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As noted by former Under Secretary of Defense for Acquisition, Technology, and Logistics, Mr. Frank Kendall, “All acquisition managers should routinely analyze *all cost elements* and consider reasonable measures to reduce them, with prudent ... considerations of associated risks.”<sup>42</sup> Included in the domain of *all elements* are not only direct costs but indirect costs as well. All too often indirect costs have received short shrift in the defense cost analysis community, with pass-through values accepted without due diligence.

This research has sought to illuminate and meld into a holistic whole the two critical elements of the escalation conundrum for indirect costs, measurement and projection. For the measurement challenge, benchmark metrics were identified and assessed from a 360-degree perspective, using healthcare as a test case or proxy for all major elements or components of a company’s overhead. The benchmarks focused on who pays for healthcare: the employee or consumer, a defense company, the government (Medicare, Medicaid), or all three. A best-fit index was identified for defense firms – the Employer Cost of Employee Compensation (ECEC) – Union Firms.

On the second issue, this research takes advantage of market data which reflects expectations inferred from the prices and yields of financial instruments actively traded on Wall Street, such as Treasuries and, more recently, inflation derivatives. Macro inflation is projected three decades ahead using the market data, with a medical delta or differential then tacked on. Uncertainty bounds for the forecasts are established using PDFs inferred from call/put prices for inflation.

Together, the benchmarks and the projections enable the independent estimation of outyear escalation rates, information useful to all parties – labor unions, firms, contract negotiators, program offices, and government cost analysts.

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<sup>42</sup> USD(AT&L) Memo, “Should Cost Management in Defense Acquisition,” 6 Aug 2013



