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The Pentagon Struggles with the Ghost of Rickover



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America's greatest national security advantage is the breadth and vitality of its free-market economy. The Pentagon should be drawing on all of it: established manufacturers, commercial technology companies, a rebuilt middle tier, and disruptive entrepreneurs competing to deliver better weapons faster and more affordably. For more than 50 years, Washington has instead maintained accounting and procurement rules that divide American industry into two camps: companies organized around government compliance requirements and companies that avoid them.

Recently, I warned that the Pentagon's August 18 supplier-transparency memo could become the most damaging defense acquisition policy in 50 years. I stand by that criticism. Government-unique demands for actual costs segmented by contract, profit benchmarks, and unprecedented access to contractor financial systems threaten to extend the Pentagon's control of its captive suppliers across the commercial economy. This will drive away the companies and private investment that the Pentagon urgently needs.

But in a recent turn of events, a September 14 memo—"Fostering One Strong Industrial Base," signed by Deputy Secretary Steve Feinberg—cauterizes the wound created by the first memo to a degree. It prevents applying the Cost Accounting Standards (CAS) to nontraditional and commercial contractors and potentially offers a path forward for traditional contractors to emerge from the morass of government regulation. This could be a significant step toward repairing the divide between defense and the vibrant commercial economy.

Admiral Hyman Rickover's career captures how that chasm was created. The now-mythical innovator helped deliver the *Nautilus* submarine in less

than seven years after the approval of the naval nuclear reactor program. Then this transformational hero turned into a bean-counting apparatchik once it was decided the navy no longer needed to innovate or for industry to compete for new solutions.

Rickover's transition to chief cost bureaucrat came about because he confronted a real problem when producing submarines at scale. The government depended on a number of sole-source suppliers whenever it limited competition after an initial award. His solution to keep prices low was to demand uniform cost-accounting data as a means to cap profits, measured as a percentage of government-approved costs. His late-1960s campaign and congressional testimony helped produce CAS in 1970, but things didn't work out as planned. CAS welcomed in an era of heavy oversight and regulation and ever-spiraling costs within an ever-dwindling defense industrial base.

Rickover's diagnosis may have been fit for a public shipyard or government-bound contractors trained to build to spec. His cure just didn't fit the real American economy. When a sole-source prime performs government-unique work, receives reimbursement for its costs, and functions as an extension of the state, the Rickover cost-based oversight approach may perhaps be the only lever to rely on. The mistake was making that arrangement the precondition for the rest of American industry to ever support national defense.

Companies answered rationally to these incentives. Defense incumbents absorbed the regime and specialized in compliance with byzantine rules. Mixed firms isolated covered work or built separate accounting machinery. Meanwhile, commercial firms capped their government exposure, sought exemptions, refused clauses, or walked away. CAS helped split the

industrial base in two by making the boundary between defense and commercial too expensive to cross.

We have been trying to repair this divide ever since. I arrived on Capitol Hill in 1994, the year the Federal Acquisition Streamlining Act first exempted commercial items from CAS. This effort, while positive, ultimately proved inadequate. Congress protected a category of products from overregulation when it should have allowed commercial companies to solve military problems without having to remake themselves.

In 2015, to do just that, I returned to Congress to create a Pentagon version of the CAS-avoiding Other Transactions model that NASA used to launch SpaceX. Ten years later, as a result of that legislation, dozens of new SpaceXs are knocking on the door, but the Pentagon leadership, wedded to the old cost-based mindset, is still not ready to let them in.

The Feinberg memos need to be evaluated based on this history. The August 18 memo has not been rescinded and, because it is based on the old Rickover cost and pricing model, will continue to do harm and send mixed signals to industry until it is. The September 14 memo does walk back some, but not all, of the first memo's nonsense. That is an improvement. Unfortunately, that progress could be undermined by the implementation of the first memo's provisions to still demand cost and pricing data, grant the government unprecedented access to company computer systems, and arbitrarily limit profits.

The Pentagon needs to choose. It should emulate the innovative 1950s Rickover and exorcise the ghost of the 1960s one. That means repealing the first Feinberg memo in its entirety.