government oversight of contracts changed over the past 10–15 years? How have cutbacks in budgets affected the contracting process?

Doing business with the government

Government contracting is a big business. Each year the government spends over \$200 billion buying

goods and services. The Department of Defense alone accounts for over \$120 billion in prime contract awards, more than 60% of all federal procurement dollars (U.S. Congress, 2003c). U.S. government contracts account for approximately one-fifth of the federal budget. This means the U.S. government by far is the largest consumer and customer for prime contract awards, including those for defense, space exploration, foreign aid, and others.

Private for-profit contractors now represent a large and growing business. In terms of numbers, the greatest concentration is in the Washington, D.C. area close to government agencies. Many of these contractors rely on selling to the government for nearly all of their business. Most are well-established firms with a staff of proposal writers, accountants, auditors, engineers, and lawyers. Some of these firms can afford to spend large sums putting together a proposal. Quite often the selection weighs heavily on the technical content of the proposal and less so on the actual cost. The procedure tends to favor the larger and more established contractors. They have a distinct advantage over small firms even if those groups have the technical expertise in the field. Small firms don't have the resources, the visibility, and the connections that large firms command.

Over the years the U.S. Congress has investigated many reports on contractors' profits, holding hearings and doing studies. Because of the large amount of business the government conducts with contractors, many of those reports have been covered by the media, which has also done its own investigations into alleged contractor abuse. What is not always explored is why these abuses occur and how the system that the government has created might lead to an environment in which abuse is possible.

Doing business with the government is both complex and risky. As contracting has grown over the past 20 years, there has been an increasing number of regulations and guidelines to follow. However, in spite of the complex regulations, doing business with the U.S. government can be a rewarding experience.

The contracting process

According to the procurement regulations, government contracts are supposed to be awarded to the

bidder providing 'best value' to government. The determination is based on cost and non-cost factors such as technical excellence, management capabilities, and professional experience. Contractors must show compliance with the terms and conditions of the contract. The regulations and directives governing the acquisition of supplies or services are established in the Federal Acquisition Regulations (FAR).

The federal government employs two different methods for procuring goods: sealed bidding and negotiated procurement (Holtz, 1979). The former is a method of contracting that employs competitive sealed bids that are awarded to the lowest responsible bidder. The latter, contract by negotiation, is a method that makes use of discussions and negotiations to reach a contractual agreement (Nash and Cibinic, 1993).

Sealed bidding is a competitive method of contracting and is generally perceived as impartial in the way of obtaining competitive bids. Sealed bidding anticipates adequate price competition because without it there is no assurance that the price of the lowest bidder will be fair and reasonable. The contract type in a sealed-bid acquisition is the firm fixed-price type.

Under the fixed-price type of contract maximum risk and responsibility is borne by the contractor, who assumes full responsibility for profit or losses. By bidding on the solicitation, the contractor agrees to the fixed type contract at inception. This type of contracting is suitable for use in acquisitions with definite specifications or standard items on which adequate information on cost is available.

Procurement by negotiation is a more flexible method of contracting. Negotiation leads to a discussion on estimated costs, deficiencies that can be corrected, and consideration of delivery requirements. Government contracting officers decide which firms are within a 'competitive range' and are technically qualified. Those who are in the competitive range are invited to make a 'best and final offer,' on which the final selection is made. Then final offers are made based on the negotiated points. Some of the disadvantages with the negotiated contracts are: the subjectivity and judgment that is involved in the decision, and administration of these contracts tends to be more costly because it involves more documentation and takes more time.

The two broad categories of contracts are fixed-price and cost-reimbursement. Within these basic

types, there are a number of other specific types. For instance, under fixed price there is also the fixed-price incentive contract. Fixed-price contracts are based on an agreed-upon unit cost for the goods or service. From the point of view of the government, fixed-price is preferable because it imposes the greatest risk on the contractor. The contractor has an incentive to control cost and perform efficiently. However, under cost-reimbursement type contracts, the cost risk is assumed mainly by the government. It is obligated to pay when the contractor spends more than anticipated.

What has happened as the government has turned toward more and more contracting is that it has created a system in which the bidding process and type of contract are increasingly those that are least favorable to the government. Though the push to contract has always been based on an argument that it will increase efficiency and reduce cost, in fact the government increasingly eschews the proven benefits of competitive bidding for negotiated deals that tend to cost more. Similarly, though there is no question that fixed-cost contracts are most beneficial to the government, a huge percentage of business is done on a "cost-plus" basis in which inefficiency and cost overruns are rewarded. In a fixed-price or incentive contract, the opposite would be true.

Reform efforts

The administration of President Bill Clinton made an effort to reform the federal procurement system. It started with the 1993 National Performance Review, billed as a campaign to "reinvent government." During the second half of the 1990s there was significant streamlining. The procurement reforms were aimed at a stronger contract administration and increased competition. The government also tried to push for performance-based contracting, in which past performance is part of the proposal evaluation process. Compliance with the requirement was inconsistent, however (Cole and Beausoleil, 2002). During his campaign, President George W. Bush pledged to improve government service and reduce costs by requiring more competitive contracting, but recent government audits show there has, in fact, been less competition (Harris, 2004; Scherer, 2004; Utt, 2004; U.S. Congress, 2003a).

Lawmakers have made many inquiries to try to remedy the effects of significant reductions in comprehensiveness in contract management and the problems in the acquisition of services for the government. The General Accounting Office, Congress's watchdog agency, has noted that while spending for service contracts has increased significantly in recent years, the workforce to manage those contracts has been reduced (GAO, 2003a). In March 2004 the Defense Department inspector general criticized the recently formed Office of Reconstruction and Humanitarian Assistance in Iraq because "contracting rules were either circumvented or liberally interpreted." The report emphasized that competition was limited and there was little oversight (DOD, 2004). In reference to recent Pentagon contracts the inspector general noted that "there had been very serious problems." But these types of criticisms had been leveled at federal agencies in recent years, which have been accused of being both negligent and inept in discovering problems and not taking appropriate action (U.S. Congress, 1992).

The reasons for behavior that contradicts the very tenets that the government claims to be embracing in turning to contractors to do government work are complex. The broad categories are (1) the specialized nature of many of the goods and services required by the government; (2) the increasing expertise and specialization of a small group of contractors; (3) the close relationship between many contractors and government officials who deal with them, including the revolving door that often sends contractors into government positions and former government officials into contracting firms; (4) the low standard the government demands of its contracts and contractors; (5) the continual use of cost-plus type contracts that result in cost overruns and tend to be more costly than incentive-type contracts; (6) the lack of good accounting procedures; (7) the lack of adequate oversight; and (8) in the case of war-related contracts, the time urgency that means normal controls end up being circumvented.

Well-connected contractors

Government contracting regulations are rather complex but the growth of contracting has been fueled by the move toward a less restrictive

free-market-based economy. Moreover, contracting by the government frequently departs from the competitive free-market model in a number of ways. While most contracts for work with the U.S. government must be won competitively, a significant number are awarded with no or limited competition. Economic theory stresses that open competition will drive down bids, and therefore, lower the cost to the entity doing the contracting. However, the extent of competition depends on the number of firms submitting bids and the firms' expected costs. The higher the number of bids and the closer their expected cost, the greater the competition. But when the procurement process is not open or competitive, the chance of cost savings decreases. Some reasons for a lack of competition could be the unjustified exclusion of firms from the bidding process or favoritism in the selection of contracts.

In September 2001, the DOD inspector general released an audit of more than 423 contract awards made by 15 defense contracting organizations. Many organizations made numerous sole-source awards without giving companies a chance to compete and without justifying the limited competition, the inspector general found. The audit revealed that 72% were sole-source contracts (Harris, 2004). In March 2004, the inspector general found that there were some major problems with the contracts to rebuild war-torn Iraq, particularly overpricing and lack of oversight. In fact, he noted that 22 of the 24 contracts awarded had not properly followed procurement rules (Eckholm, 2004a).

Contracting officers and private contractors often develop long-term relationships governed by their own specific needs and expectations. These relationships could influence the delivery of service and the way contracting is managed. Some of the larger contractors have developed a close bond with government agencies. They have become influential constituents who are familiar with the people and procedures of the government agencies that award contracts.

According to Guttman and Willner, the contracting process "is dominated by the network of relationships that exist between contractor and agency, and these relationships are crucial in the awarding and administration of contracts" (1976, p. 24). Contracting is foremost a business and the cultivation of inside contacts in government is

important because it provides an advantage in accessing information that others do not have. This is perhaps one of the reasons private contractors rely on 'personal contacts.' A common phenomenon in Washington is that lucrative lobbying jobs await many leaving government service (Wayne, 2003).

Many of the senior contract administration staff of these contracting firms are former government officials. From a business standpoint, former contracting officers and other key officials with Washington expertise are essential to have on board. They are attracted to the private sector because their expertise and inside knowledge, they retain inside contacts, and are specially adept at securing contracts because they know their way in and out of government. The contracting process is seen by small contractors as an insider's game that favors larger contractors (U.S. Congress, 2003b). The nexus between former government officials and their new role as clients to the government has been criticized as representing a conflict of interest, but former government officials are seen as prized commodities for their intimate knowledge of government policies affecting their business.

Flaws in contract requirements

Effective government contracts require careful administration. Without adequate public administration, inefficiencies and abuses are likely to surface. The rules established in the FAR provide for fair competition and proper contract management, which reduces the chances of corruption in the procurement process. The regulations have traditionally stressed completion of duties over excellence, however. For most of the 1990s, contractors were not overly concerned with achieving high levels of performance since what was required of them was the *level of effort*. They simply needed to show that they went through the motions of fulfilling the contract specifications. If they did not meet the goals, if there were cost overruns, if there were problems in implementation, they did not have to be concerned about the effect on present or future contracts because they were not being judged on performance outcome, only on whether they could show that they had made an effort to carry out the conditions of the contract (Berrios, 2000). Although

in the late 1990s the government tried to move away from this practice by using past performance reports, corrective actions were insufficient (Berrios, 2000; Cole and Beausoleil, 2002).

The FAR, particularly since 1995, requires that past performance be used as an evaluation factor in the selection process (FAR 15.304(c)(2)(ii)). The evaluations should be taken into account to match it with the performance of competing contractors and to see how the contractor might perform in future contracts. In contrast with the previous requirement that only level of effort was required, there were now measurable performance standards to enable the government to make a judgment regarding how well the contractor has complied with all aspects of the contract, and not just on end results. However, as Cole and Beausoleil (2002) note, "while the grading system might look good on paper, its practical value is questionable." An agency's ability to control the information might not always be uniform. Another problem is that "the compliance with the requirement to conduct evaluations upon completion of contract activities has been low. As a result, past performance has not proven to be an effective tool of evaluation in source selection." (Cole and Beausoleil, 2002, p. 125).

The reasons provided by Cole and Beausoleil is that "contracting officers complain that they do not have time to conduct evaluations" (2002, p. 125). They note that of "those evaluations that are initiated, many are not completed because the technical officers are reluctant to participate, often because they see the evaluation process as too time-consuming." (2002, p. 125). Others see no purpose in the evaluation once the contract has been completed. Part of the problem is that negative information on the contractor has to be documented in detail and since there is a shortage of manpower there is no incentive to do it. In short, "the result is that most contracts are not being evaluated, and of those that are, the usefulness of many of the evaluations is questionable." (Cole and Beausoleil, 2002, p. 126).

The shift to cost-reimbursable contracts also affected performance. David Cooper, director of acquisition and sourcing management at the GAO, testified that in service contract outsourcing the government regularly utilizes what is regarded as the riskiest form of contracts: cost-reimbursable contracts. Further, he said, these contracts were awarded

on a non-competitive basis. "The 22 orders we reviewed, with a total value of \$553 million, typically provided for reimbursing the contractors' costs, leaving the government bearing most of the risk of cost growth. Further, although competition helps agencies ensure they obtain the best value under contracts, a majority of these orders were awarded without competing proposals having been received." (Commercial Activities Panel, 2001)

According to GAO (2003a), since 1997 while federal spending on service contracts increased by 11%, there was a significant decrease in the procurement workforce. This growth in spending combined with downsizing the acquisition workforce has created an environment that does not lead to improvement in contractor performance. As the number of contracts awarded has increased, there are less people to oversee contractors, to make the proper decisions about the use of government funding, and to evaluate activities and develop new strategies. For instance, in the case of USAID, Zeller notes that "many of the most experienced Foreign Service officers have left" and the agency is not prepared for its contract oversight mission (Zeller, 2004, p. 37). He states that, "in Iraq, for example, the agency had to take steps to outsource even the oversight of the contracts it has let. The agency hired the Army Corps of Engineers to help oversee the largest contract, the \$600 million construction deal awarded to Bechtel Corp. And last June, USAID hired Washington-based Management Systems International to help oversee the remaining contracts." (Zeller, 2004, p. 37)

Lack of oversight

The government's attempts to upgrade its standards have not succeeded in changing performance. One reason was lack of oversight, another is lack of consequences. The government did not have adequate oversight so it was not in a position to effectively monitor performance. Furthermore, even when performance was not up to par, the pattern of relying to the same contractors over and over did not end. As long as contractors know that they can continue to be awarded contracts, they have no incentive to improve their performance.

There is still inadequate monitoring and evaluation of contracts. Although the FAR also covers oversight, this is one of the weakest links in the government contracting process, and in recent years has gotten weaker. In 2002, Comptroller David Walker said that he was “not confident that agencies have the ability to effectively manage cost, quality, and performance in contracts.” (Scherer, 2004)

Streamlining of the procurement process in recent years has not been in tandem with the rapid growth in procurement in the last few years. Lack of resources has forced government agencies to reduce the number of procurement personnel. Furthermore, government agencies are under pressure to award contracts at the discretion of contracting officers, but there is often little connection between writing up the specifications desired and monitoring performance to see if they are fulfilled.

In 2001, the DOD inspector general found in the acquisition contracts reviewed, that the department’s contracting workload increased by 12%, although the federal workforce was reduced by half. Furthermore, the inspector general office found problems in each of the service contracts it reviewed in a study that involved a sampling of contracts with a total value of \$6.7 billion.

Frequently, oversight is contracted out as well, and sometimes the entity that won the contract is given oversight responsibility. “The Pentagon has created a system where contractors are evaluating themselves and then making recommendations on how much more money they need,” said U.S. Sen. Jack Reed (D-R.I.), a member of the Senate Armed Services Committee (Scherer, 2004).

Deficiencies in contract administration result in inadequate management. The focus is on getting the job done. Inadequate cost controls can lead to inflated costs. For instance, cost accounting standards apply to cost-based contracts above certain thresholds (\$7.5 million) and require that contractors accurately account for their costs. However, if contracts are considered “commercial service” contracts they might be exempt from accountability standards.

The government has been faulted for failing to supervise private contractors even when red flags have been raised about specific firms. In the mid-1990s, a whistleblower revealed that the company, then known as Brown & Root, had overcharged the

government on a contract to convert military bases to civilian uses. The Halliburton subsidiary agreed to pay \$2 million fine, but admitted no wrongdoing. Eckholm also notes that “a former field buyer for Kellogg Brown & Root in Kuwait described a corporate culture in which supervisors told buyers, ‘don’t worry about the price. It’s cost-plus’” (2004a, p. 8). Audits have not kept pace with the number of contracts awarded (GAO, 2004c).

Although the Services Acquisitions Reform Act approved in April 2003 was intended to fix some deficiencies, recent events do not reflect change. Although the government says that it favors the use of performance-based contracts and even set a target to have 10% of eligible contracts be performance-based contracts, most agencies lag behind in meeting that goal (U.S. Congress, 2003b).

Market structure

Another important issue in government contracts has been the increasing concentration of the largest, more experienced contractors. These contractors have a better inside knowledge of the trade. The top contractors receive the lion’s share of contracts both in numbers and dollar value. The strategic behavior of these firms leaves little room for the smaller, less established contractors to win contracts. In a recent congressional hearing it was noted that “historically, small businesses have faced many barriers accessing the federal procurement marketplace” (U.S. Congress, 2003a, b). The impediments are mainly lack of resources and technical sophistication and sometimes bureaucratic contract bundling. The large number of contracts received by the bigger firms suggests that they have market power. One notable aspect of contracting is that contracts are fewer but larger in value (Berrios, 2000).

The market structure of contractors competing for government contracts has oligopolistic characteristics. A key feature of this market is the concentration in terms of the high percentage received by the largest firms. The nature of the market structure provides useful insight as to the competitiveness and procurement practices in this business. The data also reveals that contractors are concentrated in the Washington, D.C. area (Berrios, 2000).

TABLE I
Top 10 contractors with the Department of Defense

Rank		Company name	Awards (billions \$)	
2004	2003		2004	2003
1	1	Lockheed Martin Corporation	20.7	21.9
2	2	Boeing	17.1	17.3
3	3	Northrop Grumman Corporation	11.9	11.1
4	4	General Dynamic Corporation	9.6	8.2
5	5	Raytheon Company	8.5	7.9
6	7	Halliburton	8.0	3.9
7	6	United Technologies Corporation	5.1	4.5
8	9	Science Technology International	2.5	2.6
9	10	Computer Sciences Corporation	2.4	2.5
10	11	Humana Inc.	2.4	2.4

Source: Department of Defense, *Procurement FY2004*.

In defense, the top ten contractors that won contracts in 2003 also won in 2004 (see Table I).

A GAO review of a Department of Defense test program to involve more small businesses in contracting said that contractors participating have experienced "mixed success in meeting their various small business subcontracting goals." According to the report, government officials said that "two of the major challenges they identified include (1) the increased breadth, scope, and complexity of DOD prime contracts that require, among other things, teaming arrangements with other, typically large contractors and (2) prime contractors' strategic sourcing decisions to leverage their purchasing power by reducing the number of their suppliers including small businesses" (GAO, 2004a). The pattern established in which large contractors win contracts is not easy to change.

Windfalls of war

Because of the urgency to award contracts for Iraq's reconstruction, the contracting process was speeded up and in many cases standard procedures were not enforced. The flaws in the system noted above have been exacerbated.

When the U.S. engages in war, there is a flurry of corporate deal-making with defense industry giants. In recent decades, companies such as Boeing,

Lockheed-Martin, Northrop and others have been tapped to deliver the hardware. Though these firms have engaged in price-gouging (Silverstein, 2004; Wayne, 2004a,b) and government officials have been found to have ties with them, presenting conflicts of interest, they have the size and expertise to deliver wartime supplies and services. Boeing, for instance, has been investigated over allegations that a DOD contracting officer favored the company in exchange for a job there (Wayne, 2004b).

When the U.S. became involved in Iraq, bidding for contracts was restricted and the selection process accelerated. As contracts to restore infrastructure and provide services were awarded, European companies were kept out of the lucrative deals. In the provision of certain types of reconstruction and services, defense contracts went to large established contractors in the U.S. One of those lucrative awards went to the Bechtel Group for \$680 million to help rebuild Iraq's infrastructure. Bechtel had posted revenue of \$11.6 billion in 2002.

In the case of the Iraq War, a number of the contracts are sole-source arrangements, which give the winner a monopoly. The DOD inspector general's review of 24 contracts worth \$122.5 million awarded to the Office of Reconstruction and Humanitarian Assistance/Coalition Provisional Authority and the Defense Contracting Command-Washington found that "thirteen of the 24 contracts, valued at approximately \$111 million, were awarded

on a sole-source basis to fill urgent needs” (DOD 2004, 1). The review found that “contracting rules were either circumvented or liberally interpreted” (DOD, 2004, 2). Contract requirements were not established, supply schedules were misused, personal services contracts were inappropriately awarded, “out-of-scope activities” were permitted, and “price reasonableness determinations” were not supported, and there was “little or no Government surveillance on awarded contracts. In one example, a contractor was paid even though he was on vacation. In another, vehicles were airlifted into Iraq at a cost of hundreds of thousands of dollars without prior approval.” (DOD, 2004, 2).

A sole-source contract was awarded in March 2003 to Kellogg Brown & Root (KBR), a subsidiary of Halliburton, to restore Iraqi oil wells and refineries. This contract has caused numerous problems with the company because it received the contract for work in Iraq on a non-competitive basis. The International Advisory and Monitoring Board in Iraq, an oversight body, has complained that the Halliburton company has not provided details about the non-competitive contract after repeated requests to do so. The company had been awarded the contract for essentially importing fuel. The Defense Contract Audit Agency has found \$219 million in questionable costs in this Restore Iraqi Oil (RIO) contract worth approximately \$2.5 billion (US Congress, 2005). A second RIO contract was awarded to Halliburton worth approximately \$1.2 billion.

Awarding contracts mainly to prime contractors obviously does not entail or encourage competition and fairness. The government points to contracting as a more businesslike way of handling its needs, but in fact its arrangements often erase the fundamental function of the marketplace. “Contracting officers were supposed to determine which companies were best suited to perform work, yet they routinely accepted officials’ recommendations about which vendors to hire” (Harris, 2004, p. 61). The Inspector General’s report cited a case in which Office of Reconstruction and Humanitarian Assistance officials sent a statement of work along with a resume for Terry Sullivan, an employee with longtime government intelligence contractor SAIC, who they wanted to hire as an intelligence analyst. Sullivan wrote the statement of work himself. The contracting officer used that information to justify the

award of a sole-source order worth nearly \$400,000 (DOD, 2004).

Accusations of conflicts of interest have surfaced because the major contractors are closely tied to former and current government officials. For instance, former Secretary of State George Shultz sits on the board of directors of Bechtel. He was also chairman of the advisory committee for the liberation of Iraq, a pro-war group with close ties to the White House. Former Secretary of Defense Casper Weinberger has been counsel to Bechtel. A number of other people on the board are former generals or politicians linked to companies that receive large defense contracts (Harris, 2004; Herbert 2003; Shorrock 2004 and Wilson 2000). A top Army contracting officer has raised concerns about the contract to KBR, saying that she was under pressure to sign off from individuals “associated with favorite companies” (Verloy, 2004). She called for an investigation of procurement practices and has since sought whistleblower protection.

The GAO released a report in July 2004 in which it “focused on four logistics support contracts used by the military to support U.S. troops around the world” (GAO 2004b). While the GAO found that some of the logistical support contracts were working effectively, it documented extensive problems associated with the way in which the largest logistical support contract, the Army’s Logistics Civil Augmentation Program (LOGCAP) contract, has been handled in Iraq. The private contractor on the LOGCAP contract is Halliburton’s subsidiary KBR. Halliburton has been awarded task orders under LOGCAP worth as of September 2004, \$8.6 billion for work in Iraq. The GAO and a congressional report examined numerous facets of Halliburton’s contract with the U.S. military to provide essential services to the troops in Iraq. It found significant problems in almost every area, including ineffective planning, insufficient training of contract management officials, and a pattern of recurring problems with controlling costs, meeting schedules, documenting purchases, and overseeing subcontractors (GAO, 2004b; US Congress, 2005). The latter report notes that there are \$813 million of “questioned costs” and \$382 million of “unsupported costs” in this contract (see Table II).

Inadequate oversight has also been evident in these contracts. Allegations have risen over the lack

TABLE II
DCAA audits of Halliburton's Iraq contracts

	"Questioned" costs	"Unsupported" costs	Combined
LOGCAP Contract	\$813 million	\$382 million	\$1.195 billion
RIO contract	\$219 million	\$60 million	\$279 million
Totals	\$1.032 billion	\$442 million	\$1.474 billion

Source: U.S. Congress, *Halliburton's Questioned and Unsupported costs in Iraq Exceed \$1.4 Billion*, June 27, 2005.

of accountability in the rebuilding process in Iraq (Eckholm, 2004a, b). An internal Pentagon audit has found that Halliburton, of which vice president Dick Cheney was the CEO from 1995 to 2000, failed to adequately account for \$4.2 billion it has received for its services. Also, four of its finance employees have revealed that the company engaged in systematic accounting fraud (Morgenson, 2004). As a result, Halliburton has been under scrutiny by Congress over its multimillion-dollar contracts with the U.S. military in Iraq. Investigators found that Halliburton inflated costs and overcharged the government for its services. In early 2004, the Defense Department announced that Halliburton had agreed to reimburse the government \$27.4 million for possible overcharges. But since the other charges of overbilling have been made.

The Congressional report released in mid-2005 is the first comprehensive assessment of Halliburton's pattern of unreasonable billing in Iraq. It found that excessive and questionable costs have multiplied since the beginning of the war despite numerous audits and reports in the media about these abuses. Government auditors at the Defense Contract Audit Agency have identified more than \$1 billion in "questioned" costs, an amount that significantly exceeds previously known estimates.

Halliburton has incentive to inflate costs, the investigators found, because of the structure of the cost-plus contracts it received. Halliburton is reimbursed for all of its costs and it receives an additional fee as a percentage of these costs. The more it is reimbursed, the higher these additional fees.

"Army auditors found that Halliburton 'inflated' its costs estimates, charged 'excessive costs,' billed for equipment that 'wasn't necessary' and submitted millions of dollars in 'duplicate costs' under the LOGCAP contract," the report said. Despite many

reports showing overcharging, the Bush administration has not taken any action (US Congress, 2005, i). "To the contrary, there have been instances in which Halliburton has received preferential treatment from Defense Department officials," the report noted. DOD officials overruled objections from career contracting officers, waived requirements, and disregarded warnings from auditors (US Congress, 2005, ii). The DOD's failure to take action was encouraging Halliburton's "continued disregard of U.S. taxpayers' interests," auditors said in a written memorandum last year (US Congress, 2005, ii). In July of 2005, "the U.S. military signed another work order with Halliburton to do nearly \$5 billion in new work in Iraq." (New York Times, 7 July 2005: A8)

Another type of contracting that has grown more common in the military is the "outsourcing" of jobs to private contractors. Outsourcing has changed the traditional norms of military command and control because all sorts of jobs once done by the military are now contracted out. The demand for private security companies expanded even more quickly after September 11 and today a number of vital tasks have been entrusted to these private military contractors. The rationale for outsourcing is that private contractors can do the job for less. In theory, contracting when it is subject to fair competition can reduce costs, but in practice the bidding process is not always transparent and there have been a number of cases in which favoritism has been charged. Moreover, the type of contract that is most commonly used is cost-plus or cost reimbursement, which is the least optimal for the government because it provides incentives to the contractor to engage in cost overruns (Berrios, 2000).

Facing budgetary pressures, there are also insufficient personnel to oversee and monitor their

performance, as has occurred in contracts outside the war arena. And as these contractors have grown in size and number, they have also gained more political clout. Many of these contractors are also veterans and former retired officers that had links to the CIA or the Department of Defense.

Private contractors are providing security protection, battlefield operations, maintaining equipment, and all sorts of services to feed and house the troops (Avant, 2004; Chaterjee, 2004; Harris 2004; Singer, 2003). Singer estimates that there are some 15,000 private military contractors on the ground assisting American troops in Iraq. The Pentagon cannot provide an accurate figure because it has no idea how many workers have been hired by all the contractors and subcontractors. What is better known was the lack of Pentagon audits, which were originally absent. The contract management office lacked the personnel to oversee the contracts but has had to add people after the complaints surfaced (Gao 2003b).

In addition to the abuses and flaws revealed in the military contracting system, so far it has failed to achieve its bottom line: cost savings (Markusen 2004). A report by the Defense Acquisition University concluded that “cost-based outsourcing initiatives” had failed to achieve the ambitious goals in terms of savings, and had moreover greatly compromised the Department of Defense’s ability to pursue its mission of providing an effective defense and fighting force to the nation (Anderson et al., 2002). The report flatly asserts: “Cost-driven outsourcing strategies are undermining the Department of Defense.” It says that outsourcing “will not produce the level of savings projected by DOD. Savings targets are unrealistic and unobtainable.... More important, by emphasizing cost-based initiatives, DOD risks losing sight of its primary mission: to fight and win our nation’s wars.” (Anderson et al., 2002, p. 7–4).

Concluding remarks

For a variety of reasons documented here, the government has taken a logical concept – to employ economic principles and businesses practices to achieve efficiency and cost savings – and ended up with poor results because it failed to adhere to the proven framework available. It em-

braced the idea of competitive bidding, but often proceeded to award no-bid contracts or to allow an oligopolistic structure in which contractors are able to obtain favorable circumstances at low risk to their firms. It committed to more efficient services procured through private contractors, but then overwhelmingly turned to “cost-plus” or cost reimbursement type contracts, which provide less incentive to control costs and, in fact, reward overruns and inefficiency. It sought to save money by turning over many of its functions to private contractors, but failed to enforce adequate oversight that could prevent corruption and price-gouging. The government also failed to put in place regulations and controls that would prevent ties between government and contracting officers that lead to preferential treatment.

Congressional hearings and recent internal audits have revealed that various government agencies such as USAID, the Army Corps of Engineers, and the Defense Department have used improper contracting practices and shown a lack of accountability. The General Accounting Office and watchdog groups have also charged that these government agencies did not allow for sufficient competition to award contracts, did not determine reasonable prices, and did not provide contractor oversight, which opened the door to abuses. Although some of these issues have been raised before, the government has been slow in reacting. The government has yet to ensure proper financial management, a more transparent process, and a level playing field by making the process more competitive.

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