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Does Competitive Sourcing Really Pay?

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Does Competitive Sourcing Really Pay?

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Executive Summary

The Office of Management and Budget (OMB) *Circular A-76*, *Performance of Commercial Activities,* has been around for over 40 years. *A-76* was commonly used to refer to the process of outsourcing non-inherently governmental jobs in the 1990's. The *A-76* circular was substantially revised to simplify and standardize implementation guidance and was released in its current form on May 29, 2003. The OMB now uses *A-76* to help implement the competitive sourcing initiative on President Bush's Management Agenda. The stated policy objective in the revised circular is, "To ensure that the American people receive maximum value for their tax dollars, commercial activities should be subject to the forces of competition" (OMB, 2003, May 29). The purpose of this study is to determine if *A-76* competitions have resulted in saving the taxpayers money. More specifically, has *A-76* saved the Department of Defense (DoD) money over the long term?

The thinking goes that by subjecting the non-inherently governmental jobs being performed by government employees to the "forces of competition," the American taxpayer should benefit in the form of better service at lower cost. As stated in the *Federal Acquisition Regulation* (*FAR*), "Commercial activities should be subjected to the forces of competition" (Part 7.302). In this study, I will be primarily concerned with the lower cost expectation and some of the broader policy implications of this strategy.

So the question is: have *A-76* competitions saved the DoD money? A General Accounting Office (GAO) report in 2000 on *A-76* studies in the DoD concluded that the Department had saved $290 million dollars on 286 studies conducted from 1995 to 1999. However, the study goes on to say that there were some problems in the way the Government calculated baseline costs, which were often based on authorized positions rather than on actual positions, and that the cost-savings estimates did not include the costs of conducting the studies or the cost of implementing and managing them (GAO, 2000). In other words, true cost savings must consider the costs of conducting the studies and the costs of administering the contracts or otherwise monitoring performance. It was also, "noted that the level of savings will be difficult to track in the long term because workload requirements change, affecting program costs and the baseline from which savings are calculated" (2000).

A more recent study conducted by the IBM Center for The Business of Government found that competition results in significant savings. This study examined competitions conducted from 1994 though the first quarter of 2004 and used the DoD's own data-collection system to conclude that there was, "an average estimated savings of 44 percent of baseline costs, for a total savings of $11.2 billion" (Gansler & Lucyshyn, 2004, October, p. 28, 32). The study also found that although there were relatively few government civilian employees involuntarily separated, most of the savings associated with the competitions came as a result of reducing the number of positions by 24,852 (2004, October). The number of positions was reduced regardless of who won the competition—the government or a contractor. The savings estimate was also based on estimated cost and did not consider the cost of conducting the study or administering the contracts.

In another report (GAO-04-367), the GAO indicates that although the DoD has achieved savings though competitive sourcing, it is difficult to estimate precisely the amount of these savings (2004). Further, the Office says significant challenges face the agencies implementing competitive sourcing, including: difficulty in identifying non-inherently governmental positions for competition, a constantly changing environment, insufficient staff to plan and carryout the competitions and a lack of funding to implement and administer the program (2004).

In a widely publicized White Paper, the Office of Management and Budget (OMB) looked at 217 competitive sourcing studies conducted in FY 2004 and estimated these studies would "generate a net savings," or cost avoidance of $1.4 billion over three to five years (2005, January). They claim that the data suggests the savings are primarily because of larger competitions and more frequent use of standard competitions that require in-house teams to come up with a most efficient organization. Put another way, "competition drives bid prices down and efficiencies up" (2005, January). It remains to be seen whether or not this will remain true over the life of the contracts.

An interesting study by David Galley (2002), an adjunct faculty member at George Washington University, examined the impact of public-private competitions on the costs of providing maintenance and repair services for buildings on 104 Army installations from 1989 to 1999. He says that the study, "shows conclusively that the impact of those *A-76* competitions on costs depended on the category of the winner" (pp. 3-18). If the private sector won, there was significant cost savings; but if the work was kept in-house, there was not (2002). One offered explanation for this was that the Army did not monitor the in-house work force's performance like it did when a contractor was involved.

A study at the US Air Force Academy examined five different studies conducted during FY 2001 to 2003 which resulted in significantly reducing the number of employees performing competitive sourcing functions. However, a survey of employees and managers familiar with the competitive sourcing programs indicated that 80% felt the services were worse than before the studies had been done and only about half thought the program saved money for the Air Force (Green, Heppard & Forrester, 2004, pp. 4-11). In one conclusion, this study also indicated that, "Estimates used to compute savings omit many costs, e.g., study costs, retraining costs, loss of productivity, severances packages, etc." (2004).

In a briefing paper entitled *Show Me The Money,* Max Sawicky of the Economic Policy Institute investigated the evidence presented by the Office of Management and Budget (OMB) in support of the *Revised A-76 Circular* that purported to show that *A-76* competitions saved money. One of the studies cited in this paper was conducted at the Center for Naval Analysis (CNA) and involved 16 competitions for 2,800 jobs. His findings indicated that in every case, the "observed cost" (or the actual cost of performance) exceeded the bid price. The "effective cost" (the actual cost taking into consideration the change in the scope of work) exceeded the bid price in nine out of fourteen cases (Sawicky, 2003). An interesting observation in this study was that even if there are apparent savings, they are not returned to the taxpayer. In effect, competitions are really a vehicle for expanded government because, "agency savings do not translate into budget savings" (2003, p. 8, 12).

In light of these and other studies on outsourcing in the DoD, it is interesting that a recent article in the *Federal Times* asserts that according to a Pentagon official, "it's unclear if the military always saves money when it contracts with private companies to perform support services." Claude Bolton, assistant secretary of the Army for acquisition, logistics and technology, is quoted as saying that, "While it may be clear that a particular contract will save millions of dollars right away, there is no simple way to determine if that remains true four or five years down the road" (as cited in Lubold, 2006, p. 13). In other words, estimated savings at the beginning may not translate into actual savings in the end.

"Ah, there's the rub." Federal employees unions and others have been making this case for years. Testifying before Congress, the president of the American Federation of Government Employees, Bobby Harnage (2001, March 15), indicated that even as the number of federal government employees in the DoD steadily decreased by over 280,000 from 1992 to 1999, the cost of service contracts increased from $39.9 billion to $51.8 billion (p. 1). In the DoD, service contracts are now the largest segment of DoD procurements and make up over 50% of all contract dollars awarded (Lubold, 2006, April 24, p. 13). In fact, according to a recent congressional report, spending on federal contracts has been the fastest growing part of the discretionary budget for the last five years, and service contracts are leading the way (US House, 2006). As anyone familiar with the federal budget can tell you, the budget has not gone down regardless of how many jobs are contracted out or how many activities are turned over to contractors. In the DoD, budgets have increased almost every year since 1994, and they are not expected to go down anytime soon (OMB, 2005).

So, does outsourcing or competitive sourcing really save the taxpayer money? It may save money on some contracts, but there is a question about whether the government customer is getting the same or better service. Also, projected savings and actual savings are two entirely different things. The comptroller general of the United States, David Walker, was quoted recently as saying, "they (contractors) often fail to deliver the promised efficiency and savings. Private companies cannot be expected to look out for taxpayers' interests" (as cited in Shane, 2007, February 4). Generally, it does not appear *A-76* is saving the taxpayer money overall. As pointed out above, the federal budget is not decreasing, in spite of the hundreds of thousands of jobs that have been contracted out. Both Congress and the Executive branch like to tell voters they are cutting the bureaucracy, but in reality they are merely transferring government functions to private contractors. This growing "shadow workforce" has been identified by many writers, but Paul Light of the Brookings Institute has been a leader in this area; he has an excellent book on the subject entitled *The True Size of Government,* in which he concludes, "the true size of the government is much larger than the federal employee headcount suggests" (1999, p. 44).

There is an old saying in Washington that, "there are two kinds of contractors, those with government contracts and those that want government contracts." The fact that the federal government is the largest purchaser of goods and services in the world makes it a very attractive customer. The implication that by subjecting non-inherently governmental jobs to the forces of competition somehow captures market efficiencies is on its face plausible; but on closer examination, this implication may be more apparent than real. First, as stated by Professor Dan Guttman of Johns Hopkins University in a recent article, although, "we associate the utility of contractors with the notion that the private sector brings market forces to bear on government activities, this is only true where a commercial market exists for the government purchases" (2004, p. 24). He goes on to say, "where government is the primary or predominant purchaser of services or goods the picture is less clear" (2004). As has been demonstrated by Peck and Sherer (1962) in their classic analysis of weapon system procurement, markets are difficult to duplicate in a governmental setting primarily because the government entity really doesn't have any market competition for many of the products they buy. As they point out, the government is often the only buyer (p. 60). This rational can also be applied to services the government purchases. For instance, typically the work (services) is to be performed on a government installation; the work will be performed during certain hours, and the work is controlled by a performance work statement or statement of work with some type of government monitoring. The services may even be performed in a combat environment. This is not exactly "market conditions."

Secondly, as has been asked by others and included in Dan Guttman's article, "In what respect is a contractor that earns nearly 100% of its income from doing government work engaged in a commercial activity?" (2004, p. 29, quoting from the "Bell Report"). Third, if the government can manage its organization better by creating a "most efficient organization," why isn't it doing so already?—because, as has been shown (See IBMCBG study cited above), most of the alleged savings comes from reducing the number of employees. Fourth, the whole debate about what is inherently governmental varies from time to time and place to place. There is conflicting guidance from agencies on what is inherently governmental, and some of it even seems to be in conflict with the *Federal Acquisition Regulations*. And finally, social and economic policies like equal employment opportunity, veteran's preference, providing jobs for the handicapped and disabled, health insurance and retirement benefits for employees are now discounted in the name of competition. Is this really what "competitive sourcing" is supposed to be about?

Competitive sourcing (or, as it used to be called, "commercial activities") is about private-sector contractors doing commercial work. This should not be that hard to define. Like Lt. General Donald Hoffman, military deputy in the office of the assistant secretary of the Air Force said, "We don't need Air Force plumbers and Air Force electricians when right outside the gate there is a contractor to do that stuff" (as cited in Lubold, 2006, p. 13). I think he is right. Those are excellent examples of commercial activities. But simply because some contractors want more government work, and some government officials want to give it to them (for a variety of reasons), that still doesn't make almost everything the government does a commercial activity. It is high time that the public and their elected representatives recognize that reducing the size of government is about more than eliminating federal employees before it's too late. In fact, a good first step might be for congress to take the recommendation of their own analysts and, "further prescribe that certain government activities are to be considered inherently governmental" (Grasso, 2003, October 20, p. 23). This would remove the arbitrary discretion of understaffed agencies looking for a way to outsource their work, and perhaps save us from ourselves, while making sure all the agencies use the same criteria when determining what jobs are to be outsourced.

Although it may be unpopular to say that the government has a higher calling than the purely monetary incentive of business to make a profit, it is nevertheless true. The government typically has a mission to accomplish, and it may not be financially feasible from a business point of view. When this is the case, why should taxpayers be expected to not only pay for the service but to also pay a profit? This is especially true when the services being performed are not really commercial services. For competitive sourcing to really work, the first step must be, as Professor Steven Schooner has indicated, "to determine which functions are inherently governmental and which are not" (2004, p. 295). It should not be that difficult to identify a commercial service or activity. Then, "the government should begin outsourcing those services that are most readily available in the private sector" (2004, p. 296). This is the only way the government can truly benefit from "market forces." To try to compete jobs that are not typically performed in the private sector is not in the public interest and will not save the taxpayer money in the long run.

Beyond the cost savings or cost avoidance that may or may not be associated with competitive sourcing, there is the question of what is in the best interest of the government and the public. On this point, an outsourcing survey conducted by Deloitte Consulting Corporation of 25 world class organizations found that, "outsourcing is an extraordinarily complex process and the anticipated benefits often fail to materialize" (2005, April, pp. 3-4). Further, they say, "In the long run, organizations that continue to outsource will experience a loss of bargaining power to vendors as the supply side consolidates" (2005, April). Both of these phenomena have occurred in the Defense industry in over the past 20 years and, "it is unlikely that the defense industry will ever approximate a competitive market" (Driessnack & King, 2004, January-April). As the supply side continues to consolidate domestically and internationally, is it really in our national interest to contract out more and more government activities? Perhaps the debate we should be having is what is in our national best interest from the taxpayer's point of view—because as we have seen, the cost of government is not going down.

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Does Competitive Sourcing Really Pay?

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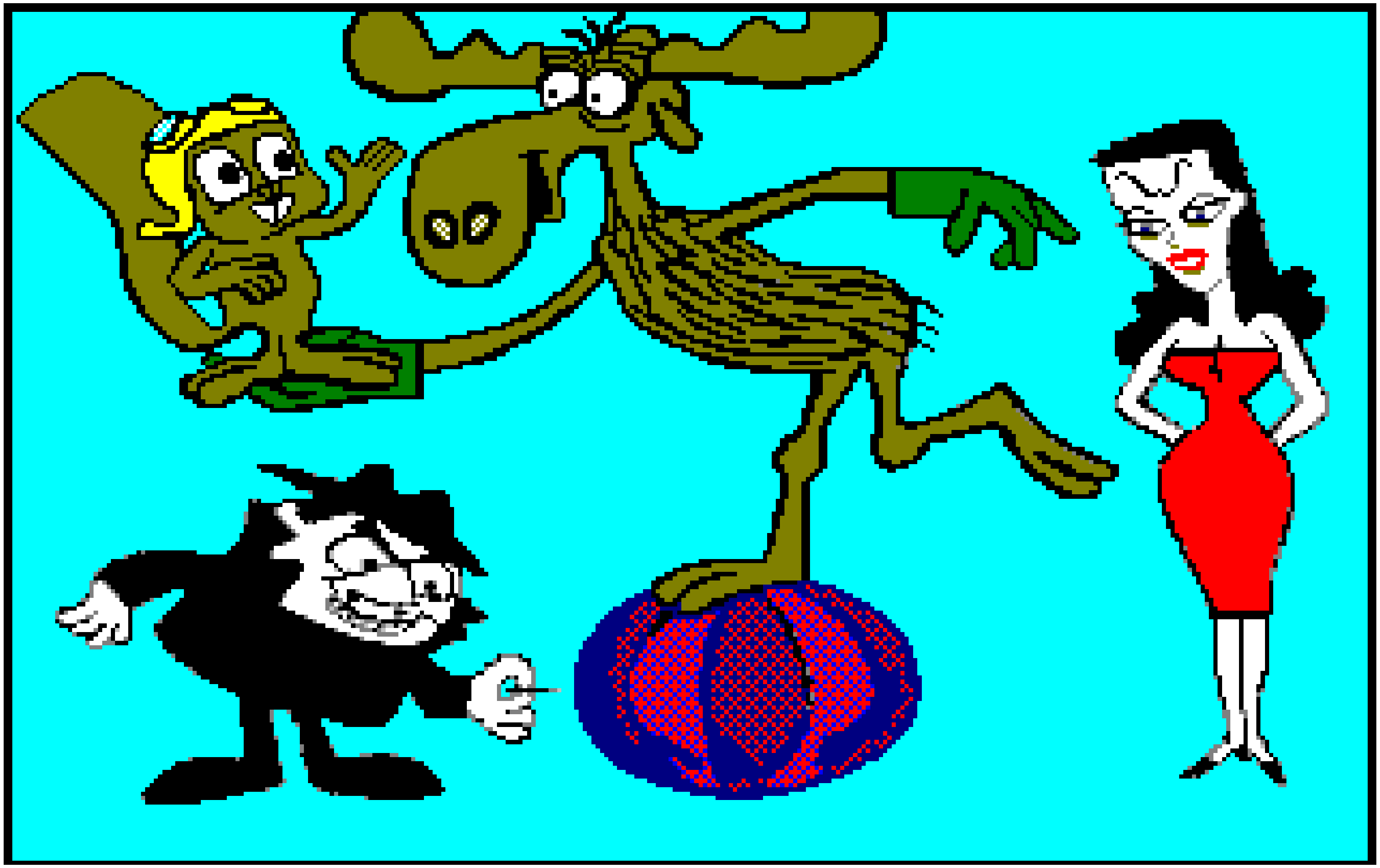
“The Good Old Days”
US vs. THEM



Overview of A-76

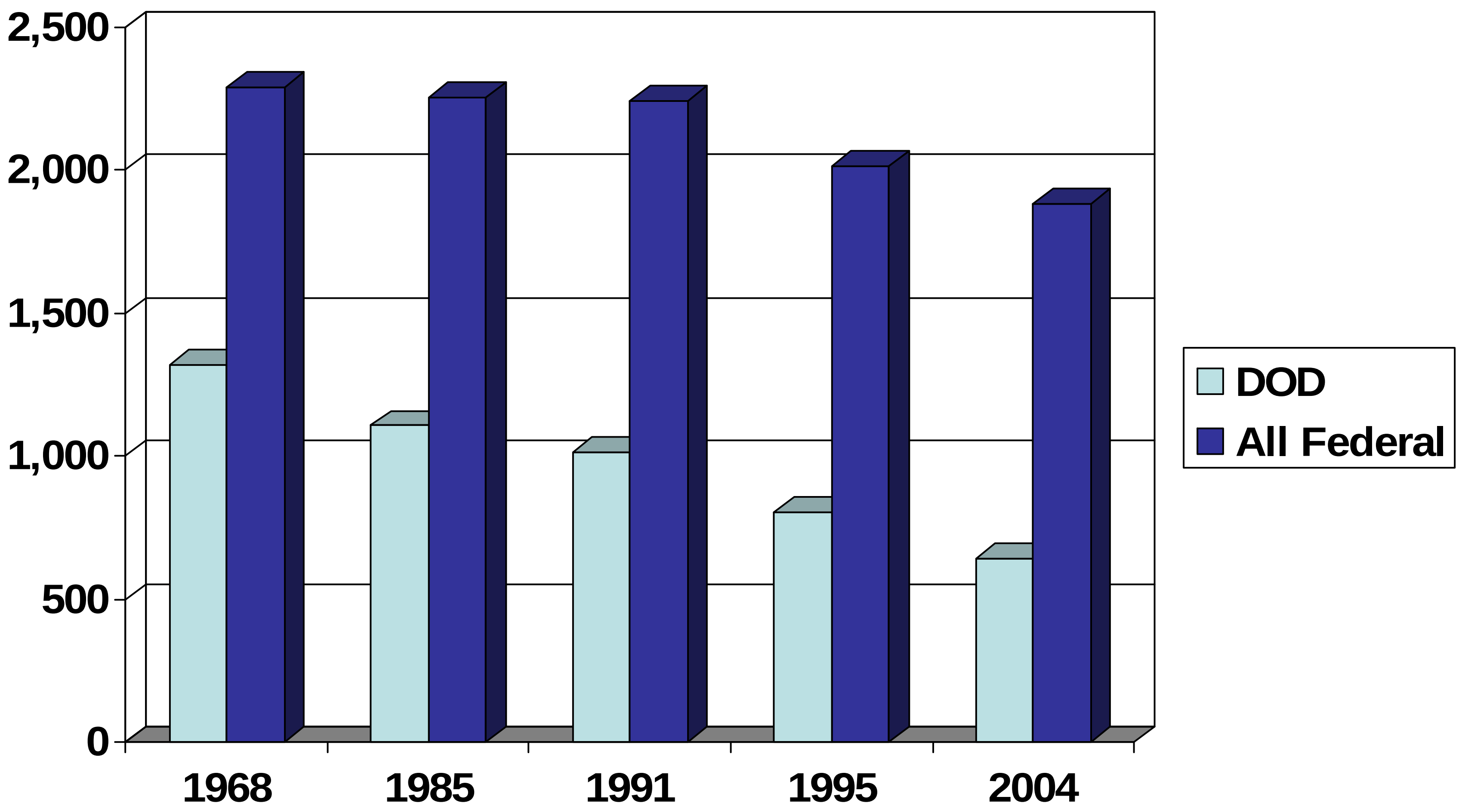
- Performance of Commercial Activities
- FAR 7.3 Government Policy is to rely on private sector for supplies and services
- Non-inherently governmental jobs should be competed (FAIR Act annual inventory)
- OMB goal for competing jobs is 50%
- Presidents Management Agenda: ensure maximum value for tax dollars

Number of Jobs Competed

- Jobs Competed 1994 - 2004
- DOD Civilian Jobs competed 68,259
- All Civilian Jobs competed 214,000 (est.)

Total Executive Branch Civilian Employees

(Selected years, in thousands, Source FY 2006 Budget Historical Tables)



DOD Shadow Workforce

(Sources: Paul Light, Brookings Institution and OMB FY 2006 Historical Tables. Numbers in thousands.)

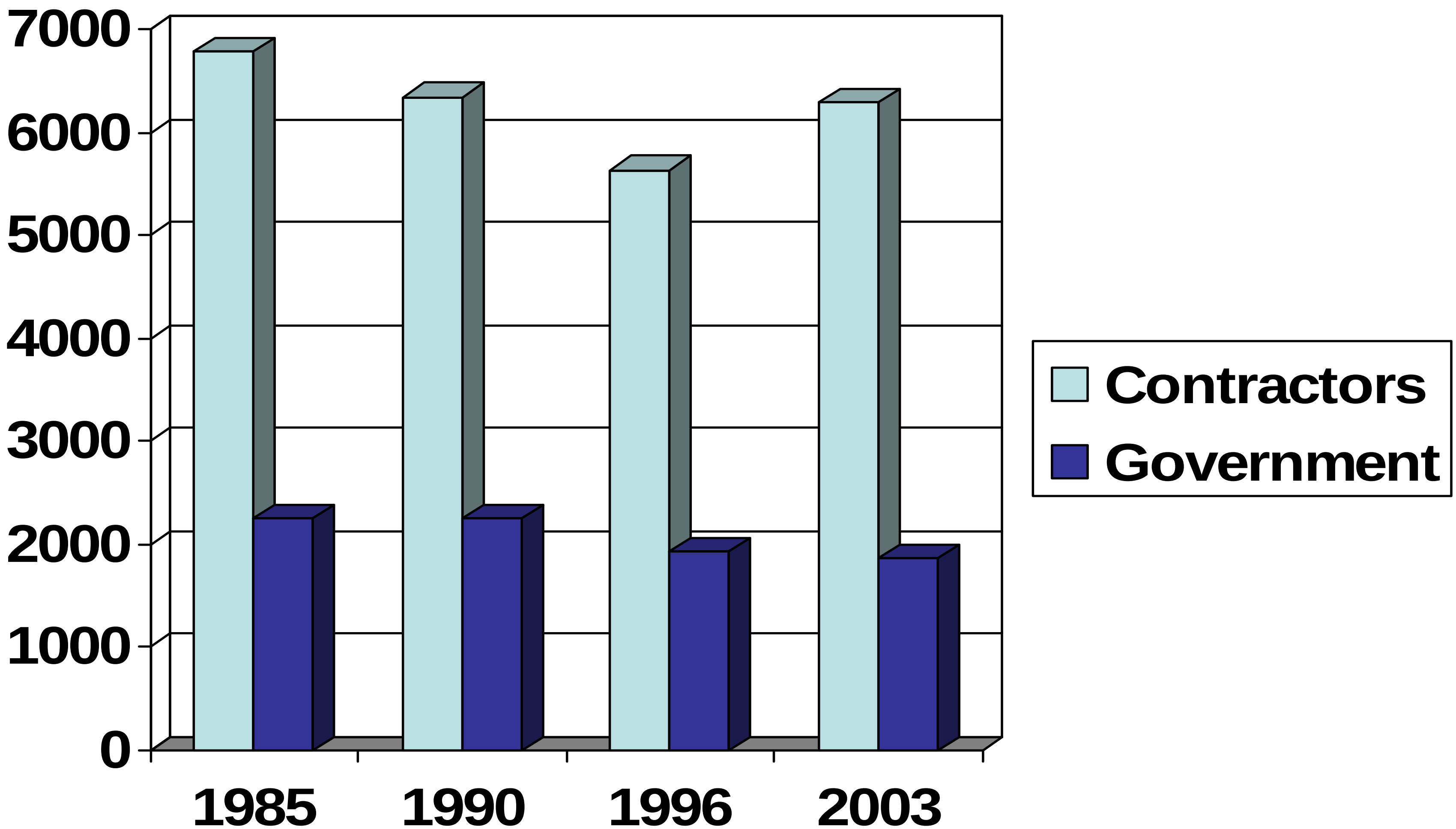
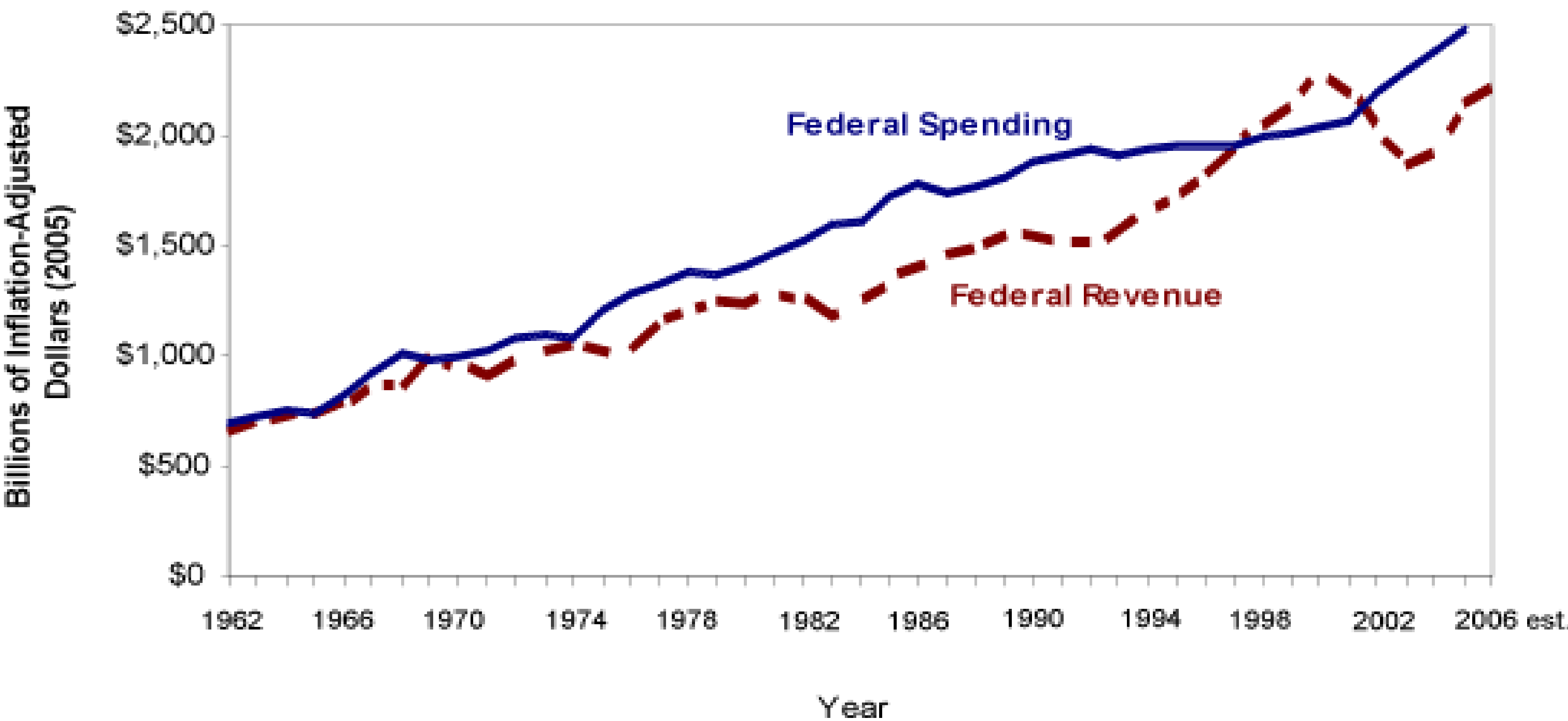


Chart C-1 The Heritage Foundation

Chart C-1. Total Federal Tax Revenue and Spending, 1962-2006



Federal Tax Revenue Has More Than Tripled Since 1962, But Federal Spending Has Quadrupled

Source: Receipts from FY 2007 Historical Tables, Budget of the United States Government, Table 2.1; Outlays from FY 2007 Historical Tables, Budget of the United States Government, Table 8.1.

Summary

- Savings are difficult to calculate
- A-76 competitions have saved money on some outsourced contracts
- Outsourcing jobs has not saved money overall
- Dissatisfaction with government is at historic high.

Questions?